Georgia Department of Audits and Accounts
Performance Audit Operations
Russell Hinton, State Auditor
Leslie McGuire, Director

Why we did this review

The Senate Appropriations Committee requested this special examination of the Georgia Lottery Corporation (GLC). The Committee specifically requested comparisons of GLC's sales and proceeds to other state lotteries and an analysis of GLC's prize payout percentages and amounts remitted to the state. In addition, the Committee requested information on GLC's bonus or incentive pay plans and whether GLC was considered a "model" lottery operation.

Who we are

The Performance Audit Operations Division was established in 1971 to conduct in-depth reviews of state programs. The purpose of these reviews is to determine if programs are meeting their goals and objectives; provide measurements of program results and effectiveness; identify other means of meeting goals; evaluate the efficiency of resource allocation; and assess compliance with laws and regulations.

Website: www.audits.ga.gov
Phone: 404-657-5220
Fax: 404-656-7535

The Georgia Lottery Corporation

Analysis of Sales, Proceeds, and Incentive Pay

What we found

The Georgia Lottery Corporation (GLC) is one of the highest performing state lottery programs in the nation. Of the 42 state lotteries that existed in 2009 (the most recent year comparable information was available), the GLC ranked 5th in sales, 2nd in per capita sales, and its growth has exceeded most other state lotteries in recent years. Lottery officials attribute GLC's relatively high sales to its utilization of high prize payouts to encourage lottery ticket purchases. The percentage of GLC's sales paid out as prizes was 63.3%, which was 5th highest among other lotteries (whose average prize payout ratio was 59.2%). GLC's high prize payout ratio resulted in 25.7% of sales transferred for state program use, which ranked 29th among existing lotteries. However, due to GLC's high level of sales, it ranked 7th in the total amount transferred for state program use and 4th in per capita proceeds transferred to the state.

Our review of GLC's financial records identified a correlation between increases in GLC's prize payout percentage and increases in proceeds transferred to the state. Over the last 14 years, GLC's prize payout percentage increased from 51.9% to 62.9%. While the increase in prize payouts primarily came from decreases in the rate (or percentage) of sales transferred to state programs (which decreased from approximately 35% to 26%), GLC's sales doubled from $1.7 billion to $3.4 billion. The increases in sales more than compensated for decreases in the rate/percentage of sales transferred to the state, and the actual amount transferred to the state increased 52% from $581.4 million to $883.9 million.

We found that the language in the Lottery for Education Act is somewhat ambiguous regarding the amount of lottery proceeds that is expected to be transferred to the state. The Act provides that the GLC should "as nearly as practical" remit "at least 35%" of lottery proceeds to the state annually and also requires that the Lottery be operated in a manner that "maximizes revenues." GLC has not remitted at least 35% of lottery proceeds since fiscal year 1997. GLC's Board has directed GLC to pursue the goal of maximizing revenue for education.

If the General Assembly wishes to establish more direct control over the Lottery, clarifying the law by removing ambiguous language and conflicting goals would be necessary. However, if the General Assembly establishes a firm requirement regarding the minimum percentage of sales to be remitted to the State, it should ensure that the requirement level that it sets does not limit GLC's ability to develop new products and to react to changing market conditions. If GLC was required to start remitting 35% of its sales to the state, it would have to abandon its current marketing strategy and it would almost certainly result in significant reductions in sales and proceeds. Achieving a 35% return to the state would require that prize payouts for instant games be reduced, which would most likely result in a (potentially significant) reduction in sales volume, and the net effect would be that the state would receive 35% of a much smaller amount of lottery sales.

In addition to commissions paid to sales staff, GLC has employee bonus (or incentive payment) plans for its executive staff and for its non-commissioned staff. In fiscal year 2010, GLC awarded approximately $532,000 in incentive payments to its executive staff and approximately $1.36 million to its non-commissioned employees (total incentive payments were 0.056% of GLC's net sales). GLC's incentive payments to executive staff ranged from $25,460 to $143,277 and its incentive payments to non-commissioned employees ranged from $1,321 to $23,184. We found that few other state lottery programs offer incentive payment plans to its executive and non-commissioned employees. A survey published in 2009 found that six of 43 state lotteries had incentive plans for their chief executives. Our survey of 10 states found two states had incentive plans for their executive staff and two states had incentive plans for their non-commissioned employees. In addition, the number of eligible employees and the amount of incentive awards was less in those states than is offered by GLC.

Finally, we found that while Georgia's Lottery is generally considered to be high performing, most state lotteries created after GLC was established have not emulated many of GLC's more innovative attributes. Of seven state lotteries created after 1993, one had a prize payout percentage near Georgia's, one had a public corporation organization structure, and one awarded incentive pay to its executive level and non-commissioned employees.

In its response to the report, GLC indicated that performance measures are the best indicator of any business model and the audit accurately describes the GLC's high performance. GLC noted that it was established as a public benefit corporation and given the flexibility to operate as an entrepreneurial enterprise to allow it to effectively respond to an ever-changing marketplace. In addition, GLC expressed concern about the ability to compare lotteries, indicating that each U.S. lottery has been established and operates under unique circumstances. Additional comments provided by GLC have been incorporated throughout the report.

Table of Contents

Purpose of this Special Examination

The Senate Appropriations Committee requested this special examination of the Georgia Lottery Corporation (GLC) and specifically asked the Department of Audits and Accounts (DOAA) to answer the following questions:

Sales and Proceeds

- How does Georgia's lottery compare to other state lotteries in terms of sales and growth?
- How does Georgia compare in terms of the percent of revenues spent on prizes and operations?
- What is the practice in other states regarding the percent/amount transferred for state program use?
- How is the amount transferred by the Georgia Lottery Corporation to the Lottery for Education Account determined?
- Is there a correlation between the increases/decreases in spending for prizes and operations and the amount transferred to the Lottery for Education Account?
- Should the state require (rather than suggest) a minimum percentage of gross revenues that should be transferred to the Lottery for Education Account?

Bonuses/Incentive Pay

- Please provide an analysis of the bonuses [incentive payments] paid to GLC employees.
- Is there a correlation between incentive payments and the amount transferred to the Lottery for Education Account?
- Who determines the incentive payments and what criteria are used to award them?
- Is [the use of incentive payments] common to other state lotteries?

Model Lottery

- Is Georgia considered a model and if so, why? If not, who is and why?

Appendix A provides more details about the scope of this special examination and the methodologies used to address the project's objectives. The content of this report has been discussed with appropriate GLC personnel, and a draft of the report was provided to the GLC for review. The GLC was given an opportunity to provide a written response, and responses have been included in this report as appropriate.

Background

History of the Lottery

In 1992, voters in Georgia approved a constitutional amendment authorizing the state to operate and regulate a lottery. In 1993, the Georgia Lottery for Education Act was approved, and the Georgia Lottery Corporation (GLC) was created to oversee operations of the state lottery. The first Georgia Lottery tickets were sold on June 29, 1993.

The charge given to the Georgia Lottery Corporation (GLC) in the Lottery for Education Act is to provide entertainment to the public, maximize revenues, and ensure that the lottery is operated with integrity and without political influence. According to state law (O.C.G.A §50-27-2(1)), the net proceeds of the Lottery are to be used to "support improvements and enhancements for educational purposes and programs." The Act specifically designates that the Lottery's net proceeds are to be used "to supplement, not supplant, existing resources for educational purposes and programs (O.C.G.A §50-27-2(1))."

In large part, the Lottery was established to provide additional funding for students outside of grades k-12. The two programs that have received a large majority of lottery funds are the state's voluntary pre-kindergarten program and the state's college tuition assistance program (known as the HOPE scholarship program). Since the lottery's inception, the pre-kindergarten program has received $4.0 billion in lottery proceeds, while the HOPE scholarship program has received $5.6 billion (as of July 2010).[1]

Lottery Structure, Governance, and Legislative Oversight

The Lottery Act established a "public corporation" structure for lottery operations. As such, the GLC is an instrumentality of the state but not a state agency. The Lottery Act also requires that the GLC be self-funded. Therefore, the GLC does not receive an annual appropriation from the General Assembly to pay for operating expenses but instead funds operating expenses with revenue generated from ticket sales and remits net proceeds to the state.

The Act further provides that the GLC be governed by a Board of Directors. The Board's seven members are appointed by the Governor and confirmed by the Senate to serve five year terms. The Board's chairperson and vice chairperson are elected by the Board members.

Legislative oversight is provided by the General Assembly's Georgia Lottery Corporation Legislative Oversight Committee. This committee is comprised of all the members of the House Committee on Regulated Industries and all the members of the Senate Economic Development Committee. The Lottery Oversight Committee meets at the discretion of its Chairman and has historically met at least annually to review the operations of the GLC.

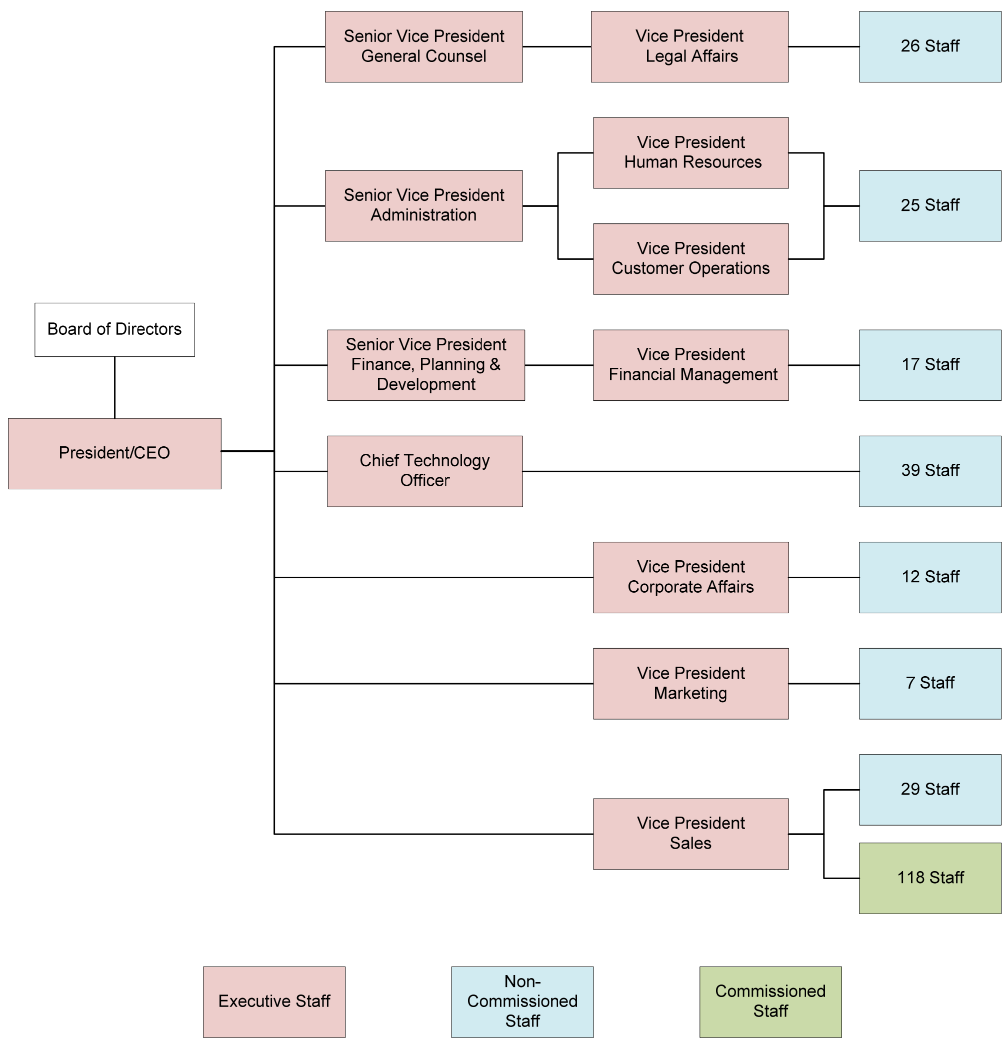
GLC Organization and Operations

The GLC's daily operations are managed by a Chief Executive Officer (CEO) who is appointed by its Board of Directors. The Act charges the CEO with a broad range of powers and duties including: administering the lottery, employing personnel, entering into contracts, preparing a budget, and submitting quarterly reports to GLC's Board, the State Accounting Office, and the State Auditor's Office.

[1] The state auditor's special report on ***Selected Summary Information on the State Lottery*** identified that total funding provided from the Lottery for Education Account was about $11.1 billion (including about $1.5 billion provided for technology equipment and research).

The GLC is headquartered in Atlanta and has seven additional district offices. The GLC has approximately 285 full-time employees (including a 12-person executive team) and six divisions. Of the 147 employees in the sales unit of the Sales and Marketing Division, 118 are classified as employees eligible for commissions in addition to regular salaries. All of GLC's other employees are classified as non-commissioned employees that are eligible for incentive pay in addition to regular salaries. (See **Exhibit 1**.)

Exhibit 1
Organizational Structure of GLC
As of February 2011



Source: Georgia Lottery Corporation Records

Lottery Revenues and Expenses

The Lottery has two basic types of products: online games and instant games. Online games (also known as draw games) use a computer terminal network that players access via a local retail store. Online games include numbers games, keno, and lotto-style games. Online games may be the product of an individual state (e.g., Georgia's Cash 4) or may be a multi-state product (e.g., Mega Millions). Instant games (also known as scratch-off games) are ticket games that require a player to remove a latex coating to determine if the ticket is a winner. GLC offers five Georgia-only online games, four multi-state online games, and 77 varieties of instant games (as of February 2011). In fiscal year 2010, GLC had net ticket sales of almost $3.4 billion. In addition to ticket sales, GLC had other income of $5.3 million that was primarily retailer line fees paid for use of GLC's online terminals.

In fiscal year 2010, GLC's largest expense was prizes paid on lottery games (about $2.1 billion). In addition, GLC paid retailers commissions of approximately $239 million for selling and cashing winning tickets and contractor fees of almost $68 million for gaming systems and supplies. Other significant expenses included salaries, benefits, advertising, and marketing.

GLC transferred net proceeds of almost $883.9 million to the Lottery for Education Account in fiscal year 2010. **Exhibit 2** summarizes GLC's revenues, expenses, and transfers to the state for fiscal year 2010.

Exhibit 2
GLC Revenues and Expenses
Fiscal Year 2010

Description		TOTAL
Revenues		
Online Game sales	$1,231,909,000	
Instant Game sales	$2,413,488,000	
Less: Free Tickets	-$257,972,000	
Net Ticket Sales	$3,387,425,000	
Other Income	$5,330,000	
Total Revenue		**$3,392,755,000**
Expenses		
Prizes	$2,129,144,000	
Retailer commissions	$239,297,000	
Contractor fees	$67,721,000	
Salaries and benefits	$21,658,000	
GLC Staff Incentive Pay/Bonuses [1]	$1,890,000	
Advertising	$25,233,000	
Retailer merchandising & marketing	$13,825,000	
All other expenses	$10,109,000	
Total Expenses		**$2,508,877,000**
Net Proceeds Transferred to the State		**$883,878,000**

[1] Executive and non-commissioned employee incentive pay

Source: GLC's Financial Records

Requested Information

*Much of the information requested by the Senate Appropriations Committee is related to comparisons of Georgia's Lottery to lotteries in other states. Extensive data on all state lotteries is compiled annually by a private company and published in **LaFleur's World Lottery Almanac (**which is sold to individuals interested in lottery operations). We utilized information in the Almanac to identify the relative ranking of Georgia's Lottery to all other state lotteries; however, due to the proprietary nature of this data, specific information on other states was not included in this report. (Any specific information on other states included in this report was obtained by surveys conducted by the audit team.)*

SALES AND PROCEEDS

How does Georgia's Lottery compare to other state lotteries in terms of sales and growth?

With respect to sales, the Georgia Lottery is one of the highest performing state lottery programs in the nation. As shown in **Exhibit 3**, the Georgia Lottery's $3.4 billion in net sales in fiscal year 2009 ranked 5th among the 42 existing state lottery programs. Three of the states that ranked higher than Georgia had significantly higher populations (with populations ranging from 18.5 million to 24.8 million higher than Georgia's).

A comparison of "per capita" sales provides a better measure for comparing the relative sales performance of state lotteries since states with larger populations have more potential customers. Therefore, states with larger populations generate more total sales than smaller states that have the same percentage of their population purchasing lottery tickets. As shown in **Exhibit 4,** the Georgia Lottery's $345 in per capita sales in fiscal year 2009 ranked 2nd among the 42 existing state lottery programs. This indicates that Georgia's Lottery has more "market saturation" than other state lotteries. The average per capita sales in fiscal year 2009 among the other 41 state lottery programs was $157 compared to Georgia's per capita sales of $345. If Georgia's Lottery had per capita sales of $157 it would generate about $1.6 billion in annual sales as opposed to the $3.4 billion in annual sales it achieved with per capita sales of $345.

The Georgia Lottery's sales growth also exceeded the average growth rate of other state lotteries in recent years despite having a relatively high level of market saturation. As shown in **Exhibit 5** on page 7, for the period fiscal year 2006 through 2009 Georgia's Lottery per capita sales increased 9.2% from $316 to $345, while the average of per capita sales of the other lotteries decreased from $159 to $157. During this same timeframe, per capita sales for three state lotteries in states contiguous to Georgia decreased from $212 to $198, and per capita sales for three states with lotteries that were roughly the same size as Georgia's (in terms of net sales) decreased from $208 to $203.

Exhibit 3
State Lottery Program Comparison: Total Sales
Fiscal Year 2009

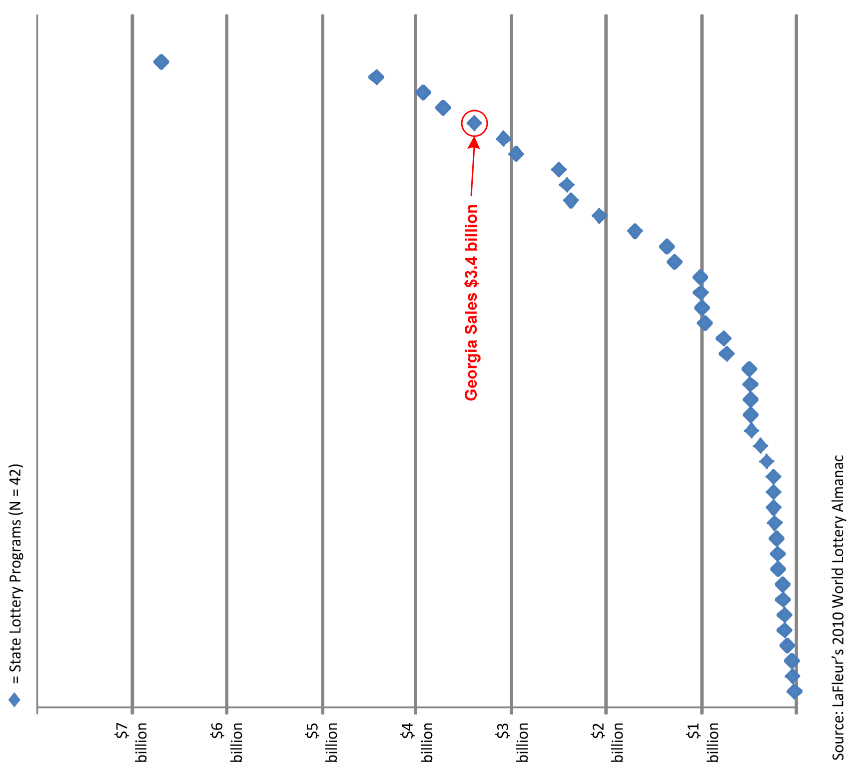


Exhibit 4
State Lottery Program Comparison: Per Capita Sales
Fiscal Year 2009

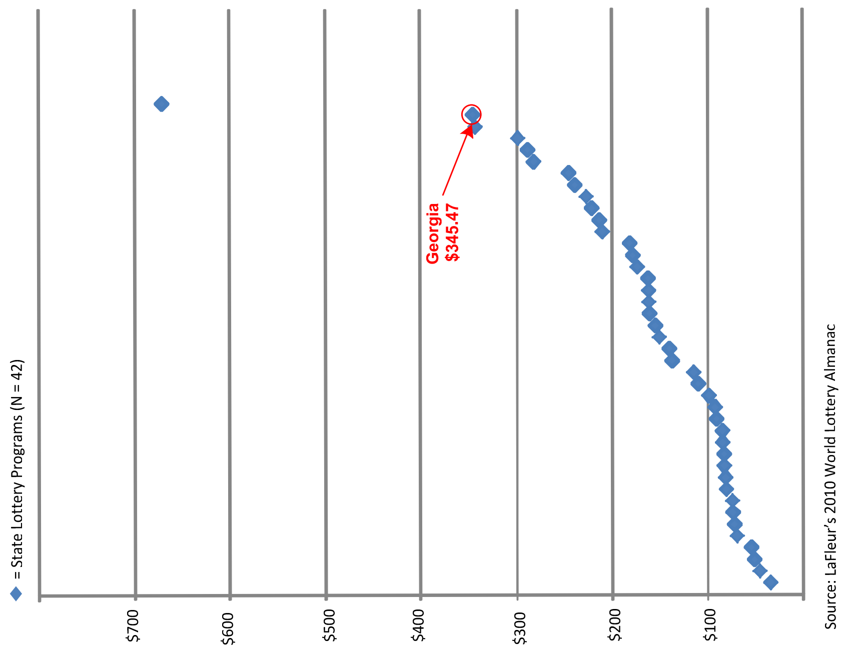
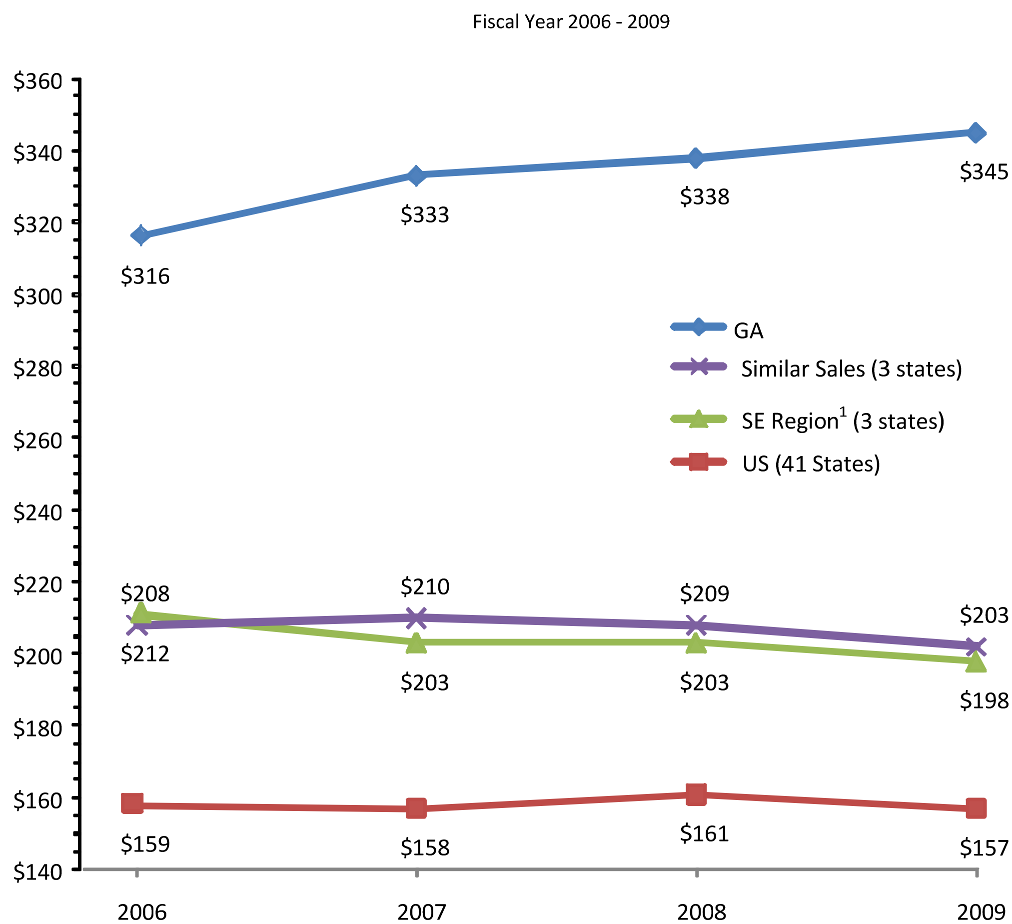


Exhibit 5
Per Capita Ticket Sales



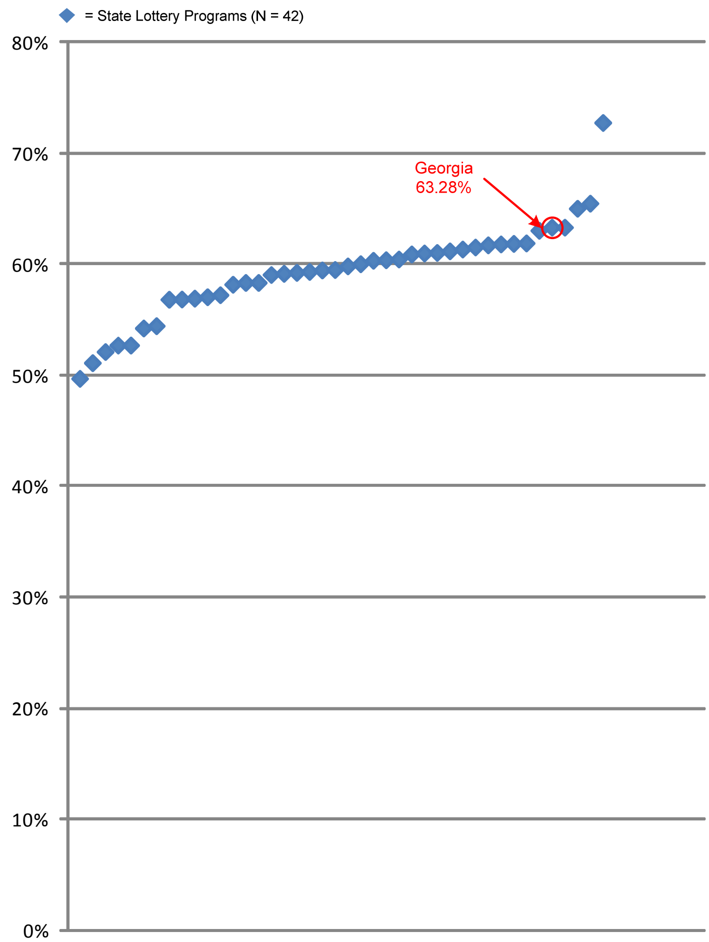
[1]Data does not include North Carolina, which began a lottery in FY06

Source: LaFleur's 2010 World Lottery Almanac

How does Georgia compare in terms of the percent of revenues spent on prizes and operations?

As shown in **Exhibit 6**, the Georgia Lottery ranked 5th highest in prize payout percentage among the 42 existing state lottery programs for fiscal year 2009. The $2.1 billion in prizes awarded by the Georgia Lottery in fiscal year 2009 was 63.3% of its net sales. Among the other 41 state lottery programs, the average prize payout percentage was 59.2%. The prize payout percentages for all 42 states ranged from 49.7% to 72.7%. Georgia Lottery Officials attributed Georgia's relatively high total and per capita sales to its utilization of high prize payouts to encourage more lottery ticket purchases.

Exhibit 6
State Lottery Program Comparison:
Prize Payments As A Percent of Total Sales
Fiscal Year 2009



Source: LaFleur's 2010 World Lottery Almanac

When comparing state lotteries' prize payout percentages, it should be noted that the percentages are influenced by whether or not the lottery uses free tickets as prizes. Based on information obtained from *LaFleur's 2010 World Almanac* and GLC, it appears that GLC and 14 other states make at least some use of free tickets as prizes. Five states do not use free tickets as prizes; the use of free tickets as prizes in the remaining 23 state lotteries is unknown.

GLC and three other lotteries account for free tickets by deducting them from total sales (other states may only report net sales, having already taken into account free tickets). The resulting net sales are used to calculate the percentage of sales that are paid as prizes. GLC noted that the use of free tickets provides a marketing tool to provide players with a "winning experience" without cost to the lottery since the winning tickets are not included in net sales or in expenses. As a result, a lottery that uses free tickets as prizes would have a lower prize ratio than if it used cash prizes in lieu of free tickets. As shown in **Exhibit 7,** GLC's use of free tickets as prizes in fiscal year 2009 resulted in net proceeds of $872,082,000. If cash prizes had been used in lieu of free tickets, the net proceeds would also have been $872,082,000. However, the prize payout percentage resulting from the use of free tickets was 63.28%, while the prize payout percentage that would have resulted from the use of break even cash prizes would have been 65.96%.

Exhibit 7
Comparison of Free Ticket Use to Use of Break Even Cash Prizes
Fiscal Year 2009

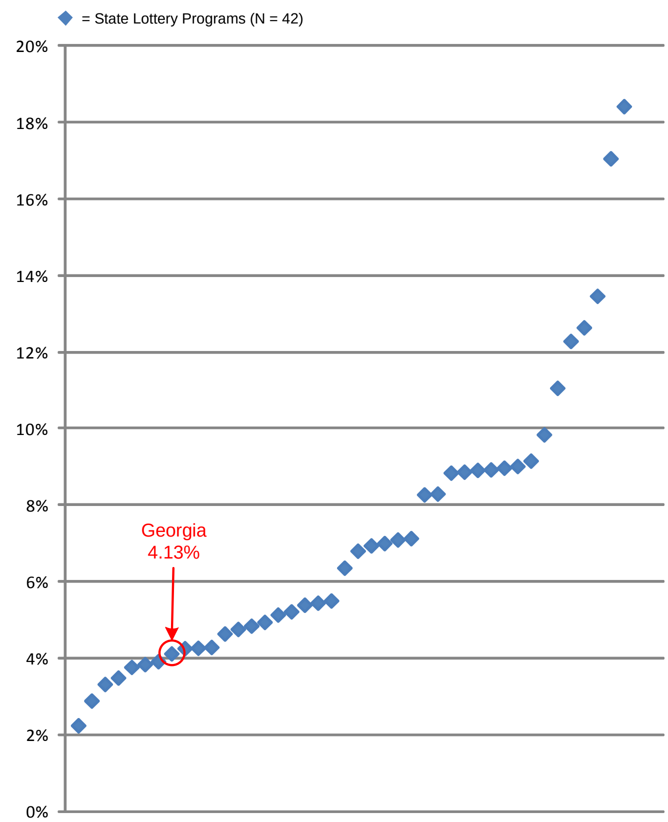
Description	Use of Free Tickets			Comparable Use of Break Even Cash Prizes	
	$	%		$	%
Gross Sales	$3,663,061,000			$3,663,061,000	
Less: Free Tickets	-$267,418,000				
Net Sales	$3,395,643,000	100.00%		$3,663,061,000	100.00%
Other Income	$6,216,000			$6,216,000	
Total Revenue	$3,401,859,000			$3,669,277,000	
Prize Expense	$2,148,681,000			$2,148,681,000	
Plus: Break Even Cash Prizes				$267,418,000	
Total Prize Expense	$2,148,681,000	63.28%		$2,416,099,000	65.96%
Gross Proceeds	$1,253,178,000	36.91%		$1,253,178,000	34.21%
Other Expenses	$381,096,000			$381,096,000	
Net Proceeds to Education	$872,082,000	25.7%		$872,082,000	23.8%

Source: GLC Records

As shown in **Exhibit 8**, the Georgia Lottery's operating expense ratio ranked 8th lowest among the 42 existing state lottery programs for fiscal year 2009. The GLC's $140 million in operating expenses[2] in fiscal year 2009 was 4.1% of its total sales. Among the other 41 state lottery programs, the average operating expense percentage was 7.26%, ranging from 2.25% to 18.4%. It should be noted that we did not evaluate the efficiency of GLC's operations. However, comparisons of operating expense ratios can be impacted by "economies of scale" that are available to larger operations. Organizations with relatively high sales may have lower expense ratios since common fixed expenses (along with additional variable expenses) are divided by higher sales figures, which can result in lower expense ratios. Compared to three state lottery programs with similar total sales volume to Georgia's, the Georgia Lottery had the 2nd lowest expense ratio.

[2] Per *LaFleur's 2010 World Lottery Almanac*, operating expenses appear to include vendor fees, advertising, and other gaming expenses. (Information on the breakout between these cost categories was not available.)

Exhibit 8
State Lottery Program Comparison:
Administrative and Operational Expense as a Percentage of Sales
Fiscal Year 2009



Source: LaFleur's 2010 World Almanac

GLC Response: *Managing prize payouts for and across all lottery games is vital to maximizing revenue dollars for HOPE & Pre-K. The Georgia Lottery is continually evaluating, developing, testing and implementing new games and promotions in an on-going effort to optimize its product mix, respond to the marketplace and maximize the dollars returned to education. There is a direct correlation between the amount of prize payout (and thus prizes) provided in any given game and the total sales dollars derived from a game. Higher sales equate to higher dollars being returned to education.*

When comparing prize payout percentages across state lotteries, each state lottery offers different products with different prize payouts, according to their specific markets. Many older state lotteries have a history with online/draw games. These historically older games have much lower prize payouts and therefore, a larger percent of their sales (not necessarily more dollars) are returned to the causes they support.

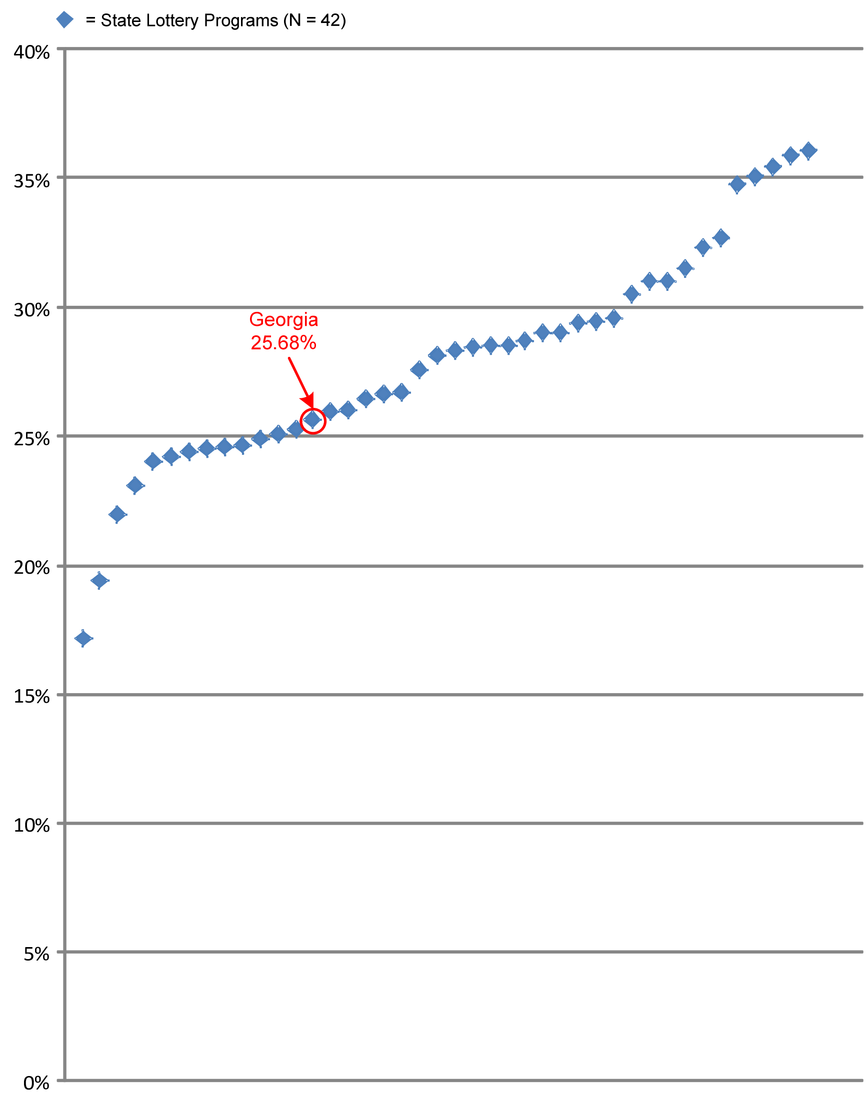
It should be noted that total prize expense can be compared across lotteries. Prize expense is consistently calculated as a percentage of sales, net of free tickets. Free tickets are non-financial transactions used as an effective, cost-free marketing tool and have no bearing on the prize payout percentage calculated for any lottery.

Department of Audits and Accounts Response*: Lotteries that offer free tickets have an additional marketing tool that is not available to lotteries that do not offer free tickets. Therefore, simple comparisons of prize payout percentages between lotteries without accounting for the impact of free tickets may be misleading. For example, if the two columns in Exhibit 7 represented two state lotteries (one that used free tickets and one that did not use free tickets), a simple comparison of prize payout percentages would indicate that the lottery using free tickets had a lower prize payout percentage. However, this comparison would not acknowledge that the use of free tickets enabled the lottery to achieve the lower prize payout percentage. States that use free tickets can increase their prize payout through the use of free tickets (in order to increase sales) without increasing their prize payout percentages, while states that do not use free tickets do not have this option.*

What is the practice in other states regarding the percent/amount transferred for state program use?

The Georgia Lottery's percentage of sales transferred for state program use was lower than the majority of other state lotteries. As shown in **Exhibit 9**, GLC ranked 29th among the 42 existing state lottery programs with regards to the percentage of sales transferred for state program use for fiscal year 2009. The GLC remitted 25.7% of net lottery sales in net proceeds to the state in fiscal year 2009, while the average for the other 41 existing state lottery programs was 28.0% (with the states ranging from 17.1% to 36.1%). GLC officials acknowledged that its transfer percentage was relatively low, but noted that the low percentage resulted from its higher prize payout percentage that generated higher sales and ultimately higher dollar transfers for state program use.

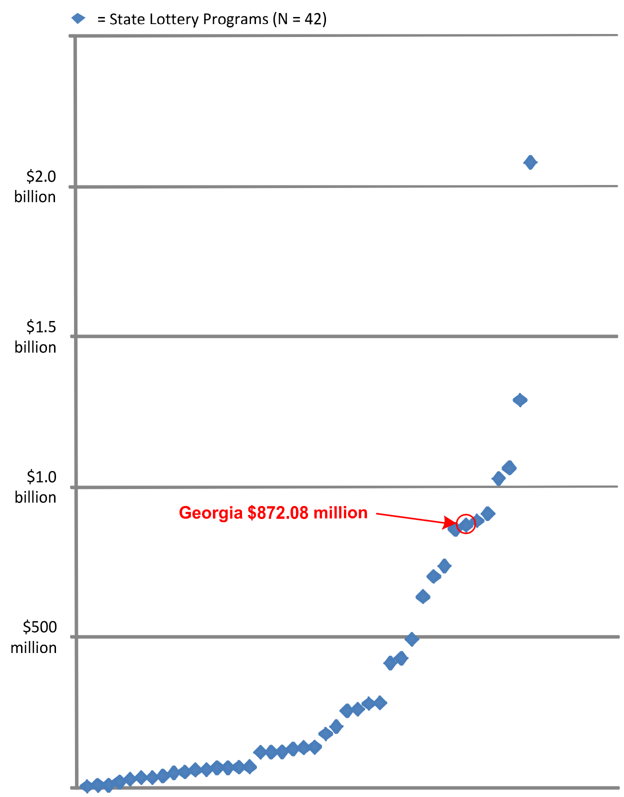
Exhibit 9
State Lottery Program Comparison:
Proceeds as a Percent of Sales
Fiscal Year 2009



Source: LaFleur's 2010 World Lottery Almanac

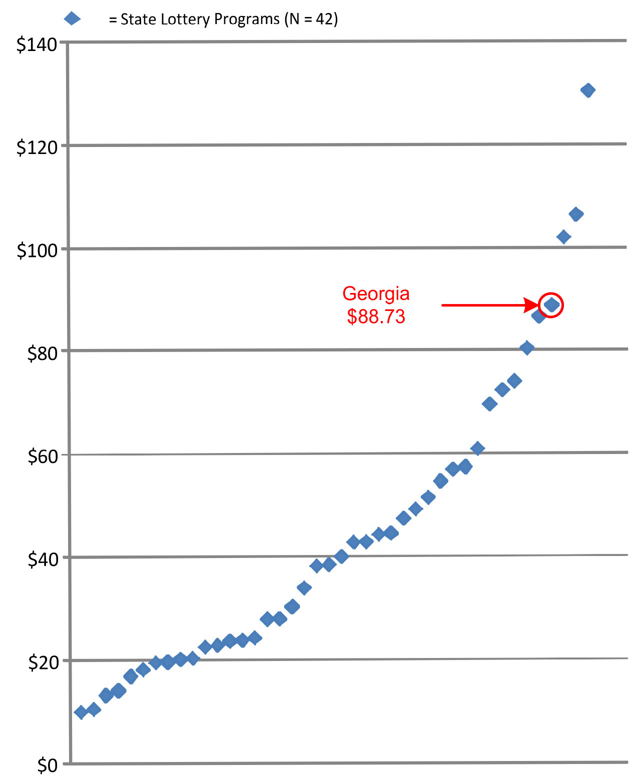
With respect to total and per capita net proceeds transferred for state program use, the Georgia Lottery is one of the highest performing state lottery programs in the nation. The Georgia Lottery's $872 million in total net proceeds transferred to the State in fiscal year 2009 ranked 7th among the 42 existing state lottery programs. (See **Exhibit 10**.) The Georgia Lottery's $89 in per capita net proceeds in fiscal year 2009 ranked 4th among 42 state lottery programs. (See **Exhibit 11**.) In comparison, the average per capita net proceeds transferred for program use for the other 41 existing state lottery programs was $44, with per capita net proceeds ranging from $10 to $130.

Exhibit 10
State Lottery Program Comparison: Total Proceeds Transferred to State
Fiscal Year 2009



Source: LaFleur's 2010 World Lottery Almanac

Exhibit 11
State Lottery Program Comparison: Per Capita Proceeds Transferred To State
Fiscal Year 2009



Source: LaFleur's 2010 World Almanac and U.S. Census Bureau Data

How is the amount transferred by the Georgia Lottery Corporation to the Lottery for Education Account determined?

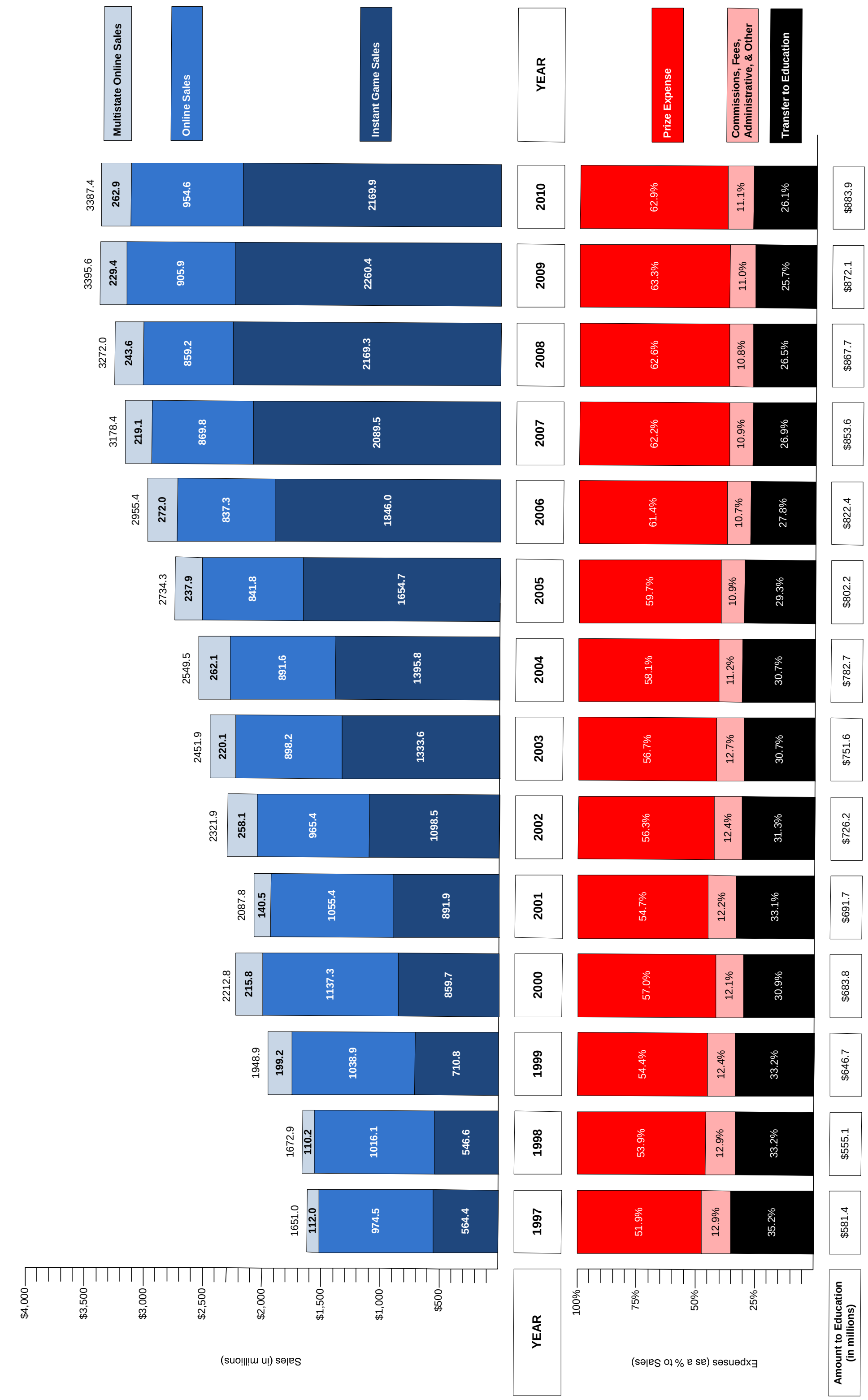
Our review of GLC's operations for fiscal year 2010 identified that all lottery net proceeds were transferred to the State Treasury for credit to the Lottery for Education Account as required by the Georgia Lottery for Education Act (O.C.G.A. §50-27-13). The Lottery's net proceeds include all moneys derived from the lottery less operating expenses such as prizes, commissions, and funding required by state law for compulsive gambling education and treatment. Since available funds are automatically transferred to the State Treasury, GLC reported that its Board does not pre-approve the transfers but is informed after the transfers are made.

Is there a correlation between the increases/decreases in spending for prizes and operations and the amount transferred to the Lottery for Education Account?

Our review of GLC's financial records for fiscal year 1997 through fiscal year 2010 identified that there is a correlation between increases in the Georgia Lottery's prize payout percentage and increases in net proceeds transferred to the state. **Exhibit 12** (on page 15) presents trend data demonstrating increases in prize payouts resulting in increases in sales and increases in dollars for state programs. As shown in the **Exhibit**, GLC's prize payout percentage increased from 51.9% to 62.9% while its operating expenses decreased from 12.9% to 11.1% over the 14 years shown in the Exhibit. During this same period, sales doubled from $1.7 billion to $3.4 billion. While the increase in prize payouts primarily came from decreases in the rate (or percentage) of sales transferred to state programs (which decreased from 35.2% to 26.1%), the resulting increases in sales more than compensated for the decreases in the percentage transferred with the actual dollars transferred to the state increased 52% from $581.4 million to $883.9 million.

As also shown in **Exhibit 12**, the large increases in sales attained by GLC over the last 14 years are almost entirely attributable to increases in its instant game sales. Since 1997, the GLC's online game sales have remained relatively unchanged, while its instant game sales have almost quadrupled (from about $0.6 billion to $2.2 billion). While factors such as the condition of the general economy and advertising campaigns impact sales, GLC attributes the increases in its instant game sales primarily to its strategy of increasing its instant game prize payout percentages. We confirmed that while GLC's aggregated prize payout percentage for online games has remained at approximately 50%, its prize payout percentage for instant games has increased to 72% since 1997. Analysis of data in ***LaFleur's World Lottery Almanac*** indicates that the instant game market segment generally has a higher prize payout percentage than online games. The aggregate instant game payout percentage for 35 lotteries that had data on instant games was 66.7%, while the aggregate online game payout percentage for these lotteries was only 53.1%. High payout strategies are commonly used in the gaming industry to encourage activity and maximize revenues. For example, the American Casino Guide reported that Las Vegas slot machines have payout percentages that average more than 90%.

Exhibit 12
Correlation Between Prize Expense and Funds Transferred to Education
Fiscal Years 1997 - 2010



Source: GLC Records

Should the state require (rather than suggest) a minimum percentage of gross revenues that should be transferred to the Lottery for Education Account?

The Georgia Lottery for Education Act provides that the GLC should "as nearly as practical" remit "at least 35%" of lottery proceeds to the state annually. As the law is currently written, one could argue that a mandate is already in place, and GLC has not remitted at least 35% of lottery proceeds since fiscal year 1997. However, there is some ambiguity created by the phrase "as nearly as practical," and the 35% of net proceeds remittance target may also be interpreted as a suggestion and not an absolute requirement. In addition, the Lottery for Education Act also provides that the lottery should be operated in a manner that "maximizes revenues." In 2007 board minutes, GLC's Board directed the Lottery to pursue the goal of maximizing revenue and did not mention the 35% objective.

While there is evidence that increases in GLC's net proceeds can be attributed to increases in its prize payout percentages, the examination team could not determine if GLC has fully maximized education dollars to the state. A comprehensive evaluation of GLC's marketing and prize strategy would require market data that is not available to the examination team and is beyond the timeframe available to conduct this examination. However, GLC has contracted for expert advice to help it design its prize strategy. In October 2006, GLC contracted with a gaming industry consulting firm to identify the profit maximizing prize payout percentage for GLC instant games at various price points. The study used empirical data aggregated from thirteen state lottery programs (including Georgia) and identified that Georgia Lottery's instant game prize payout percentage was below profit maximizing levels for some price points, indicating that the GLC's prize payout for instant games could be adjusted upward to maximize net profit. Our comparison of GLC's actual results (in 2009) to the report's projections indicated that the analysis needs to be updated. GLC noted that new games (that were not included in the original analysis) have been started that changed the Lottery's product mix. Our review of GLC's fiscal year 2009 actual cumulative sales for four types of instant games ($1, $2, $5, and $10) identified that actual sales were more than 35% greater than the sales projections in the consultant's study. The examination team recommends that GLC periodically reevaluate its strategy and obtain updated studies to help it refine its prize strategy and to better justify and explain its prize payout decisions.

If the General Assembly wishes to establish more direct control over the Lottery, clarifying the law by removing ambiguous language and conflicting goals would be necessary. However, if the General Assembly establishes a firm requirement regarding the minimum percentage of sales to be remitted to the State, it should ensure that the requirement level that it sets does not limit GLC's ability to develop new products and to react to changing market conditions. It may be possible that small reductions in prize payout percentages could be made that would not negatively impact sales and would result in more dollars (and a higher percentage return) to the state. However, if GLC was required to start remitting 35% of its sales to the state, it would have to abandon its current marketing strategy and it would almost certainly result in significant reductions in sales and proceeds. Achieving a 35% return to the state would require that prize payouts for instant games be reduced, which would most likely result in a (potentially significant) reduction in sales volume, and the net effect would be that the state would receive 35% of a much smaller amount of lottery sales.

Concerns about whether GLC is maximizing education dollars to the state might alternatively be addressed by requiring the GLC (or the Lottery Corporation Legislative Oversight Committee) to provide additional information to the General Assembly regarding its marketing strategy. For example, Tennessee lawmakers adopted statutory language very similar to that in the Georgia Lottery for Education Act when it created a state lottery in 2004. Like Georgia, Tennessee included a 35% of lottery proceeds remittance target; however, Tennessee's law provided its lottery corporation with explicit authority to remit less than 35% of lottery proceeds as long as such decisions were accompanied with a written explanation of how the reduced percentage would maximize net proceeds.

GLC Response: *The GLC is governed by a seven-member board of directors, appointed by the Governor, to ensure that the Lottery is operated with integrity and dignity. The board oversees its entire operations, including sales and marketing strategy and corresponding annual operating plan. The board requires the GLC to contract with independent auditing firms to ensure the GLC's financial viability on an annual basis, and requests profit optimization studies be conducted periodically by independent gaming experts to ensure the GLC is maximizing revenues to its beneficiaries.*

The GLC is currently accountable to the General Assembly and the citizens of Georgia through a system of audits and reports. The GLC is required under Code Section 50-27-33 to "submit quarterly and annual reports to the Governor, state auditor, and the oversight committee disclosing the total lottery revenues, prize disbursements, operating expenses and administrative expenses of the corporation during the reporting period." The GLC is happy to share with any member of the legislature – and are required by existing law to do so – information regarding all aspects of our operations upon request, including but not limited to the reports mentioned above.

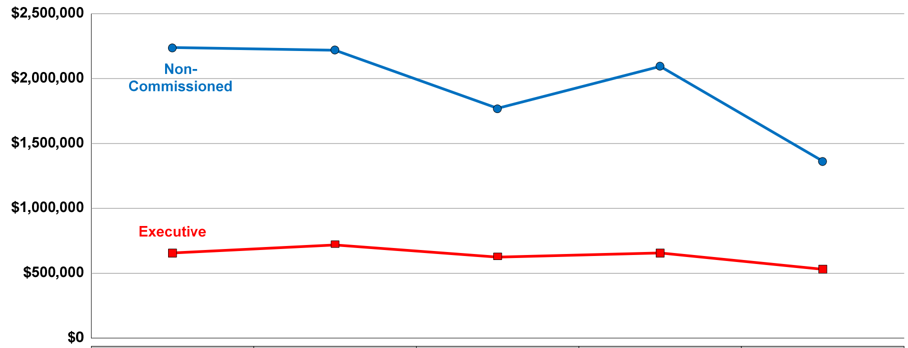
BONUSES/INCENTIVE PAY

The GLC has established three broad employee categories (executive, non-commissioned, and commissioned) and has established separate incentive pay plans for each. This examination excludes commissioned employees and instead focuses on incentive payments for executive and non-commissioned employees for the period fiscal years 2006 through 2010. Commissioned employees were excluded from the examination because use of commissions for certain sales personnel appear to be widely-utilized by state lottery operations and the nature of the questions given to us by the Senate Appropriations Committee indicated interest in bonuses paid to executive and non-commissioned employees.

Please provide an analysis of the bonuses [incentive payments] paid to GLC employees.

In fiscal year 2010, the GLC awarded $1,890,200 in performance incentive payments to executive and non-commissioned staff. The total incentive payment was equal to 0.06% of net sales and 0.21% of net proceeds for the fiscal year. Executive staff were paid a total of $532,153 (28%), with individual payments ranging from $25,460 – $143,276 and an average payment of $44,346. Non-commissioned staff were paid a total of $1,358,047 (72%), with individual payments ranging from $1,321 – $23,184 and an average payment of $8,762. **Exhibit 13** provides an historical perspective of the fiscal year 2010 incentive payments. The graph shows that the total performance incentive payments for executive and non-commissioned staff were lower in fiscal year 2010 than in prior years. For example, in fiscal year 2009 the GLC paid $2,747,721 in performance incentive payments, $857,522 (45%) more than in fiscal year 2010.

Exhibit 13
Incentives Earned by Georgia Lottery Corporation Employees
From FY 2006 to FY 2010



	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Number of Employees					
Non-Commissioned	148	157	152	156	155
Executive	14	13	13	12	12
Total Incentive Pay for Grades					
Non-Commissioned	$2,241,223	$2,229,847	$1,775,529	$2,098,687	$1,358,047
Executive	$669,000	$709,000	$625,000	$649,034	$532,153
Incentive Pay Range					
Non-Commissioned	$2,062 – $43,687	$661- $30,000	$941 - $30,000	$2,687 - $30,000	$1,321- $23,184
Executive	$30,000 - $215,000	$30,000 - $236,500	$30,000 - $150,000	$30,000 - $204,034	$25,460 - $143,277

Source: GLC Records

Incentive pay plans are intended to reward employees with additional financial compensation above their base salary if the individual or organization meets or exceeds management's expectations of performance. The management theory in support of the use of incentive pay plans is that they are thought to motivate employees to execute their job duties more effectively and/or efficiently, which in turn results in more sales and lower expenses (and ultimately higher proceeds) for the employee's organization. The Lottery for Education Act establishes the Georgia Lottery as a public corporation; as such, GLC is an instrument of the state but not a state agency. The Act also gives the GLC authority to offer "production incentive" payments as part of its employee compensation plan. The Act does not specify which types of employees should be eligible/ineligible to receive incentive payments, nor does the law provide any further framework regarding the design of incentive pay policies (e.g., criteria for awarding pay, maximum payout, etc.). Since its inception, GLC has offered commission incentives to certain employees involved with sales operations as well as performance incentives to its executives and other (non-commissioned) staff.

GLC Response: *GLC indicated that its variable pay model has proven to be effective and efficient to help manage fixed costs, create focus on key business objectives, and compensate employees when performance goals are attained. It also reiterated that in fiscal year 2010 incentives to GLC executives and non-commissioned employees (167 Georgians) accounted for less than 0.056% of total lottery revenues.*

Is there a correlation between the incentive payments and the amount transferred to the Lottery for Education Account?

Academic studies of employee motivation identified two primary viewpoints regarding the use of bonuses/incentive pay. Opponents of incentive pay argue that it is not a strong motivator and affects individual job performance only marginally (if at all). Within this viewpoint, incentive pay is considered a cost to the organization. Advocates of incentive pay, on the other hand, contend that it is a strong motivator that inspires employees to perform exceptionally, resulting in higher sales, higher productivity (lower expenses), and higher profit margins. Because of the multitude of variables involved in an organization's operations, it is difficult to measure the impact of incentives on sales and profits; and it is beyond the scope of this project to attempt to isolate the impact of incentives on the performance of GLC employees.

If one presumes that the performance incentive pay has little or no effect on lottery sales during the year, the total amount of performance pay represents additional funds that could have been remitted to the state in the form of net proceeds. Net proceeds for fiscal year 2010 were $883,878,000. Therefore, under this assumption, net proceeds would have increased by $1,890,200 (the amount of awarded incentive pay) to $885,768,200.

If one subscribes to the theory that performance incentive pay encourages greater effort and efficiencies, then granting incentive pay should result in more dollars to the state for education. The examination team could not determine if a statistical correlation exists between the net proceeds remitted to the state and the incentive payments awarded to executive and non-commissioned employees. However, if the incentive pay awarded to GLC's executive and non-commissioned staff in fiscal year 2010 ($1,890,200) resulted in additional effort or performance that generated $7,242,146 of additional sales, the additional sales cover the cost of the incentive pay (based on the 26.1% of sales that was remitted to the State in fiscal year 2010). If less than $7,242,146 of additional sales were generated, the funds remitted to the state would be less than would have been remitted if the incentive had not been awarded. Conversely, if more than $7,242,146 of additional sales were generated, the funds remitted to the state would be greater than if the incentive had not been awarded.

GLC Response: *The GLC board of directors has commissioned numerous independent compensation studies throughout the GLC's existence to examine the compensation practices at the GLC, as compared to a relevant cross-section of the marketplace. Human resources consulting firms have advocated the use of incentive programs to increase productivity and efficiency. GLC incentive plans are designed with carefully crafted goals that need to be met before any incentive payment is made.*

Who determines the incentive payments and what criteria are used to award them?

In fiscal year 2010, the GLC had incentive pay plans for executive-level and non-commissioned employees that defined the general criteria used to determine whether to award incentive pay and that established the formulas used to calculate award amounts. The method for calculating incentive pay for fiscal year 2010 for the two incentive plans is described in detail below.

GLC's Executive Incentive Plan

The principle components of the incentive pay plan for executive-level employees were approved by the GLC Board in August 2009 and were first applied in fiscal year 2010. Under this incentive plan, GLC executives are awarded incentive pay based on the two components described below. The base incentive available is 40% of base salary for the CEO, 25% of base salary for Senior Vice Presidents, and 20% of base salary for Vice Presidents. With both of the incentive components, employees may be awarded more or less than the base incentive amount as described below.

- **Proceeds Criterion** = 80% of the base incentive available to an employee is awarded based on achieving goals for the amount of proceeds the GLC remits to the state. If the GLC remits proceeds above the target for the fiscal year, the award is multiplied by a factor of 1.1, 1.25, or 1.5. If remitted proceeds are less than the target, the award is multiplied by a factor of 0.9, 0.8, 0.75, or 0.0. (See **Exhibit 14**.)
- **Individual Performance Criterion** = 20% of the base incentive available to an employee is awarded based on an assessment of the employee's execution of job duties as reported in an annual job appraisal. Employees are rated using a three-category scale: exceeds expectations, meets expectations, and does not meet expectations. Employees that exceed expectations have their performance incentive amount multiplied by a factor ranging from 1.25 to 1.5. Employees that meet expectations have their base incentive amount multiplied by a factor ranging from 0.75 to 1.25. Employees that do not meet expectations do not receive any individual performance incentive. (See **Exhibit 14**.)

GLC's 2010 executive employee incentive plan was based on a study performed by a human resources firm that was contracted through the State Personnel Administration (SPA). SPA revised the study and developed a recommended design for a plan that was approved by GLC's Board. One of the changes resulting from the 2010 incentive plan was that GLC's CEO received a $81,000 increase in base salary (from $286,000 to $367,000), and the CEO's incentive was reduced from a four-year average of 74% to a target of 40%. (The CEO's total salary and incentive pay compensation changed from approximately $490,000 in fiscal year 2009 to approximately $510,000 in fiscal year 2010.) The change in the CEO's base salary resulted from the consultant's determination that the CEO's salary was lower than statistical information available on private company CEO salaries; however, the salaries of several other Lottery executives (whose salaries were also lower than private company salaries) were not changed as a result of the survey.[3]

[3] In 2010 GLC's executives did not receive increases as a result of the study. However, they did receive pay increases that were comparable to the increases received by all executives ranging from 3.4% to 7.0%.

GLC's Non-Commissioned Employee Incentive Plan

The incentive pay plan for GLC's non-commissioned employees has been in effect since the Lottery's inception, and the plan is re-approved annually by GLC management.[4] Non-commissioned employees are paid incentives based on the three components or criterion described below:

- **Sales Criterion** – Employees are eligible to receive up to 8% of their base pay based on achieving different levels of sales goals. (See **Exhibit 15**.)
- **Proceeds Criterion** – Employee are eligible to receive up to 17% of their base pay for achieving different levels of proceeds goals. (See **Exhibit 15**.)
- **Individual Performance Criterion** - Non-commissioned employees undergo an annual performance appraisal and are rated under a five-category scale: outstanding, exceeds expectations, meets expectations, needs improvement, and does not meet expectations. These assessments are associated with a multiplication factor ranging from 0 to 1.1 that is applied to the employee's sales and proceeds incentive pay awards to determine the employee's total incentive award. (See **Exhibit 15**.)

GLC's Annual Incentive Goals

Each year GLC management sets goals for sales and proceeds. **Exhibit 14** shows the goals that were set for the Executive Incentive Plan for fiscal year 2010 and **Exhibit 15** shows the goals that were set for the non-commissioned employees for fiscal year 2010.

Exhibit 14
Executive Incentive Plan Goals
Fiscal Year 2010

Goal Type	Goals	Multiplication Factor
Proceeds Goals (80% of Possible Incentive)	OVER $929,250,000	1.50
	$902,700,000 - $929,249,999	1.25
	$893,850,000 - $902,699,999	1.10
	$880,575,000 - $893,849,999	1.00
	$867,300,000 - $880,574,999	0.90
	$854,025,000 - $867,299,999	0.80
	$840,750,000 - $854,024,999	0.75
	BELOW $840,750,000	0.00
Individual Performance Goals (20% of Possible Incentive)	Exceeds Expectations	1.25 – 1.50
	Meets Expectations	0.75 – 1.25
	Did Not Meet Expectations	0.00

Source: GLC Records

[4] GLC's Board also approves a budget annually that includes the organization's sales goals, proceeds goals, and summary financial information on the expected incentive expenditures.

Exhibit 15
Non-Commissioned Employees Incentive Plan Goals
Fiscal Year 2010

Goal Type	Goals	Percentage or Multiplication Factor for Paygrades				
		13-14	11-12	9-10	7-8	5-6
Sales Goals	$3.9 Billion	8%			7%	
	$3.8 Billion	7%			6%	
	$3.7 Billion	6%			5%	
	$3.6 Billion	5%			4%	
	$3.5 Billion	4%			3%	
	$3.4 Billion	3%			2%	
Proceeds Goals	$902 Million	17%	16%	15%	14%	13%
	$894 Million	16%	15%	14%	13%	12%
	$887 Million	14%	13%	12%	12%	11%
	$880 Million	13%	12%	11%	11%	10%
	$873 Million	11%	10%	9%	9%	8%
	$865 Million	10%	9%	8%	8%	7%
	$857 Million	8%	7%	6%	6%	6%
	$849 Million	6%	6%	5%	5%	5%
	$841 Million	4%	4%	4%	3%	3%
	$834 Million	3%	3%	3%	2%	2%
Individual Performance Goals	Outstanding	1.10				
	Exceeds Expectations	1.05				
	Meets Expectations	1.00				
	Needs Improvement	0.50				
	Did Not Meet Expectations	0.00				

Source: GLC Records

It should be noted that while GLC's budgeted goal was for $885 million of proceeds to be remitted to the state, the award schedule used by GLC provided for full payment of 80% of the executive's target incentive if proceeds of $880,575,000 to $893,849,999 were remitted.

Incentive Payments Awarded For Fiscal Year 2010

For fiscal year 2010, GLC had total sales of $3.6 billion and remitted proceeds of $883.9 million to the state. The incentive payments awarded through GLC's Executive and Non-Commissioned Employee incentive plans are described below.

Executive Incentive Payments for Fiscal Year 2010

The $883.9 million of proceeds remitted to the state by GLC meets the requirement shown on **Exhibit 14** for full payment of the portion of executive incentive awarded under the incentive plan's proceeds criterion (80% of the employees base incentive). The remaining 20% of the employee's base incentive was awarded based on the employee's performance appraisal. (The personal performance award is multiplied by a factor ranging from 0 to 1.5 based on the employee's performance rating.) As shown in **Exhibit 16**, five of GLC's 12 executives were rated as "Meeting Expectations" and seven were rated as "Exceeding Expectations." When these two components are combined, the average incentive received by GLC's executives ranged from 20.7% to 39% of base salary.

Exhibit 16
Executive Employees Incentives Awarded
Fiscal Year 2010

Employees		Base Pay[1]		Target Incentive (% of Salary)	Individual Performance Factor (# Employees)			Actual Incentive Award		
Position	Number of	Total	Average		Did Not Meet (0.0)	Meets (0.75-1.25)	Exceeds (1.25-1.50)	Total	Average	Avg. % of Base Pay
CEO	1	$367,000	$367,000	40.0%	Confidential[2]			$143,277	$143,277	39.0%
Sr. VP	4	$747,200	$186,800	25.0%	0	2	2	$191,761	$ 47,940	25.7%
VP	7	$951,450	$135,921	20.0%	0	2	5	$197,115	$ 28,159	20.7%
TOTAL	12	$2,065,650						$532,153		

[1] "Base Pay" reflects the annual salary used to calculate incentive pay and may not reflect the actual salary expenditure for an individual or pay grade for the fiscal year.
[2] Appraisal ratings for individuals are considered to be confidential.

Source: GLC Salary and Incentive Pay Records

Non-commissioned Staff Payments for Fiscal Year 2010

The $3.6 billion in sales generated by GLC met the requirement shown on **Exhibit 15** for incentive awards of 4% to 5% of base salaries (based on paygrade). The $883.9 million of proceeds remitted to the by GLC met the requirement for incentive awards of 10% to 13% of base salaries. The total incentives awarded from these two components are multiplied by a factor ranging from 0 to 1.1 based on the employee's performance rating. As shown in **Exhibit 17**, two of GLC's 155 non-commissioned employees were rated as "Needing Improvement," 36 were rated as "Meeting Expectations," 107 were rated as "Exceeding Expectations," and ten were rated as "Outstanding." When these three components are combined, the average incentive received by GLC's non-commissioned employees (for the various paygrades) ranged from 14% to 18.9% of their base salaries.

Exhibit 17
Non-Commissioned Employees Incentives Awarded
Fiscal Year 2010

Employees		Base Pay[1]		Possible Incentive		Individual Performance Factor					Actual Incentive Pay		
Paygrade	Number of Employees	Total	Average	Sales (% of Base Salary)	Proceed (% of Base Salary)	Did Not Meet (0.0)	Needs Improvement (0.75)	Meets (1.0)	Exceeds (1.05)	Outstanding (1.1)	Total $ Amt. Awarded	Average $ Amt. Awarded	Avg. % of Base pay Received
13-14	17	$1,721,904	$101,288	5%	13%	0	0	1	14	2	$324,987	$19,117	18.9%
11-12	27	$1,956,594	$72,466	5%	12%	0	0	4	21	2	$343,521	$12,723	17.6%
9-10	24	$1,280,779	$53,366	5%	11%	0	0	5	16	3	$212,327	$8,847	16.6%
7-8	58	$2,379,965	$41,034	4%	11%	0	1	16	39	2	$361,535	$6,233	15.2%
5-6	29	$826,690	$28,507	4%	10%	0	1	10	17	1	$115,677	$3,989	14.0%
TOTAL	155	$8,165,932				0	2	36	107	10	$1,358,047		

[1] "Base Pay" reflects the annual salary used to calculate incentive pay and may not reflect the actual salary expenditure for an individual or pay grade for the fiscal year.

Source: GLC Salary and Incentive Pay Records

Is [the use of incentive payments] common to other state lotteries?

The GLC offers performance incentive pay at higher amounts and to a wider set of employees than other state lotteries.

- **Chief Executive Officer/Executive Director** – A survey conducted by the Arkansas Democrat Gazette in 2009[5] identified that 6 of 43 state lottery chief executive officers/executive directors were eligible to receive incentive payments. (See **Exhibit 18** on page 26.) Among the six states that offered incentive pay to their chief executive officers/executive directors, the payments ranged from $8,000 (Illinois) to $150,000 (Georgia). The incentive pay awarded to GLC's Chief Executive Officer was larger than any counterpart in the survey.

- **Executive-Level Employees** – A survey of 10 state lotteries (Connecticut, Florida, Kentucky, Louisiana, New Mexico, North Carolina, North Dakota, Oklahoma, Pennsylvania, and South Carolina) conducted by the examination team identified that two of the lotteries offered incentive pay to their executive/senior level employees during fiscal year 2008. Connecticut had 15 executive-level employees eligible to receive up to 10% of their base salary in incentive pay. Kentucky had one executive-level employee eligible to receive up to 20% of their salary (paygrade midpoint). In comparison, the GLC had 11 executive-level employees eligible to receive up to 20%-25% of their base

[5] The examination team concluded that the data was sufficiently reliable for this analysis based on verification work described in Appendix A (see page 29).

salary in incentive pay in 2010 (GLC did not have an approved incentive plan in fiscal year 2008).

- **Non-Commissioned Employees** – The examination team's survey of 10 state lotteries identified that two of the lotteries offered incentive pay to their non-commissioned (non-sales) employees. Kentucky had two non-commissioned employees eligible to receive up to 10-20% of their salary paygrade midpoint and North Dakota had two employees eligible to receive up to $1,000 in incentive pay annually. In comparison, GLC had approximately 150 employees eligible to receive incentive pay from up to 6% to 25% of their base salary in fiscal year 2010.

GLC Response: *While the audit team was tasked with comparing the Georgia Lottery Corporation to other state lotteries, the GLC was established to operate as a business. It is difficult to compare compensation practices among state lotteries as most are state agencies that include extensive post-retirement benefits (i.e. retiree medical benefits, pensions, etc.), unlike the GLC. Further, the comparison does not mention or correlate the success, efficiency or effectiveness of the employees in other states.*

Exhibit 18
State Lottery Chief Executive Base Salary and Incentive Pay
Fiscal Year 2008

STATE LOTTERY	AGE OF THE LOTTERY	BASE SALARY + INCENTIVE PAY (In Thousands)
Tennessee[1,2]	7	$436 $44
Georgia[1,2]	18	$286 $150
Arkansas	1	$324
North Carolina	5	$247
Kentucky[1,2]	22	$220 $22
South Carolina	9	$227
Louisiana[1,2]	19	$192
Oklahoma	5	$184
Connecticut[1,2]	39	$164 $10
Iowa	25	$170
Oregon	26	$166
New Mexico	15	$165
New York	44	$164
Maryland	38	$143
Indiana[2]	21	$107 $32
Colorado	28	$138
Virginia	22	$136
Texas	19	$135
California	25	$134
Kansas	23	$133
Pennsylvania	39	$131
Michigan	38	$130
Illinois[2]	37	$116 $8
Massachusetts	39	$122
Rhode Island	37	$122
Washington	28	$121
Florida	23	$120
New Jersey	40	$116
Minnesota	21	$114
Ohio	36	$109
Missouri	25	$107
Arizona	30	$105
Delaware	35	$102
Vermont	33	$96
Maine	37	$95
Idaho	22	$94
Nebraska	17	$93
Wisconsin	22	$93
West Virginia	25	$93
New Hampshire	47	$91
Montana	24	$87
South Dakota	23	$68
North Dakota	7	$60

$50K $100K $200K $300K $400K $500K

[1] Public Corporation
[2] Actual Incentive Pay for Tennessee and Georgia – Maximum opportunity for incentive pay for Kentucky, Louisiana, Connecticut, Indiana, and Illinois

Sources: Arkansas Gazette Survey and National Association of State and Provincial Lotteries

MODEL LOTTERY

Is Georgia considered a model, and if so, why? If not, who is and why?

The Georgia Lottery is an industry leader in performance. In fiscal year 2009, for example, the Georgia Lottery ranked 2nd among 42 state lotteries in per capita sales and 4th in per capita proceeds to state government, both key indicators used to measure performance in the industry. In addition, GLC management noted numerous occasions when representatives from other lotteries visited the corporation to inquire about operations. Based on our survey of state lotteries, five lottery officials commented that Georgia's Lottery is an industry performance leader.

While the organization and structure of state lotteries can be impacted by political as well as economic considerations, another indication that the Georgia Lottery may be considered to be a model is the extent to which its innovative attributes have been emulated by lotteries established after the GLC. Seven state lotteries were established after Georgia's Lottery was created in 1993[6]: New Mexico (1996), South Carolina (2002), North Dakota (2004), Tennessee (2004), Oklahoma (2005), North Carolina (2006), and Arkansas (2009). We found that some attributes of the Georgia Lottery that were adopted by most of the state lottery programs, while other attributes were not, as described below.

- **Education Program Beneficiary(s)** - The Georgia Lottery for Education Act requires that lottery proceeds can only be used to fund education initiatives in the state. At the time the Georgia Lottery was created in 1993, restricted use of lottery proceeds for education was a unique policy among state lottery programs. The examination team found evidence suggesting that six of seven state lotteries created after the Georgia Lottery have adopted similar funding restrictions.

- **Prize Payout Percentages** - Prize payout percentages reflect management's strategy for maximizing revenue and net proceeds. In fiscal year 2009, the GLC paid 63.3% of its lottery ticket sales in the form of prizes, compared to 59.2% for all other state lottery programs. Six of seven lotteries created after Georgia's lottery had sales and prize data available for the examination team to review.[7] Of these six, the South Carolina Lottery had a prize payout percentage near that of Georgia's Lottery (63.0%) for fiscal year 2009. The other five state lotteries had prize payout percentages that were lower and more in-line with the majority of state lotteries (from 49.7% to 61.0%).

- **Organizational Structure** - The public corporation organizational structure of the Georgia Lottery has been adopted by one of seven state lottery programs created since the GLC was created in 1993. The Tennessee Lottery (created in 2004) is a public corporation; however, the six other state lottery programs are organized as either units within an existing state agency, as commissions, or authorities.

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[6] The Nebraska lottery started only two months after Georgia in 1993, and therefore it was not considered in this analysis.

[7] The Arkansas Lottery, which started operation in 2009, did not have sales data reported in *La Fleur's 2010 World Lottery Almanac*.

- **Executive Base Pay** - The CEOs/Executive Directors in seven state lottery programs created after the GLC had base salaries (in fiscal year 2008) that ranged from $60,000 to $436,144. In comparison, GLC's CEO base salary was $286,000 and the average for these seven lotteries was $234,744. The examination team found some anecdotal evidence to suggest that the some of the higher CEO/Executive Director salaries for lotteries started in recent years can be linked to the states paying a premium to hire individuals with experience in starting new lotteries.

- **Employee Bonus/Incentive Pay** – Of the seven lottery programs created after the GLC, one awards incentive pay to executive-level and non-commissioned employees as the GLC does. In Tennessee, the state law (which is almost identical to Georgia's law) permits the Tennessee Lottery Corporation to offer "production incentive payments." On the other hand, one state put legal restrictions on incentive pay. South Carolina state law forbids the executive director's compensation from being based upon or a function of profitability or total sales.

GLC Response: *While this question was provided to the Department of Audit[s], it is difficult to determine how one might evaluate, or audit, if an organization is a "model" or not. There are a myriad of reasons why any particular state may or may not adopt similar characteristics to the Georgia Lottery that have nothing to do with the perceived notion of the Georgia Lottery as a "model". The Georgia Lottery was not founded to serve as a model for other states to emulate. Georgia's Lottery was created to serve the citizens of Georgia in our unique situation for our specific educational purposes.*

Appendix A
Objectives, Scope, and Methodology

The Senate Appropriations Committee requested that the Department of Audits and Accounts (DOAA) conduct this special examination of the Georgia Lottery Corporation (GLC) to answer the following questions:

Sales and Proceeds

- How does Georgia's lottery compare to other state lotteries in terms of sales and growth?
- How does Georgia compare in terms of the percent of revenues spent on prizes and operations?
- What is the practice in other states regarding the percent/amount transferred for state program use?
- How is the amount transferred by the Georgia Lottery Corporation to the Lottery for Education Account determined?
- Is there a correlation between the increases/decreases in spending for prizes and operations and the amount transferred to the Lottery for Education Account?
- Should the state require (rather than suggest) a minimum percentage of gross revenues that should be transferred to the Lottery for Education Account?

Bonuses/Incentive Pay

- Please provide an analysis of the bonuses [incentive payments] paid to GLC employees.
- Is there a correlation between the incentive payments and the amount transferred to the Lottery for Education Account?
- Who determines the incentive payments and what criteria is used to award them?
- Is [the use of incentive payments] common to other state lotteries?

Model Lottery

- Is Georgia considered a model and if so, why? If not, who is and why?

Scope

In most of the analyses for this examination, the time period under review was limited to the most recent fiscal year for which data were available. In isolated instances when it provided beneficial context or was required to fully answer an objective, a longer time period was analyzed. This examination excludes incentive pay provided to commissioned employees and focuses on incentive payments to executive-level and non-commissioned employees. In addition, the examination team reviewed base salary and incentive pay and did not include additional benefit components like retirement benefits.

Methodologies: Sales and Proceeds

For analyses of the sales, proceeds, and operations of the Georgia Lottery and other state lottery programs, the examination team relied on data from the ***La Fleur's 2010 World Lottery Almanac***. The La Fleur's World Lottery Almanac is produced annually from surveys of state lottery programs and is considered an authoritative source for this type of data. The examination team (a) compared a sample of data published by La Fleur's to alternate data sources such as the North American Association of State and Provincial Lotteries, the U.S. Census Bureau, and the Georgia Lottery, (b) surveyed state lottery programs to confirm the accuracy of La Fleur's figures, and (c) conducted interviews with the La Fleur's publisher to determine their method for ensuring data reliability. The examination team concluded that this data was sufficiently reliable for these analyses. It should be noted that the Almanac is sold to individuals interested in Lottery operations; therefore, due to the proprietary nature of this data specific information on other states was not included in this report.

For analyses of the Georgia Lottery Corporation's revenue and expenses, the examination team relied on audited financial statements and the GLC's profit and loss statement. The examination team did not conduct independent verification of these data, with one exception; the examination team did confirm the accuracy of the reported net proceeds transferred to the state during the period under review. In addition, the examination team did not conduct analyses to evaluate the efficiency of operations within the GLC but relied exclusively on operating expense ratios as an indicator of the relationship between operating costs and net proceeds.

For analyses of the relationship between prize payout and net proceeds, the examination team consulted with subject matter experts, reviewed independent studies that used empirical data to test statistical correlations, and reviewed studies funded by the GLC on the topic of profit maximization for instant games.

For analyses of mandates related to net proceed remittances and programmatic goals, the examination team reviewed the Lottery for Education Act and the Georgia Constitution.

Methodologies: Bonus/Incentive Pay

For analysis of incentive pay, we conducted a literature review to identify studies on the use of incentive pay and reviewed GLC's incentive strategies, plans, and payments. The examination team relied on the "base pay" used to calculate incentive pay. As a result, the base pay may be different than the actual salary expenditure for an individual or pay grade if changes in base pay were made during the fiscal year.

For analyses regarding the use of incentive pay in other state lottery programs, the examination team relied on a comprehensive survey of state lottery CEO/Executive Director salary and incentives conducted by the Arkansas Democrat Gazette and a survey conducted by the examination team. (This survey was the most comprehensive and recent data set available on the topic of state lottery CEO/Executive Director compensation.) The examination team confirmed that the figures reported by the Arkansas Democrat Gazette were sufficiently reliable for these analyses through our own sample survey of ten state lottery programs and other reliability tests. The state lotteries surveyed included contiguous states (Florida, North Carolina, and South Carolina), similar size lotteries (in terms of sales) (Florida and Pennsylvania), lotteries that were corporations (Connecticut, Kentucky, Louisiana, New Mexico), and state lotteries created after the Georgia Lottery (New Mexico, North Carolina, North Dakota, Oklahoma, South Carolina).

In addition, our survey of ten state lottery programs was used to determine the use of incentive pay for executive-level and non-commissioned employees.

Methodologies: Model Lottery

For analyses of whether the Georgia Lottery is considered a "model," the examination team focused exclusively on the following seven state lottery programs created at least one year after the Georgia Lottery in 1993: Arkansas, New Mexico, North Carolina, North Dakota, Oklahoma, South Carolina, and Tennessee. The examination team surveyed officials from these programs, reviewed laws, policies, and compensation practices, as well as operations/performance indicators to evaluate similarities with the Georgia Lottery.

This project was not conducted in accordance with generally accepted government auditing standards (GAGAS); however, it was conducted in accordance with Performance Audit Division policies and procedures for non-GAGAS engagements. These policies and procedures require that we plan and perform the engagement to obtain sufficient, appropriate evidence to provide a reasonable basis for the information reported and that date limitations be identified for the readers.