

SUNSET ADVISORY COMMISSION

STAFF REPORT
WITH DECISION MATERIAL

*Texas
Lottery Commission*

MAY 2012



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Cover photo: The Texas Capitol is a marvel of craftsmanship down to the smallest details. The beautifully carved wood door frames are emphasized with elaborate, custom-designed bronze hinges and hardware produced especially for the building by Sargent and Co. of New Haven, Connecticut, in the late 1880s. The eight inch by eight inch hinges are inscribed with the words "Texas Capitol", decorated with incised designs of geometric and stylized floral motifs, and weigh over seven pounds each.

TEXAS LOTTERY COMMISSION

**SUNSET STAFF REPORT WITH DECISION MATERIAL
MAY 2012**

This document is intended to compile all recommendations and action taken by the Sunset Advisory Commission for an agency under Sunset review. The following explains how the document is expanded and reissued to include responses from agency staff and the public.

- *Sunset Staff Report, March 2012* – Sunset staff develops a separate report on each individual agency, or on a group of related agencies. Each report contains both statutory and management recommendations developed after the staff’s extensive evaluation of the agency.
 - *Sunset Staff Report with Hearing Material, April 2012* – Adds responses from agency staff and the public to Sunset staff recommendations, as well as new issues raised for consideration by the Sunset Commission at its public hearing.
 - *Sunset Staff Report with Decision Material, May 2012* – Adds additional responses, testimony, or new issues raised during and after the public hearing for consideration by the Sunset Commission at its decision meeting.
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SUMMARY

SUMMARY

The Texas Lottery Commission (Commission) walks a tightrope in balancing the many contradictions in the State's attitudes about gaming. The agency is charged with operating the lottery, much like a business, to generate revenue for the State through gaming, but must remain mindful of gaming's many vocal opponents in Texas. Now in its 20th year, Texas' lottery has reached a mature phase in which sales have begun to level off, requiring the agency to be as innovative as possible designing and marketing its games, but it must do so under caps on spending for advertisements and statutory direction to not unduly influence anyone to buy a lottery ticket.

In addition, the Commission must approach its responsibilities within the ongoing debate about expanded gaming that is beyond its control, and well beyond the scope of the Sunset staff review of the agency. Depending on the approach taken, such gaming could increase sales for new games already under the Commission's purview, with the possibility of greater monetary return to the State, or alternatively could squeeze existing sales in the competition for gambling dollars.

The Commission must also balance its effort to efficiently operate the State's lottery while handling the thorny regulation of charitable bingo. A complex, cash-based enterprise with very real opportunities for fraud, bingo justifies the need for regulation because of the potential financial harm to charitable organizations in whose name the games are played and the possible loss of bingo prize fee revenue to the State and local governments. The oversight of bingo requires the Commission to balance a statutory framework between commercial interests and the charities the games are supposed to benefit. Ultimately, however, the turnkey approach by which commercial interests support the charities' bingo operations makes it difficult to determine whether charities are sufficiently benefitting from the games as laid out in the Texas Constitution.

Further illustrating the agency's precarious position is its history with Sunset reviews. The agency underwent review in both 2002 and 2004, but its Sunset bills failed to pass either time, and the agency was continued in separate legislation. Explanations for the bills' failure vary, but it is clear that the controversial nature of the agency's business presents more challenges than most state agencies face.

The current Sunset review found that despite these challenges, the Commission successfully balances the various demands placed on it. However, Sunset staff identified an opportunity to promote agency effectiveness and accountability by increasing the size of the Lottery Commission so that it is better able to oversee the business of the agency,

The Commission must balance its effort to efficiently operate the State's lottery while handling the thorny regulation of charitable bingo.

especially in approving the agency's major contracts. The agency also has opportunities to better track information to help improve its performance and efficiency and potentially increase revenue to the State. Sunset staff also sought to address the agency's ability to effectively regulate charitable bingo by ensuring that licensing fees cover the cost of regulation and replace the lottery funding the agency must currently use to subsidize bingo regulation. Recommendations to bring the Bingo Enabling Act more in line with standard licensing provisions are also included.

The following material summarizes Sunset staff's recommendations on the Texas Lottery Commission.

Issues and Recommendations

Issue 1

An Expanded Lottery Commission With Clear Contract Oversight Would Improve Accountability and Effectiveness.

The Lottery Commission's three-member, part-time oversight body is unlike many state agency boards in that it does not approve major contracts. Contract approval rests solely with the executive director, including recent approval of the agency's new lottery operator contract worth an estimated \$747 million. Requiring Lottery Commission members to approve major contracts would ensure that they know the process that produced the contract is sound, and would give a higher level of accountability to some of the biggest contracts in state government. Having just three members is also unusual among state agency policy bodies and policy bodies of other states' lotteries. Expanding to five members would allow the Commission to better divide the workload and develop expertise to give more attention to the challenging aspects of lottery operations and bingo regulation, and to critical agency functions such as contracting.

Key Recommendations

- Increase the Texas Lottery Commission from three to five public members.
- Require the Lottery Commission to approve major contracts.

Issue 2

Improved Information Collection and Reporting Would Enhance Oversight of the Commission's Critical Contracting Activities.

Contracting for goods and services is a core function of the Lottery Commission, which spent nearly \$158 million, or 78 percent of its administrative budget, on contracts in fiscal year 2011. Sunset staff evaluated the agency's contracting practices and found the Commission successfully follows established contracting standards. The Sunset review also identified several opportunities to improve contract oversight by enhancing information gathering and reporting on contract sanctions, negotiations, and close-out analysis. This information would provide additional means for agency management and Commission members to evaluate whether the agency is getting the most value from its numerous contracts.

Key Recommendation

- Direct the Commission to improve collection and dissemination of information about contract sanctions, outcomes of negotiations, and contract close-out results.

Issue 3

Regular Analysis and Reporting on the Effectiveness of Ongoing Lottery Strategies Would Improve Accountability and, Potentially, Revenues to the State.

The Texas lottery has been successful at producing nearly \$1 billion in revenue for the State each year, primarily for the Foundation School Fund. However, like many other agencies with mature state lotteries, the Commission is facing ongoing challenges to maintain and increase this revenue into the future. Many complex factors affect lottery performance, such as the mix and design of games offered, number and quality of lottery retailers, and agency administrative efficiency. While the Sunset review revealed Texas' lottery is generally high performing when compared to other states, the agency could benefit from setting formal goals, tracking factors affecting its performance and efficiency, evaluating the success of ongoing programs, and consistently reporting this information to the public and Commission members. The changes would require the agency to continue producing a business plan based on a previous Sunset recommendation, with additional required elements, and would improve the agency's overall accountability.

Key Recommendation

- Require the Lottery Commission to develop a comprehensive business plan including specific evaluations of, and goals tied to, efficiency and performance.

Issue 4

Inadequate Funding and Inefficiencies in Its Auditing and Inspection Process Severely Limit the Agency's Ability to Regulate Bingo.

The agency's Charitable Bingo Operations Division (Division) monitors compliance with the State's bingo laws and rules through financial audits, bingo game inspections, and bingo equipment testing. Without this oversight, state bingo revenues and bingo games, which operate on a cash basis and generate almost \$700 million in annual sales, would be more susceptible to theft and fraud.

However, the Division's ability to protect the public and the industry from financial harm is severely hindered by insufficient funding and an inefficient audit and inspection process. Much of the bingo license fee revenue the State collects is not appropriated back to the agency for bingo regulation, and the structure of the bingo appropriations bill pattern has intensified the impact of recent budget cuts. Also, the agency does not have authority to charge fees for some of the bingo regulation it provides, while many of the bingo licensing fees it does charge do not cover the costs of regulation. Due to these funding shortfalls, the agency must subsidize bingo regulation with lottery funds which would otherwise go to the Foundation School Fund. In addition, the Division does not have a targeted approach to its audit and inspection process, reducing its ability to use scarce resources efficiently. Ensuring that licensing fees cover the cost of regulation would provide the resources necessary for the Division to more effectively oversee charitable bingo and would increase revenue to the Foundation School Fund.

Key Recommendations

- The House Appropriations and Senate Finance Committees should consider removing bingo prize fees from the agency's bill pattern.
- Remove the fixed license amendment fee from statute and require the Commission to adjust the fee by rule, and authorize the agency to charge a fee to cover the costs of adding bingo hall workers to the Registry of Approved Bingo Workers.
- Require the agency to use risk analysis to select licensees for bingo inspections, and put its inspection policies in rule.
- Require the Commission to develop a goal to audit all the highest-risk bingo licensees within a certain timeframe, and put its audit policies in rule.
- The Commission should reassess the full cost of bingo regulation and seek to adjust license fees and its legislative appropriations request accordingly.

Issue 5

Elements of the Bingo Enabling Act Do Not Conform to Commonly Applied Licensing Practices.

For more than 30 years, Sunset staff have reviewed numerous agencies performing licensing and regulatory activities, and have identified standards that are common practices throughout these agencies' statutes, rules, and procedures. The Bingo Enabling Act has licensing provisions that do not follow model licensing practices and does not contain other standard enforcement provisions, hindering the agency's ability to provide consistent regulation, protect the public, and safeguard state revenue.

Key Recommendations

- Require the Commission to address felony and misdemeanor convictions according to established standards in the Occupations Code.
- Require the agency to create a standard bingo license renewal process, and remove the nonstandard provisions for two-year bingo license fees.
- Remove the statutory fee levels for bingo manufacturer and distributor licenses.
- Authorize the Commission to place suspended bingo licensees and registered workers on probation.
- Expand the Lottery Commission's authority to temporarily suspend bingo licenses to prevent financial losses to the State.

Issue 6

Elements of the State Lottery Act Do Not Conform to Commonly Applied Licensing Practices.

In assessing the Commission's regulation of nearly 17,000 lottery retailers, several areas where the Commission's statute and procedures do not match model licensing standards were found. In particular,

additional improvements to the Commission's complaint process are needed to complete the agency's efforts to implement previous Sunset recommendations. The changes are aimed at ensuring the public and lottery retailers understand the Commission's role in accepting and investigating complaints, and that agency management and Commission members have data necessary to monitor lottery regulatory activities.

Key Recommendations

- Require the Commission to develop complaint procedures, track and analyze complaints, and provide better information about what to expect once a complaint is filed.
- Conform the Lottery Act to the Commission's current practice of conducting hearings through the State Office of Administrative Hearings.

Issue 7

The Lottery Commission's Statute Does Not Reflect Standard Elements of Sunset Reviews.

Among the standard elements considered in a Sunset review, the Sunset Commission adopts Across-the-Board recommendations as standards for state agencies to reflect criteria in the Sunset Act designed to ensure open, responsive, and effective government. Because a Sunset bill for the Lottery Commission has never passed, several of these provisions are missing entirely from the agency's statute and must be applied, and others must be updated. In addition, the Texas Sunset Act directs the Sunset Commission to recommend the continuation or abolishment of each reporting requirement imposed on an agency under review. Sunset staff found that one of the Lottery Commission's nine required reports does not serve a useful purpose and should be eliminated.

Key Recommendations

- Update and apply standard Across-the-Board recommendations to the Lottery Commission.
- Abolish the Commission's report on lottery tickets sold and prizes awarded, and continue the Commission's other reports.

Issue 8

Texas Has a Continuing Need for the Texas Lottery Commission.

For almost 20 years, the Texas Lottery Commission has both operated the Texas lottery and regulated charitable bingo, and the need for those functions continues. Texans spend up to \$4 billion on lottery tickets and \$700 million on bingo games each year, showing their continued interest in the games. Revenue from the lottery and bingo continue to be important to the State, local governments, and charitable organizations. The lottery provides about \$1 billion each year to the Foundation School Fund, while each year bingo provides about \$28 million to the State and local governments and another \$34 million to charities. Without lottery and bingo games, these entities would have to find other sources of revenue. The Lottery Commission has the expertise and organizational structure to administer the lottery and oversee bingo regulation. No significant cost savings or administrative efficiencies from other structures were identified.

Key Recommendation

- Continue the Texas Lottery Commission for 12 years.

Fiscal Implication Summary

Issue 4 of this report could result in an increase to the Foundation School Fund of \$1.47 million annually.

Issue 4 — Providing for the agency to set or adjust various bingo licensing fees would increase revenue to the General Revenue Fund, allowing the agency to recover the full cost of bingo regulation. The additional revenue would ensure that bingo regulation would no longer need to be subsidized by approximately \$1.47 million in lottery funds, resulting in a gain of an equal amount in the Foundation School Fund.

Texas Lottery Commission

Fiscal Year	Gain to Foundation School Fund
2014	\$1,470,0000
2015	\$1,470,0000
2016	\$1,470,0000
2017	\$1,470,0000
2018	\$1,470,0000

AGENCY AT A GLANCE
MARCH 2012

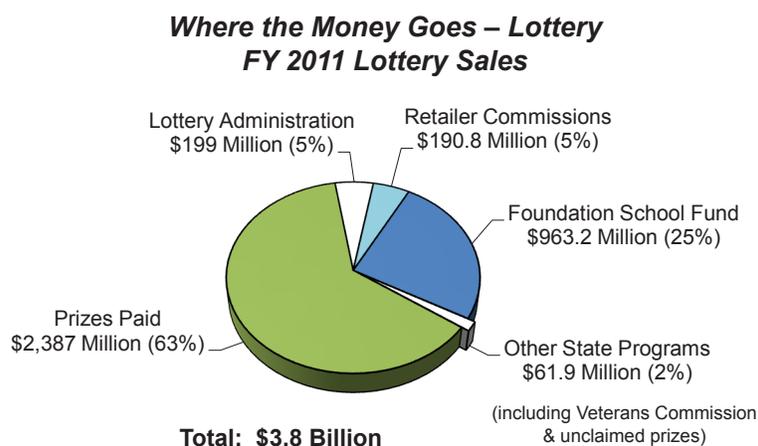
AGENCY AT A GLANCE

The Lottery Commission (Commission) administers the state lottery and regulates charitable bingo activities. The Commission's mission is to generate revenue for the State, primarily for education, through the responsible management and sale of lottery products. The Commission also provides charitable organizations the opportunity to raise funds for charitable purposes by conducting bingo. To achieve its mission, the Commission carries out the following key activities:

- licenses lottery retailers; develops, approves, and markets lottery games; conducts lottery drawings; and processes winning ticket claims;
- manages several major contracts for day-to-day lottery operations, mass media advertising, and instant ticket production, among others;
- licenses and monitors bingo industry participants, including charitable organizations and for-profit businesses; and
- collects bingo taxes and prize fees and helps allocate a share of the prize fees to cities and counties.

Key Facts

- **Lottery.** Texas voters approved a state lottery in 1991 by a two-to-one margin. About 40 percent of Texans 18 and older participate in the Texas lottery, according to a recent annual survey conducted by the Commission.¹ Through fiscal year 2011, the lottery has generated more than \$19 billion for the State, including \$13.6 billion for the Foundation School Fund. In fiscal year 2011, lottery sales reached a record \$3.8 billion, which translated to more than \$1 billion transferred to the State that year. The chart, *Where the Money Goes – Lottery*, provides more detail on the use of lottery funds in fiscal year 2011.

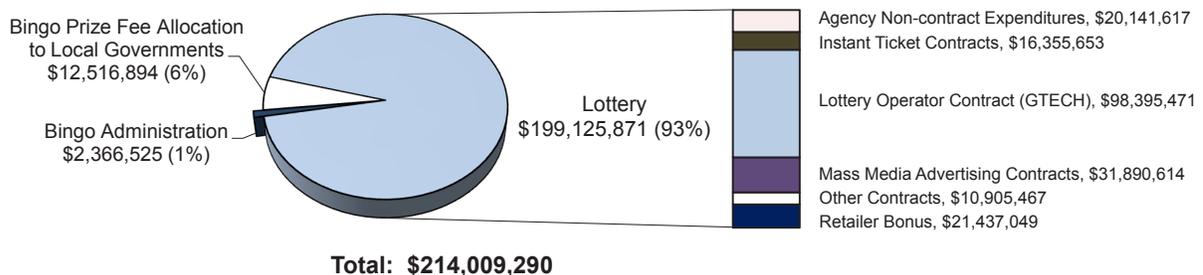


- **Lottery Commission.** The Lottery Commission is the three-member, Governor-appointed policymaking body that oversees the agency. The Commission consists of three public members appointed to six-year staggered terms. One of the members must have experience in the bingo industry.

- Funding.** In fiscal year 2011, the Commission’s operating revenue totaled \$214 million, including about \$199 million from the General Revenue Dedicated-Lottery Account to support lottery operations, and about \$14.9 million from General Revenue to support bingo regulation. The bingo appropriation includes \$12.5 million in bingo prize fees the Commission passes through to local governments and does not use for administration. The Commission used the remaining \$2.4 million to regulate the bingo industry. Budget cuts for the 2012–13 biennium reduced this administrative funding for bingo regulation by more than one-quarter.

The chart, *Lottery Commission Expenditures*, shows that more than 90 percent of the agency’s expenditures supported lottery operations in fiscal year 2011, with about 80 percent of those expenditures for contracts for lottery operations, mass media advertising, instant ticket production, and other functions. GTECH Corporation, an international gaming company, has been the State’s lottery operator since the lottery’s inception in 1992, and won its third contract with the State in 2010. The new, nine-year contract began in fiscal year 2012, and is worth an estimated \$83 million per year, with payments to GTECH based on a percentage of overall sales.

**Lottery Commission Expenditures
FY 2011**



- Staffing.** The Commission has about 309 employees. Of that number, 255 work in Austin, while the remaining 54 work at four bingo regional offices and 15 lottery claim centers across the state. Thirty-three of the agency’s staff are dedicated to bingo, while the remaining 276 focus on lottery operations and support services.
- Lottery Operations.** The Commission offers two types of lottery products, online (drawing) and instant games, which are sold by a network of lottery retailers, primarily convenience stores. The Commission currently licenses close to 17,000 lottery retailers, who receive a 5-percent commission on lottery sales, plus other bonuses and incentives for selling lottery products.

Online games are traditional lottery drawing games in which players select a set of numbers for a specified drawing date. The Commission currently offers seven types of online games: *Lotto Texas*, *Pick 3*, *Daily 4*, *Cash Five*, *Texas Two Step*, and *Mega Millions* and *Powerball*, two multi-state lottery games. Instant games, also called scratch-offs, consist of preprinted tickets with symbols hidden under a latex covering. The Commission offers up to 90 different instant games each year, ranging in price from \$1 to \$50 per ticket. In fiscal year 2011, sales of instant games made up nearly 75 percent of all lottery sales.

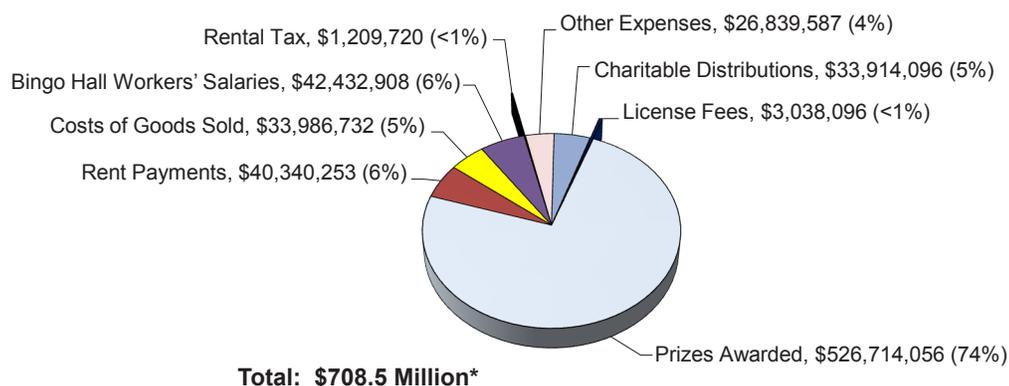
The structure of the lottery's administration is known nationally as the Texas Model, where the Commission outsources many day-to-day operations of the lottery but directly manages other key functions. The lottery operator contract with GTECH Corporation includes the gaming system, retailer terminals, and communications network needed for online ticket sales, in addition to a call center, marketing support, field sales and technical staff, and warehousing and distribution for instant game tickets. In addition to the GTECH contract, the Commission also manages major contracts for mass media advertising services and instant game ticket production. The Commission directly manages other key lottery functions such as retailer licensing and enforcement, prize payment at claim centers, game drawings at the Commission's public drawing studio, and approval of products and advertising. As part of its licensing and enforcement functions, the Commission resolved 370 complaints about lottery retailers in fiscal year 2011, resulting in 107 reprimands and nine suspensions. The agency also summarily suspended 618 retailers and revoked 68 for having insufficient funds to pay the agency for tickets sold.

- Charitable Bingo.** In 1980, Texas voters decisively approved charitable bingo on a local option basis if games are conducted by certain nonprofit organizations and if proceeds are spent in Texas for charitable purposes. Currently, 552 local jurisdictions in Texas allow bingo. Over time, games have evolved beyond traditional paper cards to include electronic card-minding devices and instant pull-tab bingo tickets. In calendar year 2010, bingo gross receipts totaled a record \$699.4 million, with \$526.7 million of that amount awarded as prizes.

The Commission licenses and monitors all bingo-related activities and participants, including organizations, individuals, and entities that conduct bingo games, lease premises for the conduct of bingo, and manufacture or distribute bingo supplies. The Commission licenses 1,140 charities to conduct bingo, and 400 commercial lessors to lease bingo locations to charities. The Commission resolved 162 complaints regarding these licensees in fiscal year 2011, and issued 477 warning letters, two agreed orders, 22 revocations, and collected \$207,300 in administrative penalties.

Bingo generates revenue for charities in the form of charitable distributions, which totaled \$33.9 million in calendar year 2010, or 4.8 percent of gross receipts and 19.6 percent of net receipts (after prizes are paid). The most common types of charities conducting bingo include fraternal, veterans, and religious organizations such as the Knights of Columbus, American Legion, or churches. The chart, *Where the Money Goes – Bingo*, provides more detail on the use of bingo revenue in calendar year 2010.

Where the Money Goes – Bingo
Calendar Year 2010 Bingo Expenditures



* Calendar year 2010 bingo expenditures exceed the \$699.4 million in bingo gross receipts for that year, mostly due to additional charitable distributions required by recent legislation.

In addition to charitable distributions, bingo also produces revenue for the State and local jurisdictions through a 5-percent fee on bingo prizes, which comes out of the total amount of prizes awarded. This fee generated \$26.1 million in calendar year 2010, of which \$12.2 million was returned to local jurisdictions and the remainder went to the General Revenue Fund. That year, an additional \$1.2 million went to General Revenue from a 3-percent tax on rental of premises where bingo is conducted. Bingo licensees paid an additional \$3 million in license fees to the State to help pay the cost of regulating bingo.

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¹ University of Houston Hobby Center for Public Policy, *Demographic Survey of Texas Lottery Players 2011* (Houston: University of Houston Hobby Center for Public Policy, 2011), p. 1.

ISSUES

ISSUE 1

An Expanded Lottery Commission With Clear Contract Oversight Would Improve Accountability and Effectiveness.

Background

The Texas Lottery Commission (Commission) is governed by a three-member, Governor-appointed oversight board. The members serve part time, and one must have experience in the bingo industry. Statute requires the Commission to meet at least six times each year, though in practice the Commission meets almost every month. The Commission adopts rules and sets policies to enforce and administer the State Lottery Act and the Bingo Enabling Act, and is charged by law to ensure games are conducted fairly and in compliance with the law.¹ The State Lottery Act authorizes the executive director, not the Commission, to establish a procurement procedure and make any purchases, leases, or contracts necessary to operate a lottery.²

Findings

Unlike many state agency policy bodies, the Lottery Commission does not approve the agency's major contracts.

Because the State Lottery Act gives the Commission's executive director sole approval authority over all contracts, the Commission's accountability for the agency's contracting process is reduced. Contracts play an enormous role in the agency's operations, with three-quarters of the agency's fiscal year 2011 administrative expenditures going to contracted services. Approval of contracts is a standard practice of state agency governing bodies, though the size of contracts receiving approval varies among agencies. The Texas Board of Criminal Justice, for example, approves all contracts over \$1 million, and the Texas Transportation Commission approves comprehensive development agreements, among other contracts, that can be worth hundreds of millions of dollars. Governing body approval does not take the place of the rigorous staff work and safeguards currently built into the agency's contracting process, nor does it indicate members know every detail of a contract. It does, however, help confirm that they know the process that produced the contract is sound and provides a needed level of accountability for some of the largest business decisions in state government.

Governing body approval of contracts helps confirm the process that produced the contracts is sound.

In 2002 and 2004, the Sunset Commission recommended requiring the Lottery Commission to approve major contracts and noted that Commission members had limited involvement in the agency's major procurements and expenditures.³ Legislation containing the recommendation did not pass, but agency staff took the initiative to begin providing regular updates to Commission members before taking action on major procurements as a way of receiving feedback on these contracts. While this feedback loop is important, agency contract approval still rests solely with a single employee, including recent approval of the agency's new nine-year lottery operator contract worth

an estimated \$747 million. Additionally, the Lottery Commission is exempt from many state contracting requirements because of its unique business-like functions.⁴ While the agency generally follows the requirements, its exemptions make high-level accountability regarding contracts even more important.

The small size of the Commission limits its ability to develop expertise to help improve oversight.

Having just three members limits the Commission's ability to divide its workload and develop expertise in specialized matters related to lottery and bingo. Many state boards and commissions overseeing large operations use committees of their membership to divide the work and develop such expertise. While the Commission could create two-member committees, they could not work simultaneously, defeating the primary purpose of committees to spread the workload. Contracting is clearly an important matter at the Commission that could benefit from the attention of a committee.

Lottery operations are more complex than when the agency was first established in 1993, including participation in two multi-state lottery games. The agency also faces challenges as the lottery matures and new strategies are necessary to maintain sales. In addition, the regulation of charitable bingo continues to present its own challenges in overseeing such a unique enterprise. The limited ability for Commission members to specialize on matters in such a complex environment can result in a greater reliance on agency staff for policy development. While staff appears to do a good job providing members with information about agency operations, this limited ability for members to divide their increasingly complex workload can affect their ability to guide policy making for the agency. Emblematic of this situation is the executive director's approval of contracts instead of the Commission, as discussed in the preceding material. A larger commission would allow members to focus on challenging aspects of lottery operations, as well as bingo, to more effectively guide the agency into the future.

A smaller concern relates to communication challenges for the Commission by having just three members. If two members discuss an agency topic without advance posting, they potentially could be violating the Texas Open Meetings Act. Under terms of the Act, two members of the Lottery Commission cannot even talk on the phone with each other about basic agency operations. These limitations further cement Commission members' reliance on agency staff for policy development.

Most state agency policy bodies in Texas have at least five members, as do almost all other states' lottery agency policy bodies.

Most other state agency governing bodies have more than three members. Of the 97 boards or commissions appointed by the Governor, just six have three members. Of the six, half have members that serve full time and so

Many state boards and commissions use committees of their membership to divide work and develop expertise.

The Commission's small size can cause a greater reliance on staff.

do not compare to the part-time Lottery Commission.⁵ The Legislature has increased the size of three-member state boards in the last decade, expanding both the Texas Department of Transportation and Department of Public Safety oversight bodies from three to five members in 2003 and 2007, respectively.

Of the state lotteries with dedicated policy bodies, only Texas and New Hampshire have three members. All other lottery oversight boards have between five and nine members, with the exception of Connecticut which has 13.

Recommendations

Change in Statute

1.1 Increase the Texas Lottery Commission from three to five public members.

This recommendation would expand the size of the Lottery Commission by two members. Commission members would continue to serve part time, and the requirement that one member have experience with bingo would also continue. With more members, the Commission should consider creating committees to oversee major functions of the agency, such as contracting, that could benefit from increased attention.

1.2 Require the Lottery Commission to approve major contracts.

This recommendation would give procurement authority to the Commission, which could delegate most procurement duties to the executive director while retaining approval of major contracts. The Commission by rule would determine which procurements would be considered major, based on the cumulative value of the contract and other relevant factors. Commission members would have final approval authority for major contract awards but would not be required to sign contracts. The executive director would continue to work out final details and sign contracts as is current agency practice.

Fiscal Implication

Expanding the Lottery Commission would have a small cost because travel reimbursement for two new members would require about \$9,000 annually. The agency currently receives up to 7 percent of lottery sales for its administration and should use this funding to pay these expenses.

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¹ Section 466.015, Texas Government Code; Section 2001.054, Texas Occupations Code; Sections 467.101(b) and 467.102, Texas Government Code.

² Section 466.101(a), Texas Government Code.

³ Sunset Advisory Commission, *Texas Lottery Commission*, Staff Report (August 2002), pp. 23–24, Sunset Advisory Commission, *Texas Lottery Commission*, Staff Report (April 2004), p. 22.

⁴ Section 466.105, Texas Government Code.

⁵ The Texas Alcoholic Beverage Commission and the Veteran's Land Board have three part-time members while the Public Utility Commission, Texas Commission on Environmental Quality, and the Texas Workforce Commission have three full-time members.

RESPONSES TO ISSUE 1

Recommendation 1.1

Increase the Texas Lottery Commission from three to five public members.

Agency Response to 1.1

The agency agrees with all the recommendations contained in the Sunset Staff Report. (Gary Grief, Executive Director and Phil Sanderson, Charitable Bingo Operations Director – Texas Lottery Commission)

For 1.1

Dawn Nettles, Publisher – The Lotto Report, Garland

Against 1.1

None received.

Modification

1. Require one member of the Texas Lottery Commission to have extensive lottery playing experience. (Dawn Nettles, Publisher – The Lotto Report, Garland)

Recommendation 1.2

Require the Lottery Commission to approve major contracts.

Agency Response to 1.2

The agency agrees with all the recommendations contained in the Sunset Staff Report. (Gary Grief, Executive Director and Phil Sanderson, Charitable Bingo Operations Director – Texas Lottery Commission)

For 1.2

None received.

Against 1.2

None received.

STAFF RECOMMENDED ACTION

Adopt Recommendations 1.1 and 1.2.

ISSUE 2

Improved Information Collection and Reporting Would Enhance Oversight of the Commission's Critical Contracting Activities.

Background

Contracting for goods and services is a core function of the Lottery Commission (Commission). In fiscal year 2011, the agency's contracted expenditures totaled \$157.7 million, representing 78 percent of its administrative budget. The agency's top three contracted functions for lottery operations, instant tickets, and mass media advertising represent the majority of these expenditures, as shown in the chart, *Top Lottery Contracts*. In addition to these major contracts, the Commission has about 30 other contracts worth \$100,000 or more.

Top Lottery Contracts – FY 2011

Contract	Vendor(s)	Expenditure
Lottery Operator	GTECH Corporation	\$98.4 million
Mass Media Advertising	Tracy Locke and LatinWorks	\$31.9 million
Scratch-off Ticket Production	Scientific Games, GTECH Printing, and Pollard Banknote	\$16.4 million
Total		\$146.7 million

The Legislature has established some basic, statutory contracting requirements and standards for state agencies to follow, such as the *State of Texas Contract Management Guide* which includes model contract provisions and solicitation procedures, and the Contract Advisory Team which reviews high-risk contract solicitations.¹ These general standards apply to the Commission, even though the Lottery Act exempts the agency from many of the State's specific contracting requirements found in other statutes.²

When evaluating an agency's contracting practices, Sunset staff uses the general framework established in statute and in the *Guide*, as well as other documented contracting standards and best practices, such as those developed by other oversight entities. Sunset staff has compiled a list of high-level contracting standards to help evaluate an agency's contracting practices, recognizing the individual circumstances, risks, and needs of each agency and contract. Staff also looks for other opportunities to improve contracting practices specific to each agency's unique situation.

In this context, Sunset staff found the Commission successfully follows established contracting standards, including those relating to planning for and conducting a solicitation, evaluating proposals and making awards, and ensuring compliance with ethical standards for staff and contractors. The following findings do not so much identify material deficiencies with the Commission's contracting activities as they identify additional opportunities to improve contract oversight by enhancing information gathering and reporting of contract management activities to agency management and Commission members.

Findings

The agency does not have a comprehensive system for gathering and reporting information about contract sanctions to management or Commission members.

Agencies should have available to them a range of sanctions that can be invoked for noncompliance with contract terms. Agencies should track and report information about the use of sanctions to management and to agency boards to help provide an overall picture of contract management issues and inform future contract solicitations.

The Commission includes sanctions and liquidated damage provisions in its contracts, and regularly assesses penalties for noncompliance with these provisions. In particular, the agency does penalize the lottery operator, GTECH Corporation, for failing to meet strict service levels such as call center wait times and retailer terminal down time. In fiscal year 2011, the agency assessed \$722,590 in sanctions against GTECH. While the agency appears to be appropriately using sanctions to ensure compliance with specific contract provisions, it does not adequately track its overall use of sanctions in all of its contracts so that this information can be used as a management and oversight tool. With the exception of the GTECH contract, the agency does not maintain high-level tracking information that can be easily viewed and reported to agency management and Commission members. To produce summary information about all contract sanction activity requested by Sunset staff, lottery staff had to review numerous purchase vouchers to determine whether sanctions had been issued during a given time period and provide a total amount of sanctions issued by contract.

Centrally maintaining detailed sanction information and regularly providing summarized sanction activity to agency management and Commission members would help inform oversight of the agency's contract management activities. This information is also useful to identify or evaluate needed changes to a contract's scope or structure when contemplating contract amendments or a new solicitation for similar services.

The agency has improved documentation of negotiations, but should better track and report negotiation outcomes.

Developing a plan before negotiating with a potential contractor, appropriately staffing contract negotiations, and thoroughly documenting decisions made during a negotiation can help ensure that agencies get what they are looking for at the best value. Agencies should also document and report negotiation outcomes to ensure valuable information about the management of this critical contract step is available to agency management and oversight boards to improve negotiations and decision making.

The Commission follows a standard set of steps to plan for and carry out negotiations, including developing a negotiation team and strategy before meeting with potential vendors. In addition, in response to a series of

The agency assessed \$722,590 in sanctions against the lottery operator in fiscal year 2011.

recommendations made by the State Auditor's Office in 2006 and 2008, the Commission has improved documentation of its negotiation process, including developing written procedures and a check list to identify specific documentation required for negotiations.³ However, the agency does not consistently track or report overall information about how well it performs in negotiations, such as a comparison of initial negotiation goals with the final outcomes. Such information can help Commission members and agency management be more fully aware of the agency's overall performance in negotiations, such as whether the agency was able to negotiate lower costs or otherwise demonstrate a successful outcome for the State. While the Sunset review did not reveal specific concerns with the agency's performance or process regarding negotiations, more consistent tracking and reporting of this information would enhance oversight of the agency's critical contract management functions.

The agency produces useful analysis upon contract close-out that should be shared with the Commission.

Agencies should formally close-out a contract in writing after verifying completion of all contract terms, and assess the overall success of the contract, including the contractor's performance. Final results of major contracts should be reported to the agency's board.

The Commission follows clear procedures to formally close-out contracts and document any vendor performance issues. As a result of previous Sunset recommendations, the agency also performs a review comparing its original expectations and projections used to justify the procurement to the actual expenditures.⁴ These reviews produce useful information, such as an analysis and explanation of any variance between the original projections and actual outcomes. The results of these reviews are routed to agency management as they are completed, but overall information is not evaluated in any summary format and is not regularly presented to Commission members. A regular look at the overall results of these reviews would provide agency management and Commission members with an additional means to evaluate whether the agency is getting the most value from its numerous contracts.

Additional reporting on contract activities would help ensure the agency gets the most value from its numerous contracts.

Recommendation

Management Action

2.1 Direct the Commission to improve collection and dissemination of information about contract sanctions, outcomes of negotiations, and contract close-out results.

This recommendation would direct the agency to collect and provide specific additional information to management and Commission members to enhance the tools available for contract oversight. Specifically, the recommendation would direct the agency to develop a centralized method for tracking

and reporting overall contract sanction activity, outcomes of negotiations, and results of contract close-out reports. The information should be tracked by contract and also collected in summary format to help agency management and Commission members evaluate the agency’s performance of contract management functions. The agency should develop or amend formal procedures to reflect these changes and regularly provide information to Commission members regarding the results of this analysis.

Fiscal Implication

This recommendation would not have a fiscal impact to the State.

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¹ Chapters 2261 and 2262, Texas Government Code.

² Section 466.105, Texas Government Code.

³ State Auditor’s Office, *An Audit Report on Procurement at the Texas Lottery Commission*, report no. 06–062 (August 2006); *A Follow-up Audit Report on Workforce Management, Procurement, and Lotto Texas Activities at the Texas Lottery Commission*, report no. 08–022 (February 2008).

⁴ Sunset Advisory Commission, *Texas Lottery Commission*, Staff Report (April 2004), p. 22.

RESPONSES TO ISSUE 2

Recommendation 2.1

Direct the Commission to improve collection and dissemination of information about contract sanctions, outcomes of negotiations, and contract close-out results.

Agency Response to 2.1

The agency agrees with all the recommendations contained in the Sunset Staff Report. (Gary Grief, Executive Director and Phil Sanderson, Charitable Bingo Operations Director – Texas Lottery Commission)

For 2.1

None received.

Against 2.1

None received.

STAFF RECOMMENDED ACTION

Adopt Recommendation 2.1.

ISSUE 3

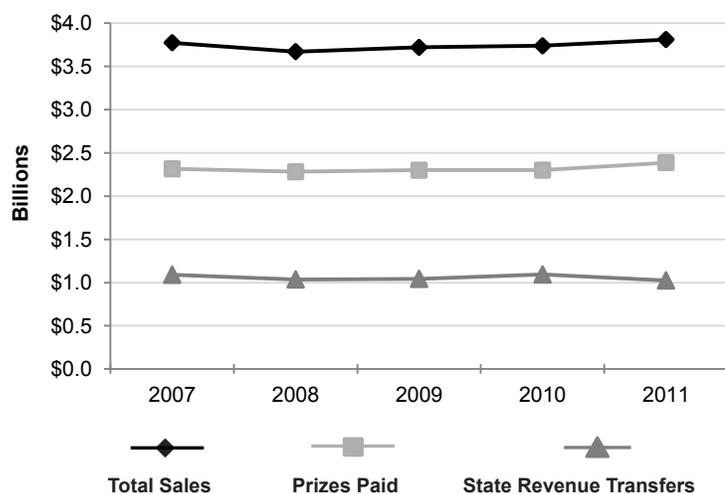
Regular Analysis and Reporting on the Effectiveness of Ongoing Lottery Strategies Would Improve Accountability and, Potentially, Revenues to the State.

Background

The Texas lottery exists to generate revenue for the State, and has been successful in doing so, raising more than \$19.2 billion for education and other state purposes since the first tickets were sold in 1992. In recent years, the lottery has produced about \$1 billion in state revenue each year, primarily for the Foundation School Fund. The chart, *Texas Lottery Performance*, depicts the lottery's total ticket sales, prizes paid, and state revenue transfers over the last five fiscal years. This information over the life of the lottery can be found in Chart 1, Appendix A.

The chart demonstrates the lottery's relatively flat overall sales and revenue transfers to the State in recent years. This trend is not unique to Texas, as many mature state lotteries began experiencing flat or declining lottery revenues in the last few years.¹ Estimates by Commission staff and the Comptroller of Public Accounts project a continuation of this stable revenue trend in upcoming years.² Many complex factors contribute to lottery performance, as described in more detail below.

**Texas Lottery Performance, 5-Year Trend
FYs 2007–2011**



Source: Texas Lottery Commission

Findings

The Legislature provides the Commission significant budget flexibility to fulfill its unique business role, placing more responsibility on the agency to ensure its own efficiency.

The lottery operates efficiently according to spending limits set by the Legislature, but comparisons with other states indicates potential opportunities for improvement. The Legislature appropriates funding to the lottery based on a not-to-exceed amount of 12 percent of estimated ticket sales each biennium.³ Statute and rider require that retailers receive between 5 and 5.5 percent of these sales for commissions and sales incentives.⁴ The remaining 6.5 to 7 percent covers the agency's administrative costs, including payments to the lottery operator and other contractors, as well as general

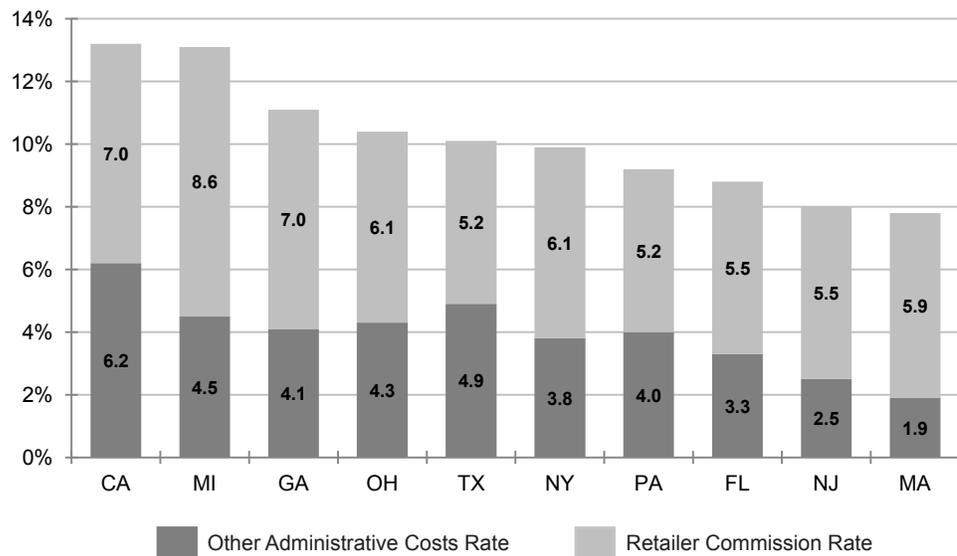
The lottery operates efficiently according to legislative spending caps, but comparisons with other states show opportunities for improvement.

overhead and operating costs. The agency has not recently been subject to General Revenue budget reductions like most state agencies because the General Revenue Dedicated-Lottery Account is not used to certify the State’s budget. However, the agency returns any unused administrative funds to the Foundation School Fund at the end of each fiscal year.

The agency has performed well when compared to the legislatively established limit of spending no more than 12 percent of sales on total administration (including retailer commissions). For many years, the agency’s overall expense rate has hovered around 10 percent of sales, with the agency’s administrative costs and retailer commissions split about equally at 5 percent of sales each. The agency returned \$13.35 million in unspent administrative funds to the Foundation School Fund in fiscal year 2011, which is fairly typical of returned funds over the last few years.

The legislative cap of 12 percent was based on the agency’s administrative expense rate in 1997, so may not be the best measure of overall efficiency. Sunset staff compared administrative expense rates of the top 10 grossing state lotteries, as shown in the chart, *Comparison of Administrative Expense Rates*.

**Comparison of Administrative Expense Rates
Top 10 State Lotteries – FY 2010**



Source: Teresa La Fleur et al., eds., *La Fleur’s 2011 World Lottery Almanac*, 19th ed. (Rockville: TLF Publications, Inc., 2011), pp. 265–272.

While the Texas lottery’s overall expense rate of 10 percent of sales is about average, other top grossing states generally spend more on retailer commissions and less on other administrative costs, the factor over which they have the greatest control. At 5 percent of total sales, the Texas lottery’s other administrative costs rate is higher than the average of 4 percent and higher than all states but California. States such as New Jersey and Florida have rates in the 2.5 to 3.3 percent range. Given the differences in state

lottery structures and other factors, the Texas lottery's administrative expense rate is not an extreme outlier when compared to other states, particularly since the Commission has had to use lottery revenue to subsidize bingo operations, as discussed in detail in Issue 4. Nevertheless, the comparison does indicate the potential for increased efficiency. Possible revenue gains from increased administrative efficiency are small compared to the overall revenue generated from lottery operations; however, a 1-percent improvement in administrative efficiency would translate to \$2 million in additional revenue for the Foundation School Fund, based on the agency's fiscal year 2011 lottery expenditures.

The Commission is missing an opportunity to better track factors affecting its performance and efficiency through consistent analysis, reporting, and goal setting.

Commission staff clearly monitor and understand the wide range of issues affecting the lottery's performance on an operational level, but the agency does not formally summarize or publicly present this information on a regular basis. Factors affecting lottery performance are varied and complex, making a simple set of measures for evaluating lottery performance challenging, but not impossible, to develop. Sunset staff examined lottery literature, in particular, the work of legislative oversight bodies in other states, and found several common factors useful in understanding lotteries, described in the textbox, *Evaluating Lottery Performance*. Specific information about the Texas lottery's performance in several of these areas, including comparisons to other states, is provided in Appendices A and B. Generally, this analysis shows the Texas lottery is a high performing lottery, but also reveals some factors helpful in understanding unique challenges faced in Texas and possible areas for improvement.

In the past, the agency has made significant efforts to produce detailed research regarding several of these factors, at the request of Commission members. However, this research is now five or more years old, and should be updated more regularly, instead of on an ad hoc basis. The agency has existing staff and access to vendor resources with specific expertise in topics such as market and demographic research, statistical analysis, advertising, national lottery trends, and product development. By better

Evaluating Lottery Performance

On the most basic level, lotteries should be evaluated on how much revenue they produce for government purposes. Factors affecting revenue generation include:

- the overall amount of lottery sales
- administrative expenses
- lottery products offered and design of games, including prize payout percentage

Evaluations of lottery operations typically examine the following more detailed factors:

Factors affecting sales:

- number and quality of lottery retailers
- amount and effectiveness of advertising
- lottery product mix offered
- design of prize payout and odds of lottery products
- player perceptions of lottery, including integrity and fairness of lottery systems and successful regulation of retailers
- other uncontrollable but important factors such as how frequently jackpot games "roll" and increase in size; weather events; and general economic issues such as available disposable income

Factors affecting administrative efficiency:

- retailer compensation and incentive programs
- negotiated rates for outsourced services
- standard agency overhead costs
- lottery-specific overhead costs such as drawings studios, security, and claim centers

coordinating this expertise, the agency could more consistently provide a high-level assessment of the lottery's performance.

Additionally, the Commission does not formally set and report on specific, measureable goals in several areas critical to the lottery's success. For example, the agency does not set specific revenue goals for itself, beyond the more conservative estimates developed for budget purposes, and does not set and report on specific goals for recruitment of additional lottery retailers. Performance measures developed during the biennial budget process are limited and do not reflect the dynamic, business-like environment in which the lottery operates. By comparison, the Florida lottery's *Long Range Program Plan* includes specific internal agency goals that go beyond basic projections, including revenue targets and administrative efficiency goals.⁵ While some specific goals should be developed in coordination with the lottery operator, the Commission is ultimately responsible for the successful operation of the lottery and setting its overall goals.

The Commission does not set formal revenue or retailer recruitment goals.

The agency has made great strides with a previous Sunset recommendation to produce a business plan, but the plan lacks the evaluation component envisioned in the original recommendation.

In 2002 and 2004, the Sunset Commission recommended the agency develop a comprehensive business plan to assess the overall performance and cost-effectiveness of the agency's major initiatives and programs.⁶ Even though the resulting bills did not pass and the recommendation was not put in law, the agency developed and implemented the plan on its own initiative. The Commission recently approved the third version of the plan developed since 2002. Overall, the business plan has become a valuable document, and the agency would benefit from having an ongoing statutory requirement to produce the plan as previously recommended by Sunset, so that future agency administrators continue to implement it.

The agency should also continue to improve and build upon the current business plan to meet the specific objectives set out in the previous Sunset recommendation. Currently, the plan describes the agency's challenges and opportunities in operating the lottery and regulating bingo, and outlines future initiatives the agency plans to undertake, similar to its strategic plan. However, the plan lacks the evaluation component envisioned in the previous Sunset recommendation. This evaluation was specifically aimed at providing a periodic review of the value of the agency's ongoing programs; whether programs are achieving stated objectives; and importantly, whether the programs are operating efficiently. Adding an evaluation of these elements, in addition to the goals, high-level performance information, and research described previously would distinguish the business plan from the strategic plan, improve the agency's accountability, and provide valuable information to Commission members and the public about factors affecting overall lottery performance.

Evaluation should include a periodic review of whether programs are achieving stated objectives and operating efficiently.

Recommendation

Change in Statute

3.1 Require the Lottery Commission to develop a comprehensive business plan including specific evaluations of, and goals tied to, efficiency and performance.

This recommendation would build upon the agency's current business plan and a previous Sunset recommendation aimed at evaluating, and ultimately improving, the agency's performance and cost-effectiveness. The agency should develop and update the plan according to an internally developed schedule approved by the Commission, and should provide information and updates regarding the plan's progress to the Commission in a public meeting at least annually. The recommendation would require the plan to set specific goals, evaluate the agency's overall performance, effectiveness of specific programs and initiatives, and ongoing efficiency of operations. The agency should dedicate existing resources to coordinate the plan's development and evaluation, and should consider specific factors described in the textbox on page 21, *Evaluating Lottery Performance*. While most critical for the agency's lottery operations, the plan should also include similar analysis and information, as applicable, regarding the agency's regulation of charitable bingo.

Fiscal Implication

The recommendation would not have a significant fiscal impact to the State, but enhanced agency efficiencies could result in incremental increases to Foundation School Fund revenue.

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¹ "Lackluster Lotteries," *State Legislatures*, September 2010, p. 6, accessed February 5, 2012, <http://www.ncsl.org/LinkClick.aspx?fileticket=Ut%2f9BGKv1E%3d&tabid=21074>.

² Texas Lottery Commission, *Legislative Appropriations Request for Fiscal Years 2012 and 2013*, August 30, 2010, p. 6.E.2. Texas Comptroller of Public Accounts, *Biennial Revenue Estimate: 2012–2013 Biennium*, January 2011, p. 20.

³ Section 466.355(b)(2), Texas Government Code.

⁴ Section 466.358(a), Texas Government Code; Rider 10, page VII-12, Article VII (H.B. 1), Acts of the 82nd Legislature, Regular Session, 2011 (the General Appropriations Act).

⁵ Florida Lottery, *Long Range Program Plan Fiscal Years 2012–13 through 2016–17*, September 30, 2011, accessed February 5, 2012, <http://floridafiscalportal.state.fl.us/PDFDoc.aspx?ID=3464>.

⁶ Sunset Advisory Commission, *Texas Lottery Commission*, Staff Report (April 2004), p. 22; Sunset Advisory Commission, *Texas Lottery Commission*, Staff Report (August 2002), p. 25.

RESPONSES TO ISSUE 3

Recommendation 3.1

Require the Lottery Commission to develop a comprehensive business plan including specific evaluations of, and goals tied to, efficiency and performance.

Agency Response to 3.1

The agency agrees with all the recommendations contained in the Sunset Staff Report. (Gary Grief, Executive Director and Phil Sanderson, Charitable Bingo Operations Director – Texas Lottery Commission)

For 3.1

None received.

Against 3.1

None received.

Modification

1. Operate the lottery with a lower administrative cost and higher retailer commission. (Doug DuBois, Jr., Director of Member Services and Governmental Affairs – Texas Food and Fuel Association, Austin)

Staff Comment: The testimony did not provide sufficient detail to draft specific language to implement this recommendation. Currently, lottery retailers receive a 5-percent commission on lottery sales.

STAFF RECOMMENDED ACTION

Adopt Recommendation 3.1.

ISSUE 4

Inadequate Funding and Inefficiencies in Its Auditing and Inspection Process Severely Limit the Agency's Ability to Regulate Bingo.

Background

To monitor bingo licensees' compliance with bingo statute and rules, the Charitable Bingo Operations Division (Division) of the Texas Lottery Commission (Commission) performs financial audits, bingo game inspections, and bingo equipment testing. The Division initiates audits if a licensee presents a high risk of financial harm according to the Division's audit risk analysis, if the Division receives an outside complaint about the licensee, if the Division discovers a major violation during an inspection, or if the licensee self-reports a financial problem. The Division performs inspections of bingo halls to ensure licensees are conducting bingo fairly, and checks for requirements such as collecting the correct amount of bingo prize fees. In fiscal year 2011, the Division completed 24 compliance audits and 369 game inspections.

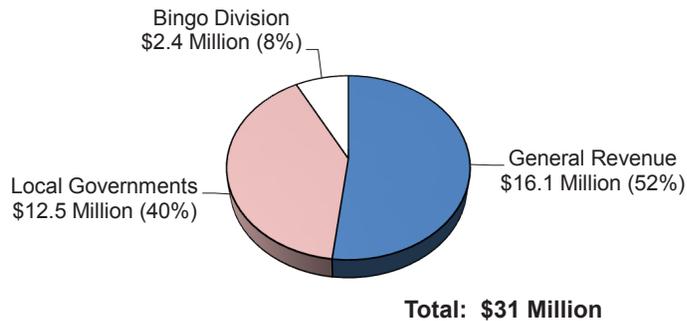
State law requires the Division to be self-supporting, meaning that the revenue the agency collects from the bingo industry should cover all Division expenditures.¹ To participate in the bingo industry, all bingo licensees pay licensing fees as shown in the table, *Bingo License Fees*. Bingo players also pay a 5-percent fee on bingo prizes, which provides an equal share of revenue to the State and to local governments that have authorized bingo. In addition, bingo lessors pay a 3-percent tax on rental payments they receive. These fees and tax have not been adjusted for more than 20 years. In fiscal year 2011, the Division collected \$3.1 million in licensing fees, \$26.7 million in prize fees, and \$1.2 million in rental tax. To understand how the bingo revenue is used, please see the chart *Where Bingo State Revenue Goes* on the following page.

***Bingo License Fees
FY 2011***

Type of License	Fee Amount	Number
Bingo Conductor License (includes one and two-year licenses)	\$100 – \$2,500	1,140
Bingo Lessor License (includes one and two-year licenses)	\$100 – \$2,500	400
Bingo Equipment Manufacturer License	\$3,000	17
Bingo Equipment Distributor License	\$1,000	15
License Amendment (all license types)	\$10	689
Temporary License to Conduct Bingo	\$25	7,254

For the 2012–2013 biennium, the Legislature reduced the Bingo Division's budget by 26 percent compared to 2010–2011 appropriations, most of which came out of the Division's budget for auditing. As a result, the Division's staff has fallen from 47 authorized positions in fiscal year 2011 to 33 positions now, including the elimination of almost half of its 18 non-managerial audit positions.

**Where Bingo State Revenue Goes
FY 2011**



Findings

The State has an interest in regulating charitable bingo to protect bingo players, charities, and public funds from fraud.

The State regulates charitable bingo with the intent to ensure fair conduct of bingo games, oversee the proper distribution of proceeds to charities, and enforce the collection and distribution of state and local bingo revenues. In calendar year 2010, charitable bingo brought in a record \$699 million in gross receipts, with \$34 million going to charities, more than \$18 million going to the State, and \$12.2 million going to local governments. Without state oversight, bingo games, which operate on a cash basis, would be more susceptible to theft and fraud, and the State would be vulnerable to financial loss of state bingo revenues. In addition, continuing to regulate charitable bingo fulfills the intent of the Texas Constitution, which only authorizes bingo for charitable purposes, and continues the efforts of the Legislature over the years to restrict commercial interests' involvement in the industry.

Without state oversight, bingo games, which operate on a cash basis, would be more susceptible to theft and fraud.

The Division does not receive sufficient revenue to cover the cost of regulating bingo.

- **License fee revenue not appropriated for bingo regulation.** Bingo license fees generate more revenue than the agency receives for bingo regulation. In fiscal year 2011, the Division collected \$3.1 million in license fees and spent \$2.4 million in appropriated funds for bingo regulation, after budget cuts. This situation is certainly not unique to bingo regulation. Many licensing programs collect more revenue than is appropriated to cover the costs of regulation. For bingo, however, the loss of such funding can affect more than just the quality of regulation, though that effect can be severe. The resulting lack of oversight can create opportunities for fraud, and can potentially affect the amount of money for charitable distributions and the collection of prize fee revenues for the State and local governments.

- **Appropriations bill pattern compounds the impact of budget cuts.** Across-the-board budget cuts have been applied to the total appropriation for bingo, including the pass through of bingo prize fees to local governments, magnifying the impact on the Division. These pass-through prize fees comprise more than 80 percent of the Division's appropriation and are guaranteed in statute and rider to be fully paid to local governments.² As a result, the cost of the entire budget cut had to be absorbed in the remaining 20 percent for bingo operations. This action reduced funding for the Bingo Division by more than \$750,000 annually for the 2012–2013 biennium. Had the cuts been based on the Division's operational costs, they would have been approximately \$130,000 annually.
- **Lottery program subsidy of bingo regulation.** Since 2003, the Commission has had to use the State's lottery revenue to subsidize bingo operations because appropriations have not covered direct and indirect administrative costs. The Commission determined in 2008 that this subsidy amounted to about \$1.47 million annually.³ The agency has sought direction from the Legislature regarding the practice and has sought to increase bingo fees to pay these extra costs, but no specific action has been taken and the subsidy continues.⁴ Out of a \$191 million annual budget for running the lottery, \$1.47 million may not seem significant, but this is money that could go to the Foundation School Fund. For this reason, the Bingo Division should improve its accounting for all direct and indirect costs of regulation on a regular basis. Regularly accounting for all these costs in a formal way would highlight activities and functions that have not been accounted for in the Division's fee setting, and give the Legislature a more accurate estimate of the costs of bingo regulation for appropriations purposes.
- **Bingo licensing fees inadequate for regulatory needs.** Despite the fact that bingo appropriations have not reflected revenue from bingo license fees, these fee levels are still too low to meet regulatory needs. Most of the fees for bingo licensees are set at minimum levels in statute, allowing the Division to increase fees to raise revenue as needs dictate and subject to legislative appropriation. The Division has increased fees temporarily in the past to address special needs, but generally imposes the same fees on most licensees today as in the earliest days of bingo in Texas. In the 2011 session, the Legislature approved a one-time appropriation, contingent on a temporary fee increase, to pay for needed enhancements to the Division's aging computer system, but the Commission withdrew the fee increase after protests by bingo licensees.

As above, this situation also is not unique to bingo regulation. Regulatory programs are commonly financed by fees assessed against the same individuals or entities who stand to be most affected by those regulatory programs. The bargain works when the regulated community understands its obligation to pay fees sufficient to fund regulations to adequately

The Commission subsidizes bingo regulation with more than \$1.47 million in funds that would otherwise go to public education.

The Commission has not increased bingo license fees for more than 20 years.

police the industry. The oil and gas industry most recently endorsed such an approach to increase its own fees to end a longtime dependence on General Revenue funding. This fee increase occurred despite claims that the industry paid for its regulatory costs through severance taxes deposited into General Revenue. That those claims received little traction during the legislative consideration of oil and gas fee increases should also help settle any claim that bingo regulatory costs are already covered by revenues to the State and local governments from prize fees paid by bingo winners. The approach to paying for regulation in Texas is clear — that licensees have an obligation to pay adequate fees for the state machinery that polices and legitimizes them.

Another consideration in any discussion about fee levels for bingo licensees is the possible impact on charitable distributions. An increase in fees will likely cause a reduction in funding for charities after all other allowable expenses have been deducted from gross revenues. However, the adequacy of the bingo industry's regulatory programs to ensure the integrity of the games should be at least as important — and certainly less expensive — as other allowable expenses for facility rentals or compensation and health care benefits for bingo hall employees. The latest such expense, for lobbying costs for charitable bingo interests, is currently being litigated.

Licensees should pay adequate fees for the state machinery that polices and legitimizes them.

- **Other bingo regulatory activities lack full cost recovery.** The Bingo Act does not provide the opportunity for the Division to collect fees to cover its costs for administering bingo license amendments and maintaining the registry of bingo workers.

Bingo license amendment fee. To make a change to a license, such as altering the bingo playing time, bingo location, or transferring a license, a bingo licensee must pay a fixed \$10 license amendment fee set in statute.⁵ However, this fee does not cover the average cost of performing license amendments. In fiscal year 2011, the agency processed 689 license amendments in an average of about seven days per amendment. As a standard, the Legislature has generally given licensing agencies flexibility to set licensing fees at levels necessary to cover costs by removing fixed fee amounts and caps in statute. The appropriations process controls the funding the agency ultimately receives, and thus dampens any agency incentive to raise fees too high.

Bingo worker registry fee. Statute requires that all bingo hall workers, such as bookkeepers, managers, and cashiers, register with the Commission and be listed on the Registry of Approved Bingo Workers, which currently has 16,703 workers. Bingo workers may remain on this list for three years before they must renew. As part of the application process, the Division performs background checks to verify that applicants do not have a criminal history that would make

them ineligible, and then issues an identification card if approved. Although statute gives the Commission authority to charge a fee for the identification card, the agency has never done so. Statute does not give clear authority for the Commission to charge a fee to cover the costs of actually processing original or renewal applications for the worker registry. By comparison, the Racing Commission has authority to charge fees for background checks of persons involved in racing events such as clerks and maintenance staff.⁶

The lack of a targeted approach harms the Bingo Division's audit and inspection process.

Due to budget cuts, the Division expects to complete fewer audits in fiscal years 2012 and 2013 than originally projected. The Division previously expected to complete 58 audits in fiscal year 2012, but now the Division expects to conduct 40 audits, less than 3 percent of the regulated community. Despite this low percentage, the Division does not set a goal to audit the highest-risk licensees within a certain time period to better target scarce resources. In comparison, the Texas Comptroller's Audit Division does not have the resources to audit all permitted sales tax payers under its jurisdiction, but it does have a goal of auditing the highest-risk sales tax payers every four years. To provide more transparency to licensees, the Division should perform its current risk analysis to set a goal to audit all the highest-risk licensees.

Although the Division plans to inspect every bingo hall within three to four years, it does not select bingo halls using risk-based analysis. The Division conducted 369 bingo hall inspections in fiscal year 2011, and set a target of 450 inspections for fiscal year 2012, adjusted to 360 after budget cuts. The Division is limited in how many inspections it can conduct because it has only one inspector. Prioritizing inspections based on risk is a standard procedure many state agencies use, and would allow the Division to focus scarce resources on the highest-risk bingo halls.

The agency has no risk-based process for inspecting bingo halls.

Recommendations

Change in Appropriations

4.1 The House Appropriations and Senate Finance Committees should consider removing bingo prize fees from the agency's bill pattern.

This recommendation expresses the will of the Sunset Commission that the House Appropriations and Senate Finance Committees consider separating bingo prize fees from the Lottery Commission's bill pattern so that these fees will not be used to calculate budget cuts for bingo regulation in the future. Prize fees would continue to be appropriated to local governments through rider. The recommendation would help ensure that future budget cuts to the agency are based on actual agency costs and not pass-through funds over which it has no control.

Change in Statute

4.2 Remove the fixed license amendment fee from statute, and require the Commission to adjust fees by rule.

This recommendation would give the agency flexibility to adjust the license amendment fee to cover costs. The Commission would also determine whether to vary the fee depending on the complexity of the amendment, and set any new fee levels in rule. For instance, transferring a license may require a background check and involve more work than simply changing the bingo playing time. The public would have the opportunity to comment on proposed fees through the rulemaking process. The recommendation would allow the agency to more quickly adjust to the changing costs of license amendments and provide licensees with more timely service.

4.3 Authorize the agency to charge a fee to cover the costs of adding bingo hall workers to the Registry of Approved Bingo Workers.

The Commission should evaluate the fee level necessary to cover the costs of processing worker registry applications and renewals, and put the fee in rule. Included in the fee would be the cost of a criminal background check, the identification card, processing the application fee, and any other administrative costs deemed appropriate by the Commission. Bingo workers would only pay the fee for new original applications or upon renewal every three years. As with any rulemaking, the Commission would account for stakeholder input when setting the fee level. This recommendation would allow the agency to stop diverting much needed resources from other regulatory functions also meant to protect the public.

4.4 Require the agency to use risk analysis to select licensees for bingo inspections, and put its inspection policies in rule.

The agency should implement a plan to inspect the highest-risk bingo halls first. The Commission would evaluate risk according to different factors, such as high sales, compliance history, time since last inspection, and other factors the Commission considers important, and then rank licensees by highest risk. On a regular basis, factors could be adjusted as necessary to make the risk plan more effective. This recommendation would also direct the Commission to put its bingo inspection policy in rule to make the process more transparent to licensees and the public. The recommendation would help the agency more quickly monitor the highest-risk licensees and better allocate scarce resources.

4.5 Require the Commission to develop a goal to audit all the highest-risk bingo licensees within a certain timeframe, and put its audit policies in rule.

The recommendation would require the Bingo Division to use its audit risk analysis to determine the highest-risk licensees, set a reasonable goal for auditing them within a specific timeframe, and report this goal to the Commission. A reasonable audit goal would account for limited Division resources, be actually attainable within five years or less, and be updated annually based on the latest risk analysis. The recommendation does not expect the agency to audit all bingo licensees within a set amount of time, but only a subset made up of the highest-risk licensees. The Commission also would describe its audit policy in rule to inform licensees and the public of the agency's efforts to ensure compliance.

Management Action

4.6 The Commission should reassess the full cost of bingo regulation and seek to adjust license fees and its legislative appropriations request accordingly.

This recommendation would direct the Commission to reassess its expenses for bingo regulation to account for direct and indirect expenses for bingo regulation and the cost of any support services provided by another division of the agency to the Bingo Division. The agency would use this information to set bingo license fees and to report bingo regulatory costs in the agency's Legislative Appropriations Request. On a regular basis, the Commission should analyze each bingo license fee, including those authorized in this report, to determine the full cost of regulation, and adjust each fee level in rule as necessary. In determining any new fee levels, the Commission should take into account input from stakeholders to ensure transparency and fairness to licensees and the public. This recommendation assumes that any extra revenue from license fees would be appropriated back to the agency to cover costs. Providing adequate funding ensures that the agency can effectively regulate the bingo industry and places less strain on lottery revenues.

Fiscal Implication

These recommendations should have a positive fiscal impact to the State. Authorizing the agency to adjust its license amendment fee could lead to a gain in General Revenue of \$10,000 annually, and charging a fee for applications to be listed on the worker registry could result in a gain to General Revenue of \$140,000 annually. These estimates are based on charging a theoretical \$25 fee for both fee types, but the Commission would determine the actual amount. The agency would also collect more revenue by adjusting existing license fees to better reflect the cost of regulating bingo, including costs currently subsidized by the lottery. Adjusting fees to recover the estimated \$1.47 million subsidized by lottery funds would result in a gain to General Revenue to pay for bingo regulation and the deposit of an equal amount in the Foundation School Fund. Implementing a risk analysis for bingo inspections, and putting the inspection and audit policies in rule could be accomplished within the agency's current budget.

Texas Lottery Commission

Fiscal Year	Gain to Foundation School Fund
2014	\$1,470,000
2015	\$1,470,000
2016	\$1,470,000
2017	\$1,470,000
2018	\$1,470,000

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¹ Sections 2001.104(a), 2001.158(a), 2001.205(b), 2001.209(b), Texas Occupations Code.

² Section 2001.503, Texas Occupations Code; Rider 9, page VII-12, Article VII (H.B. 1), Acts of the 82nd Legislature, Regular Session, 2011 (the General Appropriations Act).

³ Transcript of Proceedings before the Texas Lottery Commission (August 20, 2008), p. 119, accessed February 6, 2012, <http://www.txlottery.org/export/sites/lottery/Documents/legal/meetings/tlc082008.txt>.

⁴ Transcript of Proceedings before the Texas Lottery Commission (June 13, 2011), p. 113, accessed February 6, 2012, <http://www.txlottery.org/export/sites/lottery/Documents/legal/meetings/2011/06-13-2011.txt>.

⁵ The Legislature reduced the fee from \$25 to \$10 in 1999.

⁶ Section 7.05, Texas Racing Act, Art. 179e, Vernon's Texas Civil Statutes.

RESPONSES TO ISSUE 4

Recommendation 4.1

The House Appropriations and Senate Finance Committees should consider removing bingo prize fees from the agency's bill pattern.

Agency Response to 4.1

The agency agrees with all the recommendations contained in the Sunset Staff Report. (Gary Grief, Executive Director and Phil Sanderson, Charitable Bingo Operations Director – Texas Lottery Commission)

For 4.1

None received.

Against 4.1

None received.

Recommendation 4.2

Remove the fixed license amendment fee from statute, and require the Commission to adjust fees by rule.

Agency Response to 4.2

The agency agrees with all the recommendations contained in the Sunset Staff Report. (Gary Grief, Executive Director and Phil Sanderson, Charitable Bingo Operations Director – Texas Lottery Commission)

For 4.2

None received.

Against 4.2

Stephen Fenoglio, Attorney – VFW of Texas and River City Bingo, Austin

Recommendation 4.3

Authorize the agency to charge a fee to cover the costs of adding bingo hall workers to the Registry of Approved Bingo Workers.

Agency Response to 4.3

The agency agrees with all the recommendations contained in the Sunset Staff Report. (Gary Grief, Executive Director and Phil Sanderson, Charitable Bingo Operations Director – Texas Lottery Commission)

For 4.3

None received.

Against 4.3

Stephen Fenoglio, Attorney – VFW of Texas and River City Bingo, Austin

Recommendation 4.4

Require the agency to use risk analysis to select licensees for bingo inspections, and put its inspection policies in rule.

Agency Response to 4.4

The agency agrees with all the recommendations contained in the Sunset Staff Report. (Gary Grief, Executive Director and Phil Sanderson, Charitable Bingo Operations Director – Texas Lottery Commission)

For 4.4

None received.

Against 4.4

None received.

Recommendation 4.5

Require the Commission to develop a goal to audit all the highest-risk bingo licensees within a certain timeframe, and put its audit policies in rule.

Agency Response to 4.5

The agency agrees with all the recommendations contained in the Sunset Staff Report. (Gary Grief, Executive Director and Phil Sanderson, Charitable Bingo Operations Director – Texas Lottery Commission)

For 4.5

None received.

Against 4.5

None received.

Recommendation 4.6

The Commission should reassess the full cost of bingo regulation and seek to adjust license fees and its legislative appropriations request accordingly.

Agency Response to 4.6

The agency agrees with all the recommendations contained in the Sunset Staff Report. (Gary Grief, Executive Director and Phil Sanderson, Charitable Bingo Operations Director – Texas Lottery Commission)

For 4.6

None received.

Against 4.6

None received.

STAFF RECOMMENDED ACTION

Adopt Recommendations 4.1 through 4.6.

ISSUE 5

Elements of the Bingo Enabling Act Do Not Conform to Commonly Applied Licensing Practices.

Background

The Bingo Enabling Act authorizes the Charitable Bingo Operations Division (Division) of the Texas Lottery Commission (Commission) to regulate the bingo industry through licensing and enforcement activities. Individuals and entities involved in conducting games, leasing premises, manufacturing and distributing game materials, and actually staffing the games must obtain a license or registration from the Division. Generally, applicants must satisfy a criminal background check and meet other requirements depending on the license type. For example, conductors must also provide proof of federal nonprofit status and manufacturers must post a bond with the agency. Currently, the Division oversees 1,140 conductors, 400 commercial lessors, 17 manufacturers, 15 distributors, and 16,703 individuals on the Registry of Approved Bingo Workers. Bingo licensees that violate the Bingo Enabling Act or agency rules face enforcement actions from the agency, including administrative penalties and license revocation.

Sunset Commission staff has observed and documented common licensing practices during more than 30 years of experience and compiled them into a set of licensing and regulatory standards. The findings below compare these licensing standards with select portions of the bingo statute in an effort to make the statute more consistent with common licensing practices.

Findings

The Bingo Enabling Act contains licensing provisions that do not follow model licensing practices, limiting the fair treatment of licensees and public protection.

- **Application of criminal history requirements.** As a general standard, statute requires most licensing agencies that conduct criminal background checks to determine which crimes should disqualify a person from licensure. Chapter 53 of the Occupations Code provides general guidance for making such a determination that includes ensuring that an offense relates to the duties and responsibilities of the licensed occupation.¹ To comply with this law, an agency must develop guidelines for applying this standard, publish them in the Texas Register, and use them when denying, suspending, or revoking a license.²

Although the Bingo Enabling Act describes circumstances in which criminal history can disqualify a bingo licensee from being licensed or a bingo worker from being registered, it does not ensure that the crime relates to the actual activity being regulated. The Bingo Act requires the Commission to deny, suspend, or revoke a license or bingo worker registration if the licensed or registered person has been convicted of a

The Bingo Enabling Act does not ensure that disqualifying criminal convictions relate to the regulated activity.

Tracking two-year licenses paid for annually increases the agency's administrative burden.

felony, criminal fraud, gambling or a gambling-related offense, or a crime of moral turpitude within the last ten years.³ The Act also provides for disqualifying corporations and other businesses from being licensed if persons convicted of a crime or their close relative have financial interests in that business. This language, however, does not reflect the State's standard approach for applying criminal history information, which is to target the offense, including cases of deferred adjudication, to the activity being licensed. Requiring the Commission to follow Chapter 53 provisions would help the agency focus on those behaviors that pose a threat to the bingo industry or public.

- **Standard renewal process.** A licensing agency should have a renewal process that ensures continued competence of licensees before renewing a license. Currently, bingo conductors and lessors may renew licenses by generally meeting the same requirements as for license issuance.⁴ However, statute does not specifically provide for license renewal by bingo manufacturers and distributors. Also, agency rules do not adequately describe the renewal process for any type of bingo license, potentially hindering licensees' and the public's ability to understand those processes.

Two-year licenses. Licensing agencies may provide two-year licenses as a way to lower administrative costs because the licensees do not have to renew every year. Agencies providing two-year licenses typically charge double the license fee up front. However, the Bingo Act gives bingo conductors and lessors the choice of an annual or a two-year license and allows those opting for a two-year license the choice of paying the total licensing fee up front or annually. This arrangement appears to be unique among licensing agencies in the state and essentially defeats the purpose of the two-year license. In addition, agency staff have noted that tracking annual two-year license fees increases the administrative burden on the Division.

The Commission does not have the flexibility to adjust manufacturer and distributor license fees to cover costs.

Statute also requires the Commission to charge bingo manufacturers and distributors an extra \$1,000 fee for two-year licenses.⁵ The fee has no apparent regulatory purpose and is an unfair financial burden. Statute had required an extra \$25 fee to be paid by conductors and commercial lessors who opted for two-year licenses, but that extra charge was removed by the Legislature in 2009.⁶ In fiscal year 2011, nine manufacturers and distributors had a two-year license.

- **Authority to set fees.** Over time, the Legislature has removed many fixed fees and fee caps in statute to give agencies flexibility to set fee levels in rule to cover the costs of regulation. In these cases, the Legislature's appropriation authority serves to ensure fee levels are not set too high. In contrast, the Bingo Act sets annual license fees for bingo manufacturers at \$3,000 and distributors at \$1,000, limiting the agency's ability to adjust fee levels as needs change.

The Bingo Enabling Act does not contain standard enforcement provisions that could strengthen the agency’s ability to provide consistent regulation, protect the public, and safeguard state revenue.

- **Complaint policy and procedures.** Licensing agencies should follow clear policies and procedures describing all phases of the complaint process, including receipt, investigation, and resolution. Complaints could include external sources such as the public, or internal sources such as alleged violations arising from audits or inspections. Although Sunset Commission recommendations in 2002 and 2004 to require the agency to adopt a complaint process were not enacted by the Legislature, the agency has made a strong effort to implement them.⁷ For example, it has posted a complaint form on its charitable bingo website, developed the Compliance Activity Monitoring Process (CAMP) database to track complaints, developed internal complaint procedures, and established a process for conducting regular meetings among high-level staff to discuss complaint issues. However, the Bingo Act, agency rules, and other public information, such as the Division’s website, continue to lack basic provisions related to the agency’s complaint procedures.

Licensing agencies should track, analyze, and report the sources and types of complaints and the results of investigations. The agency has made much progress in this area, but the CAMP system still lacks the capability to produce reports showing the resolution of complaints by the type of allegation. For example, the Division had a difficult time compiling the number and resolution of bingo complaints arising from all types of regulatory activities, such as audits and licensing activities, because they are tracked in several different databases. The agency also does not report statistics about complaints received and resolved each year, limiting the public’s ability to assess the agency’s enforcement performance. Licensing agencies benefit from this data because it helps them judge whether their enforcement actions are appropriate and consistent, and allows them to identify problems and trends to target regulation.

The agency is unable to produce reports about the resolution of bingo complaints by allegation type.

- **Hearings at the State Office of Administrative Hearings.** Statute requires many state agencies to use the State Office of Administrative Hearings (SOAH) for their hearings to ensure independence and professionalism. Although the Commission currently uses SOAH to conduct all of its bingo hearings, the Bingo Act does not require it. Clearly specifying that the Division use SOAH would keep the bingo hearings process independent of the agency’s other enforcement functions and keep the process fair for licensees.
- **Full range of sanctions.** An agency should have a full range of sanctions to ensure it has enough authority to match the punishment to the violation. A full range of sanctions would include revocation or suspension of a license, denial of license renewal, probation of a suspended

license, administrative penalty, and reprimand. Although the Bingo Division has authority to suspend a license, it does not typically use this authority because it could affect other charities' ability to conduct bingo. For example, suspending a conductor/lessor that leases its property to other charities would force those charities to stop doing business during the length of the suspension. Instead, the Division is forced to revoke a license or take some other action in cases when a suspension could be more appropriate. If the Commission had authority to place a suspended license on probation, the licensee could continue to practice, but with certain restrictions aimed at addressing the violation or other deficiency of the licensee, thereby protecting the State.

The agency does not have clear authority to temporarily suspend a license to prevent financial loss to the State.

- **Schedule of sanctions.** Licensing agencies should use a schedule of sanctions to establish appropriate actions for specific violations of law or rule. Although the 2002 and 2004 Sunset reviews recommended that the Lottery Commission adopt rules to provide guidance in assessing administrative penalties against bingo licensees, the bills did not pass.⁸ Since that time, the agency has adopted a schedule in rule on its own initiative describing when it will apply a warning or administrative penalty for certain common types of bingo violations. However, the schedule does not detail the circumstances when the agency will revoke, suspend, or refuse to renew a license. Providing a full schedule of sanctions would help ensure fair and consistent treatment of all violators.
- **Temporary suspension.** Generally, licensing agencies have temporary suspension power for activities that can result in substantial and immediate harm to the public. The Commission currently has this authority for cases threatening the health, safety, morals, or welfare of the public. However, this authority does not clearly allow the agency to temporarily suspend a license to prevent financial loss to the State if a licensee fails to remit the required quarterly taxes or prize fees. Granting the agency this authority would strengthen its ability to protect the State's interests.

Recommendations

Change in Statute

5.1 Require the Commission to address felony and misdemeanor convictions according to established standards in the Occupations Code.

This recommendation would require the Commission to adopt guidelines on applying Chapter 53 of the Occupations Code when using criminal history information in bingo licensing and worker registry decisions. This change would ensure that the agency follows the State's guidelines to evaluate the offense as it relates to the responsibilities of the license, whether the person has been convicted of a felony or received deferred adjudication. In so doing, it would also ensure that enforcement of criminal history requirements is appropriate for each type of bingo license or registration.

The recommendation would not remove more specific provisions currently in the Bingo Act disqualifying persons convicted of criminal fraud, gambling, or gambling-related offenses. It also would not affect

provisions currently in law disqualifying corporations and other businesses from being licensed if persons convicted of a crime or their close relative have financial interests in that business.

5.2 Require the agency to create a standard bingo license renewal process, and remove the nonstandard provisions for two-year bingo license fees.

This recommendation would add renewal criteria for manufacturers and distributors reflecting the requirements for initial licensure, similar to the way statute currently lists renewal criteria for bingo conductors and lessors. The recommendation would also require the Commission to document through rule its renewal process for all bingo licenses from submission to completion. These guidelines in rule would provide notice, maintain consistency, and designate standard renewal practices.

This recommendation would also remove from statute the ability of bingo conductors and lessors who opt for a two-year license to pay the renewal fee annually. These licensees would still be able to opt for a one-year license, as is currently provided in law. The recommendation would also remove the extra fee that manufacturers and distributors pay for a two-year license. This recommendation would help make the license renewal process fairer for all license types.

5.3 Remove the statutory fee levels for bingo manufacturer and distributor licenses.

This recommendation would amend the Bingo Act to remove the fixed fees for bingo manufacturer and distributor licenses, and instead require the Commission to set fees at levels necessary to cover the costs of bingo regulation. The Commission would be required to put fee levels in rule, allowing stakeholders the opportunity to provide feedback through the rulemaking process. The Legislature's oversight of the agency's spending levels through the appropriations process would ensure the Commission's actions stay within reasonable bounds.

5.4 Require the Commission to develop complaint procedures, track, analyze, and report complaints, and provide more information to bingo licensees.

Under this recommendation, the Commission would be required to adopt rules describing policies for all phases of the complaint process, including complaint receipt, investigation, and resolution. The recommendation would allow the public and bingo licensees to better understand the Commission's role in the complaint process, how to file a complaint, and what to expect after a complaint is filed.

The recommendation would also require the agency to analyze complaint information to identify trends and issues, report on these trends to the public, and adjust bingo regulation accordingly. The agency's analysis should include tracking complaints by the type of violation from initiation to resolution, evaluating the performance of the enforcement process, and any other information the agency believes is necessary. A standard, Across-the-Board recommendation in Issue 7 of this report complements this recommendation by requiring the Commission to maintain documentation on complaints.

5.5 Conform the Bingo Act to the Commission's current practice of conducting hearings through the State Office of Administrative Hearings.

This recommendation would require the Commission to use SOAH for all bingo-related hearings, and would repeal current provisions that allow the Bingo Division to use an agency-appointed hearings examiner. The Commission would continue to hold final authority to accept, reverse, or modify a proposal for decision made by a SOAH judge, as is standard in the Administrative Procedure

Act.⁹ This recommendation would ensure that the Commission continues to benefit from SOAH's consistent standard of independence and professionalism.

5.6 Authorize the Commission to place suspended bingo licensees and registered workers on probation.

This recommendation would allow the Commission to use probation of a suspended license or registration as a sanction. The Commission would put probation procedures in rule, including how it will impose appropriate conditions, notify those on probation of necessary actions to meet those conditions, and track their progress. With this authority, the agency would have a full range of sanctions, giving it greater leeway to tailor enforcement actions to the severity of the violation.

5.7 Require the Commission to amend its current penalty schedule to include a full range of sanctions.

The agency would develop a schedule of sanctions to include revocation, suspension, and denial of license renewal, in addition to the sanctions currently addressed in the agency's bingo penalty schedule. The Commission would need to develop clear policies to guide its staff in any deviations from this schedule for mitigating factors. The public and bingo licensees would have the opportunity to participate in development of the schedule through the rulemaking process.

5.8 Expand the Lottery Commission's authority to temporarily suspend bingo licenses to prevent financial losses to the State.

This recommendation would amend the Bingo Act to give the agency authority to temporarily suspend a bingo license to prevent financial loss to the State, such as when a licensee fails to remit quarterly taxes or prize fee payments to the agency. The Commission would identify in rule the circumstances in which it would use this new authority, including in its schedule of sanctions, as recommended above.

Fiscal Implication

These recommendations would not result in a significant fiscal impact to the State. Recommendation 5.2 would result in a loss of about \$4,500 annually to the General Revenue Fund from the elimination of the extra fee charged to manufacturers and distributors for two-year licenses.

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¹ Section 53.021(a)(1), Texas Occupations Code.

² Section 53.025, Texas Occupations Code.

³ Section 2001.313(e)(1), Texas Occupations Code.

⁴ Sections 105(a) and 159(a), Texas Occupations Code.

⁵ Section 214(b), Texas Occupations Code.

⁶ H.B. 1474, 81st Texas Legislature, Regular Session, 2009.

⁷ Sunset Advisory Commission, *Texas Lottery Commission*, Staff Report (August 2002), p. 51; Sunset Advisory Commission, *Texas Lottery Commission*, Staff Report (April 2004), p. 36.

⁸ Sunset Advisory Commission, *Texas Lottery Commission*, Staff Report (August 2002), p. 51; Sunset Advisory Commission, *Texas Lottery Commission*, Staff Report (April 2004), p. 37.

⁹ Section 2001.058(e), Texas Government Code.

RESPONSES TO ISSUE 5

Recommendation 5.1

Require the Commission to address felony and misdemeanor convictions according to established standards in the Occupations Code.

Agency Response to 5.1

The agency agrees with all the recommendations contained in the Sunset Staff Report. (Gary Grief, Executive Director and Phil Sanderson, Charitable Bingo Operations Director – Texas Lottery Commission)

For 5.1

None received.

Against 5.1

Stephen Fenoglio, Attorney – VFW of Texas and River City Bingo, Austin

Recommendation 5.2

Require the agency to create a standard bingo license renewal process, and remove the nonstandard provisions for two-year bingo license fees.

Agency Response to 5.2

The agency agrees with all the recommendations contained in the Sunset Staff Report. (Gary Grief, Executive Director and Phil Sanderson, Charitable Bingo Operations Director – Texas Lottery Commission)

For 5.2

None received.

Against 5.2

None received.

Recommendation 5.3

Remove the statutory fee levels for bingo manufacturer and distributor licenses.

Agency Response to 5.3

The agency agrees with all the recommendations contained in the Sunset Staff Report. (Gary Grief, Executive Director and Phil Sanderson, Charitable Bingo Operations Director – Texas Lottery Commission)

For 5.3

None received.

Against 5.3

None received.

Recommendation 5.4

Require the Commission to develop complaint procedures, track, analyze, and report complaints, and provide more information to bingo licensees.

Agency Response to 5.4

The agency agrees with all the recommendations contained in the Sunset Staff Report. (Gary Grief, Executive Director and Phil Sanderson, Charitable Bingo Operations Director – Texas Lottery Commission)

For 5.4

None received.

Against 5.4

None received.

Recommendation 5.5

Conform the Bingo Act to the Commission's current practice of conducting hearings through the State Office of Administrative Hearings.

Agency Response to 5.5

The agency agrees with all the recommendations contained in the Sunset Staff Report. (Gary Grief, Executive Director and Phil Sanderson, Charitable Bingo Operations Director – Texas Lottery Commission)

For 5.5

None received.

Against 5.5

None received.

Recommendation 5.6

Authorize the Commission to place suspended bingo licensees and registered workers on probation.

Agency Response to 5.6

The agency agrees with all the recommendations contained in the Sunset Staff Report. (Gary Grief, Executive Director and Phil Sanderson, Charitable Bingo Operations Director – Texas Lottery Commission)

For 5.6

None received.

Against 5.6

None received.

Recommendation 5.7

Require the Commission to amend its current penalty schedule to include a full range of sanctions.

Agency Response to 5.7

The agency agrees with all the recommendations contained in the Sunset Staff Report. (Gary Grief, Executive Director and Phil Sanderson, Charitable Bingo Operations Director – Texas Lottery Commission)

For 5.7

None received.

Against 5.7

None received.

Recommendation 5.8

Expand the Lottery Commission's authority to temporarily suspend bingo licenses to prevent financial losses to the State.

Agency Response to 5.8

The agency agrees with all the recommendations contained in the Sunset Staff Report. (Gary Grief, Executive Director and Phil Sanderson, Charitable Bingo Operations Director – Texas Lottery Commission)

For 5.8

None received.

Against 5.8

None received.

STAFF RECOMMENDED ACTION

Adopt Recommendations 5.1 through 5.8.

ISSUE 6

Elements of the State Lottery Act Do Not Conform to Commonly Applied Licensing Practices.

Background

The Texas Lottery Commission (Commission) performs several standard licensing and enforcement functions in its regulation of lottery retailers. To be eligible to sell lottery tickets in Texas, individual retailers and entities must complete and submit an application to the Commission. The agency generally issues licenses unless it finds that the applicant does not meet experience, character, or general fitness requirements. The agency also enforces the State Lottery Act and regulations by investigating complaints and taking action as appropriate to deal with any violations. The agency currently licenses close to 17,000 lottery retailers and received 364 complaints from the public regarding retailers in fiscal year 2011.

Regulating lottery retailers requires common activities that the Sunset Commission staff has observed and documented over more than 30 years of reviews and compiled into a set of standards for licensing and regulatory programs. The following material highlights areas where the Commission's statute and rules differ from the model standards and describes the potential benefits of conforming to standard practices.

Findings

The Commission lacks publicly available, formal procedures to guide complaint filing, investigation, tracking, and analysis.

Licensing agencies should accept and investigate complaints against regulated individuals or entities following clear procedures describing all phases of the complaint process, including receipt, investigation, and resolution. Clear complaint procedures promote consistency and ensure public and licensee awareness. Licensing agencies should also be required to track and analyze the sources and types of complaints and the results of investigations to better understand the regulatory environment, manage resources more effectively, and identify problem areas and trends.

In 2002 and 2004, the Sunset Commission recommended statutory changes aimed at improving the agency's complaint process, but the resulting bills did not pass.¹ Since that time, the agency has taken steps to address the identified concerns, such as posting a complaint form on its website, developing a database called the Compliance Activity Monitoring Process (CAMP) to track complaints, developing internal complaint procedures, and holding regular meetings among high-level staff to discuss complaint issues. However, the Lottery Act and the agency's rules and other public information such as its website continue to lack basic information about the agency's complaint procedure or what to expect once a complaint is filed.

The agency has improved its complaint process as a result of previous Sunset reviews, but statutory change is still needed.

In addition, while the CAMP system collects useful information, it lacks the data and programming necessary to produce reports showing the resolution of complaints by the type of allegation. This type of enforcement data helps agencies show the public the rigorousness of their complaint processes. This information is also useful as a management tool for the agency to assess the appropriateness and consistency of enforcement efforts and to identify problem areas and trends so the agency can target enforcement accordingly.

*SOAH conducted
261 lottery
hearings in fiscal
year 2011.*

The Lottery Act does not require the Commission to conduct hearings through the State Office of Administrative Hearings.

Many state agencies must conduct their hearings through the State Office of Administrative Hearings (SOAH), which offers independence and professionalism in conducting hearings. In fiscal year 2011, the Commission used SOAH to conduct its 261 hearings relating to lottery retailers, though the Lottery Act does not require this practice, as is standard for other agencies. Requiring the use of SOAH would ensure the lottery hearing process continues to be separated from the agency's other enforcement functions, which allows for greater independence and fairness to licensees.

Recommendations

Change in Statute

6.1 Require the Commission to develop complaint procedures, track and analyze complaints, and provide better information about what to expect once a complaint is filed.

Under this recommendation, the Commission would be required to adopt rules that clearly lay out policies for all phases of the complaint process, including complaint receipt, investigation, and resolution. Requiring clear and easy-to-find complaint procedures would ensure the public and retailers understand the Commission's role in accepting and investigating complaints, how to file a complaint, and what to expect after a complaint is filed.

The recommendation would also provide ongoing statutory direction requiring the agency to analyze complaint information to identify trends and issues and adjust its regulatory approach as appropriate. These agency efforts should include the ability to show the resolution of complaints by the type of allegation as a way of assessing how well its enforcement process is working. A standard, Across-the-Board recommendation in Issue 7 of this report complements this recommendation by requiring the Commission to maintain documentation on complaints.

6.2 Conform the Lottery Act to the Commission's current practice of conducting hearings through the State Office of Administrative Hearings.

This recommendation would require the Commission to use SOAH for all hearings relating to licensed lottery retailers, but would maintain the Commission's final authority to accept, reverse, or modify a proposal for decision made by a SOAH judge as is standard in the Administrative Procedure Act.² Requiring the use of SOAH ensures the Commission will continue to benefit from SOAH's consistent standard of independence and professionalism in carrying out the hearings process.

Fiscal Implication

The recommendations would not result in a fiscal impact to the State.

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¹ Sunset Advisory Commission, *Texas Lottery Commission*, Staff Report (April 2004), p. 36; Sunset Advisory Commission, *Texas Lottery Commission*, Staff Report (August 2002), pp. 70–71.

² Section 2001.058(e), Texas Government Code.

RESPONSES TO ISSUE 6

Recommendation 6.1

Require the Commission to develop complaint procedures, track and analyze complaints, and provide better information about what to expect once a complaint is filed.

Agency Response to 6.1

The agency agrees with all the recommendations contained in the Sunset Staff Report. (Gary Grief, Executive Director and Phil Sanderson, Charitable Bingo Operations Director – Texas Lottery Commission)

For 6.1

None received.

Against 6.1

None received.

Recommendation 6.2

Conform the Lottery Act to the Commission's current practice of conducting hearings through the State Office of Administrative Hearings.

Agency Response to 6.2

The agency agrees with all the recommendations contained in the Sunset Staff Report. (Gary Grief, Executive Director and Phil Sanderson, Charitable Bingo Operations Director – Texas Lottery Commission)

For 6.2

None received.

Against 6.2

None received.

STAFF RECOMMENDED ACTION

Adopt Recommendations 6.1 and 6.2.

ISSUE 7

The Lottery Commission's Statute Does Not Reflect Standard Elements of Sunset Reviews.

Background

Over the years, Sunset reviews have come to encompass an increasing number of standard elements either from direction traditionally provided by the Sunset Commission, or from statutory requirements added by the Legislature to the Criteria for Review in the Sunset Act, or from general law provisions typically imposed on state agencies. The following material highlights the changes needed to conform the Lottery Commission's (Commission) statute to Sunset Across-the-Board recommendations, and to address the need for the agency's required reports.

- **Sunset Across-the-Board provisions.** The Sunset Commission has developed a set of standard recommendations that it applies to all state agencies reviewed unless an overwhelming reason exists not to do so. These Across-the-Board recommendations (ATBs) reflect an effort by the Legislature to place policy directives on agencies to prevent problems from occurring, instead of reacting to problems after the fact. ATBs are statutory administrative policies adopted by the Sunset Commission that contain "good government" standards for state agencies. The ATBs reflect review criteria contained in the Sunset Act designed to ensure open, responsive, and effective government.
- **Reporting requirements.** The Texas Sunset Act establishes a process for state agencies to provide information to the Sunset Commission about reporting requirements imposed on them by law and requires the Commission, in conducting reviews of state agencies, to consider if each reporting requirement needs to be continued or abolished.¹ The Sunset Commission has interpreted these provisions as applying to reports that are specific to the agency and not general reporting requirements that extend well beyond the scope of the agency under review. Reports required by rider to the General Appropriations Act are included as a matter of law, but under a presumption that the appropriations committees have vetted these requirements each biennium. Reporting requirements with deadlines or that have expiration dates are not included, nor are routine notifications or notices, or posting requirements.

Findings

The Lottery Commission's statute does not reflect standard language typically applied across the board during Sunset reviews.

Because a Sunset bill for the Lottery Commission has never passed, several Across-the-Board provisions are missing entirely from the agency's statute and some must be updated. Each provision is discussed in more detail below.

- **Public membership.** The Commission's statute contains much of the standard language designed to ensure its members are more responsive to the public's broad interests rather than the entities regulated by the

agency. However, the Commission's statute does not contain a provision that prohibits Commission members from being registered or licensed by the agency.

While the agency provides training for Commission members, requiring it in law helps ensure both its scope and its continuance.

- **Conflict of interest.** The Commission's statute contains standard language to prevent potential conflicts of interest by Commission members, but not high-ranking agency employees, with professional trade organizations. Specifically, the agency's statute does not prohibit the agency's general counsel from lobbying on behalf of lottery or bingo interests, or prohibit high-ranking agency employees and their spouses from being closely affiliated with a bingo or lottery professional trade association.
- **Grounds for removal.** The Commission's statute does not reflect all of the standard language related to the statutory basis and process for removing a member of a policymaking body who does not maintain qualifications, has a conflict of interest, or no longer attends meetings. Specifically, the Lottery Commission's statute does not lay out the process to be followed if the agency's director has knowledge that a potential ground for removing a Commission member exists.
- **Board member training.** The agency's statute does not specify the type of training and information Commission members need for them to properly discharge their duties. While the agency provides this training, specifying it in law helps ensure both its scope and its continuance.
- **Policymaking and staff functions.** The agency's statute does not provide for separating the policymaking functions of the Commission from the day-to-day administrative functions of agency management. Such a provision can help avoid confusion about who is in charge of operations that can undermine an agency's effectiveness.
- **Public testimony.** The agency's statute does not provide an opportunity for the public to appear before and speak before the Commission, though the Commission does so at its meetings. Requiring it in law underscores its continuing importance as a source of additional information and perspective to improve the overall decision-making process.
- **Complaint information.** The Commission's statute does not require the agency to maintain complete information on complaints, though the agency has a complaint tracking process. Having it in law would help maintain a system for acting on complaints and keeping proper documentation of complaints to ensure that problems will be addressed and in a timely fashion.
- **Alternative dispute resolution.** The Commission's governing statute does not include a standard provision relating to alternative rulemaking and dispute resolution that the Sunset Commission routinely applies to agencies under review. This provision helps improve rulemaking

and dispute resolution through more open, inclusive, and conciliatory processes designed to solve problems by building consensus rather than through contested proceedings.

The Lottery Commission has one reporting requirement that is no longer necessary.

State law requires the Lottery Commission to produce nine reports, two of which are required by rider to the General Appropriations Act. One of these requirements is to prepare a report of the total number of lottery tickets sold and the number and amounts of prizes awarded for each lottery game, and to make this report available for public inspection. Aspects of how the lottery is run make such a report impractical. With approximately 85 instant games each year and 26 online drawings each week, the sheer volume of information to capture and categorize in such a report would be difficult. Also, because game winners have 180 days in which to claim prizes, such reports would require a lag time to reflect the number and amount of prizes awarded that would further complicate the report's preparation and its usefulness. The agency's website provides more useful and accessible information regarding each game's winners, and the agency separately maintains sales data in its daily accounting practices. The report has not been requested by the public in more than five years.

Sunset staff analysis determined that the other eight reports continue to provide useful information and should be continued. These reports are listed below. Appendix C contains more detail on all of the Commission's reporting requirements.

- Annual report on lottery revenue, prize disbursements, and other expenses
- Annual independent financial audit and report on all agency accounts and transactions
- Biennial study of all aspects of lottery security
- Biennial demographic study of lottery players
- Annual report on minority business participation in agency contracts and lottery retailer licensing
- Biennial report on bingo adjusted gross receipts, net proceeds, and a comparison of the two
- Retailer sales commission and incentive program report (rider)
- Semi-annual instant ticket game closure report (rider)

One agency report has not been requested in more than five years.

Recommendations

Change in Statute

7.1 Update and apply standard Across-the-Board recommendations to the Lottery Commission.

- **Public membership.** This provision would add language to update statute to prohibit Commission members from being registered or licensed by the agency.
- **Conflict of interest.** This recommendation would prohibit high-level agency employees from being an officer, employee, or paid consultant of a bingo or lottery professional trade association, and prohibit high-level employees' spouses from being an officer, manager, or paid consultant of a bingo or lottery professional trade association. It would also update statute to prohibit the agency's general counsel from lobbying on behalf of lottery or bingo interests.
- **Grounds for removal.** This provision would add language specifying notification requirements for when the agency's director has knowledge that a potential ground for removing a Commission member exists.
- **Board member training.** This recommendation would clearly establish the type of information to be included in the Commission member training. The training would need to provide Commission members with information regarding the legislation that created the Lottery Commission; its programs, functions, rules, and budget; the results of its most recent formal audit; the requirements of laws relating to open meetings, public information, administrative procedure, and conflicts of interest; and any applicable ethics policies.
- **Separation of duties.** Under this recommendation, the Commission must adopt policies clearly defining its role of setting policy separate from staff responsibilities.
- **Public testimony.** This provision would add specific statutory language to ensure the opportunity for public input to the Commission on issues under its jurisdiction.
- **Complaint information.** This recommendation would require the agency to maintain a system for acting on complaints and that the agency make information available regarding its complaint procedures. The agency must also maintain documentation on all complaints and periodically notify complaint parties of the status of complaints.
- **Alternative dispute resolution.** This provision would ensure that the Commission develops and implements a policy to encourage alternative procedures for rulemaking and dispute resolution that conforms, to the extent possible, to model guidelines by the State Office of Administrative Hearings. The agency would also coordinate implementation of the policy, provide training as needed, and collect data concerning the effectiveness of these procedures.

7.2 Abolish the Commission's report on lottery tickets sold and prizes awarded and continue the Commission's other reports.

This recommendation would eliminate the report of tickets sold and prizes awarded for each lottery game. This report, which has not been requested in at least five years, is impractical and has largely been supplanted by more timely and useful information available on the agency's website. The remaining eight reports currently required by the Commission would be continued because they provide information

useful to both the agency and the public. Appendix C summarizes all of the Commission's reporting requirements and shows which would be continued and which abolished under this recommendation. To comply with a recent change in law, the reports to the Legislature should be provided in an electronic format only.

Fiscal Implication

These recommendations would not have a fiscal impact to the State.

¹ Sections 325.0075, 325.011(13), and 325.012(a)(4), Texas Government Code.

RESPONSES TO ISSUE 7

Recommendation 7.1

Update and apply standard Across- the- Board recommendations to the Lottery Commission.

Agency Response to 7.1

The agency agrees with all the recommendations contained in the Sunset Staff Report. (Gary Grief, Executive Director and Phil Sanderson, Charitable Bingo Operations Director – Texas Lottery Commission)

For 7.1

None received.

Against 7.1

None received.

Recommendation 7.2

Abolish the Commission's report on lottery tickets sold and prizes awarded and continue the Commission's other reports.

Agency Response to 7.2

The agency agrees with all the recommendations contained in the Sunset Staff Report. (Gary Grief, Executive Director and Phil Sanderson, Charitable Bingo Operations Director – Texas Lottery Commission)

For 7.2

None received.

Against 7.2

None received.

STAFF RECOMMENDED ACTION

Adopt Recommendations 7.1 and 7.2.

ISSUE 8

Texas Has a Continuing Need for the Texas Lottery Commission.

Background

Since 1993, the Texas Lottery Commission (Commission) has operated the lottery and overseen regulation of charitable bingo, two popular games approved by Texas voters by decisive margins in separate constitutional elections. The Commission's mission is to generate revenue for the State, primarily for education, through the responsible management and sale of lottery products, and to provide charitable organizations the opportunity to raise funds for charitable purposes by conducting bingo. To achieve its mission, the Commission develops, approves, and markets lottery games; licenses lottery retailers; manages major contracts for various lottery services; enforces statutes and rules; licenses and monitors bingo industry participants; and collects bingo taxes and prize fees.

In fiscal year 2011, the Commission spent \$214 million, about \$199 million of which went to lottery operations. The agency passed through \$12.5 million in bingo prize fees to cities and counties, using just \$2.4 million to regulate charitable bingo activities in fiscal year 2011. The Commission employs 309 staff, with 276 dedicated to lottery operations and support services and 33 to bingo. The agency maintains 15 lottery claim centers and four bingo regional offices across the state staffed by 54 employees.

Findings

Texas has a continuing need to effectively operate the lottery and regulate bingo.

More than 20 years after approving the lottery, Texans show their continued interest in playing lottery games by spending more than ever on tickets, almost \$4 billion in fiscal year 2011.¹ Ensuring confidence that the games are conducted fairly is paramount to the lottery's future success. Though the Commission outsources many of the lottery's major functions, it maintains close oversight of those functions and conducts other activities to ensure the lottery operates according to state law. The agency works closely with the lottery operations contractor, along with a third-party contract monitor, to ensure the State receives good value for the \$83 million-a-year contract. The agency also licenses almost 17,000 lottery retailers and takes enforcement action against any that violate state laws or agency rules. Additionally, the agency performs the important function of electronically withdrawing lottery earnings from retailer bank accounts each week and remitting them to the State Treasury.

Texans also show continued interest in playing bingo, spending a record \$699 million in calendar year 2010.² Because bingo halls operate on a cash basis, state oversight continues to be important to ensure that bingo games are fairly played, revenue is used for its authorized charitable purposes, and that state and local government revenues are collected and distributed.

Annual spending on lottery and bingo games recently hit record levels — almost \$4 billion on lottery and \$700 million on bingo.

While the agency's efforts to effectively regulate charitable bingo have been seriously affected by recent budget cuts, it continues to issue licenses, conduct audits and inspections, and take enforcement action against those that violate the Bingo Enabling Act or agency rules.

Revenue from the lottery and bingo continues to be important to the State.

Since 1991 when Texans approved a lottery to raise funds for the State, more than \$13.6 billion has gone to the Foundation School Fund, \$5.3 billion to the General Revenue Fund, and \$160 million to teaching hospitals that support indigent health care. Since the Legislature authorized a scratch-off game dedicated to assisting veterans in 2009, almost \$16 million has been transferred to the Texas Veterans Commission. Without the revenue generated by the lottery, the State would have to find other funding sources for these purposes.

Since 1981, bingo has generated more than \$971 million for charitable purposes.³ Aside from licensing fees that go to the State intended to cover the cost of regulation, bingo also generates revenue for the State and participating local jurisdictions through prize fees and rental taxes. In fiscal year 2011, the State, counties, and cities received \$27.9 million in prize fees and rental taxes. Without revenue from bingo, charities, local governments, and the State would have to find other funding sources.

The Lottery Commission is the most appropriate agency to administer the lottery and regulate charitable bingo.

While other organizational options exist and have been used in the past, the Commission has the expertise and organizational structure to administer the lottery and oversee bingo regulation. The Comptroller's Office has housed both lottery and bingo in the past as a type of incubator, as shown in the textbox *Lottery and Bingo Regulation Over Time*. However, the complexity of both games has increased over time, requiring significant expertise that is different from the Comptroller's tax collection responsibilities. Another organizational option could be merging the Commission with the Texas Racing Commission to create a state gaming agency. A similar proposal was introduced last legislative session, but the bill did not receive a hearing.⁴ As with the Comptroller's Office, the very different activities and responsibilities of the two agencies require specific expertise that would need to be

The lottery has raised more than \$13.6 billion for the Foundation School Fund.

Lottery and Bingo Regulation Over Time

1980 – Texas voters approve charitable bingo, initially administered by the Comptroller's Office.

1990 – The Legislature transfers bingo regulation from the Comptroller's Office to the Texas Alcoholic Beverage Commission.

1991 – Texas voters approve the lottery, initially administered by the Comptroller's Office.

1993 – The Legislature creates the Lottery Commission and transfers administration of the lottery and charitable bingo regulation to the new agency.

maintained. In addition, the Lottery Commission has not experienced the kinds of problems, and does not present opportunities for cost savings, to justify such a move.

Federal law generally prohibits complete privatization of state lotteries, but by outsourcing many day-to-day lottery functions, the Commission is still able to take advantage of the private sector's logistical and operational experience and access to capital.⁵ For example, the agency's lottery operations contractor provides and maintains equipment for lottery retailers across the state and provides the field marketing sales force necessary to service the needs of retailers, relieving the Commission from a major capital expense as well as the numerous staff needed to provide these services. The agency retains oversight of outsourced functions by monitoring and enforcing performance standards defined by contract.

Federal law generally prohibits complete privatization of state lotteries.

The regulation of bingo is generally well-placed at the Lottery Commission. Regulating charitable bingo is clearly different from operating the lottery, but bingo regulation benefits from the Commission's enforcement, legal, and administrative services. While the lottery may compete with bingo for players' entertainment dollars, the statutory requirement to have a separate director for charitable bingo that reports to the Lottery Commission helps address any potential conflicts of interest between bingo regulation and lottery operations. A separate bingo agency is not warranted and would likely result in administrative inefficiencies. The Texas Department of Licensing and Regulation (TDLR) effectively regulates many occupations across the state and could assume responsibility for regulating charitable bingo as well. However, moving the regulation from one agency to another would not result in administrative savings. In addition, the larger issues affecting the regulation of bingo relate more to budgetary and resource constraints addressed elsewhere in this report than to the kind of organizational deficiencies that TDLR could help address.

A separate bingo agency is not warranted and would result in administrative inefficiencies.

Most other states administer lotteries and regulate bingo, though their regulatory structures vary greatly.

Forty-two other states have lotteries. Six state lotteries are operated by quasi-private boards, and another 12 are housed in larger state agencies such as a department of revenue. The remaining states operate their lotteries through independent agencies like the Texas Lottery Commission.

Forty-seven other states authorize and regulate bingo, though their regulatory structures vary greatly. In most states, bingo is regulated at the state level by a gaming commission or a division within a larger agency such as a department of revenue or public safety. Four states delegate bingo regulation to local jurisdictions, and four other states house bingo regulation within their lottery agencies.

Recommendation

Change in Statute

8.1 Continue the Texas Lottery Commission for 12 years.

This recommendation would continue the Texas Lottery Commission as the agency responsible for operating the state lottery and regulating charitable bingo. This recommendation would also delete the Sunset date relating to the Lottery Division — vestiges from lottery operations being housed at the Comptroller's Office — while updating the Sunset date relating to the Lottery Commission as a whole. A requirement that the lottery operations contract must contain a provision stating that the contract expires if the lottery is abolished would remain in law.

Fiscal Implication

If the Legislature continues the Lottery Commission using the existing organizational structure, the agency's annual budget of an estimated \$214 million from lottery proceeds and bingo fees would continue to be required for the agency's operations.

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- ¹ "Summary of Financial Information," Texas Lottery Commission, accessed February 8, 2012, <http://www.txlottery.org/export/sites/lottery/Documents/financial/Monthly-Transfer-Document.pdf>.
 - ² Texas Lottery Commission, *Charitable Bingo 2010 Annual Report* (Austin: Texas Lottery Commission, 2010), p. 8.
 - ³ *Ibid.*, p. 18.
 - ⁴ H.B. 700, 82nd Texas Legislature, Regular Session, 2011.
 - ⁵ Scope of Exemption for State-Conducted Lotteries Under Fed. Lottery Statutes, 32 Op. O.L.C. (2008).

RESPONSES TO ISSUE 8

Recommendation 8.1

Continue the Texas Lottery Commission for 12 years.

Agency Response to 8.1

The agency agrees with all the recommendations contained in the Sunset Staff Report. (Gary Grief, Executive Director and Phil Sanderson, Charitable Bingo Operations Director – Texas Lottery Commission)

For 8.1

Doug DuBois, Jr., Director of Member Services and Governmental Affairs – Texas Food and Fuel Association, Austin

Against 8.1

Bill Brian, Amarillo

Herschel V. Forester, Member – Stop Predatory Gambling

Rob Kohler, Lobbyist/Consultant – Texas Baptist Christian Life Commission, Austin

Suzii Paynter, Director – Texas Baptist Christian Life Commission, Austin

Dr. Weston Ware – Stop Predatory Gambling, Cedar Hill

Rodger Weems, Chairman – Texans Against Gambling, Grand Prairie

Modifications

1. Before making any recommendations regarding the Lottery Commission, the Sunset Commission should research where lottery sales occur and what socio-economic, demographic, and sales data is available on lottery players; what lottery revenues have purchased for education and whether the lottery has provided an increase in education funding or replaced other revenue sources; and how long after the lottery was passed were other taxes increased to pay for education, and how lottery revenue for education relates to property tax rates and other taxes to pay for education by year. (Suzii Paynter, Director and Rob Kohler, Lobbyist/Consultant – Texas Baptist Christian Life Commission, Austin)
2. Abolish the Texas lottery and in its place, raise the alcohol excise tax by 10 cents per serving or 60 cents per six pack. (Rodger Weems, Chairman – Texans Against Gambling, Grand Prairie)

STAFF RECOMMENDED ACTION

Adopt Recommendation 8.1.

NEW ISSUES

NEW ISSUES

The following issues were raised in addition to the issues in the staff report. These issues are numbered sequentially to follow the staff's recommendations.

9. Prohibit lottery retail clerks from scanning/checking tickets except to validate winning tickets to cash in. Instead, require players to check their own tickets to determine winners using self-check machines found in each store. (Dawn Nettles, Publisher – The Lotto Report, Garland)
10. Prohibit lottery retail clerks from purchasing lottery products where they work. (Dawn Nettles, Publisher – The Lotto Report, Garland)
11. Prohibit lottery retail clerks from playing lottery games while working. (Dawn Nettles, Publisher – The Lotto Report, Garland)
12. Require all clerks who sell lottery products to be listed on a registry of approved lottery clerks after passing a background check, as is done for bingo workers. The Lottery Commission should charge clerks a fee to cover registry costs and require renewal every two years. (Dawn Nettles, Publisher – The Lotto Report, Garland)
13. Require the Lottery Commission to hire outside investigators and individuals to conduct sting operations on store clerks who steal winning lottery tickets and make findings public to protect consumers and the State of Texas. (Dawn Nettles, Publisher – The Lotto Report, Garland)
14. Prohibit the Lottery Commission from editing draft reports of studies it has contracted for. (Dawn Nettles, Publisher – The Lotto Report, Garland)
15. Require the Lottery Commission to accept complaints by phone. (Dawn Nettles, Publisher – The Lotto Report, Garland)
16. Provide for the Lottery Commission to pay disputed and pending claims if overwhelming evidence exists about the rightful owner of the ticket without waiting the months or even years required to conduct an investigation. (Dawn Nettles, Publisher – The Lotto Report, Garland)
17. Require the Lottery Commission to eliminate its policy of requiring members of the public who wish to testify at its meetings to fill out a witness form before the meeting noting each item they wish to address. (Dawn Nettles, Publisher – The Lotto Report, Garland)
18. Require the Lottery Commission to enforce conflict of interest provisions regarding the lottery operations contractor. (Dawn Nettles, Publisher – The Lotto Report, Garland)
19. Prohibit the Lottery Commission from conducting keno-style games that have four drawings per day. (Dawn Nettles, Publisher – The Lotto Report, Garland)

20. Limit the number of online state-run games to five, and limit the number of drawings that may be held each week. (Dawn Nettles, Publisher – The Lotto Report, Garland)

Staff Comment: The Lottery Commission currently conducts 22 drawings each week for its five state-run online games.

21. Require a cap on the odds of each state-run game to be no more than approximately 60 percent of the state's population, excluding multi-state games. (Dawn Nettles, Publisher – The Lotto Report, Garland)
22. Prohibit the Lottery Commission from using computerized drawings. (Dawn Nettles, Publisher – The Lotto Report, Garland)
23. Require the Lottery Commission to provide full accounting to the Legislature of prize monies for each lottery game, and require each game to pay prizes out of its own earnings as a stand-alone business. (Dawn Nettles, Publisher – The Lotto Report, Garland)
24. Require at least 50 percent of sales to be returned to players by way of prizes. (Dawn Nettles, Publisher – The Lotto Report, Garland)
25. Require pari-mutuel payouts for all online lottery games. (Dawn Nettles, Publisher – The Lotto Report, Garland)
26. Require self-check ticket machines to indicate whether a ticket has been paid. (Dawn Nettles, Publisher – The Lotto Report, Garland)
27. Provide for store clerks that sell lottery tickets to be fined for failing to destroy tickets that have been validated, unless a customer demands the return of the validated ticket and clerks fear for their safety. (Dawn Nettles, Publisher – The Lotto Report, Garland)
28. Require all scratch tickets to be picked up from retailers within 14 days after a close date for the game has been issued. (Dawn Nettles, Publisher – The Lotto Report, Garland)
29. Require the Lottery Commission to comply with consumer protection laws in advertising. (Dawn Nettles, Publisher – The Lotto Report, Garland)
30. Change the bingo prize structure so that prizes up to \$50 do not count toward the \$2,500 per occasion prize limit. (Steve Bresnen – Coalition for the Survival of Charitable Bingo, Austin)

STAFF RECOMMENDED ACTION

Staff makes no recommendations on the new issues.

APPENDICES

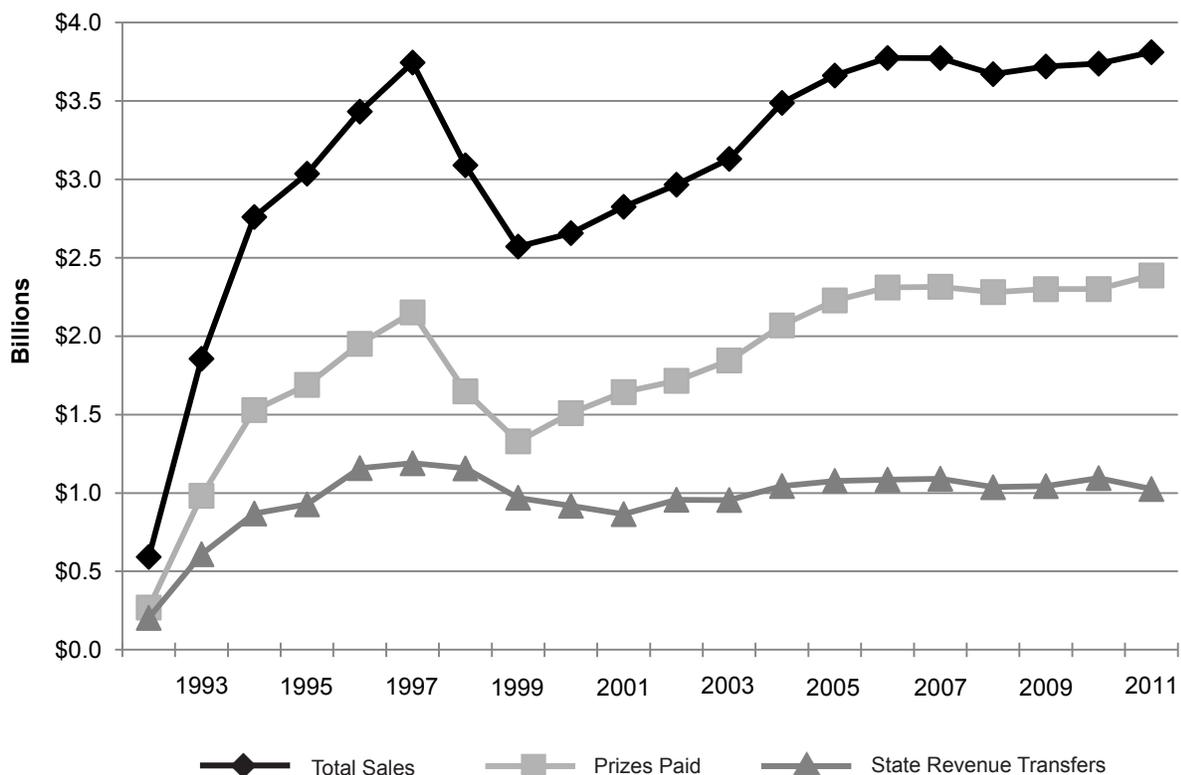
APPENDIX A

Texas Lottery Trends and Performance

Overall Sales, Prizes Paid, and State Revenue Transfers. Chart 1 shows the lottery’s overall performance since its inception in 1992. In recent years, the lottery has returned an average of \$1 billion to the Foundation School Fund and other state programs each year. The negative impact on sales in fiscal years 1998 and 1999 resulted from a legislative cap of 52 percent on prize payout during those years. Since that time, the lottery’s sales have increased in rough proportion to prize payouts, translating into relatively stable returns to the State. Lottery Commission staff attribute this trend to the maturity of the lottery, where increased prize payouts are needed to keep players interested in the games. The State Comptroller and Commission staff project a leveling-off of sales growth in future years.

Chart 1

**Texas Lottery Total Sales, Prizes Paid, and Transfers to State
FYs 1992–2011**



Source: Texas Lottery Commission

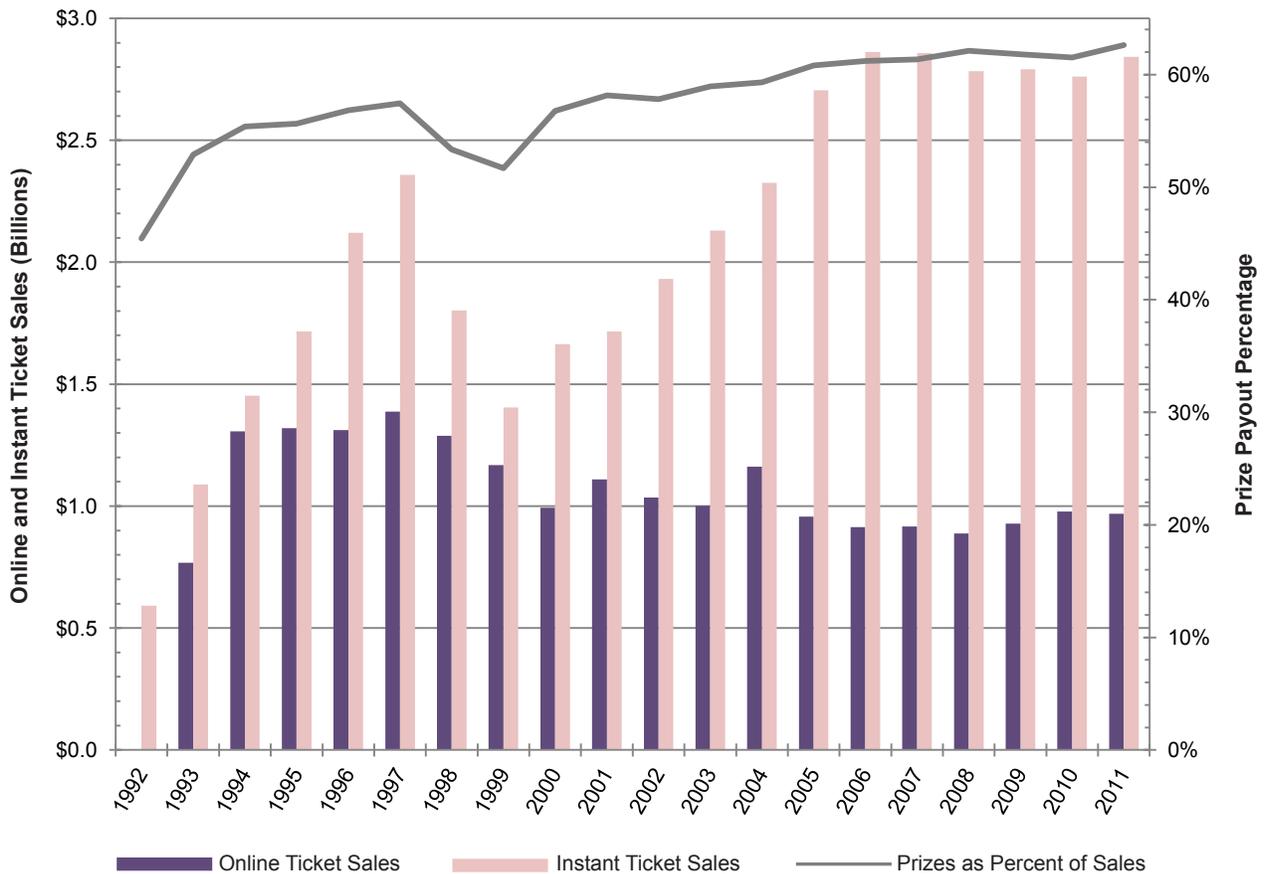
Appendix A

Product Mix and Prize Payout Over Time. The prize payout percentage is a critical component of lottery business models. All lotteries must carefully plan and adjust the prize payout of games to balance keeping players’ interest with maximizing revenue return to the state. While higher prize payouts are often associated with increased sales, a higher prize payout reduces the amount of “profit” available for government transfers. Many states have experimented with capping the prize payout percentage of games, but the current trend is to give lotteries the flexibility to set the prize payout percentage at a level that maximizes return to the state.

Since the Texas lottery’s inception, the prize payout design for online games has remained constant at 50 percent, while prize payouts for instant ticket games have been higher, averaging about 68 percent in fiscal year 2011. Over time, instant tickets have become more popular, reaching almost \$2.8 billion in sales in fiscal year 2011, or three times the amount of online ticket sales that year. As the proportion of sales made up by instant tickets increased, the lottery’s overall prize payout percentage also increased, but has leveled off in recent years. The overall prize payout was 62.6 percent in fiscal year 2011, as shown in Chart 2.

Chart 2

**Texas Lottery Product Mix and Prize Payout Percentage
FYs 1992–2011**



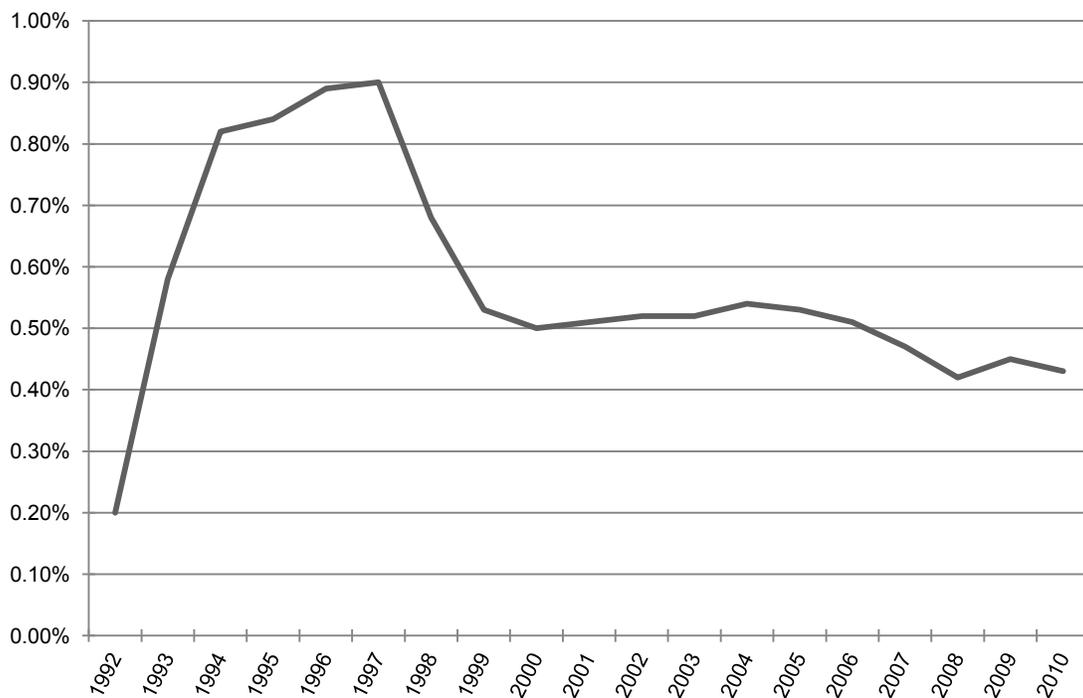
Source: Texas Lottery Commission

Appendix A

Lottery's Share of Disposable Personal Income. Disposable personal income is the total personal income available to individuals for spending or saving after paying government taxes. Chart 3 shows the Texas lottery's fiscal year per capita sales (not adjusted for inflation) as a percentage of calendar year per capita disposable personal income (also not adjusted for inflation.) The chart shows that, as the lottery has matured, its share of disposable personal income had declined. (The chart also shows the negative effect on sales of a legislative cap on prize payout in effect during fiscal years 1998 and 1999.)

Chart 3

**Texas Lottery's Market Share of Disposable Personal Income
1992–2010**



Source: Texas Lottery Commission, Texas State Library and Archives Commission, U.S. Bureau of Economic Analysis

APPENDIX B

How the Texas Lottery Compares with Other State Lotteries

The following charts compare information about the Texas lottery to other state lotteries in the United States using fiscal year 2010 data, the most recent year comparative data are available. All comparisons use the same top 10 state lotteries in the United States, ranked by total ticket sales, as shown in Chart 1.

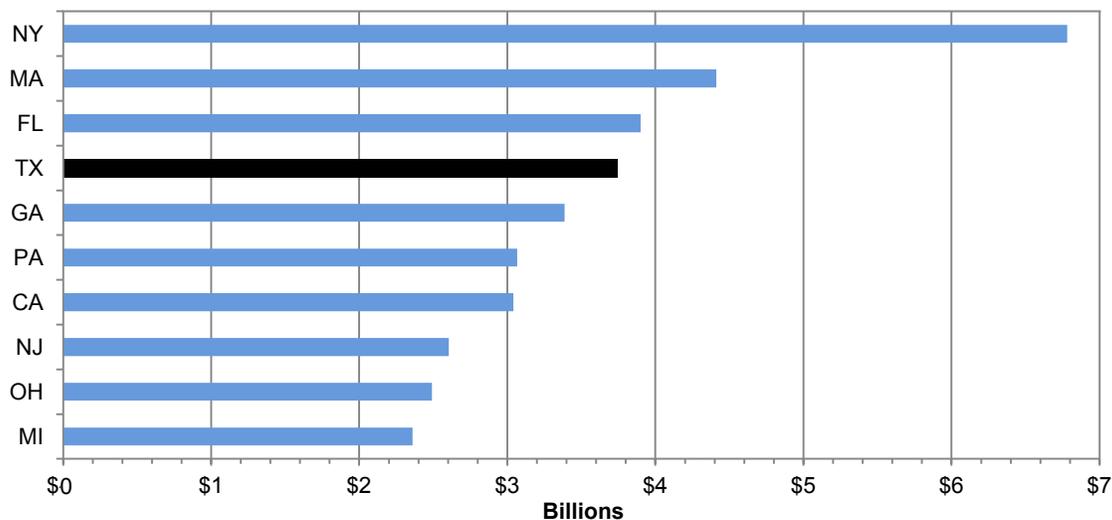
While useful in providing a high-level picture of the Texas lottery as compared to other state lotteries, these comparisons pose various challenges given the unique nature of each lottery's enabling statutes, product mix offered, and other characteristics. For example, several states with high-ranking sales such as Massachusetts and New York derive a large percentage of sales from keno games, which are not authorized in Texas. Keno games involve drawings as frequent as every five minutes, and are often played in bars and restaurants.

Unless otherwise noted, all comparative data in these charts are derived from the following compilation of self-reported lottery data: Teresa La Fleur et al., eds., *La Fleur's 2011 World Lottery Almanac*, 19th ed. (Rockville: TLF Publications, Inc., 2011).

Total Sales. Chart 1 shows the top 10 grossing state lotteries in the United States. Texas ranked fourth with \$3.7 billion in overall sales in fiscal year 2010. The data include only revenue from traditional lottery games and do not include revenue from video lottery terminals (VLTs) authorized in some states. If sales from keno games were excluded, Texas' ranking would rise to third, and Massachusetts would fall to fourth.

Chart 1

Top Ten State Lotteries by FY 2010 Total Sales

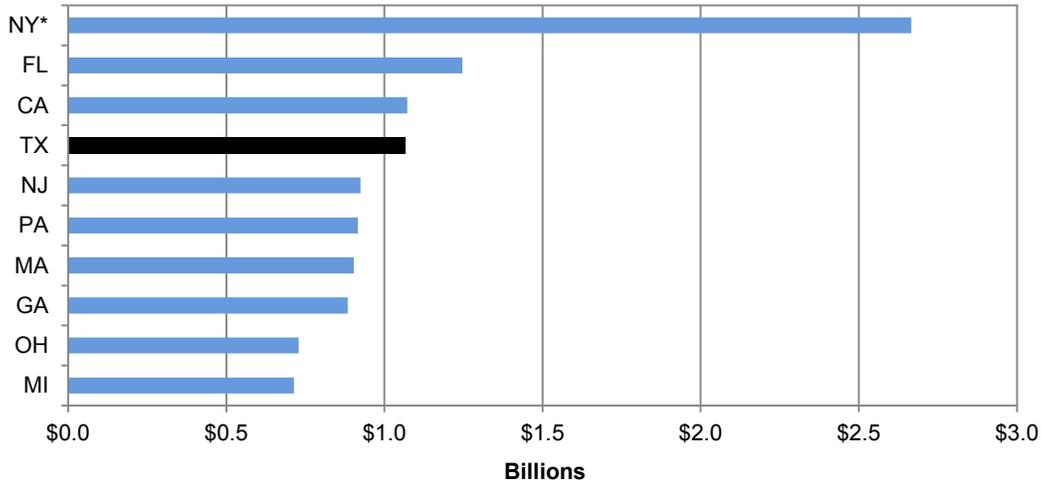


Appendix B

Government Transfers. Chart 2 ranks the 10 top grossing lotteries by government revenue transfers, or the “profit” each state made from lottery operations. Similar to overall sales, Texas ranked fourth in government transfers, with \$1.06 billion transferred to the State in fiscal year 2010.

Chart 2

**Government Transfers
Top Ten State Lotteries – FY 2010**

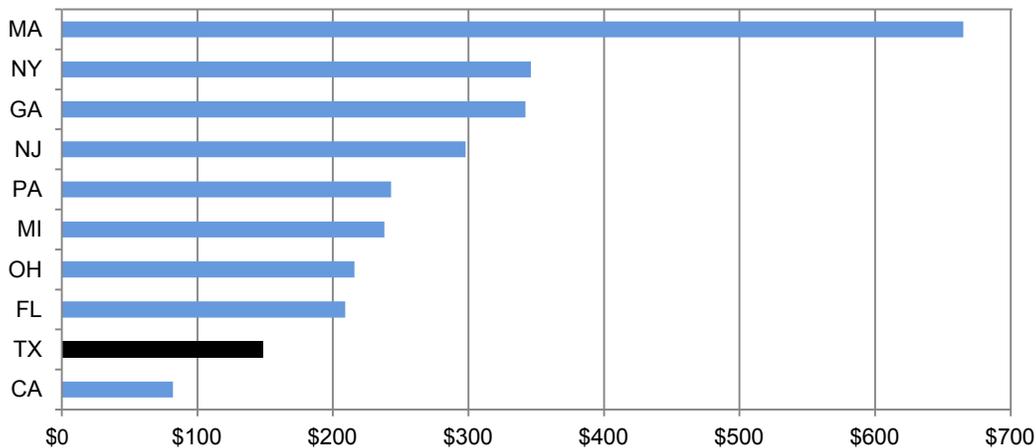


**Includes revenue generated from video lottery terminals (VLTs) in New York.*

Per Capita Sales. As shown in Chart 3, when comparing the Texas lottery’s per capita sales of \$148 to the top 10 grossing state lotteries, Texas’ ranking drops to ninth.

Chart 3

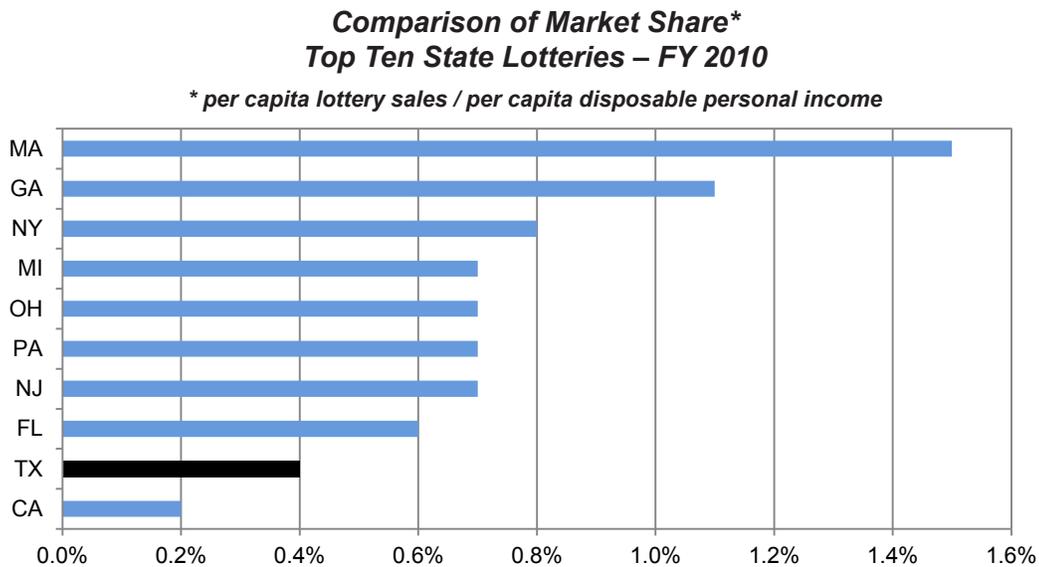
**Per Capita Sales
Top Ten State Lotteries – FY 2010**



Appendix B

Market Share. Disposable personal income is the total personal income available to individuals for spending or saving after paying government taxes. Chart 4 compares the top 10 grossing state lotteries' per capita sales as a percentage of per capita disposable personal income. The chart shows the Texas lottery's relatively low market share compared to other top-performing state lotteries.

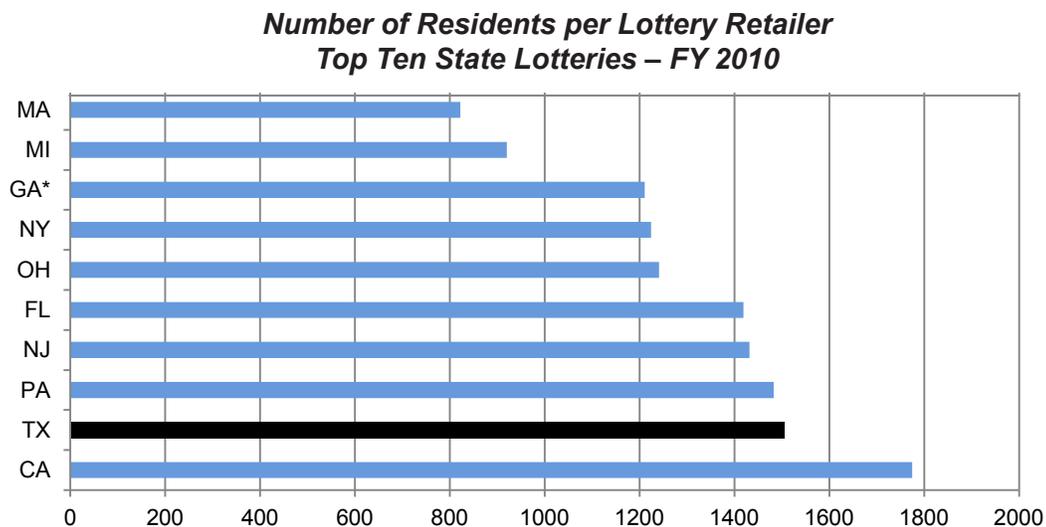
Chart 4



Sources: U.S. Bureau of Economic Analysis and La Fleur's 2011 World Lottery Almanac

Retailer Saturation. The number of residents per lottery retailer is one measure of the availability of lottery products to potential customers. In fiscal year 2010, Texas had one lottery retailer for every 1,505 citizens. As shown in Chart 5, when compared to the top 10 grossing state lotteries, the Texas lottery ranks on the low end in terms of retailer saturation.

Chart 5

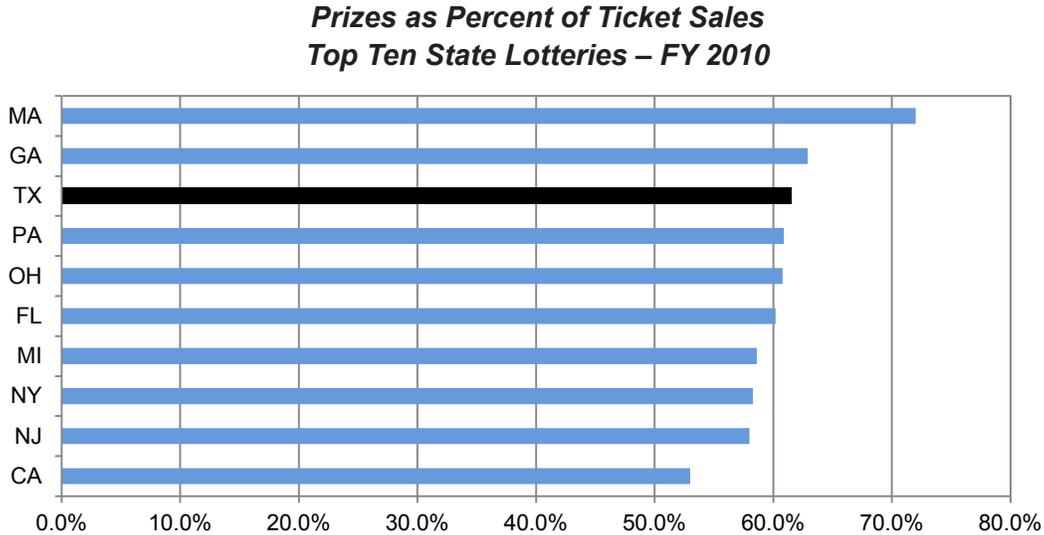


* FY 2009 data for Georgia

Appendix B

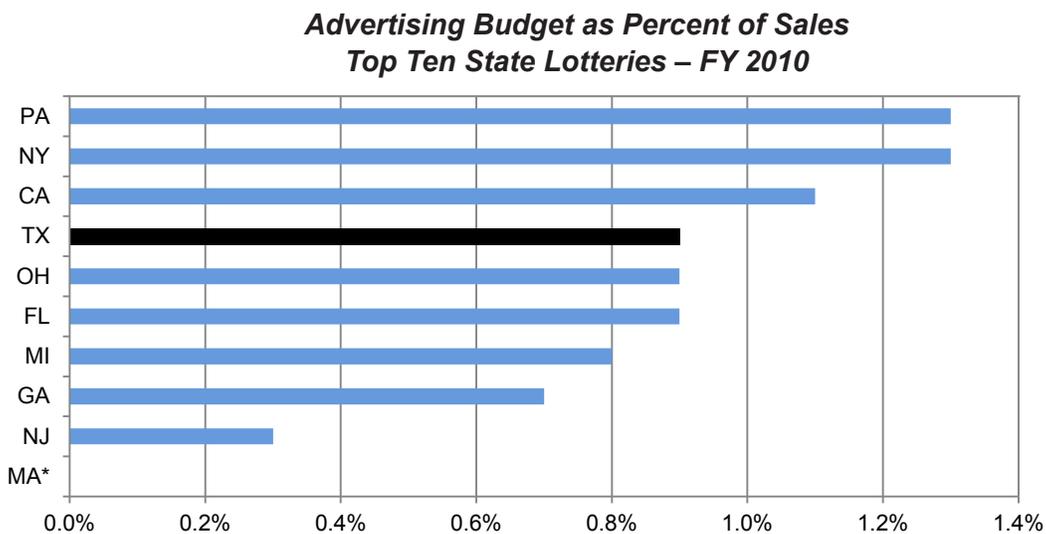
Prize Payout Percentage. Chart 6 compares the overall prize payout percentage of the 10 top grossing state lotteries. The chart shows that the Texas lottery’s fiscal year 2010 prize payout percentage of 60.6 percent was about average.

Chart 6



Advertising Budget as a Percent of Sales. In fiscal year 2010, the Texas lottery’s advertising budget was \$32.4 million, which represented about 0.9 percent of the lottery’s total \$3.7 billion in sales that year. When compared to the top 10 grossing state lotteries, the Texas lottery’s spending on advertising is about average.

Chart 7



* Massachusetts’ relatively small advertising budget was about \$2 million in fiscal year 2010, which rounded to 0 percent because its fiscal year 2010 sales were very high at about \$4.4 billion.

APPENDIX C

Texas Lottery Commission Reporting Requirements

Report Title	Legal Authority	Description	Recipient	Sunset Evaluation
1. Minority business participation	Government Code §466.107(c)	Level of minority business participation pertaining to Commission contracts and sales agent licensing	Governor and the Legislature	Continue
2. Demographic study of lottery players	Government Code §466.021(a) and (b)	Income, age, sex, race, education, and frequency of participation of players in the lottery	Governor, Legislature, and the Lottery Commission	Continue
3. Lottery security	Government Code §466.020(e) and (f)	All aspects of lottery security	Governor and the Legislature	Continue
4. Independent financial audit and report	Government Code §466.017(a)	All accounts and transactions for the lottery. Audit report must contain recommendations to enhance the earnings capability of the lottery and improve the efficiency of lottery operations	Governor, Legislature, Commission, and the Executive Director	Continue
5. Lottery tickets sold and prizes awarded	Government Code §466.025	Total number of tickets sold and the number and amounts of prizes awarded for each lottery game	Must be available for public inspection	Eliminate – See Recommendation 7.2
6. Annual lottery report	Government Code §466.016	Summary of lottery revenue, prize disbursements, and other expenses from preceding fiscal year	Governor, Legislature, Comptroller, Legislative Budget Board, State Auditor's Office, and the Legislative Reference Library	Continue
7. Bingo report	Occupations Code §2001.060	Total amounts of bingo adjusted gross receipts and net proceeds reported by licensed authorized organizations from their bingo operations, and a comparison of the two	Governor, Lieutenant Governor, Speaker of the House, and chairs of standing committees with primary jurisdiction over charitable bingo	Continue
8. Instant ticket game closure	Rider 13, page VII-12, Article VII (H.B. 1), Acts of the 82nd Legislature, Regular Session, 2011 (the General Appropriations Act)	Number of instant ticket games closed and the amount of time to end the sale of each game following closure	Legislative Budget Board	Continue

Appendix C

Report Title	Legal Authority	Description	Recipient	Sunset Evaluation
9. Retailer sales performance commission and incentive program	Rider 10(b), page VII-12, Article VII (H.B. 1), Acts of the 82nd Legislature, Regular Session, 2011 (the General Appropriations Act)	Projected benefits to lottery ticket sales and state revenues of any retailer sales performance commission or incentive program before the Commission may implement the program	Governor and the Legislative Budget Board	Continue

APPENDIX D

Staff Review Activities

During the review of the Texas Lottery Commission, Sunset staff engaged in the following activities that are standard to all Sunset reviews. Sunset staff worked extensively with agency personnel; attended Commission meetings; conducted interviews and solicited written comments from interest groups and the public; reviewed agency documents and reports, state statutes, legislative reports, and previous legislation; and researched the organization and functions of similar state agencies in other states.

In addition, Sunset staff also performed the following activities unique to this agency.

- Interviewed all current Lottery Commission members.
- Attended a live drawing of the Commission's online games.
- Toured the Austin warehouse, data center, and administrative offices of GTECH Corporation, the lottery operations contractor in Texas.
- Accompanied GTECH Corporation sales staff on visits to lottery retailers in San Antonio and visited GTECH Corporation's San Antonio sales office and data center recovery site.
- Interviewed staff at the Lottery Commission's claim center and bingo regional office in San Antonio.
- Observed Lottery Commission staff conducting a bingo hall inspection and visited two additional bingo halls in Austin.
- Observed a hearing at the State Office of Administrative Hearings regarding a Registry of Approved Bingo Workers case.
- Interviewed staff from the Texas Comptroller's Office, State Auditor's Office, Legislative Budget Board, Texas Department of Transportation, Texas Department of Licensing and Regulation, and Texas Facilities Commission.

Sunset Staff Review of the *Texas Lottery Commission*

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