

E75D State Lottery Agency

Operating Budget Data

(\$ in Thousands)

	FY 02 <u>Actual</u>	FY 03 <u>Working</u>	FY 04 <u>Allowance</u>	FY 03 - 04 <u>Change</u>	FY 03 - 04 <u>% Change</u>
Special Funds	\$50,557	\$51,984	\$53,266	\$1,282	2.5%
Contingent & Back of Bill Reductions	0	-12	-72	-60	
Adjusted Special Funds	\$50,557	\$51,972	\$53,194	\$1,222	2.4%
Adjusted Grand Total	\$50,557	\$51,972	\$53,194	\$1,222	2.4%

- The allowance provides \$105,207 for the purchase of 500 additional Keno game monitors.
- One-time fiscal 2003 expenditures related to the lottery's move to a new headquarters facility reduces the budget by \$830,000.

Personnel Data

	FY 02 <u>Actual</u>	FY 03 <u>Working</u>	FY 04 <u>Allowance</u>	<u>Change</u>
Regular Positions	175.00	175.00	173.00	-2.00
Contractual FTEs	5.50	5.50	5.50	0.00
Total Personnel	180.50	180.50	178.50	-2.00

Vacancy Data: Regular Positions

Budgeted Turnover: FY 04	6.92	4.00%
Positions Vacant as of 12/31/02	3.00	1.73%

- The State Lottery Agency's budgeted turnover rate of 4.0% requires an average of 6.92 positions remain vacant throughout fiscal 2004 to achieve the \$403,823 in savings required. After adjusting for the abolishment of 2 positions, the agency's current number of vacant positions is 3.0 equating to just \$185,125 in salary and fringe benefits. Additional vacancies will be needed to meet the budget requirement. The statewide hiring freeze, in effect through fiscal 2004, may result in additional vacancies in the State Lottery Agency and thus allow the agency to meet the turnover budget target.
- In accordance with Section 20 of the fiscal 2003 budget bill, two regular positions have been abolished.

Note: Numbers may not sum to total due to rounding.

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Analysis in Brief

Major Trends

Agent Earnings Keep Pace with Sales: Lottery agents are compensated with commissions and bonuses for selling and cashing lottery tickets. The expenditure for these commissions and bonuses have increased commensurate with the increase in lottery sales. As a percentage of total sales, these commissions and bonuses have remained at approximately 6.5%.

Operating Budget Cost to Sales Ratio: The lottery's operating budget has increased from \$47.8 million in fiscal 2001 to a proposed \$53.2 million for fiscal 2004. As a percentage of total sales, however, the agency's budget has declined from 3.95% to a proposed fiscal 2004 ratio of 3.47% of total sales.

Prize Payouts Remain Stable: In order to keep game interest high, the lottery changes its game offerings and at times the individual game matrix. Prize payouts have remained at approximately 56.0% of total sales.

Issues

Budget Reconciliation and Financing Act (BRFA) of 2003 Proposes Transfer of Unclaimed Prize Fund to State General Fund: SB 657/HB 935, the BRFA of 2003, includes a provision that would transfer up to \$10.0 million from the unclaimed prize fund depending upon the lottery's ability to increase the amount of revenues transferred to the general funds by up to \$10.0 million. **The Department of Legislative Services (DLS) recommends that this provision be struck from SB 657.**

Overview of Revenue Results and Forecasts: Fiscal 2002 sales reached \$1.3 billion, resulting in revenues of \$414.1 million to the general fund. Current revenue estimates total \$432.0 million to the general fund for fiscal 2003 and \$448.5 million for fiscal 2004. **The State Lottery should brief the committees on its efforts to increase sales and the player base.**

Bills Which May Affect General Fund Revenues from Lottery Sales: Several bills have been introduced which could affect the distribution of lottery revenues to the general fund. **DLS recommends that the lottery comment upon the effect that enactment of these bills would have on general fund revenues.** Legislation has also been introduced that would change the requirements that lottery agents keep separate bank accounts for lottery related sales revenues. **DLS recommends that the agency discuss the impact that this proposal would have on the lottery's ability to account for lottery revenues.**

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Recommended Actions

	<u>Funds</u>
1. Add budget bill language limiting increases through budget amendments to instant ticket printing, freight costs, and vendor fees.	
2. Add budget bill language requiring that the Legislative Policy Committee has 45 days to review plans for any new lottery game.	
3. Reduce funds for customer and agent satisfaction management studies.	\$ 116,550
4. Reduce funds for general consulting services.	27,251
5. Reduce funds for vehicle maintenance and repairs and gas and oil.	30,000
6. Delete funds for pay-for-performance awards	6,125
7. Reduce funds for employee training and staff development.	33,500
8. Reduce funds for in-house telecommunications.	50,000
9. Reduce funds for marketing lottery products to corporate and municipal entities.	150,000
Total Reductions	\$ 413,426

Updates

Marketing and Advertising Budget Remains Flat: The lottery's marketing and advertising budget is approximately \$15.0 million which is essentially the same amount appropriated for fiscal 2003. This update summarizes the individual expenditure items that comprise the lottery's marketing and advertising budget.

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Operating Budget Analysis

Program Description

The Maryland State Lottery Agency administers and operates the State lottery games for the purpose of generating revenue for the State. The State Lottery Commission, consisting of five members appointed by the Governor, has oversight responsibility for the agency. The lottery, which has been in operation since 1973, consists of six divisions plus a security unit. The six divisions are: Administration, Finance, and Operations (AFO); Information Technology; Marketing; Sales; Public Affairs; and Executive.

The lottery games are sold through lottery agents which are private businesses that receive fees in exchange for selling the games to the public. All operating expenses of the agency are paid out of the proceeds from the games.

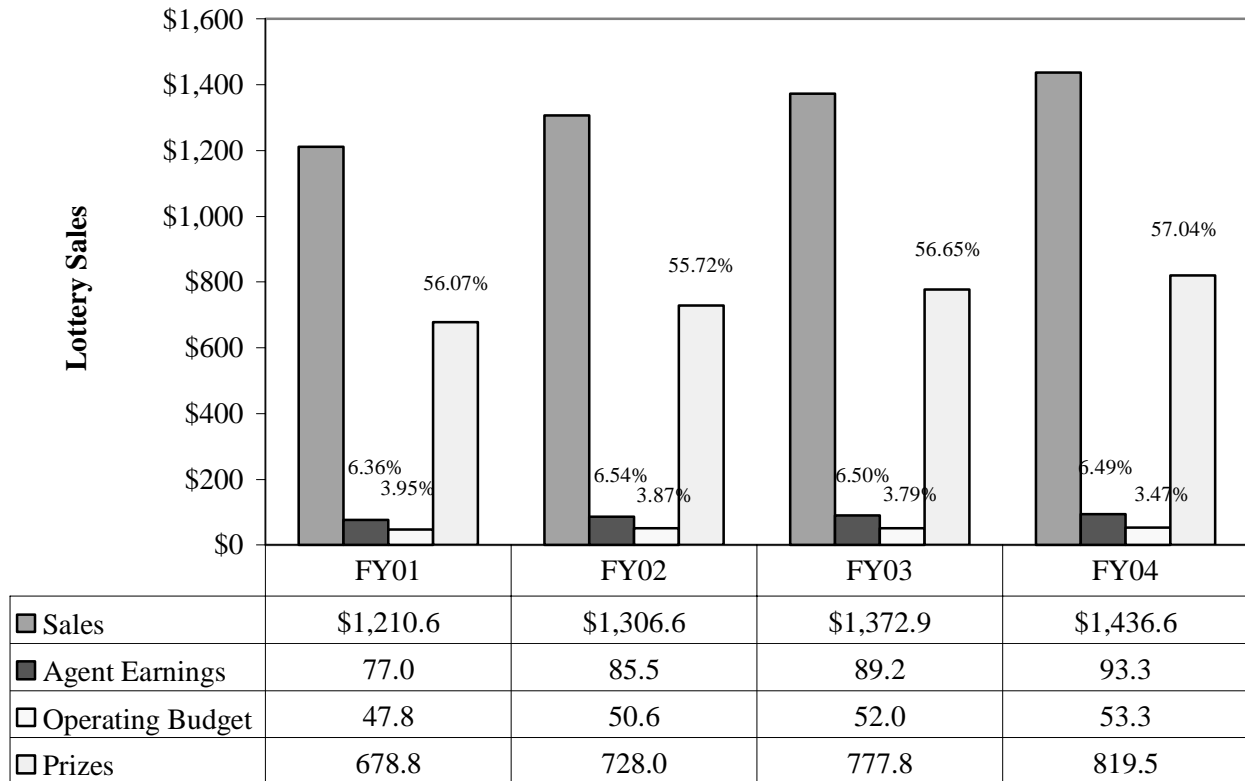
The lottery currently offers seven games: Pick 3, Pick 4, Lotto, Instant Games, Bonus Match Five, Keno, and the Mega Millions. In February 2002, the lottery began testing increasing the frequency of the Keno drawing from once every five minutes to once every four minutes. The increased frequency was a success and made permanent. Also during fiscal 2002, the lottery changed the matrix of what was once the Big Game and now offers Mega Millions. Finally, the lottery expects to introduce a revamped Lotto game sometime during fiscal 2004. In fiscal 2002, 55.72% of sales receipts was paid for prizes, 6.54% paid for agent commissions and redemption fees, 3.87% paid the agency's operating costs, and the remaining 33.87% of the receipts was credited as revenue to the State.

Performance Analysis: Managing for Results (MFR)

Exhibit 1 provides fiscals 2001 and 2002 actual and fiscals 2003 and 2004 estimated figures for lottery sales, agent earnings, lottery operating budget expenses, and prize amounts.

Exhibit 1

**Lottery Sales and Selected Expenditures
(\$ in Millions)**



Source: Governor’s budget books, fiscal 2001 Vol. I

- **Agent Earnings Keep Pace with Sales:** Lottery agents are compensated with a commission for selling and cashing lottery tickets. In addition, the lottery maintains an agent bonus and incentive program that is capped at one-half of 1% of gross sales. As shown in Exhibit 1, the total amount of agent commissions and bonuses is expected to be \$93.3 million in fiscal 2004, or \$16.3 million more than what was paid to agents in fiscal 2001. However, as a percentage of total sales these commissions and bonuses have remained steady at approximately 6.5% of gross sales annually.
- **Operating Budget Cost to Sales Ratio:** One of the agency’s MFR goals is to achieve a ratio of operating costs to sales of 5% or less on an annual basis. As shown in Exhibit 1, the lottery has surpassed its objective in fiscal 2001 and 2002 with operating costs as a percentage of sales of 3.95% and 3.87% respectively. Based on anticipated sales and operating costs for fiscal 2003 and 2004, the lottery will continue to maintain a cost to sales ratio below 4%. Moreover, if the fiscal 2003 and 2004 sales and operating cost estimates hold true, in each of fiscal 2001 through 2004, the lottery will reduce its operating cost to sales ratio from 3.95% to 3.47%.

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- **Prize Payouts Remain Stable:** Prize payouts for the games operated by the lottery are expected to be \$819.5 million in fiscal 2004, which is up from the \$678.8 million paid out in prizes in fiscal 2001. However, prize payouts have remained at approximately 56.0% as a percentage of total sales in fiscal 2001 and 2002 and are expected to increase only slightly in fiscal 2004 to 57.04%.

Fiscal 2003 Cost Containment

The fiscal 2003 cost containment reflects the reversion of \$11,786 in special funds used to support free transit ridership for State employees contingent upon enactment of a provision in the Budget Reconciliation and Financing Act of 2003, SB 657/HB 935.

Governor's Proposed Budget

The fiscal 2004 allowance for the State Lottery Agency is \$53.2 million, which is \$1.2 million or 2.3% over the fiscal 2003 working appropriation. **Exhibit 2** summarizes the major changes.

Exhibit 2

Governor's Proposed Budget State Lottery Agency (\$ in Thousands)					
	<u>FY 02</u>	<u>FY 03</u>	<u>FY 04</u>	<u>FY 03 - 04</u>	<u>FY 03 - 04</u>
	<u>Actual</u>	<u>Working</u>	<u>Allowance</u>	<u>Change</u>	<u>% Change</u>
Special Funds	\$50,557	\$51,984	\$53,266	\$1,282	2.5%
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Where It Goes:

Personnel Expenses

Abolished/transferred positions	-\$83
Cost containment	629
Increased turnover rate	-55
Employee and retiree health insurance cost increase	215
Retirement contribution cost increase	26
Other fringe benefit adjustments	-33
Deferred compensation match	-61

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Where It Goes:

New Game Equipment

Additional lease purchase and maintenance for 500 keno monitors.....	105
Fully annualized cost of fiscal 2003 game terminal lease purchases and maintenance contract – fiscal 2003 only included one lease payment when two annual lease payments will be required.....	506

Office Relocation

Elimination of one-time modular furniture for new office.....	-230
Elimination of one-time office relocation moving expenses.....	-200
Elimination of one-time build-out and wiring expenditures for new office location.....	-400
Rent – annualization of rent for new headquarters facility.....	103

Online and Instant Ticket Vendor Contracts

Increased fees for instant ticket printing contract to reflect Board of Revenue Estimates (BRE) instant ticket sales estimates.....	264
Increased fees for online instant ticket gaming system fee based on sales estimate – this appears to be under-funded based on BRE for instant game sales.....	36
Increased instant ticket printing delivery charges – additional lottery agents.....	26
Reduced fees for online gaming telecommunication system fee.....	-93
Increased fees for online gaming system vendor fee based on BRE sales estimate.....	731

Miscellaneous

Reduced staff development, and sales & motivational training expenditures – the budget still provides \$67,000 for training related expenses.....	-14
Reduced contractual employee payments and increased contractual employee turnover rate.....	-13
Reduced communication costs – including reduction in the Department of Budget and Management paid telecommunication.....	-36
Reduced travel costs – including reduction in out-of-State travel related to NASPL conference.....	-9
Allowance provides \$70,233 for the replacement of nine vehicles – the fiscal 2003 budget for vehicle replacement was reduced as a result of cost containment purposes and only provided \$28,331 for the replacement of four vehicles.....	42
Web site development costs.....	-100
Reduced funding for information technology training.....	-9
Reduced funding for information technology consultant services.....	-12
Reduced budget for supplies and software upgrades.....	-61
Additional funds for computer upgrades – no funds provided in fiscal 2003 due to cost containment.....	36
Reduced funding for information technology equipment.....	-88

Total	\$1,222
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Note: Numbers may not sum to total due to rounding.

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Personnel Expenses

The fiscal 2004 allowance provides \$9.9 million for personnel expenses to support 173 regular employees. These expenses account for 18.6% of the agency's total budget and account for \$638,045 of the \$1.2 million of additional funds provided in the allowance. The increase in personnel expenses results primarily from a statewide increase in the cost of employee and retiree health insurance and the shift of fiscal 2002 cost containment carried forward into fiscal 2003 from the agency's personnel budget to other object expenditure categories. The lottery loses two regular positions to abolishment resulting in savings of \$83,000, and an additional \$52,000 in savings results from an increase in the agency's budgeted turnover rate from 3.53% for fiscal 2003 to 4.0% for fiscal 2004.

New Game Equipment – Annualization of Equipment Purchased in Fiscal 2003

The allowance provides \$105,207 for the lease purchase of 500 Keno monitors. The lottery continues to expand the network of locations offering Keno to take advantage of the growth in Keno sales. The agency intends to enter into a five-year lease purchase agreement financed through the State Treasurer. Annual lease payments are calculated at \$150,414 and will be paid in bi-annual installments. For fiscal 2004, the lottery intends to make just one lease payment in the amount of \$75,207. The addition of a maintenance contract adds another \$30,000 to the budget annually for the five-year term of the lease.

The allowance also provides an additional \$506,725 representing the annualization of new game equipment purchased in fiscal 2003. For fiscal 2003, the lottery purchased an additional 150 player activated terminals, 250 instant ticket vending machines, and 500 Keno monitors also through a five-year lease purchase with the Treasurer. The fiscal 2003 budget provided funds sufficient to make one lease payment with bi-annual lease payments beginning in fiscal 2004, representing the additional funds.

Office Relocation

On December 2, 2002, the lottery officially moved its headquarters from the Reisterstown Road Plaza to Montgomery Park in Baltimore City. The move has enabled the lottery to consolidate its headquarters, sales office, and warehouse facility under one roof. The fiscal 2003 budget included a portion of the additional annual rent cost associated with the new headquarters facility to reflect the agency's partial year occupancy. The fiscal 2004 allowance annualizes the agency's rent which adds \$103,018 to the budget. A number of one-time office relocation expenses are eliminated from the budget including \$400,000 for additional build-out and wiring, \$230,000 for the purchase of new modular furniture, and \$200,000 for office relocation and moving expenses.

Sales-based Costs

Sales-based costs, primarily from instant ticket printing and online vendor fees, increase nearly \$1,031,000 in fiscal 2004. The allowance is based on instant ticket sales of \$353.8 million (compared to \$329.1 million in fiscal 2003) and online game sales including online instant sales of \$1,389 million

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(compared to \$1,283 million in fiscal 2003). Fees for the delivery of instant tickets to lottery agents adds another \$26,000 to the budget, and telecommunication charges to support the lottery's online game terminal network are reduced by \$93,000 resulting from a modification in the vendor contract.

Impact of Cost Containment

The fiscal 2004 allowance reflects the elimination of the appropriation for matching employee deferred compensation contribution up to \$600 contingent upon the enactment of a provision in the Budget Reconciliation and Financing Act (BRFA) of 2003.

Issues

1. Budget Reconciliation and Financing Act of 2003 Proposes Possible Transfer of Unclaimed Prize Fund to State General Fund.

SB 657/HB 935, the BRFA of 2003, includes a provision that would transfer up to \$10.0 million from the unclaimed prize fund depending upon the lottery's ability to increase the amount of revenues transferred to the general funds by up to \$10.0 million.

The current Board of Revenue Estimates (BRE) forecast for the lottery's transfer to the general funds is \$431,991,000 for fiscal 2003. The Governor's proposal would essentially increase this estimate by \$10.0 million and in the event that the lottery is unable to meet this increased revenue expectation would make up the difference by requiring a transfer from the unclaimed prize fund.

The unclaimed prize fund is a statutorily required (State Government Article, Section 9-122) fund that consists of prize winnings that have not been claimed for more than 182 days after the drawing in which the prize is won. The statute allows the lottery to use these funds for use for other prizes, and it has done so during fiscal 2003 to help the agency meet the BRE revenue estimate which, when established, assumed the use of these funds. According to the lottery, the unclaimed prize fund balance carried forward into fiscal 2003 was \$5.7 million, and through December 31, 2002, an additional \$8.4 million was deposited into the fund. The lottery has used all but \$3.2 million of these funds to enhance sales and general fund revenues. The lottery expects to deposit an additional \$5.7 million into the unclaimed prize fund through the end of fiscal 2003 but also expects to be able to use these funds to continue to increase sales and revenues.

DLS recommends against the proposed increase to the lottery's general fund revenue estimate or alternative transfer from the unclaimed prize fund. Since the BRE fiscal 2003 revenue estimates already call for a substantial increase in revenues over that which was attained in fiscal 2002 based in part on the use of the unclaimed prize fund, taking funds out of the unclaimed prize fund could result in a reduction in lottery revenues.

2. Overview of Revenue Results and Forecasts

Fiscal 2002 Results

The lottery recorded total sales of \$1,306.6 billion during fiscal 2002. This represents a \$96.0 million, or 7.93% increase over sales recorded for fiscal 2001. These sales resulted in net revenue of \$442.5 million, of which \$414.1 million was credited to the State's general fund after distributing \$26.2 million to the Maryland Stadium Authority and \$2.2 million to the Horse Racing Special Fund. Chapter 512, Acts of 2001 required that lottery revenues be distributed to the Horse Racing Special Fund to replace any payments made pursuant to the Racing Facility Redevelopment Program, unless otherwise provided in the budget. The amount of lottery funds distributed was required to be equivalent to the

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payments made to the bond fund. Chapter 512 was effective for fiscal 2002 only, and the funds were used to provide mandated grants to the Maryland State Fair, county fairs, and local agricultural education programs.

Pick 3 sales increased by \$1.5 million, or 0.5% above the fiscal 2001 sales figures. Pick 4 sales increased by \$2.8 million, or 1.41% over fiscal 2001 sales figures. Large deviations from statistically expected payouts in these games have resulted in revenue growth that diverges from sales growth. In fiscal 2002, Pick 3 revenues declined by 6.6% while Pick 4 revenues increased by nearly 11%. Lotto sales continued to decline in fiscal 2002, down \$14.2 million, or 27.36% below fiscal 2001 sales figures. Lotto games sales are expected to continue to decline, and the lottery expects to introduce a revamped Lotto game sometime during fiscal 2004 to try to boost sales.

Cash-in-Hand was discontinued in early fiscal 2003. Sales had declined every year since it was first introduced. The game was replaced with Bonus Match 5 which returned after a five-year hiatus. The forecast assumes sales of these two games in fiscal 2003 will equal fiscal 2002 Cash-in-Hand sales.

Instant ticket sales increased by \$35.1 million, or 13.29% above fiscal 2001 sales figures. Innovation in the game mix has driven this growth which is expected to continue in fiscal 2003 and 2004. In fact, instant ticket sales are expected to surpass Pick 3 making it the second largest game behind Keno.

Keno sales grew by \$36.2 million, or 11.33% above fiscal 2001 sales figures. Fiscal 2002 sales were boosted by an increase in the number of terminals and toward the end of the year by increasing the draw from every five minutes to every four minutes. There are approximately 1,800 Keno outlets, and another 100 may be in place by the end of fiscal 2003.

The Big Game is now the new and improved Mega Millions. Since the start of 2003, New York, Ohio, and Washington State have joined the consortium. The minimum jackpot increased from \$5 million to \$10 million, and the odds of winning the jackpot increased, which should result in a quicker escalation of the jackpot to much higher levels than were attained previously. These changes have enhanced the attractiveness of the game, and as a result, sales increased by \$30.3 million, or 69.96% above fiscal 2001 sales figures.

Legislation adopted by the 2002 General Assembly authorized the Lottery Agency to take part in an international lottery game. The international consortium is headquartered in Australia and includes a number of Western European and Asian countries as well as a number of other states. The loot-type game is scheduled to begin in January 2004, and while the structure of the game and starting date are not quite finalized, implementation is near enough that \$12.3 million of sales has been included in the fiscal 2004 estimates.

Fiscal 2003 Revenue Performance

BRE set the net revenue target for fiscal 2003 at \$453.9 million which would result in general fund revenues of \$432.0 million. This is an increase from the previous estimate (March 2001), which set fiscal 2002 general fund revenues at \$417.5 million. A game-by-game comparison of year-to-date sales (through January 31) in **Exhibit 3** shows that sales are up \$28.6 million or 3.92% for all the lottery games.

Exhibit 3

Fiscal 2003 Year-to-date Sales Versus Fiscal 2002

<u>Game</u>	<u>FY 2002 Sales</u>	<u>FY 2003 Sales</u>	<u>Difference</u>	<u>% Change</u>
Pick 3	\$178,039,706	\$173,403,890	-\$4,635,816	-2.6%
Pick 4	117,881,009	117,945,545	64,536	0.1%
Lotto	23,422,282	20,471,558	-2,950,724	-12.6%
Cash-in-Hand	13,489,843	3,871,668	-9,618,175	-71.3%
Instant Games	166,068,483	179,825,245	13,756,762	8.3%
Keno	204,609,897	219,078,572	14,468,675	7.1%
Match 5	0	12,205,355	12,205,355	100.0%
International	0	0	0	0.0%
Mega Millions	31,311,333	38,213,163	6,901,830	22.0%
Let It Ride	1,329,863	0	-1,329,863	-100.0%
Total	\$736,152,416	\$765,014,996	\$28,862,580	3.9%

Note: Includes sales as of January 31, 2002, for fiscal 2002, and sales of January 31, 2003, for fiscal 2003.

Source: Maryland State Lottery

However, gross revenues are up \$15.2 million, or 6.24% above revenue attainment through January 31, 2003, as shown in **Exhibit 4**. Most of this increase results from a large deviation from statistically expected payouts for the Pick 3 game. While Pick 3 sales have declined by \$4.6 million, gross revenues are \$11.3 million greater through the first seven months of fiscal 2003 as compared to the first seven months of fiscal 2002. Following patterns evident in fiscal 2002 revenue figures, games such as Keno, Keno Bonus, instant tickets, and Mega Millions show strong revenue growth in the first seven months of fiscal 2003 as compared to the first seven months of fiscal 2002. **DLS recommends that the lottery brief the committees concerning the fiscal 2003 revenue attainment. Specifically, what are the root causes for the large increase in Pick 3 revenues and can these increased revenues be sustained through the end of fiscal 2003, and to what degree of confidence does the agency have that it will be able to meet and possibly exceed the fiscal 2003 revenue estimate established by BRE.**

International Lottery Game Will Not Contribute Revenues in Fiscal 2003

Chapter 449, Acts of 2002 authorized the State Lottery Agency to enter into agreements to operate multi-jurisdictional lottery games. The lottery intends to participate in a new game introduced by the International Lottery Alliance. It was anticipated that the new game would be available beginning in January 2003 and produce net revenues of \$5.5 million in fiscal 2003. However, the introduction of the game has been delayed until January 2004, and as a result, the lottery will not produce any revenues from the multi-jurisdictional game until fiscal 2004. BRE includes \$12.3 million sales from the multi-jurisdictional game in its fiscal 2004 estimates

DLS recommends that the lottery discuss why the introduction of the multi-jurisdictional game was delayed and if the anticipated January 2004 introduction is speculative.

Exhibit 4**Fiscal 2003 Year-to-date Revenues Versus Fiscal 2002**

<u>Game</u>	<u>FY 2002 Revenues</u>	<u>FY 2003 Revenues</u>	<u>Difference</u>	<u>% Change</u>
Pick 3	\$68,950,518	\$80,242,952	\$11,292,434	16.4%
Pick 4	53,353,117	48,488,725	-4,864,392	-9.1%
Lotto	8,966,309	8,208,591	-757,718	-8.5%
Cash-in-Hand	4,668,593	1,299,384	-3,369,209	-72.2%
Instant Games	35,283,754	36,423,418	1,139,664	3.2%
Keno	58,884,962	64,855,667	5,970,705	10.1%
Match 5	0	3,504,728	3,504,728	100.0%
International	0	0	0	0.0%
Mega Millions	12,787,927	15,546,112	2,758,185	21.6%
Let It Ride	486,015	0	-486,015	-100.0%
Total	\$243,381,195	\$258,569,577	\$15,188,382	6.2%

Note: Includes revenues as of January 31, 2002, for fiscal 2002, and revenues as of January 31, 2003, for fiscal 2003.

Source: Maryland State Lottery

Fiscal 2004 Forecast

As shown in **Exhibit 5**, fiscal 2004 general fund revenues are projected to be \$16.5 million greater than fiscal 2003 revenues. The December 2002 BRE report shows general fund revenues of \$448.5 million after allowing for the transfer of \$22.0 million to the Maryland Stadium Authority. The BRE revenue estimates for the lottery are very substantial when you consider that as early as fiscal 2001 the lottery produced just \$385.0 million to the State general fund.

The State Lottery Agency should be prepared to brief the committees on the latest results and forecasts with respect to sales and revenues and the steps being taken to increase both. In addition, the lottery should advise the committees on what steps it intends to take to meet the substantial income estimate established by BRE.

Exhibit 5

Actual and Projected Lottery Revenues
Fiscal 2001 through 2004
(\$ in Millions)

	<u>FY 01 Actual</u>	<u>FY 02 Actual</u>	<u>FY 03 BRE</u>	<u>FY 04 BRE</u>
Sales	\$1,210.6	\$1,306.6	\$1,372.9	\$1,436.6
Net Revenue	407.0	442.5	453.9	470.5
Less Stadium Authority Transfer	22.0	26.2	21.9	22.0
Less Transfer to Horse Racing	0.0	2.2	0.0	0.0
Total Revenue to General Fund	\$385.0	\$414.1	\$432.0	\$448.5
Change from Prior Year		\$29.1	\$17.9	\$16.5

Source: Board of Revenue Estimates; Fiscal 2004 Governor's Budget Book Volume I

3. Bills Which May Affect General Fund Revenues from Lottery Sales

Several bills introduced in the 2003 session propose to affect the distribution of revenues generated by the lottery. A summary of these bills is provided in **Exhibit 6**.

DLS recommends that the lottery comment upon the effect that enactment of these bills would have on general fund revenues.

Exhibit 6

Bills Which May Affect General Fund Revenues from Lottery Sales

<u>Proposed Legislation</u>	<u>Effect</u>
HB 513 / SB 14	Requires the State Lottery Agency to remit unclaimed prizes to the Comptroller's Office. The Comptroller is then required to pay the unclaimed prize money into the Development Disabilities Administration account of the Community Service Trust Fund for providing community-based services.
SB 168	Requires State Lottery revenues in excess of the estimate for a fiscal year to be distributed to local school systems instead of being deposited into the State's general fund. Distribution would be based on the lottery ticket sales in the county in which the local school system is located.
HB 440	Authorizes the County Executive and the County Council of Prince George's County to pass a local ordinance (PG-418-03) imposing a surcharge on State Lottery tickets purchased in Prince George's County.

Source: Department of Legislative Services

Legislative Proposal Would Allow Agents to Commingle Lottery Proceeds

One of the audit findings identified in the December 2002 Department of Legislative Services Office of Legislative Audits (OLA) audit of the State Lottery Agency concerns the requirement that the lottery ensure that lottery agents deposit lottery proceeds in bank accounts designated by the Treasurer that are separate from the agent's business accounts. The auditors found that the lottery generally allowed agents to commingle lottery collections with business funds in violation with State law requiring the establishment of separate accounts for the deposit of lottery proceeds.

The introduction of SB 62 would allow lottery agents to commingle proceeds collected or deposited from the sale of lottery tickets with the business receipts of the licensed agent. Essentially, this legislation seeks to codify the current practice of commingling lottery and nonlottery funds used by some sales agents.

DLS recommends that the Lottery comment on the potential impact SB 62 could have on losses attributed to the nonpayment of lottery sale proceeds.

Video Lottery Terminals and Lottery's Role

The cornerstone of the Governor's budget plan includes the legalization of video lottery terminals for public use. The administration's proposed legislation authorizing video lottery terminals, SB 322 and HB 359, would essentially abolish the State Lottery Agency and the Horse Racing Agency as units of State government and replace these agencies with a new State Lottery and Horse Racing Agency and Commission responsible for the administration and regulation of gaming in the State.

Another legislative proposal for the legalization of video lottery terminals, SB 699 and HB 78, would require the State Lottery Agency and Commission to regulate the operation of video lottery terminals.

DLS recommends that the lottery brief the committees concerning the potential impact that either abolishing or requiring the lottery to regulate and administer video lottery terminals might have on current lottery gaming operations.

Recommended Actions

1. Add the following language:

, provided that this appropriation may not be increased by budget amendment or otherwise except for increases in instant ticket printing, freight costs, and vendor fees, when sales exceed projections upon which the budget is based.

Explanation: This language allows the Lottery to increase its budget by amendment only for items specifically related to sales beyond budgetary projections. Any other requests should be handled through a deficiency appropriation which is subject to legislative approval.

2. Add the following language:

Further provided that no part of this appropriation may be used for the implementation of a new lottery game until the Legislative Policy Committee has had 45 days to review and consider the implementation of the new lottery game.

Explanation: This language requires legislative review prior to the implementation of a new lottery game. This language is not intended to prevent the Lottery from running various types of instant ticket games or change the game matrix of established games.

- | | <u>Amount
Reduction</u> | |
|---|------------------------------------|----|
| 3. Reduce funds for management studies. This reduction would reduce by one-half the funding for Managing for Results agent satisfaction and public approval performance measurement studies. The agency currently conducts these studies on a quarterly basis, and the funding would allow for the continuation of such studies twice annually. | \$ 116,550 | SF |
| 4. Reduce funds for consulting services for the ongoing evaluation of the agency's performance. This reduction provides \$22,749 which is the same amount expended for these activities in fiscal 2002. | 27,251 | SF |
| 5. Reduce funds for vehicle maintenance and repairs and gas and oil. The allowance provides \$203,455 while the actual fiscal 2002 expenditures was \$140,677. The proposed reduction would allow for an 11.04% annual increase over the fiscal 2002 actual expenditure. | 30,000 | SF |

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6.	Delete funds for pay-for-performance bonuses.	6,125	SF
7.	Reduce funds for employee training and staff development. This reduction would still provide \$33,500 to support training initiatives.	33,500	SF
8.	Reduce funds for in-house telecommunication expenditures. This includes funds for data communication lines to support mainframe links with online vendors, funds for remote access dial-up to mainframe, and telecommunication lines for internet website traffic. This reduction would still provide \$60,800 for fiscal 2004. The fiscal 2001 and 2002 actual expenditures were \$51,995 and \$44,128 respectively.	50,000	SF
9.	Reduce funds for marketing lottery products to corporate and municipal entities. This reduction would provide \$100,000 to this marketing initiative. The fiscal 2002 actual expenditure was \$96,045.	150,000	SF
Total Special Fund Reductions		\$ 413,426	

Updates

1. Marketing and Advertising Budget Remains Flat

Exhibit 7 shows the individual components of the lottery's marketing and advertising budget for fiscal 2003 and 2004. The total marketing and advertising budget proposed for fiscal 2004 is \$14,990,241 which is the same amount provided for fiscal 2003. The only noteworthy change concerns the \$648,000 listed advertising agency fees in fiscal 2004. This is actually not a new expenditure item but a change in the manner in which the lottery's new marketing contracts compensates the advertising agency. The old contract compensated the advertising agency by a percentage of media placements, and these costs were reflected directly in the television and radio advertising expenditures. The new contract compensates the advertising agency by a fixed monthly fee which is determined by the total value of the agency's advertising budget for the fiscal year. As a result, the figures presented below reflect a reduced expenditure for radio and television marketing that are now captured under a separate advertising agency fee line item.

Exhibit 7

Lottery Marketing and Advertising Budget Fiscal 2003 Appropriation and Fiscal 2004 Allowance

<u>Description</u>	<u>FY 03 Approp.</u>	<u>FY 04 Allow.</u>	<u>Change</u>
Public Affairs General	\$25,000	\$25,000	\$0
Public Affairs Drawing Events	85,000	85,000	0
Public Affairs Promotional Material	161,811	161,621	-190
Public Affairs Sponsorships	183,810	184,000	190
Public Affairs Promotional Events	55,000	55,000	0
Outdoor Advertising	200,000	200,000	0
Direct Mail Advertising	200,000	200,000	0
Radio Advertising	4,057,000	3,733,000	-324,000
Television Advertising	4,469,000	4,145,000	-324,000
Print Media Advertising	1,280,000	1,280,000	0
Point of Sale Advertising	1,000,000	1,000,000	0
Advertising Production	1,580,000	1,580,000	0
Public Relations Advertising	144,000	144,000	0
Internet – Web site Advertising	100,000	100,000	0
Relationship Marketing	250,000	250,000	0
Advertising Agency Fees	0	648,000	648,000
Drawing Commitment*	1,200,000	1,200,000	0
Total	\$14,990,621	\$14,990,241	\$0

*The lottery includes drawing commitments in its advertising budget, but the Governor's budget includes this item in contractual services. The drawing commitment is a bartering arrangement in which the lottery agrees to purchase commercial air time in exchange for televising of daily lottery drawings.

Source: State Lottery Agency

Current and Prior Year Budgets

Current and Prior Year Budgets State Lottery Agency (\$ in Thousands)

	<u>General Fund</u>	<u>Special Fund</u>	<u>Federal Fund</u>	<u>Reimb. Fund</u>	<u>Total</u>
Fiscal 2002					
Legislative Appropriation	\$0	\$48,698	\$0	\$0	\$48,698
Deficiency Appropriation	0	0	0	0	0
Budget Amendments	0	2,949	0	0	2,949
Reversions and Cancellations	0	-1,090	0	0	-1,090
Actual Expenditures	\$0	\$50,557	\$0	\$0	\$50,557
Fiscal 2003					
Legislative Appropriation	\$0	\$51,984	\$0	\$0	\$51,984
Budget Amendments	0	0	0	0	0
Working Appropriation	\$0	\$51,984	\$0	\$0	\$51,984

Note: Numbers may not sum to total due to rounding.

E75D - State Lottery Agency

Fiscal 2002

The lottery finished fiscal 2002 \$1,858,823 above its fiscal 2002 legislative appropriation. An additional \$2,948,639 was provided by budget amendment as shown below, and cost containment actions for fiscal 2002 resulted in reductions of \$1,081,000.

- \$2,423,639 funded the fiscal 2002 online vendor and instant ticket printing fees which are calculated as a percentage of sales. The lottery reverted \$8,816 of these funds at the close of fiscal 2002;
- \$400,000 was provided for advertising to support the reintroduction of the Big Game; and
- \$125,000 funded additional market research for a variety of marketing and promotional activities.

E75D - State Lottery Agency

Appendix 2

Object/Fund Difference Report
State Lottery Agency

<u>Object/Fund</u>	<u>FY 02 Actual</u>	<u>FY 03 Working Appropriation</u>	<u>FY 04 Allowance</u>	<u>FY 03 - FY 04 Amount Change</u>	<u>Percent Change</u>
Positions					
01 Regular	175.00	175.00	173.00	-2.00	-1.1%
02 Contractual	5.50	5.50	5.50	0	0%
Total Positions	180.50	180.50	178.50	-2.00	-1.1%
Objects					
01 Salaries and Wages	\$ 9,536,622	\$ 9,281,786	\$ 9,980,241	\$ 698,455	7.5%
02 Technical & Spec Fees	325,561	257,481	228,585	-28,896	-11.2%
03 Communication	1,075,665	980,772	944,691	-36,081	-3.7%
04 Travel	80,395	89,158	80,158	-9,000	-10.1%
06 Fuel & Utilities	0	70,826	70,826	0	0%
07 Motor Vehicles	240,153	225,120	271,300	46,180	20.5%
08 Contractual Services	37,051,491	36,940,805	37,778,034	837,229	2.3%
09 Supplies & Materials	184,375	229,301	168,675	-60,626	-26.4%
10 Equip - Replacement	331,474	207,066	227,418	20,352	9.8%
11 Equip - Additional	1,354,863	2,426,029	2,532,960	106,931	4.4%
13 Fixed Charges	376,287	875,251	982,935	107,684	12.3%
14 Land & Structures	0	400,000	0	-400,000	-100.0%
Total Objects	\$ 50,556,886	\$ 51,983,595	\$ 53,265,823	\$ 1,282,228	2.5%
Funds					
03 Special Fund	\$ 50,556,886	\$ 51,983,595	\$ 53,265,823	\$ 1,282,228	2.5%
Total Funds	\$ 50,556,886	\$ 51,983,595	\$ 53,265,823	\$ 1,282,228	2.5%

Note: Fiscal 2003 appropriations and fiscal 2004 allowance do not include cost containment and contingent reductions.