

Arizona State Lottery Commission

JLBC: Brian Cary
 OSPB: Bret Cloninger

DESCRIPTION	FY 2004 ACTUAL	FY 2005 ESTIMATE	FY 2006 JLBC	FY 2007 JLBC
OPERATING BUDGET				
<i>Full Time Equivalent Positions</i>	110.0	110.0	110.0	110.0
Personal Services	3,991,000	4,418,500	4,418,500	4,418,500
Employee Related Expenditures	1,150,800	1,237,000	1,227,500	1,227,500
Professional and Outside Services	250,800	344,400	344,400	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	7,040,900	6,905,600
SPECIAL LINE ITEMS				
Advertising	9,646,000	9,580,400	9,903,600	9,903,600
Compulsive Gambling Treatment and Information	267,600	0	0	0
Instant Tickets	5,493,300	6,893,300	7,182,000	7,182,000
On-Line Vendor Fees	9,139,600	8,151,100	8,348,300	8,348,300
Retailer Commissions	24,137,300	23,773,700	24,575,600	24,575,600
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	59,914,800	59,779,500

FUND SOURCES

Other Appropriated Funds

State Lottery Fund	58,230,800	58,088,700	59,914,800	59,779,500
SUBTOTAL - Other Appropriated Funds	58,230,800	58,088,700	59,914,800	59,779,500
SUBTOTAL - Appropriated Funds	58,230,800	58,088,700	59,914,800	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	262,487,200	262,487,200

CHANGE IN FUNDING SUMMARY

	FY 2005 to FY 2006 JLBC		FY 2005 to FY 2007 JLBC	
	\$ Change	% Change	\$ Change	% Change
Other Appropriated Funds	1,826,100	3.1%	1,690,800	2.9%
Total Appropriated Funds	1,826,100	3.1%	1,690,800	2.9%
Non Appropriated Funds	6,843,800	3.5%	6,979,100	3.6%
Total - All Sources	8,669,900	3.4%	8,669,900	3.4%

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.

PERFORMANCE MEASURES	FY 2003 Actual	FY 2004 Actual	FY 2005 Estimate	FY 2006 JLBC
• Amount of estimated on-line sales (\$ in millions)	163.0	183.3	132.0	--
• Increase in on-line sales from prior year (\$ in millions) (NEW)	11.7	20.3	--	4.0
• Amount of estimated instant ticket sales (\$ in millions)	159.3	183.3	160.5	--
• Increase in instant ticket sales from prior year (\$ in millions) (NEW)	15.8	24.0	--	8.0
• % of active retailer accounts in good standing	99.1	99.6	99.8	--
• % of agency staff turnover	13.4	15.4	11.4	--
• Administration as a % of total cost	7.8	7.6	8.3	--
• Customer satisfaction rating for retailers (Scale 1-8)	6.5	7.0	6.1	7.0
• % of Lottery ticket sales distributed to state beneficiaries	29.7	29.4	27.95	--

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. The agency's survey of retailers showed an increase in overall satisfaction with the Lottery's services in FY 2004. The JLBC recommends 2 new performance measures – year-over-year increases in on-line sales and in estimated tickets sales – to replace the absolute amounts of on-line sales and instant ticket sales, respectively. This will better measure whether the Lottery's efforts are producing net increases in the 2 major games categories each year.

RECOMMENDED CHANGES FROM FY 2005

Operating Budget

The JLBC recommends \$7,040,900 from the State Lottery Fund for the operating budget in FY 2006 and \$6,905,600 in FY 2007. These amounts would fund the following adjustments:

Standard Changes	OF	FY 2006 \$(22,900)	FY 2007 \$(22,900)
-------------------------	-----------	-------------------------------------	-------------------------------------

The JLBC recommends a decrease of \$(22,900) from the State Lottery Fund in FY 2006 and FY 2007 for standard changes.

Computer Replacement OF 110,000 0

The JLBC recommends 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 backup system was purchased in 1996 and by FY 2006 will no longer be compatible with the other systems. The Government Information Technology Agency (GITA) approved the Lottery's Project Investment Justification for the computer upgrade in October 2004.

The JLBC recommends replacing the current backup system 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

Computing Resources OF 69,100 69,100

The JLBC recommends an increase of \$69,100 from the State Lottery Fund in FY 2006 and FY 2007 for the replacement of personal computing resources. A 3-year technology replacement schedule for FY 2005, FY 2006 and FY 2007 was approved by GITA. However, funding was not approved to begin the cycle in FY 2005.

Reinstating the replacement schedule would ensure that the agency would have the technology needed to perform required job functions. The agency would continue to improve systems productivity and stability. It expects to achieve cost savings through equipment standardization, improved security and network management software, and avoidance of non-warranty repairs.

Replace Office Furniture OF 58,900 33,600

The JLBC recommends 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. Much of the furniture has been in use since 1987 and the functionality of desks, cubicles and chairs has declined. The JLBC recommends funds to replace 46 desks and 29 cubicles FY 2006 and 132 chairs in FY 2007.

Many cubicle parts are broken and the agency does not have the flexibility to reconfigure cubicles. Many of the cubicles being used are not designed to accommodate a personal computer and keyboard. The desks used by the majority of the staff either have typewriter extensions that are too small to accommodate a PC, mouse, and keyboard,

or they are standard 2-pedestal desks without lowered surfaces for PC keyboards. New desks and cubicles that are ergonomically designed for the PC environment would improve productivity and reduce repetitive action injuries such as carpal tunnel syndrome. Three workers' compensation claims related to repetitive action injuries have been reported by the agency's Human Resources Director.

Special Line Items

Advertising

The JLBC recommends \$9,903,600 from the State Lottery Fund for Advertising in FY 2006 and FY 2007. These amounts would fund the following adjustments:

Sales Increase OF 323,200 323,200

The JLBC recommends 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 for Legislative Consideration – 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 JLBC recommends 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 JLBC recommends \$7,182,000 from the State Lottery Fund for Instant Tickets in FY 2006 and FY 2007. These amounts would fund the following adjustments:

Sales Increase OF 288,700 288,700

The JLBC recommends 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 for Legislative Consideration – 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 JLBC recommends \$8,348,300 from the State Lottery Fund for On-Line Vendor Fees in FY 2006 and FY 2007. These amounts would fund the following adjustments:

Sales Increase OF 197,200 197,200

The JLBC recommends 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 for Legislative Consideration – 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 JLBC recommends \$24,575,600 from the State Lottery Fund for Retailer Commissions in FY 2006 and FY 2007. These amounts would fund the following adjustments:

Sales Increase OF 801,900 801,900

The JLBC recommends 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 for Legislative Consideration – 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 JLBC recommends \$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 JLBC recommends \$2,814,400 from the State Lottery Fund for the Telecommunications 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.

* * *

JLBC RECOMMENDED FORMAT — Operating Lump Sum with Special Line Items by Agency

JLBC RECOMMENDED FOOTNOTES

Standard Footnotes

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 FY 2007.

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 FY 2007.

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 or \$8,348,300 in FY 2006 and FY 2007, or 4.99% of actual on-line ticket sales.

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 estimated to be 6.7% of total ticket sales, or \$24,575,600 in FY 2006 and FY 2007.

JLBC RECOMMENDED STATUTORY CHANGES

Powerball Profit Distribution

The JLBC recommends requiring the Lottery to return to the state 31.6% of Powerball sales up to a maximum of \$31,000,000 in FY 2006 and FY 2007 to the General Fund. The FY 2004 and FY 2005 rate is 31.6% as provided in Laws 2004, Chapter 283. The recommended rate maintains the return at this amount. The Lottery revenue distribution table includes this return from Powerball in both FY 2006 and FY 2007. (See "Other Issues for Legislative Consideration – Lottery Forecast" for additional information.)

OTHER ISSUES FOR LEGISLATIVE CONSIDERATION

Lottery Forecast

The JLBC Staff forecasts a decrease in overall Lottery sales for FY 2005, followed by an increase in FY 2006 and no change in FY 2007. For FY 2005, total Lottery sales are forecast to be \$354,800,000. For FY 2006 and

FY 2007, the JLBC Staff forecasts Lottery sales of \$366,800,000 in each fiscal year.

The largest contributor to the FY 2005 forecasted decrease 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 calls for a decrease in FY 2005 followed by modest growth in FY 2006 and flat growth in FY 2007.

Among the state-only games that the Lottery administers, instant tickets have been the most successful, posting a 10.9% compound annual growth rate over the last 5 years. The JLBC Staff forecasts continued growth in instant ticket sales over the next 3 years fueled by growth in the retailer base and population.

However, the recent growth in instant ticket sales has been tempered by a (4.9)% compound annual decrease in state-only on-line game sales during the same period. The JLBC Staff forecasts a continued downward trend in state-only on-line game sales as players are drawn to instant ticket games and the potential of large jackpots offered by Powerball.

One risk to the forecast is the potential impact on Lottery sales by the expansion of Native American gaming. Voters approved Proposition 204 in the November 2002 General Election, which provides for additional slot machines and table games such as blackjack in Native American casinos. It is possible that current Lottery players will substitute casino gaming for playing the Lottery, but the extent of the substitution effect cannot be measured.

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	183.3	163.3	167.3	167.3
Total Sales	<u>\$366.5</u>	<u>\$354.8</u>	<u>\$366.8</u>	<u>\$366.8</u>
Less:				
Operating Budget	\$58.2	\$58.1	\$59.9	\$59.8
Prizes ^{1/}	204.9	198.2	202.6	202.7
Net Profit ^{2/}	<u>\$103.4</u>	<u>\$98.5</u>	<u>\$104.3</u>	<u>\$104.3</u>
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	9.0	9.0
Health & Welfare				
Programs	3.7	3.8	5.3	5.3
General Fund	<u>32.8</u>	<u>34.5</u>	<u>36.4</u>	<u>36.4</u>
Total Transfer	\$103.4	\$98.5	\$104.3	\$104.3
^{1/} Prizes are estimated by subtracting net profit and operating budget expenditures from total Lottery sales. ^{2/} To derive the profit transfer amounts, we applied the actual FY 2004 rate of return for each game to the current forecast.				

The JLBC Staff forecast of Lottery profits for FY 2006 and FY 2007 applies the FY 2004 percent return to the state for each individual game. In FY 2004, the Lottery returned a total of 28.9% of all tickets sold.

SUMMARY OF FUNDS	FY 2004 Actual	FY 2005 Estimate
State Lottery (LOA2122/A.R.S. § 5-521)		Partially-Appropriated
Source of Revenue: Sales of lottery tickets, retailer license fees and interest earnings.		
Purpose of Fund: A portion of the fund is appropriated to pay for all costs of the Arizona State Lottery Commission. In addition, Laws 2003, Chapter 262 transfers \$2,500,000 in FY 2004 from the State Lottery Fund to the General Fund and Laws 2004, Chapter 275 transfers \$2,500,000 from the State Lottery Fund to the General Fund in FY 2005. After all expenses are paid including the prize monies displayed below in the Non-Appropriated Funds Expended line, Lottery profits are distributed to the Local Transportation Assistance Fund, the County Assistance Fund, the Heritage Fund, the Arizona Clean Air Fund, the Economic Development Commission, various health and welfare programs, the General Fund, and the Local Transportation Assistance Fund-Mass Transit, revenues permitting.		
Appropriated Funds Expended - Capital	31,900	41,200
Appropriated Funds Expended - Operating	58,230,800	58,088,700
Appropriated Funds Expended - Profit Distributions	103,361,000	98,514,000
Non-Appropriated Funds Expended	202,367,500	195,728,600
Funds Transferred to General Fund	2,500,000	2,500,000
Year-End Fund Balance	0	0

[Click here to return to the Table of Contents](#)