

**E75D**  
**State Lottery Agency**

***Operating Budget Data***

(\$ in Thousands)

	<u>FY 06</u> <u>Actual</u>	<u>FY 07</u> <u>Working</u>	<u>FY 08</u> <u>Allowance</u>	<u>FY 07-08</u> <u>Change</u>	<u>% Change</u> <u>Prior Year</u>
Special Fund	\$54,631	\$58,449	\$57,956	-\$493	-0.8%
<b>Total Funds</b>	<b>\$54,631</b>	<b>\$58,449</b>	<b>\$57,956</b>	<b>-\$493</b>	<b>-0.8%</b>

- The fiscal 2008 allowance for Lottery operations is about half a million less than the 2007 working appropriation. Absent the one-time reduction due to use of health insurance surplus funds, the budget grows by \$108,259, or 0.2%.
- Personnel expenses are set to increase \$232,924, primarily from salary increments. Among nonpersonnel changes, costs for contractual services are set to decline by \$1 million. Decreases in contractual services include lower Instant ticket printing costs and telecommunication costs; these are partially offset by increases in the on-line system contract and advertising.

***Personnel Data***

	<u>FY 06</u> <u>Actual</u>	<u>FY 07</u> <u>Working</u>	<u>FY 08</u> <u>Allowance</u>	<u>FY 07-08</u> <u>Change</u>
Regular Positions	176.50	171.00	172.00	1.00
Contractual FTEs	<u>11.70</u>	<u>8.50</u>	<u>9.50</u>	<u>1.00</u>
<b>Total Personnel</b>	<b>188.20</b>	<b>179.50</b>	<b>181.50</b>	<b>2.00</b>

***Vacancy Data: Regular Positions***

Turnover, Excluding New Positions	6.45	3.75%
Positions Vacant as of 12/31/06	8.00	4.68%

- The allowance includes one new regular position for an assistant attorney general and one new contractual position for a fiscal accounts clerk.

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

For further information contact: Monica L. Kearns

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## *Analysis in Brief*

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### Major Trends

***Sales Increased in 2006 but 2007 Is Running Behind:*** The Lottery recorded sales of \$1.56 billion in fiscal 2006, a 5.1% increase over 2005. In spite of projections for continued sales growth, fiscal 2007 sales as of December 31, 2006, are \$756 million, compared to \$765 million at the same point the previous year.

***General Funds Increased in 2006 but Are Expected to Drop in 2007:*** General fund revenues grew to \$480.5 million in fiscal 2006, but they are expected to decline to \$477.4 million in fiscal 2007, according to the Board of Revenue Estimates.

***Prizes and Agent Earnings Are Increasing Their Share of Expenditures:*** Since fiscal 2003, prizes have increased as a share of sales by two percentage points, reaching 57.8% in 2006. By law Lottery agent commission rates will increase from 5.0 to 5.5% of sales in fiscal 2007, as authorized by 2005 legislation. Both factors reduce revenues to the general fund.

### Issues

***Ten-year Sales Trends: Same Four Games Are Top Sellers:*** Pick 3 was the highest selling game in fiscal 1997 at 33% of sales, followed by Keno, Pick 4, and Instant tickets. In fiscal 2006, Instant tickets were the best sellers, bringing in 28% of sales, followed by Pick 3, Keno, and Pick 4. **The Department of Legislative Services (DLS) recommends that the Lottery comment on whether it has plans to further boost sales for Pick 3 or if it expects the growth in new games to compensate for the Pick 3 long-term sales decline.**

***New Game Development Concentrates on Monitor Games:*** Fiscal 2007 will be the first full fiscal year for a new monitor game called Race Trax. As new monitor games are introduced, there is a likely substitution effect on existing monitor games. On a different note, the Lottery was authorized to participate in international games in the 2002 legislative session, but currently it has no plans to do so. **DLS recommends that the Lottery comment on how they will measure whether there is a net increase in monitor game sales relative to the development and operation of new monitor games. DLS also recommends that the Lottery comment on any plans to participate in international games.**

***New On-line System Contract Brings New Machines and Efficiencies:*** As part of its new contract, the Lottery's on-line system vendor provided new terminal machines and data connections for Lottery agents. The new system allows tickets to be produced more quickly and enables several monitor games to run at once, among other improvements. **DLS recommends that the committees adopt narrative requesting that the Lottery provide information on the cost of using satellite connections compared to land line connections and justification for the satellite connections if they cost more.**

## Recommended Actions

	<u>Funds</u>
1. Add language requiring General Assembly approval for games similar to slot machines or video lottery terminals.	
2. Add language that authorizes the Lottery to increase its budget by amendment only as it relates to sales beyond projections.	
3. Add language that requires legislative review of new lottery games.	
4. Delete funds for position reclassifications.	\$ 57,000
5. Adopt narrative that requests information on telecommunication costs.	
<b>Total Reductions</b>	<b>\$ 57,000</b>

## Updates

***Lottery's Contracts for the On-line System and Instant Ticket Printing Include Performance Provisions:*** During the 2006 legislative interim, DLS studied agency contracts totaling more than \$1 million to see if they have performance-based provisions. Of the Lottery's five relevant contracts, those related to the on-line system and Instant ticket printing have provisions related to performance.

***Minority Business Enterprise Practices:*** The Lottery has met or nearly met its goals for minority business enterprise participation since fiscal 2003. Furthermore, the Lottery follows necessary procedures for competitive bids related to minority business enterprise participation.

*E75D – State Lottery Agency*

**E75D**  
**State Lottery Agency**

***Operating Budget Analysis***

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**Program Description**

Since 1973, the Maryland State Lottery Agency has administered and operated lottery games to generate revenue for the State. The Lottery currently offers nine games: Pick 3, Pick 4, Keno, Keno Bonus, Mega Millions, Bonus Match Five, Instant Games, Multi-Match (which replaced Lotto in February 2006), and a new game called Race Trax.

All games, except Instant Games, are on-line, meaning players pick their numbers or use computer generated numbers, receive a ticket, and then wait for a drawing to see if they have won. With Instant Games, players scratch off a latex covering on a ticket play area to reveal pre-printed combinations. Games are sold through lottery agents, which are private businesses that receive commissions and fees in exchange for selling the games to the public.

Proceeds from the games pay for prizes, agent earnings, and all operating expenses of the agency. In fiscal 2006, 57.8% of sales paid for prizes, 6.6% paid for agent commissions and redemption fees, 3.5% paid for agency operations, and the remaining 30.8% was credited as revenue to the State.

The State Lottery Commission, consisting of five members appointed by the Governor, has oversight responsibility for the agency. The agency's six divisions include Administration, Finance, and Operations; Information Technology; Marketing; Sales; Public Affairs; and Executive. The Lottery also has a security unit.

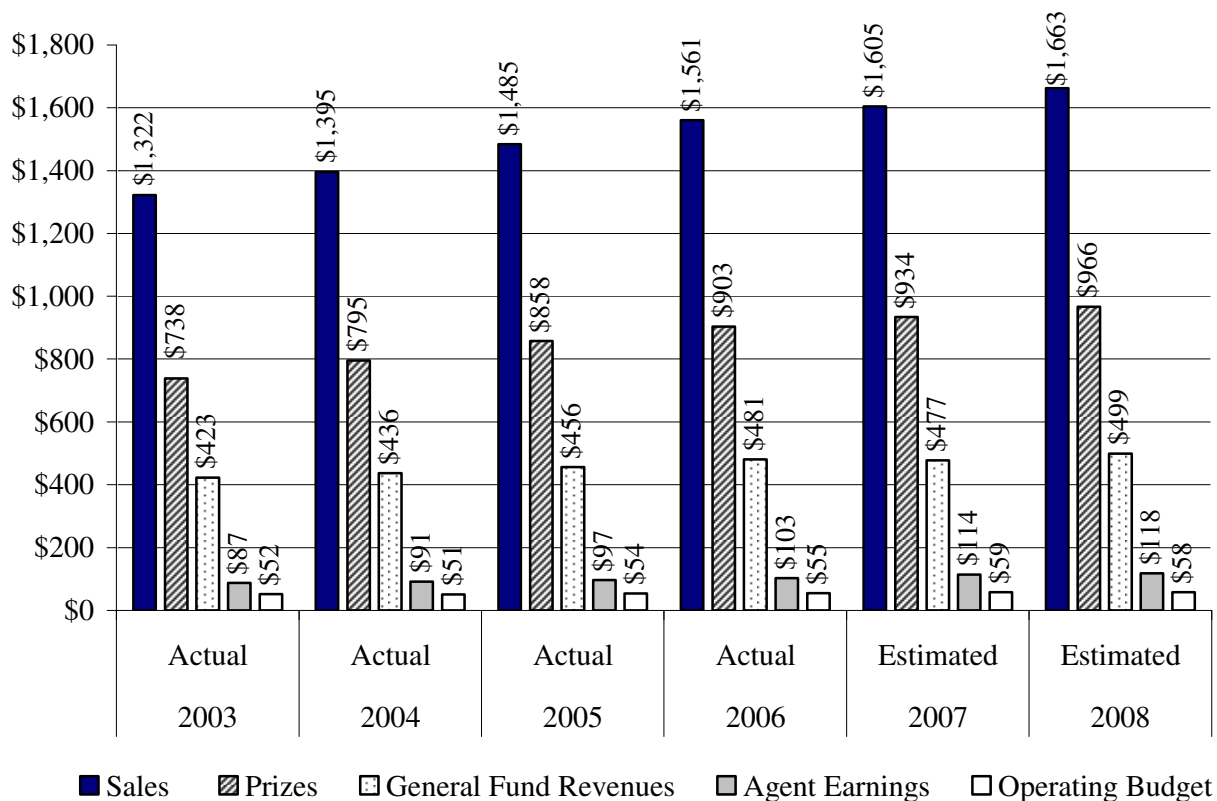
**Performance Analysis: Managing for Results**

**Sales Increased in 2006 but 2007 Is Running Behind**

The Lottery recorded sales of \$1.56 billion in fiscal 2006, exceeding the Board of Revenue Estimates projection of \$1.55 billion. As shown in **Exhibit 1**, this growth represents a \$75.9 million (5.1%) increase over fiscal 2005. All games grew in fiscal 2006. Instant tickets had the largest dollar increase at \$24.3 million, followed by Mega Millions (the multi-state lottery game), Keno Bonus, and Pick 4. See Issue 1 for a discussion of long-term sales trends by game.

The Lottery has increased its overall sales every year since at least fiscal 2001, averaging 5.2% growth each year. The growth is expected to continue, albeit at a lower rate, with sales projected to reach \$1.6 billion in fiscal 2007 and to nearly \$1.7 billion in 2008. In fact, Maryland ranks fifth among states with lotteries in sales per capita. **Appendix 3** shows sales by county.

**Exhibit 1**  
**Lottery Sales and Expenditures**  
**Fiscal 2003-2008**  
**(\$ in Millions)**



Note: Numbers may not sum to sales total due to rounding. General fund revenues represented here do not include funds transferred to the Maryland Stadium Authority.

Source: Governor’s Budget Books, Fiscal 2005-2008

In spite of projections, sales so far in fiscal 2007 are behind where they were at the same point in fiscal 2006. As of December 31, 2006, fiscal 2007 sales are \$756.0 million, compared to \$765.0 million the previous year. Mega Millions and Multi-Match are farthest off the mark. Mega Millions sales are \$24.9 million below the fiscal 2006 level; this game is the multi-state lottery and sales have suffered because the jackpots have been relatively low. Multi-Match was introduced to replace Lotto to boost sales, but so far in fiscal 2007, Multi-Match has earned \$15.4 million, whereas Lotto had earned \$17.1 million at the same point the previous year. Even Keno, which is generally a growth game for the Lottery, is \$6.3 million below the same point in fiscal 2006.

From mid-November 2006 to mid-December 2006, the Lottery did not have an advertising firm in place and no advertisements were running. The previous advertising vendor, Eisner Communications, went out of business suddenly, and it took several weeks to select a new vendor. Interestingly, it is not clear whether or how the lack of advertising affected sales. The Lottery reports that it could not effectively market its holiday scratch off games or the new Countdown to Millions game. However, advertising was in place in late December, and in fact, December achieved record sales even though sales year-to-date have been slow. **The Lottery should brief the committees on its explanation for the recent slowing of sales.**

### **General Funds Increased in 2006 but Are Expected to Drop in 2007**

Tracking with sales, general fund revenues from Lottery games grew to \$480.5 million in fiscal 2006, a \$25.0 million (5.4%) increase over 2005.

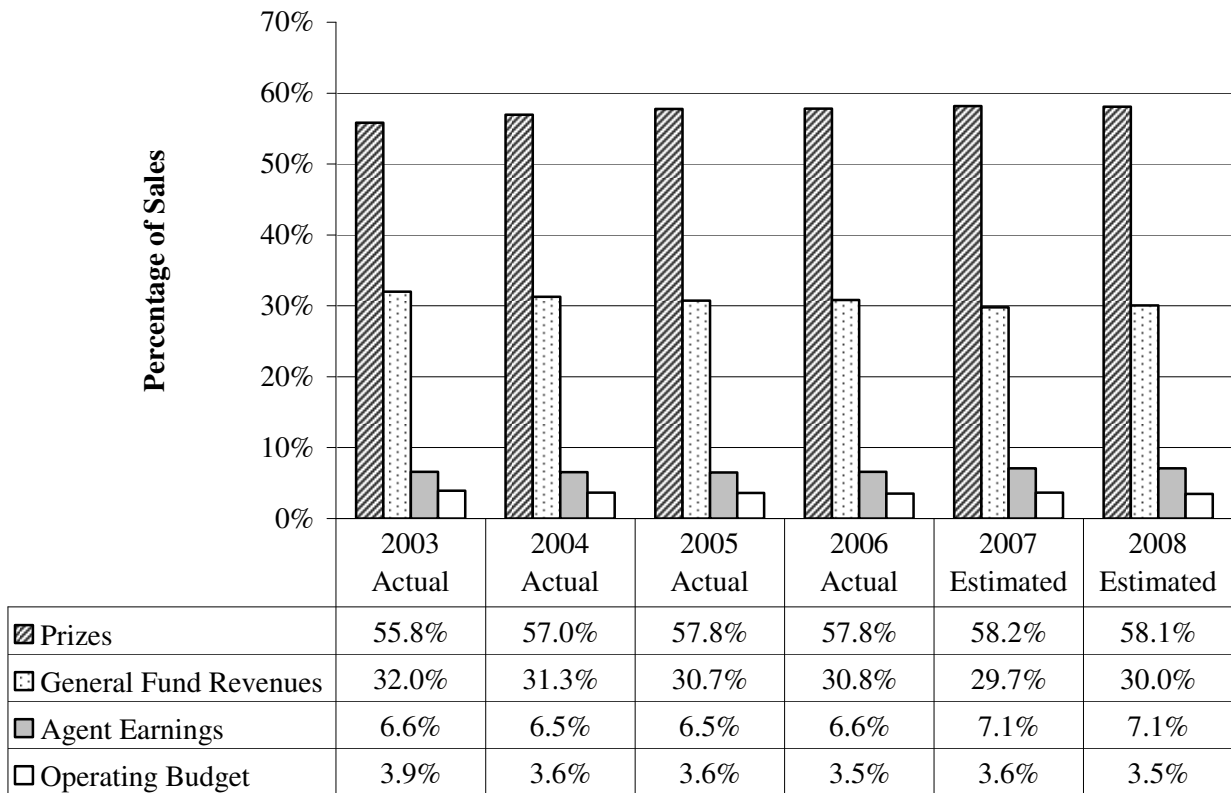
Importantly, general fund revenues are expected to decline to \$477.4 million in fiscal 2007, according to the Board of Revenue Estimates. As prizes and agent earnings are increasing their share of expenditures, general funds are strained. The prize payout ratio through November 2006 had reached a near historic high of 59.6% of sales. The outlook for fiscal 2008 is better because the projections are based on longer term statistical trends (with lower prize payout ratios) – general fund revenues are projected to be \$499.2 million. However, this revenue number may not be attained if the fiscal 2007 trend continues.

### **Prizes and Agent Earnings Are Increasing Their Share of Expenditures**

As shown in **Exhibit 2**, prizes make up the largest proportion of Lottery expenditures, followed by general fund revenues, agent earnings, and the agency operating budget.

- ***Prizes Hold Steady as Share of Sales, but Increase Expected:*** Prize payouts were 57.8% of sales in fiscal 2006, which is the same level as 2005. Looking back to 2003, prizes have increased as a share of sales by two percentage points, and the Lottery expects an increase again in fiscal 2007. Prize payouts have grown because Keno and Instant tickets have increased their share of sales, and these games have higher payout ratios.
- ***State Share of Sales Inched Upward:*** The State's general fund share of sales was 30.8% in fiscal 2006, as compared to 30.7% in 2005. This is a better result than the Lottery expected because higher prize payouts and increased agent earnings are putting pressure on the State's share of revenues. Indeed, the Lottery expects the State's share to decline in fiscal 2007.
- ***Agent Earnings Bump Up:*** Lottery agents are compensated with a commission for selling and cashing Lottery tickets. The Lottery also has an agent bonus and incentive program that is capped at one-half of 1.0% of gross sales. The Budget Reconciliation and Financing Act of 2005 authorized retailer commission rates to increase from 5.0 to 5.5% of sales beginning in fiscal 2007. As a result, agent earnings are expected to increase their share of sales from 6.6% in fiscal 2006, which has been the historic level, to 7.1% in 2007.

**Exhibit 2  
Lottery Expenditures as a Proportion of Sales  
Fiscal 2003-2008**



Note: General fund revenues represented here do not include funds transferred to the Maryland Stadium Authority.

Source: Governor’s Budget Books, Fiscal 2005-2008

- Operating Budget Expenses Are Stable and Meet Objective:** The Lottery has an objective to keep its operations efficient, with administrative costs totaling no more than 4.0% of sales. The agency has been meeting this objective and is expected to continue to meet it in fiscal 2007 and 2008. Administrative costs averaged 3.7% of sales annually from fiscal 2003 to 2006.

**Governor’s Proposed Budget**

The fiscal 2008 allowance for Lottery operations is \$57.95 million, which is about half a million less than the 2007 appropriation. **Exhibit 3** shows the major change amounts.

**Exhibit 3**  
**Governor’s Proposed Budget**  
**State Lottery Agency**  
**(\$ in Thousands)**

<b>How Much It Grows:</b>	<b>Special Fund</b>	<b>Total</b>
2007 Working Appropriation	\$58,449	\$58,449
2008 Governor’s Allowance	<u>57,956</u>	<u>57,956</u>
Amount Change	-\$493	-\$493
Percent Change	-0.8%	-0.8%

**Where It Goes:**

**Personnel Expenses**

Salary increments .....	\$260
Employee retirement system.....	216
New positions .....	78
Reclassification.....	57
Overtime earnings.....	52
Health insurance costs decline due to one-time savings.....	-467

**Other Changes**

Advertising expenditures.....	1,281
On-line gaming system contract payment increases due to higher sales.....	716
Equipment repairs and maintenance.....	164
In-house telephone system upgrade and other communication increases .....	104
Motor vehicles .....	79
Fuel and utilities .....	61
Other expenditure increases.....	25
Instant ticket printing costs.....	-2,048
Land-based telecommunications lines no longer needed .....	-1,071

**Total** **-\$493**

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

## **Personnel Expenses**

Regular personnel expenses increase \$232,924 in fiscal 2008 as compared to 2007. Salary increments are set to increase by 3.0%, which is somewhat above the statewide average of 2.3%. Health insurance costs are set to decline at the Lottery, as with all State agencies, because of one-time savings. These one-time savings represent use of fund balance because the State has overbudgeted health insurance costs in recent years; at the Lottery, costs decline by a net \$466,980. Among other personnel items, contributions to the employee retirement system increase by \$215,855 in the fiscal 2008 allowance.

The proposed new regular position is for an assistant attorney general VI. The allowance would fund conversion of an existing assistant attorney general from a contractual to a regular employee. As the Lottery has developed more games and promotions, the need for legal services has grown. The proposed new contractual position is for a fiscal accounts clerk I. This position would provide clerical support in the customer resource center, particularly the claim center, the subscription processing division, and the sales network unit. Although funds are budgeted for position reclassifications, those amounts are not needed because no positions have been identified to be reclassified. **The Department of Legislative Services (DLS) recommends that the reclassification funds be deleted.**

## **Nonpersonnel Expenses**

Of the nonpersonnel changes in the operating budget, the most significant is related to contractual services. Overall, costs for these services are set to decrease by \$1 million.

Among the decreases, Instant ticket printing costs are expected to drop by \$2.0 million. Costs for ticket printing are tied to sales, so as sales volume increases, they increase; however, the Lottery expects lower costs related to specialty ticket printing. Telecommunications costs are expected to decline by \$1.1 million. The new on-line gaming system is satellite-based, and so it eliminates the need for a separate land-based communications contract with Verizon. The land-based communications contract was kept in place during the first three months of fiscal 2007 so the Lottery could ensure that the new on-line system was functioning effectively.

Among the increases, the on-line system contract rises from \$15.5 million in fiscal 2007 to \$16.2 million in 2008. Like ticket printing, the costs of the on-line system are tied to sales volume. The system connects all agents with the Lottery agency so that sales and other data can be shared. A new system was installed in July 2006 that provides new touch screen terminals and communications based on satellite connections.

Also, advertising expenditures are set to grow from \$17.95 million in fiscal 2007 to \$19.23 million in 2008. The main reason for the growth is an increase in the contract to televise live Lottery drawings. The Lottery chose WBAL-TV's proposal to provide these services, even though the cost is about \$854,000 more than the incumbent WJZ-TV bid of \$1.30 million, because WBAL-TV has superior viewership, and the station also will provide Lottery promotional spots on its affiliated radio station.

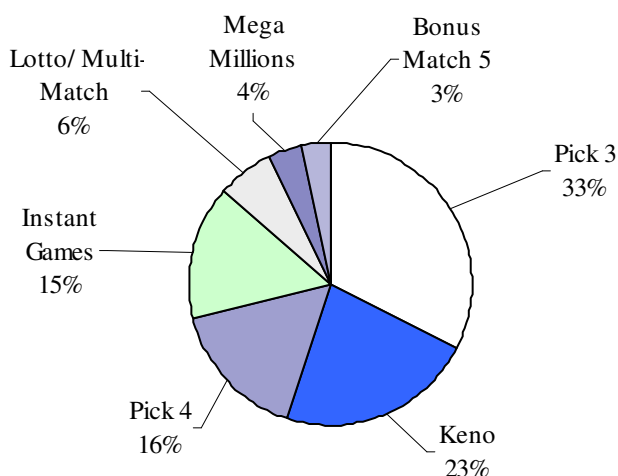
## Issues

### 1. Ten-year Sales Trends: Same Four Games Are Top Sellers

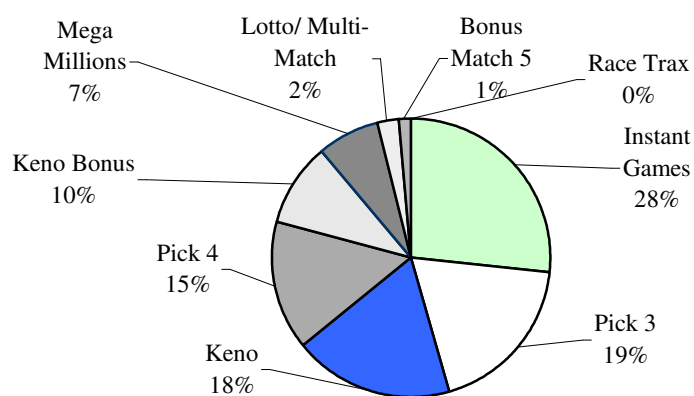
The makeup of Lottery sales by game has changed since fiscal 1997, as shown in **Exhibit 4**. However, the top four selling games 10 years ago still are the top sellers, although their rank order has changed.

**Exhibit 4**

**Lottery Fiscal 1997 Sales by Game**  
Total Sales = \$1,043.6 Million



**Lottery Fiscal 2006 Sales by Game**  
Total Sales = \$1,561.8 Million



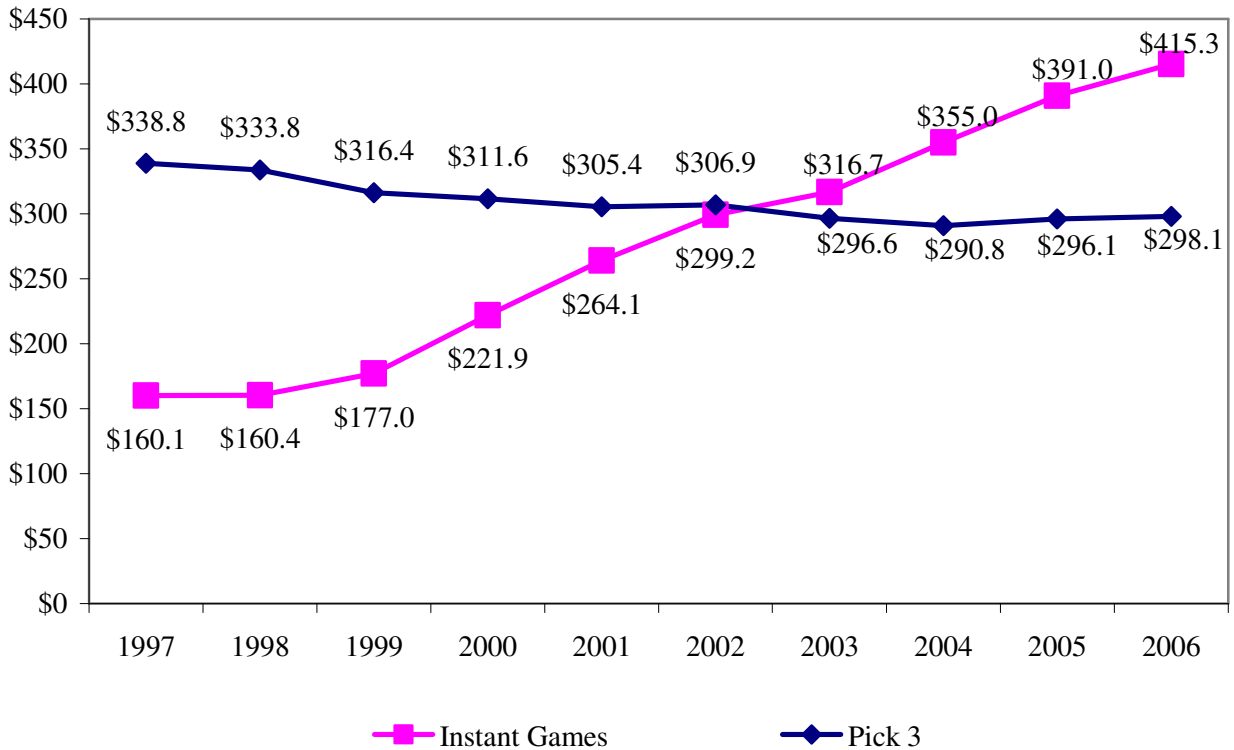
Source: State Lottery Agency

### Pick 3 Replaced by Instant Games as Highest Seller

Pick 3 was the highest selling game in fiscal 1997 at 33% of sales, followed by Keno, Pick 4, and Instant ticket games. In fiscal 2006, Instant ticket games were the best sellers, bringing in 28% of sales, followed by Pick 3, Keno, and Pick 4. If Keno and Keno Bonus are considered together, they brought in 28% of sales in fiscal 2006, equal to the top selling game.

Three games sold less in fiscal 2006 than they did 10 years earlier. Pick 3 declined the most, selling \$338.8 million in fiscal 1997 but \$298.1 million in 2006, as shown in **Exhibit 5**. Pick 3 saw an uptick recently because of special promotions the Lottery conducted to boost interest in the game; the promotions gave players different ways to win. Sales of Lotto and Bonus Match 5 also declined. Instant ticket games gained the most, selling \$160.1 million in fiscal 1997 and \$415.3 million in 2006, as shown in Exhibit 5. **DLS recommends that the Lottery comment on whether it has plans to further boost sales for Pick 3 or if it expects the growth in new games to compensate for the Pick 3 long-term sales decline.**

**Exhibit 5**  
**Pick 3 and Instant Game Sales**  
**Fiscal 1997-2006**  
**(\$ in Millions)**



Source: State Lottery Agency

## **2. New Game Development Concentrates on Monitor Games**

The Lottery believes that monitor games like Keno are the most promising games in development. Indeed, Keno and Keno Bonus together represented about 28% of sales in fiscal 2006, which matches the sales brought in by the top-selling Instant Games. The Lottery is studying various types of card games and racing games that would be displayed on monitors, and it will be conducting player research over the next several months.

It should be noted that as new monitor games are introduced, there is a likely substitution effect. In other words, monitor game sales as a whole may rise, but new monitor games may take away sales from existing monitor games. **DLS recommends that the Lottery comment on how they will measure whether there is a net increase in monitor game sales relative to the development and operation of new monitor games.**

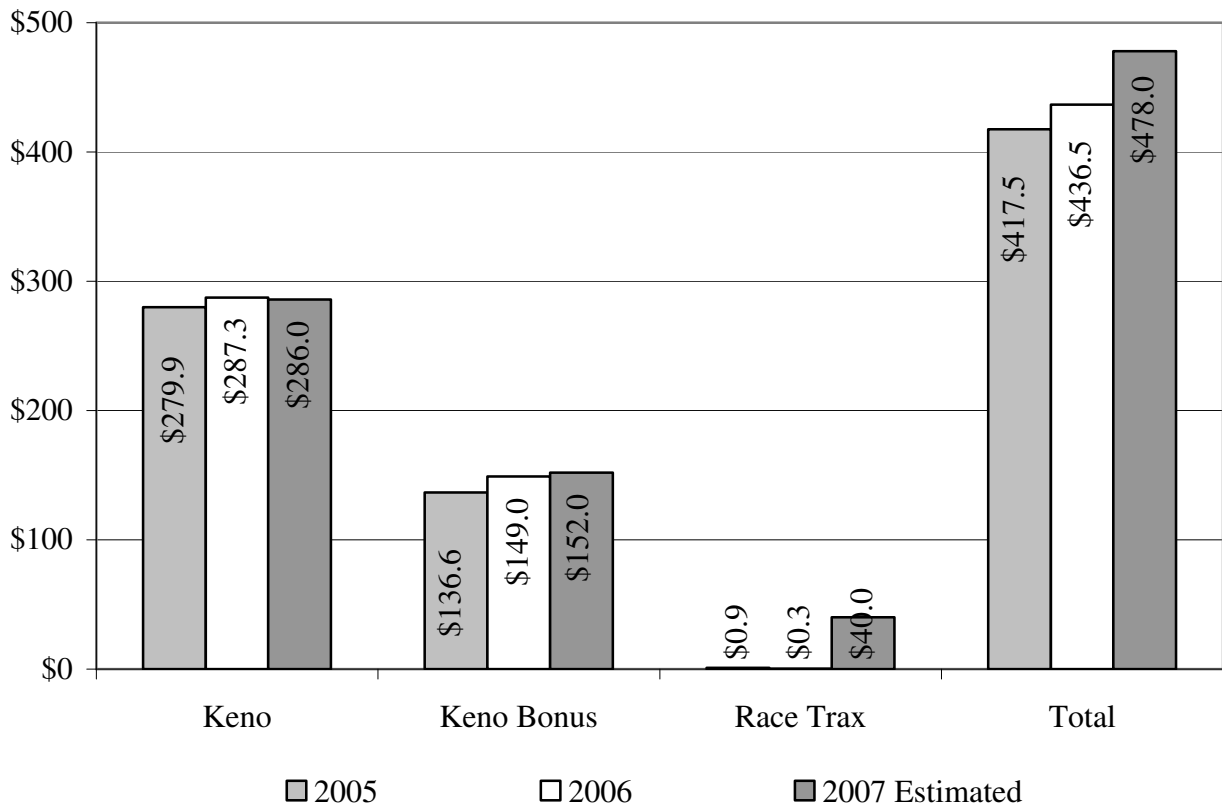
### **Race Trax Expected to Boost Monitor Game Sales**

Fiscal 2007 is the first full fiscal year for the Lottery's new Race Trax monitor game. Currently, 750 agents are offering Race Trax, and it should be offered by 1,000 agents across all counties by the end of January 2007. This game displays a horse race on a monitor and runs every three to four minutes, like Keno games. The Lottery projects sales of \$40.0 million for Race Trax in fiscal 2007. Through December 31, 2006, which is halfway through the fiscal year, the game earned \$13.4 million. The Lottery reduced Keno sales projections by \$4.0 million to account for a likely substitution effect from Race Trax. **Exhibit 6** shows how total monitor sales are expected to grow by \$41.5 million (9.5%) in fiscal 2007, but Keno may slightly drop and Keno Bonus may grow only a small amount.

### **No Current Plans for International Games**

The Lottery is authorized to participate in multi-jurisdictional games. In the 2002 legislative session, the agency advocated for legislation that authorizes it to participate in international games as part of its multi-jurisdiction authorization, and this legislation passed (Chapter 449 of 2002). The agency intended to participate in an international game beginning in fiscal 2003, but the plans were dropped. Currently, there are no plans for participating in international games. The Lottery reports, however, that it is discussing potential further collaboration with states that are part of the Mega Millions and Powerball games. **DLS recommends that the Lottery comment on any plans to participate in international games.**

**Exhibit 6  
Monitor Game Sales  
Fiscal 2005-2007  
(\$ in Millions)**



Source: State Lottery Agency

### 3. New On-line System Contract Brings New Machines and Efficiencies

In October 2005, the Lottery entered into a new five-year, eight-month contract with its gaming system vendor, Scientific Games, Inc. As part of the new contract, the vendor is providing updated terminal machines for Lottery agents that are based on satellite connections rather than land telecommunication lines. Installation of the new system began in May 2006, and the entire system was converted in July 2006. The Lottery budgeted \$16.2 million for the on-line contract in 2008.

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The Lottery reports that the conversion to the new terminal system had only a minimal negative effect on sales as agents and customers became accustomed to it. Efficiencies and improvements gained by the new system include:

- faster read time on terminals, which enables more tickets to be produced more quickly;
- touch screen terminals that make it easier for agents to operate and train new agents;
- the ability to run several monitor games at one time;
- the ability to implement more promotions and to target promotions by geographic area and retailer; and
- a new order and inventory system for Instant tickets. The vendor supplies personnel who call all agents on a weekly basis and take orders for Instant tickets. The amount of tickets ordered by each agent is packaged in the Lottery warehouse and shipped. Previously, agents received orders once a week based on a pre-established quota. Furthermore, when the Lottery introduces a new game, tickets may be sent to all retailers on the same designated shipping date. Previously, it took at least two weeks for shipments of new games to reach all retailers. This new method should also be able to improve estimates of Instant ticket printing needs.

**DLS recommends that the committees adopt narrative requesting that the Lottery provide information on the cost of using satellite connections compared to land line connections and justification for the satellite connections if they cost more.**

## ***Recommended Actions***

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1. Add the following language to the special fund appropriation:

, provided that no funds may be expended or committed to develop or implement any new lottery game using class II or class III gaming machines, or any other gaming device which plays or functions in a manner similar to a slot machine or a video lottery terminal, unless that new game or machine is specially authorized by an act of the General Assembly.

**Explanation:** This language requires the General Assembly to authorize the development or implementation of any new lottery game using class II or class III gaming machines or any device which simulates a slot machine or video lottery terminal.

2. Add the following language to the special fund appropriation:

Further 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 the projections upon which the budget is based.

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

3. Add the following language to the special fund appropriation:

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 comment on the implementation of the new game.

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

<b>Information Request</b>	<b>Author</b>	<b>Due Date</b>
Description and justification for any new game(s)	State Lottery Agency	45 days prior to implementation

*E75D – State Lottery Agency*

- |  | <b><u>Amount<br/>Reduction</u></b> |
|--|------------------------------------|
| 4. Delete funds for position reclassifications. No positions have been identified at this time as needing to be reclassified so the funds are not necessary. | \$ 57,000 SF                       |
| 5. Adopt the following narrative:  |                                    |

**Telecommunication Costs Related to the On-line Gaming System:** As part of its contract with its on-line gaming system vendor, the Lottery connects to agents via satellite connections rather than land-based telecommunication lines. Previously, the Lottery connected to agents with land-based lines, and the State has invested significant amounts in developing high-speed land line connections. The committees request that the Lottery provide information on the cost of using satellite connections compared to land line connections. If it costs more to use satellites, the Lottery should justify their use.

<b>Information Request</b>	<b>Author</b>	<b>Due Date</b>
Telecommunication costs for the on-line gaming system	State Lottery Agency	October 1, 2007
<b>Total Special Fund Reductions</b>		<b>\$ 57,000</b>

## ***Updates***

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### **1. Lottery’s Contracts for the On-line System and Instant Ticket Printing Include Performance Provisions**

During the 2006 legislative interim, DLS studied agency contracts totaling more than \$1 million to see if they have performance-based provisions. The Lottery has five contracts that total more than \$1 million per year for services related to the on-line gaming system, Instant ticket printing, advertising, televising of lottery drawings, and on-line telecommunications (which is being phased out).

The on-line system and Instant ticket printing contracts have provisions related to performance. The on-line system connects all Lottery agents to the agency’s headquarters so that sales and other data can be shared, and the contract is the Lottery’s second largest contract, at about \$11.0 million per year. (The advertising contract is the largest at about \$15.0 million per year.) The on-line contract is structured so that the vendor – Scientific Games, Inc. – is paid a percentage of sales. In this way, the vendor has an incentive to provide high quality services that enhance sales. The Instant ticket printing contract, which totals \$4.3 million for fiscal 2008, is similarly structured.

The on-line system contract has other performance-based provisions. The vendor receives a financial benefit if the net income of a certain game grows by a higher percentage than it did in the preceding fiscal year. The game is chosen each year by the Lottery. If the game’s net income grows by more than the baseline percentage, the vendor receives 10% of the increase. The on-line contract also has a provision that if the system has more than two minutes of degraded performance on any business day, the Lottery can seek damages. Degraded performance can mean, for example, that Lottery agents cannot sell tickets, cash tickets, process claims, cancel tickets, or produce accounting reports.

### **2. Minority Business Enterprise Practices**

The fiscal 2007 budget bill included a restricted appropriation of \$100,000 for advertising expenditures within the Lottery. Before the funds were released, the Lottery had to describe plans to ensure that its advertising contract complies with the State’s Minority Business Enterprise (MBE) goals and that advertising subcontracts are competitively bid. The Lottery submitted this information, and the funds were released in November 2006.

Importantly, the Lottery’s advertising firm – Eisner Communications – closed for business on November 10, 2006, and the agency is seeking a new firm. However, the Lottery has indicated that it will ensure its future advertising contracts meet the requirements of the budget bill language as did the Eisner contract.

## **Minority Business Enterprise Goals Generally Met**

The Lottery reported that its advertising contract with Eisner Communications contained a 20% MBE participation goal, with subtotals of 8% for African American-owned businesses and 10% for women-owned businesses. The Lottery has met or nearly met these goals since fiscal 2003. Eisner subcontracted with MBE firms to help meet the goals, and most of the subcontracts were for work on commercial production and newspaper print media. The Lottery monitors MBE participation through monthly reports, and the Lottery has an MBE Liaison Officer to review the reports and facilitate MBE participation.

## **Competitive Bidding of Subcontracts Problem Resolved**

In a December 2002 report, the Office of Legislative Audits found that the Lottery's advertising contractor awarded a subcontract that was not competitively bid as required. The subcontract was awarded to an MBE firm to help meet the Lottery's MBE procurement goals. In a follow-up audit from November 2003, the auditors found that the Lottery had addressed this problem. Furthermore, the Lottery audit released in October 2005 did not find that this problem had recurred. The Lottery reports that Eisner, with oversight from the Lottery, conducted a competitive bidding process for projects as they arose by issuing specifications to various vendors, including MBEs, and requesting a price quote from interested firms.

## ***Current and Prior Year Budgets***

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

	<b><u>General Fund</u></b>	<b><u>Special Fund</u></b>	<b><u>Federal Fund</u></b>	<b><u>Reimb. Fund</u></b>	<b><u>Total</u></b>
<b>Fiscal 2006</b>					
Legislative Appropriation	\$0	\$53,185	\$0	\$0	\$53,185
Deficiency Appropriation	0	0	0	0	0
Budget Amendments	0	2,178	0	0	2,178
Reversions and Cancellations	0	-731	0	0	-731
<b>Actual Expenditures</b>	<b>\$0</b>	<b>\$54,631</b>	<b>\$0</b>	<b>\$0</b>	<b>\$54,631</b>
<b>Fiscal 2007</b>					
Legislative Appropriation	\$0	\$58,278	\$0	\$0	\$58,278
Budget Amendments	0	171	0	0	171
<b>Working Appropriation</b>	<b>\$</b>	<b>\$58,449</b>	<b>\$0</b>	<b>\$0</b>	<b>\$58,449</b>

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

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## **Fiscal 2006**

The Lottery finished fiscal 2006 at \$1.4 million above its legislative appropriation. Special funds increased by \$2.2 million through a budget amendment. Of this amount, \$902,850 was for on-line system vendor fees and \$538,072 was for instant ticket printing. These expenditures are related to sales, so as sales volume increases, they increase.

Another \$466,892 was added for the Lottery's use of the State "backbone" telecommunications contract. The final \$269,885 of the increase was to install a computer storage area network that allows all Lottery servers to share storage space.

A cancellation of \$730,956 was made at the end of the year to align budgeted amounts with actual expenditures. On-line system vendor fees accounted for \$242,930 of the cancellation because the amendment made earlier in the year to increase appropriations for this purpose was overestimated. Likewise, the amendment for Instant ticket printing was overestimated, and so \$377,884 was cancelled for this purpose.

## **Fiscal 2007**

In fiscal 2007, special funds increase \$171,133 due to the State employee cost-of-living adjustment.

**Object/Fund Difference Report  
State Lottery Agency**

<u>Object/Fund</u>	<u>FY06 Actual</u>	<u>FY07 Working Appropriation</u>	<u>FY08 Allowance</u>	<u>FY07 - FY08 Amount Change</u>	<u>Percent Change</u>
<b>Positions</b>					
01 Regular	176.50	171.00	172.00	1.00	0.6%
02 Contractual	11.70	8.50	9.50	1.00	11.8%
<b>Total Positions</b>	<b>188.20</b>	<b>179.50</b>	<b>181.50</b>	<b>2.00</b>	<b>1.1%</b>
<b>Objects</b>					
01 Salaries and Wages	\$ 10,932,185	\$ 11,641,380	\$ 11,874,304	\$ 232,924	2.0%
02 Technical and Spec. Fees	398,472	336,769	310,953	-25,816	-7.7%
03 Communication	877,423	371,009	475,434	104,425	28.1%
04 Travel	67,518	57,700	68,200	10,500	18.2%
06 Fuel and Utilities	117,286	99,792	160,682	60,890	61.0%
07 Motor Vehicles	365,804	361,206	439,816	78,610	21.8%
08 Contractual Services	40,126,332	43,853,242	42,807,494	-1,045,748	-2.4%
09 Supplies and Materials	173,362	176,500	189,000	12,500	7.1%
10 Equipment – Replacement	40,184	59,525	70,525	11,000	18.5%
11 Equipment – Additional	663,200	509,139	576,139	67,000	13.2%
13 Fixed Charges	869,510	982,808	983,650	842	0.1%
<b>Total Objects</b>	<b>\$ 54,631,276</b>	<b>\$ 58,449,070</b>	<b>\$ 57,956,197</b>	<b>-\$ 492,873</b>	<b>-0.8%</b>
<b>Funds</b>					
03 Special Fund	\$ 54,631,276	\$ 58,449,070	\$ 57,956,197	-\$ 492,873	-0.8%
<b>Total Funds</b>	<b>\$ 54,631,276</b>	<b>\$ 58,449,070</b>	<b>\$ 57,956,197</b>	<b>-\$ 492,873</b>	<b>-0.8%</b>

Note: The fiscal 2007 appropriation does not include deficiencies, and the fiscal 2008 allowance does not reflect contingent reductions.

**Lottery Sales by County  
Fiscal 2006**

<u>County</u>	<u>Total Sales</u>	<u>% of Sales</u>
Allegany	\$11,127,049	0.7%
Anne Arundel	161,274,587	10.4%
Baltimore	238,940,997	15.3%
Calvert	23,516,925	1.5%
Caroline	6,755,980	0.4%
Carroll	29,933,858	1.9%
Cecil	16,490,135	1.1%
Charles	50,591,475	3.2%
Dorchester	7,595,378	0.5%
Frederick	34,441,933	2.2%
Garrett	2,763,022	0.2%
Harford	52,671,758	3.4%
Howard	36,063,887	2.3%
Kent	4,400,333	0.3%
Montgomery	144,751,573	9.3%
Prince George's	317,228,536	20.4%
Queen Anne's	9,327,293	0.6%
St. Mary's	34,958,282	2.2%
Somerset	5,895,246	0.4%
Talbot	7,403,076	0.5%
Washington	26,213,933	1.7%
Wicomico	18,962,454	1.2%
Worcester	26,066,433	1.7%
Baltimore City	290,059,704	18.6%
<b>Total</b>	<b>\$1,557,433,847</b>	<b>100.0%</b>