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	FY 2004 Actual	FY 2005 Estimate	FY 2006 Approved	FY 2007 Approved
OPERATING BUDGET				
<i>Full Time Equivalent Positions</i>	110.0	110.0	110.0	110.0
Personal Services	3,991,000	4,418,500	4,493,600	4,418,500
Employee Related Expenditures	1,150,800	1,237,000	1,383,500	1,227,500
Professional and Outside Services	250,800	344,400	352,700	344,400
Travel - In State	222,300	246,400	246,400	246,400
Travel - Out of State	13,400	16,700	16,700	16,700
Other Operating Expenditures	1,187,800	562,800	549,400	549,400
Equipment	128,400	0	238,000	102,700
OPERATING SUBTOTAL	6,944,500	6,825,800	7,280,300	6,905,600
SPECIAL LINE ITEMS				
Advertising ^{1/}	9,646,000	9,580,400	9,903,600 ^{2/}	9,903,600 ^{2/}
Compulsive Gambling Treatment and Information	267,600	0	0	0
Instant Tickets ^{1/}	5,493,300	6,893,300	7,182,000 ^{3/}	7,182,000 ^{3/}
On-Line Vendors Fees ^{1/}	9,139,600	8,151,100	8,348,300 ^{4/}	8,348,300 ^{4/}
Retailer Commissions ^{1/}	24,137,300	23,773,700	24,575,600 ^{5/}	24,575,600 ^{5/}
Sales Incentive Program	25,300	50,000	50,000	50,000
Telecommunications	2,577,200	2,814,400	2,814,400	2,814,400
AGENCY TOTAL	58,230,800	58,088,700	60,154,200^{6/}	59,779,500^{6/}
FUND SOURCES				
<u>Other Appropriated Funds</u>				
State Lottery Fund	58,230,800	58,088,700	60,154,200	59,779,500
SUBTOTAL - Other Appropriated Funds	58,230,800	58,088,700	60,154,200	59,779,500
SUBTOTAL - Appropriated Funds	58,230,800	58,088,700	60,154,200	59,779,500
Other Non-Appropriated Funds	202,367,500	195,728,600	202,572,400	202,707,700
TOTAL - ALL SOURCES	260,598,300	253,817,300	262,726,600	262,487,200

AGENCY DESCRIPTION — The Arizona Lottery is responsible for administering sanctioned games of chance. Arizona-specific games include instant tickets, the Pick, Pick 3 and Fantasy 5 on-line games. Arizona also participates in the multi-state Powerball on-line game.

- ^{1/} Instant Tickets, Advertising, On-line Vendor Fees, and Retailer Commissions are appropriated as a percentage of sales. Therefore, the amounts shown for those line items are estimates only.
- ^{2/} An amount equal to 2.7% of gross lottery game sales, but no more than \$11,000,000, is appropriated for Advertising in accordance with A.R.S. § 5-505, that states that not more than 4% of the annual gross revenues shall be expended for Advertising. This amount is currently estimated to be \$9,903,600 in FY 2006 and \$9,903,600 in FY 2007. (General Appropriation Act footnote)
- ^{3/} An amount equal to 3.6% of actual instant ticket sales is appropriated for the printing of instant tickets or for contractual obligations concerning instant ticket distribution. This amount is currently estimated to be \$7,182,000 in FY 2006 and \$7,182,000 in FY 2007. (General Appropriation Act footnote)
- ^{4/} An amount equal to a percentage of actual on-line game sales as determined by contract is appropriated for payment of on-line vendor fees. This amount is currently estimated to be \$8,348,300 in FY 2006 and \$8,348,300 in FY 2007 or 4.99% of actual on-line ticket sales. (General Appropriation Act footnote)
- ^{5/} An amount equal to 6.5% of gross lottery game sales is appropriated for payment of sales commissions to ticket retailers. In accordance with Laws 1997, Chapter 214, an additional amount of not to exceed 0.5% of gross lottery game sales is appropriated for payment of sales commissions to ticket retailers. The combined amount is currently estimated to be 6.7% of total ticket sales, or \$24,575,600 in FY 2006 and \$24,575,600 in FY 2007. (General Appropriation Act footnote)
- ^{6/} General Appropriation Act funds are appropriated as an Operating Lump Sum with Special Line Items by Agency.

PERFORMANCE MEASURES	FY 2003	FY 2004	FY 2006
	Actual	Actual	Approved
• Increase in on-line sales from prior year (\$ in millions)	11.7	20.3	4.0
• Increase in instant ticket sales from prior year (\$ in millions)	15.8	24.0	8.0
• Customer satisfaction rating for retailers (Scale 1-8)	6.5	7.0	7.0

Comments: On-line sales and instant tickets sales were significantly higher than the budgeted forecasts in FY 2003 and FY 2004. Several large Powerball jackpots stimulated higher on-line sales.

Operating Budget

The budget provides \$7,280,300 from the State Lottery Fund for the operating budget in FY 2006 and \$6,905,600 in FY 2007.

The approved amount includes an increase of \$216,500 from the State Lottery Fund in FY 2006 and a decrease of \$(22,900) in FY 2007 for statewide adjustments. *(Please see the Statewide Adjustments section at the end of this Appropriations Report for details.)*

Computer Replacement

The approved amount includes a one-time increase of \$110,000 from the State Lottery Fund in FY 2006 for the purchase of a computer system. The Lottery currently has 3 systems. One system is used for production processing, a second system is used for software development and quality assurance testing, and the third is used as a backup for the system processing.

The current backup system, which was purchased in FY 1996, will be replaced to allow Powerball processing to continue uninterrupted in the event of a system failure. In addition to having a reliable production system, having a redundant backup system configuration is a requirement to participate in the Powerball multi-state game.

Replace Personal Computers

The approved amount includes an increase of \$69,100 from the State Lottery Fund in FY 2006 and FY 2007 for the replacement of personal computing resources in accordance with a 3-year technology replacement schedule approved by the Government Information Technology Agency.

Replace Office Furniture

The approved amount includes an increase of \$58,900 from the State Lottery Fund in FY 2006 and an increase of \$33,600 in FY 2007 for the replacement of office furniture.

Special Line Items

Advertising

The budget provides an estimated \$9,903,600 from the State Lottery Fund for Advertising in FY 2006 and

FY 2007. The approved amount includes an increase of \$323,200 from the State Lottery Fund in FY 2006 and FY 2007 for Advertising due to higher projected sales. *(See "Other Issues – Lottery Forecast" for more information.)*

Monies in this line item are used to promote and market Lottery games. The actual appropriation is for 2.7% of total ticket sales. The amount displayed is derived by applying the approved spending percentage to the forecasted sales total.

Compulsive Gambling Treatment and Information

The budget provides no funding from the State Lottery Fund for Compulsive Gambling Treatment and Information in FY 2006 and FY 2007. Prior to FY 2004, the Lottery Commission used these monies for a toll-free hot line and contracted counseling and treatment programs for compulsive gamblers. In FY 2004, the Lottery Commission stopped providing these services and transferred the monies to the Gaming Department, which operates a problem gambling program pursuant to Proposition 202. The FY 2005 budget formalized this transfer.

Instant Tickets

The budget provides an estimated \$7,182,000 from the State Lottery Fund for Instant Tickets in FY 2006 and FY 2007. The approved amount includes an increase of \$288,700 from the State Lottery Fund in FY 2006 and FY 2007 for Instant Tickets due to higher projected sales. *(See "Other Issues – Lottery Forecast" for more information.)*

Monies in this line item are used to pay for instant ticket printing and distribution costs. The actual appropriation is for 3.6% of instant ticket sales. The amount displayed is derived by applying the approved spending percentage to the forecasted sales total.

On-Line Vendor Fees

The budget provides an estimated \$8,348,300 from the State Lottery Fund for On-Line Vendor Fees in FY 2006 and FY 2007. The approved amount includes an increase of \$197,200 from the State Lottery Fund in FY 2006 and FY 2007 for On-Line Vendor Fees due to higher projected

sales. (See “Other Issues – Lottery Forecast” for more information.)

Monies in this line item are used to pay the vendor that operates the on-line game computer system. The actual appropriation is equal to the percentage specified in the Lottery’s contractual agreement with the vendor. This is currently estimated to be 4.99% of on-line ticket sales. The displayed amount is derived by applying the approved percentage to the forecasted sales total.

Retailer Commissions

The budget provides an estimated \$24,575,600 from the State Lottery Fund for Retailer Commissions in FY 2006 and FY 2007. The approved amount includes an increase of \$801,900 from the State Lottery Fund in FY 2006 and FY 2007 for Retailer Commissions due to higher projected sales. (See “Other Issues – Lottery Forecast” for more information.)

Monies in this line item are used to compensate retailers for selling lottery tickets. The actual appropriation is equal to 6.5% of total ticket sales. Pursuant to statute, an additional 0.5% of total ticket sales may be paid to retailers based on their attainment of specified sales and marketing objectives. Since 40% of retailers are estimated to meet these objectives, this would result in an additional 0.02% in retailer commissions and a total retail commission rate of 6.7%. The displayed amount is derived by applying the approved percentage to the forecasted sales total.

Sales Incentive Program

The budget provides \$50,000 from the State Lottery Fund for the Sales Incentive Program in FY 2006 and FY 2007. These amounts are unchanged from FY 2005. Monies in this line item are used to provide monetary incentives to employees in the Lottery’s Marketing Division for working with retailers to increase sales.

Telecommunications

The budget provides \$2,814,400 from the State Lottery Fund for Telecommunications costs in FY 2006 and FY 2007. These amounts are unchanged from FY 2005. Monies in this line item are used to pay for all costs related to the Lottery’s telecommunications network. The Lottery provides telecommunications services to retailers who sell on-line game tickets through a contract with private vendors.

Additional Legislation

General Revenues Budget Reconciliation Bill

The General Revenues Budget Reconciliation Bill (Laws 2005, Chapter 288) includes a provision that requires the Lottery to return to the state 31.6% of total revenue accruing from the sale of multi-state lottery tickets in FY 2006. This provision is a continuation of FY 2005

session law. Current permanent law would only require that the Lottery return 29% of multi-state ticket sales.

The bill also includes a provision that no deposits may be made to the Mass Transit Fund until the General Fund receives \$37,000,000 from Powerball sales. These provisions will allow an additional \$5,972,000 to be deposited to the General Fund above the amount provided by statute.

Other Issues

Lottery Forecast

The following table displays the January 2005 JLBC Staff forecast of Lottery ticket sales and the corresponding profit distribution. For FY 2006 and FY 2007, the JLBC Staff forecasts Lottery sales of \$366,800,000 in each fiscal year.

Forecast of Lottery Revenue Distribution				
(\$ in Millions)				
	FY 2004	FY 2005	FY 2006	FY 2007
Sales:				
Instant Sales	\$183.2	\$191.5	\$199.5	\$199.5
On-Line Sales	<u>183.3</u>	<u>163.3</u>	<u>167.3</u>	<u>167.3</u>
Total Sales	\$366.5	\$354.8 ^{1/}	\$366.8	\$366.8
Less:				
Operating Budget	\$58.2	\$58.1	\$59.9	\$59.8
Prizes ^{2/}	<u>204.9</u>	<u>198.2</u>	<u>202.6</u>	<u>202.7</u>
Net Profit ^{3/}	\$103.4	\$98.5	\$104.3	\$104.3
Profit Transfers:				
LTAf	\$23.0	\$23.0	\$ 23.0	\$ 23.0
CAF	7.7	7.7	7.7	7.7
Heritage	20.0	20.0	20.0	20.0
Econ. Development	2.7	2.7	2.9	2.9
Mass Transit	13.5	6.8	3.0	3.0
Health & Welfare Programs	3.7	3.8	5.3	5.3
General Fund	<u>32.8</u>	<u>34.5</u>	<u>42.4</u>	<u>42.4</u>
Total Transfer	\$103.4	\$98.5	\$104.3	\$104.3

^{1/} Total Sales were \$365.8 million through May 2005 and are projected to be approximately \$399 million for the entire fiscal year.
^{2/} Prizes are estimated by subtracting net profit and operating budget expenditures from total Lottery sales.
^{3/} To derive the profit transfer amounts, we applied the actual FY 2004 rate of return for each game to the current forecast.

The largest contributor to the forecast is the multi-state Powerball game. In FY 2004, this game reached its highest historical sales level due to large jackpots in July 2003, December 2003, and May 2004. Due to the uncertainty of predicting when large jackpots will accumulate, the forecast called for a decrease in FY 2005 followed by modest growth in FY 2006 and flat growth in FY 2007.

Sources and Uses of Lottery Profit Distributions

The chart below shows the sources of Lottery profits by revenue stream and illustrates the distributions to fund beneficiaries for FY 2004. A brief description of each beneficiary and its Lottery-generated revenue sources precedes the table.

Local Transportation Assistance Fund (LTAF)

LTAF receives shares of the proceeds from the Pick, Fantasy 5, and Instant Tickets games. The funds are distributed to counties, cities, and towns. The uses include road building, traffic signals, sidewalk and alley repair, general maintenance, and Dial-a-Ride operating expenses.

County Assistance Fund (CAF)

Shares of the proceeds from 3 games – The Pick, Fantasy 5, and Instant Tickets – are directed to CAF, which receives a maximum of \$7,650,000 each fiscal year. The monies are distributed to the General Funds of each of the counties to be used at their discretion.

Heritage Fund

The Heritage Fund receives a portion of the proceeds from the Pick, Fantasy 5, and Scratch Bingo games up to a maximum of \$20 million. Monies are divided equally between the Game and Fish Commission Heritage Fund and the State Parks Board Heritage Fund. The funds are used to promote wildlife habitat and education programs, rehabilitate historic buildings, acquire and develop parkland, and renovate trail systems, among other purposes.

General Fund

The General Fund derives most of its Lottery proceeds from the sale of multi-state (Powerball) tickets. It also receives additional funds that are remaining after the statutory funding obligations have been met.

Commerce and Economic Development (CEDC) Fund

Administered by the Arizona Department of Commerce, CEDC receives its funds from the sales of 2 Arizona Lottery Scratchers games. The funds are used to support the state's community and economic development goals, initiatives, and strategic plans as defined and developed by the CEDC.

Health and Welfare Programs

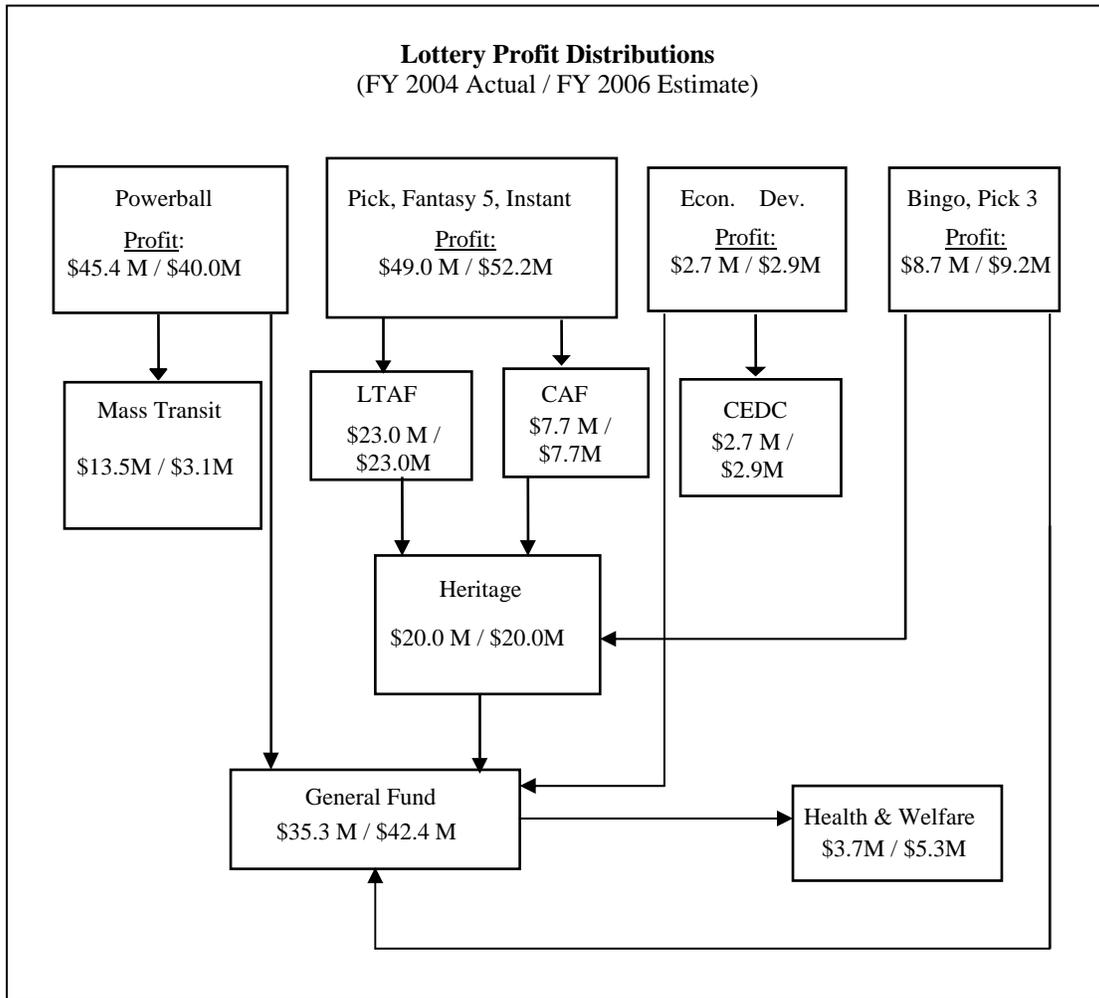
The Healthy Arizona Funds received Lottery monies for the first time in FY 2004. The \$3,670,700 received was pro-rated and distributed among the following agencies:

- \$1,079,186 to the Department of Economic Security for the Healthy Families program.
- \$862,614 to the Board of Regents for the Arizona Health Education Center program.
- \$646,043 to the Department of Health Services (DHS) for teenage pregnancy prevention.
- \$433,143 to DHS for the Disease Control Research Center.
- \$433,143 to DHS for the Health Start program.
- \$216,571 to DHS for the Women, Infants and Children food program.

Mass Transit Fund

The Mass Transit Fund (otherwise known as LTAF II) receives its monies from Powerball ticket sales after obligations to the General Fund are met. The funds are used by the counties to enhance existing public transportation systems.

Lottery Profit Distributions
(FY 2004 Actual / FY 2006 Estimate)



ARIZONA LOTTERY FUND DISTRIBUTION
JLBC FORECAST
FY 2004 Actual - FY 2006 Forecast

FUND DISTRIBUTION	FY 2004	FY 2006
LTAf	\$ 23,000,000	\$ 23,000,000
CAF	7,650,000	7,650,000
HERITAGE	20,000,000	20,000,000
GENERAL FUND*	32,837,700	42,375,200
CEDC	2,674,500	2,904,900
HEALTH & WELFARE:	3,670,700	5,319,800
Healthy Families	1,079,186	1,564,000
AZ Health Education Center	862,615	1,250,200
Teen Pregnancy Prevention	646,043	936,300
Disease Control Research	433,143	627,700
Health Start	433,143	627,700
WIC	216,571	313,900
MASS TRANSIT	13,528,100	3,062,900
TOTAL DISTRIBUTION*	\$103,361,000	\$104,312,800

* Excludes General Fund appropriations transfers and CASA