

ARIZONA STATE LOTTERY COMMISSION

Geoffrey E. Gonsler, Executive Director

A.R.S. § 5-501

JLBC Analyst: Jim Rounds

State Lottery Fund	FY 1998 Actual	FY 1999 Estimate	FY 2000 Approved	FY 2001 Approved
FTE Positions	121.0	121.0	123.0	125.0
Personal Services	3,443,900	3,804,400	3,949,900	4,084,900
Employee Related Expenditures	725,100	784,800	834,600	883,700
Professional and Outside Services	108,100	171,800	207,200 ^{1/}	208,500 ^{1/}
Travel - In State	152,500	183,900	197,900	211,900
Travel - Out of State	22,200	16,700	16,700	16,700
Other Operating Expenditures	1,425,900	1,243,400	1,384,800	1,664,000
Equipment	678,300	0	6,000	5,100
Operating Subtotal	6,556,000	6,205,000	6,597,100	7,074,800
Instant Tickets ^{2/}	3,023,500	3,034,700 ^{3/}	3,133,100 ^{3/}	3,234,600 ^{3/}
Advertising ^{2/}	7,886,400	9,362,800 ^{4/}	6,462,800 ^{4/}	6,165,100 ^{4/}
On-Line Vendor Fees ^{2/}	4,661,100	5,492,500 ^{5/}	4,895,600 ^{5/}	4,389,500 ^{5/}
Retailer Commissions ^{2/}	16,236,600	16,448,100 ^{6/}	15,558,500 ^{6/}	14,842,000 ^{6/}
Sales Incentive Program	33,100	50,000	50,000	50,000
Telecommunications	1,998,000	1,989,800	2,289,500	2,090,500
Compulsive Gambling Treatment and Information	0	0	500,000 ^{7/}	500,000 ^{7/}
Total Appropriations	40,394,700	42,582,900	39,486,600 ^{8/9/10/11/}	38,346,500 ^{8/9/10/11/}

^{1/} Includes an adjustment for Office of the Attorney General legal services. (See the Salary Adjustment table at the front of this report for more information.)

^{2/} Advertising, Instant Tickets, On-line Vendor Fees, and Retailer Commissions are appropriated as a percentage of sales and, therefore, the amounts shown for those line items in FY 1999 – FY 2001 are estimates only.

^{3/} An amount equal to 3.1% of 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 \$3,536,100 in FY 2000 and \$3,637,600 in FY 2001. (General Appropriation Act footnote) Subsequently, based upon the revised forecast, this amount is estimated to be \$3,133,100 in FY 2000 and \$3,234,600 in FY 2001.

^{4/} 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 \$6,462,800 in FY 2000 and \$6,165,100 in FY 2001. (General Appropriation Act footnote)

^{5/} An amount equal to a percentage of on-line game sales as determined by contract is appropriated for payment of on-line vendor fees. This amount is currently estimated to be \$4,435,400 in FY 2000 and \$3,929,300 in FY 2001 or 3.54% of on-line ticket sales. (General Appropriation Act footnote) Subsequently, based upon the revised forecast, this amount is estimated to be \$4,895,600 in FY 2000 and \$4,389,500 in FY 2001.

^{6/} 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 6.65% of total ticket sales, or \$15,917,600 in FY 2000 and \$15,184,500 in FY 2001. (General Appropriation Act footnote) Subsequently, based upon the revised compensation rate of 6.5%, this amount is currently estimated to be \$15,558,500 in FY 2000, and \$14,842,000 in FY 2001. (See "Retailer Commissions" below for more information.)

^{7/} Of the amount appropriated for Compulsive Gambling Treatment and Information, 50% shall be used to contract for a statewide toll free crisis hotline to promote public education and awareness about compulsive gambling problems and to provide public information on gambling addiction. The remaining 50% of the appropriated amount shall be used to contract for the treatment of individuals who are compulsive gamblers. (General Appropriation Act footnote)

^{8/} In addition to the amounts appropriated above, the sum of \$277,200 is appropriated in FY 2000 to lease 105 instant ticket vending machines, and \$554,400 is appropriated in FY 2001 to lease 210 instant ticket vending machines. If S.B. 1335 of the 44th Legislature, 1st Regular Session is not enacted into law, the \$277,200 appropriated for the additional 105 instant ticket vending machines in FY 2000 reverts to the State Lottery Fund on July 1, 1999. In addition, if the same legislation is not enacted into law, the \$554,400 appropriated for the 210 instant ticket vending machines in FY 2001 and the \$90,400 appropriated for the additional 2 investigator positions in FY 2001 revert to the State Lottery Fund on July 1, 2000. (General Appropriation Act footnote) This appropriation is included in the above operating budget display, and is not in addition to the amounts shown in the table. However, the Governor vetoed SB 1335. Therefore, these monies will not be available for expenditure on the ITVMs and 2 investigator positions and instead will revert to the State Lottery Fund on the specified dates.

^{9/} Before expending any of the FY 2001 appropriation to lease an additional 105 machines above FY 2000, the commission shall submit to the Joint Legislative Budget Committee for review by July 31, 2000 a report of estimated instant ticket sales increases from the 105 instant ticket vending machines acquired in FY 2000. The report shall indicate if the increase in state profit from the increase in instant ticket sales was greater than the cost of the machines. If the report does not demonstrate that the machines generated enough state profit to pay for the cost of the machine lease, the \$277,200 appropriated in FY 2001 for the additional 105 instant ticket vending machines and the \$90,400 appropriated in FY 2001 for the additional 2 investigator positions revert to the State Lottery Fund on August 1, 2000. (General Appropriation Act footnote) This review will not be required since the monies for the additional ITVMs will not be available for expenditure and instead will revert to the State Lottery Fund as a result of a gubernatorial veto. (See footnote 8.)

^{10/} General Appropriation Act funds are appropriated as an Operating Lump Sum with Special Line Items by Agency.

^{11/} This amount does not include a \$1,500,000 "trigger" appropriation made by Laws 1999, Chapter 5, 1st Special Session. Triggered appropriations in FY 2000 or FY 2001 depend on the availability of excess revenues. (For more information, refer to the "Summary of Appropriations Triggered by Revenues" table at the front of this report.)

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Agency Description — *The Arizona Lottery is responsible for administering sanctioned games of chance to generate revenues for the state. The beneficiary funds are the Local Transportation Assistance Fund (LTAF), the County Assistance Fund (CAF), the Heritage Fund, the Commerce and Economic Development Commission (CEDC), the Arizona Clean Air Fund (ACAF), the LTAF specifically for mass transit uses, various health and welfare programs, and the General Fund. A portion of unclaimed prizes benefits the Court Appointed Special Advocate (CASA) program.*

Instant Ticket Vending Machines (ITVMs) — The approved FY 2000 amount includes an increase of \$39,800 for contractual obligations related to the leasing of the commission's current 221 ITVMs. This amount is continued in FY 2001. The new ITVM contract includes an annual increase per machine of \$180 for a total annual cost of \$2,640 per machine.

The approved FY 2000 amount also includes an increase of \$277,200 to lease 105 new ITVMs. The approved FY 2001 amount includes a further increase of \$277,200 to lease an additional 105 new ITVMs. A related footnote requires the reversion of the monies appropriated for the additional machines if S.B. 1335 of the 44th Legislature, 1st Regular Session is not enacted into law (*see Other Issues at the end of this narrative*). Since S.B. 1335 was vetoed by the Governor, the monies will revert to the State Lottery Fund and will not be spent on additional ITVMs.

Furthermore, another footnote requires the reversion of the FY 2001 ITVM monies to the State Lottery Fund if the commission does not demonstrate to the Joint Legislative Budget Committee that the additional FY 2000 machines generated enough state profit to offset the related lease costs. Since the additional ITVM monies will revert to the State Lottery Fund and will not be spent, no review will be required.

Retailer Enforcement — The approved FY 2000 amount includes an increase of \$90,400 for 2 investigator positions that will monitor retailer compliance with Arizona laws related to underage gambling. The approved FY 2001 amount includes a further net increase of \$84,400 for 2 additional investigator positions that will monitor underage gambling laws specifically related to the increase in approved ITVM machines. This amount includes a reduction of \$(6,000) to eliminate one-time Equipment related to the additional 2 investigators approved for FY 2000.

A footnote requires the reversion of the monies appropriated for the additional FY 2001 investigators if S.B. 1335 of the 44th Legislature, 1st Regular Session is not enacted into law. Since S.B. 1335 was vetoed by the Governor, the monies appropriated for the 2 positions will revert to the State Lottery Fund and will not be spent.

Service Agreements — The approved FY 2000 amount includes an increase of \$65,100 for contractual costs related to an outside auditor, Attorney General services, and software services. This amount is continued in FY 2001.

Lease-Purchase Expiration — The approved amount includes a reduction of \$(188,400) beginning in FY 2000 to eliminate funding for lease-purchase payments on the AS400 computer. The final payment will be made in FY 1999.

Instant Tickets — The approved amounts include an estimated increase of \$98,400 in FY 2000, and a further estimated increase of \$101,500 in FY 2001 to be used on instant ticket printing and distribution. The actual appropriation is for 3.1% of instant ticket sales. The JLBC Staff currently forecasts instant ticket sales growth of \$3,176,800 in FY 2000, and forecasts growth of \$3,272,100 in FY 2001. The displayed increases are derived by applying the forecasted sales amounts to the approved spending percentage. (*See Other Issues for a discussion of the JLBC Staff forecast of Lottery ticket sales.*)

Advertising — The approved amounts include an estimated decrease of \$(2,900,000) in FY 2000, and a further estimated decrease of \$(297,700) in FY 2001. Monies in this Special Line Item are used to market Lottery games. The actual appropriation in FY 2000 and FY 2001 is for 2.7% of total ticket sales; this is down from the FY 1999 approved 3.7%. The JLBC Staff currently forecasts a total ticket sales decline of \$(13,685,900) in FY 2000 and forecasts a further total ticket sales decline of \$(11,023,900) in FY 2001. The displayed reductions are derived by applying the forecasted sales amounts to the reduced approved spending percentage. (*See Other Issues for a discussion of the JLBC Staff forecast of Lottery ticket sales.*)

In addition, Laws 1999, Chapter 5, 1st Special Session appropriated \$1,500,000 from the General Fund to market Lottery games. This appropriation, however, is contingent on the amount of General Fund revenues available in FY 2000 or FY 2001. Prior to September 1, 1999 and 2000, JLBC and OSPB will calculate total revenues and determine if sufficient monies are available to trigger the appropriation. (*For more information on this and other triggered appropriations see the "Summary of Appropriations Triggered by Revenues" table at the front of this report.*)

On-Line Vendor Fees — The approved amounts include an estimated decrease of \$(596,900) in FY 2000, and a further estimated decrease of \$(506,100) in FY 2001. Monies in this Special Line Item are used to pay the vendor that operates the on-line game computer system. The actual appropriation in FY 2000 and FY 2001 is equal to the percentage in the commission's contractual

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agreement with the vendor. This is currently estimated to be 3.54% of on-line ticket sales. The JLBC Staff currently forecasts an on-line ticket sales decline of \$(16,862,700) in FY 2000 and forecasts a further on-line ticket sales decline of \$(14,296,000) in FY 2001. The displayed reductions are derived by applying the forecasted sales amounts to the estimated approved spending percentage. (*See Other Issues for a discussion of the JLBC Staff forecast of Lottery ticket sales.*)

Retailer Commissions — The approved amounts include an estimated decrease of \$(889,600) in FY 2000, and a further estimated decrease of \$(716,500) in FY 2001. Monies in this Special Line Item are used to compensate retailers for selling Lottery tickets. The actual appropriation in FY 2000 and FY 2001 is equal to 6.5% of total ticket sales. An additional 0.5% would be available for distribution if approved incentives are met. The Joint Legislative Budget Committee has not yet approved the incentives as required by statute.

The JLBC Staff currently forecasts a total ticket sales decline of \$(13,685,900) in FY 2000 and forecasts a further total ticket sales decline of \$(11,023,900) in FY 2001. The displayed budget uses only the 6.5% fixed compensation rate. However, if the Legislature approves the commission's sales incentive plan this summer, the actual distribution percentage could reach an estimated 6.65% of total ticket sales. (*See Other Issues for a discussion of the JLBC Staff forecast of Lottery ticket sales.*)

Sales Incentive Program — The approved amounts provide monetary incentives to employees in the Marketing Division for working with retailers to increase ticket sales.

Telecommunications — Monies in this Special Line Item are used to pay for all costs related to the Arizona Lottery's communications network. The approved amount includes a FY 2000 increase of \$299,700 to pay for one-time computer service improvements, and to accommodate 2.5% growth in network connections. The approved FY 2001 amount includes a reduction of \$(250,000) to eliminate the one-time FY 2000 funding, and an increase of \$51,000 to accommodate an additional 2.5% growth in the network.

Compulsive Gambling Treatment and Information — The approved amounts in this newly created Special Line Item are to be used on programs related to gambling addiction. Each year, \$250,000 shall be used to contract for a compulsive gambling toll-free crisis hotline, and \$250,000 shall be used to contract for treatment of individuals who are compulsive gamblers.

Capital Outlay Appropriations: Chapter 2, 1st Special Session — Appropriates \$27,600 in FY 2000 and \$30,800 in FY 2001 from the State Lottery Fund to the Arizona State Lottery Commission for building renewal.

Excess Balance Transfers: Lottery Prize Fund — Laws 1999, Chapter 6, 1st Special Session transfers \$1,500,000 from the Lottery Prize Fund to the General Fund in FY 1999. The Lottery Prize Fund receives a varying percentage of Lottery ticket sales to be used as prizes. A portion of the monies set aside for prizes go unclaimed and remain in the fund. The FY 1998 ending balance was \$4,486,800.

Lottery Fund — Laws 1999, Chapter 6, 1st Special Session also transfers \$2,393,600 in FY 2000 and \$2,283,400 in FY 2001 from the Lottery Fund to the General Fund. The Lottery Fund retains a portion of Lottery ticket sales, and is used to pay for all costs related to the operation of the agency.

The designated transfer represents an amount equal to 1% of the JLBC Staff forecast of total Lottery ticket sales. These monies are available for transfer due to a reduction in the amount appropriated for Advertising. (*See Advertising and Other Issues discussion for more information.*)

Additional Legislation: Tax Relief and Fiscal Control (Chapter 5, 1st Special Session) — This act appropriated \$1,500,000 from the General Fund to the Arizona State Lottery Commission for additional Advertising expenditures. This appropriation, however, is contingent on the amount of General Fund revenues available in FY 2000 or FY 2001. Prior to September 1, 1999 and 2000, JLBC and OSPB will calculate total revenues and determine if sufficient monies are available to trigger the appropriation. (*See the Advertising discussion above for more information.*)

Omnibus Budget Reconciliation; Public Finances (Chapter 3, 1st Special Session) — This act includes a provision that requires the commission to return to the state 31.6% of the total annual revenues accruing from the sale of multi-state Lottery tickets. Current permanent law would only require that the commission return 29% of multi-state ticket sales. The provision will allow an estimated additional \$2,117,100 in FY 2000, and an additional \$1,955,400 in FY 2001 to be deposited into the Local Transportation Assistance Fund's Mass Transit program.

Other Issues: Veto of S.B. 1335 — This bill prohibits the commission from implementing video Lottery games, and specifies courses of action if retailers violate state gambling laws. The General Appropriation Act includes an increase of \$277,200 in FY 2000 and a further increase of \$277,200 in FY 2001 to lease additional ITVMs. Also included in the budget legislation is an increase of \$90,400 for 2 investigators to regulate the additional machines. A footnote requires the reversion of these monies if S.B. 1335 is not enacted into law. Since this bill was vetoed by the Governor, the monies for the ITVMs and the investigators will revert to the State Lottery Fund.

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Lottery Profit Forecast and Distribution — The JLBC Staff forecasts total Lottery ticket sales of \$239,362,000 in FY 2000 and sales of \$228,338,100 in FY 2001. This represents a (5.4)% and (4.6)% sales decline in FY 2000 and FY 2001, respectively. The forecasted sales decline is primarily the result of diminishing on-line ticket sales. Sales of Lotto tickets, which reached \$75,853,000 in FY 1996 and has been a stable revenue producer since its creation in FY 1985, is forecasted to drop to \$33,928,200 by FY 2001. Other on-line games are also experiencing similar declines.

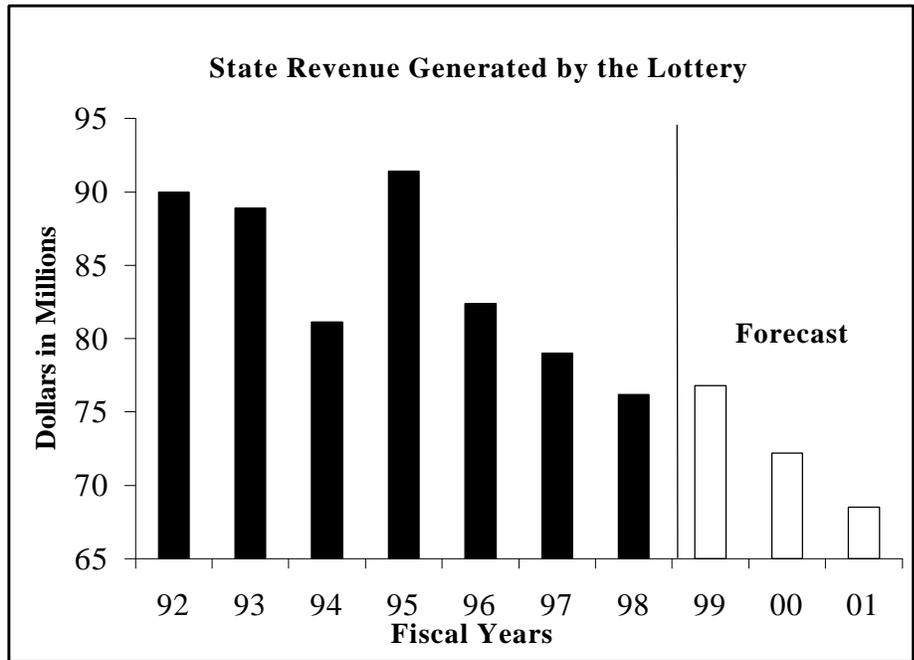
The one exception is the Powerball game. Sales of Powerball tickets received a temporary boost from a game reconfiguration that resulted in larger jackpot amounts. Consumers responded to these large jackpot amounts and purchased \$74,861,400 in tickets in FY 1998; this was up from the FY 1998 sales level of \$65,365,400. The General Fund and the Mass Transit program have benefited from the sales increase.

Despite this recent increase in sales, the JLBC Staff expects this to be a temporary solution to the sales decline, and forecasts that Powerball sales will decline by (8.3)% in FY 2000, and by (7.6)% in FY 2001. The forecasted decrease in Powerball collections will only exacerbate the problem of a declining overall sales level.

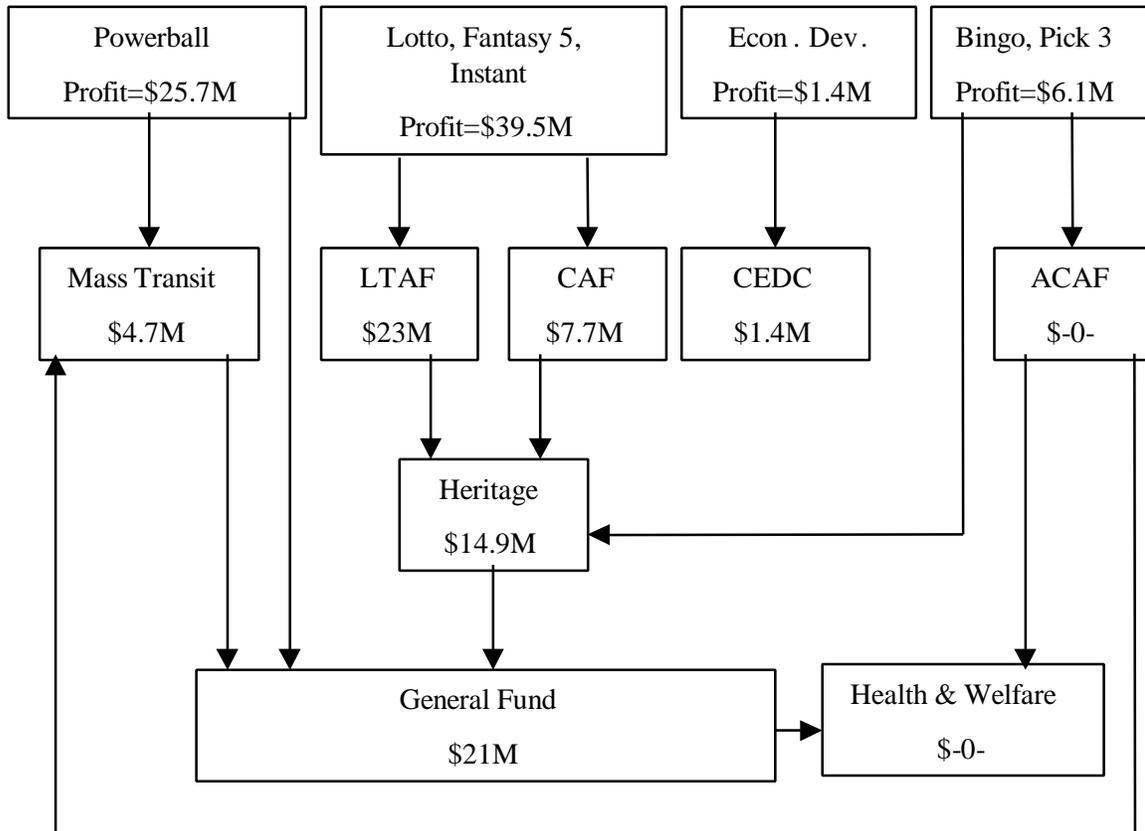
The following table displays the JLBC Staff forecast of Lottery ticket sales and the corresponding profit distribution. Included in the table are total ticket sales amounts, on-line ticket sales amounts, and instant ticket sales amounts. These forecasted amounts were used to provide the previously discussed budget estimates. The graph on the next page depicts the recent downward trend in Lottery profit collections. Note the temporary increase in FY 1999 from the Powerball game reconfiguration. Following the graph is a visual representation of the statutory profit distribution and associated revenue flows for FY 2000.

Forecast of Lottery Revenue Distribution			
	<u>FY 1999</u>	<u>FY 2000</u>	<u>FY 2001</u>
Sales:			
Instant Sales	\$97,892,100	\$101,068,900	\$104,341,000
On-Line Sales:			
Lotto	46,697,700	39,753,800	33,928,200
Powerball	88,844,700	81,426,100	75,207,900
Other On-Line	<u>19,613,400</u>	<u>17,113,200</u>	<u>14,861,000</u>
Total Sales	\$253,047,900	\$239,362,000	\$228,338,100
Less:			
Operating Budget	\$42,582,900	\$39,486,600	\$38,346,500
Prizes	<u>133,122,600</u>	<u>127,151,300</u>	<u>121,026,000</u>
Net Profit ^{1/}	\$77,342,400	\$72,724,100	\$68,965,600
Profit Transfers:			
LTAf	\$23,000,000	\$23,000,000	\$23,000,000
CAF	7,650,000	7,650,000	7,650,000
Heritage	17,211,800	14,937,800	13,144,100
Clean Air	0	0	0
Econ. Development	1,406,700	1,406,700	1,406,700
Mass Transit	7,073,900	4,729,600	2,764,800
Health & Welfare Programs	0	0	0
General Fund	<u>21,000,000</u>	<u>21,000,000</u>	<u>21,000,000</u>
Total Transfer	<u>\$77,342,400</u>	<u>\$72,724,100</u>	<u>\$68,965,600</u>

^{1/} The JLBC Staff Lottery profit forecast applies to total sales a 30.4% rate of return in FY 2000 and a 30.2% rate of return in FY 2001. To derive the return amounts, we applied the FY 1998 rate of return for each game to the current forecast. The commission is only required to return 21.5% of instant ticket sales and 29% of on-line ticket sales. Therefore, the realized distribution will depend on the actual rate of return adopted by the commission in the displayed years.



FY 2000 Lottery Profit Distribution



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