

Arizona State Lottery Commission

	FY 2011 ACTUAL	FY 2012 ESTIMATE	FY 2013 APPROVED
OPERATING BUDGET			
<i>Full Time Equivalent Positions</i>	104.0	104.0	97.8
Personal Services	3,976,700	4,617,300	4,617,300
Employee Related Expenditures	1,721,600	1,715,000	1,732,500
Professional and Outside Services	326,100	384,300	384,300
Travel - In State	212,400	269,800	269,800
Travel - Out of State	5,100	16,700	16,700
Other Operating Expenditures	914,200	1,156,600	1,156,600
Equipment	37,700	0	0
OPERATING SUBTOTAL	7,193,800	8,159,700	8,177,200
SPECIAL LINE ITEMS			
Advertising	14,486,300	15,500,000	15,500,000
Charitable Commissions	0	556,400	567,500 ^{1/}
Instant Tickets ^{2/}	9,286,700	13,678,900	14,359,800 ^{3/}
On-Line Vendor Fees ^{2/}	7,735,700	8,011,500	7,988,100 ^{4/}
Retailer Commissions ^{2/}	38,954,100	39,778,900	41,000,000 ^{5/}
AGENCY TOTAL	77,656,600	85,685,400^{6/}	87,592,600^{7/8/}
FUND SOURCES			
<u>Other Appropriated Funds</u>			
State Lottery Fund	77,656,600	85,685,400	87,592,600
SUBTOTAL - Other Appropriated Funds	77,656,600	85,685,400	87,592,600
SUBTOTAL - Appropriated Funds	77,656,600	85,685,400	87,592,600
Other Non-Appropriated Funds	361,933,100	364,386,600	376,282,500
TOTAL - ALL SOURCES	439,589,700	450,072,000	463,875,100

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

Operating Budget

The budget includes \$8,177,200 and 97.8 FTE Positions from the State Lottery Fund in FY 2013 for the operating budget. These amounts fund the following adjustments:

Statewide Adjustments

The budget includes an increase of \$17,500 from the State Lottery Fund in FY 2013 for statewide adjustments. (Please see the Agency Detail and Allocations section.)

- ^{1/} An amount equal to 20% of tab ticket sales is appropriated for payment of sales commissions to charitable organizations. This amount is currently estimated to be \$567,500 in FY 2013. (General Appropriation Act footnote)
- ^{2/} 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.
- ^{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 \$14,359,800 in FY 2013. (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 \$7,988,100, or 3.7% of actual on-line ticket sales in FY 2013. (General Appropriation Act footnote)
- ^{5/} An amount equal to 6.5% of gross lottery game sales, less Tab Tickets, is appropriated for payment of sales commissions to ticket retailers. 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 \$41,000,000 in FY 2013. (General Appropriation Act footnote)
- ^{6/} In addition to these amounts, a total of \$228,800 OF is appropriated in FY 2012 for costs associated with an additional pay period. (Please see the Agency Detail and Allocations.)
- ^{7/} General Appropriation Act funds are appropriated as an Operating Lump Sum with Special Line Items by Agency.
- ^{8/} In addition to these amounts, the General Appropriation Act included one-time FY 2013 adjustments for a state employee health insurance payment holiday and employee retention payments. These specific adjustments will be allocated to individual agencies at a later time. (Please see the General Provisions section.)

Advertising

The budget includes \$15,500,000 from the State Lottery Fund in FY 2013 for Advertising. This amount is unchanged from FY 2012.

Monies in this line item are used to promote and market Lottery games.

Charitable Commissions

The budget includes \$567,500 from the State Lottery Fund in FY 2013 for Charitable Commissions. This amount funds the following adjustments:

Tab Ticket Increase

The budget includes an increase of \$11,100 from the State Lottery Fund in FY 2013 to realign spending with projected revenues.

Monies in this line item are used to compensate charities for selling lottery 'Tab Tickets.' Laws 2010, Chapter 126 established a special type of instant ticket, Tab Tickets, to be sold exclusively by charitable organizations, who receive a 20% commission for selling the games. The displayed amount is derived by applying the approved percentage, 20%, to the forecasted Tab Ticket sales. A.R.S. § 5-505 and 5-555 also allow the department to collect up to 35% of total Tab Ticket sales for their operating budget and the department will distribute the remainder as prizes. A.R.S. § 5-555 does not become effective until July 1, 2012 and supplants language in A.R.S. § 5-505.

Instant Tickets

The budget includes \$14,359,800 from the State Lottery Fund in FY 2013 for Instant Tickets. This amount funds the following adjustments:

Instant Ticket Sales Increase

The budget includes an increase of \$680,900 from the State Lottery Fund in FY 2013 for Instant Tickets due to higher projected sales. (See Table 1 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 includes \$7,988,100 from the State Lottery Fund in FY 2013 for On-Line Vendor Fees. This amount funds the following adjustments:

On-Line Vendor Fees Decrease

The budget includes a decrease of \$(23,400) from the State Lottery Fund in FY 2013 for On-Line Vendor Fees due to lower projected sales. (See Table 1 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 a percentage of on-line ticket sales specified in the Lottery's contractual agreement with the vendor, which is 3.7%.

Retailer Commissions

The budget includes \$41,000,000 from the State Lottery Fund in FY 2013 for Retailer Commissions. This amount funds the following adjustments:

Retailer Commissions Increase

The budget includes an increase of \$1,221,100 from the State Lottery Fund in FY 2013 for Retailer Commissions due to higher projected sales. (See Table 1 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 non-Tab Ticket sales. Pursuant to statute, an additional 0.5% of total non-Tab 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.

Lottery Forecast and Distributions

The JLBC Staff forecasts a 2.2% increase in overall Lottery ticket sales in FY 2012, followed by a 3.1% increase in FY 2013. For FY 2012 and FY 2013, the JLBC Staff forecasts Lottery ticket sales of \$596,496,900 and \$614,778,700, respectively.

Sources and Uses of Lottery Profit Distribution

Table 1 shows the sources of forecasted Lottery profits by revenue stream and illustrates the actual distributions to fund beneficiaries for FY 2011 and the JLBC Staff projected distributions for FY 2012 and FY 2013. A brief description of each beneficiary follows in the order that they receive Lottery-generated revenue in accordance with A.R.S. § 5-522, 5-534 and 5-572. The latter section does not become effective until July 1, 2012 and supplants language in A.R.S. § 5-522.

State Lottery Revenue Bond Debt Service Payment Fund
Laws 2010, 6th Special Session, Chapter 4 authorized the Arizona Department of Administration (ADOA) to issue a 20-year, \$450,000,000 Lottery revenue bond by December

31, 2010 to be deposited into the General Fund. The payments are made from Lottery revenues that would have otherwise been deposited into the General Fund. The FY 2011 bond payment was \$21,445,900, which is interest only. The interest-only bond payment in FY 2012 is expected to be \$20,709,600 and the principal and interest payment for FY 2013 is expected to be \$37,499,600. Chapter 4 requires the first Lottery proceeds to be distributed to the State Lottery Revenue Bond Debt Service Payment Fund.

Maricopa County Mass Transit

A U.S. District Court has recently ruled that the state must spend a certain portion of Lottery revenues annually for mass transit in Maricopa County. This decision restores Lottery distributions for mass transit in Maricopa County based on legislation passed in 1993.

Laws 1993, 6th Special Session, Chapter 1 allocated not less than 31.5% of multi-state Powerball revenues to public transportation programs, otherwise known as Local Transportation Assistance Fund (LTAF) II. This allocation was capped at \$18,000,000 and was contingent upon the General Fund receiving \$45,000,000 in Lottery revenues.

These monies were allocated to political subdivisions. Maricopa County's share was part of the state's implementation plan to ensure compliance with the federal Clean Air Act.

Laws 2010, 7th Special Session, Chapter 12 redirected these monies to the General Fund. In September 2011, the U.S. District Court in the case of *Paisley v. Darwin* ruled that the Arizona Legislature must restore the distribution of mass transit monies to Maricopa County because the distribution was part of the state implementation plan to ensure compliance with the Clean Air Act.

The District Court reinstated the 1993 formula relative to Maricopa County. As a result, the state must calculate Maricopa County's share of 31.5% of statewide Powerball proceeds and distribute those monies to the county. For purposes of this calculation, the dollar level of statewide proceeds is not to exceed \$18,000,000. The Maricopa County distribution is contingent upon the General Fund receiving \$45,000,000 in Lottery revenues. The court order does not restore mass transit funding to any other local entity.

The projected annual distribution of Powerball proceeds to the Maricopa Public Transportation Fund is \$11,200,000 in FY 2012 and \$11,312,000 in FY 2013. Adding these distributions is likewise projected to reduce total transfers to the General Fund by \$(3,832,400) in FY 2012 and \$(5,685,600) in FY 2013. The University Capital Improvement (UCI) Fund distribution would absorb the remainder of the impact. These amounts are based upon

the Lottery Commission interpreting the court order to have a full year fiscal impact in FY 2012.

General Fund - Part 1

The statutory distribution requires the General Fund to receive up to \$84,150,000. As permanent law beginning in FY 2013, the FY 2013 Revenues Budget Reconciliation Bill (BRB) (Laws 2012, Chapter 297) modified the beneficiary distribution by increasing the General Fund - Part 1 distribution requirements by \$3,500,000, from the \$80,650,000 requirement in FY 2012. The General Fund - Part 2 would receive up to an additional \$15,490,000 (for a total of \$99,640,000) after the statutory funding obligations have been met through the Homeless Shelters distribution. After all other statutory obligations have been met, the General Fund - Part 3 would receive all remaining revenues.

The profit distributions in FY 2012 and FY 2013 are forecasted to fulfill requirements for General Fund - Part 1 and Part 2. It is assumed that Lottery revenue bond payments of \$20,709,600 in FY 2012 and \$37,499,600 in FY 2013 count towards the \$84,150,000 General Fund - Part 1 requirement. General Fund distributions, net of bond payments, are therefore projected to be \$75,430,400 in FY 2012 and \$62,140,400 in FY 2013.

Heritage Fund

Statute caps annual distributions to the Arizona Game and Fish Commission's Heritage Fund at \$10,000,000. The funds are used to promote wildlife habitat and education programs and to rehabilitate historic buildings. In FY 2012 and FY 2013, the fund is projected to receive its entire allocation.

Health and Welfare Programs

Statute requires annual inflation adjustments for the Health and Welfare distribution. The revised allocation cap is \$19,592,400 in FY 2012 and \$20,436,200 in FY 2013. These amounts are distributed among the following agencies:

- 29.4% to the Department of Economic Security (DES) for the Healthy Families program.
- 23.5% to the Arizona Board of Regents (ABOR) for the Arizona Health Education Center program.
- 17.6% to the Department of Health Services (DHS) for teenage pregnancy prevention.
- 11.8% to DHS 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.

Health and Welfare Programs are expected to receive their entire allocation in both FY 2012 and FY 2013.

Homeless Shelters

Under the statutory distribution, DES would receive up to \$1,000,000 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. The fund is estimated to receive its full allocation in both FY 2012 and FY 2013.

General Fund - Part 2

As noted above, the General Fund would receive up to an additional \$15,490,000 after all prior allocations have been met. In FY 2012 and FY 2013, the General Fund is estimated to receive its entire allocation of \$15,490,000.

Arizona Competes Fund

Statute caps annual distributions to the Arizona Competes Fund at \$3,500,000. The FY 2013 Revenues BRB, as permanent law, modified the beneficiary distribution by moving the Arizona Competes Fund distribution after the General Fund – Part 2 distribution. Laws 2011, 2nd Special Session, Chapter 1 previously directed the first \$3,500,000 of the beneficiary distribution, after all related debt service transfers, to the Arizona Competes Fund. Allotments to this fund are used for administering grants to qualifying businesses for the purpose of attracting, retaining, and expanding business within the state. This fund is estimated to receive its full allocation in both FY 2012 and FY 2013.

University Capital Improvement Fund

This fund serves as the source for up to 80% of the annual debt service associated with \$800,000,000 of University Capital construction lease-purchase. This fund received \$5,963,900 in FY 2011, which was 80% of the annual debt service payments. The UCI Fund is expected to receive \$2,864,200 in FY 2012 and \$4,766,200 in FY 2013, which is less than 80% of the expected debt service payment for each year. The full 80% would have generated revenues to the fund of \$10,231,900 in FY 2012 and \$10,392,700 in FY 2013. *(Please see the FY 2013 ABOR Capital Outlay section for more details.)*

General Fund - Part 3

The General Fund receives all remaining revenues after all statutory funding obligations have been met. In FY 2012 and FY 2013, the General Fund is estimated to receive \$0.

Other Issues

Reduce Vacant FTE Positions

The FY 2013 budget reduced FTE ceilings for large agencies with a significant number of unfunded, unfilled positions. Although there were variations, the general policy was to reduce the vacancy factor to 10% for agencies with more than 100 FTE Positions. The budget for the Lottery Commission includes a reduction of (6.2) OF FTE Positions in FY 2013 for this policy, incorporated into the figures above.

Attorney General Charge

Laws 2012, Chapter 302, the FY 2013 Criminal Justice BRB, revises the mechanism for agencies to pay their Attorney General prorata charges. Prior to FY 2013, agencies paid a percent of their personal services to the Attorney General as part of a statewide allocation of that department's expenses. This prorata charge was separate from any funding arrangement contained in an agency's intergovernmental agreement with the Attorney General.

The Criminal Justice BRB eliminated the prorata personal services charge. An agency's General Fund appropriation will no longer be charged for Attorney General Services. The prorata Non-General Fund charge has been converted into a flat dollar amount as annually specified by the General Appropriations Act. Section 134 of the General Appropriations Act specifies a statewide FY 2013 Non-General Fund charge of \$1,906,400 for Attorney General services. The Lottery Commission's share of this Non-General Fund charge will be \$24,800. Agencies will pay this charge from their appropriated and non-appropriated non-General Fund sources; the Criminal Justice BRB requires agencies to report to JLBC by September 1 annually the specific funds used.

Table 1

**Forecast of Lottery Revenue Distribution
(\$ in Millions)**

<u>Sales</u>	<u>FY 2011</u>	<u>FY 2012</u>	<u>FY 2013</u>
Instant Sales	\$374.5	\$380.0	\$398.9
On-Line Sales	<u>209.0</u>	<u>216.5</u>	<u>215.9</u>
Total Sales	\$583.5	\$596.5	\$614.8
<i>Less:</i>			
Operating Budget ^{1/}	\$ 77.7	\$ 85.6	\$ 87.6
Fund Transfers ^{2/}	1.8	1.9	0.0
Gaming Distribution	0.3	0.3	0.3
Prizes ^{3/}	<u>361.9</u>	<u>364.4</u>	<u>376.3</u>
Net Profit ^{4/}	\$141.8	\$144.3	\$150.6
 <u>Profit Transfers</u>			
Debt Service Fund ^{5/}	\$ 21.4	\$ 20.7	\$ 37.5
Maricopa County Mass Transit ^{6/}	N/A	11.2	11.3
General Fund - Part 1 ^{7/}	65.9	59.9	46.6
Heritage	10.0	10.0	10.0
Health and Welfare Programs	18.8	19.6	20.4
Homeless Shelters	1.0	1.0	1.0
General Fund - Part 2 ^{7/}	15.5	15.5	15.5
Arizona Commerce Authority ^{8/}	N/A	3.5	3.5
University Capital	6.0	2.9	4.8
General Fund - Part 3 ^{7/}	0.0	0.0	0.0
Economic Development ^{9/}	<u>3.2</u>	<u>N/A</u>	<u>N/A</u>
Total Transfer	\$141.8	\$144.3	\$150.6

- ^{1/} Of this amount, an estimated \$556,400 in FY 2012 and an estimated \$567,500 in FY 2013 will be distributed to charities.
- ^{2/} Transfers in FY 2011 include a \$1,328,100 continued Fund Reduction and Transfer (FRAT) and a \$453,800 pay/benefit reduction. In FY 2012, there is a \$1,352,400 continued FRAT and a \$509,400 pay/benefit reduction.
- ^{3/} Prizes are estimated by subtracting net profit and operating budget expenditures from total Lottery sales.
- ^{4/} To derive the profit transfer amounts, the actual FY 2011 rate of return for each game was applied to the current budget forecast. The cumulative profit transfer rate is 24.67%.
- ^{5/} Of the \$21,445,900 in debt service payments for FY 2011, \$2,255,000 was paid with profits generated in FY 2010.
- ^{6/} As a result of a federal court order, Maricopa County's share of Local Transportation Assistance Fund II monies was reinstated starting September 2011. (*See Lottery Forecast and Distributions for more information.*)
- ^{7/} Excluding fund transfers, total distributions to the General Fund totaled \$81,440,500 in FY 2011 and are estimated to be \$75,430,400 in FY 2012 and \$62,140,400 in FY 2013.
- ^{8/} Laws 2012, Chapter 297 moves the Arizona Competes Fund distribution from before General Fund – Part 1 to after General Fund – Part 2, beginning in FY 2013.
- ^{9/} Dedicated funding from 2 instant ticket games. Economic Development transfer was permanently eliminated in FY 2012 by Laws 2011, 2nd Special Session, Chapter 1.