



January 2017

Report No. 17-01

# Review of the Florida Lottery, 2016

## *at a glance*

Lottery transfers to the Educational Enhancement Trust Fund increased in Fiscal Year 2015-16 to \$1.693 billion, or \$196 million more than the prior year. This increase is due to a combination of factors including increased sales associated with a record-setting Powerball jackpot and continued scratch-off sales growth.

Several additional game and product distribution options are available to further increase transfers to education. However, some of these options could represent expanded gambling.

The Lottery continues to outperform the legislative performance standard for its operating expense rate and has an expense rate that is second lowest in the nation.

The Lottery should continue its ongoing efforts to

- expand the retailer network;
- improve its data analysis and reporting capabilities for identifying and investigating potential ticket theft or brokering by retailers; and
- increase the number of retailer locations with ticket self-checkers and provide a ticket scanning function in its mobile app so that players can more easily determine for themselves whether a ticket is a winner.

## 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.<sup>1, 2</sup>

## Background

The Department of the Lottery generates funds for education by selling 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 contracted terminal-based gaming system for a drawing at a later time. Scratch-off games are tickets with removable covering that players scratch off to determine instantly whether they have won.

The Lottery is self-supporting and receives no general revenue funds. For Fiscal Year 2016-17, the Legislature appropriated \$167.1 million from Lottery sales revenue and authorized 420 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 2015-16, prizes totaled \$3.869 billion and retailer commissions totaled \$337 million.<sup>3</sup> Total ticket sales for this time

<sup>1</sup> 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 revenue enhancement and efficiency and the Auditor General to conduct the financial audit.

<sup>2</sup> A complete list of prior OPPAGA reports that identify revenue enhancement and operational efficiency options for the Department of the Lottery is available on our [website](#).

<sup>3</sup> 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 and/or 1% of the prize value for winning tickets they redeem up to \$599. Retailers also can receive bonuses for selling select winning tickets and performance incentive payments.

period were \$6.062 billion, ranking Florida the third highest among U.S. lotteries in total sales.<sup>4</sup>

Since its inception, the Lottery has outsourced its core functions to produce, advertise, and sell tickets. The Lottery allocated approximately 75%, or \$125.7 million, of its Fiscal Year 2016-17 appropriation to produce and advertise draw and scratch-off games.<sup>5</sup> These vendor contracts include those listed below.

- A contract with PP+K, Inc. for general market advertising services, as well as Spanish language advertising services. This contract expires in October 2021.
- Two contracts with IGT (formerly named GTECH Corporation) to provide a terminal-based gaming system. The department extended its existing contract with IGT while it completed the procurement process for a new contract.<sup>6</sup> The department subsequently selected IGT for the new contract, under which services will fully commence as of October 30, 2017. IGT continues to provide services under its original contract during the transition. The new contract establishes a different basis for vendor fees—IGT will be paid 0.7865% of net draw game ticket sales plus net scratch-off ticket sales, compared to 1.0699% of draw game ticket sales under the prior contract.<sup>7</sup> The gaming system includes computer systems and retailer terminals, jackpot signs, self-service ticket inquiry

checkers, full-service vending machines, telecommunications, and technical support services. This new contract expires in April 2031 (the department exercised the first of three three-year renewal options when it signed the contract on September 1, 2016).

- A contract with Scientific Games International to print, market, and distribute scratch-off game tickets. This contract expires in September 2018.

## Revenue Performance —

In Fiscal Year 2015-16, Lottery sales increased to \$6.062 billion compared to the prior year's sales of \$5.583 billion (an increase of \$479 million). The increase was primarily due to additional sales associated with a record-setting Powerball jackpot and continued scratch-off sales growth.<sup>8,9</sup> Draw game sales increased by \$248 million, while scratch-off game sales increased by \$231 million.

During the same period, Lottery transfers to the Educational Enhancement Trust Fund increased to \$1.693 billion, or \$196 million (13%) more than the prior year. Transfers exceeded the legislative standard of \$1.206 billion and the Lottery's internal objective of transferring \$1.508 billion to the Educational Enhancement Trust Fund.<sup>10</sup>

<sup>4</sup> Also, Florida ranked 11th highest among U.S. lotteries in per capita sales for Fiscal Year 2015-16.

<sup>5</sup> Of the \$125.7 million, approximately \$86.2 million was allocated to produce draw and scratch-off games and \$39.6 million was allocated to advertising.

<sup>6</sup> This contract originally expired in March 2015 (after the department exercised both of its two-year renewal terms), but the department extended the contract for six months, through September 2015, while it was undergoing the procurement process for a new contract. The department rejected all bids for the original invitation to negotiate (ITN) in January 2015 and issued a new ITN in February 2015. In June 2015, the department entered into an 18-month emergency contract extension with IGT (starting in September 2015). In December 2016, the department amended this emergency extension. The amended emergency extension expires either on October 30, 2017, or when the Lottery has approved the successful conversion to the new gaming system and sales have commenced, but in no event later than April 1, 2018.

<sup>7</sup> Net ticket sales are gross ticket sales minus cancelled, free, or promotional tickets and other adjustments for draw games.

<sup>8</sup> In January 2016, Florida's 11th Powerball jackpot winner was one of three nationally to win the record-setting \$1.59 billion jackpot. This series of 19 Powerball jackpot rollovers began November 7, 2015. The series of rollovers generated more than \$117.1 million for education in Florida and \$14.4 million in retailer commissions and bonuses, and created 5.4 million winning Florida tickets totaling more than \$58.8 million in prizes, including 18 new millionaires.

<sup>9</sup> On October 4, 2015, the Multi-state Lottery Association (MUSL) launched enhancements to the Powerball game in an effort to stimulate sales after a period without large jackpots. MUSL changed the game matrix to stimulate larger jackpots and feature better overall odds, established a \$50,000 third prize and added a 10X multiplier on Power Play. As a result, Powerball rolled to a new world record jackpot of \$1.59 billion on January 13, 2016 and generated the biggest Florida sales week ever with \$230.7 million in a single week.

<sup>10</sup> The Lottery's legislatively-approved performance standards are reported in its long-range program plan—*Long Range Program Plan Fiscal Years 2017-18 through 2021-22*, Florida Lottery, September 30, 2016.

## Revenue Enhancement——

The Lottery took steps during Fiscal Year 2015-16 to increase its sales and transfers to the Educational Enhancement Trust Fund. To further increase sales and transfers, the Lottery could implement new games and it could also implement new ways of selling tickets to further enhance its revenues. However, adding new games or introducing new product distribution methods could represent an expansion of legalized gambling and could produce negative social costs.<sup>11, 12</sup> In addition, some of the sales from new games would be the result of sales shifts from existing games.

### *The Lottery took steps to increase sales from existing types of games*

The Lottery increased its sales by continuing to enhance its product mix. For example, the Lottery launched its first family of holiday-themed scratch-off games on October 25, 2015. The department reports that games launched as families accounted for \$1.85 billion, or half of all scratch-off sales, in Fiscal Year 2014-15. A family of scratch-off games includes multiple price points for tickets that have a similar theme, such as Holiday Gifts or Holiday Millions. With a scratch-off family of games, the Lottery can advertise between four and six price-points at one time. The Lottery achieved holiday game sales of \$163.5 million, which resulted in \$30.25 million in transfers to the Educational Enhancement Trust Fund. This was a 27% increase compared to Fiscal Year 2014-15 holiday games sales.

To promote EZmatch™ sales for both FANTASY 5® and LUCKY MONEY™, the Lottery offered more and higher EZmatch™ prizes during an eight-week promotional period between February 1 and March 27, 2016.<sup>13</sup> The department reports that this promotion resulted in an additional \$4.8 million in sales, generating an added \$1.3 million in transfers.

In addition, on April 5, 2016, the Lottery began to sell a licensed WHEEL OF FORTUNE® scratch-off game. Tickets were priced at \$5 and the game set a single week sales record at the \$5 price point, achieving more than \$7.6 million in sales in a single week, as well as a second consecutive week of sales above \$7 million. After 12 weeks, the game generated \$58.6 million in sales and \$10.7 million in transfers to the Educational Enhancement Trust Fund.

In August 2016, the Lottery re-branded its daily draw game category by renaming Cash 3 and Play 4 as Pick 3 and Pick 4, respectively, and adding two new games—Pick 2 and Pick 5. The December 2016 Revenue Estimating Conference forecasted that all of the pick games together as a group would increase sales by \$4.7 million in Fiscal Year 2016-17.

The department also changed its expectation for retailers to activate new scratch-off games from 85% of retailers to 95% by close of business on Friday of the week new games are launched (within four days, as new scratch-off games are typically launched on a Tuesday). To encourage timely game activation, the department implemented retailer activation incentives for selected games, as discussed later in this report.

To further increase sales and transfers, the Lottery could implement additional games or expand product distribution by adopting new ways of selling lottery tickets. Some of these options are discussed in the sections below. For more information, Appendix A details additional new game options and Appendix B lists additional product distribution options, along with their advantages and disadvantages.

Fiscal impact estimates assume lottery customers and retailers would be educated and ready to play as soon as new games or product distribution options were made available. These estimates also assume that Florida's sales experience would be similar to that of other U.S. lotteries. However, Florida's sales

<sup>11</sup> For more information on negative social costs, see *Lottery Profits Flat; Increasing Retailer Outlets is Critical to Increasing Sales*, OPPAGA Report No. 10-16, January 2010; and *Gambling Impact Study*, Spectrum Gaming Group, October 2013.

<sup>12</sup> Fiscal impact estimates presented in this report do not account for negative social costs and shifts of other taxable economic activity. These factors could reduce the net revenue to the state.

<sup>13</sup> Players pay an additional \$1 per ticket for EZmatch™ for a chance to win cash instantly. The terminal prints additional numbers and instant prize amounts on the ticket and if any of these numbers match the player's numbers for the draw game, the player wins the prize shown.

experience may differ depending on a variety of factors including how the Florida Lottery implements the option.

For the purposes of this report, we did not evaluate whether new game or product distribution options could affect revenues from the gaming compact between the State of Florida and the Seminole Tribe of Florida.<sup>14</sup> If the Lottery were to implement a new option, it would need to determine whether the implementation would have any potential impact on compact revenues.

### ***New lottery games could generate additional revenues***

Florida could consider adding lottery games such as draw games that offer different play styles or prize payment structures than are currently offered.

One example is the All or Nothing game with drawings held multiple times per day. We identified six state lotteries that currently offer an All or Nothing game—Arizona, Georgia, Iowa, Minnesota, North Carolina, and Texas. Tickets are \$1 or \$2 per play, and players win prizes by matching none, some, or all of the numbers drawn. For example, in Texas, players select 12 numbers from 1 to 24 and win a top prize of \$250,000 by matching all 12 numbers drawn or by matching none of the numbers drawn; drawings are four times a day. According to the Florida Lottery's market research vendor, the game tested well with players. However, based on experience with similar games, Lottery administrators believe that such a game may have a limited life cycle with initial sales increases that later

decline. We estimate that implementing the All or Nothing game could generate approximately \$10 million in additional transfers during the first full year of implementation.<sup>15</sup>

Another option is to participate in one of the two multi-state draw games that provide lifetime payments to top prize winners. Currently, 21 U.S. lotteries participate in the Lucky for Life game and 8 U.S. lotteries participate in the Cash4Life game.<sup>16</sup> Lucky for Life tickets are \$2 and players choose five numbers between 1 and 48 and one Lucky Ball number between 1 and 18. Cash4Life tickets are also \$2, and players choose five numbers between 1 and 60 and also a Cash Ball number between 1 and 4. Both of these games have drawings twice a week (Monday and Thursday) and offer a top prize of \$1,000 a day for life.

Lottery administrators reported that they are joining Cash4Life in early 2017. The advantages of participating in a multi-state lifetime payment game include that these games provide an opportunity for bigger prizes and that lifetime payment games have favorable brand recognition. However, as with All or Nothing, this type of game may have a limited life cycle after which sales decline. We estimate that implementing the Cash4Life game could generate approximately \$22 million in additional transfers during the first full year of implementation.<sup>17</sup>

Another option is fast play type instant-terminal games. We identified 11 U.S. lotteries that currently offer fast play games.<sup>18</sup> Fast play games are instant win games that print directly from a lottery retailer's

<sup>14</sup> A gaming compact between the State of Florida and the Seminole Tribe of Florida was approved by the Governor on 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.

<sup>15</sup> We estimated a range of potential All or Nothing transfer revenue (\$5 million to \$15 million, with a median of \$10 million) based on the highest and lowest per capita sales in states that offer All or Nothing, which we applied to Florida's estimated population for 2017. The estimate assumes a draw game transfer rate to the Educational Enhancement Trust Fund of 40.89%, based on the December 2016 Revenue Estimating Conference projected transfers for Fiscal Year 2017-18 and that 10% of the sales would be shifted from existing game sales.

<sup>16</sup> The Arkansas, Connecticut, Colorado, Delaware, District of Columbia, Idaho, Iowa, Kentucky, Maine, Massachusetts, Michigan,

Minnesota, Missouri, Montana, New Hampshire, North Carolina, North Dakota, Ohio, Rhode Island, South Carolina, and Vermont lotteries participate in Lucky for Life, and the Georgia, Indiana, Maryland, New Jersey, New York, Pennsylvania, Tennessee, and Virginia lotteries participate in Cash4Life.

<sup>17</sup> We estimated a range of potential Cash4Life transfer revenue (\$3 million to \$51 million, with a median of \$22 million) based on the highest and lowest per capita sales in states that offer Cash4Life, which we applied to Florida's estimated population for 2017. The estimate assumes a transfer rate to the Educational Enhancement Trust Fund of 36.65%, based on the Cash4Life payout rate of 55%, and an administrative expense rate of 8.35%. The estimate also assumes that 15% of the sales would be shifted from existing game sales.

<sup>18</sup> The Arkansas, District of Columbia, Indiana, Minnesota, Montana, New Hampshire, New Jersey, New Mexico, Ohio, Vermont, and Virginia lotteries offer fast play games.



terminal. Players are not required to fill out playslips, choose numbers, or wait for a drawing. Other lotteries offer fast play games in a wide variety of themes and play styles similar to the options on scratch-off tickets. For example, players match numbers, symbols, or prize amounts to win. Like scratch-off games, new fast play games can be released every few months, while phasing out older games.

The odds of winning with fast play games are closer to scratch-off tickets than draw games. And like scratch-off tickets, other lotteries offer fast play games in a variety of price points, ranging from a \$1 to \$20 per ticket. However, instant win draw games such as fast play games have less visual display at the point of sale than scratch-off games and, therefore require more effort to raise retailer and player awareness of the games. Also, if the Florida Lottery were to implement multiple fast play games at the same time, this would require additional coordination between the Lottery, vendors, and retailers. We estimate that implementing fast play games could generate approximately \$14 million in additional transfers during the first full year of implementation.<sup>19</sup>

### ***New ticket-selling methods could also generate additional revenues***

The Legislature and the Lottery could consider expanding product distribution, as described 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 that 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.<sup>20</sup>

Currently, Illinois, Georgia, Michigan, and Kentucky sell lottery products online for players using a computer or mobile device. In 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, Lucky Day Lotto, Mega Millions, Pick 3, Pick 4, and Powerball. The Georgia Lottery offers Fantasy 5, Keno!, Mega Millions, Powerball, and instant games online. The Michigan Lottery offers Fantasy 5, Lotto, Mega Millions, Powerball, online versions of keno, and instant games online. The Kentucky Lottery launched internet sales in April 2016. It offers both draw games (Kentucky Cash Ball, Mega Millions, and Powerball) and instant games online.<sup>21</sup> Lotteries that sell products online require that players be at least 18 years of age and located within the state when making a lottery purchase.<sup>22</sup> Potential revenue from implementing Internet sales in Florida is approximately \$8 million in additional transfers per year.<sup>23</sup>

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.<sup>24</sup> In

<sup>19</sup> We estimated a range of potential fast play transfer revenue (\$1 million to \$100 million, with a median of \$14 million) based on the highest and lowest per capita sales in states that offer fast play games, which we applied to Florida's estimated population for 2017. Our estimate assumes a transfer rate to the Educational Enhancement Trust Fund of 29.65%, based on a fast play payout of 62%, and an administrative expense rate of 8.35%, suggested by the Florida Lottery. The estimate also assumes that 35% of sales would be shifted from existing game sales.

<sup>20</sup> Subsequent to this decision, Delaware, Nevada, New Jersey, and the U.S. Virgin Islands enacted laws to permit online casino gaming. The Delaware Lottery partners with three casinos to offer online games through the casinos' websites. The types of online games offered include poker, slots, and table games.

<sup>21</sup> Although the Minnesota Lottery previously sold lottery tickets online, the Minnesota Legislature passed legislation in 2015 that prohibited the lottery from selling instant tickets over the Internet (formerly called eScratch tickets) and selling tickets at gas pumps and ATMs. The Minnesota Lottery discontinued all online sales as of August 2015.

<sup>22</sup> To verify players are of legal age to purchase lottery tickets, lotteries use methods such as age-verification and identity-verification technology to assess information players provide to pre-register on the lottery website. To verify players are located within the state when making a purchase, lotteries often use geo-location technology.

<sup>23</sup> We estimated a range of potential Internet transfer revenue (\$2 million to \$74 million, with a median of \$8 million) based on the highest and lowest per capita sales in states that offer Internet sales, which we applied to Florida's estimated population for 2018. Our estimate assumes a transfer rate to the Educational Enhancement Trust Fund of 25.41%, based on the December 2016 Revenue Estimating Conference draw game and scratch-off projected transfers for Fiscal Year 2018-19. The estimate also assumes that 5% of sales would be shifted from existing game sales per the Florida Lottery.

<sup>24</sup> 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

addition, the state would need to 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. As has happened in other states, retailers may oppose this option due to concerns that they would lose lottery sales commissions and revenues from sales of other in-store products, as players would no longer need to visit a retailer to make a lottery purchase.

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.<sup>25</sup> 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. We estimated that annual sales through subscriptions could generate an additional \$5 million in transfers to education.<sup>26</sup> As with Internet sales, retailers may oppose this option due to concerns that they would lose lottery sales commissions and revenues from sales of other in-store products.

### ***Expanding the retailer network could also increase revenues***

Another option to increase sales is for the Lottery to expand its retailer network. In Fiscal Year 2014-15, the top 11 U.S. lotteries ranked by per capita sales had an average of 1,143 residents per retailer. During that

period, the Florida Lottery averaged 1,492 residents per retailer. Adding 4,155 new retailers to Florida's retailer network would meet the top-performing lotteries' market penetration and has the potential to generate about \$131 million annually in additional transfers to the Educational Enhancement Trust Fund. More modest growth of 200 retailers would generate about \$6 million annually in transfers.<sup>27</sup>

The Lottery's Long-Range Program Plan for Fiscal Years 2017-18 through 2021-22 includes a goal to increase the retailer network. The number of retailers in the network varies daily, but point-in-time data shows that it has declined slightly from 13,061 as of June 30, 2015, to 13,033 as of June 30, 2016, or a net loss of 28 retailers. Lottery administrators attribute some of the decline to corporate chain retailers being bought out by other corporate chain retailers, which then closed unprofitable stores, as well as retailers going out of business for other reasons.

Lottery administrators believe that one way to expand the retailer network is to use more full-service vending machines (FSVMs), which allow customers to purchase draw game and scratch-off tickets without assistance from a clerk or cashier. Over the last few years, the department has leased 1,500 instant ticket vending machines (ITVMs), which only dispense scratch-off tickets, and 500 FSVMs. Lottery administrators report that they have had requests from corporate retailer chains for FSVMs that exceed the current number of available machines, including both current lottery retailers and those not currently selling lottery products.

In an effort to attract more retailers and thus increase the size of the network, the department contracted with IGT to provide FSVMs at 39% of lottery retailer locations (approximately 5,100 FSVMs).<sup>28</sup> Lottery

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instrument issued by a bank to purchase lottery products.

<sup>25</sup> We identified 11 U.S. lotteries that offer subscription sales for draw games—Illinois, Maine, Maryland, Massachusetts, Minnesota, New Hampshire, New York, North Carolina, North Dakota, Vermont, and Virginia.

<sup>26</sup> We estimated a range of potential subscription transfer revenue (\$1 million to \$11 million, with a median of \$5 million) based on the highest and lowest per capita sales in states that offer subscription sales, which we applied to Florida's estimated population for 2018. Our estimate assumes a draw game transfer rate to the Educational Enhancement Trust Fund of 40.89%, based on the December 2016 Revenue Estimating Conference projected transfers for Fiscal Year 2017-18. The estimate also assumes that 5% of sales would be shifted from existing game sales per the Florida Lottery.

<sup>27</sup> We estimated potential transfer revenues from expanding the retailer network by assuming that new retailers would achieve at least the average weekly gross sales new retailers achieved in Fiscal Year 2015-16. The estimate assumes all new retailer terminals are active for a full year and that 20% of their sales would be shifted from existing retailers.

<sup>28</sup> In-lane sales is another option to attract more retailers, but we did not identify any U.S. lotteries that have implemented this option. Although the British Columbia Lottery has implemented in-lane sales, Florida Lottery administrators report that U.S. lotteries are still in the process of developing the software needed to implement this option, as well as addressing security issues. In-lane sales allows customers to buy lottery tickets at the checkouts in individual checkout lanes in locations such as grocery stores. Similar to a gift card transaction, the consumer selects a

administrators report that they are beginning to phase out the ITVMs in favor of FSVMs. The terms of its new contract with IGT provide that the Lottery will keep the existing 500 Gemini Ultra FSVMs (as currently configured) in the field for five years following the October 30, 2017 contract conversion date at no additional cost to the Lottery. The Lottery received an early deployment of an additional 500 Gemini Ultra 24-bin FSVMs in fall 2016, and placed these machines primarily in locations where ITVMs had been placed. The balance of the FSVMs will be 28-bin touch screen FSVMs and will be placed primarily in existing Lottery retailer locations during 2017, according to Lottery officials. If the Lottery succeeds in recruiting additional corporate chain retailers after placing the FSVMs at existing retailers, it will reassess the location of the FSVMs and consider moving machines from the least profitable locations.

## Operational Efficiency

The Lottery continues to keep its expenses as a percentage of sales low and below the legislative standard. However, the Lottery should continue its ongoing efforts to

- improve its data analysis and reporting capabilities for identifying and investigating potential ticket theft or brokering by retailers; and
- increase the number of retailer locations with ticket self-checkers for players and provide a ticket scanning function in its mobile app so that players can more easily determine for themselves whether a ticket is a winner.

### *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.<sup>29</sup> Compared to other U.S. lotteries, the Florida Lottery had the second lowest operating expense rate in Fiscal Year

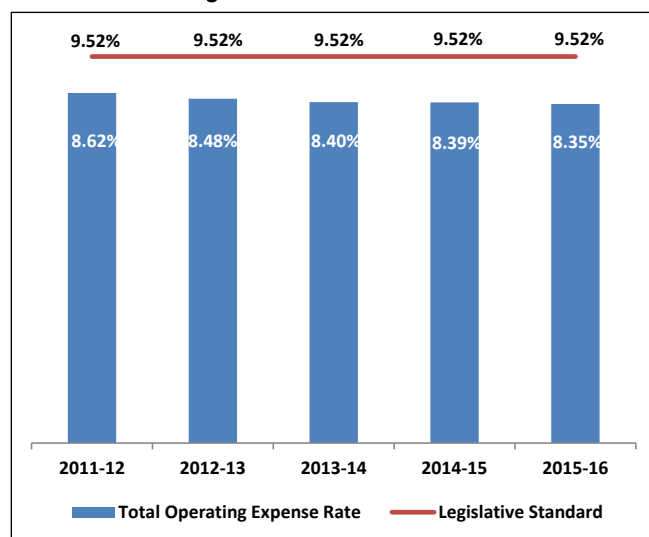
pre-printed card from a display within the store for a specific number of quick pick draw game tickets, and upon check-out, the cashier scans the bar code on the card; quick pick tickets would be printed on the customer's receipt.

<sup>29</sup> Operating expenses include payments to gaming vendors and retailer commissions.

<sup>30</sup> Florida Lottery's ranking is based on the latest fiscal year data

2014-15, behind Massachusetts.<sup>30</sup> According to department administrators, a primary reason for its low operating expense rate is that the department had stable operating expenses while ticket sales increased.

### Exhibit 1 The Lottery's Operating Expense Rate Continues to Be Below the Legislative Standard



Source: Department of the Lottery long range program plans.

### *Lottery administrators continue to enhance processes for protecting players against ticket theft by retailers*

As we noted in our 2015 report, all lotteries face the challenge of ensuring public confidence in the integrity of their operations.<sup>31</sup> One significant threat to this confidence occurs when retailers or their employees steal winning tickets from players. Lotteries also face the potential for ticket brokers to buy winning tickets from players for less than the amount won to help people avoid paying state-owed debt or child support, losing eligibility for public assistance, being identified as a retailer who is stealing winning tickets, etc.<sup>32</sup>

available from La Fleur's 2016 World Lottery Almanac.

<sup>31</sup> *Lottery Transfers Continue to Increase; Options Remain to Enhance Revenues and Improve Efficiency*, OPPAGA Report No. 15-03, January 2015.

<sup>32</sup> If a lottery winner owes money to the state, such as for taxes or fees, or owes child support, the department withholds the amount owed from the player's winnings if the amount won is \$600 or more.

Theft of winning tickets and ticket brokering are crimes. These actions also violate the terms of the Lottery's contracts with retailers, which provide that the Lottery may suspend or terminate the contract of a retailer for reasons such as engaging in conduct prejudicial to public confidence in the Lottery.

The Lottery has continued to implement its Retailer Integrity Program that includes several components intended to address potential illegal retailer behavior. These components include following up on customer complaints, conducting operations to identify retailers/clerks who steal winning tickets, and providing ticket self-checkers for players at approximately half of its retailer locations so that players can determine for themselves whether a ticket is a winner and how much they have won.<sup>33, 34</sup> In 2015, the Lottery further enhanced the program by adding a random retailer inspection component. It conducted 111 retailer contract compliance operations in 2015 and 326 in 2016.<sup>35</sup>

As of December 2016, Lottery administrators reported that they were currently investigating 126 retailers. This represents about 1% of the approximately 13,000 lottery retailers. Between December 9, 2015 and December 7, 2016, the Lottery reported that it terminated the contracts of 35 retailers for reasons primarily related to conduct prejudicial to public confidence.

According to Lottery administrators, if they substantiate that a retailer/clerk is stealing winning tickets, they pursue an arrest. The Lottery reports that during 2016, its law enforcement officers made 15 arrests as of December 2016, of which 2 were retailers, 5 were clerks working in a retail location, and 8 were individuals arrested with charges such as grand theft or presentation of fraudulent and/or altered tickets. Also, Lottery law enforcement officers assisted other law enforcement agencies with 24 additional arrests that included situations such as

burglary, robbery, or internal theft at a lottery retailer.<sup>36</sup>

According to Lottery administrators, they are also continuing to pursue upgrading their investigations case management system to more efficiently handle an increase in the investigation caseload and improve their analytical capabilities. They are planning to participate in a new system in collaboration with other state law enforcement agencies; the Department of Highway Safety and Motor Vehicles (DHSMV) is the lead agency for implementing the case management system. The Lottery reports that its workload more than doubled from 2013 to 2016—from 816 total investigations in 2013 to 1,891 in 2016.<sup>37</sup> Lottery administrators believe that the new system will help with allocating investigation resources, strengthening their collaboration with other law enforcement agencies by making it more efficient to share information on cases, and improving their analytical capabilities by making it easier to identify whether a particular person or household is the subject of another investigation. Lottery administrators signed a memorandum of understanding (MOU) with DHSMV administrators on January 17, 2017, and expect to migrate to the new system within 60 days.

In addition, Lottery administrators believe that the services they will receive as part of a new gaming system vendor contract will enhance the Retailer Integrity Program. For example, the vendor will provide two on-site analysts/programmers to improve the Lottery's ability to analyze data and generate reports from its data system. The vendor also will provide other services to assist the department with fraud detection. Lottery administrators expect that these enhancements will improve the Lottery's capabilities for identifying and investigating potential ticket theft or brokering by retailers.<sup>38</sup> In addition, the vendor will provide ticket self-checkers for players at all retailer locations that can accommodate them so that players can determine

<sup>33</sup> Lottery staff identify retailers for these operations based on customer complaints and other audit selection criteria.

<sup>34</sup> For additional information about the Retailer Integrity Program, see OPPAGA [Report No. 15-03](#), January 2015.

<sup>35</sup> As of December 7, 2016.

<sup>36</sup> The department has assisted other law enforcement agencies with

investigations that involve lottery retailers or their employees who may have stolen lottery tickets or committed other offenses.

<sup>37</sup> As of December 6, 2016.

<sup>38</sup> For instance, department employees currently conduct individual data queries to identify frequent winners and determine whether these winners are retailers. Staff also separately check whether retailers they are investigating have been the subject of customer complaints.



for themselves if their tickets are winners. The vendor also will assist the Lottery in improving its mobile app to include the ability for players to scan their tickets to identify winners. The Lottery is scheduled to receive the full range of services under its new gaming system vendor contract as of October 30, 2017.

The Lottery should continue its ongoing efforts to improve its data analysis and reporting capabilities for identifying and investigating potential ticket theft or brokering by retailers, as well as increase the number of retailer locations with ticket self-checkers and provide a ticket scanning function in its mobile app so that players can more easily determine for themselves whether a ticket is a winner.

***The Lottery's retailer incentive programs are increasingly focused on modifying specific retailer behaviors to enhance sales***

Retailer incentive programs provide retailers bonus commissions for selling winning tickets or taking actions that can lead to increased sales of lottery products. The Florida Lottery has received an annual appropriation of \$2.325 million for retailer incentives in each of the last four years.

The Lottery uses these funds for a variety of retailer incentive programs. These programs include paying retailers a bonus for selling a winning jackpot ticket or grand prize scratch-off ticket, which serves as both a sales incentive and a retailer recruitment tool, and is the most frequent type of incentive program used by lotteries in other states that we contacted. The Lottery also has implemented incentives that focus on rewarding retailer behaviors that Lottery officials believe enhance sales.

For example, for the new scratch-off game launch in April 2016, retailers who activated all three new games within two days of the official launch date were entered into a drawing for cash prizes. The department reports that sales for this launch during the first two days were 6.6% higher than the

same launch period in 2015 and 23.5% higher after four days. According to Lottery officials, the reason for encouraging early game activation is that scratch-off games sell best when they are new and being advertised.

Over time, the Lottery has placed more emphasis on incentive programs that focus on rewarding retailer behaviors intended to enhance sales. We reviewed the department's expenditure of retailer incentive funds over a five-year period. From Fiscal Years 2011-12 to 2015-16, the percentage of incentive funds that the Lottery spent on incentives that reward certain retailer behaviors increased from 22% to 41%.

***To further its business strategies, the department uses its statutory authority to adopt administrative rules as emergency rules***

When the Legislature created the Lottery in 1987, it gave the Department of the Lottery statutory authority to adopt and retain administrative rules as emergency rules, with less explanation, public input, and formality than other executive branch agencies.<sup>39</sup> The 1987 Legislature found that the Lottery needed emergency rulemaking power to provide additional funds to benefit the public, and to support the unique nature of lottery operations by enabling quick department responses to changes in the marketplace.<sup>40</sup> As of December 2016, the Lottery has 146 emergency rules that primarily relate to scratch-off or draw games, and two rules adopted by the typical rule promulgation process.<sup>41</sup>

To better understand the department's implementation of its emergency rulemaking for topics not related to the games, OPPAGA spoke with Lottery officials about four specific non-game related emergency rules: Facility Leases (53ER09-51); Retailer Applications (53ER13-56); a Code of Ethics for department officers and employees (53ER12-18); and Agency Procurement of Commodities and Contractual Services (53ER07-55).<sup>42</sup> The department noted that it is a

<sup>39</sup> Section 24.109(1), F.S.

<sup>40</sup> Section 9, Ch. 87-65, L.O.F.

<sup>41</sup> The two permanent rules address confidential information (Rule 53-1.005, F.A.C.) and internal audit functions (Rule 53-1.007, F.A.C.). The department reported that these two rules were adopted at the

direction of Lottery management in 1993 and have remained as non-emergency rules since that time.

<sup>42</sup> The numbering system for emergency rules displays the year of rule adoption immediately following the "ER" designation.

best business practice to be able to make changes in an expedited manner, and that it uses emergency rulemaking as part of its strategic and planning processes. Department officials identified benefits to the agency from each non-game emergency rule, such as a higher square footage threshold in the Facility Lease rule before competitive solicitation is required, and the ability to update retailer integrity requirements in an expedited manner under the Retailer Application rule.

The department promulgated the employee ethics rule in 2012 to comply with s. 24.105(20), *Florida Statutes*, which directs the department to adopt a code of ethics for employees to supplement the standards already in law for public officers and employees. Lottery officials reported similarly that the emergency rule on ethics allows the department to have flexibility to respond quickly to changing marketplace conditions. The department also stated that the ethics rule allows the Lottery to adjust its rule requirements quickly in response to opinions issued by the Commission on Ethics.

The department's emergency rule on procurement specifically finds that, due to the unique nature of its business, strict compliance with Ch. 287, *Florida Statutes*, and the rules adopted thereunder would impair or impede the effective and efficient operation of the Lottery, and provides alternative procedures for purchasing commodities and contractual services in an open and competitive manner. The department identified several benefits it achieves from this emergency rule, including an expanded definition for emergency purchases and exemption from the 1% transaction fee otherwise payable for certain purchases through MyFloridaMarketplace. In addition, Lottery officials stated that the rule allows for quicker procurements by providing a higher threshold (\$65,000 compared to \$35,000) before competitive solicitation is required, and by shortening public notice posting requirements (72 hours compared to 7 business days) for Lottery

decisions to enter sponsorship agreements or purchase licenses to use trademarks or other intellectual property. They noted that the rule also supports the department's statutory authority to require a compressed and accelerated protest process for its contract selection decisions.<sup>43</sup> Under the rule provisions, in all areas not covered by its terms, the department follows Ch. 287, *Florida Statutes*.

### ***The department has entered into multiple extensions of contractual agreements***

During our review the department reported that it has extended seven contracts beyond the originally contemplated time periods, including optional extensions, from July 1, 2013 to the present.<sup>44</sup> Three of these contracts involved advertising (general market advertising, Spanish language advertising, and market research and analyses); one involved the Lottery gaming system (e.g., computer systems, retailer terminals, self-service ticket checkers, vending machines, and technical support); two involved financial services (one banking and one auditing for Lottery games); and one involved a district office lease.

Extensions ranged from 6 months to 24 months, with the majority extended for one year or more.<sup>45</sup> The department reported that the need for contract extension typically occurs when other more significant procurement matters demand officials' attention during the same timeframe as planned procurement efforts for a contract; as a result, the existing contract timeframe is extended. Lottery officials stated that this basis for extension is consistent with the department's strategic priorities and cited statutory and rule authority to extend Lottery services contracts in this manner.

One such statutory provision is s. 287.057(12), *Florida Statutes*, which states that "Extension of a contract for commodities or contractual services must be in writing for a period not to exceed six

<sup>43</sup> Section 24.109(2)(a), *F.S.*, provides that a formal written protest of any action subject to protest must be filed within 72 hours after the receipt of notice of the intended action. In contrast, s. 120.57(3)(b), *F.S.*, provides that a protestor must file a Notice of Protest within 72 hours, but then has ten days from the notice filing to submit the formal written protest.

<sup>44</sup> The seven contracts represented a total dollar value of

approximately \$338 million; of this, more than \$111 million was for advertising and media buys and \$222 million was for the Lottery gaming system and related services.

<sup>45</sup> The office lease was not considered in calculating contract extensions because month-to-month extensions of real property leases are an ordinary business practice.

months... There may be only one extension of a contract unless the failure to meet the criteria set forth in the contract for completion of the contract is due to events beyond the control of the contractor.” The department cites this provision as its authority to enter each initial six-month extension of its contracts.

The department also referenced its own statutory authority to adopt emergency rules that determine when circumstances constitute an emergency requiring the department to take action necessary to maintain the Lottery’s operation.<sup>46</sup> Rule 53ER07-55, *Florida Administrative Code*, the emergency rule the Lottery adopted to address procurement and contracting for services; subsection (9) provides information about emergency purchases, which is the specific basis on which the department acted to extend its contracts.<sup>47</sup> Such actions require a senior manager to provide written certification under oath stating the conditions and circumstances of the emergency, which is then submitted to the Secretary for approval.

## Recommendations —————

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

### *Department Options*

We recommend that the Department of the Lottery continue its ongoing efforts to

- expand the retailer network; and
- improve its data analysis and reporting capabilities for identifying and investigating potential ticket theft or brokering by retailers, as well as increase the number of retailer locations with ticket self-checkers and provide a ticket scanning function in its mobile app so that players can more easily determine for themselves whether a ticket is a winner.

### *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 business analysis that includes 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(2), *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 C.

<sup>46</sup> The department cited ss. [24.105\(13\)](#) and [24.109\(1\)](#), *F.S.*

<sup>47</sup> Rule [53ER07-55](#), *F.A.C.*, defines a valid emergency as a circumstance

caused by an unexpected turn of events beyond the control of the Lottery involving the security, integrity, or the financial status of the Lottery; or involving public health, welfare, safety, injury, or loss.

## Appendix A

# New Lottery Game Options

New games that attract new players have the potential to increase revenues to education but could be considered an expansion of gambling. Exhibit A-1 lists new game options, their advantages and disadvantages, and estimated revenues where we were able to develop reasonable estimates. Some of the sales from new games would be the result of sales shifts from existing games; our estimates include a component to address sales shift. However, 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, could increase the negative social costs of gambling because their rapid play style may be more addictive than other types of games. In addition, implementing games with a high prize payout, such as higher priced scratch-off games, would require careful analysis of the Lottery Revenue Bond rate floor, as transfers to the Educational Enhancement Trust Fund need to meet or exceed the transfer rates specified in the bond covenants.<sup>48</sup> Estimates of annual revenue assume full implementation by July 1, 2017. However, some options would require additional time to implement, such as launching a keno or monitor game. For purposes of this report, we did not evaluate whether new game options could affect revenues from the gaming compact between the State of Florida and the Seminole Tribe of Florida.<sup>49</sup> If the Lottery were to implement a new option, it would need to determine whether the implementation would have any potential impact on compact revenues.

### Exhibit A-1

#### New Games Have the Potential to Increase Revenues to Education

Option	Advantages	Disadvantages
<b>All or Nothing</b> For \$1 or \$2, players select 10 to 12 numbers from up to 24 numbers and win the top prize by matching all numbers drawn or by matching none of the numbers drawn; drawings are held multiple times per day	<ul style="list-style-type: none"> <li>Could generate approximately \$10 million in transfers to education during the first full year of implementation<sup>1</sup></li> </ul>	<ul style="list-style-type: none"> <li>May have a limited life cycle after which sales decline</li> </ul>
<b>Multi-state Draw Game With a Lifetime Payment Top Prize</b> For \$2, players select 5 numbers from up to 60 and a number for a cash ball or lucky ball, for a top prize that winners can choose to receive in installments over their lifetime	<ul style="list-style-type: none"> <li>Could generate approximately \$22 million in transfers to education during the first full year of implementation<sup>2</sup></li> <li>Multi-state games provide an opportunity for bigger top prizes</li> </ul>	<ul style="list-style-type: none"> <li>May have a limited life cycle after which sales decline</li> </ul>

<sup>48</sup> 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. Therefore, the Lottery would need to ensure that prize payouts and expenses for new games enable it to meet or exceed the minimum transfer rate needed to remain in compliance with bond covenants. For revenue bonds sold in 2016, the Division of Bond Finance covenants that transfers will not be reduced below 38% of gross revenue from sales and other earnings, excluding application processing fees, except upon written certification of a lottery consultant that the amounts deposited into the trust fund will not be less than the amounts projected for each of the next three fiscal years as determined by the Consensus Estimating Conference's estimate of deposits at the 38% rate.

<sup>49</sup> A gaming compact between the State of Florida and the Seminole Tribe of Florida was approved by the Governor on 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.

Option	Advantages	Disadvantages
<b>Fast Play Games</b> Fast play is a series of quick play style instant win games printed from the retailer terminal; players can match numbers, symbols, or prize amounts to win; a variety of themes are available, similar to scratch-off games, and the prices points range from \$1 to \$20	<ul style="list-style-type: none"> <li>▪ Could generate approximately \$14 million in transfers to education during the first full year of implementation<sup>3</sup></li> <li>▪ Shorter life-cycle games can be refreshed frequently to keep players interested in the games.</li> <li>▪ Ability to have higher price point draw games</li> </ul>	<ul style="list-style-type: none"> <li>▪ Instant win draw games have less visual display at the point of sale than scratch-off games and therefore require more effort to raise retailer and player awareness of the games</li> <li>▪ Will require considerable coordination between Lottery staff, vendors, and retailers because of frequent launch schedules</li> </ul>
<b>Expand Higher Priced Scratch-Off Games</b> Standard scratch-off games offered at prices of \$25 or more, with higher prizes and prize payout percentages	<ul style="list-style-type: none"> <li>▪ The Lottery has experienced significant revenues from higher priced scratch-off tickets; for example, the \$10,000,000 Florida Cash game generated approximately \$52.1 million in transfers for Fiscal Year 2014-15</li> </ul>	<ul style="list-style-type: none"> <li>▪ 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</li> </ul>
<b>Fast Keno</b> Players choose from 10 to 12 numbers from a panel of 80 numbers with the hope of matching their choices to 20 numbers drawn by the central computer at Lottery headquarters; it may be played frequently (e.g., every four to five minutes); players watch a monitor at a retailer location to determine if they have won or leave the premises and check the lottery's website for the winning numbers  Implementing this option may require legislative action to modify the requirement for a drawing to be witnessed by an accountant, given that electronic drawings could occur every four to five minutes (s. 24.105(9)(d), <i>F.S.</i> )	<ul style="list-style-type: none"> <li>▪ Could generate approximately \$115 million per year in additional recurring transfers to education<sup>4</sup></li> <li>▪ Can be limited to social settings such as bars, restaurants, and fraternal organizations, although other U.S. lotteries allow traditional lottery retailers to participate; some state lotteries also offer Keno-to-Go at traditional lottery retailer sites whereby players purchase tickets, leave the premises, and check the lottery website to see if they have won<sup>5</sup></li> <li>▪ Would help the Lottery recruit new retailers in social venues</li> </ul>	<ul style="list-style-type: none"> <li>▪ May be addictive due to its rapid play style</li> <li>▪ Requires legislative budget approval for additional gaming system equipment</li> <li>▪ Sales are dependent on new retailer participation</li> </ul>
<b>Daily Keno</b> Players choose as many as 10 numbers from a panel of 80 numbers in the hope of matching their choices to 20 to 22 numbers drawn by the central computer at Lottery headquarters; the game may be played more than once per day	<ul style="list-style-type: none"> <li>▪ Could generate approximately \$10 million per year in additional recurring transfers to education<sup>6</sup></li> </ul>	<ul style="list-style-type: none"> <li>▪ May have a limited life cycle after which sales decline</li> </ul>
<b>Monitor Games</b> Computer animated games, such as simulated horse racing, poker, and bingo, that are played on in-store monitors similar to the way Fast Keno is played  Implementing this option 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> )	<ul style="list-style-type: none"> <li>▪ Could generate approximately \$6 million per year in additional recurring transfers to education<sup>7</sup></li> <li>▪ Could appeal to emerging markets of Lottery players that have grown up playing computer games</li> <li>▪ Allows the Lottery to recruit new retailers in social venues such as bars and restaurants</li> <li>▪ Could be limited to pari-mutuel facilities or social settings, such as bars and restaurants</li> </ul>	<ul style="list-style-type: none"> <li>▪ May be addictive due to its rapid play style</li> <li>▪ Requires legislative budget approval for additional gaming system equipment</li> </ul>

<sup>1</sup> We estimated a range of potential All or Nothing transfer revenue (\$5 million to \$15 million, with a median of \$10 million) based on the highest and lowest per capita sales in states that offer All or Nothing, which we applied to Florida's estimated population for 2017. The estimate assumes a draw game transfer rate to the Educational Enhancement Trust Fund of 40.89%, based on the December 2016 Revenue Estimating Conference projected transfers for Fiscal Year 2017-18 and that 10% of the sales would be shifted from existing game sales.

<sup>2</sup> We estimated a range of potential Cash4Life transfer revenue (\$3 million to \$51 million, with a median of \$22 million) based on the highest and lowest per capita sales in states that offer Cash4Life, which we applied to Florida's estimated population for 2017. The estimate assumes a transfer rate to the Educational Enhancement Trust Fund of 36.65%, based on the Cash4Life payout rate of 55% and an administrative expense rate of 8.35%. The estimate also assumes that 15% of the sales would be shifted from existing game sales.

<sup>3</sup> We estimated a range of potential fast play transfer revenue (\$1 million to \$100 million, with a median of \$14 million) based on the highest and lowest per capita sales in states that offer fast play games, which we applied to Florida's estimated population for 2017. Our estimate assumes a transfer rate to the Educational Enhancement Trust Fund of 29.65%, based on a fast play payout of 62%, and an administrative expense rate of 8.35%, suggested by the Florida Lottery. The estimate also assumes that 35% of the sales would be shifted from existing game sales.



<sup>4</sup> We estimated a range of potential Fast Keno transfer revenue (\$16 million to \$710 million, with a median of \$115 million) based on the highest and lowest per capita sales in states that offer Fast Keno, which we applied to Florida's estimated population for 2018. Our estimate assumes a transfer rate to the Educational Enhancement Trust Fund of 30.38%, based on 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.

<sup>5</sup> We identified 16 U.S. lotteries that offer Fast Keno—California, Delaware, District of Columbia, Georgia, Kansas, Kentucky, Maryland, Massachusetts, Michigan, Missouri, New York, Ohio, Oregon, Rhode Island, U.S. Virgin Islands, and West Virginia.

<sup>6</sup> We estimated a range of Daily Keno transfer revenue (\$6 million to \$24 million, with a median of \$10 million) based on the highest and lowest per capita sales in states that offer Daily Keno, which we applied to Florida's estimated population for 2017. The estimate assumes a draw game transfer rate to the Educational Enhancement Trust Fund of 40.89%, based on the December 2016 Revenue Estimating Conference projected transfers for Fiscal Year 2017-18 and that 5% of the sales would be shifted from existing game sales.

<sup>7</sup> We estimated a range of potential monitor game transfer revenue (\$2 million to \$146 million, with a median of \$6 million) based on the highest and lowest per capita sales in states that offer monitor games, which we applied to Florida's estimated population for 2018. Our estimate assumes a transfer rate to the Educational Enhancement Trust Fund of 30.38%, based on 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.

Source: OPPAGA analysis of lottery 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 increase revenues to education. For example, authorizing product distribution through the Internet and increasing the number of retailers have the potential to increase revenues by making lottery products more readily available to players. Exhibit 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, 2017. However, some options would likely require additional time to implement. For purposes of this report, we did not evaluate whether new product distribution options could affect revenues from the gaming compact between the State of Florida and the Seminole Tribe of Florida.<sup>50</sup> If the Lottery were to implement a new option, it would need to determine whether the implementation would have any potential impact on compact revenues.

### Exhibit B-1

#### Expanding Product Distribution Has the Potential to Increase Revenues to Education

Option	Advantages	Disadvantages
<b>Internet Sales</b> The Legislature would enact laws to authorize intrastate Internet sales of lottery products  Implementing this option would require statutory changes to allow player-activated terminals (s. 24.105, <i>F.S.</i> ) and use of credit cards or other instruments issued by a bank for lottery purchases without requiring purchase of \$20 in other goods (s. 24.118, <i>F.S.</i> )	<ul style="list-style-type: none"> <li>▪ Could generate approximately \$8 million per year in additional recurring transfers to education<sup>1</sup></li> <li>▪ Provides more convenience to players who prefer to purchase their lottery products from their personal computer or cellular device</li> </ul>	<ul style="list-style-type: none"> <li>▪ 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</li> <li>▪ Requires legislative budget approval for enhanced systems and technology</li> <li>▪ Could be considered an expansion of gambling</li> <li>▪ As has happened in other states, retailers may oppose this option due to concerns that they would lose lottery sales commissions and revenues from sales of other in-store products, as players would no longer need to visit a retailer to make a lottery purchase</li> </ul>
<b>Subscription Play</b> The state would allow players to subscribe to game drawings for up to one year in advance on the Florida Lottery website; for prizes under a specified amount (e.g., \$600), players would receive automatic credit or the Lottery would mail them a check  Implementing this option may require statutory changes to allow player-activated terminals (s. 24.105, <i>F.S.</i> ) and use of credit cards or other instruments issued by a bank for lottery purchases without requiring purchase of \$20 in other goods (s. 24.118, <i>F.S.</i> )	<ul style="list-style-type: none"> <li>▪ Could generate approximately \$5 million per year in additional recurring transfers to education<sup>2</sup></li> <li>▪ Internet technology has made subscription services much easier and more cost-effective for lotteries to manage</li> <li>▪ The Lottery would receive revenues from subscription sales in advance of drawings</li> <li>▪ Key benefits for the consumers are no missed draws, no waiting in lines, and ease of prize claims</li> <li>▪ Provides the ability for people to play who may not be able to otherwise, such as seasonal residents</li> </ul>	<ul style="list-style-type: none"> <li>▪ 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</li> <li>▪ Game changes after tickets are purchased require communication with players and possibly a replacement ticket</li> <li>▪ Could reduce unclaimed prize funds, as prizes may be automatically credited to players</li> <li>▪ Could be considered an expansion of gambling</li> <li>▪ As has happened in other states, retailers may oppose this option due to concerns that they would lose lottery sales commissions and revenues from sales of other in-store products, as players would no longer need to visit a retailer to make a lottery purchase</li> </ul>

<sup>50</sup> A gaming compact between the State of Florida and the Seminole Tribe of Florida was approved by the Governor on 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.

Option	Advantages	Disadvantages
<p><b>Paying at the Pump for Lottery Products (Play at the Pump)</b></p> <p>Players would be able to purchase lottery products as part of the transaction involved in purchasing gasoline at the pump or using an ATM; most lotteries with this option charge players a \$1.00 flat fee for each transaction, which is for the vendor that provides the technology that enables play at the pump purchases<sup>3,4</sup></p> <p>Implementing this option may require statutory changes to</p> <ul style="list-style-type: none"> <li>allow player-activated terminals (s. 24.105, <i>F.S.</i>)</li> <li>allow use of credit cards or other instruments issued by a bank for lottery purchases without requiring purchase of \$20 in other goods (s. 24.118, <i>F.S.</i>)</li> <li>modify the definition of and requirements for lottery retailers (ss. 24.103 and 24.112, <i>F.S.</i>)</li> <li>modify the definition of and requirements for lottery vending machines (s. 24.112, <i>F.S.</i>)</li> <li>address the prohibition against selling lottery tickets at anything other than the price set by the Lottery (s. 24.117, <i>F.S.</i>)</li> </ul>	<ul style="list-style-type: none"> <li>A November 2015 impact conference adopted a positive, indeterminate impact estimate for lottery point-of-sale terminals<sup>5</sup></li> <li>The ability to purchase tickets at the pump would increase convenience and avoid the loss of sales from players who have no need to walk into the store to pay for gas</li> <li>Offering this option at ATMs may help expand the retailer network to non-traditional locations</li> <li>Purchases can be limited to a certain amount per week<sup>6</sup></li> <li>Can be configured to require verification of age<sup>7</sup></li> </ul>	<ul style="list-style-type: none"> <li>Could be considered an expansion of gambling</li> <li>Paying at the pump eliminates the need for many consumers to go inside stores, which might affect the sale of other products retailers sell; however, Minnesota Lottery officials found that in-store sales were not negatively affected</li> </ul>
<p><b>Expand Retailer Network</b></p> <p>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</p>	<ul style="list-style-type: none"> <li>Adding 200 new retailers has the potential to generate approximately \$6 million per year in additional recurring transfers to education<sup>8</sup></li> <li>Florida has been below average in terminal density compared to other successful Lottery states, so expanding its network could improve per capita sales</li> <li>Could increase product distribution and awareness, making products available to new players who do not shop where products are currently being sold</li> </ul>	<ul style="list-style-type: none"> <li>May require legislative budget approval for more terminals, depending on the extent of growth</li> <li>The non-traditional lottery business model may require the development of different products, compensation frameworks, and distribution strategies</li> <li>May require additional lottery staff to service new accounts</li> </ul>

<sup>1</sup> We estimated a range of potential Internet transfer revenue (\$2 million to \$74 million, with a median of \$8 million) based on the highest and lowest per capita sales in states that offer Internet sales, which we applied to Florida's estimated population for 2018. Our estimate assumes a transfer rate to the Educational Enhancement Trust Fund of 25.41%, based on the December 2016 Revenue Estimating Conference draw game and scratch-off game projected transfers for Fiscal Year 2018-19. The estimate also assumes that 5% of sales would be shifted from existing game sales per the Florida Lottery.

<sup>2</sup> We estimated a range of potential subscription transfer revenue (\$1 million to \$11 million, with a median of \$5 million) based on the highest and lowest per capita sales in states that offer subscription sales, which we applied to Florida's estimated population for 2018. Our estimate assumes a draw game transfer rate to the Educational Enhancement Trust Fund of 40.89%, based on the December 2016 Revenue Estimating Conference projected transfers for Fiscal Year 2017-18. The estimate also assumes that 5% of sales would be shifted from existing game sales per the Florida Lottery.

<sup>3</sup> The Minnesota Lottery originally developed the technology and payment processes needed to implement this option in 2012, but the Minnesota Legislature passed legislation in 2015 to prohibit it. The Missouri Lottery began offering Play at the Pump and ATM sales in fall 2013 in select locations, followed by the California Lottery in the fall of 2014. California's Play at the Pump sales are limited to participating gas stations in Sacramento and Los Angeles counties. The North Carolina Education Lottery began offering Play at the Pump in 2015 at a limited number of retailers. The Pennsylvania Lottery implemented this option in February 2016, followed by the New Mexico Lottery in July 2016.

<sup>4</sup> To make purchases, players use a debit or credit card and select the option to purchase lottery tickets as part of the transaction for purchasing gas or using an ATM. (The Missouri, New Mexico, and North Carolina lotteries only allow use of debit cards but the California and Pennsylvania lotteries allow either a debit or credit card.) Players pay a flat fee of \$1.00 for each transaction. The lottery purchase shows on the receipt. The lottery automatically credits the account associated with the debit or credit card for prizes under a certain amount (e.g., \$600).

<sup>5</sup> A Florida impact conference in November 2015 considered fiscal impact estimates for lottery point-of-sale terminals ranging from \$500,000 to \$3.2 million in recurring transfers based on the sales experience of North Carolina's use of gas pump point-of-sale terminals in 2015.

<sup>6</sup> The California and Pennsylvania lotteries limit Play at the Pump weekly purchases to \$50, while the North Carolina Education Lottery's weekly limit is \$70, the New Mexico Lottery's weekly limit is \$75, and the Missouri Lottery's weekly limit is \$100.

<sup>7</sup> To verify that a player is at least 18 years of age, the California Lottery requires players to swipe a driver's license or state-issued identification card to make a Play at the Pump purchase. The North Carolina Education Lottery requires players to enter the year of their birth, which the system cross references to the birth date linked to the debit card used for purchase. The Missouri Lottery requires players to enter the last four digits of their social security number and their zip code, which is then verified by a third party provider. The Pennsylvania Lottery requires players to push a button to self-certify that they are of age before the transaction will continue.

<sup>8</sup> We estimated potential transfer revenues from expanding the retailer network by assuming that the 200 retailers would achieve at least the average weekly gross sales new retailers achieved in Fiscal Year 2015-16. The estimate assumes all 200 terminals being active for a full year and that 20% of their sales would be shifted from existing retailers.

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

## Appendix C

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RICK SCOTT  
Governor



TOM DELACENSERIE  
Secretary

January 23, 2017

Mr. R. Philip Twogood  
Coordinator  
The Florida Legislature's Office of Program  
Policy Analysis and Government Accountability  
111 West Madison Street, Room 312  
Tallahassee, FL 32399-1475

Dear Mr. Twogood:

Thank you for the opportunity to respond formally to your office's draft report: "Review of the Florida Lottery, 2016." We appreciate the diligence of your staff to thoroughly analyze the Lottery's performance over the years, to help identify opportunities to increase our revenues and efficiencies, and we will take your recommendations under consideration.

1. **Recommendation:** We recommend that the Department of the Lottery continue its efforts to expand the retailer network.

**Response:** The Department agrees with the recommendation and will continue its efforts to expand the retailer network. These efforts will be greatly aided by the new gaming contract, which will include a net increase in ticket vending machines of approximately 3,000, in order to provide consistent equipment throughout the network meeting both consumer and retailer demand and include potential new retailers who require vending machines to accommodate their trade styles.

2. **Recommendation:** We recommend that the Department of the Lottery improve its data analysis and reporting capabilities for identifying and investigating potential ticket theft or brokering by retailers, as well as increase the number of retailer locations with ticket self-checkers and provide a ticket scanning function in its mobile app so that players can more easily determine for themselves whether a ticket is a winner.

**Response:** The Department agrees with the recommendation and will benefit greatly by technological enhancements that will be part of the new gaming contract. These enhancements will provide significant security upgrades which will help protect consumers by improving data analysis and reporting capabilities for identifying and investigating potential ticket theft or brokering by retailers. Additionally, the new contract will dramatically increase the number of retailers with ticket self-checkers and

Phillip Twogood, Coordinator  
Office of Program Policy Analysis and Government Accountability  
January 23, 2017  
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provide mobile app scanning capabilities so players can more easily check their tickets themselves.

Again, we would like to thank you and your staff for your diligent efforts to help us increase our revenues and efficiencies and offering us the opportunity to provide additional information to express our views. The Florida Lottery is proud of the record growth generated in both sales and transfers to the Educational Enhancement Trust Fund and will continue to remain true to our mission to serve as a reliable contributor to education in Florida.

Sincerely,



Thomas R. Delacenserie  
Secretary

TRD/ms

cc: David Mica, Jr, Chief of Staff  
Joan Schoubert, Deputy Secretary – Administration  
Josie Tamayo, General Counsel  
Andy Mompeller, Inspector General





# *The Florida Legislature*

## *Office of Program Policy Analysis and Government Accountability*

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