

Executive Director: Art Macias

JLBC Analyst: Juan Beltran

	FY 2007 Actual	FY 2008 Estimate	FY 2009 Approved
OPERATING BUDGET			
Full Time Equivalent Positions	110.0	110.0	110.0
Personal Services	4,472,300	5,010,500	5,010,500
Employee Related Expenditures	1,610,000	1,722,900	1,724,900
Professional and Outside Services	300,400	383,400	383,400
Travel - In State	273,100	269,800	269,800
Travel - Out of State	23,900	16,700	16,700
Other Operating Expenditures	609,300	651,200	1,204,600
Equipment	234,300	265,700	265,700
OPERATING SUBTOTAL	7,523,300	8,320,200	8,875,600
SPECIAL LINE ITEMS			
Advertising	10,571,800	11,000,000	20,162,700 ^{2/}
Instant Tickets ^{1/}	8,594,200	9,244,300	9,283,700 ^{3/}
On-Line Vendor Fees ^{1/}	8,004,700	8,506,200	9,031,200 ^{4/}
Retailer Commissions ^{1/}	30,610,300	31,338,600	32,284,600 ^{5/}
Sales Incentive Program	48,400	50,000	50,000
Telecommunications	1,134,700	654,400	654,400
Lump Sum Reduction	0	(84,400)	(84,900)
AGENCY TOTAL	66,487,400	69,029,300	80,257,300^{6/}
FUND SOURCES			
<u>Other Appropriated Funds</u>			
State Lottery Fund	66,487,400	69,029,300	80,257,300
SUBTOTAL - Other Appropriated Funds	66,487,400	69,029,300	80,257,300
SUBTOTAL - Appropriated Funds	66,487,400	69,029,300	80,257,300
Other Non-Appropriated Funds	301,563,800	310,817,200	323,588,100
TOTAL - ALL SOURCES	368,051,200	379,846,500	403,845,400

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, 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/} Based on projected sales, this amount is currently estimated to be \$20,162,700 in FY 2009. Laws 2008, Chapter 287 eliminates the 4% advertising cap, and allows the Lottery to spend up to 18.5% of total annual sales for operating expenses including advertising beginning September 26, 2008. This estimate of advertising expenditures was provided by the Lottery Commission.
- ^{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 \$9,283,700 in FY 2009. (General Appropriation Act footnote as adjusted for revised Lottery revenue forecast.)
- ^{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. (General Appropriation Act footnote as adjusted for changes in the on-line contract.)
- ^{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 \$32,284,600 in FY 2009. (General Appropriation Act footnote as adjusted for revised Lottery forecast)
- ^{6/} General Appropriation Act funds are appropriated as an Operating Lump Sum with Special Line Items by Agency.

PERFORMANCE MEASURES	FY 2005	FY 2006	FY 2007	FY 2009
	Actual	Actual	Actual	Approved
• Increase in on-line sales from prior year (\$ in millions) Comments: On-line sales are largely jackpot driven, impacting sales in any given year.	(5.4)	41.0	(17.7)	5.2
• Increase in instant ticket sales from prior year (\$ in millions)	36.4	30.1	11.2	2.2
• Customer satisfaction rating for retailers (Scale 1-8)	7.6	7.8	7.4	7.5

This agency's FY 2008 and FY 2009 budget was originally appropriated in Laws 2007, Chapter 255. For details on this agency's original FY 2008 and FY 2009 budgets, please see the *FY 2008 Appropriations Report*. The following narrative provides a comprehensive listing of all FY 2009 changes, whether as part of Chapter 255 or this year's budget.

Operating Budget

The budget provides \$8,875,600 and 110 FTE Positions from the State Lottery Fund for the operating budget in FY 2009. These amounts fund the following adjustments:

Continue FY 2008 Statewide Adjustments

The budget continues an increase of \$285,500 from the State Lottery Fund in FY 2009 for FY 2008 statewide adjustments. *(Please see the FY 2008 Statewide Adjustments narrative at the end of this Appropriations Report for details.)*

New Statewide Adjustment

The budget provides an increase of \$2,000 from the State Lottery Fund in FY 2009 for new statewide adjustments. *(Please see the New Statewide Adjustments narrative at the end of this Appropriations Report for details.)*

Additional Vehicle

The budget provides a decrease of \$(17,700) from the State Lottery Fund in FY 2009 for one-time costs associated with the purchase of an additional vehicle for the Security Division.

Personnel Funding

The budget provides a decrease of \$(28,900) from the State Lottery Fund in FY 2009 for one-time costs associated with the hiring of a Product Management Assistant and a Special Investigator.

Agencywide Performance Based Compensation Plan

The budget provides an increase of \$750,000 from the State Lottery Fund for the Agencywide Performance Based Compensation Plan in FY 2009. The FY 2009 Education Budget Reconciliation Bill (BRB) (Laws 2008, Chapter 287), appropriates \$750,000 to allow Lottery staff to receive performance incentives, directly tied to sales

objectives and agency sales goals. Monies are used to incentivize and retain qualified staff.

The Director of the State Lottery is required to submit a report on or before August 15 of each year to the Director of the JLBC and the Director of the Governor's Office of Strategic Planning and Budgeting containing the following:

- A summary of the criteria used to evaluate employee performance and distribution of any appropriation for the preceding year as performance pay.
- An accounting of total distributions of that appropriation.
- The percentages of that distribution that were based on individual employee performance and on lottery sales goals.

Advertising

The budget provides \$20,162,700 from the State Lottery Fund for advertising in FY 2009. This amount funds the following adjustments:

Advertising Cap Elimination

The budget provides an increase of \$9,162,700 from the State Lottery Fund for advertising in FY 2009. A.R.S. § 5-505 had previously limited Lottery advertising to no more than 4.0% of total annual gross Lottery revenues. Notwithstanding that provision, the FY 2008-2009 General Appropriations Act had further restricted advertising to 2.7%, but no more than \$11,000,000.

The FY 2009 budget adjusted these provisions. Laws 2008, Chapter 285, Section 26 suspended the General Appropriations Act caps for FY 2009. Laws 2008, Chapter 287 also eliminated the 4% cap in permanent law. As a result, there is no longer any specific limitation on advertising expenditures. The Lottery's overall administrative expenses, however, are capped at 18.5% of total annual revenues.

The funding level of \$20,162,700 is currently the Lottery's estimate of their advertising expenditures in FY 2009. Monies in this line item are used to promote and market Lottery games.

Instant Tickets

The budget provides \$9,283,700 from the State Lottery Fund for Instant Tickets in FY 2009. This amount funds the following adjustments:

Instant Ticket Sales Increase

The budget provides an increase of \$39,400 from the State Lottery Fund in FY 2009 for Instant Tickets due to higher projected sales.

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 \$9,031,200 from the State Lottery Fund for On-Line Vendor Fees in FY 2009. This amount funds the following adjustments:

New Vendor Contract

The budget provides an increase of \$525,000 from the State Lottery Fund in FY 2009 for On-Line Vendor Fees due to 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 a percentage of on-line ticket sales specified in the Lottery's contractual agreement with the vendor. The new contractor will incorporate network-related telecommunication costs for the first time, which will result in a decreased appropriation for the Telecommunications Special Line Item (SLI). (See the *Telecommunications SLI* for more information.)

The displayed amount is derived by applying the approved percentage to the forecasted sales total. The new contract rate of 4.0322% was applied to all of FY 2008 and FY 2009.

Retailer Commissions

The budget provides \$32,284,600 from the State Lottery Fund for Retailer Commissions in FY 2009. These amounts fund the following adjustments:

Sales Increase

The budget provides an increase of \$946,000 from the State Lottery Fund in FY 2009 for Retailer Commissions due to higher projected sales.

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 0.2% 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 2009. This amount is unchanged from FY 2008. 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 \$654,400 from the State Lottery Fund for Telecommunications in FY 2009. This amount is unchanged from FY 2008.

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.

Lump Sum Reduction

Additional Hiring Freeze Reduction

The budget provides an additional decrease of \$(500) from the State Lottery Fund in FY 2009 originally enacted as part of the FY 2008 budget revisions. This amount represents the agency's share of a statewide hiring freeze reduction. (Please see the *Statewide Hiring Freeze Reduction* section at the end of this *Appropriations Report* for details.)

Fund Transfers

The budget provides a transfer of \$5,996,400 from the State Lottery Fund to the General Fund in FY 2008 and \$4,543,600 in FY 2009. These transfers are not part of the agency's appropriation and are not reflected in the table above.

Revised Lottery Forecast and Distribution

The FY 2009 Education BRB (Laws 2008, Chapter 287) makes several changes in lottery operations in order to generate additional sales. These additional sales are to be primarily used to pay for 80% of the debt service associated with a new \$1 billion university capital construction lease-purchase issuance. (Please see the *FY 2009 Arizona Board of Regents Capital Outlay* section for details.)

To generate additional sales, Chapter 287:

- Removes the cap on Lottery advertising, which will effectively increase the level of advertising from \$11 million to \$20.2 million. *(Please see the Advertising Special Line Item.)*
- Appropriates \$750,000 to allow Lottery staff to receive performance incentives, directly tied to sale objectives and agency sales goals.

Beyond the statutory revisions, the Lottery Commission would implement several other administrative changes to increase sales:

- Offer higher prizes and increase aggregate game payouts from 60% to 70%.

- Increase utilization of “Lottery Express” machines, where customers are able to purchase all Lottery products. These machines were first integrated into the traditional network of instant ticket vending machines in FY 2007.

In FY 2008, the Lottery had estimated sales of \$467.7 million (and preliminary actual sales of \$472.9 million). Prior to the Chapter 287 changes, the JLBC Staff had forecast FY 2009 sales of \$481.9 million. With the Chapter 287 revisions, the Lottery Commission estimates increasing its sales level to \$576.1 million. *(Please see Table 1.)*

	Actuals FY 2007 ^{1/}	FY 2008 JLBC Estimate ^{1/}	FY 2009 JLBC Estimate ^{2/}	FY 2009 Lottery Estimate ^{3/}
Sales:				
Instant Sales	\$261.0	\$256.8	\$257.9	\$315.5
On-Line Sales	<u>201.2</u>	<u>211.0</u>	<u>224.0</u>	<u>260.6</u>
Total Sales	\$462.2	\$467.7 ^{4/}	\$481.9	\$576.1
Less:				
Operating Budget	\$ 66.5	\$ 69.1	\$ 70.1	\$ 89.6
Prizes ^{5/}	<u>258.8</u>	<u>259.8</u>	<u>268.3</u>	<u>329.1</u>
Net Profit ^{6/}	\$137.0	\$138.9	\$143.5	\$157.4
Profit Transfers:				
General Fund ^{7/}	31.0	31.0	31.0	31.0
LTAf II	9.8	18.0	18.0	9.5
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
Health and Welfare Programs	20.7	21.3	21.7	21.8
Homeless Shelters		1.0	1.0	1.0
General Fund ^{7/}	21.9	13.6	17.7	26.0
University Capital			0	12.7
Water Supply Development ^{8/}			0	0
Community Protection ^{8/}			0	0
Economic Development ^{9/}	<u>2.9</u>	<u>3.4</u>	<u>3.4</u>	<u>4.7</u>
Total Transfer ^{10/}	\$137.0	\$138.9	\$143.5	\$157.4

^{1/} Lottery used a different distribution formula in FY 2007 and FY 2008. These 2 years have been restated using the new distribution formula.
^{2/} Prior to Laws 2008, Chapter 287.
^{3/} Lottery Commission estimate after removal of advertising caps.
^{4/} Total preliminary actual sales were \$472.9 million.
^{5/} Prizes are estimated by subtracting net profit and operating budget expenditures from total Lottery sales.
^{6/} To derive the profit transfer amounts, the actual FY 2007 rate of return for each game was applied to the current forecast.
^{7/} In combination, two separate allocations total \$57 million in FY 2009.
^{8/} Effective beginning in FY 2010.
^{9/} Dedicated funding from 2 instant ticket games.
^{10/} Total Transfers might not add due to rounding.

Table 2

**Long Term Projections
(\$ in Millions)**

	Lottery Baseline Sales ^{1/}	Lottery Sales with changes ^{2/}	Beneficiaries Transfers ^{3/}	Available for University Capital Funding ^{4/}
FY 2010	\$510.7	\$638.4	\$136.1	\$13.6
FY 2011	552.9	694.8	137.9	26.5
FY 2012	600.2	759.1	139.8	41.4
FY 2013	630.2	797.0	141.9	48.5
FY 2014	661.8	836.9	144.1	55.8

^{1/} Lottery Commission Sales estimate without Chapter 287 or other changes.

^{2/} Lottery Commission Sales estimate with Chapter 287 and other changes.

^{3/} Beneficiary transfers up to and including the General Fund segment of the distribution formula.

^{4/} These amounts are available to pay for 80% of the annual debt service payments for the newly authorized \$1 billion University Bonding Package as required by Laws 2008, Chapter 287.

The Lottery Commission also forecasts further sales growth in future years as a result of the Chapter 287 changes. The Lottery anticipates sales will grow to \$638.4 million by FY 2010 and \$836.9 million by FY 2014. (Please see Table 2.)

Chapter 287 also modified the distribution formula of lottery proceeds to add the new university construction debt service contributions along with new payments to the Water Supply Development and Community Protection Initiative Funds. Except for the Commerce and Economic Development (CEDC) Fund, which still receives its funds from the sales of 2 Arizona Lottery Scratchers games, every beneficiary now receives funding from all ticket sources. The CEDC Fund is administered by the Arizona Department of Commerce and used to support the state's community and economic development goals, initiatives, and strategic plans as defined and developed by the CEDC. (Please see Table 1 for revised distribution formula.)

A brief description of each beneficiary follows in the order that they receive funding:

General Fund – Part 1

The General Fund receives up to \$31 million prior to other distributions. Laws 2008, Chapter 287 requires the General Fund to receive up to an additional \$26 million in FY 2009 above the \$31 million requirement (for a total of \$57 million.) Beginning in FY 2010, the General Fund would receive an additional \$15.49 million (for a total of \$46.49 million) after the statutory funding obligations have been met through the Homeless Shelters distribution.

Mass Transit Fund

The Mass Transit Fund (otherwise known as LTAF II) receives its monies after the \$31 million distribution to the General Fund is met. Starting in FY 2009, it will receive a maximum of \$9 million increasing by 10% every year until total revenues reach a maximum of \$18 million. However, Chapter 287 (Section 37) allocates \$9,499,300 from the State Lottery Fund in FY 2009 to the LTAF II Fund. The

funds are used by the counties to enhance existing public transportation systems.

Local Transportation Assistance Fund (LTAF)

The LTAF fund receives a maximum of \$23 million annually. 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)

The County Assistance Fund receives a maximum of \$7.65 million 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 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 park land, and renovate trail systems, among other purposes.

Health and Welfare Programs

Statute requires annual inflation adjustments for the Health and Welfare distribution. The current allocation is \$21.7 million. The amount is distributed among the following agencies:

- 29.4% to the Department of Economic Security for the Healthy Families program.
- 23.5% to the Board of Regents for the Arizona Health Education Center program.
- 17.6% to the Department of Health Services (DHS) for teenage pregnancy prevention.
- 11.8% to the AZ Biomedical Research Commission for Disease Control Research.
- 11.8% to DHS for the Health Start program.

- 5.9% to DHS for the Women, Infants and Children food program.

Homeless Shelters

The Department of Economic Security receives \$1 million for Homeless Shelters. The department shall use the funding to distribute grants to nonprofit organizations, including faith based organizations, for homeless emergency and transitional shelters and related support services.

General Fund – Part 2

As noted above, the General Fund receives an additional \$15.49 million after all prior allocations have been met.

University Capital Improvement Fund

The FY 2009 Education BRB requires that after all Lottery revenue beneficiaries have received their statutory distributions, up to \$20 million shall be deposited into the University Capital Improvement Fund in FY 2009. The Lottery estimates that this fund will receive approximately \$12.7 million in FY 2009.

This fund will serve as the source for 80% of the debt service associated with \$1 billion University Capital construction lease purchase. *(Please see the FY 2009 Arizona Board of Regents Capital Outlay section for details.)*

Water Supply Development Funding

The FY 2009 Education BRB adds the Department of Environmental Quality's Water Supply Development Fund as a new recipient starting in FY 2010. The purpose of this \$10 million distribution is to provide financial assistance to water suppliers for planning and design of water supply systems; purchasing or refinancing debt obligations for water providers; purchasing insurance for local bond obligations; and paying costs to administer the fund.

Community Protection Initiative Funding

The FY 2009 Education BRB adds the State Land Department's Community Protection Initiative Fund as a new recipient starting in FY 2010. The purpose of the fund is to assist local governments and private landowners in reducing the volume of hazardous fuels on nonfederal forested land in the state.

Table 3 illustrates the FY 2007 actual Lottery profit distribution.

Table 3

Lottery Profit Distributions
(FY 2007 Actuals)

