

**E75D  
State Lottery Agency**

***Operating Budget Data***

(\$ in Thousands)

	<u>FY 08 Actual</u>	<u>FY 09 Working</u>	<u>FY 10 Allowance</u>	<u>FY 09-10 Change</u>	<u>% Change Prior Year</u>
Special Fund	58,445	59,221	59,084	-138	-0.2%
FY 2009 Cost Containment	0	0	0	0	
Contingent & Back of Bill Reductions	0	0	-99	-99	
<b>Adjusted Special Fund</b>	<b>\$58,445</b>	<b>\$59,221</b>	<b>\$58,985</b>	<b>-\$237</b>	<b>-0.4%</b>
<b>Adjusted Grand Total</b>	<b>\$58,445</b>	<b>\$59,221</b>	<b>\$58,985</b>	<b>-\$237</b>	<b>-0.4%</b>

- The fiscal 2010 allowance includes a fiscal 2009 deficiency of almost \$2.4 million for nine positions, consulting services, and related expenses to implement Chapter 4 of the 2007 special session. This Act established the operational and regulatory framework for video lottery terminals (VLTs) in the State.
- Absent contingent reductions, the fiscal 2010 allowance declines by close to \$138,000; driven mainly by declines in advertising costs and equipment maintenance costs.

***Personnel Data***

	<u>FY 08 Actual</u>	<u>FY 09 Working</u>	<u>FY 10 Allowance</u>	<u>FY 09-10 Change</u>
Regular Positions	171.00	171.00	171.00	0.00
Contractual FTEs	<u>10.25</u>	<u>9.50</u>	<u>9.50</u>	<u>0.00</u>
<b>Total Personnel</b>	<b>181.25</b>	<b>180.50</b>	<b>180.50</b>	<b>0.00</b>

***Vacancy Data: Regular Positions***

Turnover and Necessary Vacancies, Excluding New Positions	7.42	4.34%
Positions and Percentage Vacant as of 12/31/08	3.00	1.75%

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

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- The agency’s staffing level remains constant. There were three vacancies at the end of calendar 2008, well below the vacancies necessary to meet turnover.

## *Analysis in Brief*

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### Major Trends

***Sales and Revenues Increase in 2008; Decline Expected in 2009:*** The Lottery recorded sales of \$1.67 billion in fiscal 2008, an increase of over 6% from the previous year. However, based on sales to date in fiscal 2009, sales and revenues are expected to falter by year-end.

***Prizes and Agent Earnings Expected to Jump as Share of Expenditures:*** Unusually high prize payouts are driving an expected increase in prizes and agent earnings as a percentage of sales for fiscal 2009.

### Issues

***Fiscal 2008 Sales Driven by Growth in Instant Games:*** Instant tickets now represent the largest game offered by the State Lottery Agency (SLA) in terms of sales. Instant ticket games have surpassed monitor games in popularity for the first time. Sales for fiscal 2009, however, are expected to decline for the first time in over 10 years. **The Department of Legislative Services (DLS) recommends that the Lottery comment on the expected decline in sales and revenues and how it will combat the factors that are contributing to the decline.**

***Administration of Video Lottery Terminals:*** Chapter 4 of the 2007 special session established the operational and regulatory framework for VLTs in the State. The State Lottery Agency is tasked with the responsibility of administering the program. Despite an apparent need for resources to fulfill this new responsibility, the fiscal 2010 allowance does not include any funds related to video lottery terminal regulation. **DLS recommends that the agency be prepared to comment on (1) its expanded responsibility; (2) how it expects to fulfill its role given potentially limited resources; and (3) what it expects the impact will be on traditional lottery sales.**

### Recommended Actions

	<u>Funds</u>
1. Reduce funds for relationship marketing.	\$ 200,000
<b>Total Reductions</b>	<b>\$ 200,000</b>

## **Updates**

***Report on Local Gaming in Maryland:*** Chapter 474 of 2008 required SLA to report on the prevalence and the impact of local gaming activities in the State. The report makes a number of recommendations based in large part on the lack of centralized or uniform data on local gaming regulations and revenues.

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

***Operating Budget Analysis***

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**Program Description**

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

All games, except Instant Games, are online, 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 preprinted 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 2008, 57.8% of sales paid for prizes, 7.0% paid for agent commissions and redemption fees, 3.5% paid for agency operations and the remaining 29.7% was credited as revenue to the State.

The State Lottery Commission has oversight responsibility for the agency. In 2008, the commission was expanded to nine members from five to address additional responsibilities stemming from the video lottery terminal (VLT) legislation. 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**

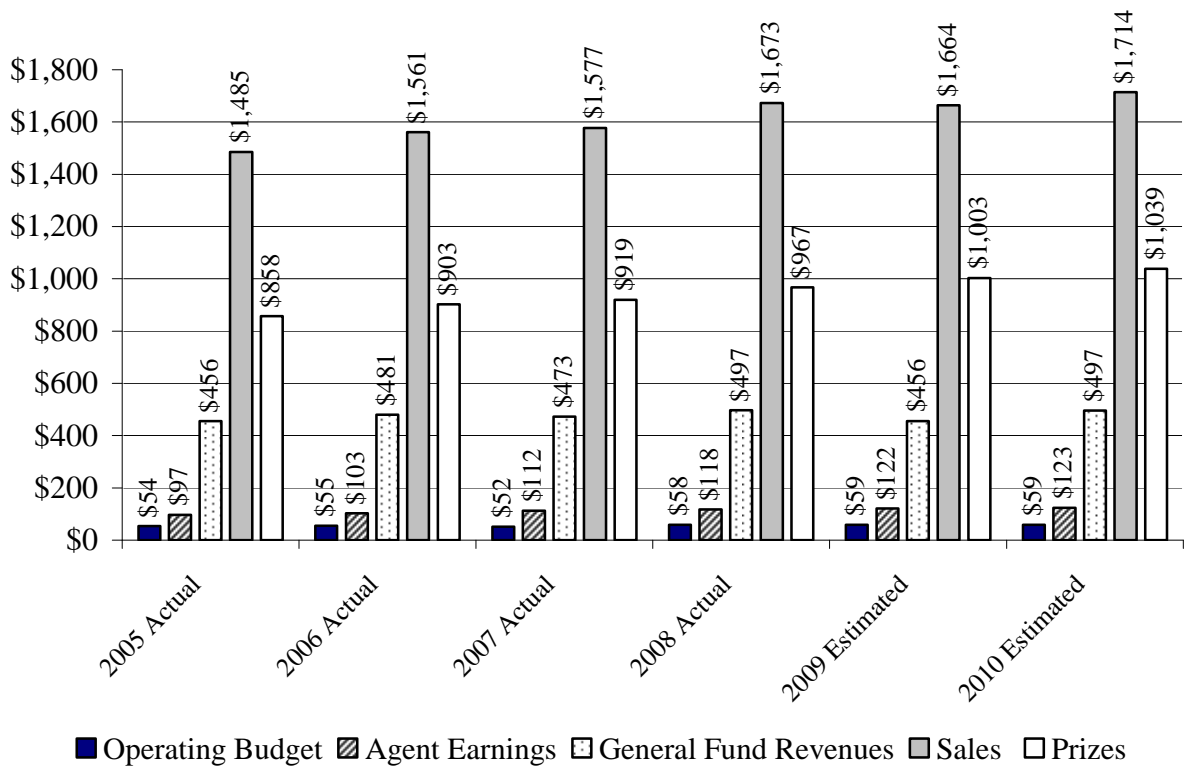
**Sales and Revenues Increase in 2008; Decline Expected in 2009**

The Lottery recorded sales of \$1.67 billion in fiscal 2008, an increase of over 6% from the previous year. However, the sales did not meet the mark that was expected, falling short of estimates by about \$36 million.

The growth in sales may be attributed, in large part, to a fairly significant increase in instant ticket and Mega Millions sales. This increase was able to offset declines in other popular games such as Pick 3 and Pick 4. See Issue 1 for a discussion of sales and revenue trends by game and **Appendix 2** for sales by jurisdiction.

**Exhibit 1** shows the financial components of SLA. As shown, general fund revenues experienced an increase of \$24 million (5%) in fiscal 2008. Revenues would have grown over 7%; however, Chapter 589 of 2008 required that any lottery revenue overattainment be transferred to a special fund providing inflationary adjustments for community health service providers.

**Exhibit 1**  
**Lottery Sales and Expenditures**  
**Fiscal 2005-2010**  
**(\$ in Millions)**



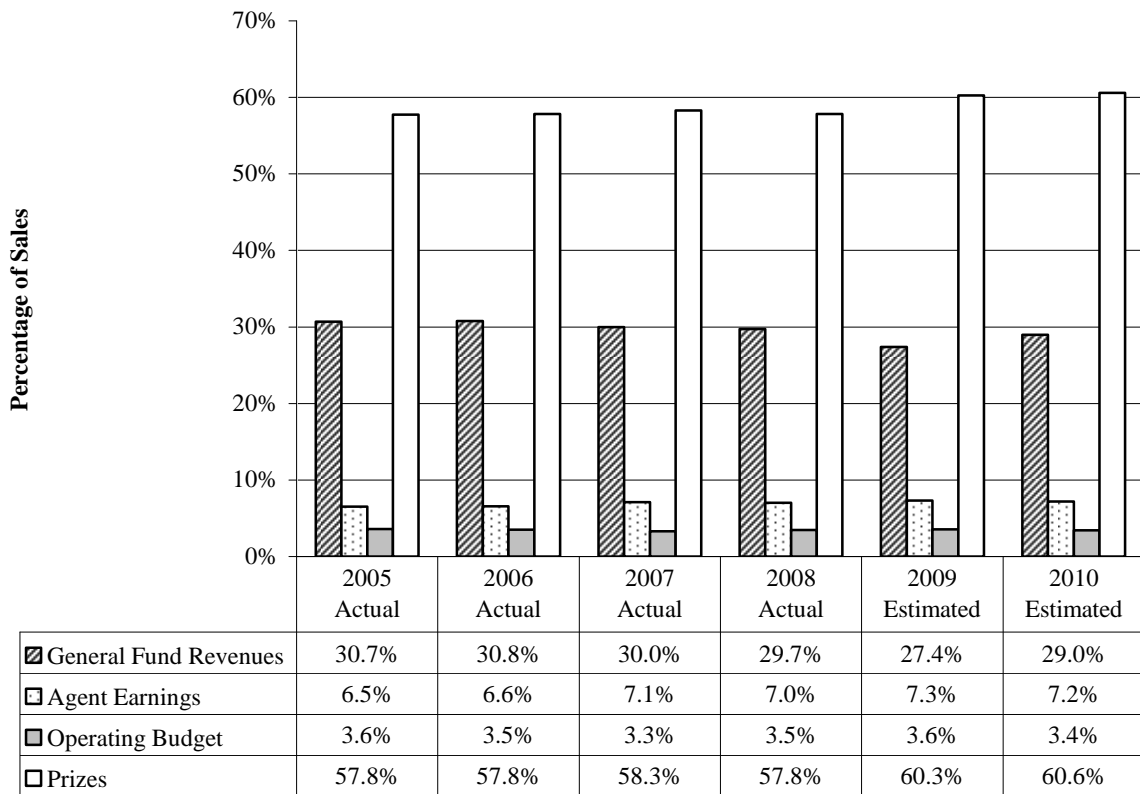
Source: Governor’s Budget Books, Fiscal 2005-2010

The slowing economy and some unusually high payouts are contributing to a projected decline in sales and revenues in fiscal 2009. However, the exhibit shows that a rebound is expected for fiscal 2010.

## Prizes and Agent Earnings Expected to Jump as Share of Expenditures

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

**Exhibit 2**  
**Lottery Expenditures as a Proportion of Sales**  
**Fiscal 2005-2010**



Source: Governor’s Budget Books, Fiscal 2005-2009

In fiscal 2007, prize payouts reached a recent high in terms of their share of overall expenditures. But in fiscal 2008, the prize payout proportion returned to a more typical level. However, as mentioned, fiscal 2009 payouts have been unusually high. Therefore, it is expected that prizes will comprise 60.3% of Lottery financial activities in fiscal 2009, up from 57.8% in fiscal 2008.

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High payouts serve to increase agents' share of expenditures, because agents earn a 3.0% cashing commission on winning tickets. In fiscal 2008, agents held 7.0% of total expenditures. However, in fiscal 2009, this is expected to increase to 7.4%. It should be noted that included in this figure, in addition to the cashing commission, are a 5.5% sales commission and an agent bonus and incentive program that is capped at one-half of 1.0% of gross sales.

The agency is remaining well within its stated goal of achieving a ratio of administrative costs to sales of 4% or less. The agency's budget was 3.5% of total expenditures in fiscal 2008. However, to the extent that the agency's budget grows to fulfill responsibilities associated with Chapter 4 of the 2007 special session, a new performance measure may need to be considered. This topic is discussed further under Issue 2 in this analysis.

## **Fiscal 2009 Actions**

### **Proposed Deficiency**

Included in the fiscal 2010 allowance is a proposed fiscal 2009 deficiency appropriation of \$2,368,635. Of this amount, \$1.7 million is derived from the Vendor Reimbursement Account and the remainder is general funds. The Vendor Reimbursement Account includes special funds derived from charges that the Lottery is able to impose on VLT vendors for some of the costs associated with administering the program. These funds are to implement provisions of Chapter 4 of the 2007 special session establishing the regulatory framework for VLTs at five locations across the State.

Specifically, the deficiency includes \$227,270 for the addition of nine new positions responsible for a variety of duties related to the initial stages of the VLT program:

- five positions responsible for the agency's new licensing duties;
- one assistant attorney general to assist with additional regulations that will be promulgated;
- two information technology specialists to create databases to track large amounts of data, including program costs and license renewal periods; and
- one accountant manager to create a new billing department for the agency.

An additional \$1.5 million of this proposed deficiency will fund outside investigative services to provide comprehensive financial background checks for VLT program applicants. Both criminal and financial checks must occur before any facility operation license may be awarded. The Department of State Police will be responsible for criminal background checks. Further consultant services will be required to assist the agency with the preparation of the request for proposals for the central VLT monitor and control system that will be owned or leased by the lottery commission. The fee for this service is budgeted at \$200,000.

The proposed deficiency also includes \$335,000 for equipment. The majority of this amount is for a document imaging system to store the various records of applicants and licensees of the VLT

program. The remaining funds in the proposed deficiency are for various minor start-up costs of the VLT program and costs associated with the additional positions.

A more thorough discussion of the VLT program is provided in Issue 2.

### **Impact of Cost Containment**

Over two rounds of cost containment for fiscal 2009, the agency relinquished \$745,032 in special funds. About half of this amount is attributable to statewide reductions in health insurance and retiree contributions. The remaining funds were due to adjustments to the agency's contracts that are based on lottery sales. Sales estimates were adjusted downward, allowing the agency to contribute \$374,276 to the cost containment effort.

A provision in the back of the fiscal 2010 budget bill removes the deferred compensation matching contribution for participating State employees, contingent on legislation. The agency's share of this reduction is \$99,232 in special funds.

### **Proposed Budget**

As shown in **Exhibit 3**, the fiscal 2010 allowance declines by \$137,633 in special funds. Absent the general funds proposed in the deficiency appropriation, the agency's budget is exclusively special funds derived from lottery sales.

### **Personnel**

The agency's staffing level remains constant at 171 full-time regular positions and 9.5 contractual full-time equivalents. Personnel costs increase by about \$617,000, largely driven by health insurance and retiree health insurance costs. Salaries increase only 0.6%, or \$60,800, over the fiscal 2009 working appropriation.

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

<b>How Much It Grows:</b>	<b><u>Special</u> <u>Fund</u></b>	<b><u>Total</u></b>
2009 Working Appropriation	\$59,221	\$59,221
2010 Allowance	<u>59,084</u>	<u>59,084</u>
Amount Change	-\$138	-\$138
Percent Change	-0.2%	-0.2%
Contingent Reductions	-\$99	-\$99
Adjusted Change	-237	-237
Adjusted Percent Change	-0.4%	-0.4%
<b>Where It Goes:</b>		
<b>Personnel Expenses</b>		
Increments and other compensation .....		\$61
Employee and retiree health insurance .....		451
Employee retirement .....		76
Workers' compensation premium assessment.....		82
Turnover adjustments .....		-81
Contingent reduction of deferred compensation match.....		-99
Other fringe benefit adjustments .....		28
<b>Other Changes</b>		
Fleet vehicle replacement .....		36
Increase in Instant ticket printing based on expected revenues .....		911
Decline in television, radio, and outdoor advertising .....		-1,436
Increase in relationship marketing.....		200
Lease payment for new instant ticket vending machines .....		396
Decrease in costs to repair instant ticket vending machines .....		-769
Decrease in special audit fees.....		-58
Decrease in association dues .....		-13

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**Where It Goes:**

Decrease in postage and telecommunication costs.....	-34
Increase in fuel and utilities.....	30
Decrease in supplies and materials.....	-19
Other miscellaneous changes .....	1
<b>Total</b>	<b>-\$237</b>

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

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**Contractual Services**

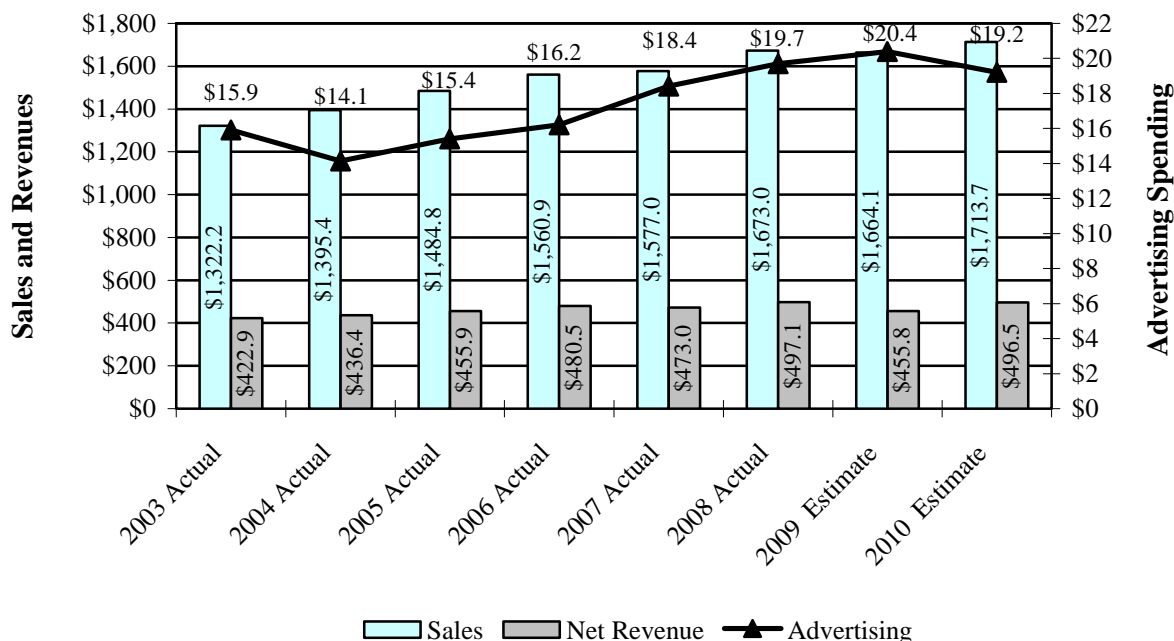
The core of the agency’s budget is for contractual services. As mentioned above, sales of instant tickets are expected to continue to grow. The contract for the printing of the tickets is based on expected annual revenues. Accordingly, the fiscal 2010 allowance reflects the projected increase. Costs to print instant tickets increase by about \$911,000.

Advertising represents a significant portion of its contractual services. Included in the fiscal 2010 allowance is \$19.2 million in special funds for advertising. This represents a net decline of about \$1.2 million. The agency expects to reduce television, radio, and outdoor advertising, while increasing its budget for relationship marketing by \$200,000.

The goal of the agency’s advertising is to reach as many potential lottery players as possible and to broaden the appeal of games, thereby increasing sales. However, it is difficult to assess the impact of advertising on sales.

**Exhibit 4** shows sales and revenues as compared to advertising expenditures. Advertising expenditures include funds for radio, television, print, and other advertisements as well as for promotional events and materials. Such spending increased by over \$2.0 million in fiscal 2007. Based on legislation enacted in 2005, agent sales commissions increased to 5.5% in fiscal 2007, reducing potential revenues. Claiming that the increased commission would do nothing to increase sales, the agency instead increased marketing efforts to mitigate this loss. However, as advertising expenses increased, net revenues fell in fiscal 2007 by approximately \$7.4 million, or 1.5%. Similarly, in fiscal 2009, advertising spending increases; however, its impact does not appear to be sufficient to offset the factors that dampened sales.

**Exhibit 4**  
**Sales and Revenue Trends Compared to Advertising Spending**  
**Fiscal 2003-2010**  
**(\$ in Millions)**



Source: Governor’s Budget Books, Fiscal 2006-2008; Lottery budget requests, fiscal 2005-2008

The real impact of advertising on sales is difficult to assess without sustained periods of time, both with and without advertising. From mid-November to mid-December 2006, the Lottery did not have an advertising firm in place, and no advertisements were running. The previous advertising vendor went out of business, and it took several weeks to select a new vendor. However, aggregate sales for December 2006 were higher than the same month the previous year. But, mirroring the fiscal year as a whole, the new game, Race Trax, drove this increase. Many of the other games showed slowed sales compared to the previous year.

It is true that both sales and advertising expenses have increased since fiscal 2003. Sales increased by 4.8% annually from fiscal 2003 to 2008. Similarly, advertising expenditures have increased by 4.4% annually in that same time period. It should be noted that funds for advertising fell in fiscal 2004 to \$14.1 million, a decrease of 11.3% from the previous year. However, between fiscal 2004 and 2005, sales grew by over 6.9%, outpacing the six-year average. It is, therefore, difficult to make a definitive positive correlation between advertising expenditures and sales.

## **Instant Ticket Vending Machines**

The agency has a new contract for the provider of instant ticket vending machines (ITVM). The lottery currently owns 951 ITVMs that are aging and in need of increasing maintenance. The new contractor will provide, install, and maintain new machines at lottery retailers across the State. The allowance includes an increase of \$396,360 for the lease payment for the machines.

The new contract includes a warranty provision which includes repair services for the first year of the contract (calendar 2009). As such, the allowance reflects a decrease in repair costs of \$769,080.

## **Video Lottery Terminal Program**

What might be most notable about the agency's fiscal 2010 allowance is what is not provided. Despite the deficiency request, there are no funds evident in the fiscal 2010 allowance to implement the VLT program. It is assumed that the agency would need to continue, and perhaps increase, the funds provided in the deficiency in 2010 and beyond. It is further assumed that a proposed appropriation may be forthcoming in a supplemental budget. However, this lack of definitive information leaves a fully implemented VLT program without the full scrutiny of the budget hearing process. This lack of scrutiny is especially important in light of the significant policy and fiscal implications of this new program.

Additionally, the fiscal 2010 allowance does not include funds for the agency to conduct a VLT and lottery market analysis as required by the enabling legislation. The analysis should determine the jurisdiction of residence, demographic characteristics, and annual net customer spending for each of the following gaming products: VLTs; Keno; Instant games; daily games; multistate games; and any other product the agency deems appropriate. The Act specifically mandated that the fiscal 2010 budget include \$250,000 for this purpose. Again, however, these funds are not evident in the allowance.

**The Department of Legislative Services (DLS) recommends that the agency discuss why the VLT program is not represented in the fiscal 2010 allowance and comment on the expected ongoing costs of the program.**

## **Impact of the Budget Reconciliation and Financing Act of 2009**

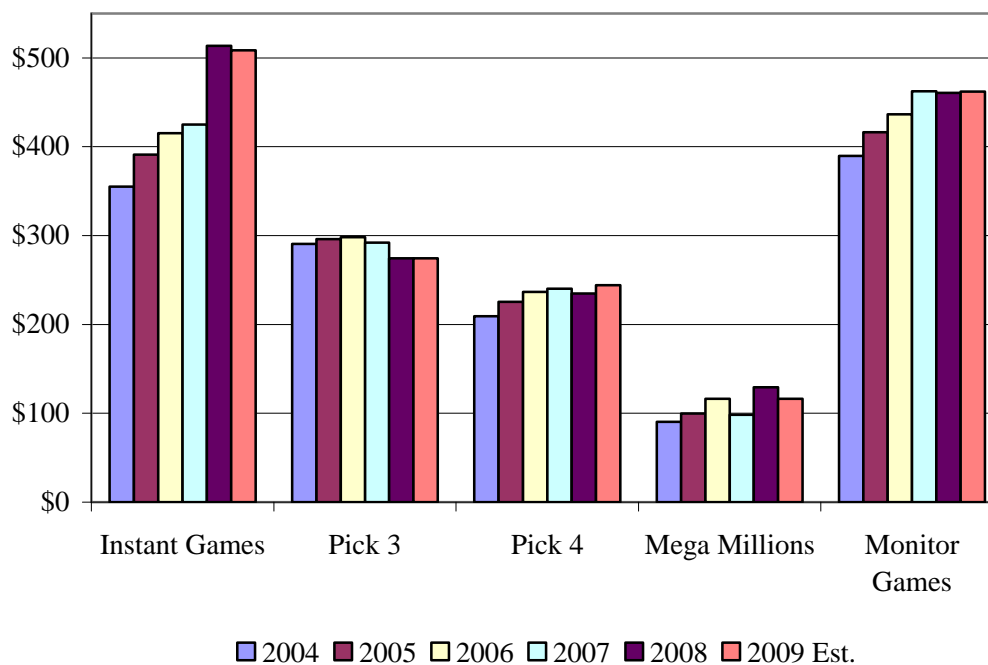
While nothing in the Budget Reconciliation and Financing Act (BRFA) of 2009 directly impacts the programmatic budget of the agency, it does contain a provision that impacts lottery sales agents. Sales agents are entitled to a commission on the gross receipts from ticket sales. The commission rate was increased from 5.0 to 5.5% beginning in 2007. The BRFA reverses this increase and returns the sales commission rate to 5.0%. This action is expected to increase general fund revenues by \$8,570,000.

## Issues

### 1. Fiscal 2008 Sales Driven by Growth in Instant Games

An otherwise lackluster sales year was salvaged by significant growth in instant ticket games and Mega Millions sales in fiscal 2008. In total, sales grew 6.1% fueled by an increase of 20.9% and 31.8% in instant games and Mega Millions, respectively. **Exhibit 5** shows the total sales of the more popular games for fiscal 2004 through an estimate for fiscal 2009.

**Exhibit 5**  
**Sales – Selected Games**  
**Fiscal 2004-2009**  
**(\$ in Millions)**



Source: State Lottery Agency; Board of Revenue Estimates

Exhibit 5 clearly shows the relative popularity of the games, with instant games and monitor games claiming most of the public’s gaming dollars. However, despite the introduction of a new monitor game, overall sales fell slightly for such games. A substitution effect is a likely contributing factor for this result. While sales for the new games, Race Trax and Maryland Hold’Em increased, sales for the more mature games, Keno and Keno Bonus, fell. Monitor game sales are expected to remain flat in fiscal 2009.

Both Pick 3 and Pick 4 experienced declines in sales in fiscal 2008. For Pick 3, this is consistent with a slow downward trend over the last several years. However, it reverses a trend of recent increases for Pick 4.

### **Outlook for Fiscal 2009**

Through November, fiscal 2009 sales are down 0.8% from the previous year. A number of factors appear to be contributing to this trend. The economic downturn is negatively affecting the customer base of bars and restaurants, thereby dampening sales of monitor games. Additionally, the lack of large jackpots is contributing to a decline in Mega Millions sales.

Similarly, general fund revenues are trending downward. In addition to the negative sales pressure, unusually high payouts are driving this trend. For example, over 1,400 players picked a winning 1-1-1-1 series in Pick 4 leading to a combined \$7 million payout. Several other popular Pick 3 and Pick 4 number series also hit this year, well beyond the normal odds.

### **Impact of Game Mix on General Fund Revenue**

The decline in popularity of traditional numbers games in favor of instant and monitor games is likely to have an impact on revenues. Different games have different payout ratios. To the extent that high payout games increase in sales at a greater rate than low payout games, general fund revenues are affected.

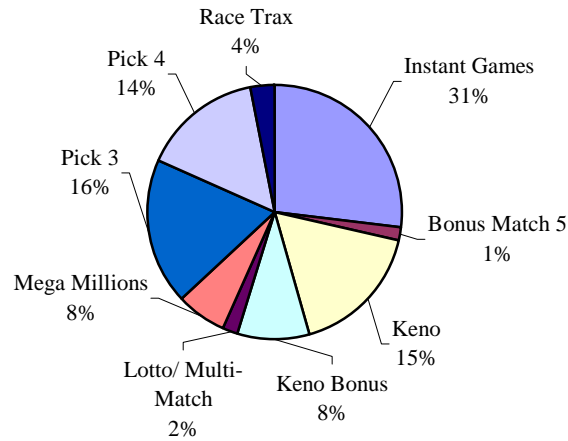
Instant games and monitor games have the highest payouts. **Exhibit 6** shows sales and revenues for each game type in fiscal 2008. As shown in Exhibit 6, instant tickets made up 31% of sales in fiscal 2008. However, these games only contributed to 17% of general fund revenue. Conversely, despite the recent spate of high payouts, Pick 3 is traditionally the lowest payout game. Pick 3 was responsible for 16% of sales in fiscal 2008 and 24% of the revenue.

The combination of high payouts, a struggling economy, and the rising popularity of higher payout games are contributing to lower lottery sales and revenue estimates. The potential substitution effect that may be caused by the introduction of VLTs competing for limited gambling dollars can only exacerbate the issue.

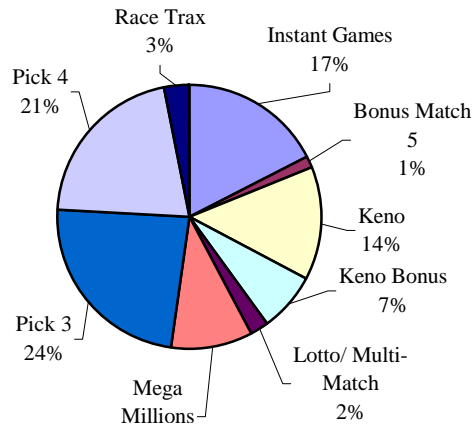
**DLS recommends that the Lottery comment on the expected decline in sales and revenues and how it will combat the factors that are contributing to the decline.**

**Exhibit 6  
Sales and Revenues  
Fiscal 2008**

**Sales**



**Revenues**



Source: State Lottery Agency

## **2. Administration of Video Lottery Terminals**

Chapter 4 of the 2007 special session established the operational and regulatory framework of VLTs in the State subject to voter approval. In November 2008, the statewide ballot question to allow VLTs passed by a vote of 59 to 41%. The State Lottery Commission and Agency are tasked with the responsibility of administering the VLT program.

Reflecting this increase in responsibility, the enabling legislation increased the size of the commission from five to nine members. The Act strengthens various conditions of appointment and specifies that the membership include members with experience in law enforcement, finance, public accountancy, and information technology. Additionally, one member must serve as a liaison to the State Racing Commission.

A primary responsibility of the commission is to hear and decide license applications and causes affecting the granting, suspension, revocation, or renewal of licenses. It will also be responsible for the collection of fees and for levying penalties.

The Act requires the commission to own or lease the VLT machines. The Act also requires the lottery commission (through the agency) to operate a central monitor and control system into which all licensed VLTs must be connected. The system will (1) monitor, retrieve, and audit the operations, financial data, and program information of all VLTs; (2) allow the Lottery to account for all money inserted in and payouts from any VLT; (3) disable any VLT as the Lottery deems necessary; (4) support and monitor progressive jackpot systems; and (5) any other function as required by the Lottery.

It is difficult to gauge the resources that the Lottery will need to fulfill the regulation requirements of the State's VLT program without knowing the content of the proposals for operator licenses. The proposals may or may not contain complicated business structures with varying levels of ownership, finances, and management that would need to be vetted prior to issuance of an operator's license. The content of the proposals will dictate the amount of work required by the agency. However, it is clear that the agency will incur significant ongoing costs to run the program. The fiscal note accompanying the legislation estimates that annual costs of a fully implemented program will be about 4.5% of VLT gross proceeds. The fiscal note estimates costs of \$1.2 million for fiscal 2009 and \$6.2 million for fiscal 2010. The legislation provides for 2.0% of VLT proceeds to mitigate agency costs. It is assumed, that within the request for proposal process or facility operation license, the agency can recover some costs through fees from applicants. Unfortunately, as mentioned in the Governor's Proposed Budget section of this analysis, the fiscal 2010 allowance includes no funds for the program. Presumably, funds are forthcoming; however, the agency's program is currently free from the full scrutiny of the budget hearing process.

## **Impact on Lottery Sales**

It is possible that Lottery sales will fall when the VLT program is fully implemented. Playing the lottery is a form of gambling, and it is reasonable to expect that Marylanders who currently play the lottery may opt to use those disposable dollars to play VLTs instead.

DLS estimated in the fiscal note accompanying the enabling legislation that VLTs, when fully implemented, will cause a permanent reduction in lottery revenues of 10% annually versus what is currently forecasted. This estimate is based on the experience of other states that have authorized additional gambling and experienced substantial decreases in lottery sales. In addition, compared to those states where data is available, Maryland has substantially greater lottery operations, measured on both a gross volume and per capita basis. Therefore, it is possible that lottery sales might decrease more sharply than these other states.

**DLS recommends that the agency be prepared to comment on (1) its expanded responsibility; (2) how it expects to fulfill its role given potentially limited resources; and (3) what it expects the impact will be on traditional lottery sales.**

## ***Recommended Actions***

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	<b><u>Amount Reduction</u></b>
1. Reduce the increase in funds for relationship marketing. This action will return funds to the fiscal 2009 level.	\$ 200,000 SF
<b>Total Special Fund Reductions</b>	<b>\$ 200,000</b>

## ***Updates***

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### **1. Report on Local Gaming in Maryland**

Chapter 474 of 2008 altered the definition of slot machines to address concerns about an increase in illegal gaming devices that resulted from interpretation of local gaming statutes and court cases. The legislation also required the lottery agency to submit a report that (1) outlines the current statutory and regulatory provisions governing gaming activities in local jurisdictions; (2) provides information on the prevalence of gaming activities in local jurisdictions; (3) analyzes the financial impact of local gaming activities; (4) examines the impact of gaming activities in local jurisdictions on other gaming activities regulated by the State; and (5) makes recommendations as to how the State may exercise additional or improved oversight of gaming activities.

To meet this mandate, the agency contacted each jurisdiction and obtained applications, permits, financial reports, and any other record received by each jurisdiction in the previous three years. The agency also conducted phone surveys and enlisted the assistance of the State Attorney General's office to fulfill the report requirements.

The report made a number of key findings which led to several recommendations. Notably, it was determined that it was difficult to assess the impact of local gaming due to the lack of a centralized reporting system. This is exacerbated by differing reporting requirements across jurisdictions. Accordingly, the report recommends that a centralized reporting system using standardized forms and documents be adopted and that a statewide organization be the repository of this information. Other recommendations include clarification of the gaming provisions under the criminal law statute; defining the standards for the "bona fide" nature of charitable and nonprofit organizations; and setting uniform payout rates.

The haphazard manner of information reporting made it difficult for the Lottery to assess the impact of local gaming on statewide gaming activities. However, the report concluded that, based on limited data, local gaming does have an impact on lottery proceeds. The largest impact appears to come from instant bingo and tip jars. According to the report, for every dollar increase in local gaming, the Lottery sees a decline of \$0.25. Conversely, the report found no impact on horse racing revenues.

## *Current and Prior Year Budgets*

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### 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>
<b>Fiscal 2008</b>					
Legislative Appropriation	\$0	\$57,956	\$0	\$0	\$57,956
Deficiency Appropriation	0	0	0	0	0
Budget Amendments	0	1,826	0	0	1,826
Cost Containment	0	-370	0	0	-370
Reversions and Cancellations	0	-967	0	0	-967
<b>Actual Expenditures</b>	<b>\$0</b>	<b>\$58,445</b>	<b>\$0</b>	<b>\$0</b>	<b>\$58,445</b>
<b>Fiscal 2009</b>					
Legislative Appropriation	\$0	\$59,760	\$0	\$0	\$59,760
Cost Containment	0	-745	0	0	-745
Budget Amendments	0	206	0	0	206
<b>Working Appropriation</b>	<b>\$0</b>	<b>\$59,221</b>	<b>\$0</b>	<b>\$0</b>	<b>\$59,221</b>

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

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## **Fiscal 2008**

The fiscal 2008 legislative appropriation was increased by \$1,626,798 in special funds for contractual services. The agency has a contract for instant game ticket sales, printing, and delivery. That contract is based on a percentage of total sales of instant tickets. Sales for fiscal 2008 exceeded the original projections on which the budget was based. As such, costs for the instant ticket contract increased by approximately 8%. The special funds are generated by the sales of lottery tickets.

The original appropriation was increased by an additional \$199,693 for a cost-of-living salary increase for lottery employees.

Conversely, a fiscal 2008 budget amendment on cost containment resulted in the decrease of \$351,000 in special funds due to over budgeting for the online gaming system contract due to a revised sales estimate for online games. Also, the agency cancelled about \$967,000 in special funds, primarily due to the overbudgeting for the online gaming contract. Additional cost containment resulted in the reduction of one vacant position for a saving of \$19,180.

## **Fiscal 2009**

The cost-of-living salary adjustment increased the agency's special funds in fiscal 2009 by \$206,384. Conversely, over two rounds of cost containment for fiscal 2009, the agency relinquished \$745,032 in special funds.

## ***Audit Findings***

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Audit Period for Last Audit:	February 3, 2005 – March 16, 2008
Issue Date:	December 2008
Number of Findings:	4
Number of Repeat Findings:	1
% of Repeat Findings:	25%
Rating: (if applicable)	n/a

***Finding 1:*** The State Lottery Agency (SLA) did not adequately monitor the provisions of its gaming system contract related to equipment installations and certain liquidated damages and did not document its rationale for not assessing potential liquidated damages totaling approximately \$1.3 million.

***Finding 2:*** Two lottery prize payments made by SLA were not adequately supported. In five other instances, the Social Security numbers of winning recipients were not accurately recorded in its automated payment system.

***Finding 3:*** SLA lacked adequate procedures to ensure that an advertising contractor aired all required promotional broadcasts.

***Finding 4:*** **SLA’s wide area network was not adequately secured.**

\*Bold denotes item repeated in full or part from preceding audit report.

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

<u>Object/Fund</u>	<u>FY08 Actual</u>	<u>FY09 Working Appropriation</u>	<u>FY10 Allowance</u>	<u>FY09 - FY10 Amount Change</u>	<u>Percent Change</u>
<b>Positions</b>					
01 Regular	171.00	171.00	171.00	0	0%
02 Contractual	10.25	9.50	9.50	0	0%
<b>Total Positions</b>	<b>181.25</b>	<b>180.50</b>	<b>180.50</b>	<b>0</b>	<b>0%</b>
<b>Objects</b>					
01 Salaries and Wages	\$ 12,047,771	\$ 12,489,101	\$ 13,106,095	\$ 616,994	4.9%
02 Technical and Spec. Fees	275,023	333,548	332,994	-554	-0.2%
03 Communication	350,269	400,547	366,190	-34,357	-8.6%
04 Travel	58,874	68,000	68,000	0	0%
06 Fuel and Utilities	174,966	180,089	209,959	29,870	16.6%
07 Motor Vehicles	481,608	303,692	339,221	35,529	11.7%
08 Contractual Services	43,281,996	43,629,170	42,413,629	-1,215,541	-2.8%
09 Supplies and Materials	164,958	192,500	174,000	-18,500	-9.6%
10 Equipment – Replacement	73,106	65,525	89,082	23,557	36.0%
11 Equipment – Additional	565,770	571,636	1,009,996	438,360	76.7%
13 Fixed Charges	970,365	987,566	974,575	-12,991	-1.3%
<b>Total Objects</b>	<b>\$ 58,444,706</b>	<b>\$ 59,221,374</b>	<b>\$ 59,083,741</b>	<b>-\$ 137,633</b>	<b>-0.2%</b>
<b>Funds</b>					
03 Special Fund	\$ 58,444,706	\$ 59,221,374	\$ 59,083,741	-\$ 137,633	-0.2%
<b>Total Funds</b>	<b>\$ 58,444,706</b>	<b>\$ 59,221,374</b>	<b>\$ 59,083,741</b>	<b>-\$ 137,633</b>	<b>-0.2%</b>

Note: The fiscal 2009 appropriation does not include deficiencies. The fiscal 2010 allowance does not include contingent reductions.