



# Secretary of State Audit Report

## Oregon State Lottery: Video Lottery Compensation in the United States and Canada

### Summary

#### PURPOSE

In November 2003, the Oregon State Lottery asked the Audits Division to conduct a survey of how states and Canadian provinces compensate video lottery retailers. To accomplish this, we conducted a telephone survey that included questions about compensation rates and other factors that could affect these rates. We supplemented the survey with additional information we obtained from lottery agency websites and other sources.

#### RESULTS IN BRIEF

We surveyed nine states, including Oregon, and nine Canadian provinces that have video lottery or gaming. Appendix A presents a summary of our survey results. We found that eight jurisdictions have video lottery operations similar to Oregon. Retailer commissions in these jurisdictions are generally lower than those in Oregon. They range from 15 percent to 25 percent of the cash remaining after payment of prizes, while retailers in Oregon receive up to 35 percent.

### Background

The Oregon State Lottery (Lottery) was created through the initiative process in 1984. It is a self-supporting agency that raises revenue for state government. A five-member Commission appointed by the Governor and approved by the Senate oversees Lottery's operations. The Governor also appoints the Lottery's director subject to Senate confirmation.

All Lottery proceeds after payment of prizes and administrative expenses are dedicated to specific public purposes. Initially, Lottery profits were to be used only for economic development and job creation. Subsequently, voters added public education, and parks and salmon restoration as public purposes that would receive Lottery funding.

The legislature is responsible for allocating Lottery funding. In the 2001-2003 biennium, the legislature allocated about \$511 million to public education, \$112.1 million to economic development, and \$110.7 million to parks and salmon restoration.<sup>1</sup>

The games Lottery currently offers are Megabucks, Win for Life, Powerball, Pick 4, Scorecard, Sports Action, Keno, Scratch-its, Breakopens, and Video Lottery. Video lottery in Oregon consists of poker games (e.g. stud and draw poker games) displayed on a video terminal.

Video lottery generates the most revenue of all Lottery games. It accounted for about 51 percent of total Lottery revenue during fiscal year 2003 after payment of prizes and retailer commissions. Video lottery retailers in Oregon, which must have an on-premise liquor license, include bars, taverns, lounges and two racetrack facilities.

According to Lottery, during fiscal year 2003, there were about 1,973 video lottery retailers in Oregon.<sup>2</sup> The Oregon Lottery's commission structure currently falls into four tiers. Retailers receive a commission of

<sup>1</sup> The legislature also allocated about \$6.2 million to a problem gambling treatment fund.

<sup>2</sup> The number of retailers fluctuates during the year. According to Lottery, this is the average number of retailers during fiscal year 2003.

# Background (continued)

35 percent on their first \$200,000 of net receipts (cash remaining after payment of prizes) during the year. The commission declines by 5 percent for each additional \$200,000 in net receipts so that retailers receive 20 percent on net receipts above \$600,000. During fiscal year 2003, retailers received a total of approximately \$159 million in commissions, or about 32 percent of video lot-

tery net receipts. Based on fiscal year 2003 data, a one percent change in video lottery retailer commissions equates to nearly \$5 million per year.

We identified 17 states and Canadian provinces that also have video lottery or gaming. Retailers in these jurisdictions include bars, taverns, pubs, racetracks, veteran organizations with a liquor li-

cense, bowling lanes, pool halls, hotels, ferry boats and riverboats, and casinos. Video lottery games in these jurisdictions include poker, blackjack, keno, bingo, and reel games. The only video lottery game in New York, which just recently started its program, is a video version of a scratch-off ticket.

## Audit Results

### Jurisdictions Similar to Oregon Pay Lower Commissions

We found that eight jurisdictions have video lottery operations similar to those in Oregon. As in Oregon, a lottery agency owns and operates video lottery machines in these jurisdictions and is responsible for the cost of maintaining and repairing them. Also, retailers in these jurisdictions generally have relatively few machines, as do those in Oregon, while some retailers in the other jurisdictions have a large number of machines. Specifically, the average number of machines per establishment in six of the jurisdictions similar to Oregon is 10 or fewer.<sup>3</sup> The average number of machines per establishment in Oregon is 4.8. In contrast, the average number of machines at racetracks in West Virginia is 2,383, and the average number of machines at racetracks and riverboats in Iowa is 1,168 and 871, respectively.<sup>4</sup>

Figure 1 lists the jurisdictions similar to Oregon, along with retailer commission rates for comparable establishments. It shows that these eight jurisdictions generally pay their retailers lower commissions than does Oregon.

**Figure 1: Commission Rates in Jurisdictions Similar to Oregon**  
(Percentage of Cash Remaining After Payment of Prizes)

|   |                  |
|---|------------------|
| Alberta   | 15%              |
| Saskatchewan                                    | 15% <sup>5</sup> |
| Manitoba  | 20% <sup>6</sup> |
| Prince Edward Island                            | 20%              |
| New Brunswick                                   | 22%              |
| Quebec  | 22%              |
| New Foundland (annual net revenue) <sup>7</sup> |                  |
| Less than \$400,000                             | 25%              |
| Greater than \$400,000                          | 20%              |
| Nova Scotia                                     | 25%              |
| Oregon (FY 2003 average rate)                   | 32% <sup>8</sup> |

Five of the eight jurisdictions similar to Oregon have reduced retailer commissions over time.<sup>9</sup> For example, retailers in Nova Scotia received a commission of 35 percent when video lottery began in 1991. The commission decreased three times since then to its current rate of 25 percent. Similarly, the commission rate in New Brunswick was 35 percent

when the program began in late 1990. Since then, the rate decreased seven times to its current rate of 22 percent.

### Remaining Jurisdictions Differ from Oregon

The primary difference between Oregon and the other states we surveyed is that a lottery agency does not own or operate the machines in these states and is not responsible for their repair and maintenance.<sup>10</sup> Rather, these responsibilities fall to a retailer or third party operator.

Ontario is the remaining jurisdiction that differs from Oregon. While it has a lottery agency that owns video lottery terminals, it has only slot machines—some mechanical and some video—located at racetracks and casinos.

Retailers in the jurisdictions differing from Oregon tend to receive a higher level of compensation. In some cases, however, compensation is split between a retailer and third party operator. For example, in Montana, retailers receive 85 percent of the cash remaining after payment of prizes, but typically split this with third party operators. Iowa has yet another arrangement. There, retail-

<sup>3</sup>The average number of machines per commercial establishment was not available for Manitoba. A racetrack there has 140 machines.

<sup>4</sup>These average machine per establishment figures are based on fiscal year 2003 data.

<sup>5</sup>Retailers in Saskatchewan with three or fewer machines also receive a bonus of \$10 Canadian per machine per week.

<sup>6</sup>The commission rate for the racetrack is 75 percent.

<sup>7</sup>Net revenue figures are in Canadian dollars. Commission rates for New Foundland and Nova Scotia are rounded to the nearest whole percent.

<sup>8</sup>This is the percentage of net receipts, or cash remaining after payment of prizes, paid in commissions in fiscal year 2003.

<sup>9</sup>The commission rate in Quebec was 20 percent in 1994. It increased to 30 percent later that year, declined to 26 percent in 2001, and declined further to 22 percent as of November 2003.

<sup>10</sup>In Oregon, retailers are responsible for keeping machines clean and presentable, and for minor maintenance (e.g. changing paper, clearing jams, etc.). Lottery is responsible for repairs and preventable maintenance.

## Audit Results (continued)

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ers do not split compensation with a third party operator. Rather, they pay a wagering tax of 20 percent of the cash remaining after payment of prizes and retain 80 percent.

Another factor that distinguishes some of the jurisdictions that differ from Oregon is the type of establishment that has video lottery or gaming. For example, in Delaware, only racetracks have video

lottery. In Rhode Island, video lottery is located at a racetrack and a jai alai facility.

Additional information on these jurisdictions is contained in Appendix A.

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## Objectives, Scope and Methodology

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As requested by the Oregon State Lottery in November 2003, we surveyed jurisdictions in the U.S. and Canada to obtain information about compensation video lottery retailers receive. Our survey included nine states, including Oregon, and nine Canadian provinces. We identified these as jurisdictions in North America that offer some form of video lottery. We conducted telephone interviews with knowledgeable officials from these jurisdictions, using a standard set of questions relating to com-

penetration rates and other factors that could affect these rates. We supplemented the survey with information we obtained from lottery agency websites and other sources.

Some Canadian provinces provided us with information about First Nations facilities. We did not include this information in this report.

We consider this engagement to be a non-audit service. Non-audit services include engagements for which the ob-

jective is to provide information or data to a requesting party without verification, analysis, or evaluation of the information or data. In completing this engagement, we followed generally accepted government auditing standards relating to independence, professional judgment, competence, and quality control and assurance.

We conducted our fieldwork during the period December 2003 through January 2004.



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*The courtesies and cooperation extended by the officials and staff of the  
Oregon State Lottery were commendable and much appreciated.*

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