

# TEXAS LOTTERY COMMISSION

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## Agency at a Glance

The Texas Lottery 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.

## Summary

The Texas Lottery Commission walks a tightrope in balancing the many contradictions in the State's attitudes about gaming. The agency is charged with operating the lottery to generate revenue for the State through gaming, but must remain mindful of gaming's many vocal opponents in Texas. 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.

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The Sunset Commission found that while the agency successfully manages the various demands placed on it, an opportunity exists to promote agency effectiveness and accountability by increasing the size of the three-member Lottery Commission so that it is better able to oversee the business of the agency, 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.

The Sunset Commission also sought to strengthen 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. The following material summarizes Sunset Commission recommendations on the Texas Lottery Commission.

## ***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. Having just three members is also unusual among state agency policy bodies and limits the Commission's ability to develop expertise to help improve oversight.

## **Recommendations**

### ***Change in Statute***

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

Under this recommendation, 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 could consider creating committees to oversee major functions of the agency, such as contracting, that would 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 as it determines, based on the value of the contract and other 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.

## ***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. The Sunset Commission found that the agency successfully follows established contracting standards, but identified opportunities to improve contract oversight by enhancing information gathering and reporting on contract sanctions, negotiations, and close-out analysis.

## 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.**

Under this recommendation, the agency should collect and provide specific additional information to management and Commission members to enhance the tools available for contract oversight. Specifically, the agency should 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.

## *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 mature state lotteries, the Texas lottery 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 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.

## 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 aimed at evaluating, and ultimately improving, the agency's performance and cost-effectiveness. The plan would be required to set specific goals, evaluate the agency's overall performance, effectiveness of specific programs and initiatives, and ongoing efficiency of operations. While most critical for the agency's lottery operations, the plan would also include similar analysis and information, as applicable, regarding the agency's regulation of charitable bingo.

## *Issue 4*

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

The ability of the agency's Charitable Bingo Operations Division to prevent theft and fraud in the \$700 million-per-year bingo industry 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.

## 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 pass-through funds over which it has no control will not be included in the calculation of budget cuts for bingo regulation in the future. Prize fees would continue to be appropriated to local governments through rider. Future budget cuts to the agency would be based on actual agency costs.

### *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. The public would have the opportunity to comment on proposed fees through the rulemaking process. Fee revenue would still have to be appropriated to the agency, dampening the incentive to raise fees too high.

#### **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 would 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. Also, like any fee, revenues collected must be appropriated to the agency, removing the incentive to set the fee too high.

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

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.

#### **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.**

This 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 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.**

Under this recommendation, the Commission should reassess its expenses for bingo regulation to account for direct and indirect expenses 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.

## ***Issue 5***

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

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.

## **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.

#### **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 require bingo manufacturers and distributors to meet renewal criteria reflecting the requirements for initial licensure, similar to the way statute currently lists renewal

criteria for bingo conductors and lessors. The recommendation would require the Commission to document through rule its renewal process for all bingo licenses from submission to completion. 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, and would remove the extra fee that manufacturers and distributors pay for a two-year license.

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

This recommendation would remove 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.

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

The Commission would be required to adopt rules describing policies for all phases of the complaint process, including complaint receipt, investigation, and resolution so the public and bingo licensees can better understand the Commission's complaint process for bingo matters. 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.

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

Statute would clearly provide for the Commission to use the State Office of Administrative Hearings (SOAH) for all bingo-related hearings, and would repeal current provisions that allow the Bingo Division to use an agency-appointed hearings examiner. This recommendation would ensure that the Commission continues to use SOAH's independent hearings.

### **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 be required to put probation procedures in rule, including how it would impose appropriate conditions, notify those on probation of necessary actions to meet those conditions, and track their progress.

### **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 Commission's authority to temporarily suspend bingo licenses to prevent financial losses to the State.**

This recommendation would allow the agency 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 be required to identify in rule the circumstances in which it would use this new authority, including in its schedule of sanctions, as recommended above.

## ***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.

### **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 adopt rules that clearly lay out policies for all phases of the complaint process, including complaint receipt, investigation, and resolution so the public and retailers can better understand the Commission's complaint process as it relates to the lottery. 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.

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

Statute would clearly provide for the Commission to use SOAH for all hearings relating to licensed lottery retailers. Requiring the use of SOAH ensures the Commission will continue to use SOAH's independent hearings as it currently does.

## ***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. The Sunset Commission found that one of the Lottery Commission's nine required reports does not serve a useful purpose and should be eliminated.

## Recommendations

### *Change in Statute*

#### **7.1 Update and apply standard Across-the-Board Recommendations to the Lottery Commission.**

- **Public membership.** This provision would prohibit Commission members from being registered or licensed by the agency.
- **Conflict of interest.** This would prohibit a high-level agency employee from being an officer, employee, or paid consultant of a bingo or lottery professional trade association, and prohibit a high-level employee's spouse from being an officer, manager, or paid consultant of a bingo or lottery professional trade association. The agency's general counsel would also be prohibited from lobbying on behalf of lottery or bingo interests.
- **Grounds for removal.** This provision would specify 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 Commission member training, including information regarding the Commission's enabling legislation and other applicable state laws.
- **Separation of duties.** Under this recommendation, the Commission would be required to adopt policies clearly defining its role of setting policy separate from staff responsibilities.
- **Public testimony.** This provision would ensure the opportunity for public input to the Commission on issues under its jurisdiction.
- **Complaint information.** The agency would have to maintain a system for acting on complaints and make information available regarding its complaint procedures. The agency also would be required to maintain documentation on all complaints and periodically notify complaint parties of the status of complaints.
- **Alternative dispute resolution.** This provision would ensure the Commission develops and implements a policy to encourage alternative procedures for rulemaking and dispute resolution that conforms to model guidelines by the State Office of Administrative Hearings. The agency also would be required to 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.**

The report of tickets sold and prizes awarded for each lottery game 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 of the Commission would be continued because they provide information useful to both the agency and the public.

## 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. The Lottery Commission has the expertise and organizational structure to administer the lottery and oversee bingo regulation.

### Recommendation

#### Change in Statute

##### 8.1 Continue the Texas Lottery Commission for 12 years.

This recommendation would continue the 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.

### Fiscal Implication Summary

These recommendations would result in an estimated annual gain of \$1.47 million to the Foundation School Fund, as summarized below.

*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 to the Foundation School Fund.

#### 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

