

STATE OF IOWA



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November 17, 2009

Terry Rich, Chief Executive Officer
Iowa Lottery
2323 Grand Avenue
Des Moines, IA 50312

Subject: Formal replies have not accounted for 30 of 60 recommendations

Dear Mr. Rich:

Seven months ago I publicly released my office's investigative report about the Iowa Lottery. As you know, our report found that the Lottery has not adequately protected its customers from fraud and theft by retailers. This includes likely acts of fraud which have gone undetected, possibly even large-scale fraud.

Our report included 60 recommendations designed to aid the Lottery in correcting these shortcomings. Since that time, the Lottery has taken a number of positive steps. These include:

- Developing and implementing a searchable computer database for Lottery investigators.
- Seeking bids to make "ticket checkers" available to customers in 2011.
- Continuing to conduct undercover "security checks" throughout the state to ensure retailers take appropriate actions when customers present winning tickets.

In addition, we have observed signs of what seems to be a stronger emphasis by Lottery management on the importance of being a proactive regulator. A September 1 article in *The Des Moines Register* quoted you as saying, "All of the things we are talking about are for customer convenience. We want to do anything we can to help the player know when they have won and obviously to pay them. But we also have to keep the maximum possible security so that people can't scam the system."

I believe this is the correct approach. You and your staff are to be commended for recognizing that positive changes were needed, and for making the effort to effect these improvements.

At the same time, I want to bring your attention to what I see as a disconnect between your statements and your actions concerning the complete set of 60 recommendations. You should know that we did not expect the Lottery would agree with all 60 recommendations; we anticipated at least some recommendations would be rejected. What we did expect (and

in fact have requested) was for the Lottery to specify which recommendations it was accepting and which recommendations it was rejecting (along with the specific rationale for each rejected recommendation). We also expected that there might be opportunities for further dialog, as warranted, concerning the rejected recommendations.

Statements you made around the public release of our report seemed to affirm our expectations. “This is an extremely serious issue, one we believe must immediately be brought to Iowans’ attention so we all can have an open, frank and timely discussion about consumer protection issues in our state,” you were quoted as saying in the Lottery’s April 21, 2009, press release. “I called last week for the Ombudsman’s Office to immediately release the report and I’m pleased to see that has now happened.”

Seven months later, however, you have yet to specify – for the complete set of 60 recommendations – those that you accept and the specific rationale for each rejected recommendation. I have requested this specific information from you on more than one occasion (see my letters to you dated March 27 and July 14). But your responses have been general, and have not identified the entirety of recommendations you are rejecting as well as your specific rationale.

In addition, your initial responses indicated that you agreed with most of my recommendations. The Lottery’s April 21 press release stated, “Rich said the lottery agrees with or has already implemented many of the concepts in principle outlined in the report but disagrees with some of the findings due to concerns regarding player security; game security; and undue governmental intrusion, red tape and impractical business application in the retail environment.” And on June 11, you told members of the Government Oversight Committee that you agreed with “most” of my 60 recommendations.

Several months later, however, we can find evidence of your agreement for only about 12 of the 60 recommendations.

The remaining 48 presumably fall into five categories you identified in your April 15 written reply and in the Lottery’s April 21 press release. We believe we have a good understanding of which recommendations you have placed into two of these categories:

1. “*Concerns regarding undue governmental intrusion, red tape and impractical business application.*” Your August 4 letter identified 11 specific recommendations which you are rejecting for this reason.
2. “*We do not agree that administrative rules or laws need to be revised to achieve an enhancement of lottery security in Iowa.*” We have identified seven recommendations which fall under this category. (The number is actually 11, but 4 of those are identified in your August 4 letter as involving “undue governmental intrusion.”)

If our above analysis is correct, this means that we can accurately account for the Lottery’s response to 30 of the 60 recommendations:

- 12 have been accepted.
- 11 have been rejected due to concerns about undue governmental intrusion, etc.
- 7 have been rejected because the Lottery does not agree that administrative rules or laws need to be revised.

This leaves 30 recommendations unaccounted for. We cannot find any indication that your formal replies specifically acknowledged or responded to these other 30 recommendations. While the two of us did have an informal meeting in the summer to discuss all 60 recommendations, that discussion did not sufficiently address my need for specific information.

Based on your formal responses, we are left to presume that these 30 recommendations have been rejected for one of the remaining reasons you offered in April:

3. *Personal security risks*: We can only find one recommendation which might fall in this category. But that recommendation (#53) involved adding a musical jingle to game terminals, and it appears the Lottery has since implemented this recommendation.
4. *Game security concerns*: We can only find one recommendation which might fall in this category (#43).
5. *Cost-benefit factors*: From our review, it is not clear which recommendations you are rejecting for this reason.

Moreover, among these 30 remaining recommendations, we find a number which do not appear to clearly fit into any of these three categories. Here are some examples:

- #15: The Lottery should develop an incentive program for retailers and store employees to make suggestions to the Lottery for improving security procedures and policies.
- #20: The Lottery's Security Division should review its "activity concerns" and "suspicious validations" procedures to determine the feasibility of improvements that would enable these procedures to proactively and reliably alert the Division to possible criminal activity.
- #21: The Lottery should adopt a policy requiring that any customer contacts concerning potential retailer fraud or theft must be immediately forwarded to the Security Division.
- #22: In order to impress upon staff the scope of fraud and theft that can occur, the Lottery should provide training for all relevant employees concerning the various means and methods of known Lottery crimes.
- #24: The Lottery should amend its Licensing Terms and Conditions to specifically prohibit licensed retailers from charging a fee, withholding a portion of the prize payout, or making any kind of a profit, in the process of validating and redeeming tickets for customers.
- #35: The Lottery should develop protocols to improve coordination between the Security Division and law enforcement agencies (including the DCI, municipal police, and county sheriff's departments) to ensure that alleged violations of law are properly investigated. This could include, but not be limited to, legislative clarification of their respective roles and improvements to Iowa Code chapter 99G or other areas of state law as appropriate. This could also include the concept of assigning regulatory oversight to a third-party agency independent of the Iowa Lottery, as has occurred with the provincial lottery in Ontario, Canada.

- #36: The Lottery should develop and implement an internal system designed to ensure that the licensing status of retailers is assessed when a violation is found.
- #39: The Lottery should develop and implement a policy requiring investigators to attempt to determine, in all theft cases and to the best of their ability, the amount of any prize money redeemed from the stolen tickets, and by whom.
- #44: The Lottery should advise its customers, in simple, clear, and unambiguous terms that all sources, including the terminals, can err. In addition, the Lottery should advise that it would be wise for customers to:
 - Rely on multiple sources before concluding a ticket is not a winner.
 - Never hand a ticket to a store employee without knowing whether it is a winner.
- #45: The Lottery should educate its customers about the various Lottery-related scams, including but not limited to “palming” and “partial win payment.” The purpose would be to educate customers about the scams so that they can understand how to reduce the risk of falling victim to such scams.

For an example of how this could be written, see the newspaper article sub-headlined “Four Ways Retailers Can Steal Your Winning Ticket,” published by the *Vancouver Sun* on May 30, 2007.

- #49: The Lottery should amend its Licensing Terms and Conditions to specifically require that all licensees which sell online games must have a CDU.
- #56: The Lottery should consolidate all of its retailer directives and guidelines into a single electronic manual that can be quickly and easily referenced by clerks. The Lottery should regularly update the manual as necessary and communicate these updates to retailers.

I believe that you and I have much in common with regard to these recommendations, especially after reading your recent public statement: “We want to do anything we can to help the player know when they have won and obviously to pay them. But we also have to keep the maximum possible security so that people can’t scam the system.”

In revisiting these issues with you now, we believe it would be helpful to remember that all 60 of our recommendations originated from the following four areas of concern:

Enforcement (what is needed)

Iowa Lottery performance (what we found)

Proactive enforcement procedures	→	Weak, reactive enforcement procedures
Effective complaint-handling practices	→	Significant shortfalls with complaint-handling practices
Holding violators accountable	→	Violators frequently not held accountable
Customer education and protection	→	Inadequate customer education and protection efforts

Enclosed with this letter are four tables which organize the 60 recommendations into these four areas. Each table is further divided into two groups: Recommendations which have been accepted, and recommendations which have apparently not been accepted.

The breakdown of recommendations accepted and not accepted in each area looks like this:

- Proactive enforcement procedures: 6 of 20 accepted
- Effective complaint-handling practices: 4 of 15 accepted
- Holding violators accountable: 0 of 6 accepted
- Customer education and protection: 2 of 19 accepted

I ask that you carefully review these tables and then advise me of any errors or omissions. In particular, I am asking for your assistance in helping me to understand how to properly account for the 30 remaining recommendations discussed above.

After you have had an opportunity to review these tables, please contact me so that we can set up a meeting to discuss these issues with relevant staff. At that meeting, I would also like to discuss with you the following relevant issues:

1. According to a June 12, 2009, article published in *The Des Moines Register*, you told members of the Government Oversight Committee, “If we had to make sure every store clerk never ripped off a customer, it would cost too much.”

On this point, I agree with you. Regulatory “perfection” has never been our goal for the Lottery, and we explained this in our report. This is why our recommendations were designed to establish a proactive enforcement system to ensure that customers’ interests are **reasonably** secure and that thieves are **routinely** held accountable.

As Lottery Vice President Mary Neubauer told us, there is no such thing as the “perfect panacea” that will stop all fraud.

2. Considering the current fiscal crisis across state government, I do not understand why the Lottery would not want to begin pursuing restitution for prize monies paid out on stolen tickets. (See recommendation #40.) Pursuing such restitution could be a net gain from a fiscal perspective.

The Lottery’s decision to continue allowing thieves to keep prize money from stolen tickets effectively also means there continue to be incentives to steal Lottery tickets.

Your formal responses have not even acknowledged this important recommendation. Informally, you have told us that while you agree that thieves should not be allowed to keep prize money from stolen tickets, you have been advised by legal counsel that the Lottery does not have sufficient legal authority to pursue legal recovery of these monies. So, while you voice some concern about the status quo, it appears that you are not willing to actually do anything to change the status quo.

In your April 15 formal reply to my report, you claimed, “Integrity is at the heart of our operations.” If in fact integrity is at the heart of the Lottery’s operations, why would the Lottery not want to find a way to stop thieves from keeping prize money from stolen tickets – to ensure that crime never pays?

3. Your August 4, 2009, e-mail to me stated in part, “Also, out of respect, I did not include one critical point in this letter which we discussed in person. Some of the other recommendations which we believe are good in concept, may be the result of misunderstandings by your office, i.e.: when tickets are delivered to a retail location, they become the property of that location, as described in administrative rule 531-13.5(99G).”

That may be true, but our focus has been on the prize money. Are you saying that the prize money that accrues from a winning instant ticket also becomes the property of that retail location?

4. Without additional information, your rejection of all recommendations that would require changes to the Lottery statute or administrative rules seems arbitrary. Your August 4, 2009, letter stated, “We do not believe any new laws or administrative rules need to be written since **we already have the procedures and authority to make changes**, not to mention oversight from the Attorney General’s Office, DCI, Auditor’s Office, Legislature and Governor’s Office, input from your office, and statutory requirements to manage the lottery in a professional manner.” [emphasis added]

For each of these legislative recommendations, please be prepared to discuss one of two things: Please identify the changes that Lottery has implemented or is preparing to implement; or the specific rationale for your decision to reject the recommendation. (This involves the following seven recommendations: #13, #18, #19, #31, #47, #59 and #60.)

5. The written guidelines for Operation Starburst, which you shared with my investigators on August 10, 2009, stated in part, “It is possible that criminal acts may occur in multiple jurisdictions around the State during this operation. **In compliance with 99G.35, paragraph (c), the office of the County Attorney having jurisdiction will be contacted....**” [emphasis added]

The highlighted sentence comports with our understanding of Code section 99G.35(c). In fact, it seems to be consistent with our Recommendation #37, which stated, “The Lottery’s Security Division should commit to investigate all reports that it receives involving thefts or alleged thefts of Lottery tickets to their logical conclusion, regardless of a retailer’s wishes, unless it determines that a law enforcement agency will investigate. If a retailer refuses to fully cooperate with such an investigation, the Security Division should consider exercising its authority to issue a subpoena for the records and should consider referring the matter for suspension or revocation of the retailer’s Lottery license.”

That recommendation was based on our finding that the Lottery has allowed store owners to determine whether clerks who steal tickets or swindle customers should be referred for criminal prosecution, even though the Lottery is mandated by law to refer all suspected violations.

However, your August 4 letter identified Recommendation #37 as among those you are rejecting because of concerns about undue governmental intrusion.

6. The written guidelines for Operation Starburst also stated in part, “A criminal act, however, will be presumed not to have occurred until the ticket has been presented by the employee for redemption....”

Does this mean that the act of a clerk taking such a ticket and giving it to a third party for redemption is not considered to be a criminal act?

7. The new "Retailer Compliance Inspection" checksheet, which Joe Diaz shared with my investigators on August 10, lists two items which are actually not required by the Lottery's rules and regulations.

These are "Customer Display Unit Properly Positioned" and "Customer Receipt."

Frankly, we think it is good that the Security Division is checking on these and other items when investigators visit retailers. We are curious, however, why the Security Division is checking for these two items, given the fact that neither item is actually required by the Lottery's rules and regulations. How can the Security Division enforce something that is not actually required?

In addition, while I recommended that the Lottery take steps to require both items, your formal responses have not acknowledged these recommendations (#42 and #49).

8. I need to remind you that my report found the "Sign It" program to be a good first step that has limitations. The report noted that educating customers to sign their tickets is important, but that step alone does not inoculate those customers from being victimized by fraud or theft. My report stated: "The Lottery and its licensed retailers are now required to verify the presence of a signature on any ticket submitted for checking or validation. However, they are not required to ensure that the signature on a ticket matches the identity of the person presenting it. Under these rules, a thief can claim the prize for a winning ticket, even if the signature on that ticket is from the victim."

None of your responses to date have disputed this finding. I bring this to your attention because of the Lottery's recent public statements about the value of the signature requirement. The Lottery's August 6, 2009, press release stated in part, "The easiest way for consumers to protect themselves is by signing their tickets as soon as they are purchased ... because that identifies the tickets as belonging to that person."

This is a concern because I believe such a statement exaggerates how much protection customers can attain by signing their tickets. This concern is magnified by the fact that you have only accepted 2 of my 19 recommendations in the area of customer education and protection.

9. You recently sent me a copy of the October 28, 2009, letter regarding the upcoming suspension for Pronto Groceries & Gas in Garner. We are interested in learning more about the incident that led to this suspension. Please provide a copy of the Security Division's case file regarding this incident.
10. I am planning to submit several Lottery-related legislative proposals for consideration by the General Assembly. The deadline for submitting these proposals is November 30, so depending on when we meet, I may be compelled to submit these proposals before our meeting.

While I certainly respect your authority to reject my recommendations, I want to remind you that all 60 were carefully formulated based on our review of a tremendous amount of information, including an audit of three years' worth of the Security Division's casework. We believe our recommendations are reasonable, practical, and fiscally responsible.

We also are mindful of the fact that a lottery that does not adequately protect its customers risks losing their confidence, potentially harming the lottery and, in turn, the government that depends on its profits.

After you have had a chance to consider all of this information, please call or e-mail me at your convenience so that we can set up the meeting I am requesting. Let's aim for accomplishing this by December 18, 2009.

Thank you for your continued assistance.

Sincerely,

A handwritten signature in black ink, appearing to read "William P. Angrick II". The signature is fluid and cursive, with a long horizontal stroke at the end.

William P. Angrick II

JEB/jbc

Enclosure: Status of Recommendations November 2009