

MINNESOTA STATE LOTTERY

***FINANCIAL AUDIT**

FOR THE YEAR ENDED JUNE 30, 1992

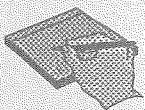
AUGUST 1993

***See description of this new
report style in the following
Note to Report Readers.**

**Financial Audit Division
Office of the Legislative Auditor
State of Minnesota**

93-41

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



Note to Report Readers

The Financial Audit Division introduces a new report style in nine audits being released during the Summer of 1993. The division plans to use the new style on a trial basis and will later evaluate report readers' preferences. The new style replaces the traditional format of reporting only on an "exception basis." In the traditional format, auditors commented primarily on problems which the reports presented as findings and recommendations. Readers may have grown accustomed to using report length as a gauge for the extent of problems. With the new style, report length is not a reliable indicator of the extent of audit findings. These new reports contain more extensive factual and analytical data. Report readers should find this additional information useful. The division has attempted to make the new report style easy to identify and understand.

Identifying the New Report Style

The division distinguishes the new style reports by printing the report title in red ink, rather than the black ink used for traditional financial audit reports. All Financial Audit Division reports continue to use the gray-colored report covers. The report title shows through the window cutout on the gray cover. The inside cover page highlights the new style. This Note to Report Readers follows the inside cover page and describes the new style.

New Features

The new reports devote a separate chapter to each major audit area. Chapters contain detailed information on the audit scope, analytical results, and conclusions. Each chapter also elaborates on applicable management practices and processes. Financial auditors have always accumulated this additional information, but traditionally retained the information in the working papers and did not publish it as part of the final report.

To provide for a quick understanding of the audit results, the chapter structure allows readers to visually scan for items of interest or concern. Readers should look for the following features in each chapter:

1. The audit conclusions summarized at the beginning of the each chapter,
2. Tables and charts highlighting important financial information, and
3. Any audit findings and recommendations.

Aside from the format for presenting audit findings and recommendations, the new report style preserves the other elements of the traditional financial audit report. Report readers should recognize these other standard elements of the traditional reports: (1) Scope and Conclusions Letter, (2) Table of Contents, (3) Introduction, (4) Agency Response, and (5) an inserted Report Summary (although the new style uses a modified version of the report summary). Audit findings continue to be numbered and presented in bold-faced print. Recommendations are highlighted in italics. However, the Audit Findings and Recommendations are embedded in the appropriate report chapters, rather than aggregated in a separate report section.

Reasons for the Change

The traditional financial audit reports have several limitations. The reports often tend to be very technical documents. Also, reports with few findings communicate the audit results in a very abbreviated manner. Exception-based reporting requires auditors to either present audit findings or to simply state that the audit revealed no findings. This reporting style does not allow for positive conclusions or analysis of areas without audit findings.

The division was concerned about the risk that some report readers may have difficulty understanding audit results. It had begun to narrow its audit scope for several larger, more complex agencies. These "selected scope" audits were an effort to stretch scarce staff resources into as many audits as possible. But the division was particularly concerned that readers would project the audit results from a few selected programs to conclusions about an entity's overall financial management. The new report style more effectively presents the audit scope within the context of the entity's total operations.

Exception-based reporting does not fully accommodate the extent that auditors must exercise professional judgment. Auditors must interpret laws and policies. They must weigh the costs of control deficiencies against the benefits of preventing potential problems. It is particularly challenging to audit entities that are exempt from standard state policies and regulations. For those audits, the auditors must judge whether the entity has adopted "reasonable" and prudent practices for a public entity. Many issues require difficult decisions about whether or not an audit finding exists. Under the traditional report format, the auditor presents comments only when concluding that a finding exists. The new report style removes this limitation. Although the auditor's judgment remains important, the new report style also allows readers to reach their own conclusions.

Audits with the New Report Style

Look for the new report style in the audits of the following nine entities.

Department of Corrections	Department of Human Services
State University System	Community College System
Department of Natural Resources	University of Minnesota Medical School
Minnesota State Lottery	Environment and Natural Resources
State Public Defender	Trust Fund

Eight of the nine are "selected scope" audits covering only some programs of the entity. The Minnesota State Lottery is an entity-wide audit limited to testing for legal compliance with state laws and regulations.

Share Your Comments

If you have comments about the new report style, please contact the Financial Audit Division at (612) 296-1730.

SUMMARY

State of Minnesota
Office of the Legislative Auditor
Centennial Office Building • St. Paul, MN 55155
612/296-4708

MINNESOTA STATE LOTTERY

FINANCIAL AUDIT FOR THE YEAR ENDED JUNE 30, 1992

Public Release Date: August 13, 1993

No. 93-41

AGENCY BACKGROUND

The Minnesota State Lottery is governed by Minn. Stat. Section 349A. The director of the Lottery is George R. Andersen, who was appointed by the governor. For fiscal year 1992, the Lottery collected and expended \$298 million. The beneficiaries of Lottery proceeds include the state General Fund, which receives 60% of net proceeds and the Environment and Natural Resources Trust Fund, which receives 40%.

SELECTED AUDIT AREAS

♦ *Lottery Ticket Sales, Prize Expense, Reserves and Distributions*

The Lottery sells instant scratch tickets and on-line numbers game tickets. The statutorily required minimum payout for instant and on-line game prizes were 55 and 45 percent, respectively.

The Lottery appropriately accounted for ticket sales revenue, sales tax, and retailer commissions during fiscal year 1992. It met minimum prize payout percentages and returned unclaimed prize dollars to subsequent games, as required by statute. We continue to question the Lottery's authority to maintain reserve accounts. Except for amounts retained as reserves, the Lottery transferred required amounts to the General Fund and Environment and Natural Resources Trust Fund for fiscal year 1992.

♦ *Lottery Operations*

The Lottery's administrative or operating costs are paid from ticket revenue. Fiscal year 1992 operating costs were limited by statute to 15 percent of gross revenues.

The Lottery complied with statutory limitations on administrative costs and advertising expense. However, certain similar costs related to promotions and public relations are excluded from the advertising definition. Expenditures in all three categories were appropriately documented and authorized.

Contact the Financial Audit Division for additional information.

296-1730



STATE OF MINNESOTA
OFFICE OF THE LEGISLATIVE AUDITOR
CENTENNIAL BUILDING, ST. PAUL, MN 55155 • 612/296-4708
JAMES R. NOBLES, LEGISLATIVE AUDITOR

Senator Phil Riveness, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

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 financial related audit of the Minnesota State Lottery as of and for the fiscal year ended June 30, 1992. Chapter 1 provides a brief description of the agency's activities and finances. Chapters 2 and 3 discuss the results of our audit.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial activities attributable to the transactions of the Minnesota State Lottery are free of material misstatements.

We performed tests of the Minnesota State Lottery's transactions to obtain reasonable assurance that the lottery 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.

Special Review

We also conducted a special review of selected financial transactions of the Minnesota State Lottery for the period July 1, 1991 through October 31, 1992. We reviewed financial transactions related to employee salary increases and additional compensation, travel and vehicle expense, and business meeting expenses. We issued a separate report on the results of this review on January 15, 1993. In the report we questioned the reasonableness of the director's salary bonus and the effectiveness of the authorization for marketing staff incentive payments. We also questioned the Lottery's compliance with established policies governing special expenses and department head expenses, use of leased vehicles and purchases of gifts for board members. The 1993 Legislature placed a limitation on the amount of bonus payments which the Lottery and public and nonprofit corporations, created by law, may make in any year.

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Management Responsibilities

The management of the Minnesota State Lottery is responsible for establishing and maintaining an internal control structure. This responsibility includes compliance with applicable laws and regulations. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that:

- assets are safeguarded against loss from unauthorized use or disposition;
- transactions are executed in accordance with applicable legal and regulatory provisions, as well as management's authorization; and
- transactions are recorded properly on the Minnesota State Lottery and the statewide accounting systems in accordance with Lottery and Department of Finance policies and procedures, respectively.

Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

Internal Control Structure

For purposes of this report, we have classified the significant internal control structure policies and procedures in the following categories:

- ticket sales,
- prize expense,
- beneficiary distributions,
- tax in lieu of sales tax,
- retailer commissions and incentives,
- advertising, and
- promotions.

For all of the internal control structure categories listed above, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation. Our review was more limited than would be necessary to express an opinion on the Minnesota State Lottery's system of internal accounting control taken as a whole. We also considered whether the Minnesota State Lottery's financial activities were conducted in a reasonable and prudent manner for a public entity. To achieve this objective, we reviewed

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selected financial policies and practices in effect during the audit period and as of the time of our fieldwork in February 1993.

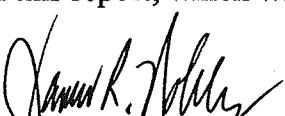
Work of Other Auditors

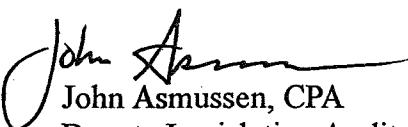
As provided in Minn. Stat. Section 349A.14, the lottery contracted with a certified public accounting firm to conduct a financial audit of lottery financial activity for the fiscal year ended June 30, 1992. The firm issued an unqualified opinion on the lottery's financial statements for the period. We reviewed the auditor's workpapers and relied on their work, where appropriate, in determining the extent of our testing.

Conclusions

The results of our tests indicate that with respect to the items tested, except for the issue discussed in finding 1, 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.

This report is intended for the information of the Legislative Audit Commission and management of the Minnesota State Lottery. This restriction is not intended to limit the distribution of this report, which was released as a public document on August 13, 1993.


James R. Nobles
Legislative Auditor


John Asmussen, CPA
Deputy Legislative Auditor

End of Fieldwork: March 5, 1993

Report Signed On: August 4, 1993

Minnesota State Lottery

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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
Claudia Gudvangen, CPA	Audit Manager
Michael Hassing	Auditor-in-Charge
Melissa Gamble	Auditor
Rhonda Regnier, CPA	Auditor

Exit Conference

The issues in this report were discussed with the following staff of the Minnesota State Lottery on July 26, 1993:

George R. Andersen	Director
Mary Ellen Hennen	Assistant Director for Administration
Robert Okerlund	Fiscal Manager

Minnesota State Lottery

Chapter 1. Introduction

The Minnesota State Lottery was created in June 1989. Minn. Stat. Section 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.

The mission of the Lottery is to provide secure gaming opportunities, while offering fun and entertainment, to the public within the guidelines of the Lottery statute. Additionally, the Lottery intends to maximize the contributions to those projects and programs identified by the Legislature as beneficiaries. Beneficiaries of Lottery proceeds include the state General Fund, which receives 60 percent of net proceeds and the Environment and Natural Resources Trust Fund, which receives 40 percent.

Table 1 summarizes financial activity for fiscal year 1992.

Table 1-1
Minnesota State Lottery Financial Summary
Fiscal Year 1992

Revenue

Ticket Sales	\$297,602,893
Other Income	<u>1,189,548</u>
Total Revenue	<u>\$298,792,441</u>

Expenses and Distributions

Prize Expense and Reserves	\$172,609,012
Beneficiary Distributions	54,650,727
Tax in Lieu of Sales Tax	19,344,186
Retailer Commissions and Incentives	17,533,322
Advertising	7,608,818
Promotions	1,680,109
Other Expenses	<u>25,366,267</u>

Total Expenses and Distributions **\$298,792,441**

Source: Minnesota State Lottery audited financial statements and supporting accounting records.

Chapter 2. Lottery Ticket Sales, Prize Expense, Reserves, and Distributions

Chapter Conclusions

The Lottery appropriately accounted for ticket sales revenue, sales tax, and retailer commissions during fiscal year 1992. It met minimum prize payout percentages and returned unclaimed prize dollars to subsequent games, as required by statute. We continue to question the Lottery's authority to maintain reserve accounts. Except for amounts retained as reserves, the Lottery transferred required amounts to the General Fund and Environmental and Natural Resources Trust Fund for fiscal year 1992.

The Minnesota State Lottery sells instant scratch tickets and on-line numbers game tickets. Table 2-1 shows ticket sales and related prize expense for fiscal year 1992.

Table 2-1
Ticket Sales and Prize Expense
Fiscal Year 1992

	<u>Ticket Sales</u> <u>Revenue</u>	<u>Prize</u> <u>Expense</u>	<u>Percent</u>
Instant Tickets	\$205,906,353	\$128,444,218	62.38%
On-Line Games	<u>91,696,540</u>	<u>43,661,557</u>	47.62%
Total	<u>\$297,602,893</u>	<u>\$172,105,775</u>	57.83%

Source: Minnesota State Lottery accounting records.

Lottery operations are fully automated. This helps ensure that only validated winning tickets are paid as prizes, retailer accounts are appropriately updated, and accounting transactions are promptly and accurately recorded.

Minnesota State Lottery

Ticket Sales

Individuals may purchase Lottery tickets at over 3,800 retailers throughout the state, including the headquarters and six regional offices. The Lottery recognizes sales revenue and related prize and other expenses as ticket packs are sold. The Lottery sweeps retailer bank accounts once a week and deposits the net receipts from ticket sales in the state lottery fund outside the state treasury.

Retailers receive a five percent commission on the sale of Lottery tickets. Special promotion programs allow retailers to earn additional commissions. The Lottery automatically credits the commission to the retailer account based on sales. Retailer commissions paid during fiscal year 1992 totalled \$15,542,424, or 5.22 percent of gross revenues.

The Lottery's accounting system also automatically calculates the amount of tax based on sales. Minn. Stat. Section 297A.259 requires the Lottery to transmit 6.5 percent of gross receipts to the Department of Revenue each month. The Lottery transferred \$19,344,186 to the Department of Revenue for fiscal year 1992.

We verified that the processes for recording ticket sales, sales tax, and commissions were reasonable and determined that the Lottery accounting system can be relied on for accurate financial information. We also verified that, for fiscal year 1992, the Lottery complied with statutory provisions for the payment of sales tax and Lottery rules for the payment of retailer commissions.

Prize Expense

The Lottery recognizes prize expense as tickets are sold, based on the established prize payout structure for the game. The Lottery establishes an individual prize structure for each instant game. The number and amount of prizes varies by game. This flexibility allows the Lottery to have different types of games available for sale at any given time. Minn. Stat. Section 349A.10 Subd. 2 (b) (2) (ii) provides that, for fiscal year 1992, prizes for instant games had to be at least 55 percent of gross receipts. The minimum prize payout increased to 60 percent for fiscal year 1993.

On-line games have a statutorily required minimum payout of 45 percent of gross receipts. The prize levels for the Daily-3 game remain constant, based on the type and amount of wager, although the actual liability varies over time. The Gopher-5 and Powerball on-line games have minimum jackpot amounts of \$100,000 and \$2,000,000 respectively. The jackpots continue to grow, based on sales volume, until a winning ticket is sold. The low tier (other than jackpot) prizes for these games include both preestablished and pari-mutuel determined amounts.

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Players have up to one year following the date of the drawing or close of an instant game to claim a prize. Thereafter, all rights to a prize are forfeited, and the prize becomes unclaimed. The Lottery is required by Minn. Stat. Section 349A.08 Subd. 5 to return unclaimed prize money to the prize pool of subsequent lottery games. This increases the prize payout percentage for the instant games. For on-line games, the Lottery has used the unclaimed prizes to develop additional opportunities to win, like the Daily-3 bonus spin. The Lottery director determines how much of the unclaimed prize balance will be put into the current games when the prize structures are developed. Table 2-2 shows unclaimed prize financial activity from inception of the Lottery to December 31, 1992.

Table 2-2
Unclaimed Prizes
As of December 31, 1992

	<u>Total</u>	<u>Instant Games</u>	<u>On Line Games</u>
Unclaimed prizes	\$8,143,078	\$6,438,832	\$1,704,246
Amounts returned to subsequent games	<u>5,119,799</u>	<u>4,269,345</u>	<u>850,454</u>
Balance to be added to future games	<u>\$3,023,279</u>	<u>\$2,169,487</u>	<u>\$ 853,792</u>

Source: Minnesota State Lottery accounting records and supporting documentation.

The legal requirement to return unclaimed funds to the Lottery prize pool is different than the requirements for many other state programs. Normally, state agencies must report unclaimed amounts to the Commissioner of Commerce, who searches for the owner. The majority of those funds then subsequently revert to the state's General Fund. The Lottery is somewhat different from these programs because specific owners of the unclaimed prizes are not known.

We reviewed the Lottery's procedures for recording prize expense and prize payouts and returning unclaimed prizes to prize pools. We determined that the Lottery's practices were reasonable. We also verified that the Lottery complied with statutory provisions regarding minimum prize payouts.

Retailer Incentive and Prize Reserves

The Lottery is required to deposit net proceeds in the state treasury within thirty days after month end. Net proceeds are the balance in the Lottery fund after transfers to the Lottery prize fund and credits to the Lottery operations account. The Lottery has withheld from distributions amounts used to fund two types of reserve accounts. The Lottery classifies the reserve accounts as liabilities and charges them to expense as tickets are sold. As a result, the Lottery can hold onto these proceeds for future use.

Minnesota State Lottery

One of the reserves is for the retailer incentive program. Table 2-3 shows financial activity related to the retailer incentive reserve from inception of the Lottery through January 31, 1993.

**Table 2-3
Retailer Incentive Reserve
As of January 31, 1993**

Total amounts reserved	\$4,236,473
Liquidated from reserve:	
Sweatshirts	716,563
Jackets	639,054
Promotional tickets	464,669
Pen, pencils, and key tag set	156,567
Watches	148,149
Nylon flags	88,901
Golf balls	48,839
Total Liquidated	<u>\$2,262,742</u>
Balance in Reserve	<u>\$1,973,731</u>

Source: Minnesota State Lottery accounting records and supporting documentation.

The Lottery continues to reserve one percent of the prize structure for the retailer incentive program. Liquidations from the reserve account are included with retailer commissions and are not a part of Lottery operations. Disbursements during fiscal year 1992 were properly supported with invoices. In addition, retailer incentive procedures exist for merchandise purchases.

The Lottery also maintains a prize reserve, which can be used for future prizes should a game not produce sufficient sales to cover payouts to date. At June 30, 1992, the prize reserve balance was \$1,219,404, as compared to \$707,237 at June 30, 1991. Lottery management said they intend to reduce the reserve to approximately \$1 million.

1. Prior Finding Not Resolved: The Lottery does not have specific authority to maintain reserve accounts.

In our prior and current audits we have questioned the authority for the reserve accounts. We believe that if the Lottery thinks such reserves are necessary, it should seek specific legislative authority for the practice. The Lottery has stated that establishment of the reserves is a prudent business practice. It believes that the general statutory provisions, which

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allow the director to establish rules necessary for the efficient operation and administration of the Lottery, provide authority for such actions. The issue was discussed at hearings during the 1993 legislative session. However, no specific action was taken.

Recommendation

- *The Lottery should deposit reserve funds in the state treasury or obtain specific authority for the accounts.*

Distributions

The Lottery is required to transfer net proceeds at the end of each month to the State Treasurer. Net proceeds are defined as the balance in the lottery fund after transfers to the lottery prize fund and credits to the lottery operations account. Minn. Stat. Section 349A.10, Subd. 5 provides that 40 percent of net proceeds should be credited to the Minnesota Environment and Natural Resources Trust Fund, and the remainder is credited to the General Fund.

Table 2-4 shows the beneficiary distributions for fiscal year 1992.

Table 2-4
Beneficiary Distributions
Fiscal Year 1992

<u>Fund</u>	<u>Amount</u>	<u>Percent</u>
General Fund	\$32,790,836	60%
Environment and Natural Resources Trust Fund	<u>21,859,891</u>	<u>40%</u>
Total	<u>\$54,650,727</u>	<u>100%</u>

Note: The amounts transferred do not include balances retained by the Lottery for reserves, which totalled \$3,012,287 at June 30, 1992.

Source: Minnesota State Lottery accounting records.

Minnesota State Lottery

Chapter 3. Lottery Operations

Chapter Conclusions

The Lottery complied with statutory limitations on administrative costs and advertising expense. However, certain similar costs related to promotions and public relations are excluded from the advertising definition. Expenditures in all three categories were appropriately documented and authorized.

Minn. Stat. Section 349A.10 Subd. 3 limited the operating or administrative costs of the Lottery to 15 percent of gross revenues in fiscal year 1992. This limit was reduced to 14.5 percent of gross revenues for fiscal year 1993. Operating costs for fiscal year 1992 were 12.4 percent of gross revenues, calculated in accordance with statutory definitions, as shown in Table 3-1.

Table 3-1
Operating Expense Limitation
Fiscal Year 1992

	<u>Amount</u>	<u>Percent of Gross Revenue</u>
Gross Revenue:		
Ticket Sales Revenue	\$297,602,893	
Less: Sales Tax	<u>19,344,186</u>	
Gross Receipts	\$278,258,707	
Other Income	<u>1,189,548</u>	
Gross Revenue	<u>\$279,448,255</u>	
Operating Expenses:		
Advertising	\$ 7,608,818	2.72%
Salaries and Benefits	7,146,278	2.56%
On-line Vendor Expense	6,153,204	2.20%
Ticket Costs	3,611,959	1.29%
Promotion and Public Relations	1,680,109	.60%
Communication	1,581,881	.57%
Occupancy Costs	1,561,085	.56%
Supplies and Materials	1,298,684	.46%
Purchased Services	1,204,560	.43%
Other	<u>2,808,616</u>	<u>1.01%</u>
Total Operating Expenses	<u>\$34,655,194</u>	<u>12.40%</u>

Note: Operating expenses excludes amounts paid to Lottery retailers as sales commissions or incentives.

Source: Auditor calculation from audited financial statements.

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Advertising, Promotion, and Public Relations

The Lottery has an aggressive marketing plan to promote both sales and public service. The plan is accomplished through advertisements, promotional events, and public relations. The most visible aspect of marketing is advertising. However, the Lottery also considers the other components important to its overall success.

In fiscal year 1992, the Lottery spent a total of \$9,288,927, or approximately 3.3 percent of gross revenue, on marketing related activities, including advertising, promotion and public relations. This expense represents approximately 27 percent of its total operating expenses. These amounts do not include salaries and benefits for Lottery staff engaged in marketing activities.

In addition to an overall limitation on operating expenses, the Legislature has imposed a restriction on the amount the Lottery may annually spend on advertising. Minn. Stat. Section 349A.10 Subd. 3(c) limits the amount spent on contracts for the preparation, publication, and placement of advertising to 2.75 percent of gross revenues. For fiscal year 1992, the Lottery recorded advertising expenses of \$7,608,818 or 2.72 percent of gross revenue.

Table 3-2 shows the breakdown of advertising expense.

**Table 3-2
Advertising Expense
Fiscal Year 1992**

TV Media and Production	\$2,773,388
Radio Media and Production	2,092,382
Print Media and Production	856,413
Outdoor Media and Production	821,514
Point of Sale Production	781,002
Other	<u>284,119</u>
 Total Advertising	 <u>\$7,608,818</u>

Source: Minnesota State Lottery accounting records.

In its marketing manual, the Lottery differentiates advertising expense from other related expenses such as promotion, sponsorships, and public relations. It defines Lottery advertising to include:

The presentation of goods (lottery tickets) in a medium where the Minnesota State Lottery is directly identified and for which the Minnesota State Lottery has paid for the space or time.

Minnesota State Lottery

The Lottery used advertising industry dictionaries as the starting point for its definitions, refining them to meet its particular circumstances.

The Lottery contracts with a private firm to create, develop, produce, and disseminate Lottery ads. The Lottery director is responsible for the final approval and authorization prior to the production of any ads. There was appropriate documentation and approvals for all invoices we reviewed. In addition, the Lottery followed its established definitions and consistently recorded items as advertising, promotion, or public relations.

Although we generally concluded that the Lottery complied with the statutory limitation on advertising expenses, we believe some questions remain as to the legislative intent of the restriction. We believe that some of the items which the Lottery classifies as promotion expense could be considered advertising. For example, the Lottery contracts for certain materials which it refers to as beneficiary advertising. These items, such as the Environmental Journal radio series, are designed to describe the purpose and recipients of Lottery proceeds distributed to the Environmental and Natural Resources Trust Fund. Since these ads do not directly promote ticket sales, the Lottery classifies them as promotion expense rather than advertising.

The Lottery defines promotions as activities that supplement both personal selling and advertising, coordinate them and help to make them effective. Promotions are normally short-term or nonrecurring in nature and can be targeted to the public. Lottery promotions include exhibits, displays, sponsorships, and Lottery goods such as caps, T-shirts, cups, etc.

Promotional expenses for fiscal year 1992 are shown in Table 3-3.

**Table 3-3
Promotional Expenses
Fiscal Year 1992**

Premium Items Production (Lottery goods)	\$ 502,688
Major Events Sponsorships	429,550
Public Relations and Information	237,707
Promotional Tickets	169,358
Beneficiary Related Materials	159,709
Retailer Promotions and Information	82,520
Local Community Events Sponsorships	31,593
Other Promotional Events	<u>66,984</u>
 Total Promotions	 <u>\$1,680,109</u>

Source: Minnesota State Lottery accounting records.

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The two largest promotional accounts are for premium item production (T-shirts, hats, golf balls, trinkets, etc.) and major events sponsorship (Taste of Minnesota, WE Fest, MN Timberwolves-NBA). These two accounts made up more than 55 percent of promotional expenditures in fiscal year 1992. The Lottery also participated in many smaller events at retailer outlets and in local communities.

Public relations, which the Lottery accounts for within the promotional category, is defined as activities of persons or organizations intended to promote a public understanding of Lottery operations and generate good will. The Lottery believes it develops a good corporate citizen image by supporting community events. Lottery public relation materials also include press releases, newsletters, its annual report, and other general information brochures.

We reviewed the process for purchasing and recording the premium production items. The transactions were documented and approved, and the items were appropriately recorded on the Lottery's inventory system. We also reviewed the major corporate sponsorship events. Again, there was appropriate documentation and authorization for the events. It is difficult to assess the value to the Lottery of good will and benefits derived from the various sponsorships. To ensure that participation in a promotional event is cost effective, the Lottery is developing a cost tracking system. This system will allow the Lottery to determine the amount spent on each event, and make a comparison to associated sales during the event.



Proceeds Benefit Our Natural And Economic Environments.

George R. Andersen
Director

August 2, 1993

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

Dear Mr. Nobles:

We have received the audit for FY93, and appreciate the opportunity to comment.

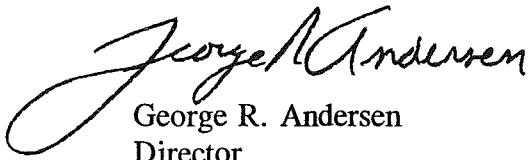
Reserve accounts were again raised as an issue. As noted, the matter has been discussed in legislative hearings, with justification and existing legal authority cited. Such accounts are both authorized and essential to the operation of the Lottery, are common in the industry and are, as you noted, properly managed.

The report editorially comments on advertising promotions and public relations, each an element of overall marketing. The Lottery utilizes standard published definitions for "advertising", with the exception that we include certain additional materials within the definition - a more conservative approach. These elements of marketing are indeed distinct. We follow the published definitions of each and, of course, are well within the statutory guidelines.

We were gratified that we have again been reviewed and that you found our financials and process for accounting in good order.

We work very hard at maintaining firm control and accountability, and appreciate such reviews.

Very truly yours,


George R. Andersen
Director