

Executive Director: Art Macias

JLBC Analyst: Leatta McLaughlin

	FY 2005 Actual	FY 2006 Estimate	FY 2007 Approved
<b>OPERATING BUDGET</b>			
<i>Full Time Equivalent Positions</i>	110.0	110.0	110.0
Personal Services	4,178,900	4,582,300	4,787,400
Employee Related Expenditures	1,234,400	1,399,700	1,623,200
Professional and Outside Services	297,900	357,100	366,800
Travel - In State	207,800	246,400	246,400
Travel - Out of State	13,400	16,700	16,700
Other Operating Expenditures	529,200	550,100	616,200
Equipment	100,500	238,000	102,700
<b>OPERATING SUBTOTAL</b>	<b>6,562,100</b>	<b>7,390,300</b>	<b>7,759,400</b>
<b>SPECIAL LINE ITEMS</b>			
Advertising <sup>1/</sup>	10,280,400	11,000,000	11,000,000 <sup>2/</sup>
Instant Tickets <sup>1/</sup>	7,310,700	8,856,000	9,635,400 <sup>3/</sup>
On-Line Vendor Fees <sup>1/</sup>	8,132,600	10,736,700	8,287,600 <sup>4/</sup>
Retailer Commissions <sup>1/</sup>	26,505,400	30,898,000	31,816,600 <sup>5/</sup>
Sales Incentive Program	27,000	50,000	50,000
Telecommunications	2,565,100	2,814,400	2,814,400
<b>AGENCY TOTAL</b>	<b>61,383,300</b>	<b>71,745,400</b>	<b>71,363,400<sup>6/</sup></b>

**FUND SOURCES**

Other Appropriated Funds

State Lottery Fund	61,383,300	71,745,400	71,363,400
SUBTOTAL - Other Appropriated Funds	61,383,300	71,745,400	71,363,400
<b>SUBTOTAL - Appropriated Funds</b>	<b>61,383,300</b>	<b>71,745,400</b>	<b>71,363,400</b>
Other Non-Appropriated Funds	225,300,000	256,400,000	267,800,000
<b>TOTAL - ALL SOURCES</b>	<b>286,683,300</b>	<b>328,145,400</b>	<b>339,163,400</b>

**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.

- <sup>1/</sup> 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.
- <sup>2/</sup> 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. (FY 2006 General Appropriation Act footnote) As of July 2006, this estimate is capped at \$11,000,000 in FY 2006 and FY 2007.
- <sup>3/</sup> 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. (FY 2006 General Appropriation Act footnote) As of July 2006, this estimate is \$8,856,000 in FY 2006 and \$9,635,400 in FY 2007.
- <sup>4/</sup> 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. (FY 2006 General Appropriation Act footnote) As of July 2006, this estimate is \$10,736,700 in FY 2006 and \$8,287,600 in FY 2007 due to a new on-line vendor contract, which will reduce the appropriation to 3.8012% of sales beginning September 1, 2006.
- <sup>5/</sup> 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. (FY 2006 General Appropriation Act footnote) As of July 2006, this estimate is \$30,898,000 in FY 2006 and \$31,816,600 in FY 2007.
- <sup>6/</sup> General Appropriation Act funds are appropriated as an Operating Lump Sum with Special Line Items by Agency.

PERFORMANCE MEASURES	FY 2003	FY 2004	FY 2005	FY 2007
	Actual	Actual	Actual	Approved
<ul style="list-style-type: none"> <li>Increase in on-line sales from prior year (\$ in millions) Comments: On-line sales are largely jackpot driven, impacting sales in any given year.</li> </ul>	11.7	20.3	(5.4)	4.0
<ul style="list-style-type: none"> <li>Increase in instant ticket sales from prior year (\$ in millions)</li> </ul>	15.8	24.0	36.4	8.0
<ul style="list-style-type: none"> <li>Customer satisfaction rating for retailers (Scale 1-8)</li> </ul>	6.5	7.0	7.6	7.0

This agency's budget was originally appropriated in Laws 2005, Chapter 286. For details on this agency's original FY 2007 budget, please see the *FY 2006 Appropriations Report*. Laws 2006, Chapter 344 made adjustments to the agency's FY 2007 budget as discussed below.

### **Operating Budget**

The budget provides \$7,759,400 from the State Lottery Fund for the operating budget in FY 2007. The amount includes an increase of \$743,800 from the State Lottery Fund for statewide adjustments. *(Please see the Statewide Adjustments section at the end of this Appropriations Report for details.)*

### **Special Line Items**

#### **Advertising**

The budget provides \$11,000,000 from the State Lottery Fund for Advertising in FY 2007. The approved amount includes an increase of \$1,096,400 from the State Lottery Fund due to a revised Lottery game sales estimate.

Monies in this line item are used to promote and market Lottery games. The actual appropriation is for 2.7% of total ticket sales, but no more than \$11,000,000.

#### **Instant Tickets**

The budget provides \$9,635,400 from the State Lottery Fund for Instant Tickets in FY 2007. The approved amount includes an increase of \$2,453,400 from the State Lottery Fund due to a revised Lottery instant tickets estimate.

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 \$8,287,600 from the State Lottery Fund for On-Line Vendor Fees in FY 2007. The approved amount includes a decrease of \$(60,700) from the State Lottery Fund due to a revised Lottery on-line game sales estimate and a new on-line vendor contract.

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 but will change to 3.8012% as of September 1, 2006. The displayed amount is derived by applying the approved percentage to the forecasted sales total.

#### **Retailer Commissions**

The budget provides \$31,816,600 from the State Lottery Fund for Retailer Commissions in FY 2007. The amount includes an increase of \$7,241,000 from the State Lottery Fund due to a revised Lottery game sales estimate.

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.

### **Additional Legislation**

#### **Powerball Distribution**

The General Revenues Budget Reconciliation Bill (Laws 2006, Chapter 351) 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 2007. This provision is a continuation of session law originally enacted in FY 2003. 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 \$6,000,000 to be deposited to the General Fund above the amount provided by statute.

The bill also specifies the Legislature's intent that Powerball distributions be made as prescribed in statute in FY 2008.

**Other Issues**

**Forecast**

The following table displays the revised January 2006 JLBC Staff forecast of Lottery ticket sales and the corresponding profit distribution. For FY 2006, the JLBC Staff estimates Lottery sales of \$461,200,000, followed by a forecast of \$474,900,000 in sales revenue for FY 2007.

<b>Forecast of Lottery Revenue Distribution</b>				
<b>(\$ in Millions)</b>				
	<b>FY 2004</b>	<b>FY 2005</b>	<b>FY 2006</b>	<b>FY 2007</b>
<b>Sales:</b>				
Instant Sales	\$183.2	\$219.7	\$246.0	\$267.7
On-Line Sales	<u>183.3</u>	<u>177.9</u>	<u>215.2</u>	<u>207.2</u>
Total Sales	\$366.5	\$397.6	\$461.2 <sup>1/</sup>	\$474.9
<b>Less:</b>				
Operating Budget	\$58.2	\$61.4	\$71.7	\$71.4
Prizes <sup>2/</sup>	<u>204.9</u>	<u>225.3</u>	<u>256.4</u>	<u>267.8</u>
Net Profit <sup>3/</sup>	\$103.4	\$110.9	\$133.1	\$135.7
<b>Profit Transfers:</b>				
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	2.9	3.8	4.1
Mass Transit	13.5	5.1	16.2	13.1
Health & Welfare Programs	3.7	17.0	17.4	17.7
General Fund	<u>32.8</u>	<u>35.2</u>	<u>45.0</u>	<u>50.1</u>
<b>Total Transfer</b>	<b>\$103.4</b>	<b>\$110.9</b>	<b>\$133.1</b>	<b>\$135.7</b>

1/ Total Sales were \$435.8 million through May 2006 and are projected to be approximately \$461.2 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 2005 rate of return for each game to the current forecast.

The largest single contributor to the forecast is the multi-state Powerball game. Although sales declined in FY 2005, a series of very large jackpots in October 2005, February 2006, and April 2006 produced a surge in Powerball sales in FY 2006. Due to the uncertainty of predicting when large jackpots will accumulate, the revised forecast calls for a modest decrease in Powerball sales in FY 2007. Continued growth in instant ticket sales revenue is expected to produce a net increase in total Lottery revenue in FY 2007.

**Sources and Uses of Lottery Profit Distributions**

The chart on the following page shows the sources of Lottery profits by revenue stream and illustrates the actual distributions to fund beneficiaries for FY 2005 and the projected distributions for FY 2007. 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 \$20,000,000. 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.

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.

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.

Health and Welfare Programs

The Healthy Arizona Funds reached the \$17,000,000 statutory limit for the first time in FY 2005, with adjustments for inflation to be made in subsequent fiscal years. The \$17,000,000 received was pro-rated and distributed among the following agencies:

- \$5,000,000 to the Department of Economic Security for the Healthy Families program.
- \$4,000,000 to the Board of Regents for the Arizona Health Education Center program.
- \$3,000,000 to the Department of Health Services (DHS) for teenage pregnancy prevention.
- \$2,000,000 to DHS for the Disease Control Research Center.
- \$2,000,000 to DHS for the Health Start program.
- \$1,000,000 to DHS for the Women, Infants and Children food program.

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.

