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Lottery Revenue Has Increased Over the Past Year; Options Remain to Enhance Transfers

at a glance

Lottery transfers to the Educational Enhancement Trust Fund increased by \$130 million in Fiscal Year 2011-12. To maintain and stimulate sales during 2012, the Lottery continued to launch new products and enhance product distribution.

Several additional game and product distribution options are available to increase transfers to education. However, some of these options could represent expanded gambling and some could affect revenues from the gaming compact between the State of Florida and the Seminole Tribe of Florida.

The Lottery's operating expense rate continues to meet legislative performance standards. To gain an overall perspective on the effectiveness and return on investment of its retailer recruitment methods, the Lottery should annually conduct a recruitment cost-benefit analysis.

Scope

As directed by the Legislature, OPPAGA examined the Department of the Lottery and assessed options to enhance its earning capability and improve its efficiency.¹

¹ Section 24.123, F.S., requires an annual financial audit of the Lottery, which is to include recommendations to enhance the Lottery's earning capability and efficiency. The Joint Legislative Auditing Committee directed OPPAGA to assess efficiency and the Auditor General to conduct the financial audit.

Background

The Department of the Lottery generates funds for education and enables the state's citizens to play state-operated lottery games. The Lottery sells both draw and scratch-off games. Draw games allow players to select from a range of numbers on a play slip. Draw game tickets are printed by terminals that are connected to the Lottery's central computer system for a drawing at a later time. Scratch-off games are tickets with latex covering that players scratch off to determine instantly whether they have won.

The Lottery is self-supporting and receives no general revenue. For Fiscal Year 2012-13, the Legislature appropriated \$149 million from Lottery sales revenue and authorized 423 positions for Lottery operations. Prizes and retailer commissions are paid directly from sales revenues and do not appear in the department's appropriation. In Fiscal Year 2011-12, prizes were \$2.77 billion and retailer commissions were \$247.7 million.²

Since its inception, the Lottery has outsourced its core functions to produce, advertise, and sell tickets. In Fiscal Year 2012-13, the Lottery allocated approximately 75%, or \$111.7 million, of its \$149 million appropriation to produce

² To sell its products, the Lottery contracts with a wide range of retailers across the state, such as supermarkets, convenience stores, gas stations, and newsstands. Retailers receive commissions for selling Lottery products at a rate of 5% of the ticket price in addition to 1% of the prize value for redeeming winning tickets. Retailers can also receive bonuses for selling select winning tickets and performance incentive payments.

and advertise draw and scratch-off games. Vendor contracts include those listed below.

- In October 2010, the Lottery entered a four-year renewal contract by executing two, two-year renewal options with GTECH, its draw gaming system vendor, to provide computer systems, instant ticket and full service vending machines, retailer terminals, software, telecommunications, and technical support services.
- In September 2010, the Lottery entered a two-year renewal contract with Machado Garcia-Serra Advertising, Inc., for Hispanic market advertising. The department and Machado Garcia-Serra entered into a final one year renewal contract in November 2012.
- In August 2009, the Lottery entered a three-year contract with St. John & Partners Advertising and Public Relations, Inc., for general market advertising. In October 2010, the Lottery exercised its first one-year renewal option to take effect August 2012.
- In September 2008, the Lottery entered a six-year contract with Scientific Games to print, market, and distribute scratch-off game tickets.

Revenue Performance —————

In Fiscal Year 2011-12, the Lottery transferred \$1.322 billion to the Educational Enhancement Trust Fund, \$130 million more than the prior year. Transfers exceeded the legislative standard of \$1.206 billion, the Lottery's internal objective of transferring at least \$1 billion annually to the Educational Enhancement Trust Fund, and the Revenue Estimating Conference forecast.³ Revenues are projected to continue to increase during the current fiscal year. The November 2012 Revenue Estimating Conference projected that the Lottery's transfers to education will increase by \$48 million in Fiscal Year 2012-13.

³ The Lottery's legislatively-approved performance standards are reported in its long-range program plan: *Long Range Program Plan Fiscal Years 2013-14 through 2017-18*, Florida Lottery, September 30, 2012.

Revenue Enhancement Options—

The Lottery has taken steps in the past year to maintain and increase its sales and transfers to the Educational Enhancement Trust Fund, such as enhancing its product mix by adding a higher priced (\$25) scratch-off game, and continuing to increase its product distribution outlets through instant ticket vending machines. The Lottery has also deployed 500 full service vending machines as of November 2012, which dispense both scratch off and draw game tickets, as authorized by the 2012 Legislature.

To further increase sales and transfers, the Lottery could implement additional games or expand product distribution by adopting new ways of selling lottery tickets. While some of these options are discussed below, Appendix A provides a more detailed list of new game options and Appendix B lists additional product distribution options, along with the advantages and disadvantages of each option. The estimated values of the revenue enhancements presented in Appendices A and B are based on individual options; if multiple options were implemented concurrently, the fiscal impact of each would likely be smaller due to shifts in sales from one game to another. In addition, adding new lottery games or expanding distribution options could represent an expansion of legalized gambling and could produce negative social costs.⁴

New lottery games could generate substantial revenues, but could represent expanded gambling

Florida could consider adding several lottery games that might attract new players and substantially increase state revenues, such as joining another multi-state game or implementing fast keno. Joining Mega Millions, which is another multi-state game that operates similar to Powerball, is authorized

⁴ For more information on the negative social costs, see our 2010 report, *Lottery Profits Flat; Increasing Retailer Outlets is Critical to Increasing Sales*, OPPAGA [Report No. 10-16](#), January 2010.

by s. 24.105(18), *Florida Statutes*. Multi-state lottery associations permitted states to cross-sell Powerball and Mega Millions starting in January 2010. All U.S. lotteries except Florida and California sell both multi-state games, and California recently announced plans to start offering both. Thus, the Florida Lottery would be the only U.S. lottery that does not sell both multi-state games.

Implementing Mega Millions has several advantages. For example, it could help avoid losing sales to bordering states. Georgia participates in both Mega Millions and Powerball, while Florida only participates in Powerball. Rather than potentially lose sales to Georgia, particularly when Mega Millions offers large jackpots, Florida could keep sales in-state by selling both games. Also, since Powerball drawings are held Wednesday and Saturday, and Mega Millions drawings are held Tuesday and Friday, cross-selling would provide players more choice of games offering large jackpots. In addition, while Powerball increased to a \$2 price per ticket, Mega Millions continues to provide players a \$1 per ticket option for a multi-state game. Moreover, in a recent Florida player/retailer research survey, nearly two-thirds of respondents indicated they would purchase Mega Millions.

However, although potential recurring transfers to education may be positive, potential revenue amounts are indeterminate. Consultant analyses have shown mixed results on the sales impact in Florida, as implementing Mega Millions is projected to partially offset sales from Florida Lotto and Powerball.

Another game option would be to introduce fast keno, which could generate between \$58 million and \$269 million in additional transfers.^{5, 6} Fourteen U.S. lotteries offer fast

keno.⁷ To implement fast keno in Florida, the Legislature would need to grant budget authority for the Lottery to spend sales revenue to acquire a fast keno gaming system.⁸ Fast keno is reportedly more addictive than traditional lottery games, though not as addictive as video lotteries. If it were offered on video lottery terminals, fast keno could impact revenues from the gaming compact between the State of Florida and the Seminole Tribe of Florida.^{9, 10}

New ticket-selling methods could also generate additional revenues

The Legislature and the Lottery could consider expanding product distribution, as shown in Appendix B. For example, selling lottery products over the Internet could increase sales and provide more convenience to players. The U.S. Department of Justice released a legal opinion in December 2011 that found state lotteries' use of the Internet and out-of-state transaction processors to sell lottery tickets to adults within their states' borders does not violate federal law.

⁶ We estimated a range of potential fast keno revenue based on the highest and lowest per capita sales in states that offer fast keno, which we applied to Florida's estimated population for 2014 after excluding outlier states from the upper and lower quartiles. Our estimate assumes a transfer rate to the Educational Enhancement Trust Fund of 30.38%, based the average fast keno payout in other states of 60.62%, and an administrative expense rate of 9%, which was determined by the Florida Lottery. The estimate also assumes that 10% of sales would be shifted from existing game sales.

⁷ Lotteries in California, the District of Columbia, Georgia, Kansas, Maryland, Massachusetts, Michigan, Missouri, New York, Ohio, Oregon, Rhode Island, the U.S. Virgin Islands, and West Virginia offer fast keno.

⁸ Implementing fast keno also may require legislative action to modify the requirement for a drawing to be witnessed by an accountant, given that electronic drawings could occur every five minutes (s. 24.105(9)(d), *F.S.*).

⁹ A gaming compact between the State of Florida and the Seminole Tribe of Florida was approved by the Governor April 7, 2010, ratified by Ch. [2010-29](#), *Laws of Florida*, and approved by the U.S. Department of the Interior on July 6, 2010. The gaming compact provides the Tribe with partial but substantial exclusivity with respect to the play of covered games in exchange for payments to the state derived from gaming proceeds.

¹⁰ Video lottery terminals are player activated and can be programmed to play casino-style games such as poker, blackjack, fast keno, and bingo; or simulate mechanical slot machines or roulette wheels.

⁵ Fast keno is a draw lottery game in which players choose from 10 to 12 numbers from a panel of 80 numbers in the hope of matching their choices to 20 numbers drawn by a central computer. Fast keno is similar in principle to other draw games, but occurs more frequently (typically every five minutes) and is often played in a social setting such as a bar or restaurant.

Subsequent to this decision, two states have begun online sales of lottery tickets. In March 2012, Illinois became the first state to sell individual draw game tickets over the Internet. The Illinois Lottery website allows players who are over the age of 18 and are residents of Illinois to purchase tickets for Lotto, Mega Millions, and Powerball. In addition, as of November 2012, individuals who register on the Georgia Lottery website are able to purchase Mega Millions, Powerball, and Fantasy 5 tickets online while located within the state of Georgia.

Offering lottery products over the Internet would require statutory revisions. Florida law currently restricts the use of player-activated terminals and does not authorize the use of credit cards or other instruments issued by a bank for lottery purchases without a purchase of \$20 in other goods.¹¹

In addition, authorizing the sale of lottery products over the Internet has the potential to affect revenues from the gaming compact, depending on whether the Seminole Tribe of Florida chooses to also offer Internet gaming. If only the state offers this option and the tribe's net win of covered games drops more than 5% below its net win from the previous 12-month period, the tribe may no longer be required to make guaranteed minimum payments to the state.¹² Instead, the tribe may continue to make payments based on the percentage revenue sharing amount, which may be lower than the guaranteed minimum.¹³

¹¹ Section 24.105(9)(a), *F.S.*, restricts the use of player-activated machines and s. 24.118(1), *F.S.*, requires the purchase of no less than \$20 of other goods and services in order to use a credit card or other instrument issued by a bank to purchase lottery products.

¹² "Guaranteed minimum payments" are defined by the compact as totaling \$700 million during years three through five of the compact (Fiscal Years 2012-13 through 2014-15).

¹³ The "percentage revenue sharing amount" is a payment owed to the state during years three through five of the compact that is based on varying percentages of net win received by the tribe that year. The gaming compact between the State of Florida and the Seminole Tribe of Florida provides that the tribe will pay the greater of the percentage revenue share amount or the guaranteed minimum revenue sharing payment per cycle.

However, the compact provides that if the tribe also offers Internet gaming, as authorized by law, state revenue from the compact may not be affected.

Subscription sales is another product distribution method that could increase sales. Other states permit subscription sales for certain draw games through the mail or via the Internet.¹⁴ Typically, players purchase subscriptions for three months to a year's worth of drawings for numbers they select or request as quick picks. Players make purchases by filling in forms and submitting them on the lottery's website or downloading forms and mailing them in with a payment. For instance, New Hampshire sells Hot Lotto, Mega Millions, Powerball, and Tri-State Megabucks subscriptions over the Internet. Players must be 18 years of age or older and have a New Hampshire mailing address, as federal law requires state regulations to include age and location verification to reasonably block access to minors and persons located outside the state. According to Lottery estimates, if Florida performed at average levels, annual sales through subscriptions could generate an additional \$10 million in transfers to education.

Operational Efficiency Options—

The Lottery continues to keep its expenses as a percentage of sales low. For additional efficiencies, it should complete annual retailer recruitment cost-benefit analyses as an ongoing feedback loop to plan recruitment activity and give the department an overall perspective on the effectiveness and return on investment of its recruitment efforts.

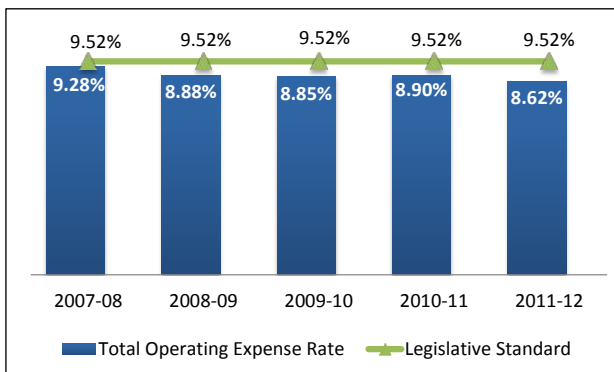
¹⁴ Ten U.S. lotteries offer subscription sales for draw games: Illinois, Maine, Maryland, Massachusetts, Minnesota, New Hampshire, New York, North Dakota, Vermont, and Virginia. Six lotteries accept credit cards, two require players to mail in a check or money order, and two require a valid bank account for electronic fund transfers.

The Lottery's operating expense rate is lower than the legislative standard

The Lottery's operating expenses in relation to its ticket sales continue to be lower than the legislative standard, as shown in Exhibit 1. Compared to other U.S. lotteries, the Lottery had the 3rd lowest expense rate (8.93%) in Fiscal Year 2010-11, behind New Jersey (7.70%) and Massachusetts (7.71%).¹⁵

Exhibit 1

The Lottery's Operating Expense Rate Continues to Be Below the Legislative Standard



Source: Department of the Lottery Long Range Program Plans.

Retailer recruitment cost-benefit analyses should help Lottery evaluate the return on investment of recruitment activities

The department's Sales Division is responsible for recruiting independent and corporate retailers to sell lottery products, thus enhancing Lottery revenues by working to maintain and expand the retailer network. In Fiscal Year 2010-11, the top 10 U.S. lotteries ranked by per capita sales had an average of 1,200 residents per retailer. During that period, Florida Lottery averaged 1,450 residents per retailer. Adding 2,800 new retailers to Florida's retailer network would meet the top-performing lotteries' market penetration and has the potential to generate about \$88.5 million annually in additional transfers to the

Educational Enhancement Trust Fund.¹⁶ Expanding the retailer network has been shown to increase lottery sales more than advertising.¹⁷

In our 2011 report, we recommended that the department annually complete a retailer recruitment cost-benefit analysis and use the resulting data to evaluate the cost efficiency of recruitment activities, adjust these efforts as needed, and plan future activities.¹⁸ Retailer recruitment cost-benefit analyses provide ongoing feedback to plan recruitment efforts and give the department an overall perspective on the effectiveness and return on investment of its recruitment methods. At the time of our 2011 report, the department had just completed a cost-benefit analysis of its retailer recruitment efforts from July 2006 through December 2010.

The department has not implemented our recommendation to annually complete a retailer recruitment cost-benefit analysis due to reorganizing this function and shifting its recruitment focus, but plans to conduct a cost-benefit analysis in the future. According to department administrators, a primary reason they did not conduct a cost-benefit analysis of 2011 retailer recruitment efforts was that they merged the former Business Development unit into the Sales Division; the reorganization was completed in December 2011. Formerly, the two units both had responsibilities for corporate retailer recruitment.

Another reason department administrators cited for waiting to conduct a cost-benefit analysis was that the department shifted its recruitment efforts to place a stronger

¹⁶ We estimated potential revenues from expanding the retailer network by assuming that the 2,800 retailers would achieve at least the average weekly gross sales new retailers achieved in 2012. The estimate assumes all 2,800 terminals being active for a full year and that 20% of their sales would be shifted from existing retailers.

¹⁷ For more information on adding retailers to increase education transfers, see our 2010 report, *Lottery Jackpots, Retailer Density, and Advertising Drive Transfers to Education*, OPPAGA [Report No. 10-17](#), January 2010.

¹⁸ *Lottery Profits Decline; Options Available to Enhance Transfers to Education*, OPPAGA [Report No. 11-12](#), March 2011.

¹⁵ Florida Lottery's ranking is based on the latest fiscal year data available from La Fleur's *2012 World Lottery Almanac*.

emphasis on increasing sales at its existing corporate retailers and recruiting additional corporate chain stores, while reducing the effort spent on recruiting independent retailers. To improve sales at existing corporate retailers, Lottery is working with the retailers to gain approval to use methods such as plan-o-grams and menu boards to boost sales, as well as to increase the number of displays (product facings) and secondary sales locations through the use of lottery vending machines.¹⁹ Lottery is also working with these retailers to offer Lottery products when they open new stores, such as adjacent liquor stores. For corporate chain recruitment, Lottery has developed a list of chains that do not sell Lottery products, such as Target and Walgreens, and maintains contact with corporate headquarters to try to gain approval to offer Lottery products, even if only on a pilot basis.²⁰

For independent retailers, Lottery is primarily depending on referrals from its website. Administrators said that they eliminated staff positions at the central office that used to take calls from interested retailers and route the referrals to district offices. Instead, Lottery's website directs potential retailers to the district offices, which are responsible for following up on these leads. Sales representatives are also responsible for contacting new retailers they see opening up for business in their regions.

Due to the reorganization and shift in focus, Lottery administrators are waiting until the end of Fiscal Year 2012-13 to conduct a retailer recruitment cost-benefit analysis, as this will allow for an analysis of a full year's operation under its new direction. Given the magnitude

of the changes it has made, this would be an appropriate time to evaluate the costs and sales return of the recruitment methods it is using with various types of retailers.

Recommendations

While the department and the Legislature have increased transfers to education, there are additional actions that could increase sales and efficiency, and ultimately increase transfers to education.

Department Options

We recommend that the Department of the Lottery continue efforts to expand the retailer network and conduct a cost-benefit analysis of retailer recruitment efforts, as currently planned, at the end of Fiscal Year 2012-13. The department should also annually update the analysis and use the resulting data to evaluate the cost efficiency of recruitment activities, adjust these efforts as needed, and plan future activities.

Legislative Options

The Legislature could consider authorizing the Lottery to expand its current games and product distribution methods to enhance revenues, as described in Appendices A and B. If the Legislature is interested in a particular option, it could direct the Department of the Lottery to provide a more detailed analysis that includes advantages and disadvantages, potential revenues and costs, timeframes for implementation, needed statutory changes, and any impacts on the gaming compact with the Seminole Tribe of Florida.

Agency Response

In accordance with the provisions of s. 11.51(5), *Florida Statutes*, a draft of our report was submitted to the Secretary of the Department of the Lottery for review and response. The Secretary's written response to this report is in Appendix D.

¹⁹ Plan-o-grams are monthly notifications from the Department of the Lottery that inform retailers of the top selling scratch-off games so that they can stock and prominently display the top sellers. Menu boards display the scratch-off games being sold at a specific store.

²⁰ The Department of the Lottery has embarked on a pilot project with Walmart in which the retailer's Neighborhood Market stores are selling lottery products in 37 of its main stores and 15 of its liquor stores. Currently, Florida is the only U.S. lottery for which Walmart sells lottery products.

Appendix A

New Lottery Game Options

New games that attract new players have the potential to substantially increase revenues to education. Table A-1 lists these options, their advantages and disadvantages, and estimated revenues where we were able to develop reasonable estimates. The estimated revenues are based on individual options; if multiple options were implemented concurrently, the fiscal impact of each would likely be smaller due to shifts in sales from one game to another. Some new games that could generate significant revenue, such as fast keno and video lottery terminals, could increase the negative social costs of gambling and, in some cases, could impact revenue from the gaming compact between the State of Florida and the Seminole Tribe of Florida. Estimates of annual revenue assume full implementation by July 1, 2013. However, some options would require additional time to implement, such as launching a keno game.

Table A-1

New Games Have the Potential to Increase Revenues to Education

Option	Advantages	Disadvantages
Mega Millions Multi-state games, such as Mega Millions, often reach very large jackpot sizes because they cover most states	<ul style="list-style-type: none"> Offers players greater opportunities for very large jackpots Since Powerball drawings are held Wednesday and Saturday, and Mega Millions drawings are held Tuesday and Friday, cross-selling would provide players more choice of games offering large jackpots. While Powerball increased to \$2 per ticket, Mega Millions continues to provide players a \$1 per ticket option for a multi-state game. In a June 2012 Florida player/retailer research survey, nearly two-thirds of respondents said they would purchase Mega Millions. Potential recurring transfers to education may be positive but are indeterminate at this time; consultant analyses have shown mixed results on the sales impact in Florida due to an offsetting sales shift from Florida Lotto and Powerball. Authorized by s. 24.105(18), <i>F.S.</i>, and thus would not require statutory changes 	<ul style="list-style-type: none"> More frequent mega jackpots could reduce incentive for occasional players to respond to large jackpots Probable sales shift from Powerball and Florida Lotto Threat to Florida Lotto as a brand; player/retailer research survey indicated Lotto is the game on which players would most likely spend less Could be considered an expansion of gambling Might require a change in the name of Florida's current Mega Money game to minimize player confusion with Mega Millions

Option	Advantages	Disadvantages
Fast Keno Draw lottery game in which players choose from 10 to 12 numbers from a panel of 80 numbers in the hope of matching their choices to 20 numbers drawn by the central computer at Lottery headquarters; may be played frequently (e.g., every five minutes)	<ul style="list-style-type: none"> ▪ Potential recurring transfers to education range from \$58 million to \$269 million per year.¹ ▪ Can be limited to pari-mutuel facilities or social settings such as bars and restaurants ▪ Would help the Lottery to recruit new retailers in social venues 	<ul style="list-style-type: none"> ▪ Fast keno is reportedly more addictive than traditional lottery games, though not as addictive as video lotteries. ▪ Could be considered an expansion of gambling ▪ May require legislative action to modify the requirement for a drawing to be witnessed by an accountant, given that electronic drawings could occur every five minutes (s. 24.105(9)(d), <i>F.S.</i>) ▪ Requires legislative budget approval for a fast keno gaming system ▪ If it were offered on video lottery terminals, fast keno could impact revenue from the gaming compact between the State of Florida and the Seminole Tribe of Florida.² ▪ Requires careful analysis of impacts on Lottery Revenue Bond rate floor³
Daily Keno Draw lottery game in which players choose as many as 10 numbers from a panel of 80 numbers in the hope of matching their choices to 20-22 numbers drawn by the central computer at Lottery headquarters	<ul style="list-style-type: none"> ▪ Potential recurring transfers to education range from \$6 million to \$11 million per year.⁴ 	<ul style="list-style-type: none"> ▪ Could be considered an expansion of gambling
Video Lottery Terminals Players use video terminals that can be programmed to play casino-style games such as poker, blackjack, fast keno, and bingo, or simulate mechanical slot machines or roulette wheels	<ul style="list-style-type: none"> ▪ Potential recurring transfers to education range up to a gain of \$306.8 million per year depending on how it is implemented and after accounting for potential lost Seminole Tribe of Florida gaming revenue if determined to impact the revenue sharing agreement; see Appendix C for additional information on the impact of different implementation methods on the amount of revenue that may be gained from implementing video lottery terminals.⁵ ▪ To reduce issues/concerns about underage players, play could be limited to pari-mutuel facilities. 	<ul style="list-style-type: none"> ▪ Could result in a loss of \$34.5 million per year in recurring transfers to education depending on how it is implemented and after accounting for potential lost Seminole Tribe of Florida gaming revenue if determined to impact the revenue sharing agreement (see Appendix C) ▪ Because of its rapid play style, it may be more addictive than other lottery games, and thus increase social costs associated with problem and pathological gambling. ▪ Represents a substantial change for gambling in Florida by permitting casino-style lottery games statewide, which could be criticized by anti-gambling groups ▪ Would require legislative action to authorize player-activated video lottery terminals in Florida (s. 24.105, <i>F.S.</i>) ▪ Requires legislative budget approval for a video lottery gaming system ▪ Could erode sales of traditional Florida Lottery games within certain market segments

Option	Advantages	Disadvantages
Higher Priced Scratch-off Games Standard scratch-off games offered at prices of \$25 or more, with higher prizes and prize payout percentages	<ul style="list-style-type: none"> ▪ The Lottery's October 2012 introduction of a \$25 scratch-off game linked to its 25th anniversary achieved weekly sales of over \$10 million, exceeding the sales performance of its top \$20 game. 	<ul style="list-style-type: none"> ▪ Florida's previous introduction of \$30 tickets generated lower than expected sales, but this may have been due to the play style of the ticket and the state of the economy at the time. ▪ Requires careful analysis of impacts on Lottery Revenue Bond rate floor³
Monitor Games Computer animated games simulating horse racing, golf, etc., that are played on in-store monitors similar to the way fast keno is played	<ul style="list-style-type: none"> ▪ May have less association to casino gambling than fast keno ▪ Could appeal to emerging markets of Lottery players that have grown up playing computer games ▪ Allows the Lottery to recruit new retailers in social venues such as bars and restaurants ▪ Can be limited to pari-mutuel facilities or social settings such as bars and restaurants 	<ul style="list-style-type: none"> ▪ Because of its rapid play style, it could be more addictive than traditional lottery games. ▪ Could be considered an expansion of gambling ▪ Requires legislative budget approval for a new gaming system ▪ May require legislative action to modify the requirement for a drawing to be witnessed by an accountant, given that electronic drawings could occur frequently (s. 24.105(9)(d), <i>F.S.</i>) ▪ Requires careful analysis of impacts on Lottery Revenue Bond rate floor³

¹ We estimated a range of potential fast keno revenue based on the highest and lowest per capita sales in states that offer fast keno, which we applied to Florida's estimated population for 2014 after excluding outlier states from the upper and lower quartiles. Our estimate assumes a transfer rate to the Educational Enhancement Trust Fund of 30.38%, based the average fast keno payout in other states of 60.62%, and an administrative expense rate of 9%, which was determined by the Florida Lottery. The estimate also assumes that 10% of sales would be shifted from existing game sales.

² A gaming compact between the State of Florida and the Seminole Tribe of Florida was approved by the Governor April 7, 2010, ratified by Ch. [2010-29](#), *Laws of Florida*, and approved by the U.S. Department of the Interior on July 6, 2010. The compact provides the tribe with partial but substantial exclusivity with respect to the play of covered games in exchange for payments to the state derived from gaming proceeds.

³ Proceeds from Lottery Revenue Bonds have been used to finance the cost of constructing, acquiring, reconstructing or renovating educational facilities at various locations throughout the state. The term bond rate floor is one the Lottery uses to describe and monitor the lowest Educational Enhancement Trust Fund transfer rate allowed in order to ensure the Lottery remains in compliance with the covenants established with each bond issuance.

⁴ We estimated a range of daily keno revenue based on the highest and lowest per capita sales in states that offer daily keno, which we applied to Florida's estimated population for 2014. The estimate assumes a draw game transfer rate to the Educational Enhancement Trust Fund of 40.67%, based on the November 2011 Revenue Estimating Conference projected transfers for Fiscal Year 2014-15, and that 10% of the sales would be shifted from existing game sales.

⁵ We estimated video lottery terminal revenue by assuming that 1,000 video lottery terminals would be active a full year in 20 pari-mutuel facilities operating outside Broward and Miami-Dade counties. The estimates are based on Florida's lowest pari-mutuel net income per slot machine to the highest net income per slot machine. We then adjusted these figures to a 35% tax rate and compensated for shifts from other state revenue sources, including the Lottery, sales tax, and slot machine tax.

Source: OPPAGA analysis of industry and Department of the Lottery information.

Appendix B

Product Distribution Options

Making lottery products more accessible and convenient for players by expanding product distribution has the potential to substantially increase revenues to education. Authorizing product distribution through the Internet, increasing the number of retailers, and expanding the use of full service vending machines have the potential to increase revenues by making lottery products more readily available to residents and tourists. Table B-1 lists these and other product distribution options that could increase Lottery sales and education transfers, their advantages and disadvantages, and estimated revenues where we were able to develop reasonable estimates. The estimated revenues are based on individual options; if multiple options were implemented concurrently, the fiscal impact of each would likely be smaller due to shifts in sales from one point of sale to another. Estimates of annual revenue assume full implementation by July 1, 2013. However, some options would likely require additional time to implement.

Table B-1

Expanding Product Distribution Has the Potential to Increase Revenues to Education

Option	Advantages	Disadvantages
Authorize Internet Sales The Legislature would enact laws to authorize intrastate Internet sales of lottery products	<ul style="list-style-type: none"> Provides more convenience to players who prefer to purchase their lottery products from their personal computer or cellular device The U.S. Department of Justice released a legal opinion in December 2011 that found state lotteries' use of the Internet and out-of-state transaction processors to sell lottery tickets to adults within their states' borders does not violate federal law. Two states have begun online sales of lottery tickets. In March 2012, Illinois became the first state to sell individual draw game tickets over the Internet. The Illinois Lottery website allows players to purchase tickets for Lotto, Mega Millions, and Powerball, as long as they are over the age of 18 and residents of Illinois. In addition, as of November 2012, individuals who have registered on the Georgia Lottery website are able to purchase Mega Millions, Powerball, and Fantasy 5 tickets online while located within the state of Georgia. Canadian lotteries are selling individual games over the Internet using technology that detects the player's location (e.g., British Columbia Lottery Corporation at www.bclbc.com). 	<ul style="list-style-type: none"> Must comply with federal laws that require state regulations to include age and location verification to reasonably block access to minors and persons located outside the state Requires a statutory change to allow player-activated terminals (s. 24.105, <i>F.S.</i>) Requires legislative budget approval for enhanced systems and technology Use of credit cards or other instruments issued by a bank for lottery purchases without purchase of \$20 in other goods would require a law change (s. 24.118, <i>F.S.</i>) Could be considered an expansion of gambling Could impact revenue from the gaming compact between the state and the Seminole Tribe of Florida
Subscription Play Players can subscribe to game drawings for up to one year in advance on the Florida Lottery website	<ul style="list-style-type: none"> The Department of the Lottery estimates potential revenue of about \$10 million annually in additional transfers to the Educational Enhancement Trust Fund. Internet technology has made subscription services much easier and more cost-effective for lotteries to manage. Key benefits for the consumers are no missed draws, no waiting in lines, and ease of prize claims. Provides the ability for people to play who may not be able to otherwise, such as seasonal residents and physically challenged residents Subscription play is offered by 10 U.S. lotteries. 	<ul style="list-style-type: none"> May require a statutory change to allow player-activated terminals (s. 24.105, <i>F.S.</i>) Use of credit cards or other instruments issued by a bank for lottery purchases without a purchase of \$20 in other goods would require a law change (s. 24.118, <i>F.S.</i>) Must comply within federal laws that require state regulations to include age and location verification to reasonably block access to minors and persons located outside the state Game changes require communication with players and possibly a replacement ticket. Could have an effect on unclaimed prize funds, as prizes may be automatically credited to players Could be considered an expansion of gambling

Option	Advantages	Disadvantages
Expand Retailer Network Add additional corporate and independent Lottery retailers in both traditional locations, such as convenience and grocery stores, and non-traditional locations, such as chain drug stores, mass merchandisers, home improvement centers, bars, and restaurants	<ul style="list-style-type: none"> ▪ Adding 2,800 new retailers has the potential to generate about \$88.5 million annually in additional transfers to the Educational Enhancement Trust Fund.¹ ▪ Florida has been below the average in terminal density compared to other successful Lottery states, so expanding its network should improve per capita sales. ▪ Could increase product distribution and awareness, making products available to new players who don't shop where products are currently being sold ▪ Expanding the retailer network has been shown to increase lottery sales more than advertising 	<ul style="list-style-type: none"> ▪ Requires legislative budget approval for more terminals ▪ Retailer expansion has been difficult during recession because retailer closings have been higher than new retailers recruited. ▪ The non-traditional lottery business model may require the development of different products, compensation frameworks, and distribution strategies. ▪ May require additional lottery staff to service new accounts
Expand Full Service Vending Machines Increase the number of full service vending machines that dispense both scratch-off and draw game tickets	<ul style="list-style-type: none"> ▪ The Revenue Estimating Conference predicted net education funding gains of \$21 million in the first full year of deploying 350 full service vending machines. ▪ Allows additional product access at high volume Lottery retailers ▪ Provides more convenience to players who do not want to stand in line to purchase tickets ▪ May attract large corporate retailers currently not selling lottery products because the vending machines minimize the need for on-site operators and increase player choice and the potential for larger sales ▪ Allows retailer network expansion into non-traditional retailer locations such as airports because the vending machines minimize the need for on-site operators ▪ Would not require a modification to the Lottery retailer contracts that require retailers to carry both scratch-off and draw games 	<ul style="list-style-type: none"> ▪ The 2012 Legislature provided budget authority of \$2.9 million to lease full service vending machines. Expanding the number of machines would likely require legislative budget approval to lease more vending machine units. ▪ Requires monitoring of underage play ▪ Some criticize the potential ease of access to problem gamblers.
Electronic Instant Ticket Vending Machine Players touch a video screen and receive the image of the instant ticket on the screen to reveal the outcome of the ticket	<ul style="list-style-type: none"> ▪ The Department of the Lottery projected potential recurring transfers to education ranging from \$33 million to \$114 million per year depending on how implemented. ▪ Provides a business model allowing retailer network expansion into non-traditional retailer locations, such as bars and restaurants 	<ul style="list-style-type: none"> ▪ Could impact revenue from the gaming compact between the state and the Seminole Tribe of Florida if these devices are deployed at any licensed pari-mutuel facility or if more than 10 machines are installed at any location ▪ Requires legislative budget authority to purchase or lease electronic instant ticket vending machines ▪ Requires monitoring of underage play ▪ Some stakeholders criticize the potential ease of access by problem gamblers.

¹ We estimated potential revenues from expanding the retailer network by assuming that the 2,800 retailers would achieve at least the average weekly gross sales new retailers achieved in 2012. The estimate assumes all 2,800 terminals being active for a full year and that 20% of their sales would be shifted from existing retailers.

Source: OPPAGA analysis of industry and Department of the Lottery information.

Appendix C

Estimates of Net Revenues for Video Lottery Terminals

The Governor approved a gaming compact between the State of Florida and the Seminole Tribe of Florida on April 7, 2010, which was ratified by the Legislature in Ch. [2010-29](#), *Laws of Florida*, and approved by the U.S. Department of the Interior on July 6, 2010. The compact provides the tribe with partial but substantial exclusivity with respect to the play of covered games in exchange for payments to the state derived from gaming proceeds.

Introducing video lottery terminals statewide could impact revenue from the gaming compact by potentially creating offsetting revenue losses that could affect whether the state achieves a net revenue increase. The compact states that in the event that the state authorizes expanded gaming beyond what was legal at the time of the signing of the compact, Seminole Tribe of Florida gaming payments may cease. As shown in Table C-1, Florida could implement video lottery terminals in several ways, some of which have greater potential to result in a net revenue increase after accounting for potential lost revenue from the gaming compact.

Table C-1
Introducing Video Lottery Terminals Could Be a Revenue Gain or Loss Depending on Implementation
(estimates in millions)

Revenue Source	Class II Bingo Only ¹		Class II Games ¹		Class III Slot Machines ¹	
	Low Estimate	High Estimate	Low Estimate	High Estimate	Low Estimate	High Estimate
Video Lottery Terminals ²	\$192.4	\$360.2	\$213.8	\$400.3	\$285.1	\$533.7
Indian Gaming Revenues ³	226.9	226.9	226.9	226.9	226.9	226.9
Net Revenue	-\$34.5	\$133.3	-\$13.1	\$173.4	\$58.2	\$306.8

¹ As defined by the federal Indian Gaming Regulatory Act, class II gaming means the game of chance commonly known as bingo (whether or not electronic, computer, or other technologic aids are used in connection with it), but may include other games of chance such as pull-tabs, lotto, and other games similar to bingo, whereas class III gaming means all forms of gaming that are not class I gaming or class II gaming (25 U.S.C. 2703).

² We estimated net revenue from video lottery terminals by assuming that 1,000 video lottery terminals would be active a full year in 20 pari-mutuel facilities operating outside Broward and Miami-Dade counties. We developed the estimates based on Florida's lowest pari-mutuel net income per slot machine and the highest net income per slot machine. We then adjusted these figures to a 35% tax rate and compensated for shifts from other state revenue sources including the Lottery, sales tax, and slot machine tax.

³ The Revenue Estimating Conference met November 8, 2012, and adopted this estimate for Indian Gaming revenues in Fiscal Year 2014-15.

Source: Revenue Estimating Conference and OPPAGA analysis.

Appendix D

RICK SCOTT
Governor



CYNTHIA F. O'CONNELL
Secretary

FLORIDA LOTTERY

January 25, 2013

R. Philip Twogood
Coordinator
Office of Program Policy Analysis and Government Accountability
111 West Madison Street
Tallahassee, Florida 32399-1475

Dear Mr. Twogood:

The Lottery has received your office's report: "Lottery Revenue Has Increased Over the Past Year; Options Remain to Enhance Transfers." We appreciate the report recognizing the Florida Lottery's recent efforts, including the Lottery's operating expense continuing to be lower than the legislative standard. We value the efforts your staff has put forward during the analysis of the Lottery's performance and their efforts in identifying how it might be improved.

Our response centers on the "Department Options" detailed in the Recommendations section of the report.

1. Recommendation: The Department of the Lottery continues efforts to expand the retailer network and conduct a cost-benefit analysis of retailer recruitment efforts, as currently planned, at the end of Fiscal Year 2012-13. The department should also annually update the analysis and use the resulting data to evaluate the cost efficiency of recruitment activities, adjust these efforts as needed, and plan future activities.

Response: The Lottery agrees with this recommendation and has plans to complete the cost-benefit analysis of recruiting methods shortly after the close of FY 2012-13.

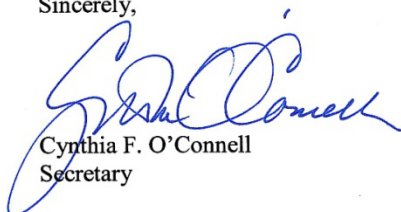


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R. Philip Twogood
Coordinator
Office of Program Policy Analysis and Government Accountability
January 25, 2013
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I would like to thank your staff for their efforts on behalf of the Lottery and look forward to receiving your final report.

Sincerely,



Cynthia F. O'Connell
Secretary

cc: J. Bruce Hoffmann, Chief of Staff
Glenda Thornton, General Counsel
Cynthia B. Jackson, Chief Financial Officer
Dennis Harmon, Deputy Secretary
Andy Mompeller, Inspector General
Kim B. Mills, Director of Auditing, Executive Office of the Governor

The Florida Legislature Office of Program Policy Analysis and Government Accountability



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