

Maximizing dollars for education: Why the Tennessee Lottery moved from ball drawings to automated drawings

By Rebecca Paul Hargrove, President and CEO

Why did the Tennessee Education Lottery Corporation (TEL) change from ball drawings to automated drawings? The answer to this important and appropriate question is simple.

The change was made “to maximize net lottery proceeds.”

When Tennesseans voted to create a state lottery, the primary reason was to generate dollars to fund a variety of new programs to improve education in the state. The often stated hope was that by providing scholarships to deserving Tennessee students, many would attend college who otherwise might not be able to do so and that many of these “best and brightest” would stay in the state upon completion of their degrees. Our job was and is to provide the funds to allow this hope to become reality. Funding is also used for pre-kindergarten and after-school programs.

It is little wonder then that when the enabling law was passed to create the corporation to operate the lottery, the General Assembly clearly articulated that “the corporation shall strive to maximize net lottery proceeds.” This legislative directive provides both the mission and motivation for the TEL. This mandate is reflected in many areas of operation such as:

- Our constant focus on creating new and exciting games.
- Providing superior customer service.
- Being at the cutting edge of the industry.
- Providing valuable training and assistance to retailers.
- Obtaining feedback from our customers.

The results speak for themselves—over \$1 billion of net lottery proceeds have been raised for education in Tennessee in just three-and-one-half years. That’s enough to fund 250,000 scholarships of \$4,000 each!

Every responsible business organization must make numerous business decisions in order to control costs and expenses to maximize profits. Our management team is no different. Of the six U.S. lotteries set up as corporations (instead of state agencies), a review of the most recent audited financial statements indicates Tennessee has the second lowest percentage of cost of goods sold (prize, retailer commissions, gaming vendor costs, etc.), and second lowest percentage of general and administrative costs (personnel, advertising, rent, etc.) as a percent of sales.

The choice to change from ball drawings to automated drawings is a prime example of a decision that has a direct impact on the amount of dollars we are able to transfer to education.

Here are some of the major factors that led to the ultimate decision to make the change:

- Contracts with television stations that produced and aired drawings expired in March 2007. Two stations did not want to renew under existing terms; projected

new terms would cost the Lottery at least an additional \$4.5 million each year. Those cost estimates have now risen to over **\$5 million each year**.

- Estimates to produce and air automated drawings were substantially less-approximately \$221,000 for the first year and \$61,000 each year thereafter.
- Cash 3, Cash 4 and Lotto 5 made up only 10.5 percent of the Tennessee Lottery's overall sales.
- Industry trends showed that 96 percent of the other U.S. lotteries were using automated drawings for at least one of their games.

After carefully evaluating those factors, the TEL made the difficult decision to transition to three-dimensional drawings that could still be viewed daily by players rather than incur the several million dollars of expense required to produce and televise daily live drawings. Although we knew the change would be difficult for some of our customers, the end-result of saving millions in operational costs was too important to ignore.

Unfortunately, the change to automated drawings was made more complicated by a programming error, which was corrected 23 days after the equipment began operating. Since the error has been corrected, a thorough review of the equipment has resulted in a positive report that shows absolutely no evidence of fraud. (For details about the error and the Internal Controls report, see www.tnlottery.com, About Us, Reports.)

Thanks to our customers, sales have remained strong since the Lottery changed to automated drawings and after the programming error was discovered. In fact, the Lottery's transfer to the state's Lottery for Education Account for the quarter July 1, 2007-Sept. 30, 2007 was nearly 9 percent higher than the year before.

It is our goal to maintain an open-door policy to those who want to learn more about our operation. Currently, auditors from the Office of the Comptroller of the State of Tennessee are nearing the end of a thorough review of the entire process involved with the change of drawing methods. Also, KPMG, LLP, an independent accounting firm, has been engaged to perform a compliance audit of the automated drawing software and equipment.

For those who have questions about how the drawings are conducted, please accept an open invitation to observe one or more in person. Give us a call at 615-324-6500.

The TEL is most appreciative of the ongoing support of and continuing participation in the Tennessee Lottery. Likewise, we remain steadfast in our commitment to the students and families of Tennessee. Our motivation to maximize net lottery proceeds is the key to our daily operations as well as the foundation in our long-term strategic planning. In fulfilling our mission, we see hope become reality in Tennessee.

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