

**E75D**  
**State Lottery and Gaming Control Agency**

***Operating Budget Data***

(\$ in Thousands)

	<b><u>FY 15</u></b> <b><u>Actual</u></b>	<b><u>FY 16</u></b> <b><u>Working</u></b>	<b><u>FY 17</u></b> <b><u>Allowance</u></b>	<b><u>FY 16-17</u></b> <b><u>Change</u></b>	<b><u>% Change</u></b> <b><u>Prior Year</u></b>
General Fund	\$66,263	\$25,003	\$21,806	-\$3,197	-12.8%
Deficiencies and Reductions	0	0	-36	-36	
<b>Adjusted General Fund</b>	<b>\$66,263</b>	<b>\$25,003</b>	<b>\$21,770</b>	<b>-\$3,233</b>	<b>-12.9%</b>
Special Fund	72,023	78,516	77,493	-1,023	-1.3%
Deficiencies and Reductions	0	0	-40	-40	
<b>Adjusted Special Fund</b>	<b>\$72,023</b>	<b>\$78,516</b>	<b>\$77,453</b>	<b>-\$1,062</b>	<b>-1.4%</b>
<b>Adjusted Grand Total</b>	<b>\$138,286</b>	<b>\$103,519</b>	<b>\$99,223</b>	<b>-\$4,296</b>	<b>-4.1%</b>

- After back of the bill reductions related to health insurance savings, the fiscal 2017 allowance for the State Lottery and Gaming Control Agency (SLGCA) declines by about \$4.3 million, or 4.1%, from the fiscal 2016 working appropriation. Contributing to this decline are lower than expected costs for the Instant Ticket Lottery Machine program at veterans organizations and lower lease costs for State-owned video lottery terminal (VLT) machines.
- Mitigating the decline in the fiscal 2017 allowance is a \$4.0 million increase in special funds for advertising under regular lottery operations. Other increases include additional personnel costs related to the opening of a sixth casino facility mid-year fiscal 2017.

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

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***Personnel Data***

	<b><u>FY 15 Actual</u></b>	<b><u>FY 16 Working</u></b>	<b><u>FY 17 Allowance</u></b>	<b><u>FY 16-17 Change</u></b>
Regular Positions	305.60	314.60	327.60	13.00
Contractual FTEs	<u>8.75</u>	<u>9.00</u>	<u>9.00</u>	<u>0.00</u>
<b>Total Personnel</b>	<b>314.35</b>	<b>323.60</b>	<b>336.60</b>	<b>13.00</b>

***Vacancy Data: Regular Positions***

Turnover and Necessary Vacancies, Excluding New Positions	16.52	5.25%
Positions and Percentage Vacant as of 12/31/15	11.00	3.50%

- The fiscal 2017 allowance includes 13 additional full time equivalent (FTE) positions under the VLT and gaming program in anticipation of the opening of a sixth casino facility in Prince George’s County.
- Contractual staff FTE count does not increase in the fiscal 2017 allowance; however, salaries for contractual staff increase, which will be discussed in this analysis.
- At the end of calendar 2015, the lottery agency reports 11 vacant positions; too few to meet its budgeted turnover. The agency may be required to find other budgeted monies to fund its filled positions in the upcoming fiscal year.

## *Analysis in Brief*

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### Major Trends

**Traditional Lottery Performance Measures Increase in Fiscal 2015:** Proceeds from traditional lottery games pay for prizes, agent earnings, and contribute to general fund revenue for the State. Strong sales in fiscal 2015 contributed to especially profitable results for lottery players and retail agents.

**Gaming Audit Findings Reported:** The lottery agency has been responsible for the State’s VLT and gaming program since fiscal 2008. In fiscal 2014, the agency began reporting measures that demonstrate its oversight role of the State’s gaming facilities. Specifically, the agency is reporting the number of audits and audit findings related to casino accounts, records, and control procedures.

### Issues

**Sales of Traditional Lottery Games Rebound in Fiscal 2015:** The sales of traditional lottery games rebounded in fiscal 2015, driven largely by a significant increase in instant ticket sales. Based in part on the findings detailed in the agency’s white paper entitled *Perspective of the Future of the Lottery*, the agency is focusing sales efforts on instant tickets and on a new draw game: Cash4Life. **The Department of Legislative Services (DLS) recommends that SLGCA comment on its current trend of sales and revenues, and in particular, the increase in sales of instant ticket games. Additionally, the agency should comment on its new multistate jackpot game and how it expects to ensure its success. Finally, the agency should comment on its white paper on the *Perspective of the Future of the Lottery*.**

**VLT and Gaming Program: Sixth Facility to Open in Fiscal 2017:** Since fiscal 2008, SLGCA has been tasked with the responsibility of administering the gaming program for the State. The agency is responsible for the regulation and licensing of operators, accounting for and distribution of revenues, managing the program’s central system, and the purchase or lease of a portion of the gaming machines. The State’s sixth and last gaming facility is expected to open in January 2017. SLGCA continues to make adjustments to its personnel and other resources to address the expanded gaming market. Revenues from the gaming facilities continue to make a significant impact on the State’s fiscal health. **DLS recommends that SLGCA comment on the status of the State’s gaming program including the agency’s preparations for the impending introduction of the sixth gaming facility.**

### Recommended Actions

1. Concur with Governor’s allowance.

*E75D – State Lottery and Gaming Control Agency*

**E75D**  
**State Lottery and Gaming Control Agency**

***Operating Budget Analysis***

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**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, 5 Card Cash, and most recently Cash4Life.

All games, except Instant Games, are draw games, 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.

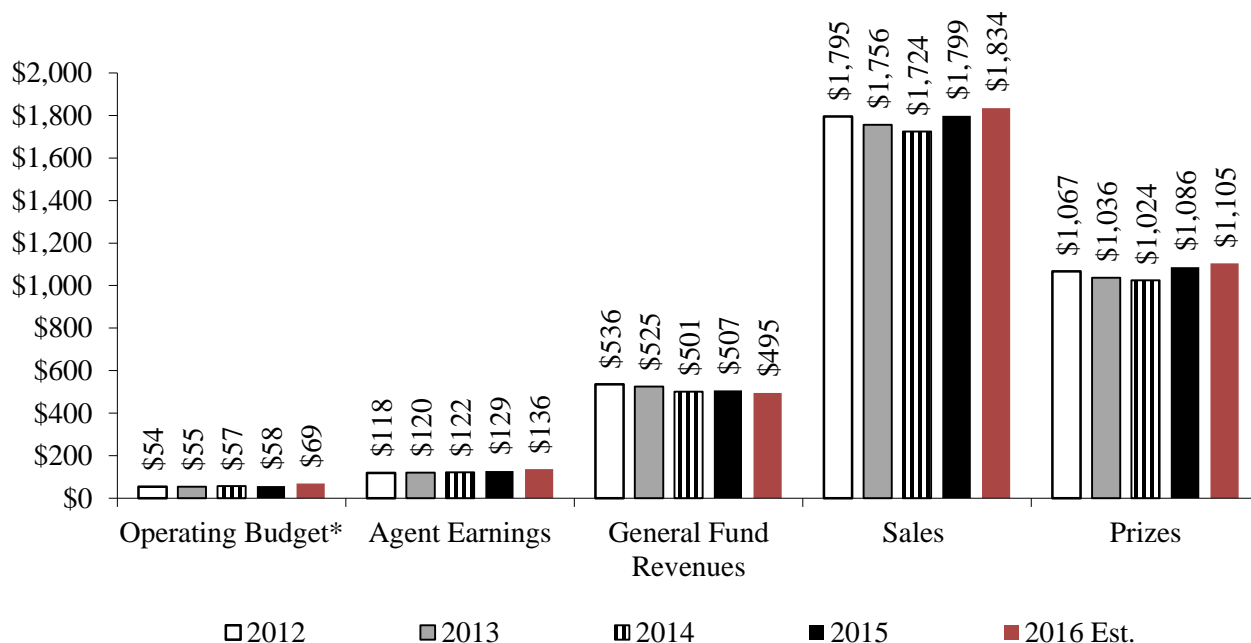
The State Lottery Gaming and Control Commission has oversight responsibility for the agency. In 2008, the commission was expanded to address additional responsibilities stemming from the video lottery terminal (VLT) legislation. The agency is responsible for the administration of the VLT program including accounting for and distributing VLT revenues, managing the program's central system, and regulating and licensing of operators. In fiscal 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. Traditional Lottery Performance Measures Increase in Fiscal 2015**

Proceeds from the traditional lottery games pay for prizes, agent earnings, and all operating expenses of the agency. In fiscal 2015, 60.4% of sales paid for prizes, 7.1% paid for agent commissions and redemption fees, 3.2% paid for agency operations, and 28.1% was credited as revenue to the State (a small percentage is forwarded to the Maryland Stadium Authority per statute). **Exhibit 1** shows total lottery sales and the distribution of those sales from fiscal 2011 through an estimate for fiscal 2016.

**Exhibit 1**  
**Lottery Sales and Expenditures**  
**Fiscal 2012-2016 Est.**  
**(\$ in Millions)**



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

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

Source: Maryland State Budget Books, Fiscal 2011 to 2017

Prize payouts reached a high mark in fiscal 2015, and payouts are expected to increase again in fiscal 2016. Further, prize payouts represented a larger share of total sales than in the previous year (60.4% compared to 59.0%). This may be due, in part, to the increase in sales of instant tickets, which tend to have higher payout rates. Agents also experienced an increase in their earnings in fiscal 2015. Agents earn 5.5% of sales at retail establishments as well as 3.0% in cashing commissions. According to the lottery agency, there are 4,596 lottery retailers. Of these, 301 retailers participate in the Expanded Cashing Authority Program and are allowed to cash winnings of up to \$5,000. All other retailers may cash winning tickets up to \$600.

As shown in the exhibit, sales and revenues also increased in fiscal 2015. A more in depth discussion of sales and revenues can be found in the Issues section of this analysis.

## **2. Gaming Audit Findings Reported**

At the encouragement of the Department of Legislative Services (DLS), the agency began to report performance measures for its gaming program in the fiscal 2016 budget cycle. The agency began its responsibilities associated with the State’s gaming program in 2008. An entirely new division was established with new and unique duties that enable the regulation and oversight of the casino facilities. It is, therefore, important to have performance oversight through the legislative budget process.

The statute requires that the lottery agency issue regulations requiring regular audits of gaming facilities. Those audits must disclose whether the accounts, records, and control procedures maintained by the video lottery operation licensees are as required by statute and by regulation. The agency is now reporting on the number of casino audits and reviews and the number of findings. It is too early to be able to report on any trends in these measures; however, for informational purposes, the lottery agency performed 118 audits and reviews and catalogued 185 findings in fiscal 2015. According to the agency, once a gaming facility is alerted to a finding, the facility management must report on how it will address the finding. Depending on the severity of the finding, the agency’s enforcement division may issue appropriate disciplinary action. The agency will then perform follow up audit test work to ensure that the finding has been resolved. The agency may wish to consider adding a performance measure that would track the rate in which findings are resolved and the number of repeat findings at any one facility.

### **Fiscal 2016 Actions**

#### **Cost Containment**

In fiscal 2016, the Administration implemented an across-the-board cost containment initiative that included a general 2% reduction. SLGCA relinquished \$507,000 in general funds. It was able to achieve these savings through reduced costs for VLT leases.

### **Proposed Budget**

As shown in **Exhibit 2**, after adjusting for a back of the bill reduction in health insurance, the fiscal 2017 allowance decreases by almost \$4.3 million, or 4.1%, from the fiscal 2016 working appropriation. This is largely due to lower than expected costs for the Instant Lottery Ticket Program for veteran organizations and fewer costs related to State-owned VLTs at gaming facilities. However, Exhibit 2 also shows other components of the allowance that mitigate these decreases.

**Exhibit 2**  
**Proposed Budget**  
**State Lottery and Gaming Control Agency**  
**(\$ in Thousands)**

<b>How Much It Grows:</b>	<b><u>General Fund</u></b>	<b><u>Special Fund</u></b>	<b><u>Total</u></b>
Fiscal 2015 Actual	\$66,263	\$72,023	\$138,286
Fiscal 2016 Working Appropriation	25,003	78,516	103,519
Fiscal 2017 Allowance	<u>21,770</u>	<u>77,453</u>	<u>99,223</u>
Fiscal 2016-2017 Amount Change	-\$3,233	-\$1,062	-\$4,296
Fiscal 2016-2017 Percent Change	-12.9%	-1.4%	-4.1%

**Where It Goes:**

**Personnel Expenses**

New position (13 full-time equivalents related to the opening of the Prince George’s facility).....	\$625
Employee and retiree health insurance .....	450
Retirement.....	357
Workers’ compensation premium assessment .....	110
Turnover adjustments .....	76
Overtime .....	56
Regular earnings .....	-197
Other fringe benefit adjustments.....	38

**Other Changes**

***Regular Lottery Operations***

Advertising and Promotions .....	4,014
Maintenance for instant ticket vending machines.....	396
Vehicle purchase and fuel.....	357
Contractual staff salaries.....	133
Software upgrades.....	90
One-time upgrade to telephone system in fiscal 2016 .....	-345
Instant ticket printing .....	-772
Lower than expected costs for lottery machines at veterans organizations .....	-5,098

***Video Lottery Terminal and Gaming Operations***

Maintenance for State-owned machines .....	805
Removal of one-time costs related to sixth gaming facility.....	-1,137
Outside background investigations services .....	-1,394



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**Where It Goes:**

Reduced lease costs for State-owned machines .....	-2,972
Other .....	112
<b>Total</b>	<b>-\$4,296</b>

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

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**Across-the-board Reductions**

The fiscal 2017 budget bill includes an across-the-board reduction for employee health insurance, based on a revised estimate of the amount of funding needed. This agency’s share of these reductions is \$36,294 in general funds and \$39,686 in special funds. There is an additional across-the-board reduction to abolish vacant positions statewide, but the amounts have not been allocated by agency.

**Regular Lottery Operations**

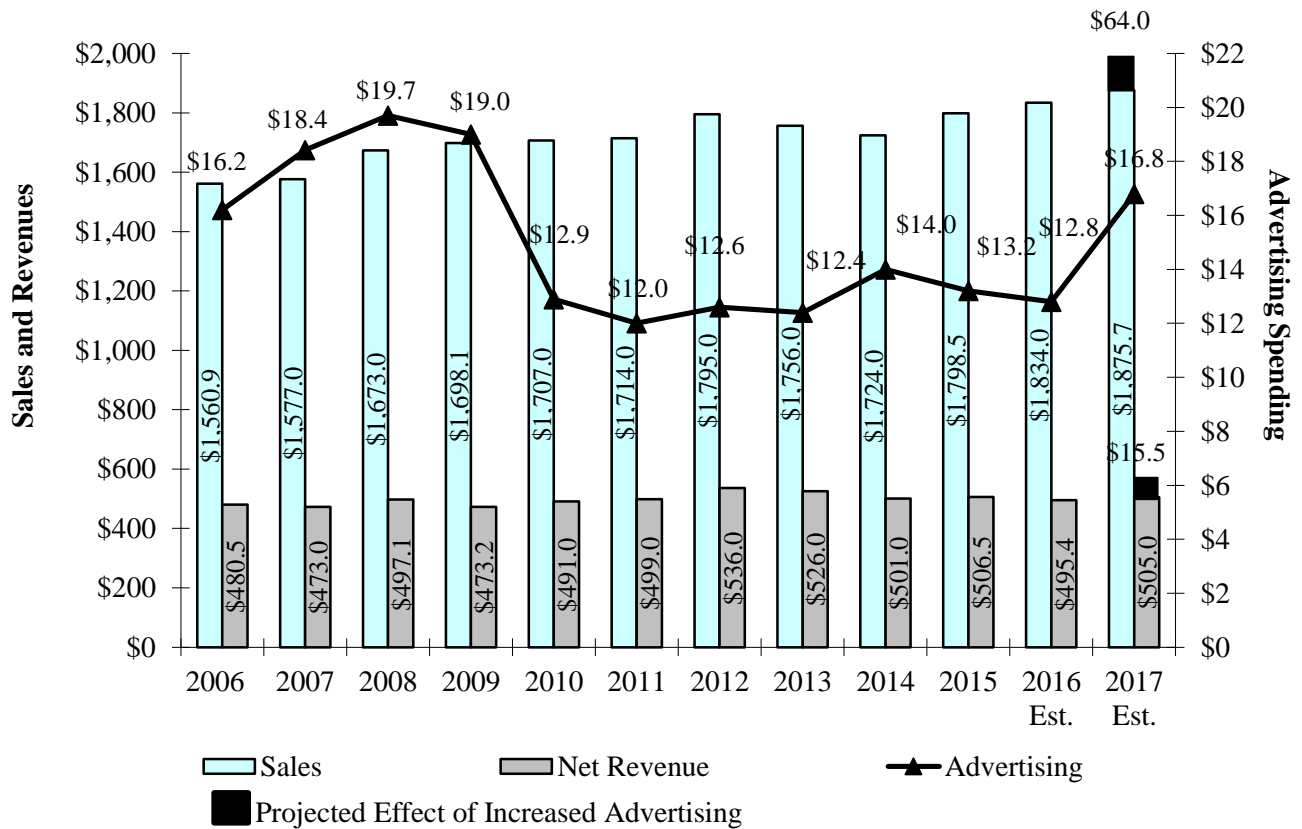
Absent VLT and gaming operations, the fiscal 2017 allowance for regular lottery operations decreases by about \$1.0 million from the fiscal 2016 working appropriation. The decrease is primarily attributable a reduction in budgeted funds for the veterans organizations’ instant ticket machine program. Chapter 1 of the second special session of 2012 authorized the lottery agency to issue licenses to veterans organizations for up to five instant ticket machines. The agency began issuing the licenses in fiscal 2015, and the first full year of budgeting was fiscal 2016. As it was a completely new program, the lottery agency overestimated the funding needs for the program in fiscal 2016. The fiscal 2017 allowance more accurately reflects program needs and as such, declines by about \$5.1 million. The bulk of the funding for the program is for the vendor, which provides the instant ticket machines, the tickets, and the central monitoring system. The vendor receives a portion of the proceeds. Similarly, the veterans organizations earn a sales and cashing commission from the total proceeds. Additionally, the Maryland Veterans Trust Fund receives 10% of the proceeds, and the General Fund receives the remainder. The General Fund received about \$342,000 in fiscal 2015. In fiscal 2016, the program is expected to generate about \$380,000.

The other notable decline in the allowance is for instant ticket printing, \$772,000. Despite a new strategic effort to increase sales of instant tickets, the agency actually expects to spend less funds on their printing. This is because the agency has analyzed its sales patterns and has determined that many expensively produced tickets have no greater appeal to players than other tickets. For example, tickets with licensed and trademarked images (often costly) are selling at no greater rate than those without those images. As such, the agency will target its sales efforts elsewhere; namely increased advertising. Mitigating the decreases in the fiscal 2017 allowance for regular lottery operations is an increase in the agency’s advertising funding, an approximate increase of \$4 million.

Advertising expenditures include funds for radio, television, print, and other advertisements, as well as promotional events and materials. Cost containment in fiscal 2010 reduced the agency’s

advertising budget by \$6 million from the original fiscal 2010 appropriation. Despite the decline in advertising after fiscal 2009, record sales were achieved between fiscal 2010 and 2012. However, sales did decline in fiscal 2013 and 2014 before rebounding to a new record level in fiscal 2015 with an advertising budget barely above that in fiscal 2010. This despite competition from the State’s gaming facilities. **Exhibit 3** shows sales and revenues as compared to the agency’s advertising budget.

**Exhibit 3**  
**Regular Lottery Sales and Revenue Trends Compared to Advertising Spending**  
**Fiscal 2006-2017**  
**(\$ in Millions)**



Source: Governor’s Budget Books, Fiscal 2006-2016; Lottery Budget, Fiscal 2005-2015

As shown in the exhibit, SLGCA did receive a one-time increase in advertising funds in fiscal 2014. Indeed, sales increased in fiscal 2015. It is difficult to ascertain the impact of advertising on sales. Many other factors affect player behavior, notably the occurrence of large jackpot prizes. However, the agency notes that a study conducted by the New York lottery contends that for every \$1 spent on advertising, a state can generate an approximate \$5 in net revenue. Based on that study, the agency is forecasting an increase in revenues of \$15.5 million in fiscal 2017 from the increased

advertising budget. In fact, the Administration's fiscal 2017 budget plan reflects this additional revenue.

Also included in the allowance is an increase in funds for contractual staff salaries. The agency has added a contractual publication specialist to assist with marketing efforts and an instant ticket product specialist. Additionally, the allowance includes additional funds for vehicle purchases. Lottery sales representatives travel extensively to visit retailer locations.

Finally, notably absent from the fiscal 2017 allowance is evidence of a new contract for the central system for regular lottery operations. The current contract with the system's vendor was originally set to expire at the end of fiscal 2016. However, due to delays associated with developing the Request for Proposal in conjunction with the Department of Information Technology, the agency was obliged to extend the contract for an additional year. (See Appendix 3 for additional detail.)

## **VLT and Gaming Operations**

Chapter 1 of the second special session of 2012 altered the provisions governing the ownership of the VLT machines at the State's casinos. The legislation specified that the operators of the Baltimore City, Anne Arundel, Cecil, and Prince George's facilities would all be required to own their own VLT machines. Conversely, the State would maintain ownership of the machines at the Allegany and Worcester facilities. The fiscal 2016 budget was the first full year of funding that reflected this new ownership structure. At the time, the lottery agency assumed it would lease, and not purchase, all its remaining machines. However, the lottery has instead kept some of its purchased machines. As such, the fiscal 2017 allowance reflects this reality and includes funds for the maintenance of those machines (\$805,000). The majority of the State-controlled machines will continue to be leased; however, the lottery was able to renegotiate its terms at a more favorable rate. As such, leased costs decline in the budget by approximately \$2.9 million.

An additional change in the budget worth noting is the decline in funds needed for contractual background investigation services, \$1.4 million. The lottery agency is required to ensure proper licensure of casino owners and employees. The workload was extensive and required the agency to contract with outside entities to assist in the investigations. However, as the agency has increased its staff, the need for outside services has declined.

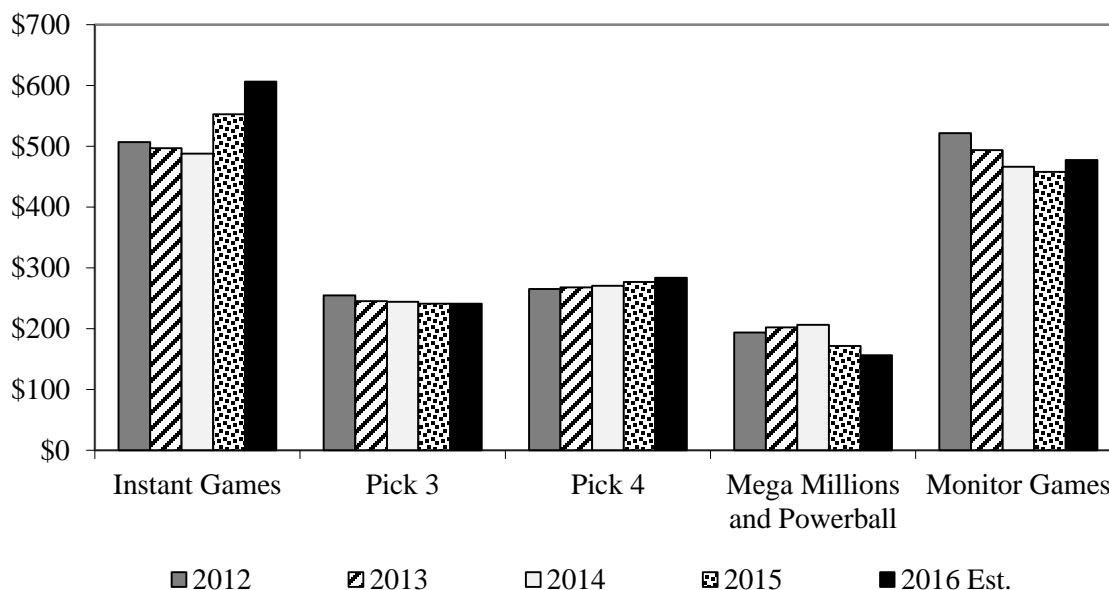
Offsetting some of the decreases under the gaming program are the increased funds for new personnel. The fiscal 2017 allowance includes approximately \$625,000 in general funds for 13 new positions. The positions are related to the opening of the sixth casino facility in Prince George's County, scheduled for January 2017. Statute requires that SLGCA have compliance officers, who are State employees, at each casino at all times. The allowance includes funds for 12 such positions and for 1 casino auditor to ensure financial compliance with State regulations. The lottery agency expects to hire for these positions early in the second quarter of fiscal 2017.

## Issues

### 1. Sales of Traditional Lottery Games Rebound in Fiscal 2015

An increase in sales of traditional lottery games in fiscal 2015 was driven largely by a significant uptick in sales of instant games. **Exhibit 4** shows the total sales of selected games from fiscal 2012 through an estimate for fiscal 2016. The exhibit clearly shows the relative popularity of the games, with instant tickets and monitor games like Keno, claiming most of the sales.

**Exhibit 4**  
**Sales Selected Games**  
**Fiscal 2012-2016 Est.**  
**(\$ in Millions)**



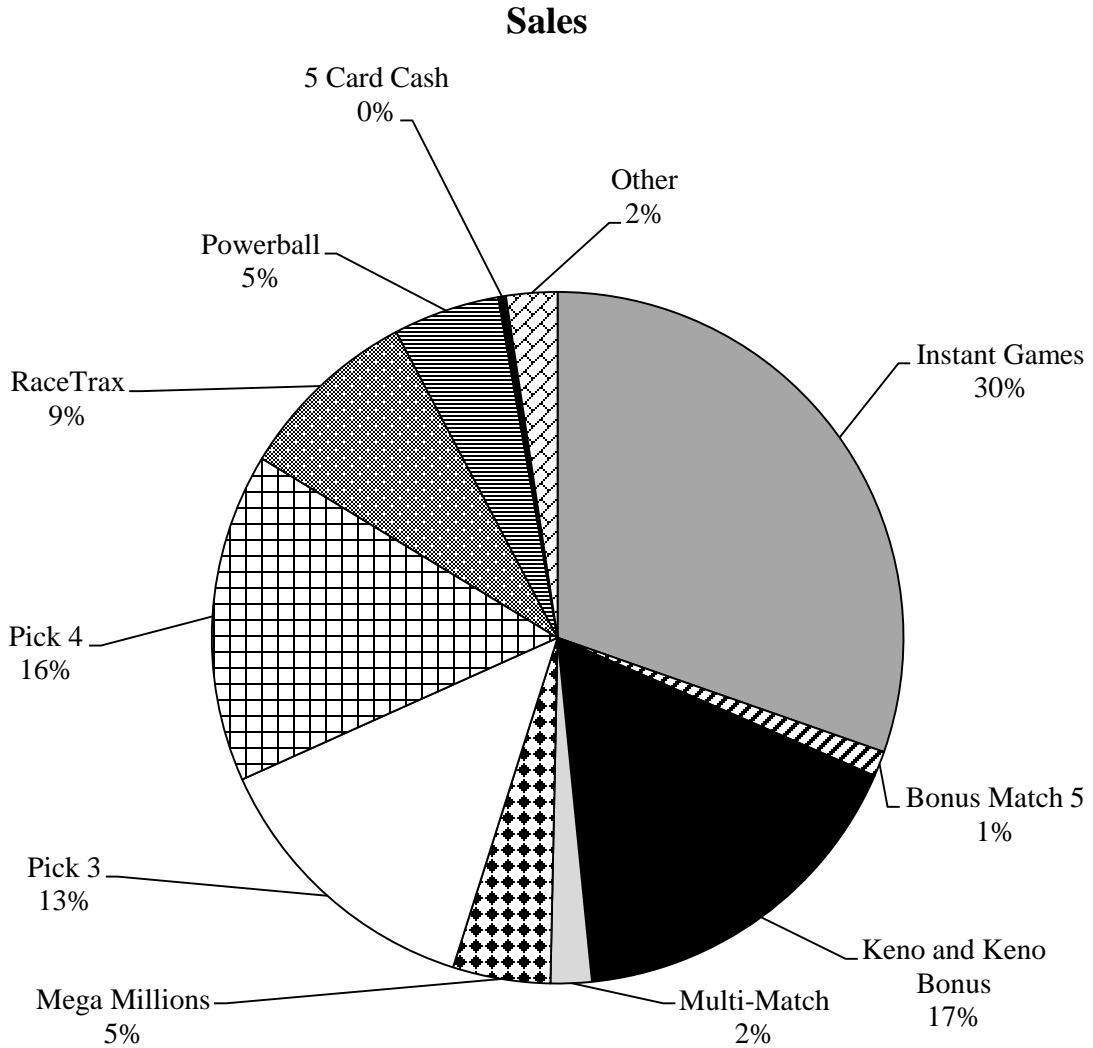
Source: State Gaming and Lottery Control Agency

SLGCA has noted that sales of instant tickets have been underperforming as compared to other states. As such, the agency has increased its efforts to market these games. Fiscal 2015 instant ticket sales increased by 13.8% over fiscal 2014. Another significant increase is expected in fiscal 2016. Sales of other games remained fairly stable in fiscal 2015, with the exception of the jackpot games. Combined sales of Mega Millions and Powerball declined in fiscal 2015. This demonstrates how strongly sales are tied to large jackpots. There were two jackpot drawings in fiscal 2015 that were over \$400 million, compared with three such jackpots in fiscal 2014. The fiscal 2016 estimate for the jackpot games did not anticipate the record breaking prize for the January 2016 Powerball game and, therefore, should be considerably higher.

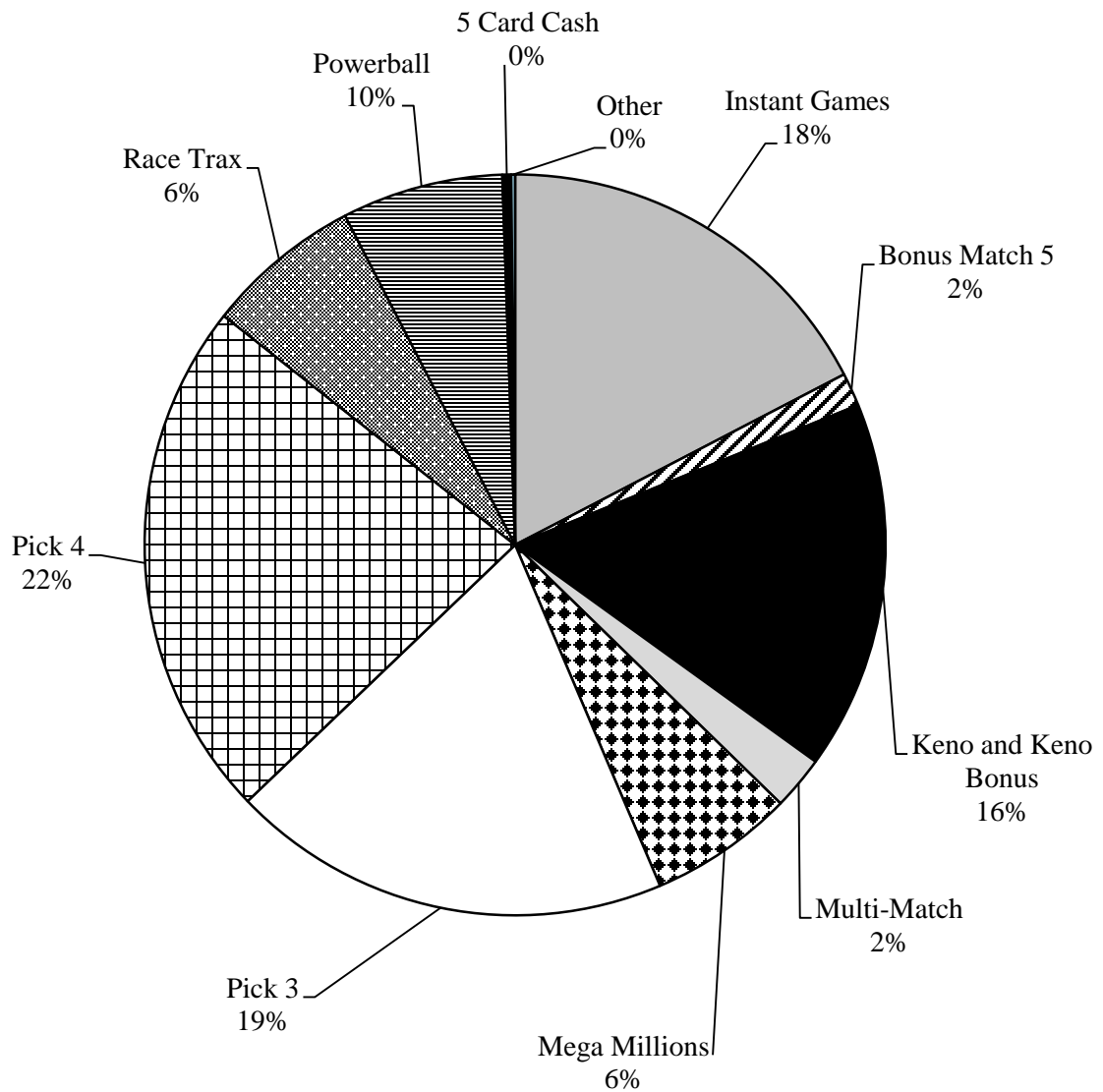
The mix of games is important to maintaining customer interest and to the returns to the General Fund. Because of this variety, any negative impact on revenues from one game can be mitigated by other games.

**Exhibit 5** shows sales and revenues for each game type in fiscal 2015. As shown, instant games make up 30% of sales but only 18% of revenue. Instant tickets are popular, in part, because of the high payout, which drives down revenues to the State. In contrast, Powerball makes up only 5% of total sales but generates 10% of the revenue to the State.

**Exhibit 5**  
**Sales and Revenues**  
**Fiscal 2015**



### Revenues



Source: State Gaming and Lottery Control Agency

Included in the “other” category is a small amount (\$1.6 million in sales) for the Monopoly Millionaires Club game. This game was a short-lived effort to add another multistate jackpot game to the lottery agency’s offerings. However, in December 2014, the lottery agency announced that it would suspend the game due to disappointing sales. Other states came to that same conclusion. In its place, in August 2015, the lottery agency requested Legislative Policy Committee approval to introduce the multistate draw game Cash4Life to Maryland. Cash4Life is a multistate draw game that offers a top prize of \$1,000 per day for life. This prize structure differs from the agency’s current mix of games.

Thus, the agency believes that it will further its goal of increasing sales and revenue within the framework of a mature lottery. The lottery agency began sales of its new game in January 2016.

### **Effort to Study Lottery Revenues**

In response to concerns about declining sales, Chapter 293 of 2014 established the Task Force to Study Lottery Revenue. The task force was required to study factors that affect lottery sales and any means to improve sales. A report was due by January 1, 2015. However, for various reasons, the task force never convened. Instead, SLGCA volunteered to submit a white paper to address the issues delineated in the legislation. Specifically, the report studied the causes of the decline in lottery sales in fiscal 2013 and 2014 and explored potential innovations that could improve lottery products and ultimately, revenues. The report was issued in August 2015.

The fiscal 2017 budget as introduced does reflect one of the main topics of the report, *ie.*, the advertising budget. The report argues that part of the decline in sales was attributable to the fairly significant decline in the agency's advertising budget in fiscal 2010. The report cites other factors including the distraction of management time during the launch of the State's VLT program, the poor performance of national jackpot games, and the relatively weak performance of Maryland's instant ticket games.

The report also highlights some means to improve sales beyond increases in marketing. Specifically, the agency hopes to emphasize sales of instant tickets; attract new retailers; introduce new draw games (such as Cash4Life); and invest in digital activity, mobile apps, and social media. It should be noted that the report also examined the effect of increasing retailer commission on sales. The report determined that there is no direct relationship between the level of retailer commission and sales performance.

**DLS recommends that SLGCA comment on its current trend of sales and revenues, and in particular, the increase in sales of instant ticket games. Additionally, the agency should comment on its new multistate jackpot game and how it expects to ensure its success. Finally, the agency should comment on its white paper on the *Perspective on the Future of the Lottery*.**

## **2. VLT and Gaming Program: Sixth Facility to Open in Fiscal 2017**

Since fiscal 2008, SLGCA 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 other responsibilities.

## **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. It currently houses 850 machines and 22 table games.
- **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, but now has the 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 Arundel Mills Mall in Anne Arundel County. In June 2012, the Maryland Live! facility opened with 3,171 VLTs. As of January 2016, the facility has placed into operation 4,059 VLTs and 202 table games.
- **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. The facility opened in May 2013 and currently has 627 VLTs and 18 table games.
- **Baltimore City:** On July 31, 2012, the location commission awarded the Baltimore City casino operation license to CBAC Gaming, LLC for a facility with 3,750 VLTs, subject to certain contingencies. That facility opened in August 2014 with 2,500 VLTs and 147 table games. It currently has 2,200 VLTs and 178 table games.
- **Prince George's County:** On December 20, 2013, the location commission awarded the Prince George's casino operation license to MGM National Harbor, LLC for a facility with 3,600 VLTs and 140 table games. The statute allows the casino to open as soon as July 2016. Expected opening date is now January 2017.

## **Revenues**

The agency accounts for and disperses the revenue derived from the State's gaming facilities. **Exhibit 6** shows the gross revenue from the facilities in fiscal 2015, compared to the estimate of that revenue. Revenues for both VLTs and table games fell slightly short of expectations. To the extent that revenues fail to meet projections, general fund deficiencies must be provided in the following year to make up the shortfall in the Education Trust Fund (ETF).



**Exhibit 6**  
**Maryland Gaming Facilities**  
**Gross Revenues**  
**Fiscal 2015**  
**(\$ in Millions)**

	<u>2015</u> <u>Estimate</u>	<u>2015</u> <u>Actual</u>	<u>Difference</u>
<b>Video Lottery Terminal Revenues</b>			
Education Trust Fund	\$320.5	\$316.5	-\$4.0
Facility Owner	256.2	253.9	-2.3
Horse Racing Purse Account	46.5	46	-0.5
Local Impact Aid	36.8	36.4	-0.4
Racetrack Facility Renewal Account	7.2	7.1	-0.1
State Lottery Agency	12.1	11.9	-0.2
Small, Minority and Women-Owned Business Account	10.0	9.9	-0.1
<b>Subtotal</b>	<b>\$689.3</b>	<b>\$681.7</b>	<b>-\$7.6</b>
<b>Table Games</b>			
Education Trust Fund	\$73.2	\$71.3	-\$1.9
Facility Owner	292.9	285.1	-7.8
<b>Subtotal</b>	<b>\$366.1</b>	<b>\$356.4</b>	<b>-\$9.7</b>
<b>Total</b>	<b>\$1,055.4</b>	<b>\$1,038.1</b>	<b>-\$17.3</b>

Source: Board of Revenue Estimates; Department of Legislative Services

**Net Effect of Changes to Gaming Revenue Distribution**

The statute specifies the distribution of casino revenues, including the distribution to the facility operators. The distribution of VLT revenue to the owners varies by facility based on a number of factors. **Exhibit 7** details the operator share of VLT revenues at benchmarks that are set in statute.

**Exhibit 7  
Casino Operator Share of Revenue  
Current through Fiscal 2020**

	<u>Horseshoe Casino Baltimore</u>	<u>Maryland Live!</u>	<u>Hollywood Casino at Perryville</u>	<u>The Casino at Ocean Downs</u>	<u>Rocky Gap Casino and Resort</u>	<u>MGM National Harbor Casino</u>
Current Operator Share	39%	33%	33%	43%	50%	-
Share After VLT Ownership Transfer – April 2015	39%	41%	39%	43%	50%	-
Share after Issuance of Prince George’s License (Not before July 1, 2016)	46%	49%	39%	43%	50%	44%
Lottery Commission May Award Increase in Operator Share after July 1, 2019	46%-49%	49%-51%	39%-44%	43%	50%	44%

VLT: video lottery terminal

Source: State Gaming and Lottery Control Agency

The ownership of the VLT machines transferred to the facility operators in April 2015. This only affected the facilities in Anne Arundel and Cecil counties. Facilities with fewer than 1,000 machines do not have to assume ownership of their machines. For the larger facilities, their share of revenues was adjusted upward to account for the fact that the facilities will be responsible for the procurement of their machines. This adjustment equates to less support for the ETF. However, the lottery is spending considerably less to support the machine ownership for these facilities. Based on (1) the actual costs to the State for the VLTs at the Anne Arundel and Cecil counties facility; and (2) the offsetting increase in operator share for those two facilities, DLS is estimating that the State is netting about \$27.5 million in fiscal 2016 for the benefit of the ETF.

Another adjustment to operator share will occur once the license is issued for the facility in Prince George’s County. The State’s gaming program was originally planned with a total of five casinos. A sixth one was added by legislation in fiscal 2012 after other facilities were underway. To adjust for the increased and unexpected competition from a sixth casino, operator shares were again adjusted upward for the facilities in Anne Arundel County and Baltimore City. The increase in operator share must be used for marketing, advertising, promotional costs, and capital improvements. The State Lottery Gaming and Control Commission may choose to further increase operator share by up to 5% until July 1, 2019, at the facilities in Anne Arundel and Cecil counties and Baltimore City.

*E75D – State Lottery and Gaming Control Agency*

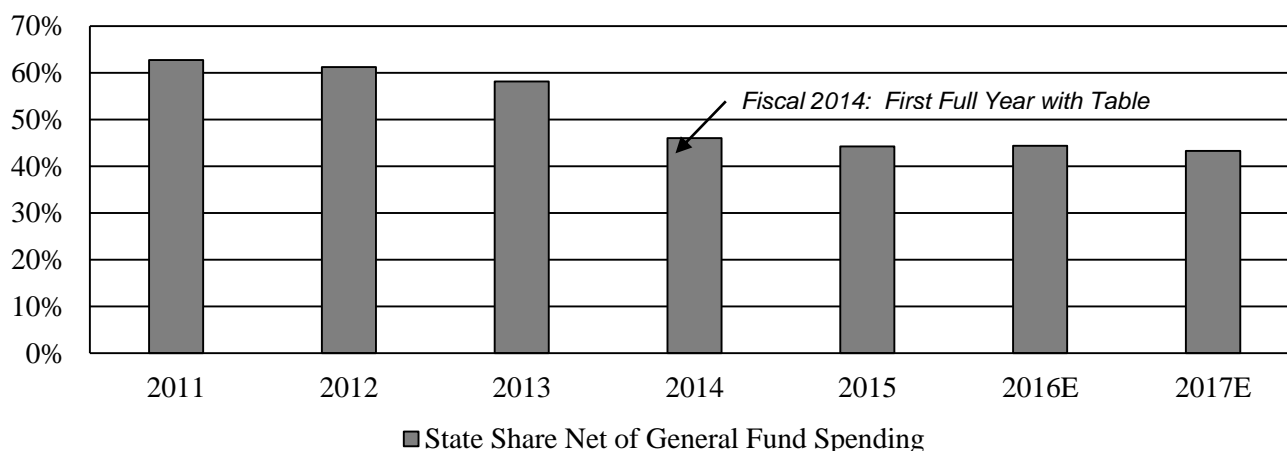
In contrast to this tiered and somewhat complicated structure, table game revenue is distributed: 80% to the facility owners and 20% to the State for deposit in the ETF. The distinction is largely based on industry standards and on the recognition that table games are more costly to operate for the facility owner due primarily to labor costs. However, beginning in fiscal 2017, 5% (taken from the share for the ETF) will be for local impact aid.

Also affecting the gaming revenue distribution are decisions made by the casinos to expand table games at the expense of VLTs. In January 2015, the Maryland Live! Casino and the Horseshoe Casino in Baltimore submitted requests to the lottery agency and commission to reduce the number of VLT machines and to increase the number of table games at their respective facilities. Specifically, Maryland Live! has requested the reduction of 300 VLTs and an increase of 13 table games. Similarly, the Horseshoe Casino requested the reduction of 300 VLTs and an increase of 30 table games.

The significant difference in the State share of revenues between VLTs and table games necessitates a close scrutiny when determining the appropriate mix of gaming options. In 2015, the lottery contracted with a consultant who determined that, despite the difference in the State share of revenue, the gaming market in Maryland indicates that a reduction in VLTs and an increase in table games would, in the long run, be beneficial for both the operators and the State. Accordingly, in late January 2015, the lottery commission approved the requests of both Horseshoe Casino and Maryland Live! to alter the mix of gaming options. However, in the short run, that benefit is not yet evident as shown in **Exhibit 8**.

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**Exhibit 8**  
**Share of Total Gross Revenues Going to the State**  
**Fiscal 2011-2017 Est.**



Note: Total gross revenues includes video lottery terminal and, starting in fiscal 2013, table game revenue. The share going to the State is equal to the total less the amount that is retained by the casino operators netted against the general fund spending to support the program. General fund spending dropped between fiscal 2014 and 2016 as the Hollywood Casino Perryville and Maryland Live! facilities took over ownership of the video lottery terminal machines.

Source: Board of Revenues Estimates; Department of Legislative Services

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*E75D – State Lottery and Gaming Control Agency*

In fiscal 2014, the State share of gaming revenues declined considerably due the introduction of table games. As the trend toward more table continues, the share, at least in the short run, is expected to decline.

**DLS recommends that SLGCA comment on the status of the State’s gaming program including the agency’s preparations for the impending introduction of the sixth gaming facility.**

## ***Recommended Actions***

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1. Concur with Governor's allowance.

## *Current and Prior Year Budgets*

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### Current and Prior Year Budgets 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>
<b>Fiscal 2015</b>					
Legislative Appropriation	\$71,134	\$70,639	\$0	\$0	\$141,772
Deficiency Appropriation	1,600	2,995	0	0	4,595
Cost Containment	-1,424	-100	0	0	-1,524
Budget Amendments	21	116	0	0	137
Reversions and Cancellations	-5,067	-1,626	0	0	-6,694
<b>Actual Expenditures</b>	<b>\$66,263</b>	<b>\$72,023</b>	<b>\$0</b>	<b>\$0</b>	<b>\$138,286</b>
<b>Fiscal 2016</b>					
Legislative Appropriation	\$24,861	\$78,284	\$0	\$0	\$103,145
Budget Amendments	142	232	0	0	374
<b>Working Appropriation</b>	<b>\$25,003</b>	<b>\$78,516</b>	<b>\$0</b>	<b>\$0</b>	<b>\$103,519</b>

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. Numbers may not sum to total due to rounding.

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## **Fiscal 2015**

The fiscal 2015 budget increased by approximately \$4.6 million in fiscal 2015 due to deficiencies for the agency – almost \$3.0 million in special funds and \$1.6 million in general funds. Specifically, under traditional lottery operations, the budget increased by \$2,531,000 in special funds for vendor payments for instant ticket lottery machines that are housed at licensed veterans organizations as authorized by Chapter 1 of the second special session of 2012. Also under traditional lottery operations, the budget increased by \$463,688 in special funds to pay increased costs for the contract for instant ticket printing. Under the VLT and gaming program, a deficiency increased general funds in fiscal 2015 by \$1 million to facilitate the final payment for the 2011 purchase of VLTs. Finally, there was a fiscal 2015 general fund deficiency (\$600,000) to complete the agency’s eLicensing system.

Additionally, the fiscal 2015 appropriation was reduced by \$100,000 in special funds due to the July 2014 cost containment actions taken by the Board of Public Works (BPW). The agency achieved these savings by holding open several vacant positions. A subsequent BPW cost containment action in January 2015 reduced general funds by over \$1.4 million.

Finally, as part of the State Employee Voluntary Separation Program, SLGCA relinquished \$50,000 in general funds in fiscal 2015. A budget amendment adds \$187,000 for the fiscal 2015 cost-of-living adjustment. The agency relinquished over \$1.6 million in special funds at the end of the year due to lower than expected costs in instant ticket printing, the contract costs for its online gaming system, and in marketing expenses.

A sizable portion of general and special funds went unspent by the end of the fiscal year. This was due to the transfer of VLT machine ownership from the State to gaming facility owners. The lease costs were overbudgeted and some costs were offset due to larger than expected proceeds from the sale of the machines.

## **Fiscal 2016**

To date, the fiscal 2016 original appropriation was increased by a budget amendment to offset a 2% employee pay reduction. General funds increased by \$142,000 and special funds increased by \$232,000.

## ***Audit Findings***

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Audit Period for Last Audit:	March 7, 2011 – March 19, 2014
Issue Date:	April 2015
Number of Findings:	5
Number of Repeat Findings:	2
% of Repeat Findings:	40%
Rating: (if applicable)	n/a

- Finding 1:***    **The SLGCA network was not adequately secured from untrusted traffic.**
- Finding 2:***    Network workstations and servers were not sufficiently protected against malware.
- Finding 3:***    **Mainframe access controls, account and password controls, and security reporting were not sufficient.**
- Finding 4:***    SLGCA did not distribute unclaimed VLT funds in a manner consistent with State regulations.
- Finding 5:***    SLGCA had not published the award of three contracts, collectively valued at approximately \$106 million, on eMaryland Marketplace as required.

\*Bold denotes item repeated in full or part from preceding audit report.



# Major Information Technology Projects

## State Lottery and Gaming Control Agency Lottery Central Monitoring and Control System

<b>Project Status<sup>1</sup></b>	Planning	<b>New/Ongoing Project:</b>	New.					
<b>Project Description:</b>	Lottery Central Monitoring and Control System (LCMCS): Services include system implementation, operation, and maintenance of the LCMCS and related systems; sales, marketing, instant ticket inventory, distribution, accounting, terminals, software, and telecommunications network that shall connect lottery retailers to the primary and back up data centers.							
<b>Project Business Goals:</b>	n/a							
<b>Estimated Total Project Cost<sup>1</sup>:</b>	\$24 million annually	<b>Estimated Planning Project Cost<sup>1</sup>:</b>	Planning conducted within the State Lottery and Gaming Control Agency budgeted resources.					
<b>Project Start Date:</b>	October 1, 2013	<b>Projected Completion Date:</b>	Fiscal 2018					
<b>Schedule Status:</b>	Project is on track and a Request for Proposal (RFP) is scheduled for release early in third quarter fiscal 2016.							
<b>Cost Status:</b>	Will be estimated at the end of the RFP process.							
<b>Scope Status:</b>	n/a							
<b>Project Management Oversight Status:</b>								
<b>Identifiable Risks:</b>	If the RFP is delayed, the one-year conversion process may be delayed for one year.							
<b>Additional Comments:</b>								
<b>Fiscal Year Funding (\$ in Thousands)</b>	<b>Prior Years</b>	<b>FY 2017</b>	<b>FY 2018</b>	<b>FY 2019</b>	<b>FY 2020</b>	<b>FY 2021</b>	<b>Balance to Complete</b>	<b>Total</b>
Personnel Services	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Professional and Outside Services	0.0	0.0	24,000.0	24,000.0	24,000.0	24,000.0	0.0	96,000.0
Other Expenditures	100.0	0.0	0.0	0.0	0.0	0.0	0.0	100.0
<b>Total Funding</b>	<b>\$100.0</b>	<b>\$0.0</b>	<b>\$24,000.0</b>	<b>\$24,000.0</b>	<b>\$24,000.0</b>	<b>\$24,000.0</b>	<b>\$0.0</b>	<b>\$96,100.0</b>

<sup>1</sup> Initially, an agency submits a Project Planning Request. After the requirements analysis has been completed and a project has completed all of the planning required through Phase Four of the Systems Development Lifecycle (Requirements Analysis), including a baseline budget and schedule, the agency may submit a Project Implementation Request and begin designing and developing the project when the request is approved. For planning projects, costs are estimated through planning phases. Implementation projects are required to have total development costs.

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

<u>Object/Fund</u>	<u>FY 15 Actual</u>	<u>FY 16 Working Appropriation</u>	<u>FY 17 Allowance</u>	<u>FY 16 - FY 17 Amount Change</u>	<u>Percent Change</u>
<b>Positions</b>					
01 Regular	305.60	314.60	327.60	13.00	4.1%
02 Contractual	8.75	9.00	9.00	0.00	0%
<b>Total Positions</b>	<b>314.35</b>	<b>323.60</b>	<b>336.60</b>	<b>13.00</b>	<b>4.0%</b>
<b>Objects</b>					
01 Salaries and Wages	\$ 22,681,310	\$ 24,297,757	\$ 25,888,719	\$ 1,590,962	6.5%
02 Technical and Spec. Fees	351,179	351,674	461,809	110,135	31.3%
03 Communication	462,231	482,888	413,527	-69,361	-14.4%
04 Travel	227,104	59,000	59,000	0	0%
06 Fuel and Utilities	178,851	222,592	256,216	33,624	15.1%
07 Motor Vehicles	357,596	181,998	550,144	368,146	202.3%
08 Contractual Services	48,398,587	59,278,745	55,786,379	-3,492,366	-5.9%
09 Supplies and Materials	232,665	211,000	291,000	80,000	37.9%
10 Equipment – Replacement	412,147	132,500	132,500	0	0%
11 Equipment – Additional	46,333,644	17,089,522	14,118,000	-2,971,522	-17.4%
13 Fixed Charges	18,649,052	1,201,322	1,332,011	130,689	10.9%
14 Land and Structures	1,834	10,000	10,000	0	0%
<b>Total Objects</b>	<b>\$ 138,286,200</b>	<b>\$ 103,518,998</b>	<b>\$ 99,299,305</b>	<b>-\$ 4,219,693</b>	<b>-4.1%</b>
<b>Funds</b>					
01 General Fund	\$ 66,263,057	\$ 25,003,449	\$ 21,806,259	-\$ 3,197,190	-12.8%
03 Special Fund	72,023,143	78,515,549	77,493,046	-1,022,503	-1.3%
<b>Total Funds</b>	<b>\$ 138,286,200</b>	<b>\$ 103,518,998</b>	<b>\$ 99,299,305</b>	<b>-\$ 4,219,693</b>	<b>-4.1%</b>

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. The fiscal 2017 allowance does not include contingent reductions.

**Fiscal Summary**  
**State Lottery and Gaming Control Agency**

<u>Program/Unit</u>	<u>FY 15 Actual</u>	<u>FY 16 Wrk Approp</u>	<u>FY 17 Allowance</u>	<u>Change</u>	<u>FY 16 - FY 17 % Change</u>
00 State Lottery Agency	\$ 138,286,200	\$ 103,518,998	\$ 99,299,305	-\$ 4,219,693	-4.1%
<b>Total Expenditures</b>	<b>\$ 138,286,200</b>	<b>\$ 103,518,998</b>	<b>\$ 99,299,305</b>	<b>-\$ 4,219,693</b>	<b>-4.1%</b>
General Fund	\$ 66,263,057	\$ 25,003,449	\$ 21,806,259	-\$ 3,197,190	-12.8%
Special Fund	72,023,143	78,515,549	77,493,046	-1,022,503	-1.3%
<b>Total Appropriations</b>	<b>\$ 138,286,200</b>	<b>\$ 103,518,998</b>	<b>\$ 99,299,305</b>	<b>-\$ 4,219,693</b>	<b>-4.1%</b>

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. The fiscal 2017 allowance does not include contingent reductions.