



Casino Prohibition Rule
Retailer Compliance Review Update
January 30, 2020

Casino Prohibition Rule (CPR)

Key provisions of the rule:

- Prohibits the operation of casinos in the state.
- Video Lottery Terminals (VLTs) may be placed only in establishments that are not casinos.
- An establishment is not a casino if annual non-Lottery sales are at least 50 percent of the establishment's total income.
- Shall consider other factors allowed under the CPR when sales are below 50%: appearance, food service accoutrements, advertising, etc.
- Risk if requirements not met: Out of compliance with CPR.

Focus on Limited Menu and Café/Small Eatery Retailers

This segment of retailers is extremely important to Lottery's business:

- 281 retailers out of 2,220 Video Lottery retailers
- \$232 million in annual Lottery sales (24% of Video Lottery sales)
- \$826,000 average annual Lottery sales per retailer
- \$171,000 average annual commissions per retailer

(For the 12-month period ending 9/29/2019)

Retail Contracts Compliance Work

Each Limited Menu Retailer and Café/Small Eatery is assessed every year to determine compliance with the Casino Prohibition Rule (OAR 177-040-0061). The assessment includes:

- Completing annual sales analysis to determine the percentage of non-Lottery and Lottery income. 52% of the retailers reported non-Lottery sales of less than 50% of the total income between May 2018 and April 2019.
- Site inspections are completed annually to assess, among other things, if a reasonable person would perceive the business as a place for on-premises consumption of food and beverage.
- If non-Lottery sales were less than 50%, other factors are considered, such as: history, appearance, food service accoutrements, meals & menus, overall atmosphere, etc. The Retailer is notified in writing of the results and any recommendations.
- Review business records if non-Lottery sales appear inaccurate.

Internal Audit Reviews

In response to 2015 Secretary of State Audit Report to help Lottery strengthen existing controls and facilitate compliance with the CPR:

Lottery Internal Audit Department is conducting reviews of all 281 retailers over a five-year period.

- 2018: 60 retailers reviewed
- 2019: 62 retailers reviewed
- 2020 to 2022: 159 retailer reviews to be scheduled.

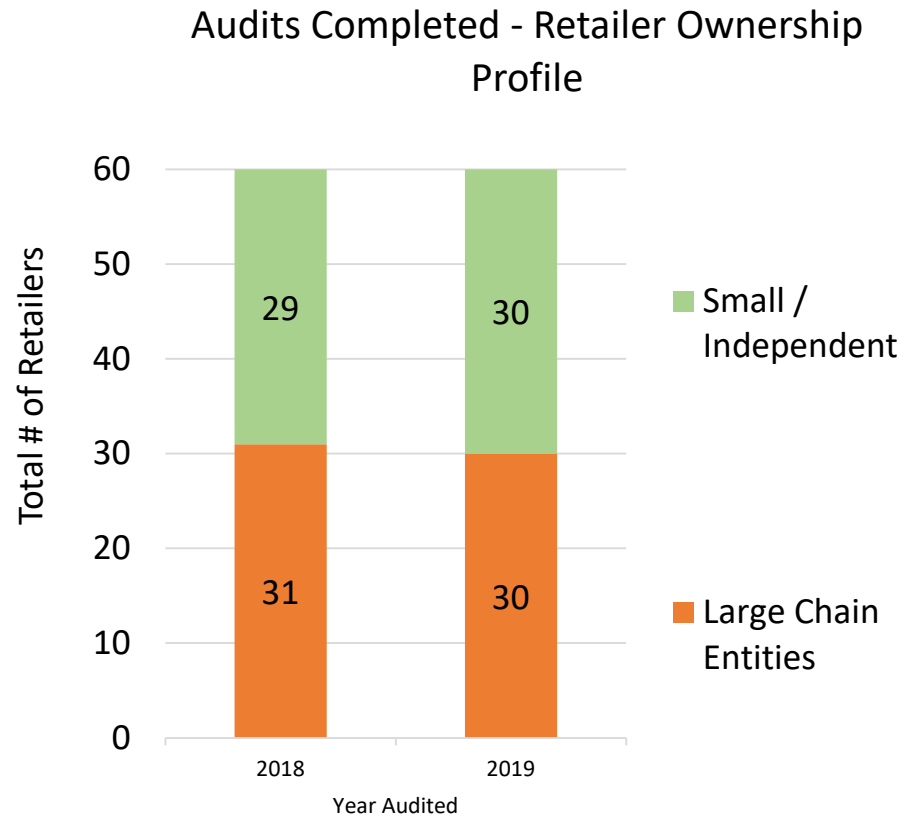
The reviews supplement the annual site inspections and analyses by Retail Contracts.

Internal Audit Reviews

Objectives and scope of the retailer reviews:

- Measure accuracy of the annual Gross Sales Reports of non-Lottery sales.
- Identification of non-Lottery revenues not allowed according to CPR. Example: complimentary food & non-alcoholic beverages.
- Completeness of sales and cost records.
- Assess general business controls and reliability of records.

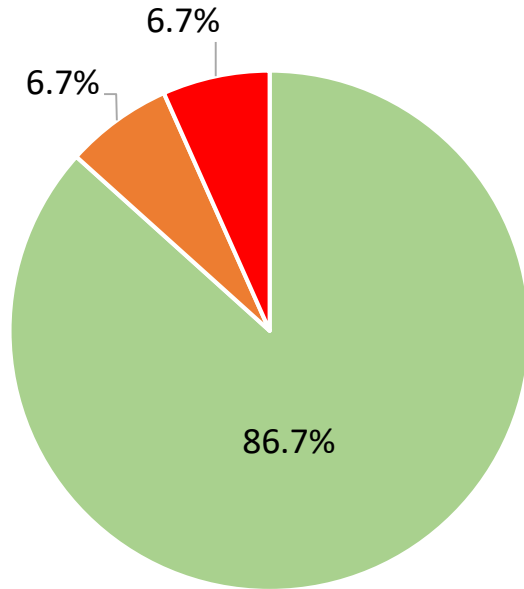
Internal Audit Reviews – Independent Retailers vs. Large Corporate Entities



Business controls and reliability of reported non-Lottery sales has been found to be better at the large chain entities.

Internal Audit Reviews – Gross Sales Report Accuracy

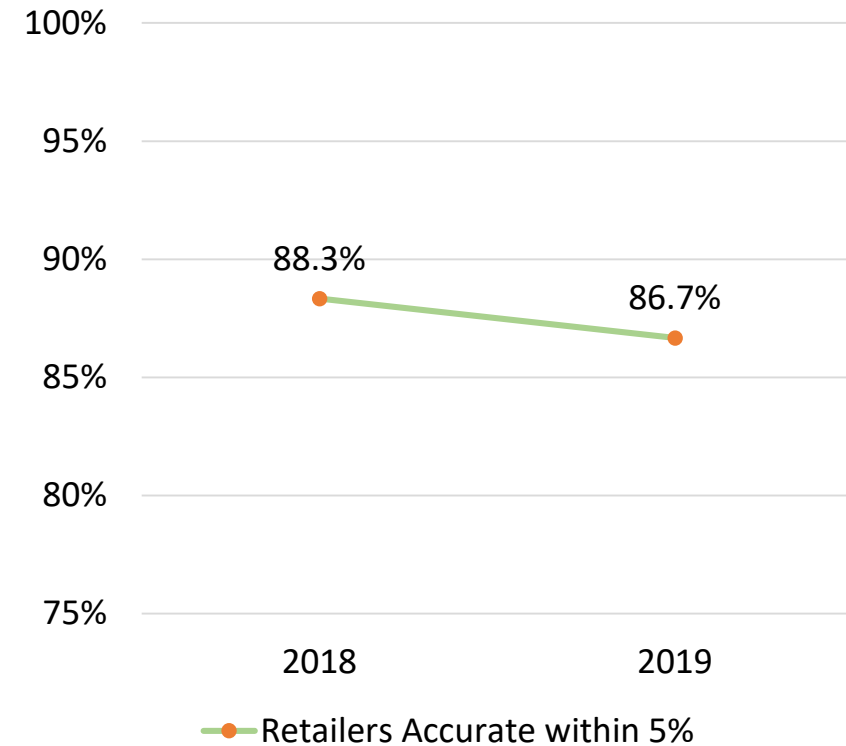
2019 Retailer Gross Sales Report Accuracy for 60 Retailers



Reported
Non-Lottery
Sales
Accuracy:

- Accurate within 5% = 52
- Understated > 5% = 4
- Overstated > 5% = 4

Pct of Retailers Reporting Sales Accurately Within 5%

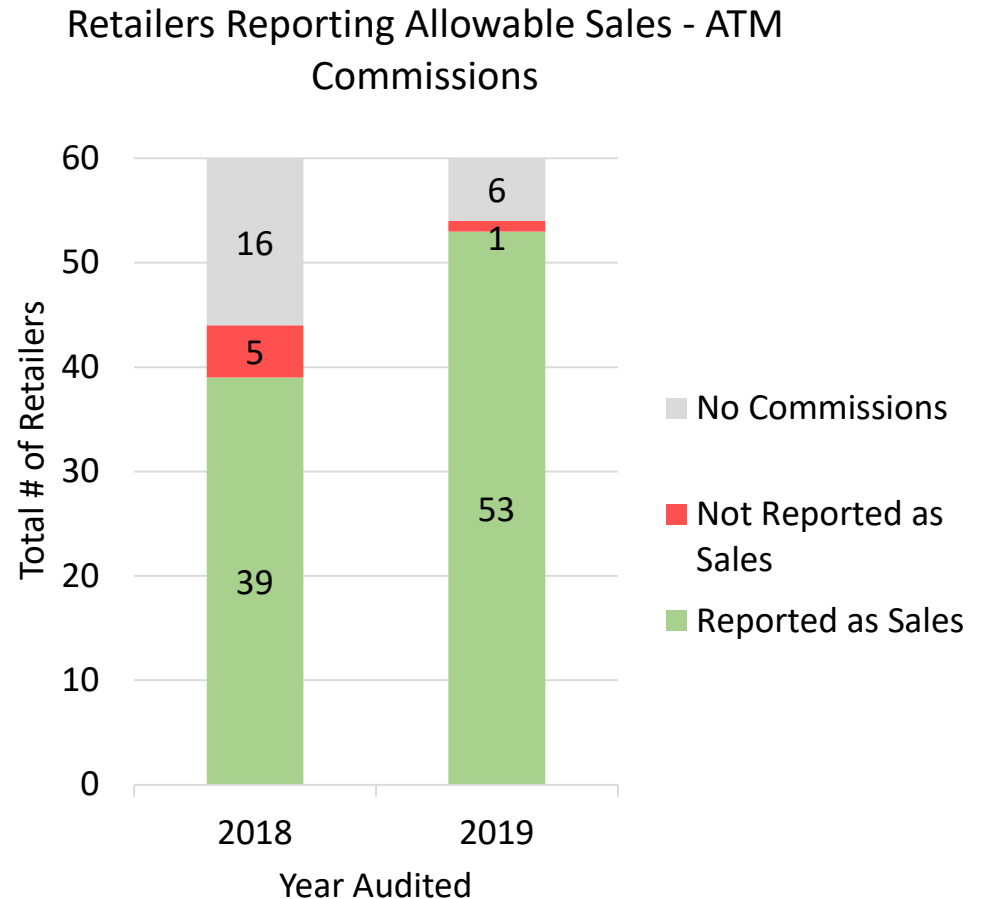


Internal Audit Reviews – Non-Lottery Sales in Gross Sales Reports

Recommendation in 2018: Improve instructions on the Gross Sales Report for the types of sales that are and are not reportable and improve the layout of the gross sales report.

Results observed in 2019:

- Complimentary food/beverage not allowed (three retailers in 2018 and 2019; no change).
- Tobacco company rebates – allowable (improved from five to eleven retailers)
- ATM commissions revenue - allowable (improved; see chart).

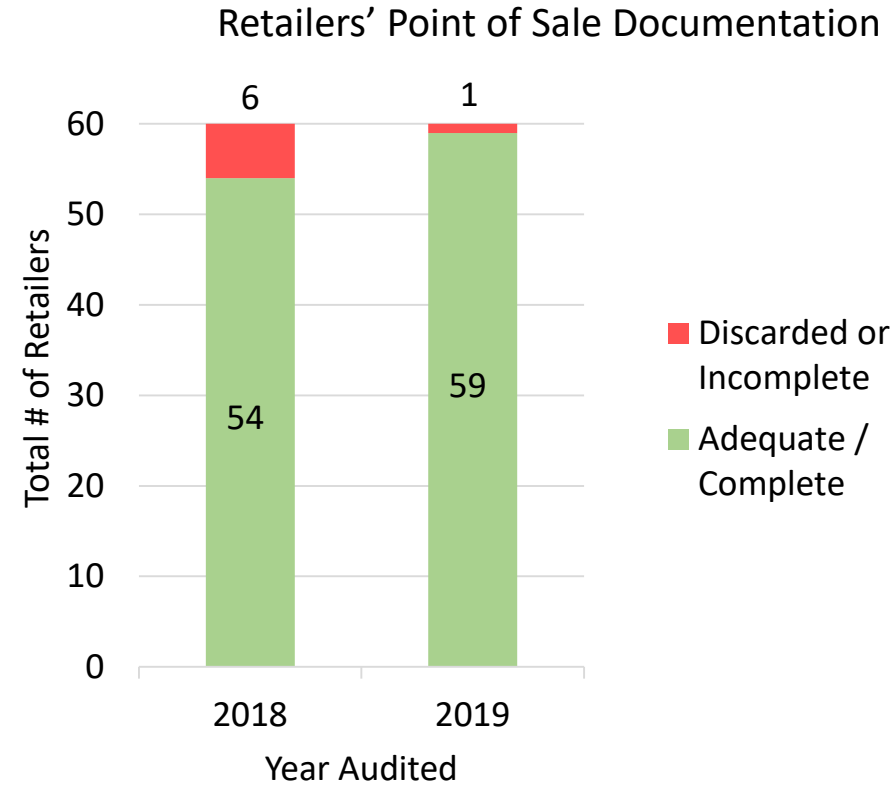


Internal Audit Reviews – Point of Sale Documentation

Recommendation in 2018: Improve instructions on the Gross Sales Report for the specific records that should be retained for a minimum of two years, including point-of-sales tapes or reports.

Results observed in 2019:

- More retailers with good point-of-sale documentation (improved; see chart).
- More retailers installing cloud-based systems such as Square.

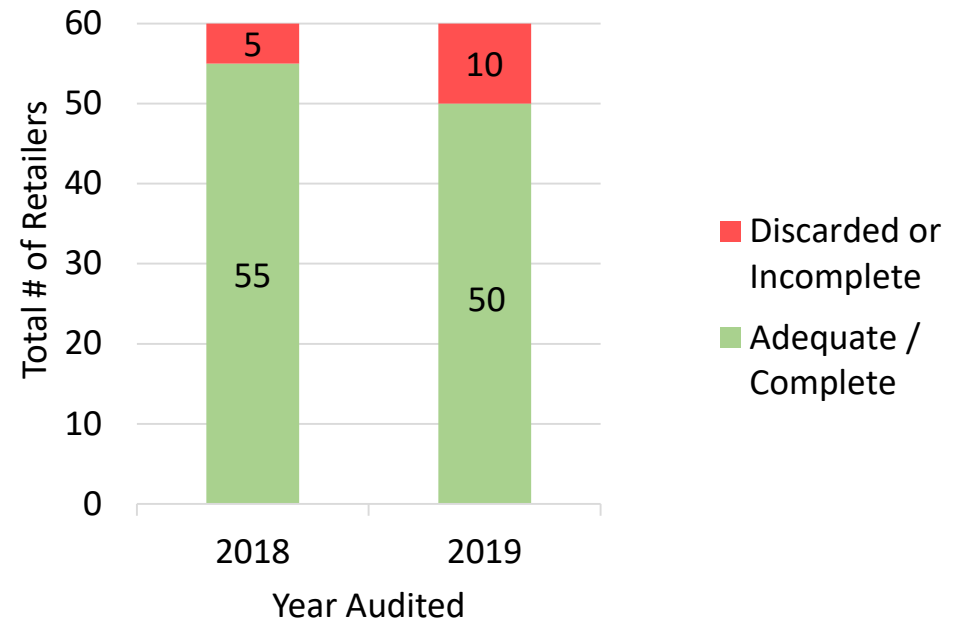


Internal Audit Reviews – Cost of Sales Documentation

Results of 2019 Review: We observed an increase in number of retailers with inadequate records for cost of sales.

Recommendation in 2019: Add instructions to the Gross Sales Report that describe how retailers can comply with the CPR requirements for cost of sales records.

Retailers' Cost of Sales Documentation



Internal Audit Reviews – Recommendations for Follow-Up Reviews

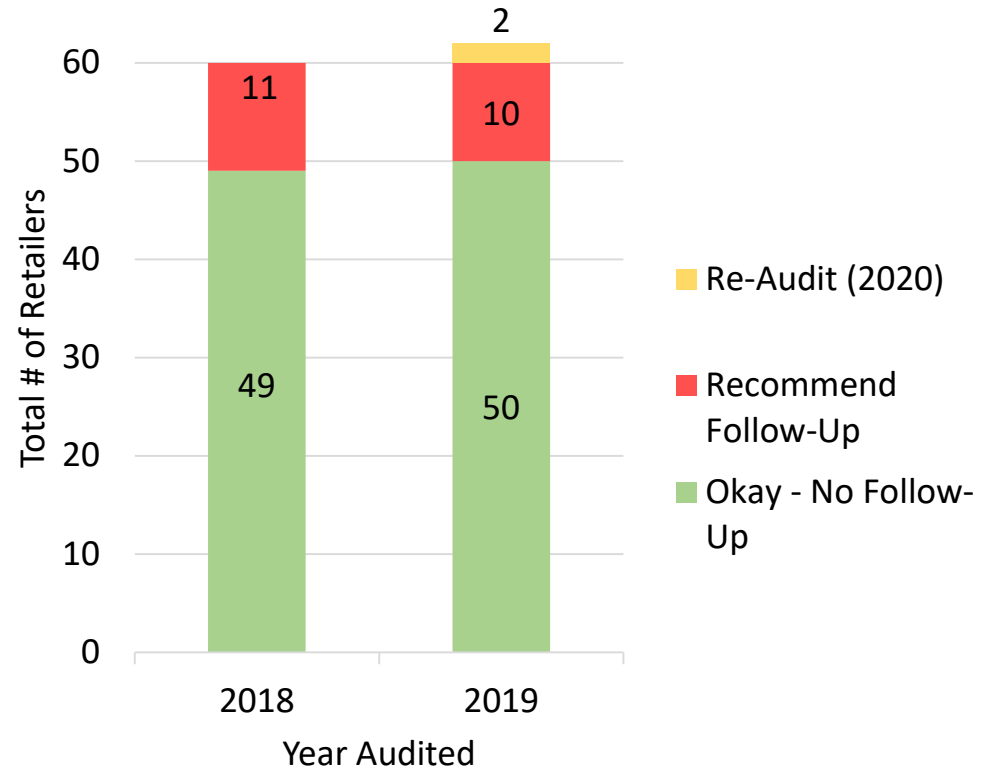
Internal Audit identified retailers with a combination of deficiencies:

- Reported sales accuracy.
- Compliance with CPR sales reporting.
- Completeness and retention of records.

Recommendations in 2019:

- Retail Contracts conduct follow-up reviews at ten retailers (slight improvement over 2018; see chart).
- Internal Audit will re-audit two retailers because records were insufficient to measure accuracy.

Figure 9: Recommended Follow-Up Reviews



Retail Contracts – Follow-Up Results

- As a result of the 2018 reviews, eleven retailers were recommended for follow-up reviews in 2019.
- In January 2019, Retail Contracts notified these retailers in writing of the issues discovered during the review and follow-up reviews would be completed later in the year.
- Ten follow-up reviews were completed in October and November 2019 (1 retailer closed earlier in the year). The results found improved reporting accuracy and recordkeeping. Only one retailer was recommended for additional follow-up due to a concern of comingled cost of goods records with other locations owned by the retailer.