

Approved: 1-28-97
Date

MINUTES OF THE SENATE COMMITTEE ON FEDERAL AND STATE AFFAIRS.

The meeting was called to order by Senator Lana Oleen at 11:15 a.m. on January 22, 1997 in Room 254-E of the Capitol.

All members were present.

Committee staff present: Mary Galligan, Legislative Research Department
Theresa Kiernan, Revisor of Statutes
Midge Donohue, Committee Secretary

Conferees: Barb Hinton, Director
Division of Legislative Post Audit

Others attending: See attached list

Senator Oleen introduced Mary Galligan, Legislative Research Department, who presented an overview of statutory authority of the Kansas Lottery (Attachment #1), and discussed how the Lottery is organized and explained its functions. She said the Lottery had been reauthorized three times and was slated to expire in 1996, but current statute, passed during the 1995 Session, sets consideration for abolition of the Lottery on July 1, 2002.

In discussing the composition of the five-member Lottery Commission whose members serve at the pleasure of the Governor, Ms. Galligan pointed out that the appointees were subject to Senate confirmation. Senator Oleen advised that confirmation hearings on Lottery Commission appointees would come before the Senate Federal and State Affairs Committee when a four year term expired and/or an opening occurred on the Commission.

Ms. Galligan stated the ultimate goal of the Lottery is to produce revenue for the state, and the Lottery Act requires that the operation of the Lottery and prizes be financed from ticket sales revenue. She outlined expenditure limitations imposed by the legislature and noted those minimum requirements are currently being exceeded. She explained that the legislature does not make specific appropriations for the Lottery, only establishes limitations.

Senator Schraad expressed an interest in information from other states concerning advertising costs, and Senator Oleen advised that, as a member of the National Council of Legislators from Gaming States, she would be attending a meeting this week and will have additional information for comparison purposes, particularly in the area of what occurs when specific cuts are made in the advertising budget for a state-owned lottery.

Responding to concerns expressed by committee members during the site visit to the Lottery, Ms. Galligan outlined the qualifications that must be met by retailers and explained the procedures in place for their selection.

She addressed law enforcement authority of the Lottery which rests largely, but not exclusively, with the Executive Director and Lottery employees and added that enforcement responsibilities are assigned to an Assistant Attorney General who works exclusively with the Lottery.

Senator Gooch stated that, although he was impressed with procedures of the Lottery, he was disturbed by the absence of people of color on staff, noting that none was observed while touring the Lottery facility, and asked for information concerning hiring practices.

Senator Oleen noted Senator Gooch's concerns, but stated it would be unfair to conclude people of color were being denied employment, absent information to sustain that claim, and she will ask representatives of the Lottery to provide the information he is seeking.

Barb Hinton, Legislative Post Auditor, was introduced by Senator Oleen. Ms. Hinton reviewed and made available to members of the committee the Financial and Compliance Audit Report, Kansas Lottery, Fiscal

CONTINUATION SHEET

MINUTES OF THE SENATE FEDERAL & STATE AFFAIRS COMMITTEE, Room 254-E, Statehouse,
at 11:00 a.m. on January 22, 1997.

Year 1996, which is on file with the Legislative Post Audit Division, along with a copy of a Kansas Lottery financial summary prepared by the Legislative Division of Post Audit (Attachment 2).

She noted there were no findings of problems by the independent auditor, stating it was a good report for the Kansas Lottery, and commended the Lottery staff. Ms. Hinton concluded her presentation by responding to questions from members of the committee.

Senator Becker made a motion that the minutes of the January 16, 1997, meeting be approved. Senator Schraad seconded the motion; the motion carried.

The meeting concluded at 12:00 noon; the next meeting is scheduled for January 27, 1997.

SENATE FEDERAL & STATE AFFAIRS COMMITTEE GUEST LIST

DATE: 1-22-97

NAME	REPRESENTING
Denise Everhart	K-RACE
Barb Hinton	Post Audit
Frances Wood	WCTU + Church of the ^{Kansas} Nazarene
Dave Schneider	Kansas For Life At Its Best
Glenn Thompson	Stand Up For Kansas
Dan Hamer	—
Pat Dobbell	WGP
Jim Edwards	KOCT
Albert Murray	Visitor
Connie Murray	Visitor
Mark Healy	VISITOR
Sharon Walker	VISITOR
Amy Campbell	R. Rice Law Office
Keith L. Saville	Kansas Lottery
Jim Gordon	Kan Lottery
Patrick D. Kerley	CPA

January 22, 1997

KANSAS LOTTERY STATUTORY AUTHORITY

What Is The State's Role With Respect to Gambling in Kansas?

States generally carry out four functions in regard to legal gambling: regulation, promotion, enforcement, and collection of taxes and other revenue. The four functions are defined for purposes of this discussion as follows:

1. regulation means to control or direct conduct by administrative rule or law; one common method of exercising regulatory authority is through licensure by which the state controls the location, amount, and conduct of gambling;
2. promotion means to encourage the existence and expansion of a given activity; this could include advertising and marketing, provision of technical assistance, and subsidies;
3. enforcement means to compel obedience to laws and to impose a course of action (sanctions) to ensure compliance with laws; and
4. collection of taxes and revenue means, in this context, the mechanisms used by agencies with statutory oversight to obtain revenues due to the state.

How Is the Lottery Organized and What Are its Functions?

The state is the only entity constitutionally authorized to own and operate a lottery other than bingo and parimutuel wagering on horse and dog racing.¹ The Legislature established a free-standing agency, the Kansas Lottery, to administer and conduct lottery games (K.S.A. 74-8701 *et seq.*). Since the Lottery is state owned and operated, there is no licensure function,

¹ Since passage of the lottery amendment to the *Constitution*, the precise meaning of the term lottery in the *Kansas Constitution* has been a matter of debate. That debate became more heated with emergence of tribal gaming and related questions about the scope of gambling permitted in Kansas. In accordance with 1993 S.R. 1844, the Attorney General filed a petition for writ of *mandamus* and *quo warranto* seeking an interpretation of the constitutional provision. The Supreme Court's opinion issued January 27, 1994 stated that "lottery," as used in the *Kansas Constitution*, means any game involving the three elements of chance, consideration, and prize (*State, ex rel. Stephen v. Finney*, 254 Kan. 632 (1994)).

as there is with bingo. However, the contractual relationship between retailers and the Lottery is commonly referred to as a license.

The Executive Director of the Lottery is appointed by the Governor and confirmed by the Senate (K.S.A. 74-8703(a)). The Director must administer the Lottery in accordance with statute. The operation must be financially accountable to the Governor, Legislature, the State Treasurer, and the Kansas Lottery Commission (K.S.A. 74-8706(b)).²

The Lottery Commission is composed of five members appointed by the Governor to serve four-year terms. Appointees are subject to Senate confirmation. The Commission has an advisory role with respect to the Lottery's operations and policies (K.S.A. 74-8709(e)); however, it must approve the Lottery's proposed annual budget and all major procurements recommended by the Executive Director (K.S.A. 74-8909(d) through (f)).

The Executive Director selects and contracts with retailers who must meet qualifications enumerated in statute (K.S.A. 74-8708(g) and (h)). Those retailers are the only entities from which lottery tickets can be purchased (K.S.A. 74-8718(a)(2)). There is nothing in statute to preclude bingo licensees or licensees of the Racing Commission or the ABC from being Lottery retailers.

The Lottery is authorized to adopt rules and regulations; however, temporary rules and regulations are not subject to the state's statutory rule and regulation oversight process established in K.S.A. 77-415 *et seq.* Rules and regulations may include specified information about implementation of lottery games and awarding of prizes (K.S.A. 74-8710(a)). The 1995 Legislature created a mechanism for additional oversight of the Lottery regarding establishment of new games by requiring gubernatorial approval of all new lottery games (K.S.A. 74-8710(b)).

A significant difference between bingo and lottery statutes is that the former are much more prescriptive about the treatment of prizes, operation of games, and the nature of premises for games than are the latter. Many specifics regarding implementation of bingo games are set forth in statute, whereas lottery statutes leave specifics of games to be articulated in rules and regulations (which in this case, are less regulatory than descriptive as to which games and how they will be conducted). The disparate treatment might be attributed to the fact that bingo is conducted by private entities regulated by the Secretary of Revenue, while the Lottery is conducted by the state. As was previously noted, the Lottery is not a licensing agency and conditions on third-party actions are primarily included in contracts. To some extent, differences between bingo and lottery games (essential elements of call and instant bingo are defined in statute, whereas lottery games may take several forms) may account for the dissimilar treatment in statute.

The Lottery is directly involved primarily in promotion. Promotion is clearly the major function of the Kansas Lottery, as evidenced by the statutory requirement that the Executive Director select as lottery retailers ". . . such persons as deemed best able to serve the public convenience and promote the sale of tickets or shares in accordance with marketing plans developed by the Kansas Lottery" (K.S.A. 74-8708(a)). To ensure that promotion activities are

² Financial accountability is clearly the objective of K.S.A. 74-8707, which requires accounts and transactions of the Kansas Lottery and Commission to be subject to an annual financial-compliance audit, performed under the direction of the Legislative Post Audit Committee.

optimally effective, the Executive Director may engage a firm experienced in research marketing analysis to evaluate marketing effectiveness and make recommendations to enhance marketing programs (K.S.A. 74-8706(e)).

The Kansas Lottery Commission is also authorized to enter into written agreements with one or more states or corporations for joint lottery activities, and to participate in the operation, marketing, and promotion of such activities (K.S.A. 74-8709(g)). That is the statutory authorization for Kansas participation in the multi-state lottery, the interstate agreement for which is codified in K.S.A. 74-8731.

The ultimate goal of the Lottery is to produce revenue for the state, so its function as a revenue collection entity is integral to its promotion function. In contrast to bingo and parimutuel wagering, state revenue from lottery games is not generated from a tax. (The state does not tax a product it sells to the public. Indeed, lottery tickets are exempt from the state sales tax; see K.S.A. 74-8721.) Since there is no licensing requirement, no revenue is generated from license fees. However, applicants for lottery retailer contracts must pay an application fee (K.S.A. 74-8710). The bulk of lottery revenues are generated from ticket sales. Each contract between the Lottery and a retailer requires that the retailer have the capacity to relay to the Lottery proceeds from ticket sales electronically.

The Lottery Act requires that operation of the Lottery and prizes be financed from ticket sales revenue. A minimum of 45 percent of sales revenue is to be utilized to pay prizes. A minimum of 30 percent is to be transferred to the State Gaming Revenues Fund.³ That leaves a maximum of 25 percent of sales revenue available for Lottery operation. The expenditure limitation of the Lottery is established by each Legislature in an appropriation act. Ticket sales revenue in excess of amounts needed to meet those statutory minimums and to operate the Lottery have traditionally been transferred to the State General Fund. In addition, the Legislature has transferred funds from both the Lottery and Racing Commission's operating funds to support the gaming unit of the KBI.

The Lottery has some law enforcement authority under the Act, but that authority is consistent with the Lottery's need to ensure the integrity of its games in order to maximize revenue. Enforcement authority created by the Lottery Act rests largely, but not exclusively, with the Executive Director and Lottery employees. Among the Executive Director's enforcement powers are the ability to require lottery retailers to furnish proof of financial stability; examine any materials of a retailer to document compliance with the Act; issue subpoenas to gain access to retailer records; and administer oaths and take depositions (K.S.A. 74-8704(a)(5) through (a)(8)). Employees designated by the Executive Director as law enforcement officers are authorized to: make arrests, conduct searches and seizures, and carry firearms while investigating violations of the law or in the course of routine conduct of their duties; and issue notices to appear in court (K.S.A. 74-8714). Enforcement responsibilities also are assigned to an Assistant Attorney General who works exclusively with the Lottery to enforce criminal and civil provisions of the Act (K.S.A. 74-8715).

³ The 1996 Legislature required in the appropriation act for FY 1997 that a minimum of 30.75 percent of lottery ticket sales revenue be transferred to the State Gaming Revenue Fund.

KANSAS LOTTERY FINANCIAL SUMMARY
Prepared by the Legislative Division of Post Audit

	FY 1988	FY 1989	FY 1990	FY 1991	FY 1992	FY 1993	FY 1994	FY 1995	FY 1996
REVENUES (MILLIONS)	\$ 66.2	\$ 68.8	\$ 65.2	\$ 70.2	\$ 77.8	\$ 115.3	\$ 153.4	\$ 178.3	\$ 183.4
EXPENSES AS % OF REVENUES:									
PRIZES (45% OR MORE)	45 %	49 %	44 %	47 %	48 %	51 %	52 %	52 %	52 %
STATUTORY TRANSFERS (AFTER '88, 30% OR MORE)	17	31	30	30	30	30	31	31	32
OTHER EXPENSES	<u>25</u>	<u>29</u>	<u>22</u>	<u>22</u>	<u>21</u>	<u>18</u>	<u>16</u>	<u>16</u>	<u>17</u>
TOTAL EXPENSES	87 %	109 %	96 %	99 %	99 %	99 %	99 %	99 %	101 %
NET OPERATING INCOME	\$ 8.3	\$ -6.6	\$ 1.9	\$ 1.1	\$ 0.7	\$ 0.7	\$ 1.0	\$ 1.8	\$ -1.2
OTHER TRANSFERS (MILLIONS)									
STATE GENERAL FUND				\$ 1.5					
GAMING REVENUE FUND					\$ 2.8				
INVESTIGATIONS FEE FUND						\$ 0.2	\$ 0.1	\$ 0.1	\$ 0.1
ENDING FUND BALANCE	\$ 8.1	\$ 1.6	\$ 3.4	\$ 3.0	\$ 1.0	\$ 1.7	\$ 2.7	\$ 4.5	\$ 3.3

- ◇ Although not required by statute, in fiscal year 1988, the Lottery transferred \$11.4 million to the State Gaming Revenue Fund.
- ◇ In fiscal year 1989, operating costs reached their highest levels compared to revenues, and the Lottery lost \$6.6 million.
- ◇ In fiscal year 1990, prize payments and operating costs were reduced, and, in spite of decreased revenues, the Lottery showed a net income of almost \$2 million.
- ◇ Since fiscal year 1990, revenues and prize payments as a percentage of revenues have increased. During that same time, operating costs as a percentage of revenues have started to decline.
- ◇ The financial statements indicate that during this eight-year period, the Lottery has transferred about \$283 million to the State Gaming Revenue Fund.

NOTE: Based on the audited annual financial statements prepared by the Kansas Lottery.

TRANSFERS TO STATE GAMING REVENUE FUND:									
STATUTORY TRANSFERS	11.4	21.6	19.2	21.1	23.1	34.2	47.8	55.2	58
OTHER TRANSFERS					2.8				

S. Fed. & State Affairs
1-22-99
Attachment # 2