



**COLORADO**  
**Department of Revenue**

Executive Director's Office

Physical Address:  
1375 Sherman Street  
Denver, CO 80203

Mailing Address:  
P.O. Box 17087  
Denver, CO 80217-0087

August 4, 2014

Dianne E. Ray, CPA  
State Auditor  
Colorado Office of the State Auditor  
1525 Sherman St., 7<sup>th</sup> Floor  
Denver, CO 80203

Dear Ms. Ray:

In response to your request, we have prepared an updated status report regarding the implementation of audit recommendations contained in the August 2013 *Performance Audit of the Colorado Lottery*. The attached report provides a brief explanation of the actions taken by the Department of Revenue and the Colorado Lottery to implement each recommendation.

Lottery has worked diligently to implement the recommendations from the performance audit. Improvements in the auto-reorder system have been realized. The staff bonus plan has been reevaluated to be simpler, more efficient and more transparent. The Lottery Commission and the Lottery continue to make significant strides related to maximum proceeds for the beneficiaries. The communication interface between the Commission and the Division has been formalized by considering the needs of each entity. Lastly, processes and policies have been documented and include additional controls and training for investigative staff.

We look forward to your review of our progress and providing an update during the Legislative Audit Committee meeting in August.

If you have any questions, please do not hesitate to contact me at (303) 866-5610 or by email at [Barbara.Brohl@state.co.us](mailto:Barbara.Brohl@state.co.us).

Sincerely,

A handwritten signature in blue ink that reads "Barbara J. Brohl".

Barbara J. Brohl  
Executive Director

# AUDIT RECOMMENDATION STATUS REPORT

**AUDIT NAME:** The Colorado Lottery, Department of Revenue Performance Audit, (August 2013)

**AUDIT NUMBER:** 2205

**DEPARTMENT:** Department of Revenue

**DATE:** August 1, 2014

## SUMMARY INFORMATION

*Please complete the highlighted sections with summary information for all audit recommendations.*

<b>Rec. Number</b>	<b>Agency's Response</b>	<b>Implementation Status</b> <i>(Implemented, Implemented and Ongoing, Partially Implemented, Not Implemented, or No Longer Applicable) Please refer to the attached sheet for definitions of each implementation status option.</i>	<b>Implementation Date</b>	<b>Revised Implementation Date</b> <i>(Complete only if agency is revising the original implementation date.)</i>
1a	Agree	Implemented and Ongoing	December 2013	
1b	Agree	Partially Implemented	January 2014	July 2015
1c	Agree	Partially Implemented	June 2014	July 2015
2a	Agree	Implemented	July 2014	
2b	Agree	Implemented	July 2014	
3a	Agree	Partially Implemented	October 2014	January 2016
3b	Agree	Implemented and Ongoing	August 2013	
4a	Agree	Partially Implemented	October 2014	July 2015
4b	Agree	Implemented	March 2014	December 2013
5	Agree	Implemented	December 2014	September 2013
6a	Agree	Implemented	January 2014	
6b	Agree	Implemented	January 2014	
6c	Agree	Implemented	January 2014	June 2014

## DETAIL OF IMPLEMENTATION STATUS

**Note: The Colorado Lottery and Department agreed with all of the audit recommendations.**

### **Recommendation No. 1:**

The Colorado Lottery should establish controls that will allow the auto-reorder and courier system to operate as intended and to realize cost-savings anticipated with the system's implementation by:

- a. Fully implementing and providing training and accountability measures for the recently created policies and procedures related to the auto-reorder system.

## **Current Implementation Status for Rec 1, part a: Implemented and Ongoing**

### **Agency's Update:**

Auto reorder rules were developed in April 2013 and ongoing monitoring and documentation of compliance with rules are in place across Colorado. As of June 2014, 93% of all retailers are using auto reorder for their Scratch ticket inventory replenishment. Ongoing training and compliance plans were in place in mid-FY14 and will continue in FY15.

- b. Conducting a comprehensive evaluation of sales force needs and determining where expenses can be reduced, including what the sales representatives' duties should be with respect to the retailers, the frequency of retailer visits, how many sales representatives are needed, how many sales routes there should be, and the number and type of vehicles needed for these routes.

## **Current Implementation Status for Rec 1, part b: Partially Implemented**

### **Agency's Update**

Optimal staffing recommendations have been postponed until after conversion to the new Lottery gaming system and will be reviewed in late FY15. After that time an optimal staffing model for Lottery sales representatives will be put into place starting July 2015. Recently, Lottery was able to eliminate one sales route as a result of internal realignment of positions.

- c. Using the results of this evaluation to reduce expenditures as determined, including adjusting the number and types of vehicles; revise sales representative job descriptions to reflect changes to roles, including decreased responsibilities for inventory control as needed; and implement a training plan for sales staff to educate them on the use of the auto-reorder system and how to maximize its benefits.

## **Current Implementation Status for Rec 1, part c: Partially Implemented**

### **Agency's Update:**

Colorado Lottery fleet was reduced by two vehicles in FY14 and smaller footprint vehicles are also being used on some sales routes. Job descriptions have been updated to reflect changes to roles and decreased inventory controls. Training of staff on the use of the auto-reorder system is ongoing. Full analysis of staffing and roles post-conversion to a new gaming system will allow for completion of this recommendation in late FY15.

## **Recommendation No. 2:**

The Colorado Lottery (the Lottery) should ensure that any staff bonus incentive awards offered to staff are designed to meet the Lottery's goal of increasing sales in order to increase beneficiary proceeds. In designing and implementing the bonus incentives, the Lottery should:

- a. Determine the method that would be most appropriate for calculating individual awards for staff and ensure that this method is recorded in the written plan, used by the Lottery to calculate awards, and implemented in a manner that is efficient and transparent to staff and Lottery's stakeholders.

### **Current Implementation Status for Rec 2, part a: Implemented**

#### **Agency's Update**

This recommendation was completed with the FY14 and FY15 Sales Performance Awards Plans.

- b. Ensure that all of the incentives included in the written plan are designed to award individual achievement for increases in sales, and do not award activities that cannot be shown to result in sales increases.

### **Current Implementation Status for Rec 2, part b: Implemented**

#### **Agency's Update**

The FY14 Sales Performance Awards Plan required that Lottery organizational goals (sales and proceeds) be achieved before any bonus dollars were available for territory sales incentives. The total dollars that could be earned was also reduced in half to achieve overall cost savings. No incentives were paid out in FY14 as a result of organizational goals not being met. The same Sales Performance Awards Plan was approved for FY15 with updated organizational and territory goals.

---

## **Recommendation No. 3:**

The Colorado Lottery (the Lottery) should ensure that prize payout structures result in the maximum proceeds for beneficiaries by:

- a. Establishing and adhering to a process for evaluating and documenting the specific impacts that prize payout percentages have on total sales in Colorado for both scratch and state jackpot games and ensuring that these reviews are conducted on a regular basis as state demographics and other factors change over time. The Lottery should report back to the Legislative Audit Committee and its Interim Committee of Reference in the fall of 2014 on the results of its evaluation.

### **Current Implementation Status for Rec 3, part a: Partially Implemented**

#### **Agency's Update:**

Lottery has developed a process for evaluating and documenting the impacts that prize payout percentages have on total sales in Colorado for both Scratch and state Jackpot games. This includes development and adherence to prize payout strategies for a sufficient period of time that allow for appropriate analysis of sales by price point. Not until late FY15 will all Scratch games be in the market following the FY14 prize payout strategy and for this reason, complete analysis of sales impact is expected on the Scratch portfolio early-mid FY16.

State Jackpot games are undergoing current review to determine 1) if game performance meets design parameters, 2) if game generates consistent revenues and 3) if potential payout changes risk game performance.

- b. Providing documented reasoning to the Lottery Commission when proposed prize payout percentages for scratch games differ from those included in the annual scratch product plans and requiring that these proposed changes be supported by data showing the projected impact that changing the payout percentage will have on sales and proceeds.

### **Current Implementation Status for Rec 3, part b: Implemented and Ongoing**

#### **Agency's Update**

Every month the Lottery Commission receives complete information about new games from the Scratch Manager, including the history of prize payouts on those games and any deviations from prize payout policy, if any. Since August 2013, there have not been any games brought to the Commission for approval with prize payouts that differ from the Scratch Game Product Plan approved by the Commission.

---

### **Recommendation No. 4:**

The Colorado Lottery (the Lottery) and the Colorado Lottery Commission (the Commission) should work together to develop sales compensation and Retailer Award Incentive for Sales Excellence (RAISE) bonus plans that incentivize retailers and maximize proceeds for beneficiaries by:

- a. Establishing a comprehensive ongoing process to collect, analyze, and utilize data to assist in the development of a long-term retailer compensation strategy that aligns with the Lottery's organizational goals. The Lottery should report back to the Legislative Audit Committee and its Interim Committee of Reference in the fall of 2014 on the measures it has put in place to reduce retailer compensation.

### **Current Implementation Status for Rec 4, part a: Partially Implemented**

#### **Agency's Update**

After a preliminary presentation of data and information to the Lottery Commission in mid FY14 on retailer compensation, a staff recommendation was approved to postpone further discussion and

any potential changes in retailer compensation until after the gaming system conversion is complete. This discussion will resume in late FY15. Also, a Retailer Forum has just been formed and will allow for an open dialog with retailers about Lottery business practices, including input on retailer compensation arrangements, a critical component in the overall evaluation.

- b. Amending Lottery rules for retailer compensation as needed to ensure the Lottery Commission has appropriate oversight of the retailer bonus plan, including the RAISE bonus, and amendments to those plans and to require that justification be provided to demonstrate how changes to retailer compensation will result in increased sales.

**Current Implementation Status for Rec 4, part b: Implemented**

**Agency's Update:**

In December 2013, the Lottery Commission reviewed the various components of the Lottery's retailer compensation program, including the current rules governing Commission powers and duties related to the compensation plans. No changes to the rules were recommended. The current rules require the Lottery Commission to approve all retailer compensation plans except the RAISE bonus plan which is under the authority of the Lottery Director as delegated and in accordance with Colorado Lottery Rule 5.17(d).

**Recommendation No. 5:**

The Colorado Lottery (the Lottery) and the Colorado Lottery Commission (the Commission) should work together to ensure that communication on the Lottery's operations is optimal for both entities. This work may include establishing a standard, formalized forum to discuss information requests made by Commission members and the status of the requests. In particular, the Commission's monthly agenda could include time that is set aside to discuss the status of special or one-time information requests, such as those made prior to the Commission voting on a new game, to help ensure that miscommunication between meetings does not occur and all needed requests are fulfilled in a timely and complete manner prior to the deadlines for significant votes.

**Current Implementation Status for Rec 5: Implemented**

**Agency's Update:**

An Information Request section has been added to the monthly Lottery Commission agenda, providing an opportunity for special requests for reports or information from the Commission. Overall, communication, as well as the dissemination of information to the Commission, has improved over the past year.

**Recommendation No. 6:**

The Colorado Lottery should improve its investigation processes by:

- a. Establishing comprehensive, written policies and procedures for conducting all types of investigations, including which staff is responsible for which aspects of the process, and when and how follow-up actions should occur.

**Current Implementation Status for Rec 6, part a: Implemented**

**Agency's Update**

Comprehensive written policies and procedures for conducting all types of investigations as documented in the audit recommendation have been completed.

- b. Establishing a system of supervisory review that ensures cases will be closed appropriately and all investigative activities will be clearly delegated and documented.

**Current Implementation Status for Rec 6, part b: Implemented**

**Agency's Update:**

Lottery has established a system of supervisory review that ensures cases will be closed appropriately and all investigative activities clearly delegated and documented.

- c. Providing ongoing training to staff as needed after comprehensive investigative processes have been implemented.

**Current Implementation Status for Rec 6, part c: Implemented**

**Agency's Update:**

Training of staff commenced in June 2014 on comprehensive investigative processes. Training had been postponed due to the arrival of a new Director of Security in January and a new investigator in late spring.

---



August 4, 2014

Dianne E. Ray, CPA  
State Auditor  
Colorado Office of the State Auditor  
1525 Sherman Street, 7<sup>th</sup> Floor  
Denver, CO 80203

Dear Ms. Ray;

In response to your request, we have prepared an updated status report regarding the implementation of audit recommendations made to the Colorado Lottery Commission contained in the August 2013 *Performance Audit of the Colorado Lottery*. The attached report provides a brief explanation of the actions taken by the Colorado Lottery Commission to implement each recommendation.

Two of the three recommendations addressed to the Commission have been implemented. One recommendation is partially implemented with respect to the sales compensation that incentivize retailers.

If you have any questions, please do not hesitate to contact me at 970-301-3313 or by email at [lotus2050@msn.com](mailto:lotus2050@msn.com).

Sincerely,

A handwritten signature in blue ink that reads "Margie Martinez Perusek".

Margie Martinez Perusek, Commissioner  
Colorado Lottery

# AUDIT RECOMMENDATION STATUS REPORT

**AUDIT NAME:** The Colorado Lottery, Department of Revenue Performance Audit, (August 2013)

**AUDIT NUMBER:** 2205

**DEPARTMENT:** The Colorado Lottery Commission

**DATE:** August 1, 2014

## SUMMARY INFORMATION

*Please complete the highlighted sections with summary information for all audit recommendations.*

<b>Rec. Number</b>	<b>Agency's Response</b>	<b>Implementation Status</b> <i>(Implemented, Implemented and Ongoing, Partially Implemented, Not Implemented, or No Longer Applicable) Please refer to the attached sheet for definitions of each implementation status option.</i>	<b>Implementation Date</b>	<b>Revised Implementation Date</b> <i>(Complete only if agency is revising the original implementation date.)</i>
4a	Agree	Partially Implemented	October 2014	July 2015
4b	Agree	Implemented	March 2014	December 2013
5	Agree	Implemented	December 2014	September 2013

## DETAIL OF IMPLEMENTATION STATUS

**Note: The Colorado Lottery Commission agreed with all of the audit recommendations.**

### Recommendation No. 3:

The Colorado Lottery (the Lottery) should ensure that prize payout structures result in the maximum proceeds for beneficiaries by:

- a. Establishing and adhering to a process for evaluating and documenting the specific impacts that prize payout percentages have on total sales in Colorado for both scratch and state jackpot games and ensuring that these reviews are conducted on a regular basis as state demographics and other factors change over time. The Lottery should report back to the Legislative Audit Committee and its Interim Committee of Reference in the fall of 2014 on the results of its evaluation.

### **Current Implementation Status for Rec 3, part a: Partially Implemented**

#### **Commissioner's Update:**

C.R.S 24-35-208 (1)(c) provides authority to the Lottery Commission to govern prize payouts. As the result of a staff developed process and strategy, the Commission is in the middle of an 18 month review to evaluate a revised prize payout plan. Commissioner Frances Koncilja objected to the process and strategy as the issue involves public policy. Commissioner Koncilja believes that the reduction in revenue occurring in the last 8 months is likely the result of the reduction of payouts to players and that the current strategy may have an economic

impact not previously considered. A complete analysis of the impact on sales is anticipated in FY16.

#### **Recommendation No. 4:**

The Colorado Lottery (the Lottery) and the Colorado Lottery Commission (the Commission) should work together to develop sales compensation and Retailer Award Incentive for Sales Excellence (RAISE) bonus plans that incentivize retailers and maximize proceeds for beneficiaries by:

- a. Establishing a comprehensive ongoing process to collect, analyze, and utilize data to assist in the development of a long-term retailer compensation strategy that aligns with the Lottery's organizational goals. The Lottery should report back to the Legislative Audit Committee and its Interim Committee of Reference in the fall of 2014 on the measures it has put in place to reduce retailer compensation.
- b. Amending Lottery rules for retailer compensation as needed to ensure the Lottery Commission has appropriate oversight of the retailer bonus plan, including the RAISE bonus, and amendments to those plans and to require that justification be provided to demonstrate how changes to retailer compensation will result in increased sales.

#### **Current Implementation Status for Rec 4, part a: Partially Implemented**

#### **Current Implementation Status for Rec 4, part b: Implemented**

##### **Commission's Update:**

Recommendation 4, part a:

After a preliminary presentation of data and information to the Lottery Commission in mid FY14, a staff recommendation was approved to postpone further discussion and any potential changes in retailer compensation until after the gaming system conversion is complete. Another factor in consideration is the positive or negative changes as a result of lowering the prize payout percentages. We are capturing data over an 18 month period prior to making decisions to change the retailer sales compensation. This discussion will resume in late FY15. Lottery staff is in the process of developing a Retailer Forum that will allow for an open dialog with retailers about Lottery business practices, including input on retailer compensation arrangements.

Recommendation 4, part b:

In December 2013, the Lottery Commission reviewed the various components of the Lottery's retailer compensation program, including the current rules governing Commission powers and duties related to the compensation plans. No changes to the rules were recommended. The current rules require the Lottery Commission to approve retailer compensation plans with the exception of the RAISE (Retailer Awards Incentive for Sales Excellence) bonus plan which is under the authority of the Lottery Director as delegated and in accordance with Colorado Lottery Rule 5.17 (d).

## **Recommendation No. 5:**

The Colorado Lottery (the Lottery) and the Colorado Lottery Commission (the Commission) should work together to ensure that communication on the Lottery's operations is optimal for both entities. This work may include establishing a standard, formalized forum to discuss information requests made by Commission members and the status of the requests. In particular, the Commission's monthly agenda could include time that is set aside to discuss the status of special or one-time information requests, such as those made prior to the Commission voting on a new game, to help ensure that miscommunication between meetings does not occur and all needed requests are fulfilled in a timely and complete manner prior to the deadlines for significant votes.

### **Current Implementation Status for Rec 5: Implemented**

#### **Commission's Update:**

The Commission, working with Lottery staff, established processes to ensure that communication is optimal for both entities. Based on the audit recommendation, an Information Request section has been added to the monthly Lottery Commission agenda, providing an opportunity for special requests for reports or information from Lottery staff. Information requests are fulfilled in a timely and complete manner to meet the Commission's needs.

---

**COLORADO LOTTERY  
FINANCIAL HIGHLIGHTS  
\$ IN MILLIONS  
FOR THE ELEVEN (11) MONTHS ENDED MAY 31, 2014 AND 2013**

The table included below and the graphs included on page 2 present certain summarized operating results of the Colorado Lottery for the eleven months ended May 31, 2014 and 2013 and should be read in conjunction with the financial statements presented herein. The graphs included on page 2 are presented for the purpose of demonstrating the Colorado Lottery's compliance with certain statutes that pertain to its operations.

	For the Eleven Months Ended May 31,			
	FY 2014		FY 2013	
	Total	Actual Percent	Total	Actual Percent
<b>INCOME</b>				
Gross Ticket Sales	\$502.84		\$523.42	
Nonoperating revenue	0.70		0.58	
<b>TOTAL INCOME</b>	<b>503.54</b>		<b>524.00</b>	
<b>LESS:</b>				
<b>PRIZES</b>	<b>\$310.38</b>	<b>61.7% (1)</b>	<b>\$324.15</b>	<b>61.9% (1)</b>
<b>RETAILER COMMISSIONS AND BONUSES</b>	<b>\$37.20</b>	<b>7.4% (2)</b>	<b>\$39.05</b>	<b>7.5% (2)</b>
<b>ADMINISTRATIVE COSTS</b>				
Ticket Costs and Vendor Fees	9.98		10.29	
Other Operating Expenses	25.86	(4)	25.26	
<b>TOTAL ADMINISTRATIVE COSTS (Note 3)</b>	<b>35.84</b>	<b>7.1% (3)</b>	<b>35.55</b>	<b>6.8% (3)</b>
	120.12		125.25	
<b>NET CHANGE IN NET ASSETS</b>	<b>(0.73)</b>		<b>(0.80)</b>	
<b>PROCEEDS DISTRIBUTION</b>	<b>\$120.85</b>	<b>24.0% (3)</b>	<b>\$126.05</b>	<b>24.1% (3)</b>

Note 1: Percent of gross ticket sales - per C.R.S. 24-35-210 (9) total disbursements for lottery prizes shall be no less than fifty percent of the total revenue accruing from the sale of lottery tickets or shares.

Note 2: Percent of gross ticket sales.

Note 3: Percent of total income.

Note 4: Total operating expenses per the statement of revenues, expenses and changes in fund net position includes unappropriated expenses such as depreciation and accrued annual and sick leave. The actual administrative costs percentage would be slightly lower if they were removed from the calculation.