MINNESOTA STATE LOTTERY

SPECIAL REVIEW OF THE DIRECTOR'S COMPENSATION AND OTHER SELECTED ISSUES

JANUARY 1993

Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

93-02

Centennial Office Building, Saint Paul, MN 55155 ● 612/296-4708

MINNESOTA STATE LOTTERY

SPECIAL REVIEW OF THE DIRECTOR'S COMPENSATION AND OTHER SELECTED ISSUES

Public Release Date: January 22, 1993 No. 93-02

OBJECTIVES:

Our review addressed the following issues:

- What is the basis for employee compensation at the Lottery? What amount of incentive compensation or bonuses has the Lottery paid to its employees? Did the Lottery use an appropriate process to determine the amount of such additional compensation?
- What costs did the Lottery incur for travel, employee expense reimbursements, and other business expenses?

We performed tests of the Lottery's transactions to obtain reasonable assurance that it had, in all material respects, administered its programs in compliance with applicable laws and regulations.

We also considered whether the Lottery's financial activities were conducted in a reasonable and prudent manner for a public entity.

CONCLUSIONS:

We found that the Minnesota State Lottery complied, in all material respects, with applicable finance-related legal provisions.

We had some concerns about the reasonableness of certain transactions:

- We conclude that the State Lottery Board did not use appropriate standards in determining the director's bonus amount.
- We found that the legal authority to make incentive payments to marketing staff is ineffective unless negotiated through the state's collective bargaining process.
- We question the Lottery's compliance with established policies governing special expenses and department head expenses, the Lottery's use of leased vehicles and purchases of gifts for board members.

Contact the Financial Audit Division for additional information.
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Representative Ann Rest, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

The Honorable Arne H. Carlson
Governor of Minnesota

Ms. Grace Nelson, Chair
Minnesota State Lottery Board

Members of the Minnesota State Lottery Board

Mr. George R. Andersen, Director
Minnesota State Lottery

Audit Scope

We have conducted a special review of selected financial transactions of the Minnesota State Lottery. Our review included the following areas:

- employee salary increases and additional compensation;
- travel, including employee and board member expense reimbursements and vehicle expense; and
- business meeting expenses.

Our review covered the period July 1, 1991 through October 31, 1992. As appropriate, we included selected transactions from earlier years. We began the special review at the request of Governor Arne H. Carlson in part because of questions about the basis for payment of a salary bonus to the Lottery director.

Specifically, we addressed the following issues:

- What is the basis for employee compensation at the Lottery? What amount of incentive compensation or bonuses has the Lottery paid to its employees? Did the Lottery use an appropriate process to determine the amount of such additional compensation?

- What costs did the Lottery incur for travel, employee expense reimbursements, and other business expenses?

As a part of this special review, we performed tests of the Lottery's transactions to obtain reasonable assurance that it had, in all material respects, administered its programs in compliance with applicable laws and regulations. However, our objective was not to provide an opinion on overall compliance with such provisions. We also considered whether the Lottery's financial activities were conducted in a reasonable and prudent manner for a public entity.

Audit Techniques

We interviewed Lottery officials about their policies and practices related to employee compensation, travel and other business expenses. We also reviewed supporting documentation for salary bonuses and other increases. We interviewed all members of the Lottery Board regarding the basis for bonus payments to the director. We reviewed supporting documentation, on a test basis, for travel and other business expense payments. We also reviewed reports prepared by the certified public accounting firm which conducted a financial statement audit of the Lottery for the year ended June 30, 1992.

In our prior audits of the Lottery, for the years ended June 30, 1990 and 1991, we have questioned certain administrative expense practices. As appropriate, we followed up on the current status of those audit findings during this review.

Section I provides a brief description of the Lottery's activities and finances. We discuss our review of employee salary increases and additional compensation in Section II and our review of travel and other business expenses in Section III.

Conclusions

The results of our tests indicate that, with respect to the items tested, the Minnesota State Lottery complied, in all material respects, with the provisions referred to in the audit scope paragraphs. With respect to items not tested, nothing came to our attention that caused us to believe that the Minnesota State Lottery had not complied, in all material respects, with those provisions.

In Sections II and III, we discuss our concerns about the reasonableness of certain financial practices of the Minnesota State Lottery. In Section II we conclude that the State Lottery Board did not use appropriate standards in determining the director's bonus amount.

We also found that the legal authority to make incentive payments to marketing staff is ineffective unless negotiated through the state's collective bargaining process. In Section III we question the Lottery's compliance with established policies governing special expenses and department head expenses. We also question the Lottery's use of leased vehicles and purchases of gifts for board members.

The Lottery director's response to findings 2 through 7 is attached. Those issues are primarily subject to the director's administrative control. The State Lottery Board is responsible for the issue discussed in finding 1. State law prohibited the board from discussing a draft of this report. Thus, it was not possible to obtain a formal response from the board prior to publication of this report.

This report is intended for the information of the Legislative Audit Commission, the Governor and the Minnesota State Lottery. This restriction is not intended to limit the distribution of this report, which was released as a public document on January 22, 1993.

James R. Nobles
Legislative Auditor

John Asmussen, CPA
Deputy Legislative Auditor

Report Signed On: January 15, 1993

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Audit Participation

The following members of the Office of the Legislative Auditor prepared this report:

John Asmussen, CPA	Deputy Legislative Auditor
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I. Introduction

The Minnesota State Lottery was created in June 1989. Minn. Stat. Chapter 349A governs the Lottery and its operations. The Lottery is under the supervision and control of a director, George R. Andersen, who was appointed by the governor. The State Lottery Board, also appointed by the governor, advises the director on all aspects of the Lottery. It also may approve additional compensation for the director.

Lottery revenues are distributed to designated beneficiaries as defined in statute. Beneficiaries of Lottery revenues include the state General Fund, which receives 60 percent of net proceeds and the Environment and Natural Resources Trust Fund, which receives 40 percent.

The following schedule summarizes Lottery financial activity for the years ended June 30, 1992 and 1991:

	Years Ended June 30	
	1992	1991
Revenue		
Ticket Sales	$297,602,893	$321,487,363
Other Income	1,189,548	1,381,107
Total Revenue	$298,792,441	$322,868,470
Expenses and Other Disbursements		
Prize Expense	$172,609,012	$179,428,852
Beneficiary Distributions	54,650,727	66,880,273
Tax in Lieu of Sales Tax	19,344,186	19,289,242
Retailer Commissions and Incentives	17,533,322	18,236,198
Advertising	7,608,818	12,239,184
Salaries and Benefits	7,146,278	6,774,503
On-line Vendor Expense	6,153,204	4,812,590
Ticket Costs	3,611,959	4,377,955
Promotion	1,680,109	3,111,985
Other	8,454,826	7,717,688
Total Expenses and Other Disbursements	$298,792,441	$322,868,470

Source: Minnesota State Lottery audited financial statements.

II. Employee Salary Increases and Additional Compensation

The Lottery employs staff at its Roseville headquarters and at six regional offices located throughout the state. For fiscal year 1992, employee salaries and related benefits totalled $7,146,278. State law provides that Lottery staff are state employees and requires the Lottery to adhere to the provisions of Minn. Stat. Chapter 43A. As of December 2, 1992, the Lottery had the following positions:

177	Classified
11	Unclassified
10	Temporary
6	Student Workers
204	Total Employees

In most respects, the Lottery administers its salaries in the same manner as other state agencies. Salaries and benefits are negotiated through the state's collective bargaining process. Five different bargaining unit agreements or compensation plans establish the salary levels and benefits for the Lottery's employees. The Department of Employee Relations includes the Lottery's positions on its state employee data base. The Lottery's central office is responsible for personnel and payroll processing for all staff. The Department of Finance produces payroll warrants for Lottery employees on the state's central payroll system.

State law permits the Lottery to exceed the state compensation plans in two instances. The State Lottery Board may provide additional compensation to the director. Also, the director is allowed to make incentive payments to marketing employees.

Director's Compensation

The State Lottery Board generated significant media attention and public displeasure when it recommended a $44,500 bonus for the director at its October 16, 1992 meeting. The director's annual salary, established pursuant to Minn. Stat. Section 15A.081, Subd. 1, was $75,500. The suggested bonus equalled almost 60 percent of his salary. The director had received bonuses of $12,000 in 1990 and $6,000 in 1991.

The board adopted the suggested bonus at the October meeting. At the director's request, at its November meeting, the board voted to reconsider its action and defer any bonus until after the Legislature had an opportunity to review the bonus policy during the next legislative session.

Minnesota State Lottery

1. The State Lottery Board did not use appropriate standards in determining the director's bonus amount.

The Lottery Board had a fairly structured process for evaluating the director's performance. However, it did not use appropriate criteria or standards to equate the results of this evaluation to a reasonable bonus amount. We believe the board failed to consider all relevant information in arriving at the bonus amount. In addition, we believe the decision on a bonus amount was not primarily based on performance but on the board's perception that the director's present salary level was too low.

We believe that many of the board members did not have an appropriate focus regarding reasonable compensation for public entity employees. Several members come from a business environment and they related the bonus amount to compensation levels in the private for profit and nonprofit sectors. In addition, the governing statutes give somewhat conflicting guidance to the Board. On the one hand, the Lottery is created as a state agency and Lottery employees, including the director, are state employees. However, the Legislature granted the Lottery exemptions from various policies and procedures applicable to other state agencies. The statutory provision authorizing the director's bonus, in itself, was unique for state agencies. Many board members, right or wrong, believed that the Legislature recognized that the Lottery was different from other state activities and, as such, should operate similar to a private business.

Minn. Stat. Section 349A.03, Subd. 3, relating to additional compensation for the director provides:

> *The board shall adopt objective criteria for evaluating the performance of the director. The criteria must include, but is not limited to, the performance factors in section 349A.02, subdivision 2, paragraph (b) clauses (1) to (4). The board may approve, by majority vote of all members, compensation for the director in addition to the compensation provided under section 15A.081, subdivision 1, based on the director's performance in office as evaluated according to the board's criteria. The additional compensation shall be paid from the lottery operations account. The board may not approve additional compensation under this subdivision more often than once in a 12-month period.*

Section 349A.02, Subd. 2, Para. b clauses (1) to (4) identifies the following performance criteria:

- *gross revenue from the sale of lottery tickets;*
- *efficiency of the administration of lottery operations;*
- *public confidence in the integrity of the lottery; and*
- *compliance with advertising requirements in section 349A.09*

Minnesota State Lottery

In April 1992, the State Lottery Board hired a consultant to conduct a management study of Lottery operations. In July, the consultant, board members and director met to discuss the preliminary results of the study. There were 125 recommendations or comments on Lottery operations. Sixteen of the recommendations specifically related to the director's performance. At this time, the board also established a three member compensation committee (renamed performance appraisal subcommittee) to develop a process for the director's annual performance appraisal.

Between July and October, the consultant worked with this subcommittee to prepare information on "observed or reported responses" to the management study recommendations relating to the director. At the direction of the board, he also researched a comparison of compensation for various Minnesota state and city administrators and the directors of lotteries in the United States. A memorandum providing this data was distributed to the board in September. Schedule 1 provides information on the compensation of other lottery directors, as shown in the consultant's memorandum. The consultant cautioned the board members when reviewing this information that a variety of variables should be considered, including cost of living, size of organization, success of organization, term of office and benefits, and "hidden compensation."

The consultant presented his report on the status of the management study recommendations at the October 16 closed meeting of the board held to conduct the director's performance appraisal. The director also provided the board with information on sales revenue, the operating budget, advertising, and Lottery accomplishments during the year. The board members completed evaluation worksheets rating the director in each of three broad areas: internal management, public confidence, and relationships with key constituents. They also provided an overall evaluation. The results of this evaluation, which the director requested be a part of the public record, were:

Percent	Scale
57.1	Greatly exceeds board recommendations and expectations
42.8	Exceeds board recommendations and expectations
	Fully meets board recommendations and expectations
	Failed to meet board recommendations and expectations

After completion of the performance appraisal, the board held a public meeting to determine the director's bonus.

The chair of the performance appraisal subcommittee, who is also board chair, had previously asked the consultant to develop a formula for determining appropriate additional compensation based on the results of the performance evaluation. The formula allowed for a bonus ranging from $3,000 to $20,000 depending on the evaluation scores. The board chair said that she anticipated a bonus amount in the $10,000 to $12,000 range based on the expected scores. The consultant told us that the actual board ratings would have resulted in a $12,000 bonus using the suggested formula.

Schedule 1
1992 U.S. Lottery Director Salaries

Lottery	Salary	Bonus
Arizona	$70,000	None
California	$90,250[1]	None
Colorado	$50,508-$67,608	None
Connecticut	$53,281-$68,349	None
D.C.	$85,000-$91,000	None
Delaware	$60,600	None
Florida	$89,000	None
Idaho[2]	$54,800	Annual bonus upon approval by lottery commission
Illinois	$60,349	None
Indiana	$78,750	None
Iowa	$67,100-$95,100	Yes - $12,000
Kansas	$67,925	None
Kentucky[3]	$96,900	Yes
Louisiana	$85,000[4]	Yes
Maine	$40,726-$58,510	None
Maryland	$67,496-$83,012	None
Massachusetts	$90,000	None
Michigan	$67,300	Annual longevity-$260
Minnesota	$57,500-$78,500	Determined by the lottery board annually
Missouri	$73,000	None
Montana	$49,376	None
New Hamshire	$63,430	15-year longevity pay - $400/yr
New Jersey	$85,000	None
New York	$94,936	None
Ohio	$50,294-$79,946	None
Oregon	$85,728	None
Pennsylvania	$61,000	None
Rhode Island	$70,000	None
South Dakota	$62,257	None
Texas	$79,500	None
Vermont	$48,700	None
Virginia	$91,000	None
Washington	$73,572	None
West Virginia	$60,000	None
Wisconsin	$76,415	None

[1]The salary for lottery director is set at $95,000, but all state officials took a 5% salary reduction this year.

[2]The Idaho and Iowa lottery directors currently utilize the Multi-State Lottery incentive option to increase their compensation. Idaho receives a total of $63,200 and Iowa $107,100. Despite Iowa's lower cost of living, it is a directly comparable midwestern lottery state.

[3]The Kentucky lottery director, who resigned to take a significant pay increase with G-Tech Corp., was awarded a pro-rated bonus of $20,000, yielding total compensation of $116,900.

[4]The president's salary is budgeted at $89,256, but salary adjustments are pending.

Source: September 14, 1992 memorandum from L. Peter Bast, Ph.D, to Minnesota State Lottery Board members.

Although this process was briefly mentioned at the public meeting, the subcommittee never presented its recommendations. Instead, one board member suggested a $20,000 bonus. After some discussion, another board member recommended the bonus effectively be $44,500. The member's recommendation was based on a belief that the director's total compensation should be in the range of $120,000 for the year. After some additional discussion, the board approved the $44,500 bonus amount on a voice vote. The board faxed a press release to the governor announcing the bonus. Shortly after receiving the fax, Governor Carlson expressed his displeasure about the size of the bonus. At the director's request, at the November meeting, the board voted to reconsider and table the issue, pending legislative review.

Board members gave us various reasons why they believed their action in approving the proposed bonus for the director was proper. Primarily they were concerned that the Lottery would lose the current director, either to other lotteries, or to lottery-related private employers. They believed that the director could earn more in these other positions than in his current position with the Minnesota Lottery. The board member who initiated the $44,500 amount did so based on private for profit and nonprofit sector compensation levels. This member had read in the newspaper that the average director of a trust or foundation in Minnesota was paid $150,000. That amount is consistent with a statement in the consultant's report on the median salary for chief executive officers of charitable foundations. The board member felt that the size of the Lottery's financial operations and the administrative responsibilities of the director were as significant as those positions.

Board members also felt that the director should be rewarded for doing a good job during the past year. They cited the fact that Lottery revenues were within one percent of the budget even in bad economic times. In addition, for fiscal year 1992, the Lottery did not spend the total 15 percent of revenue authorized in statute for administration. Board members viewed this action as "returning" an additional $2.8 million to the state. They also cited the fact that the director had addressed and made progress on all the recommendations made to him earlier in the year as a part of the management study.

We do not question the board's conclusions on the director's performance. It followed an appropriate decision-making process to support its conclusion. However, we do question the basis for the board's decision on a bonus amount. Although we believe the board members were well intentioned in their desire to adequately compensate the director, we do not believe they used appropriate criteria to arrive at the amount. The detailed information on other lottery directors compensation, which the consultant provided, did not support the board's decision. Although there is a wide range in compensation amounts, as shown in Schedule 1, they do not reach the $120,000 level. Actually, only 5 of 35 states identified in the consultant's report had established bonus provisions.

Also, we do not believe it is appropriate to base public sector compensation on compensation levels in the private for profit or nonprofit sectors. It is probable that the director could receive a higher salary in the private sector, as could many other public officials and employees. However, Minn. Stat. Section 349A.11(3)(c) restrains the director from accepting many lottery-related private sector opportunities. Furthermore, as a public entity, the Lottery must operate within the bounds of reasonableness for the public sector.

Recommendation

- *The Legislature should either eliminate or limit the board's authority to provide a compensation bonus to the director. If the statutory authority for the director's bonus is retained, the Legislature should establish parameters for the Board to follow in arriving at a reasonable bonus amount.*

Marketing Incentive Payments

The Lottery also has statutory authority to make incentive payments to marketing employees. It has not exercised this authority to date. Lottery staff began discussing a process for providing the additional compensation. They established some suggested criteria for calculating the proposed payments. For example, they identified sales goals for certain marketing personnel.

2. The legal authority to make incentive payments to marketing staff is ineffective unless negotiated through the state's collective bargaining process.

The Lottery has not made these incentive payments primarily because of failure of the various participants in the collective bargaining process to agree on a plan. For example, the parties have not determined appropriate criteria for calculating the incentive payments for those eligible employees not directly involved in the sales process.

Minn. Stat. Section 349A.02, Subd. 5, discusses the incentive plan:

> *Subject to the provisions of section 43A.18, subdivision 1, the director may develop and implement a plan for making incentive payments to employees of the division whose primary responsibilities are in marketing.*

Section 43A.18, Subd. 1, provides that the compensation, terms, and conditions of employment for all employees represented by an exclusive representative shall be governed solely by the applicable collective bargaining agreement.

The Department of Employee Relations has taken the position that the Lottery could not implement the incentive plan if it is not a part of the collective bargaining process. Lottery management and union representatives have discussed various alternatives and options. However, a specific plan has not been developed.

Recommendation

- *The Legislature should eliminate the statutory provision authorizing incentive payments for marketing staff. If an incentive plan is considered appropriate, it should be established and implemented through the collective bargaining process.*

Other Employee Salary Increases

Lottery employees received annual salary increases, similar to other state employees. In accordance with applicable bargaining unit agreements or compensation plans, certain employees received automatic cost-of-living adjustments and progression step increases. Additional achievement awards and discretionary performance-based salary increases were also available.

We tested these increases for fiscal year 1992. We found that the Lottery complied with applicable bargaining unit agreements and compensation plans in administering the salary increases.

The Lottery paid achievement awards or performance-based salary increases to 44 employees during fiscal year 1992. The awards ranged from $1,000 to $1,629 and totalled $49,333. The applicable bargaining agreements or compensation plans have percentage and dollar maximums limiting the payments. Three of the plans also limit the number of employees eligible to receive an increase.

III. Travel and Business Meeting Expenses

Lottery staff and board members are eligible for reimbursement of travel expenses incurred while conducting official Lottery business. In addition, board members receive $55 per diem payments for board meeting attendance pursuant to Minn. Stat. Section 15.059. The various collective bargaining agreements and compensation plans define the types of eligible travel expenses and the reimbursement basis. The Lottery has drafted an employee expense reimbursement policy and procedure to provide further guidance.

The bargaining agreements also refer to payments for special expenses, which are not anticipated by the regular expense guidelines. The Department of Employee Relations issued an administrative procedure, which provides guidance for the payment of special expenses.

As a department head whose salary is established pursuant to Minn. Stat. Chapter 15A, the director has an annual expense account of $1,500. In accordance with statutory guidelines, this account can be used for necessary expenses in the normal performance of duties for which no other reimbursement is provided.

Lottery accounting records show that the Lottery incurred the following expenses related to travel and business meetings for the year ended June 30, 1992:

Lottery Vehicle Leases, Mileage and Repair	$369,713
Lottery Vehicle Cellular Phones	144,846
Personal Vehicle Mileage Reimbursements	13,335
Public Carrier Travel	32,971
Lodging and Meal Reimbursements	82,449
Other Business Meeting Expenses	27,997
Total	$671,311

Lottery employees use the standard expense reimbursement forms for state employees. The Lottery processes employee expense reimbursements through the State Treasury and records the payments on the statewide accounting system. Of the $671,311 in expenses shown above, $85,332 was paid to Lottery employees as expense reimbursements. The remaining $585,979 in payments were made directly to vendors other than Lottery employees and were not processed through the State Treasury nor recorded on the statewide accounting system.

Employee Expense Reimbursements and Business Meetings

The Lottery did not comply with certain policies and procedures established to control special and department head expenses. Generally, the bargaining agreements and compensation plans provide for expense reimbursement only when an employee is in travel status. Meal expenses in the metropolitan area (for those employees based in the area) are not reimbursable under these guidelines. The Lottery is authorized to pay for these items only in accordance with special expense or department head guidelines. We found that:

3. The Lottery does not have an approved special expense plan. It also accepts occasional gifts from a vendor in order to enhance its business meetings.

State agencies are required to have an approved special expense plan on file with the Departments of Employee Relations and Finance. In addition, agencies must develop internal policies and procedures to control and monitor special expenses. The Lottery does not have a special expense plan which has been approved by Employee Relations and Finance. It uses special expense forms to seek internal approval for purchases. However, the expenses are not subject to external review and approval. We identified the following types of expenses which we believe should be subject to a special expense plan:

- Meals or refreshments for meetings where the majority of participants are not state employees. The Lottery periodically has meetings with various constituents, such as retailers, in a meal setting.

- Meals or refreshments for Lottery Board meetings. The Lottery regularly supplies box lunches or buffet lunches for the board meetings. The lunches range in cost from $80 to $300 per board meeting. Board members who are from outside the metropolitan area would be eligible for expense reimbursement under regular policies.

- Other meals in the metropolitan area. In June 1992, the Lottery paid $1,494 for 2,490 meal tickets for Taste of Minnesota. The Lottery had a booth at the event. Employees who sold Lottery games were given the tickets because they were required to remain at the event during their meal breaks.

- Employee meals which are part of a structured conference or workshop. For example, in October 1992, the Lottery held a two day conference for all employees at a total cost of approximately $29,000. The conference provided one breakfast, two lunches and a dinner. The meal expenses totalled $13,193. In addition, a Lottery vendor, Automatic Wagering, Inc., hosted a reception for which it paid $2,400.

In addition, in July 1991, the Lottery co-sponsored a meeting with the Multi State Lottery at a Twin City hotel. The Lottery paid $1,139 for the event. These costs were eventually reimbursed - $588 by the Multi State Lottery and $551 by Automatic Wagering, Inc.

Recommendations

- *The Lottery should develop a comprehensive special expense plan and submit it to the Departments of Employee Relations and Finance for approval.*
- *The Lottery should discontinue the practice of accepting vendor gifts as a means of enhancing business meetings.*

4. The Lottery does not have a mechanism to ensure that other business expenses of the director fall within the $1,500 annual limitation provided in statute.

The Lottery director periodically incurs expenses for meals and other items which normally would not be reimbursable. These items are not paid as a part of the normal employee expense reimbursement process. Separate payments are made to the director based on submitted documentation. For example, the director was reimbursed $351 in May 1992 for the cost of various meal meetings with other attendees at a national conference in Virginia. These costs can appropriately be paid from the department head expense account. However, the Lottery does not control the total of these types of business expenses. We could not determine whether the $1,500 department head expense limitation was exceeded.

Recommendation

- *The Lottery should establish control over the director's business expenses payable from the department head expense authorization of $1,500.*

5. The Lottery's practice of providing board members gifts and promotional items to employees is questionable.

The Lottery has purchased holiday gifts for board members and the Attorney General representative who attends board meetings. In December 1990, the Lottery purchased seven portfolios at a total cost of $611. In December 1991, it purchased eight engraved pen and pencil sets at a total cost of $486. In that same month it also purchased ten fruit baskets at a cost of $376. In December 1992, the Lottery purchased eight food baskets at a cost of $298. In addition board members are given all of the promotional items purchased as retailer incentives.

The propriety of expenditures for gifts for board members and other meeting participants is questionable. We believe it could create the impression of a conflict, particularly with a board which establishes the director's compensation.

In our prior audits we have questioned the Lottery's authority to give promotional items, such as jackets, to employees. We still believe the practice is inappropriate. Staff from the

Department of Employee Relations told the Lottery that the department does not consider the promotional items to be compensation. Employee Relations based its conclusion in part on the assumption that the items are routinely distributed to the general public. In fact, the Lottery does not distribute most promotional items directly to the general public. For the most part, the items are provided to Lottery retailers as a sales incentive award or for special promotional events.

Recommendation

- *The Lottery should discontinue the practice of purchasing gifts for board members and providing promotional items to employees.*

We also reviewed a sample of regular employee expense reimbursements. Generally, the Lottery is in compliance with applicable bargaining agreements, compensation plans, and its internal travel policy regarding employee expense reimbursements. We noted only isolated instances where employees did not comply with established policies or had not submitted adequate documentation.

Lottery Vehicles

The Lottery has a significant investment in leased vehicles, which may not be cost beneficial. It has a fleet of vehicles, mostly assigned to individual staff, for use in conducting Lottery business. There currently are 66 vehicles, including 5 full-size vans, 52 mini-vans, 8 cars and 1 truck. During fiscal year 1992, the Lottery spent an average of $30,000 per month on lease and mileage payments for the vehicles. The Lottery leases the majority of the vehicles from the state's Central Motor Pool. It leases the cars assigned to executive and security staff from private vendors.

6. The Lottery is making minimal use of the full-size vans and some mini-vans may also be underutilized.

For the 14 months ended August 1992, three vans averaged from 145 to 224 miles per month. One of the vans averaged less than 50 miles per month during 11 of the 14 months. The Lottery paid a $255 monthly rental fee for each van. Some of the mini-vans also have limited usage. On a strict cost comparison, the mini-vans would have to average 1,800 miles per month to serve as a cost beneficial alternative to reimbursing employees the personal vehicle reimbursement rate of 27 cents a mile. During the same 14 month period, 27 mini-vans averaged less that 1,800 miles per month, and 8 averaged less than 1,000 miles. The Lottery pays $305 plus 10 cents a mile for the mini-vans.

Every lottery marketing representative is assigned a mini-van for conducting Lottery business. The marketing representatives are based at one of the regional offices located throughout the state. The Lottery assigns each representative to a specific territory which includes approximately 300 retailers. The representatives distribute a stock of point-of-sale advertising materials, game brochures and information and promotional items to retailers. Lottery management believes the mini-vans are needed to provide space for all these materials. Two regional offices have full-size vans, and three are assigned to the headquarters office. Staff use the vans for delivering large items and as backups when the mini-vans need servicing.

Recommendation

- *The Lottery should continue to review the use of leased vans and mini-vans. Where usage is minimal, the Lottery should consider more cost effective means of providing transportation.*

In previous audits of the Lottery we have questioned the need for executive staff to be assigned permanent vehicles. We questioned whether the Lottery had complied with Minn. Stat. Section 16B.55 and the Department of Administration's policy on employee use and assignment of state owned vehicles. Currently, the director, the marketing director, the director of security and two employees of the security division are assigned cars permanently. Two other executive staff vehicles are now available on a pool basis.

The employees with permanent car assignments commute between home and the Roseville office. The Lottery cites the necessity to be available for emergency on-call situations and to travel throughout the state as the primary reasons these individuals need assigned cars.

7. Vehicle use beyond the normal commute for the executive staff does not justify the need for permanently assigned vehicles. In our opinion, the Lottery is incurring unnecessary costs to lease, fuel and maintain these vehicles. It would be more cost effective to have the employees use pool cars or to reimburse them for use of their personal vehicles.

We reviewed mileage logs and employee certifications of the number of commute trips for these vehicles during fiscal year 1992 and the four months ended October 31, 1992. The following schedule shows our estimate of vehicle usage during the 16 month period:

	Lottery Director	Marketing Director	Security Director	Security Staff	Security Staff
Total Miles	17,237	10,750	22,045	25,447	25,180
Commute Miles	7,905	8,460	12,960	6,894	3,930
Business Miles	9,332	2,290	9,085	18,553	21,250
Average Monthly Business Miles	583	143	568	1,160	1,328

Minnesota State Lottery

The Department of Administration, in a memorandum to Lottery staff, stated that mileage ranging from 1,100 to 1,800 miles per month is within the range which justifies a cost effective assignment of vehicles. However, they also stated that assumes that the mileage is predominantly business and not commuting. We believe only two employees meet Administration's criteria for permanently assigned cars.

Recommendation

- *The Lottery should review the usage of permanently assigned vehicles to ensure that their primary use is business. Where the noncommute mileage does not justify permanent assignment of a vehicle, the cars should be put in pool status or the leases canceled.*

MINNESOTA STATE LOTTERY

Proceeds Benefit Our Natural And Economic Environments.

George R. Andersen
Director

January 15, 1993

Mr. James R. Nobles
Legislative Auditor
Office of the Legislative Auditor
Veterans Service Building
St. Paul, Minnesota 55155

Dear Mr. Nobles:

We have reviewed the revised draft audit report on the Minnesota State Lottery, dated January 15, 1993. This letter represents the Lottery's response to that report. The Lottery will not directly respond to the Legislative Auditor's recommendation #1 relating to the awarding of additional compensation for the Director of the Lottery. Comments relating to this issue will be made by members of the State Lottery Board.

Recommendation #2: We concur with the auditor's recommendation that if an incentive plan for marketing employees is established, it be accomplished through the collective bargaining process. In fact, state law requires the Lottery to follow the collective bargaining process in establishing any such plan.

On the other hand, we believe that the auditor's other recommendation relating to this issue, that the Legislature should eliminate the incentive payments for marketing staff, is without justification. In originally enacting this provision, the Legislature recognized that the marketing functions of the Lottery were unique to state government and that it was important to provide incentive payments to marketing employees. While the Lottery recognizes that any incentive plan would be subject to collective bargaining, the Lottery believes that this statutory provision authorizing such payment should remain in law.

Recommendation #3: The Lottery concurs with the Legislative Auditor's recommendation that it should formalize a comprehensive special expense plan and have it submitted to the Departments of Employee Relations and Finance for approval. In fact, the Lottery is currently writing such a plan and will be submitting it to the appropriate departments for approval in the very near future.

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It should be noted that as part of that plan, there will be some reference to use of vendor payments in connection with an event that the Lottery sponsors, attends and/or coordinates. Often the Lottery facilitates a meeting held in Minnesota that is attended by vendors and public officials from around the country. In these instances, the Lottery may expend money for rooms and/or meals, and later be reimbursed for those expenses by the appropriate organizations or vendors. It is important to point out that in these situations the Lottery is not receiving any direct benefit, but is merely acting as a clearinghouse for activities and costs associated with the event or conference.

In describing some of these expenses the Legislative Auditor refers to meeting with "various constituents, such as retailers". Retailers are much more than "constituents"; they are the Lottery's sales partners, without which the Lottery could not operate. The report also references the Lottery staff conference where AWI, Inc. paid for a reception. Many of AWI's staff attended the conference, and in lieu of requiring AWI to pay a fee for their attendance, AWI agreed to host, prior to dinner, a reception where soft drinks and common hors d'oeuvres were provided.

Recommendation #4: The Lottery currently has a department head expense account. The Lottery concurs with the Legislative Auditor's recommendation that the Lottery should control expenditures from this account to ensure that only proper expenses are allowed and that the expenditures remain within the $1,500 department head expense limitation. To our knowledge the Lottery has never exceeded the $1,500 department head expense limitation.

Recommendation # 5: It is vital that premium items distributed to Lottery retailers and to the public for promotional purposes are also distributed to Lottery employees. Distribution to Lottery employees provide valuable aid in conducting promotions and increasing the public's awareness of the Lottery's products. Recently the Department of Employee Relations informed the Lottery that they do not consider the Lottery's distribution of premium items to Lottery employees as additional compensation to those employees. This was the Legislative Auditor's primary objection to this practice as stated in previous audit reports.

The Auditor's current report states that the Department of Employee Relations' conclusion is based in part on the assumption that the items are routinely distributed to the general public, when in fact, these items are provided to Lottery retailers as sales incentive awards or for special promotional events. This is not correct. The majority of premium items are distributed to the general public through special events in which the Lottery may be involved, or through promotions run in conjunction with the Lottery's retailers. Only about a third of the premium items purchased during the previous two fiscal years were used as sales incentives for Lottery retailers, and many of those were distributed to the general public as part of a promotion by the retailer. Further, retailers and their sales clerks are part of the public.

Furthermore, the Lottery does not believe that providing minor gifts to Lottery Board members constitutes a conflict of interest. The providing of these nominal gifts has always been within state guidelines.

Recommendation #6: The Lottery concurs with the auditor's recommendation that we should continue to review the use of leased vans and mini-vans, and where usage is minimal, we should consider more cost-effective means of providing transportation.

The Lottery has two types of vans: cargo vans which are used by some of the regional offices and at the Lottery's headquarters, and mini-vans which are used as work stations by the Lottery's field marketing staff. The Lottery has been monitoring the usage of its cargo vans and has, during the previous year, canceled leases on two cargo vans because they were not being effectively used. The cargo vans currently being used by the Lottery are being used to deliver special promotional materials, to pick up items at regional offices, and as back-ups for the mini-vans. The use of these cargo vans are important to the Lottery's operations and are needed on a number of occasions each month. To lease or rent these vehicles on a daily basis would be cost prohibitive, and on occasion, these vehicles may not be available when they are needed.

The Lottery's field marketing staff use the mini-vans to visit and work with the Lottery's 3,900 retailers statewide. These employees use the mini-vans as their offices; each is equipped with cellular phone, files, and extensive promotional and point-of-sale material to be used by retailers who sell lottery tickets. While some of these vans average less than 1,800 miles per month (the lowest averages approximately 750 miles per month), the alternative of requiring these employees to use their personal vehicles and be reimbursed for their use is not a practical alternative. Employees need to carry promotional and advertising material. Certainly a personal vehicle would not be able to properly handle the size and volume of material that is required to be carried. Further, keeping their personal vehicle stocked appropriately might not allow it to be used for personal purposes and the process of loading

and unloading it for such use would take time that the employee should be using to work with retailers. Furthermore, providing a vehicle ensures that they have reliable transportation and present a consistent image of the Lottery.

Recommendation #7: We concur with the Legislative Auditor's recommendation that the Lottery should review the usage of permanently assigned vehicles to ensure that their primary use is business. The auditor's calculation of non-commute mileage for the executive vehicles in their report is misleading since it includes within the calculation of commute miles instances where the staff person may have been conducting business on the way to or from their home (i.e. business meetings, hearings, visits with retailers on the way to or from home). Also, the Auditor's conclusion that vehicle use beyond the normal commute for executive staff does not justify the need for assigned vehicles is without merit when one considers the requirements of Minnesota law and the Department of Administration's memorandum to the Lottery. The Auditor's report gives the impression that vehicles must have between 1,100 to 1,800 exclusively in business miles to justify permanent assignment of vehicles. In fact, the Department of Administration's memo states if the Lottery's vehicles mileage range from 1,100 to 1,800 per month, then they would be justified in permanently assigning the vehicles to staff so long as the mileage was ***predominantly*** business (not exclusively for business). In other words, if vehicles range from 1100 to 1800 in mileage and a majority of the miles are for business purposes, then permanent assignment is justified.

Also, the Auditor's report does not recognize the other justifications under Minnesota law for state agencies to permanently assign vehicles to employees. In fact, other state agencies have permanently assigned vehicles to employees based on these other criteria, regardless of the mileage usage for those vehicles.

Thank your for the opportunity to comment on your report.

Very Truly Yours,

George R. Andersen

George R. Andersen
Director