Taking Chances on Integrity:

An Investigation of the Iowa Lottery

Iowa Citizens' Aide/Ombudsman
William P. Angrick II

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Contributors

Investigators

Jeff Burnham, Senior Assistant Ombudsman
Bert Dalmer, Assistant Ombudsman

Intern (Research Assistant)

Chris Natynski

Legal Counsel

Ron Rowland

Deputy Ombudsman

Ruth Cooperrider

Table of Contents

Preface

The Office of Citizens' Aide/Ombudsman (Ombudsman) is an independent and impartial investigative agency within the legislative branch of Iowa state government. Its powers and duties are defined in Iowa Code chapter 2C (2009).

The Ombudsman has authority to investigate, in response to a complaint or on his own motion, any administrative action of Iowa state and local government agencies. The Ombudsman can investigate to determine whether agency action is unlawful, contrary to policy, unreasonable, unfair, oppressive, or otherwise objectionable. The Ombudsman may also be concerned with strengthening procedures and practices which lessen the risk that objectionable administrative actions will occur.

The Ombudsman may also decide to publish a report of his findings and conclusions, as well as any recommendations for improving agency law, policy, or practice. If the report is critical of the agency, the agency is given the opportunity to reply to the report, and the reply is attached to the published report.

This report serves two main purposes. The first is to report the findings and conclusions of my office's investigation of the Iowa Lottery's performance in regulating fraud and theft by retailers and their employees.

The second is to present my recommendations for steps the Lottery can take that would strengthen its enforcement procedures and practices. The purpose of these recommendations is to ensure that customers' interests are reasonably protected by reducing the risk of retailer fraud and theft, and increasing the likelihood that violators are held accountable.

In preparing this report, we have strived not to identify a number of individuals: customers, retailers and their employees, as well as theft suspects. As noted above, this investigation focuses on the Iowa Lottery's regulatory performance. In reviewing that performance, we examined the Lottery's response to alleged violations by various retailers and store employees, a number of whom later pled guilty to Lottery-related crimes. We found other individuals who have claimed significant prizes from the Lottery, some of whom were identified in press releases as retailers or their employees.

While many of their identities are in fact a matter of public record, the actions of those customers, retailers, and store employees are not the focus of our investigation. I am, therefore, exercising my authority under Iowa Code chapter 2C (2009) to not identify these individuals in this report.

This investigation was borne from my review of Canadian ombudsman investigations of the provincial lotteries in Ontario and British Columbia. Those reports, released in the first half of 2007, documented a veritable scandal with regard to retailer fraud and theft.

After a preliminary assessment, I initiated an Ombudsman investigation of these issues pursuant to the authority in Iowa Code chapter 2C (2009). My decision was communicated to the Lottery in an October 5, 2007, letter to then-CEO Dr. Edward Stanek.

My letter of notice stated in part:

> This investigation will focus on, but not necessarily be limited to, the following issues:
>
> 1. Whether the Iowa Lottery has been operating with integrity and dignity, as required by Iowa Code Chapter 99G.
>
> 2. Whether the Iowa Lottery has acted reasonably in ensuring that retailers and retailer employees don't take advantage of customers who entrust them with a ticket.

William P. Angrick II

Executive Summary

A. IOWA LOTTERY OVERVIEW

> The general assembly finds and declares … [t]hat lottery games shall be operated and managed in a manner that provides continuing entertainment to the public, maximizes revenues, and ensures that the lottery is operated with integrity and dignity and free from political influence.
>
> — *Iowa Code section 99G.2 (2009)*

Since its establishment in 1985, the Iowa Lottery has raised more than $1.1 billion for state government programs. For the fiscal year which ended June 30, 2008, the Lottery reported profits of approximately $56.5 million. The Lottery's profits are deposited into the state's general fund, which pays for various state programs including education, social services, veterans affairs and public safety.

The Lottery depends on a network of approximately 2,500 licensed retailers to sell its products and to pay out most prizes worth $600 or less. Stores paid out 83 percent of all prize money in fiscal year 2007, according to Lottery statistics. In communities across Iowa, these retailers and their employees represent the public face of the Lottery system.

The Lottery says that licensed retailers are required to follow its "Licensing Terms and Conditions." These terms permit the Lottery to impose license sanctions, up to and including revocation, "if a retailer fails to comply with any applicable law or administrative rule, these terms and conditions, or instructions given to the retailer."

B. CANADIAN LOTTERY SCANDAL

In 2007 two Canadian ombudsmen offices published major investigative reports on retailer fraud involving the provincial lotteries of Ontario and British Columbia. Those investigations were triggered by media reports that some retailers were claiming significantly more major prizes than one would expect given the odds.

Based on their investigations, the ombudsmen in Ontario and British Columbia found that the lotteries' lax approach to enforcement had enabled some retailers and clerks to manipulate the process to their advantage, up to and including theft of some customers' winning tickets. Both reports recommended that the lotteries implement a system of proactive checks and balances designed to reduce the potential for fraud and theft, and to increase the chances that thieves would be detected and held accountable.

Both lotteries accepted *all* of the ombudsmen's recommendations (and in several cases the lotteries went beyond what had been recommended). Since then, there has been a sea change in how the Ontario and British Columbia lotteries view the importance of protecting their customers' interests. Investigations of other lotteries across Canada followed, with similar results.

There have been no similar investigations of lotteries in the United States. This could create the impression that the threat of retailer fraud is a distinctly Canadian problem. But that impression is contradicted by recent media reports. In 2008, for example, a Louisiana store clerk was charged with stealing a customer's winning ticket worth $800,000.

In 2008 and 2009 the California Lottery conducted undercover sting operations where agents posing as customers presented decoy winning tickets to clerks. Some clerks paid out only a fraction of the prize money, while some said the tickets were not winners and went on to claim the prize money for themselves. The stings led to the arrests of at least ten individuals working at lottery retail outlets.

C. IOWA OMBUDSMAN INVESTIGATION

After reviewing the Canadian ombudsmen reports and conducting a preliminary assessment, we initiated an investigation of the Iowa Lottery's oversight of alleged retailer fraud.

The Lottery's Security Division is responsible for investigating allegations of theft and fraud involving Lottery products. As part of our investigation, we reviewed all of the Security Division's investigative case files for calendar years 2005, 2006, and 2007. This involved approximately 434 files. No outside entity had ever before audited the Lottery's investigative case files.

We identified approximately 122 files that involved alleged impropriety by retailers or their employees. Our review of those 122 files forms the basis for many of the findings and conclusions in this report.

We divided the 122 files into three general categories:

- **Customers alleging impropriety by retailers: 34 cases**
  These cases involved incidents where customers complained about the actions of a retailer or store employee. We determined that the majority of these complaints were essentially substantiated by Security Division investigators. Two files involved store employees who were found to have stolen a customer's winning ticket. Many involved acts of lesser significance.

- **Internal thefts prosecuted: 54 cases**
  These cases generally involved store employees who were accused of, and subsequently prosecuted for, Lottery-related theft or fraud. The vast majority (47) involved store employees who were charged with stealing instant tickets from the stores where they worked.

- **Internal thefts not prosecuted: 34 cases**
  These cases involved incidents where store employees were alleged to have committed Lottery-related theft or fraud, but were not prosecuted. Of these 34 cases, we determined that 33 were essentially substantiated – meaning the employer and/or the Lottery investigator found that an internal theft had occurred. The vast majority (27) involved store employees who were found to have stolen instant tickets from the stores where they worked.

We surmise that there likely were additional cases of internal theft not identified as such within the case files. These involved stores that made theft reports where the case files did not indicate whether the suspects were store employees.

The rest of this Executive Summary highlights our findings, conclusions, and recommendations.

D. RETAILER PRIZE CLAIMS

Iowa law prohibits certain individuals from purchasing Lottery tickets and from receiving payment for prize winners. This includes Lottery employees and some contractors, as well as immediate family members residing in the same household.

The prohibition does not apply to licensed retailers. In fact, the Lottery does not prohibit retailers or their employees from purchasing tickets and redeeming prizes at their own stores – even when the same individual is simultaneously "the customer" and "the clerk."

This means that any retailer or clerk who obtains a winning ticket worth $600 or less can conceivably pay himself or herself from the store cash register, with little or no oversight by the Lottery. The Lottery also does not track "high-tier" prizes (worth more than $600) claimed by retailers.

As part of our investigation, we compiled a partial list of prizes claimed by retailers. We did this by reviewing various resources, including hundreds of Lottery press releases, some of which have identified winners as retailers or store employees.

The list we compiled is undoubtedly far from complete. Still, we were able to find that some retailers and store employees have been uncommonly lucky playing the Lottery. In 2007 alone, we found that retailers and store employees claimed at least 28 high-tier prizes, totaling $676,352.

This included a store owner and a store clerk who each claimed $250,000 prizes from instant tickets from the stores where they worked. In all of 2007, only seven other people claimed an instant-ticket prize of $250,000 or more.

When the Lottery received those two $250,000 prize claims, it was already tracking the developing scandal in Canada. But the Lottery did not investigate either prize claim before honoring them.

The store owner and the store clerk, both from northwest Iowa, have also claimed other Lottery prizes. The store owner (and her husband) have claimed 16 prizes since 1991 for a total of $263,501; 11 of their claims have occurred since 2004. The store clerk alone claimed eight prizes for $266,000 in less than one year's time.

In all, we found nine retailers and store employees who have claimed five or more high-tier prizes. At least four of those nine claimed additional prizes in late 2008 or early 2009. This includes a northern Iowa retailer who has claimed 67 prizes over the past several years for a total of $100,626.

We also found:

- Prizes claimed by retailers under circumstances that should have triggered a closer review. For example, an assistant manager of a central Iowa convenience store claimed a $100,000 instant-ticket prize in 2006, just one day after a property she owned was sold to a bank in response to a foreclosure action.

- Some store employees who pled guilty to Lottery theft had claimed big prizes in the past. This included the manager of a northeastern Iowa convenience store who pled guilty to first-degree theft in 2008 in connection with the theft of $45,204 in tickets and cash from a Pull-tab vending machine. The same manager had claimed a $10,000 instant-ticket prize about one year before he was arrested. Overall he had claimed 17 prizes totaling $33,290. The Lottery investigator who handled that case first learned about those prize claims when we asked him about them.

E. THE NEED FOR A PROACTIVE ENFORCEMENT SYSTEM

The collective good fortune of these retailers and store employees is remarkable. The Lottery sold nearly 198 million tickets in fiscal year 2007. Only 2,101 were high-tier prize winners.

This means that:

- **0.001 percent** of tickets sold in fiscal year 2007 were high-tier prize winners.

- **99.999 percent** of tickets sold in fiscal year 2007 were not high-tier prize winners.

Put another way, this means that a person (*on average*) would have needed to buy 94,216 Lottery tickets, across all games, in order to expect one high-tier prize winner. When you eliminate the two games that do not produce high-tier prizes (Pick 3 and Pull-tabs), one high-tier win would have been expected (*on average*) for every 67,450 tickets purchased.

Moreover, among people who are inclined to steal Lottery tickets, those who sell them have several inherent advantages. These advantages include direct access to unsold tickets, control over the process of validating tickets for customers, and payouts of most prizes. Control over these procedures allows retailers and their employees to have temporary control of customers' tickets. This can enhance the ability of a scam artist to trick customers without their knowledge.

These inherent advantages do not mean that a retailer who claims a major prize should be presumed guilty of fraud or theft. But it does mean that there are good reasons for the Lottery to build a proactive system of checks and balances that will neutralize the inherent retailer advantages; and then it must apply those checks and balances with vigilant oversight. Such a system can help ensure that customers' interests are reasonably secure and that thieves are routinely held accountable, thereby promoting the Lottery's integrity and dignity, as mandated by Iowa Code section 99G.2 (2009).

F. IOWA LOTTERY LACKS A PROACTIVE ENFORCEMENT SYSTEM

We identified four integral components that are necessary for a lottery enforcement system to effectively neutralize the inherent retailer advantages. We then examined the Lottery's performance in establishing these four components:

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

1. WEAK, REACTIVE ENFORCEMENT PROCEDURES

Lottery officials acknowledged that their current enforcement procedures – which largely depend on complaints from customers – miss virtually all incidents where customers are unaware that they have been tricked out of a winning ticket or prize money. This means that there likely have been instances of fraud, possibly involving significant prizes, that have gone undetected. The Lottery must work to correct this fundamental shortcoming.

a. Records system inadequate

In January 2007 the Security Division's investigators were provided with a new electronic database for storing and archiving their case work. It was the first time in a decade that the Lottery's investigators had an electronic database to catalog and archive their work.

While it has been an improvement, the new database is limited by the fact that it is not searchable. When we asked how an investigator would know whether a theft or fraud suspect was a "repeat offender," the investigative supervisor replied, "We wouldn't know."

In addition, we found numerous inaccuracies and omissions in our review of case files from 2005 through 2007. Some files were so incomplete or inaccurate that it was impossible to determine what actually occurred without consulting other sources. The names of suspects and customer complainants were misspelled or incomplete in a number of files.

Furthermore, the Security Division does not maintain any log of store employees who have been prosecuted for Lottery-related theft.

We believe these problems, taken collectively, impede the Security Division's ability to effectively track patterns of criminal activity involving retailers and their employees.

b. Limited oversight of retailer prize claims

To find retailers who are using the inherent advantages for improper benefit, a lottery needs detailed, searchable data of retailer prize claims. Analysis of such data can help serve as an "early warning system" of suspicious activity.

Security Division managers agreed it would be a good idea for the Lottery to require retailers and their employees to identify themselves as such when they claim a high-tier prize. However, the Lottery does not have such a policy.

Several Canadian lotteries have also adopted policies requiring that major prize claims (i.e., $10,000 or more) by retailers and members of their immediate families be automatically investigated to determine whether the tickets were obtained legitimately.

The Iowa Lottery, however, does not automatically investigate any prize claims by retailers or store employees. Security Division managers agreed that such a practice would be a good enforcement tool. Other Lottery managers, however, told us that they have been reluctant to launch investigations of retailers who claim multiple high-tier prizes.

2. SIGNIFICANT SHORTFALLS WITH COMPLAINT-HANDLING PRACTICES

Our review of the Lottery's files revealed an investigative approach that is often constrained by incuriosity and, at times, an indifference to getting to the bottom of a given situation.

The Security Division has no written policies on how to conduct investigations. In the absence of written protocols, Lottery investigators often fall back on word-of-mouth advice or embedded office culture to guide them in their work.

This was particularly evident in cases where the only potential victim was a customer. We found numerous customer complaints where leads went unexplored and potential crimes were not pursued. Many of these were the types of cases where the Lottery investigator would need to "make the case." Most of the time they didn't even try.

a. No consequences for three retailers who kept hundreds of dollars from customers under false pretenses

Three separate customers in northeast Iowa complained that they redeemed winning tickets worth $1,000, but that retailers kept several hundred dollars of the prize winnings. In each case, the retailer falsely claimed that several hundred dollars needed to be kept for withholding taxes. The retailer later claimed the $1,000 prize from the Lottery, and in the process came out with a profit between $250 and $550.

The Security Division did not report any of these incidents to law enforcement or prosecutors, nor did it consider imposing license sanctions against the retailers, two of whom were store owners.

Two of the retailers claimed several other high-tier prizes in the months before and after these incidents. These other prize claims raise the possibility that the incidents complained about may not have been isolated. However, the Lottery did not investigate any of the other prize claims.

b. Inadequate responses to allegations of "pickouts"

Of the various lottery-related scams, perhaps the most insidious is referred to as "pickouts." This is a practice where a store employee takes unsold instant tickets, scratches them lightly, "picks out" the winners, and then sells the non-winners to the public.

This scam directly victimizes any customer who is unaware that he has purchased instant tickets that were already scratched. The customer perceives that he has bought legitimate instant tickets, but they are in fact guaranteed losers. Given the nature of this scam, it is critical that the Lottery give serious scrutiny to any allegation of pickout activity.

The Lottery received at least ten separate allegations of possible pickout activity from 2005 through 2007. None of these ten complaints received serious scrutiny from the Lottery. Two were effectively ignored, including one that was not forwarded to the Security Division.

In four cases, Lottery investigators left the investigating to others, including store management. In one of these cases, we asked the investigator why he deferred such a potentially significant complaint to store management. "Because that's the way we've always done it," he replied.

c. Inadequate investigation of internal theft case involving up to $86,000

A northeast Iowa convenience store reported that it had a $15,000 shortage in its Lottery accounts. The Lottery case file shows that the investigator worked the case for about two weeks and believed criminal activity had probably occurred. The investigator provided a police officer with spreadsheets detailing the inventory and cashing records of numerous instant-ticket packs that the Lottery had provided to the store.

The investigator did not perform any further substantive work on the investigation. A police captain called the investigator three months later to seek the Lottery's continued assistance, but was rebuffed. "[The investigator] advised that as far as he was concerned, the Lottery Commission was out of the investigation as it was deemed a case of theft which required local law enforcement jurisdiction," the captain wrote in his report.

There are several reasons why we believe that the investigator should have continued with the investigation, including:

- A professional audit found $86,472 in Lottery shortages at the store. However, the investigator did not obtain or review the audit report, which the store arranged and paid for as a direct result of advice from the investigator himself.

- In his notes, the investigator referred to written statements in the case file from two witnesses who alleged that the manager had taken tickets without paying for them. There was no indication that either witness was contacted by the Lottery or the police department.

- The police investigation has languished, a police captain told us, in part because analyzing the professional audit "is like reading Greek."

- "It would be great if the Lottery Commission would go in, do their own internal investigation and send us a report based on their calculations," the captain added. "It would be nice to be able to fall back on them, since it's their bailiwick, and let them tear it up."

d. Prize claim histories of theft suspects rarely checked, other crimes potentially missed

The Lottery paid a $10,000 Touch Play prize to a manager of a bowling alley in northeast Iowa. Six weeks later, the manager was arrested after admitting he had forged two other Touch Play tickets and redeemed them at local stores for $296. A few days after his arrest, the police chief reported the matter to the Security Division. The information in the file indicates the investigator took notes of the chief's phone call, typed the notes into the file, and then closed the case.

The investigator was not aware of the $10,000 prize claim. The failure to identify the manager's $10,000 prize claim was not isolated. Among store employees who were identified as suspects in Security Division case files from 2005 through 2007, we found that at least 16 had previously claimed high-tier prizes. The prize claims for 12 were not identified in the case files. Some of those claims had been made just a few days or weeks before the report was filed.

We also found two store employees who claimed high-tier prizes shortly after being arrested and charged with internal theft of Lottery tickets. Neither of these prize claims were noted in the case files.

In all cases of alleged theft or fraud, we believe it is reasonable to expect Lottery investigators to routinely check suspects' prize claims – both before and after the alleged impropriety – and to review any high-tier prize claims that are discovered.

3. VIOLATORS OFTEN NOT HELD ACCOUNTABLE

We found that the Lottery has never sanctioned a retailer for theft or fraud.

Furthermore, the vast majority of store employees accused of stealing Lottery tickets have been allowed to keep any prize money obtained from those stolen tickets. This is because the Lottery does not try to recoup prize money in stolen-ticket cases. By neglecting to recover prizes obtained through theft, the Lottery has unwittingly created incentives to steal tickets. The Lottery must take immediate steps to ensure that crime never pays.

In addition, the Lottery rarely reports suspected violations to police and prosecutors, even though it is required to do so by law. Suspected violations are often not fully investigated or reported to law enforcement specifically because of retailers' wishes.

a. Lottery more concerned with underage persons buying tickets than stealing them

Complaints of underage persons illegally buying tickets have been aggressively pursued by the Lottery, as they should be. A recent Lottery report shows that the agency received seven complaints about purchases by underage customers from fiscal year 2005 through fiscal year 2007. The Lottery substantiated two of those complaints and suspended both stores' licenses.

By contrast, we found that 29 underage store clerks were substantiated to have stolen Lottery tickets during the same period. This means that the number of instances where Lottery investigators substantiated internal theft by an underage employee was 14 times higher than the number of substantiated cases of underage sales from fiscal year 2005 through fiscal year 2007. In addition, underage persons accounted for approximately one-third of the individuals prosecuted for, or suspected of, internal theft from 2005 through 2007.

This suggests that the Lottery should be addressing the phenomenon of underage internal theft at least as aggressively as its approach to underage sales. But there was no indication that the Lottery was even aware of this phenomenon or its pervasiveness. Of the individuals we identified as being underage at the time of the thefts, many were not identified as such in the Lottery's case files. We made those identifications through non-Lottery records.

b. Investigators routinely failing to determine how much prize money is obtained from stolen tickets

We found a number of cases involving tickets stolen by store employees where Lottery investigators did not attempt to determine the total amount of prize money obtained from tickets that had been stolen.

This included a part-time pharmacy employee who pled guilty to first-degree theft in connection with the theft of at least $107,138 worth of instant Lottery tickets. Police determined that the woman redeemed 97 winning tickets over a three-week period and suspected that she had cashed many more stolen tickets.

But the Lottery investigator did not attempt to learn how much prize money the woman had collected from the stolen tickets that she redeemed for prize money. She also claimed a $1,600 prize that was paid out directly by the Lottery; this was not mentioned in the case file.

This raises a critical question: How can the Lottery hold thieves accountable if investigators do not determine how much prize money those thieves obtained from the stolen tickets?

c. Lottery does not try to recoup prize money in internal theft cases

From 2005 through 2007, we found 45 internal theft cases where prize money was obtained from stolen tickets and the suspects were later prosecuted for the thefts. Most of those employees were ordered to pay restitution to the *stores* for the retail value of the stolen tickets.

But only two of the 45 employees were ordered to pay restitution to the *Lottery* for the prize money they obtained from the stolen tickets. The prosecutors in those two cases told us that the Lottery initially resisted pursuing restitution. "At first, they [Lottery staff] said, 'We don't ever ask for restitution,'" one prosecutor told us. "They were reluctant at first." But she persisted because "it looked like they [Lottery] had been harmed by the theft."

The Lottery's investigative supervisor confirmed that the Security Division routinely turns down prosecutors offering to pursue restitution for the Lottery. The supervisor said he generally responds to such inquiries by saying, "I'm sorry, we're not a victim."

However, we believe that the Lottery is a victim for restitution purposes. It is our opinion that the Lottery can and should seek restitution for the value of prize money paid out from stolen tickets. Obtaining such restitution would serve at least two important purposes:

- It would financially benefit the Lottery and the public who play and are served by the Lottery.

- It would also convey the message that "crime does not pay," thus helping to preserve the Lottery's integrity and dignity, which is mandated by Iowa Code section 99G.2(3) (2009).

4. INADEQUATE CUSTOMER EDUCATION AND PROTECTION EFFORTS

At the urging of the Iowa Legislature's Government Oversight Committee, the Lottery in 2008 implemented two new procedures designed to help safeguard customers from possible fraud.

In March 2008 the Lottery began a new program called, "Sign It. It's Yours." The program requires retailers and the Lottery to verify that a signature appears on all tickets submitted for checking or for a prize payout. The Lottery then reprogrammed its terminals to automatically generate a customer receipt for every instant-scratch or lotto ticket that is checked or cashed.

The addition of the "Sign It" program and customer receipts in 2008 were good first steps. But we found that both procedures have limitations. As a result, customers are not adequately protected and additional customer-protection measures are needed.

a. Limitations of "Sign It" program and customer receipts

Customers who sign their tickets and ask for receipts could still be susceptible to various potential retailer scams. This includes any customer who hands a ticket to a store employee without knowing whether it is a winning ticket, and if so, the prize amount. This also includes any customer who suspects something is amiss during the validation process but does not retrieve the ticket back from the store employee.

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.

We also found no indication that the Lottery is actively and routinely checking to make sure its licensed retailers are complying with the new signature requirement. In late 2008 we presented unsigned tickets to clerks at ten central Iowa stores. When we asked them to check our tickets, five required us to sign our tickets, while five did not.

When it introduced the new customer receipts, the Lottery suggested they would prevent fraud. In a newspaper article about the receipts, a Lottery vice president was quoted as saying, "Both the retailer and the customers have receipts available showing the outcome of the play. There is no question in anybody's mind what the outcome of the play was because it is shown right there on that piece of paper."

However, the Lottery is not requiring retailers to provide or offer receipts to customers. We question the effectiveness of the new receipts if the Lottery does not require retailers to offer them to customers. To illustrate the problem, when we asked clerks at ten central Iowa stores to check our tickets in late 2008, only four offered us a receipt.

As a state enterprise, the Lottery holds the burden of ensuring that receipts are offered to its customers, on whom the Lottery depends for generating tens of millions of dollars in profits for state government every year.

b. The need to educate customers to know the results before handing tickets to retailers

A Lottery vice president told us that the Lottery has historically stressed that customers:

> … should never be relying upon one single device or one single entity as the be-all end-all of the information about your lottery ticket. You should have tried to figure out if your ticket was a winner before you got to the store and you should be looking at many different sources for information.

That seems like excellent advice, the kind of information that Lottery customers could use to protect their interests. However, we did not find any publicly disseminated information from the Lottery comparable to this official's statement.

c. The need to install self-serve "ticket checker" devices

Many lotteries allow customers the option of checking their own tickets by offering self-serve "ticket checker" devices at licensed retailers. These devices allow customers to determine the actual results of the ticket without needing to hand the ticket over to a clerk.

The Lottery has occasionally received requests from customers asking for ticket checkers to be installed. The Lottery has typically responded by saying that the cost of adding ticket checkers would be prohibitive.

In a written presentation to the Government Oversight Committee at its January 30, 2008, meeting, a Lottery vice president claimed that providing ticket checkers would cost "approximately $30 million annually." One week later, the then-Acting Lottery CEO received a letter from Scientific Games International, Inc. (SGI), the Lottery's vendor for online games. The February 8, 2008, letter presented three proposals for what SGI would offer if the Lottery agreed to exercise the last one-year option on the contract that was then in place.

Under the first proposal, SGI offered three items:

- Installation of up to 2,000 ticket checkers at no charge, an estimated $1.3 million proposition.
- A 17 percent reduction in contract fee rates, an additional estimated $1.3 million proposition.
- An additional $100,000 for the Lottery to purchase new computer equipment for sales staff.

The Lottery Board, at its July 17, 2008, meeting, declined SGI's offer for ticket checkers. The Board instead agreed to a different SGI offer, a 34 percent reduction in contract fee rates which would lead to an estimated $2.6 million in savings for the Lottery, according to SGI's February 8, 2008, letter.

The Board's decision came after the then-Acting CEO told the Board that "there was no need to rush forward with ticket checking technology at the present time because of the steps already taken to protect the Lottery's retailers and players through the ticket signing requirement and the issuing of ticket receipts."

As explained previously, the "Sign It" program and the customer receipts have limitations and are not guarantees against fraud or theft. As a result, we believe that the Lottery should install self-serve ticket-checker devices as soon as practical and at a reasonable cost.

G. LOTTERY INDIFFERENT TO THE LESSONS OF THE CANADIAN SCANDAL

In late 2006, Canadians learned that lottery retailers had been claiming significantly more major prizes than one would expect given the odds. It would have been only natural to wonder if Iowa had a similar phenomenon.

The Iowa Lottery showed no such curiosity.

The Canadian scandal presented an opportunity for the Iowa Lottery to evaluate and improve its operations and security practices. But the Iowa Lottery did not take meaningful advantage of that opportunity.

When we interviewed the then-Acting CEO – nearly two years after the Canadian scandal first emerged – it became clear that he did not realize there have been cases of Iowa Lottery customers being victimized by retailers and store employees. "You have cases where someone has defrauded a customer," he at one point asked us. He later acknowledged, "I'm not familiar with the cases."

Iowa Lottery management should have been studying the Canadian investigations and implementing improvements as appropriate if for no other reason than the fact that Iowa Code section 99G.7(2) required it:

> The chief executive officer shall conduct an ongoing study of the operation and administration of lottery laws similar to this chapter **in other states or countries**, of available literature on the subject, of federal laws and regulations which may affect the operation of the lottery and of the reaction of citizens of this state to existing or proposed features of lottery games **with a view toward implementing improvements that will tend to serve the purposes of this chapter**. [emphasis added]

Members of the Lottery's upper management team told us that they had read the Canadian investigative reports. But those same managers had difficulty identifying and explaining a number of proactive enforcement policies which were discussed in those reports. When we asked about the practice of requiring retailers to identify themselves when claiming a major prize, the Lottery's recently retired vice president for security described it as "a good idea," then added, "If I would have thought about that back then I could have pursued it."

We responded by noting that we learned about that practice by reading the same Canadian investigative reports that had already been reviewed by Iowa Lottery management. "Well, I must have missed it then," the recently retired vice president for security told us.

The then-Acting CEO expressed concerns about several proactive policies adopted by the Canadian lotteries. But it also became clear that he had not evaluated those policies. When we asked whether he had conducted a cost-benefit analysis, he replied, "I'm waiting to see what you have to say in your report to see just exactly what you found."

H. CONCLUSIONS

The Iowa Lottery and the state government it serves have a self-interest in ensuring that customers are reasonably protected from potential risks. 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.

When we pressed the Lottery's top managers about taking steps designed to reduce the instances of fraud, some resisted. "We may not agree with every remedy that you suggest as being another thing and yet another thing and yet another thing that can be done to make nirvana because I don't think we can get there," the then-Acting CEO told us.

"I don't think there's going to be any perfect system anywhere in the world as long as human beings are involved," a Lottery vice president said.

But taking reasonable steps to establish a proactive Lottery enforcement system is not a pursuit of "nirvana" or "perfection." The purpose instead is to promote the Lottery's integrity and dignity, which is mandated under Iowa Code section 99G.2(3) (2009).

During our interview of the then-Acting CEO, it became clear that he did not realize there have been cases of Iowa Lottery customers being victimized by retailers and store employees. After we told him about several cases of Iowa Lottery customers being defrauded, he proclaimed:

> You haven't demonstrated that anybody is on any appreciable level – out of the millions of transactions, you've got a handful of cases that you say weren't properly handled and we still haven't seen one where anybody got really rooked. I haven't seen it.

We believe this perspective misses the point: The Lottery has a weak, reactive enforcement system where large-scale fraud may be occurring without customers or the Lottery realizing it. The fact that we did not uncover a case of large-scale fraud in our review of three years of Lottery activity should not be viewed as a vindication of the Lottery's deficiencies.

Moreover, the Lottery does not meet its mandate to operate with integrity and dignity by waiting for customers to report large-scale fraud before establishing a proactive enforcement system.

Based on our investigation, we conclude:

1. The Iowa Lottery has not been operating with the degree of integrity and dignity that it could and should, as required by Iowa Code chapter 99G.

2. The Iowa Lottery has not acted reasonably in ensuring that retailers and retailer employees do not take advantage of customers who entrust them with a ticket.

I. RECOMMENDATIONS

This report presents 60 recommendations designed to aid the Lottery in correcting these shortcomings. These recommendations are distributed throughout the various sections of this report and are also consolidated in a final "Recommendations" section.

These recommendations include:

1. The Lottery should propose amending Iowa Code chapter 99G to include the protection of the interests of Lottery customers as a specific objective.

2. The Lottery should adopt a policy requiring that it will pursue restitution from any individual who obtains prize money from stolen tickets and who is subsequently prosecuted for that theft. The Lottery should also seek restitution for prize money claimed by individuals who received a stolen ticket from a person who is subsequently prosecuted in connection with that stolen ticket.

3. The Lottery should develop and implement a program of mandatory e-registration for all Iowa retailers and store employees, similar to the programs already developed by the lotteries in Ontario and Québec. The program should require retailers and employees to electronically register their names and other pertinent information before they can obtain a confidential access code necessary for operating an Iowa Lottery terminal.

4. The Lottery should develop and implement a program of mandatory e-training for all Iowa retailers and their clerks, similar to the programs already developed by the lotteries in Ontario and Québec. This training should incorporate a Retailer Code of Conduct similar to those in Quebec and British Columbia, which require sellers to act in the public interest and abide by general principles of integrity. The successful completion of this training should be documented by the Lottery and kept on file for reference and investigation purposes.

5. The Lottery should consider proposing an amendment to Iowa Code chapter 99G to prohibit any individual convicted of violating chapter 99G from handling Lottery products for any licensee.

6. The Lottery should explore the merits of amending Iowa Code chapter 99G to prohibit retailers and store employees from purchasing and redeeming Lottery products at their place of employment. The purpose is to offset the inherent retailer advantages.

7. The Lottery should consider proposing an amendment to Iowa Code chapter 99G to provide that Lottery products shall not be sold *by* any person who has not reached the age of twenty-one, because the statute already provides that Lottery products shall not be sold *to* any person who has not reached the age of twenty-one.

8. The Lottery's Security Division should implement methods and procedures to ensure that reports of alleged "pickout" activity receive priority treatment.

9. The Lottery's Security Division should develop and implement a policy requiring its investigators to routinely check and document the prize claim history of all identified suspects. The policy should encourage investigators to review previous high-tier prize claims when circumstances warrant.

10. The Lottery should develop a method to flag the names of all theft or fraud suspects so that any subsequent prize claims they submit will be brought to the attention of the Security Division for possible investigation.

11. 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.

12. 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.

13. 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 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.

14. The Lottery should take immediate steps to bolster the customer-education information on its website and in its literature, as well as ensuring that the improved literature is distributed to all licensed retailers.

    The information should clearly emphasize simple steps that all customers can follow to protect their interests. Based on our review of advice on other lottery websites, here is an example of how the new information could be presented:

    SIMPLE STEPS FOR THE SMART LOTTERY CUSTOMER
    Don't become a victim of a scam artist! Here are three simple steps:

    1. **Know** the results of all tickets before handing them to a retailer. Treat each ticket you purchase as a winning ticket until proven otherwise.

    2. **Sign** all tickets as soon as possible after purchase, and definitely before handing them to a retailer. For winning tickets, it might also be a good idea to make a copy of both sides of the ticket, especially if you consider the prize amount to be significant.

    3. **Obtain** all tickets back from retailers, as well as the accompanying receipts. This will allow you to review the results of the transaction, especially if the results differed from what you had determined, or if you observe a retailer acting suspiciously while validating a ticket (in which case you are encouraged to report the matter to the Lottery immediately).

    You can always redeem tickets directly through the Lottery. If you mail a winning ticket to Lottery offices, we suggest that you make a copy of the front and back of your ticket for your records.

Overview

Thomas Jefferson hailed the lottery as the perfect tax … laid only upon the willing.

— Website of Scientific Games Corporation, a major vendor for the Iowa Lottery [1]

When the Legislature first authorized gambling, a bargain was struck: Iowans could buy lottery tickets and wager at racetracks and casinos, but there would be zero tolerance for corruption…. Implicit in that bargain was complete openness, so the people of Iowa could see for themselves the impact of gambling and whether it was being properly policed.

— March 6, 2006, editorial in The Des Moines Register [2]

I. HISTORICAL BACKGROUND

Lotteries played an integral role in early American history. They helped raise money for the Jamestown settlement, Harvard College and even the Continental Army. But after the demise of the scandal-plagued Louisiana Lottery in 1894, lotteries were banned until the 1960s. [3]

In Iowa all forms of gambling were prohibited for more than a century after statehood in 1846. *The Des Moines Register* warned in 1938, "Iowa has been caught in the swirl of a new get-something-for-nothing fad – and it is bingo."[4] The gambling prohibition was lifted in 1972 when voters repealed Article III, section 28 of the Iowa Constitution.[5] The General Assembly in 1973 authorized games of chance such as bingo and raffles, and subsequently authorized:

- Pari-mutuel wagering at horse and dog racetracks (1983).
- A state lottery (1985).
- Excursion boat gambling (1989).

[1] Scientific Games, Lottery Museum Intro, http://www.autotote.com/SGCorp/mus_history.asp (last visited Feb. 27, 2009).
[2] Editorial, *Open Lottery Records, or Pull Machines; Public Deserves Full Information about Gambling*, DES MOINES REG., Mar. 6, 2006, at 8A.
[3] CHARLES T. CLOTFELTER ET AL., STATE LOTTERIES AT THE TURN OF CENTURY: REPORT TO THE NATIONAL GAMBLING IMPACT STUDY COMMISSION (1999), http://govinfo.library.unt.edu/ngisc/reports/lotfinal.pdf.
[4] Mike Kilen, *Fickle Iowans Gamble Billions*, DES MOINES REG., Mar. 12, 2006, at 1A.
[5] LEGISLATIVE SERV. BUREAU (NOW LEGISLATIVE SERVICES AGENCY), IOWA GEN. ASSEMBLY, LEGISLATIVE GUIDE TO GAMBLING IN IOWA (2000), http://www.legis.state.ia.us/Central/LSB/Guides/gaming.htm.

The Iowa Lottery was established in May 1985 as a division of the Department of Revenue (DOR). In 2003, it was removed from the DOR and established as an independent authority in the executive branch, when legislation was enacted creating the Iowa Lottery Authority (Lottery) under Iowa Code chapter 99G.

The enabling legislation includes Iowa Code section 99G.2 (2009), "Statement of purpose and intent," which states in part:

> That lottery games shall be operated and managed in a manner that provides continuing entertainment to the public, maximizes revenues, and **ensures that the lottery is operated with integrity and dignity** and free from political influence. [Emphasis added][6]

The law also mandates the Lottery to develop and maintain a statewide network of lottery retailers that will, among other things, ensure the Lottery's integrity:

> The general assembly recognizes that to conduct a successful lottery, the authority must develop and maintain a statewide network of lottery retailers that will serve the public convenience and promote the sale of tickets or shares and the playing of lottery games while ensuring the integrity of the lottery operations, games, and activities.[7]

The statute criminalizes certain actions in Iowa Code section 99G.36 (2009):

> 1. A person who, with intent to defraud, falsely makes, alters, forges, utters, passes, redeems, or counterfeits a lottery ticket or share or attempts to falsely make, alter, forge, utter, pass, redeem, or counterfeit a lottery ticket or share, or commits theft or attempts to commit theft of a lottery ticket or share, is guilty of a class "D" felony.
>
> 2. Any person who influences or attempts to influence the winning of a prize through the use of coercion, fraud, deception, or tampering with lottery equipment or materials shall be guilty of a class 'D' felony.
>
> 3. No person shall knowingly or intentionally make a material false statement in any application for a license or proposal to conduct lottery activities or make a material false entry in any book or record which is compiled or maintained or submitted to the board pursuant to the provisions of this chapter. Any person who violates the provisions of this section shall be guilty of a class 'D' felony.

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[6] The statute does not explicitly state a preference among the three mandates (provide continuing entertainment, maximize revenues, and operate with integrity and dignity). However, it may be instructive to consider that the word "integrity" appears 16 times in Chapter 99G, while "entertainment" appears twice and "maximizes revenues" appears once. *See* IOWA CODE CHAPTER 99G (2009).

[7] IOWA CODE SECTION 99G.24(1) (2009).

II. IOWA LOTTERY OVERVIEW

> The lottery's performance plan identifies sales, distribution and resource management as its core functions and measures the lottery's effectiveness by the revenues it transfers to the state.
>
> — *Mary Neubauer, Lottery Vice President for External Relations, in 2003 article in Public Gaming International* [8]

In recent years, Lottery press releases and reports have commonly noted that, since its establishment in 1985, the agency has raised more than $1.1 billion for state government programs.[9] The Lottery reported profits of approximately $56.5 million for the fiscal year which ended June 30, 2008.[10] The Lottery's profits are deposited into the state's general fund[11], which pays for various state programs, including education, social services, and public safety.

Agency performance reports state that the Lottery has approximately 112 employees separated into five divisions: Security, Finance, Operations, Sales and Marketing.

The 2004 performance report described the Lottery's product lines:

> **Instant games** generally have a scratch-off covering removed to identify winning tickets….
>
> **Pull-tab tickets** are played by opening tabs to reveal whether a prize has been won.
>
> **Online games** are "numbers" games where computerized tickets are generated from a terminal.
>
> **Touch Play tickets** are dispensed from vending machines that have video monitors that display the results of the ticket while entertaining electronic tones indicate whether the ticket has won a prize. [emphasis added][12]

Sales of Touch Play tickets began in May 2003 under a limited market test involving 30 machines; Touch Play sales went statewide in April 2004.[13] The General Assembly ended the Touch Play program in 2006 after complaints from the public. May 3, 2006, was the final day of the Touch Play program.[14]

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[8] Mary Neubauer, *The Lottery Remakes Itself into a Corporate-Model Lottery*, PUBLIC GAMING INT'L, Sept. 2003, at 8.
[9] IOWA LOTTERY AUTHORITY PERFORMANCE REPORT (2008), http://www.ialottery.com/AboutUs/2008PerformanceReport.pdf.
[10] Id.
[11] *See* IOWA CODE SECTION 99G.2 (2009).
[12] IOWA LOTTERY AUTHORITY PERFORMANCE REPORT (2004), http://publications.iowa.gov/3277/2/Lottery.doc.
[13] February 20, 2006, report by Vice President for External Relations Mary Neubauer to the Gaming Subcommittee of the House State Government Committee.
[14] IOWA LOTTERY, IOWA LOTTERY REPORT ON OPERATIONS (June 2008) (on file with author).

A. LICENSED RETAILERS

The Lottery depends on a network of approximately 2,500 licensed retailers to sell its products and to pay out most prizes worth $600 or less. In communities across Iowa, these retailers and their employees represent the public face of the Lottery system. As of July 2008, most Lottery licenses were held by convenience stores (1,555), grocery stores (365), and bars (189).[15]

Some retailers sell just one of the Lottery's product lines, while others sell all three product lines. Licensed retailers sell and validate tickets through computer terminals provided by the Lottery.

The Lottery sets out rules for licensed retailers to follow, some of which originate in the statute, Iowa Code chapter 99G (2009), and administrative rules. In addition, the Lottery says that licensed retailers are required to follow its "Licensing Terms and Conditions."[16] This document describes numerous rules that licensees must follow, such as:

- "Retailers shall cooperate fully with the Lottery in the investigation of any missing, lost, or stolen tickets."

- "Retailers shall immediately notify the Security Department, if tickets or Lottery property are stolen, lost, or damaged or if the retailer, an owner of the retailer's business, an officer or employee of the business, the business, or an agent of the business is convicted of a felony or gambling related offense."

- "The retailer is responsible for the conduct of its employees and members, which is within the scope of the retailer's lottery license."

The Licensing Terms and Conditions also permit the Lottery to impose license sanctions, up to and including revocation, "if a retailer fails to comply with any applicable law or administrative rule, these terms and conditions, or instructions given to the retailer."

Asked whether the Licensing Terms and Conditions is the "contract" between the Lottery and licensed retailers, then-Acting CEO Ken Brickman responded, "We don't have any separate document that constitutes a contract…. [T]he licensing agreement and terms and conditions are the instruments by which we do business and enforce the requirements and obligations of a retailer."[17]

B. EXTREMELY SMALL ODDS OF WINNING A MAJOR PRIZE

The Lottery sold nearly 198 million tickets in fiscal year 2007. Only 2,101 were "high-tier"[18] prize winners.[19]

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[15] Letter from Ken Brickman, then-Acting CEO, to Ombudsman investigator (Aug. 6, 2008) (on file with author).
[16] *See Appendix A.*
[17] Sworn Interview of Ken Brickman at the Office of Citizens' Aide/Ombudsman (Sept. 17, 2008).
[18] The Lottery defines a high-tier prize as any that is more than $600.
[19] Attachment, Letter from Ken Brickman, then-Acting CEO, to Ombudsman (May 19, 2008) (on file with author).

This means that:

- **0.001 percent** of tickets sold in fiscal year 2007 were high-tier prize winners.
- **99.999 percent** of tickets sold in fiscal year 2007 were not high-tier prize winners.

Put another way, this means that a person (*on average*) would have needed to buy 94,216 Lottery tickets, across all games, in order to expect one high-tier prize winner. When you eliminate the two games that do not produce high-tier prizes (Pick 3 and Pull-tabs), one high-tier win would have been expected (*on average*) for every 67,450 tickets purchased.[20]

Moreover, high-tier prizes are significantly outnumbered by lesser prizes. Among all prizes claimed for each game in fiscal year 2007, here are the percentages that were high-tier prizes:[21]

- Instant tickets: 0.012 percent
- Powerball: 0.008 percent
- Hot Lotto: 0.003 percent
- $100,000 Cash Game: 0.003 percent
- Pick 4: 6.42 percent
- For Pick 3 and Pull-tabs: 0 percent (these two games do not have high-tier prizes)

C. RETAILERS CONTROL PAYOUT PROCESS FOR MOST PRIZE-WINNING TICKETS

The Lottery allows retailers to pay out prizes for all winning tickets worth $600 or less.[22] In fiscal year 2007, retailers paid out 83 percent of all prize money, according to Lottery statistics.[23]

Retailers who pay out prizes on winning tickets generally receive a credit for those payouts from the Lottery.[24] The prize-credit process occurs automatically – with little or no oversight by the Lottery – when stores' electronic terminals signal the Lottery computer system that a prize has been paid by a retailer.

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[20] We obtained these odds through our own calculations of Lottery data; we confirmed their accuracy with statisticians at Iowa State University.

[21] Attachment, Letter from Ken Brickman, then-Acting CEO, to Ombudsman (May 19, 2008) (on file with author).

[22] Conversely, the Lottery's Licensing Terms and Conditions prohibits retailers from paying out any high-tier prize, i.e., more than $600. This prohibition is based on Internal Revenue Service reporting requirements. Sworn Interview of Steve King at the Office of Citizens' Aide/Ombudsman (Sept. 17, 2008.)

[23] Letter from Ken Brickman, then-Acting CEO, Iowa Lottery, to Ombudsman investigator (Nov. 6, 2008) (on file with author).

[24] There is one exception: The Lottery does not credit retailers for prizes paid out on winning Pull-tab tickets, as the cost of those prizes is included in the pre-retail-sale transaction between the Lottery and retailers who sell Pull-tab tickets.

D. RESTRICTIONS DO NOT APPLY TO RETAILERS

Iowa's lottery statute prohibits certain individuals from purchasing Iowa Lottery tickets and from receiving payment for prize winners.[25] This includes Lottery employees and some contractors, as well as immediate family members residing in the same household.

The prohibition does not apply to retailers. In fact, Lottery rules do not prohibit retailers or their employees from purchasing tickets and redeeming prizes at their own stores – even when the same individual is simultaneously "the customer" and "the clerk."

This means that any retailer or clerk who obtains a winning ticket worth $600 or less can conceivably pay himself or herself from the store cash register, with little or no oversight by the Lottery. This raises the question of how many retailers and clerks have been claiming untracked and unscrutinized prizes of $600 or less.

E. SECURITY DIVISION

The Lottery described the Security Division's duties in an attachment to the Lottery's December 2007 report to the Iowa Legislature's Government Oversight Committee:

> The Security Division designs and implements security policies and procedures affecting computer systems, facilities, Lottery and vendor personnel, and product control to insure the total and complete honesty and integrity of the Lottery. Protects the Lottery's premises from intrusion or harm, and recommends unusual circumstances for investigation. Coordinates all licensing matters pertaining to the Lottery.[26] Interprets license rules and recommends appropriate action. Reviews and recommends the selection of all equipment used for Lottery drawings and events. Maintains all equipment to insure randomization of drawings and jackpot events.[27]

While Security Division investigators are on the front lines of safeguarding the Lottery's integrity, they are not peace officers. This primarily means they do not have the power of arrest. "It was kind of a strange job, you know, you're law enforcement but you're not law enforcement," recently retired Investigator Larry Steele told us.[28]

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[25] IOWA CODE SECTION 99G.31(g) and (h) (2009).

[26] The Security Division is also responsible for investigating allegations of theft and fraud involving Lottery products.

[27] *See* ATTACHMENT C, KEN BRICKMAN & MARY NEUBAUER, IOWA LOTTERY, IOWA LOTTERY REPORT ON OPERATIONS (Dec. 2007) (on file with author).

[28] Sworn Interview of Larry Steele at the Office of Citizens' Aide/Ombudsman (Oct. 8, 2008).

III. CANADIAN INVESTIGATIONS INTO RETAILER FRAUD

> [L]otteries are a game of trust and without trust, players will simply take their marbles and go home, depriving the province of important revenue….
>
> When that underlying trust is shaken, the government funding structure based on lottery revenue is placed at risk. That affects not only lottery participants, but everyone.
>
> *— "A Game of Trust," 2007 report by the Ombudsman of Ontario (Canada)*

In 2007 two Canadian ombudsman offices published major investigative reports on retailer fraud involving the provincial lotteries of Ontario and British Columbia. Those investigations were triggered by media reports that some retailers, and some of their employees, were claiming significantly more major prizes than mere chance would suggest.

According to the Ontario Ombudsman's report, a professor of statistics concluded that the rate of Ontario retailers and employees claiming major prizes for instant-ticket games was about 15 times more than expected; while the rate of retailers and employees claiming major prizes for online games was about 3.5 times more than expected.[29]

The British Columbia Ombudsman's report found at least 21 retailers and store employees had claimed multiple major prizes between 1999 and 2007, including:

- One who had claimed 13 prizes, each over $3,000, in one year.
- A second who had claimed 11 prizes in five years for a total of more than $300,000.
- Another who had claimed more than $10,000 every year for three years, and more than $100,000 overall.[30]

Canadian media reports said some store clerks were able to fool customers into thinking they had won a minor prize, when in fact they had won a large prize (and then the clerks would keep the difference for themselves). The most infamous case involved an Ontario retailer who cheated an elderly man out of a winning ticket worth $250,000 (in Canadian dollars), by falsely telling him that he had merely won a free ticket.

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[29] OMBUDSMAN ONTARIO, A GAME OF TRUST (2007), http://www.ombudsman.on.ca/media/3268/a_game_of_trust_20070326.pdf.

[30] OMBUDSMAN BRITISH COLUMBIA, WINNING FAIR AND SQUARE: A REPORT ON THE BRITISH COLUMBIA LOTTERY CORPORATION'S PRIZE PAYOUT PROCESS (2007), http://www.ombud.gov.bc.ca/resources/reports/Special_Reports/Special%20Report%20No%20-%2031.pdf.

The British Columbia report quoted a retailer as follows:

> If the player doesn't understand how to play the ticket, it's quite easy for the retailer to look at the ticket and tell them it's not a winner, throw it into their garbage or recycling, and retrieve it later and validate it.

Based on their investigations, the ombudsmen in Ontario and British Columbia found that their lotteries' lax approach to enforcement had enabled some retailers and clerks to manipulate the process to their advantage, up to and including theft of some customers' winning tickets.

Both reports recommended that the lotteries implement a system of proactive checks and balances designed to reduce the potential for fraud and theft, and to increase the chances that thieves would be detected and held accountable.

They found that two integral components of such a system would be:

- To track, monitor, and analyze prizes claimed by retailers and their employees.
- To automatically review all significant prize claims, with even greater scrutiny placed on prizes claimed by retailers, their employees, and members of their immediate families.

The most significant change was triggered by the Ontario Ombudsman. He found that an inherent conflict exists when a lottery "dependent on retailers for its profits is expected to take on a disciplinary role as well." As a result, he recommended taking regulatory oversight responsibilities away from the Ontario lottery and assigning them to a third-party government agency, independent of the lottery.[31]

In response to the ombudsmen reports, the chief executives of both lotteries were fired, and both lotteries accepted all of the ombudsmen's recommendations (and in several cases the lotteries went beyond what had been recommended).[32] Since then, there has been a sea change in how the Ontario and British Columbia lotteries view the importance of protecting their customers' interests. "The Ombudsman's report released last March provided a clear road map for change," an Ontario lottery official stated. "Improved levels of customer service and protection of lottery products creates a healthy and sustainable organization."[33]

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[31] Regulatory oversight of the Ontario lottery is now handled by the Alcohol and Gaming Commission of Ontario.

[32] The Ontario lottery also implemented a number of improvements in response to recommendations by KPMG, an international auditing firm that the lottery hired as a consultant shortly after the scandal first emerged in October 2006.

[33] Press Release, Ontario Lottery & Gaming Corp., OLG Delivers First Quarterly Status Report to Ontario Ombudsman (June 28, 2007), *available at* http://www.olg.ca/about/media/news_release.jsp?contentID=news_release_070628_01 (quoting Board Chairman Michael Gough).

Investigations of other lotteries across Canada followed, with similar results. "An audit in Nova Scotia found retailers and their employees pocketed 85 winning tickets – each more than $25,000 – for a total of $14 million," one newspaper reported.[34] The same audit found that retailers and their employees "won major prizes ($25,000 and greater) 19 times more than statistically expected."[35]

REPORTS AROUND THE UNITED STATES

There have been no similar investigations of lotteries in the United States. This could create the impression that the threat of retailer fraud is a distinctly Canadian problem. But that impression is contradicted by recent media reports:

- A customer's winning ticket worth $1.4 million was stolen by an Arizona store clerk in 2005.[36]

- In 2007 a 7-Eleven clerk in California was charged with grand theft in connection with a winning ticket worth $555,000. "The female clerk told the customer he won $4 on his Mega Millions picks, and then pocketed his winning ticket worth $555,000," the newspaper article reported.[37]

- In 2008 a store clerk in Louisiana was charged with stealing a customer's ticket that was an $800,000 prize winner.[38] Media reports said she scanned the ticket and told him it was not a winner.

- In 2008 and 2009 the California Lottery conducted undercover sting operations where agents posing as customers presented decoy winning tickets to clerks. Some clerks paid out only a fraction of the prize money, while some said the tickets were not winners and went on to claim the prize money for themselves. The stings led to the arrests of at least ten individuals working at lottery retail outlets.[39]

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[34] Chinta Puxley, *Lotteries Seek to Polish Image,* CAN. PRESS, Dec. 13, 2007, *available at* http://www.conveniencestores.ca/index2.php?option=com_content&do_pdf=1&id=83.

[35] MINISTERIAL PANEL ON TICKET LOTTERY CONTROLS, CONTROLS AND REGULATIONS OF ATLANTIC LOTTERY CORPORATION TICKET LOTTERIES IN NOVA SCOTIA (2007), http://www.gov.ns.ca/lwd/agd/docs/MinAdvisoryPanelTicketLotteryReport.pdf.

[36] David Pittman, *Clerk Accused of Stealing $1M Lottery Ticket*, TUCSON CITIZEN, Aug. 19, 2005, at 1A.

[37] Art Campos, *Big Winner is Nearly Huge Loser; Store Clerk is Accused of Stealing Customer's $555,000 Lottery Ticket*, SACRAMENTO BEE, Aug. 24, 2007, at A1.

[38] Leslie Williams, *Store Clerk Stole Winning Lottery Ticket, Police Say*, TIME-PICAYUNE (New Orleans), Sept. 24, 2008, at 4.

[39] Press Release, California Lottery, Lottery Consumer Protection Operation Stings Retailer Rip-offs (June 26, 2008), *available at* http://www.calottery.com/Media/CurrentQuarter/20082ndQtr/MediaAdvisory_06-26.htm; Press Release, California Lottery, Lottery Stings Retailer Rip-offs in Northern California (Feb. 18, 2009), *available at* http://www.calottery.com/Media/CurrentQuarter/MediaAdvisory_02-18.htm.

A 2001 incident in Kansas prompted the following newspaper editorial[40]:

> [A] store clerk in Topeka tried to cheat a ticket buyer out of – gulp! – a quarter-million-dollar jackpot.
>
> The clerk … told the Kansas Cash ticket-holder that he had won $100 when, in fact, the ticket was worth $255,626....
>
> Yet, the lottery needs to guard its credibility jealously. This is not someone else's problem – in other words, just some rogue clerk. To think that would be missing the point. Certainly buyers need to beware. But any system that would nearly let a clerk rob a customer of a quarter-million is questionable.
>
> The lottery has various levels of security procedures in place, but they need to be rethought. Officials can't sit back and chalk this up to just another criminal in their midst. They need to do everything possible to prevent this kind of thing from happening again.
>
> It's more than the customer's money that's at stake; it's also the lottery's credibility.
>
> How much is that worth?

These media reports highlight instances where clerks were caught and prosecuted. It stands to reason that there have been other such incidents that have been going undetected.

[40] Editorial, *The Kansas Lottery*, TOPEKA CAP.-J., Jan. 2, 2002.

IV. DECISION TO CONDUCT SIMILAR REVIEW

A. OUR PREVIOUS LOTTERY INVESTIGATION

Our office raised the possibility of retailer fraud with the Iowa Lottery in the mid-1990s. We were investigating a complaint about a lottery terminal that had misidentified a winning ticket as a non-winner. In response, then-CEO Dr. Ed Stanek confirmed that terminals can malfunction. But he cited a lack of customer complaints in support of his contention that it was an extremely rare occurrence.[41]

Dr. Stanek objected to our suggestion that he tell Lottery customers what he knew about risks such as terminals malfunctioning. By January 1998 Dr. Stanek accepted my recommendation to improve the language in Lottery literature with the goal of helping customers better understand how to "play the game" (without mentioning that terminals can make mistakes or the risk of retailer fraud, which we had noted during our investigation).

The highlight of our 1998 agreement was that the Lottery agreed to:

- Put the new language on informational stickers "to be placed on or near all lottery terminals, playstations and vending machines."
- Advise retailers to place the stickers in a position unobstructed from the general public and to immediately contact Lottery officials in the event stickers are removed or altered.

B. PRELIMINARY ASSESSMENT

In 2007, in the wake of the Canadian reports, we conducted a preliminary assessment of whether the Iowa Lottery had sufficient safeguards to ensure that prize monies were going to the rightful owners of winning tickets.

We approached the assessment (and this investigation) with the presumption that the vast majority of Iowa retailers and clerks are honest, reputable and do not engage in fraud or theft. At the same time, life experience suggests it would be naïve to assume that no retailers or clerks have been engaging in fraud or theft.

Our preliminary assessment found that even before the scandal emerged, the Canadian lotteries had proactive mechanisms to identify, investigate and respond to suspicious activity by retailers. The ombudsmen found those safeguards were inadequate and were poorly executed by lottery staff. From our preliminary assessment, it was unclear whether the Iowa Lottery had any proactive mechanisms to identify, investigate and respond to suspicious activity by retailers.

[41] Regarding the frequency of terminal malfunctions, we did not disagree with Dr. Stanek. But we have come to the conclusion that the term "rare" is somewhat meaningless in the context of an enterprise with annual sales in the tens of millions.

In addition, even before the Canadian scandal emerged, prize claimants in Ontario had to satisfy the lottery that they were in fact the owner of the ticket.[42] Ontario lottery management had considered moving to a "pay the bearer" policy, which has been the policy of the Iowa Lottery. But according to the Ontario Ombudsman's report, one Ontario lottery manager argued against such a change in an e-mail to other managers:

> If we move to a pay-the-bearer policy, Prize Office staff will no longer make efforts to determine if a ticket is being presented [for] payment by the proper parties. If we don't ask basic questions to determine ownership at the time of redemption it will have implications with respect to stolen tickets … insider wins…. Our ability to deal with these issues will be eroded.[43]

He was expressing concerns about a policy that the Iowa Lottery has had for years.[44]

In response to the Canadian scandal, the lotteries in Ontario and British Columbia began implementing dozens of improvements. We found that the vast majority of those improvements had not been adopted by the Iowa Lottery.

As part of our preliminary assessment, we also conducted a "spot check" of licensed retailers to check the Lottery's compliance with our 1998 agreement. We visited 15 stores that sell Lottery tickets in the Des Moines area, and found only one that had a sticker on or near the terminal in an unobstructed position.

We also reviewed information on the Lottery's website and found that the Lottery had issued two press releases in January 2007 that identified a convenience store clerk as the winner of two significant prizes – $10,000 and then $250,000. Both prizes came from instant-scratch tickets from the store where she works; and both occurred at a time when the Lottery was already tracking news reports from Canada about the issue of retailer fraud and theft.

C. NOTICE OF INVESTIGATION

Based on our preliminary assessment, and under the authority of Iowa Code chapter 2C (2009), I initiated an investigation of the Lottery's oversight of alleged retailer fraud. My decision was communicated to the Lottery in an October 5, 2007, letter to then-CEO Dr. Edward Stanek.[45]

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[42] OMBUDSMAN ONTARIO, A GAME OF TRUST (2007), http://www.ombudsman.on.ca/media/3268/a_game_of_trust_20070326.pdf.

[43] OMBUDSMAN ONTARIO, A GAME OF TRUST (2007), http://www.ombudsman.on.ca/media/3268/a_game_of_trust_20070326.pdf (quoting Apr. 21, 2006, internal e-mail).

[44] IOWA CODE SECTION 99G.31(1) (2009) states, "The chief executive officer shall award the designated prize to the holder of the ticket or share upon presentation of the winning ticket or confirmation of a winning share."

[45] *See Appendix B.*

My letter stated in part:

> This investigation will focus on, but not necessarily be limited to, the following issues:
>
> 1. Whether the Iowa Lottery has been operating with integrity and dignity, as required by Iowa Code Chapter 99G.
>
> 2. Whether the Iowa Lottery has acted reasonably in ensuring that retailers and retailer employees don't take advantage of customers who entrust them with a ticket.

Our 31-page preliminary assessment was attached. My letter included this request:

> Please make available, for our review, all of your agency's investigative files and/or records for calendar years 2006 and 2007 concerning reviews (whether triggered by a customer complaint or not) involving the actions of retailers, retailer employees and Lottery terminals. This would include, but not be limited to, logs and/or notes of a customer's initial attempt to express a concern to the Lottery.

No outside entity had ever before audited the Lottery's investigative case files.

V. LOTTERY RESPONSE

> Since there is no complaint, could it be that the motive of the ombudsman is to get lottery security secrets that most lottery employees do not have access to and use them to compromise the lottery?
>
> *— October 26, 2007, e-mail by then-CEO Stanek to Vice President for External Relations Neubauer*

Soon after the Lottery received my October 5, 2007, notice of investigation, internal Lottery communications show its staff began taking several steps to address some of the issues identified in our preliminary assessment:

1. **October 10, 2007**: The Lottery surveyed 15 stores in the Des Moines metropolitan area and found only two had an "Ombudsman sticker"[46] on or near its terminal in an unobstructed position (as required in the 1998 agreement).[47]

2. **October 10, 2007**: The Lottery placed a "super rush" order for 15,000 new stickers for immediate distribution to all licensed retailers. The e-mail placing the order stated that the Lottery needed the stickers "as soon as possible (super rush) to satisfy the State Ombudsman Office. We hope to have these labels within a week if possible."[48]

3. **October 11, 2007**: The Lottery began conducting, for the first time in its history, regular reviews of individuals claiming multiple high-tier prizes.[49]

4. **Sometime in October 2007 (date unclear)**: The Lottery started making plans to review and discuss the issue of retailer fraud at the next public meeting of the Lottery Board on November 1. Though management had been monitoring developments in Canada since late 2006, this would mark the first time that the Iowa Lottery would discuss the issue of retailer fraud at a Board meeting.[50]

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[46] Internal Lottery communications refer to the labels as "Ombudsman stickers."

[47] E-mail from Tom Warner, Iowa Lottery, to Larry Loss, V.P. for Sales, Iowa Lottery (Oct. 10, 2007) (on file with author).

[48] E-mail from Tammy Cooper, employee, Iowa Lottery, to private vendor (Oct. 10, 2007) (on file with author).

[49] E-mail from Therese Spaulding, Validations Manager, Iowa Lottery, to Steve King, V.P. for Finance, Iowa Lottery (Oct. 11, 2007) (on file with author); Sworn Interview of Therese Spaulding at the Office of Citizens' Aide/Ombudsman (Sept. 15, 2008); Sworn Interview of Steve King at the Office of Citizens' Aide/Ombudsman (Sept. 17, 2008).

[50] IOWA LOTTERY, DEPARTMENT MONTHLY PLAN (undated) (on file with author).

On October 15, 2007, then-Executive Vice President Ken Brickman[51] submitted a preliminary response letter to me.[52] His letter gave no hint that the Lottery was taking behind-the-scenes steps in response to the concerns identified in our preliminary assessment.

Brickman's letter also:

- Suggested that our investigation would be an unnecessary waste of time and resources.
- Accused our lead investigator of being biased against the Lottery and demanded that he be removed from the investigation.
- Implied that the Lottery might be beyond our agency's jurisdiction.

On November 1, 2007, Neubauer presented a memo[53] to the Lottery Board[54] at its regularly scheduled meeting. The primary theme of Neubauer's memo was to assert that the Iowa Lottery took its watchdog role much more seriously than the Canadian lotteries.

Then-Acting CEO Brickman formally responded to my notice of investigation through a November 5, 2007, letter.[55] On the central issue of retailer fraud, Brickman wrote:

> We believe there are individuals who will commit fraud. We doubt that they will exclude the lottery from the list of possible opportunities. However, with the extensive record-keeping associated with lottery products, it is much more likely they will be caught and prosecuted when compared to other types of fraud, such as a retail employee giving change for a $10 bill when he or she actually had been given a $20 bill.

LOTTERY DENIES REQUEST TO REVIEW ITS INVESTIGATIVE FILES

The November 5, 2007, letter by then-Acting CEO Brickman also stated:

> The lottery's investigative files are confidential under Iowa Code Chapters 99G and 22. Instead, we are providing for your review summaries of investigations by the Iowa Lottery Security staff concerning retailers, retailer employees or lottery terminals during calendar years 2006 and 2007.

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[51] Brickman was subsequently appointed Acting CEO, following the October 31, 2007, retirement of Dr. Edward Stanek. On February 4, 2009, Governor Chet Culver appointed Terry Rich as the Lottery's new CEO. The appointment was confirmed by the Iowa Senate on March 5, 2009.

[52] *See Appendix C*.

[53] *See Appendix D*.

[54] The members of the Lottery Board at the time were: Tim Clausen of Sioux City (chairperson), Elaine Baxter of Burlington, Mary Junge of Cedar Rapids, Mike Klappholz of Cedar Rapids, Tom Rial of Des Moines, and State Treasurer Michael Fitzgerald of Des Moines (ex-officio member).

[55] *See Appendix E*.

Attached was a four-page report containing generic one- or two-sentence summaries of 26 cases from 2006 and 54 cases from 2007.

By early December 2007 I began receiving inquiries from the co-chairs of the Government Oversight Committee (Committee). I had previously apprised them that I intended to investigate the issue of potential Lottery retailer fraud. As a result, when the Committee co-chairs became aware of Neubauer's November 1, 2007, memo to the Board, they asked me whether it was related to an investigation by my office.

The Committee subsequently requested appearances from my office and the Lottery at its January 23, 2008, meeting. At that meeting, the Lottery reiterated its position that its investigative files needed to be kept confidential. A newspaper article published the next day reported:

> Neubauer, in addressing the Legislature's Government Oversight Committee on Wednesday, suggested the records couldn't be shared without giving the ombudsman access to security codes and other information that would enable Angrick or someone in his office to rig a Lottery game in their favor.
>
> Angrick told lawmakers he doesn't want any security codes and is only interested in the investigations into citizens' complaints of wrongdoing.[56]

A January 25 article in the same newspaper quoted Brickman as follows:

> Some of those files would have exhibits, pieces of information, that would disclose how we catch crooks, how we protect our system, how our system operates internally. That information we can't disclose.[57]

However, within a week Brickman allowed my investigators to have full access to the Security Division's complaint files. My investigators did not find any files containing "security codes."

We later asked Security Division officials about upper management's stated concerns regarding "security codes." Included was the following exchange with Harry Braafhart, the recently retired Vice President for Security:

> *Braafhart*: Nothing was removed or redacted that I am aware of. At all.
>
> *Ombudsman investigator*: Can you fathom then why people who were not in [the] Security Division were telling us that there were things in those files that needed to be protected from our eyes?
>
> *Braafhart*: No.[58]

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[56] Clark Kauffman, *Investigation Looks at Lottery Security*, DES MOINES REG., Jan. 24, 2008, at 1A.
[57] Clark Kauffman, *Official Seeks Leads on Lottery Problems*, DES MOINES, REG., Jan. 25, 2008, at 1B.
[58] Sworn Interview of Harry Braafhart at the Office of Citizens' Aide/Ombudsman (Oct. 8, 2008).

Asked what input he made on the issue, Braafhart told us:

> I said that I am proud of the job that my investigators have done over the years and I said as far as I'm concerned anybody can look at those files.

And later in the same interview:

> *Ombudsman investigator*: Had you communicated up to that point that indeed you didn't see any security codes or Social Security Numbers or anything that needed protection?
>
> *Braafhart*: Yes. I made that statement.
>
> *Ombudsman investigator*: To the other VPs [vice presidents] and CEO?
>
> *Braafhart*: Yes.

VI. OMBUDSMAN INVESTIGATION

A. SECURITY DIVISION CASE FILES

Beginning on February 6, 2008, we spent several days at Lottery headquarters reviewing all of the Security Division's investigative case files for calendar years 2005, 2006, and 2007. This involved approximately 434 files.

We subsequently identified approximately 122 files that involved alleged impropriety by retailers or their employees. Our review of those 122 files forms the basis for many of the findings and conclusions in this report.

We divided the 122 files into three general categories:

1. CUSTOMERS ALLEGING IMPROPRIETY BY RETAILERS: 34 CASES

These cases involved incidents where customers complained about the actions of a retailer or store employee.[59] We determined that the majority of these complaints were essentially substantiated by Security Division investigators.

These complaints of retailer impropriety involved a variety of issues with differing levels of significance. One customer reported that a clerk mistakenly ripped up his $2,500 winning instant ticket; he was able to redeem it at a regional office.[60] Another customer said she picked her own Powerball numbers on a "play slip"[61] and handed it to a clerk, only to later realize that the clerk had given her a ticket with the wrong numbers. She contacted the Lottery because she said the clerk was "very nasty" when she went back to explain the problem.[62]

Two files involved store employees who were found to have stolen a customer's winning ticket. Each case involved a customer who reported accidentally dropping a winning ticket at a store, and a store employee who later found the ticket and cashed it for herself.

In the first case, a customer reported that he lost a $1,000 winning Touch Play ticket at a store. A store employee later found the ticket and cashed it. She eventually gave the prize money to the customer after police threatened to charge her with Lottery theft.[63]

The other case involved a customer who reported that he had lost a $50 winning ticket at a store. The investigation revealed that the clerk later found the ticket and redeemed it, even though she knew it belonged to the customer. The clerk was prosecuted for theft. Out of the three years of case files that we examined, this was the *only* case where a retailer or store employee was prosecuted for victimizing a customer.[64]

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[59] Of these 34 files, two were from 2005, four were from 2006, and 28 were from 2007.

[60] Iowa Lottery Security Investigator Report, Case No. 07-057 (2007).

[61] Then-Acting CEO Brickman explained that a "play slip" is "a piece of paper stock that has boxes on it where a player who chooses to pick their own numbers and doesn't want the clerk to enter those numbers manually into the terminal … that player can then fill out the boxes on their own and hand it to the clerk."

[62] Iowa Lottery Security Investigator Report, Case No. 07-010 (2007).

[63] The case file [Iowa Lottery Security Investigator Report, Case No. 06-085 (2006)] noted that the same clerk also had a $1,000 Touch Play prize claim from two months prior. But the Lottery investigator did not review that prior prize claim to see whether it involved similar circumstances.

[64] Iowa Lottery Security Investigator Report, Case No. 06-095 (2006).

At least six customers alleged that a store shortchanged them during transactions. This included three who were still owed a dollar or two from relatively complicated transactions involving Lottery tickets and purchases of gas or merchandise.[65]

Three other customers complained that they redeemed winning tickets worth $1,000, but that retailers kept several hundred dollars of the prize winnings.[66] In each case, the retailer falsely claimed that several hundred dollars needed to be kept for withholding taxes. The retailer later claimed the prize money from the Lottery. The Security Division did not report any of these incidents to law enforcement or prosecutors, nor did it consider whether to impose license sanctions against the stores, even though two of the cases involved store owners.[67]

2. INTERNAL THEFTS PROSECUTED: 54 CASES

These cases generally involved store employees who were accused of, and subsequently prosecuted for, Lottery-related theft or fraud.[68] The vast majority (47) involved store employees who were charged with stealing instant tickets from the stores where they worked. One case involved a bowling alley manager who was prosecuted for redeeming counterfeit Touch Play tickets at other stores.[69] Another case involved a clerk who tried to redeem an altered Pull-tab ticket at another store.[70] Five cases involved theft of other items, such as Pull-tab tickets, online tickets, and even cash from Lottery machines.[71]

To provide a glimpse into what occurs in cases of internal theft, we have compiled some representative segments from actual cases.[72]

The 54 cases which led to prosecutions involved 61 separate defendants who were employees. Four cases involved multiple defendants. One case involved a mother and her teen-age daughter.[73]

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[65] Iowa Lottery Security Investigator Report, Case No. 07-051 (2007); Iowa Lottery Security Investigator Report, Case No. 07-092 (2007); Iowa Lottery Security Investigator Report, Case No. 07-143 (2007).
[66] The mere act of a retailer redeeming a $1,000 prize-winning ticket (or any prize winner of more than $600) is a violation of the Lottery's Licensing Terms and Conditions, as previously noted.
[67] Iowa Lottery Security Investigator Report, Case No. 05-072 (2005); Iowa Lottery Security Investigator Report, Case No. 05-092 (2005), Iowa Lottery Security Investigator Report, Case No. 06-053 (2006). These cases will be discussed in greater detail in the "Findings and Analysis" section of this report.
[68] Only one of these 54 cases did not involve a store employee. The lone exception involved a woman who was prosecuted for stealing $167 worth of tickets from the Lottery's regional office in Mason City. She was able to access the tickets while cleaning the offices as an employee of a contractor. Iowa Lottery Security Investigator Report, Case No. 07-062 (2007).
[69] Iowa Lottery Security Investigator Report, Case No. 06-101 (2006).
[70] Iowa Lottery Security Investigator Report, Case No. 07-076 (2007).
[71] Iowa Lottery Security Investigator Report, Case No. 05-105 (2005), Iowa Lottery Security Investigator Report, Case No. 05-108 (2005); Iowa Lottery Security Investigator Report, Case No. 06-046 (2006); Iowa Lottery Security Investigator Report, Case No. 07-059; Iowa Lottery Security Investigator Report, Case No. 07-114 (2007).
[72] *See Appendix F*.
[73] Iowa Lottery Security Investigator Report, Case No. 06-051 (2006).

3. INTERNAL THEFTS NOT PROSECUTED: 34 CASES

These cases involved incidents where store employees were alleged to have committed Lottery-related theft or fraud, but were not prosecuted. Of these 34 cases, we determined that 33 were essentially substantiated – meaning the employer and/or the Lottery investigator found that an internal theft had occurred. Of the 33 cases that were substantiated, more than half (20) were not reported to law enforcement or to prosecutors.[74]

Of the 33 cases that were substantiated, 27 involved store employees who were found to have stolen instant tickets from the stores where they worked. The other six cases involved theft of Pull-tab tickets, online tickets, or cash from Lottery machines.[75]

Those 33 substantiated cases involved 41 suspects. Five cases involved multiple suspects. One case involved a mother, her two daughters, and her boyfriend.[76]

4. ADDITIONAL CASES OF INTERNAL THEFT

We also found approximately 154 other case files identified by the Lottery as involving theft that was not internal (thefts that did not involve a store employee). A cursory check revealed that some of these cases were unresolved, with no suspect being identified, and could have involved store employees.

Here are three examples:

1. A store owner reported a pack of instant tickets had been stolen. He said the pack was delivered while he was away on vacation and said "the last time anyone saw this pack of tickets they were on his desk." The file noted that the owner was filing a report with local law enforcement.[77]

2. A store reported that a pack of instant tickets was stolen from the ticket dispenser. "Unknown how or when or who," the investigator wrote. He encouraged the manager to report the incident to local law enforcement.[78]

3. One of the Lottery's regional offices reported that nine packs of instant tickets (with a retail value of $2,700) were missing from a store. An investigator called the store and left a message for the manager to call back. "No one ever called back," the investigator wrote. He then closed the case.[79]

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[74] This is noteworthy in light of IOWA CODE SECTION 99G.35(1) (2009) ("The lottery security office shall perform all of the following activities in support of the authority mission…. Report *any suspected violations* of this chapter to the appropriate county attorney or the attorney general and to any law enforcement agencies having jurisdiction over the violation.") (Emphasis added).

[75] Iowa Lottery Security Investigator Report, Case No. 05-004 (2005); Iowa Lottery Security Investigator Report, Case No. 05-046 (2005); Iowa Lottery Security Investigator Report, Case No. 05-050 (2005); Iowa Lottery Security Investigator Report, Case No. 06-002 (2006); Iowa Lottery Security Investigator Report, Case No. 06-110 (2006); Iowa Lottery Security Investigator Report, Case No. 07-077 (2007).

[76] Iowa Lottery Security Investigator Report, Case No. 06-122 (2006).

[77] Iowa Lottery Security Investigator Report, Case No. 07-069 (2007).

[78] Iowa Lottery Security Investigator Report, Case No. 05-027 (2005).

[79] Iowa Lottery Security Investigator Report, Case No. 05-098 (2005). It is worth noting that the Licensing Terms and Conditions requires retailers to report any instances of tickets being stolen and to cooperate with the Security Division's attempts to investigate such matters. Neither of these requirements was noted in

Internal theft should not be ruled out simply because the suspect(s) was not identified. This means that an unknown number of these 154 other files may have involved internal theft, which in turn means that there likely were more cases of internal theft than the 88 previously referenced in this section.

B. OTHER INVESTIGATIVE RESOURCES

For many of the Security Division's case files, in order to understand what actually occurred, it was necessary to obtain additional information from other sources, especially police reports and court files. Towards this end, we identified and contacted:

- Investigating law enforcement agencies to obtain incident and supplemental reports.
- Appropriate clerks of court and prosecutors to obtain court-related documents and information.
- Various store officials and customers who filed complaints.

We also obtained and reviewed the following relevant information:

- Lottery records from 2006 and 2007 that involved customer complaints which were not forwarded to the Security Division.
- The Lottery's database of prize claimants to determine the full history of high-tier prizes claimed by suspect retailers and store employees, as well as other individuals who claimed multiple major prizes.[80]
- Suspects' criminal backgrounds on Iowa Courts Online.[81]
- Restitution orders.
- Hundreds of Lottery press releases over the past several years, which allowed us to identify dozens of retailers and store employees who have claimed major prizes.[82]
- Various online sources to confirm the identity of various suspects (from the Security Division's case files) and/or winners of major prizes.
- The two Canadian ombudsman investigative reports regarding their provincial lotteries.

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this case file.

[80] The database we reviewed is comprised of 213,100 prize claims paid out by the Lottery (including its five regional offices) from May 10, 1986, through February 15, 2008. The database does not include any prize claims paid by retailers, which includes the vast majority of prize claims for $600 and less.

[81] Iowa Courts Online Search, http://www.iowacourts.state.ia.us/ESAWebApp?SelectFrame (last visited Feb. 27, 2009).

[82] Internet Archives, Wayback Machine, http://www.archive.org/web/web.php (last visited Feb. 27, 2009); Iowa Lottery, Press Room, http://www.ialottery.com/PressRoom/PressRoom_WinnerNews.html (last visited Mar. 2, 2009).

- Relevant information from the websites of several lotteries, including status reports by the Ontario, British Columbia and Québec lotteries regarding progress towards implementing dozens of recommendations for improvement.

- Media reports from Iowa, other states and Canada.

- Responses to dozens of written questions and information requests that we made to the Lottery during this investigation.

- Sworn interviews of 12 Lottery employees and two recent Lottery retirees.[83]

C. CONTACTS FROM PUBLIC

In January 2008 the media reported my request encouraging the public to contact my office with concerns about the Lottery. In response, we received several dozen contacts from the public.

Here are some representative samples of comments made by these individuals:

- "I know a lot of people who work in c-stores [convenience stores] and they all say co-workers have pulled this scam at some point."

- "I have been told (heard) that others are aware of ticket 'sellers' holding 'dead/loser' tickets near a machine and running those thru instead of running the ones you give them. I have not seen this myself, but because of the many articles I have been reading, I am watching the vendors more closely when turning in my tickets."

- "I have had two occasions over the years where I knew I had a small winner and the clerk told me I did not have a winner. I had them check again and they then found their 'error.' I believe it was a mistake both times on their part or I would have reported it to lottery headquarters."

[83] The sworn interviews were transcribed; verbatim quotes from those transcripts are included throughout this report. The two recent retirees were Vice President for Security Harry Braafhart and Lottery Investigator Larry Steele. In addition, we interviewed Vice President for Finance Steve King the day before his retirement from the Lottery. We did not interview former Lottery CEO Dr. Edward Stanek, who retired on October 31, 2007.

Findings and Analysis

I. SOME RETAILERS HAVE BEEN UNCOMMONLY LUCKY

In 2007 a northwest Iowa store owner claimed a $250,000 prize from an instant ticket that came from her store. Her big win was announced in a press release issued by the Iowa Lottery:

> [The retailer] was spending the day with her girlfriend … when they decided to stop by the store to see her husband…. [They] own the store.
>
> "On my way to give [her friend] a ride to her house, we just drove through the drive through [of the store] and [my husband] said, 'Here, why don't you just scratch some lottery tickets?'"
>
> [The retailer] scratched the tickets on the spot and revealed the big winner![84]

A. REPEAT RETAILER WINNERS

One out of 67,000. Those are the approximate chances of buying an Iowa Lottery ticket and having it win a high-tier prize (more than $600).[85]

Iowa retailers and their employees have claimed dozens of high-tier prizes. In 2007 alone, we found that retailers and store employees claimed at least 28 high-tier prizes, totaling $676,352. Those prize winners included a store owner (mentioned above) and a store clerk, both from northwest Iowa, who each claimed $250,000 prizes from instant tickets from the stores where they worked.[86] In all of 2007, only seven other people claimed an instant-ticket prize for $250,000 or more. We could not establish whether any of the other seven involved retailers or store employees.

The Iowa Lottery was already tracking the developing scandal in Canada when it received those two $250,000 prize claims in early 2007. The Iowa Lottery did not investigate either prize claim before honoring them. Through our investigation, we found that the Iowa Lottery generally does not investigate prize claims by anyone unless it has received a complaint.

We found that the store owner and the store clerk have also claimed other big prizes. The store owner (and her husband) have claimed 16 prizes since 1991 for a total of $263,501; 11 of their claims have occurred since 2004. The store clerk alone claimed eight prizes for $266,000 in less than one year's time.[87]

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[84] Press Release, Iowa Lottery, Sibley Woman Wins $250,000 (Apr. 9, 2007) (on file with author).

[85] We obtained these odds through our own calculations of Lottery data; we confirmed their accuracy with statisticians at Iowa State University.

[86] *Lucky Lake Park Woman Wins Second Big Prize*, LOTTERY ACTION (Iowa Lottery, Des Moines, Iowa), Feb. 19-Mar. 4, 2007 at 2.

[87] These prize claim histories are based on our review of the Lottery's database of prize claimants, and also our review of the Lottery's online "Big Winners List." Iowa Lottery, Recently Claimed Big Prizes,

In all, we found nine retailers and store employees who have claimed five or more high-tier prizes – the odds for winning one of which are about one in 67,000. At least four of those nine claimed additional prizes in late 2008 or early 2009. This includes a northern Iowa retailer who has claimed 67 prizes over the past several years (March 2005 through March 2009) for a total of $100,626.[88]

B. LIST OF RETAILER PRIZE CLAIMS NOT COMPLETE

The Lottery does not track prizes claimed by retailers and their employees. As a result, we compiled a partial list by reviewing various resources, including hundreds of Lottery press releases, some of which have identified winners as retailers or store employees.

But our list of prizes claimed by retailers and their employees is undoubtedly far from complete. The resources we relied upon allowed us to review many of the Lottery's press releases for the past several years, but some were not available. In addition, the Lottery does not require retailers or their employees to identify themselves as such when claiming a prize. This means there likely have been other retailers and store employees who claimed major prizes but were not identified as such in the Lottery's press releases.

This in turn means that the number and value of Iowa Lottery prizes claimed by retailers and their employees is unknown.

C. RETAILER PRIZE CLAIMS THAT SHOULD HAVE BEEN REVIEWED

We found prizes claimed by retailers and store employees under circumstances that should have triggered a closer review. The tickets that led to these prizes all came from the stores where the prize claimants were employed. For example:

- A clerk from a northwest Iowa convenience store claimed a $30,000 instant-ticket prize in July 2006, just one month after the Security Division was informed that another employee of the same store was being prosecuted for lightly scratching instant tickets, selling the losing tickets, and redeeming the winners.[89]

- An assistant manager of a central Iowa convenience store claimed a $100,000 instant-ticket prize in February 2006, just one day after a property she owned was sold to a bank in response to a foreclosure action.[90]

- A clerk from a southeastern Iowa liquor store claimed a truck valued at $28,000 through an instant scratch ticket in November 2003. Earlier that year, he had lost a $26,057 judgment to an auto finance company, court records show. He had also lost possession of a motor vehicle in 2002 after being sued by the finance company.[91]

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http://www.ialottery.com/WinnersCircle/WinnersCircle_claimedprizes.asp (last visited Mar. 25, 2009).

[88] Id.

[89] Press Release, Iowa Lottery, Fort Dodge Store Clerk Wins $30,000 (July 12, 2006) (on file with author); Iowa Lottery Security Investigator Report, Case No. 06-100 (2006).

[90] *Des Moines Woman Gets $100,000 Birthday Present*, LOTTERY ACTION (Iowa Lottery, Des Moines, Iowa), Feb. 20-Mar. 5, 2006, at 3; and court records reviewed through Iowa Courts Online Search, http://www.iowacourts.state.ia.us/ESAWebApp?SelectFrame (last visited Feb. 27, 2009).

[91] Press Release, Iowa Lottery, Sigourney Man Wins New Chevy Truck (Nov. 4, 2003) (on file with author) and court records reviewed through Iowa Courts Online Search, http://www.iowacourts.state.ia.us/ESAWebApp?SelectFrame (last visited Feb. 27, 2009).

We also found that some store employees who pled guilty to Lottery theft had claimed big prizes in the past. This includes:

- The manager of a northeastern Iowa convenience store who pled guilty to first-degree theft in 2008 in connection with the theft of $45,204 in tickets and cash from a Pull-tab vending machine. The same manager had claimed a $10,000 instant-ticket prize in September 2006; and overall, he had claimed 17 prizes totaling $33,290.[92]

- The manager of a northeastern Iowa bowling alley who admitted that he redeemed counterfeit Touch Play tickets in May 2006. Six weeks before, he claimed a $10,000 Touch Play prize.[93]

Given the evidence it had gathered against those two managers, it would be reasonable to expect that the Lottery would have retroactively investigated their prior prize claims. However, the investigator who handled both cases first learned about those prize claims when we asked him about them.[94]

We found one similar prize claim that was retroactively investigated. It involved the gift shop manager from an eastern Iowa riverboat casino. She was accused of stealing hundreds of instant tickets from the gift shop in 2007.

The Lottery case file[95] includes a Division of Criminal Investigation (DCI) file, which shows that the manager's employer suspected that she may have also stolen a $50,000 winning instant ticket in 2006, as it also originated from the gift shop.

Because of the employer's suspicions, the DCI investigator interviewed the gift shop manager about the origins of the $50,000 winning ticket from 2006. The Lottery's 2006 press release about that prize claim had quoted her as saying:

> The one who takes my place at work came in and [as I was leaving] I said, "Two Lucky 7's. I'll see you later. I'm going home to relax for the night." Then I got home and I'm like, "Oh my gosh! Honey, we won!"[96]

However, the gift shop manager told the DCI investigator that her 2006 press-release statement was not true, according to the DCI file. The manager said she had actually "played" the $50,000 winning ticket during her shift at the gift shop. She also said that she had purchased that ticket before "playing" it.

Because there was no evidence to the contrary, no charges were filed related to the $50,000 prize claim from 2006. The gift shop manager eventually pled guilty to second-degree theft in connection with the theft of hundreds of tickets in 2007.

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[92] Iowa Lottery Security Investigator Report, Case No. 07-114 (2007) and our review of the Lottery's database of prize claimants.
[93] Iowa Lottery Security Investigator Report, Case No. 06-101 (2006) and our review of the Lottery's database of prize claimants.
[94] Sworn Interview of Larry Steele at the Office of Citizens' Aide/Ombudsman (Oct. 8, 2008).
[95] Iowa Lottery Security Investigator Report, Case No. 07-140 (2007).
[96] Press Release, Iowa Lottery, Bride-To-Be Wins $50,000 Playing Iowa Lottery (Oct. 24, 2006) (on file with author).

We found that the gift shop manager had also claimed three other high-tier prizes totaling $8,000 in the months before she was accused of stealing instant tickets.[97]

D. OTHERS WITH SIGNIFICANT PRIZE CLAIM HISTORIES

We found that approximately 173 people have claimed at least five high-tier prizes over the history of the Lottery, when Touch Play prizes are excluded. When Touch Play is included, about 791 people have claimed at least 10 high-tier prizes.[98]

For the vast majority of these individuals, we were unable to determine whether they have worked for stores that sell Lottery tickets. It is therefore possible that some of these individuals were also retailers or store employees.[99]

[97] Based on our analysis of the Lottery's database of prize claimants.
[98] All of these prize claim histories are based on our review of the Lottery's database of prize claimants.
[99] For more information and analysis regarding individuals with significant prize claim histories, *see Appendix G, "Major Winners."*

II. INHERENT RETAILER ADVANTAGES

> *Ombudsman investigator*: So if clerks have greater access to lottery tickets, if they act as a change agent for the lottery in paying out prizes and accepting money in, by virtue of that additional access should they be held to a higher standard than a player from the general public?
>
> *Larry Steele*: Well, they're actually an agent for the state by selling that. Yes, they should have a little higher standard.
>
> — *Exchange during October 8, 2008, interview of recently retired Investigator Larry Steele*

Several Canadian lotteries consider retailers and their employees to be "insiders" who should be subjected to additional scrutiny when they claim major prizes.

In her November 1, 2007, memo to the Lottery Board, Vice President for External Relations Neubauer noted that Iowa law does not consider retailers or their employees as "insiders." She wrote that retailers "don't have access to confidential information associated with the lottery and they can't affect the outcome of drawings."

We grant that retailers and their employees do not have access to confidential information and cannot affect the winning numbers that are drawn for online games like Powerball. However, among people who are inclined to steal Lottery tickets, those who sell them have several inherent advantages.

In interviews with our investigators, employees of the Security Division generally acknowledged that retailers and their employees have inherent advantages and, in turn, should be held to a higher standard than customers.[100]

Our analysis has revealed that retailers and their employees have at least four distinct, inherent advantages:

1. **Direct access to unsold tickets.** From 2005 through 2007, the Lottery received an average of about 25 reports annually of store employees stealing unsold tickets from the stores where they were employed.

2. **Control over validation procedures.** Retailers and their employees control the process of validating customers' tickets (i.e., scanning them through the terminal to see if they are winners). During this process, retailers and clerks have temporary control of customers' tickets. This can enhance the ability of a scam artist to trick customers without their realization.

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[100] Sworn Interview of recently retired Vice President for Security Harry Braafhart at the Office of Citizens' Aide/Ombudsman (Oct. 8, 2008); Sworn Interview of Investigator Supervisor John Ellison at the Office of Citizens' Aide/Ombudsman (Sept. 19, 2008); Sworn Interview of recently retired Investigator Larry Steele at the Office of Citizens' Aide/Ombudsman (Oct. 8, 2008); Sworn Interview of Investigator Ken Moon at the Office of Citizens' Aide/Ombudsman (Sept. 19, 2008).

As for how this can yield an advantage, consider "palming," a technique found by the Canadian investigations. With palming, a dishonest retailer would keep a few losing tickets near the terminal. When any unsuspecting customer would hand over a ticket to see if it was a winner, the retailer would use his palm to discretely swap that ticket with one of the known losing tickets. The retailer then entered the non-winning ticket into the terminal scanner, which produced a "Not a Winner" receipt to be handed to the customer. Unless the customer was on top of the situation, they would leave the store and the retailer could later check the customer's original ticket and claim any prize for himself.[101]

A slightly different scam was described in "Lottery Action," a periodic newsletter that the Iowa Lottery publishes for licensed retailers. A customer tried to redeem what she thought was a winning ticket but the clerk said the ticket was a non-winner. "The clerk then threw the ticket in the wastebasket behind the counter," the article said. "The player asked for the ticket back and the clerk gave her a ticket, but she did not believe it was the same one she had just scratched. The next day, the player said she was shopping at another store and witnessed the clerk from the day before cashing a $250-winning ticket at that store."[102]

The clerk was eventually charged with felony theft of the customer's ticket. While that clerk was caught, it was only because of an unlikely occurrence – the customer happened to see the clerk cashing the ticket the next day at another store.

This shows how temporary control over a customer's ticket can create an advantage for a thief – even in situations where a customer already knows that the ticket is a winner before handing it to a clerk.

3. **Control over prize payout procedures.** Retailers and their employees also can control the payment of prizes worth $600 or less. (Stores paid out 83 percent of all prize money in fiscal year 2007, according to Lottery statistics.[103]) The Canadian investigations described a technique which illustrates how this can yield an advantage (referred to as "partial win payment"). In this scenario, a clerk tells customers that they've won a smaller amount than the actual prize, i.e., telling a customer he has won $50 when it was actually $250, and then pockets the difference.

   In addition, retailers and their employees can pay themselves for the vast majority of winning tickets with no review by the Lottery. This means that for any winning tickets gained illicitly, a retailer scam artist can pay himself or herself the prize money for the vast majority of those winning tickets, with no record of who claimed those prizes.

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[101] In his public comments, then-Acting CEO Brickman has acknowledged that palming has probably occurred in the context of the Iowa Lottery. *See* Clark Kauffman, *Official Seeks Leads on Lottery Problems*, DES MOINES REG., Jan. 25, 2008, at 1B ("I would say that, far and away, the vast majority of all the retail clerks in Iowa are honest, good people. Could you find a foul ball occasionally that would palm a lottery ticket? Sure.").

[102] *Player Helps Security Catch Theft Suspect*, LOTTERY ACTION (Iowa Lottery, Des Moines, Iowa), Oct. 22-Nov. 4, 2001, at 3.

[103] Letter from Ken Brickman, then-Acting CEO, Iowa Lottery, to Ombudsman investigator (Nov. 6, 2008) (on file with author).

4. **Heightened awareness of how to play and how to win.** This advantage is best explained by a statement from the Ontario Ombudsman's report, "A Game of Trust." It stated in part, "[R]etailers, as a number of statistical experts suggested, have a natural advantage over other players through their exposure to the lottery system. Retailers are privy to a great deal of information regarding the precise odds of winning particular games, and the number of unclaimed prizes."

   As for how this could work in practice, consider the following comment that was submitted anonymously to *The Des Moines Register* website, in connection with an article about our investigation: "Another trick I heard from an old friend years ago was that while he sold tickets he would ask customers if they had won anything. Knowing that about every fifth or sixth ticket was a winner for certain games it was like shooting fish in a barrel for him. Near the end of the day they had purchased several tickets with 75% of them being winners. They just sat all day keeping track of the ticket count an(d) increasing their odds of winning."[104]

[104] Anonymous online commenter to article by Clark Kauffman, *Investigation Looks at Lottery Security*, DES MOINES REG., Jan. 24, 2008, at 1A.

III. THE NEED TO REDUCE THE INHERENT RETAILER ADVANTAGES

> Many other jurisdictions recognize that although the vast majority of retailers are honest and law-abiding, the obligation to ensure public trust and confidence as well as the integrity of the lottery system requires proper checks and balances to guard against theft or fraud or other insider advantages.
>
> — *"A Game of Trust," 2007 report by the Ombudsman of Ontario (Canada)*

> When lotteries were introduced, determining if you had a winning ticket was a manual process carried out by the ticket holders. Changes to the control systems were not adequately considered as lotteries grew in popularity and technology was introduced.
>
> — *"Controls and Regulation of Atlantic Lottery Corporation Ticket Lotteries in Nova Scotia," report issued in October 2007 by the Nova Scotia Ministerial Panel on Ticket Lottery Controls*

In the United States, lotteries were generally successful until the late 19th century. But by 1894, major scandals brought down the Louisiana Lottery, which had operated nationally. This triggered a backlash and lotteries were outlawed for the next seven decades.

It is probably not a coincidence that most modern lotteries openly acknowledge their need to maintain integrity. In Iowa, the Lottery's need to operate with "integrity and dignity" is mandated in the law that established the agency.

How can the Lottery ensure that it is operating with integrity, particularly in light of the inherent retailer advantages? The Canadian investigations revealed that to maintain integrity, a lottery needs to establish a proactive system of checks and balances that will reduce the inherent retailer advantages; and then it must apply those checks and balances with vigorous oversight. Such efforts can help ensure that customers' interests are reasonably secure, and that thieves are routinely held accountable.

We identified four integral components that are necessary for a lottery enforcement system to effectively neutralize the inherent retailer advantages:

A. Proactive enforcement procedures

B. Effective complaint-handling practices

C. Holding violators accountable

D. Educating and protecting customers

The remainder of this section will describe these components. Subsequent sections of this report will analyze the Lottery's performance in achieving a meaningful enforcement system.

A. PROACTIVE ENFORCEMENT PROCEDURES

In a perfect world, any customer cheated out of a ticket or prize money would realize it and report it for investigation. Operating on a "complaint only" basis might be sufficient.

But that is not how things work in the real world. The primary goal of a scam artist is to victimize people without their knowledge. When they succeed, their crime will be invisible to a "complaint only" model, because victims do not file complaints about crimes they're not aware of. The Canadian investigations found that if a lottery is not proactively looking for incidents involving fraud and/or theft, it will miss a good share of such activity.

There are numerous policies that a lottery can adopt and implement under an umbrella of proactive enforcement. Here are several examples that have been adopted by the Canadian lotteries:

1. Automatic prize-payout interviews of all winners at or above a certain threshold

2. Tracking and analyzing prize claims by retailers and their employees

3. Automatic investigations of all prize claims by retailers and their employees at or above a certain threshold

4. Regular integrity testing, which allows a lottery to proactively monitor retailers' compliance with the lottery's rules and regulations

B. EFFECTIVE COMPLAINT-HANDLING PRACTICES

"We take these complaints very seriously." That was one of the first things Iowa Lottery Investigator Roger Mott told the manager of a central Iowa grocery store after driving there from Iowa Lottery headquarters in Des Moines in July 2007.[105]

Mott's drive was triggered by a phone call from a woman who reported seeing teen-agers buying Pull-tab tickets at the grocery store. If true, those purchases were illegal, since Iowa law bans anyone under the age of 21 from buying Lottery products.

Mott was unable to determine the identities of the teen-agers. But in response to his suggestion, store management moved the machine that dispenses Pull-tab tickets so it would be easier for store employees to monitor who was buying tickets. In short, Mott took an active interest in the matter, and his actions resulted in an improved situation.

We found other examples of similar efforts by the Iowa Lottery's Security Division:

- Investigators worked with DCI agents and local law enforcement on undercover projects regarding illegal gambling devices.[106]

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[105] Iowa Lottery Security Investigator Report, Case No. 07-075 (2007).

[106] Iowa Lottery Security Investigator Report, Case No. 05-088 (2005); Iowa Lottery Security Investigator Report, Case No. 06-096 (2006).

- A woman reported that a $3,050 winning ticket was missing from her purse after she had "passed out" at another individual's apartment and awoke the next afternoon. About a week later, a man presented the ticket and a prize claim form to the Lottery. Because the ticket had been flagged as stolen, a Lottery investigator questioned the man, who said he had found the ticket in a parking lot.

  The investigation found that the man was telling the truth. However, the Lottery gave the prize money to the woman.[107]

- A store in Black Hawk County was reportedly using illegal advertising for Touch Play. The investigator assigned to the case did not bother trying to call the store. Instead, he made the two-hour drive to the store, helped the owner remove the word "slot" from the sign, and then drove back to Des Moines.[108]

- In a similar case, a Lottery sales representative spoke with the owner of a Clinton store early one morning about his sign stating, "New Video Slots Here." After the sales representative was unable to persuade the owner to change the sign, a Lottery investigator made the three-hour drive to Clinton. He arrived at 5:30 p.m. and told the owner that the sign was in violation and must be changed immediately.

  The owner said he would review the rules that night and decide the next morning whether to change the sign. To the Lottery, that was not an acceptable answer; it deactivated the store's Touch Play machines that evening. A memo in the case file described the matter as a "protracted refusal to remove the sign." In this case, "protracted refusal" referred to events lasting about 10 hours.[109]

These cases show that the Lottery's investigators are capable of conducting effective and proactive investigations. Here are four common features of such cases:

- **Taking it seriously**: In the above-mentioned case, the investigator told a store manager that the Lottery takes underage complaints "very seriously."[110] In a separate case which involved a sign with the phrase "slot machine," then-CEO Ed Stanek wrote that "the Lottery takes misrepresentation of its name, trademarks and games very seriously."[111]

- **Physically going to the store (sometimes undercover)**

- **Good recordkeeping and documentation**

- **Proactive:** Above all else, the one common thread in these cases was that the investigator took ownership of the case and worked toward an appropriate resolution.

[107] Iowa Lottery Security Investigator Report, Case No. 06-066 (2006).
[108] Iowa Lottery Security Investigator Report, Case No. 05-089 (2005).
[109] Iowa Lottery Security Investigator Report, Case No. 05-052 (2005).
[110] Iowa Lottery Security Investigator Report, Case No. 07-075 (2007).
[111] Letter from Dr. Stanek, then-CEO, to eastern Iowa retailer (Mar. 9, 2005) (on file with author).

C. HOLDING VIOLATORS ACCOUNTABLE

Proactive enforcement procedures and effective complaint-handling practices are a good start, but are not enough to ensure that customers are reasonably protected. A lottery also needs to ensure that violators are held accountable.

This can be accomplished by making sure that:

- Thieves are routinely apprehended and prosecuted.
- Thieves are routinely required to give up the "fruits" of their crimes. A retailer or store employee who obtains prize money from stolen tickets should not be able to keep that prize money.
- Licensed retailers who violate a lottery's rules are held accountable, with license suspensions and revocations when appropriate.
- Lottery investigators have reliable, accurate, and readily searchable records that allow them to identify possible patterns of theft and fraud among suspects and stores.

D. EDUCATING AND PROTECTING CUSTOMERS

Lotteries can further help customers by providing a variety of tools at the retail level. These include:

- **Ticket checkers:** Many lotteries allow customers the option of checking their own tickets by offering self-serve "ticket checker" devices at licensed retailers. These devices allow customers to determine the actual results of the ticket without needing to hand the ticket over to a clerk. The value of these devices was explained in the Nova Scotia lottery report, which stated, "The ultimate control is allowing the player to control the validation process without surrendering the ticket."[112]
- **Customer display units:** These are electronic screens, placed next to terminals, that show the results of the ticket validation process. This allows customers to immediately see the results of a particular transaction.[113]
- **Musical jingles:** Many lotteries have programmed their terminals to play a musical tune or "jingle" whenever a winning ticket is scanned through. This acts as a cue to customers that their ticket is a winner.

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[112] MINISTERIAL PANEL ON TICKET LOTTERY CONTROLS, CONTROLS AND REGULATIONS OF ATLANTIC LOTTERY CORPORATION TICKET LOTTERIES IN NOVA SCOTIA (2007), http://www.gov.ns.ca/lwd/agd/docs/MinAdvisoryPanelTicketLotteryReport.pdf.

[113] The Canadian ombudsman investigations recommended that these units be redesigned so that they can be locked in place by the lottery. This was because it was discovered that some retailers would turn the screen away from customers, effectively negating the benefit of having the device.

- **Receipts:** Terminals can be programmed to generate a receipt whenever a ticket is scanned through. The receipt would show whether the ticket was a winner, and if so, the amount of the prize. Retailers and clerks would be required to offer the receipts to customers, to ensure accurate results.

- **"Big Win" terminal freeze:** Programming terminals to "freeze" automatically whenever a significant winning ticket is validated.

The key with these consumer protection tools is to create a system of checks and balances. As Vice President for External Relations Mary Neubauer told us, "No device, no one solution is going to be a perfect panacea."[114]

But simply offering these tools to customers is not enough. Lotteries also need to educate their customers about the underlying purpose behind each tool, and how to best use them so as to maximize their benefit.

[114] Sworn Interview of Mary Neubauer at the Office of Citizens' Aide/Ombudsman (Sept. 15, 2008).

IV. WEAK, REACTIVE ENFORCEMENT PROCEDURES

> Whether illegal activities did occur or the extent of their occurrence does not reduce the urgency and importance of ensuring that the controls over ticket lotteries are designed, implemented and operate consistently to ensure prizes are paid to legitimate prize winners.
>
> — *"Controls and Regulation of Atlantic Lottery Corporation Ticket Lotteries in Nova Scotia," report issued in October 2007 by the Nova Scotia Ministerial Panel on Ticket Lottery Controls*

> BCLC [*British Columbia Lottery Corporation*] takes a reactive approach, a customer complaint driven approach. In other words, BCLC relies on customers to determine that there may be a problem and then to report it to BCLC. Of course, the problem with this approach is that customers are the ones being duped – if they do not know they are being taken advantage of, why would they complain?
>
> — *"Winning Fair and Square: A Report on the British Columbia Lottery Corporation's Prize Payout Process," by the British Columbia Ombudsman*

The previous section of this report explained the need to establish a proactive enforcement system to increase the likelihood of detecting scam artists and holding them accountable.

Has the Iowa Lottery established proactive enforcement procedures? That question is examined in this section.

A. RECORDS SYSTEM INADEQUATE

1. INVESTIGATORS' DATABASE IS NOT SEARCHABLE

In January 2007 the Security Division's investigators were provided with a new electronic database for storing and archiving their case work. It was the first time in a decade that the Lottery's investigators had an electronic database to catalog and archive their work.

While it has been an improvement, the new database is limited by the fact that it is not searchable, according to Investigator Supervisor John Ellison. We asked if a "searchability function" is something that investigators could use. "And we're working on it," Ellison replied. "We're actually in the process of doing that now. Our IT department is developing a database right now with that criteria."[115]

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[115] Sworn Interview of John Ellison at the Office of Citizens' Aide/Ombudsman (Sept. 19, 2008).

Ellison said the unit installed a searchable database around 1990 or 1991. "It tracked everything," Ellison recalled. "If we had a retailer call in and say, 'Hey, I just had a burglary or whatever and we've contacted the police department and this is our suspect,' I put that information in and boom, 'Hey, we had this guy before.' And I look up that case, almost the same MO [modus operandi] and everything. So it gives you a better feel that you're on the right track."

Computers became more advanced, however, and Ellison said the program that drove the database became obsolete in the mid 1990s. Without any kind of electronic database, Ellison said investigators were left to search their files by hand and memory, a practice that continues to this day.

The lack of a searchable database leaves a gap in the unit's ability to track patterns. When we asked how an investigator would know whether a theft or fraud suspect was a "repeat offender," Ellison replied, "We wouldn't know."

We put the question to recently retired Investigator Larry Steele this way:

> *Ombudsman investigator*: So essentially all you got is your memory and your case files?
>
> *Steele*: Yeah.[116]

But memories have limitations. In June 2006 Steele himself opened a case file about a store clerk who was being prosecuted for stealing tickets from a northwest Iowa convenience store. In doing so, Steele did not realize that he had already opened (and closed) another case file in late 2005 regarding the same clerk and the same incident.[117]

OMBUDSMAN RECOMMENDATION

1. The Lottery should take whatever action is necessary to enable the Security Division to implement, as soon as practically possible, a searchable database for the purpose of recording information related to investigations. The database should include a mechanism for storing and searching the names and methods of individuals suspected of violating Iowa Code chapter 99G.

2. INADEQUATE RECORDKEEPING PRACTICES

One Security Division case involved an employee who was suspected of engaging in stealing tickets from an eastern Iowa gas station. The last note added to the file by the Lottery investigator stated:

> I, have been advised that [the] former clerk … has worked out a plea bargain arrangement with the … County Attorney's Office. Terms of the plea bargain, were not made public.[118]

[116] Sworn Interview of Larry Steele at the Office of Citizens' Aide/Ombudsman (Oct. 8, 2008).
[117] Iowa Lottery Security Investigator Report, Case No. 06-100 (2006); Iowa Lottery Security Investigator Report, Case No. 05-109 (2005).
[118] Iowa Lottery Security Investigator Report, Case No. 07-085 (2007).

Iowa Courts Online, however, does not list any Lottery-related cases involving the suspect clerk. We spoke with an assistant county attorney, who said she was unable to find any documentation verifying that the case was referred to her office.[119]

In other words, the clerk was not prosecuted, even though the Lottery file says she was. The same phenomenon occurred with at least two other cases.[120]

In our review of approximately 122 Security Division case files from 2005 through 2007, we found numerous inaccuracies and omissions. Some files were so incomplete or inaccurate that it was impossible to determine what actually occurred without consulting other sources.

The names of suspects and customer complainants were misspelled or incomplete in a number of files. In one case file we found that a phone number, street address, and street spelling of a complainant were all incorrect.[121]

Handwritten notes of Lottery investigators were usually not included in the files. We learned that two Lottery investigators have routinely shredded their own handwritten notes.[122] This is despite the fact that both of the Security Division's managers told us that they expect investigators to include their handwritten notes in the files.[123]

These practices run counter to standard operating procedures of modern police departments. In addition:

1. In the 88 files involving alleged internal theft, the suspect was not identified in approximately 28. Two of those 28 suspects were prosecuted but were not identified in the case file.[124]

2. In at least 17 files there was no indication whether criminal charges were filed against the suspect employee.

3. Only a handful of files involving internal theft included information regarding the number of tickets stolen, the retail value of tickets stolen, the number of stolen tickets redeemed, and the total amount in cash prizes obtained from the stolen tickets.

We also found no indication that the Security Division maintains a log of store employees who have been prosecuted for Lottery-related theft or fraud. Without such a list, institutional memory is perhaps the only way for investigators to know whether a suspect clerk has engaged in prior criminal activity, or whether a store has had previous incidents involving theft or fraud.

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[119] Telephone Interview of assistant county attorney by an Ombudsman investigator (Apr. 7, 2008).
[120] Iowa Lottery Security Investigator Report, Case No. 05-034 (2005); Iowa Lottery Security Investigator Report, Case No. 07-055 (2007).
[121] Iowa Lottery Security Investigator Report, Case No. 07-109 (2007).
[122] Sworn Interview of Ken Moon at the Office of Citizens' Aide/Ombudsman (Sept. 19, 2008); Sworn Interview of Roger Mott at the Office of Citizens' Aide/Ombudsman (Sept. 19, 2008).
[123] Sworn Interview of Harry Braafhart at the Office of Citizens' Aide/Ombudsman (Oct. 8, 2008); Sworn Interview of John Ellison at the Office of Citizens' Aide/Ombudsman (Sept. 19, 2008).
[124] Iowa Lottery Security Investigator Report, Case No. 06-055 (2006); Iowa Lottery Security Investigator Report, Case No. 07-095 (2007).

We believe these problems, taken collectively, impede the Security Division's ability to effectively track patterns of criminal activity involving retailers and their employees.

OMBUDSMAN RECOMMENDATIONS

2. The Lottery's Security Division should devise and implement a standardized case-file report for its investigators to log information pertaining to suspects, victims, stores and store employees.

3. The Lottery's Security Division should devise and implement specific investigative documentation standards and guidelines. A more disciplined approach to investigative recordkeeping would improve the integrity of the Lottery's investigations. Lottery investigators should also receive instructions on:

   ▪ Retaining any handwritten notes in their case files.

   ▪ Using a word-processing program for narratives in order to alert them to spelling, punctuation and grammar mistakes.

   ▪ What information must be included and in what specific format.

B. NO PRIZE PAYOUT INTERVIEWS

The lotteries in Ontario and British Columbia require prize payout interviews for all prize claims of $10,000 or more. Such interviews enable a lottery investigator to inquire about the origins of the winning ticket and to ask whether the prize claimant is a retailer or associated with a retailer. When an interview causes the investigator to find that the claim is suspicious, the matter is then referred to police for a full investigation.

The Iowa Lottery does not conduct prize payout interviews.

OMBUDSMAN RECOMMENDATION

4. The Lottery should adopt and implement a policy requiring prize-payout interviews by Security Division investigators of all significant prize claims above an appropriate threshold. The interview should focus on the origins of the winning ticket, how the customer validated it, and whether the prize claimant is a retailer, or associated with any retailer or retailer employee.

C. LIMITED OVERSIGHT OF RETAILER PRIZE CLAIMS

To find retailers and store employees who are using the inherent advantages for improper benefit, a lottery needs detailed, searchable data of retailer prize claims. This includes the number of claims, the size of the claims, the frequency of the claims, and how those claims compare with specific game odds. Analysis of such data can help serve as an "early warning system" of suspicious activity.

On this point, the Ontario Ombudsman wrote, "It seems logical that the more accurate information the Corporation has at its disposal regarding the incidence of retailer lottery wins … the better it will be equipped to assess whether there are security issues relating to its various lottery products."[125]

[125] OMBUDSMAN ONTARIO, A GAME OF TRUST (2007),

Towards this end, several Canadian lotteries now require retailers and store employees to identify themselves when claiming a major prize. Since some retailers and employees might try to avoid making such an identification when claiming a prize, the lotteries in Ontario and Québec have devised a rather simple yet effective way to close that loophole.

A recent report by the Québec lottery, for example, explained that the lottery has made "e-learning training mandatory for retailers and their employees in order to obtain a confidential access code for operating the terminal."[126] In order to complete the mandatory e-training, retailers and employees must enter their names into an electronic register managed by the lottery.

This allows the lottery to compare the names on the electronic register with the names of all prize claimants. The Québec lottery report said that more than 13,000 retailers and store employees had registered their names as of November 2008.

1. IOWA RETAILERS NOT REQUIRED TO SELF-IDENTIFY WHEN CLAIMING A PRIZE

During interviews, both Braafhart and Ellison agreed that it would be a good idea for the Lottery to require retailers and their employees to identify themselves as such when they claim a high-tier prize. "In this day and age and since the Canadian scandal up there, it would be a pretty simple way to check to see if we've got a clerk winning multiple times," Braafhart told us.[127]

Managers in other divisions were less enthusiastic about the idea of requiring retailers and employees to identify themselves as such when claiming a high-tier prize. When we said that we did not see the harm of requiring retailers to self-identify when claiming a high-tier prize, Vice President for External Relations Neubauer responded, "You don't see the harm. I don't see the advantage."[128]

2. "QUARTERLY DUPLICATE WINNERS" REPORTS

Within a week of receiving the October 5, 2007, letter of notice for this investigation, the Lottery began conducting a formal review of individuals who claim multiple high-tier prizes in any given quarter.[129]

Under this initiative, Lottery staff generate quarterly reports that identify individuals who have claimed more than one high-tier prize during a particular three-month period. The list does not differentiate between retailers and non-retailers. Upper management then discusses the contents of each quarterly report. One participant told us that these quarterly discussions typically last five to ten minutes.[130]

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http://www.ombudsman.on.ca/media/3268/a_game_of_trust_20070326.pdf.

[126] LOTO-QUEBEC, ACTION PLAN FURTHER TO KPMG RECOMMENDATIONS- REVIEW OF PRIZE PAYMENT PROCESSES AND PROCEDURES (2008), www.loto-quebec.com/corporatif/pdf/documentsinterets/tableau_suivi_KPMG_ang.pdf.

[127] Sworn Interview of Harry Braafhart at the Office of Citizens' Aide/Ombudsman (Oct. 8, 2008).

[128] Sworn Interview of Mary Neubauer on at the Office of Citizens' Aide/Ombudsman (Sep. 15, 2008).

[129] Sworn Interview of Therese Spaulding at the Office of Citizens' Aide/Ombudsman (Sept. 15, 2008); Sworn Interview of Steve King at the Office of Citizens' Aide/Ombudsman (Sept. 17, 2008).

[130] Sworn Interview of Steve King at the Office of Citizens' Aide/Ombudsman (Sept. 17, 2008).

The effort is intended to identify prize claims that appear to be suspicious, which could then be referred to the Security Division for a formal investigation. Several participants told us that they were not aware of any formal investigations triggered by the quarterly reviews.[131] Investigator Supervisor John Ellison said he thought there had been one formal investigation, but he could not recall the specifics.[132]

While this initiative shows promise, we believe it is not being utilized in a way that would yield meaningful results.

a. Report parameters are too restrictive

The Lottery's quarterly reports exclude any prizes claimed before April 2006. The reports also exclude many prizes claimed between April 2006 and the quarter under review. We found that the only time that an individual's previous prize claims are included is when the individual had a previous quarter with multiple high-tier prize claims.

As a result:

- If Lottery Player "A" claimed three $1,000 prizes in one quarter and a $100,000 prize in a prior quarter, the report would only include the three $1,000 prize claims.

- If Lottery Player "B" claimed a $25,000 prize in one quarter and a $250,000 prize in another quarter, the report would not include either claim.

- If Lottery Player "C" was a store clerk who claimed a $250,000 prize in one quarter and had claimed seven other high-tier prizes totaling $16,000 before April 2006, the report would not include any of those prize claims.

If we had used these same parameters for our investigation, we would have missed many of the prize claims identified in Section I and Appendix G of this report.

b. Review parameters are too restrictive

Lottery officials who participate in these reviews told us that investigations are generally deemed unnecessary for prize claims involving games that have better odds of winning than other games.

"I'd say almost all of them in our opinion do not come across as suspicious," explained Validations Manager Spaulding, who produces the quarterly reports.[133]

Vice President for External Relations Mary Neubauer explained, "In general people who are claiming multiple prizes are loyal players who play our games quite frequently, and when you do that it increases your chances of winning."[134]

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[131] Sworn Interview of Therese Spaulding at the Office of Citizens' Aide/Ombudsman (Sept. 15, 2008); Sworn Interview of Ken Brickman at the Office of Citizens' Aide/Ombudsman (Sept. 17, 2008); Sworn Interview of Steve King at the Office of Citizens' Aide/Ombudsman (Sept. 17, 2008).
[132] Sworn Interview of John Ellison at the Office of Citizens' Aide/Ombudsman (Sept. 19, 2008).
[133] Sworn Interview of Therese Spaulding at the Office of Citizens' Aide/Ombudsman (Sept. 15, 2008).
[134] Sworn Interview of Mary Neubauer at the Office of Citizens' Aide/Ombudsman (Sept.15, 2008).

If management decides that more information is needed about a particular repeat winner, sales staff in that area are contacted. "I did call two regional managers at one point just to gather a little more information," said Vice President for Marketing Joe Hrdlicka. "Because these were retailers. 'Tell me about these retailers.' 'They're regular players, they do win.' But nothing I learned from those conversations constituted anything irregular or inappropriate."[135]

It is true that some games have better odds, and this in turn may cause some people to buy tickets for those games at a higher rate. But this does not mean that prize claims involving those games cannot involve fraud or theft, especially since the Lottery's consideration of these prize claims does not include a detailed analysis comparing the game odds, the number of wins, or the number of tickets reportedly purchased by the repeat winners.

c. Lottery concerned about offending retailers

Several Canadian lotteries have adopted policies requiring that major prize claims (i.e., $10,000 or more) by retailers, store employees, and members of their immediate families be automatically investigated to determine whether the tickets were obtained legitimately.

The Iowa Lottery does not automatically investigate any prize claims by retailers or store employees, though Security Division managers agreed that such a practice would be a good enforcement tool.[136]

In fact, Lottery management expressed reluctance to launch investigations of high-tier winners, which they said includes retailers and store employees.[137] We found that this reluctance greatly limits the usefulness of the "quarterly duplicate winner" reviews.

Validations Manager Spaulding cited the example of the northern Iowa retailer who has claimed at least 67 prizes over the past several years for a total of $100,626. "He takes offense to anyone, you know, questioning how much he's spending on his lottery products," Spaulding explained. She added, "That's why you hate to send in an investigator right away to start interviewing the claimant because we don't want to offend our players either."

Spaulding said that this retailer has specifically requested no publicity about any of his prize claims. "He expressed a real hesitation with any publicity or inquiry into his playing habits," Spaulding said.

d. Conclusion

Vice President for Finance Steve King told us that the goal of the "quarterly duplicate winners" reports was to take what the Canadians have been doing and "go one step further."[138] That is a laudable goal, but in reality this initiative pales in comparison to what the Canadian lotteries have been doing.

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[135] Sworn Interview of Joe Hrdlicka at the Office of Citizens' Aide/Ombudsman (Oct. 7, 2008).
[136] Sworn Interviews of Harry Braafhart at the Office of Citizens' Aide/Ombudsman (Oct. 8, 2008); Sworn Interview of John Ellison at the Office of Citizens' Aide/Ombudsman (Sept. 19, 2008).
[137] Sworn Interview of Therese Spaulding at the Office of Citizens' Aide/Ombudsman (Sept. 15, 2008).
[138] Sworn Interview of Steve King at the Office of Citizens' Aide/Ombudsman (Sept. 17, 2008).

3. PROHIBITING RETAILERS FROM PERSONAL USE OF LOTTERY PRODUCTS WHERE THEY WORK

In British Columbia, lottery retailers and employees are restricted from purchasing, playing, or validating personal lottery tickets at their location of employment.[139]

We found that several Iowa retailers already have instituted similar restrictions on their own employees.[140]

OMBUDSMAN RECOMMENDATIONS

5. The Lottery should explore the merits of amending Iowa Code chapter 99G to prohibit retailers and store employees from purchasing and redeeming Lottery products at their place of employment. The purpose is to offset the inherent retailer advantages.

6. The Lottery should develop and implement a program of mandatory e-registration for all Iowa retailers and store employees, similar to the programs already developed by the lotteries in Ontario and Québec. The program should require retailers and employees to electronically register their names and other pertinent information before they can obtain a confidential access code necessary for operating an Iowa Lottery terminal.

7. The Lottery should modify its administrative rules to adopt the following terms, definitions and insider win procedures:

   A ‘‘related party’’ is someone with a connection to an Iowa Lottery retailer. ‘‘Related parties’’ include any directors, officers, partners, owners, and employees of licensed retailers, and their immediate family members, including spouse (whether married or common law relationship), children, parents, siblings and any other relatives who reside with them.

   ‘‘Insiders’’ are a subset of ‘‘related parties’’ and include, among others, lottery retailers, their employees who sell and redeem lottery products, and their immediate families.

   Individuals falling into either of these two classifications and who claim a prize will be subject to insider win procedures to be defined by the Iowa Lottery. It is the responsibility of the related party/insider to advise the Iowa Lottery of their relationship to a licensed retailer upon claiming their prize.

   A “suspicious claim” is defined as a prize claim whereby the Iowa Lottery is not satisfied that the claimant is a legitimate winner and there exists a perceived or apparent criminal activity. All suspicious claims will be referred to law enforcement for investigation.

[139] British Columbia Lottery Corp., Frequently Asked Questions, http://www.bclc.com/app/Footer/FAQ.asp?category=Lotteries (last visited Mar. 24, 2009).

[140] These prohibitions were referenced in the following case files: Iowa Lottery Security Investigator Report, Case No. 05-133 (2005); Iowa Lottery Security Investigator Report, Case No. 07-008 (2007); Iowa Lottery Security Investigator Report, Case No. 07-045 (2007); Iowa Lottery Security Investigator Report, Case No. 07-077 (2007).

8. The Lottery should modify its "Winner Claim Form" to include a question about whether the claimant is a "related party."[141] The "Winner Claim Form" already requires claimants to declare, under penalty of perjury, that the information supplied is true and correct.

9. The Lottery's Security Division should begin tracking and analyzing high-tier prize claims by "related parties." This includes the number of claims, the size of the claims, the frequency of the claims, and how those claims compare with specific game odds.

10. The Lottery's Security Division should investigate any prize claim above an appropriate threshold when the claimant is identified as a "related party." The primary purpose would be to determine whether the ticket was obtained legitimately.

D. POTENTIAL LAUNDERING OF STOLEN TICKETS

One store clerk who was prosecuted for internal theft submitted a voluntary statement to police which stated:

> It started off small; only scratching a few tickets off at work and redeeming them elsewhere. After a while it started getting worse. I would take about twenty tickets or so home per shift. After a while with them not finding out, I started taking tickets from the back of the packs. This was around the end of my tenure there. I did take a few packs that were unopened. I know it was wrong and I deeply wish that I hadn't done it. **I gave the tickets to [a friend] and he would cash them in Iowa City**…. I am very sorry about the whole thing and would like to apologize to everybody I stole from. [emphasis added][142]

That clerk and his friend both pled guilty to Lottery theft, and each was ordered to pay $3,828 in restitution to the store for the retail value of the stolen tickets. This was an unsuccessful attempt at laundering, where a retailer or store employee steals tickets, then gives them to a third party to cash the winners.

Laundering has also been used by some retailers and store employees to try to conceal prize winnings gained through tickets stolen from customers. A Louisiana store clerk who stole a customer's winning ticket worth $800,000 in 2008 gave the ticket to her mother, who claimed the prize winnings. Both the clerk and her mother were arrested and charged.[143]

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[141] A copy of the Lottery's current "Winner Claim Form" is attached as *Appendix H*.

[142] Voluntary statement to police by clerk who was the subject of Iowa Lottery Security Investigator Report, Case No. 05-011 (2005).

[143] Leslie Williams, *Store Clerk Stole Winning Lottery Ticket, Police Say*, TIME-PICAYUNE (New Orleans), Sept. 24, 2008, at 4.

A $1.4 million ticket stolen by an Arizona retailer in 2005 was also laundered. The retailer gave the ticket to her sister, who claimed the prize winnings.[144] These cases show the need to review not just prizes claimed by retailers and their employees, but also individuals with a close connection to retailers.

We found several high-tier Iowa Lottery prizes claimed by relatives of store employees who were suspected of stealing tickets, none of which appear to have been detected by Lottery investigators. For example, one store clerk was discovered in November 2005 by her employer to have been stealing instant tickets.[145] Our investigation revealed that six months prior, the clerk's boyfriend had claimed a $25,000 instant-ticket prize.[146]

We also found major prizes claimed by relatives of store employees who were not suspected of stealing tickets. In March 2006, for example, the Lottery issued a press release about a man who claimed a $30,000 instant ticket prize. The press release said his wife was the manager of the convenience store where he had purchased the ticket.[147]

Similarly, in April 2001, the Lottery issued a press release about a woman who claimed a $25,000 instant ticket prize. The press release said she bought the ticket at the gas station where her husband was the manager, and that he even redeemed the ticket for her.[148]

There is certainly not enough information to conclude that such claims involved fraud or theft. But at the same time, it would be naïve to rule out impropriety without a proper investigation. The phenomenon of laundering could be extremely difficult to track, and would, therefore, allow a retailer or store employee to hide potentially criminal conduct and make money in the process.

OMBUDSMAN RECOMMENDATION

11. The Lottery should explore procedures and practices to improve its ability to detect laundering of tickets obtained by theft or fraud.

E. INADEQUATE PUBLICITY PROCEDURES

1. NO PRESS RELEASES FOR SOME SIGNIFICANT PRIZE CLAIMS

The Lottery has an administrative rule which states:

> By submitting a claim, the player agrees that the prize winner's name may be used for publicity purposes by the lottery.[149]

[144] David Pittman, *Clerk Accused of Stealing $1M Lottery Ticket*, TUCSON CITIZEN, Aug. 19, 2005, at 1A.
[145] Iowa Lottery Security Investigator Report, Case No. 05-109 (2005).
[146] Based on our review of the Lottery's database of prize claimants and court records through Iowa Courts Online Search, http://www.iowacourts.state.ia.us/ESAWebApp?SelectFrame (last visited Feb. 27, 2009).
[147] Press Release, Iowa Lottery, Alden Man Cheers up with $30,000 Win (Mar. 8, 2006) (on file with author).
[148] *Multi-Dollar Scratch Games Pay Off*, VIP CONNECTION NEWSLETTER (Iowa Lottery, Des Moines, Iowa), Aug. 2001, at 3.
[149] IOWA ADMIN. CODE 531-11.1(2) (2009).

The Lottery typically transmits a press release to announce prize claims of $10,000 or more. However, we found a number of major prize claims for which there were no press releases. Here are some examples:[150]

1. An Ottumwa man won $100,000 on January 21, 2005.

2. A Des Moines man won $100,000 on December 2, 2005.

3. A Sibley man won $200,000 on February 21, 2006.

4. A Lenox man won $100,000 on June 12, 2006.

5. A Davenport woman won $200,000 on September 22, 2006.

6. A Des Moines woman won $100,000 on October 30, 2006.

We asked the Lottery why it did not transmit press releases for certain major prize claims. In response, Lottery officials said they do not issue a press release when the claimant requests no publicity.[151] While this may seem reasonable, it also creates an opportunity for retailers and store employees to claim major prizes without the general public learning about it.

In addition, the Lottery said it occasionally does not issue a press release, even when the claimant does not object to a press release. A recent situation in Ontario shows what can happen when there is no publicity of a retailer's major prize claim. A store owner claimed a $5.7 million lottery jackpot in 2005. Two years later, the store owner was arrested and charged with stealing the winning ticket from a customer.

A newspaper report about the charges, which were announced in December 2007, said that "a search of newspaper databases and news releases did not uncover any public report about the lottery jackpot" when it was claimed, even though the Ontario lottery claimed that it had issued a news release about the retailer's prize claim.[152]

2. LOTTERY EMPLOYEES DISCOURAGED FROM IDENTIFYING PRIZE WINNERS AS RETAILERS

We found at least 43 Lottery press releases over the past several years which identified prize winners as retailers or store employees. This included at least six such press releases in 2007.

In mid-2008 we noticed that none of the Lottery's press releases up to that point in the year had identified any of the prize winners as retailers or employees.

When we interviewed Lottery officials in mid-September, we asked why no press releases issued to that point in 2008 had identified a prize winner as a retailer or employee. Then-Public Affairs Manager Tina Potthoff said that her unit had been discouraged from identifying retailers in press releases about major prize winners.[153]

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[150] Based on our review of the Lottery's database of prize claimants.
[151] Letter from Ken Brickman, then-Acting CEO, to Ombudsman investigator (Aug. 6, 2008) (on file with author).
[152] Shannon Kari, *Jackpot Awarded Without Insider Probe*, NAT'L PROBE (Toronto), Dec. 21, 2007, at A6.
[153] Sworn Interview of Tina Potthoff at the Office of Citizens' Aide/Ombudsman (Sept. 15, 2008).

Asked where the discouragement came from, Potthoff told us, "It's kind of been a collective decision" which had "been talked about at senior staff meetings."

Potthoff later added:

> [I]f I were to write a press release about a retailer that I hesitate to put the fact that she's a retail clerk in the release is also for his or her protection too as a retailer….
>
> [T]o have that in the headline and sometimes local small town newspapers will take that exact thing and throw it in their newspaper, it also just doesn't seem right, I guess.

When we asked then-Acting CEO Brickman about this, he responded, "I'm not aware of any reason why there should have been any change." He added that "there was no attempt to hide it. That I'm aware of."[154]

About three weeks after these exchanges, the Lottery issued a press release which identified a $50,000 prize winner as a store employee – the first such press release in all of 2008.[155]

OMBUDSMAN RECOMMENDATION

12. The Lottery should devise and implement a new policy requiring that press releases will be issued for all prize claims of $10,000 or more, except in extenuating circumstances. The policy should require that prize claimants who are retailers or employees must be identified as such in the press release.

13. The Lottery should establish a new administrative rule declaring that, except in extenuating circumstances, claimants of prizes $10,000 or more must consent to the Iowa Lottery publishing the claimant's name and a current photograph.

F. INADEQUATE INTEGRITY TESTING

Integrity testing involves having individuals go to stores posing as lottery customers to engineer situations which test whether store employees will engage in impropriety. The British Columbia Ombudsman referred to integrity testers as "mystery shoppers."

"The mystery shoppers should also be educated in the different ways that an unscrupulous retailer may attempt to defraud a player and be asked to test these," the British Columbia Ombudsman wrote. "Finally, mystery shoppers should be specifically directed to those retailers that have been suspected of engaging in retailer fraud."[156]

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[154] Sworn Interview of Ken Brickman at the Office of Citizens' Aide/Ombudsman (Sept. 17, 2008).

[155] Press Release, Iowa Lottery, Monona County Woman Wins $50,000 Lottery Prize (Oct. 8, 2008) (on file with author).

[156] OMBUDSMAN BRITISH COLUMBIA, WINNING FAIR AND SQUARE: A REPORT ON THE BRITISH COLUMBIA LOTTERY CORPORATION'S PRIZE PAYOUT PROCESS (2007), http://www.ombud.gov.bc.ca/resources/reports/Special_Reports/Special%20Report%20No%20-%2031.pdf.

"The mere knowledge that retailers might be visited by one of these undercover agents would serve as an excellent means of deterrence and publication of the results of visits would provide a constant reminder of the importance of respecting the rules," the Ontario Ombudsman wrote.[157]

Until February 2009, it had been a number of years since the Iowa Lottery's Security Division proactively tested stores to see if they were trying to cheat customers. "We would go out undercover, not only us but sometimes we'd get a DCI agent to go in and purchase tickets and then check those tickets to see if there was anything wrong," retired Investigator Larry Steele told us.[158] Steele said investigators would document their findings on a checklist that had been developed for these store checks.

OMBUDSMAN RECOMMENDATIONS

14. The Lottery's Security Division should consider adopting a formal integrity testing or "mystery shoppers" program.

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.

G. WEAK SYSTEM OF SECURITY COMPLIANCE AUDITS

Some lotteries conduct security compliance audits to proactively audit retailers' compliance with the lottery's rules and regulations. This can include checking whether retailers:

- Require customers to sign their tickets before accepting them for validation.
- Provide customers with a receipt after validating tickets.
- Point the "customer display unit" toward customers.

Iowa Code section 99G.35(1) (2009) states in part:

> The lottery security office shall perform all of the following activities in support of the authority mission:
>
> b. Inspect at times determined solely by the authority the facilities of any vendor or lottery retailer in order to determine the integrity of the vendor's product or the operations of the retailer in order to determine whether the vendor or the retailer is in compliance with its contract.

We found that Iowa Lottery staff from various departments conduct unannounced spot checks of licensed retailers on an occasional basis. But the focus is not generally on customer security matters. We found that management views the spot checks predominantly as a marketing or sales tool.

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[157] OMBUDSMAN ONTARIO, A GAME OF TRUST (2007), http://www.ombudsman.on.ca/media/3268/a_game_of_trust_20070326.pdf.

[158] Sworn Interview of Larry Steele at the Office of Citizens' Aide/Ombudsman (Oct. 8, 2008).

Vice President for External Relations Mary Neubauer explained:

> The people involved in those checks include some members of our sales staff, they also include members of our security staff and members of our marketing and accounting staffs. Those folks will go out at different times throughout the year and do unannounced spot-checks of a retail location to ensure, for example, that the correct signage is up in the store, that retailers are handling the products appropriately. They check for a variety of different items depending upon which department of the lottery is involved.[159]

In fact, the spot checks conducted by sales and marketing staff do not monitor retailer compliance with the Licensing Terms and Conditions, according to Vice President for Marketing Joe Hrdlicka.[160] We found that staff from sales and marketing departments conduct at least as many of these spot checks as Security Division investigators.

Moreover, in recent years, the Security Division has used a generic sheet which provided no indication of what specifically was checked, what was ordered to be fixed, or what was considered to be a violation of Licensing Terms and Conditions. As a result, these checksheets did not allow Lottery management to know what their investigators actually observed when they conducted their spot checks of stores that sell Lottery tickets.

Regardless of what problems might have been remedied during investigators' spot checks, without a written record of those checks, no Lottery official would be able to track retailers that exhibit a pattern of non-compliance.

As of fall 2008, in response to our investigation, a revised checklist for these spot checks was drawn up by managers from the sales and marketing departments, according to then-Acting CEO Brickman.[161] Asked why the new lists were not drawn up by Security Division staff, Brickman replied, "Because they really aren't Security issues."

While the new, more detailed checklists are an improvement, they omit some items we would like to see checked, and they take on some marketing functions we believe are best checked by others at the Lottery.

OMBUDSMAN RECOMMENDATIONS

16. The Lottery's Security Division should conduct random and comprehensive security compliance audits of retail outlets to ensure compliance with the Lottery's rules and impose sanctions for any violations, as appropriate.

[159] Sworn Interview of Mary Neubauer at the Office of Citizens' Aide/Ombudsman (Sept. 15, 2008).
[160] Sworn Interview of Joe Hrdlicka at the Office of Citizens' Aide/Ombudsman (Oct. 7, 2008).
[161] Sworn Interview of Ken Brickman at the Office of Citizens' Aide/Ombudsman (Sept. 17, 2008).

17. Security compliance audits should be confined to security-related issues and should include checks for proper positioning of the Customer Display Units (CDUs), Ombudsman stickers, and evidence of "pickouts" and other fraud or theft. All items to be checked should be included on a single form and investigators should document problems observed. Any noncompliance with Licensing Terms and Conditions should be communicated to management for consideration of appropriate license sanctions.

H. RETAILER BACKGROUND CHECKS

A lottery can require that license applicants undergo a background check. This allows a lottery to screen out applicants with relevant criminal convictions (such as theft, fraud, or illegal gambling activity) and/or applicants who cannot demonstrate financial responsibility sufficient to adequately meet the requirements of being a licensed lottery retailer (such as someone with a history of bankruptcy or major credit problems).

1. IOWA LOTTERY CONDUCTS RETAILER BACKGROUND CHECKS

This is one proactive enforcement procedure that the Iowa Lottery has been using for many years. In his November 5, 2007, letter of response, then-Acting CEO Brickman wrote:

> All applicants for lottery retail licenses undergo background checks by the Iowa Division of Criminal Investigation and anyone who has been convicted of fraud, a felony or a gambling violation is not licensed as a lottery retailer in Iowa. [162]

2. STORE EMPLOYEES NOT CHECKED

As noted above, people with certain types of criminal convictions are automatically disqualified, by law, from being licensed as an Iowa Lottery retailer.

But those same individuals face no such barrier if they want to sell Lottery tickets as a retail *employee* because the Lottery does not require a licensed retailer's employees to undergo any kind of a background check. They can sell Lottery tickets and check tickets for customers. They also can control the redemption process at the retail level, and can conceivably pay themselves for any winning ticket of $600 or less (which make up the vast majority of all winning tickets).

This means that the Lottery's requirement for background checks does not apply to the majority of Lottery ticket sellers. To put this into perspective, among the 88 internal theft cases we reviewed, the Lottery's files referenced at least 103 suspects. None of those 103 suspects was a store owner. This means that the suspects in all internal theft cases from 2005 through 2007 were individuals who had not been subjected to a criminal background check by the Lottery before being allowed to sell and handle Lottery tickets.

[162] These background checks are required by IOWA CODE SECTION 99G.24(7) (2009).

Based on our review of court records, if background checks had been done on those 103 individuals, nine would have come back with "hits" (prior convictions for fraud, a felony, or a gambling violation, the same criteria for disqualifying a license applicant). And if theft convictions were also included, the number of "hits" would have grown to 21.[163]

Here are three examples of internal theft suspects who had prior criminal convictions:

1. A northwest Iowa convenience store clerk was suspected of stealing tickets and cash worth $64.75 from a Pull-tab vending machine. He was not prosecuted. The investigator's notes said the clerk was "an unregistered sex offender, and illegal alien, also wanted for terrorism in his native country of Nicaragua and has been turned over to Federal authorities."[164]

2. A central Iowa store clerk pled guilty to stealing 13 instant tickets with a retail value of $130. She had previously been convicted of felony-level forgery (two counts); felony-level burglary; and fourth-degree theft, according to court records.[165]

3. An employee of a contractor hired to clean the Lottery's Mason City regional office was prosecuted for stealing $167 worth of instant tickets from the office. She had a previous conviction for felony-level fraud. There was no indication in the Lottery's case file that staff was aware of her prior fraud conviction, either before or after she stole the tickets. She also had a prior conviction for fifth-degree theft.[166]

   In response to that incident, recently retired Vice President for Security Harry Braafhart told us that the Lottery implemented a policy which "required any contractor to provide information on any employee … that works at the Iowa Lottery or for any of the regional offices."[167]

If the Lottery had been requiring background checks of store employees, and had it also included theft convictions as an automatic disqualifier, there could have been up to 21 fewer incidents of internal theft from 2005 through 2007. We believe this might justify a recommendation that the Lottery should conduct criminal background checks of all individuals who routinely sell Lottery products to the public.[168]

However, in discussing this idea with Lottery officials, they expressed significant reservations about conducting background checks on all such individuals. Then-Acting CEO Brickman questioned whether such an effort would be cost-effective. He also estimated that there are tens of thousands of employees at the Lottery's licensed retailers, and that turnover rates are likely relatively high.[169]

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[163] The actual number of suspects with prior records may be higher, because the suspect was not identified in a number of case files which did not lead to prosecution.
[164] Iowa Lottery Security Investigator Report, Case No. 05-050 (2005).
[165] Iowa Lottery Security Investigator Report, Case No. 05-078 (2005). Court records show that the woman also had previously filed for bankruptcy.
[166] Iowa Lottery Security Investigator Report, Case No. 07-062 (2007).
[167] Sworn Interview of Harry Braafhart at the Office of Citizens' Aide/Ombudsman (Oct. 8, 2008).
[168] The final report of the Governor's Touch Play Task Force, issued March 6, 2006, included a "nonconsensus" recommendation to require background checks and licensing of all employees who would monitor Touch Play machines.
[169] Sworn Interview of Ken Brickman at the Office of Citizens' Aide/Ombudsman (Sept. 17, 2008).

Most lotteries do not screen individual employees, although the New Jersey lottery conducts background checks on both retailers and any employees who handle lottery products.[170]

Based on this information, we are not recommending that the Lottery require background checks on all retail employees. However, without such checks, it is vital that the Lottery give serious consideration to our other recommendations in order to establish and promote a strong enforcement system.

OMBUDSMAN RECOMMENDATION

18. The Lottery should propose amending Iowa Code section 99G.24(7)(b) to add convictions for theft to the list of disqualifying criteria for retail license applicants, allowing for appropriate exceptions.

I. SUSPECTS GOING TO WORK FOR OTHER LICENSED RETAILERS

In fall 2007 a grocery store suspected a long-time employee had stolen seven instant scratch tickets. According to the file, the store fired her and did not want to file a police report.[171] We found that the woman was working for another licensed retailer by the following spring.[172]

This shows that any theft suspect could obtain employment at other licensed retailers, as there is no law or rule to prohibit such activity, even for individuals who have pled guilty or otherwise been convicted of stealing Lottery tickets.

OMBUDSMAN RECOMMENDATION

19. The Lottery should consider proposing an amendment to Iowa Code chapter 99G to prohibit any individual convicted of violating chapter 99G from handling Lottery products for any licensee.

J. TWO PROCEDURES DESIGNED TO ALERT LOTTERY TO SUSPICIOUS ACTIVITY

Security Division management told us about two additional procedures that were designed to proactively alert investigators to suspicious activity at stores. However, management also acknowledged that neither has produced meaningful results.

1. SUSPICIOUS VALIDATIONS REPORTS

When a retailer swipes the same non-winning ticket through a terminal numerous times, that can be a possible indicator of criminal activity. With that in mind, the Security Division developed a procedure about ten years ago that was designed to alert investigators to suspicious validation activity.

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[170] E-mail from New Jersey Lottery Public Information Office to Ombudsman investigator (Jan. 8, 2009) (on file with author); New Jersey Lottery, Information for Retailers, http://www.state.nj.us/lottery/general/6-5-1_retailer.htm (last visited Feb. 27, 2009).

[171] Iowa Lottery Security Investigator Report, Case No. 07-107 (2007).

[172] Based on our review of court and police records.

Recently retired Vice President for Security Braafhart explained:

> If there was what we called suspicious validations, if there were several nonwinning tickets in a row that were scanned or if there was a ticket number that was scanned several times with a different validation code, usually it was Larry [Steele] that would contact this retailer and say, 'Hey, I think we've got something maybe you want to take a look at.' And that doesn't address the fact that it could be the retailer, I understand that.[173]

Investigator Supervisor Ellison, however, told us that this procedure has not been particularly useful, and is instead most commonly used to supplement investigations that are already open.

2. ACTIVITY CONCERNS REPORTS

These reports compare a store's sales activity for the month with sales activity at the same store for previous months. Investigator Supervisor Ellison explained:

> And let's say this is a retailer, we've got a 2000 percent increase in sales. Okay, do we have a promotion going on, what's going on here, are we giving away tickets at that store or whatever or do we have a theft problem. So it will catch – at least alert us, give us a red flag anyway on something like this happening.[174]

When this procedure was introduced several years ago, Ellison said the goal was to be more proactive. But that goal, he added, has not been realized, in part because most large increases in sales have been due to non-criminal factors such as special Lottery promotions. As a result, instead of being used proactively, Ellison said the reports have been used to supplement investigations that are already open.

OMBUDSMAN RECOMMENDATION

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.

[173] Sworn Interview of Harry Braafhart at the Office of Citizens' Aide/Ombudsman (Oct. 8, 2008).
[174] Sworn Interview of John Ellison at the Office of Citizens' Aide/Ombudsman (Sept. 19, 2008).

K. CONCLUSION

Iowa Lottery officials agree that victims of a retailer scam artist will not complain if they do not realize they were scammed. But when we asked how the Lottery detects such incidents, then-Acting CEO Brickman responded:

> Unless someone knows themselves that they've been scammed or somehow it comes to their attention that they should have taken care of the situation better and been more knowledgeable and somehow bring it to the attention of the lottery, we have no way of knowing.[175]

Because many Lottery scams can go undetected, Lottery investigators agree that retailers and their employees should be held to a higher standard. But when asked *how* they are held to a higher standard, Lottery investigators responded:

- "You know, I don't know. I mean I agree that they should be held to a higher standard somehow and I don't know how that could be done."

  — *Retired Vice President for Security Braafhart*[176]

- "Well, they're not."

  — *Investigator Supervisor Ellison*[177]

- "How does the lottery hold them to a higher standard. I guess I can't answer that. I don't – I don't know how they could or would."

  — *Retired Investigator Steele*[178]

In conclusion, it is clear that the Iowa Lottery has not established effective enforcement procedures.

[175] Sworn Interview of Ken Brickman at the Office of Citizens' Aide/Ombudsman (Sept. 17, 2008).
[176] Sworn Interview of Harry Braafhart at the Office of Citizens' Aide/Ombudsman (Oct. 8, 2008).
[177] Sworn Interview of John Ellison at the Office of Citizens' Aide/Ombudsman (Sept. 19, 2008).
[178] Sworn Interview of Larry Steele at the Office of Citizens' Aide/Ombudsman (Oct. 8, 2008).

V. SIGNIFICANT SHORTFALLS WITH COMPLAINT-HANDLING PRACTICES

> *Ombudsman investigator*: How did you know whether a complaint was best responded to by marketing, security, sales, whatever?
>
> *Deana Connelly*: I don't.
>
> *Ombudsman investigator*: So it was a judgment call by you individually.
>
> *Deana Connelly*: Correct.
>
> — *Exchange during September 15, 2008, interview of Deana Connelly* [179]

In addition to its failure to develop a system of proactive enforcement, we found significant shortfalls in the Lottery's handling of the complaints it does receive.

A. SECURITY-RELATED COMPLAINTS NOT FORWARDED TO SECURITY DIVISION

In response to our notice of investigation, then-Acting CEO Brickman wrote, "Any issues relating to security or matters of impropriety are referred to the lottery's security department."[180]

We can confidently say that this statement was not supported by the Lottery's own records.

1. SELLING A MONTH-OLD, LOSING TICKET

While getting gas in April 2006, a man bought a Powerball ticket at a store in eastern Iowa. After getting back to his home in Illinois, he realized the ticket was for a drawing that had been held a month before. It was not a winner.

He e-mailed the Lottery to complain about the incident. His e-mail described what had happened, expressed his displeasure, and included his phone number. "I never got a response on that," the man said when we contacted him. "I never knew if they checked into it or not. I would have recalled, because I'm pretty thorough in reading my e-mails."[181]

There is no indication that his complaint was forwarded to the Security Division. Our review of the case files for 2006 found no file was opened relating to this matter.[182]

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[179] Connelly has been employed as the Lottery's Licensing Secretary for nine years. As the primary backup to the receptionist, Connelly has routinely fielded telephone calls from customers and retailers. Sworn Interview of Deana Connelly at the Office of Citizens' Aide/Ombudsman (Sept. 15, 2008).

[180] *See Appendix E.*

[181] Asked about this, the Lottery told us that "the electronic record for his inquiry indicates that a reply was sent, but we do not have a copy of the response today."

[182] E-mail from an Illinois customer to Iowa Lottery (Apr. 12, 2006) (on file with author).

2. CHARGING A FEE TO REDEEM PRIZES

A woman called the Lottery in October 2007 to complain about a Des Moines grocery store. She alleged that a clerk had charged a fee when the woman tried to redeem a winning ticket.

The call was received by Linda Young, a secretary in the Marketing Division. A memo[183] indicated the complaint then went through several employees, none of whom work for the Security Division:

1. Young forwarded the complaint to her boss, Vice President for Marketing Joe Hrdlicka.

2. Hrdlicka assigned the matter to a regional sales manager, Mark Ryan.

3. Ryan asked Lottery Recruiter Bill Kehoe to contact the store.[184]

Kehoe spoke with the store's customer service manager, who in turn spoke with her employees. The manager said the store's employees denied charging a fee to redeem a winning ticket, and the Lottery effectively closed the complaint as unfounded.

We find four core problems with how the Lottery handled this complaint:

1. The complaint was not directly investigated. The important task of speaking with the employees who may have interacted with this customer was deferred to store management. This is not an effective way to get to the bottom of a matter, as store management has business interests that will not always coincide with the Lottery's security-related interests.

2. There is no indication that anyone attempted to follow up with the woman who filed the complaint.

3. When we asked about this incident five months later in 2008, the Lottery said it did not have any contemporaneous documentation about the complaint.

4. The complaint was assigned to sales staff instead of the Security Division.[185] Hrdlicka told us that the caller did not provide "very much specific information" and that was why he assigned it to sales staff. By contrast, a nearly identical complaint received by Young later that same month did get forwarded to the Security Division for investigation.[186]

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[183] The memo was written March 21, 2008, and only in response to our inquiry.

[184] Sworn Interview of Joe Hrdlicka at the Office of Citizens' Aide/Ombudsman (Oct. 7, 2008) (A recruiter works to set up new retailer accounts).

[185] It is worth noting that we contacted the Lottery about a separate complaint in 2002. In discussing that complaint, a Lottery employee explained that the agency received "lots of calls on complaints" and volunteered that, "Complaints are commonly handled by DSRs (district sales representatives)." During the current investigation, recently retired Lottery Investigator Larry Steele told us that it "was not uncommon to have a regional manager check something."

[186] That case (Iowa Lottery Security Investigator Report, Case No. 07-130) (2007) was not handled much better. The complaint alleged that two stores in a chain were charging a fee to redeem winning tickets. The complaint was closed after a regional sales manager – not a Security Division investigator – spoke with one of the store managers, who denied charging such a fee. The second store was not contacted at all. John

Hrdlicka told us these two complaints were the only two that he is aware of which alleged that a retailer had charged a fee to redeem a winning ticket.

Asked if he would handle the first complaint any differently now, Hrdlicka replied, "Oh, I would probably refer it to Security."

3. TERMINAL SAYS WINNING TICKET ALREADY PAID OUT, BUT CUSTOMER NOT YET PAID

A Waterloo customer had an instant ticket that won $10. "I took it to cashier and she ran it threw [sic]," he wrote in his December 24, 2006, e-mail to the Lottery. "She said the ticket went threw [sic] but did not print nothing out…. She gave me the ticket and said try it some other time." He tried to redeem the ticket at another store, "but they said it was already paid out."

The Lottery Web Master[187] responded by encouraging the man to take his ticket to the Lottery's regional office in Cedar Rapids or to mail it to Lottery headquarters in Des Moines.

Terminals can occasionally malfunction, a fact that the Lottery has acknowledged to us. But retailer fraud is an equally plausible explanation for these incidents. The Canadian investigations found a scam in which store clerks swiped tickets through the terminal twice. If it was a winning ticket, the second try produced a receipt indicating that the prize had already been paid out. In some cases, the clerk gave the winning ticket back to the customer, but took and kept the prize money from the cash register after the customer left.[188]

It is almost impossible to distinguish between a terminal malfunction and retailer fraud without investigating the incident in question. This means that whenever a customer alleges that a terminal (or retailer) reported their winning ticket was already paid, or was not a winner, that complaint needs to be forwarded to the Security Division for investigation.[189] As explained above, it would be a better practice not to treat it as a case of a malfunctioning terminal without a proper investigation.

However, we found two customer complaints on this topic that were not forwarded to the Security Division.[190] Diane McCool, the employee who commonly works as the Web Master, confirmed to us that she usually does not forward such cases to the Security Division.[191]

Ellison, Investigator Supervisor, told us that the decision to involve a regional sales manager "was done without our knowledge. And we were not happy. Because we had plans for that case."

[187] The Lottery Web Master is the person responsible for fielding e-mail contacts from the public.

[188] Palming could produce similar results, especially if the ticket that is swiped is a small-value prize winner that was previously paid out.

[189] We found at least two similar cases which were forwarded to the Security Division: Iowa Lottery Security Investigator Report, Case No. 07-030 (2007) and Iowa Lottery Security Investigator Report, Case No. 07-109 (2007).

[190] E-mail from a Waterloo customer to Iowa Lottery (Dec. 24, 2006) (on file with author); E-mail from a Sioux City customer to Iowa Lottery (Feb. 7, 2007) (on file with author).

[191] Sworn Interview of Diane McCool at the Office of Citizens' Aide/Ombudsman (Sept. 15, 2008).

In addition, two other employees[192] whose job duties include receiving occasional calls from customers told us that they usually forward such calls to the Validations Unit.[193]

4. APPROXIMATELY 15 COMPLAINTS NOT FORWARDED

In reviewing customer e-mails and letters to the Lottery from 2006 and 2007, we found approximately 15 security-related complaints that were not forwarded to the Security Division.

There is reason to believe there have been other such examples the Lottery cannot account for. This is because before early 2008, the Lottery did not log phone calls from customers who wanted to report a problem or file a complaint. This means there is no way to quantify or track the security-related contacts that should have been forwarded to the Security Division but were not.

5. DELAY

We also found an example of a delay in forwarding a customer's complaint to the Security Division. On September 4, 2007, a district sales representative (DSR) working out of the Mason City Regional Office documented a conversation with a customer who alleged that a grocery store "tried to fool her and her boyfriend into thinking winning tickets were actually losers."[194] The customer had already filed a report with local police, the sales representative noted.

One month later (October 5), the same sales representative documented that he was "still getting complaints" about the same grocery store trying to convince customers that a winning ticket was a non-winner.

Both reports were forwarded to the Security Division on October 10, more than a month after the Regional Office received the initial report. The DSR apparently did not record the customer's name or how to contact her.

OMBUDSMAN RECOMMENDATIONS

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.

23. The Lottery should adopt a policy requiring that the Lottery's investigative actions involving theft or fraud must be performed by Security Division investigators.

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[192] Sworn Interview of Deana Connelly at the Office of Citizens' Aide/Ombudsman (Sept. 15, 2008); Sworn Interview of Linda Young at the Office of Citizens' Aide/Ombudsman (Sept. 19, 2008).

[193] The Validations Unit is responsible for "validating" the authenticity of a winning ticket before a prize is paid to the customer who redeems it. The unit also ensures that the customer has signed the ticket and has completed a claim form that helps the Lottery determine whether the customer owes debts to the state.

[194] Iowa Lottery Security Investigator Report, Case No. 07-117 (2007).

B. INADEQUATE RESPONSES TO ALLEGATIONS OF RETAILERS CHEATING CUSTOMERS OUT OF PRIZE MONEY

From 2005 through 2007, the Security Division opened approximately 34 files that can be described as complaints from customers alleging retailer impropriety.[195] We found that most were not investigated effectively.

Here are some examples:

1. INVESTIGATOR DEFERS KEY QUESTION TO STORE MANAGER, THEN FOCUSES ON WRONG GAME

A customer alleged that a convenience store clerk paid him $5 for a ticket that won $100 in the $100,000 Cash Game. The investigator reviewed the complaint and closed it as "invalid" for two reasons.

First, at the investigator's request, the store manager reviewed the store's security videotape. The manager reported finding nothing suspicious on the tape. As previously noted, relying on store management is not an effective way to get to the bottom of a fraud or theft allegation.

Second, the investigator reviewed records of prize payouts at the store on the day in question. "The only POWERBALL CASHING was for $3.00," he wrote in the case file. It is unclear why the investigator was focusing on Powerball prizes, since the customer said the incident involved a ticket for the $100,000 Cash Game.[196]

2. CLERK CLAIMS $100 WINNING TICKET IS NOT A WINNER

After a Powerball drawing, a customer checked the numbers and learned that her ticket had won $100. She took the ticket to a convenience store in Council Bluffs. As the store clerk swiped the ticket through the terminal, the woman saw "$100" flash on the customer display unit.

The clerk, however, claimed the ticket was not a winner. The woman responded by noting that she had seen "$100" flash on the display. The clerk then scanned the ticket a second time; this time the clerk confirmed it was a $100 winner, and paid the woman her prize. The clerk told her that the terminal occasionally does not read tickets correctly.

Even though she got her $100, the woman called the Lottery the next day. She explained that she "felt the store clerk was trying to cheat her" out of the $100, the investigator wrote.[197]

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[195] As noted previously, these are the cases where the customer realized something was amiss and decided to report it to the Lottery. In the absence of a proactive enforcement system, there is reason to believe there have been other such incidents that went unreported.

[196] Iowa Lottery Security Investigator Report, Case No. 07-058 (2007).

[197] Iowa Lottery Security Investigator Report, Case No. 07-040 (2007).

According to the investigator's report, Lottery records showed:

- The ticket was initially scanned at 3:40 p.m. and the clerk pushed "no" when the terminal asked whether to cash the ticket.[198]

- The ticket was scanned through a second time, at 3:41 p.m., and the prize was then paid.

Under the circumstances, it would have been reasonable to expect that the investigator would ask the clerk to explain why she pushed "no" to cashing the ticket, while at the same time telling the customer that it was not a winner. However, the investigator told us that he did not contact the clerk.[199]

Based on this information, the investigator inexplicably closed the investigation, with a note that he "cannot prove intent" to defraud the customer. When we asked the investigator about his rationale for closing the case in that manner, he responded, "The customer got paid, as far as I'm concerned the complaint was taken care of, and probably her boss talking to her was going to do more good than me."

3. NO CONSEQUENCES FOR THREE RETAILERS WHO KEPT HUNDREDS OF DOLLARS FROM CUSTOMERS UNDER FALSE PRETENSES

In a five-month period from late 2005 to early 2006, the Security Division received three nearly identical complaints from within a 40-mile radius in northeastern Iowa.[200]

The first two complaints, received a month apart, involved owners of gas stations a half mile apart in a city in northeast Iowa. The third complaint involved an employee at a small-town convenience store 40 miles away.

In each case:

- The retailer redeemed a customer's $1,000 winning Touch Play ticket (despite the fact that Lottery rules prohibit stores from redeeming prizes of more than $600).

- The retailer paid the customer anywhere from $400 to $800, falsely claiming the rest was needed for withholding taxes (even though withholding taxes on a $1,000 prize would amount to only $50).[201]

- The retailer then claimed the $1,000 prize for himself from the Lottery, and in the process came out with a profit between $250 and $550.[202]

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[198] When a terminal identifies a scanned ticket as a winner, the monitor displays a question, asking whether to cash the ticket. The clerk can press "yes" or "no" to this prompt. The primary purpose is for situations where a store does not have enough cash on hand to pay a prize – but that was not the case in this incident.
[199] Sworn Interview of Larry Steele at the Office of Citizens' Aide/Ombudsman (Oct. 8, 2008).
[200] Iowa Lottery Security Investigator Report, Case No. 05-072 (2005); Iowa Lottery Security Investigator Report, Case No. 05-092 (2005); Iowa Lottery Security Investigator Report, Case No. 06-053 (2006).
[201] Iowa Lottery, Claiming Prizes FAQ, http://www.ialottery.com/faqs/ClaimingPrizes.html (last visited Feb. 27, 2009) ("By law, prizes of more than $600 and less than $5,000 will face a 5 percent state withholding tax.").
[202] One of the gas station owners redeemed two $1,000 winners in this manner. Both tickets were from the same customer. The owner paid the customer $800 on the first and $700 on the second. After claiming the

- The Security Division did not report any of these incidents to law enforcement or prosecutors, and Lottery investigators did not consider whether the retailers' actions were a criminal act under state law.[203] When we discussed these three cases with recently retired Vice President for Security Braafhart, he agreed that the retailers probably did steal money from the customers and that their actions were potentially criminal.[204]

- The Lottery did not consider imposing license sanctions against the retailers, even though two of the cases involved store owners.[205] Asked what should have been done to those retailers' licenses, Braafhart told us, "Probably would have at least been a suspended license, unless it was a felony charge and then it would have had to have been revoked."

- The retailer received no sanctions or other consequences for violating the Lottery's redemption rule or for keeping hundreds of dollars from customers under false pretenses.

Two of the retailers in question claimed several other high-tier Touch Play prizes in the months before and after these incidents. These other prize claims raise the possibility that the incidents complained about may not have been isolated. However, the Lottery did not investigate any of those other prize claims.[206]

The gas station owner in case file 05-072 made five Touch Play prize claims over an eight-month period for a total of $4,751. The convenience store employee in case file 06-053 made six Touch Play prize claims over a four-month period for a total of $6,787. The file shows that the investigator was aware of the first three of those prize claims.[207]

In the same two cases (05-072 and 06-053), the investigators wrote that the store agreed to pay the customer what she was still owed. Both investigators told us that they later verified with the customers that the store had paid them the proper amount, but neither investigator memorialized this important contact in their case notes. In the third case (05-092), the investigator did not even attempt to persuade the store owner to make any additional payments to the customer.[208]

The proximity of these three complaints, in terms of when and where they occurred, should have suggested a need to explore the possibilities of a larger pattern of impropriety. But instead, the Lottery worked each case separately, did nothing to hold the retailers accountable, and did not explore the possibility of a larger pattern.

$2,000 in prize money for himself, minus the $100 deduction for withholding taxes, he came out with a $400 profit.

[203] IOWA CODE SECTION 99G.36 (2009) states in part, "Any person who influences or attempts to influence the winning of a prize through the use of coercion, fraud, deception, or tampering with lottery equipment or materials shall be guilty of a class 'D' felony."

[204] Sworn Interview of Harry Braafhart at the Office of Citizens' Aide/Ombudsman (Oct. 8, 2008).

[205] Iowa Lottery Security Investigator Report, Case No. 05-072 (2005); Iowa Lottery Security Investigator Report, Case No. 05-092 (2005).

[206] Sworn Interview of Larry Steele at the Office of Citizens' Aide/Ombudsman (Oct. 8, 2008); Sworn Interview of Ken Moon at the Office of Citizens' Aide/Ombudsman (Sept. 19, 2008).

[207] In addition, the owners of the convenience store claimed four Touch Play prizes during the same period for a total of $4,001, based on our review of the Lottery's database of prize claimants.

[208] Sworn Interview of Ken Moon at the Office of Citizens' Aide/Ombudsman (Sept. 19, 2008).

Asked about these cases and their similarities, Investigator Supervisor John Ellison told us, "It was a surprise to us that it was even happening. I mean it was. It threw us – I'll tell you the truth, didn't know how to handle it."[209]

We asked recently retired Investigator Larry Steele why he did not pursue the complaint any further in case file 06-053. The interview included this exchange:

> *Ombudsman investigator*: All we know is that allegedly this customer goes in with a $1,000 winner, store only gives her 400, keeps the other portion.
>
> *Steele*: And that was her fault, that was her mistake for not collecting the money on the spot.
>
> *Ombudsman investigator*: That's her fault?
>
> *Steele*: Yeah. "Give me my money."
>
> *Ombudsman investigator*: How was she going to compel him? Does she have more authority than you?
>
> *Steele*: She could have called the local authorities or whatever.
>
> *Ombudsman investigator*: But she called you guys.
>
> *Steele*: Her daughter called.[210]

OMBUDSMAN RECOMMENDATION

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.

4. NO CALL TO CUSTOMER TO RULE OUT POSSIBILITY OF THEFT OR FRAUD

We found an additional case of concern, although it did not originate as a customer complaint.[211] A bar owner went to the regional office in Council Bluffs to try to redeem a $750 Touch Play ticket. He said that an employee had cashed out the ticket for a customer, whose signature was on the back of the ticket.[212]

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[209] Sworn Interview of John Ellison at the Office of Citizens' Aide/Ombudsman (Sept. 19, 2008).
[210] Sworn Interview of Larry Steele at the Office of Citizens' Aide/Ombudsman (Oct. 8, 2008).
[211] Iowa Lottery Security Investigator Report, Case No. 05-083 (2005).
[212] The Licensing Terms and Conditions prohibits retailers from redeeming winning tickets of more than $600. (*See Appendix A.*) However, this file gives no indication that this violation was even discussed with the bar owner.

Staff at the regional office called the Security Division to ask whether they should allow the bar owner to redeem the ticket by signing his name under the customer's name. The investigator's notes state that he contacted an employee in the accounting division:

> … and told her I was not comfortable have [sic] the bar owner sign the slip without some sort of documentation relieving the lottery of any liability.
>
> I was sure the employee paid the customer, but just in case this did not occur we needed to make the bar owner liable.

Because the customer's signature was on the back of the ticket, presumably the investigator could have tried to contact the customer to confirm that he or she had already received their rightful prize money from the bar. But the file gives no indication that any such attempts were made. We asked Investigator Roger Mott whether he tried to contact the customer in this matter, "I don't remember if I tried to reach the customer," Mott replied.[213] Based on this information, we find that Mott did not attempt to contact the customer.

Instead, Mott prepared an affidavit for the bar owner to sign, relieving the Lottery of any liability – "just in case" bar staff had obtained the ticket through fraud and/or theft. If this had been a case of fraud or theft, and if the customer was unaware, the investigator's failure to make contact with the customer virtually guaranteed it would never be detected.

C. INADEQUATE RESPONSES TO ALLEGATIONS OF "PICKOUTS"

Of the various lottery-related scams, perhaps the most insidious is referred to as "pickouts." This is a practice where a store employee takes unsold instant tickets, scratches them lightly, "picks out" the winners, and then sells the non-winners to the public.

This scam directly victimizes any customer who is unaware that he has purchased instant tickets that were already scratched. The customer perceives that he has bought legitimate instant tickets, but they are in fact guaranteed losers.

Given the nature of this scam, it is critical that Lottery investigators give serious scrutiny to any allegation of pickout activity. If a customer says he bought instant tickets but later discovered they were already scratched, it should signal that there may be other customers who were also victimized but did not notice the light scratch marks.

We found that the Lottery received at least ten separate allegations of pickout activity, or possible pickout activity, from 2005 through 2007.[214] None received serious scrutiny from the Lottery, whose handling of these ten complaints can be broken down as follows:

- **Effectively ignored:** Two were effectively ignored, including one that was not forwarded to the Security Division.

[213] Sworn Interview of Roger Mott at the Office of Citizens' Aide/Ombudsman (Sept. 19, 2008).
[214] For analysis of how the Lottery handled these complaints, *see Appendix I, "Pickouts case studies."*

- **Deferred:** Four were not investigated by the Security Division, and instead were left to others to check into. Two were deferred to store management. One was deferred to a regional manager in the Lottery's Marketing Division. One was handled by encouraging the store to file a police report.

  In one of these cases, we asked the investigator why he deferred such a potentially significant complaint to store management. "Because that's the way we've always done it," Investigator Mott replied.

  As explained previously, this is not an effective way to get to the bottom of a matter, as store management may have a private business interest in ensuring that no problems are found when a complaint is made.

- **Inadequate investigations:** Two were investigated in a manner that we found to be inadequate.

- **Suspect prosecuted, Lottery played no meaningful role:** Two cases fell in this category. In one case, the Lottery investigator deferred the complaint to store management and asked Lottery sales staff, who were not trained investigators, to monitor the store. Within a few hours of taking those steps, the investigator received a call from a local police officer, who reported that he had investigated the report and was arresting one of the store's employees.

Of these ten complaints, none received serious scrutiny by the Lottery. In addition:

1. The suspect was not identified in seven of the ten cases. As a result, if any of those individuals became the subject of a subsequent complaint involving pickouts, it is not likely that the Lottery would have a way of realizing that it was dealing with a repeat offender.

2. Among the cases where the complaint was substantiated, there is no indication that the investigators considered the interests of other customers who may have been sold "pickouts" – instant tickets that were actually guaranteed losers – without realizing it.

3. Among the cases that were not substantiated, the investigators did not consider using a possible tool – consulting the store's surveillance video tape to see whether it documented the activity that was alleged. When we asked investigator Roger Mott why he did not consult the surveillance tape in one of his "pickout" cases, he replied, "Probably should have used it. Probably dropped the ball on it."

OMBUDSMAN RECOMMENDATIONS

25. The Lottery's Security Division should implement methods and procedures to ensure that reports of alleged "pickout" activity receive priority treatment.

26. The Lottery should amend its administrative rules to require licensed retailers to have functional surveillance video cameras and to grant the Lottery access to video recordings upon request.

D. INADEQUATE INVESTIGATION OF INTERNAL THEFT CASE INVOLVING UP TO $86,000

> We want our retailers to know we're available to assist them with any type of situation they see as suspicious. That's why we're here.
>
> *— Lottery Investigator Larry Steele, as quoted in the May 4, 1998, edition of "Lottery Action" newsletter*

> Steele advised that as far as he was concerned, the Lottery Commission was out of the investigation as it was deemed a case of theft which required local law enforcement jurisdiction.
>
> *— December 2006 supplemental entry to police investigative file*

On August 29, 2006, an eastern Iowa convenience store reported that it had a $15,000 shortage in its Lottery accounts over a seven-month period.

The Lottery case file shows that Investigator Larry Steele worked the case for about two weeks and believed criminal activity had probably occurred.[215] His work culminated in a meeting with the store owner and a police officer. Steele provided the officer with spreadsheets detailing the inventory and cashing records of numerous instant-ticket packs that the Lottery had provided to the store.

We also reviewed the police investigative report. The Lottery file and the police report both indicate that the meeting focused on the need for the store to determine its actual shortages. Officials discussed preparing a criminal case against the four employees suspected – particularly the store's manager, who two years before had admitted embezzling $37,180 from the same store.[216] The other suspects were identified as the manager's boyfriend and her two daughters.[217]

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[215] Iowa Lottery Security Investigator Report, Case No. 06-122 (2006).

[216] Notarized Statement from store manager to store owner (Nov. 2, 2004), Iowa Lottery Security Report, Case No. 06-122 (2006). While the store manager's 2004 statement acknowledged that her actions had been criminal, the owner did not press charges against the store manager for those actions.

[217] We found that the manager had claimed a $10,000 instant-ticket prize in 1998; and her boyfriend subsequently claimed three $9,750 Pick 4 prizes (two in 2007 and one in 2009). Based on our review of the Lottery's database of prize claimants, and also our review of the Lottery's online "Big Winners List." Iowa Lottery, Recently Claimed Big Prizes, http://www.ialottery.com/WinnersCircle/WinnersCircle_claimedprizes.asp (last visited Mar. 25, 2009).

During the meeting with police and the store owner, Steele "stated that the theft of lottery tickets … are handled by local law enforcement," the police officer wrote in her report about the meeting. Steele confirmed to us that he told police and the store owner that he could not continue with the investigation. "I assume when we turn the records over to the investigating agency our role ends," Steele explained. "Other than maybe testimony at a later date for prosecution."[218]

The day after the meeting, Steele typed a one-page report summarizing what had been discussed. We found that Steele did not perform any further substantive work on the investigation.

However, we found five reasons why Steele should have continued with the investigation:

1. SUPERVISOR DISPUTES LIMITED LOTTERY ROLE

When we asked Steele, "Is your closing out of the investigation simply a matter that your hands are tied and that's all you can do," he replied, "That's right. That's true."

But when we asked Investigator Supervisor John Ellison whether Lottery investigations are always local matters, he responded, "No. That's an incorrect statement."[219]

Ellison clarified, "If a police department tells us that they're taking it over and with us not having police powers, it's their baby." That was not the situation with this investigation, however.

2. PROFESSIONAL AUDIT FOUND $86,472 IN LOTTERY SHORTAGES AT STORE

In direct response to Steele's advice, the store owner hired a professional accounting firm to audit the store's records.[220] The audit found the shortage involving Lottery instant ticket sales went back to 2005 and totaled $86,472[221] – much larger than previously suspected.[222]

The police file shows that the store owner informed a police captain on December 1, 2006, that the audit had just been completed. The store owner suggested that Lottery Investigator Steele should be notified so that a meeting could be arranged to review the findings, according to the captain's report.

But when the captain called Steele three days later to seek the Lottery's continued assistance, he was rebuffed. "Steele advised that as far as he was concerned, the Lottery Commission was out of the investigation as it was deemed a case of theft which required local law enforcement jurisdiction," the captain wrote in his report.

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[218] Sworn Interview of Larry Steele at the Office of Citizens' Aide/Ombudsman (Oct. 8, 2008).
[219] Sworn Interview of John Ellison at the Office of Citizens' Aide/Ombudsman (Sept. 19, 2008).
[220] Telephone Interview of store owner by an Ombudsman investigator (Apr. 10, 2008).
[221] Cover Letter and Attachments from RSM McGladrey, Inc. to the store (Nov. 30, 2006) (on file with author).
[222] In our review of Lottery files from 2005 through 2007, we only found one case where a store reported a larger Lottery-related shortage. It involved a pharmacy where a part-time employee pled guilty to first-degree theft and was ordered to pay restitution of $107,137 to the store. Iowa Lottery Security Investigator Report, Case No. 06-140 (2006).

The captain documented that Steele also said he "was not sure of what loss the [store] could directly attribute to the theft of lottery tickets." When we interviewed Steele, he explained that he did not believe the store's Lottery shortages were anywhere near the level reported by the store. "I could not see – personally even come close to what he was claiming," Steele told us.

However, we found that Steele did not obtain or review the audit report by the professional accounting firm – an audit which the store arranged and paid for as a direct result of advice from Steele himself.[223]

3. TWO WITNESSES NOT CONTACTED

In his case notes, Steele wrote, "Enclosed and attached is [sic] statements from two employees … stating how [the store manager] is taking money and LOTTERY SCRACTH [sic] TICKETS, without paying for them."

One witness wrote, "I know a lot more information than what is contained in this letter."[224] But we found that this witness was not contacted by either the Lottery or the police department about this matter.[225]

The other witness statement alleged that the suspects kept "stacks" of instant tickets in a private vehicle. We found no indication that this witness was contacted either.

4. INVESTIGATOR BELIEVED CRIMINAL ACTIVITY PROBABLY OCCURRED

While Steele expressed doubts about the size of the store's Lottery-related shortages, he had little doubt that crimes had occurred. Referring to the store manager, Steele told us, "I'm sure that she was probably taking tickets and they were cashing them."

This was in part based on Steele's knowledge that the store manager had previously admitted to embezzling $37,180 from the same store. In his case file notes, Steele wrote, "Now it appears that [the store manager] is embezzling again." He also wrote that the store manager "is very well versed at manipulating store recorders [sic] and bookkeeping."

In addition, a Lottery spreadsheet created at Steele's request showed sizable increases in Lottery activity at the store between 2005 and 2006. While Steele did not perform his own calculations of the data on the spreadsheet, he told us that he knew the increases were "fairly large."

[223] We obtained a copy of the professional audit from the store owner, as there is no copy of the audit in the Lottery case file.
[224] Witness statement, Iowa Lottery Security Investigator Report, Case No. 06-122 (2006).
[225] Telephone Interview of witness by an Ombudsman investigator (Aug. 13, 2008).

Our calculations of the data on the spreadsheet showed:[226]

- **Net sales**: A 54 percent increase in net sales (from $135,142 to $208,654, an increase of $73,512).

- **Prize payouts**: A 72 percent increase in prize payouts (from $45,776 to $78,646, an increase of $32,870). This was money ultimately paid out by the Lottery.[227]

We found no indication that Steele determined the amount of those prize payouts for tickets that may have been stolen.

5. POLICE INVESTIGATION HAS LANGUISHED

Local police obtained the audit report from the store owner and the department's investigation remains open. But the police captain told us "it's languished" in part because analyzing the professional audit "is like reading Greek."[228]

"It would be great if the Lottery Commission would go in, do their own internal investigation and send us a report based on their calculations," the captain added. "It would be nice to be able to fall back on them, since it's their bailiwick, and let them tear it up."

6. CONCLUSION

This is a major theft case. The investigation has stagnated for two years. Charges have not been filed and are not seriously contemplated.

By contrast, internal-theft suspects in other cases have been prosecuted for stealing as little as $36 worth of tickets and even $26 worth of tickets.[229] We also found a case file involving a customer who was prosecuted for stealing ten instant tickets that had little or no value. He tried to redeem them at another store, but the terminal reported that the tickets had already been redeemed.[230]

This case, which involved up to $86,000 in stolen tickets, "was definitely prosecutable," the store owner told us.

Lottery Investigator Steele saw this case a bit differently. He referred to the fact that the store owner had continued to employ the manager after her previous admission of criminal activity. "Let's just say you get bit once, too bad," Steele told us. "You get bit the second time, shame on you, and that's what happened here."

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[226] Using figures on the Lottery spreadsheet, we compared the store's Lottery-related activity for the first eight months of 2005 and the first eight months of 2006. The Lottery's spreadsheet was created on or about August 30, 2006, and therefore did not reflect activity for the final four months of 2006.

[227] The Lottery automatically credits stores for such prize payouts. This issue will be examined in greater detail in Section VI of this report.

[228] Telephone Interview of police captain by an Ombudsman investigator (Apr. 10, 2008).

[229] Iowa Lottery Security Investigator Report, Case No. 05-106 (2005); Iowa Lottery Security Investigator Report, Case No. 05-085 (2005).

[230] Iowa Lottery Security Investigator Report, Case No. 05-080 (2005) and the police incident report.

E. PRIZE CLAIM HISTORIES OF THEFT SUSPECTS RARELY CHECKED, OTHER CRIMES POTENTIALLY MISSED

In March 2006 the Lottery honored a $10,000 Touch Play prize claim from a manager of a bowling alley in northeast Iowa, agency records show. Six weeks later, the manager was arrested after admitting he had forged two other Touch Play tickets and redeemed them at local stores for $296. A few days after his arrest, the police chief reported the matter to the Security Division. The information in the file indicates the investigator took notes of the chief's phone call, typed the notes into the file, and then closed the case.[231]

We found that the investigator was not aware of the $10,000 prize claim.[232] If he had checked the Lottery's database of winners, he would have discovered the manager's $10,000 prize claim from just more than a month earlier. This would have enabled the investigator to review the man's $10,000 prize claim to see whether it might have also involved a forged Touch Play ticket.

With the manager admitting that he forged two Touch Play tickets, the failure to identify and review his much larger Touch Play prize claim was significant. There certainly is not enough information to conclude that the $10,000 prize claim was fraudulent. But at the same time, it would be naïve to rule out fraud without an investigation.

The failure to identify the manager's $10,000 prize claim was not isolated. Among store employees who were identified as suspects in Security Division case files from 2005 through 2007, we found that at least 16 had previously claimed high-tier prizes. The prize claims for 12 were not identified in the case file. Some of those claims had been made just a few days or weeks before the report was filed.

Among these cases, the most prominent involved a store manager who pled guilty to first-degree theft in connection with the theft of $45,204 worth of Pull-tab tickets and cash. The manager had claimed 17 prior prizes, totaling $33,290. Included was a $10,000 instant-ticket prize claim about one year before his employer filed a theft report with police and the Lottery.[233]

We also found two store employees who claimed high-tier prizes shortly after being arrested and charged with internal theft of Lottery tickets. Neither of these prize claims were noted in the case files.

The first involved a store clerk who claimed a $1,000 Touch Play prize just three days after being arrested for stealing $130 worth of instant tickets.[234] The other involved a store clerk who claimed a $1,000 Touch Play prize about two months after being arrested in connection with a $2,700 shortage in Touch Play machine revenue.[235]

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[231] Iowa Lottery Security Investigator Report, Case No. 06-101 (2006).
[232] Sworn Interview of Larry Steele at the Office of Citizens' Aide/Ombudsman (Oct. 8, 2008).
[233] Iowa Lottery Security Investigator Report, Case No. 07-114 (2007).
[234] Iowa Lottery Security Investigator Report, Case No. 05-078 (2005). In addition, the clerk's husband made a $1,000 Touch Play prize claim just two days after she pled guilty to Lottery theft.
[235] Iowa Lottery Security Investigator Report, Case No. 05-108 (2005).

In all cases of alleged theft or fraud, we believe it is reasonable to expect Lottery investigators to routinely check suspects' prize claims – both before and after the alleged impropriety – and to review any high-tier prize claims that are discovered. "It's pretty easy to do a search," Validations Manager Therese Spaulding told us. "You can train just about anybody to do it."[236]

Retired Vice President for Security Braafhart conceded it would be wrong to assume that a suspect's past prize claims were legitimate:

> *Ombudsman investigator*: Would you agree that you wouldn't know unless you looked into it?
>
> *Braafhart*: Yeah, I'd agree with that.[237]

Then-Acting CEO Brickman agreed that investigators should review suspects' previous high-tier prize claims. "I think if I knew that I would want to look into it, yes," Brickman told us. "It doesn't necessarily mean that there's a problem but it would be something to look into."[238]

OMBUDSMAN RECOMMENDATIONS

27. The Lottery's Security Division investigators should have direct access to the Lottery's winner database and should be adequately trained to use it.

28. The Lottery's Security Division should develop and implement a policy requiring its investigators to routinely check and document the prize claim history of all identified suspects. The policy should encourage investigators to review previous high-tier prize claims when circumstances warrant.

29. The Lottery should develop a method to flag the names of all theft or fraud suspects so that any subsequent prize claims they submit will be brought to the attention of the Security Division for possible investigation.

F. FAILURE TO PURSUE ALLEGATION THAT $250,000 JACKPOT TICKET WAS PURCHASED ILLEGALLY

We found seven case files involving allegedly fraudulent purchases of Lottery tickets. In six of the cases, the investigator worked them as theft cases:

- Three involved stolen credit cards.[239]
- One involved stolen gift cards.[240]
- One involved a stolen check.[241]

[236] Sworn Interview of Therese Spaulding at the Office of Citizens' Aide/Ombudsman (Sept. 15, 2008).
[237] Sworn Interview of Harry Braafhart at the Office of Citizens' Aide/Ombudsman (Oct. 8, 2008).
[238] Sworn Interview of Ken Brickman at the Office of Citizens' Aide/Ombudsman (Sept. 17, 2008).
[239] Iowa Lottery Security Investigator Report, Case No. 05-025 (2005); Iowa Lottery Security Investigator Report, Case No. 06-008 (2006); Iowa Lottery Security Investigator Report, Case No. 06-125 (2006).
[240] Iowa Lottery Security Investigator Report, Case No. 06-051 (2006).
[241] Iowa Lottery Security Investigator Report, Case No. 05-071 (2005).

- One involved a bad or fraudulent check.[242]

In the seventh case, the investigator did not work it as a theft case, even though one of the tickets was a $250,000 jackpot winner. That case was triggered by a letter claiming that an individual "had bragged about writing a forged bad check" to purchase instant scratch tickets.[243]

The investigator interviewed the letter's author, who said an acquaintance had been bragging about writing a bad check to purchase a ticket which turned out to be a $250,000 jackpot winner. The check-writer later gave the winning ticket to his mother, for her to claim the jackpot.

The investigator's notes show he identified the check-writer's mother and confirmed that the Lottery had paid her for a $250,000 prize claim four months prior. The investigator wrote that he subsequently contacted local police to see if they had received any reports of bad checks from the store where the ticket had been purchased. The file does not indicate how the police department responded.

Under the circumstances, the investigator had several viable options, including:

- Trying to interview the check-writer and his mother
- Seeking direction from the Lottery's legal counsel or prosecutors

But the investigator pursued neither option. Instead, he took no further action and ruled out fraud by the woman who claimed the jackpot. But that was irrelevant to the central question: Was the ticket purchased illegally?

Determining whether the ticket was purchased fraudulently should matter to the Iowa Lottery. If it was purchased fraudulently, as alleged, the man who obtained the ticket, in particular, may have benefitted from a criminal act if he shared in or was given part of the prize money.

OMBUDSMAN RECOMMENDATIONS

30. The Lottery's Security Division should reopen case file 07-020 to determine whether the ticket was purchased illegally, and proceed accordingly.

31. The Lottery should propose amending Iowa Code section 99G.31 to establish that any prizes accruing from tickets purchased unlawfully shall not be paid or shall be forfeited. This would be similar to the provision in Iowa Code section 99G.30 dealing with underage players.

[242] Iowa Lottery Security Investigator Report, Case No. 07-047 (2007).
[243] Iowa Lottery Security Investigator Report, Case No. 07-020 (2007).

G. LOTTERY HAS PROVIDED INADEQUATE EXPLANATION OF DUTIES TO INVESTIGATORS

> I was never told how to do my job by anyone.
>
> *— Former Lottery Investigator Larry Steele*
> *in an interview with Ombudsman investigators*

Larry Steele, a former sheriff's deputy and police officer for the U.S. Postal Inspection Service, was one of the Iowa Lottery's first hires in 1985. He was also the last of the Lottery's original investigators to retire from the agency in July 2008.

Steele was, in his latter years, the most prolific of the Lottery's investigators. As one of the Security Division's four investigators, Steele handled nearly half of the Lottery's theft- and fraud-related investigations we reviewed from 2005 to 2007.

Yet, despite the countless times he was called upon to investigate customer complaints and protect the integrity of Lottery games, Steele said he was never given any practical instructions on how to fulfill that mission.

"We hire investigators that have been in the field for many, many years," explained Investigator Supervisor John Ellison. "Pretty much are on their own on their cases and that's why we hire them with the amount of years that they have in."[244]

We found that the Security Division has no written policies on how to conduct investigations. According to Ellison, the Security Division does have written policies for how to conduct drawings and what to look for when visiting facilities that print the Lottery's tickets. "Those kinds of policies and procedures are in place," Ellison added. "It pretty much ends right there."

Steele's first supervisor at the Lottery, recently retired Vice President for Security Harry Braafhart, agreed that written policies would help investigators, but acknowledged that he did not develop written policies.[245]

When we asked how Lottery investigators could fulfill their responsibilities without written direction from their superiors, then-Acting CEO Ken Brickman responded:

> All these people have had police investigation background experience…. They don't need specific directions to tell them the first thing you do is 'X' or the next one is 'Y'. They know instinctively and by education and training what it is they're expected to do.[246]

However, each of the Lottery's four veteran investigators told us they were uncertain how to handle various routine situations. We found that this uncertainty brought down the quality of their work.

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[244] Sworn Interview of John Ellison at the Office of Citizens' Aide/Ombudsman (Sept. 19, 2008).
[245] Sworn Interview of Harry Braafhart at the Office of Citizens' Aide/Ombudsman (Oct. 8, 2008).
[246] Sworn Interview of Ken Brickman at the Office of Citizens' Aide/Ombudsman (Sept. 17, 2008).

For example, investigators were not in agreement about what they were supposed to check during their retailer compliance reviews. If problems were discovered during those reviews, investigators told us they did not know how to ensure that potential license sanctions were considered.

Similarly, investigators told us they were given no specific instructions on:

- How to deal with uncooperative retailers.
- What information to include in a case file.
- When to check a suspect's background for previous prize claims.

This is not to say that the Security Division lacks knowledge of good investigative techniques and practices. In fact, the Lottery's investigators have a wealth of law-enforcement experience in such areas as homicide, sexual abuse, counterintelligence, mail fraud, internal affairs, patrol, undercover security and tort claims.

During our interviews, it became clear that the Security Division's two managers had reasonable expectations of what makes for a solid investigation. However, their ideas about investigative approach and documentation were not communicated to their investigators in any formal sense. Neither was investigators' casework routinely supervised or critiqued.

In the absence of written protocols, we found that Lottery investigators often fall back on word-of-mouth advice or embedded office culture to guide them in their work. This reliance on office culture, rather than on written policy, has contributed to an enforcement model that leaves unsuspecting customers vulnerable and thieves virtually unaccountable.

OMBUDSMAN RECOMMENDATIONS

32. The Lottery's Security Division should develop and implement written policies to help guide its staff when conducting investigations.

33. The Lottery should more closely review the casework of the Security Division's investigators. This should include, but not be limited to, reviewing the completeness and accuracy of each closed investigative case file in a timely fashion, evaluating whether the case was resolved adequately, and communicating any concerns to investigators within a reasonable period of time.

34. The Lottery should ensure that investigators are availed of adequate opportunities to receive professional training on proper investigative procedures and techniques, and should require additional training as appropriate.

H. THE TOUCH PLAY DEFENSE

Security Division employees told us that their capacity to conduct effective and thorough investigations was challenged during the existence of Touch Play:[247]

- "During this Touch Play thing we were running fast, feverish and hard," Investigator Roger Mott said.[248]
- "There was complete chaos," Investigator Larry Steele said.[249]
- Investigator Ken Moon said staff was "overstressed" from the additional licensing-related duties flowing from Touch Play. "That could have led to me overlooking some of these situations to be quite honest with you," Moon said, later adding, "It just was not us, it was the entire lottery."[250]

In our analysis, this defense of inadequate investigations is plausible – but only to a certain degree, and with several caveats:

1. **Inadequate casework was not confined to Touch Play period:** We found inadequate casework throughout 2005, 2006 and 2007. Touch Play operated on a statewide basis from April 2004 to May 3, 2006. We found no discernible improvement in how investigations were handled after May 3, 2006.

2. **Security Division was not inundated with customer complaints at the time:** Two of the most egregious cases we found occurred in the fall of 2005, during the midst of Touch Play.[251] But those two cases were the only complaints from customers that the Security Division investigated in all of 2005.

3. **Lottery made extra millions from Touch Play but did not hire additional Security Division staff:** This is reinforced by the fact that the final report of the Governor's Touch Play Task Force, issued March 6, 2006, included a consensus recommendation to hire ten new full-time DCI agents to monitor compliance with Touch Play retailer requirements.

4. **The Security Division did not request assistance from the Division of Criminal Investigation (DCI), as Iowa law allows:** Iowa Code section 99G.33 (2009) states, "The department of public safety, division of criminal investigation, shall be the primary state agency responsible for investigating criminal violations under this chapter."

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[247] Touch Play sales began in May 2003 under a limited marketing test and went statewide in April 2004. MARY NEUBAUER, IOWA LOTTERY, QUESTIONS ABOUT IOWA LOTTERY PRODUCTS (Feb. 20, 2006) (http://www4.legis.state.ia.us/lfb/subcom/oversight/lottery_2006/Lottery_Response_to_Questions_2-20-06.pdf). May 3, 2006, was the final day of Touch Play sales. IOWA LOTTERY, IOWA LOTTERY REPORT ON OPERATIONS (June 2008) (on file with author).

[248] Sworn Interview of Roger Mott at the Office of Citizens' Aide/Ombudsman (Sept. 19, 2008).

[249] Sworn Interview of Larry Steele at the Office of Citizens' Aide/Ombudsman (Oct. 8, 2008).

[250] Sworn Interview of Ken Moon at the Office of Citizens' Aide/Ombudsman (Sept. 19, 2008) (Moon made his comments about Touch Play after being asked to do so by Assistant Attorney General David Van Compernolle, who sat in on all interviews of Lottery officials).

[251] Iowa Lottery Security Investigator Report, Case No. 05-072 (2005); Iowa Lottery Security Investigator Report, Case No. 05-092 (2005); both discussed previously in this section.

I. MINIMAL COORDINATION WITH LAW ENFORCEMENT AGENCIES

The Lottery's investigators must be qualified by training and experience in law enforcement; however, they are not sworn peace officers.[252] Although they are on the front lines in safeguarding the Lottery's integrity, Iowa law provides for other law enforcement agencies to play an integral role when criminal activities are suspected.

The Department of Public Safety's Division of Criminal Investigation (DCI) serves as "the primary state agency responsible for investigating criminal violations" under Iowa Code section 99G.33 (2009). The Lottery has a written contract with the DCI for carrying out these responsibilities. Under the agreement, the DCI is to "provide investigation services, including appropriate laboratory analysis, for investigating criminal violations of law under Iowa Code, Chapter 99G, as called for by the Lottery or in discharge of the [DCI's] statutory authority."[253]

In addition, Lottery investigators are to report any suspected violations to the appropriate law enforcement agency and appropriate county attorney or the attorney general.[254]

Coordination between the Lottery and law enforcement agencies is important for suspected violations to be fully investigated and, if appropriate, prosecuted. The Lottery clearly has a role in initiating investigations into allegations it receives regarding internal thefts or fraudulent activities involving Lottery tickets. Its investigators have statutory subpoena power and can administer oaths and take testimony related to an investigation.[255] Investigative duties include gathering information, determining whether probable cause exists for further action by law enforcement agencies, and coordinating with those agencies.[256] This means that Lottery investigators need to refer suspected violations to the DCI or other law enforcement agencies when cases warrant further investigation or prosecution.

However, in the cases we examined from 2005-2007, we found little coordination or involvement by the Lottery with the DCI or other law enforcement agencies:

- **DCI:** Of the hundreds of case files we reviewed, we only found a handful where DCI was involved. Charis Paulson, Assistant Director of DCI's Gaming Bureau, told us that DCI would help the Lottery with its investigations "whenever they request our assistance," but that occurs rarely. Paulson said DCI has 120 gaming agents around the state, including four agents devoted specifically to non-casino cases, any of whom could be available for Lottery-related cases.[257]

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[252] IOWA CODE SECTION 99G.35(1) (2009).
[253] Agreement for Cooperative Action Between Public Safety and Iowa Lottery Authority (July 1, 2007) (on file with author).
[254] IOWA CODE SECTION 99G.35(1)(c) (2009).
[255] IOWA CODE SECTION 99G.6 (2009).
[256] Iowa Depart. of Admin. Services, Position Description Questionnaire (PDQ) (Oct. 10, 2001) (on file with author). The Lottery investigators currently are classified as Investigator 3 positions.
[257] Telephone Interview of Charis Paulson by an Ombudsman investigator (June 18, 2008).

- **Local law enforcement:** From 2005 through 2007, 53 internal theft cases resulted in criminal charges. However, we could find only two cases where the initial report to police was made by the Lottery.[258] The other 51 cases were reported to police directly by the stores.

OMBUDSMAN RECOMMENDATION

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.

J. CONCLUSION

> The Lottery's security department has a strong record of investigation and apprehension in its cases.
>
> — *Vice President for External Relations Neubauer, November 1, 2007, memo to Lottery Board*

Good investigators turn over rocks. Not all of those rocks will reveal crimes. But the time spent in turning them over should not be viewed as time wasted.

In many of the cases we reviewed, the Iowa Lottery turned over few rocks. Its files revealed an investigative approach that is often constrained by incuriosity and, at times, an indifference to getting to the bottom of a given situation.

Internal theft cases were often closed once the investigator learned that the store had contacted police. In those cases that did lead to apprehension, much of the work was done not by the Lottery, but by local law enforcement or store officials. Lottery investigators rarely had any direct contact with internal theft suspects.

Individual cases were typically worked in a vacuum. The case files suggest that investigators generally only considered the information that was reported to them or directly related to what was reported. There was little evidence that consideration was given to systemic abuses or connections to other incidents.

This was particularly evident in cases where the only potential victim was a customer. We found numerous customer complaints where leads went unexplored and potential crimes were not pursued. Many of these were the types of cases where the Lottery investigator would need to "make the case." Most of the time they didn't even try.

[258] Iowa Lottery Security Investigator Report, Case No. 06-085 (2006); Iowa Lottery Security Investigator Report, Case No. 07-025 (2007).

VI. VIOLATORS FREQUENTLY NOT HELD ACCOUNTABLE

> The lottery business is not regulatory in nature.
>
> *— Then-Iowa Lottery CEO Dr. Edward Stanek, as quoted in 2003 in Public Gaming International* [259]

A. LOTTERY HAS NEVER SANCTIONED A RETAILER FOR THEFT OR FRAUD

The Lottery has procedures for imposing sanctions against retailers who commit theft or fraud. In his November 5, 2007, letter of response to our notice of investigation, then-Acting CEO Brickman wrote:

> When an investigation indicates retailer impropriety, we refer the case to a law enforcement agency and initiate an assessment of the retailer's licensing status for imposition of sanctions, if appropriate.

In her November 2007 memo to the Lottery Board, Vice President for External Relations Neubauer described how the Lottery decides to impose license sanctions:

> A first-time violation of the terms and conditions results in a one-week suspension of the retail license and therefore, the store's ability to sell lottery products. A second violation within a year results in a one-month suspension of the retail license; and a third violation within a year results in a one-year suspension of the retail license. Any suspected criminal activity would be referred to law enforcement.

From our review of Lottery records and sworn interviews, we found that the Lottery has never imposed a license sanction against a retailer for theft or fraud.

This came as a surprise to Harry Braafhart, who was the agency's first and only Vice President for Security before retiring in July 2008. "I just can't believe that it's zero," he told us.[260]

1. LOTTERY HAS BROAD AUTHORITY TO IMPOSE LICENSE SANCTIONS

State law mandates the Lottery to develop and maintain a statewide network of lottery retailers that will, among other things, ensure the Lottery's integrity.[261] When retailers violate that trust, Iowa Code section 99G.27 (2009) authorizes the Lottery to impose sanctions, up to and including license revocation.

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[259] Mary Neubauer, *The Lottery Remakes Itself into a Corporate-Model Lottery*, PUBLIC GAMING INT'L, Sept. 2003, at 9.
[260] Sworn Interview of Harry Braafhart at the Office of Citizens' Aide/Ombudsman (Oct. 8, 2008).
[261] IOWA CODE SECTION 99G.24(1) (2009).

The section lists nine reasons why the Lottery may impose sanctions. These include acts that would harm public confidence or the Lottery's reputation. Four are relevant to the issues that are the focus of this investigation:

- ***"a.* A violation of this chapter, a regulation, or a policy or procedure of the authority."**

  This covers a multitude of areas, including but not limited to theft, fraud, or paying out prizes of more than $600.

- **"*c.* Commission of any fraud, deceit, or misrepresentation."**

  Presumably this would include any Lottery-related dishonesty perpetrated on customers, including those incidents that do not result in criminal prosecution.

- **"*e.* Conduct prejudicial to public confidence in the lottery."**

  The statute does not define what constitutes prejudicial conduct. But it would seem reasonable to view the act of a retailer cheating a customer out of a ticket or prize money as being "prejudicial to public confidence" in the Lottery.

- **"*i.* Other conduct likely to result in injury to the property, revenue, or reputation of the authority."**

  This open-ended provision would seem to give the Lottery wide discretion to protect its reputation.

We found a number of cases where customers were victims of fraud, deceit, or misrepresentation. This includes two cases where store employees claimed the prize for a winning ticket that they knew had been lost by a customer; and three cases where retailers kept hundreds of dollars in winnings from customers under false pretenses. We also found 88 cases involving internal theft of Lottery products and cash.

But none of those cases resulted in a single penalty against any retailer.

2. STORE OWNERS CAN BE RESPONSIBLE FOR EMPLOYEES' ACTIONS

Several Lottery officials told us they do not believe the Lottery can sanction a store owner for an employee's improper or illegal actions. Vice President for External Relations Neubauer told us:

> Well, I don't think that an individual person stealing the tickets is a violation of the lottery's Terms and Conditions. That was the action by the individual person. The store certainly didn't sanction it, and in those instances the store would take action to likely have the clerk fired. I don't think it's a violation on the part of the store.[262]

[262] Sworn Interview of Mary Neubauer at the Office of Citizens' Aide/Ombudsman (Sept. 15, 2008).

But we found other information which refutes that position. First, the Lottery's administrative rules state, "The retailer is responsible for the conduct of its employees and members that is within the scope of the retailer's lottery license."[263]

Second, we found two cases where the Lottery *did* sanction an owner's license because of an employee's actions. Both cases involved store employees who allowed a customer to pay for tickets with a credit card, which is prohibited by law.[264] The Lottery suspended both stores' licenses for a week because of violations committed by store employees.[265]

3. OTHER ACTIONS THAT TRIGGERED LICENSE SANCTIONS

As part of this investigation, we asked the Lottery for:

> Any and all records that document instances where suspensions, revocations, terminations, or cancellations of retailer licenses were imposed or considered.

In response, the Lottery provided records documenting 16 such sanctions in its 23-year history. Among the reasons for license sanctions were:

- Improper signage that referred to Touch Play machines as "slot machines."
- Failure to notify the Lottery of a change in store ownership.
- Failing to place Touch Play machines in an area where underage persons are restricted from entering.

The fact that the Lottery has imposed sanctions for the above-mentioned violations makes its failure to have ever imposed a sanction for theft or fraud all the more remarkable.

4. STAFF NOT FAMILIAR WITH PROCEDURES FOR SANCTIONING VIOLATORS

Every investigator told us he had a working knowledge of the Licensing Terms and Conditions that govern retailer conduct. But none – not even Investigator Supervisor John Ellison – knew *how* to hold retailers accountable when they violated that agreement:

> *Ombudsman investigator*: [W]ho, precisely, polices compliance with Terms and Conditions?
>
> *Ellison*: I don't know. I don't.[266]

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[263] IOWA ADMIN. CODE 531-13.10 (2009). A nearly identical provision is also in the Licensing Terms and Conditions ("The retailer is responsible for the conduct of its employees and members, which is within the scope of the retailer's lottery license."). (*See Appendix A.*)

[264] IOWA CODE SECTION 99G.30(5) (2009).

[265] The Lottery conveyed these two suspension notices in February 1, 2008, letters to a grocery store and a convenience store, both in the same southeastern Iowa town.

[266] Sworn Interview of John Ellison at the Office of Citizens' Aide/Ombudsman (Sept. 19, 2008).

Ellison's direct supervisor, Braafhart, acknowledged there is no "actual written procedure or mechanism" to direct investigators how to report retail violations for consideration of license sanctions:

> *Ombudsman investigator*: Is that to mean that your expectation of your investigative guys would be that you'd be informed of any [violations]?
>
> *Braafhart*: Yes.[267]

But some investigators told us they thought their supervisors were reading their case files and identifying license violations on their own. Said Investigator Ken Moon:

> I'm assuming that there is a review process from the supervisors who … if they see a problem, would take it before a committee to discuss that licensing issue.[268]

This misunderstanding between investigators and their superiors may help explain why the Lottery has never imposed sanctions against a retailer for fraud or theft.

OMBUDSMAN RECOMMENDATION

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.

B. SUSPECTED VIOLATIONS NOT REPORTED TO LAW ENFORCEMENT AND PROSECUTORS, CONTRARY TO LAW

> The lottery security office shall perform all of the following activities in support of the authority mission:
>
> … c. Report any suspected violations of this chapter to the appropriate county attorney or the attorney general and to any law enforcement agencies having jurisdiction over the violation.
>
> — *Iowa Code section 99G.35(1)(c) (2009)*

Toward the beginning of our investigation, then-Acting CEO Brickman wrote, "When an investigation indicates retailer impropriety, we refer the case to a law enforcement agency."[269] And in her 2007 Memo to the Lottery Board, Vice President for External Relations Neubauer wrote, "Any suspected criminal activity would be referred to law enforcement."

Those statements seemed to be consistent with Code section 99G.35(1)(c) (2009). Later in the investigation, however, we found that the Lottery's practices are in fact different than those suggested in management's initial written descriptions.

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[267] Sworn Interview of Harry Braafhart at the Office of Citizens' Aide/Ombudsman (Oct. 8, 2008).
[268] Sworn Interview of Ken Moon at the Office of Citizens' Aide/Ombudsman (Sept. 19, 2008).
[269] *See Appendix E*.

As an example, consider the following interview exchange:

> *Ombudsman investigator*: How much influence should a retailer have over whether you pursue a theft allegation against one of their clerks?
>
> *Lottery investigator*: It's totally up to him.[270]

We also spoke with a store official who told us, "They [the Lottery] leave it up to us as to the way we want it handled, in the long run."[271]

1. SUSPECTED THEFTS NOT REPORTED TO POLICE BECAUSE OF RETAILER'S WISHES

We found that Lottery investigators almost always allowed stores to decide whether police reports should be filed in cases of internal theft. The Lottery followed this practice even when there was a suspected violation of Lottery laws, in which case section 99G.35(1)(c) (2009) mandated the Lottery to report suspected violations to police. The Lottery also followed this practice in cases where it had not identified the suspect (including cases where the suspect could have been the store owner).

We also found approximately 18 cases from 2005 through 2007 where the Lottery investigator suspected internal theft of Lottery tickets, but did not report their suspicions to police and prosecutors because of the retailer's wishes. These included the following cases:

- A grocery store reported that an employee "admitted taking and scratching off lottery scratch off tickets several times in the last few months," according to the case notes. The store fired the employee, a high school student whom the case file did not identify. The investigator closed the case without finding out the name of the employee.[272]

- A grocery store reported that a female bakery employee had stolen $300 worth of instant tickets and cashed the winners at another store. "The employee has admitted to the theft, and [the store] prefers to handle this case internally," the investigator wrote. "They [store management] were told that we could send them information that pertains to this case, but they were not interested at this time. They refused to give the name of the suspect." The investigator closed the case without finding out the name of the employee.[273]

- A convenience store reported that $600 worth of instant tickets had been stolen, and the manager suspected a clerk. The case notes state that a store supervisor "has watched the video surveillance and saw the female clerk take two pack [sic] of tickets." The file indicates at least 18 of those stolen tickets were winners and redeemed for $76 in prize money.

[270] Sworn Interview of Roger Mott at the Office of Citizens' Aide/Ombudsman (Sept. 19, 2008).
[271] Telephone Interview of a store official by an Ombudsman investigator (Apr. 3, 2008).
[272] Iowa Lottery Security Investigator Report, Case No. 05-100 (2005).
[273] Iowa Lottery Security Investigator Report, Case No. 07-137 (2007).

In the end, the store chose to handle the matter internally and the Lottery obliged. Regarding the identity of the clerk (a 17- or 18-year old female), the investigator wrote, "Store keeping name confidential" – apparently even from the Lottery itself.[274]

2. SUSPECTED THEFTS NOT FULLY INVESTIGATED BECAUSE OF RETAILER'S WISHES

A Lottery sales representative discovered that nine instant tickets were missing from a central Iowa liquor store in August 2007. The missing tickets were reported to the Security Division as a "theft problem."

The investigator's case notes stated:

> During my visit with the owner of this store, [she] said she has not, nor will she contact the … Police Department. [The owner] said she knows who the individual was that took the tickets. [The owner] said that the individual that took the tickets has paid for them and she does not wish to pursue this issue any further. This situation will be closed with the problem being taken care of by the store owner.[275]

The Lottery's case file suggests that someone may have been stealing tickets but the investigator did not find out who. When we asked about this case, the Lottery investigator acknowledged that the thief could have been anyone, even the owner.[276]

The Lottery's Licensing Terms and Conditions state in part, "Retailers shall cooperate fully with the Lottery in the investigation of any missing, lost, or stolen tickets." Instead of allowing the owner to rebuff his inquiry, the investigator should have asserted the Lottery's authority to investigate the matter further.

If the owner had cooperated, the investigator could have developed information necessary to pursue the matter to its logical conclusion. The investigator then could report any suspected violations to police and prosecutors.

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[274] Iowa Lottery Security Investigator Report, Case No. 07-035 (2007). While this case involved $600 in stolen tickets and was not pursued further, we found several cases where clerks were prosecuted for stealing much smaller amounts of tickets: Iowa Lottery Security Investigator Report, Case No. 06-142 (2006) ($40 worth of tickets); Iowa Lottery Security Investigator Report, Case No. 05-106 (2005) ($36 worth of tickets); Iowa Lottery Security Investigator Report, Case No. 05-085 (2005) ($26 worth of tickets). The only difference: The stores in those three cases reported the incidents to police, whereas the store in Iowa Lottery Security Investigator Report, Case No. 07-035 (2007) did not.

[275] Iowa Lottery Security Investigator Report, Case No. 07-091 (2007).

[276] Sworn Interview of Ken Moon at the Office of Citizens' Aide/Ombudsman (Sept. 19, 2008).

If, on the other hand, the owner still refused to cooperate, the Lottery could have threatened, and if necessary, imposed a license sanction.[277] The Lottery can pursue an investigation without a store's cooperation and has the authority to subpoena witnesses and records.[278] The Lottery can also request assistance from the Iowa Division of Criminal Investigation or local police to execute search warrants, question suspects, and make arrests.

But when we asked Lottery investigators how they have dealt with uncooperative retailers, they expressed strong reservations about requiring retailers to cooperate. "If they don't want to cooperate, you know, they didn't cooperate," recently retired Investigator Larry Steele told us. "There's nothing I could do. I'm not a police officer."[279]

3. REASONS WHY LOTTERY SHOULD PURSUE INTERNAL THEFT CASES TO THEIR LOGICAL CONCLUSION

During our investigation, Lottery officials acknowledged that the law mandates the Security Division to report suspected violations of Iowa Code chapter 99G to police and prosecutors. But they argued that it makes little sense to file a police report if the retailer declines to pursue criminal charges.[280]

We believe that the Lottery's practice on this issue is fundamentally flawed. We see a number of reasons why the Lottery should pursue internal theft cases to their logical conclusion, regardless of the store owner's wishes:

1. The Lottery and its customers are harmed whenever prize money is obtained from stolen tickets. (This point is discussed in detail later in this section.)

2. Customers can also be victims any time a retailer or store employee lightly scratches instant tickets, "picks out" the winners, and sells the non-winners.

3. The failure to prosecute thieving store employees, even if they are fired, creates an incentive for them to continue their activity at other licensed stores without a criminal record that can be considered by store owners.

4. An investigation may yield information that causes the Lottery to consider license sanctions, even when no criminal charges are filed. A documented record of those investigations would also be useful for investigators who receive future complaints about the same store or individual.

5. Lottery officials acknowledged to us that clerks who steal tickets from their employers may not be shy about stealing from customers as well. "I think a thief will steal from anybody, any way, any how," Investigator Supervisor Ellison told us.

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[277] The Lottery, by comparison, imposed sanctions in other cases where stores had signs describing Touch Play machines as "slots." In one such case, the Lottery temporarily deactivated a store's Touch Play machines because the owner failed to change a sign within ten hours of the Lottery's first request. Iowa Lottery Security Investigator Report, Case No. 05-052 (2005).

[278] IOWA CODE SECTION 99G.6 (2009).

[279] Sworn Interview of Larry Steele at the Office of Citizens' Aide/Ombudsman (Oct. 8, 2008).

[280] Sworn Interview of Ken Brickman at the Office of Citizens' Aide/Ombudsman (Sept. 17, 2008); Sworn Interview of Harry Braafhart at the Office of Citizens' Aide/Ombudsman (Oct. 8, 2008).

We conclude, therefore, that the Lottery has the authority – and a fiduciary responsibility – to ensure that allegations of internal theft are always fully investigated.

4. LOTTERY OFFICIALS: NO SUCH THING AS A STORE OWNER STEALING TICKETS FROM THEIR OWN STORE

During interviews with Lottery officials, we suggested an additional reason why all internal theft cases should be pursued to their logical conclusion: Until a suspect is identified, it is possible that the thief could be the store owner. We noted that the practice of allowing store owners to decide how far cases are pursued means there may have been theft cases where a store owner called a halt to the investigation of his own crime.

In response, several Lottery officials told us that it is *impossible* for store owners to steal Lottery tickets from their own stores. Consider the following exchange with recently retired Vice President for Security Harry Braafhart:

> *Ombudsman investigator*: But what if the retailer is the thief of those tickets. Would you treat that any differently?
>
> *Braafhart*: I don't know how the retailer can be the thief of the tickets. I'm not following where you guys are going with this.
>
> *Ombudsman investigator*: Well, let's be clear then. I'm just going to ask you point-blank. So if I own a store, I'm the retailer and I have lottery tickets at my disposal and I just take the tickets and scratch them off, dozens at a time, I'm looking for a winner, and if I find a winner for $250,000 and I go to the lottery and I get my money, I'm asking you is there any problem with that. It's a yes or a no.
>
> *Braafhart*: No, there's no problem with that. If you've already paid for that ticket, that book of tickets, you can do with it whatever you want. I mean as far as yourself. As long as you're not doing something fraudulent by trying to alter them or nothing. But you've paid for the book of tickets.[281]

Braafhart's position is not supported by the Lottery's own administrative rules. Chapter 13 of those rules deals with the disposition of instant tickets after a retailer obtains them from the Lottery. It states in part:

- "Tickets shall be sold at the price designated by the lottery. Retailers shall not sell tickets for a price other than that specified by the lottery."[282]
- "No retailer or any employee or member of a retailer shall attempt to identify a winning ticket prior to the sale of the ticket."[283]

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[281] Sworn Interview of Harry Braafhart at the Office of Citizens' Aide/Ombudsman (Oct. 8, 2008).

[282] IOWA ADMIN. CODE 531-13.2(2) (2009). These same provisions are also included in Licensing Terms and Conditions. (*See Appendix A.*)

[283] IOWA ADMIN. CODE 531-13.2(3) (2009). Regarding this issue, Licensing Terms and Conditions states in part, "Retailers shall not attempt to identify winning tickets until a signed ticket is presented for validation

The Lottery's position also ignores the fact that, because of Lottery commissions, retailers pay up to seven percent less for instant tickets than the general public.

OMBUDSMAN RECOMMENDATION

37. 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.

C. LOTTERY MORE CONCERNED WITH UNDERAGE PERSONS BUYING TICKETS THAN STEALING THEM

We found that complaints of underage persons illegally buying tickets have been aggressively pursued by the Lottery, as they should be. Iowa Code section 99G.30(3) (2009) states:

> A ticket or share shall not be sold to a person who has not reached the age of twenty-one…. A prize won by a person who has not reached the age of twenty-one but who purchases a winning ticket or share in violation of this subsection shall be forfeited.

A recent Lottery report[284] shows that the agency received seven complaints about purchases by underage customers from fiscal year 2005 through fiscal year 2007. The Lottery substantiated two of those complaints and suspended both stores' licenses.

By contrast, we found that 29 underage store clerks were substantiated to have stolen Lottery tickets during the same period. This means that the number of instances where Lottery investigators substantiated internal theft by an underage employee was 14 times higher than the number of substantiated cases of underage sales from fiscal year 2005 through fiscal year 2007.

When considering all files that we reviewed from 2005 through 2007 (calendar years), we found that 33 underage clerks were substantiated to have stolen Lottery tickets. Those 33 underage persons accounted for approximately one-third of the 103 individuals prosecuted for, or suspected of, internal theft during the three-year period.

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by a player." (*See Appendix A.*)

[284] The governor's office administers a website, "Results Iowa: Accountability for Iowa," which has performance reports of executive departments, including the Iowa Lottery. *See* http://www.resultsiowa.org/lottery.html (last visited Mar. 27, 2009).

Those numbers suggest that the Lottery should be addressing the phenomenon of underage internal theft at least as aggressively as its approach to underage sales. But we found that has not been the case. In response to the 33 substantiated cases of underage internal theft, the Lottery did not impose license sanctions against any of the stores where the thefts occurred.[285] It also did not try to recover any of the prize money obtained from tickets stolen by the 33 underage individuals.

Moreover, we found no indication that the Lottery was even aware of this phenomenon or its pervasiveness. Of the 33 individuals we identified as being underage at the time of the thefts, many were not identified as such in the Lottery's case files. We made those identifications through non-Lottery records.

The 33 underage theft suspects fell in two groups: Those who were prosecuted, and those who were suspected but not prosecuted.

1. UNDERAGE THEFT SUSPECTS WHO WERE PROSECUTED

We found that 22 underage clerks were prosecuted for internal theft from 2005 through 2007. The most prominent example involved five employees who pled guilty to stealing $36,680 worth of Lottery tickets from a small grocery store in northwest Iowa. Four of the employees were underage, including a 17-year old and a 16-year old.[286]

2. UNDERAGE THEFT SUSPECTS WHO WERE NOT PROSECUTED

We found that 11 underage persons were suspected to have committed internal theft, either by their employer and/or by the Lottery investigator, but were not prosecuted. Three were discussed in previous sections of this report:

- A high-school-aged employee admitted taking and scratching instant Lottery tickets several times over a few months.[287]
- An underage store employee had been tampering with $69 worth of instant tickets at two stores in a chain.[288]
- A 17- or 18-year old employee stole two entire packs of instant tickets with a retail value of $600. The file indicates at least 18 winners were redeemed for prize money totaling $76.[289]

OMBUDSMAN RECOMMENDATION

38. The Lottery should consider proposing an amendment to Iowa Code chapter 99G to provide that Lottery products shall not be sold *by* any person who has not reached the age of twenty-one, because the statute already provides that Lottery products shall not be sold *to* any person who has not reached the age of twenty-one.

[285] As previously noted, the Lottery's rules say that retailers are responsible for the Lottery-related conduct of their employees.
[286] Iowa Lottery Security Investigator Report, Case No. 06-106 (2006).
[287] Iowa Lottery Security Investigator Report, Case No. 05-100 (2005).
[288] Iowa Lottery Security Investigator Report, Case No. 06-115 (2006).
[289] Iowa Lottery Security Investigator Report, Case No. 07-035 (2007).

D. INVESTIGATORS ROUTINELY FAILING TO DETERMINE HOW MUCH PRIZE MONEY IS OBTAINED FROM STOLEN TICKETS

A woman's desire to support a casino-gambling habit triggered the biggest Lottery theft case of the three years we reviewed. The 70-year-old, part-time pharmacy employee pled guilty in August 2007 to first-degree theft in connection with the theft of at least $107,138 worth of instant Lottery tickets. Actual losses may have been higher – the case file indicates she was suspected to have been stealing tickets since 1997.[290]

The Lottery's case file included a police report that showed the woman redeemed 97 winning tickets over a three-week period at just one store. The report showed that the investigating officer suspected that the woman had cashed many more stolen tickets.

But the Lottery investigator did not attempt to learn how much prize money the woman had collected from the stolen tickets that she redeemed for prize money. We found that she also claimed a $1,600 prize that was paid out directly by the Lottery; this was not mentioned in the case file.

So while the woman was ordered to pay restitution for the retail value of the tickets she stole, she was able to keep any prize money that she obtained from those stolen tickets – in part because the Lottery did not attempt to determine the amount of prize money obtained.

This was not an isolated case. We found a number of internal theft cases – involving store employees who were prosecuted – where Lottery investigators did not attempt to determine the total amount of prize money obtained from tickets that had been stolen.

Other examples include:

- A store clerk stole 507 tickets. Information about stolen tickets being redeemed for the prize money is scattered throughout the case file, but there is no indication of an attempt to calculate the total.[291]

- A store clerk stole $3,828 worth of tickets. The file shows 41 were redeemed, but the prize amounts are not listed.[292]

- Two store clerks were suspected to have stolen between $14,000 and $15,000 worth of tickets from their employer. The case file suggests that approximately $2,000 in prize money may have been obtained from stolen instant tickets. But the file includes no indication of an attempt by the investigator to calculate the total.[293]

This raises a critical question: How can the Lottery hold thieves accountable if investigators do not determine how much prize money those thieves obtained from the stolen tickets?

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[290] Iowa Lottery Security Investigator Report, Case No. 06-140 (2006).
[291] Iowa Lottery Security Investigator Report, Case No. 07-003 (2007).
[292] Iowa Lottery Security Investigator Report, Case No. 05-011 (2005).
[293] Iowa Lottery Security Investigator Report, Case No. 05-023 (2005).

We asked Investigator Roger Mott about a case in which a store reported that a clerk had scratched at least $69 worth of instant tickets through pickouts activity:[294]

> *Ombudsman investigator*: Did you find out how much that suspect got in stolen money?
>
> *Mott*: No, I did not.
>
> *Ombudsman investigator*: Why not?
>
> *Mott*: I don't know.
>
> *Ombudsman investigator*: … Do you have any idea whether he may have had some prize money that he got through those stolen tickets?
>
> *Mott*: I have no clue.
>
> *Ombudsman investigator*: It's possible that he won a bit of money.
>
> *Mott*: Well, he could have, I reckon.[295]

The clerk in that case was not prosecuted because the store declined to file a police report.

OMBUDSMAN RECOMMENDATION

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.

[294] Iowa Lottery Security Investigator Report, Case No. 06-115 (2006).
[295] Sworn Interview of Roger Mott at the Office of Citizens' Aide/Ombudsman (Sept. 19, 2008).

E. LOTTERY DOES NOT TRY TO RECOUP PRIZE MONEY IN INTERNAL THEFT CASES

> *Ombudsman investigator*: Most of the folks who have been prosecuted for internal theft, any prize money they got, they got to keep it. Does that surprise you?
>
> *Harry Braafhart*: Yeah, it does. And I believe that ideally that they should not get to keep it.
>
> — *Exchange during October 8, 2008, interview of recently retired Vice President for Security Braafhart*

In criminal cases, payment of restitution to the victim can be an effective way of holding an offender accountable.[296] Our investigation revealed, however, that most store employees who stole Lottery tickets were able to keep any prize money obtained from the tickets they stole.

From 2005 through 2007, we found 45 internal theft cases where prize money was obtained from stolen tickets and the suspects were later prosecuted for the thefts. Most of those employees were ordered to pay restitution to the *stores* for the retail value of the stolen tickets.[297] But only two of the 45 employees were ordered to pay restitution to the *Lottery* for the prize money they obtained from the stolen tickets.

In those two cases:

- One defendant was ordered to pay restitution of $395 to the store (for the retail value of the stolen tickets) and $206 to the Lottery (for the prize money obtained from the stolen tickets).[298]

- Another defendant was ordered to pay $4,176 in restitution to the store (for the retail value of the stolen tickets) and $3,596 in restitution to the Lottery (for prizes claimed from the stolen tickets).[299]

The Lottery did not pursue restitution from the other 43 internal-theft defendants mentioned above – even though we found that all 43 used stolen tickets to obtain prize money from the Lottery. (Prize payouts for winning tickets are generally made by the Lottery. The Lottery either pays out prizes directly, to any individual who redeems a winning ticket directly from the Lottery; or it pays out prizes indirectly, by crediting the account of any store that pays out a prize; this credit occurs regardless of whether the ticket was sold by that store.)[300]

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[296] Restitution means payment of pecuniary damages to the victim of the crime. IOWA CODE SECTION 910.1 (2009).

[297] Due to the manner in which stores obtain instant tickets from the Lottery, the store is usually the victim for the retail value of any unsold instant tickets that are stolen from that store.

[298] Iowa Lottery Security Investigator Report, Case No. 06-108 (2006).

[299] Iowa Lottery Security Investigator Report, Case No. 06-046 (2006).

[300] The two exceptions involve Pull-tab prizes and any prize that a store pays out in contradiction of a

Because Lottery investigators routinely fail to determine how much prize money is obtained from stolen tickets, there was no way for us to calculate the total amount of prize money obtained by the 43 internal-theft defendants mentioned above.

1. SUSPECTS KEEP PRIZE MONEY EVEN WHEN EVIDENCE IS STRONG

a. Cases where suspect was prosecuted

One case involved the theft of several hundred instant tickets by a convenience store clerk. The file shows that the Lottery investigator spoke with a local police detective. In recounting that conversation, the Lottery investigator wrote that the clerk admitted "she stole 300 to 400 lottery scratch off tickets and did not pay for them, and to redeeming the winners from these tickets at four [local] lottery retailers."[301]

Court records show that the clerk later pled guilty and was ordered to pay $287 in restitution to the store for the value of the stolen tickets. She was not ordered to pay restitution for any of the prize money she obtained from the stolen tickets.

That case was not an isolated example. Of the 45 internal theft cases in which prize money was obtained and the suspect(s) was prosecuted, we found that:

- The suspects in 11 cases admitted to redeeming the winning tickets for the prize money, or to giving the winning tickets to others for that purpose.[302]
- An additional 14 case files documented the existence of a store surveillance video showing stolen tickets being redeemed for prize money at a time and place that corresponded with Lottery prize-payout records.[303]

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terminal message specifically directing the store to refer the customer to the Lottery (the system allows the Lottery to "flag" tickets that have been reported as stolen).

[301] Iowa Lottery Security Investigator Report, Case No. 07-025 (2007). There is no indication in the file that the investigator tried to determine the amount of prize money that the suspect obtained from the stolen tickets.

[302] We found these admissions in either the police file or in the Lottery investigators' case notes (i.e., referencing information provided to the Lottery by local police). Iowa Lottery Security Investigator Report, Case No. 05-011 (2005); Iowa Lottery Security Investigator Report, Case No. 05-023 (2005); Iowa Lottery Security Investigator Report, Case No. 05-035 (2005); Iowa Lottery Security Investigator Report, Case No. 06-106 (2006); Iowa Lottery Security Investigator Report, Case No. 06-127 (2006); Iowa Lottery Security Investigator Report, Case No. 06-142 (2006); Iowa Lottery Security Investigator Report, Case No. 07-025 (2007); Iowa Lottery Security Investigator Report, Case No. 07-028 (2007); Iowa Lottery Security Investigator Report, Case No. 07-067 (2007); Iowa Lottery Security Investigator Report, Case No. 07-079 (2007); Iowa Lottery Security Investigator Report, Case No. 07-097 (2007).

[303] Iowa Lottery Security Investigator Report, Case No. 05-018 (2005); Iowa Lottery Security Investigator Report, Case No. 05-029 (2005); Iowa Lottery Security Investigator Report, Case No. 05-053 (2005); Iowa Lottery Security Investigator Report, Case No. 05-085 (2005); Iowa Lottery Security Investigator Report, Case No. 06-051 (2006); Iowa Lottery Security Investigator Report, Case No. 06-099 (2006); Iowa Lottery Security Investigator Report, Case No. 06-118 (2006); Iowa Lottery Security Investigator Report, Case No. 06-140 (2006); Iowa Lottery Security Investigator Report, Case No. 07-001 (2007); Iowa Lottery Security Investigator Report, Case No. 07-060 (2007); Iowa Lottery Security Investigator Report, Case No. 07-062 (2007); Iowa Lottery Security Investigator Report, Case No. 07-095 (2007); Iowa Lottery Security Investigator Report, Case No. 07-097 (2007); Iowa Lottery Security Investigator Report, Case No. 07-139 (2007). We also found several cases where there was no video available because the store did not have a surveillance video camera or it was not working properly at the time.

- Three cases had admissions from suspects, corroborating surveillance video, and corresponding prize-payout records.[304]

The clerks in all 25 cases subsequently pled guilty, and most were required to pay restitution to the stores for the value of the stolen tickets. But *none* of those clerks was required to pay restitution for the prize money obtained from stolen tickets.

b. Cases where theft was suspected but no charges filed

A hospital gift shop found that a number of its unsold instant tickets were missing. In the case file, the Lottery investigator wrote that a hospital security officer had watched video surveillance tapes and reported that:

> … a female employee is seen removing Iowa Lottery instant scratch tickets from the dispenser when she opens the store. The employee hides the tickets and whenever she is not busy she scratches the latex from the tickets and redeems them.[305]

The hospital security officer later reported that the employee "had won one thousand dollars a week or two ago," the Lottery investigator wrote. The investigator subsequently confirmed that the employee had recently claimed a $1,000 instant ticket prize from the Lottery.

No charges were filed, as the hospital opted against filing a police report. This case was among 26 additional internal theft cases where the Lottery investigator and/or the retailer found that prize money was obtained from stolen tickets but the employee(s) was not prosecuted.

As a result, the suspects in these 26 cases were not ordered to pay restitution for either the retail value of the stolen tickets or for any prize money obtained from those tickets. Among these cases:

- Seven case files documented the existence of a store surveillance video showing the suspect redeeming stolen tickets for prize money at a time and place that corresponded with Lottery prize-payout records.[306]

- One case file documented that a store employee was "cashing Iowa Lottery instant tickets without paying for them," the investigator wrote. "A customer noticed the employee doing this in front of the manager. The customer informed the manager, and the manager terminated the employee."[307]

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[304] Iowa Lottery Security Investigator Report, Case No. 05-011 (2005); Iowa Lottery Security Investigator Report, Case No. 06-106 (2006); Iowa Lottery Security Investigator Report, Case No. 06-127 (2006).
[305] Iowa Lottery Security Investigator Report, Case No. 06-109 (2006).
[306] Iowa Lottery Security Investigator Report, Case No. 05-079 (2005); Iowa Lottery Security Investigator Report, Case No. 06-045 (2006); Iowa Lottery Security Investigator Report, Case No. 06-102 (2006); Iowa Lottery Security Investigator Report, Case No. 06-109 (2006); Iowa Lottery Security Investigator Report, Case No. 07-055 (2007); Iowa Lottery Security Investigator Report, Case No. 07-107 (2007); Iowa Lottery Security Investigator Report, Case No. 07-118 (2007).
[307] Iowa Lottery Security Investigator Report, Case No. 07-138 (2007).

2. WHY THE LOTTERY DOES NOT PURSUE RESTITUTION

When we asked Lottery officials if people who steal Lottery tickets should get to keep prize money from those stolen tickets, the universal answer was "no." "I don't think they should be able to keep the fruits of their crime," recently retired Investigator Larry Steele told us.[308]

However, Lottery officials are less certain about what role they should play in holding thieves accountable. Some told us that they do not consider the Lottery as a victim in cases where prize money is obtained from stolen tickets, while others were uncertain or had a different view. We asked seven Lottery officials this basic question: Who is the victim when prize money is paid out on stolen tickets? Our question generated *five* different answers:

- The store is the victim.
- The Lottery is the victim.
- The store and the Lottery are both victims.
- Sometimes the store is the victim, and sometimes the Lottery is the victim.
- There is no victim.

Several Lottery officials told us that whether winning tickets were stolen or purchased is of no legal consequence with regard to prize payouts. "We aren't out money so we aren't entitled to get it back," then-Acting CEO Brickman told us. He later added, "The reality of the transaction is that it's exactly the same as if the clerk had sold rather than stole the ticket."[309]

Even in the two cases where prize-money restitution was ordered to the Lottery, prosecutors told us that the Lottery initially resisted pursuing restitution. "At first, they [Lottery staff] said, 'We don't ever ask for restitution,'" one prosecutor told us. "They were reluctant at first." But she persisted because "it looked like they [Lottery] had been harmed by the theft."[310]

Investigator Supervisor John Ellison confirmed that the Security Division routinely turns down prosecutors offering to pursue restitution for the Lottery. Ellison said he generally responds to such inquiries by saying, "I'm sorry, we're not a victim."[311]

The only exception, Ellison said, would be cases where tickets are stolen directly from the Lottery, before they are provided to a retailer. However, the Lottery had such a theft case in 2007 and did not pursue restitution for the prize money obtained from the stolen tickets.[312]

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[308] Sworn Interview of Larry Steele at the Office of Citizens' Aide/Ombudsman (Oct. 8, 2008).
[309] Sworn Interview of Ken Brickman at the Office of Citizens' Aide/Ombudsman (Sept. 17, 2008).
[310] Telephone Interview of assistant county attorney by an Ombudsman investigator (May 27, 2008).
[311] Sworn Interview of John Ellison at the Office of Citizens' Aide/Ombudsman (Sept. 19, 2008).
[312] Iowa Lottery Security Investigator Report, Case No. 07-062 (2007). The file shows that the suspect stole $167 worth of instant tickets from the Lottery's regional office in Mason City and obtained $66 in prize money from the stolen tickets. The defendant was ordered to pay restitution to the Lottery for the value of the tickets ($167), but no restitution was ordered for the prize money.

We found a different opinion among the Security Division's three investigators – Ken Moon, Roger Mott, and Larry Steele. Each agreed that the Lottery can itself be a victim in "prize money by theft" scenarios. Asked to explain why the Lottery received restitution in one of the two cases previously referenced, Mott told us, "Because in my determination we were out that money. We lost that money."[313]

We found that the lack of consensus among Lottery staff may help explain why the agency did not recoup prize money in most internal theft cases prosecuted between 2005 and 2007.

3. OMBUDSMAN'S PERSPECTIVE

It is true the Lottery has already planned to pay out the prize money on tickets that are subsequently stolen. However, for restitution purposes, we believe that the Lottery is a victim.

Under Iowa law, prize money from tickets that is unpaid, unused, unclaimed, or forfeited is retained or delivered to the Lottery. Iowa Code section 99G.31(2)(b) (2009) states that a prize:

> [S]hall not be paid arising from claimed tickets that are stolen, counterfeit, altered, fraudulent, unissued, produced or issued in error, unreadable, not received, or not recorded by the authority within applicable deadlines.

Thus, prize money not yet paid out on stolen tickets remains with or still belongs to the Lottery. This affirms that the Lottery possesses a right to that money. The fact that it was paid out due to the illegal actions of the claimant should not extinguish that right.

The Lottery's right to seek restitution or to recoup prizes paid on stolen tickets is reinforced by other analogous provisions of law. Unclaimed prize money becomes part of the Lottery's pool from which future prizes are to be awarded or used for special prize promotions.[314] Furthermore, prizes on a ticket purchased or sold in violation of chapter 99G are treated as unclaimed prizes.[315]

Another provision states that a prize won by a person under 21 years of age shall be forfeited.[316] While that law does not state what happens to the forfeited money, as it does for unclaimed prizes, then-Acting CEO Brickman told us the following:

> As with any other unclaimed prizes, funds attributable to forfeiture would be available to the Lottery for use in future prize pools or, if not needed for that purpose, as with other funds excess to the Lottery's operations needs, the amount of the forfeited prize ultimately would be included with funds certified for transfer to the General Fund.[317]

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[313] Sworn Interview of Roger Mott at the Office of Citizens' Aide/Ombudsman (Sept. 19, 2008).
[314] IOWA CODE SECTION 99G.31(d) (2009).
[315] IOWA CODE SECTION 99G.31(e) (2009).
[316] IOWA CODE SECTION 99G.30(3) (2009).
[317] Letter from Ken Brickman, then-Acting CEO, Iowa Lottery, to Ombudsman (Jan. 23, 2009) (on file with author).

We see no reason why prizes from stolen tickets should not be treated in a similar manner. If store employees who steal tickets were ordered to pay restitution to the Lottery for any prize money obtained, that money would go back to the "prize pool" for future prizes or promotions. This in turn means the State presumably could stand to gain financially if the Lottery were to recoup prize money obtained from stolen tickets.

It is our opinion, therefore, that the Lottery can and should seek restitution for the value of prize money paid out from stolen tickets. And, as previously noted, Iowa courts have ordered such restitution in at least two cases.

Obtaining restitution would serve at least two important purposes:

- It would financially benefit the Lottery and the public who play and are served by the Lottery.

- It would also convey the message that "crime does not pay," thus helping to preserve the Lottery's integrity and dignity, which is mandated by Iowa Code section 99G.2(3) (2009).

Otherwise, the deterrent effect of the criminal prosecution is diminished, especially for individuals willing to risk stealing tickets on the belief that they can profit from it.

For these reasons, we believe the Lottery should find a way to recoup prize winnings from stolen tickets, even if the Lottery should encounter legal challenges to its status as a victim in seeking restitution. This may require amending Iowa law or adopting rules that grant or clarify the Lottery's authority to recoup the money or to obtain it through forfeiture procedures.

OMBUDSMAN RECOMMENDATIONS

40. The Lottery should adopt a policy requiring it to take the necessary steps to pursue restitution from any individual who obtains prize money from stolen tickets and who is prosecuted for that theft. In the event a court determines the Lottery is not a victim for restitution purposes, the Lottery should seek authority, if necessary, and establish a civil process to recoup the prize money from such individuals. In circumstances where an individual, other than the person who stole a ticket, claims the prize money, the Lottery should determine whether it should initiate a criminal or civil proceeding to recoup the prize money.

41. The Lottery's Security Division should devise and maintain a standardized form for calculating and reporting prize payouts in connection with stolen tickets. Lottery investigators should transmit this form to prosecutors as a routine means of pursuing restitution from Lottery ticket thieves.

VII. INADEQUATE CUSTOMER EDUCATION AND PROTECTION EFFORTS

> [T]he Iowa Lottery has taken many proactive steps through the years to remind consumers about the security tips they can follow to be fully informed when they play lottery games.
>
> … The lottery offers its players a plethora of information they can use to determine the outcome of their tickets. However, we have felt that there is no substitute for player responsibility and player diligence, despite all the assistance that we can provide.
>
> — *Vice President for External Relations Neubauer, November 1, 2007, memo to Lottery Board*

The Lottery has made broad proclamations that it has taken many steps to educate and protect its customers. Has the Lottery taken adequate steps to educate and protect its customers? That question is examined in this section.

A. "SIGN IT" PROGRAM AND RECEIPTS

At the urging of the Iowa Legislature's Government Oversight Committee, the Lottery in 2008 implemented two new procedures designed to help safeguard customers from possible fraud. In March 2008 the Lottery began a new program called, "Sign It. It's Yours." Under the program, retailers and the Lottery are required to verify that a signature appears on all tickets submitted for checking or for a prize payout.[318]

The Lottery then reprogrammed its terminals to automatically generate a customer receipt for every instant-scratch or lotto ticket that is checked or cashed. Both changes were in response to concerns expressed by members of the Government Oversight Committee during its January 30, 2008, meeting.[319]

1. LOTTERY SUGGESTS NEED FOR FURTHER IMPROVEMENTS FORESTALLED

Lottery officials have suggested that these two improvements significantly reduce the possibility of fraud and in turn forestall the need for other improvements.

"This is an expensive undertaking. We understand that," Vice President for External Relations Neubauer was quoted as saying in a newspaper article about the changes.[320] "But if this is what people want us to be doing to protect us from even the possibility of fraud, we are happy to do that."

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[318] IOWA ADMIN. CODE 531-11.1(5) (2009).

[319] The members' concerns followed presentations by the Ombudsman and the Lottery, which the Committee had requested after learning that our office had initiated this investigation.

[320] William Petroski, *For Safety, Lottery Asks Buyers to Sign Tickets*, DES MOINES REG., Feb. 21, 2008, at 1A.

During a subsequent discussion about a proposal to install self-serve ticket-checkers[321] at retail outlets, then-Acting CEO Brickman told the Lottery Board that "there was no need to rush forward with ticket checking technology at the present time because of the steps already taken to protect the Lottery's retailers and players through the ticket signing requirement and the issuing of ticket receipts."[322]

Brickman made a similar comment when we asked whether the Lottery should require all stores to have customer display units (CDUs).[323] "It's not as important now as it was before we had the ticket receipts," Brickman told us.[324]

2. "SIGN IT" AND RECEIPTS: GOOD IMPROVEMENTS, BUT HAVE LIMITATIONS

Both the signature requirement and the receipts are good steps. But we found that both also have limitations.

a. Limitations of "Sign It" program

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.

We also found no indication that the Lottery has been actively and routinely checking to make sure its licensed retailers are complying with the new signature requirement. In late 2008 we presented unsigned tickets to clerks at ten central Iowa stores. When we asked them to check our tickets, five required us to sign our tickets, while five did not.

b. Limitations of receipts

When it introduced the new customer receipts, the Lottery suggested they would prevent fraud. "When a player wins a prize, the receipt will show the amount won, eliminating any possibility of confusion over the winnings that should be paid out," the Lottery's press release said.[325]

In a newspaper article about the receipts, Neubauer was quoted as saying, "Both the retailer and the customers have receipts available showing the outcome of the play. There is no question in anybody's mind what the outcome of the play was because it is shown right there on that piece of paper."[326]

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[321] Many lotteries allow customers the option of checking their own tickets by offering ticket-checker devices at licensed retailers. These devices allow customers to determine the results of a ticket without needing to hand the ticket over to a retailer.

[322] Meeting Minutes of Lottery Board (July 17, 2008) (on file with author).

[323] The customer display unit is an electronic screen that shows whether a ticket scanned through a terminal is a winner.

[324] Sworn Interview of Ken Brickman at the Office of Citizens' Aide/Ombudsman (Sept. 17, 2008).

[325] Press Release, Iowa Lottery, Iowa Lottery Implements Receipts Phase of Player Security Program (May 2, 2008) (on file with author).

[326] William Petroski, *For Safety, Lottery Asks Buyers to Sign Tickets*, DES MOINES REG., Feb. 21, 2008, at 1A.

Contrary to its public suggestions, we found that the Lottery is not requiring retailers to provide or offer receipts to customers. "Retailers are encouraged but not required to offer the receipts to customers," then-Acting CEO Brickman acknowledged.[327]

We question the effectiveness of the new receipts if the Lottery does not require retailers to offer them to customers. To illustrate the problem, when we asked clerks at ten central Iowa stores to check our tickets in late 2008, only four offered us a receipt.

As a state enterprise, the Lottery holds the burden of ensuring that receipts are offered to its customers, on whom the Lottery depends for generating tens of millions of dollars in profits for state government every year.

In addition, the Lottery website includes a video that advises customers how to use the receipts.[328] In the video, Vice President for External Relations Neubauer suggests that customers compare the serial numbers on the receipt with those on the ticket, to make sure that they match. But later in the video, she notes that winning tickets are not returned to customers. This raises the question: How can customers compare the serial numbers if winning tickets are not returned to them?

c. Overall limitations

Most importantly, customers who sign their tickets and ask for receipts could still be susceptible to various potential retailer scams, such as "partial win payment" and "palming":

- **Partial Win Payment:** A clerk tells customers that they have won a smaller amount than the actual prize, i.e., telling a customer he has won $50 when it was actually $250, and then pockets the difference after the customer leaves.

- **Palming:** A dishonest clerk keeps a few losing tickets near the terminal. When any unsuspecting customer hands over a ticket to see if it is a winner, the clerk uses his palm to discreetly swap that ticket with one of the known losing tickets. The clerk then enters the non-winning ticket into the terminal scanner, which produces a "Not a Winner" receipt to be handed to the customer. Unless the customer is on top of the situation, they would leave the store, and the clerk could later check the customer's original ticket and claim any prize for himself.

These potential scams arise from the fact that store employees take temporary control of customers' tickets during the validation process, and also control the payout process for most prizes of $600 or less. These procedures can allow a scam artist to trick customers without their knowledge – even those who sign their tickets and ask for receipts. This includes any customer who hands a ticket to a store employee without knowing whether it is a winning ticket, and if so, the prize amount. This also includes any customer who suspects something is amiss during the validation process but does not retrieve the ticket back from the store employee.

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[327] Letter from Ken Brickman, then-Acting CEO, Iowa Lottery, to Ombudsman (Jan. 27, 2009) (on file with author).

[328] *See* Iowa Lottery, Videos & More, http://www.ialottery.com/VideosAndMore/Videos/Video_Player.asp (last visited Mar. 24, 2009) (follow "Player Mail: Receipts" hyperlink).

OMBUDSMAN RECOMMENDATION

42. The Lottery should amend its Licensing Terms and Conditions to require that retailers must offer receipts to customers for every ticket that is checked or cashed.

B. THE NEED FOR RETAILERS TO RETURN ALL TICKETS TO CUSTOMERS

The Lottery instructed retailers, in a 2008 newsletter, to offer all non-winning tickets back to customers.[329] But that directive did not apply to winning tickets. In fact, whenever Iowa retailers pay out a Lottery prize to a customer who presents a winning instant ticket, the retailer is required to destroy the winning ticket.[330]

In Canada, the British Columbia Ombudsman found that the provincial lottery there was aware that requiring retailers to destroy winning tickets "could make it easier for retailers to 'defraud the player.'"[331]

The British Columbia Ombudsman's report then stated:

> [B]y not having the original ticket returned, players are put at a serious disadvantage when the player suspects that they were not paid the correct amount and takes their complaint to BCLC [British Columbia Lottery Corporation].
>
> In brief, BCLC is generally unable to investigate this type of complaint thoroughly unless the player can provide the exact details of the validation transaction.

OMBUDSMAN RECOMMENDATION

43. The Lottery should devise and implement a procedure whereby retailers would return all tickets to customers with appropriate markings to identify whether the ticket is not a winner; has been validated but not paid out; or is a winner and has been paid out. The procedure should specifically require retailers to return all tickets to customers with the appropriate markings.

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[329] *Retailers: After you Check a Nonwinning Ticket*, LOTTERY ACTION (Iowa Lottery, Des Moines, Iowa), Jan. 28 – Feb. 10, 2008, at 3.

[330] *See Appendix A.* ("SECTION B – INSTANT/SCRATCH GAMES … Retailers shall obtain and mutilate each ticket paid to prevent double payment.").

[331] OMBUDSMAN BRITISH COLUMBIA, WINNING FAIR AND SQUARE: A REPORT ON THE BRITISH COLUMBIA LOTTERY CORPORATION'S PRIZE PAYOUT PROCESS (2007), http://www.ombud.gov.bc.ca/resources/reports/Special_Reports/Special%20Report%20No%20-%2031.pdf.

C. THE NEED TO EDUCATE CUSTOMERS TO KNOW THE RESULTS BEFORE HANDING TICKETS TO RETAILERS

> He is sure this terminal has cheated him and other people out of money before he started keeping track.
>
> — *Investigator's notes describing a conversation with the customer who filed the complaint* [332]

1. TERMINAL MALFUNCTIONS

A Carlisle man was in a group of ten co-workers who pooled their money to buy 100 Powerball tickets every week. The man commonly checked the tickets at a local convenience store. Like many customers, he would hand the tickets to a store clerk who ran them through the Lottery terminal to see if any were winners.

Over time, the man began to realize the terminal had a problem. "I used to never look at the numbers," he told us. "Then they'd say, 'No winner' but I knew there was [a winner]."[333]

When he mentioned the problem to the clerks, he said they told him, "It happens all the time." It came to a head one day when he checked and found one ticket was a $3 winner. He took the tickets to the same store, where a clerk ran the tickets through the terminal. Once again it mistakenly indicated that none was a winner. But when the clerk ran the tickets through a second time, the terminal correctly identified the $3 winner.

That is when the man reported the problem to the Lottery. "He is sure this terminal has cheated him and other people out of money before he started keeping track," the investigator wrote. The investigator told the man that someone would go to the store to check the terminal.

From the investigator's notes, there is no indication that he ever followed-up with the man.[334] "That's the last I ever heard, that I can recollect, from anybody," the man told us. "I don't believe the Lottery ever called me back or let me know what was going on."

As for the terminal, a technician checked it and found that the document scanner needed to be cleaned. The Lottery told us that no further problems involving that terminal have been reported or discovered since that time.

This man was not alone. In reviewing Lottery records, we found several other examples of customers reporting that a terminal mistakenly identified a winning ticket as a non-winner.[335]

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[332] Iowa Lottery Security Investigator Report, Case No. 07-109 (2007).
[333] Telephone Interview of the customer by an Ombudsman investigator (Apr. 10, 2008).
[334] Iowa Lottery Security Investigator Report, Case No. 07-109 (2007).
[335] Other similar reports were made. E-mail from a northeastern Iowa customer (Dec. 24, 2006) (on file with author); E-mail from an eastern Iowa customer (June 29, 2007) (on file with author); E-mail from a southern Iowa customer (Aug. 22, 2007) (on file with author).

2. LOTTERY CONFIRMS: TERMINALS CAN MALFUNCTION, OTHER SOURCES ALSO IMPERFECT

The man might have been able to avoid these problems if only he knew what Lottery management has known for years.

"There can be malfunctions with individual terminals just as there can be malfunctions with any electrical or mechanical device in existence," then-Acting CEO Brickman wrote in his November 5, 2007, letter of response to our notice of investigation. Then-CEO Dr. Ed Stanek made a similar statement to our office in response to a previous investigation.[336]

While customers "have a wide array of sources available," he indicated that no one source is guaranteed against error. His letter noted that the media can make a mistake when it reports winning online-game numbers.

Store employees could also make a mistake when validating a ticket. In addition, the Lottery website has a disclaimer stating that the Lottery does not guarantee the accuracy of information on its website, which would include winning numbers for online games like Powerball or Hot Lotto.[337]

3. LOTTERY ADVISES THAT CUSTOMERS SHOULD KNOW THE RESULTS BEFORE HANDING TICKETS TO RETAILERS

Brickman's November 5, 2007, letter also indicated it is acceptable for customers to rely on terminals, but only if they already know whether their ticket is a winner. "[C]ustomers should not rely solely on any one source of information to determine the winning or nonwinning status of lottery tickets," Brickman wrote.

Vice President for External Relations Neubauer told us that the Lottery has historically stressed that customers:

> … should never be relying upon one single device or one single entity as the be-all end-all of the information about your lottery ticket. You should have tried to figure out if your ticket was a winner before you got to the store and you should be looking at many different sources for information.[338]

That seems like excellent advice, the kind of information that Lottery customers could use to protect their interests.

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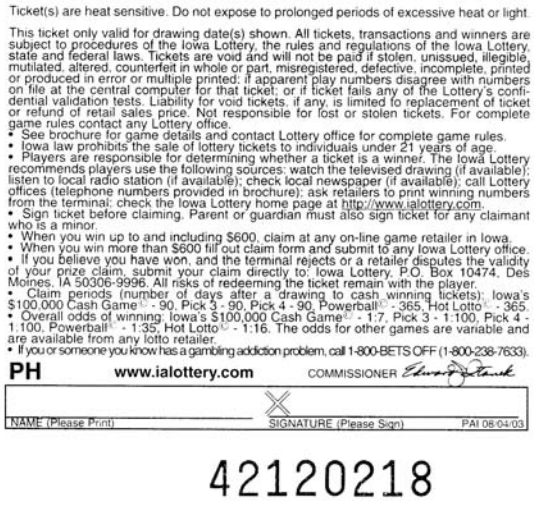
[336] Letter from Dr. Ed Stanek, then-CEO, Iowa Lottery, to Ombudsman (Apr. 4, 1995) (on file with author) ("As with any mechanical or electronic device, errors can occasionally occur.").
[337] Iowa Lottery, Legal Requirements, http://www.ialottery.com/LegalRequirements/disclaimer.html (last visited Mar. 2, 2009).
[338] Sworn Interview of Mary Neubauer at the Office of Citizens' Aide/Ombudsman (Sept. 15, 2008).

4. LOTTERY HAS NOT SHARED THIS ADVICE WITH ITS CUSTOMERS

We could not find any publicly disseminated information from the Lottery comparable to Neubauer's statement to us: "You should have tried to figure out if your ticket was a winner before you got to the store and you should be looking at many different sources for information."

a. Information on the backs of tickets and Lottery website

The back of all online tickets includes the following information (actual size):



Ticket(s) are heat sensitive. Do not expose to prolonged periods of excessive heat or light.

This ticket only valid for drawing date(s) shown. All tickets, transactions and winners are subject to procedures of the Iowa Lottery, the rules and regulations of the Iowa Lottery, state and federal laws. Tickets are void and will not be paid if stolen, unissued, illegible, mutilated, altered, counterfeit in whole or part, misregistered, defective, incomplete, printed or produced in error or multiple printed; if apparent play numbers disagree with numbers on file at the central computer for that ticket; or if ticket fails any of the Lottery's confidential validation tests. Liability for void tickets, if any, is limited to replacement of ticket or refund of retail sales price. Not responsible for lost or stolen tickets. For complete game rules contact any Lottery office.

- See brochure for game details and contact Lottery office for complete game rules.
- Iowa law prohibits the sale of lottery tickets to individuals under 21 years of age.
- Players are responsible for determining whether a ticket is a winner. The Iowa Lottery recommends players use the following sources: watch the televised drawing (if available); listen to local radio station (if available); check local newspaper (if available); call Lottery offices (telephone numbers provided in brochure); ask retailers to print winning numbers from the terminal; check the Iowa Lottery home page at http://www.ialottery.com.
- Sign ticket before claiming. Parent or guardian must also sign ticket for any claimant who is a minor.
- When you win up to and including $600, claim at any on-line game retailer in Iowa.
- When you win more than $600 fill out claim form and submit to any Iowa Lottery office.
- If you believe you have won, and the terminal rejects or a retailer disputes the validity of your prize claim, submit your claim directly to: Iowa Lottery, P.O. Box 10474, Des Moines, IA 50306-9996. All risks of redeeming the ticket remain with the player.
- Claim periods (number of days after a drawing to cash winning tickets): Iowa's $100,000 Cash Game© - 90, Pick 3 - 90, Pick 4 - 90, Powerball© - 365, Hot Lotto© - 365.
- Overall odds of winning: Iowa's $100,000 Cash Game© - 1:7, Pick 3 - 1:100, Pick 4 - 1:100, Powerball© - 1:35, Hot Lotto© - 1:16. The odds for other games are variable and are available from any lotto retailer.
- If you or someone you know has a gambling addiction problem, call 1-800-BETS OFF (1-800-238-7633).

PH www.ialottery.com COMMISSIONER

NAME (Please Print) SIGNATURE (Please Sign) PAI 08-04-03

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In referring to that information, then-Acting CEO Brickman told us, "And unfortunately I don't have a magnifying glass so I can't read all the print."[339]

The Lottery's website includes a section titled, "Security Tips at the Retail Level,"[340] which has the following information:

> The first line of defense in consumer protection is always for players to arm themselves with the information they need to determine whether their tickets have won a prize. That's much the same thing we all should be doing to ensure, for example, that a clerk has given us the proper change or that the milk we bought at the local store rang up for the right price.
>
> There are lots of ways that you as a lottery player can check the results of your tickets:
>
> ● Watch the televised drawings in lotto games.
>
> ● Check the information here on the lottery Web site.

[339] Sworn Interview of Ken Brickman at the Office of Citizens' Aide/Ombudsman (Sept. 17, 2008).
[340] Iowa Lottery, Player Security, http://www.ialottery.com/Player_Security/PS_RetailTips.html (last visited Mar. 3, 2009).

● Ask retailers to print out winning numbers from the lottery terminal.

● Call one of the lottery's five regional offices around the state for information.

● Listen to lottery results on local radio stations.

● And check lottery results in local newspapers.

However, we believe there is no substitute for player responsibility and player diligence, despite all the assistance that we can provide.

While the information on the backs of tickets and on the Lottery website is somewhat helpful, it does not specifically caution customers against relying solely on terminals or any other source of information to determine whether a ticket is a winner; nor does it specifically encourage them to employ more than one source.

b. Lottery press releases

We also found that the Lottery's own press releases are replete with stories of winning customers who rely exclusively on store clerks to check their tickets. These press releases, written by Lottery staffers, give no indication that these customers were engaging in a practice that is discouraged by top management.

Here are excerpts from two such Lottery press releases:

- [A Grinnell man] won $10,000 in the Sept. 20 Powerball drawing…. [The man] said he always has the store clerk check his tickets for him. He had no idea that he held a big winning ticket the day after the drawing when he had it checked!

  "It was quite a surprise," he laughed. "When this particular ticket came up, they said, 'You won some money and you've got to go to Des Moines.'"[341]

- [A Cedar Rapids man] claimed the jackpot for the July 5 $100,000 Cash Game drawing….

  When [the man] had his winning ticket checked, the store clerk seemed more shocked than he was!

  "She was a nervous wreck. She'd never seen [a winning ticket] that big before," [the man] said. "I just didn't believe it at first. I thought it was some kind of mistake. I thought maybe she was playing a joke on me."[342]

[341] Press Release, Iowa Lottery, [Man] Wins $100,000 in Sept. 20 Powerball Drawing (Sept. 23, 2006) (on file with author).
[342] Press Release, Iowa Lottery, Cedar Rapids Man Wins $100,000 Prize (July 18, 2008) (on file with author).

In the context of potential retailer fraud and terminal malfunctions, we find the prevalence of customers who rely exclusively on handing tickets to store employees (who could make a mistake or try to trick them) to run through a terminal (which could make a mistake) is a significant problem which the Lottery has not addressed.

5. SOURCE ERRORS COULD BE CAUSE OF SOME UNCLAIMED PRIZES

In the fiscal year ending June 30, 2006, the Iowa Lottery reported unclaimed prizes of nearly $1.2 million.[343] The figure jumped to nearly $1.8 million for the fiscal year ending June 30, 2007.[344]

Just in calendar year 2007, for example, the following significant prizes went unclaimed:

- A $100,000 winner from the $100,000 Cash Game that was sold in Davenport and expired in May.
- A $100,000 winner from the $100,000 Cash Game that was sold in Altoona and expired in October.
- A $200,000 winning Powerball ticket sold in Des Moines that expired in March.
- A $200,000 winning Powerball ticket sold in Marion that expired in July.

In addition, a $30 million Powerball jackpot sold in Indiana went unclaimed in 2003. The money reverted back to the individual states where the tickets had been sold. The Iowa Lottery received about $1.2 million in one-time income, and those funds were subsequently transferred to the state's general fund.

Is it possible that the owners of those tickets relied on terminals or other sources that made a mistake? No one likely knows the answer, but it is reasonable to wonder.

OMBUDSMAN RECOMMENDATIONS

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.

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[343] IOWA CODE SECTION 99G.31(2)(d) (2009) defines "unclaimed prizes" as those for which a valid claim is not made for the prize money within an applicable period to be determined by the Lottery. According to the Lottery website, Powerball and Hot Lotto tickets are valid for 365 days after the drawing in which the prize was won; tickets for the other online games ($100,000 Cash Game, Pick 3 and Pick 4) are valid for 90 days after the drawing; and instant-scratch tickets are valid within 90 days of the end of the game. *See* Iowa Lottery, Games, http://www.ialottery.com/Games/unclaimed.asp (last visited Mar. 3, 2009).

[344] OFFICE OF AUDITOR OF STATE, STATE OF IOWA, IOWA LOTTERY AUTHORITY- INDEPENDENT AUDITOR'S REPORTS BASIC FINANCIAL STATEMENTS AND SUPPLEMENTARY INFORMATION SCHEDULE OF FINDINGS (2007), http://publications.iowa.gov/6017/1/0860-6270-B000.pdf.

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.[345]

46. The Lottery should take immediate steps to bolster the customer-education information on its website and in its literature, as well as ensuring that the improved literature is distributed to all licensed retailers.

    The information should clearly emphasize simple steps that all customers can follow to protect their interests. Based on our review of advice on other lottery websites, here is an example of how the new information could be presented:

    SIMPLE STEPS FOR THE SMART LOTTERY CUSTOMER
    Don't become a victim of a scam artist! Here are three simple steps:

    1. **Know** the results of all tickets before handing them to a retailer. Treat each ticket you purchase as a winning ticket until proven otherwise.

    2. **Sign** all tickets as soon as possible after purchase, and definitely before handing them to a retailer. For winning tickets, it might also be a good idea to make a copy of both sides of the ticket, especially if you consider the prize amount to be significant.

    3. **Obtain** all tickets back from retailers, as well as the accompanying receipts. This will allow you to review the results of the transaction, especially if the results differed from what you had determined, or if you observe a retailer acting suspiciously while validating a ticket (in which case you are encouraged to report the matter to the Lottery immediately).

    You can always redeem tickets directly through the Lottery. If you mail a winning ticket to Lottery offices, we suggest that you make a copy of the front and back of your ticket for your records.

47. The Lottery should propose amending Iowa Code chapter 99G to include the protection of the interests of Lottery customers as a specific objective.

[345] This article appears to have been based on a section titled "Potential Scams – Under $10,000" (found on pages 38-41) *in* OMBUDSMAN BRITISH COLUMBIA, WINNING FAIR AND SQUARE: A REPORT ON THE BRITISH COLUMBIA LOTTERY CORPORATION'S PRIZE PAYOUT PROCESS (2007), http://www.ombud.gov.bc.ca/resources/reports/Special_Reports/Special%20Report%20No%20-%2031.pdf. The *Vancouver Sun* article is attached as *Appendix J*.

D. THE NEED TO IMPLEMENT ADDITIONAL CUSTOMER PROTECTION TOOLS

1. SELF-SERVE TICKET CHECKERS

a. Customers have asked for ticket checkers

"Why doesn't the iowa lottery [sic] get those ticket checkers like illinois [sic] has?" a customer wrote in a March 13, 2007, e-mail to the Lottery Web Master. "That way people could check their own tickets to see if they are winners and not have to tie up the clerks at the stores."

"Thanks for contacting us," the Web Master replied. "We may consider purchasing these in the future; however, the price has been prohibitive in the past. We appreciate your input."

We found that the Lottery has occasionally received requests from customers asking for self-serve ticket checkers to be installed, usually noting that lotteries in adjacent states have them.[346] The Lottery has typically responded by saying that the cost of adding ticket checkers would be prohibitive.

b. Lottery rejected 2008 offer for ticket checkers

In her written presentation to the Government Oversight Committee at its January 30, 2008, meeting, Vice President for External Relations Neubauer explained why the Lottery had not installed ticket checkers:

> The Lottery is nearing the end of its current equipment contract and based upon 2,250 locations that sell instant-scratch and lotto games in the state, it would cost approximately $30 million annually to provide the self-check devices today.

One week after Neubauer presented that information to the Government Oversight Committee, then-Acting CEO Brickman received a letter from Scientific Games International, Inc. (SGI), the Lottery's vendor for online games. The February 8, 2008, letter presented three proposals for what SGI would offer if the Lottery agreed to exercise the last one-year option on the contract that was then in place.[347]

Under the first proposal, SGI offered three items:

- Installation of up to 2,000 ticket checkers at no charge, an estimated $1.3 million proposition.[348]

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[346] The lotteries in Kansas, Nebraska, Minnesota, Illinois, and Missouri all offer ticket checkers for their customers.

[347] Lottery records show that SGI faxed the same letter to then-Board Chairman Tim Clausen on February 19, 2008.

[348] Under the offer, the Lottery would have had to pay approximately $162,500 to install ticket checkers in all 2,250 locations that sell instant-scratch and lotto games in the state. SGI's offer also said the Lottery "would need to modify its instant-ticket design to include a barcode under the latex," but did not provide an estimated cost for that modification.

- A 17 percent reduction in contract fee rates, an additional estimated $1.3 million proposition.

- An additional $100,000 for the Lottery to purchase new computer equipment for sales staff.

The Lottery Board, at its July 17, 2008, meeting, declined SGI's offer for ticket checkers. The Board instead agreed to a different SGI offer, a 34 percent reduction in contract fee rates which would lead to an estimated $2.6 million in savings for the Lottery, according to SGI's February 8, 2008, letter.[349]

The Lottery Board's decision came after then-Acting CEO Brickman told the Board that "there was no need to rush forward with ticket checking technology at the present time because of the steps already taken to protect the Lottery's retailers and players through the ticket signing requirement and the issuing of ticket receipts."[350]

According to the minutes, had the Board agreed to pursue the offer of ticket checkers, it would have taken up to a year for the devices to be operational.

OMBUDSMAN RECOMMENDATION

48. The Lottery should act to ensure that ticket checker devices are installed, as soon as practical and at a reasonable cost, at the outlets that sell instant-scratch and lotto games.

2. CUSTOMER DISPLAY UNITS (CDUs)

The Iowa Lottery's website includes this statement:

> The Iowa Lottery has customer display units along with its sales and validations terminals in retail locations that sell lotto tickets. The customer display unit shows the results of a particular transaction, and players can see the information on the screen.[351]

We found complaints from some customers who mentioned, as a secondary concern, that the CDU at a particular store was turned away from customers.[352] We also found that one entire chain, does not have a CDU at any of its 24 Lottery-licensed outlets.[353]

[349] That proposal also included "at no additional cost, the licensing and printing of SGI's proprietary bar code technology," according to the minutes of the Board's July 17 meeting.
[350] Meeting Minutes of Lottery Board (July 17, 2008) (on file with author).
[351] Iowa Lottery, Player Security, http://www.ialottery.com/Player_Security/PS_RetailTips.html (last visited Mar. 2, 2009).
[352] *See, e.g,,* Iowa Lottery Security Investigator Report, Case No. 07-036 (2007).
[353] Sworn Interview of Ken Brickman at the Office of Citizens' Aide/Ombudsman (Sept. 17, 2008).

During interviews, employees and managers of the Security Division all agreed that the CDUs are an important customer-protection tool.[354] But they also said that they did not know why an entire chain was apparently allowed to "opt out" of having the CDUs.

We found the answer from Vice President for Sales Larry Loss. He told us that the retail chain had recently redesigned its stores, and apparently decided that it no longer wanted the CDUs. Loss said he determined the retain chain's decision was acceptable.[355] Asked for his reasoning, Loss told us, "We don't have anything that requires them to absolutely use [CDUs]."[356]

An attachment referenced by the Licensing Terms and Conditions states that retailers licensed to sell online games are required to "[a]llow placement of a CDU sign within six feet of the lottery terminal."[357] That language does not actually require stores to have a CDU, Lottery managers told us. Stores are "required to allow it. If we see that we need it," then-Acting CEO Brickman said.[358]

A recent forensic audit of the Ontario lottery found that activity associated with palming has decreased significantly since the lottery increased the visibility of CDUs.[359]

OMBUDSMAN RECOMMENDATIONS

49. The Lottery should amend its Licensing Terms and Conditions to specifically require that all licensees which sell online games must have a CDU.

50. The Lottery should work immediately to ensure that CDUs are installed and operating properly at all retailers licensed to sell online games.

51. The Lottery should work to develop a mechanism to lock CDUs permanently in place so that the devices always face customers.

[354] Sworn interview of Harry Braafhart at the Office of Citizens' Aide/Ombudsman (Oct. 8, 2008); Sworn Interview of John Ellison at the Office of Citizens' Aide/Ombudsman (Sept. 19, 2008); Sworn Interview of Larry Steele at the Office of Citizens' Aide/Ombudsman (Oct. 8, 2008); Sworn Interview of Ken Moon at the Office of Citizens' Aide/Ombudsman (Sept. 19, 2008); Sworn Interview of Roger Mott at the Office of Citizens' Aide/Ombudsman (Sept. 19, 2008).

[355] In reaching his decision, Loss told us that he had no communications with the retail chain, nor with anyone else in the Lottery management team.

[356] Telephone Interview of Larry Loss by an Ombudsman investigator (Oct. 23, 2008).

[357] *See Terminal Specification Sheet*, Iowa Lottery (on file with author).

[358] Sworn Interview of Ken Brickman at the Office of Citizens' Aide/Ombudsman (Sept. 17, 2008).

[359] DELOITTE & TOUCHE LLP ONTARIO LOTTERY AND GAMING CORPORATION: A DATA ANALYTIC REVIEW OF LOTTERY TRANSACTIONS (2009).

3. "BIG WIN" TERMINAL FREEZE

This procedure is triggered any time a terminal validates a winning ticket worth $10,000 and above in British Columbia, and $5,000 and above in Ontario. Under this procedure, the terminal stops working and the retailer is required to call the lottery to "unfreeze" the terminal. A lottery representative then speaks directly with the customer and provides instructions on how to redeem the prize.

The Ontario lottery recently learned that the number of incidents involving the "partial win payment" scam has apparently declined since it implemented the "big win" terminal freeze procedure.[360] The Iowa Lottery does not have a terminal freeze procedure.

OMBUDSMAN RECOMMENDATION

52. The Lottery should adopt and implement a "big win" terminal freeze procedure any time a terminal validates a winning ticket worth $10,000 or more.

4. MUSICAL JINGLES

Many lotteries have programmed their terminals to play a musical tune or "jingle" whenever a winning ticket is validated. This helps cue customers that their ticket is a winner, and would presumably make it more difficult for retailer scam artists to trick a customer out of prize money or even the ticket itself. "Winning tickets scanned through a lottery terminal will play a musical tune," says a statement on the Kansas Lottery website. "Players should always be alert for a musical tune."[361]

The Iowa Lottery has elected not to have such a jingle. In her November 2007 memo to the Lottery Board, Vice President for External Relations Neubauer wrote:

> Our terminals are capable of that change and we've discussed that idea in the past. But we've chosen not to use it because of concerns over public safety. A winning jingle might tip off stalkers to a particular player's good fortune, leaving that person vulnerable to attack once they left the retail establishment.

Neubauer later claimed that safety concerns about the jingles have "been expressed by players."[362] We subsequently asked the Lottery for examples of customers expressing concerns about a musical jingle. In response, the Lottery provided e-mails from two customers. Contrary to Neubauer's claim, neither e-mail expressed safety concerns about adding a musical jingle.[363]

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[360] DELOITTE & TOUCHE LLP ONTARIO LOTTERY AND GAMING CORPORATION: A DATA ANALYTIC REVIEW OF LOTTERY TRANSACTIONS (2009).

[361] Kansas Lottery, Warning! Protect Your Winnings, http://www.kslottery.com/lotteryinfo/ticketsecuritytips.htm (last visited Mar. 2, 2009) ("[P]layers should always be alert for a musical tune…).

[362] This statement was in Neubauer's written presentation to the Government Oversight Committee on January 30, 2008.

[363] A November 4, 2007, e-mail to the Lottery from a southeast Iowa customer suggested that the Lottery "should institute an alarm going off each time a winning ticket is scanned." A February 20, 2008, e-mail to the Lottery from a central Iowa customer suggested adding a light that would turn on whenever a terminal

OMBUDSMAN RECOMMENDATION

53. The Lottery should develop and install a musical jingle to help cue customers that their ticket is a winner, and to make it more difficult for a retailer to trick a customer out of prize money or even the ticket itself.

5. TOLL-FREE TELEPHONE NUMBER FOR CUSTOMERS

A number of lotteries offer toll-free telephone numbers for customers. The website of the British Columbia lottery includes a "Player First" section which states in part:

> We Want To Hear From You
>
> If you have comments or concerns please call toll free:
>
> Consumer Services
> 1-866-815-0222[364]

The Iowa Lottery, by contrast, does not offer a toll-free telephone number for customers. However, the Iowa Lottery does offer a toll-free number for licensed retailers. The website of the Iowa Lottery includes a "Retailers" section which states in part:

> 800 number is for retailers only
>
> The Iowa Lottery's 800 number is for retailer use only. It should not be given out to the public because the extra volume of calls can prevent us from responding as quickly to retail issues.[365]

OMBUDSMAN RECOMMENDATION

54. The Lottery should offer a toll-free phone number dedicated to customers who have a complaint, question or comment.

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scans a winning ticket.

[364] British Columbia Lottery Corp., Improving the Lottery: Improving Customer Support, http://www.bclc.com/cm/AboutBCLC/PlayerFirst/CustomerSupport.htm (last visited Mar. 24, 2009).

[365] Iowa Lottery, Retailer FAQs & Tips, http://www.ialottery.com/retailers/RetailerFAQs.html (last visited Feb. 27, 2009).

E. CONCLUSION

> The other thing that I think is just a general statement about the self-checkers is that you shouldn't be looking at any device as being the perfect panacea as the solution to an issue for people checking their tickets.
>
> — *Vice President for External Relations Neubauer, in her sworn interview*

We could not agree more with the above statement by Neubauer. Of the various possible procedures for educating and protecting customers, none offers the perfect solution.

Taken together, however, the checks and balances discussed in this section could significantly improve the level of protection for customers of the Iowa Lottery.

The 2008 addition of the "Sign It" program and customer receipts were good steps in the right direction. But as this section has demonstrated, those improvements alone still leave customers inadequately protected. Based on this information, we conclude that the Lottery has not taken adequate steps to educate and protect its customers.

VIII. LOTTERY HAS PROVIDED INADEQUATE DIRECTIVES TO RETAILERS

> It isn't rocket science to be a retailer and sell.
>
> *— Then-Acting Lottery CEO Brickman in September 17, 2008, interview with Ombudsman investigators*

Lottery customers depend on store clerks to be knowledgeable and honest brokers. That is especially true when customers do not understand all the rules, and when the Lottery itself falls short on policing retailers.

With that in mind, we examined whether the Lottery has ensured that store clerks know what is expected of them, and what penalties may befall them for betraying customers' trust.

A. INSTRUCTIONS TO CLERKS ARE VAGUE, INCONSISTENT AND NOT EASILY ACCESSIBLE

When an Iowa retailer wants to apply for a license to sell Lottery tickets, the Lottery provides him with a Retailer Application Kit. A cover letter informs the retailer that he must read an enclosed copy of Licensing Terms and Conditions and agree to its provisions before he can be licensed to sell tickets. By signing an enclosed application, the retailer certifies that he has read and understood the Terms and Conditions and agrees to comply with them.

Lottery officials told us that retailers are required to follow additional provisions in Iowa Code chapter 99G and the Lottery's administrative rules.[366] However, the Retailer Application Kit does not include copies of the Lottery's laws or rules, and the few references made to them are inconspicuous and vague. Moreover, the Lottery provides none of these documents directly to retail clerks. This is despite the fact that clerks – not licensed retailers – handle the bulk of many stores' Lottery transactions.

Even after we reviewed these three technical and fairly lengthy documents – chapter 99G, administrative rules, and Licensing Terms and Conditions – we had many unanswered questions about clerks' responsibilities to customers. Questions such as what to do with losing tickets, how to spot and handle an altered ticket, or whether it is acceptable to charge a fee to cash tickets are not explicitly addressed.

A "retailer manual" referenced in Licensing Terms and Conditions appeared to be a document that might provide further guidance for clerks. When we asked the Lottery for the manual, we received four versions of the document, the newest of which the Lottery said it last distributed in 2001. While there are some useful directives in the manuals, we found inconsistencies when we compared them to provisions in Licensing Terms and Conditions, Iowa law, and other Lottery materials.

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[366] Sworn Interview of Mary Neubauer at the Office of Citizens' Aide/Ombudsman (Sept. 15, 2008); Sworn Interview of Ken Brickman at the Office of Citizens' Aide/Ombudsman (Sept.17, 2008).

Here are two examples of those inconsistencies:

Determining the winner of a ticket

- "The person in physical possession of the ticket is the owner of the ticket and is entitled to prize payment, regardless of any signature or other writing that may be found on the ticket after purchase."

  – Instant Ticket & Pull Tab Retailer Reference Manual (2001)

- "The person who signs the ticket is thereafter considered the owner of the ticket."

  – Iowa Admin. Code 531–11.4 (2009)

- "The prize shall be given to the person who presents a winning ticket."

  – Iowa Code section 99G.31(2)(a) (2009)

Prize payouts

- "Retailers are required by Iowa Lottery Terms and Conditions to pay prizes up to $100."

  – Instant Ticket & Pull Tab Retailer Reference Manual (2001)

- "Prizes up to $100 may be redeemed at any retail location."

  – "Sign It. It's Yours." leaflet (2008)

- "Retailers must pay all prizes of $25 or less and may pay prizes of $600 or less."

  – Licensing Terms and Conditions (2008)

Regardless of these discrepancies, the Lottery told us that none of the four retailer manuals was technically still "in force."[367] We have no indication that the Lottery ever informed its licensed retailers and clerks of this fact.

The Lottery told us that an electronic training mode on store terminals now serves as the retailer manual.[368] But when we reviewed the electronic material, we found it was less substantive than the information contained in the outdated paper manuals.

[367] Letter from Ken Brickman, then-Acting CEO, to Ombudsman investigator (Aug. 6, 2008) (on file with author).
[368] Letter from Ken Brickman, then-Acting CEO, to Ombudsman (May 19, 2008) (on file with author).

Lottery newsletters, another potential source of information for retailers, have generally lacked useful directions for clerks on conducting Lottery transactions. We reviewed several years' worth of the periodic newsletters and found that they have primarily served as a vehicle for game announcements, features on winning customers, and the like. The newsletter has contained occasional tips on proper security procedures. But, according to one store manager we interviewed, those tips "might be lost in there, just like the written correction might be lost in the local newspaper."[369] Furthermore, the newsletters are not required reading for retailers or clerks.

The Lottery says it prefers to deliver its guidance in person through its sales representatives, who visit stores weekly and are available to offer any verbal advice that stores need. Then-Acting CEO Brickman told us this is "the best way to ensure that information is disseminated and understood" by retailers.[370]

However, we discovered that best practices in the area of player security are not widely known or followed by retailers. In late 2008, we asked clerks at ten central Iowa retailers to check our tickets and found only four that required us to sign our tickets and offered us receipts.[371] The signature requirement and the printing of customer receipts were introduced by the Lottery just months before our audit and were touted publicly in advertising campaigns as part of a new Lottery "Player Security" initiative.[372]

B. CLERKS NOT HELD TO SPECIFIC STANDARDS OF CONDUCT

We also found that the Lottery has no retailer "code of conduct" that might dissuade dishonest behavior. Several Canadian lotteries have implemented a code of conduct that applies to all retailers and any retail employee who handles lottery tickets.

One such code of conduct adopted by the British Columbia lottery[373] states in part:

- "As an authorized lottery retailer or lottery retailer employee, I understand the integral role I play in instilling player and public confidence in BCLC's [British Columbia Lottery Corporation] products and services and, therefore, I pledge to safeguard BCLC's commitment to integrity, respect and social responsibility by committing to the following conduct, rules and practices."

- "I acknowledge that failure to comply with the above conduct, rules and practices will result in progressive disciplinary action, up to and including termination of the Lottery Operations Agreement."

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[369] Telephone Interview of store manager by an Ombudsman investigator (Apr. 10, 2008).
[370] Letter from Ken Brickman, then-Acting CEO, Iowa Lottery, to Ombudsman (Nov. 6, 2008) (on file with author).
[371] We asked one retail clerk who checked our winning Hot Lotto ticket to apply $1 of our $3 in winnings toward the purchase of a new ticket. The clerk issued us a new ticket and concluded the transaction without paying us the difference. After a momentary pause, the clerk "remembered" our winnings and re-opened the cash register to pay us. The clerk did not require a signature or offer us a receipt.
[372] As noted in a previous section, we also found that the Lottery is not requiring retailers to provide or offer receipts to customers.
[373] British Columbia Lottery Corporation, Lottery Retailer Code of Conduct, http://www.bclc.com/documents/PlayerFirst/LotteryRetailerCodeofConduct.pdf (last visited March 4, 2009).

A cover letter sent to retailers by the British Columbia includes this:

> **Q: Why is BCLC making Lottery Retailers follow a Retailer Code of Conduct?**
>
> **A:** It is important for all Lottery Retailers to understand the contract obligations of their Lottery Operation Agreement (LOA) to make certain they understand the expectations BCLC has of Lottery Retailers…. By following the Retailer Code of Conduct, Lottery Retailers will operate their lottery business with a high level of integrity.[374]

Although the Iowa Lottery has the authority to suspend or revoke a retailer's license for behaviors that are "prejudicial to public confidence"[375] or "inimical to the proper operation"[376] of the Lottery, those provisions are not well-defined. Furthermore, it does not appear the Lottery has ever cited those provisions as a basis for issuing a sanction against a retailer.

C. NO STANDARDS OF CONDUCT CAN YIELD QUESTIONABLE BEHAVIOR

The failure of the Iowa Lottery to be explicit about its retailer expectations and vigilant in its enforcement can have far-reaching effects. Take, for instance, the store owner in northeast Iowa who told us he has paid out several major prizes that, due to their size, normally must be claimed directly from the Lottery. This retailer agreed to "buy" several customers' winning tickets at a fraction of their value, presumably, he said, because the customers wanted to avoid paying back taxes or child support from Lottery prize winnings. The retailer then claimed those prizes from the Lottery as his own.[377]

The Lottery's winner database shows that this store owner and his business claimed 12 high-tier prizes over an eight-month period, for a total of more than $10,000. We found no indication that the Lottery noticed or investigated this retailer's spate of prize claims, or had any awareness of this phenomenon.

The retailer did not seem troubled by his involvement in this scheme. "I know others are doing it, so I figured it was legal," the retailer told us. We are not certain that this retailer practice is illegal, but, at a minimum, we find it to be objectionable, since it circumvents established government processes to collect debts.

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[374] Letter from Jim Lightbody, Lottery Gaming V.P., British Columbia Lottery Corp., to Lottery Retailer (July 17, 2007), *available at* http://www.bclc.com/documents/PlayerFirst/LotteryRetailer6Directives.pdf.
[375] IOWA CODE SECTION 99G.27(1)(e) (2009).
[376] IOWA ADMIN. CODE 531-12.12(1)(l).
[377] Telephone Interview of retailer by an Ombudsman investigator (Aug. 11, 2008).

D. OTHER LOTTERIES, STORES SEE A NEED FOR SPECIFIC INSTRUCTIONS

One manager with a regional retail chain told us that, in comparison to the written guidelines of other state lotteries, "There's really not a lot from the state of Iowa."[378] Indeed, we discovered that the Nebraska Lottery disseminates two retailer manuals with well-organized, easy-to-read instructions on most questions a clerk might have.[379] One Nebraska Lottery official told us the agency is in the process of condensing and combining the two manuals for easier reference.

We found that some larger retail chains in Iowa produce their own written training manuals in place of those not provided by the Lottery. Predictably, however, we noticed that one such manual is partly based on the Lottery's incomplete and outdated directives.

E. CONCLUSION

Overall, we found that the Lottery's directives are incomplete and are not assembled for easy reference by store clerks who are likely to be busy and may need the information at a moment's notice. We also found no formal, comprehensive retailer training program. These shortcomings foster misunderstandings and bad practices among retailers, and also limit the ability of Lottery investigators to hold violators accountable.

Making the Lottery's ground rules clear for retailers and clerks alike is not only good business – it might also help to deter fraud and theft. The clerk who realizes it is a felony to steal a single $1 Lottery ticket may be less inclined to engage in theft than the clerk who lacks that knowledge.

OMBUDSMAN RECOMMENDATIONS

55. The Lottery should develop and implement a program of mandatory e-training for all Iowa retailers and their clerks, similar to the programs already developed by the lotteries in Ontario and Québec. This training should incorporate a Retailer Code of Conduct similar to those in Québec and British Columbia, which require sellers to act in the public interest and abide by general principles of integrity. The successful completion of this training should be documented by the Lottery and kept on file for reference and investigation purposes.[380]

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.

57. The Lottery should void all outdated versions of the retailer manual and should notify all retailers and clerks of this action.

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[378] Telephone Interview of retail chain manager by an Ombudsman investigator (Dec. 15, 2008).

[379] NEBRASKA LOTTERY, RETAILER MANUAL (2007); NEBRASKA LOTTERY, SCRATCH PASS-THROUGH MANUAL (2007).

[380] Section IV of this report includes a recommendation that the Security Division should develop and implement a program of mandatory e-registration for all Iowa retailers.

58. The Lottery should add easy-to-find links to Iowa Code chapter 99G, Lottery administrative rules, Licensing Terms and Conditions, and the new Retailer Code of Conduct on its website. The Lottery should direct all current and prospective retailers and clerks how to find these laws and rules, and emphasize that failure to comply will result in progressive disciplinary action, up to and including termination of the store's license. Additionally, the Lottery should post conspicuous warnings to all retailers and clerks that stealing, altering or counterfeiting a single Lottery ticket with an intent to defraud is a felony under Iowa Code section 99G.36.

59. The Lottery should propose legislation to bring Iowa Code chapter 99G in conformity with Iowa Administrative Rules 531-11.1 and 531-11.4, which it amended in 2008 as part of "Sign It. It's Yours." Additionally, the Lottery should reconcile inconsistent directives among its Licensing Terms and Conditions, retailer manual, and other documents.

60. The Lottery should propose legislation or promulgate a rule that would prohibit retailers and their employees from obtaining Lottery tickets from customers for financial or other considerations.

IX. OPPORTUNITY IGNORED: LOTTERY INDIFFERENT TO THE LESSONS OF THE CANADIAN SCANDAL

> We will continue to pursue every opportunity to enhance the honesty and integrity of our lottery systems. We are committed to put the customer first, and have begun the cultural transformation to entrench this fundamental philosophy into what is now our new way of doing business…. In all, the Ombudsman and KPMG[381] made 60 individual recommendations. OLG[382] accepted and committed to complete all of them.
>
> — *From the Ontario lottery's "Summary Report to the Ombudsman," September 2008* [383]

> I think we should seriously consider hiring a consultant to look over these issues for us. Or, we could implement the recommendations from KPMG….
>
> — *Vice President for External Relations Neubauer in an October 26, 2007, e-mail to other managers*

> We know more than KPMG ever will know about lotteries. But an outside look appears objective.
>
> — *Then-Iowa Lottery CEO Dr. Ed Stanek's October 26, 2007, e-mail reply to Neubauer*

In late 2006, Canadians learned that lottery retailers had been claiming significantly more major prizes than one would expect given the odds. It would have been only natural to wonder if Iowa had a similar phenomenon.

The Iowa Lottery showed no such curiosity.

The previous five sections of this report diagnosed the Lottery's shortcomings in key areas that are crucial to minimizing fraud and protecting customers. The Canadian scandal, which highlighted similar shortcomings, presented an opportunity for the Iowa Lottery to evaluate and improve its operations and security practices. But we found that the Iowa Lottery did not take meaningful advantage of it.

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[381] KPMG is an international auditing firm which was hired as a paid consultant by the Ontario lottery when the scandal first emerged to conduct a review of all its lottery-related operations and practices.
[382] Ontario Lottery and Gaming Corporation.
[383] ONTARIO LOTTERY & GAMING CORP., SUMMARY REPORT TO THE OMBUDSMAN (2008), http://www.olg.ca/assets/documents/olg_commitment/summary_report_to_the_ombudsman.pdf.

A. IOWA LOTTERY WAS MONITORING THE CANADIAN SCANDAL

Internal Iowa Lottery e-mails show that management monitored the developments out of Canada from the moment the scandal began to emerge in October 2006. Attached to a number of those e-mails were Canadian media reports about investigations of major prizes that had been claimed by retail employees.

Included was one newspaper article from Ontario which stated:

> The odds that the 214 insiders who claimed major prizes … won as a result of pure luck, is one in a trillion, trillion, trillion, trillion, said University of Toronto professor Jeffrey Rosenthal, who conducted the analysis.
>
> The program airing Wednesday night suggests this may be a problem across Canada and the United States.[384]

If the Iowa Lottery had gone back and reviewed its own press releases about major prize winners – as we did – they would have found dozens of high-tier prizes claimed by retailers and their employees.

The Iowa Lottery's internal e-mails included a Canadian media report that some store employees had claimed major prizes while having court-related financial problems, including bankruptcy.[385] We found that at least two Iowa store employees had court-related financial problems just before they claimed major prizes. (These individuals and their prize claims are discussed in Section I of this report.)

In addition, a few months after the Canadian scandal emerged, a northwest Iowa convenience store clerk claimed a prize of $10,000. One month later, that same clerk claimed a prize of $250,000. Both prizes were awarded from instant tickets that had come from the store where she worked. That information was included in press releases issued by the Iowa Lottery, but we found that neither prize claim was investigated.

A few months later, an Iowa store owner claimed a $250,000 prize. Her prize came from an instant ticket that came from the store she owned with her husband. The Lottery's press release said her husband handed her the ticket and told her, "Here, why don't you just scratch some lottery tickets?"[386]

By the time of that $250,000 prize claim, the Iowa Lottery already knew about the two Canadian investigations, including the Ontario Ombudsman's report that was highly critical of that lottery for failing to adequately review major prize claims by retailers.[387] According to that same report, a professor of statistics concluded that the rate of Ontario retailers winning major prizes for instant games was about 15 times more than expected; while the rate of retailers winning major prizes for online games about 3.5 times more than expected.

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[384] Shannon Kari, *Lottery "Insiders" Win Big Bucks*, GLOBE AND MAIL (Toronto), Oct. 25, 2006, *available at* http://www.theglobeandmail.com/servlet/story/RTGAM.20070326.wlotterynew25/BNStory/National/.
[385] Chad Skelton, *Lucky Lottery Retailers Also Bankrupt*, VANCOUVER SUN, June 1, 2007, *available at* http://www2.canada.com/vancouversun/news/story.html?id=5215c7ba-3b2c-453d-95c3-499946d0545b.
[386] Press Release, Iowa Lottery, Sibley Woman Wins $250,000 (Apr. 9, 2007) (on file with author).
[387] The Ontario Ombudsman's report was released in March 2007, and the British Columbia Ombudsman's report was released in May 2007.

Despite its knowledge of those developments, the Iowa Lottery paid out the store owner's $250,000 instant-ticket prize claim without first reviewing it.

The two Canadian reports made devastating findings and issued dozens of recommendations to improve the lotteries' enforcement systems. In response, the chief executives of both lotteries were fired, and both lotteries accepted all of the ombudsmen's recommendations.

Those reports did not hurt Canadian lottery ticket sales. A May 27, 2007, e-mail circulated among Iowa Lottery managers included a media report that quoted an Ontario lottery official as saying, "We've had a better year this year than last year."[388]

The British Columbia Ombudsman's report triggered a May 30, 2007, e-mail from then-Executive Vice President Ken Brickman to other members of the Iowa Lottery management team:

> We have our player reporting system and we have no known retailer prize theft problem. However, as part of our ongoing introspection, this excerpt from an article on the perceived problem in BC and the lottery's action plan for addressing the problem presents an opportunity for us to see if we can identify anything that we can do to improve our procedures. Please give this some thought and at our next Meeting of the Minds, we will discuss these suggested vulnerabilities and responses raised in BC.

That e-mail seemed to represent a sign that Iowa Lottery management might have been carefully studying the Canadian improvements. But Brickman subsequently told us that the Lottery has no record of whether the management discussion suggested in his May 30, 2007, e-mail even occurred.[389]

B. TIP OF THE ICEBERG: IOWA LOTTERY POLICIES COMPARED WITH CANADIAN LOTTERY POLICIES

After we issued our October 5, 2007, notice of investigation, the Iowa Lottery conveyed a message that its enforcement policies compared favorably with those being implemented by the Canadian lotteries. The key vehicle for this message was a November 1, 2007, memo to the Lottery Board from Vice President of External Relations Neubauer.[390]

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[388] Teresa Roncon, Ontario lottery spokeswoman [Antonella Artuso, *Lottery Dream Lives on*, SUN MEDIA (Canada), May 26, 2007, *available at* http://cnews.canoe.ca/CNEWS/Lotteries/LotteryNews/2007/05/26/4210512-sun.html].

[389] Letter from Ken Brickman, then-Acting CEO, Iowa Lottery, to Ombudsman (Nov. 6, 2008) (on file with author).

[390] *See Appendix D*.

After writing that "there may be improvements that can be made," Neubauer added:

> After consumer complaints in Ontario and Quebec, the lotteries there each have spent hundreds of thousands of dollars on consultants' evaluations of their systems. They are now in the process of implementing many of the consultants' suggestions for improvements, which have turned out to be some of the things we already have been doing for years.

In response to Neubauer's memo, the Iowa Lottery Board voted against hiring a consultant to conduct a review of its operations and practices.

We have found, however, that the Iowa Lottery at that time had *not* adopted the vast majority of the improvements that the Canadian lotteries were implementing.

1. CANADIAN LOTTERY POLICIES ADOPTED BEFORE THE SCANDAL EMERGED

Even before their scandal, the Canadian lotteries already had a number of proactive enforcement policies that were intended to reduce the inherent retailer advantages. None of these policies was in place at the Iowa Lottery at the time Neubauer presented her memo to the Iowa Lottery Board.

a. British Columbia lottery policies before scandal [391]

Anyone claiming a prize of $10,000 or more in British Columbia was subjected to an interview before the prize was paid. The main purpose of the interview was to ask the prize claimant when and where the winning ticket was purchased. The responses were checked to ensure that the claimant's answers were accurate. If the claimant was identified as a retailer or store employee, there would also be a review by the security unit.

If the lottery was not satisfied that the claim was valid, it could withhold the prize payout for a year, after which the issue could have gone to the courts.

Before the scandal, the British Columbia lottery had several other policies and procedures that the Iowa Lottery did not have. These included:

- A musical jingle at the terminal where winning tickets were validated.
- A requirement that retailers provide a receipt for every ticket that was checked.[392]
- A prohibition on retailers and store employees from playing lottery games while on duty.

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[391] These policies are based on our review of OMBUDSMAN BRITISH COLUMBIA, WINNING FAIR AND SQUARE: A REPORT ON THE BRITISH COLUMBIA LOTTERY CORPORATION'S PRIZE PAYOUT PROCESS (2007), http://www.ombud.gov.bc.ca/resources/reports/Special_Reports/Special%20Report%20No%20-%2031.pdf.

[392] The Iowa Lottery subsequently introduced receipts in May 2008 in response to concerns expressed by members of the Government Oversight Committee during its January 30, 2008, meeting.

- Self-serve ticket checkers at nearly half of participating outlets.

b. Ontario lottery policies before scandal [393]

Anyone claiming a prize of $50,000 or more in Ontario was subjected to a prize payout interview with three primary questions: Is this your ticket? Are you sharing this prize? Are you affiliated with the lottery in any way?

If the claimant was identified as a retailer or store employee, there would be additional questions on ticket purchase and validation history, as well as the insider's own playing patterns. The purpose was to confirm that the ticket was purchased by the individual presenting it.

As the prize amount grew in size, more senior lottery officials would be required to approve payment. In cases where details were still in dispute, players would be asked to sign a declaration asserting their prize claim, and payment could be delayed until the ticket expired (generally one year).

Before the scandal, the Ontario lottery also had:

- A musical jingle when winning tickets were validated.

- A procedure that involved the freezing of terminals when a prize of $50,000 or more was validated. With this initiative, when a major winning ticket was validated, a "Big Winner" jingle and video message were displayed on the customer display unit. During the freeze, lottery terminal activity was suspended and the retailer was prompted to call the lottery so that a representative could confirm ticket details with the customer.

- A policy requiring that all customer complaints regarding retailer theft, fraud, and dishonesty would be logged in a single database.

2. ONTARIO LOTTERY IMPROVEMENTS IN RESPONSE TO SCANDAL

The Ontario lottery has implemented dozens of improvements since the scandal emerged in October 2006. Most resulted from recommendations by either the Ontario Ombudsman or the Ontario lottery's hired consultant, KPMG.

The Ontario lottery accepted *all* of the 60 recommendations made by KPMG and the Ontario Ombudsman – and in several cases the lottery went beyond what was recommended.

Among the dozens of improvements that were made, we could only find one that had already been adopted by the Iowa Lottery before Neubauer's November 1, 2007, memo to the Board. (Criminal background checks of retailers applying for a license to sell lottery products.)[394]

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[393] These policies are based on our review of OMBUDSMAN ONTARIO, A GAME OF TRUST (2007), http://www.ombudsman.on.ca/media/3268/a_game_of_trust_20070326.pdf.

[394] For an overview of the improvements that have been made just by the Ontario lottery, *see Appendix L, "Ontario Case Study."*

3. ONTARIO LOTTERY THANKFUL FOR OMBUDSMAN'S INVESTIGATION

The past two years has seen the Ontario lottery move out from the middle of a scandal to a dynamic process of introspection and improvement.

In its September 2008 "Summary Report to the Ombudsman," the Ontario lottery wrote in part:[395]

- "Guided by your report and recommendations, meaningful and widespread changes have been implemented at OLG [*Ontario Lottery and Gaming Corporation*]. A culture devoted to player protection has been fostered. Our collective commitment to fairness and integrity has been renewed."

- "The central theme of the Ombudsman's report was putting customers first. We responded to this theme by creating the **Player Protection Program**."

- "In response to the Ombudsman, we were able to quickly implement an extensive array of customer-focused changes that were extremely simple and effective."

- "While no system is 100 per cent foolproof, we believe our new series of overlapping controls has significantly mitigated any inherent risk. The cumulative impact of the changes makes any retailer impropriety more difficult and riskier to undertake."

- "Lottery retailers are valued business partners of OLG, but they are not our customers."

In the same report to the Ontario Ombudsman, the Ontario lottery also wrote:

> One of the most significant findings of the Ombudsman related to the manner in which OLG delivered on its mandate. He said that, over time, OLG became overly focused on the creation of revenues for the Government of Ontario at the expense of other important aspects of its mandate….
>
> The Board of Directors and OLG's senior management team accepted this finding as honest and accurate and they committed to change the strategic focus and management culture of the organization accordingly.

[395] ONTARIO LOTTERY & GAMING CORP., SUMMARY REPORT TO THE OMBUDSMAN (2008), http://www.olg.ca/assets/documents/olg_commitment/summary_report_to_the_ombudsman.pdf.

C. IOWA LOTTERY TOP MANAGERS NOT KNOWLEDGEABLE ABOUT CANADIAN LOTTERY PROACTIVE ENFORCEMENT POLICIES

Iowa Lottery management should have been studying the Canadian investigations and implementing improvements as appropriate if for no other reason than the fact that Iowa law required it:

> The chief executive officer shall conduct an ongoing study of the operation and administration of lottery laws similar to this chapter **in other states or countries**, of available literature on the subject, of federal laws and regulations which may affect the operation of the lottery and of the reaction of citizens of this state to existing or proposed features of lottery games **with a view toward implementing improvements that will tend to serve the purposes of this chapter**. [emphasis added][396]

Members of the Lottery's upper management team told us that they had read the Canadian investigative reports. "We wanted to review what had occurred up there and to make sure that if we had any of the same situations, that we would attempt to remedy that and change any procedures that we had so that we would not be in the same situation as what was found in Canada," recently retired Vice President for Security Harry Braafhart told us.[397]

Braafhart added that he and the other vice presidents went through the reports "point by point" and "if we had a problem in that area, we would certainly fix it."

But during interviews, the Iowa Lottery's top managers had difficulty identifying and explaining the Canadian lotteries' key proactive enforcement policies, which were scrutinized in those reports:

> *Ombudsman investigator*: Now, you've read the Canadian reports. Do you know, do they have any mechanisms up there that are designed to increase the chances that a scam is detected by the lottery?
>
> *Braafhart*: I don't know, I don't remember.

1. REQUIRING RETAILERS TO IDENTIFY THEMSELVES WHEN CLAIMING PRIZES

Before retiring in July 2008, Braafhart had been the only Vice President for Security in the history of the Iowa Lottery. Beginning in 2001, Braafhart delegated the unit's supervisory duties to John Ellison, who before that had himself been a Lottery investigator since 1988.

When we asked about the practice of requiring retailers and their employees to identify themselves when claiming a major prize, Braafhart described it as "a good idea," then added, "If I would have thought about that back then I could have pursued it."

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[396] IOWA CODE SECTION 99G.7(2) (2009).
[397] Sworn Interview of Harry Braafhart at the Office of Citizens' Aide/Ombudsman (Oct. 8, 2008).

We responded by noting that we learned about that practice by reading the same Canadian investigative reports that had already been reviewed by Iowa Lottery management. "Well, I must have missed it then," Braafhart responded.

Asked about the same policy, Ellison replied, "It is a good idea. I just didn't think of it."[398]

2. INVESTIGATING MAJOR PRIZE CLAIMS BY RETAILERS

We received similar responses when we asked about adopting a policy to investigate major prize claims by retailers and their employees. "I don't see any problem with that," Braafhart told us.

But when we asked whether the Iowa Lottery had ever considered such a policy, he replied, "Not that I'm aware of."

3. POSSIBLE FRAUD INVOLVING ONLINE TICKETS

Ellison told us that online tickets cannot be susceptible to fraud by retailers. "How are you going to do that?" he asked us.

But online ticket fraud was the genesis of the Canadian scandal. This was underscored by an infamous case highlighted in the Ontario Ombudsman's report. That case involved Bob Edmonds, a 78-year-old man who was defrauded out of a $250,000 winning ticket when a retailer told him he had only won a free ticket. The retailer kept the winning ticket for herself.

In a separate case, an Ontario retailer was arrested in December 2007 and charged with stealing a $5.7 million winning online ticket from a customer.[399]

4. THEN-ACTING CEO HAS NOT EVALUATED CANADIAN POLICY MEASURES

Then-Acting CEO Brickman expressed concerns about several key proactive policies adopted by the Canadian lotteries. But it also became clear that he had not evaluated those policies. During one exchange, we pointed out that the Iowa Lottery does not have protocols that would allow it to become aware of instances of fraud or theft in which the customer victim doesn't realize it.

Brickman responded, "Can you give me an example of how a protocol can be accomplished of that nature? I'm kind of interested to hear."[400]

We responded by noting the possibility of requiring retailers and their employees to identify themselves as "insiders" when claiming major prizes. Brickman objected, saying that the Lottery would have no way of detecting individuals who fail to identify themselves as retailers or store employees when claiming a major prize.

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[398] Sworn Interview of John Ellison at the Office of Citizens' Aide/Ombudsman (Sept. 19, 2008).
[399] Shannon Kari, *Jackpot Awarded Without Insider Probe*, NAT'L PROBE (Toronto), Dec. 21, 2007, at A6.
[400] Sworn Interview of Ken Brickman at the Office of Citizens' Aide/Ombudsman (Sept. 17, 2008).

"How do they do it up in Canada then?" we replied. "I have no idea," Brickman responded. He later clarified his remarks by adding, "I don't know every detail about how they're doing it [in Canada], I don't know what they use for registration purposes and all that, but I do know they've got a database of some kind in Ontario."

The discussion culminated in this exchange:

> *Brickman*: [W]e're certainly open to suggestions on things that we might do to improve the system, but there is a point where every one of the suggestions there is not necessarily the optimum solution. And you have to weigh these things. You have to weigh these things.
>
> *Ombudsman investigator*: Cost?
>
> *Brickman*: To some extent. Practicality as to whether it's really effective. Is it – what's the cost-benefit. Cost-benefit.
>
> *Ombudsman investigator*: So what have you done, Ken Brickman, to see what the cost-benefit analysis is on this type of a step?
>
> *Brickman*: I'm waiting to see what you have to say in your report to see just exactly what you found.

D. IOWA LOTTERY MANAGEMENT HAS NOT REVIEWED ITS CASE FILES

When we interviewed then-Acting CEO Brickman – nearly two years after the Canadian scandal first emerged – it became clear that he did not realize there have been cases of Iowa Lottery customers being victimized by retailers and store employees. "You have cases where someone has defrauded a customer," Brickman at one point asked us. He later acknowledged, "I'm not familiar with the cases."

Harry Braafhart, who was Vice President for Security before retiring in July 2008, admitted that he also had not reviewed his unit's case files:

> *Ombudsman investigator*: Has anybody at the lottery in the last year reviewed the case files from a quality control perspective?
>
> *Braafhart*: I don't know what a quality control perspective would mean.
>
> *Ombudsman investigator*: Well, to see if they were up to snuff, to see what's actually in the files.
>
> *Braafhart*: No.
>
> *Ombudsman investigator*: Has anybody done that?
>
> *Braafhart*: No.

> *Ombudsman investigator*: … Do you think somebody, whether you or somebody else, should have sat down and reviewed the case files or maybe not?
>
> *Braafhart*: I guess I don't understand what you'd be looking for. What would we be looking for?[401]

Had Iowa Lottery upper management conducted an internal review of the Security Division's case files and acted accordingly, it is possible that the Lottery may have discovered these shortcomings.

[401] Sworn Interview of Harry Braafhart at the Office of Citizens' Aide/Ombudsman (Oct. 8, 2008).

Conclusions

> The Iowa Lottery takes great pride in the work done by its security department and believes those efforts are integral to maintaining the integrity of the lottery.
>
> *— December 2007 operations report by the Iowa Lottery to the Iowa Legislature's Government Oversight Committee*

A. THE NEED FOR A PROACTIVE SYSTEM OF CHECKS AND BALANCES

The Iowa Lottery and the state government it serves have a self interest in ensuring that customers are reasonably protected from potential risks. 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.

Among people who are inclined to steal Lottery tickets, those who sell them have several inherent advantages. These advantages include direct access to unsold tickets, control over the process of validating tickets for customers, and payouts of most prizes.

This does not mean that a retailer or store employee who claims a major prize should be presumed guilty of fraud or theft. But it does mean that there are good reasons for the Lottery to build a proactive system of checks and balances that will neutralize the inherent retailer advantages; and then it must apply those checks and balances with vigilant oversight. Such a system can help ensure that customers' interests are reasonably secure and that thieves are routinely held accountable, thereby promoting the Lottery's integrity and dignity, as mandated by Iowa Code section 99G.2(3) (2009).

B. IOWA LOTTERY LACKS A PROACTIVE SYSTEM OF CHECKS AND BALANCES

We identified four integral components that are necessary for a lottery enforcement system to effectively neutralize the inherent retailer advantages. We then examined the Lottery's performance in establishing these four components:

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

1. WEAK, REACTIVE ENFORCEMENT PROCEDURES

Lottery officials acknowledged that their current enforcement procedures – which largely depend on complaints from customers – miss virtually all incidents where customers are unaware that they have been tricked out of a winning ticket or prize money. This means that there likely have been instances of fraud, possibly involving significant prizes, that have gone undetected. The Lottery must work to correct this fundamental shortcoming.

2. SIGNIFICANT SHORTFALLS WITH COMPLAINT-HANDLING PRACTICES

Our review of the Lottery's files revealed an investigative approach that is often constrained by incuriosity and, at times, an indifference to getting to the bottom of a given situation.

The Security Division has no written policies on how to conduct investigations. In the absence of written protocols, Lottery investigators often fall back on word-of-mouth advice or embedded office culture to guide them in their work.

This was particularly evident in cases where the only potential victim was a customer. We found numerous customer complaints where leads went unexplored and potential crimes were not pursued. Many of these were the types of cases where the Lottery investigator would need to "make the case." Most of the time they didn't even try.

3. VIOLATORS OFTEN NOT HELD ACCOUNTABLE

We found that the Lottery has never sanctioned a retailer for theft or fraud.

Furthermore, the vast majority of store employees accused of stealing Lottery tickets have been allowed to keep any prize money obtained from those stolen tickets. This is because the Lottery does not try to recoup prize money in stolen-ticket cases. By neglecting to recover prizes obtained through theft, the Lottery has unwittingly created incentives to steal tickets. The Lottery must take immediate steps to ensure that crime never pays.

In addition, the Lottery rarely reports suspected violations to police and prosecutors, even though it is required to do so by law. Suspected violations are often not fully investigated or reported to law enforcement specifically because of retailers' wishes.

4. INADEQUATE CUSTOMER EDUCATION AND PROTECTION EFFORTS

At the urging of the Iowa Legislature's Government Oversight Committee, the Lottery in 2008 implemented two new procedures designed to help safeguard customers from possible fraud.

In March 2008 the Lottery began a new program called, "Sign It. It's Yours." The program requires retailers and the Lottery to verify that a signature appears on all tickets submitted for checking or for a prize payout. The Lottery then reprogrammed its terminals to automatically generate a customer receipt for every instant-scratch or lotto ticket that is checked or cashed.

The addition of the "Sign It" program and customer receipts in 2008 were good first steps. But we found that both procedures have limitations and are not being fully complied with. As a result, customers are not adequately protected and additional customer-protection measures are needed.

C. THE DESIRE TO IMPROVE

Several Lottery employees acknowledged the need to improve the agency's performance in these areas. "We are always wanting to improve. I mean we do," Investigator Supervisor John Ellison told us. "And I think given the chance you'll see a huge difference a year from now."[402]

Recently retired Vice President for Security Braafhart said, "I think that you folks have some very valid points and some good ideas, and hopefully some of the changes will be made over there and it will be a better lottery."[403]

Several Lottery employees told us that they now have a heightened awareness of the need to handle customer complaints with care. Comments like "I'm more diligent" were common. "And now since your investigation has started we do follow up on all those different things," then-Public Affairs Manager Tina Potthoff told us. "We do follow up to make sure, 'Hey, was it handled. Hey, do you need any other information.'"[404]

In discussing the need to keep records related to a customer's complaint, Vice President for Marketing Joe Hrdlicka said, "I think the investigation has given me a bigger and better and brighter understanding for how important that is."

Asked where the impetus for the change came from, Hrdlicka replied, "It came from me. I want to do my job well."

D. CLOSING

The Lottery has made proclamations that maintaining its integrity is its top priority:

- "The Lottery's first priority is to operate with integrity," states the Lottery's Records Retention and Open Records Policy.[405]

- "The Iowa Lottery wants to do everything it can to prevent even the slightest possibility of fraud," then-Acting CEO Brickman was quoted as saying in a May 2008 Lottery press release.

However, when we pressed Brickman about what steps top management had taken to reduce the instances of fraud, he replied, "We may not agree with every remedy that you suggest as being another thing and yet another thing and yet another thing that can be done to make nirvana because I don't think we can get there."

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[402] Sworn Interview of John Ellison at the Office of Citizens' Aide/Ombudsman (Sept. 19, 2008).
[403] Sworn Interview of Harry Braafhart at the Office of Citizens' Aide/Ombudsman (Oct. 8, 2008).
[404] Sworn Interview of Tina Potthoff at the Office of Citizens' Aide/Ombudsman (Sept. 15, 2008).
[405] IOWA LOTTERY AUTHORITY RECORDS RETENTION AND OPEN RECORD POLICY (2008), http://www.ialottery.com/contactus/ILAOpenRecordsPolicy.pdf.

Similarly, Vice President for External Relations Neubauer told us, "I don't think there's going to be any perfect system anywhere in the world as long as human beings are involved."

But taking reasonable steps to establish a proactive Lottery enforcement system is not a pursuit of "nirvana" or "perfection." The purpose instead is to promote the Lottery's integrity and dignity, which is mandated under Iowa Code section 99G.2(3) (2009).

Consider the definitions:[406]

- **Integrity** is defined as "firm adherence to a code of [especially] moral or artistic values: incorruptibility."

- **Dignity** is defined as "the quality or state of being worthy, honored or esteemed."

During our interview of Brickman, it became clear that he did not realize there have been cases of Iowa Lottery customers being victimized by retailers and store employees. After we told him about several such cases, Brickman proclaimed:

> You haven't demonstrated that anybody is on any appreciable level – out of the millions of transactions, you've got a handful of cases that you say weren't properly handled and we still haven't seen one where anybody got really rooked. I haven't seen it.

We believe this perspective misses the point: The Lottery has a weak, reactive enforcement system where large-scale fraud may be occurring without customers or the Lottery realizing it. The fact that we did not uncover a case of large-scale fraud in our review of three years of Lottery activity should not be viewed as a vindication of the Lottery's deficiencies.

Moreover, the Lottery does not meet its mandate to operate with integrity and dignity by waiting for customers to report large-scale fraud before establishing a proactive enforcement system.

Based on our investigation, we conclude:

1. The Iowa Lottery has not been operating with the degree of integrity and dignity that it could and should, as required by Iowa Code chapter 99G.

2. The Iowa Lottery has not acted reasonably in ensuring that retailers and retailer employees do not take advantage of customers who entrust them with a ticket.

Throughout this report, we have presented recommendations designed to aid the Lottery in correcting these shortcomings. These recommendations are consolidated in the following "Recommendations" section.

[406] MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY, ELEVENTH EDITION, principal copyright 2003.

Recommendations

1. The Lottery should take whatever action is necessary to enable the Security Division to implement, as soon as practically possible, a searchable database for the purpose of recording information related to investigations. The database should include a mechanism for storing and searching the names and methods of individuals suspected of violating Iowa Code chapter 99G.

2. The Lottery's Security Division should devise and implement a standardized case-file report for its investigators to log information pertaining to suspects, victims, stores and store employees.

3. The Lottery's Security Division should devise and implement specific investigative documentation standards and guidelines. A more disciplined approach to investigative recordkeeping would improve the integrity of the Lottery's investigations. Lottery investigators should also receive instructions on:

   ▪ Retaining any handwritten notes in their case files.

   ▪ Using a word-processing program for narratives in order to alert them to spelling, punctuation and grammar mistakes.

   ▪ What information must be included and in what specific format.

4. The Lottery should adopt and implement a policy requiring prize-payout interviews by Security Division investigators of all significant prize claims above an appropriate threshold. The interview should focus on the origins of the winning ticket, how the customer validated it, and whether the prize claimant is a retailer, or associated with any retailer or retailer employee.

5. The Lottery should explore the merits of amending Iowa Code chapter 99G to prohibit retailers and store employees from purchasing and redeeming Lottery products at their place of employment. The purpose is to offset the inherent retailer advantages.

6. The Lottery should develop and implement a program of mandatory e-registration for all Iowa retailers and store employees, similar to the programs already developed by the lotteries in Ontario and Québec. The program should require retailers and employees to electronically register their names and other pertinent information before they can obtain a confidential access code necessary for operating an Iowa Lottery terminal.

7. The Lottery should modify its administrative rules to adopt the following terms, definitions and insider win procedures:

   A ‘‘related party’’ is someone with a connection to an Iowa Lottery retailer. ‘‘Related parties’’ include any directors, officers, partners, owners, and employees of licensed retailers, and their immediate family members, including spouse (whether married or common law relationship), children, parents, siblings and any other relatives who reside with them.

   ‘‘Insiders’’ are a subset of ‘‘related parties’’ and include, among others, lottery retailers, their employees who sell and redeem lottery products, and their immediate families.

   Individuals falling into either of these two classifications and who claim a prize will be subject to insider win procedures to be defined by the Iowa Lottery. It is the responsibility of the related party/insider to advise the Iowa Lottery of their relationship to a licensed retailer upon claiming their prize.

   A “suspicious claim” is defined as a prize claim whereby the Iowa Lottery is not satisfied that the claimant is a legitimate winner and there exists a perceived or apparent criminal activity. All suspicious claims will be referred to law enforcement for investigation.

8. The Lottery should modify its “Winner Claim Form” to include a question about whether the claimant is a “related party.”[407] The “Winner Claim Form” already requires claimants to declare, under penalty of perjury, that the information supplied is true and correct.

9. The Lottery’s Security Division should begin tracking and analyzing high-tier prize claims by “related parties.” This includes the number of claims, the size of the claims, the frequency of the claims, and how those claims compare with specific game odds.

10. The Lottery’s Security Division should investigate any prize claim above an appropriate threshold when the claimant is identified as a “related party.” The primary purpose would be to determine whether the ticket was obtained legitimately.

11. The Lottery should explore procedures and practices to improve its ability to detect laundering of tickets obtained by theft or fraud.

12. The Lottery should devise and implement a new policy requiring that press releases will be issued for all prize claims of $10,000 or more, except in extenuating circumstances. The policy should require that prize claimants who are retailers or employees must be identified as such in the press release.

13. The Lottery should establish a new administrative rule declaring that, except in extenuating circumstances, claimants of prizes $10,000 or more must consent to the Iowa Lottery publishing the claimant’s name and a current photograph.

[407] A copy of the Lottery’s current “Winner Claim Form” is attached as *Appendix H*.

14. The Lottery's Security Division should consider adopting a formal integrity testing or "mystery shoppers" program.

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.

16. The Lottery's Security Division should conduct random and comprehensive security compliance audits of retail outlets to ensure compliance with the Lottery's rules and impose sanctions for any violations, as appropriate.

17. Security compliance audits should be confined to security-related issues and should include checks for proper positioning of the Customer Display Units (CDUs), Ombudsman stickers, and evidence of "pickouts" and other fraud or theft. All items to be checked should be included on a single form and investigators should document problems observed. Any noncompliance with Licensing Terms and Conditions should be communicated to management for consideration of appropriate license sanctions.

18. The Lottery should propose amending Iowa Code section 99G.24(7)(b) to add convictions for theft to the list of disqualifying criteria for retail license applicants, allowing for appropriate exceptions.

19. The Lottery should consider proposing an amendment to Iowa Code chapter 99G to prohibit any individual convicted of violating chapter 99G from handling Lottery products for any licensee.

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.

23. The Lottery should adopt a policy requiring that the Lottery's investigative actions involving theft or fraud must be performed by Security Division investigators.

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.

25. The Lottery's Security Division should implement methods and procedures to ensure that reports of alleged "pickout" activity receive priority treatment.

26. The Lottery should amend its administrative rules to require licensed retailers to have functional surveillance video cameras and to grant the Lottery access to video recordings upon request.

27. The Lottery's Security Division investigators should have direct access to the Lottery's winner database and should be adequately trained to use it.

28. The Lottery's Security Division should develop and implement a policy requiring its investigators to routinely check and document the prize claim history of all identified suspects. The policy should encourage investigators to review previous high-tier prize claims when circumstances warrant.

29. The Lottery should develop a method to flag the names of all theft or fraud suspects so that any subsequent prize claims they submit will be brought to the attention of the Security Division for possible investigation.

30. The Lottery's Security Division should reopen case file 07-020 to determine whether the ticket was purchased illegally, and proceed accordingly.

31. The Lottery should propose amending Iowa Code section 99G.31 to establish that any prizes accruing from tickets purchased unlawfully shall not be paid or shall be forfeited. This would be similar to the provision in Iowa Code section 99G.30 dealing with underage players.

32. The Lottery's Security Division should develop and implement written policies to help guide its staff when conducting investigations.

33. The Lottery should more closely review the casework of the Security Division's investigators. This should include, but not be limited to, reviewing the completeness and accuracy of each closed investigative case file in a timely fashion, evaluating whether the case was resolved adequately, and communicating any concerns to investigators within a reasonable period of time.

34. The Lottery should ensure that investigators are availed of adequate opportunities to receive professional training on proper investigative procedures and techniques, and should require additional training as appropriate.

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.

37. 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.

38. The Lottery should consider proposing an amendment to Iowa Code chapter 99G to provide that Lottery products shall not be sold *by* any person who has not reached the age of twenty-one, because the statute already provides that Lottery products shall not be sold *to* any person who has not reached the age of twenty-one.

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.

40. The Lottery should adopt a policy requiring that it will pursue restitution from any individual who obtains prize money from stolen tickets and who is subsequently prosecuted for that theft. The Lottery should also seek restitution for prize money claimed by individuals who received a stolen ticket from a person who is subsequently prosecuted in connection with that stolen ticket.

41. The Lottery's Security Division should devise and maintain a standardized form for calculating and reporting prize payouts in connection with stolen tickets. Lottery investigators should transmit this form to prosecutors as a routine means of pursuing restitution from Lottery ticket thieves.

42. The Lottery should amend its Licensing Terms and Conditions to require that retailers must offer receipts to customers for every ticket that is checked or cashed.

43. The Lottery should devise and implement a procedure whereby retailers would return all tickets to customers with appropriate markings to identify whether the ticket is not a winner; has been validated but not paid out; or is a winner and has been paid out. The procedure should specifically require retailers to return all tickets to customers with the appropriate markings.

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.

46. The Lottery should take immediate steps to bolster the customer-education information on its website and in its literature, as well as ensuring that the improved literature is distributed to all licensed retailers.

    The information should clearly emphasize simple steps that all customers can follow to protect their interests. Based on our review of advice on other lottery websites, here is an example of how the new information could be presented:

    SIMPLE STEPS FOR THE SMART LOTTERY CUSTOMER
    Don't become a victim of a scam artist! Here are three simple steps:

    1. **Know** the results of all tickets before handing them to a retailer. Treat each ticket you purchase as a winning ticket until proven otherwise.

    2. **Sign** all tickets as soon as possible after purchase, and definitely before handing them to a retailer. For winning tickets, it might also be a good idea to make a copy of both sides of the ticket, especially if you consider the prize amount to be significant.

    3. **Obtain** all tickets back from retailers, as well as the accompanying receipts. This will allow you to review the results of the transaction, especially if the results differed from what you had determined, or if you observe a retailer acting suspiciously while validating a ticket (in which case you are encouraged to report the matter to the Lottery immediately).

    You can always redeem tickets directly through the Lottery. If you mail a winning ticket to Lottery offices, we suggest that you make a copy of the front and back of your ticket for your records.

47. The Lottery should propose amending Iowa Code chapter 99G to include the protection of the interests of Lottery customers as a specific objective.

48. The Lottery should act to ensure that ticket checker devices are installed, as soon as practical and at a reasonable cost, at the outlets that sell instant-scratch and lotto games.

49. The Lottery should amend its Licensing Terms and Conditions to specifically require that all licensees which sell online games must have a CDU.

50. The Lottery should work immediately to ensure that CDUs are installed and operating properly at all retailers licensed to sell online games.

51. The Lottery should work to develop a mechanism to lock CDUs permanently in place so that the devices always face customers.

52. The Lottery should adopt and implement a "big win" terminal freeze procedure any time a terminal validates a winning ticket worth $10,000 or more.

53. The Lottery should develop and install a musical jingle to help cue customers that their ticket is a winner, and to make it more difficult for a retailer to trick a customer out of prize money or even the ticket itself.

54. The Lottery should offer a toll-free phone number dedicated to customers who have a complaint, question or comment.

55. The Lottery should develop and implement a program of mandatory e-training for all Iowa retailers and their clerks, similar to the programs already developed by the lotteries in Ontario and Québec. This training should incorporate a Retailer Code of Conduct similar to those in Quebec and British Columbia, which require sellers to act in the public interest and abide by general principles of integrity. The successful completion of this training should be documented by the Lottery and kept on file for reference and investigation purposes.

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.

57. The Lottery should void all outdated versions of the retailer manual and should notify all retailers and clerks of this action.

58. The Lottery should add easy-to-find links to Iowa Code chapter 99G, Lottery administrative rules, Licensing Terms and Conditions, and the new Retailer Code of Conduct on its website. The Lottery should direct all current and prospective retailers and clerks how to find these laws and rules, and emphasize that failure to comply will result in progressive disciplinary action, up to and including termination of the store's license. Additionally, the Lottery should post conspicuous warnings to all retailers and clerks that stealing, altering or counterfeiting a single Lottery ticket with an intent to defraud is a felony under Iowa Code section 99G.36.

59. The Lottery should propose legislation to bring Iowa Code chapter 99G in conformity with Iowa Administrative Rules 531-11.1 and 531-11.4, which it amended in 2008 as part of "Sign It. It's Yours." Additionally, the Lottery should reconcile inconsistent directives among its Licensing Terms and Conditions, retailer manual, and other documents.

60. The Lottery should propose legislation or promulgate a rule that would prohibit retailers and their employees from obtaining Lottery tickets from customers for financial or other considerations.

Appendix A: Iowa Lottery Licensing Terms and Conditions

IOWA LOTTERY
2323 GRAND AVENUE
DES MOINES, IOWA 50312-5307

LICENSING TERMS AND CONDITIONS
February 2008

The provisions of Iowa Code chapter 99G, 531 Iowa Administrative Code, and any other applicable statutory or regulatory provisions are herein incorporated by reference. If a provision in this document conflicts with an applicable statutory or regulatory provision, the statutory or regulatory provision preempts the conflicting provision in this document. All retailers should familiarize themselves with applicable statutes and regulations.

SECTION A – GENERAL TERMS AND CONDITIONS

1. **SCOPE.** By accepting an Iowa Lottery license, a retailer agrees to be bound by these terms and conditions. The requirements contained in Section "A" are applicable to all retailers. The requirements in "B" through "D" are applicable only to retailers selling the particular product described in each of these sections.

2. **AMENDMENTS.** These terms and conditions may be unilaterally amended by the Lottery by providing the retailer with 14 days written notice of amendment.

3. **EXPIRATION OF LICENSE.** A license is valid until it expires, is terminated by a change of circumstances, is surrendered by the licensee, or until it is revoked by the lottery. A license that does not have an expiration date will continue indefinitely until surrendered, revoked or terminated by a change in circumstances.

4. **TRANSFER OF LICENSE PROHIBITED.** Lottery licenses may not be transferred to any other person or entity and do not authorize the sale of lottery products at any location other than the licensed premises specified on the license.

5. **REPORTING CHANGES IN CIRCUMSTANCES OF THE RETAILER.** Every change of business structure of a licensed business, such as from a sole proprietorship to a corporation, and every change in the name of a business must be reported to the lottery prior to the change. Substantial changes in the ownership of a licensed business must also be reported to the lottery prior to the change. A substantial change of ownership is defined as the transfer of 10 percent or more equity in the licensed business from or to another single individual or legal entity. If a change involves the addition or deletion of one or more existing owners or officers, the licensee shall submit any documentation the lottery may require. All changes will be reviewed by the lottery to determine if the existing license should be continued. All changes must be reported to the Security Department of the Iowa Lottery.

6. **DISPLAY OF LICENSE.** Retailers shall display the lottery license in an area visible to the general public wherever tickets are being sold. Retailers must immediately report loss or damage to a license to the Vice President of Security.

7. **LICENSEE DISCIPLINE.** A retailer's license may be revoked, suspended, terminated or limited by the Lottery if a retailer fails to comply with any applicable law or administrative rule, these terms and conditions, or instructions given to the retailer.

8. **PERSONS AUTHORIZED TO SELL TICKETS.** Lottery tickets may be sold only by a licensed retailer or by employees of the retailer who is authorized to sell lottery tickets. If the retailer is a non-profit organization, members of the organization may also sell lottery tickets if authorized by the organization. The retailer is responsible for the conduct of its employees and members, which is within the scope of the retailer's lottery license.

9. **PURCHASERS MUST BE 21.** Tickets shall not be sold to persons under the age of 21.

10. **METHOD OF SALE.** Tickets shall be sold in person, across the counter or through approved vending machines; tickets shall not be sold over the telephone, through the mail or on the Internet.

11. **CREDIT PROHIBITED.** Tickets shall not be sold to players on credit card charge, or any other form of credit.

12. **PRICE**. Tickets shall be sold at the price designated by the lottery. Retailers shall not sell tickets for a greater amount than the amount specified by the lottery. Retailers may sell tickets for a lesser amount for promotion purposes if authorized by the lottery.

13. **DEFECTIVE TICKETS.** Tickets that are erroneous or mutilated when received by a retailer may be immediately returned to the lottery for credit. After confirmation of delivery, the retailer is responsible for the condition and security of the tickets and for any losses resulting from tickets that become lost, stolen, or damaged.

14. **TIME OF SALES.** Scratch/instant, pull-tab and on-line games shall be sold during all regular business hours whenever the Lottery computer system is operational.

15. **CLAIMS SERVICE.** Retailers must provide claims services during all regular business hours whenever the Lottery's computer system is operational. Retailers shall verify there is a signature on any ticket(s) submitted for checking or validation. Retailers shall provide claim forms to players for prizes, which must be claimed from the Lottery. Prizes in excess of $600, disputed prizes, and other prizes, which may be specified by the Lottery, must be claimed at a Regional Lottery Office or Lottery Headquarters.

16. **SALES REQUIREMENTS.** The Lottery may specify minimum sales quotas, which must be met by retailers. Sales quotas will be provided to the retailer in writing. Retailers may be required to sell all lottery products as a condition of obtaining a license to sell a specific product.

17. **SALES INSTRUCTIONS.** Retailers shall comply with all Lottery instructions regarding ticket sales and related topics. If required by the Lottery, these instructions shall be maintained in the retailer manual. Sales shall be made in a knowledgeable, courteous and responsible manner. Retailers and employees may be required to attend training sessions.

18. **SALES TO DISABLED.** Retailers must make reasonable accommodations to assist disabled players in compliance with state and federal law.

19. **COMPLIANCE WITH LAWS AND RULES.** Retailers shall comply with all applicable federal, state and local laws and rules when acting pursuant to a Lottery license. These laws and rules include, without limitation, laws prohibiting discrimination in employment, the Lottery's enabling legislation, the administrative rules and specific game rules of the Lottery, and laws prohibiting the sale of gambling products.

20. **RETAILER COMPENSATION.** The lottery, with board approval, shall set the base amount of retailer compensation. The base amount of compensation shall be specified in this document. The lottery may increase the total amount of retailer compensation by implementing sales incentive programs.

21. **PAYMENT TO LOTTERY.** Retailers are required to pay for lottery tickets or shares by means of an electronic funds transfer from the retailer's account. The lottery may allow a retailer to make payments by another method if the retailer can show that the electronic funds transfer system imposes a significant hardship on the retailer or if the lottery determines that the retailer's payment history justifies use of an alternative payment method. Any payment made to the lottery by an applicant for a license or by a licensed retailer either by a check which is dishonored or by an electronic funds transfer (EFT) which is not paid by the depository shall be grounds for immediate denial of the application for a license or for the suspension or revocation of an existing license. The lottery may assess a surcharge and interest up to the maximum allowed by applicable state law for each dishonored check or EFT. The lottery may also alter the payment terms or a retailer's license and require a retailer to reimburse the lottery for costs, including but not limited to attorney fees and court costs, which occur as a result of a dishonored check or EFT. The venue for any legal action will be Polk County, Iowa.

22. **INDEMNIFICATION OF LOTTERY.** The retailer and its successors and assignees shall defend, protect, indemnify and hold harmless the Lottery, the State of Iowa, and all employees thereof from and against all claims, liabilities, damages, expenses or actions arising from any act or omission, including willful or negligent acts or omissions, of the retailer or the retailer's employees or agents while performing under the authority of a Lottery license.

23. **INSPECTION OF PREMISES.** Retailers shall allow the lottery to enter upon the licensed premises in order to inspect lottery materials, Instant Ticket Vending Machine (ITVM) or Pull-tab Vending Machine (PTVM) placements, tickets, terminals, customer display units (CDU), official notices and the premises. The Lottery reserves the right to approve all ITVM, PTVM, terminal and CDU placements, to require that an ITVM, PTVM, terminal or CDU be moved to a different location if the current location of the ITVM, PTVM, terminal or CDU is unacceptable, and to remove an ITVM, PTVM, terminal or CDU that is not relocated to an acceptable location.

24. **RECORDS MAINTAINED BY RETAILER.** All books and records pertaining to the retailer's lottery activities shall be available to the lottery for inspection and copying during the normal business hours of the retailer and between 8 a.m. and 5 p.m., Monday through Friday. All books and records pertaining to the retailer's lottery activities are subject to seizure by the lottery without prior notice. The Lottery or the Auditor of the State of Iowa may audit such records at any time at no cost to the Lottery.

25. **IDENTIFICATION OF WINNING TICKETS.** Retailers shall not attempt to identify winning tickets until a signed ticket is presented for validation by a player.

26. **SECURITY ISSUES.** Retailers shall cooperate fully with the Lottery in the investigation of any missing, lost, or stolen tickets. Retailers shall immediately notify the Security Department, if tickets or Lottery property are stolen, lost, or damaged or if the retailer, an owner of the retailer's business, an officer or employee of the business, the business, or an agent of the business is convicted of a felony or gambling related offense.

27. **TITLE TO TICKETS.** Title to tickets and risk of loss passes to the retailer at the time of delivery. The Lottery is not responsible for lost, damaged or stolen tickets after delivery.

28. **TITLE TO PROPERTY.** Unless otherwise indicated by the Lottery in writing, all property furnished to the retailer to facilitate the sale of tickets is owned by the Lottery or a Lottery contractor. Any such property shall be returned upon request. Such property may be used only in conjunction with ticket sales. Retailers are responsible for all damages to such property beyond reasonable wear and tear.

29. **VENDING MACHINES.** Vending machines must be placed in a Lottery-approved, high-traffic area that is easily monitored by the retailer for security and age-compliance purposes. Retailers must keep machines fully stocked and in working order during all business hours. Retailers are required to perform minor preventive maintenance. If a machine malfunctions, the retailer must call for service using the designated toll-free number.

30. **VALIDATION DEVICES.** Retailers who do not have an on-line game terminal are required to have a ticket validation device. Validation devices will be provided at no cost to retailers. Retailers are required to provide one electrical outlet and a telephone line to support the validation device. See the Terminal Specification Sheet for specific information regarding these requirements. The retailer is responsible for the cost of these requirements except as described on the Terminal Specification Sheet.

31. **TICKET DISPENSERS**. Retailers will display tickets only in ticket dispensers or containers approved by the Lottery.

32. **DISPLAY OF ADVERTISING MATERIALS.** Retailer shall display a door decal and brochures, flyers, or similar items provided by the lottery, which are designed to provide information regarding Lottery games near the point at which tickets are sold. Retailers shall display point-of-sale material provided by the Lottery in a manner that is readily seen by and available to the public. Retailers may advertise and use or display other appropriate promotional and point-of-sale material. The Lottery may require the removal of objectionable material or the discontinuance of objectionable advertising that may have an adverse impact on the lottery.

SECTION B – INSTANT/SCRATCH GAMES

1. **INSTANT GAMES DEFINED.** Instant games include scratch tickets that have a rub-off covering which is removed to identify winning tickets and electronic game cards that have a play button which is pressed to reveal plays and any prize won.

2. **RETAILER COMPENSATION.** Retailers shall receive a 5.5% sales commission on the sale price of tickets sold by the retailer. If a retailer is eligible for the Gold Star Program, they will earn 7% sales commission on the sale price of all tickets sold. The Lottery reserves the right to make the final determination of Gold Star Program eligibility.

3. **SALES REMITTANCE.** Packs of tickets shall be sold to retailers at the purchase price. The default method for the Lottery to charge retailers for tickets sold is when 70% of guaranteed prizes from the pack have been paid, or 45 days following delivery, whichever is earlier, unless the lottery and the retailer have agreed to other terms – paid upon delivery, for example. Retailers will be credited for sales commissions. Settlement will occur weekly on a net basis as of the close of business on Saturday. Payment will be transferred to the Lottery by electronic funds transfer each week on the day specified by the Lottery.

4. **CLAIMS SERVICE.** Retailers shall verify there is a signature on any ticket(s) submitted for checking or validation. Retailers must pay all prizes of $25 or less and may pay prizes of $600 or less. Payment shall be made in cash or by the retailer's check. Payment must be made regardless of where the ticket was purchased. Retailers shall obtain and mutilate each ticket paid to prevent double payment. The Lottery will reimburse the retailer for all valid prize claims paid.

5. **UNSOLD TICKETS.** The Lottery may allow partial or full credit for returned tickets as part of a special promotion or specific game. If credit will not be given, the Lottery will specifically notify retailers of this restriction.

SECTION C – ON-LINE GAMES

1. **DEFINED.** On-line games are computerized games that are played through terminals linked to the Lottery's computer system.

2. **RETAILER COMPENSATION.** Retailers shall receive a sales commission of 5.5% of the sale price of tickets sold. A sliding scale compensation plan will give retailers opportunities to earn further commission if

they exceed sales over their sales base. The Lottery will compute the retailer's sales base annually. The sales base will be determined from the preceding bi-annual sales activity. The Lottery reserves the right to make the final determination for eligibility and commission received in the sliding scale compensation plan.

3. **SALES REMITTANCE.** Retailers shall remit the proceeds from the sale of tickets along with the weekly service charge. Retailers will be credited for sales commissions. Settlement will be made weekly on a net basis and will be computed as of the close of business on Saturday. Payment will be made by electronic funds transfer on the day specified by the Lottery.

4. **CLAIMS SERVICE.** Retailers shall verify there is a signature on any ticket(s) submitted for checking or validation. Retailers must pay all prizes of $25 or less and may pay prizes of $600 or less. Payment shall be made in cash or by the retailer's check. Payment must be made regardless of where the ticket was purchased. The Lottery will reimburse the retailer for all valid prize claims paid.

5. **METHODS OF PLAY.** Plays may be entered manually using the keypad or touch screen or by means of a preprinted playslip provided by the Lottery. Facsimiles of playslips or other materials, which are not provided by the Lottery, shall not be used. Plays must be marked on the playslip by hand; machine printed playslips shall not be used. The retailer shall not allow any device to be connected to a terminal to enter plays, except as may be approved by the Lottery. Unapproved playslips or other devices may be seized by the Lottery.

6. **METHOD OF SALE.** All offers to buy and to sell on-line game tickets shall be made only at the terminal and only by methods authorized by the Lottery. The retailer shall not enter into any special agreements with players to facilitate the purchase of large quantities in a manner outside the normal method of play. A retailer shall not directly and knowingly sell a ticket or combination of tickets to any person or entity, which would guarantee such a purchaser a Jackpot Prize win.

7. **TERMINAL LOCATION.** The terminal must be in a location approved by the Lottery. The retailer may not move a terminal without the consent of the Lottery or reduce the space allotted to the terminal.

8. **TERMINAL OPERATION.** Retailers shall operate terminals in a responsible manner and shall immediately notify the Retailer Hotline of any out-of-order condition in the phone line or terminal. Retailers shall replace paper stock and repair paper jams, but retailers shall not perform any mechanical or electrical work on the terminal.

9. **ELECTRICAL REQUIREMENTS.** Retailers must provide, at their own expense, the electrical requirements as specified in the Terminal Specification Sheet. Retailers must pay all electrical charges associated with running the terminal. Electrical service to the terminal must be provided 24 hours per day.

10. **EXTREMA COMMUNICATION SYSTEM REQUIREMENTS.** The Lottery will install a communication system in the retailer's business establishment for the operation of the terminal. The initial communication system needed for operation of the terminal shall be installed at the Lottery's expense, however, any costs associated with relocation of the system for the retailer's convenience shall be paid by the retailer. The Lottery will pay all communication charges associated with operation of the Extrema terminal.

11. **WEEKLY SERVICE CHARGE.** Retailers are required to pay a weekly service charge as set by the Lottery.

12. **DISPLAY OF WINNING NUMBERS.** As soon as possible following each drawing, retailers shall prominently display the winning numbers.

13. **DISPLAY OF ADVERTISING MATERIALS.** Retailers are required to display advertising materials. For on-line games, at a minimum the retailer will display how-to-play brochures and play slips for each game in addition to the items listed in Section A – General Terms and Conditions item 32.

14. **REPORTS.** The Lottery may require retailers to maintain and deliver to the Lottery any transaction or report produced by the terminal.

15. **MISPRINTED TICKETS.** A retailer may receive credit for misprinted tickets, provided that the retailer notifies the hotline **immediately** at the time of the misprint. The retailer **must** call the Retailer Hotline to report the misprint in order to receive credit. The retailer **must** keep the ticket through the end of the draw and then give the ticket to the Lottery District Sales Representative.

16. **TICKETS PRODUCED IN ERROR.** Under some circumstances, a retailer may receive credit for tickets that are produced in error (i.e., clerk error, customer refused). The retailer **must** call the Retailer Hotline **immediately** to report any such tickets and apply for credit. If a computerized game offers cancellations, the retailer must make a reasonable effort to cancel tickets produced in error. A ticket will be considered for credit only if the retailer follows all instructions provided by the Retailer Hotline.

SECTION D – PULL-TAB GAMES.

1. **PULL-TAB TICKETS DEFINED.** Pull-tab tickets are lottery tickets that are played by exclusively opening tabs to reveal if a prize was won.

2. **RETAILER COMPENSATION.** Retailers shall receive a sales commission of 5% of the sale price of tickets sold.

3. **SALES REMITTANCE.** Pull-tab tickets shall be sold to the retailer at the retail purchase price less the sales commission and the value of the guaranteed low-end prizes in the game. Guaranteed low-end prizes are prizes that uniformly appear in each unit of tickets. Settlement shall be computed weekly as of the close of business on Saturday of the delivery week and shall be transferred to the Lottery by electronic funds transfer on the date specified by the Lottery.

4. **CLAIMS SERVICE.** Retailers shall verify there is a signature on any ticket(s) submitted for checking or validation. All prizes must be claimed only at the place of business of the retailer that sold the ticket. The winning ticket must be submitted to the retailer to obtain payment of any prize.

Appendix B: Ombudsman's October 5, 2007, Letter to Lottery

STATE OF IOWA

Telephone: (515) 281-3592
Toll Free: 1-888-426-6283
TTY: (515) 242-5065
Fax: (515) 242-6007
E-mail: ombudsman@legis.state.ia.us
Website: http://staffweb.legis.state.ia.us/cao

WILLIAM P. ANGRICK II
CITIZENS' AIDE/OMBUDSMAN

CITIZENS' AIDE/OMBUDSMAN
OLA BABCOCK MILLER BUILDING
1112 EAST GRAND AVENUE
DES MOINES, IOWA 50319

October 5, 2007

Dr. Edward Stanek, CEO
Iowa Lottery
2323 Grand Avenue
Des Moines, IA 50312

Dear Dr. Stanek:

Earlier this year, I read with great interest the ombudsman investigative reports on possible retailer fraud involving the provincial lotteries in Ontario and British Columbia. Those investigations were triggered by media reports that retailers, and their employees, were winning major lottery prizes at a much higher rate than others. This raised the issue of potential retailer fraud – whether some were using their status as "insiders" to manipulate the process to their own personal advantage, up to and including theft of some customers' winning tickets.

The media reports said some store clerks were able to fool customers into thinking they had won a minor prize, when in fact they had won a large prize. The most infamous case involved a retailer who reportedly cheated an elderly man out of a winning ticket worth $250,000 (in Canadian dollars), by falsely telling him that he had won a free ticket.

A similar scheme was described in the British Columbia report, which quotes a retailer:

> If the player doesn't understand how to play the ticket, it's quite easy for the retailer to look at the ticket and tell them it's not a winner, throw it into their garbage or recycling, and retrieve it later and validate it.

The British Columbia report found at least 21 retailers and retailer employees had been repeat winners of major prizes between 1999 and 2007. Included were individuals who won:

- 13 prizes, each over $3,000, in one year.
- 11 prizes in five years for a total of more than $300,000.
- Over $10,000 every year for four years.

In addition, the Ontario ombudsman found that the lottery paid $12.5 million to the sister of a convenience store manager, despite several inconsistencies in her answers to investigators' questions.

CANADA: INSUFFICIENT SAFEGUARDS

Based on their extensive investigations, the ombudsmen in Ontario and British Columbia concluded that their lotteries did not have sufficient safeguards to ensure that prize monies were going to the rightful owners of winning tickets.

An editorial in the *National Post* stated:

> The new report on the Ontario lottery scandal from Ontario provincial ombudsman Andre Marin is not just a jolt to the moral and statistical conscience: It is also a sobering education in the way a public agency conducts itself when it is given a legal monopoly over a particular service.
>
> Marin's investigation of the Ontario Lottery and Gaming Corporation (OLG) has yielded tales of awful customer service, dodgy record-keeping, laughable investigative procedures and above all a near-total disregard on the part of OLG for the essential condition of its business model – the customer's expectation that a winning ticket will be properly honoured.

In the aftermath of the reports, the chief executives of both lotteries were fired, and lottery agencies from the Canadian Atlantic to the Canadian Pacific have since undertaken similar examinations.

For your information, the Canadian ombudsman investigative reports can be found on the Internet as follows:

- www.ombudsman.on.ca/UploadFiles/File/PDF/OLG%20report%20ENG.pdf
- www.ombudsman.bc.ca/reports/Special_Reports/Special%20Report%20No%20-%2031.pdf

REVISITING MY PREVIOUS CONCERNS

As you may recall, Assistant Ombudsman Jeff Burnham raised the possibility of retailer fraud with you a decade ago, during an investigation triggered by a complaint about a terminal that misidentified a winning ticket as a non-winning ticket. You confirmed that terminals could err, but you said it was an extremely rare occurrence. You also said that customers should not be relying on terminals to see if their ticket is a winner, and you noted that a clerk could make a mistake as well.

It was at that point that Mr. Burnham theorized, in a letter to you, about potential retailer fraud, and recommended that the Iowa Lottery tell its customers about the various risks and how to avoid them, so that they could make informed decisions about how to spend their money on your games. You objected, and in doing so, you persuaded me that Mr. Burnham's recommendations were overbroad. I found your assertion to be reasonable, particularly since we were not aware of any other problems, at that time.

This led to our 1998 agreement, which detailed several steps your agency would take to better inform customers – especially an advisory stating that customers are responsible for determining whether a ticket is a winner. The agreement did not require the Lottery to specifically advise against terminal reliance, or to mention any of the potential risks.

In light of the major developments out of Canada, I directed Assistant Ombudsman Burnham several months ago to review the Canadian investigative reports and provide a preliminary assessment regarding whether the Iowa Lottery has sufficient safeguards to ensure that prize monies are going to the rightful owners of winning tickets.

Mr. Burnham recently completed his assessment and reported his findings in a memo (a copy is enclosed). As you will see, the memo identifies a number of potential risks to customers. This includes the potential for retailer fraud in Iowa, as well as a preliminary finding that the Iowa Lottery has not been complying with the terms of our 1998 agreement.

[NOTE: Please be advised that I consider the attached memo to be a confidential record that is part of an open Ombudsman investigation, pursuant to Iowa Code section 2C.8 and our administrative rules; and I therefore ask that you treat it as a confidential record.]

NOTICE OF INVESTIGATION

Pursuant to Iowa Code Chapter 2C, I am therefore initiating an Ombudsman investigation of these issues. This investigation will focus on, but not necessarily be limited to, the following issues:

1. Whether the Iowa Lottery has been operating with integrity and dignity, as required by Iowa Code Chapter 99G.

2. Whether the Iowa Lottery has acted reasonably in ensuring that retailers and retailer employees don't take advantage of customers who entrust them with a ticket.

I am assigning this investigation to Mr. Burnham. After the information is gathered and reviewed, I will report my findings and any recommendations to the Lottery. If I decide to publish the report I will consult with any official who might be criticized and allow them an opportunity to respond before announcing any conclusion and/or publishing a report. Any response will be attached unedited to the report.

Pursuant to our investigation, we have a number of information requests (listed below), divided into two groups:

- Information requests that are, most likely, more appropriately responded to in written format.

- Questions which Mr. Burnham will pose to you in the format of a taped interview (along with other questions that may arise in the time being and/or during the interview).

Media reports in September stated that you will be retiring on October 31. If those reports were accurate, I recognize that your ability to respond to all of these requests before your retirement may be compromised. As a result, I am asking that you contact me or Mr. Burnham at your earliest convenience so that we can make arrangements to ensure that the interview occurs prior to your retirement.

Regarding the other requests, I would prefer that you oversee whatever work is involved in preparing those responses. If that is not practical, I would ask that you delegate those responses to other senior management. Regardless, I am requesting to receive those responses within 30 days of your receipt of this letter.

If you have any questions or concerns about these requests, or the deadlines for responding, please contact me.

Information requests

1. Does the Iowa Lottery have any policies or procedures similar to the Ontario lottery's "Insider Win Policy"? If so, please provide copies.

2. What are the Lottery's policies and procedures for receiving and handling complaints by or on behalf of customers?

3. Please provide the amounts of unclaimed prizes for each of the last five fiscal years, including the portion attributed to Powerball.

4. Please submit a blank copy of the written agreement for retailers authorized to sell Iowa Lottery products.

5. If the Iowa Lottery ever used the Spectra, Spiffany or Tiffany classes of GTECH terminals, please submit copies of any written communications, especially from the year 2000 or previously, regarding the Iowa Lottery and the phenomenon of duplicate transactions – including but not limited to, efforts to determine the scope and impact on customers and/or retailers.

6. Please make available, for our review, all of your agency's investigative files and/or records for calendar years 2006 and 2007 concerning reviews (whether triggered by a customer complaint or not) involving the actions of retailers, retailer employees and Lottery terminals. This would include, but not be limited to, logs and/or notes of a customer's initial attempt to express a concern to the Lottery.

Questions

1. Did the Iowa Lottery investigate any of [redacted] prize claims, particularly the one for $250,000? If so, what were the findings and disposition?

2. Has the Iowa Lottery been tracking – and investigating – the prize claims of retailers and retailer employees who make major prize claims, including but not limited to multiple such claims? If so, what does the information show?

3. What are your thoughts regarding whether retailer fraud has been occurring in the Iowa Lottery?

4. Iowa Code section 99G.31 states in part, "A prize shall not be paid arising from claimed tickets that are stolen." How do you reconcile this requirement with the language in the administrative rules – including sub-rule 20.11(1), which states, "A ticket or share is owned by its physical possessor until a signature is placed on the back of a ticket in the area designated for signature"?

5. If a customer presents an unsigned ticket to a store clerk for validation, and the clerk obtains the ticket without the customer's knowledge or consent, do you believe that is theft? If so, explain how the Iowa Lottery would respond if that customer filed a complaint.

6. In that same hypothetical, if the clerk signs the ticket and submits a prize claim, please explain whether the Lottery should honor that claim. For example, do you believe the "bearer instrument" standard would effectively require the Lottery to honor the store clerk's claim?

7. If your answer to the previous question is "no," please explain your answer, and also comment on how the clerk's actions would be discovered, especially if the winnings are less than $600 and the clerk pays himself or herself in the store.

8. If a customer alleges that a store clerk fraudulently obtained his winning ticket, and if the prize payment has already been made to the clerk, does the Iowa Lottery investigate the customer's complaint? If so, please provide examples from actual complaint files.

9. Do you continue to believe that customers should not be relying on terminals to determine if a ticket is a winner? If so, what do you think of the "Check-A-Ticket" devices that seem to be popular in a number of lotteries across the United States and Canada? Have you shared your concerns with administrators of those lotteries?

10. Was the Lottery Commission's 2000 decision to move away from GTECH in any way related to the duplicate transactions investigations in the United Kingdom, New Hampshire and Texas?

11. Has the Iowa Lottery done anything to address the software bugs which you acknowledged in your January 31, 2003 letter of response to Mr. Burnham? If so, please explain.

12. When was the last time the Iowa Lottery provided retailers with the stickers and brochures that you promised to distribute in our 1998 agreement?

13. Regarding the information that is statutorily confidential pursuant to Code sub-sections 99G.34(3) and (4), have there ever been any independent reviews of this information (i.e., by the Office of State Auditor or other outside entities)?

14. Has the Iowa Lottery acted pursuant to the authority granted by Code section 99G.35 (to report any suspected violations of Chapter 99G to the appropriate county attorney or the attorney general) and/or Code section 99G.36 (which identifies several acts as a Class D felony; includes "steal a ticket," "attempt to steal a ticket," and "influence the winning of a prize through the use of coercion, fraud or deception")? If so, please explain.

15. Code section 99G.11 states in part, "A member of the board, any officer, or other employee of the authority shall not directly or indirectly, individually, as a member of a partnership or other association, or as a shareholder, director, or officer of a corporation have an interest in a business that contracts for the operation or marketing of the lottery as authorized by this chapter, **unless the business is controlled or operated by a consortium of lotteries in which the authority has an interest.**" [emphasis added]

    Regarding the language in bold, what is your interpretation of its affect on the other language?

16. Does the computerized draw for the $100,000 Cash Game rely on a "pseudo random" number generator or a more sophisticated hardware random number generator?

Thank you for your assistance. As stated above, please let me know if you have any questions or concerns.

Sincerely,

William P. Angrick II

WPA/jbc

cc: Iowa Lottery Board (Chairperson Timothy Clausen; and Board Members Elaine Baxter, Mary Junge, Mike Klappholz, Tom Rial and Michael L. Fitzgerald)

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Appendix C: Then-Executive Vice President Brickman's October 15, 2007, Letter to Ombudsman

2323 Grand Avenue • Des Moines • Iowa • 50312-5307
Telephone: 515-725-7900 • Fax: 515-725-7882
www.ialottery.com

Chester J. Culver • Governor
Patty Judge • Lt. Governor

Edward J. Stanek, Ph.D. • Chief Executive Officer

Oct. 15, 2007

Mr. William P. Angrick II
Citizen's Aide/Ombudsman
Ola Babcock Miller Building
1112 E. Grand Ave.
Des Moines, Iowa 50319

Dear Mr. Angrick:

Dr. Stanek has assigned response to your letter dated October 5, 2007 to me. I am the Executive Vice President of the Iowa Lottery Authority and assisted you with your inquiry of 1993-1997. I assure you that I intend to cooperate with your inquiry to the fullest extent possible. Dr. Stanek is scheduled to retire in less than 3 weeks and has numerous other duties to ensure the continuity of millions of dollars of lottery operations upon his transition in addition to his normal duties. He is also working with the attorney general's office regarding litigation both initiated by the Lottery and to defend the state from lawsuits related to TouchPlay. He has several thousand pages of documents to review in order to prepare for delivering depositions scheduled to take place before he leaves.

I think it is important to point out that while the documents from your office contain many theories, it appears that you are initiating this inquiry of your own volition since there is no documentation mentioned that your office has received a current complaint involving the Iowa Lottery.

Most of your documentation asserts lottery problems outside of Iowa in areas such as Ontario, British Columbia, and the United Kingdom although U.S. jurisdictions are mentioned. The source of the U.K. experience years ago was with a supplier that the Iowa Lottery has not engaged since 2001 and there was no such issue in Iowa. The problems with the lotteries in Canada resulted from citizen complaints left unattended and possibly ignored by their lotteries, something we do not do here. In addition there are fundamental differences in law.

Since you have not had a single complaint regarding the Iowa Lottery in many years, it leaves me to wonder what precipitated this inquiry and the justification of the expense that will be borne by the taxpayers for both the time of your office and mine.

Your letter mentioned media accounts of Dr. Stanek's impending retirement and you state, "If those reports were accurate…." You clearly acknowledge that media reports

may not be "accurate" on that insignificant item yet you apparently accepted the veracity of your colleague's quotes in the reason for your investigation to be media accounts in Minnesota, Wisconsin, Illinois, Kansas, British Columbia, Texas, California, Tennessee, and Indiana not to mention CNN and a blogger in Texas.

The documents you provided have a prosecutorial flavor rather than the tenor of an inquiry. They suggest that somewhere for some reason as yet to be determined, you have concluded that there is something sinister, not yet known, lurking, and the Lottery is guilty of something unless proven innocent. I have serious concerns about the genesis and intention of this inquiry.

The documents were prepared by Mr. Burnham of your staff. Had you tried to contact us before launching a formal inquiry, we could have had a dialogue regarding the substance of the issues involving other lottery jurisdictions as they relate to Iowa. But you have chosen not to use dialogue to preliminarily or informally discuss your issues. Instead you have chosen a confrontational approach. Also, your inquiry, which from our last experience could take as long as four years, seems to be attempting to race against Dr. Stanek's announced retirement deadline of less than 3 weeks.

If we could have had a conversation about the matters before you began your inquiry, I could have told you that the issues you raised regarding the U.K. were investigated by the Iowa Lottery and its vendor seven years ago, and that the issues did not exist in Iowa. Likewise, I could have told you that the issues you raised regarding the Kansas Lottery were fully investigated here seven years ago and that the Iowa Lottery ensured those issues did not impact its system.

But you apparently have not wanted a conversation; rather, you chose to employ a missive fraught with rumor and innuendo but remarkably devoid of facts relating to Iowa.

Do not take any of my comments to imply that the issues involved are unimportant. Quite the converse is true. We have addressed them and will continue to do so.

Because the paper that led you to open the formal inquiry is fraught with hearsay, innuendo, prejudice and preformed conclusions and is based on second-hand media accounts and not a citizen complaint or inquiry, in the interest of objectivity, I respectfully request that Mr. Burnham be taken off the project and another staff member assigned, as well as your assurance that Mr. Burnham will have nothing to do with this inquiry.

I also am flummoxed at your suggestion that the lottery has not followed through with the consumer informational advisories we discussed 10 years ago. The lottery has ordered and placed thousands of the information stickers through the years. The lottery also has woven much of the same information into its brochures that are in retail locations; has included the information on the back of lotto tickets; and has placed the information on its Web site.

You seem fixated upon the stickers being affixed to lottery terminals, but the terminals cannot always be installed in locations where the public would easily see such a sticker. That is why the lottery also has affixed the stickers in many locations to its vending machines. You also seem to be looking for just one brochure regarding the information we discussed. In fact, the information regarding lottery office locations, telephone numbers and its Web site have been included in nearly all of our game brochures so that it is routinely available. We also include that information in many of the news releases we send out statewide each day.

I also had to smile at your office's implication that the lottery did not inform the public about the Player Security pages we added to our Web site late last year. In fact, those new pages were announced at a joint news conference with the attorney general's office in January; included in a statewide news release we distributed at that time and again in February; advertised for months with Web banners on the lottery Web site and other prominent Web sites around the state; and mentioned in statewide public service radio ads we produced and paid for along with the attorney general's office. If we could have had a conversation before you began your formal inquiry, I could have told you that those extensive efforts were part of a joint campaign with the attorney general to warn consumers about the possibility of fraud and scam attempts and to provide overall security suggestions.

There are many other erroneous issues raised in your office's letter and memo, but they are so numerous that I do not currently have time to address them all. I simply raise that point so you are not left with the impression that I have addressed all errors in your missive.

The Lottery will attempt to respond in the time frame you have requested, however I note that we have reservations about your office's jurisdiction with regard to this inquiry and additional concerns regarding your request for confidential information. We reserve the right to raise these issues at a later time.

Again, we take these matters extremely seriously. Integrity is tantamount to the operation of our lottery, as is openness and translucency in government. We will respond to your questions and trust we can conclude this undertaking in less than the 3 ½ years involved in your inquiry of the 1990s.

Sincerely,

Kenneth A. Brickman
Executive Vice President

Cc: Stanek; AAG

Appendix D: Vice President Neubauer's November 1, 2007, Memo to Lottery Board

Chester J. Culver
Governor

Patty Judge
Lt. Governor

To: **Iowa Lottery Board**

From: **Mary Neubauer**
Vice President, External Relations

Date: **Nov. 1, 2007**

Re: **Review of Consumer Reporting and Security Processes**

For about a year, we at the Iowa Lottery have been tracking a series of security-related, consumer protection issues that have arisen at lotteries in Canada. Ed Stanek has been sending along information regarding the Canadian developments to you as we continued to monitor the situation.

There are fundamental differences between the way consumer concerns and security issues were handled at some of the lotteries in Canada and the processes we have in place here. We also believe that the Iowa Lottery has taken many proactive steps through the years to remind consumers about the security tips they can follow to be fully informed when they play lottery games. Nevertheless, the issues that have arisen in Canada deserve attention by all lotteries.

We believe we have a well-developed system here in Iowa that provides consumers with information about lottery tickets and their results. In addition, our security and integrity standards ensure that 100 percent of issues referred to our security department are investigated. But, that does not mean that there aren't other approaches we could consider using here.

Let's start a discussion today and continue it at future Board meetings so we all can examine the issues together as part of our public meetings.

The issues in Canada date back to 2001 when an Ontario man visited a variety store that sold lottery tickets and asked the store owner's wife, who was working at the check-out counter that day, to check his lotto tickets. She told him he had won a free ticket, but didn't mention any other prizes. The man later became suspicious when he read in the paper that the store owner and his wife had won a $250,000 prize. He contacted the Ontario Lottery Corporation and was able to provide documentation to the lottery showing that he had regularly played the numbers that were on the $250,000-winning ticket. He also provided details about what happened when he went into the store to have his lotto tickets checked that day.

The man's account was in stark contrast to that of the supposed winning couple, who could not say when or where the ticket was obtained or if there was any significance to the numbers chosen. Despite that, it appears that it took the lottery months to look into the matter. And even then, much of the lottery's activity began only after local police had arrested the husband-and-wife team who ran the store and charged them with fraud and theft. After that, the man still had to go to court to try to collect his winnings. The civil litigation lasted for three years, but he did eventually receive a $150,000 settlement from the retailers involved and a $200,000 settlement from the Ontario Lottery.

It's important to point out that there are no complaints of situations reported by Iowa Lottery players being ignored or left uninvestigated. Any issues relating to security or possible matters of impropriety are referred to the Iowa Lottery's security department, where 100 percent of referrals are investigated, and when appropriate, referred to law enforcement.

We want to go over some other key differences between the situation that existed in Ontario and the processes and standards we have in place here.

First and foremost, the Iowa Lottery requires that those applying for a lottery retail license undergo background checks by the Iowa Division of Criminal Investigation. Anyone who has been convicted of a fraud, felony or gambling violation is not licensed as a lottery retailer in Iowa. At the time of the case we've been discussing in Ontario, no pre-screening was done of those who applied to sell lottery products there.

In addition, the Iowa Lottery issues terms and conditions for its retail licenses and those businesses that are licensed to sell lottery tickets must comply with those terms and conditions. A first-time violation of the terms and conditions results in a one-week suspension of the retail license and therefore, the store's ability to sell lottery products. A second violation within a year results in a one-month suspension of the retail license; and a third violation within a year results in a one-year suspension of the retail license. Any suspected criminal activity would be referred to law enforcement. Any conviction for fraud, compromising the security or integrity of the lottery, illegal gambling, or any felony, would lead to a license revocation. In Iowa a revoked license applies for 10 years unless the Board finds that the violation was minor or unintentional.

At the time of the case in Ontario, there was no specific "Code of Conduct" for retailers there.

There have been instances where retailer licenses have been suspended in Iowa. In 2006, for example, two retail licenses were suspended after documented cases of underage sales at those stores. Such instances have been rare -- retailers in Iowa in general have a strong record of handling and selling a wide range of products, including lottery tickets. But in the instances where there have been violations, the lottery has dealt with them according to its retailer terms and conditions.

Another major difference between the situation described in Canada and the procedures of the Iowa Lottery lies in the key area of investigation. The Iowa Lottery has its own staff of five investigators, all of whom are required to have a history of law enforcement work and training.

Our investigators must have law enforcement academy training at a minimum and complete annual continuing education classes in law enforcement matters. Through the years, Harry Braafhart, our Vice President of Security, has provided you with reports at Board meetings about the investigations conducted by the Iowa Lottery's security department. Many of those investigations have been prompted by reports of stolen tickets or ownership disputes over lottery tickets. The lottery's security department has a strong record of investigation and apprehension in its cases.

Let me give you a couple key examples. One is a case many of us remember well. In 1999, an Urbandale convenience store clerk came to lottery headquarters and claimed a $28 million Powerball jackpot. After he made his claim but before the prize was paid, an underage co-worker came forward and claimed a share of the prize. The lottery investigated the claim and involved the Attorney General's office. The co-worker filed a lawsuit against the claimant. It was determined that the case was not a criminal matter, so the details of the lottery's investigation were made available to the parties, who then reached a settlement agreement, ending the litigation.

The other case involves a $100,000-winning Powerball ticket that was claimed in 2001 by an 85-year-old woman from Sperry in southeastern Iowa. After the prize had been paid, the lottery received a telephone call from a man who said he suspected that the winning ticket had been stolen from a group of co-workers at a Mediapolis company who pooled their money to buy Powerball tickets. The lottery investigated the case and was able to show that the winning ticket had been switched out from among those that were purchased for the group of co-workers. As it turned out, the woman who bought tickets on behalf of the group lived with her grandmother. The grandmother pleaded guilty later that year to felony theft in the case. She had stolen the winning ticket from its hiding place under a bird cage in the home she shared with her granddaughter.

There are two different examples for you – one involving a dispute before a prize was paid and the other involving questions that arose after the prize was paid. In both instances, the lottery investigated the matter and sought and received the assistance of outside law enforcement, which ultimately brought the cases to resolution.

We're proud of the success rate lottery security has achieved through the years. Nationally, arrests are made in just 16 percent of burglary cases, but because of the specific information that can be provided about lottery tickets, arrests have been achieved in 88 percent of burglaries investigated by lottery security. Theft cases investigated by lottery security are solved about 85 percent of the time.

That is not to say there haven't been concerns expressed by lottery players about retailers in the state. There have been, and those instances have been investigated by the lottery. A case earlier this year in Burlington is a good example. In that instance, an elderly woman called the lottery and spoke with one of our security officers. She said she had recently redeemed a Powerball ticket at a local supermarket and was certain that she had won $200,000, but the clerk had only paid her $35. She was not sure where she had purchased the ticket and couldn't remember exactly when she had redeemed it, but thought it was on one of two days.

Even with just those few details to work with, our security department was able to check the lottery records from the store involved. Our security officer was able to show that the woman had indeed won $35 in the Powerball drawing on July 11. She had matched three numbers to win a $7 prize and by adding the Power Play to her ticket, her prize had been multiplied to $35.

Our security officer then called the woman back with his findings and she thanked him for his help and his time.

That is the same approach our security department uses in any case it investigates. If there is something amiss, we want to know that so we can rectify the situation. If there is nothing wrong, we want to know that as well and be able to share that information with those involved so they can have peace of mind.

Another major area of difference between the procedures of the Iowa Lottery and those that were highlighted in Ontario has to do with the issue of so-called "insider wins." In Ontario, it is legal for lottery employees and their immediate family members to play the lottery. In addition, it is legal for employees of the lottery's key contractors and subcontractors to play the lottery. There are additional security checks that are conducted if any of those people wins a large prize, but they are not prevented from playing. There have been concerns expressed in Ontario and some other Canadian provinces about the issues involved when retailers or retail employees play the lottery, but not as much discussion about lottery employees or employees of lottery contractors playing the games.

That is in stark contrast to state law here in Iowa and the security requirements of our lottery. Iowa Code section 99G.31 makes it illegal for lottery tickets to be purchased or for prizes to be paid to Iowa Lottery Board members; employees of the lottery, or to any spouse, child, brother, sister or parent residing as a member of the same household in the principal place of residence of any of those people. The law also puts those same restrictions on employees, agents and subcontractors of lottery vendors who have access to confidential information that could compromise the integrity of the lottery. Specified family members of those people also are prohibited from purchasing tickets or winning lottery prizes.

So, here in Iowa, lawmakers considered "insiders" to be employees of the lottery and employees of subcontractors or vendors with inside information that could compromise the lottery if they were allowed to play. The lottery maintains a database of the Social Security numbers of all its employees; the employees of the independent auditors assigned to work at lottery drawings; and those employees of subcontractors and vendors who have inside access to information that might compromise the integrity of the lottery. The database also includes the Social Security numbers of the appropriate relatives of those people. When tickets are claimed at the lottery, the identity of the person claiming the prize is checked against that database so a prize won't be paid to an "inside" person.

Retailers, by contrast, don't have access to confidential information associated with the lottery and they can't affect the outcome of drawings. Yes, they sell lottery tickets, but they can't get into the computer system that contains game information or generates plays. They also aren't

included in the state law defining "insiders" in Iowa, so they aren't included in the lottery's database that's checked during prize redemption.

The lottery's efforts to protect its sales and validations system are double-checked on an annual basis by the state Auditor's office, which contracts with an auditing firm to conduct an SAS 70 audit of the lottery system. In addition, every two years, the Multi-State Lottery Association reviews the Iowa Lottery's computer system and associated controls to ensure they meet the security and integrity standards for participation in multi-jurisdictional games.

Finally, we come to the issue of consumer protection. The lottery has taken a number of steps through the years to provide the public with information about lottery games and prizes. But we have been putting on an especially heavy push in that area since early this year, when we conducted a news conference and began a public-service campaign with the Attorney General's office to warn people about the lottery scams that have been sweeping the country.

Leading up to the January news conference, we expanded and centralized the security information we have on our Web site and made "Player Security" one of the main links on our home page. We announced the expanded player security information in a statewide news release; we advertised the new security pages for months with Web banners on our Web site and other prominent sites around the state; and we mentioned it in statewide public service radio ads we produced and paid for along with the attorney general's office.

In addition to those security reminders, the lottery for years has provided information in its game brochures about its office locations, telephone numbers and Web site address. We also include that information in many of the news releases we send out every day.

But that's not all. For more than a decade, the lottery also has provided informational stickers on its sales terminals, vending machines, play stations and ticket dispensers that remind players to check the accuracy of their tickets when they purchase them. The stickers advise players to sign the backs of their tickets before they claim them and to contact the lottery if they have any concerns. All of that information, as well as lists of prizes still available in our games and lists of prizes that have yet to be claimed, are available on our Web site. That's in addition to the security reminders that are printed on the backs of our tickets.

Our information also advises players that there are several ways they can check the results of their tickets: They can watch the televised drawings in lotto games, check the information on the lottery Web site, ask retailers to print out winning numbers from the lottery terminal, call one of the lottery's five regional offices around the state, listen to lottery results on local radio stations, and check lottery results in local newspapers.

The first line of defense in consumer protection is always for players to arm themselves with the information they need to determine whether their tickets have won a prize. That's much the same thing we all should be doing to ensure, for example, that a clerk has given us the proper change or that the milk we buy at the local store rings up for the right price. The lottery offers its players a plethora of information they can use to determine the outcome of their tickets. However, we

have felt that there is no substitute for player responsibility and player diligence, despite all the assistance that we can provide.

Hopefully, this has provided you with an overview of many of the security issues the lottery deals with on a daily basis. Again, there have been no consumer complaints here like those that have occurred in Canada. But we're not saying that we think our system is flawless. There may be improvements that can be made.

After consumer complaints in Ontario and Quebec, the lotteries there each have spent hundreds of thousands of dollars on consultants' evaluations of their systems. They are now in the process of implementing many of the consultants' suggestions for improvements, which have turned out to be some of the things we already have been doing for years.

We're not sure of the merit of some of the improvements prescribed in Canada, however. One of the relatively simple ideas is for a musical "jingle" that would play from the lottery terminal each time a winning ticket was scanned. Our terminals are capable of that change and we've discussed that idea in the past. But we've chosen not to use it because of concerns over public safety. A winning jingle might tip off stalkers to a particular player's good fortune, leaving that person vulnerable to attack once they left the retail establishment. Those are the types of issues that must be weighed when you're talking about new ideas that could be implemented.

We welcome your comments today regarding the security details we've covered, and whether you think it would be a good idea for the lottery to pursue an outside consultant to evaluate our security processes. At future Board meetings, we'd like to continue this conversation and focus in on particular areas we've covered in general today.

Appendix E: Then-Acting CEO Brickman's November 5, 2007, Letter to Ombudsman

2323 Grand Avenue · Des Moines · Iowa · 50312-5307
Telephone: 515-725-7900 · Fax: 515-725-7882
www.ialottery.com

Chester J. Culver · Governor
Patty Judge · Lt. Governor

November 5, 2007

Mr. William P. Angrick II
Citizen's Aide/Ombudsman
Ola Babcock Miller Building
1112 E. Grand Ave.
Des Moines, Iowa 50319

Re: Your Information Requests of October 5 and 22, 2007

Dear Mr. Angrick:

I enclose the answers to the queries posed in your letters of October 5 and 22, 2007.

Sincerely,

Kenneth A. Brickman
Acting CEO

Answers to Oct. 5, 2007, and Oct. 22, 2007, Information Requests And Questions From Citizens' Aide/Ombudsman

1. The Iowa Lottery's "insider win" policy is defined in Chapter 99G.31 of the Code, which states:

g. No ticket or share issued by the authority shall be purchased by and no prize shall be paid to any member of the board of directors; any officer or employee of the authority; or to any spouse, child, brother, sister, or parent residing as a member of the same household in the principal place of residence of any such person.
h. No ticket or share issued by the authority shall be purchased by and no prize shall be paid to any officer, employee, agent, or subcontractor of any vendor or to any spouse, child, brother, sister or parent residing as a member of the same household in the principal place of residence of any such person if such officer, employee, agency, or subcontractor has access to confidential information which may compromise the integrity of the lottery.

By our reading of the statute, the Legislature considers "insiders" to be employees of the lottery and employees of subcontractors or vendors with inside information that could compromise the integrity of the lottery and certain family members of such persons living in the same household.

The lottery maintains a Social Security-number database of all its employees; independent auditor employees assigned to work at lottery drawings; and those employees of subcontractors and vendors with insider access to information that might compromise the integrity of the lottery. The database also includes the Social Security numbers of the appropriate relatives.

When tickets are claimed for prizes of more than $600 at the lottery, the identity of the claimant is established and matched against the database to avoid payment of a prize to the inside persons.

Retailers do not have access to confidential information, are not included in the relevant Code sections, and are therefore not included in the database.

2. All letters, e-mails or other inquiries from the public to the lottery are routed to the appropriate person or department depending upon subject matter and answered if the person sending the inquiry can be identified. Any inquiries relating to security issues or matters of impropriety are referred to the lottery's security department, where 100 percent of referrals are investigated.

3. A schedule of unclaimed lotto prizes for fiscal years 2003-2007 is attached.

The schedule does not include unclaimed prizes from instant-scratch and pull-tab games. Outstanding instant prizes could occur when a ticket is purchased and the prize is not claimed (unclaimed prize), but they also could be the result of a ticket that went unsold and was returned to the lottery when the game ended (that is an unsold, not unclaimed, prize). The only way to accurately determine the amount associated with unclaimed prizes would be to play and record many millions of returned tickets and subtract those prizes from all of the remaining outstanding prizes in the game. The net (all remaining prizes, less those prizes from tickets returned unsold to the lottery upon a game's end) would quantify the unclaimed instant prizes.

4. Retailers are licensed by the lottery and as such are required to comply with the terms and conditions of licensure. A copy of the lottery's licensing packet is attached and the terms and conditions are included in that packet. Also attached is a sample copy of a lottery retailer license.

5. The Iowa Lottery used a Tiffany-class GTECH terminal from July 1, 1991, through June 30, 2001. We are enclosing a letter dated Oct. 20, 2000, confirming that no such malfunction as had been reported in the United Kingdom ever affected terminals in Iowa.

6. The lottery's investigative files are confidential under Iowa Code Chapters 99G and 22. Instead, we are providing for your review summaries of investigations by the Iowa Lottery Security staff concerning retailers, retailer employees or lottery terminals during calendar years 2006 and 2007.

Answers to Questions

1. Any issues relating to security or matters of impropriety are referred to the lottery's security department, where 100 percent of referrals are investigated and when appropriate, referred to law enforcement. At the time the $250,000 prize was claimed, there was no security-related matter or issue of impropriety involved and that remains the case at this time. We had inquired about the winner you referenced. The winner generally buys tickets by the pack ($300 worth) in the "$35 Million Cash Spectacular" instant-scratch game and purchases tickets frequently. All of the prizes above $600 that have ever been claimed by that winner are in the "$35 Million Cash Spectacular" game. All of the prizes are from tickets purchased at a convenience store where the winner is employed and a grocery store in a nearby town where the winner does not work. Although the winner works at the convenience store, most of the prizes claimed from the lottery were purchased at the grocery store.

2. Any issues relating to security or matters of impropriety are referred to the lottery's security department, where 100 percent of referrals are investigated and when appropriate, referred to law enforcement. Unless there are circumstances involved that would indicate an investigation is warranted, we do not investigate prize claims by retail employees or any other prize winner.

3. Any issues relating to security or matters of impropriety are referred to the lottery's security department, where 100 percent of referrals are investigated and when appropriate, referred to law enforcement. There have been instances of retail employee theft of lottery tickets and all instances reported to the lottery have been investigated by our security staff, all of whom must have law enforcement academy training at a minimum and complete annual continuing education classes in law enforcement matters. Local and state law enforcement often are also involved in such investigations, and the filing of charges and prosecution of cases is conducted by local and state law enforcement authorities outside the Iowa Lottery.

We believe there are individuals who will commit fraud. We doubt that they will exclude the lottery from the list of possible opportunities. However, with the extensive record-keeping associated with lottery products, it is much more likely they will be caught and prosecuted when compared to other types of fraud, such as a retail employee giving change for a $10 bill when he or she actually had been given a $20 bill.

All applicants for lottery retail licenses undergo background checks by the Iowa Division of Criminal Investigation and anyone who has been convicted of fraud, a felony or a gambling violation is not licensed as a lottery retailer in Iowa.

4. Iowa Administrative Code in section 20.12 (Ticket Validation Requirements) also states in part, "All claims for prizes are subject to validation by the lottery. To be a valid ticket or share and eligible to receive a prize, all of the following requirements must be satisfied..." Those requirements include the following: "g. The ticket or share must not be stolen."

The reconciliation of the two sections involves looking at both prize eligibility and ownership. If the ticket meets eligibility requirements specified in the Iowa Code (99G.31) and Iowa Administrative Code (20.12) the prize will be paid to the owner of the ticket as defined in the Iowa Administrative Code section 20.11(1).

If the ticket does not meet the eligibility requirements specified in Iowa Code (99G.31) and Iowa Administrative Code (20.12) the prize will not be paid.

As with any other bearer instrument, such as a bearer bond, mere possession of an Iowa Lottery ticket does not guarantee the payment of the instrument when evidence of theft is presented.

If there is any indication of an ownership-related issue involving a lottery ticket, the situation is investigated. In addition, the lottery maintains a database of stolen tickets and payment of prizes from those tickets is blocked until the situation is investigated and a determination can be made as to whether or not the claim should be paid. If criminal activity appears to be involved, the matter is referred to law enforcement. If an ownership issue is raised after a prize has been paid, the lottery fully investigates the matter and refers it to law enforcement if appropriate.

5. Your hypothetical is unclear and confusing. It begs the question of how the clerk came into possession of the ticket without the knowledge and consent of the player when the hypothetical states the player gave the ticket to the clerk.

6. Again, your hypothetical is unclear and confusing since it does not address how the clerk came into possession of the ticket. However, any dispute over ownership of a ticket is investigated by the lottery. If evidence of criminal activity in connection with a transaction is found, it is referred to the appropriate law enforcement agency. If criminal activity is not indicated and the parties engage in civil litigation, our investigation materials may be made available to the litigants. A highly publicized example of how the system works can be found in the 1999 Powerball grand prize of Timothy Schultz, a clerk in an Urbandale convenience store. After Mr. Schultz made his claim but before the prize was paid, an underage co-worker came forward and claimed a share of the prize. The lottery investigated the claim and involved the Attorney General's Office. The co-worker filed a lawsuit. The results of the investigation were made available to the parties (since it was determined not to be a criminal matter), who then reached a settlement agreement, ending the litigation. When, as in the Schultz case, there is no evidence of misfeasance or malfeasance, our role ends at this step. When an investigation indicates retailer impropriety, we refer the case to a law enforcement agency and initiate an assessment of the retailer's licensing status for imposition of sanctions, if appropriate.

7. Again, your hypothetical is unclear and confusing since it does not address how the clerk came into possession of the ticket. However, any issues relating to security or matters of impropriety are referred to the lottery's security department, where 100 percent of referrals are investigated and when appropriate, referred to law enforcement. Any dispute over ownership of a ticket is investigated by the lottery. If evidence of criminal activity in connection with a transaction is found, it is referred to the appropriate law enforcement agency. If no criminal activity is indicated and the parties engage in civil litigation, our investigation materials are available to the litigants.

For example, when the lottery receives a call from a player concerned that a store clerk may have stolen his or her winnings on a lotto ticket, the store's activity is reviewed. That review can determine whether such a ticket existed, and if so, the exact ticket in question. The review can reveal when the ticket was validated along with the place, time and date that the ticket was sold and the plays on the ticket.

8. Any issues relating to security or matters of impropriety are referred to the lottery's security department, where 100 percent of referrals are investigated and when appropriate, referred to law enforcement. Any dispute over ownership of a ticket is investigated by the lottery. If evidence of criminal activity in connection with a transaction is found, it is referred to the appropriate law enforcement agency. If no criminal activity is indicated and the parties engage in civil litigation, our investigation materials are available to the litigants.

9. You appear to have taken out of context written comments produced at least 10 years ago. The point we were trying to make at that time and that is still the case today is that customers should not rely solely on any one source of information to determine the winning or nonwinning status of lottery tickets. There can be malfunctions with individual terminals just as there can be malfunctions with any electrical or mechanical device in existence. There also can be malfunctions with the "check-a-ticket" devices you pointed out. Additionally, the media that reports lottery numbers as a service to their readers, viewers, and listeners can sometimes report incorrect information, a situation over which the lottery has no control as we do not control the media. One cannot demand perfection in an imperfect world, but one can strive for and demand a system and process that function extremely well, as is the case with the Iowa Lottery. Players have a wide array of sources available for information about lottery tickets including the lottery Web site, winning numbers reports from lottery terminals, game brochures, play slips, winning numbers lines and media reports – as well as the scanning of tickets through a lottery terminal. Employing more than one of those sources of information can give more assurance to players that they have determined the true status of their tickets.

10. No.

11. The Iowa Lottery regularly tests the output of random number generator software in the terminals to ensure that it is functioning as designed. In addition, the software itself contains safeguards to ensure that each time a terminal is signed on to begin transactions, it receives a new "seed" to feed into the random number algorithm. Having said that, one must remember that randomization by its nature can and will produce duplicate number combinations. To prevent a terminal from issuing duplicate plays would be to prevent random selection.

12. The Iowa Lottery places the stickers on sales terminals, vending machines, and/or play stations on an ongoing basis. From 1999 to the present, the lottery has ordered and received thousands of such stickers (which are either red or yellow) seven times, including in February and October of this year, to ensure an ongoing supply. Stickers can occasionally come off the equipment onto which they were affixed and if that happens, lottery employees replace them. Our most recent version of the stickers is composed of what we hope will be a more durable material and adhesive to achieve greater economy and a longer life. Each year, the lottery audits its vending machines for placement issues. One of the items that is checked in those audits is the placement of the stickers. The lottery also provides information from the stickers on its brochures and play slips, on its Web site and in news releases it distributes regarding lottery matters.

13. Regarding 99G.34(3), an SAS 70 audit of the lottery's computerized sales and validations system is performed each year by an outside auditing firm under contract with Office of the Auditor of State. Every two years, the Multi-State Lottery Association performs a review of the lottery's computer system and associated controls to ensure that they meet the security and integrity standards for participation in multi-jurisdictional games. In addition, every six months the lottery must conduct a self-audit of its computer system and associated controls to ensure that they meet the standards.

Regarding 99G.34(4), investigatory records of the Iowa Lottery are not audited but those that are referred to law enforcement and prosecutors are reviewed by those outside entities as part of their investigatory and judicial processes and repeatedly have led to convictions through the years.

14. There have been numerous instances in which Iowa Lottery security has referred cases involving suspected violations of Iowa Code Chapter 99G to the appropriate law enforcement or prosecutorial agency. The filing of charges and prosecution of cases is conducted by authorities outside of the Iowa Lottery. Compliments from law enforcement agencies and prosecutors to lottery security are quite common. For example, a county attorney sent a letter of appreciation in September 2006 to a lottery security officer who had assisted the Davenport Police Department with a case involving stolen lottery tickets. The lottery was able to provide information that led to the apprehension of a man who had an extensive criminal record and was wanted in Illinois. Scott County Attorney William Davis said in his letter to the lottery: "Without your assistance and cooperation, we could not have secured a conviction."

15. The language you noted in bold provides an exception to the other language to allow the Iowa Lottery to participate in multi-jurisdictional lottery games under the auspices of an organization such as the Multi-State Lottery Association, which administers several games on behalf of its member lotteries. Those games include Powerball and Hot Lotto. The CEOs of the member lotteries in the games serve on the Board of Directors of the Multi-State Lottery Association and the boards of its associated game groups.

16. It uses a hardware random number generator.

Although it is not a numbered request, in your Oct. 5 memo and your Oct. 22 letter, you referenced a 2002 situation at the Kansas Lottery. We question the information as you have presented it. We are especially concerned about your characterization of there being an "intense scrutiny" of the Kansas Lottery at that time. We do not believe that is an accurate portrayal of the circumstance. We fear that your office is choosing deliberately inflammatory language in an attempt to justify an erroneous, preconceived conclusion.

In 2002, a Kansas Lottery player took a lotto ticket into a retail store, where the clerk told him that he had a winning ticket and paid him what allegedly was a prize of a few hundred dollars. The player later thought that he may have won a $250,000 prize in the lotto game. He contacted the security department at the Kansas Lottery immediately. The store clerk later took the winning ticket in question to the Kansas Lottery to try to validate it. Lottery security intercepted and questioned the clerk, who confessed to taking the ticket from the customer.

Kansas lawmakers asked the executive director of that state's lottery about the matter and concluded that the standards and practices of the lottery were appropriate and in fact, did lead to an apprehension in the case. That is quite a different situation than the description you gave.

The Iowa Lottery monitored the Kansas activities at the time and was well aware of the details of that incident. Like the Kansas Lottery, the Iowa Lottery has security and integrity standards in place to ensure investigation of consumer concerns. The Iowa Lottery, like the Kansas Lottery, has taken repeated steps through the years to provide consumer security reminders to its players. Those efforts have included but are not limited to, stickers being placed on lottery equipment in the field; information included in lottery brochures; information posted to the lottery Web site; and information included in news releases distributed by the lottery.

Any dispute over ownership of a ticket is investigated by the Iowa Lottery. If evidence of criminal activity in connection with a transaction is found, it is referred to the appropriate law enforcement agency. If criminal activity is not indicated and the parties engage in civil litigation, our investigation materials may be made available to the litigants.

Any issues relating to security or matters of impropriety are referred to the lottery's security department, where 100 percent of referrals are investigated and when appropriate, referred to law enforcement.

Appendix F: Representative Samples From Internal Theft Cases

I have an addiction to lottery tickets.

— Clerk prosecuted for stealing Lottery tickets, as quoted in police report [408]

You could see that?

— A separate clerk prosecuted for stealing Lottery tickets, as quoted in police report, upon learning that a surveillance camera had recorded his actions [409]

Store clerks who have been prosecuted for stealing Lottery tickets were motivated by everything from boredom (07-089) to needing to buy diapers for their baby (07-025) to the lure of the "easy buck" (07-097).

To illustrate what internal theft typically involves, here are excerpts from four separate cases:

1. "On all three videotapes a female on duty clerk … is shown removing and not paying for instant lottery tickets from the store ticket dispenser. Sometimes this female clerk would scratch off removed tickets, and throw away losers, and remove cash from cash register for winning tickets. Sometimes she would place tickets in her pocket, which she removed from ticket dispenser without paying for them."

   — Investigator's notes from case file 06-108

2. "[A]n employee … is shown on store surveillance video tape scratching off lottery instant tickets while on duty. According to [owner], this employee was using her fingernail to scratch off a portion of latex on instant scratch off ticket, apparently looking for winning tickets. She would then place losers back in the dispenser to sell to customers and cash winning tickets."[410]

   — Investigator's notes from case file 05-109

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[408] This incident was also the subject of Iowa Lottery Security Investigator Report, Case No. 05-023 (2005).

[409] This incident was also the subject of Iowa Lottery Security Investigator Report, Case No. 06-128 (2006).

[410] That practice is sometimes referred to as "pick outs," where a clerk lightly scratches instant tickets, "picks out" the winners, and then sells the losers to unsuspecting customers. This is a scam that directly victimizes customers, although it stands to reason that many would not be aware of it.

3. "The first time I ever stole tickets from [the store] it was about 9 months ago and I would start out by taking 2 to 3 at a time while working the closing shift…. Then I would start taking more. Every other week or so I would then take between 6 to 8 tickets and then gratually [sic] start taking between 10 to 12 tickets each time I worked. I would take 12 tickets from each kind of ticket and there were 12 different tickets in each box."

— "Witness Statement Form" submitted by the store clerk who was the subject of case file 07-079

4. "I asked [the clerk] if he had ever taken scratch tickets without paying for them. He advised that he had. He said it all started out where he'd take a couple of tickets here and there. He saw that no one noticed that there were tickets missing so he figured that they didn't keep close track of them. He started taking more and more. He said it was like and [sic] "addiction" and got totally out of control. He said he really wanted to stop. But couldn't. He described it as the 'easy buck.'

   "… [The clerk] said that he realizes that he was wrong and shouldn't have stolen the tickets. He believed that it was partly due to the easy access the employees had to them."

— Police report regarding store clerk who was the subject of case file 07-097

Appendix G: Major Winners

This appendix focuses on individuals who have claimed relatively significant prizes over the history of the Iowa Lottery. This is the first such review ever conducted regarding Iowa Lottery prize claimants.

The first part of this appendix presents retailers and store employees with relatively significant prize claim histories. The second part of this appendix presents other individuals with significant prize claim histories.

Although some Lottery press releases identified prize winners as retail employees, many did not. Since the Lottery does not require retail employees to identify themselves as such when they claim a prize, our list of significant retailer winners is likely incomplete.

When reviewing this information, several important points should be kept in mind:

1. **The odds of winning a single major prize are extremely small**. On average, the odds of buying an Iowa Lottery ticket and winning a high-tier prize (worth more than $600) are one out of 94,216.

   When you eliminate the two games that do not produce high-tier prizes (Pick 3 and Pull-tabs), one high-tier win would be expected, *on average*, for every 67,450 tickets purchased.[411]

2. **It is likely that many of the individuals referenced in this appendix have claimed additional, lesser prizes**. The Lottery does not record the identity of anyone who claims prizes from a retailer (Lottery rules permit retailers to pay out any prize claims of $600 or less). This means that it is difficult, if not impossible, to determine the full extent of any one individual's complete prize claim history.

3. **It is possible that some of the individuals referenced in this appendix have claimed additional high-tier prizes**. This is due to a number of factors, including variations in claimant's names and misspellings in the Lottery's database of prize claimants. We found a few such examples, but we suspect that we missed many others.[412] In addition, nothing restricts third parties from legally claiming prizes from tickets they did not purchase.

4. **The vast majority of the prize claims identified in this appendix were not investigated by the Lottery**.

[411] We obtained these odds through our own calculations of Lottery data; we confirmed their accuracy with statisticians at Iowa State University.

[412] Numerous individuals listed in the database have multiple versions for spelling their names. For example, "J. Customer," "Jim Customer" and "James Customer" could all represent the same individual.

A. RETAILERS AND STORE EMPLOYEES

> The Iowa Lottery's retailers are our lifeblood. They are on the front lines helping our players every day. In fact, our retailers are also our customers.
>
> — *From the Iowa Lottery Annual Report for fiscal year 2003*

1. INTERNAL THEFT SUSPECTS WHO PREVIOUSLY CLAIMED HIGH-TIER PRIZES

Among the retailers and store employees who were subject of a Security Division investigative file from 2005 through 2007, we found that at least 16 had previously claimed high-tier prizes. The timing of those prior claims varied; some occurred in the days or weeks before a report was made to the Security Division; others occurred months or, in some cases, years before Security was contacted.

Of the 16 store employees, the three who had claimed the most prize money were:

1. Manager of a northeast Iowa bowling alley: $10,000 from a single prize claim.[413]

2. Manager of a northeast Iowa convenience store: 17 prize claims totaling $33,290.[414]

3. Manager of an eastern Iowa casino gift shop: 6 high-tier prize claims totaling $60,000.[415]

All three subsequently pled guilty to Lottery-related theft or fraud for incidents unrelated to these prize claims.

2. OTHER RETAILERS WITH SIGNIFICANT PRIZE-CLAIM HISTORIES

We found that several dozen other retailers and store employees have claimed high-tier prizes. The most prolific include:

- The owner of an eastern Iowa convenience store: 9 prize claims for a total of $25,950.

- Husband and wife owners of a northwest Iowa store: 16 prize claims for a total of $263,501.

- A northern Iowa retailer: 67 prize claims for a total of $100,626.

[413] Iowa Lottery Security Investigator Report, Case No. 06-101 (2006).
[414] Iowa Lottery Security Investigator Report, Case No. 07-114 (2007).
[415] Iowa Lottery Security Investigator Report, Case No. 07-140 (2007).

The largest claim ever made by an Iowa retailer was in 1999. An Urbandale convenience store clerk claimed a Powerball jackpot worth $15.9 million with a ticket that he said he had sold to himself while working at an Urbandale convenience store.[416] The clerk was one of only six Iowans ever to have claimed a Powerball jackpot, according to information on the Lottery's website. His was the fourth largest Powerball prize in Iowa history.

The clerk's claim generated some public interest, particularly when it was reported that an underage co-worker claimed to have paid for half of the ticket and was therefore entitled to half of the jackpot.[417] The article in *The Des Moines Register* reported:

> Iowa's lottery chief believes that retail workers should still be able to sell themselves lottery tickets.
>
> "Something like this could have happened between two customers on the other side of the cash register," said Iowa Lottery Commissioner Ed Stanek. "It is inconsequential that employees were involved."
>
> But Stanek acknowledged that to avoid any conflict of interests, a host of other people – including Iowa lottery employees and contractors plus their immediate families and household members – are banned from buying lottery tickets.

In addition to the 1999 Powerball jackpot prize claim, we found 12 other claims by retailers and store employees for individual prizes of $100,000 or more:

1. A northwest Iowa convenience store clerk: $250,000 instant-ticket prize, January 23, 2007

2. A northwest Iowa store owner: $250,000 instant-ticket prize, April 6, 2007

3. A southwest Iowa convenience store clerk: $200,000 Powerball prize, August 3, 2006

4. An assistant manager of a central Iowa convenience store: $100,000 instant-ticket prize, February 3, 2006

5. An employee of a northern Iowa grocery store: $100,000 instant-ticket prize, February 16, 2005

6. A clerk at a northwest Iowa truck stop: Grand prize from the $100,000 Cash Game, January 21, 2004

7. An employee of a northern Iowa grocery store: Grand prize from the $100,000 Cash Game, December 1, 2003

8. A clerk at a northern Iowa convenience store: Grand prize from the $100,000 Cash Game, May 12, 2003

[416] William Petroski, *Clerk's Ticket Purchase Defended*, DES MOINES REG., Feb. 27, 1999, at 1M.
[417] The underage co-worker subsequently dropped her claim.

9. Husband-and-wife owners of an eastern Iowa grocery store: $100,000 Powerball prize, February 24, 2003[418]

10. An employee of a northern Iowa convenience store: $100,000 instant-ticket prize, February 25, 2002

11. A card dealer at an eastern Iowa riverboat casino: Grand prize from the $100,000 Cash Game, May 8, 2001

12. An employee of an eastern Iowa store: $100,000 instant-ticket prize, May 6, 1996

B. MAJOR PRIZE CLAIMANTS NOT IDENTIFIED AS RETAILERS

We also found other individuals not identified as retailers or store employees with relatively significant prize-claim histories. As previously noted, the fact that a prize claimant was not publicly identified as a retailer or store employee does not necessarily mean he was not a retailer or store employee.

1. PROLIFIC WINNERS (LARGEST NUMBER OF PRIZE CLAIMS)

A Harlan man has been perhaps the most frequent Lottery prize claimant. He has made 3,489 prize claims totaling $23,067, according to our analysis of the Lottery's database of prize claimants. That is an average of less than $7 per prize claim.

We found dozens more individuals with more than 100 prize claims. This includes a Des Moines man who has claimed 273 prizes for $70,925, and a Mason City man who has claimed 110 prizes for $110,818.

2. BIGGEST WINNERS (TOTAL AMOUNT CLAIMED) [419]

In the fall of 2002, a central Iowa man won $100,000 in the $100,000 Cash Game. His win was announced in "Lottery Action," a periodic newsletter that the Lottery publishes for licensed retailers. The article said the man "is probably one of the luckiest people one could ever meet because it was the second time he's won the top prize in the game! The first time was in 1992."

The man may have been lucky, but he is not alone. At least 12 other individuals have claimed two prizes of at least $100,000, based on our analysis of the Lottery's database of prize claimants.

What separates the central Iowa man from others, however, is that his son won a third $100,000 prize a few years later.[420] We could not find any other examples of one family winning three prizes of $100,000 or more. This family's feat is remarkable when considering that the odds of winning the $100,000 grand prize in the $100,000 Cash Game are 324,000 to 1, according to information on the Lottery website.

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[418] The man also claimed a $10,000 Powerball prize on December 27, 2006.

[419] This section does not include one-time jackpot winners from online games such as Powerball and Hot Lotto.

[420] Press Release, Iowa Lottery, [Customer] Wins Top Prize in Oct. 31 Cash Game Drawing (Nov. 1, 2006) (on file with author).

The other 12 individuals who have won two prizes of at least $100,000 includes:

- Three people who also had other high-tier prize claims. All three won the grand prize twice in the $100,000 Cash Game.[421]
- Four people who won $100,000 twice in the same drawing (which can happen if an individual has more than one ticket with the winning set of numbers).[422]
- A central Iowa man who won a $700,000 Iowa Lotto jackpot on January 25, 1992; then won the grand prize in the $100,000 Cash Game on March 25, 1994.
- A central Iowa man who won a $275,000 Super Cash Lotto prize on May 11, 1995; then won a $100,000 Powerball prize on August 5, 1996.
- Three people who won $100,000 in two separate drawings (and have had no additional prize claims).[423]

3. OTHER INDIVIDUALS WITH SIGNIFICANT PRIZE-CLAIM HISTORIES

By most people's standards, a Dubuque woman has had success playing the Lottery. In May 2007, she claimed a $21,000 instant-ticket prize. Eight months later, she claimed a $15,000 instant-ticket prize.

In actuality, dozens of individuals have been even more successful playing the Lottery. Here are a few:

1. Spencer man: 2 prize claims for $60,000
2. Bouton woman: 2 for $60,000
3. Ottumwa woman: 3 for $60,888
4. Davenport man: 3 for $63,000
5. Marion man: 2 for $66,666
6. Perry man: 6 for $68,001
7. Gowrie man: 5 for $71,300
8. Newton woman: 10 for $74,200
9. Urbandale man: 36 for $83,894

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[421] A Solon man (12 prize claims for $210,005); a central Iowa woman (13 prize claims for $213,956); and a Centerville woman (4 prize claims for $226,100).

[422] A Davenport woman (October 18, 2007), a Pleasant Valley woman (May 19, 2006), a Winterset man (August 29, 2001); and a Cedar Rapids man (March 29, 2001). The Cedar Rapids man's prize claims were for Powerball; the others were from the $100,000 Cash Game.

[423] A Glenwood woman (October 24, 2000 and April 10, 2007); a Denver man (August 21, 1995 and September 11, 2007); and a Dow City man (August 14, 1992 and July 10, 1995). Of those six prize claims, all but one came from the $100,000 Cash Game.

10. Waterloo woman: 4 for $85,300

11. Waterloo man: 8 for $93,000

12. Fort Dodge man: 20 for $117,637

13. Milford woman: 2 for $120,000

14. Cedar Rapids man: 29 for $126,672

15. Hartley man: 15 for $137,944

16. Ottumwa man: 2 for $140,000

17. Colo woman: 12 for $150,219

18. Ottumwa man: 36 for $152,301

19. Winterset man: 6 for $154,500 (the only individual we found with three claims of $50,000 or more, the last of which was made on March 4, 2008)

20. West Branch man: 10 for $162,500

21. Fort Dodge man: 8 for $163,658

22. West Des Moines man: 3 for $1.96 million (including two major Hot Lotto prize claims. The first, in October 2005, was for $79,762, Then, seven months later, he won a $1.88 million jackpot.)

Appendix H: Lottery "Winner Claim Form"

WINNER CLAIM FORM

REFERENCE NO.

Send completed form to:
Iowa Lottery
P.O. Box 10474
Des Moines, IA 50306-0474

INSTRUCTIONS TO WINNER (Use one form per winning ticket.)

- Sign the back of your winning ticket.
- You must complete this form to claim a prize. The information requested in Item 3 is optional.
- Prizes must be claimed within the time frames specified by the rules for the game and/or promotion. Rules are available in game brochures; via the lottery Web site at www.ialottery.com; or upon request.
- The signature at Item 11 must match the signature on the back of your ticket. If you are a minor, your parent/guardian must also sign at Item 10.
- If you are claiming a portion of this prize for someone else (such as your spouse or members of a group) you must identify all other winners entitled to any portion of this prize by filing Internal Revenue Service Form 5754 with us. Form 5754 is available from the Lottery. Questions should be discussed with your tax advisor.
- Staple the ticket to the bottom of the form where indicated.

1. NAME _____

2. ADDRESS _____ UNIT _____

CITY _____ STATE _____ ZIP _____

3. PHONE NUMBER (___ ___ ___) ___ ___ ___ - ___ ___ ___ ___

4. SOCIAL SECURITY # ___ ___ ___ - ___ ___ - ___ ___ ___ ___

5. PRIZE CLAIMED $___ ___ ___ ___ ___ ___ ___ ___ ___ .00

6. GENDER ☐ M ☐ F

7. BIRTH DATE ___ ___ / ___ ___ / ___ ___ ___ ___

8. ARE YOU A U.S. CITIZEN? ☐ YES ☐ NO IF NO, WHAT IS YOUR CITIZENSHIP? _____

9. I CERTIFY THAT (check one): ☐ I am the sole owner of this ticket. ☐ I am claiming this ticket on behalf of multiple winners, which I agree to identify on IRS Form 5754 within 2 weeks.

WINNER CERTIFICATION: I certify that I am the sole owner of the lottery ticket submitted with this form, or that I have been authorized by all other owners of this ticket to claim the prize on their behalf. I also certify that 1) the purchaser of this ticket was at least 21 years old or that, if a gift, this ticket was given to me by the purchaser, who was at least 21 years old; 2) that I have not altered this ticket in any way; 3) that this ticket is not stolen; 4) that I am not disqualified by law from receiving a prize from the Iowa Lottery Authority and 5) that I am not subject to backup withholding due to my failure to report interest and dividend income. Parent or guardian must also sign ticket for any claimant who is a minor. Under penalties of perjury, I declare that to the best of my knowledge and belief that the information supplied on this form is true and correct and that I have correctly identified any other person who is entitled to any of these winnings.

10. PARENT/GUARDIAN'S SIGNATURE _____ **DATE** _____
(Only required if claimant is a minor)

BY SIGNING THIS CLAIM FORM, I agree to indemnify and hold harmless the state of Iowa and the Iowa Lottery Authority, its elected officials, appointees, employees, agents and volunteers from any judgments, liabilities, losses, settlements or damages, including reasonable attorney's fees incurred as a result of any untrue or inaccurate information which I have supplied in connection with claiming this prize.

BY SIGNING THIS CLAIM FORM, I authorize the Iowa Lottery Authority to use my name and likeness for any publicity purposes that it deems desirable. I authorize the lottery to begin my membership in the Iowa Lottery **VIP Club**. I understand that the lottery will use my e-mail address for this purpose only, and it will not sell, share or rent my e-mail address with any other persons or entities.
My e-mail address is: _____ Check here if you **do not** want to be a VIP Club member: ☐

The Internal Revenue Service does not require your consent to any provision of this document other than the certifications required to avoid backup withholding.

11. WINNER'S SIGNATURE _____ **DATE** _____

The Lottery uses the information supplied on this form to enable it to pay you your prize, to report your prize winnings to the Internal Revenue Service and the Iowa Department of Revenue (if reporting is required), for research purposes, and for publicity purposes. The information provided may also be shared with other governmental agencies, such as the Iowa Department of Human Services, and members of the public. **PRIVACY ACT NOTICE (5 USC 552a):** Disclosure of your Social Security Number on this form is mandatory. It is authorized by 42 USC405(c)(2)(C)(i), 26 USC 3402(q), 26 USC 6041, and Iowa Code sections 99G.31, 252J.8(1), and 421.17(21). The Lottery collects this information to accurately process tax information and to cross-check various programs as required by state and federal law. In the event this information becomes the subject of a public records request, the Lottery will redact your Social Security number on the claim form. The remaining information is used for research and publicity purposes and will be made available to members of the public. Failure to provide the information on this form may delay or prevent the payment of your prize.

STAPLE TICKET HERE

FOR LOTTERY USE ONLY	
REC.BY: _____	D.E. BY: _____
REGION: _____	DATE: _____
CHECK REC. BY: _____	

Rev. 7/07

Appendix I: Pickouts Case Studies

EFFECTIVELY IGNORED

1. A northwest Iowa customer e-mailed the Lottery about four instant scratch tickets he had purchased. "I noticed all of them were printed wrong," he wrote. "The bottom of the puzzle looked as if someone had already scratched the last line of letters."[424]

   In forwarding the complaint to another staff member, the Lottery's Web Master wrote:

   > Have you heard of this happening elsewhere? **Could this be fraud?** What should he do, bring them to an office? [emphasis added][425]

   Any consideration that fraud may have occurred was apparently dismissed. The Web Master subsequently wrote back to the customer, stating, "This could have been an isolated printing problem," and offered four replacement tickets.

   Without an independent examination of the tickets in question, the Lottery should not have ruled out fraud. When we presented this matter to recently retired Vice President for Security Harry Braafhart, he agreed that this complaint should have been forwarded to the Security Division.[426]

2. A customer complained about three issues involving a northern Iowa convenience store:

   - A problem with redeeming a winning $3 Powerball ticket.
   - Employees commonly speaking in a foreign language.
   - "She also feel [sic] like some of the scratch games she has purchased have been compromised," wrote Investigator Roger Mott.[427]

   Mott contacted the owner about the first issue and, understandably, declined to look into the second issue. But Mott inexplicably made no inquiry about the allegation that instant tickets had been compromised.

[424] E-mail from customer to Iowa Lottery Web Master (Dec. 7, 2006) (on file with author).
[425] E-mail from Iowa Lottery Web Master to Iowa Lottery employee (Dec. 8, 2006) (on file with author).
[426] Sworn Interview of Harry Braafhart at the Office of Citizens' Aide/Ombudsman (Oct. 8, 2008).
[427] Iowa Lottery Security Investigator Report, Case No. 07-087 (2007).

INVESTIGATION DEFERRED

3. A customer alleged that a central Iowa convenience store tried to sell him a ticket that had been sitting on the store counter, instead of one from the Lottery ticket dispenser. The customer contacted the Lottery and reported his suspicion that store employees were scratching tickets, looking for winners, and selling the non-winners to customers.[428]

   Lottery Investigator Mott contacted the chain's district office. Mott wrote that a supervisor promised "to stop at that store tonight and see if there are any instant scratch tickets on the counter. I told him if he needed any further assistance to feel free to contact the Lottery."

   There is no indication that Mott followed up with the customer, even though Mott wrote that the man had specifically asked that Mott "let him know what action was taken." We contacted the customer, who confirmed that Mott did not follow-up with him as requested. The customer remained convinced that a store employee had tried to cheat him. "I'm not going to buy a losing ticket every time," the customer told us. "I felt like the biggest sucker alive."

   We asked Mott about this case:

   > *Ombudsman investigator*: Why did you defer this man's complaint to store management?
   >
   > *Mott*: Because that's the way we've always done it. You'll notice there that I ran that by the supervisor.
   >
   > *Ombudsman investigator*: Do you think that's a good way to get to the bottom of a complaint like that?
   >
   > *Mott*: I don't know as I ... I don't know. I just know that's what I was told to do and that's what I did.
   >
   > *Ombudsman investigator*: What do you think of that practice?
   >
   > *Mott*: I have no thought. That's a deal where you follow the chain of command, and whatever he decides, that's his decision, not mine.[429]

4. A customer reported that a central Iowa convenience store sold her a ticket that she later noticed had a three-digit "security code" exposed. A few days later she was in the same store and heard another customer complaining to the same employee about the same problem.

[428] Iowa Lottery Security Investigator Report, Case No. 07-061 (2007).
[429] Sworn Interview of Roger Mott at the Office of Citizens' Aide/Ombudsman (Sept. 19, 2008).

Lottery Investigator Mott contacted the chain's district supervisor, who subsequently reported that another supervisor checked the store and reported that "the tickets appeared to be OK."[430] We found, however, that relying on store management is not an effective way for Lottery investigators to get to the bottom of a fraud or theft allegation.

There is no information in the file indicating that Mott considered obtaining or reviewing the store's surveillance video for the afternoon in question. We contacted the chain, which confirmed that the store did have a surveillance camera at the time of this incident.

When we asked Mott why he did not consider obtaining the store's surveillance video, he responded, "Probably should have used it. Probably dropped the ball on it. I can tell you this: If I would have got another complaint from that store, it would have been fully investigated."[431]

5. An anonymous caller reported that a central Iowa convenience store was selling instant tickets that "appear to have scratch marks on the latex," wrote Lottery Investigator Larry Steele. "Caller concerned some one may be peeking under the latex for winning tickets."[432]

   Steele contacted the Lottery's regional manager, who said that "sometimes store clerks drag the ticket in a manner, that will leave scratch marks on the instant tickets while being removed from in store dispensers."

   When we asked why he deferred the matter to a regional manager, Steele said he could not recall, but added, "That was not uncommon to have a regional manager check something."[433]

   The regional manager called Steele the next day, reporting that he had inspected the store and "found no defects with the dispenser nor any marks on the latex of any tickets within the dispenser." Steele concluded that the complaint was unfounded.

   But the file does not contain sufficient information to support such a conclusion. Finding no defects with the ticket dispenser and no marks on the tickets actually *reinforced* the possibility of pickout activity. Steele told us that it would have helped to see the tickets in question, but acknowledged that he did not pursue this with the caller.

   In addition, there is no information in the file indicating that Steele considered reviewing the store's surveillance video for the afternoon in question. We contacted the store, which confirmed that it did have a surveillance camera at the time of this incident.

[430] Iowa Lottery Security Investigator Report, Case No. 07-066 (2007).
[431] Sworn Interview of Roger Mott at the Office of Citizens' Aide/Ombudsman (Sept. 19, 2008).
[432] Iowa Lottery Security Investigator Report, Case No. 07-081 (2007).
[433] Sworn Interview of Larry Steele at the Office of Citizens' Aide/Ombudsman (Oct. 8, 2008).

6. An eastern Iowa gas station reported a problem with an employee. The case was assigned to Investigator Steele. "On their store surveillance security video tape is an on duty store clerk … removing scratch off Instant tickets from the store dispenser, scratching off latex in the security code area keepimg [sic] winners and putting loosers [sic] back in dispenser," Steele wrote.[434]

   His notes state that he advised the store manager to report the matter to local police. Four months later, Steele wrote, "I have been advised the former clerk … has worked out a plea bargain arrangement with the county attorney's office. Terms of the plea bargain, were not made public."[435]

   However, the county attorney's office told us they received no Lottery-related complaint involving the clerk. While the case file indicates she was charged and entered into a plea bargain, the prosecutor's office denies that either event occurred.

INADEQUATE INVESTIGATIONS

7. A customer bought two instant scratch tickets from a central Iowa convenience store. When he began to scratch the first ticket, he noticed the security code had already been scratched off.

   The customer drove to Lottery headquarters and showed the tickets to Investigator Mott. Both tickets were non-winners. After discussing the complaint, Mott gave the man $20 worth of "Lottery Bucks," coupons that can be used towards future Lottery purchases.[436]

   According to his notes, Mott contacted the store manager, who said that the employee in question "no longer works at her store. She had discovered several tickets that had the validation code scratched off."

   Mott wrote that another store supervisor told him that the clerk also worked at another store in the same chain and the manager of that store found some of their tickets had also been scratched. Mott wrote that the same supervisor told him that "as near as she can tell fifty-one dollars in instant scratch tickets had been tamper with."

   Mott then contacted the second store, where an assistant manager said the employee in question was no longer working there, but that management found $18 worth of instant tickets that had been tampered with.

   The store supervisor subsequently called Mott back and said "she did not think charges was going to filed on the suspect. [The supervisor] told me the company has request he repay the money that was taken. This case is closed."

[434] Iowa Lottery Security Investigator Report, Case No. 07-085 (2007).
[435] Steele's typed note did not attribute this information.
[436] Iowa Lottery Security Investigator Report, Case No. 06-115 (2006).

This shows that the decision to not file a police report was made by the store. Mott simply recorded the store's decision and closed the case, without even obtaining the clerk's name. Missing from the case file was any explanation as to why the store had not already reported to the Lottery that tickets had been tampered with.[437]

We asked Mott about this case:

> *Ombudsman investigator*: Did you find out how much that suspect got in stolen prize money?
>
> *Mott*: No, I did not.
>
> *Ombudsman investigator*: Why not?
>
> *Mott*: I don't know.
>
> …
>
> *Ombudsman investigator*: Do you think – do you have any idea whether he [the suspect employee] may have had some prize money that he got through those stolen tickets?
>
> *Mott*: I have no clue.
>
> *Ombudsman investigator*: It's possible that he won a bit of money.
>
> *Mott*: Well, he could have I reckon.[438]

8. A woman went to Lottery headquarters one afternoon with three instant scratch tickets. She explained that her daughter had purchased the tickets earlier that afternoon at a central Iowa convenience store.

   The woman said the clerk had removed the tickets from a box on the counter, and not from the Lottery ticket dispenser. She also noticed the tickets were not in numerical order. Investigator Steele confirmed that the tickets sold to the woman's daughter were numbered 25, 27 and 28.[439]

   All three tickets were non-winners. Steele found that the one ticket missing from the sequence had been cashed as a prize winner.

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[437] *See Appendix A.* ("immediately notify the Security Department, if tickets or Lottery property are stolen, lost, or damaged.")
[438] Sworn Interview of Roger Mott at the Office of Citizens' Aide/Ombudsman (Sept. 19, 2008).
[439] Iowa Lottery Security Investigator Report, Case No. 07-145 (2007).

Steele then wrote:

> Upon, further investigation, I find that the facts given at the time by the complaint are not as factual has, she had stated. To much he said she said, store tells a different version of this transaction claim the pack was in the lottery dispenser and the customer bought FOUR tickets not three as stated, by complaint.
>
> There is a possibility that the tickets her daughter purchased did not come out of the lottery in counter display. I can, not prove either way. I can, not explain how tickets were out of numerical order, and no one seems to know who cashed ticket 026, from the pack in question.
>
> … I will not say this complaint is unfounded, but I have no evidence to prove other wise at this time.

There is no information to suggest Steele:

- Went to the store to inspect the instant tickets on hand or to discuss the complaint with the manager and employee involved.
- Considered reviewing the store's surveillance video for the afternoon in question. We contacted the chain, which confirmed that the store did have a surveillance camera at the time of this incident.
- Asked the complainant if she had a receipt from the transaction in question, since the store disputed how many tickets had been purchased.
- Reviewed store records regarding Lottery sales transactions from the afternoon in question.
- Realized that the store was part of the same chain and in the same city as a similar allegation involving pickout activity described in case file 07-066 (discussed earlier in this appendix). The clerk's name was not memorialized in either case file. So even if the two cases involved the same individual, it is unlikely the Lottery would have been able to recognize this.

We find that this case should have received greater scrutiny, especially considering that Steele determined that the missing ticket had been cashed for the prize money.

SUSPECT PROSECUTED, LOTTERY PLAYED NO MEANINGFUL ROLE

9. A Lottery sales representative received a complaint that a northeast Iowa convenience store was selling instant tickets that had already been scratched. He reported it to the Security Division and the complaint was assigned to Investigator Steele.

On the day he received the complaint, Steele wrote, "Someone should check this establishment on a weekend to see if there is merit to this complaint." The next day, Steele wrote that he had advised the chain's headquarters of the complaint and also asked the Lottery's regional office "to keep watching this retailer regards this complaint."[440]

About four hours later, Steele wrote that he had received a phone call from a local police officer, who reported that he was arresting a store clerk on charges of Lottery theft. The clerk "is shown on store video tape putting LOOSE instant tickets back in display dispenser," Steele wrote.

Consider the contrast of how this complaint was investigated:

- The Lottery investigator deferred the matter to store management and asked Lottery sales staff, who were not trained investigators, to monitor the store.

- The police officer investigated the allegation and found probable cause to make an arrest.

10. A Lottery regional manager notified the Security Division that a northwest Iowa convenience store had an internal problem. "An employee … is shown on store surveillance video tape scratching off lottery instant tickets while on duty," Investigator Steele wrote.[441]

    "According to [the owner], this employee was using her fingernail to scratch off a portion of latex on instant scratch off ticket, apparently looking for winning tickets," Steele added. "She would then place losers back in the dispenser to sell to customers and cash winning tickets."

    The store reported finding 40 tickets with a total retail value of $230 that had been lightly scratched. The file shows that about a week later, local police arrested the employee.[442] The information in the Lottery file does not indicate that Steele played any meaningful role in terms of assisting the police investigation or doing any further analysis of the employee's prize claims history.

    We found that two people associated with the employee made significant instant-ticket prize claims around the time of her pickout activity:

    - A man identified in the police report as the employee's boyfriend claimed a $25,000 instant ticket prize approximately six months before the employee was arrested.

    - Another employee at the same store, identified in court records as one of the first employee's defense witnesses, claimed a $30,000 instant ticket prize about seven months after the arrest.

[440] Iowa Lottery Security Investigator Report, Case No. 07-124 (2007).
[441] Iowa Lottery Security Investigator Report, Case No. 05-109 (2005).
[442] The clerk later pled guilty to one count of Lottery fraud, according to court records.

Appendix J: "Can Lottery Retailers Be Trusted?," Published by The Vancouver Sun Newspaper

canada.com
WHERE PERSPECTIVES CONNECT

Friday » February 27 » 2009

Can lottery retailers be trusted?

With $530 million in prize money at stake, weak points in the lottery system raise concerns

Chad Skelton
Vancouver Sun

Originally published Vancouver Sun Wednesday, May 30, 2007

FOUR WAYS RETAILERS CAN STEAL YOUR WINNING TICKET

Retailers win lottery prizes in B.C. at several times the rate of the rest of us -- raising fears that some may be stealing customers' winning tickets. But how exactly does a retailer steal your ticket? Based on complaints received from the public, the B.C. ombudsman laid out several scenarios in her report Tuesday, including:

1 No Validation Slip
When a customer asks a retailer to check his ticket, the retailer is supposed to give back a validation slip that says whether or not the ticket is a winner. But if the retailer doesn't give the customer a validation slip, he can simply tell the customer the ticket is a loser, pretend to throw it out -- and then claim the prize himself. Public display screens on the lottery terminal should say the ticket was a winner and play a jingle. But if the screen is blocked or the volume turned down, the customer may not notice.

2 Palming
In this scenario, the retailer keeps a stack of known losing tickets beside the terminal. When a customer hands him a ticket to check, he palms it and instead inserts one of the known losing tickets into the machine -- producing a "Not a Winner" validation slip which he then hands to the customer. The validation slip does not contain the customer's winning numbers on it -- only a 20-digit code -- so there is no easy way for him to know that he's been duped. The retailer can then check the real ticket later and, if it's a winner, claim the prize himself. The way BCLC's validation system works, winning tickets can be checked only once. But a non-winning ticket can be checked multiple times -- so a retailer can keep validating a losing ticket without getting caught.

3 Partial Win Payment
In this scenario, retailers tell the customer she's won -- but a smaller amount than the actual prize. In one case documented by BCLC, a senior citizen who had won $1,277 was told she'd won just $1,000 -- something she didn't realize until much later. This scam is easier if the terminal screen -- which shows the amount won -- is obscured.

4 Already Validated
In this scenario, a retailer validates the winning ticket twice. On the second try, the terminal produces an "Already Validated" slip, which the retailer gives to the customer -- telling them the prize has already been claimed. Not surprisingly, customers often complain when this happens. But BCLC's way of investigating the matter is to check with the retailer whether he paid the prize or not. "If the retailer claims to have paid the prize, the player's claim ... will be denied," reads one BCLC policy document from 1999. "This means that BCLC will always make the assumption that the retailer, not the player, is right."

SUSPICIOUS CASES

The ombudsman cited specific examples of retailers or retail employees with unusually

good luck. Below is the lottery win record of an unnamed employee at an unidentified lottery retail outlet, amounting to more than $300,000: 2001/2002

First prize: $25,000-$49,999 2002/2003 First prize: $25,000-$49,999 2003/2004 First prize: $25,000-$49,999 Second prize: $3,001-$9,999 Third prize: $20,000-$24,999 Fourth prize: $15,000-$19,999 2004/2005 First prize: $50,000-$74,999 Second prize: $20,000-$24,999 Third prize: $15,000-$19,999 Fourth prize: $10,000-$14,999 2006/2007 First prize: $25,000-$49,999

OTHER NOTABLES

Co-owners of a lottery outlet: $100,000-$124,999 between 2003/2004 and this year. Two co-workers at a lottery outlet: $50,000-$74,999 from 2001-2002 to 2005-2006. Employee at a lottery outlet: $25,000-$49,999 from 2002-2003 to 2005-2006.

CLOSE WINDOW

Appendix K: British Columbia "Lottery Retailer Code of Conduct"

LOTTERY RETAILER CODE OF CONDUCT

player first

As an authorized lottery retailer or lottery retailer employee, I understand the integral role I play in instilling player and public confidence in BCLC's lottery products and services and, therefore, I pledge to safeguard BCLC's commitment to integrity, respect and social responsibility by committing to the following conduct, rules and practices:

INTEGRITY

- I will not, at any time, purchase, play or validate my personal lottery tickets at my place of employment
- I will comply with BCLC rules, regulations, instructions, directives and operating manuals, and will pay particular attention to follow all validation procedure requirements when validating players' tickets
- I will report any lost or unattended lottery tickets or self-serve terminal vouchers to BCLC Hotline immediately
- I will not tamper with lottery products or equipment in any manner and I will immediately report all equipment malfunctions to BCLC Hotline
- I will honour all prize claims within my prize payout limit
- I will not sell lottery products outside of my regular business hours
- I will declare myself as a lottery retailer when claiming a prize at any BCLC Prize Payout Office or other Regional Prize Payout locations and I understand that my prize claim will be subject to a detailed security investigation
- I will only operate lottery equipment when trained to do so, and I will participate in additional training and certification programs as required by BCLC
- I will cooperate with all investigative, security inspection and enforcement activities conducted by BCLC, including detailed security investigations into my prize claims
- I will cooperate and comply with all Gaming Policy Enforcement Branch (GPEB) registration requirements

RESPECT

- I will provide high quality, respectful service to all lottery players
- I will not engage in conduct that is contrary to the public interest or harmful to the integrity or reputation of BCLC and BCLC's products or services
- I will always ask players to sign the back of their tickets at the time of purchase

SOCIAL RESPONSIBILITY

- I will not sell or validate lottery tickets to anyone under 19 years of age
- I will display all information materials provided by BCLC relating to responsible gaming
- I will not personally loan money or advance credit to players for the purchase of lottery products (credit cards are permitted)

I acknowledge that failure to comply with the above conduct, rules and practices will result in progressive disciplinary action, up to and including termination of the Lottery Operations Agreement (LOA).

IMPORTANT CONTACT INFORMATION:

- BCLC Hotline: 1-800-667-1649
- BCLC Consumer Services Toll Free Number: 1-866-815-0222
- BCLC Responsible Gaming Toll Free Number: 1-888-795-6111

British Columbia Lottery Corporation

Revision: May 2007

Appendix L: Ontario Case Study

This appendix presents an overview of the Ontario lottery's policy improvements. We are presenting this information in two sections:

A. Ontario lottery policy improvements made before November 1, 2007, when Vice President Neubauer provided the Lottery Board with a memo implying that the Iowa Lottery had already adopted many of the improvements that were being implemented by the Canadian lotteries.[443]

B. Ontario lottery improvements made after November 1, 2007.

The Ontario policy improvements that follow are based on information from the following sources:

- A page on the Ontario lottery website that chronicles the highlights of its "Lottery Prize Integrity Program" and is available at www.olg.ca/pip_history.jsp
- The Ontario Lottery's September 2008 "Summary Report to the Ombudsman"[444]
- "A Game of Trust," report issued in March 2007 by the Ombudsman of Ontario

These lists are not exhaustive; they do not include other policy improvements that we did not find to be relevant for the purposes of this investigation.

A. ONTARIO LOTTERY IMPROVEMENTS IMPLEMENTED BEFORE NOVEMBER 1, 2007 [445]

1. Tracking insider wins, including retailer wins, of $1,000 and more.
2. A police review of all insider wins, including retailer wins, of $10,000 or more.
3. Installation of ticket checkers at all lottery terminal locations.
4. Providing customers with receipts for all ticket validation transactions at the lottery terminal.[446]
5. Mandatory investigations for all prize claims of $10,000 or more[447] and suspicious claims are referred to the provincial police for investigation.
6. Printing "winner" or "non-winner" on online tickets that are checked by terminals.

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[443] *See Appendix D*.
[444] ONTARIO LOTTERY & GAMING CORP., SUMMARY REPORT TO THE OMBUDSMAN (2008), http://www.olg.ca/assets/documents/olg_commitment/summary_report_to_the_ombudsman.pdf.
[445] We found that none of these improvements had been implemented by the Iowa Lottery as of November 1, 2007.
[446] The Iowa Lottery subsequently introduced customer receipts in May 2008 in response to concerns expressed by members of the Government Oversight Committee during its January 30, 2008, meeting. However, the Lottery does not require retailers to offer the receipts to customers.
[447] Prior to the scandal, the threshold for these investigations had been at $50,000.

7. Requiring the customer display screen to be visible to customers at all times and improving the on-screen information when a winning ticket is validated.

8. Amended the retailer contract to include a "zero tolerance" policy for fraud, theft or dishonest behavior.

9. Began an ongoing public awareness campaign, emphasizing the need for customers to sign their tickets and check them using the newly-installed ticket checker devices.

10. Began routing all validation discrepancies to the lottery's investigations unit.

11. Removed lottery sales staff from enforcement issues involving retailers.

12. Created a new "Office of Player Protection" which receives all calls regarding theft, fraud and dishonesty.

13. Began conducting a five-step validation program that included retailer audits.

14. Added a signature line to the front of online tickets.

15. Implemented outreach and education audits to instruct retailers about their responsibilities.

16. Maintain and analyze statistical information about insiders' prize claims to determine unusual win patterns for possible investigation.

17. Consult individual win history for all insider-win investigations through an enhanced "Insider Wins" database.

18. Require retailers to keep virtually all surfaces around the terminal clear of tickets or lottery paper.

19. Repositioned the CDUs (customer display units) to improve visibility to customers.

20. Initiated a best-practice review with Canadian and international lottery jurisdictions regarding prize payout policies and procedures.

21. Trained prize claims staff on procedures for identifying suspicious prize claims to be escalated for investigation.

22. Refined and documented the procedures and guidelines for investigations.

B. ONTARIO LOTTERY IMPROVEMENTS IMPLEMENTED AFTER NOVEMBER 1, 2007 [448]

1. Required retailers to return all winning and non-winning tickets to customers.

2. Required retailers to sign a declaration that they understand the obligations and expectations of being an insider and that they will communicate this to their employees.

3. Asked an independent, external audit firm to conduct a comprehensive forensic audit of past prize claims. Any findings that suggest wrongful or criminal behavior will be reported to law enforcement and key findings will be made public.

4. Regulatory oversight of the Ontario lottery was assumed by another agency, the Alcohol and Gaming Commission of Ontario (AGCO).[449] The new regulations established inspections of the lottery system's integrity and a process to deal with prize-claim disputes. "Ontario is one of the first jurisdictions to develop comprehensive, independent third-party oversight of the lottery system and the regulation of retailers," an AGCO press release stated.

5. Established a secret shopper program, conducted by an independent retailer performance monitoring organization. The program includes anonymous visits to retailers by secret shoppers to assess retailer compliance with specific point-of-sale procedures. It also includes escalating penalties against retailers found to be in violation.

6. Required that press releases for all prize claims for $10,000 or more be posted on the lottery's website. It also required that press releases for all such claims by "insiders" (including retailers) be posted on the website and publicized for 30 days before the prize can be paid.

7. Reduced the "terminal freeze" threshold for winning tickets from $10,000 to $5,000.

8. Improved the information on customer receipts for winning tickets of $5,000 or more to include notification that the lottery will immediately call the customer at the store.

9. Added a "Retail Play" button to lottery terminals to identify retailer personal play. This allows the lottery to "brand" tickets and resultant receipts as the personal transactions of retailers and their staff. "Through the monitoring and analysis of the data, we are in a much stronger position today to know who is handling our products at the point of sale, and the playing habits and win trends of those individuals," the Ontario lottery wrote in a September 2008 status report to the Ombudsman of Ontario.

10. Established a program which can automatically suspend a terminal when there is unusual retailer activity.

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[448] We found that only one of these Ontario improvements had been implemented by the Iowa Lottery as of January 1, 2009.

[449] AGCO already regulated casinos, charitable gaming, and liquor licenses.

11. Required that customers must sign their tickets before a retailer can validate them.[450]

12. Introduced new winning and non-winning musical tones with voice-over messages on lottery terminals.

13. Added a signature box to the front of instant tickets.

14. Adopted a new "Related Party/Insider Win" policy, which includes guidelines for prize claims found to be suspicious.

15. Conducted a public awareness survey.

[450] The Iowa Lottery introduced the ticket-signature requirement in March 2008 in response to concerns expressed by members of the Government Oversight Committee during its January 30, 2008, meeting.

Lottery CEO Terry Rich's Reply

2323 Grand Avenue • Des Moines • Iowa • 50312-5307
Telephone: 515-725-7900 • Fax: 515-725-7882
www.ialottery.com

Chester J. Culver • Governor
Patty Judge • Lt. Governor
Terry Rich • Chief Executive Officer

April 15, 2009

Mr. William Angrick II
Iowa Citizens' Aide/Ombudsman
Ola Babcock Miller Building
1112 East Grand Avenue
Des Moines, IA 50319

Dear Bill:

Thank you for providing us with a copy of your upcoming report. We know that your office spent a lot of time and effort to produce it and we are happy to review your work.

We are treating your agency's report in the same serious business manner and with the same open-minded reception that we give to an audit conducted at the Iowa Lottery, whether it be a financial audit or an audit of our information-technology systems.

The end result of your work is a report that admittedly "did not uncover a case of large-scale fraud" involving Iowa's lottery, supporting your original assessment that "the vast majority of Iowa retailers and clerks are honest, reputable and do not engage in fraud or theft." All citizens of Iowa and anyone beyond our state's borders who has ever played an Iowa Lottery game can be heartened by that news.

That finding makes sense when you consider that in calendar year 2008, the Lottery's Security Department handled 182 inquiries compared to the 148,136,301 transactions that year for the sale and cashing of Lottery tickets in our state. In other words, 99.99999877 percent of those transactions had no security-related inquiry associated with them.

There is nothing in your agency's report we have not already discussed, considered or implemented at the Iowa Lottery. However, the conclusions and opinions appear to be based upon idealistic possibilities, while our decisions must be based upon what is reasonable, practical and fiscally responsible. We also believe the process must involve input from Iowa citizens and lawmakers.

Because the primary focus in the report is your agency's opinions about the possibility of retailer fraud, it is important that these facts be very clear:

- No fraud or theft was committed or suspected by any state employee involved in the regulation of Iowa's lottery.
- No large-scale fraud was found or reported involving Iowa's lottery.
- Integrity is at the heart of our operations. We do not believe that your overall conclusions are a true representation of what you found at the Iowa Lottery.
- We believe that we are conforming with Iowa Code section 99G.2(3) that states in its entirety: "that lottery games shall be operated and managed in a manner that provides continuing entertainment to the public, maximizes revenues, and ensures that the lottery is operated with integrity and dignity and free from political influence."
- We have made enhancements to many facets of Iowa Lottery operations through the years, including the area of security, and strive for continuous improvement.

With those thoughts in mind, we agree with or have already implemented many of the concepts in principle outlined in your agency's recommendations, although we reserve the right to question specific research background within the report. We disagree with the remainder due to concerns regarding undue governmental intrusion, red tape and impractical business application; game security concerns; personal security risks; and cost-benefit factors.

For example, your agency's report mentions self-checkers. We've been looking at ticket checkers for years. As with any technology, products get better and less costly over time. We believe this will be a viable option in the very near future, but we're not there yet.

We also do not agree that administrative rules or laws need to be revised to achieve an enhancement of lottery security in Iowa.

As someone new to state government, I want to express my hope that we can work together to elevate the positive tone of our discussions. I fear that the interactions of our offices thus far have left the public with the unfortunate impression of government quarreling and fingerpointing, not to mention the enormous resources that were involved. Producing this report involved the staff time of about two dozen state employees over two years' time, when both our organizations desire the same result: to protect the citizens of Iowa. I believe that government should lead by example and when offices argue, it leaves a less-than-flattering impression of how government works. I look forward to working with you to renew our efforts toward a harmonious working relationship.

Lastly, we ask that the report be released to the public immediately so that in the spirit of true openness we can ensure the most open, timely and fair discussion possible of our differences of opinion.

Thank you again for your agency's efforts. I truly believe we share the same goals.

Sincerely,

Terry Rich
Chief Executive Officer

Former Lottery CEO Dr. Edward Stanek's Reply

April 14, 2009

William P. Angrick II
Citizen's Aide/Ombudsman
1112 East Grand Avenue
Des Moines, IA 50319

Dear Mr. Angrick:

Thank you for the opportunity to comment on the Ombudsman's investigation of retailer related security practices of the Iowa Lottery dated March 27, 2009. My ability to provide meaningful comments is limited. Many of the interviews and circumstances discussed in the report postdate my retirement or were issues evolving prior to my retirement in 2007 but not culminating until after I left the Lottery.

In my opinion, the report does not give sufficient credit to the tens of thousands of law abiding retail clerks that are the interface between the lottery and its customers. Without their work in return for sparse commissions the state would have foregone over a billion dollars in lottery proceeds.

It is encouraging to note that after 2 years of intensive study, the Ombudsman concludes "... WE DID NOT UNCOVER A CASE OF LARGE-SCALE FRAUD IN OUR REVIEW OF THREE YEARS OF LOTTERY ACTIVITY..." on page 13 of the Executive Summary (Emphasis added.). (Actually the report documents instances in 2008 so the report spans more than three years.) This conclusion is probably the principal interest to policy makers and the public. It should appear near the beginning of the report and not be buried on page 13 of the summary. In fact, the Ombudsman did not uncover any cases of confirmed retailer fraud that the Lottery or law enforcement had not addressed or were addressing at some level. Yet in the report there is no acknowledgment of this accomplishment.

That does not mean that there are not improvements or corrections to lottery practices that could be addressed. At first glance some of the recommendations appear proactive with potential, but experience will dictate that they too have limitations. Some are unenforceable, or won't work as intended. Although years have passed, I somewhat remember reviewing the Ontario Ombudsman's report and to go a step further I vaguely remember being privy to the report by the accounting firm hired to advise the Ontario Ombudsman. I believe that in-spite of all the recommendations made, the accounting firm noted that the only way to prevent retailer fraud was to have on file the fingerprints and DNA samples of all retail clerks and to compare them to the fingerprints and DNA samples of everyone claiming a lottery prize and to further use gloves and tongs to handle every prize claim document and keep it in a plastic bag as evidence. But such practices would still not stop felons from stealing tickets from customers and then using surrogates to conspire on prize claims with them. Only fingerprinting and getting DNA samples from every person in the state along with comprehensive records of their families and social relations would work – but then again only for the universe of claims being made

by Iowa citizens. Other claims could still be made by travelers and people who live in border states for which the identity tracking would not be available.

Nonetheless, a number of recommendations should receive serious consideration by the Lottery and I would guess that many have already been followed as part of the Lottery's efforts to continually improve even without a report from the Ombudsman.

I understand that the Ombudsman self-initiated this study without a complaint from the Iowa public. Once the study was initiated the Ombudsman publicly through the media solicited complaints about the Lottery. Only a few responses were received and the representative sample in the report seemed to amount to hearsay and did not generate further investigation by the Ombudsman. Over the 23 year history of the Iowa Lottery, Iowa's three million person public has had the opportunity to voice its concerns to the Lottery Board, Legislators, the Governor, members of Congress, the Attorney General, the media, and the thousands of peace officers in the state police, county sheriffs, and city law enforcement. Despite there never being a scandal in the Iowa Lottery's operations, the Lottery had always been open to suggestions for improvement and I hope it has remained so after my retirement.

No existing laws, regulations, or administrative practices are perfect. They are all subject to improvement through amendment or repeal as circumstances change and greater bodies of knowledge are accumulated. The Legislature meets for several months every year to improve on its decisions of the years before. If its earlier work was perfect there would never be a need for it to meet again. Although I disagree with some of the facts and analyses in the report, the Lottery's procedures and practices should be subject to similar ongoing improvement. Decisions and actions are based on human and technical systems – all of which are frail and subject to infinite improvements.

As an example, the Ombudsman recommended to Legislative committees that the Lottery require all lottery tickets to be signed before prize claims are processed. After the Lottery adopted the Ombudsman's recommendation, the Ombudsman in this report points out limitations to his own past recommendation.

In the end, there are no administrative sanctions that can be imposed by the Lottery such as revoking a retailer license that can be as effective of a deterrent as the penalty of going to prison for a felony under existing laws. So stiffening administrative sanctions is of less value than carrying through on criminal prosecutions in the rare instances where they are warranted.

Lastly, the Ombudsman makes a number of assertions regarding what the acting-CEO of the Lottery knew or should have known at various times regarding issues emerging in Canada and perhaps even at the Iowa Lottery. As I frantically devoted night and day to litigation and transition issues just before my retirement, the Lottery's second in command was in charge of daily operations and probably was not as involved with issues emerging in Canada as what might have normally been the case. After I left, he became

acting-CEO and suddenly he had both jobs (his and mine) for almost a year and a half. Unknown to me at the time of my retirement, the head of security would retire 8 months after me and the Chief Financial Officer soon after that. So the acting- CEO actually held down 4 of the top positions at the Lottery simultaneously and single-handedly - an impossible task for any one human.

I hope that the remarks above are considered toward achieving a practical balance among available resources, government invasiveness, and desired results in structuring the next plateau in pursuit ever of evasive perfection.

Sincerely,

Edward J. Stanek

Ombudsman Comments

The Ombudsman is required by law to consult with agencies and individuals that are criticized in an investigative report, and to attach their written replies to the report, unedited.

The Ombudsman received two written replies to this report:[451]

- An April 15, 2009, letter from Lottery CEO Terry Rich.
- An April 14, 2009, letter from former Lottery CEO Dr. Edward J. Stanek.

Ten other current and former Lottery employees were offered the opportunity to reply to the report but deferred their replies to CEO Rich.

A. COMMENT TO CEO RICH'S REPLY

Our investigation of the Lottery's regulatory performance uncovered a wide range of systemic deficiencies. Above all else we found a weak, reactive enforcement system where fraud may be occurring without customers or the Lottery realizing it. These deficiencies can be corrected over time, but it will require commitment and strong managerial direction.

I am encouraged by what I have seen as some positive developments since the confirmation of Rich as the new Lottery CEO. The hiring of a new security director and the undertaking of field tests of retailers' compliance are examples of this development.

However, the Lottery's written reply to my report minimizes the significance and range of the deficiencies and does not specifically address the 60 recommendations for improvement, while portraying my report as generally giving the Lottery a clean bill of health. The facts that the Lottery's investigative files did not reveal a case of "large-scale fraud" or that the Lottery did not have security-related inquiries on more than 99 percent of transactions do not necessarily mean more instances of fraud did not occur.

In making its point, the Lottery takes a statement from my report and quotes it prominently – and, I believe, out of context. Here is what my report actually says on this point, followed by the Lottery's portrayal:

- *Ombudsman report*: The Lottery has a weak, reactive enforcement system where large-scale fraud may be occurring without customers or the Lottery realizing it. The fact that we did not uncover a case of large-scale fraud in our review of three years of Lottery activity should not be viewed as a vindication of the Lottery's deficiencies.
- *Lottery reply*: The end result of your work is a report that admittedly "did not uncover a case of large-scale fraud" involving Iowa's lottery, supporting your original assessment that "the vast majority of Iowa retailers and clerks are honest, reputable and do not engage in fraud or theft." All citizens of Iowa and anyone beyond our borders who has ever played an Iowa Lottery game can be heartened by that news.

[451] Both replies are in my report immediately before this "Ombudsman Comment" section.

Another key theme to my report is that operating on a "complaint-only" basis is not sufficient for a modern lottery. When scam artists succeed, their crime will be invisible to the customer, and in turn to a lottery which operates on a complaint-only model. If a lottery is not proactively looking for incidents involving fraud and theft, it will miss a good share of such activity. A prevention model of regulation is called for in Iowa.

This fundamental point, however, is not reflected in the Lottery's reply. It states that out of approximately 148 million transactions in 2008, the Lottery received 182 inquiries. "In other words," the letter goes on, "99.99999877 percent of those transactions had no security-related inquiry associated with them."

While technically accurate, that statement is misleading. It omits the fact that the Lottery has been operating with a complaint-only enforcement model that will not detect incidents involving victims who do not realize that they were scammed – points which Lottery management conceded during the investigation.

The Lottery's reply also asserts, "There is nothing in your agency's report we have not already discussed, considered or implemented at the Iowa Lottery." This could be read to suggest that my report did not address any issues that Lottery officials were not already aware of and responding to. However, my report, when carefully read, presents a host of issues where that was not the case.

Simply put, the findings in my report are far from a badge of honor for the Lottery.

The opportunity to reply offered the Lottery a forum to articulate any concerns it has about my report, particularly the findings and conclusions. The problems documented in my report are not acknowledged or specifically addressed in the Lottery's reply. As a consequence, it is unclear to what extent the Lottery recognizes any of the deficiencies.

I requested the Lottery to inform me which of my 60 recommendations it accepts or does not accept and to explain the reasons for not accepting a recommendation. On this, the Lottery's reply is vague. The letter states that the Lottery agrees with many of the "concepts in principle" behind our recommendations but reserves the right to challenge the basis for those at a later time. The letter also says the Lottery disagrees with some of the 60 recommendations for various reasons, but does not provide specific explanations. There is little specificity as to what the Lottery intends to do with the recommendations.

My office's investigation found that Lottery officials have been taking chances with the agency's integrity and dignity, which it is mandated by law to protect. In reply, the Lottery asserts that integrity "is at the heart of our operations."

Life teaches that integrity is not attained through words alone. Only time and action will tell whether Lottery officials have learned this most important lesson. I hope that in the months ahead the Lottery will make additional changes to better meet its responsibilities.

B. COMMENT TO FORMER CEO STANEK'S REPLY

Similar to the Lottery's reply, Dr. Stanek's reply mostly minimizes the significant deficiencies, does not specifically address the 60 recommendations for improvement, and mistakenly portrays my report as generally giving the Iowa Lottery a clean bill of health.

In his reply, Dr. Stanek states that he disagrees with "some of the facts and analyses" in my report, but for the most part does not specify or elaborate what they are.

Dr. Stanek makes another point which merits comment. He wrote:

> Although years have passed, I somewhat remember reviewing the Ontario Ombudsman's report and to go a step further I vaguely remember being privy to the report by the accounting firm hired to advise the Ontario Ombudsman. I believe that in-spite of all the recommendations made, the accounting firm noted that the only way to prevent retailer fraud was to have on file the fingerprints and DNA samples of all retail clerks and to compare them to the fingerprints and DNA samples of everyone claiming a lottery prize and to further use gloves and tongs to handle every prize claim document and keep it in a plastic bag as evidence.

Although this recommendation was not included in my report, we verified that a consulting firm (KPMG) did recommend in 2006 that the Ontario lottery consider preserving tickets as evidence for *potential* DNA and fingerprint examination.[452] However, contrary to Dr. Stanek's recollection, the recommendation applied only to winning tickets worth $10,000 or more and did not involve the collection of DNA and fingerprints from retail clerks. The Ontario lottery accepted the recommendation and now stores such tickets in clear plastic bags.[453]

Dr. Stanek notes even this recommendation, along with other improvements I recommended, have limitations. However, my recommendations are not necessarily aimed at pursuing perfection. Rather, they offer an array of improvements to establish a proactive Lottery enforcement system, with the goal of promoting the Lottery's integrity and protecting customers.

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[452] ONTARIO LOTTERY AND GAMING CORPORATION, PHASE II REPORT – LOTTERY REVIEW (2006), http://www.olg.ca/assets/documents/play_confidence/kpmg_report_phase_two.pdf.

[453] STATUS OF OLG ACTION IN RESPONSE TO KPMG RECOMMENDATIONS – PHASE I, II, III RECOMMENDATIONS (2006), http://www.olg.ca/assets/documents/olg_commitment/olg_response_kpmg_march2008.pdf.