

STATE OF WEST VIRGINIA
PRELIMINARY PERFORMANCE REVIEW
OF THE
WEST VIRGINIA LOTTERY

**Revenues Compare Favorably
with Other States**

OFFICE OF LEGISLATIVE AUDITOR
Performance Evaluation and Research Division
Building 1, Room W-314
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PE 97-16-87

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December 1997

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Antonio E. Jones, Ph.D.
Director

December 14, 1997

The Honorable Billy Wayne Bailey
State Senate
Drawer A
Covel, West Virginia 24719

The Honorable Vicki Douglas
House of Delegates
Building 1, Room E-213
1900 Kanawha Boulevard, East
Charleston, West Virginia 25305-0470

Dear Chairs:

Pursuant to the West Virginia Sunset Law, we are transmitting a Preliminary Performance Review of the West Virginia Lottery, which will be presented to the Joint Committee on Government Operations on Sunday, December 14, 1997. The issue covered herein is "Revenues Compare Favorably with Other States."

Sincerely,

A handwritten signature in cursive script, appearing to read "Antonio E. Jones".

Antonio E. Jones

AEJ/wsc

Enclosure

Joint Committee on Government and Finance

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Executive Summary

The preliminary review of the West Virginia Lottery was performed to evaluate the lottery's revenues in comparison with lottery systems of other states or districts. The average percentage increase/decrease in annual per capita revenues since fiscal year 1986, or since the inception of the game, was compared with other systems on a per game basis. West Virginia operates three different styles of games:

On-line games are played by purchasing a ticket from a licensed sales agents of the lottery which has numbers on it that the player selects, (i.e. 123, for the 3 digit game). The lottery then has a random drawing at a predetermined time to determine a winner which will have a ticket with the numbers that match the numbers randomly selected.

Instant games are played by scratching the latex covering off the play area on the ticket. The play symbols revealed determine whether the ticket is a winner by matching 3 digits or beating a corresponding number. There is a wide variety of themes to instant games and different ways to win with each.

Video Lottery is a lottery game which is available at licensed racetracks sanctioned by local referendum. It is a keyboard operated video screen which the player wins credits by betting on the results of the game for replay or cash.

Our evaluation compared five different **on-line games**. The ranking of the West Virginia Lottery within the different systems is as follows:

On-Line		
Game	Average Annual % Increase in Per Capita Revenues	Rank
3-digit	19.92%	6 of 16
4-digit	20.83%	2 of 14
Lotto	3.38%	18 of 27
Powerball	49.05%	5 of 11
Keno	6.37%	7 of 12

The on-line games of the West Virginia Lottery when put in percentage form and averaged, indicates performance better than 55% of the systems compared.

The percentage increase or decrease in revenues and ranking for **instant games** is reported below:

Instant Games		
Game Style	Average Annual % Increase in Per Capita Revenues	Rank
Scratch-off	6.96%	17 of 27

The **video lottery** was compared with four other video lottery systems. The ranking of the lottery within these five systems is as follows:

Video Lottery	
Average Annual % Increase in Per Capita Revenues	Rank
121.94%	3 of 5

West Virginia Lottery's per capita revenues of their games have shown an increase since their inception. Therefore, the Legislative Auditor's Performance Evaluation and Research Division concludes that the **West Virginia Lottery is performing at least average, and sometimes above average when compared to other systems.**

Agency Background, Review Objective, Scope and Methodology

On April 13, 1985, the West Virginia Legislature created the West Virginia Lottery, lottery commission, and the State Lottery Fund by passage of the State Lottery Act. All moneys received from the sale of lottery tickets, materials and games shall be deposited with the state treasurer and placed into the fund. The fund, or commission shall not receive any appropriation, loan or other transfer of state funds after the initial appropriation. A minimum annual average of forty-five percent of the gross amount received from each lottery shall be allocated and disbursed as prizes. Not more than fifteen percent of the gross amount received from each lottery shall be allocated to and may be disbursed as necessary for fund operation and administration expenses. Any amount in excess of the sixty percent allocated to prizes and operational expenses shall be allocated as net profit. In the event that the percentage allotted for operations and administration generates a surplus, the surplus shall be allowed to accumulate to an amount not to exceed \$250,000.

Net profits are allocated to the State of West Virginia as operating transfers and are distributed as funds dedicated to the school building debt service fund to retire ten year bonds. Also, the funds are dedicated to the education, arts, sciences and tourism debt service fund. Both of the above dedications of monies are to be paid as one tenth of the projected annual principal, interest and coverage ratio requirements. The remaining amounts shall be annually appropriated as the Legislature sees fit as net profit to: (1) The lottery education fund; (2) the school construction fund; (3) the lottery senior citizens fund; (4) the division of natural resources and the West Virginia development office.

The West Virginia Lottery Commission shall receive thirty percent net terminal income from **video lottery**, which shall be paid into the general revenue fund of the state to be appropriated by the Legislature. In addition to the thirty percent, one percent is dedicated to the Vietnam veteran's memorial fund, and three percent of net terminal income to the tourism promotion fund.

The preliminary review of the lottery was performed to evaluate the revenues produced in relation to other lottery systems in the United States, disregarding operational and administrative expenses. Thirty eight different lottery systems, including the District of Columbia, are in existence today. Each one is individually unique due to underlying mandates, game types, state populations, and geography.

Therefore, the main concern was to construct a model which would put the different lottery systems' revenues on a reasonably comparable basis. Total revenues per lottery system were broken down by game. State populations were obtained, including the District of Columbia, to produce a per capita amount of revenues. This allowed comparisons with states that have vastly different populations to West Virginia.

Game types were also taken into consideration. West Virginia is one of only five states that currently operate a video lottery system; versus instant games which are operated by all systems. The states that had close to the same amount, and styles of games as the West Virginia Lottery were compared. In addition to the states with similar systems, all states with video lottery systems and

“Keno” games were compared due to the limited number of systems which participate in these two game styles. The instant and lotto games were compared with more systems than the other games due to their widespread use by virtually all systems. It was determined to compare these two games with states that have similar systems, and any states over the past eleven years which have had an average population difference with West Virginia of less than one hundred percent. The systems which are close to West Virginia geographically, Ohio, Kentucky, Virginia, Pennsylvania, Maryland and the District of Columbia, were also compared.

The data used for the review were obtained from industry journals which have accumulated gross revenues from lottery systems around the world. These figures are rounded to the millions and unaudited. The data, per capita revenues, were scheduled to allow a percentage increase/decrease evaluation from one year to the next since nineteen eighty six, or the games inception. These figures were then averaged over the period evaluated and ranked with the systems being compared. This allowed an evaluation of the per capita revenues growth, or lack thereof, over the period of existence in relation to other systems.

Summary of West Virginia Lottery Revenues and Expenses for 1997

Fiscal year ending June 30, 1997 financial statements disclosed total revenues of \$245,119,362, less commissions of \$61,348,251, for net lottery revenues of \$183,771,111. The prize costs for 1997 were \$92,796,572, for a gross profit of \$90,974,539. Total operating expenses of \$19,634,096, and other income of \$1,416,336, left \$72,756,779 for operating transfers to the State of West Virginia. (See Table 1 next page)

TABLE 1	
Fiscal Year 1997 Revenues and Expenses	
Total Revenues	\$245,119,362
Less: Commissions to Sales Agents	(61,348,251)
Net Revenue	183,771,111
Less: Prize Costs	(92,796,572)
Gross Profit	90,974,539
Less: Operating Expenses	(19,634,096)
Other Income	1,416,336
Operating transfers to West Virginia	\$72,756,779

Source : West Virginia Lottery Financial Statements, June 30, 1997
and Independent Auditors' Report.

Revenues of West Virginia Lottery: 1986-1997 (Figures in millions of dollars)

TABLE 2				
Total West Virginia Lottery Sales				
Fiscal Year	On-Line Games	Instant Games	Video Lottery	Total
1986	0	53.0	0	53
1987	12.7	54.0	0	66.7
1988(1)	21.9	34.0	0	55.9
1989	31.9	27.0	0	58.9
1990	43.1	23.9	.023	67.023
1991	43.5	35.2	1.0	79.7
1992	45.1	44.4	3.9	93.4
1993(2)	68.1	46.9	4.7	119.7
1994	84.2	52.5	5.6	142.3
1995	90.9	61.7	27.5	180.1
1996	86.4	76.7	47.2	210.3
1997	82.6	80.3	82.3	245.2
Total	610.4	589.6	172.223	1372.22

(1) - Powerball began (on-line game)

(2) - Keno began (on-line game)

Source: Appendix A

Graph Illustrations: Appendix B

ISSUE AREA 1: West Virginia Lottery's on-line games, 3-digit, 4-digit, Lotto, Powerball, and Keno ranked 6th, 2nd, 18th, 5th, and 8th respectively, in average annual percentage increase of per capita revenues among selected states.

The West Virginia Lottery operates a variety of on-line lottery games. On-line games operate by a licensed sales agent selling tickets to the public with the use of computerized terminals. The West Virginia Lottery then has a drawing at a designated time to determine the winner which has the matching numbers. The **three digit** game began full operation in fiscal year 1987. It has been a consistent revenue source for the lottery. The average percentage annual increase of per capita revenues since 1987 is 19.92%, which ranks sixth with the sixteen systems compared. (See Table 3)

TABLE 3			
3 Digit Game			
State	Beginning Year of Calculation	Annual Average % Increase/Decrease in Per Capita Revenues	Rank
Virginia	1989	119.90%	1
California	1992	48.63%	2
Kentucky	1990	42.12%	3
Missouri	1987	23.92%	4
Georgia	1994	20.40%	5
West Virginia	1987	19.92%	6
Wisconsin	1993	9.71%	7
Pennsylvania	1986	1.72%	8
Delaware	1986	1.66%	9
Michigan	1986	1.47%	10
Ohio	1986	1.27%	11
District of Columbia	1986	.27%	12
Rhode Island (1)	1987	-.56%	13
Maine	1986	-.91%	14
Indiana	1991	-1.34%	15
Maryland	1986	-3.84%	16

(1) - Rhode Island combines 3 and 4 digit revenues.

Source: Appendix A

The **four digit** game began full operation in fiscal year 1987. It has also been a consistent revenue source for the lottery. The average percentage annual increase of per capita revenues since fiscal year 1987 is 20.83%, which ranks second with the fourteen systems compared. (See Table 4)

TABLE 4			
4 Digit Game			
State	Beginning Year of Calculation	Annual Average % Increase/Decrease in Per Capita Revenues	Rank
Kentucky	1994	223.06%	1
West Virginia	1987	20.83%	2
Ohio	1986	11.77%	3
Virginia	1992	11.05%	4
Pennsylvania	1986	9.83%	5
District of Columbia	1986	9.73%	6
Indiana	1992	7.85%	7
Delaware	1986	7.50%	8
Michigan	1986	6.92%	9
Maryland	1986	3.80%	10
Maine	1986	3.36%	11
Oregon	1987	3.33%	12
California	1996	-13.34%	13
Wisconsin	1994	-15.88%	14

Sources: Appendix A

Lotto has been in full operation since fiscal year 1987. It has had an average percentage annual per capita revenue increase of 3.38% and ranks eighteenth out of twenty-seven systems compared. This game style is the most difficult to evaluate due to the ever changing styles of lotto from system to system. The key here is that the lottery has maintained a steady revenue with lotto that has not decreased over time. (See Table 5 next page)

TABLE 5
Lotto

State	Beginning Year of Calculation	Annual Average % Increase/Decrease in Per Capita Revenues	Rank
Nebraska	1995	126.10%	1
Montana	1991	100.56%	2
New Hampshire	1992	63.83%	3
Virginia	1990	52.64%	4
Colorado	1989	46.38%	5
Indiana	1990	44.47%	6
Iowa	1986	38.78%	7
South Dakota	1994	34.58%	8
Oregon	1986	30.53%	9
California	1987	22.17%	10
District of Columbia	1986	19.55%	11
Kansas	1988	17.09%	12
Kentucky	1990	15.15%	13
Idaho	1994	10.77%	14
Delaware	1986	5.35%	15
Vermont	1986	4.74%	16
Maine	1986	3.90%	17
West Virginia	1987	3.38%	18
Wisconsin	1991	3.22%	19
Missouri	1987	2.89%	20
Ohio	1986	.81%	21
Michigan	1986	-4.65%	22
Maryland	1986	-5.95%	23
Connecticut	1986	-6.43%	24
Georgia	1994	-10.18%	25
Pennsylvania	1986	-11.30%	26
Rhode Island	1986	-13.49%	27

Sources: Appendix A

Powerball/Lotto America is a multi-state lottery system in which the lottery has been participating in since fiscal year 1988. It's revenues tend to fluctuate in relation to the jackpot size. The larger the jackpot, the higher the revenues. The per capita revenues from Powerball/Lotto America has had an average annual increase of 49.05% and ranks fifth out of eleven systems compared. (See Table 6)

TABLE 6			
Powerball/Lotto America			
State	Beginning Year of Calculation	Annual Average % Increase/Decrease in Per Capita Revenues	Rank
Delaware	1991	57.51%	1
Oregon	1988	55.88%	2
Indiana	1991	50.96%	3
Wisconsin	1990	50.57%	4
West Virginia	1988	49.05%	5
District of Columbia	1988	48.59%	6
Missouri	1988	48.52%	7
Kentucky	1991	40.81%	8
Rhode Island	1989	38.58%	9
Idaho	1990	13.89%	10
Nebraska	1995	-17.24%	11

Sources: Appendix A

Keno is a game which is drawn every five minutes and played at adult environments. The lottery has been operating it since fiscal year 1993. It has had an average annual percentage per capita increase in revenues of 6.37% and ranks eighth out of the twelve systems compared. (See Table 7)

TABLE 7			
Keno			
State	Beginning Year of Calculation	Annual Average % Increase/Decrease in Per Capita Revenues	Rank
Massachusetts	1993	435.10%	1
Kansas	1991	108.05%	2
Georgia	1996	81.36%	3
New York	1989	59.36%	4
Maryland	1993	28.63%	5
California	1993	20.54%	6
Rhode Island	1993	8.51%	7
West Virginia¹	1993	6.37%	8
Oregon	1992	5.14%	9
Washington	1993	-4.84%	10
Michigan	1990	-12.76%	11
Colorado	1992	-16.42%	12

Source: Appendix A

¹West Virginia Lotteries Keno game is only available at ABCC licensed “pouring establishment”. This limited availability, currently 230 retailers out of an on-line system of 1, 335 retailers, is in contrast to other systems where Keno is offered system-wide.

ISSUE AREA 2: West Virginia Lottery's instant game average annual percentage increase/decrease of per capita revenues rank 17th with other systems compared.

Instant games are printed tickets which the public purchases from licensed agents and scratch off a latex material to reveal an underlying object or number which denotes whether the ticket is a winner. Scratch-off instant tickets have been in operation since fiscal year 1986. They have been consistent performers since the inception of the West Virginia Lottery. The scratch-off annual average percentage per capita increase in revenues is 6.96% and rank seventeenth out of twenty-eight systems compared. (See Table 8 next page)

TABLE 8
Instant Games

State	Beginning Year of Calculation	Annual Average % Increase/Decrease in Per Capita Revenues	Rank
Georgia	1993	636.91%	1
New Mexico	1996	82.76%	2
Vermont	1986	37.83%	3
New Hampshire	1986	35.57%	4
Ohio	1986	28.58%	5
Maine	1986	26.54%	6
Delaware	1986	24.09%	7
Maryland	1986	23.46%	8
District of Columbia	1986	20.61%	9
Connecticut	1986	18.16%	10
Michigan	1986	16.91%	11
Kentucky	1989	13.46%	12
Rhode Island	1986	8.86%	13
Colorado	1986	8.72%	14
Oregon	1986	8.01%	15
Pennsylvania	1986	7.29%	16
West Virginia	1986	6.96%	17
Kansas	1988	6.27%	18
Wisconsin	1989	4.82%	19
Idaho	1990	3.20%	20
Iowa	1986	2.87%	21
Missouri	1986	2.34%	22
Indiana	1987	.99%	23
Virginia	1989	-3.29%	24
South Dakota	1988	-3.79%	25
Nebraska	1994	-5.52%	26
California	1986	-8.94%	27
Montana	1988	-11.09%	28

Sources: Appendix A

ISSUE AREA 3: West Virginia Lottery’s video lottery system’s average annual percentage increase of per capita revenues ranks 3rd with other systems.

The West Virginia Lottery initiated the **video lottery system** in fiscal year 1990. Video lottery is a self activated video version of lottery games which are keyboard operated. The player places bets for the chance to be awarded credits for cash or replay as additional bets. The video lottery per capita average annual increase in revenues is 121.94% and is ranked third out of five systems compared. The increases are due to both increased numbers of video lottery terminals, locations to play and increased popularity. (See Table 9)

TABLE 9			
Video Lottery			
State	Beginning Year of Calculation	Annual Average % Increase/Decrease in Per Capita Revenues	Rank
Delaware	1996	233.72%	1
Oregon	1992	136.44%	2
West Virginia ²	1990	121.94%	3
Rhode Island	1994	60.88%	4
South Dakota	1990	27.63%	5

Sources: Appendix A

Conclusion:

The West Virginia Lottery has a wide array of game styles to keep the revenues consistently increasing. Video lottery shows the commission’s initiative to give the public more variety and excitement in their lottery experience. With the lottery industry consistently changing and becoming more popular, it is easy to fall behind. **But the past eleven years of the West Virginia Lottery’s revenue producing capabilities shows this not to be the case in West Virginia. The lottery’s per capita revenues have shown an increase since their inception.** Therefore, the Legislative Auditor’s Performance Evaluation and Research Division concludes that the **West Virginia Lottery is performing at least average, and sometimes above average when compared to other states.**

²Video lottery games are limited to licensed racetracks in West Virginia as they are in Delaware and Rhode Island. Oregon and South Dakota’s video lottery games’ are available statewide. Video lottery was on an experimental basis from 1990 to 1994 only at Mountaineer Park, enabling legislation took effect March 18, 1994. It should also be noted that video lottery terminals in Delaware began as ticket-printing machines of the kind used in West Virginia. When Delaware terminals were converted to “coin drop” payout, sales increased dramatically.

APPENDIX A:

Sources for Report Data

Sources

“The ‘96 World Lottery Almanac.” La Fleur’s. TLF Publications, Inc. pp.319-325.

“La Fleur’s Lottery World Fiscal 1996 Report, U.S. Lotteries’ Unaudited Fiscal 1996 Sales By Game.” La Fleur’s. TLF Publications, Inc. pp.5.

“Year-End Summary Indicates Products Need More Pizzazz, Larger Prizes, North American lottery report on game sale fluctuations.” Public Gaming International ed. Kathleen L. Ward. pp. 32-41, September 1997.

“Fiscal 1996 Sales Results.” Public Gaming International pp. 20-25, September 1996

United States’ Bureau of the Census

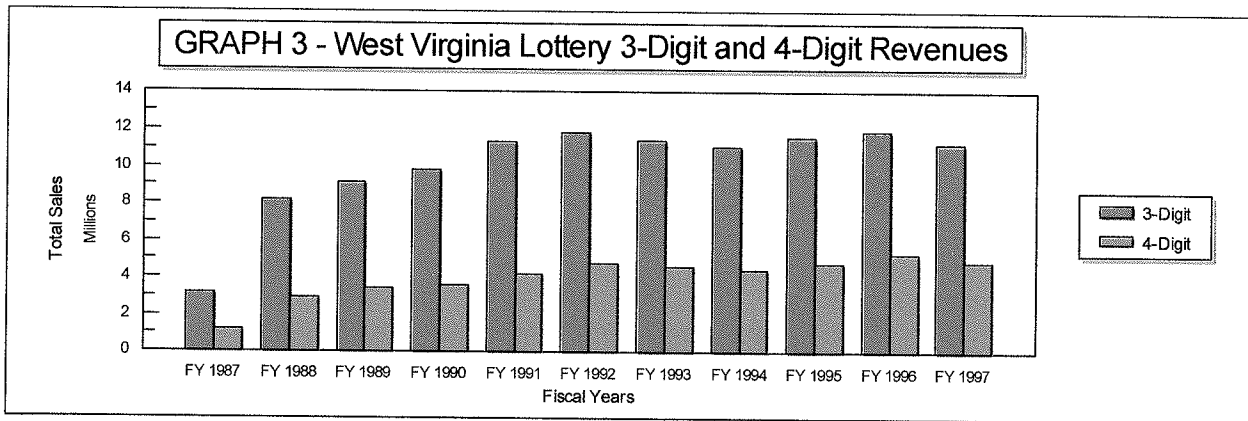
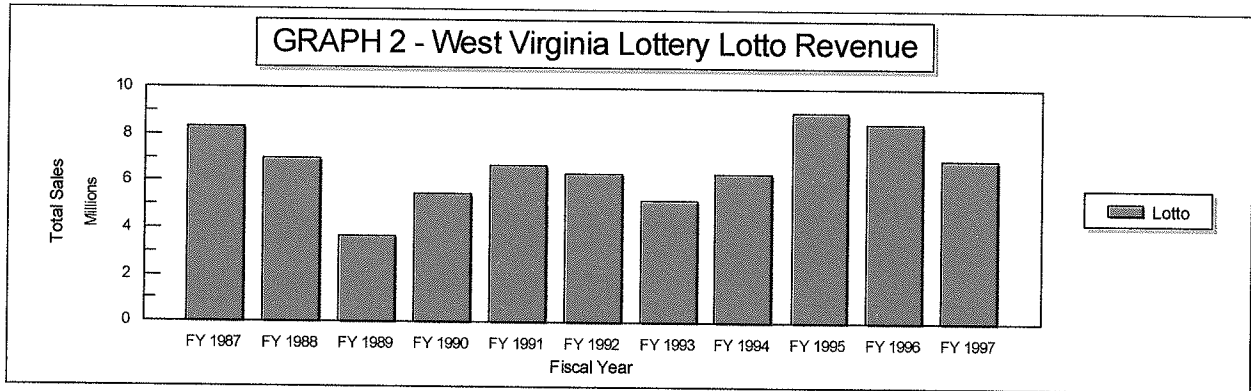
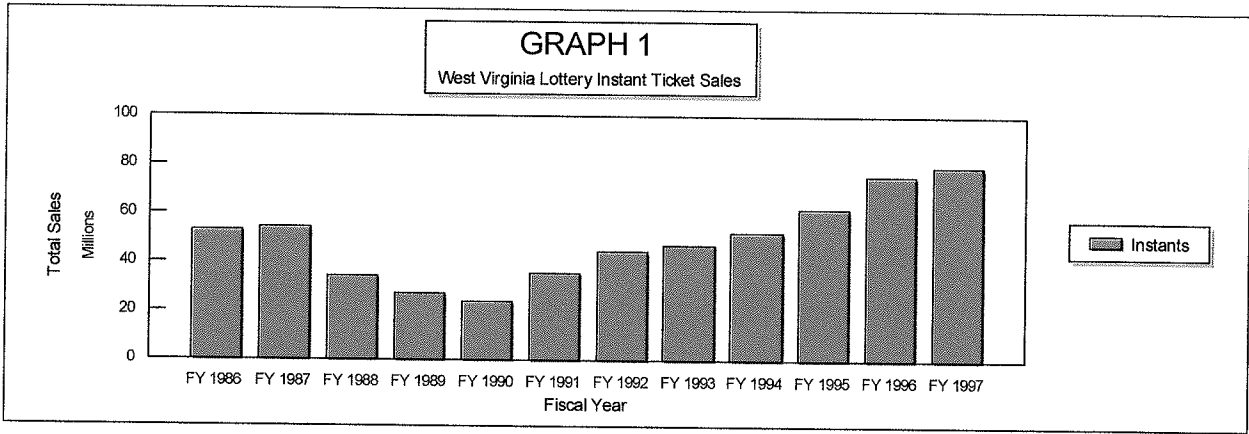
Note:

The above are the sources used for all revenues and per capita revenues disclosed in the report, with the exception of tables 1, 2 and graphs, which did not require populations from the U.S. Bureau of the Census.

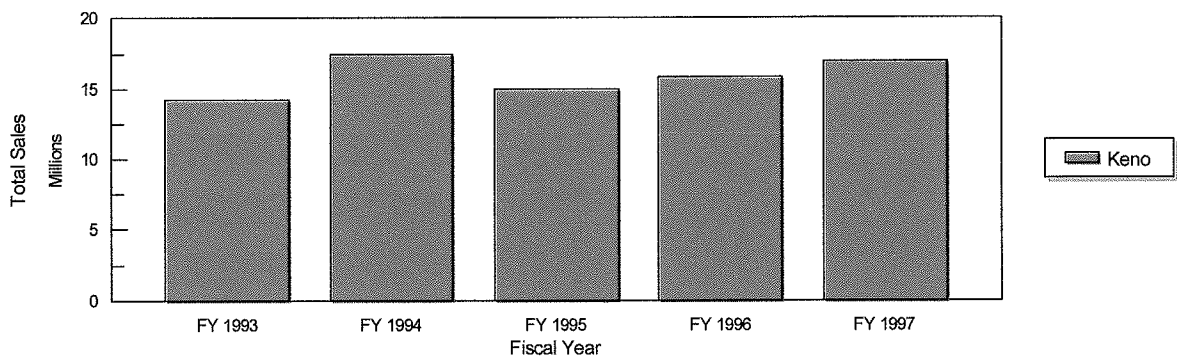
APPENDIX B

Graph Illustrations of Lottery Revenues per Game:

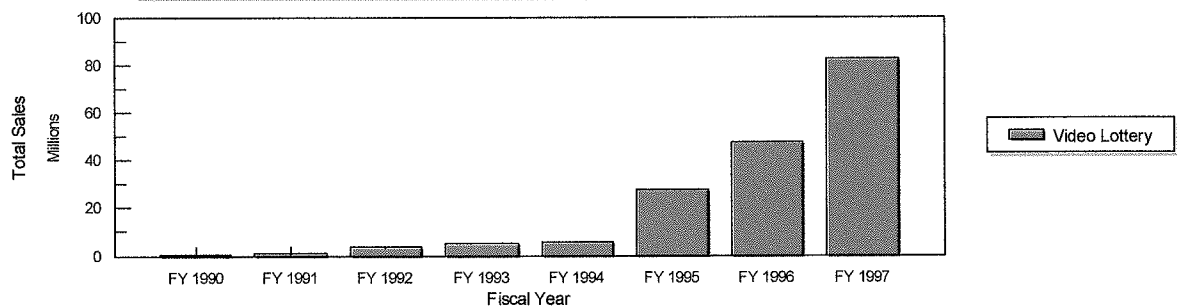
- Graph 1: Instant Ticket Sales
- Graph 2: Lotto Sales
- Graph 3: 3 Digit and 4 Digit Sales
- Graph 4: Keno Sales
- Graph 5: Video Lottery Sales
- Graph 6: Powerball Sales
- Graph 7: All Games' Sales



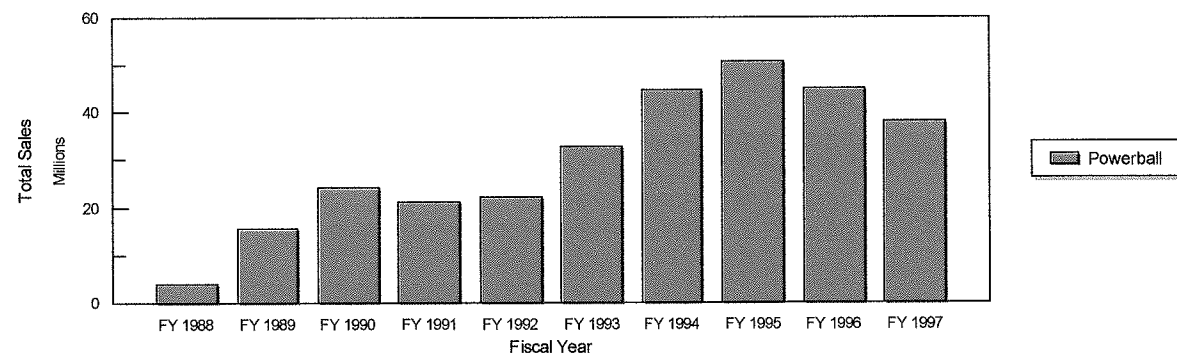
GRAPH 4 - West Virginia Lottery Keno Sales



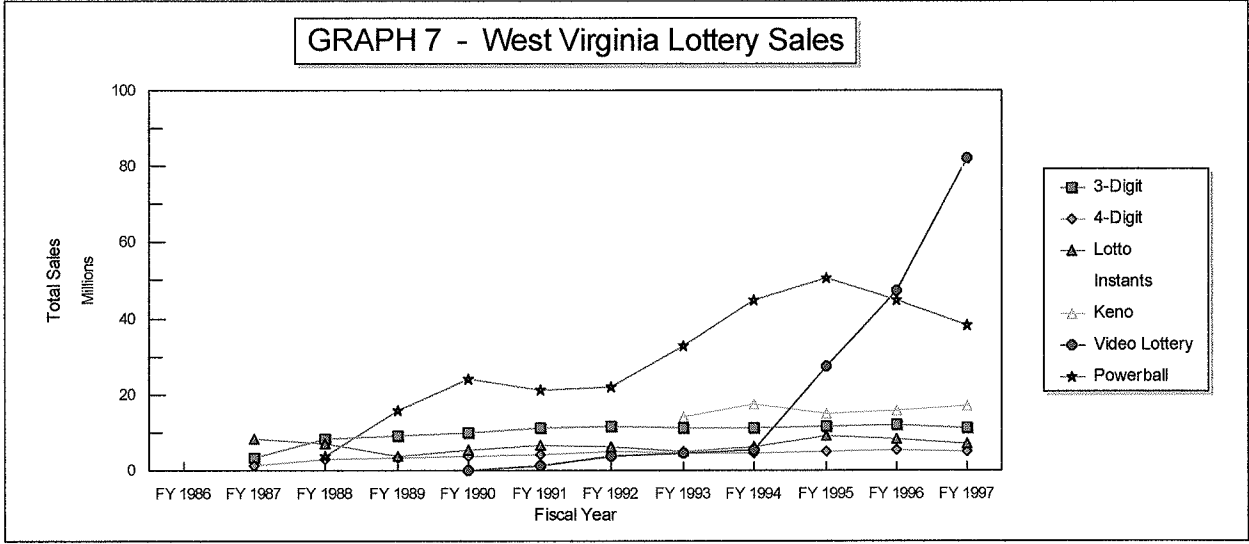
GRAPH 5 - West Virginia Lottery Video Lottery Revenue



GRAPH 6
West Virginia Lottery Powerball Sales 1988-1997



GRAPH 7 - West Virginia Lottery Sales



APPENDIX C

Calculation method for comparing data within report.

Calculation Method

Lottery comparisons based on per-capita revenues from year to year:

1. Per capita revenues were calculated for each lottery game and year.

$$\text{Lottery revenue/state or district population} = \text{per capita revenue}$$
$$4,000,000/1,800,000=2.22$$

2. The per capita revenues were then used to compute a percentage change from the previous year to the subsequent year.

$$1995 \text{ Per capita revenue} = .58 \quad 1994 \text{ Per capita revenue} = .68$$

A. $.58 - .68 = -.10$

B. $-.10 / .68 = -0.147$

C. -14.7% decrease in per capita revenues from 1994 to 1995

APPENDIX D

Agency Response



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VIA TELEX
AND INTERDEPARTMENTAL MAIL

December 11, 1997

Dr. Antonio F. Jones, Director
Performance Evaluation and Research Division
Office of Legislative Auditor
Building 1, Room W-314
1900 Kanawha Boulevard, East
Charleston, West Virginia 25305

Dear Dr. Jones:

I have just completed a review of the *Preliminary Performance Review of the West Virginia Lottery*. You and your staff are to be commended for a thorough analysis of the comparative effectiveness of the Lottery.

There are two areas where readers of your review may be aided by the inclusion of additional information. These areas concern the TRAVEL/Keno online game and video lottery games.

Your review notes that West Virginia is one of 12 state lotteries to offer the so-called "quick draw" Keno [draws every five minutes]. This kind of Keno, which the West Virginia Code calls TRAVEL, began in late 1992 as another online game available through all West Virginia online retailers. After the West Virginia Supreme Court of Appeals expressed reservations in its Mountaineer Park decision,¹ the West Virginia Legislature specifically authorized the game by statute and restricted the availability of the game to ABCC licensed "pouring establishments."² This limited availability, currently 230 retailers out of an online system of 1,335 retailers, is in contrast to the other states where Keno is offered system-wide as a general online lottery game.

Video lottery games are limited to licensed racetracks in West Virginia as they are in Delaware and Rhode Island. This is not the case in Oregon and South Dakota where video lottery games are available statewide. Video Lottery was offered on an experimental basis from

¹ *State ex rel. Mountaineer Park v. Polan*, 190 W.Va. 276, 438 S.E.2d 308 (1993).

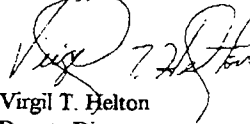
² W.Va. Code §29-22-9(b)(5).

Dr. Antonio F. Jones
Page 2
December 11, 1997

1990 through early 1994 only at Mountaineer Park. Enabling legislation for video lottery games took effect March 18, 1994. It should also be noted that video lottery terminals in Delaware began as ticket-printing machines of the kind used in West Virginia. When Delaware terminals were converted to "coin drop" payout, sales increased dramatically.

I believe your review will allow members of the 1998 Legislature to make an informed decision about the continuation of the West Virginia Lottery beyond June 30, 1998.

Sincerely,



Virgil T. Helton
Deputy Director
Finance and Administration

VTH/sh