



LOTTERY OFFICE OF
INSPECTOR GENERAL

2015 JUL -2 PM 2: 13

Randall J. Meyer, Inspector General
Rhodes State Office Tower – 30 East Broad Street
Suite 2940
Columbus, Ohio 43215-3414

June 30, 2015

Dear Mr. Meyer:

The Ohio Lottery Commission has received the IG Report of Investigation 2013-CA00072 dated May 11, 2015. Our office has reviewed the content of the report and recommendations and are respectfully providing a written response to the outlined recommendations.

1) Develop and implement policies that require the licensed retailer to conduct audits of their inventory or face penalties if they fail to do so.

The Association of Certified Fraud Examiners displays the three prongs of the fraud triangle. The prongs are Pressure, Rationalization and Opportunity. The opportunity prong exists when the control structure is perceived by the perpetrator to be weak and likelihood of the fraud being detected as unlikely. That said, Lottery products are to some degree very similar to other consumer retail products. A retailer has the inherent risk of theft and shortages from three main possible perpetrators: employees of the retailer, consumers/general public, and vendors partners (i.e. delivery workers). Shortages could be intentional or through undetected processing errors. To be a successful retailer, the retailer must ensure the opportunity prong is minimized as much as practical.

Retailers need to be careful even though they may trust various parties, such as their assigned lottery sales representative, internal employee or customers. They still need to do their part and verify the correctness of their lottery game inventory and accounting records.

It is imperative for a retailer to prevent and detect shortages from all three possible perpetrator categories listed above. The strength of their system is only as strong as the weakest link in their chain of controls. Good security and bookkeeping practices should be followed to protect the financial interest of the retailer. The Lottery has over 9,700 licensed retailers that operate under a wide range of business practices and trade styles (i.e. grocery stores, mom and pop convenient stores, gas stations, drug stores, bar/taverns, bowling alleys, etc.). Among those 9,700 licensed retailers, tens of thousands of employees operate the lottery terminals, handle ticket inventory, and reconcile daily/weekly sales records.

Ohio Administrative Code 3770-3-01(C)(3)&(4) requires retailers to maintain adequate security practices and prompt and accurate settlements of account. Failure to do so is grounds for license suspension or revocation. From a bookkeeping perspective, generally a license suspension or revocation comes from failure to settle funds with the Lottery within established timelines. Regarding establishing an active across-the-board audit of each retailer, the Lottery does not have the human resources to perform detailed audits of retailer accounting records and their unique bookkeeping practices. Determination of the adequacy and frequency of proper booking practice for the various individual business trade channels, for the purpose of levying penalties could be very costly, subjective and problematic, especially if the retailer is in good financial standing with the Lottery. Retailers are encouraged to follow best practices and the Lottery publishes such information from time-to-time in our monthly retailer lottery publication.

To help retailers, the Lottery does have a bureau of retailer accounts and stands ready to assist retailers in their questions regarding their accounting records. The Lottery has in the past assisted retailers in uncovering shortages, in which many cases, the perpetrator was an employee or even a family member of the licensed retailer.

Retailers who follow precise reconciliation procedures can immediately determine discrepancies in their ticket inventory. In essence, their daily cash drawer would be out of balance to their ticket sales and inventory counts if irregular activities are occurring. The Lottery is confident that the majority of retailers follow good bookkeeping practices.

For those retailers who have relaxed controls, shortages could occur from their own employees, customers, vendor/partners such as their Lottery representative and go undetected for an extended period of time. The Lottery will continue to provide best practice bookkeeping information in its monthly retailer publications and have available its retailer account personnel ready to assist in training any retailer in their bookkeeping practice. The Lottery will consider adding further language to OAC 3770 to strengthen and/or clarify the responsibility of the retailer to audit their own books.

2) Develop a system to prevent the licensed retailers from sharing their log-in identification and password with lottery Sales Representatives.

In regards to the risk that shortages could be due to unauthorized behavior of a Lottery Sales Representative, the non-sharing of passwords does not completely eliminate the risk of loss. It is important that the retailer monitor the sales representative's actions once they are working in the computer system while on-site at the retail establishment. This is very important even if the retailer has properly secured their password. Additionally, if a retailer is performing precise reconciliation procedures, out of balance conditions can be detected immediately. Retailers often get very busy in their hectic consumer environment and may be distracted as the lottery representative performs their functions. Again, proper

post-reconciliations procedures can detect irregularities immediately. The Lottery will reemphasize best practices for password protection in its retailer publication.

3) **Require all returns, full or partial, be returned to the warehouse to alleviate the ability for the Sales Representative to reissue tickets to retailers.**

The risk of retailer shortages is not necessarily correlated to whether tickets are returned to the warehouse or reissued to another retailer. Shortages can occur when any book of lottery tickets (inventory) is marked sold and stolen from the retailer's possession. Again, proper daily reconciliation procedures can detect these irregularities. Retailers need to be vigilant with their recordkeeping. The Lottery's Office of Security and Sales will routinely review computer driven analytical exception reports that could help detect and discourage inappropriate activity. Exception reports can identify situations where ticket movement (i.e. consignment, sales, returns, cashes) follow patterns abnormal to the "typical" activity patterns one would expect. In such cases, the reports could help detect inappropriate activity. Details of the reviews will be established by the Office of Sales and Security by early FY16.

4) **Require the Sales Representative to issue a receipt to the licensed retailer that displays all activities and transactions conducted by the Sales Representative during each visit to the licensed retailer.**

Sales representatives do issue receipts for the activities they performed on the Lottery terminal. However, in the event of an unscrupulous sales representative, they could circumvent the process of providing all of the appropriate receipts if a retailer is not vigilant. Retailers can independently determine all activity that has occurred on their account for the day on their own. Again, proper daily bookkeeping procedures can identify discrepancies.

5) **Consider the benefit of random, unannounced audits of the tickets in the lottery Sales Representative's possession.**

The Lottery agrees with the recommendation of random, unannounced audits in the Sales Representative's possession. This could detect some, but not all, circumstances of inappropriate behavior of a lottery sale representative. The Office of Sales will be developing guidelines and expectations for the nine regional offices in the state.

Additional Comments:

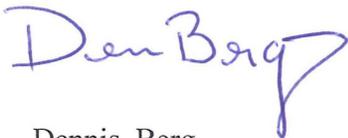
Prevention and detections of shortages is the responsibility of both the licensed Lottery retailer and the Ohio Lottery Commission. Each party plays a unique role in this oversight. The front line responsibility and control rests with the lottery retailer who can perform daily reconciliation procedures. Without this commitment from the retailer, fraud can occur from one or more of the three potential perpetrator groups.

The Lottery will perform random audits of Lottery representatives' physical inventory, develop specialized monitoring reports that can help detect inappropriate activity, educate retailers of best bookkeeping practices via our retailer publications and personally assist those retailers requesting help via our retailer accounts bureau. Additionally, newly licensed retailers are required to attend a training orientation program. Special emphasis of required bookkeeping practices to protect their own financial interests will be added to the program agenda.

Referrals:

David Dragelevich was indicted by Mahoning County Grand Jury on December 12, 2013, on one count of theft in office, as a result of the referral from the OSHP. On April 3, 2014, a superseding indictment was filed increasing the level of felony from a F4 to a F3 based on the dollar amount stolen.

Sincerely,



Dennis Berg
Director
Ohio Lottery Commission