

Program Budget Comparison

The following table summarizes the total proposed budget by year, type of expenditure, and source of funding.

Program Budget Comparison								
Budget Item	Base Fiscal 2014	Approp. Fiscal 2015	Budget Fiscal 2016	Budget Fiscal 2017	Biennium Fiscal 14-15	Biennium Fiscal 16-17	Biennium Change	Biennium % Change
FTE	31.50	31.50	30.36	30.36	31.50	30.36	(1.14)	(3.62)%
Personal Services	1,934,732	2,039,103	2,124,779	2,125,888	3,973,835	4,250,667	276,832	6.97 %
Operating Expenses	2,940,083	2,963,996	4,201,445	3,720,034	5,904,079	7,921,479	2,017,400	34.17 %
Equipment & Intangible Assets	14,333	19,500	334,333	134,333	33,833	468,666	434,833	1,285.23 %
Debt Service	81,678	89,977	81,678	81,678	171,655	163,356	(8,299)	(4.83)%
Total Costs	\$4,970,826	\$5,112,576	\$6,742,235	\$6,061,933	\$10,083,402	\$12,804,168	\$2,720,766	26.98 %
State/Other Special Rev. Funds	0	0	0	0	0	0	0	0.00 %
Proprietary Funds	4,970,826	5,112,576	6,742,235	6,061,933	10,083,402	12,804,168	2,720,766	26.98 %
Total Funds	\$4,970,826	\$5,112,576	\$6,742,235	\$6,061,933	\$10,083,402	\$12,804,168	\$2,720,766	26.98 %

Program Description

The Montana State Lottery (lottery) was created in November 1986 by a referendum vote of the people of Montana. The general purpose is to allow lottery games in which players purchase from the state, through the administration of the lottery, a chance to win a prize. A five-member Lottery Commission, appointed by the Governor, sets policy and oversees program activities and procedures.

Lottery operations are accounted for in an enterprise fund type. The lottery receives no funding from the State of Montana but rather generates money for the state general fund. Lottery is required to transfer its net revenue to the general fund on a quarterly basis.

The lottery is attached to the Department of Administration for administrative purposes only.

Program Highlights

Montana State Lottery Major Budget Highlights
<ul style="list-style-type: none"> • Executive proposed budget increases 26.98% when compared to the 2015 biennium budget • Operating expenses for a new lottery contractor and changes to a printing contract are part of the changes
Major LFD Issues
<ul style="list-style-type: none"> • Contract for validation and verification will expire with the acceptance of the new gaming system in March 2016 • Operating budget increases are related to new contracts and are not ongoing costs

Program Discussion -

Comparison of FY 2015 Legislative Base to FY 2015 Adjusted Base

The Montana State Lottery did not change the FY 2015 legislative appropriations. The number shown in the program budget comparison table above reflects the budget approved by the 2013 Legislature.

Comparison of the FY 2014 Actual Expenditures to FY 2015 Legislative Appropriations

Actual FY 2014 expenditures are \$141,750 lower than the FY 2015 legislative appropriation. The primary reasons for the difference include:

- Vacancy savings of 6.7% within the program resulted in a lower personal services cost in FY 2014
- Less spending on advertising than estimated in the budget

Executive Request

Unlike most proprietary funds the lottery is budgeted in HB 2. This is because once the direct and administrative costs of the lottery are paid the remaining funds (net revenues) are transferred to the general fund. The lottery deposited \$12.1 million in net revenues into the general fund in FY 2014, which was a decrease of 7.6% when compared to the funding transferred in FY 2013. The figure on the next page shows actual and proposed revenues, expenditures, and transfers from FY 2012 to FY 2017. As shown, as the economy in Montana began to recover from the Great Recession lottery profits transferred to the general fund rebounded, peaking in FY 2012. Part of the reason for the significant increases in FY 2012, which were sustained in FY 2013, was the national publicity surrounding the large jackpots for the MegaMillions and Powerball games. In FY 2014 the trend somewhat reversed as:

- Jackpot prize amounts moderated
- National publicity did not follow these stories at the same level
- Public expectations moderated and adjusted as a result

Department of Administration Montana State Lottery Statement of Revenues, Expenditures, and Changes in Fund Balance Between FY 2012 and FY 2017						
	Actual FY 2012	Actual FY 2013	Actual FY 2014	Appropriated* FY 2015	Proposed* FY 2016	Proposed* FY 2017
Beginning Fund Balance	\$1,481,673	\$1,159,281	\$851,288	\$581,336	\$1,593,778	\$1,245,199
Revenues	52,628,491	56,831,378	53,128,562	53,650,000	55,647,000	58,087,000
Expenditures						
Personal Services	1,809,739	1,846,661	1,988,364	2,039,103	2,124,641	2,125,757
Operating Expenses	37,973,596	42,093,420	39,201,128	37,784,049	39,936,998	39,485,587
Equipment	0	0	14,333	19,500	334,333	134,333
Capital Outlay	0	0	(14,333)	0	0	0
Debt Service	17,809	13,659	9,510	89,977	81,678	81,678
OPEB	<u>89,199</u>	<u>101,836</u>	<u>108,929</u>	<u>108,929</u>	<u>108,929</u>	<u>108,929</u>
Total Expenditures	39,890,343	44,055,576	41,307,931	40,041,558	42,586,579	41,936,284
Adjustment	132	0	0	0	0	0
Net Before Transfers	14,219,953	13,935,084	12,671,919	14,189,778	14,654,199	17,395,915
Transfers to General Fund	<u>13,060,671</u>	<u>13,083,796</u>	<u>12,090,583</u>	<u>12,596,000</u>	<u>13,409,000</u>	<u>14,440,000</u>
% Change	23.08%	0.18%	-7.59%	4.18%	6.45%	7.69%
Ending Fund Balance	<u>\$1,159,281</u>	<u>\$851,288</u>	<u>\$581,336</u>	<u>\$1,593,778</u>	<u>\$1,245,199</u>	<u>\$2,955,915</u>
* Revenues and transfers to general fund as adopted by Revenue and Transportation Interim Committee November 20,2014						

The expenditure amounts shown above are a combination of statutory appropriations for lottery prizes, commissions paid to lottery ticket or chance sales agents, vendor fees, and HB 2 appropriations for administrative costs associated with the program. The statutory appropriations are directly related to either the:

- Sale of lottery tickets and the related private retailers commissions and vendor fees
- Payment of prizes

As such, the legislature cannot impact changes to these game costs, as they are driven by the purchase of lottery tickets. In contrast, the legislature can affect the HB 2 appropriation amounts, which directly impact the level of lottery profits transferred to the general fund. The lower the administrative costs, the higher the amount available to transfer to the general fund. The HB 2 administrative costs are shown in the program budget comparison table on the first page of the program narrative and are also included as part of the costs shown in the figure above.

As shown on the program budget comparison table, the largest contributor to the increase in operating expenses is the scheduled update in the gaming system. The lottery contracts with a private entity for its gaming system, which provides for terminals at each of the approximately 850 separate retail vendors across Montana, software for both the terminals and the Montana State Lottery system, system security, and other related components. State procurement requirements provide that the contract for the gaming system must be put out for bid every 10 years. The current contract expires in March 2016.

It should be noted that even if the same vendor is selected through the bidding process, the request for proposal requires a new and updated gaming system with all new equipment for installation at each retail vendor and the lottery offices.

Bids for the system are due in December of 2014. Once the vendor is selected lottery staff will work with the contractor to refine the components need to make the change to the new system. Items that will need to be addressed prior to having the system converted include:

- Conversion schedule
- Installation of new equipment
- Testing and verification of the system prior to “go live” date
- Education of retail vendors

About 47% of the proposed \$2.2 million increase in operating expenses is due to the impact of converting to the new gaming system at the end of the 2017 biennium. The remaining increases are requests for additional authority for advertising, merchandise, and equipment.

Funding

The following table shows proposed program funding by source from all sources of authority.

Department of Administration, 15-Montana State Lottery Funding by Source of Authority						
Funds	HB2	Non-Budgeted Proprietary	Statutory Appropriation	Total All Sources	% Total All Funds	
General Fund	0	0	0	0	0.00 %	
02029 Board Of Horse Racing	0	0	0	0	0.00 %	
State Special Total	\$0	\$0	\$0	\$0	0.00 %	
Federal Special Total	\$0	\$0	\$0	\$0	0.00 %	
06001 State Lottery Fund	12,804,168	0	75,550,755	88,354,923	100.00 %	
Proprietary Total	\$12,804,168	\$0	\$75,550,755	\$88,354,923	100.00 %	
Total All Funds	\$12,804,168	\$0	\$75,550,755	\$88,354,923		

House Bill 2

The lottery is funded entirely with proprietary funds derived from lottery game revenues. Net revenues of the lottery are by state law transferred to the general fund. Therefore, the lottery is indirectly funded with general fund and by law its funding for operations must be appropriated by the legislature.

Statutory Appropriations

Beginning in FY 2014 the legislature included support for vendor fees as statutory appropriations. Prior to this the costs were appropriated in HB 2. In the 2017 biennium about 84.6% of the total proposed costs for the lottery are statutorily appropriated for lottery prizes and commissions and vendor fees paid to lottery ticket or change sales agents. The level of costs for commissions and vendor fees fluctuates in direct correlation to the ticket sales and is thus forecast to increase as are lottery revenues.

Budget Summary by Category

The following summarizes the total budget utilizing the FY 2015 Legislative base, present law adjustments, and new proposals.

Budget Summary by Category									
Budget Item	-----General Fund-----				-----Total Funds-----				
	Leg. Budget Fiscal 2016	Leg. Budget Fiscal 2017	Leg. Biennium Fiscal 16-17	Percent of Budget	Leg. Budget Fiscal 2016	Leg. Budget Fiscal 2017	Leg. Biennium Fiscal 16-17	Percent of Budget	
2015 Budget	0	0	0	0.00 %	5,112,576	5,112,576	10,225,152	0.00 %	
PL Adjustments	0	0	0	0.00 %	1,629,659	949,357	2,579,016	0.00 %	
New Proposals	0	0	0	0.00 %	0	0	0	0.00 %	
Total Budget	\$0	\$0	\$0		\$6,742,235	\$6,061,933	\$12,804,168		

Present Law Adjustments -

The "Present Law Adjustments" table shows the changes from FY 2015 legislative appropriation to the budget proposed by the executive. PSPL adjusts all personal services. LGPL provides for adjustments to other expenditures such as operating expenses. Each is discussed in the narrative that follows. Total funds in the Present Law Adjustments table do not include proprietary funds budgeted in House Bill 2.

Present Law Adjustments										
	-----Fiscal 2016-----					-----Fiscal 2017-----				
	FTE	General Fund	State Special	Federal Special	Total Funds	FTE	General Fund	State Special	Federal Special	Total Funds
DP 98 - LEG. Personal Services Present Law	0.00	0	0	0	0	0.00	0	0	0	0
DP 99 - LEG. Present Law	0.00	0	0	0	0	0.00	0	0	0	0
Grand Total All Present Law Adjustments	0.00	\$0	\$0	\$0	\$0	0.00	\$0	\$0	\$0	\$0

DP 98 - LEG. Personal Services Present Law -

The Personal Services Present Law Adjustments (PSPL) in the table below includes all present law adjustments related to personal services, including statewide present law personal services adjustments. This adjustment has been broken out by some of its component parts for a more detailed understanding of the adjustments. FY 2016 and FY 2017 contain the reductions in FTE made by the executive to implement the boilerplate language in HB 2.

Personal Services Present Law Adjustments					
FY 2016					
CP 98 PSPL Item	FTE	General Fund	State Special	Federal Special	Total Funds
State Share Health Insurance	30.36	\$0	\$0	\$0	\$0
Executive Implementation of 2015 Pay Increase		-	-	-	-
Fully Fund 2015 Legislatively Authorized FTE		-	-	-	-
Other		-	-	-	-
Personal Services Present Law Adjustments	30.36	\$0	\$0	\$0	\$0
FY 2017					
CP 98 PSPL Item	FTE	General Fund	State Special	Federal Special	Total Funds
State Share Health Insurance	30.36	\$0	\$0	\$0	\$0
Executive Implementation of 2015 Pay Increase		-	-	-	-
Fully Fund 2015 Legislatively Authorized FTE		-	-	-	-
Other		-	-	-	-
Personal Services Present Law Adjustments	30.36	\$0	\$0	\$0	\$0

The reduction shown in the other line of the table includes increases for market, training assignment progression, and longevity pay adjustments offset by decreases related to the division’s implementation of the boilerplate language for HB 2 enacted by the 2013 Legislature.

DP 99 - LEG. Present Law -

The following table outlines various components of the changes included in the LGPL adjustments. As previously discussed, the present law adjustment table does not include proprietary funds. The table below shows the changes for the proprietary funds for the lottery.

Legislative Present Law Adjustments					
CP 99 Item	General Fund	State Special	Federal Special	Proprietary Fund	Total Funds
Lottery Coronis Terminals - OTO	\$0	\$0	\$0	\$334,372	\$334,372
Lottery Conversion	-	-	-	200,000	200,000
Lottery Operating Budget Increases	-	-	-	954,000	954,000
Other	-	-	-	55,611	55,611
Legislative Present Law Adjustments	\$0	\$0	\$0	\$1,543,983	\$1,543,983
CP 99 Item	General Fund	State Special	Federal Special	Proprietary Fund	Total Funds
Lottery Operating Budget Increases	\$0	\$0	\$0	\$924,000	\$924,000
Other				(61,428)	(61,428)
Legislative Present Law Adjustments	\$0	\$0	\$0	\$862,572	\$862,572

The lottery has three major contracts:

- Gaming system – provides terminals at retail vendors, software for terminals and Montana State Lottery, system security, and other components of the system
- Instant ticket printing – prints scratch tickets
- Advertising – provides advertising campaigns to promote the various lottery games throughout Montana

The gaming system contract is rebid every 7 to 10 years. The current contract expires March 2016. The lottery is in the process of selecting a new contractor. Even if the same vendor is selected a new and updated gaming system with all new equipment will be installed at each new retail vendor (890 vendors) and the lottery offices.

As part of the conversion process, the lottery will require the selected contractor to undergo compliance and testing reviews by an independent third party. This process is referred to as an independent validation and verification contract.

**LFD
ISSUE**

Contract Will Expire With the Acceptance of the New Gaming System in March 2016

The current contract for the lottery gaming system expires March 30, 2016. The need for validation and verification of the new computerized gaming system will begin as soon as the contract is signed and will expire at the time the new system is up and running, or March 30, 2016 at the latest. The coronis terminals lease is only requested for FY 2016 as the new contractor will be responsible for this as part of the new contract. These types of contracts are considered a nonrecurring expense to the lottery, as the service is provided over a limited timeframe and is not ongoing. The legislature may wish to consider funding these requests as one-time-only appropriations.

Furthermore, the costs for the contract are an estimate. The legislature may wish to consider restricting funding for the IV & V contract so that if the actual costs are less, the funding that is not required is available to be transferred to the general fund rather than other uses within the lottery.

Legislative Option

The legislature may wish to restrict the requested funding to support for the IV & V contract and provide the appropriation as one-time-only.

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Operating Budget Increases Are Related to New Contracts and Are Not Ongoing

According to lottery staff, about 47% of the requests included in the operating budget are due to the impact of converting to the new instant ticket and gaming system contracts in the 2017 biennium. Once the system and printing contracts are in place the costs related to training, travel, and other expenses should return to previous levels. The remaining increases are for additional authority for marketing and equipment.

It should be noted that the higher the operating expenses of the lottery, the less net revenue is available for transfer to the general fund.

Legislative Option

Designate \$1.0 million of the operating budget increase request as one-time-only and restricted to implementation of the new gaming system and new printing contract.