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STATE OF NEW YORK  
OFFICE OF THE STATE COMPTROLLER

October 23, 2002

Ms. Margaret R. DeFrancisco  
Director  
New York State Division of the Lottery  
One Broadway Center  
Schenectady, NY 12301

Re: Report 2002-F-36

Dear Ms. DeFrancisco:

Pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution and Article II, Section 8 of the State Finance Law, we have reviewed the actions taken by officials of the New York State Division of the Lottery as of September 11, 2002 to implement the recommendations contained in our audit report, *Advertising Program Controls* (Report 2000-S-26). Our report, which was issued on August 20, 2001, assessed whether controls assured that the full-service advertising contractor complied with contract terms and conditions for the procurement of goods and services, provided for the effective use of lottery advertising display materials shipped to Lottery agents and were sufficient to measure the results of media advertising and the use of minority and women-owned businesses.

**Background**

The New York State Division of the Lottery (Division) administers games of chance to raise revenue that is used for public purposes determined by the Legislature. The Division reported that it employed 325 staff in fiscal year 2001-2002. The Division licenses about 15,300 agents who sell tickets for lottery games. Ticket sales for the fiscal year ended March 31, 2002 were \$4.8 billion of which about \$1.6 billion was made available for disposition by the Legislature. Division administrative expenses are limited by statute to 15 percent of ticket sales, but typically less than this is required. When expenses are less than the limit, the excess becomes available for legislative disposition. For fiscal year 2001-2002, the Division's administrative expenses were \$510 million and about \$203 million of unused administrative funds became available to the State to be used as the Legislature prescribed.

On July 25, 2001, the Division entered into a full-service advertising/communications contract with DDB New York (DDB). All advertising and marketing services must be performed in compliance with the terms and conditions of the full-service advertising contract as well as with the request for proposal (RFP) dated February 16, 2001 that underlies the contract. DDB earns an eight

percent commission on advertising production costs. For the fiscal year ended March 31, 2002, the Division spent about \$71.6 million for advertising. This represented a 1.6 percent increase over the cost of advertising for the fiscal year ended March 31, 2001. During the same period, ticket sales revenue increased 14.3 percent from \$4.2 billion to \$4.8 billion.

### **Summary Conclusions**

In our prior audit, we identified the need for significant improvements in advertising controls to ensure open and competitive subcontracting, limited and justified sole source subcontracting, the cost-efficient use of print brokers by the full-service advertising contractor, and documented and approved revisions to sub contract job specifications and cost estimates prior to the incurrence of work and expense related to the changes. In addition, controls were needed to ensure that advertising materials were received and utilized by agents. In order to effectively monitor goals and objectives, controls to assure the timeliness of contractor submissions of media advertising performance reports and progress reports on the utilization of minority and women-owned business enterprises (M/WBE) also needed improvement.

In our follow-up review, we found that Division officials have made significant progress in implementing the audit recommendations.

### **Summary of Status of Prior Audit Recommendations**

Of the 11 prior audit recommendations, Division officials have implemented 10 recommendations and partially implemented one recommendation.

### **Follow-up Observations**

#### **Recommendation 1**

*Establish monitoring procedures that ensure: the procurement of retail advertising goods and services is accomplished with bid solicitation from at least five vendors; the receipt of bids on vendor letterhead; the prior written approval of subcontract awards; and the limited, fully justified and documented use of sole source awards.*

Status - Implemented

Agency Action - The production voucher checklist was revised to require documentation that bids are solicited from five vendors, all bids are submitted on vendor letterhead, justification is provided for sole source awards, and Division approval of the estimated amount is attached and dated prior to the invoice. A Division budget analyst prepares this checklist and attaches it to all vendor payment requests before such payments are authorized. We randomly selected five production vouchers that involved the use of a subcontractor to ensure that monitoring procedures are working as intended. For all five jobs, DDB solicited bids from five vendors, bids were received on vendor letterhead, and Division approval of the production estimate was attached and dated prior to the invoice. According to Division officials, so far only one contract was awarded on a sole source basis during this fiscal year.

Although the contract was less than \$5,000, the sole source award was justified and documented by the Division. To verify that sole source awards were done on a limited basis we randomly reviewed an additional 15 vouchers and found that none of them were sole source contracts.

### **Recommendation 2**

*Evaluate whether it is cost efficient to permit the full-service advertising contractor to use print brokers to arrange for lottery advertising products. In this regard establish whether such services could be provided in-house by the full-service contractor at less expense than is currently charged.*

Status - Implemented

Agency Action - DDB is contractually required to conduct a cost analysis to evaluate the cost of print production work performed by the contractor as compared to work performed by a print broker. DDB has requested that it be allowed to have one year of actual print production jobs as their base for this analysis, and be able to work with the Division and Office of the State Comptroller to develop an analytical procedure to ensure a thorough analyses. According to Division officials, to date, DDB has not utilized print brokers for Division work.

### **Recommendation 3**

*Establish controls to ensure that Division revisions to retail advertising subcontracts are documented and are approved and communicated in writing to the full-service advertising contractor prior to the incurrence of work and expense for the changes.*

Status - Implemented

Agency Action - Written advance approval by the Division is required for any changes in costs throughout the development and execution of the project. The current contract with DDB permits the use of e-mail (printed out) as well as typed/signed correspondence as documentation of approved specification and cost estimate changes. This allows for timely notification and approval of any changes in specifications and costs. Of the five vouchers we reviewed during this follow up, two had additional costs incurred by the subcontractor. In both cases the revisions to the subcontract and additional costs were documented and approved by Division officials prior to the incurrence of work and expense for the changes.

### **Recommendation 4**

*Establish controls to ensure that additions to cost estimates for retail advertising subcontracts are provided by the full-service contractor for Division approval prior to undertaking work and expense related to the new cost estimates.*

Status - Implemented

Agency Action - (See "Agency Action" for recommendation number 3.)

#### **Recommendation 5**

*Monitor the estimated and actual costs of subcontracted jobs and follow up on variances on an ongoing basis.*

Status - Implemented

Agency Action - DDB attaches a Production Job Status Report to each invoice submitted to the Division. In this report each job is broken down by work code such as printing, layout, mechanicals and shipping. The original estimate, present estimate, over/under amount, and over/under percentage for each portion of the job is provided. A Division budget analyst and the Director of Advertising and Game Development identifies and investigates any variances. In addition, a Division budget analyst produces a weekly report of Advertising Expenditures/ Commitments. This report lists the paid amount and estimate for all jobs in the current fiscal year and is distributed to both Division and DDB officials.

#### **Recommendation 6**

*Utilize electronic shipping information to periodically verify that agents are receiving shipments of lottery advertising materials.*

Status - Implemented

Agency Action - According to Division officials, DDB uses UPS electronic shipping information to track delivery of promotional materials to agents. The return address indicated is Division headquarters so undelivered shipments will be returned to the Division. Addresses of all returned shipments are verified with the regional office and updated. Also, sales representatives and telemarketers check with agents during routine visits or calls to verify that agents have received the promotional materials and are using them.

#### **Recommendation 7**

*Instruct District Sales Representatives to give priority attention to identifying and documenting agent limitations and restrictions on the use of advertising materials. Take this information into account in determining production and shipment requirements for advertising materials.*

Status - Implemented

Agency Action - Division officials advised us that, although the top priority of a district sales representative is to help agents sell tickets, attention is given to agents' use of promotional advertising materials. In December 2001, a Retailer Tool Kit was produced and provided to all district sales representatives. Included in the Kit are samples of available permanent

point-of-sale materials. Agents can select materials from this Kit to be displayed in their establishment. The Division tracks selections from the Kit to identify items popular among agents. Also, bi-weekly sales tactics instructions issued to district sales representative advise them to check for the receipt and display of point-of-sale materials. Furthermore, a Retail Tools Committee, consisting of sales representative supervisors, regional sales coordinators and the sales program director, meet quarterly to discuss, among other things, the types of advertising materials most used by agents. According to Division officials, these efforts have resulted in the reduction of both the number and content of promotional mailings. A summary of the cost of promotional shipments provided by the Division shows an 18 percent decrease in promotional shipping costs between fiscal year 1999-2000 and fiscal year 2001-2002.

### **Recommendation 8**

*Establish written requirements for the full-service advertising contractor to provide the Post Buy Analysis report by a specified, timely due date after the end of each quarter.*

Status - Implemented

Agency Action - The Request for Proposal for a full-service advertising/communications contract dated February 16, 2001, specifies that a post-buy TV analysis be completed within 16 weeks following the end of the quarter.

### **Recommendations 9**

*Utilize the Post Buy Analysis report to assess performance of the full-service advertising contractor.*

Status - Partially Implemented

Agency Action - We obtained copies of the Post Buy Analysis report for the three quarters that DDB has contracted with the Division and noted that just one of the reports was delivered to the Division within the contractually required 16 weeks timeframe. The other 2 reports were delivered to the Division within 20 and 22 weeks. Division officials have informed us that they have instructed DDB to improve delivery of the Post Buy Analysis within the guidelines specified in the contract.

### **Recommendations 10**

*Monitor the submission of the Utilization Plan and the M/WBE progress reports by the full-service advertising contractor. Utilize the Plan and the reports in determining that M/WBE goals are being met.*

Status - Implemented

Agency Action - DDB submitted a Utilization Plan as well as four quarterly W/MBE progress reports to the Division. The contract between the Division and DDB established a goal of

one percent subcontractor participation by New York State certified minority business enterprises and one percent subcontractor participation by New York State certified women-owned businesses. The Division achieved its goal for minority business enterprises for State fiscal year 2000-2001, but did not achieve its goal for women-owned businesses. Division officials advised us that DDB has taken steps to increase business with M/WBEs. For example, DDB has distributed a list of New York certified M/WBEs internally to allow these vendors to be considered for inclusion in the bidding process.

### **Recommendations 11**

*Provide the Department of Economic Development's Division of Minority and Women's Business Development with written compliance review findings for selected contracts on an annual basis as required.*

Status - Implemented

Agency Action - The Division submits the quarterly progress reports prepared by DDB to the New York State Department of Economic Development, Division of Minority and Women's Business Development.

Major contributors to this report were Cynthia Herubin, Karen Bogucki, and Art Smith.

We would appreciate your response to this report within 30 days, indicating any actions planned or taken to address any unresolved matters discussed in this report. We also thank Division management and staff for the courtesies and cooperation extended to our auditors during this review.

Very truly yours,

Jerry Barber  
Audit Director

cc: Deirdre A. Taylor