



SUNSET ADVISORY COMMISSION

Texas Lottery
Commission

Staff Report
August 2002



TEXAS LOTTERY COMMISSION

SUNSET STAFF REPORT

Table of Contents

	PAGE
SUMMARY	1
ISSUES / RECOMMENDATIONS	
1 Texas Has a Continuing Need for the Texas Lottery Commission	7
2 The Small Size of the Texas Lottery Commission Limits Its Effectiveness and Communication Among Its Members	15
3 The Lottery Commission Is Not Performing Sufficient Analyses to Guide Major Financial Decisions	19
4 Charities Are Not Making Maximum Charitable Distributions of Bingo Profits	27
5 Components of the Lessor License Law Prevent the Commission From Maximizing Charitable Distributions From Bingo	37
6 The Bingo Division Has Not Adequately Structured and Applied Its Enforcement Process	45
7 The Bingo Advisory Committee Does Not Effectively Advise the Commission on the Needs of the Bingo Industry in Texas	55
8 State Oversight of System Service Providers Is No Longer Needed	63
9 Key Elements of the State Lottery Act Do Not Conform to Commonly Applied Licensing Practices	67
10 Key Elements of the Bingo Enabling Act Do Not Conform to Commonly Applied Licensing Practices	73

ACROSS-THE-BOARD RECOMMENDATIONS	.....	81
AGENCY INFORMATION	.....	85
APPENDICES		
Appendix A — Equal Employment Opportunity Statistics .....	.....	101
Appendix B — Historically Underutilized Businesses Statistics .....	.....	105
Appendix C — Staff Review Activities.....	.....	107

SUMMARY



Sunset Staff Report

Texas Lottery Commission

Summary

In 1980, Texas voters approved a constitutional amendment allowing the regulation of bingo for charitable fund-raising purposes. Voters approved another amendment in 1991 creating the state lottery to generate revenue for Texas government, and in 1997, the Legislature dedicated lottery revenue to public schools. To administer the lottery, the Legislature created the Texas Lottery Commission, and transferred bingo regulation to the new agency. Today, the Commission operates and markets the state lottery and regulates the charitable bingo industry through licensing and enforcement.

Sunset staff found that the Lottery Commission has generated significant revenue for the State through lottery sales and has helped thousands of local charities raise money through bingo, despite the fact that sales for both types of games have declined in recent years. The agency has also been generally successful at managing its large contracts with multiple lottery vendors, maintaining the security of its lottery games, and taking enforcement action against lottery and bingo licensees who fail to comply with the law. As a result, Sunset staff recommends continuing the Lottery Commission for 12 years. However, the Sunset review found several areas that prevent the Commission from more effectively carrying out its duties.

*The Lottery Commission
has made the lottery a
consistent revenue
generator for the State
and should therefore be
continued.*

First, the small size of the Commission limits its ability to communicate informally and focus on development of policy issues through subcommittees. The agency also does not have a comprehensive business plan to guide major financial decisions. Further, the Executive Director, and not the Commission, makes the final decision on multi-million dollar contracts. As a result, the agency is at risk of making program expenditures that are not justified or are more costly than necessary.

The Sunset review also assessed the agency's ability to regulate the charitable bingo industry. Over the years, bingo regulation has been transferred to several agencies. While Sunset staff believe the Lottery Commission has made an effort to effectively regulate bingo, several statutory changes are necessary to address specific problems. For instance, the formula used to ensure that a certain percentage of bingo revenue is spent on charitable purposes is confusing, cumbersome, and does not maximize charitable distributions. Further, the transferability of bingo lessor licenses

*For more information,
contact Karen Latta,
(512) 463-1300. Sunset
staff reports are available
online at
www.sunset.state.tx.us.*

grandfathered under an old system helps to maximize revenue for commercial interests rather than the charities. Other problems with the state's system of bingo regulation include the ineffectiveness of the Bingo Advisory Committee, the unnecessary licensing of system service providers, and the lack of comprehensive compliance and enforcement rules.

Finally, while the agency does not perform standard occupational licensing functions, it does license lottery retailers and bingo entities. As such, these licensing activities should conform to model licensing standards to ensure the fair treatment of licensees, protect the public, safeguard state revenue, and effectively manage the agency's administrative workload.

The following material provides a summary of the recommendations identified in this report.

Issues / Recommendations ---

Issue 1 Texas Has a Continuing Need for the Texas Lottery Commission.

Key Recommendation

- Continue the Texas Lottery Commission for 12 years.

Issue 2 The Small Size of the Texas Lottery Commission Limits Its Effectiveness and Communication Among Its Members.

Key Recommendation

- Expand the Texas Lottery Commission from three to five public members.

Issue 3 The Lottery Commission Is Not Performing Sufficient Analyses to Guide Major Financial Decisions.

Key Recommendations

- Require the Commission to review and approve all major expenditures.
- Require the agency to develop a comprehensive business plan.
- The agency should conduct a thorough cost-benefit analysis before approving new programs or expenditures.
- The agency should evaluate the effectiveness of current program expenditures through program-specific performance measures or periodic justification reviews.

Issue 4 Charities Are Not Making Maximum Charitable Distributions of Bingo Profits.**Key Recommendations**

- Simplify the statutory charitable distribution formula to ensure bingo proceeds are used for charitable purposes.
- The Commission should clarify the definition of charitable purpose and authorized expense.

Issue 5 Components of the Lessor License Law Prevent the Commission From Maximizing Charitable Distributions From Bingo.**Key Recommendations**

- Repeal the section of the Bingo Enabling Act that allows lessor licenses to be grandfathered.
- Repeal the transferability of lessor licenses.

Issue 6 The Bingo Division Has Not Adequately Structured and Applied Its Enforcement Process.**Key Recommendations**

- Require the Lottery Commission to adopt rules governing all compliance monitoring and enforcement procedures.
- Expand the Lottery Commission's authority to temporarily suspend bingo licenses to prevent financial losses to the State.
- The Lottery Commission should better coordinate the tracking of enforcement information.

Issue 7 The Bingo Advisory Committee Does Not Effectively Advise the Commission on the Needs of the Bingo Industry in Texas.**Key Recommendations**

- Require the Bingo Advisory Committee to develop an annual work plan and make recommendations to the Commission that identify specific issues that need addressing.
- The Commission should take a series of management actions including:
 - evaluating the necessity of the advisory committee;
 - ensuring a greater balance of public and industry members on the Committee;

- lengthening and staggering members' terms;
- developing membership requirements; and
- assigning an attorney to monitor Committee meetings.

Issue 8 State Oversight of System Service Providers Is No Longer Needed.

Key Recommendation

- Abolish regulation of system service providers and automated bingo services.

Issue 9 Key Elements of the State Lottery Act Do Not Conform to Commonly Applied Licensing Practices.

Key Recommendations

- Standardize licensing provisions in the State Lottery Act to ensure consistent licensing and effective compliance by authorizing staggered renewals and requiring compliance history review before license renewal.
- Revise elements of statutory enforcement provisions to provide for effective public protection, such as expedited investigations and a procedure for analyzing complaints.
- Change administrative aspects of the State Lottery Act to allow sufficient public notice of standardized complaint procedures.

Issue 10 Key Elements of the Bingo Enabling Act Do Not Conform to Commonly Applied Licensing Practices.

Key Recommendations

- Ensure consistent licensing in the Bingo Enabling Act by providing clear licensure qualifications, eliminating requirements which unreasonably restrict licensure, and providing a standard renewal process.
- Ensure effective compliance by subjecting temporary licenses to standard oversight and requiring the agency to review compliance history before license renewal.
- Standardize enforcement provisions in the Bingo Enabling Act to provide clear standards of conduct, ensure investigations are completed in a reasonable amount of time, and require the agency to maintain complaint information.

Fiscal Implication Summary

This report contains recommendations that will have a fiscal impact to the State. These recommendations are discussed below.

- ***Issue 2*** - Expanding the Commission would result in additional travel expenses for two new members. The agency should use its administrative allocation of lottery revenue to pay the estimated \$3,200 per year in travel expenses for the new Commission members.
- ***Issue 3*** - Requiring the agency to develop a comprehensive business plan and requiring the Commission to review and approve all major expenditures could have a positive fiscal impact to the State by better ensuring all costs are reasonable and necessary. However, the amount of potential savings could not be estimated.
- ***Issue 5*** - Repealing the laws allowing lessor licenses to be grandfathered and transferred could result in a fiscal impact to the State depending on whether lessors holding these licenses choose to convert to the standard lessor licensing structure or to discontinue leasing facilities for bingo.
- ***Issue 6*** - Allowing the Commission to temporarily suspend a bingo license when tax revenue is at stake may result in fewer losses to the State. However, the number of suspensions is not known and the savings could not be estimated.
- ***Issue 8*** - Abolishing the regulation of system service providers would result in a loss of licensing revenue of \$1,000 per licensee per year (currently two licensees), but would also result in a corresponding reduction in the agency's workload to regulate these licensees.

ISSUES / RECOMMENDATIONS

Issue 1

Texas Has a Continuing Need for the Texas Lottery Commission.

Summary

Key Recommendation

- Continue the Texas Lottery Commission for 12 years.

Key Findings

- Lottery and bingo revenue continue to be important sources of funds for Texas.
- Texas has a continuing need to effectively operate the lottery and regulate bingo.
- While other organizational structures have been tried in the past and continue to be a possibility, the lottery and bingo are effectively administered by the Lottery Commission.
- Many other states operate lotteries and regulate bingo under organizational structures similar to Texas.

Conclusion

Texas has a continuing need to ensure the effective administration and operation of the lottery and regulation of bingo. These games constitute gambling and require close supervision by the State. The games also are an important source of revenue for the State, local jurisdictions, and local charities and the Lottery Commission is responsible for maximizing lottery revenue and ensuring bingo revenue is spent on charitable purposes. The Sunset review evaluated the need for an independent agency to perform these functions. The review also assessed whether another agency could better perform the Lottery Commission's functions, especially its regulation of bingo. Sunset staff found that while other existing agencies or a new gaming or bingo regulatory agency may be able to conduct the functions, no significant savings or improvements would result from an organizational change. The Lottery Commission has generally been successful in accomplishing its mission and should be continued.

Support

The Lottery Commission's mission is to administer the lottery and regulate bingo.

- The mission of the Lottery Commission is to administer and market the lottery to generate revenue for the State and regulate bingo for charitable purposes. The agency is also responsible for maintaining the security and fairness of the lottery and bingo. The agency accomplishes these goals through the key functions of licensing, revenue collection, contract monitoring, marketing, and enforcement. The agency contracts with the GTECH Corporation to provide goods and services to the Lottery Commission in connection with the day-to-day operation of the lottery.
- In 1991, Texas voters approved a constitutional amendment to create the lottery as a means to generate revenue for the State. Until 1997, lottery revenues were deposited in the General Revenue Fund and were used to fund all manner of state expenditures. Today, lottery revenues are deposited in the Foundation School Fund, which supports the operation and maintenance of public schools. Since 1999, unclaimed prize money has been deposited in the Multicategorical Teaching Hospital Account and the Tertiary Care Fund, both of which support indigent medical care. To administer the lottery, the Legislature may appropriate to the agency up to 7 percent of the gross revenue from the sale of lottery products. For the past five years, the agency has used less than 7 percent and returned the remainder to the Foundation School Fund.
- In 1980, voters approved a constitutional amendment allowing the State to regulate bingo and allowing voters to decide if they want bingo in their local jurisdictions. Approximately 200 local jurisdictions authorize bingo and nearly 1,500 charities are licensed to conduct bingo. Charities use their bingo revenue to support their charitable purposes. The Lottery Commission collects prize fees, rental taxes, and license fees on bingo and remits this revenue to the General Revenue Fund and a percentage of the prize fees to local jurisdictions that authorize bingo.

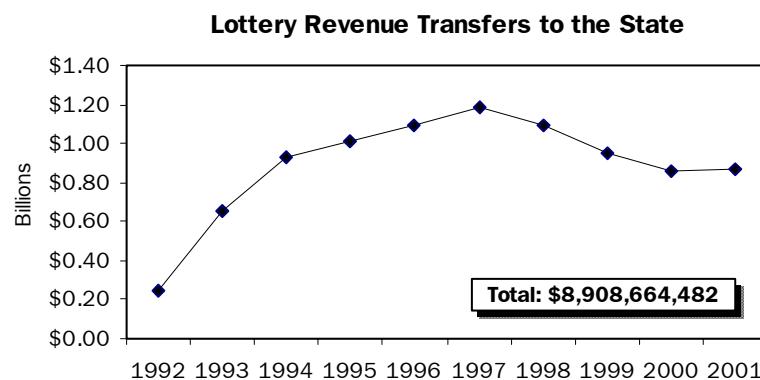
Lottery and bingo revenue continue to be important sources of funds for Texas.

- The purpose of the lottery is to generate revenue for the State. The Lottery Commission has accomplished this goal by effectively administering and marketing the lottery to maximize revenue. To date, the lottery has contributed approximately \$9.6 billion to the State. In fiscal year 2001, the lottery contributed \$825 million to the Foundation School Fund, accounting for 8 percent of that fund. Also in fiscal year 2001, \$39 million in lottery revenue went to the

Lottery revenue supports the operation and maintenance of public schools and indigent medical care.

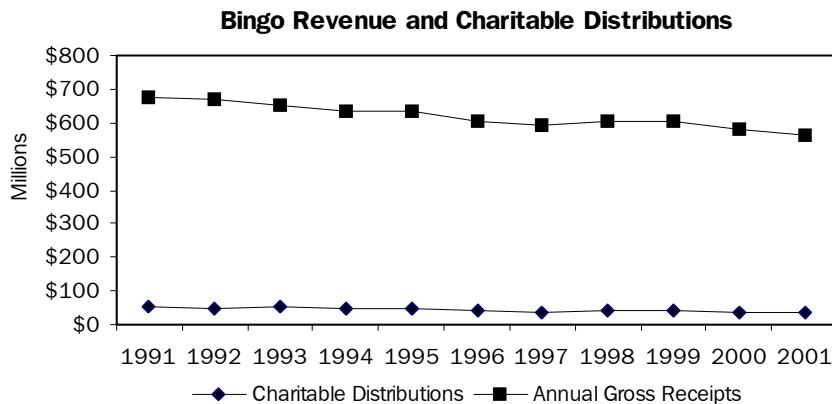
To date, the lottery has contributed approximately \$9.6 billion to the State.

two funds supporting indigent health care. The chart, *Lottery Revenue Transfers to the State*, shows the trend in the amount of money transferred to the State since the lottery's inception through fiscal year 2001. While this chart shows a decline in revenue in recent years, the lottery remains a consistent revenue generator. Without the revenue generated by the lottery, the State would have to find other funding sources for these purposes.



- The purpose of charitable bingo is to generate revenue for charitable purposes in Texas. Since 1982, bingo has generated more than \$648 million for charitable purposes. In calendar year 2001, charities around the state earned \$34.6 million from bingo, which equaled about 6 percent of gross receipts. Bingo also generates revenue for the State and local jurisdictions who authorize bingo through prize fees, licensing fees, and rental taxes. In calendar year 2001, bingo generated \$14.4 million for the General Revenue Fund and \$9.2 million for local jurisdictions. The chart, *Bingo Revenue and Charitable Distributions*, shows that both total revenue generated by bingo and charitable distributions have been decreasing in recent years. Despite these decreases, without the revenue from bingo, charities and the State would have to find other funding sources.

In 2001, charities around the state raised \$34.6 million from bingo.



- Texans continue to support the lottery and bingo. In addition to voting for constitutional amendments to create the lottery and regulate charitable bingo, many Texans also spend their money playing the games. According to a recent demographic study by the agency, 63 percent of adult Texans have purchased lottery products in the past year.¹ Further, in calendar year 2001, charities benefitted from an attendance of 24.3 million at bingo games throughout the state.²

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

The agency maintains close supervision of the lottery and the bingo industry.

- While the agency outsources much of the operation of the lottery, it maintains the vital functions of ensuring the lottery is operated in accordance with state law. For example, the agency licenses nearly 17,000 lottery retailers and takes enforcement action against those who violate the law. The agency markets the lottery through contracts with advertising firms for print, radio, and television advertisements and performs demographic research of lottery players. The agency's security staff investigates complaints from the public and tests games before they are sold to ensure the accuracy of odds. Perhaps most importantly, the agency collects revenue from lottery retailers and remits it to the State Treasury.
- The Lottery Commission also performs the function of regulating the bingo industry. Many small, local charities conduct bingo games, which can generate large sums of cash. As a result, the agency must maintain close supervision over the industry to ensure bingo revenue is used for its authorized charitable purposes. The agency accomplishes this goal by licensing nearly 2,000 bingo entities, reviewing quarterly reports submitted by licensees, auditing at-risk licensees, investigating complaints filed by the public, and taking enforcement action against violators. The agency also collects revenue owed to the State from prize fees and rental taxes on bingo operations.
- The Lottery Commission enforces the State Lottery Act and the Bingo Enabling Act to help ensure the fairness and security of lottery and bingo games. In fiscal year 2001, the agency's Security Division conducted more than 3,800 enforcement activities including inspections; investigations of complaints from the public; and background checks of employees, licensees, and vendors. The Charitable Bingo Division conducted nearly 1,200 audits and inspections of bingo halls and licensee records in calendar year 2001. The Lottery Operations Division electronically withdrew lottery earnings from the bank accounts of nearly 17,000 licensed retailers in fiscal year 2001. As a result of this activity, the agency suspended lottery licenses 2,185 times, meaning certain retailers had their licenses suspended on more than one occasion. The agency also

revoked 102 lottery retailer licenses, revoked or suspended four bingo licenses, and assessed fines against one bingo licensee.

- The agency has overcome past controversies regarding its contracting activities. It has developed a more arms-length relationship with the lottery operator, GTECH Corporation, and has implemented greater controls over this and other large contracts. As a result of recommendations from the State Auditor, the agency has created a Contract Compliance Section within the Executive Director's Office to monitor and retain all documents related to the agency's 106 major contracts. The agency appears to receive a good value from the lottery operator contract, which it recently renegotiated at a lower rate and with increased goods and services.

The agency appears to receive a good value from its lottery operator contract.

While other organizational structures have been tried in the past and continue to be a possibility, the lottery and bingo are effectively administered by the Lottery Commission.

- While other organizational options are available, the Lottery Commission effectively administers the lottery as an independent agency. The Legislature created the Lottery Commission in 1993. Before that time, the lottery was administered by a division of the Comptroller of Public Accounts. While the lottery could feasibly be returned to the Comptroller's Office, the Lottery Commission's current size and mission have grown significantly. Staff analysis showed the disadvantages would strongly outweigh any possible advantages. Another organizational option could be merging the Lottery Commission with the Texas Racing Commission to create a state gaming commission that would oversee all forms of gambling. However, the mission and operations of the two agencies differ extensively and no significant benefits were identified through the creation of a combined agency.

The Lottery Commission could also be separated from state government and allowed to operate as a corporation with a Board of Directors and few statutory restrictions. The main disadvantage of this plan is the loss of control the Legislature would have over the State's lottery. For example, the Legislature may not have a say in how the lottery is advertised or whether it should be expanded to include games such as keno or a multi-jurisdictional lottery.

- The regulation of bingo is well-placed within the Lottery Commission. Over the years, bingo regulation has gone through numerous organizational changes. Bingo was first regulated by a division of the Comptroller's Office, but was transferred to the Texas Alcoholic Beverage Commission in 1990. Bingo regulation was transferred again in 1994 to the newly-created Lottery Commission. While bingo regulation is different in some respects

Bingo regulation is well-placed within the Lottery Commission.

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

from the administration of the lottery, bingo benefits from effective enforcement, legal representation, and administrative assistance, as part of the agency. Further, the Lottery Commission effectively regulates bingo with an annual budget of approximately \$2.8 million and a staff of 49, however, some improvements are needed, as discussed in other issues of this report. Sunset staff concluded that a separate bingo agency was not warranted and would likely result in administrative inefficiencies.

Many other states operate lotteries and regulate bingo under organizational structures similar to Texas.

- Thirty-eight other states plus the District of Columbia operate a state lottery. Five state lotteries are operated by corporations with varying degrees of statutory restrictions. The other 34 lotteries are operated by traditional state agencies similar to the Texas Lottery Commission. Texas, however, is unique in that it outsources a majority of its lottery operations functions.
- Forty-seven other states plus the District of Columbia authorize and regulate the conduct of bingo. In most states, bingo is regulated at the state level by a division within a larger agency, such as a gaming commission or department of revenue or public safety. Three states delegate bingo regulation to local jurisdictions.

Recommendation

Change in Statute

1.1 Continue the Texas Lottery Commission for 12 years.

This recommendation would continue the Texas Lottery Commission as the agency responsible for administering and marketing the State lottery and regulating charitable bingo. This recommendation would also combine the Sunset provision relating to the Lottery Division with the provision relating to the Lottery Commission as a whole.³

Impact

The intent of this recommendation is to continue the agency responsible for effectively administering the lottery to maximize revenue to the State and regulating bingo to ensure bingo revenue is used for authorized purposes. The State has a continuing interest in ensuring the fairness and security of both the lottery and bingo. The State also has an interest in generating revenue for public schools and indigent health care, and in ensuring charities get the most benefit from the bingo games they conduct. The Lottery Commission has proven that it can accomplish these missions and should be continued for 12 years.

Fiscal Implication

If the Legislature continues the current functions of the Lottery Commission, using the existing organizational structure, the agency's annual appropriation of approximately \$182 million would continue to be required for its operation. This appropriation is entirely paid for by the sale of lottery products and the licensing of bingo entities.

¹ Texas Lottery Commission, *Demographic Study of Texas Lottery Players*, data compiled by the Office of Survey Research at the University of Texas at Austin (Austin, Texas, January 2001), p. 3.

² Sunset Advisory Commission overview meeting with the Texas Lottery Commission (Austin, Texas, April 4, 2002).

³ The Government Code contains two Sunset provisions related to the lottery. One provision is in the Commission's enabling statute, Government Code, Section 467.002. The other provision is in the State Lottery Act, Government Code, Section 466.003, and refers to the Lottery Division, which was originally part of the Comptroller's Office. Both provisions include an abolishment date of September 1, 2003.

Issue 2

The Small Size of the Texas Lottery Commission Limits Its Effectiveness and Communication Among Its Members.

Summary

Key Recommendation

- Expand the Texas Lottery Commission from three to five public members.

Key Findings

- The small size of the Commission limits its effectiveness and internal communication.
- The Legislature has generally created larger state agency governing bodies to properly carry out agency policymaking and oversight.
- The governing boards of most other states' lotteries are larger than the Texas Lottery Commission.

Conclusion

The work of the Texas Lottery Commission in operating the lottery and regulating charitable bingo is hampered by its small size. As a three-member, part-time policy body, members of the Commission cannot informally discuss the work of the agency without violating the Open Meetings Act. The Commission also cannot form subcommittees to help it oversee the agency. In view of these problems, the Legislature has acted to form larger policy bodies for the majority of state agencies and has recently increased the size of other three-member boards. The Sunset review examined the work of the Lottery Commission and concluded that the addition of more members would allow it to operate more effectively.

Support

The Texas Lottery Commission is a three-member, part-time governing body.

- In 1993, the Legislature created the Lottery Commission as a three-member body appointed by the Governor.
- The Commission usually meets once a month and is composed of public members, one of whom must have experience in the bingo industry. The Commission passes rules and sets policies to administer and operate the lottery and regulate bingo and employs the Executive Director, Charitable Bingo Operations Division Director, and the Internal Auditor. The Commission also has authority to revoke and suspend lottery and bingo licenses and to deny bingo licenses after a hearing.

The small size of the Commission limits its effectiveness and internal communication.

Commission members cannot informally discuss the work of the agency unless in a posted public meeting.

- The Texas Open Meetings Act presents difficult communication challenges for three-member boards. Because a meeting occurs any time a quorum discusses public business, three-member boards violate the Act whenever two members discuss the agency's work without advance posting. Under the terms of the Open Meetings Act, members of the Lottery Commission cannot informally discuss the work of the agency or directly talk with each other. In fact, one member cannot even call another member to ask a question about basic Lottery Commission business.
- The small size of the Commission limits its use of subcommittees as a tool in overseeing the agency. While the Commission could create two-member subcommittees, it cannot have two subcommittees simultaneously working on different issues — a primary benefit of subcommittees. The current size of the Commission also limits the benefit of using subcommittees to divide the Commission's workload. Although Commission members may individually discuss matters with agency personnel, this option does not provide the difference of opinions that would come from having a subcommittee of members.
- The small size of the Commission also results in members relying heavily on agency staff for policy development. Individual Commissioners may not have the time to focus on a policy area, such as bingo regulation or procurement practices. Although bingo regulation is a small part of the agency's overall mission and budget, the problems with the current regulatory system, as discussed in other issues in this report, could benefit from greater oversight by the Commission. A more significant function of the agency is

managing numerous contracts for the operation of the lottery, including the day-to-day system operation, advertising, and instant ticket manufacturing. These three functions, as performed under five separate contracts, accounted for nearly \$144 million, or 81 percent of the agency's lottery expenditures, in fiscal year 2001. The significant size of these contracts alone demands a high level of oversight by the Commission.

The Legislature has generally created larger state agency governing bodies to properly carry out agency policymaking and oversight.

- Most other state agency policy bodies have more than three members. Of 111 boards or commissions appointed by the Governor, only eight consist of three members, and three of those eight have members who serve full-time.¹
- The Legislature has acted to increase the size of state boards when doing so would allow more effective oversight. For example, in 2001, the Legislature acted on a recommendation from the Sunset Commission to increase the size of the governing board of the State Securities Board from three to five members. In making the recommendation, the Sunset Commission pointed out that a larger board would avoid conflicts with the Open Meetings Act and would allow for the use of subcommittees.²

Of 111 boards and commissions appointed by the Governor, only five consist of three part-time members.

The governing boards of most other states' lotteries are larger than the Texas Lottery Commission.

- Of the 38 other states and the District of Columbia that operate lotteries, 22 have governing bodies with five or more members.³

Recommendation

Change in Statute

2.1 Expand the Texas Lottery Commission from three to five public members.

This recommendation would increase the size of the Lottery Commission by two members. Commissioners would continue to serve on a part-time basis and one member would still be required to have experience in the bingo industry. With more members, the Commission should consider creating subcommittees to oversee bingo regulation, procurement practices, and any other functional areas needing greater oversight.

Impact

Expanding the size of the Lottery Commission would increase the members' ability to communicate while avoiding problems with the Open Meetings Act, allow the use of subcommittees, and allow individual members to focus more attention on significant functions of the agency.

Fiscal Implication

This recommendation would have a minor fiscal impact to the State. Expanding the Commission would result in additional travel expenses for two new Commission members. Based on current projections, costs would increase by about \$1,600 per Commissioner per year. The agency currently receives up to 7 percent of lottery sales for its administration and should use this allocation to pay the travel expenses of the two new Commission members.

¹ The Texas Natural Resource Conservation Commission, Public Utility Commission, and Workforce Commission are full-time commissions with three members each. The part-time three-member boards or commissions with gubernatorial appointments are the Alcoholic Beverage Commission, Lottery Commission, Department of Public Safety, Texas Department of Transportation, and the Veteran's Land Board.

² Sunset Advisory Commission, *Report to the 77th Legislature* (Austin, Texas, February 6, 2001), p. 265.

³ North American Association of State and Provincial Lotteries, *NASPL 2001 Lottery Resource Handbook*, Vol. II, (Willoughby Hills, OH, 2001).

Issue 3

The Lottery Commission Is Not Performing Sufficient Analyses to Guide Major Financial Decisions.

Summary

Key Recommendations

- Require the Commission to review and approve all major expenditures.
- Require the agency to develop a comprehensive business plan.
- The agency should conduct a thorough cost-benefit analysis before approving new programs or expenditures.
- The agency should evaluate the effectiveness of current program expenditures through program-specific performance measures or periodic justification reviews.

Key Findings

- The agency does not conduct a cost-benefit analysis for proposed expenditures, or routinely evaluate the effectiveness of current major program expenditures.
- The Lottery Commission lacks the information and authority to effectively evaluate significant agency expenditures.
- The agency does not have an agency-wide business plan to guide major financial decisions.

Conclusion

The funding process for the Texas Lottery Commission is unique among state agencies, as the Legislature appropriates a certain percentage of lottery sales for administration each fiscal year, and the agency is exempt from standard state procurement requirements. This arrangement, though common in other state lotteries, does not require the level of budgetary analysis performed by other state agencies. The Sunset review evaluated the agency's analysis of new and existing expenditures and found that several new expenditures were not thoroughly analyzed before approval, lacking cost-benefit review and relying on insufficient or inaccurate data. The agency also lacks standard mechanisms to ensure current programs are operating in a cost-effective manner. Further, the State Lottery Act does not grant the Commission specific approval authority for contracts. These recommendations are intended to ensure the agency adequately evaluates and plans for its expenditures. The recommendations would also create a higher level of oversight by providing the Commission with detailed information about significant procurements and programs, in the interest of limiting administrative costs.

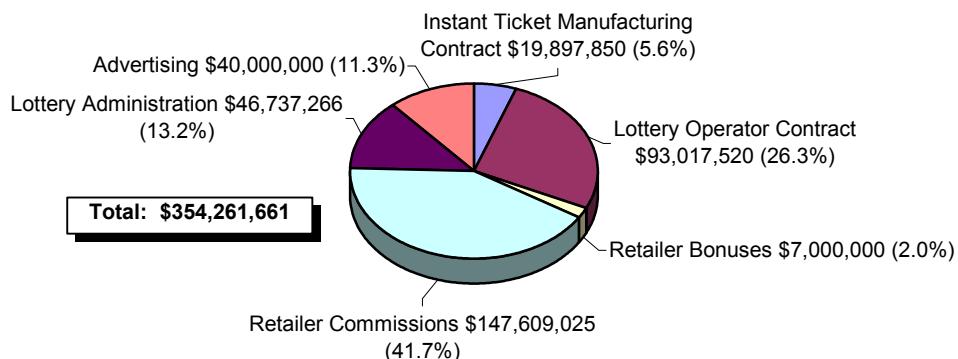
Support

The Texas Lottery Commission's appropriations and procurement structures are unlike other state agencies.

The Legislature appropriates a certain percentage of lottery sales for the agency's administration each year.

- The Legislature appropriates funding to the Lottery Commission based on up to 12 percent of the sales estimate for lottery products in the next year, as calculated by the Texas Comptroller of Public Accounts.¹ Of this estimate, 5 percent goes to retailers for sales commissions, and the remaining 7 percent is used to cover the agency's administrative costs.² The administrative allocations are shown in the pie chart, *Lottery Expenditures*. A contingency rider provides the agency with additional funding for contractual obligations if sales exceed budgeted amounts. The agency must return any unused administrative funds to the Foundation School Fund.

**Lottery Expenditures
FY 2001**



The State Lottery Act specifically exempts the lottery from the Texas Building and Procurement Commission's purchasing requirements.

- The State Lottery Act specifically exempts the Texas Lottery, but not the Charitable Bingo Operations Division, from the Texas Building and Procurement Commission's purchasing requirements and vests all procurement authority with the Executive Director.³ As a result, the Executive Director solely approves all major expenditures and procurement decisions. In fiscal year 2001, the Lottery Commission had 107 different contracts, totaling more than \$150 million, or 72 percent of the agency's appropriation. State law designates the Commission as the appellate body when a bidder protests a solicitation or contract award made by the Executive Director.

The agency does not conduct a cost-benefit analysis for proposed expenditures before initiating its contracting process.

- The agency frequently approves program expenditures without conducting a complete, accurate cost-benefit analysis. During the review, Sunset staff requested all pre-expenditure analysis documentation, and the agency could only provide materials related

to its contract bidding and award processes. Sunset staff concluded that the agency approves projects without thorough cost-benefit evaluation or long-term planning before initiating the procurement process. The Office of the State Auditor has also noted the agency's inadequate expenditure justification. In a response to a 1998 letter from the Commission requesting an increase in full-time positions, the Auditor asked the agency to provide more complete information or support for certain expenditures.⁴ The agency re-evaluated its need and subsequently withdrew the request.

This lack of evaluation and planning could potentially lead to excessive spending, duplicative efforts, or ineffective programs. Examples of agency programs that would have benefitted from more thorough pre-expenditure analysis are provided in the following paragraphs.

- Without adequate expenditure analysis, the agency often underestimates the costs of new programs. Sunset staff's review of agency documents showed that several initial cost estimates were inaccurate, resulting in subsequent costs that may not have justified the actual expenditure. Most estimates were incorrect by wide margins. For example, the cost for constructing the in-house drawings studio at the agency's headquarters in Austin exceeded the estimate by more than \$400,000.⁵ Other examples are shown in the table, *Examples of Inaccurate Cost Estimates*.

Without adequate expenditure analysis, the agency often underestimates the costs of new programs.

Examples of Inaccurate Cost Estimates					
Program	Year	Initial Estimate	Actual Cost	Difference	Explanatory Information
In-house ticket testing facility (annual operations)	1997	\$60,000 ⁶	\$95,000 ⁷	(+) \$35,000	The agency did not anticipate a significant increase in ticket testing. At the time of the estimate, the agency was testing 25 games, and estimated a 10-game increase. However, the agency is currently testing approximately 80 games per year.
In-house broadcast studio (construction)	2001	\$267,000 ⁸	\$699,529 ⁹	(+) \$432,529	The agency initially planned to house the studio at its existing warehouse facility. However, the agency constructed the studio at its headquarters instead, requiring extensive renovation to move its claim center and make room for the broadcast studio.
In-house broadcast studio (annual operations)	2001	\$1,200,000 ¹⁰	\$1,484,598 ¹¹	(+) \$284,598	The initial estimate provided to the Senate Finance Committee did not contemplate the nine employees involved in the drawings. The agency also estimated a one-time capital expenditure to purchase the studio equipment. Based on a recommendation by the Council on Competitive Government, the agency leased the equipment.
Mid-day draw (annual operations)	2002	\$504,840 ¹²	\$598,968 ¹³	(+) \$94,128	The mid-day draw has not been in effect for a full year, however the actual cost is based on year-long contracts to provide necessary services.

A recent proposed rule amendment had a negative fiscal impact of up to \$21.5 million over five years.

- Another example of the agency's lack of cost-benefit assessment was the January 2002 rule proposal to provide 1 percent retailer bonuses for cashing certain mid-level winning tickets. The agency projected a 5 percent sales increase each year, though it provided no analytical data to support this assumption.¹⁴ In fact, lottery sales have been steadily declining in recent years. In response to the proposed rule, the Senate Finance and House Appropriations Committees sent a letter noting that the agency did not adequately evaluate the negative fiscal impact of this rule amendment, reducing revenue to the Foundation School Fund of up to \$21.5 million over five years.¹⁵ Subsequently, the agency withdrew the rule from consideration.
- A third example of how more pre-expenditure analysis could have helped the agency is its headquarters lease in Austin. The agency's previous headquarters were located in a building in north Austin, with an annual lease rate of \$374,700, expiring May 1997.¹⁶ The lessor proposed a lease with an option to purchase at the end of a 10-year lease renewal term. Claiming the repairs or improvements to the existing building would exceed \$2 million, the agency began looking for new lease space in March 1996. The agency focused on properties in the central business district of Austin, an area with some of the highest rental rates in the city. The agency states the necessity for such a centralized location was to increase public awareness of the lottery, though plans for an in-house drawings studio open to the public were developed considerably later.¹⁷

In January 1997, the agency signed a three-year emergency lease for its new headquarters in downtown Austin's entertainment district, without meeting requirements for emergency purchases.¹⁸ An agency rule states the Commission may make an emergency purchase or lease of goods or services if the Commission will suffer financial or operational damage.¹⁹ The agency must document the existence of an emergency before making the lease or purchase. However, the agency could not produce such documentation.

The agency has spent more than \$2.5 million renovating office space that is not state property.

The existing headquarters lease costs \$1.75 million annually, more than two times the lease rate of the previous building, and by 2005 is expected to rent at \$2.1 million per year.²⁰ A 1998 Space Use Study conducted by the General Services Commission noted these costs, along with 9,500 excess square feet, and recommended transition to a state-owned facility when the lease expired in 2000.²¹ However, the agency recently exercised another five-year lease extension three years before its current lease was set to expire. In addition to the annual lease rate, initial renovations to the current location cost almost \$1 million. Including the cost of the new in-house drawings studio, the agency has spent more than \$2.5 million renovating office space that is not state property.²²

The agency does not routinely evaluate the effectiveness of current program expenditures.

- Currently, the agency has no formal system in place to periodically evaluate current programs and activities. The agency holds quarterly contract compliance meetings, but only to ensure general compliance with existing contractual provisions. The agency does not periodically review programs or procurements to establish the necessity of services provided or to ensure quality, effective performance. At the time the contract is set to expire, the agency determines the continued need for the goods or services. A post-expenditure review would provide an opportunity to adjust program objectives, eliminating unnecessary costs.

For example, at a recent Commission meeting, the lottery operator, GTECH, made a presentation regarding the performance of a current Lotto game change, recommending an additional change to increase sales. This presentation, requested by a Commission member, was the first time the Commission evaluated the game's performance since the change in July 2000. The forecasted sales for the initial game change were \$736.1 million per year, however sales were only \$601.1 million by the second year.²³ Sales projections were overestimated by more than \$130 million, yet the agency is considering another game change based on similar GTECH sales projections. Earlier review of the sales estimate variations and the effectiveness of the game change may have led the agency to re-evaluate the change, possibly limiting decreased sales revenue. The Commission's reliance on information provided by an interested third party, which has proven to be inaccurate at times, limits its ability to make informed policy decisions regarding agency expenditures.

The agency does not review programs or procurements for necessity or performance.

The Lottery Commission lacks the information and authority to effectively evaluate significant agency expenditures.

- Since the State Lottery Act gives the Executive Director sole approval authority over all contracts, the Commission's role in major procurements and expenditures is limited. In most other agencies, the governing board has the power to award major contracts, which it then delegates to its executive director. The new lottery operator contract with GTECH, totaling more than \$954 million over 10 years, was awarded solely by a state employee. In fact, a 1999 report from the State Auditor's Office recommended legislation that would provide greater oversight and involvement by the Commissioners in the procurement of lottery goods and services.²⁴ However, the agency took no action to seek legislation to initiate increased Commission oversight.

The lottery operator contract, totaling more than \$954 million, was awarded solely by a state employee.

The agency does not have an agency-wide business plan to guide major financial decisions.

- The agency does not currently have an agency-wide business plan requiring large expenditures to be guided by a comprehensive strategy. Without completing a thorough needs assessment and development plan before approving any new programs or expenditures, the agency cannot accurately determine the cost of implementation. Lack of predetermined goals and program-specific performance measures do not allow the agency to periodically evaluate program or contract effectiveness, and to ensure expenditures are justified.

Large agency expenditures should be guided by a comprehensive business strategy.

In fact, the agency lacks key features of a successful business plan, including a full description of the program, management information, financial data, and a financial management plan. Each of these elements are described in the textbox, *What Goes Into a Business Plan*. Without periodic review of a business plan

by the Commission to assess the overall performance and value of each major expenditure, the agency cannot ensure effective administrative spending.

What Goes Into a Business Plan²⁵

Description of the Business and the Product or Service

Characteristics of the business, customer benefits, expected demand, marketing strategy, location, accessibility, and demographics.

Management Information

Key managers/decisionmakers and their experiences and accomplishments, organizational charts, sources of assistance, salaries, and personnel needs/duties.

Financial Data

Capital equipment needs, balance sheet, breakeven analysis, income and cash flow projections, pricing strategy, and costs for labor, material, services, and overhead.

Financial Management Plan

Start-up budget, operating budget, accounting and inventory systems, and sales and profit goals.

Recommendation

Change in Statute

3.1 Require the Commission to review and approve all major expenditures.

This recommendation would give procurement authority to the Commission, who could delegate certain procurement duties to the Executive Director. This authority is typical for most state boards and commissions. All major procurements would require Commission review and approval. The Commission would determine, by rule, which procurements would be considered major, based on the cumulative value of the contract, as well as other relevant factors. To support the expenditure decisions, the agency would conduct cost-benefit analyses for all new large expenditures and periodic justification reviews of current major expenditures, and present these findings to the Commission.

3.2 Require the agency to develop a comprehensive business plan.

The Lottery Commission's major initiatives should be guided by a comprehensive business plan to ensure their cost effectiveness. The business plan should include a specific description of each program, key management information, accurate financial data, and a detailed financial management plan. The Commission should review the business plan at least annually to assess the overall performance and value of each project. Projects that fail to meet financial objectives should be adjusted or terminated.

Management Action

3.3 The agency should conduct a thorough cost-benefit analysis before approving new programs or expenditures.

Before approval of major programs and expenditures, the agency should conduct a thorough cost-benefit analysis, including supporting documentation and accurate cost projections. All major expenditures would require the Commission's review to ensure administrative spending is justified before initiating the procurement process.

3.4 The agency should evaluate the effectiveness of current program expenditures through program-specific performance measures or periodic justification reviews.

A key component of agency-wide planning should be evaluation of existing programs and activities. This recommendation would require the agency to periodically review current programs to evaluate the cost-effectiveness and necessity of the program. Regular examination and justification of major programs could result in significant savings and improvements.

Impact

These recommendations would promote more effective oversight of Lottery Commission expenditures. A comprehensive business plan will require analysis of major projects and procurements to ensure their costs and benefits are clearly and accurately identified before approval and that the program is clearly in line with the business direction of the agency. In addition, greater Commission involvement will increase accountability and result in more informed policy decisions.

Fiscal Implication

These recommendations could potentially have a positive fiscal impact to the State. Oversight of major programs and procurements should ensure that the actual costs of agency initiatives, as well as a reasonable estimate of the benefit of the initiative, are taken into consideration when committing public funds, potentially reducing the administrative costs of the agency. Costs in preparing the agency-wide business plan should be offset by resulting savings, and any savings resulting from lower administrative costs would provide additional funding to the Foundation School Fund.

-
- ¹ Texas Government Code, sec. 466.355.
- ² Texas Administrative Code, Title 16, part 9, rule 401.353(d).
- ³ Texas Government Code, sec. 466.014 (b).
- ⁴ Letter from the State Auditor's Office to Texas Lottery Commission, Executive Director, February 23, 1999.
- ⁵ Texas Lottery Commission, *Preliminary Due Diligence Report for Production & Broadcast Facility* (Austin, Texas, November 1998), p. 6.
- ⁶ Texas Lottery Commission, *Request to Exceed the Number of Full-time Equivalent (FTE) Positions* (Austin, Texas, October 1998).
- ⁷ Texas Lottery Commission, "Actual Cost Implementation of Chemistry Lab," response to Sunset information request, July 17, 2002.
- ⁸ Texas Lottery Commission, *Preliminary Due Diligence Report for Production & Broadcast Facility* (Austin, Texas, November 1998).
- ⁹ Texas Lottery Commission document, "Texas Lottery Claims Center & Security Building Operations Remodel Project Costs," (December 6, 2001).
- ¹⁰ Texas Lottery Commission memorandum from the Executive Director, re: Senate Finance Committee Testimony, January 22, 2001.
- ¹¹ Sum of current annual contract for drawing studio and production services, and annual salaries of nine agency employees dedicated completely to studio work.
- ¹² Fiscal note estimate provided to Sunset staff for fiscal year 2003, the first full fiscal year the mid-day draws will be in effect.
- ¹³ Sum of annual contracts for drawings studio and production services, broadcast satellite uplink, audit services, additional balls, and annual salaries of two additional employees required for the mid-day draw.
- ¹⁴ Texas Lottery Commission, "Fiscal Note Projections," handout provided to Sunset Advisory Commission, July 19, 2002.
- ¹⁵ Letter from Senate Finance Committee and House Committee on Appropriations to the Texas Lottery Commission, January 23, 2002.
- ¹⁶ Lease document between the Texas Lottery Commission and 6937 North IH35 Ltd. (April 7, 1992).
- ¹⁷ Sunset Advisory Commission meeting with Texas Lottery Commission staff (Austin, Texas, April 2, 2002).
- ¹⁸ Though Texas Building and Procurement Commission was involved in the headquarters building acquisition, no formal review or approval occurred.
- ¹⁹ Texas Administrative Code, Title 16, part 9, rule 401.101(b)(6).
- ²⁰ Lease document between Texas Lottery Commission and Grant Building (January 7, 1997).
- ²¹ General Services Commission Facilities Planning Program, *Texas Lottery Commission Space Use Study* (Austin, Texas, May 29, 1998), p. 5. The report discussed the Robert Mueller airport facility, but did not identify or recommend a specific state-owned facility for relocation.
- ²² Texas Lottery Commission, Lottery Operations Division staff, internal memorandum to Executive Director, August 26, 1997.
- ²³ GTECH Corporation, *On-Line Game Discussion*, report to the Texas Lottery Commission (Austin, Texas, July 23, 2002), p. 7.
- ²⁴ State Auditor's Office, *A Report on Procurement Practices at the Texas Lottery Commission* (Austin, Texas, August 30, 1999), p. 2.
- ²⁵ Federal Small Business Administration, *The Business Plan, Road Map to Success*, www.sba.gov. Accessed: August 2, 2002.

Issue 4

Charities Are Not Making Maximum Charitable Distributions of Bingo Profits.

Summary

Key Recommendations

- Simplify the statutory charitable distribution formula to ensure bingo proceeds are used for charitable purposes.
- The Commission should clarify the definition of charitable purpose and authorized expense.

Key Findings

- State law requires that charities conducting bingo make a minimum quarterly charitable distribution of bingo profits.
- Texas' charitable bingo formula allows some charities to make no minimum distribution.
- Even those charities required to make charitable distributions make minimal distributions, especially when compared to other states.
- The current formula that determines the minimum amount of bingo proceeds to be used for charitable purposes is confusing and burdensome for charities.
- Other states calculate charitable distributions in simpler ways, resulting in more money for charities.

Conclusion

The Commission regulates charitable bingo and is charged with ensuring that bingo profits are used for charitable purposes in Texas. State law requires charities that conduct bingo to spend proceeds each quarter for charitable purposes, and supplies a specific formula to calculate the minimum amount. Currently, actual charitable distributions are a small percent of total bingo gross receipts. The Sunset review determined that one reason for this inequity is the formula, which allows charities to spend a large amount of money on expenses before calculating what will go toward charitable purposes. Sunset staff found that the formula not only prevents charities from making as much money as possible for charitable purposes—the goal of bingo regulation—but that it also prevents the Commission from fulfilling its statutory duty to regulate bingo for charitable purposes. These recommendations would simplify the distribution formula while allowing charities to make more substantial charitable expenditures. At the same time, the recommendations would help the Commission fulfill its mission to regulate bingo for charity.

Support

The Commission regulates bingo for charitable purposes.

- In 1980, Texas voters approved a constitutional amendment authorizing the State to regulate charitable bingo and requiring all proceeds to be spent in Texas for authorized charitable purposes.¹ The Legislature authorized bingo on a local-option basis and charged the Commission with ensuring that bingo is fairly conducted and that proceeds are used for charitable purposes in Texas. To achieve these objectives, state law grants the Commission authority to exercise broad control and close supervision of the industry.² Accordingly, the Commission's mission is to provide charities the opportunity to raise funds for their charitable purposes by conducting bingo and determine that all charitable bingo funds are used for a lawful purpose.
- The Commission currently regulates about 1,500 bingo conductors, which are charities that conduct bingo. The textbox, *Who Are Conductors?*, gives more information about the qualifications for conductor licensure. Only non-profit organizations can conduct bingo games in Texas. To ensure charities use bingo proceeds for charitable purposes, the statute requires charities to make a minimum donation, called a distribution, for charitable purposes each quarter and to submit quarterly reports detailing expenditures and distributions. By law, bingo proceeds can only be spent on prizes, charitable distributions, and other authorized expenses.

State law requires that charities conducting bingo make a minimum quarterly charitable distribution of bingo profits.

- Though the Constitution requires that all bingo proceeds go to charity, state law requires charities to calculate a quarterly charitable distribution using a specific formula to ensure charities donate at least a minimum of profits every quarter. All distributions must be spent on charitable purposes, as described by the textbox, *Charitable Purposes*. The distribution formula requires charities to make quarterly distributions of at least 35 percent of adjusted gross

Who are Conductors?

The Commission only licenses non-profit organizations to conduct bingo. To be licensed, charities must provide proof of charitable activities and all but religious organizations and volunteer fire departments must have a current 501(c) exemption from the Internal Revenue Service. Groups eligible to conduct bingo include charitable organizations such as veterans organizations, fraternal organizations, volunteer fire departments, religious societies, and groups supporting medical research or treatment programs.

Charitable Purposes

State law defines a charitable purpose as an activity that:

- benefits needy people in the state;
- enhances opportunities for religious or educational advancement;
- relieves people from disease, suffering, or distress;
- contributes to people's physical well-being;
- assists people in establishing themselves as worthy and useful citizens;
- increases comprehension of and devotion to the nation's principles;
- enhances loyalty to the government;
- performs worthy public works in this state; or
- enables the erection or maintenance of public structures.

receipts less a specific deduction for statutorily-authorized expenses, as defined in the textbox, *Authorized Expenses*.³ In this formula, adjusted gross receipts are calculated as total gross receipts minus prizes paid, the cost of bingo paper and pull-tabs, and lease payments for card-minding devices. The textbox, *Texas' Charitable Distribution Formula*, demonstrates how charities must calculate their minimum required charitable distribution, and gives an example of how a charity would use the formula.

- The purpose of the distribution formula is to calculate the minimum required charitable distribution that must be made from bingo proceeds, but does not account for all proceeds. Money not accounted for in the formula can be used by charities to pay for other statutorily-authorized expenses or additional charitable distributions, or may be deposited in a bingo savings account for future distribution.

Authorized Expenses

- advertising
- security
- repairs to premises
- bingo supplies and equipment
- prizes
- rental, mortgage or insurance expenses
- bookkeeping, legal, or accounting services related to bingo
- payroll for callers, cashiers, ushers, janitorial services, and utilities
- license fees
- health insurance for employees

Texas' Charitable Distribution Formula

1.	All money collected through conducting bingo (Gross Receipts)	\$162,426
2. Subtract	Cost of bingo paper and pull-tabs	\$2,843
3. Subtract	All prize money awarded	\$118,460
4. Subtract	Lease payments for card-minding devices	\$10,319
5. Equals	Adjusted Gross Receipts	\$30,804
6. Multiply	Adjusted Gross Receipts by 35 percent	\$10,781
7. Subtract	Statutorily authorized expenses (not to exceed 6 percent of Gross Receipts)	\$9,746
8. Equals	Minimum Required Distribution	\$1,035

In this example, of the total \$162,426 made in the quarter, law requires that only \$1,035 be spent on charitable purposes. After subtracting the required distribution and the amount deducted for expenses from the adjusted gross receipts, the formula does not account for \$20,023. This \$20,023 can only be spent on authorized expenses or charitable distributions.

Texas' charitable bingo formula allows some charities to make no minimum distribution.

- Because the formula allows the charity to subtract many different expenses before calculating the minimum required charitable distribution, the formula can result in some charities not being required to make a quarterly distribution at all. These charities usually spend so much money on prizes and authorized expenses that no money is left to donate to the charity's cause. The textbox,

About 20 percent of active conductors were not required to make a charitable distribution in the fourth quarter of 2001.

Calculation Example Resulting in No Required Distribution, demonstrates how a charity could “zero-out” in the 35 percent formula and not be required to make a distribution for that quarter.

Calculation Example Resulting in No Required Distribution		
1.	Gross Receipts	\$90,750
2. Subtract	Cost of bingo paper and pull-tabs	\$2,917
3. Subtract	All prize money awarded	\$70,371
4. Subtract	Lease payments for card-minding devices	\$6,875
5. Equals	Adjusted Gross Receipts	\$10,587
6. Multiply	Adjusted Gross Receipts by 35 percent	\$3,705
7. Subtract	Statutorily authorized expenses (not to exceed 6 percent of Gross Receipts)	\$5,445
8. Equals	Minimum Required Distribution	\$0

In this example, though the charity collected a total of \$90,750 in the quarter, it is not required by law to make a distribution. The \$5,142 not accounted for in this formula may be spent on authorized expenses or charitable distributions.

In the fourth quarter of 2001, 1,504 charities reported to the Commission that they made money conducting bingo in that quarter. Of those, 307 charities were not required to make a charitable distribution according to the formula set in state law. These same 307 charities reported making \$5.5 million in net receipts the same quarter, after subtracting only prizes awarded from their total gross receipts.

The table, *Charities Not Required to Make a Distribution*, shows this type of information for the last nine quarters as reported to the Commission.

- In the last two years, 25 charities have never been required to make a charitable distribution in any quarter. Though most of these charities still made some distribution, Commission records show that the same 25 charities reported making a combined \$23 million in gross receipts during the same time period. After subtracting prizes paid, these charities reported making \$4 million in net receipts before expenses and charitable

Charities Not Required to Make a Distribution⁴			
Year (Quarter)	Total Charities Reporting	Charities Not Required to Make a Distribution	Net Receipts* for Charities Not Required to Make a Distribution (Millions)
1999(4)	1,665	372	\$5.9
2000(1)	1,522	233	\$3.7
2000(2)	1,572	383	\$6.3
2000(3)	1,562	348	\$6.0
2000(4)	1,583	337	\$5.6
2001(1)	1,455	210	\$3.6
2001(2)	1,499	362	\$6.6
2001(3)	1,492	273	\$5.1
2001(4)	1,504	307	\$5.5

*Net receipts equal gross receipts minus prizes paid, before any reductions for expenses or distributions.

distributions. The charities only spent a combined \$287,792 of these net receipts for charitable purposes, equaling 7.2 percent of the net receipts reported to the Commission.

One charity whose formula yielded \$0 every quarter for the last two years has made no charitable distribution at all. That charity reported to the Commission that it made \$1.4 million in gross receipts during the same time period in which it has not made a single charitable distribution.

- The only reason to operate bingo in Texas is to raise revenue for charitable purposes. Clearly, a significant number of bingo conductors do not meet the statutory goal of charitable bingo under the current regulatory scheme.

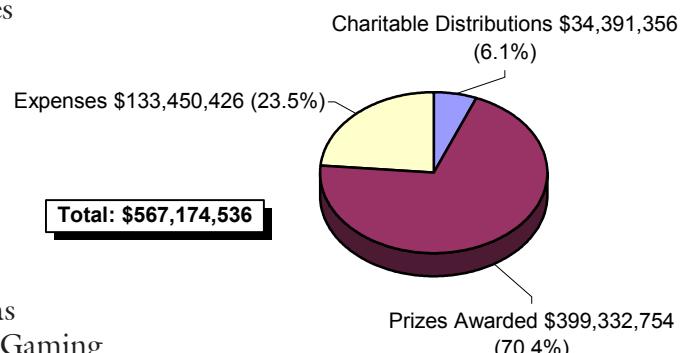
One charity has not made a single charitable distribution in the last two years, though it reported \$1.4 million in gross receipts.

Even those charities required to make charitable distributions make minimal distributions, especially when compared to other states.

- Though bingo was authorized by constitutional amendment for the purpose of allowing charities a method of fund-raising, charities are spending more money on expenses than on distributions. The chart, *Charity Expenditures*, shows how charities spent money earned conducting bingo. Of the \$567 million made in bingo sales in 2001, charities spent 70.4 percent on prizes paid, 23.5 percent on expenses, and only 6.1 percent for their own charitable distributions.
- The National Council of Legislators from Gaming States (the Council) has published the Model State Charitable Gaming Act, which studied the charitable gaming industry across the United States.⁵ The Council studied the percentage of bingo revenue that charities in each state retained for charitable purposes. To do this, the Council divided the amount of money distributed for charitable purposes by the states' net receipts, which are gross receipts minus prizes paid.

By studying 22 states' retention rates in 1997, the Council found that Texas has one of the lowest percentages of retention of money for charitable purposes. Texas' retention percentage was reported at 24.41 percent for 1997, the third lowest in the study, followed only by Oklahoma and South Carolina. Other states' retention rates were as high as 60 to 90 percent. The average retention rate for those states studied was about 40 percent. The chart, *Other States' Retention Rates*, shows detailed information for the states studied.

**Charity Expenditures
Calendar Year 2001**



Charities received more than 50 percent of bingo profits in half of the states studied.

Other States' Retention Rates⁶	
State	Percentage of Bingo Profits Retained for Charitable Purposes in 1997
Arizona	62.04
Colorado	61.95
Connecticut	71.95
Iowa	69.52
Kentucky	63.93
Louisiana	50.67
Massachusetts	45.84
Michigan	61.38
Minnesota	29.47
Mississippi	46.34
Nebraska	45.57
New Jersey	90.25
New Hampshire	52.90
New Mexico	43.77
North Carolina	51.47
North Dakota	28.08
Oklahoma	10.15
Oregon	48.00
South Carolina	5.69
Texas	24.41
Virginia	51.37
Washington	27.32

Historically, Texas has had an average retention rate of 26.26 percent since 1985, but the rate was just 20.5 percent in calendar year 2001.⁷

The current formula that determines the minimum amount of bingo proceeds to be used for charitable purposes is confusing and burdensome for charities.

- Because of the complexity of the charitable distribution formula, the Commission states that licensed charities are often confused about reporting requirements and how to calculate charitable distributions using the formula. In 1999, the Legislature created the Bingo Operator Training program, a required annual training that explains charities' responsibilities and reporting requirements to the Commission, to help alleviate this type of confusion.
- Charities are also confused about what they can use bingo profits for and what constitutes a charitable purpose. For example, one organization contacted by Sunset staff related its concern that charities such as Veterans of Foreign Wars were not able to use bingo profits for purposes such as buying flags, or for expenses such as upkeep of their Post home.⁸ According to the Commission, such distributions and expenses are allowed under the law, depending on the specific circumstances.⁹ The Commission has not promulgated rules specifying the meaning and providing examples of authorized expenses and acceptable distributions that meet the statutory definition of charitable purposes.
- Neither state law nor agency rule allow lease payments for card-minding devices to be included in the calculation of adjusted gross receipts. However, agency practice does allow these lease payments to be part of the calculation, contributing to the confusion about the formula.

The Commission's lack of rules creates confusion about what constitutes a charitable purpose.

Other states calculate charitable distributions in simpler ways, resulting in more money for charities.

- Forty-seven other states and the District of Columbia regulate charitable bingo. All states require bingo proceeds to be donated to charity, though calculation requirements vary. For example, some states require all proceeds be distributed to charity, but do not have a minimum required distribution like Texas does. For states that do have a minimum required distribution, that distribution ranges anywhere from 33 percent to 75 percent of adjusted gross receipts, which is defined differently in different states.¹⁰ Minimum required distributions are often also combined with other limitations, such as a requirement that bingo be played only at the charity's home, or a cap on the amount of money allowed to be spent on expenses.
- The National Council of Legislators from Gaming States based its Model State Charitable Gaming Act on Kentucky's bingo law because it established comprehensive regulation without being unduly burdensome on those who conduct bingo.¹¹ The Model Act notes that states have many ways to ensure that charities retain an

appropriate amount of money for charitable purposes, but highlights Kentucky's requirement that organizations retain at least 40 percent of their adjusted gross receipts. For Kentucky, adjusted gross receipts are defined as gross receipts minus prizes paid. Kentucky's actual retention rate for 1997 was about 64 percent, compared to Texas' 24.41 percent.

Recommendation

Change in Statute

4.1 Simplify the statutory charitable distribution formula to ensure bingo proceeds are used for charitable purposes.

This recommendation would redefine the charitable distribution formula to require charities to distribute a quarterly minimum of a straight percentage of adjusted gross receipts. This formula calculates adjusted gross receipts as gross receipts minus prizes awarded. The textboxes, *Current Distribution Formula* and *Revised Distribution Formula*, compare the current and proposed formulas. The Commission should receive rulemaking authority to determine the specific and appropriate percentage of adjusted gross receipts, and should work closely with the Bingo Advisory Committee and bingo licensees, and examine other states' practices to do this. Because of its charge to regulate bingo for charitable purposes, Sunset staff assumes that the percentage would not be set at a level that would jeopardize the viability of bingo operations.

Current Distribution Formula		Revised Distribution Formula	
1.	All money collected through conducting bingo (Gross Receipts)	1.	All money collected through conducting bingo (Gross Receipts)
2. Subtract	Cost of bingo paper and pull-tabs	2. Subtract	All prize money awarded
3. Subtract	All prize money awarded	3. Equals	Adjusted Gross Receipts
4. Subtract	Lease payments for card-minding devices	4. Multiply	Adjusted Gross Receipts by a percentage equal to or greater than 25 percent
5. Equals	Adjusted Gross Receipts	5. Equals	Quarterly Minimum Required Distribution
6. Multiply	Adjusted Gross Receipts by 35 percent		
7. Subtract	Statutorily authorized expenses (not to exceed 6 percent of Gross Receipts)		
8. Equals	Minimum Required Distribution		

Since Texas has a historical charitable distribution average of about 26 percent and other states' average about 40 percent, the Commission should be required to set the percentage at 25 percent or above. Charities would not deduct any expenses, except prizes, from gross receipts prior to calculating the distribution. Charities would spend the calculated distribution during the next quarter, as the statute currently requires. All other current laws and rules governing required distributions would remain the same, only the formula would change. For example, after charities calculate the distribution, they could only use the remaining proceeds for authorized expenses, as currently defined in statute, or additional charitable distributions.

Sunset staff realizes that some charities may not be able to conduct bingo under this approach to charitable distributions. However, if a charity is not conducting bingo in an economically viable way that ensures significant funds go to charity, then that charity should not conduct bingo.

Management Action

4.2 The Commission should clarify the definition of charitable purpose and authorized expense.

Charitable distribution regulation is confusing not only because of the current complexity of the formula, but also because of the confusion about how charities can spend bingo proceeds. Accordingly, this recommendation would direct the Commission to use its existing authority to pass rules clarifying and providing examples of what are acceptable distributions and expenses within the scope of the statute.

Impact

These recommendations are designed to help the Commission meet its constitutional and statutory charges to regulate bingo for charitable purposes. The Commission is statutorily granted authority to exercise broad control and close supervision of the bingo industry. As a result, ensuring that the charitable distribution formula is meeting its purpose—to ensure the maximum possible charitable distribution—is central to the Commission's objectives.

The intent of the recommendations is to increase the amount of money available to be distributed for charitable purposes, which is a goal of charitable gaming regulation and the driving force behind the 1980 voter-approved constitutional amendment. Since charities currently spend more money on expenses than charitable purposes, redefining the charitable distribution formula will not only allow charities to receive more money, but will also refocus the purpose of bingo back to the charities themselves, as originally intended. Charities will first be required to pay prizes to bingo players and make a minimum charitable distribution before paying expenses to other business interests.

Redefining the charitable distribution formula is also designed to simplify a complex formula. Clarifying the formula and what constitutes a charitable purpose could increase charity compliance by making quarterly reporting easier and less burdensome. Charities would still be required to report expenses to the Commission and the Commission would still be required to review charities' spending to ensure those expenses are authorized by statute.

Fiscal Implication

These recommendations are not expected to have a fiscal impact to the State. The recommendations are designed to ensure appropriate charitable distributions. The State and local governments would continue to receive prize fees as currently provided in law. Any charities choosing not to conduct bingo under the new formula are expected to be replaced by other charitable organizations. As a result, no change in volume of bingo play and revenue is expected from these recommendations.

Further, simplifying the formula may decrease charity noncompliance with the formula, thereby reducing the amount of time the Commission must spend on report reviews, audits, and enforcement

actions and increasing the amount of time available for other projects. However, the potential savings could not be estimated for this report.

¹ Texas Constitution, art. III, sec. 47.

² Texas Occupations Code, sec. 2001.051.

³ Texas Occupations Code, sec. 2001.458.

⁴ Sunset Advisory Commission meeting with the Texas Lottery Commission (Austin, Texas, July 2, 2002).

⁵ National Council of Legislators from Gaming States (NCLGS), *Model State Charitable Gaming Act*, (Hallandale, Florida, June 1999), p. 59.

⁶ Ibid.

⁷ Sunset Advisory Commission overview meeting with the Texas Lottery Commission (Austin, Texas, April 4, 2002).

⁸ Letter from the Department of Texas Veterans of Foreign Wars of the United States to Sunset Advisory Commission, May 13, 2002.

⁹ Sunset Advisory Commission meeting with the Texas Lottery Commission (Austin, Texas, May 29, 2002).

¹⁰ NCLGS, *Model State Charitable Gaming Act*, p. 25.

¹¹ Ibid., p. 3.

Issue 5

Components of the Lessor License Law Prevent the Commission From Maximizing Charitable Distributions From Bingo.

Summary

Key Recommendations

- Repeal the section of the Bingo Enabling Act that allows lessor licenses to be grandfathered.
- Repeal the transferability of lessor licenses.

Key Findings

- The Legislature has amended the lessor license law several times to allow grandfathering and transferability of licenses.
- The Commission is unable to phase out grandfathered lessor licenses, as originally intended.
- Though the Commission regulates bingo for charitable purposes, for-profit businesses receive more profits than charities.
- The Legislature has shown its interest in phasing out other grandfathered licenses.

Conclusion

The Commission regulates bingo as a fund-raising method for charities with the goal of maximizing money for charity. However, charities are currently making less money than for-profit businesses involved in the bingo industry. The Sunset staff review evaluated possible reasons for this inequity and concluded that the grandfathering and transferability of lessor licenses prevents the Commission from regulating lessors in the way the Legislature originally intended. These recommendations would refocus the purpose of bingo regulation to charities, help the Commission bring all lessor licensees into compliance with the current lessor license statute, and allow charities to raise more money.

Support

The Commission licenses lessors that rent space to charities to conduct bingo games.

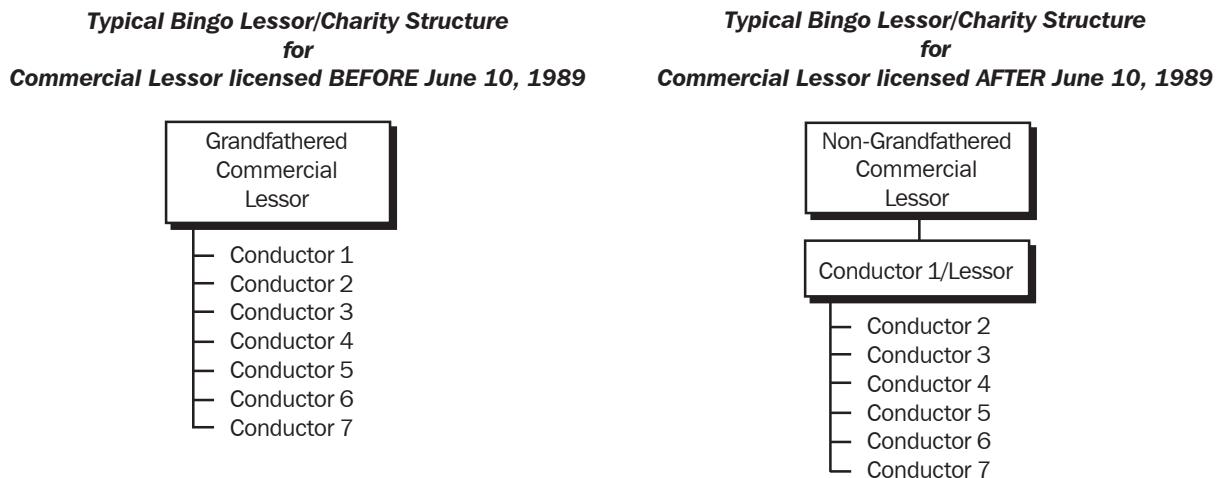
- The Constitution and State law authorize bingo for the purpose of allowing charities a method of fund-raising, and the Legislature has charged the Commission with regulating the bingo industry.¹ If charities do not have adequate space to conduct bingo in their own buildings, they will lease space from lessors, which are licensed by the Commission. The Commission regulates about 1,500 conductors, which are charities licensed to conduct bingo, and about 500 lessors. Lessors can either be for-profit commercial lessors, or charities that are licensed as conductor/lessors to rent to other charities. About 60 percent of conductors report to the Commission that they rent from lessors.
- Currently, to be licensed under the Bingo Enabling Act, commercial lessors can only rent to one licensed conductor, and that conductor can in turn be licensed as a conductor/lessor and rent to up to six other charities.² By law, a lessor cannot charge a charity more than \$600 in rent for each bingo occasion conducted, unless the charity subleases to other charities, in which case the lessor cannot charge the charity more than \$600 a day. Bingo occasions can last a maximum of four hours, and generally no more than two bingo occasions can be played at one location per day.³

The Legislature has amended the lessor license law several times to allow grandfathering and transferability of licenses.

About half of the 480 licensed lessors the Commission regulates are grandfathered commercial lessors.

- The current lessor license law reflects changes made in 1989, when the Legislature revised the Act to reduce the revenue paid to for-profit business interests and to prevent further commercialization of bingo. Before this change, commercial lessors could rent to up to seven different charities. The Legislature grandfathered commercial lessors licensed before June 10, 1989, so today some lessors still operate under the old system, in which a commercial lessor can lease directly to seven different charitable bingo conductors.⁴ The diagram, *Lessor License Structure*, shows the lessor licensing system before and after 1989. Of the total 480 licensed lessors the Commission currently regulates, 282 are grandfathered and 238 of those are grandfathered commercial lessors.
- In 1993, 1995, and 1997, the Legislature amended the Act to make lessor licenses transferable from the licensee to corporations formed by the licensee, between corporations owned by the licensee, to family members in the event of the licensee's death or incapacitation, and to another person, defined as any individual, partnership, corporation, or other group.⁵ As a result, few grandfathered lessor licenses have expired.

Lessor License Structure

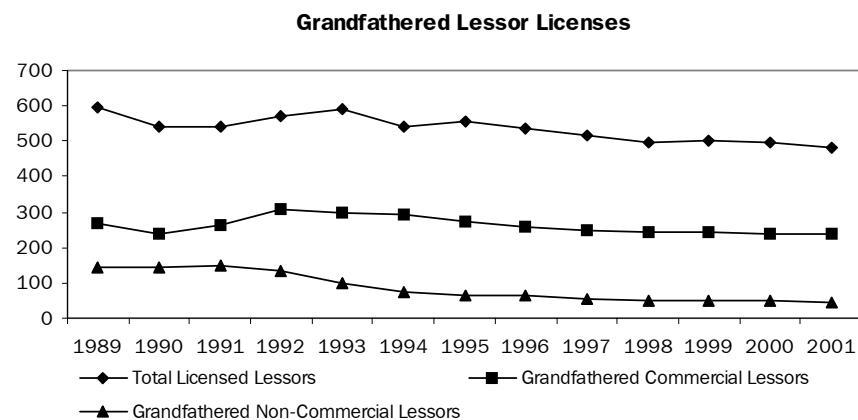


The Commission is unable to phase out grandfathered lessor licenses, as originally intended.

- When changing the structure of lessor licenses in 1989, the Legislature reduced the amount of money being paid to commercial businesses to increase the amount of money available for charities to make charitable distributions. State law requires charities to use any money received in rent from other charities for charitable purposes.⁶ The change signified the Legislature's desire to keep charities as bingo's focus, reaffirming that the Legislature's decision to create bingo regulation was primarily to create revenue for charitable purposes, not commercial ones.

The purpose of grandfathering those lessors licensed under the old system was to some day phase out grandfathered licenses completely, leaving only commercial lessors able to rent to one charity, which, in turn, leases to other charities. However, because the law now allows lessor licenses to be transferred to different entities, grandfathered licenses are perpetuated indefinitely. The number of grandfathered commercial lessor licenses has not been substantially reduced since 1989, as shown by the graph, *Grandfathered Lessor Licenses*.⁷

Beginning in 1991, non-profit grandfathered lessors began transferring their licenses to for-profit businesses. Consequently,



Eighty-seven percent of the lessor licenses transferred since 1994 have been grandfathered licenses.

the number of grandfathered commercial lessor licenses began to increase as the number of grandfathered non-commercial lessors decreased.

- Both grandfathered and non-grandfathered lessors can transfer their licenses, though non-grandfathered licenses have little commercial value, as a potential lessor can easily obtain an original license from the Commission. Since 1994, 87 lessor licenses have been transferred. Seventy-six of those transferred licenses were grandfathered licenses, comprising 87 percent of lessor licenses transferred.⁸ These licenses have been transferred between a number of types of entities, including corporations, individuals, and partnerships.
- Current statutory conditions for transferability are confusing to the Commission and the public. Currently, with prior approval of the Commission, State law specifically provides for the transfer of lessor licenses between corporations owned by the license holder and as part of the licensee's estate.

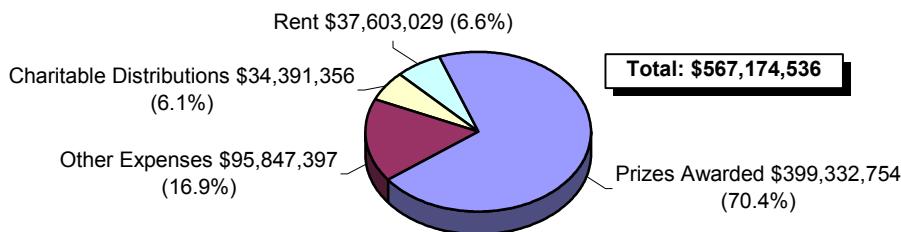
However, in past versions of the statute, the law has also provided for the transfer of a lessor license to another person, defined as an individual, partnership, corporation, or other group. When the Act was nonsubstantively recodified in 1999 into the Texas Occupations Code, this section was rewritten. Though the Commission does not interpret the current statute to specifically allow for transfers of this type, it continues to regulate the transferability of lessor licenses in accordance with the statute's language before recodification, effectively transferring lessor licenses to anyone.⁹ Because the Commission transfers grandfathered lessor licenses to anyone meeting the definition of person, it has been unable to significantly reduce the number of grandfathered licenses.

Though the Commission regulates bingo for charitable purposes, for-profit businesses receive more profits than charities.

- The Constitution and State law charges the Commission with regulating charitable gaming to allow charities a method of fund-raising. Accordingly, the Commission's mission is to provide charities the opportunity to raise funds for their charitable purposes and to determine that all charitable bingo funds are used for a lawful purpose. However, charities are making less money by conducting bingo than commercial interests.

For example, the pie chart, *Charity Expenditures*, shows the distribution of bingo revenue in 2001. Bingo generated \$567 million in total revenue, of which licensed charities distributed \$34.4 million for charitable purposes and paid lessors \$37.6 million in rent. Lessors have received more money than charitable distributions

Charity Expenditures Calendar Year 2001



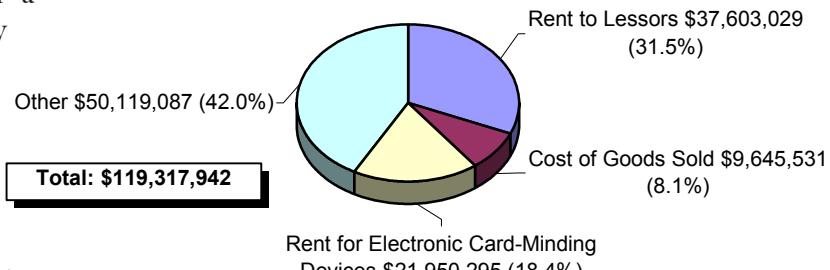
for the last three years, as shown by the chart, *Recent Bingo Trends*.

- Quarterly reports to the Commission show that rent is the single largest expense of conducting bingo for charities that lease space from lessors. The pie chart, *Expenses for Conductors Who Pay Rent*, shows the distribution of expenses for those conductors. The only category that surpasses spending for rent is the “Other” category, which is a compilation of all miscellaneous expenses, such as payroll for bingo workers and bookkeeping expenses.

Recent Bingo Trends ¹⁰			
Calendar Year	Total Bingo Revenue (Millions)	Charitable Distributions (Millions)	Rent Paid to Lessors (Millions)
1999	\$606.2	\$40.1	\$40.4
2000	\$582.3	\$36.9	\$38.4
2001	\$567.2	\$34.4	\$37.6

Expenses for Conductors Who Pay Rent Calendar Year 2001

- A grandfathered commercial lessor has the potential to earn a significant amount of money renting to charities. If a grandfathered lessor rented to the maximum of seven charities, charged the maximum of \$600 per bingo occasion, and charities conducted the maximum two occasions a day, the lessor could earn \$8,400 a week. Under this scenario, a grandfathered lessor could earn \$436,800 in a year, just renting space to charities.



The Legislature has shown its interest in phasing out other grandfathered licenses.

- Last session, the Legislature modified the requirements regarding grandfathered facilities under the jurisdiction of the Texas Natural Resource Conservation Commission. These facilities were exempt from specific emissions requirements of the Clean Air Act, passed in 1970. The Legislature recognized that while the facilities were originally grandfathered to avoid overburdening the existing industries, the grandfathered facilities were not being phased out

as originally intended, and had, in fact, found ways to keep old facilities operating in perpetuity. By modifying the grandfathered status of these facilities, the Legislature has provided for the actual phasing out of grandfathered facilities on a specific schedule.

Recommendation

Change in Statute

5.1 Repeal the section of the Bingo Enabling Act that allows lessor licenses to be grandfathered.

This recommendation would repeal the statutory clause that grandfathered lessors licensed before June 10, 1989. Instead, all lessors would be licensed under current requirements. The Commission would be granted rulemaking authority to establish a phase-in schedule, not to exceed two years, to achieve the integration of previously grandfathered lessors into the current lessor licensing structure.

5.2 Repeal the transferability of lessor licenses.

This recommendation would remove the Act's language allowing lessor licenses to be transferred. Instead, all potential lessors would have to file an application with the Commission and meet the current licensing requirements.

Impact

These recommendations are designed to assist the Commission in fulfilling its mission to regulate bingo for fund-raising purposes by bringing all lessors into compliance with the current lessor license statute. The recommendations will also increase the Commission's licensing efficiency by allowing it to regulate lessors under one system, instead of the current regulation of lessors under two different structures. Currently, by continuing to pay rent to commercial businesses, less money is available to charities for charitable distributions. The recommendation to repeal the grandfathered status of lessors is intended to accomplish the Legislature's desire to instate a new type of lessor license structure, as evidenced by the 1989 amendment to the lessor license law. By repealing the grandfathered status, and allowing those grandfathered licenses to be phased into the current licensing structure, commercial lessors will only be able to rent to one charity, as the Legislature originally intended. Because the ability to transfer lessor licenses is primarily a tool used by grandfathered lessors, abolishing this part of the statute will have little effect on other lessor licensees who can easily apply for licensure from the Commission. Because grandfathered lessor licensees can still transfer their licenses by selling corporation shares, considered stockholder transfers by the Commission and therefore not regulated by the transferability law, these recommendations should be adopted together to ensure that all lessor licensees are integrated into the current lessor licensing structure.

Fiscal Implication

These recommendations could result in a fiscal impact to the State, but it could not be estimated for this report. Grandfathered licenses would lose their market value, so either commercial lessors would choose not to be re-licensed, or would become licensed lessors under the current statute. In the former case, the State would lose the renewal fees currently received from grandfathered lessors and revenue would go down. In the latter case, revenue could remain static, as lessors would pay for a new lessor license and subsequent renewal fees. In either case, revenues to charities would increase because more charities would pay rent to conductor/lessors instead of commercial lessors, as envisioned in the licensing structure change, increasing the revenue available to charities to be spent on charitable purposes.

Abolishing the transferability clause of the Act would result in the loss of the \$10 amendment fee charged per transfer on any future transfers. However, staff workload would be reduced, and the agency would be able to reassign employees to meet other agency objectives.

¹ Texas Constitution, art. III, sec. 47.

² Texas Occupations Code, sec. 2001.152.

³ Texas Occupations Code, sec. 2001.419.

⁴ Texas Occupations Code, sec. 2001.152.

⁵ Texas Occupations Code, sec. 2001.160.

⁶ Texas Occupations Code, sec. 2001.454.

⁷ Sunset Advisory Commission meeting with the Texas Lottery Commission (Austin, Texas, July 2, 2002).

⁸ Texas Lottery Commission, Charitable Bingo Operations Division, "Charitable Bingo Lessor License Transfer Reports," e-mail to Sunset Advisory Commission, June 17, 2002.

⁹ Sunset Advisory Commission meeting with the Texas Lottery Commission (Austin, Texas, June 13, 2002).

¹⁰ Sunset Advisory Commission overview meeting with the Texas Lottery Commission (Austin, Texas, April 4, 2002).

Issue 6

The Bingo Division Has Not Adequately Structured and Applied Its Enforcement Process.

Summary

Key Recommendations

- Require the Lottery Commission to adopt rules governing all compliance monitoring and enforcement procedures.
- Expand the Lottery Commission's authority to temporarily suspend bingo licenses to prevent financial losses to the State.
- The Lottery Commission should better coordinate the tracking of enforcement information.

Key Findings

- The Bingo Division's compliance and enforcement processes are not defined in rule.
- The Bingo Division's ability to use its temporary suspension authority to enforce bingo regulations is limited by its own interpretation of the law and by current statutory language.
- The Lottery Commission does not centrally track the resolution of complaints and audit cases.
- Other state agencies have broader suspension authority and rules governing enforcement procedures.

Conclusion

The Lottery Commission's enforcement of bingo regulations needs improvement. Sunset staff reviewed the agency's bingo enforcement activities in recent years and the procedures it uses to carry out these activities. The review discovered that the agency lacks comprehensive rules governing its compliance and enforcement efforts, does not use its temporary suspension authority, and does not centrally track enforcement information. The recommendations would require the Lottery Commission to develop needed rules to ensure consistency in its compliance and enforcement efforts, provide the agency with greater enforcement authority when State revenue is at stake, and direct the agency to develop a coordinated approach to information tracking so as to better evaluate its effectiveness in this area.

Support

The Lottery Commission is responsible for enforcing the Bingo Enabling Act.

The agency regulates almost 2,000 bingo licensees.

- The Commission, through its Charitable Bingo Operations Division, regulates all activities related to conducting charitable bingo games by licensing bingo entities, and taking enforcement action against licensees who violate the law or rules. The table, *Bingo Licensees*, list the types of licenses offered by the agency and the number of entities regulated in fiscal year 2001.¹
- The Bingo Division monitors licensees' compliance by performing inspections and audits. The Division performs inspections to educate licensees on maintaining accurate records, verify location requirements, and ensure bingo sessions are conducted properly. The Division will perform an audit if it discovers any egregious violations during an inspection. The Division also conducts audits when it finds discrepancies in a licensee's quarterly reports or for a variety of other factors.
- The agency investigates complaints from the public to ensure compliance with bingo laws and rules. In fiscal year 2001, most complaints were for violations of bingo house rules, failure to pay prizes to winners, and unspecified conductor allegations. The public can report a complaint against a bingo licensee by calling the agency's toll-free phone number or writing via email or regular mail. The Security Division receives incoming complaints and may investigate and refer them to the Bingo or Legal Division, or to a local prosecutor for further action, depending on whether they allege criminal or administrative violations. If the Security Division finds a minor violation through its investigation, it may issue a verbal or written warning. The table, *Bingo Complaints*, provides data on complaints received by the agency for fiscal year 2001.²

Bingo Licensees FY 2001	
Types of Licenses	Number of Licenses
Conductor	1,477
Commercial Lessor	479
Distributor	19
Manufacturer	13
System Service Provider	2
TOTAL	1,990

Bingo Complaints – FY 2001	
Complaints received	270
Complaints alleging violations	205
– Closed due to unfounded allegation	151
– Warning issued	32
– Referred to Bingo Division:	
• Closed due to unfounded allegation	3
• Pending	6
– Referred to Legal Division:	
• Closed due to unfounded allegation	5
• Pending	3
– Referred to proper jurisdiction for criminal prosecution	5

- When the agency finds a violation of bingo laws or rules, it will give the licensee a chance to correct the violation and may attempt to resolve the situation through an agreed order. Agreed orders lay out conditions imposed by the agency which can include suspensions, administrative penalties, corrective action plans, additional training, and revocations. If the agency cannot reach an agreement with a licensee to resolve a violation, the agency may take an enforcement action. Following a hearing, the agency may deny a license renewal, revoke or suspend a license, or assess an administrative penalty. The table, *Compliance and Enforcement Information*, indicates the number of compliance monitoring efforts conducted by agency staff, and the number of enforcement actions taken in recent years.

The agency suspended or revoked only four licenses in fiscal year 2001.

Compliance and Enforcement Information³				
	FY 1998	FY 1999	FY 2000	FY 2001
Audits				
Audits completed	183	209	166	258
Audits with violations	143	151	136	172
Percentage of audits with violations	78.14%	72.25%	81.98%	66.67%
Inspections				
Inspections completed	209	272	365	711
Inspections with violations	37	30	149	299
Percentage of inspections with violations	17.70%	11.03%	46.27%	42.05%
Enforcement Actions				
Licenses denied	19	13	15	37
Licenses suspended	0	4	1	2
Licenses revoked	11	0	2	2
Agreed orders issued*	n/a	n/a	n/a	8
Amount of administrative penalties assessed	\$30,000	\$41,875	0	\$500
Licensees assessed penalties	1	4	0	1
*The Lottery Commission began issuing agreed orders in FY 2001.				

The lack of bingo rules creates the possibility of inconsistent enforcement.

The Bingo Division's compliance and enforcement processes are not defined in rule.

- While the Lottery Commission has broad authority to establish rules to administer the Bingo Enabling Act, it has adopted few rules. The Lottery Commission has made few changes to its bingo rules since the program was transferred from the Texas Alcoholic Beverage Commission in 1994. Currently, the agency lacks comprehensive rules governing its compliance monitoring and enforcement procedures. The lack of bingo rules creates the possibility of inconsistent enforcement and leaves licensees and the public without an understanding of the processes in place to enforce bingo regulations, and how to stay in compliance. In March 2002, Bingo Division staff presented a proposal to the Bingo Advisory Committee for reorganizing and updating current rules and adding needed rules. The presentation served as a starting point for future discussions, however, neither the staff nor the Committee established a clear timeline for making these rule changes.
- Specific examples of the agency's lack of necessary rules include rules governing timelines, audits and inspections, and administrative penalties. The agency's rules do not establish timelines to ensure violations discovered during audits are corrected in a timely manner. The rules also do not provide guidance for performing audits and inspections. While the Bingo Division does have internal auditing procedures, this information is not readily available to the public. Recently, the agency proposed rules that would have established timelines for correcting audit violations and guidance for conducting audits and inspections, putting existing processes into rules. Ultimately, the agency withdrew the proposed rules due to public comments that licensees were not involved enough in the rule development process, and that the rules represented an undue burden on licensees.⁴

The agency does not have rules to guide the application of administrative penalties.

The agency also does not have a structure that guides the application of administrative penalties. The statute only states that the amount of an administrative penalty may not exceed \$1,000 for each violation and the recommended penalty amount is based on the seriousness of the violation. However, no rule provides structure or guidance for assessing administrative penalties for specific violations. A lack of guidance limits the agency's ability to ensure the consistency and appropriate application of administrative penalties.

- Even in cases where the statute contemplates the Lottery Commission adopting specific rules, it has not always done so. The table, *Adoption of Bingo Rules*, indicates the number of provisions in statute that authorize or mandate the Commission to adopt rules and how many corresponding rules exist. One example of the Commission not adopting rules despite its authority relates to lesser

involvement in the conduct of bingo. The statute specifically allows the Commission to adopt rules restricting a lessor's involvement in the conduct, promotion, or administration of bingo. However, if the agency receives a complaint alleging lessor involvement, the agency will not investigate since lessor involvement is not established as a violation in rule.⁵

Adoption of Bingo Rules		
Statutory Provision	Number of Statutory Appearances	Number of Corresponding Rules
<i>Shall</i> adopt rules	7	6
<i>May</i> adopt rules	11	6

The Bingo Division's ability to use its temporary suspension authority to enforce bingo regulations is limited by its own interpretation of the law and by current statutory language.

- While the Bingo Division has authority to temporarily suspend a license, it does not use this authority. To temporarily suspend a license, the agency must prove a licensee's continued operation may constitute an immediate threat to the health, safety, morals, or welfare of the public. The agency has interpreted the statute to set a standard that is very difficult to reach. As a result, the agency has not brought a case forward using its temporary suspension authority, and thus, its authority remains untested.⁶ For example, agency staff may not interpret situations where bingo players are cheated during bingo sessions as constituting a threat to public welfare.⁷
- Under its temporary suspension authority, as written in statute, the agency is unable to suspend a license to prevent financial loss to the State if a licensee fails to remit the required quarterly taxes or prize fees. As a result, the agency is unable to prevent organizations from continuing to incur liability against the State. While the Commission may suspend a license under such circumstances, a suspension hearing may take as long as six months to be held. During this time, the licensee continues to incur further debt against the State. However, a temporary suspension hearing must occur within 10 days of the agency's notice of a hearing. The textbox, *Temporary Suspension*, explains the notice and hearing process for the agency's temporary suspension authority.

The agency is unable to temporarily suspend a license to prevent financial loss to the State.

Temporary Suspension

To begin temporary suspension proceedings, the Bingo Division Director must provide the licensee a notice of temporary suspension and a notice of a hearing to be held not later than the 10th day after the date the notice is served. At the hearing, the licensee must show cause why the license should not be temporarily suspended. If the licensee does not show cause, the Commission may suspend the license.

Between 1998 and 2001, at least 20 charities conducting bingo continued to incur debt; and still owe \$177,319 in prize fees to the State, plus accumulated interest.⁸ At least eight of the charitable organizations owe the State more than \$10,000 each, and one owes more than \$22,000. Among these charities, the Commission denied or revoked the licenses of nine, four let their licenses expire, and seven surrendered their licenses.

The agency's inability to track a complaint and its resolution make it difficult to evaluate the enforcement process.

Many state agencies establish a penalty schedule that outlines the seriousness of violations and the appropriate sanction.

The Lottery Commission does not centrally track the resolution of complaints and audit cases.

- Sunset staff had difficulty assessing the quality and consistency of the agency's enforcement activities. Since the agency does not centrally track all bingo complaints and audits resulting in violations, or their resolutions, Sunset staff could not determine whether the agency is properly enforcing bingo regulations. For example, to track the movement of complaints through the complaint process would require the coordination of three divisions – the Bingo Division, Security Division, and Legal Division. The Security Division operates its own complaint tracking system, tracking complaints only up to the point of completing the investigation.⁹ Once the Security Division refers a complaint to the Bingo or Legal Division, that complaint is tracked by a system unique to that division.

Due to the agency's inability to track a complaint and its resolution, it may have difficulty determining how long it takes for complaints to go through the process, judging how well the agency's enforcement process is performing as whole, and being aware of problems to initiate improvements.

Other state agencies have broader suspension authority and rules governing enforcement procedures.

- Several other state agencies have authority to quickly suspend a license or permit if state revenue is at stake. For example, the Lottery Commission has authority to suspend a lottery retailer license without notice or hearing if it finds the action is needed to prevent a loss of lottery revenue to the State. The Office of the Comptroller is authorized to suspend a sales tax permit without notice or hearing if it finds that the business' continued operation constitutes an immediate and substantial threat to the collection of taxes imposed on tobacco products, motor fuel, or cigarettes. The Texas Alcoholic Beverage Commission can suspend, without hearing, a permittee who fails to file a mixed beverage tax payment.
- Most regulatory state agencies have adopted rules governing all compliance and enforcement procedures. Agencies follow these procedures to ensure their powers are applied consistently and appropriately to regulated entities. For example, many state agencies have established a penalty schedule that outlines the seriousness of various violations and the appropriate sanction. In 2002, the Lottery Commission adopted a structure for the imposition of administrative penalties for lottery retailers.¹⁰ The penalty structure clearly lists types of violations and the corresponding enforcement actions for the first, second, and third occurrence of the same offense committed by a lottery retailer.

Recommendation

Change in Statute

6.1 Require the Lottery Commission to adopt rules governing all compliance monitoring and enforcement procedures.

This recommendation would require the Lottery Commission to develop rules that provide a framework for its compliance monitoring efforts, such as audits and inspections, and enforcement activities. The Lottery Commission's adoption of rules should occur no later than September 1, 2004.

The recommendation would also direct the agency to develop a penalty structure, by rule, to guide the application of administrative penalties against licensees for failing to comply with the statute and rules. Such a penalty structure would ensure the appropriate application of penalties to each violation. The Commission would develop a list to define or summarize the most common violations, and a schedule of penalties tied to the seriousness and frequency of particular offenses. The list of violations in the penalty structure would not necessarily be an exclusive list of violations of the Bingo Enabling Act or Lottery Commission rules. The penalty structure would allow for deviations if mitigating circumstances are involved, for which the Commission would need to clearly establish reasons.

The recommendation would also require the Commission to develop, by rule, timelines for resolutions of violations. A licensee would have to prove corrective measures or be subject to sanctions within the established timelines. The recommendation would require the agency to adopt an approach and time frame to follow up on significant violations committed by licensees.

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

This recommendation would amend the statute to grant the Lottery Commission authority to temporarily suspend a bingo license in instances where action is necessary to prevent financial loss to the State. For example, the Bingo Division Director could issue a temporary suspension order if a licensee fails to remit quarterly taxes or prize fee payments to the agency. To implement this recommendation, the Commission would be required to adopt rules governing the use of its temporary suspension authority. This recommendation is an expansion of the agency's current temporary suspension authority, which requires the agency to prove a licensee's continued operation may constitute an immediate threat to the health, safety, morals, or welfare of the public.

Management Action

6.3 The Lottery Commission should better coordinate the tracking of enforcement information.

The Lottery Commission should develop a system to centrally track complaints received and audits conducted and their resolutions as they move through the process from one division to another. This endeavor will require a coordinated effort by the Charitable Bingo Operations Division, Security Division, and Legal Division. As part of the coordinated effort, the Security Division and Charitable Bingo Operations Division would need to develop a common definition of what constitutes a complaint.

6.4 The Bingo Division should consider using its existing temporary suspension power and evaluate its authority to adopt bingo rules.

The Bingo Division should be encouraged to use its temporary suspension authority when the welfare of the public may be threatened, such as when a bingo hall is conducting the game in such a way as to cheat players. In addition, the Lottery Commission should evaluate its statutory authority to adopt rules and determine whether it needs to develop bingo rules in certain areas, such as lesser involvement.

Impact

Developing rules for the agency's compliance monitoring and enforcement activities will provide licensees with a better understanding of the processes in place for regulation and how to stay in compliance, and will help to ensure consistent application of the law. For example, the establishment of a penalty structure in rule would ensure the appropriate and consistent assessment of administrative penalties. Further, instituting a timeline in rule for follow-up of violations assures that licensees take corrective measures in a timely manner. Through the rulemaking process, the public and the regulated community will have the opportunity to participate in establishing agency procedures.

Amending the Lottery Commission's temporary suspension authority would allow it the ability to prevent licensees from continuing to incur debt and liability against the State. In addition, the agency should use its existing temporary suspension authority if it finds potential threats to the public welfare. The Bingo and Legal Divisions should work together to determine the best course of action when applying the agency's current authority.

Fiscal Implication

This recommendation will not have a fiscal impact to the State. The agency should develop rules using its existing resources. The recommendation amending the Lottery Commission's temporary suspension may result in fewer losses of revenue to the State, an amount which could not be estimated for this report.

-
- ¹ Texas Lottery Commission, Lottery Operations Division, "Re: updated SER Information," e-mail to Sunset Advisory Commission, May 6, 2002.
 - ² Texas Lottery Commission, Charitable Bingo Operations Division, "Information Requests," e-mail to Sunset Advisory Commission, July 11, 2002.
 - ³ Texas Lottery Commission, Charitable Bingo Operations Division, "Re: An additional information request," e-mail to Sunset Advisory Commission, June 20, 2002; Texas Lottery Commission, Charitable Bingo Operations Division, "Questions," e-mail to Sunset Advisory Commission, June 27, 2002; Texas Lottery Commission, Charitable Bingo Operations Division, "Information Requests," e-mail to Sunset Advisory Commission, July 11, 2002; Texas Lottery Commission, Charitable Bingo Operations Division, "Licenses Denied, Revoked, or Suspended," e-mail to Sunset Advisory Commission, July 15, 2002.
 - ⁴ Texas Lottery Commission, Charitable Bingo Operations Division, "Re: An additional information request," e-mail to Sunset Advisory Commission, June 20, 2002.
 - ⁵ Telephone interview with Texas Lottery Commission, Security Division staff (Austin, Texas, July 19, 2002).
 - ⁶ Telephone interview with Texas Lottery Commission, Legal Division staff (Austin, Texas, July 22, 2002).
 - ⁷ Conclusion by Sunset staff based on a discussion with Texas Lottery Commission staff.
 - ⁸ Texas Lottery Commission, "Liability Owed At Beginning and Conclusion of Administrative Process," handout provided to Sunset Advisory Commission, June 3, 2002.
 - ⁹ Sunset Advisory Commission meeting with Texas Lottery Commission (Austin, Texas, July 12, 2002).
 - ¹⁰ Texas Administrative Code, Title 16, part 9, rule 401.160.

Issue 7

The Bingo Advisory Committee Does Not Effectively Advise the Commission on the Needs of the Bingo Industry in Texas.

Summary

Key Recommendations

- Require the Bingo Advisory Committee to develop an annual work plan and make recommendations to the Commission that identify specific issues that need addressing.
- The Commission should take a series of management actions including:
 - evaluating the necessity of the advisory committee;
 - ensuring a greater balance of public and industry members on the Committee;
 - lengthening and staggering members' terms;
 - developing membership requirements; and
 - assigning an attorney to monitor Committee meetings.

Key Findings

- The Committee does not effectively carry out its duties to advise the Commission.
- The Committee's ability to be effective is limited by its membership structure.
- The Committee's meetings are ineffective and often disorganized.

Conclusion

The purpose of the Bingo Advisory Committee is to advise the Commission on the needs and problems of the charitable bingo industry. The Sunset review examined the Committee's effectiveness and discovered that its reports to the Commission lack useful feedback, and its membership structure and the conduct of its meetings limit its ability to address significant bingo issues. The Sunset review sought to make recommendations to improve the Committee's effectiveness and ability to serve as a useful resource to the Commission.

Support

The Bingo Advisory Committee advises the Texas Lottery Commission on charitable bingo issues.

BAC Appointments

- 1 General Public
- 3 Conductors (charities operating bingo games)
- 1 Lessor, Charity
- 2 Lessors, Commercial
- 1 Distributor or Manufacturer
- 1 System Service Provider

- The Bingo Advisory Committee (BAC) consists of nine members, appointed by the Commission, representing a variety of interests, as shown in the textbox, *BAC Appointments*. Members serve one-year terms. BAC meets quarterly or at the Commission's request and must adhere to the Open Meetings Act as required by agency rule. The responsibilities of the Committee are to:
 - advise the Commission on the needs and problems of the state's bingo industry;
 - comment on bingo rules during their development and before final adoption unless an emergency requires immediate action by the Commission;
 - report annually to the Commission on the Committee's activities; and
 - perform other duties as determined by the Commission.

The Committee does not effectively carry out its duties to advise the Commission.

- BAC does not meet its intended purpose of effectively advising the Commission on the needs and problems of the state's bingo industry. The Committee's reports to the Commission and the issues and rules discussed during BAC meetings lack real, concrete feedback and recommendations. As a result, the Commission may not be able to rely on BAC for insight on issues or useful feedback to assist its decisions on bingo matters. For example, the Committee consistently works on issues that require statutory, rather than rule, changes and does not provide adequate feedback to agency staff as indicated in the table, *Issues Addressed by BAC*.
- BAC does not develop any type of work plan that outlines its objectives and goals for the year. Generally, BAC does not provide a year-end summation of its accomplishments or activities, or present formal, tangible recommendations to the Commission regarding the needs of the bingo industry. A review of the BAC Chair's reports to the Commission found that while the Commission was informed of the Committee's activities, much of the feedback focused on complaints that the industry is overregulated, bingo matters are not a priority at the agency or Commission meetings, and the perception the Committee and Commission are "rubber stamps" of the Charitable Bingo Operations Division.¹

BAC does not provide a summation of its accomplishments or present tangible recommendations to the Commission.

Issues Addressed by BAC²			
Issue	Number of Meetings Discussed	Timeline	Discussion
Persons Under 18 Working in Bingo Halls	Six	2/26/99 thru 9/21/00	BAC discussed allowing persons under 18 to work in bingo halls. BAC brought the matter before the Commission twice who rejected it both times because individuals younger than 18 years cannot conduct or assist in bingo games, according to state law.
Reporting Due Date	Two	5/9/01 thru 7/25/01	BAC discussed extending the time quarterly reports are due to a later date. At two separate meetings, BAC discussed it as a possible rule change. At both meetings, agency staff informed members that the change required legislation.
Use of Debit Cards	Three	2/14/00 thru 8/29/01	Staff conducted research on the use of debit cards at bingo halls and asked BAC for suggestions on how to address several issues to draft a rule. However, the members elected not to provide suggestions.
Gift Certificate Rule	Five	2/26/99 thru 7/25/01	BAC asked staff to prepare a gift certificate rule for consideration. BAC later determined the draft rule was too cumbersome and tabled the issue.

Individuals from the bingo industry and members of BAC and the Lottery Commission raised doubts about the Committee's effectiveness.

- Throughout the Sunset staff review, individuals from the bingo industry and members of BAC and the Lottery Commission raised doubts about the Committee's effectiveness.³ Further, the BAC Chair acknowledged during a recent public meeting that the Committee is not answering the needs or the concerns of the bingo industry.⁴
- The Commission does not review BAC annually to assess its effectiveness.⁵ Although statutory guidelines in Chapter 2110 of the Texas Government Code require state agencies to annually evaluate its committees' work, usefulness, and costs, the Lottery Commission has never evaluated BAC. The Commission does have a rule that abolishes BAC in March 2003, unless the Commission affirmatively votes to continue its existence. The Commission's future plans for BAC are not known.⁶

The Committee's ability to be effective is limited by its membership structure.

- BAC members do not represent a balance of interests. Statutes regarding the composition of advisory committees in general, and BAC in particular, require a balance of interests between the public and the regulated community. However, the agency rule establishing the specific membership of BAC only allocates one slot for the general public. Members of the bingo industry dominate BAC. As such, the present composition of BAC, as dictated by agency rule, does not comply with statutory requirements for a balance of interests between industry and the public. The table, *Advisory Committee Composition*, provides statutory and agency rule language relating to committee appointments.

Advisory Committee Composition		
Section 2110.002, Texas Government Code	Section 2001.057, Texas Occupations Code	Texas Administrative Code, Section 402.567
General law governing advisory committees	Bingo Enabling Act statute creating BAC	Agency rule specifying BAC membership
The composition of an advisory committee that advises a state agency regarding an industry or occupation regulated or directly affected by the agency must provide a balanced representation between: <ul style="list-style-type: none"> ● the industry or occupation; and ● consumers of services provided by the agency, industry, or occupation. 	The Commission may appoint a bingo advisory committee consisting of nine members. The Commission shall appoint members representing a balance of interests including representatives of: <ul style="list-style-type: none"> ● the public; ● charities that operate bingo games; and ● commercial and charity lessors that participate in the bingo industry. The Commission shall include a system service provider as a member of the committee.	The following appointments shall be made representing a balance of interests : <ul style="list-style-type: none"> ● General Public – one; ● Charities that operate bingo games – three; ● Lessor, Charity – one; ● Lessor, Commercial – two; ● Distributor/Manufacturer – one; ● System Service Provider – one.

- The members' one-year terms hinder BAC's continuity and effectiveness. The short term length does not allow members to gain a significant level of knowledge to participate meaningfully in Committee activities and ensure continuity of experience and expertise. Since 1994, 18 members have served one term and 11 members have served more than one term.⁷ The absence of a staggered schedule for term expirations makes BAC vulnerable to significant turnover. Since members' terms expire at the same time every year, BAC cannot ensure an orderly succession from one committee to the next. Recently, BAC discussed recommending to the Commission lengthening the term to three years and placing members' terms on a staggered schedule, but BAC has taken no action on this item.⁸

- No standards exist for removing BAC members if they are subject to disciplinary actions by the agency. The statute and rules are limited in establishing membership standards for appointment and for maintaining service on the Committee. Agency rule requires members to pass criminal background checks to be qualified for appointment. Agency rule also states that members who fail to meet criminal history standards established for issuance of a license while serving on BAC will be disqualified from serving. Failure to attend two consecutive meetings may also be cause for removal.

The statute and rule do not specify any other requirements that members must maintain while serving on BAC. Specifically, the statute and rule do not speak to disqualifying members if their license renewals are denied or they are subject to disciplinary actions such as license suspension or revocation. No explicit procedure exists in statute or rule for removing a member other than that members serve at the pleasure of the Commission.

- Currently, the agency only licenses two system service providers. Though licensed to sell or supply automated bingo services to conductors, neither system service provider has a contract with a conductor for its services. Further, these two licensees represent only a small fraction of the nearly 2,000 bingo entities that the agency regulates. As such, this type of licensee should not be a required member of the Committee. Issue 8 of this report recommends abolishing the regulation of system service providers.

BAC members may continue to serve even if their licenses are denied or they are subject to disciplinary action.

The Committee's meetings are ineffective and often disorganized.

- Sunset staff observed several BAC meetings and, on two separate occasions, witnessed members discussing items not on the agenda, a violation of agency rule that requires BAC meetings to adhere to the Open Meetings Act. An agency attorney may attend a Committee meeting for a specific purpose, but no attorney is regularly assigned to BAC meetings to answer questions, and to ensure the Committee's compliance with the Open Meetings Act.⁹
- Sunset staff witnessed several BAC meetings that were conducted in a disorganized manner. BAC members' personal issues often become part of the meeting's discussion. Further, while the general public is allowed opportunity to make public comment, members of the audience consume a significant portion of the meetings with their comments and questions, limiting effective consideration and action on agenda items. The conduct of the meetings resembled an open forum rather than a structured public proceeding.

BAC meetings do not comply with the conduct of a structured public proceeding.

Recommendation

Change in Statute

7.1 Require the Bingo Advisory Committee to develop an annual work plan and make recommendations to the Commission that identify specific issues that need addressing.

This recommendation requires the advisory committee to develop a yearly work plan that would detail the Committee's objectives and issues it would like to address during the year. The issues addressed by the BAC should include assessing trends in the charitable bingo industry, reviewing bingo rules for needed changes, additions, or deletions, and addressing other issues as determined by the Commission. At year's end, BAC should assess its accomplishments, identify opportunities to improve the way the agency regulates charitable bingo, and develop specific recommendations for Commission action.

7.2 Eliminate the statutory designation of a slot for a system service provider on BAC.

Since the agency only licenses two system service providers and no system service provider is used in Texas, this recommendation would eliminate an unnecessary slot on the Bingo Advisory Committee.

Management Action

7.3 The Commission should evaluate the necessity of the advisory committee.

The Commission should comply with Chapter 2110, Texas Government Code that require agencies to annually evaluate a committee's work, usefulness, and costs related to its existence. The Commission should discuss BAC's continued existence during an open meeting. Before taking action, the Commission should request recommendations from agency staff on ways to improve BAC's effectiveness and usefulness to the Commission. The Commission should also request input from the advisory committee and the public.

7.4 The Commission should ensure a greater balance between public and industry members on BAC.

The Commission should provide for a balanced representation of interests on its advisory committee to comply with Chapter 2110, Texas Government Code and the Bingo Enabling Act. The Lottery Commission should consider increasing the number of general public members, with no ties to the bingo industry.

7.5 The Commission should lengthen Committee members' terms to three years and stagger the appointments.

The Lottery Commission should lengthen members' terms from one year to three years and place those terms on a staggered schedule, with one-third of the Committee's membership to be appointed every year. These changes correspond to the Committee's recent suggestions for lengthening and staggering its terms.

7.6 The Commission should develop membership requirements for BAC.

This recommendation directs the Commission, by rule, to establish membership requirements that members must maintain to serve on the Bingo Advisory Committee. Requirements should include circumstances that would disqualify members from serving the remainder of their terms, such as if a member's license renewal is denied or subject to disciplinary action. The Commission should also develop procedures for removing Committee members.

7.7 The agency should assign an attorney to monitor BAC meetings.

The General Counsel should assign an attorney to be present at BAC meetings. The attorney would be responsible for ensuring Committee members comply with Commission rule relating to compliance with the Open Meetings Act, answering certain legal questions posed by members, and providing guidance to the Committee on the procedures to follow in conducting a meeting.

Impact

The intent of the recommendations is to improve the effectiveness of BAC in meeting the needs of the Commission and the bingo industry. The recommendation to develop an annual work plan would provide the Committee with focus and direction on the issues it addresses each year. The recommendation would also increase the usefulness of the information BAC provides to the Commission.

The Commission's annual evaluation of BAC would help determine whether it still meets its intended purpose and that its work is still useful and beneficial. The recommendation to ensure the general public is adequately represented on the advisory committee aims to include the perspective of persons with no business ties to the bingo industry. Extending the term length and staggering the members' terms would provide continuity and maintain a level of experience on the Committee. The recommendation that establishes standards that members must maintain to serve on BAC ensures that members with disciplinary problems have no involvement in shaping the regulation of the bingo industry.

Fiscal Implication

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

-
- ¹ Transcripts from Texas Lottery Commission meeting., (Austin, Texas, April 25, 2002). Online. Available: www.txbingo.org/legal/docs/20020425lcm_v1.txt. Accessed: June 21, 2002.
 - ² Texas Lottery Commission, Charitable Bingo Operations Division, “Questions,” e-mail to Sunset Advisory Commission, June 27, 2002; Telephone interview with Texas Lottery Commission, Charitable Bingo Division staff (Austin, Texas, June 14, 2002); Transcripts from Bingo Advisory Committee meeting, (Austin, Texas, July 25, 2001). Online. Available: www.txbingo.org/bingo/min20010725.txt Accessed: July 3, 2002; Minutes from Bingo Advisory Committee meeting, (Austin, Texas, May 9, 2001). Online. Available: www.txbingo.org/bingo/min509.cfm Accessed: July 3, 2002.
 - ³ Bingo Advisory Committee meetings (Austin, Texas, March 20, 2002 and April 10, 2002); Sunset Advisory Commission meetings with the Texas Lottery Commission (Austin, Texas, May 9, 2002 and May 22, 2002)
 - ⁴ Transcripts from Texas Lottery Commission meeting, (Austin, Texas, August 8, 2001). Online. Available: www.txbingo.org/legal/meetings/080801.txt. Accessed: June 23, 2002.
 - ⁵ Sunset Advisory Commission meeting with the Texas Lottery Commission (Austin, Texas, June 3, 2002).
 - ⁶ Telephone interview with Texas Lottery Commission, Legal Division staff (Austin, Texas, July 2, 2002).
 - ⁷ Texas Lottery Commission, “Bingo Advisory Committee Member History,” handout provided to Sunset Advisory Commission, June 2002.
 - ⁸ Transcripts from Bingo Advisory Committee meeting, (Austin, Texas, April 10, 2002). Online. Available: www.txbingo.org/legal/docs/BAC020410v1.txt Accessed: June 6, 2002.
 - ⁹ Telephone Interview with Texas Lottery Commission, Charitable Bingo Operations Division staff (Austin, Texas, June 11, 2002).

Issue 8

State Oversight of System Service Providers Is No Longer Needed.

Summary

Key Recommendation

- Abolish regulation of system service providers and automated bingo services.

Key Findings

- Regulating system service providers offers little benefit to the State or the public and limits the availability of accounting services to conductors.
- No other state licenses system service providers.

Conclusion

The Commission licenses system service providers (SSPs), who provide tracking and accounting programs to bingo conductors. Since SSP licensure began in 1995, the Commission has licensed only four SSPs. Currently, the Commission regulates only two SSPs and no conductor uses the services of the licensed providers. The Sunset review evaluated the need for continuing this licensing program by using the Texas Sunset Act criteria. The review concluded that system service provider licensing offers little benefit to the State or the public, and should be abolished.

Support

The Lottery Commission regulates system service providers.

- In 1995, the Legislature gave the Commission the power to regulate system service providers (SSPs) through licensure. SSPs supply automated bingo services to licensed conductors, which are charities that conduct bingo games. As defined by state law, automated bingo services are computer programs that register and account for bingo sales, prizes, inventory and prize fees, generate reports for the Commission, and provide bingo conductors with other information for accounting and business purposes. By rule, automated bingo services do not include computer accounting programs that are commercially available, such as Microsoft Excel and Peachtree.

State law requires SSPs to have the automated bingo services system approved by the Commission prior to supplying or selling it to a conductor, to file quarterly reports with the Commission, and to pay an annual \$1,000 licensing fee.

- Currently, the Commission regulates two system service providers, though it has only approved one system for use.

Regulating system service providers offers little benefit to the State or the public and limits the availability of accounting services to conductors.

- The Commission licenses SSPs to ensure that conductors using automated bingo services receive a legitimate product, licensed within the scope of the Bingo Enabling Act. However, no conductor currently uses the services of a system service provider.¹ Since the regulation's inception, only one conductor has used an automated bingo services system as a pilot project, and has since stopped using it.²

According to the agency, one reason for the small number of licensees is that conductors either maintain their own records or hire an accountant or bookkeeper since the conductors have the ultimate responsibility for accurately submitting records to the Commission.

- Since the program's inception, the Commission has never received a consumer complaint about an SSP and has investigated only one automated bingo system. The Commission initiated that investigation and the administrative action is still pending. The Commission has taken no disciplinary action against any current licensed SSP, but has denied a license renewal application for a past licensee.

No conductor uses the services of the two licensed system service providers.

Currently, the Commission is in district court litigation with one licensed SSP regarding the scope of the Commission's authority over SSPs and the definition of automated bingo services.³ The Commission believes that licensed services are limited to software for accounting and tracking purposes, however, the licensee believes the scope is broader.

- State law prohibits any other bingo licensee from also being licensed as an SSP or providing automated bingo services.⁴ For example, licensed bingo equipment manufacturers and distributors cannot provide any type of accounting or equipment-tracking system for bingo conductors, though they provide other types of products. The Commission states that some manufacturers could provide some of these services, if not limited by the current statute.⁵
- Although no conductor uses these automated bingo services, the Commission expends time and money regulating them. The Commission estimates its staff has spent a cumulative 256 hours regulating SSPs in the last 18 months. This includes time spent by legal, security, bingo licensing, and bingo auditing staff at the Commission.
- As with all Sunset reviews, Sunset staff evaluated this function based on the specific criteria in the Sunset Act, such as identification of the objectives intended for the function, the problem or need the function was intended to address, and the extent to which those objectives have been achieved.⁶ Though the regulation of SSPs began to protect conductors, Sunset staff found that since few SSPs are licensed and no conductor uses automated bingo services, these objectives have not been realized and the regulation is not needed.

*The Commission's staff
spent 256 hours
regulating SSPs in the
last 18 months.*

No other state licenses system service providers.

- Forty-seven other states and the District of Columbia regulate bingo, however, no other state licenses system service providers or regulates automated bingo services.⁷

Recommendation

Change in Statute

8.1 Abolish regulation of system service providers and automated bingo services.

This recommendation would abolish the licensing requirements for system service providers and the regulation of automated bingo services. Any licensee choosing to use such services will continue to be subject to all provisions of the Act and agency rule. If licensing were repealed, the section of the Bingo Enabling Act that requires one member of the current nine-member advisory committee to be a system service provider should also be repealed, as provided for in Issue 7 of this report.⁸

Impact

Eliminating the regulation of system service providers seeks to lessen unnecessary state regulation. Since no conductor uses these services, the program has never fulfilled the Legislature's expectations for providing bingo conductors with accounting programs that require regulation and is not needed. Abolishing regulation will allow other entities to provide conductors with accounting products and services that would currently be considered automated bingo services. As required by current law, conductors will remain accountable for the accuracy of records submitted to the Commission.

Fiscal Implication

This recommendation would not result in a fiscal impact to the State. Licensing programs are required to bring in sufficient licensing revenue to offset the cost of regulation. Savings from eliminating licensure of the two existing SSPs would be offset by reductions in licensing revenue, or \$1,000 per year, per license. However, the staff workload reduction in the legal, security, bingo licensing, and bingo auditing divisions would allow the agency to reassign employees to other responsibilities.

Fiscal Year	Savings to General Revenue	Cost to General Revenue
2004	\$2,000	\$2,000
2005	\$2,000	\$2,000
2006	\$2,000	\$2,000
2007	\$2,000	\$2,000
2008	\$2,000	\$2,000

¹ Texas Lottery Commission, Charitable Bingo Operations Division, "SSP questions," e-mail to Sunset Advisory Commission, June 14, 2002; Interview with a Texas Lottery Commission bingo licensee (Austin, Texas, June 12, 2002).

² Ibid.

³ Plaintiff's Original Petition, TXTV Corporation v. Texas Lottery Commission, 98th Judicial District Court, (GN 201803).

⁴ Texas Occupations Code, sec. 2001.252.

⁵ Sunset Advisory Commission meeting with the Texas Lottery Commission (Austin, Texas, June 13, 2002).

⁶ Texas Government Code, sec. 325.011-325.012.

⁷ National Council of Legislators from Gaming States, *Model State Charitable Gaming Act*, (Hallandale, Florida, June 1999), p. 49.

⁸ Texas Occupations Code, sec 2001.057(b).

Issue 9

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

Summary

Key Recommendations

- Standardize licensing provisions in the State Lottery Act to ensure consistent licensing and effective compliance by authorizing staggered renewals and requiring compliance history review before license renewal.
- Revise elements of statutory enforcement provisions to provide for effective public protection, such as expedited investigations and a procedure for analyzing complaints.
- Change administrative aspects of the State Lottery Act to allow sufficient public notice of standardized complaint procedures.

Key Findings

- Licensing provisions in the State Lottery Act do not follow model licensing practices, affecting the fair treatment of licensees and limiting public protection.
- Nonstandard enforcement provisions of the State Lottery Act potentially reduce the agency's effectiveness regarding public protection and the safeguarding of state revenue.
- Lack of formal complaint procedures limit public notice and accountability.

Conclusion

The Texas Lottery Commission regulates nearly 17,000 licensed lottery retailers. Various licensing, enforcement, and administrative provisions in the State Lottery Act do not coincide with model licensing standards that Sunset staff have developed from experience gained through more than 70 licensing reviews. Without these standard licensing procedures, the Lottery Commission may not be able to ensure the fair treatment of licensees, protect the public from unscrupulous lottery retailers, safeguard state revenue resulting from lottery sales, or effectively manage its administrative workload. The Sunset review identified these areas by comparing the State Lottery Act and other agency rules and practices against model licensing standards to identify variations from the model and recommend necessary changes to bring them into conformity.

Support

The Texas Lottery Commission regulates and enforces the lottery by licensing retailers.

The Lottery Commission currently regulates nearly 17,000 licensed lottery retailers.

- To be eligible to sell lottery tickets in Texas, individuals and entities must complete and submit an application to the Lottery Commission. The agency issues licenses only after it finds that the applicant's experience, character, and general fitness do not meet any statutory provisions requiring denial. The agency currently regulates nearly 17,000 licensed lottery retailers.¹ In fiscal year 2001, 152 applicants were denied licensure.²
- Lottery licensing and renewal provisions are found in the State Lottery Act. The agency's enforcement methods include summary suspension and license revocation or suspension after a hearing.³ Summary suspension authority is a unique enforcement technique, giving the agency control over lottery sales terminals. If a retailer is noncompliant, the agency can simply turn off the terminal, preventing any sales activity. This technique eliminates the necessity for immediate enforcement measures such as injunctive authority.

Sunset's experience from reviewing more than 70 licensing programs has been documented for application to future reviews.

- The rapid increase and questionable practices of some licensing programs were main focuses behind creation of the Sunset Advisory Commission in Texas. The first agencies reviewed by the Commission in 1977 were primarily licensing agencies. Forty-five licensing programs have undergone Sunset review since the Commission's creation in 1977, and 24 of these programs have been reviewed more than once, resulting in more than 70 evaluations of licensing functions.
- Sunset staff has documented lessons learned in reviewing licensing programs to guide reviews of licensing agencies. These standards are not intended for blanket application to all licensing agencies, but provide a model for evaluating a licensing program's structure. Though the Lottery Commission does not perform standard occupational licensing functions, licensing lottery retailers is a vital role, ensuring public protection and safeguarding state revenue. The following material highlights areas where the State Lottery Act differs from these model standards, and describes the potential benefits of bringing these programs and statutes into conformity with standard practices.

Licensing lottery retailers is a vital function, ensuring public protection and safeguarding state revenue.

Licensing provisions in the State Lottery Act do not follow model licensing practices, affecting the fair treatment of licensees and limiting public protection.

- **Staggered renewals.** Staggered license renewal helps promote an even workload throughout the year and reduces the need for seasonal employees to handle renewal backlogs. When the Texas Lottery Commission began operations all retailers were issued licenses simultaneously, creating an increase in application processing during the summer of odd-numbered years to accommodate numerous renewals. For example, between May and August of 2001, licensing staff received more than 3,000 applications, almost three times the usual workload.⁴ The ability to stagger licenses would stabilize the workload of the licensing staff and create consistent renewal cycles, expediting application processing time. Prorated licensing fees could ease the initiation of staggered renewals.
- **Compliance history.** Before renewing a license, a licensing agency should be aware of any compliance issues that a licensee might have and the licensee's efforts to resolve those problems. Existing compliance issues should be in the process of resolution or appropriately addressed before a license is renewed.

General compliance or accounting history is currently not a factor in standard renewals. A licensee with a pattern of insufficient funds may be asked to post financial security in the form of a certificate of deposit with the application to ensure payment, however, the agency does not review other forms of accounting history or noncompliance, such as rule violations or numerous complaints. Tracking a licensee's history of compliance will assist in enforcement and ensure careful monitoring of activities before license renewal.

Nonstandard enforcement provisions in the State Lottery Act potentially reduce the agency's effectiveness regarding public protection and the safeguarding of state revenue.

- **Analyzing complaints.** Analysis of complaint information is a useful way to identify regulatory problem areas. Sources of complaints could include the general public, the licensee population, other agencies or institutions, or the licensing agency itself. Types of complaints could cover a wide range of topics, such as qualifications for licensure, compliance with established rules, and quality of service.

The Security Division maintains a complaint database to classify the complaints and produce reports, however, no further analysis is performed. The agency should use this existing database to analyze sources and types of complaints to identify and address problem areas and trends.

Between May and August, licensing staff receive almost three times the usual number of renewal applications.

The agency maintains a complaint database, but performs no further analysis.

- **Investigation time.** Investigations that are unreasonably long can prolong potentially dangerous situations for the public or disrupt licensee activities. Although some investigations require more time than others, the agency should monitor time elapsed to keep investigations within reasonable time boundaries. Currently, only internal procedures suggest investigations are completed in a reasonable amount of time. Specific statutory language requiring rules to set the expectation of a reasonable investigation time will increase accountability and ensure swift resolution of all complaints.

Lack of formal complaint procedures limit public notice and accountability.

- **Public notice of complaint procedures.** A licensing agency should make consumer information easily available to the public. The Sunset Commission has focused on availability of public information since its inception. Currently, necessary complaint procedure information is not posted on the agency's Web site, tickets, or even the license itself. The agency has no formal complaint procedure, which hinders public and licensee awareness and lacks the consistency of standard provisions. Standardization increases efficiency, simplifies administration, and informs licensees and the public of common complaint procedures.

*The Lottery Commission
has no formal complaint
procedure.*

Recommendation

Change in Statute

Licensing

9.1 Provide statutory language authorizing staggered license renewals.

This recommendation would give the agency statutory authority to stagger renewals to maintain a consistent workload throughout the year. Staggered licensing during peak months would prevent renewal backlogs. Licensing fees could be prorated to ease the initiation of staggered license renewal.

9.2 Provide statutory language requiring the agency to review compliance history before renewing licenses.

This recommendation would require the agency to review compliance history before all license renewals, and provide the agency statutory authority to deny renewals based on a licensee's track record. Reviewing compliance history will ensure timely resolution of any compliance issues and increase accountability before granting license renewals. The agency should adopt rules determining the areas of compliance history to be evaluated, such as rule violations or frequency of complaints.

Enforcement

9.3 Require the agency to analyze sources and types of complaints to identify and address problem areas and trends.

This recommendation would require the agency to analyze its reported complaint activity to identify any trends or issues concerning certain violations. The Security Division currently tracks complaint activity in a database, which could provide the necessary trend information. The agency could use this information to educate its licensees, focus on common problems, and possibly change regulatory language to address new concerns.

9.4 Provide statutory language to ensure complaints are investigated in a reasonable amount of time.

This recommendation would help ensure speedy resolution of complaints by requiring investigations to be completed in a reasonable amount of time, which should be defined by the Commission in rule. Though a current internal policy encourages timely resolution, statutory language would formalize adherence to reasonable time requirements, and provide public notice of expected time frames for resolution.

Administration

9.5 Require the agency to provide public notice of its standard complaint process.

This recommendation would require the agency to publish common complaint procedures covering the entire process, from submission to final disposition. These procedures would provide sufficient notice to both the complainant and licensee of the standard complaint process.

Impact

The application of these recommendations to the Texas Lottery Commission would result in efficiency and consistency from standardization, additional administrative flexibility, equitable processes for the public and the licensee, and additional protection to the public. The following chart, entitled *Benefits of Recommendations*, categorizes the recommendations according to their benefits.

Benefits of Recommendations				
	Benefits			
Recommendation	Efficiency from Standardization	Administrative Flexibility	Fairness to Licensee	Public Protection
Licensing				
9.1 Provide statutory language authorizing staggered license renewals.	✓	✓	✓	
9.2 Provide statutory language requiring the agency to review compliance history before license renewals.		✓	✓	✓
Enforcement				
9.3 Require the agency to analyze sources and types of complaints to identify and address problem areas and trends.		✓	✓	✓
9.4 Provide statutory language to ensure complaints are investigated in a reasonable amount of time.	✓		✓	✓
Administration				
9.5 Require the agency to provide public notice of its standard complaint process.	✓		✓	✓

Fiscal Implication

These recommendations would not have a significant fiscal impact to the State. The recommendations are procedural improvements that should not require additional resources.

¹ Texas Lottery Commission, *Self-Evaluation Report*, submitted to the Sunset Advisory Commission (August 2001) p. 94.

² Texas Lottery Commission, Lottery Operations Division, "Provisional License Denial Statistics," e-mail to Sunset Advisory Commission, June 28, 2002.

³ Texas Government Code, secs. 466.155, 466.160.

⁴ Sunset Advisory Commission meeting with Texas Lottery Commission (Austin, Texas, June 27, 2002).

Issue 10

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

Summary

Key Recommendations

- Ensure consistent licensing in the Bingo Enabling Act by providing clear licensure qualifications, eliminating requirements which unreasonably restrict licensure, and providing a standard renewal process.
- Ensure effective compliance by subjecting temporary licenses to standard oversight and requiring the agency to review compliance history before license renewal.
- Standardize enforcement provisions in the Bingo Enabling Act to provide clear standards of conduct, ensure investigations are completed in a reasonable amount of time, and require the agency to maintain complaint information.

Key Findings

- Licensing provisions in the Bingo Enabling Act do not follow model licensing practices, affecting the fair treatment of licensees and limiting public protection.
- Nonstandard enforcement provisions of the Bingo Enabling Act do not provide effective public protection or safeguard charitable revenue.

Conclusion

Various licensing and enforcement processes in the Bingo Enabling Act do not coincide with model licensing standards that Sunset staff have developed from experience gained through more than 70 licensing reviews. Without these standard licensing procedures, the Lottery Commission may not be able to ensure the fair treatment of licensees, protect the public, or safeguard charitable revenue. The Sunset review identified these areas by first developing model licensing standards based on previous reviews. The review then compared the Bingo Enabling Act and other applicable rules against these standards to identify variations from the model and to recommend necessary changes to bring them into conformity.

Support

The Texas Lottery Commission regulates and enforces the Bingo Enabling Act by licensing bingo conductors, lessors, manufacturers, distributors, and system service providers.

The Bingo Division currently regulates nearly 2,000 bingo-related entities.

- The agency's Charitable Bingo Operations Division licenses all bingo-related activities to ensure bingo is fairly conducted and proceeds are used for authorized purposes.¹ The agency licenses anyone conducting bingo games, leasing premises for bingo, manufacturing or distributing bingo supplies, or providing automated bingo services. Bingo licenses were first issued in 1982. The Bingo Division currently regulates 1,451 conductors, 468 commercial lessors, 16 distributors, 14 licensed manufacturers, and two system service providers.²
- The Bingo Enabling Act contains all bingo licensing, renewal, and enforcement provisions. The various enforcement methods include license suspension, revocation, administrative penalties, and injunctive relief. Suspension and revocation actions require a hearing, and denied applicants are entitled to a hearing upon written request. Unlike lottery licensing, the Bingo Division cannot summarily suspend licenses, but does have the authority for temporary suspensions.

Sunset's experience from reviewing more than 70 licensing programs has been documented for application to future reviews.

Licensing bingo entities is an important function, ensuring public protection and safeguarding charitable revenue.

- The rapid increase and questionable practices of some licensing programs were main focuses behind creation of the Sunset Advisory Commission in Texas. The first agencies reviewed by the Commission in 1977 were primarily licensing agencies. Forty-five licensing programs have undergone Sunset review since the Commission's creation in 1977, and 24 of these programs have been reviewed more than once, resulting in more than 70 evaluations of licensing functions.
- The Sunset staff has documented lessons learned in reviewing licensing programs to guide reviews of licensing agencies. These standards are not intended for blanket application to all licensing agencies, but provide a model for evaluating a licensing program's structure. Though the Lottery Commission does not perform standard occupational licensing functions, licensing bingo entities is an important role, ensuring public protection and safeguarding charitable revenue. The following material highlights areas where the Bingo Enabling Act differs from these model standards, and describes the potential benefits of bringing these programs and statutes into conformity with these standard practices.

Licensing provisions in the Bingo Enabling Act do not follow model licensing practices, affecting the fair treatment of licensees and limiting public protection.

- **Qualifications for licensure.** The statutes or policies of licensing agencies should not require qualifications for licensure that cannot be concretely determined or that have little or no bearing on protecting the public. Although the Bingo Enabling Act describes the license application, it does not list specific qualifications for issuance of a license, such as competency or character prerequisites. Easily determined, clear qualifications would provide both the licensee and the public notice of general licensing requirements.
- **Restricting practice.** Care should be taken to ensure that licensing provisions do not unnecessarily limit entry to the business. To be eligible for a conductor's license, the current statute requires an organization to be in existence a minimum amount of time to ensure the validity of the organization. For example, to obtain a license to conduct bingo, religious societies are required to exist in Texas for at least eight years, historical associations for five years, and fraternal organizations for three years.³ An internal policy only requires volunteer fire departments to exist for one year. Different lengths of existence arbitrarily limit licensing of certain organizations without a sound basis for licensee or public protection.
- **Temporary licenses.** A temporary license authorizes the holder to practice before meeting all licensure qualifications. Such a license should be authorized only in very limited circumstances since the public is offered no assurance of competency, and charitable revenue may not be protected. The Bingo Enabling Act currently authorizes temporary licenses for special occasions, totaling about 3,000 per year.⁴ Though subject to the same regulations as other licensees, temporary license holders are not subject to the same level of oversight, and are never inspected or audited.
- **Standard renewal process.** A licensing agency should have a renewal process that incorporates ways to ensure continued competence of licensees before renewing a license. While the statute provides specific guidelines for conductor license renewal, no renewal provisions exist in statute for lessors, manufacturers, distributors, or system service providers.⁵ The only statutory reference to renewal time frames is a general provision stating the maximum license term of one year.⁶ Without specific provisions, licensees are not aware of standard renewal guidelines.
- **Compliance history.** Before renewing a license, a licensing agency should be aware of any compliance issues that a licensee might have and the licensee's efforts to resolve those problems. Existing compliance issues should be in the process of resolution or fully

The Bingo Enabling Act does not list specific qualifications for licensure.

Temporary licenses are not subject to the same level of oversight as regular licenses.

addressed before an agency renews a license. Currently, general compliance history, such as rule violations or numerous complaints, is not a factor in bingo license renewals. However, the agency does check compliance with accounting procedures, such as timely remittance of taxes or proper charitable distributions before issuing a license renewal. The agency will also deny renewals if the licensee has taken no remedial measures after an audit. Tracking an applicant's history of compliance in all areas will assist in enforcement and ensure careful monitoring of activities before licensure.

Nonstandard enforcement provisions of the Bingo Enabling Act do not provide effective public protection or safeguard charitable revenue.

- **Standards of conduct.** Standards of conduct define appropriate behavior for licensees. These standards give the public a guide for judging appropriate behavior and a basis for complaining to the agency when these standards are not met. Standards of operation or defining how certain tasks should be accomplished are also helpful to the affected public to determine whether a function was performed appropriately. These standards are most useful in situations where licensees have close contact with the public, or where their behavior could cause serious financial implications.

Neither the Bingo Enabling Act nor agency rules provide specific standards of conduct for bingo licensees.

The Bingo Enabling Act authorizes the Commission to deny a renewal for any cause that would permit or require suspension or revocation.⁷ The language authorizing suspension or revocation is similar, citing any reason that would allow or require the Commission to refuse to issue or renew a license of the same class.⁸ This circular statutory language leaves only one broad requirement for denials, renewals, revocations, and suspensions: the licensee must comply with the chapter or any Commission rules. Currently, no rules or policies list specific qualifications for licensure, or even certain situations for denying licensure. No specific standards of conduct are available to notify the licensee or provide the agency a sound basis for acting on certain complaints.

- **Complaint information.** A licensing agency's statute should require information to be maintained on complaints. Without this type of information, tracking a licensee's competence and evaluating the performance of the Bingo Division is difficult. Though an internal policy requires five-year retention of all complaint records, the Bingo Enabling Act does not specify such a requirement. Statutory language requiring retention of complaint information would increase public accessibility and allow the agency to maintain historical complaint data.

- **Investigation time.** A licensing agency should ensure that investigations are completed in a reasonable amount of time. Investigations that are unreasonably long can prolong potentially dangerous situations for the public and disrupt licensed activities. Although some investigations require more time than others, the agency should monitor time elapsed to keep investigations within reasonable time boundaries.

Though investigation time has been significantly reduced since the Legislature transferred bingo regulation to the Texas Lottery Commission, only internal procedures exist to ensure swift resolution of all complaints. The Security Division currently has internal procedures limiting investigations to 60 days, and has maintained an average for bingo investigations of about 40 days.⁹ However, no procedures govern complaints investigated by the Bingo Division. Statutory language is needed to ensure investigations are completed in a reasonable amount of time, expediting the resolution process. Reasonable time could be defined by Commission rule.

*No procedures govern
complaint investigations
by the Bingo Division.*

Recommendation

Change in Statute

Licensing

10.1 Require the agency to adopt clear qualifications for bingo licensure.

This recommendation would require the agency to develop, through rule, comprehensive licensing qualifications. By listing specific qualifications for licensure, licensees and the public are provided sufficient notice of licensing requirements. Guidelines would also assist the agency in consistent licensing, and provide a sound basis for license denials and other enforcement matters.

10.2 Eliminate statutory requirements governing the length of time conductors must be in existence to be eligible for a license.

This recommendation would eliminate varying existence requirements for conductors currently in statute. Instead, the statute would require the Commission to adopt rules establishing standard time periods for the existence of all types of conductors. This change would ensure organizations are legitimate and established, and eliminate arbitrary or inconsistent standards for different types of organizations.

10.3 Subject temporary licenses to standard oversight.

This recommendation would subject temporary licenses to the same oversight requirements provided in statute for standard licenses. Temporary licenses would still remain available for special events, with standard oversight measures, such as audits or inspections, to ensure compliance with regular licensing provisions.

10.4 Require the agency to create a standard license renewal process.

This recommendation would require the Commission, through rule, to document its renewal process from submission to completion. The Commission would adopt agency-created provisions addressing license renewals for lessors, manufacturers, distributors, and system service providers to ensure continued competency of the licensee. These guidelines will provide notice, maintain consistency, and designate standard renewal practices.

10.5 Provide statutory language requiring the agency to review compliance history before renewing licenses.

This recommendation would require the agency to review compliance history before all license renewals, providing the agency statutory authority to deny renewals based on the licensee's track record and ensuring timely resolution of any compliance issues. Reviewing compliance history before license renewals will also increase accountability. The agency should adopt rules determining the areas of compliance history to be evaluated, such as rule violations or frequency of complaints.

Enforcement

10.6 Require the agency to adopt clear standards of conduct for licensees.

This recommendation would require the Commission to adopt, by rule, standards of conduct developed by the agency. Comprehensive standards of conduct would include ethical standards and appropriate behavior for bingo licensees. This recommendation would give notice to both the public and licensees of appropriate standards of practice, and provide greater enforcement authority for the agency to act on various complaints. Adopting standards through the rulemaking process provides bingo licensees and the public an opportunity to participate in the development of these rules.

10.7 Provide statutory language requiring the agency to maintain complaint information.

This recommendation would provide statutory language requiring information to be maintained on complaints, reinforcing the existing policy for retention of records and providing fully accessible complaint information to the public and historical data to the agency.

10.8 Provide statutory language to ensure complaints are investigated in a reasonable amount of time.

This recommendation would help ensure swift resolution of complaints by requiring investigations to be completed in a reasonable amount of time. Though an internal policy encourages timely resolution, statutory language would formalize adherence to reasonable time requirements, which should be defined by the Commission in rule.

Impact

The application of these recommendations to the Bingo Enabling Act would result in efficiency and consistency from standardization, additional administrative flexibility, equitable processes for the licensee, and additional protection of charitable revenue and the public. The following chart, entitled *Benefits of Recommendations*, categorizes the recommendations according to their benefits.

Benefits of Recommendations				
	Benefits			
Recommendation	Efficiency from Standardization	Administrative Flexibility	Fairness to Licensee	Public Protection
Licensing				
10.1 Require the agency to adopt clear qualifications for bingo licensure.	✓		✓	✓
10.2 Eliminate statutory requirements governing the length of time conductors must be in existence to be eligible for a license.	✓		✓	✓
10.3 Subject temporary licenses to standard oversight.		✓	✓	✓
10.4 Require the agency to create a standard license renewal process.		✓	✓	✓
10.5 Provide statutory language requiring the agency to review compliance history before renewing licenses.	✓	✓		✓
Enforcement				
10.6 Require the agency to adopt clear standards of conduct for licensees.	✓		✓	✓
10.7 Provide statutory language requiring the agency to maintain complaint information.		✓	✓	✓
10.8 Provide statutory language to ensure complaints are investigated in a reasonable amount of time.	✓		✓	✓

Fiscal Implication

These recommendations would not have a significant fiscal impact to the State. The recommendations change procedures in ways that should not require additional resources. For example, the agency could determine, by risk, the frequency of audits and inspections performed on temporary licenses.

¹ Texas Occupations Code, sec. 2001.051(b).

² Sunset Advisory Commission overview meeting with the Texas Lottery Commission (Austin, Texas, April 5, 2002).

³ Texas Occupations Code, sec. 2001.101.

⁴ Sunset Advisory Commission meeting with the Texas Lottery Commission (Austin, Texas, July 1, 2002).

⁵ Texas Occupations Code, sec. 2001.105.

⁶ Texas Occupations Code, sec. 2001.307.

⁷ Texas Occupations Code, sec. 2001.351.

⁸ Texas Occupations Code, sec. 2001.353.

⁹ Sunset Advisory Commission meeting with the Texas Lottery Commission (Austin, Texas, July 1, 2002).

ACROSS-THE-BOARD RECOMMENDATIONS

Texas Lottery Commission	
Recommendations	Across-the-Board Provisions
A. GENERAL	
Already in Statute	1. Require at least one-third public membership on state agency policymaking bodies.
Update	2. Require specific provisions relating to conflicts of interest.
Update	3. Require that appointment to the policymaking body be made without regard to the appointee's race, color, disability, sex, religion, age, or national origin.
Already in Statute	4. Provide for the Governor to designate the presiding officer of a state agency's policymaking body.
Update	5. Specify grounds for removal of a member of the policymaking body.
Apply	6. Require that information on standards of conduct be provided to members of policymaking bodies and agency employees.
Apply	7. Require training for members of policymaking bodies.
Apply	8. Require the agency's policymaking body to develop and implement policies that clearly separate the functions of the policymaking body and the agency staff.
Apply	9. Provide for public testimony at meetings of the policymaking body.
Apply	10. Require information to be maintained on complaints.
Apply	11. Require development of an equal employment opportunity policy.
Apply	12. Require information and training on the State Employee Incentive Program.

Texas Lottery Commission State Lottery Act*	
Recommendations	Across-the-Board Provisions
B. LICENSING	
Do Not Apply	1. Require standard time frames for licensees who are delinquent in renewal of licenses.
Not Applicable	2. Provide for notice to a person taking an examination of the results of the examination within a reasonable time of the testing date.
Not Applicable	3. Authorize agencies to establish a procedure for licensing applicants who hold a license issued by another state.
Not Applicable	4. Authorize agencies to issue provisional licenses to license applicants who hold a current license in another state.
Recommendation 9.1	5. Authorize the staggered renewal of licenses.
Do Not Apply	6. Authorize agencies to use a full range of penalties.
Not Applicable	7. Revise restrictive rules or statutes to allow advertising and competitive bidding practices that are not deceptive or misleading.
Not Applicable	8. Require the policymaking body to adopt a system of continuing education.

* Though the Lottery Commission does not perform standard occupational licensing functions, the agency licenses lottery retailers.

Texas Lottery Commission Bingo Enabling Act*	
Recommendations	Across-the-Board Provisions
B. LICENSING	
Do Not Apply	1. Require standard time frames for licensees who are delinquent in renewal of licenses.
Not Applicable	2. Provide for notice to a person taking an examination of the results of the examination within a reasonable time of the testing date.
Not Applicable	3. Authorize agencies to establish a procedure for licensing applicants who hold a license issued by another state.
Not Applicable	4. Authorize agencies to issue provisional licenses to license applicants who hold a current license in another state.
Do Not Apply	5. Authorize the staggered renewal of licenses.
Recommendation 6.1	6. Authorize agencies to use a full range of penalties.
Not Applicable	7. Revise restrictive rules or statutes to allow advertising and competitive bidding practices that are not deceptive or misleading.
Do Not Apply	8. Require the policymaking body to adopt a system of continuing education.

* Though the Lottery Commission does not perform standard occupational licensing functions, the agency licenses bingo entities.

AGENCY INFORMATION

Agency Information

Agency at a Glance

In 1991, Texas voters approved a constitutional amendment authorizing a state lottery. In 1993, the Legislature created the Texas Lottery Commission (the Commission) to assume the administration of the lottery and also transferred the administration of the Bingo Enabling Act to the new agency. Today, the Commission administers and markets the state lottery and regulates the charitable bingo industry through licensing and enforcement.

**Texas Lottery Commission
on the Internet**
Information about the lottery and bingo is available on the Internet at www.txlottery.org and www.txbingo.org.

Key Facts

- **Funding.** The Commission operated with an appropriation of \$209.4 million in fiscal year 2001 – all of which came from lottery proceeds and bingo licensing fees.
- **Lottery Revenue.** In fiscal year 2001, the lottery generated about \$2.8 billion in revenue, of which \$825 million was transferred to the Foundation School Fund. During that same year, the agency transferred unclaimed prize money totaling \$4.5 million to the Multicategorical Teaching Hospital Account and \$34.5 million to the Tertiary Care Facility Account. The remainder of the proceeds pay for prizes, the agency's administrative costs, and retailer commissions. To date, the Texas Lottery has transferred \$9.6 billion dollars to the State.
- **Bingo Revenue.** In calendar year 2001, charitable bingo generated \$567 million in revenue, of which \$34.4 million was distributed for charitable purposes. Also in that year, the Commission collected about \$24.2 million in prize fees, licensing fees, and rental taxes from the conduct of bingo.
- **Staffing.** The Commission has 335 full-time equivalent positions. Approximately two-thirds of the positions are located in the Austin headquarters and the rest are in the Commission's 22 claim centers and five regional offices.
- **Licensing.** The Commission regulates approximately 16,672 lottery retailers, 1,451 bingo conductors, 468 bingo lessors, 14 bingo equipment manufacturers, 16 bingo equipment distributors, and two bingo system service providers.

Mission Statement

- To administer and market lottery games in an efficient and secure manner using appropriate marketing tools and innovative technology to generate revenue for the State of Texas while enhancing public confidence in the integrity and fairness of the games.
- To provide authorized organizations the opportunity to raise funds for their charitable purposes by conducting bingo. To determine that all charitable bingo funds are used for a lawful purpose. To promote and maintain the integrity of the charitable bingo industry throughout Texas.

Recipients of Lottery Revenue

Foundation School Fund - Supports the operation and maintenance of public schools. School districts may use money from this fund for purposes such as purchasing supplies, library books, equipment and teacher salaries.

Multicategorical Teaching Hospital Account - Supports the reimbursement of indigent care at the University of Texas Medical Branch at Galveston.

Tertiary Care Facility Account - Supports State-designated trauma center hospitals in reimbursing the cost of indigent care.

- **Enforcement.** In fiscal year 2001, the agency received 780 complaints for both lottery and bingo, resolved 838 complaints, inspected 735 licensed lottery retailers, and inspected and audited 1,141 bingo licensees and applicants. Additionally, the Commission issued 387 agency orders resulting in sanctions.
- **Contracts.** The Commission outsources many key lottery functions including lottery games operation. The contracted lottery operator, GTECH Corporation, is responsible for providing lottery information technology systems, equipment, and sales staffing. In fiscal year 2001, the Commission spent about \$88.5 million on this contract. The Commission's other major contracts include advertising services and instant ticket manufacturing.

Major Events in Agency History

In 1997, the Legislature directed all lottery proceeds to the Foundation School Fund.

- 1980** Texas voters approve a constitutional amendment authorizing charitable bingo on a local option basis.
- 1982** The Bingo Division of the Comptroller of Public Accounts issues the first bingo licenses.
- 1990** The Legislature transfers regulation of charitable bingo to the Texas Alcoholic Beverage Commission.
- 1991** Texas voters approve a constitutional amendment to create a state lottery. The lottery is administered by the Lottery Division of the Comptroller of Public Accounts.
- 1992** The Lottery Division issues the first lottery retailer licenses and the sale of instant and online tickets begins.
- 1993** The Legislature creates the Texas Lottery Commission to administer the lottery and transfers regulation of charitable bingo to the new agency effective April 1, 1994.
- 1995** The Bingo Advisory Committee, created by the Legislature in 1993, holds its first meeting.
- 1997** The Legislature amends the State Lottery Act to direct all lottery proceeds to the Foundation School Fund, rather than the General Revenue Fund, and mandates a reduction in prize payouts for all lottery games. The Legislature also amends the Bingo Enabling Act to require the Director of the Charitable Bingo Operations Division to report directly to the Lottery Commission, rather than to the Executive Director of the agency.
- 1999** In the wake of declining lottery sales, the Legislature removes the cap on prize payouts while reducing the advertising budget. The Legislature also directs unclaimed prize money to help fund indigent health care.

Organization

Policy Body

The Commission is composed of three members appointed by the Governor with the advice and consent of the Senate to serve staggered six-year terms. One member must have experience in the bingo industry. The chart, *Texas Lottery Commission Policy Body*, contains information on current members. To be appointed to the Commission, an individual must have been a Texas resident for at least ten consecutive years immediately before appointment.

Texas Lottery Commission Policy Body		
Name (Residence)	Term	Qualification
C. Tom Clowe, Jr., Chair (Waco)	November 13, 1998 - 2005	Public member with experience in the bingo industry
Elizabeth D. Whitaker (Dallas)	March 21, 2000 - 2007	Public member
James A. Cox, Jr. (Austin)	May 30, 2002 - 2003	Public member

The Commission sets policies to administer and promote the lottery and regulate bingo. The Commission also has authority to revoke and suspend licenses issued under the State Lottery Act and the Bingo Enabling Act and to deny bingo licenses after a hearing. The Commission generally meets once a month in Austin.

The Commission receives assistance on bingo issues from the statutorily-created Bingo Advisory Committee. This Committee consists of nine members representing the public, charities that operate bingo games, commercial and charity lessors that participate in the bingo industry, distributors and manufacturers of bingo supplies, and one system service provider. The Commission appoints new members with recommendations from existing Committee members. The responsibilities of the Committee are to:

- advise the Commission on the needs and problems of the state's bingo industry;
- comment on bingo rules during their development and before final adoption unless an emergency requires immediate action by the Commission;
- report annually to the Commission on the Committee's activities; and
- perform other duties as determined by the Commission.

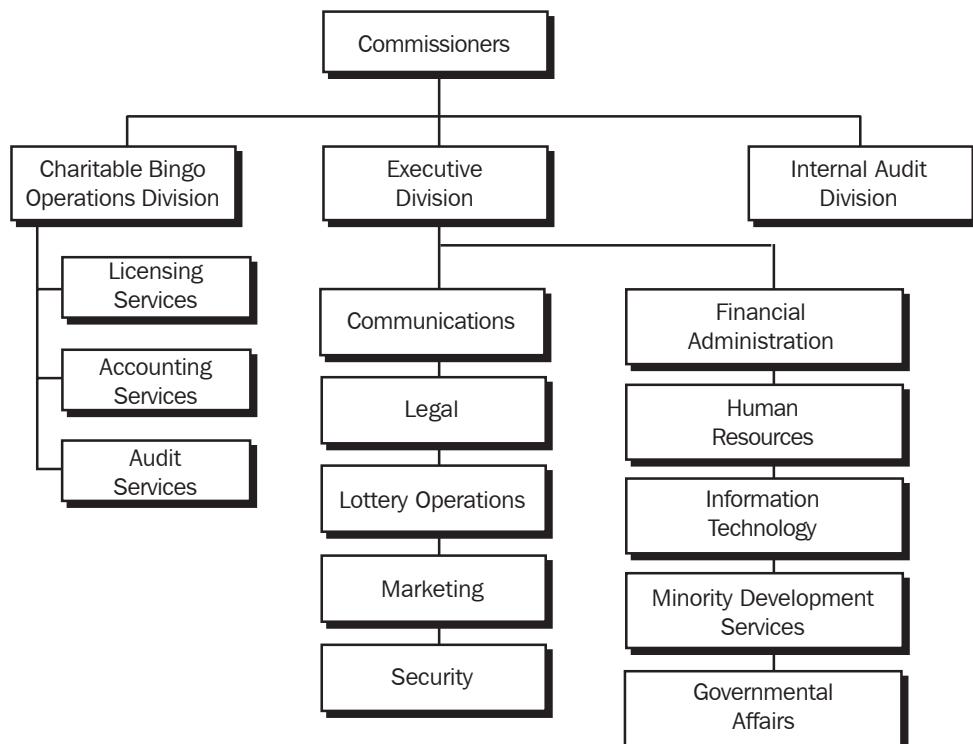
The Lottery Commission sets policies to administer and promote the lottery and regulate bingo.

Staff

The agency is organized into two main areas - lottery and bingo. The Executive Director oversees the day-to-day activities of the lottery and

administration of the agency. A separate Director oversees the Charitable Bingo Operations Division and reports directly to the Commission. The agency's security, legal, human resources, information technology, and other administrative functions are shared by both the lottery and bingo sides of the organization. The chart, *Texas Lottery Commission Organizational Chart*, depicts the agency's organization.

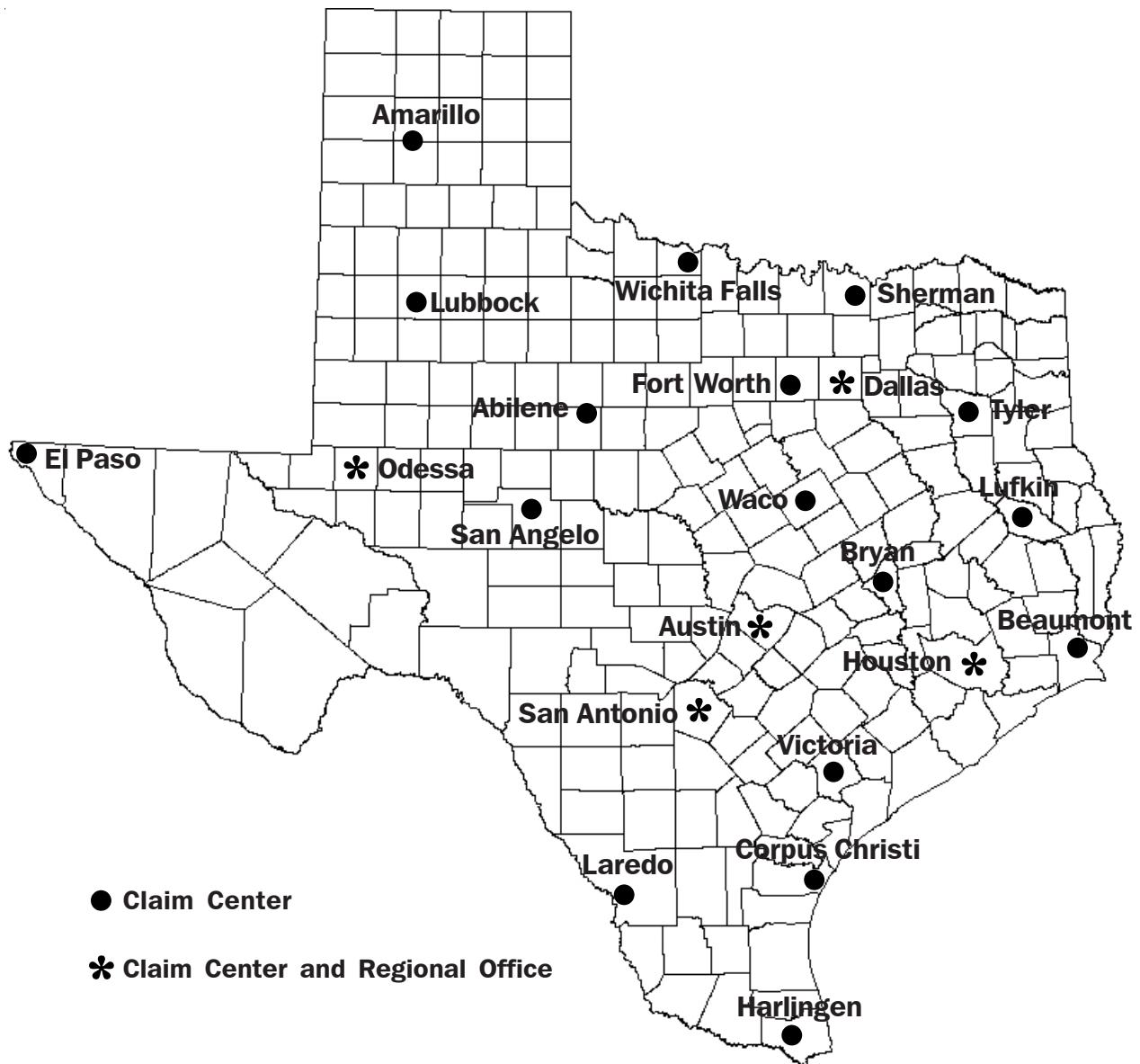
Texas Lottery Commission Organizational Chart



Commission Employees by Office		
Office	Location	Number of Positions
Headquarters	Austin	224
Claim Centers	22 locations throughout the state	66
Regional Bingo Offices	Austin, Dallas, Houston, Odessa, San Antonio	22
Regional Security Offices	Austin, Dallas, Houston, Odessa, San Antonio	23
Total Positions		335

In fiscal year 2001, the agency had 335 full-time equivalent positions. Approximately two-thirds of the agency's employees are located at the headquarters in Austin. A total of 111 employees are divided between the agency's 22 claim centers located throughout the state, five regional bingo offices, and five regional security offices. The table, *Commission Employees by Office*, shows the distribution of employees at the agency's headquarters and satellite offices. The map, *Claim Centers and Regional Offices*, shows the location of these satellite offices.

Claim Centers and Regional Offices



A comparison of the agency's workforce composition to the minority civilian labor force over the past four years is shown in Appendix A, *Equal Employment Opportunity Statistics*. The Commission generally met or exceeded the statewide civilian labor force percentages for most job categories.

Funding

Revenues

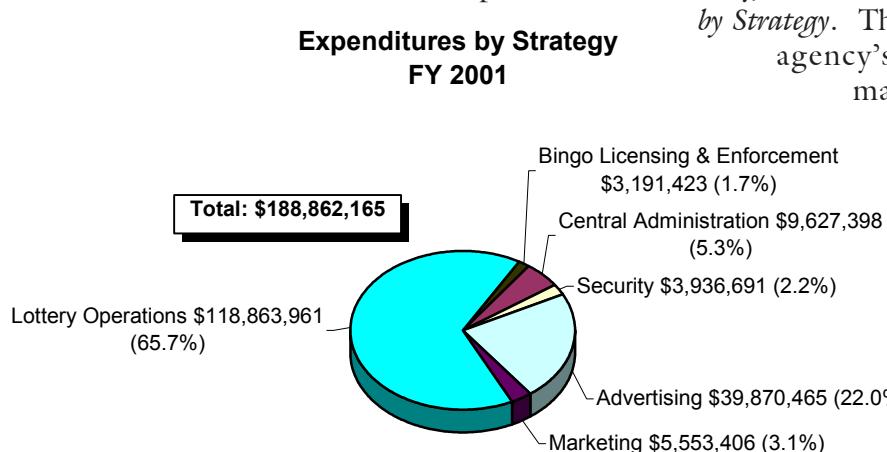
More than 98 percent of revenue and expenditures stem from the lottery.

The Lottery Commission's appropriations for fiscal year 2001 totaled \$209.4 million for administration of the lottery and the regulation of bingo. The agency received more than 98 percent of its revenues from the sale of lottery products. To administer the lottery, the statute entitles the Commission to up to 12 percent of the lottery proceeds, at least 5 percent of which is dedicated to lottery retailers in the form of commissions. Lottery proceeds and licensing fees are deposited into the General Revenue Lottery Dedicated Account and the agency receives its appropriation from this account. If the agency does not use its full appropriation, it must return that money to the Foundation School Fund. In fiscal year 2001, the agency returned \$19.9 million in unspent administrative funds.¹

The Lottery Commission also generates revenue for the State from prize fees, rental taxes, and license fees on bingo operations. This money is paid into the General Revenue Fund and a portion of it is appropriated to the agency for the purpose of regulating bingo, accounting for less than 2 percent of the agency's budget. More detailed information about revenues from the sale of lottery products and bingo regulation is provided in the following agency operations section.

Expenditures

In fiscal year 2001, nearly two-thirds of the agency's expenditures were for the operation of the lottery, as shown in the pie chart, *Expenditures by Strategy*.



Expenditures by Strategy. The next largest portion of the agency's budget went toward marketing and advertising to promote lottery products. Other expenditures include security, administration, and bingo regulation.

Appendix B describes the Commission's use of Historically Underutilized Businesses (HUBs) in purchasing goods and

services for fiscal years 1998 to 2001. In fiscal year 2001, the Commission spent nearly three-quarters of its budget on outside contractors, mainly for services such as lottery operations, instant ticket manufacturing, and advertising. The Commission generally exceeded the statewide goals for professional services and commodities, but fell short of the goals for special trade and other services.

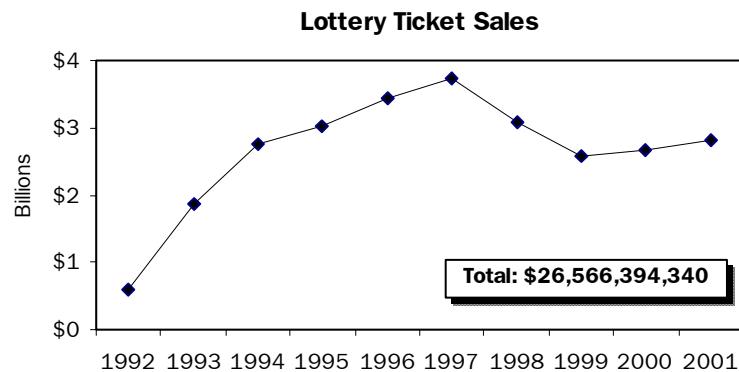
Agency Operations

The mission of the Lottery Commission is to administer and market lottery games to generate revenue for the State and regulate bingo to maximize charitable distributions. The agency is also responsible for maintaining the security, fairness, and integrity of lottery games, and the fairness and integrity of bingo games. The agency accomplishes these goals through key functions such as overseeing the operation of the lottery, licensing lottery retailers and bingo industry representatives, collecting revenue generated through the sale of lottery products and the conduct of bingo games, marketing the lottery, ensuring compliance with lottery and bingo statutes and regulations, and taking enforcement action against violators.

To date, the lottery has generated \$9.6 billion for schools and other state funds.

Lottery

In 1991, Texas voters approved a constitutional amendment to create a state lottery. To date, the lottery has generated \$9.6 billion for the State's general revenue, public schools, and indigent care programs. While ticket sales in recent years have not been as strong as they once were, as shown in the chart, *Lottery Ticket Sales*, the lottery remains a consistent revenue generator. Further, according to the agency's most recent demographic study, approximately 63 percent of all adult Texans have played at least one Texas Lottery game in the past year.



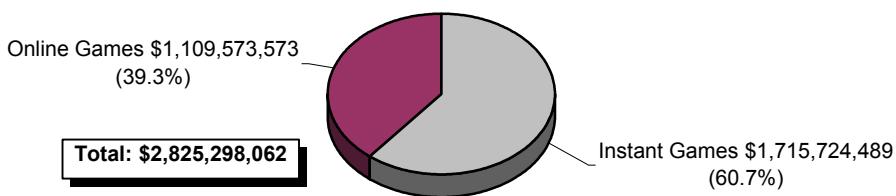
Products and Revenues

The Commission has two different lottery products, online and instant games, which are sold by licensed lottery retailers. Online games are games in which players select a set of numbers, the type of game, and amount of play for a specified drawing date. The Commission administers the drawing of the winning numbers of each game on a set schedule. The Commission currently has four types of online games: *Lotto Texas*, *Pick 3*, *Cash Five*, and *Texas Two Step*.

The Commission currently sells about 70 different scratch-off games ranging in price from \$1 to \$10.

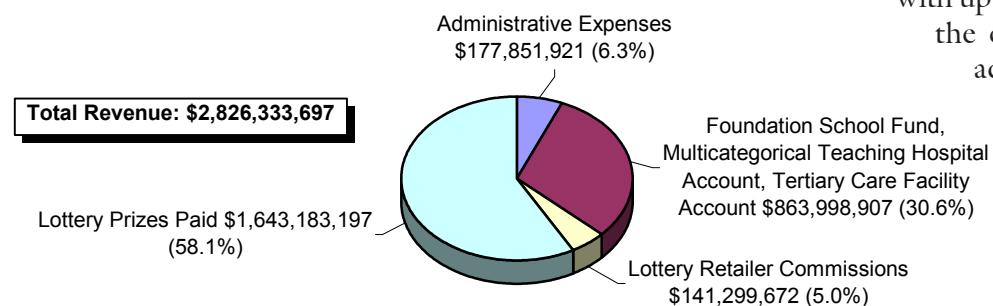
Instant games, also called scratch-off games, are games in which players buy a preprinted ticket with symbols hidden underneath a latex cover that correspond to prizes. Currently, the Commission has about 70 different scratch-off games ranging in price from \$1 to \$10. The pie chart, *Online and Instant Game Sales*, gives sales information about the Commission's games for fiscal year 2001.

**Online and Instant Game Sales
FY 2001**



The pie chart, *Lottery Revenue Distributions*, shows how the money generated by the lottery was distributed in fiscal year 2001. Of the

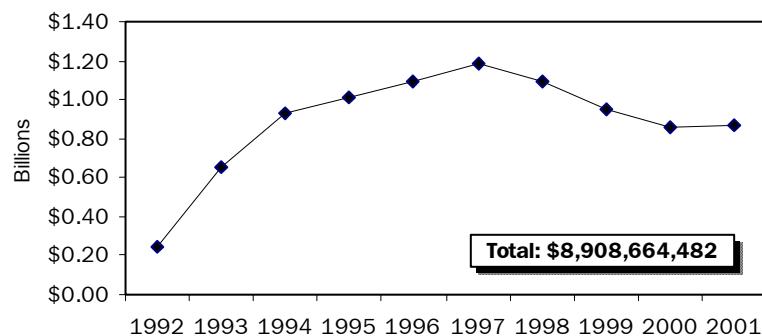
**Lottery Revenue Distributions
FY 2001**



revenue generated each year, 12 percent is reserved to cover operating costs of the lottery, with up to 7 percent covering the cost of the agency's administration and 5 percent returning to lottery retailers as sales commissions. Prize amounts for lottery tickets are also deducted from the total ticket sales.

The remainder of the revenue collected is transferred to the State. The chart, *Revenue Transfers to the State*, shows trends in the amount of money transferred to the State since the lottery's inception through fiscal year 2001.

Revenue Transfers to the State



In 1997, the Legislature amended the State Lottery Act to direct lottery proceeds to the Foundation School Fund, rather than to the General Revenue Fund. Later, in 1999, the Legislature specified that the first \$40 million of any unclaimed prize money, which was previously returned to the prize pool, be directed to the Multicategorical Teaching Hospital Account, and any money in excess of

that \$40 million per biennium will be transferred to the Tertiary Care Facility Account. The textbox, *Total Transfers to the State*, shows how much money the Commission has transferred to each of these funds from 1992 to 2001.

Operations

The Texas Lottery is the only lottery in the United States that outsources its entire lottery sales function. The Commission works closely with its contracted lottery operator, GTECH Corporation, to administer the lottery. The lottery operator's responsibilities under its contract with the Commission include:

- instant ticket and online gaming system design, operation and maintenance;
- lottery management system design, operation and maintenance;
- telecommunications network design, operation and maintenance;
- marketing research, promotions, and field sales personnel and services;
- instant ticket and online ticket stock warehousing, packing, and distribution;
- ticket order processing and telemarketing; and
- hotline support system operation.

Under its contract with the Commission, the lottery operator must meet several guidelines set by the Commission and the Legislature, such as sales goals, average prize payout percentages, and ethical and security standards. The lottery operator provides goods and services in connection with the day-to-day operations of the lottery, but the Commission retains the right to make all decisions regarding the direction and control of the lottery. Though the lottery operator administers the Commission's instant ticket games functions, the Commission contracts with two instant ticket manufacturers to produce the tickets, Scientific Games International and Pollard Banknote Limited.

Claim Centers

The Lottery Commission operates 22 claim centers around the state to provide lottery information to players and redeem prizes. Players may redeem their winning tickets and collect prizes that are worth less than \$1 million at these claim centers. For prizes of more than \$1 million, winners must travel to Austin to claim their money. In addition, lottery retailers may redeem prizes of less than \$600. The agency's

Total Transfers to the State FY 1992 - 2001	
General Revenue Fund 1992 - 1997	\$5,130,647,837
Foundation School Fund 1998 - 2001	\$3,703,560,414
Multicategorical Teaching Hospital Account 2000 - 2001	\$40,000,000
Tertiary Care Facility Account 2001	\$34,456,231

The agency's contracted lottery operator, currently GTECH, manages the day-to-day operations of the lottery.

The agency's claim centers issue approximately 1,000 prize checks per week.

claim centers issue approximately 1,000 prize checks per week statewide. The claim centers also provide information about lottery games to the public through an average of 1,800 walk-in interactions and 2,000 calls to the agency's toll-free phone line per week. The agency's Austin staff encourages large jackpot winners to seek legal and financial advice before claiming the prize and will assist winners in how to deal with media inquiries.

Licensing

To be eligible to sell lottery tickets in Texas, individuals and entities must complete and submit an application to the Lottery Commission. After criminal and financial background checks, the agency will issue a lottery retailer license. The agency will deny a license if an applicant's history includes felony convictions, misdemeanor convictions involving moral turpitude, convictions of gambling or gambling-related offenses, professional gambling, delinquent taxes, or personal or fiduciary relationships with the agency or lottery operator.

The agency processes all lottery retailer applications, license renewals, and terminations; updates retailer information; and coordinates ownership transfers and lottery terminal moves. Lottery retailer licenses are valid for two years. The agency's licensing staff handles about 1,200 transactions per month. The agency regulates approximately 16,672 licensed lottery retailers, of which 44 percent are chain stores and 56 percent are independent retailers.² As shown in the chart, *Types of Licensed Lottery Retailers*, nearly three-quarters of licensed retailers are convenience stores.

Types of Licensed Lottery Retailers



Compliance and Enforcement

The Lottery Commission is responsible for vendor and retailer compliance and enforcement. The agency closely monitors the performance of its vendors to ensure they are in compliance with contract requirements. For example, the agency monitors the services provided by the lottery operator vendor such as instant ticket storage and delivery,

field visits to retailers, ticket returns, and terminal installations. The agency also monitors its instant ticket vendors for quantity and quality control. If a vendor does not comply, the agency can assess penalties for not performing specific contracted services.

The agency also closely monitors lottery retailers for compliance with statutory licensing requirements. For example, the agency oversees the weekly electronic transfers, or sweeps, of lottery revenues from retailer bank accounts to the State Treasury and currently monitors approximately 322 delinquent accounts. If weekly sweeps find insufficient funds, the agency may take action against the retailer's license, such as summary suspension or revocation. If an issue is not resolved within a reasonable time, the agency can use collection tools such as freezing bank accounts or obtaining liens. A retailer license may also be suspended if the agency determines that the retailer location is non-compliant with the Americans with Disabilities Act requirements. Before proceedings to suspend or revoke a retailer's license, the agency can withhold any bonus incentive payments due to the retailer for selling certain prize-winning tickets. In fiscal year 2001, 2,185 summary suspensions were granted, meaning some licenses were suspended on more than one occasion, and 241 licensing proceedings were held before the State Office of Administrative Hearings.³ During that same year, the agency revoked 102 licenses.⁴

In fiscal year 2001, the agency granted 2,185 summary suspensions of lottery retailer licenses.

Marketing and Advertising

The Lottery Commission provides planning, development, production, distribution, marketing, and promotion of online and instant ticket games to maximize the sale of lottery products. The agency contracts with two advertising firms to generate television, radio, print, and outdoor advertisements for both general and minority markets. Approximately 9,000 radio spots and 1,500 television commercials are aired monthly.⁵ These firms also help the agency coordinate statewide on-air promotions. The agency spent nearly \$38.8 million on these advertising contracts in fiscal year 2001. In addition, the agency planned, coordinated, and staffed 79 promotional events in fiscal year 2001.⁶ The agency also researches the demographics of lottery players. The textbox, *Who Plays the Lottery?*, shows some of the results of this research.

Who Plays the Lottery?

According to the agency's most recent demographic study:

- 44 percent of lottery players have an annual income of \$50,000 and over;
- 63 percent have some college education; and
- 47 percent are 36 to 55 years old.

The demographic study also showed that the gender and ethnic makeup of lottery players roughly matches that of the state's population in general.⁷

Bingo

The Lottery Commission also regulates all activities related to conducting charitable bingo games in the state. Charitable bingo allows nonprofit organizations to raise funds for their charitable purposes. Regulation attempts to ensure that bingo games are conducted fairly

and proceeds derived from bingo games are used for authorized purposes. A 1980 constitutional amendment authorized bingo on local option basis and required that proceeds from bingo be spent in Texas for charitable purposes. Currently, approximately 200 local jurisdictions in Texas allow bingo. In calendar year 2001, 24.3 million people attended bingo games in Texas.⁸

Bingo Games

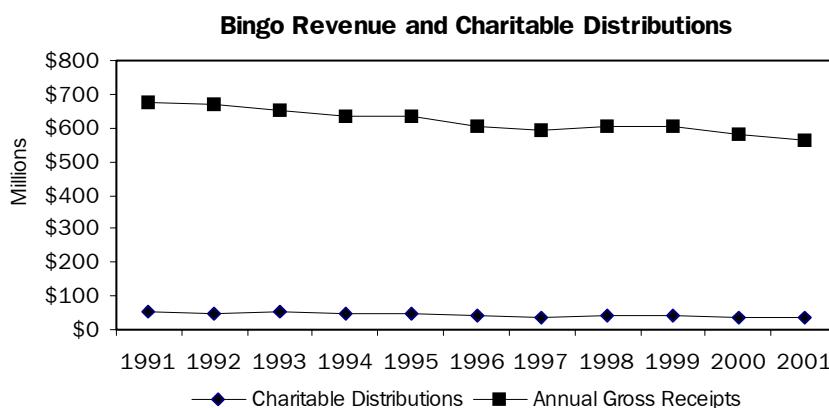
Electronic card-minding devices enable a player to play up to 66 bingo card faces at a time.

Bingo may be played using traditional paper cards, pull-tabs, and electronic card-minding devices. Pull-tabs are instant bingo tickets with perforated break open tabs that may conceal prize symbols. Electronic card-minding devices enable a player to play up to 66 bingo card faces at a time with one computerized device. The Lottery Commission tests and approves paper cards, pull-tabs, electronic card-minding devices, and pull-tab dispensers. Manufacturers submit new pull-tab games to the agency to be tested for accuracy of prize payouts and for quality and security of the games.

Most bingo games offer prizes. By law, the maximum prize per game is \$750 and the maximum prize per four-hour bingo session is \$2,500. In 2001, the prizes paid to bingo players totaled \$399.3 million.⁹

Revenue

In calendar year 2001, charitable bingo games generated \$567 million in gross receipts. The graph, *Bingo Revenue and Charitable Distributions*, shows bingo revenue distributed for charitable purposes over the last ten years.¹⁰

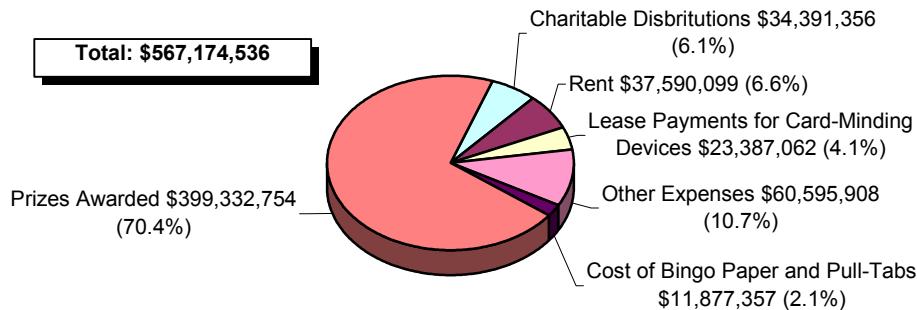


Bingo generates revenue for a variety of charitable purposes such as helping veterans with their medical costs, providing scholarships to disadvantaged students, and supporting halfway houses that treat individuals with substance abuse problems. An organization licensed to conduct bingo must distribute a minimum of 35 percent of its adjusted gross

receipts minus the licensee's authorized expenses. Overall, these expenses reduce the charitable distribution to approximately 6 percent of revenue. A breakdown of how bingo revenue was used in calendar year 2001 is illustrated in the pie chart, *Bingo Expenditures*.

In addition to revenue generated for charitable purposes, bingo also produces revenue for the State and for local jurisdictions through prize fees and taxes. The agency collects 5 percent of all bingo prizes awarded.

Bingo Expenditures Calendar Year 2001



Local jurisdictions receive almost half of bingo prize fees.

Most local jurisdictions choose to receive half of the prize fees generated by bingo in their area. In calendar year 2001, \$20.1 million was collected in prize fees, of which \$10.9 million went to the General Revenue Fund and \$9.2 million was returned to local jurisdictions. The agency also collects a tax imposed on the rental of premises where bingo is conducted. Persons leasing their premises for conducting bingo pay a 3 percent gross rental tax on the rental income they receive. In calendar year 2001, the agency collected \$1.1 million in gross rental taxes that went to the General Revenue Fund.

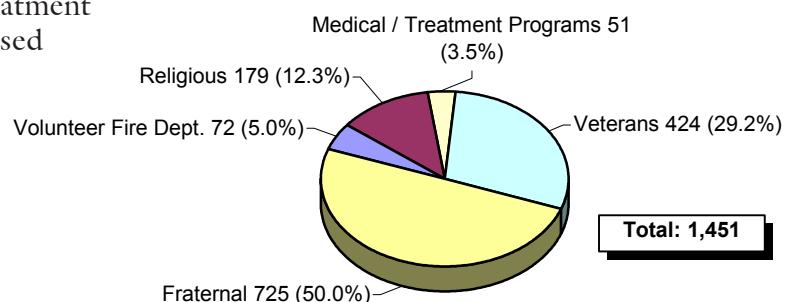
Licensing

The Lottery Commission licenses all bingo related activities to ensure bingo games are conducted in accordance with the law. The agency licenses organizations, individuals, and entities to conduct bingo games, lease premises for the conduct of bingo, manufacture or distribute bingo supplies, and provide automated bingo system services. The table, *Bingo Licensees*, lists the types of licenses offered by the agency and the number of entities currently regulated.

Groups eligible to conduct bingo include charitable organizations such as veterans organizations like the American Legion, religious societies like B'nai B'rith International, fraternal organizations like the Knights of Columbus, volunteer fire departments, and groups supporting medical research or treatment programs. A breakdown of licensed charitable organizations by type is shown in the pie chart, *Licensed Conductors*. Bingo conductors must provide proof of charitable activities and must have a current 501(c) exemption from the Internal Revenue Service except religious

Bingo Licensees	
Types of Licenses	Number of Licenses
Conductor	1,451
Commercial Lessor	468
Distributor	16
Manufacturer	14
System Service Provider	2

Licensed Conductors



societies and volunteer fire departments. Generally, a licensed organization may not conduct bingo games more than two times per day or three days per week, and individual games may not last more than four hours during a 24-hour period. The agency also issues temporary licenses to authorized organizations to conduct bingo as a one time occasion.

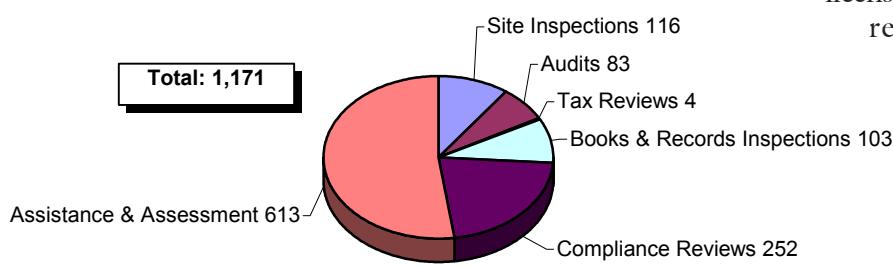
Compliance and Enforcement

The agency ensures licensees' compliance with the statute and rules, and the integrity and fairness of bingo games. The different types of audits and inspections conducted by agency staff are listed below.

The agency conducted more than 1,100 bingo audits and inspections in 2001.

- **Site Inspections** - Inspections of applicants to verify the location of the bingo premises and conduct pre-licensing interviews to explain bookkeeping responsibilities and determine the applicants' qualifications.
- **Books and Records Inspections** - Reviews of books and records designed to train a licensee in the proper method of establishing and maintaining bingo-related accounting records. Usually, new licensees receive this inspection six months after being licensed.
- **Tax Reviews** - Reviews of delinquent licensees that fail to file quarterly reports.
- **Assistance and Assessment Inspections** - Inspections to verify that organizations conduct bingo sessions in compliance with the statute and rules. Bingo auditors visit every licensed location once a year to conduct this inspection.
- **Audits** - Compliance and financial audits conducted when the agency finds serious discrepancies in a conductor's quarterly reports.
- **Compliance Reviews** - A hybrid of a compliance and financial audit that focuses on only one quarter to determine if organizations use charitable distributions for authorized charitable purposes.

**Audit and Inspection Functions
Calendar Year 2001**



The pie chart, *Audit and Inspection Functions*, provides a breakdown of the agency's compliance monitoring activities in calendar year 2001. Enforcement actions available to the agency when licensees fail to comply with bingo regulations include license denials, suspensions, and revocations. In addition, the Lottery Commission is authorized to assess administrative fines against licensees who commit violations such as failing to

submit quarterly reports or remit prize fees to the agency. In fiscal year 2001, the agency settled eight violations through agreed orders, revoked or suspended four bingo licenses, denied 37 bingo licenses, and assessed fines against one licensee.

Security

The Lottery Commission is responsible for protecting and maintaining the security and integrity of all lottery and bingo games, systems, and drawings. With the help of 31 commissioned peace officers, the agency handles administrative and criminal investigations relating to the lottery and bingo; and assists local, state, and federal authorities with investigations of possible criminal violations. The types of criminal violations relating to lottery and bingo include forgery, fraud, homicide, robbery, arson, and theft; and various forms of illegal gambling. The chart, *Security Activity*, provides specific information about the agency's security activities in fiscal year 2001. If the security staff find administrative violations through these activities, the cases are referred to the agency's Legal Division for review and possible enforcement action by the Lottery Operations or Charitable Bingo Operations Divisions. Criminal cases are referred to county and district attorneys for review.

The security staff conduct extensive criminal background checks on all lottery and bingo employees and licensees, oversee live lottery drawings, and maintain physical security at all agency locations. An in-house laboratory assesses security, quality, and environmental standards by testing a random sampling of lottery tickets and provides forensic analysis for questionable document verification.

All lottery instant games are audited to evaluate and approve the projected prize structure and parameters of each instant game to ensure its playability and integrity.

Security Activity FY 2001	
Bingo	
Complaints	191
Background Investigations	275
Required Inspections	57
Requests to Witness Destruction of Bingo Paper/Products	73
Bingo Occasion Inspections	116
Total Investigations Initiated	712
Lottery	
Complaints	589
Background Investigations	212
Retailer Inspections	735
Stolen Ticket Reports	1,561
Total Investigations Initiated	3,097

-
- ¹ Texas Lottery Commission, Financial Administration Division, "Requested items from Finance", e-mail to Sunset staff, June 26, 2002.
 - ² Texas Lottery Commission, Strategic Plan for 2003 - 2007 (Austin, Texas, June 17, 2002), p. 14.
 - ³ Memorandum from the Texas Lottery Commission to Sunset Advisory Commission, June 28, 2002.
 - ⁴ Texas Lottery Commission, Lottery Operations Division, "FY 2001 License Revocations," e-mail to Sunset Advisory Commission, July 2, 2002.
 - ⁵ Texas Lottery Commission, Marketing Division, "Re: Advertising Information Request," e-mail to Sunset Advisory Commission, June 19, 2002.
 - ⁶ Texas Lottery Commission, Marketing Division, "Re: information request," e-mail to Sunset Advisory Commission, June 12, 2002.
 - ⁷ Texas Lottery Commission, *Demographic Study of Texas Lottery Players*, data compiled by the Office of Survey Research at the University of Texas at Austin (Austin, Texas, January 2001).
 - ⁸ Sunset Advisory Commission overview meeting with the Texas Lottery Commission (Austin, Texas, April 4, 2002).
 - ⁹ Ibid.
 - ¹⁰ Ibid.

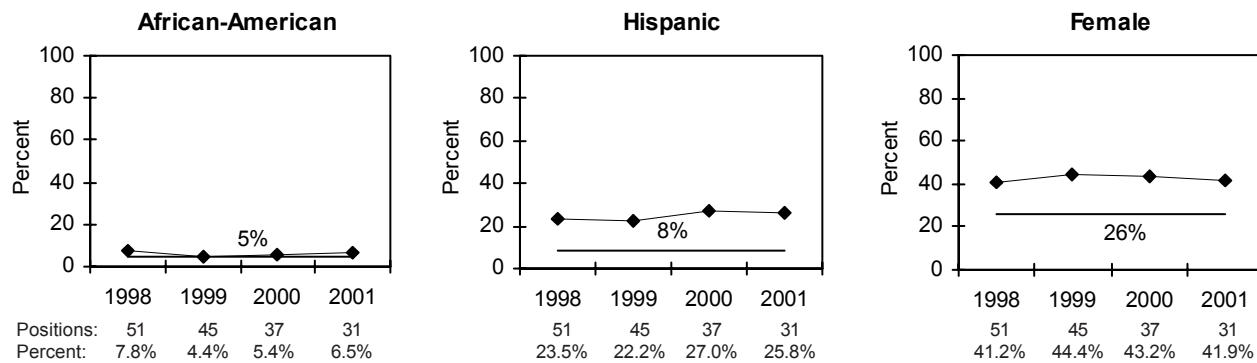
APPENDICES

Appendix A

Equal Employment Opportunity Statistics 1998 to 2001

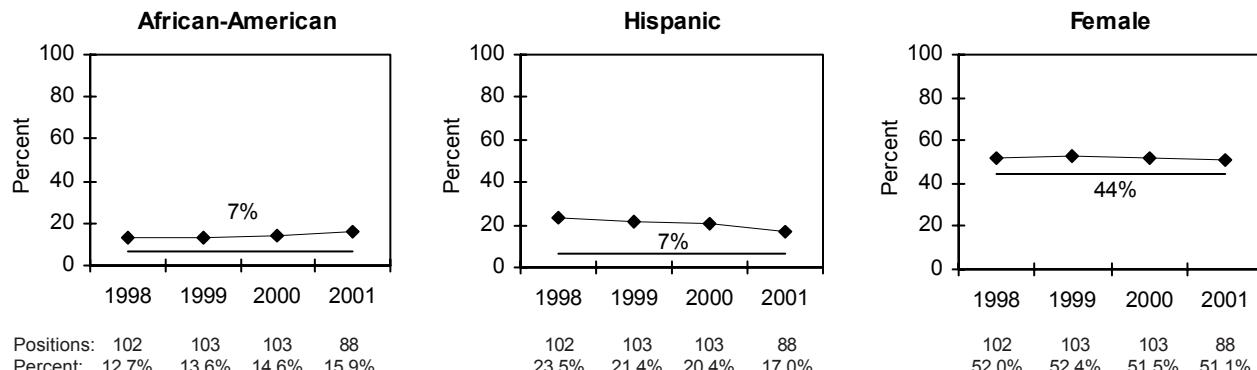
In accordance with the requirements of the Sunset Act, the following material shows trend information for the Texas Lottery Commission's employment of minorities and females in all applicable categories of the labor force.¹ The agency maintains and reports this information under guidelines established by the Texas Commission on Human Rights.² In the charts, the flat lines represent the percentages of African-Americans, Hispanics, and females in each job category. These percentages provide a yardstick for measuring agencies' performance in employing persons in each of these groups. The dashed lines represent the agency's actual employment percentages in each job category from 1998 to 2001. The agency does not employ persons in some job categories – skilled craft and service/maintenance.

State Agency Administration



The agency generally exceeded the civilian labor force percentages for African-Americans, Hispanics, and females in this category.

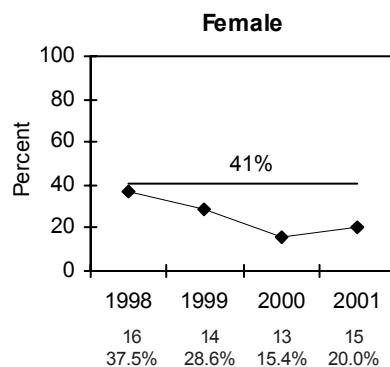
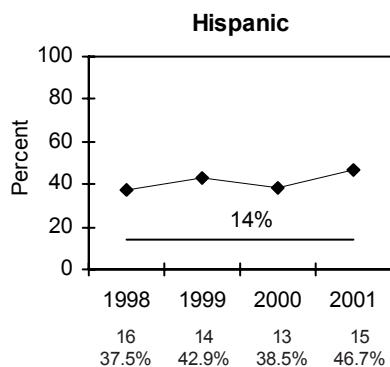
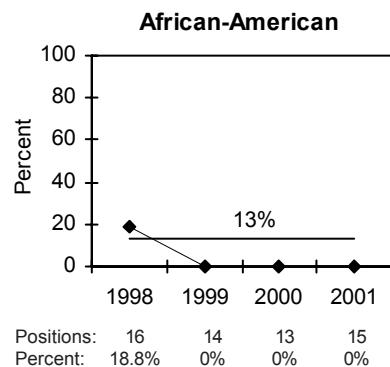
Professional



The agency consistently exceeded the civilian labor force percentages for all three groups in this job category.

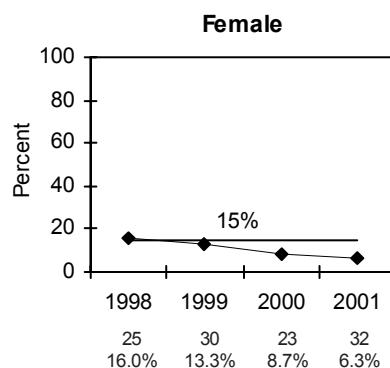
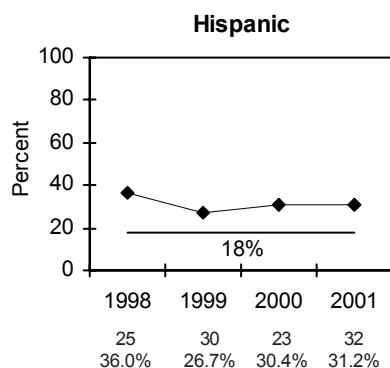
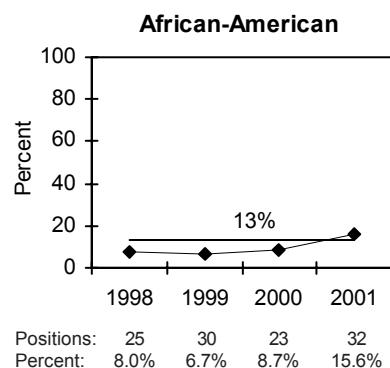
Appendix A

Technical



The agency fell below the civilian labor force percentages for African-Americans and females in technical positions, but exceeded the percentage for Hispanics.

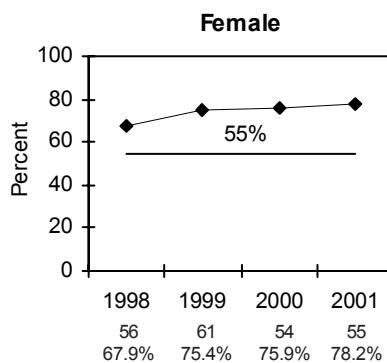
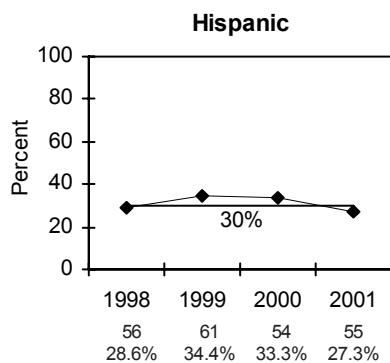
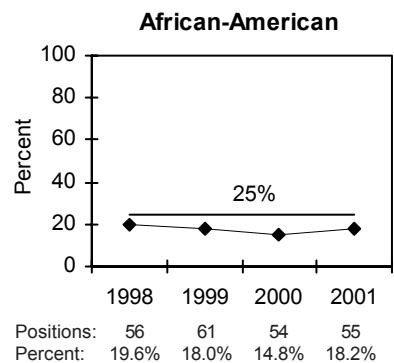
Protective Services



The agency improved its percentage of African-Americans in this job category, while consistently exceeding the civilian labor force percentage for Hispanics. The agency did not meet the percentage for females in protective services positions. In fact, this percentage has been declining.

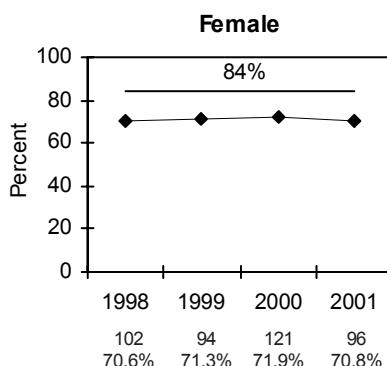
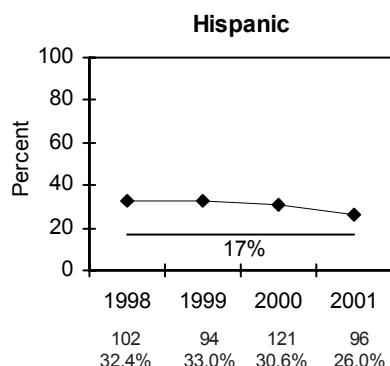
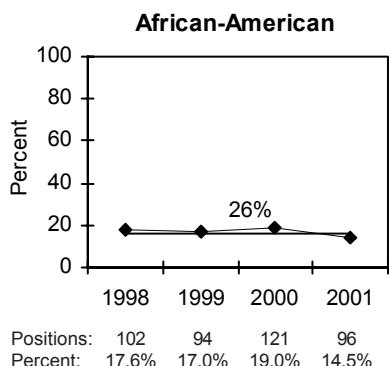
Appendix A

Para-Professional Support



The agency fell short of the civilian labor force percentages for Africans-Americans and Hispanics in this job category, but exceeded the percentage for females.

Administrative Support



The agency fell short of the civilian labor force percentages for African-Americans and females in this job category, but exceeded the percentage for Hispanics.

¹ Texas Government Code, ch. 325, sec. 325.011(9)(A).

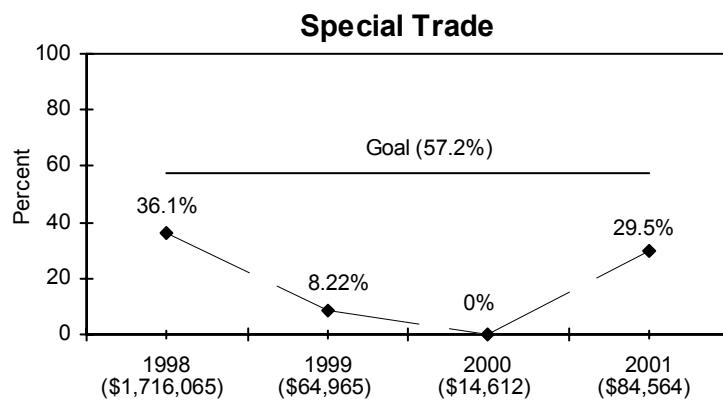
² Texas Labor Code, ch. 21, sec. 21.501.

Appendix B

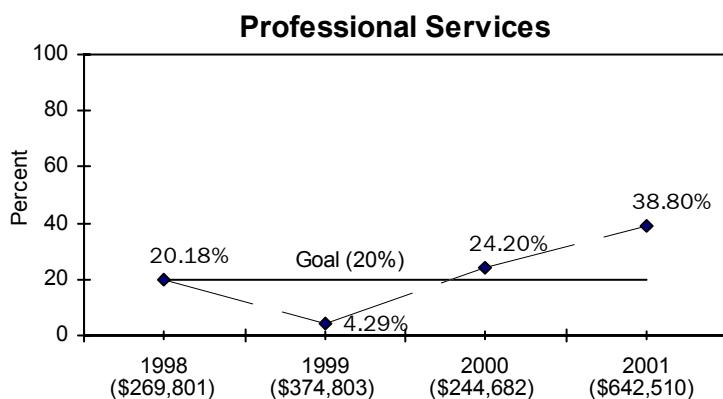
Historically Underutilized Businesses Statistics 1998 to 2001

The Legislature has encouraged state agencies to increase their use of Historically Underutilized Businesses (HUBs) to promote full and equal opportunities for all businesses in state procurement. The Legislature also requires the Sunset Commission to consider agencies' compliance with laws and rules regarding HUB use in its reviews.¹ The review of the Texas Lottery Commission revealed that the agency is generally complying with state requirements concerning HUB purchasing.

The following material shows trend information for the Texas Lottery Commission's use of HUBs in purchasing goods and services. The agency maintains and reports this information under guidelines in the Texas Building and Procurement Commission's statute.² In the charts, the flat lines represent the goal for HUB purchasing in each category, as established by the Texas Building and Procurement Commission. The dashed lines represent the percentage of spending with HUBs in each purchasing category from 1998 to 2001. Finally, the number in parentheses under each year shows the total amount the agency spent in each purchasing category. The agency has fallen below the state goal for special trade and other services. However, the agency surpassed the goal for professional services and commodities spending.



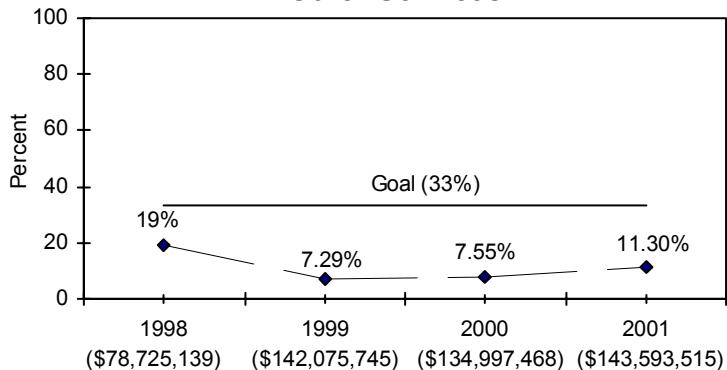
The agency fell below the state goal from 1998 to 2001.



The agency has exceeded the state goal in the past two fiscal years.

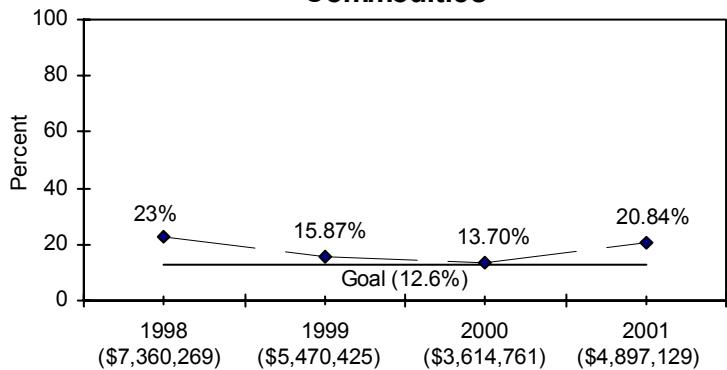
Appendix B

Other Services



The agency fell below the state goal from 1998 to 2001.

Commodities



The agency exceeded the state goal from 1998 to 2001.

¹ Texas Government Code, ch. 325, sec. 325.011(9)(B) (Vernon 1999).

² Texas Government Code, ch. 2161.

Appendix C

Staff Review Activities

The Sunset staff engaged in the following activities during the review of the Texas Lottery Commission:

- Worked extensively with the Executive Director, the Charitable Bingo Operations Division Director, other Division Directors, General Counsel, and agency staff.
- Attended Commission meetings and met with all current Commission members. Attended Bingo Advisory Committee meetings and met with or interviewed over the phone several past and current Committee members.
- Toured the GTECH facility and the Commission's warehouse facility in Austin and met with GTECH staff. Attended a live drawing of the Commission's online games and visited a bingo hall in Austin. Attended a Bingo Operator Training session in New Braunfels, and a Retailer Town Hall Meeting in Denton. Met with and accompanied Dallas regional office staff on security investigations and lottery retailer surveys.
- Conducted phone interviews with staff from the Texas Building and Procurement Commission, Texas Education Agency, Texas Department of Health, and the Texas Alcoholic Beverage Commission.
- Met with in person or interviewed over the phone representatives from the licensed bingo community and lottery retailers. Conducted interviews and solicited written comments from national, state and local interest groups.
- Talked with the staff of the Lieutenant Governor's Office, Speaker's Office, State Auditor's Office, Legislative Budget Board, Council on Competitive Government, and key legislative committees.
- Reviewed reports by the State Auditor's Office, Management Advisory Services, Legislative Budget Board, General Services Commission, and the Council on Competitive Government.
- Reviewed Commission documents including meeting minutes and transcripts, agency contracts and requests for proposals, litigation documents, reports, statutes and rules, legislative reports, and previous legislation. Performed background and comparative research using the Internet and reviewed literature on lottery and bingo issues. Researched the functions of lottery agencies and bingo regulatory bodies in other states and conducted phone interviews with representatives of the California and Florida lotteries.
- Attended contested case and summary suspension hearings at the State Office of Administrative Hearings. Attended district court hearings regarding agency contracting. Attended legislative briefings given by Commission staff.

SUNSET REVIEW OF THE TEXAS LOTTERY COMMISSION

Report Prepared By:

Karen Latta - Project Manager

**Janelle Collier
Chloe Lieberknecht
Michelle Luera
Barbara Hunley**

Ken Levine - Project Supervisor

**JOEY LONGLEY
DIRECTOR**

Sunset Advisory Commission
P.O. Box 13066
Austin, TX 78711

Robert E. Johnson Bldg., 6th Floor
1501 N. Congress Ave.
Austin, TX 78701
www.sunset.state.tx.us

(512) 463-1300
FAX (512) 463-0705