

E75D
State Lottery and Gaming Control Agency

Operating Budget Data

(\$ in Thousands)

	<u>FY 12</u> <u>Actual</u>	<u>FY 13</u> <u>Working</u>	<u>FY 14</u> <u>Allowance</u>	<u>FY 13-14</u> <u>Change</u>	<u>% Change</u> <u>Prior Year</u>
General Fund	\$28,959	\$73,008	\$86,477	\$13,469	18.4%
Contingent & Back of Bill Reductions	0	0	-13	-13	
Adjusted General Fund	\$28,959	\$73,008	\$86,464	\$13,456	18.4%
Special Fund	124,069	239,166	69,777	-169,389	-70.8%
Contingent & Back of Bill Reductions	0	0	-20	-20	
Adjusted Special Fund	\$124,069	\$239,166	\$69,757	-\$169,410	-70.8%
Adjusted Grand Total	\$153,028	\$312,174	\$156,220	-\$155,954	-50.0%

- The fiscal 2014 allowance includes several fiscal 2013 general fund deficiencies totaling \$1.97 million to support the additional responsibilities associated with expanded gaming in the State, primarily the authorization of 24-hour operations and table games.
- General funds are increasing in the fiscal 2014 allowance by about \$13.5 million due primarily to increases in personnel under the agency's gaming program and an escalation of lease costs for video lottery terminal machines.
- Special funds decline in the fiscal 2014 allowance due to a change in the manner in which casino owners receive their share of the video lottery terminal proceeds. Absent this, special funds actually increase by approximately \$3.7 million over the fiscal 2013 working appropriation. This increase is largely due to changes in personnel and contract costs under the regular lottery program.

Personnel Data

	<u>FY 12 Actual</u>	<u>FY 13 Working</u>	<u>FY 14 Allowance</u>	<u>FY 13-14 Change</u>
Regular Positions	211.50	258.50	279.50	21.00
Contractual FTEs	<u>11.75</u>	<u>10.75</u>	<u>7.75</u>	<u>-3.00</u>
Total Personnel	223.25	269.25	287.25	18.00

Vacancy Data: Regular Positions

Turnover and Necessary Vacancies, Excluding New Positions	9.80	3.79%
Positions and Percentage Vacant as of 12/31/12	25.00	9.67%

- The fiscal 2014 allowance reflects an increase of 21 full-time equivalents (FTE). This is in addition to 44 FTEs that were created by the Board of Public Works during fiscal 2013. Of the new positions, 4 are allocated to regular lottery operations, while the remainder are allocated to gaming operations.
- Of the 4 new positions allocated to regular lottery operations, 3 represent contractual conversions, as demonstrated by the decline in contractual FTEs.
- Vacancies are significantly higher than required to meet turnover; however, most of the vacancies relate to the new positions created during fiscal 2013.

Analysis in Brief

Major Trends

Sales, Prize Payouts Expect to Increase; Slight Decline in Revenue: Fiscal 2013 and 2014 are expected to show gains in sales and prize payouts. However, that increased payout amount is expected to lead to a slight decrease in revenue in fiscal 2013.

Flat Advertising Funding Leads to Increased Sales: Fiscal 2012 marked the fifteenth consecutive year that the lottery achieved record sales of traditional lottery games. The record level of sales was achieved despite a significant decline in advertising funds that began in fiscal 2010.

Issues

Traditional Lottery Games Set New Sales Record: Sales of instant games, monitor games, and jackpot games surpassed expectations in fiscal 2012. The current variety of games appears to help mitigate the impact of any one game. **The Department of Legislative Services (DLS) recommends that the State Lottery and Gaming Control Agency (SLGCA) brief the budget committees on the sales and revenue trends of its games and how it plans to continue growth in sales.**

Expanded Gaming – Expanded Agency Responsibility: SLGCA is tasked with the responsibility of administering the State’s current Video Lottery Terminal (VLT) program and with managing the changes to the State’s gaming program as enacted by Chapter 1 of the Second Special Session of 2012. Specifically, the changes that impact the agency are as follows: (1) authorizes a video lottery operation license to be awarded for a facility within Prince George’s County; (2) increases from 15,000 to 16,500 the maximum number of VLTs that may be authorized; (3) alters the distribution of VLT proceeds; (4) authorizes a video lottery licensee to offer table games; (5) transfers leasing/ownership of most VLTs, from the State to licensees; (6) renames the State Lottery Agency and reconstitutes and renames the State Lottery Commission; (7) authorizes VLT facilities to operate 24 hours per day; (8) authorizes SLGCA to issue qualifying veterans’ organizations in certain counties a license for up to five instant ticket lottery (pull-tab) machines; and (10) increases State lottery agent commissions. **DLS recommends that SLGCA brief the budget committees on the impact of gaming expansion on its budget, staffing, and responsibilities.**

Online Sales of Lottery Games: Following a 2011 ruling by the U.S. Department of Justice that paved the way for intrastate sales of lottery games over the Internet, SLGCA began the process of establishing an online sales program. The fiscal 2013 budget bill included language that withheld \$167,119 of its special fund appropriation pending a report on the possible platform and regulatory structure of online lottery sales. The agency submitted its report in September 2012; however, due to concerns about the types of online games proposed, the impact on retailers, and the authority of the agency to proceed, the budget committees delayed releasing the funds. **DLS recommends that the agency comment on its report on online lottery sales and on any plans it may have to proceed**

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with the program. DLS is also recommending that the funds in the fiscal 2014 allowance for this purpose be deleted.

Recommended Actions

	<u>Funds</u>
1. Delete funds for design of iLottery website.	\$ 366,000
Total Reductions	\$ 366,000

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Operating Budget Analysis

Program Description

Since 1973, the State Lottery and Gaming Control Agency (SLGCA) has administered and operated lottery games to generate revenue for the State. The lottery currently offers the following games: Pick 3, Pick 4, Keno, Keno Bonus and Super Keno Bonus, Mega Millions, Powerball, Bonus Match Five, Instant Games, Multi-Match, Racetrax and Racetrax Bonus, and 5 Card Cash.

All games, except Instant Games, are online, meaning that players pick their numbers or use computer-generated numbers, receive a ticket, and then wait for a drawing to see if they have won. With Instant Games, players scratch off a latex covering on a ticket play area to reveal preprinted combinations. Games are sold through lottery agents, which are private businesses that receive commissions and fees in exchange for selling the games to the public.

SLGCC has oversight responsibility for the agency. In 2008, the commission was expanded to address additional responsibilities stemming from the video lottery terminal (VLT) legislation. The agency is responsible for the administration of the VLT program, including accounting for and distributing VLT revenues; managing the program's central system; and regulation and licensing of operators. In 2012, the agency's responsibilities were further expanded to include the regulation of table games at the previously authorized VLT facilities, among other new duties. The agency's divisions include Executive; Administration, Finance, and Operations; Information Technology; Sales; Marketing and Communications; Legal; and Gaming and Enforcement.

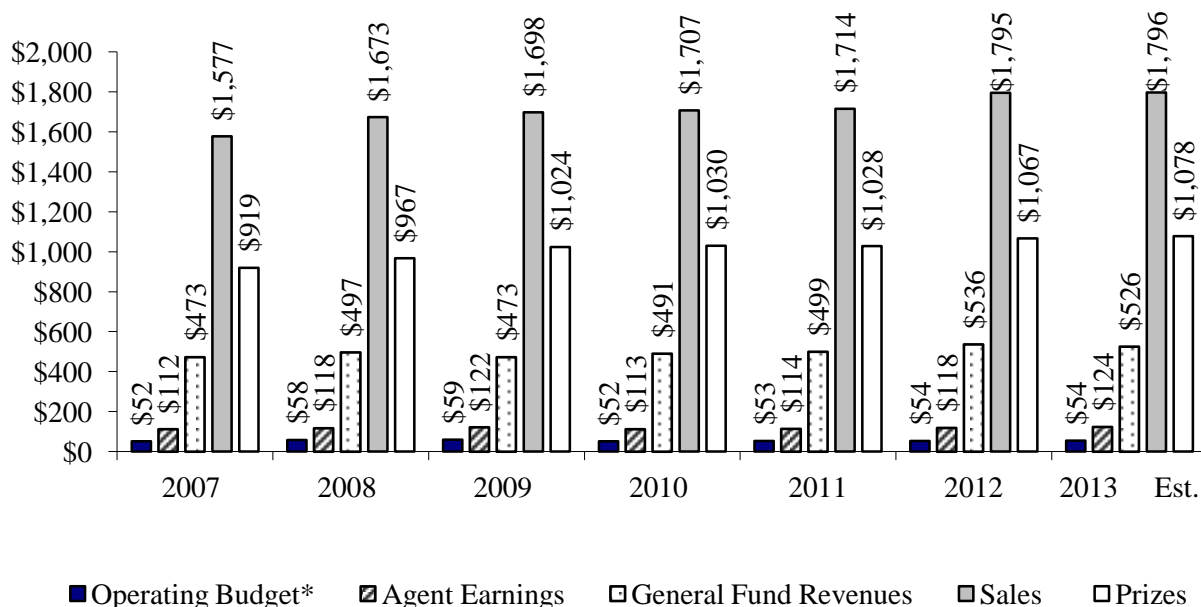
Performance Analysis: Managing for Results

1. Sales, Prize Payouts Expect to Increase; Slight Decline in Revenue

Proceeds from the games pay for prizes, agent earnings, and all operating expenses of the agency. In fiscal 2012, 59.4% of sales paid for prizes, 6.6% paid for agent commissions and redemption fees, 3.0% paid for agency operations, and 29.2% was credited as revenue to the State (a small percentage is forwarded to the Maryland Stadium Authority per statute).

As shown in **Exhibit 1**, prize payouts surpassed \$1 billion in fiscal 2009 and have not fallen below that mark. Growth in sales is again expected in fiscal 2013. However, a small decrease (1.9%) is expected in revenues.

Exhibit 1
Lottery Sales and Expenditures
Fiscal 2007-2013
(\$ in Millions)



*The operating budget does not include funds to operate the video lottery terminal program.

Note: General fund revenues exclude disbursements to the Maryland Stadium Authority.

Source: Maryland State Budget Books, Fiscal 2008-2014

The Budget Reconciliation and Financing Act of 2009 decreased the agent sales commission from 5.5 to 5.0% in fiscal 2010 through 2012. As such, agent earnings are a bit lower for these years. Chapter 1 of the Second Special Session of 2012 provides that State lottery agent commissions increased from 5.0 to 5.5% on January 1, 2013. The Act also increases State lottery agent commissions from 5.5 to 6.0% upon the issuance of a video lottery operation license in Baltimore City.

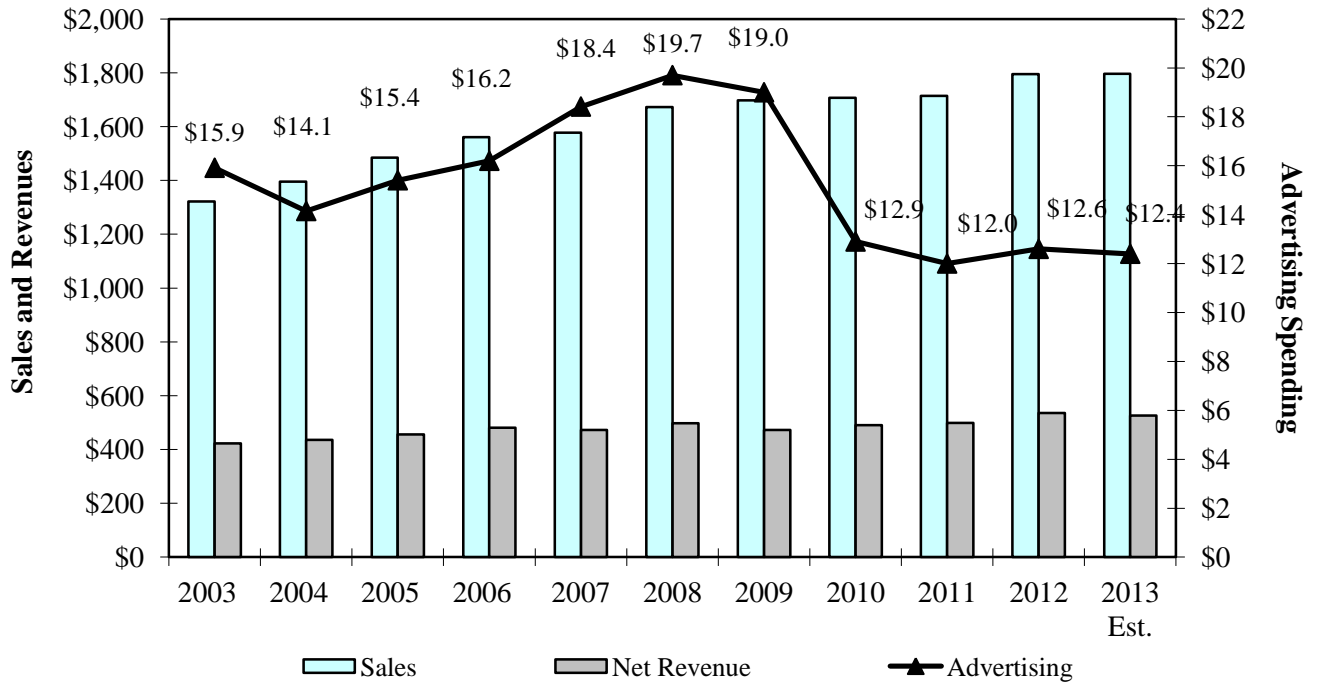
2. Flat Advertising Funding Leads to Increased Sales

For the fifteenth consecutive year, the lottery achieved record sales of its traditional lottery games in fiscal 2012. The lottery generated almost \$1.8 billion in sales, an increase of \$80.6 million.

Exhibit 2 shows sales and revenues as compared to the agency’s total advertising expenditures. Advertising expenditures include funds for radio, television, print and other advertisements, as well as promotional events and materials. The cost containment effort in fiscal 2010 reduced the advertising budget by \$6 million from the original fiscal 2010 appropriation. The budget has since remained fairly flat. However, record sales have been achieved since fiscal 2010, and record sales are predicted for fiscal 2013 and 2014.

Based on this history, the current level of advertising funding seems appropriate to lead to increased sales. However, it should be noted that year-over-year growth is not as strong as in years with significantly more funds for advertising.

Exhibit 2
Sales and Revenue Trends Compared to Advertising Spending
Fiscal 2003-2013
(\$ in Millions)



Source: Governor’s Budget Books, Fiscal 2006-2014; Lottery Budget, Fiscal 2005-2014

Fiscal 2013 Actions

Proposed Deficiency

The fiscal 2014 allowance includes deficiency appropriations for fiscal 2013 reflecting the additional responsibilities resulting from Chapter 1 of the Second Special Session of 2012. Specifically, the allowance includes \$1.6 million in general funds to provide funds for 44 full-time equivalents (FTE) that were created by the Board of Public Works in November 2012. These positions will largely be responsible for duties associated with table games and 24-hour operations. Further, the allowance includes a deficiency of about \$110,000 in general funds for 5 additional positions, again related to new agency responsibilities, namely the regulation of pull-tab machines at veterans’ organizations. Finally, the allowance includes funds for an additional 12 positions related to the opening of the casino in Allegany County. Additional details about the new positions are provided below.

Proposed Budget

As shown in **Exhibit 3**, the fiscal 2014 allowance decreases by \$156.0 million from the fiscal 2013 working appropriation. This change is skewed significantly due to the change in the manner in which casino licensees receive their share of VLT proceeds. Previously, the licensee share was included in the agency’s allowance. However, legislative changes have allowed the licensees to retain their share of proceeds prior to remittance of revenue to the lottery agency. Absent this change, the fiscal 2014 allowance actually increases by \$17.2 million.

Exhibit 3
Proposed Budget
State Lottery and Gaming Control Agency
(\$ in Thousands)

How Much It Grows:	<u>General Fund</u>	<u>Special Fund</u>	<u>Total</u>
2013 Working Appropriation	\$73,008	\$239,166	\$312,174
2014 Allowance	<u>86,477</u>	<u>69,777</u>	<u>156,253</u>
Amount Change	\$13,469	-\$169,389	-\$155,921
Percent Change	18.4%	-70.8%	-49.9%
Contingent Reductions	-\$13	-\$20	-\$33
Adjusted Change	\$13,456	-\$169,410	-\$155,954
Adjusted Percent Change	18.4%	-70.8%	-50.0%

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Where It Goes:

Personnel Expenses

New positions	\$1,243
Annualization of general salary increase	135
Increments and annualization of salaries of positions created in fiscal 2013	1,768
Employee and retiree health insurance	580
Retirement system	563
Contingent reduction to health insurance	-33
Workers' compensation premium assessment	-19
Turnover adjustments	-39
Other fringe benefit adjustments	281

Other Changes

Lottery Operations

Online gaming contract	887
Instant ticket printing	442
iLottery development consultant	-550
iLottery website development	366
Advertising	77
Decrease in contractual staff due to conversions	-77
Other changes	-51

Gaming Operations

Video lottery terminal (VLT) leasing	9,212
Costs to wire the Baltimore facility	962
Software upgrades	800
VLT machine maintenance	449
Consultant fees	42
Vendor payments (now off budget)	-173,125
Other changes	133

Total **-\$155,954**

Note: Numbers may not sum to total due to rounding.

Regular Lottery Operations

Absent VLT and gaming administration, the regular lottery allowance for fiscal 2014 increases by \$1.9 million in special funds. New personnel and contractual services are driving the increase.

Personnel

As mentioned earlier, the fiscal 2014 allowance includes the contractual conversion of 3 positions. In each case, the lottery reports that it has difficulty in retaining individuals in the following positions: 1 receptionist position responsible for interactions with visitors and phone calls; and 2 warehouse positions responsible for management of instant ticket and promotional material inventory. Additionally, the allowance includes another new position to assist with the agency's communication and marketing plan. The agency reports that this position will take the place of an outside advertising contractor. The cost of the outside contractor is approximately \$145,000.

The fiscal 2014 allowance reflects an increase in personnel costs for regular lottery operations of about \$220,000 in special funds. This is offset by the cost of the advertising contractor and contractual pay.

Contractual Services

The lottery agency maintains a service contract for the system that connects the games to the vendors from the central system. The annual cost of the contract is based on a percentage of total sales. Sales of the lottery's regular games are expected to increase in fiscal 2014. Accordingly, the cost of the contract is increasing in fiscal 2014 (by \$887,000 in special funds). Similarly, the cost to print instant tickets is increasing due to an expected increase in sales (\$442,000 in special funds).

The allowance for consulting services declines by \$550,000 in fiscal 2014. This is due to a one-time appropriation of funds in fiscal 2013 for a consultant to assist the agency in designing a system of online sales of regular lottery games (iLottery). Additional funds for the iLottery program in fiscal 2013 were restricted until the agency submitted a report to the budget committees on the potential program. Due to concerns about the program, the agency reported that it will not continue with the program at this time. However, the fiscal 2014 allowance includes \$366,000 in special funds for the design of an iLottery website. This topic is discussed further under the Issues section of this analysis.

VLT and Gaming Operations

The legislation that created the regulatory framework of the VLT program specified that the lottery agency would be allowed to retain 2% of the gross VLT revenues as special funds for the administration of the program. Additional special funds are generated through licensing fees of VLT operators and employees. However, these special funds are not sufficient to cover all costs associated with the VLT program. The fiscal 2014 allowance includes \$86.5 million in general funds and \$13.5 million in special funds (VLT operator payments are no longer included in the allowance). Absent the technical budgetary change in operator payments, the fiscal 2014 allowance for the administration of the State's gaming program increases by \$15.3 million.

Exhibit 4 summarizes the components of the fiscal 2014 allowance for the gaming program.

Exhibit 4
Video Lottery Terminal Program
Fiscal 2014 Allowance

	<u>General Funds</u>	<u>Special Funds</u>
Payments to Operators	\$0	\$0
Machine Purchase	8,677,081	0
Machine Leasing	63,806,794	5,569,356
Maintenance	0	7,763,909
Central System	4,482,841	0
Personnel	7,445,058	0
Software	1,300,000	0
Other	764,874	129,000
Total	\$86,476,648	\$13,462,265

Source: State Lottery and Gaming Control Agency

Personnel

The fiscal 2014 allowance reflects a significant increase in personnel under the agency's gaming program, driven by the changes authorized by Chapter 1 of the Second Special Session of 2012. New positions (44 FTEs) were created during fiscal 2013 to address the provisions of the legislation that came into force prior to the new budget cycle. An additional 17 FTEs are added in the fiscal 2014 allowance. The breakdown of the new positions is as follows:

- **7 Commissioners:** Statute now authorizes a salary for the Commissioners of the Maryland Lottery and Gaming Commission. Salary is budgeted at \$18,000 per commissioner;
- **1 Director of Table Games:** Responsible for management and oversight of table games;
- **1 Director of Gaming Research:** Conduct studies and research on gaming;
- **1 Assistant Director of Gaming Research:** Conduct studies and research on gaming;
- **18 Licensing Investigators:** Conduct licensing background investigations on new employees related to the opening of the casino at Rocky Gap, 24-hour operations, and table games;
- **4 Investigative and Support Staff:** Assist licensing investigators;

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- **10 Auditors/Accountants:** Oversee the collection of table game revenue, revenue from the new facility at Rocky Gap, and the revenue associated with pull-tab machines;
- **15 Compliance Officers:** Provide on-site oversight during all hours of operation related to table games and the new facility at Rocky Gap;
- **1 Information Technology Specialist:** Provide technical support for the VLT machines;
- **1 Assistant Attorney General:** Assist with the increase in regulatory workload;
- **1 Corporate Sales Representative:** Monitor and visit all facilities with pull-tab machines; and
- **1 Personnel Officer:** Assist in the recruitment and retention of new employees.

VLT Machines

Chapter 1 of the Second Special Session of 2012 altered the provision that requires the State to own or lease all the VLT machines by requiring some of the facilities to assume control of machine ownership. However, this provision is not effective until fiscal 2015. As such, the fiscal 2014 allowance reflects the continued ownership costs for the three operating facilities.

The agency leases all the machines that are housed at the Anne Arundel facility and a portion of the remaining machines. Due to the payment structure of the lease contract that allowed for lower upfront payments, lease costs are expected to increase in fiscal 2014. The allowance reflects an increase of \$9.2 million for this purpose. Similarly, the cost of the maintenance of the machines that the State owns is also increasing based on the contract structure (increase of \$449,000). Additionally, the agency is increasing its funds for software upgrades that will allow the agency to alter the themes or displays of VLT machines to keep customer interest. The allowance increases by \$800,000 for this purpose.

Other Expenses

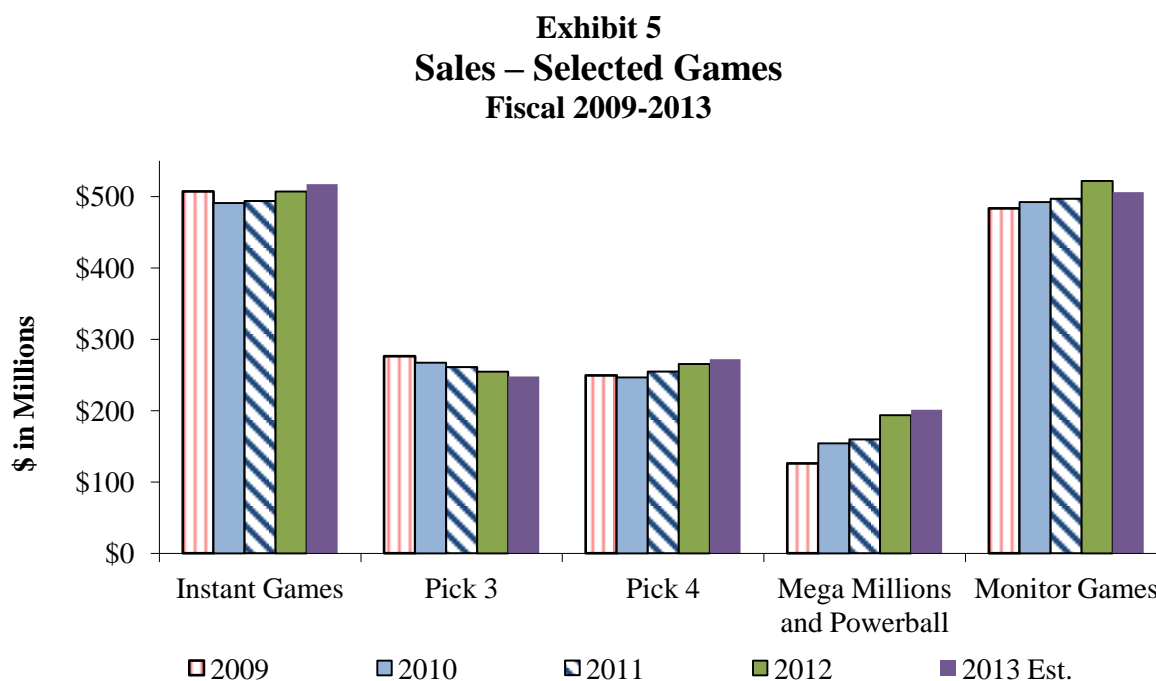
The fiscal 2014 allowance includes an increase of \$961,700 in contractual services due to costs associated with wiring the Baltimore facility to communicate with the agency's central system. The Baltimore facility is expected to open in the second quarter of 2014.

Finally, the allowance includes \$100,000 for the use of outside consultants. The agency advises that it requires a consultant to enhance the gaming licensing system. Additionally, Chapter 1 of the Second Special Session of 2012 requires the lottery to engage an outside consultant to provide continual analysis of the gaming industry.

Issues

1. Traditional Lottery Games Set New Sales Record

Of the lottery’s most popular traditional games, only Pick 3 experienced a decline in sales in fiscal 2012. This continues a trend of decreasing popularity of this game. However, the sales activity of the remaining games led to a new sales record for the lottery. **Exhibit 5** shows the total sales of selected games, from fiscal 2009 through an estimate for fiscal 2013.



Source: State Lottery and Gaming Control Agency

Exhibit 5 clearly shows the relative popularity of the games, with instant games and monitor games claiming most of the sales. Instant games, monitor games, and the jackpot games each surpassed estimated sales totals for fiscal 2012. The sales of jackpot games (Mega Millions and Powerball) increased significantly, 21.6%. Several large prizes, combined with the ticket sale price increase from \$1.00 to \$2.00 drove this increase. Sales of monitor games also posted a healthy gain of 5.0%, driven by an increased interest in the Racetrax game.

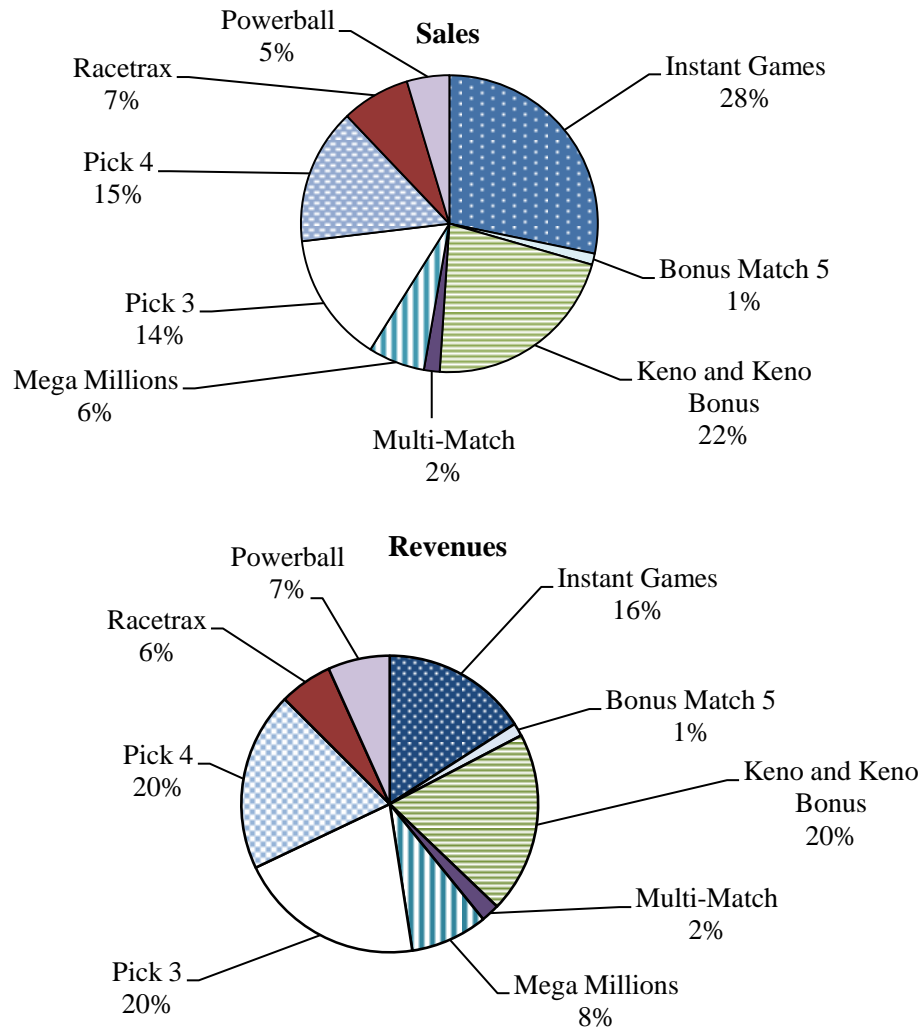
Game Variety Helpful to Bottom Line

Instant ticket games continue to be very popular, in large part, due to higher payout rates than the agency’s other offerings. This popularity, and the decline in traditional numbers games, has an

impact on the general fund revenues. However, because there are a variety of games with a variety of payout rates, any negative impact on revenues from one game is mitigated by the other games.

Exhibit 6 shows sales and revenues for each game type in fiscal 2012. As shown, instant ticket sales make up 28% of total sales but only 16% of revenue. Monitor games are increasing in popularity and do not have as high payout rates as instant tickets, leading to better revenue return. In any given year, one type of game may have a higher than normal payout. The more games offered by the agency, the less likely that an outlier payout will affect the bottom line.

**Exhibit 6
Sales and Revenues
Fiscal 2012**



Source: State Lottery and Gaming Control Agency

The Department of Legislative Services (DLS) recommends that SLGCA brief the budget committees on the sales and revenue trends of its games and how it plans to continue growth in sales.

2. Expanded Gaming – Expanded Agency Responsibility

Since 2008, the lottery agency has been tasked with the responsibility of administering the VLT program for the State. This has included the regulation and licensing of operators; accounting for and distributing VLT revenues; managing the program's central system; and the purchase or lease of gaming machines. Legislation passed during the Second Special Session of 2012 significantly expanded the agency's responsibilities and altered its current responsibilities. Also, the legislation reconstitutes the nine-member State Lottery Commission as a seven-member SLGCC. The agency's expanded role is reflected in the fiscal 2014 allowance.

Background

The Video Lottery Facility Location Commission (Location Commission) is tasked with the review and awarding of facility licenses. The Location Commission has awarded video lottery operation licenses for the following:

- ***Cecil County:*** Penn Cecil Maryland Inc. (Penn Cecil) was awarded a license to operate a VLT facility with 1,500 VLTs in Perryville in Cecil County. The facility opened to the public with 1,500 VLTs on September 27, 2010.
- ***Worcester County:*** Ocean Enterprise 589, LLC (Ocean Downs) was awarded a license to operate a facility with 800 VLTs at Ocean Downs Racetrack in Worcester County. The facility opened with 750 VLTs on January 4, 2011, and has now placed into operation its full complement of 800 VLTs.
- ***Anne Arundel County:*** PPE Casino Resorts, LLC was awarded a license to operate a facility with 4,750 VLTs adjacent to the Arundel Mills Mall in Anne Arundel County. In June 2012, the Maryland Live! facility opened with 3,171 VLTs. As of October 2012, the facility has placed into operation its full complement of 4,750 VLTs.
- ***Allegany County:*** On April 26, 2012, Evitts Resort, LLC (Evitts) was awarded a video lottery operation license to own and operate a video lottery facility adjacent to the Rocky Gap Lodge and Resort, subject to certain contingencies. However, Evitts, unable to secure the requisite construction financing for the facility, was subsequently granted approval from the Location Commission to instead operate a facility with 500 VLTs in the lodge's existing conference center space, again subject to certain contingencies. That facility is currently scheduled to open in spring 2013.

- **Baltimore City:** On July 31, 2012, the Location Commission awarded the Baltimore City video lottery operation license to CBAC Gaming, LLC for a facility with 3,750 VLTs, subject to certain contingencies. That facility is currently scheduled to open in the second quarter of 2014.

The agency accounts for and disperses the revenue derived from the VLT facilities. Currently, three facilities are generating revenue for the State. **Exhibit 7** shows the gross revenue from the three facilities over calendar 2012. Statute dictates the allocation of the revenues by purpose as shown in the exhibit.

Exhibit 7
Penn Cecil, Ocean Downs, and Maryland Live!
Video Lottery Terminal Facilities Gross Revenues
Calendar 2012

	<u>Percent</u>	<u>Revenues</u>
Education Trust Fund	49.25%	\$184,199,291
Facility Owner	33.00%	124,678,469
Horse Racing Purse Account	7.00%	26,446,948
Local Impact Aid	5.50%	20,779,745
Racetrack Facility Renewal Account	1.75%	8,485,616
State Lottery Agency	2.00%	7,556,271
Small, Minority, and Women-Owned Business Account	1.5%	5,667,203
Total	100.0%	\$377,813,543

Source: State Lottery and Gaming Control Agency

Introduction of Table Games; a Sixth Facility; and Other Changes

During a special legislative session in August 2012, the General Assembly passed comprehensive gaming legislation (Chapter 1) that included various provisions subject to voter approval by referendum at the November 2012 general election (Question 7). On November 6, 2012, the voters of Maryland approved Question 7 by a 52 to 48% margin. The major components of the legislation that affect the duties and responsibilities of the agency are detailed below.

VLT Facility in Prince George’s County

With approval of Question 7, the Location Commission is authorized to award a license for a video lottery facility in Prince George’s County within a geographic radius that includes both

National Harbor and Rosecroft Raceway. Under the legislation, an applicant for the Prince George’s County license may request to operate a maximum of 3,000 VLTs and receive up to 38% of VLT proceeds.

Upon the issuance of a Prince George’s County video lottery operation license, the Anne Arundel County and Baltimore City licensees would receive an additional 8 and 7% of VLT revenues, respectively, for certain marketing and capital improvement allowances. Furthermore, if a license is awarded in Prince George’s County, the percentage of VLT revenues distributed to the Purse Dedication Account for horse racing purses and bred funds changes from 7 to 6%.

Table Games at Video Lottery Facilities

With approval of Question 7, video lottery operation licensees will be permitted to offer table games. Prior to the issuance of a Prince George’s County video lottery operation license, 80% of table game revenues will be distributed to licensees, and the State’s Education Trust Fund (ETF) will receive the remaining 20% of table game revenues. After a Prince George’s County license is issued, the 20% distribution to the ETF will be reduced to 15%, and 5% of table game revenues will be distributed to the local jurisdictions where VLT facilities are located. Additionally, all facilities will be able to operate on a 24-hour basis.

Procurement of VLTs

Prior to enactment of the 2012 legislation, VLTs and associated equipment and software were owned or leased by the State. Now, the Baltimore City and Prince George’s County licensees will be required to purchase or lease VLTs and related equipment. Upon the expiration of the State’s master contract with VLT manufacturers in March 2015, the licensees in Anne Arundel and Cecil counties will also be responsible for procuring their own VLTs. However, the State will continue to own and/or lease machines for the facilities in Allegany and Worcester counties, unless either licensee requests to procure its own VLTs.

Instant Ticket Lottery Machines for Certain Veterans Organizations

The legislation also authorizes the agency to issue certain veterans’ organizations a license for up to five instant ticket lottery (pull-tab) machines. Veterans’ organizations in Eastern Shore counties and in Montgomery County are not eligible; however, certain Eastern Shore nonprofit organizations are currently allowed to operate up to five slot machines, provided that at least half of the proceeds are distributed to charity.

Impact on Agency: Funding and Activities

Since SLGCA became responsible for the State’s VLT program, it has increased its activities, funding, and personnel. In fiscal 2010, the agency began the fiscal year with 172.0 FTEs. The current allowance requests a total of 279.5 FTEs, a 62.5% increase in staffing. Similarly, the budget has grown from \$56.6 million in fiscal 2010 to \$156.3 million in the current allowance. This is

reflective of the additional responsibilities that the agency has undertaken since the development of the State's gaming program.

The latest changes have impacted the budget primarily in personnel costs. The statute requires that the lottery ensure that it has employees at any casino facility during hours of operation to certify revenue from VLTs and table games, receive complaints from the public, and monitor the operation and maintenance of machines, tables, and associated equipment and software. Additionally, lottery personnel are required for licensing duties for all individuals employed or contracted by each facility. The agency reports that it currently has a licensing backlog. The expansion to 24-hour operations and to table games will likely compound the backlog. Additionally, regulations are under review regarding table games which are expected to come on line by late spring/early summer 2013.

DLS recommends that SLGCA brief the budget committees on the impact of gaming expansion on its budget, staffing, and responsibilities.

3. Online Sales of Lottery Games

The General Assembly added language to the fiscal 2013 budget bill that restricted funds within the agency's budget until the agency submitted a report on the proposed platform and regulatory structure for a program of online lottery sales. Developments on this topic at the federal level prompted the agency to begin exploring the notion of allowing its regular lottery games to be sold over the Internet.

Recent Federal Developments

In 2009, officials from the New York State Lottery and the Illinois Governor's Office sought clarification from the U.S. Department of Justice (DOJ) whether their in-state Internet lottery programs would violate the Interstate Wire Act of 1961 (Wire Act) and the Unlawful Internet Gambling Enforcement Act.

In a September 2011 memorandum opinion, DOJ determined that the Wire Act's prohibitions, which had been previously cited to declare online gaming illegal in the United States, only apply to sports-related gambling activities in interstate and foreign commerce. Specifically, DOJ ascertained that interstate transmissions of wire communications that do not relate to a sporting event fall outside the reach of the Wire Act.

Report Summary

The agency submitted its report in September 2012 that outlined its objective to provide an e-commerce platform, or iLottery, to allow for the purchase of traditional lottery games through personal computers and mobile devices. As the report indicates, Minnesota, New York, and

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North Dakota offer the purchase of lottery subscriptions via their websites, and Illinois offers both subscription and same day online purchase of traditional lottery games.

Under the proposal, customers would sign up for an account, fund their “digital wallet,” and browse and purchase same-day games and subscriptions. The iLottery would also allow account holders to track their transactions and play history, as well as claim winnings online. SLGCA envisions offering draw games (such as Pick 3 and Mega Millions), monitor games (such as Keno and Racetrax), and electronic instant tickets, some of which would mimic traditional scratch-off tickets.

The agency indicates that it would employ secure software to verify the age of online lottery players (18 and over) as well as their presence within Maryland and would also adopt practices aimed at assuring that individuals using iLottery features comply with relevant rules and regulations. In the report, SLGCA also expresses a commitment to promoting responsible gaming for its iLottery players, including access to voluntary exclusion resources and the ability for an individual to customize time and/or spending limits.

The report briefly outlines plans to integrate iLottery sales with traditional brick-and-mortar retail sales. Preventing substantial losses for traditional lottery retailers, providing secure and accurate verification systems, and marketing online sales are among the challenges that would be presented by pursuing an iLottery program.

Next Steps

After reviewing the report, the budget committees declined to authorize the release of funds that would allow the agency to proceed with the development of online sales. Those funds will remain unspent and will be canceled at the end of fiscal 2013. However, as mentioned above, the agency’s fiscal 2014 allowance includes \$366,000 for the purpose of procuring consulting services to design an iLottery website.

Other than recent budget language, there is currently no regulatory or statutory provision that would strictly prohibit the lottery from proceeding with a program of iLottery. However, at a recent public legislative briefing, lottery officials declared that it has no current plan to move forward with iLottery. Additionally, legislation has been introduced in the 2013 legislative session that would prohibit the agency, unless authorized by the General Assembly, from adopting regulations that would allow a person to purchase a State lottery ticket through an electronic device that connects to the Internet.

DLS recommends that the agency comment on its report on online lottery sales. The agency should reiterate that it has no current plans to proceed with its iLottery program. Further, DLS is also recommending that the funds in the fiscal 2014 allowance for this purpose be deleted.

Recommended Actions

	<u>Amount Reduction</u>	
1. Delete funds to complete studies and an architectural design for an iLottery website.	\$ 366,000	SF
Total Special Fund Reductions	\$ 366,000	

Current and Prior Year Budgets

Current and Prior Year Budgets Maryland State Lottery and Gaming Control Agency (\$ in Thousands)

	<u>General Fund</u>	<u>Special Fund</u>	<u>Federal Fund</u>	<u>Reimb. Fund</u>	<u>Total</u>
Fiscal 2012					
Legislative Appropriation	\$29,280	\$193,178	\$0	\$0	\$222,458
Deficiency Appropriation	37	0	0	0	37
Budget Amendments	16	132	0	0	148
Reversions and Cancellations	-374	-69,241	0	0	-69,615
Actual Expenditures	\$28,959	\$124,069	\$0	\$0	\$153,028
Fiscal 2013					
Legislative Appropriation	\$73,008	\$239,045	\$0	\$0	\$312,053
Budget Amendments	0	121	0	0	121
Working Appropriation	\$73,008	\$239,166	\$0	\$0	\$312,174

Note: Numbers may not sum to total due to rounding.

Fiscal 2012

The original fiscal 2012 budget was increased by a deficiency appropriation (\$37,287) that added 3 positions to staff the Anne Arundel VLT facility due to an earlier than anticipated opening date. The original fiscal 2012 appropriation was also increased by a total of \$148,085 in general and special funds due to the allocation by budget amendment of the \$750 per employee bonus enacted in fiscal 2011. Conversely, actual expenditures were significantly reduced from the original appropriation. General funds were less than budgeted due to lower than expected equipment costs under the VLT program. Actual special fund expenditures were significantly less than expected due to a reduced payment to the VLT facility operators. Operators earn a share of VLT revenues; however, actual revenues did not meet projections that were established at the time of budget submission.

Fiscal 2013

The original fiscal 2013 appropriation was increased by \$120,981 in special funds due to the cost-of-living adjustment budget amendment.

Audit Findings

Audit Period for Last Audit:	March 17, 2008 – March 6, 2011
Issue Date:	May 2012
Number of Findings:	6
Number of Repeat Findings:	0
% of Repeat Findings:	0%
Rating: (if applicable)	n/a

- Finding 1:** The lottery network was not adequately secured from untrusted traffic, and the network was not adequately protected by the intrusion detection and prevention system.
- Finding 2:** Mainframe security reporting and review procedures were not adequate.
- Finding 3:** The service level agreements and the related independent reports did not address certain security and operational risks.
- Finding 4:** Supervisory review and approval of the resolution of incidents and instances of noncompliance at the casinos was not documented.
- Finding 5:** The lottery did not adequately monitor the VLT operations for periods of VLT inoperability.
- Finding 6:** Adequate procedures and controls were not established over the issuance of licenses and registrations and the related fees.

**Object/Fund Difference Report
State Lottery and Gaming Control Agency**

<u>Object/Fund</u>	<u>FY 12 Actual</u>	<u>FY 13 Working Appropriation</u>	<u>FY 14 Allowance</u>	<u>FY 13 - FY 14 Amount Change</u>	<u>Percent Change</u>
Positions					
01 Regular	211.50	258.50	279.50	21.00	8.1%
02 Contractual	11.75	10.75	7.75	-3.00	-27.9%
Total Positions	223.25	269.25	287.25	18.00	6.7%
Objects					
01 Salaries and Wages	\$ 15,464,016	\$ 16,485,523	\$ 20,997,246	\$ 4,511,723	27.4%
02 Technical and Spec. Fees	437,471	387,967	310,613	-77,354	-19.9%
03 Communication	354,329	433,793	468,457	34,664	8.0%
04 Travel	82,660	59,000	59,000	0	0%
06 Fuel and Utilities	144,800	159,172	150,592	-8,580	-5.4%
07 Motor Vehicles	448,278	349,755	392,856	43,101	12.3%
08 Contractual Services	50,157,170	49,358,943	51,981,119	2,622,176	5.3%
09 Supplies and Materials	159,294	694,000	1,498,400	804,400	115.9%
10 Equipment – Replacement	239,285	164,147	166,647	2,500	1.5%
11 Equipment – Additional	11,877,123	61,450,432	70,661,282	9,210,850	15.0%
12 Grants, Subsidies, and Contributions	64,379,889	173,124,600	0	-173,124,600	-100.0%
13 Fixed Charges	9,282,999	9,496,852	9,557,147	60,295	0.6%
14 Land and Structures	435	10,000	10,000	0	0%
Total Objects	\$ 153,027,749	\$ 312,174,184	\$ 156,253,359	-\$ 155,920,825	-49.9%
Funds					
01 General Fund	\$ 28,959,177	\$ 73,008,088	\$ 86,476,648	\$ 13,468,560	18.4%
03 Special Fund	124,068,572	239,166,096	69,776,711	-169,389,385	-70.8%
Total Funds	\$ 153,027,749	\$ 312,174,184	\$ 156,253,359	-\$ 155,920,825	-49.9%

Note: The fiscal 2013 appropriation does not include deficiencies. The fiscal 2014 allowance does not include contingent reductions.