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Memorandum

February 22, 2019

TO: Joint Technology Committee Members

FROM: Luisa Altmann, Research Analyst, 303-866-3518
Joint Technology Committee Staff

SUBJECT: JTC Staff Analysis of JBC-Referred FY 2019-20 Budget Request
Colorado Department of Revenue
R-03 Lottery Back-Office Restructure

Summary of Request

The Colorado Department of Revenue is requesting \$2.2 million in cash funds spending authority to replace the State Lottery Division's back-office system with a solution hosted by a third-party vendor.

Reason for Referral

This memorandum responds to the letter sent by the Joint Budget Committee (JBC) following the staff briefing on the Colorado Department of Revenue on December 7, 2018, requesting that the Joint Technology Committee (JTC) provide a technical review of the department's FY 2019-20 Lottery Back-Office Restructure budget request.

Staff Analysis

JTC staff believes that the department has provided sufficient evidence to support its decision to move the State Lottery Division's back-office system to a vendor-provided solution.

Request Details

The Colorado Department of Revenue is requesting \$2.3 million in cash funds spending authority to replace the State Lottery Division's back-office system. The total request is partially offset by a reduction of \$0.1 million and 2.0 FTE, for a net increase of \$2.2 million in cash funds spending authority being requested. The back-office system provides for various functions, such as scratch game management, predictive ordering, retailer accounting, retailer licensing, and state accounting system interfaces.

Justification. The State Lottery Division's back-office system was developed by, and is currently maintained and operated by, division IT staff. The hardware for this system has reached end-of-life and as of March 31, 2018, the division is without a service maintenance agreement, potentially leaving the division unable to obtain necessary parts. This creates risk of downtime for the Lottery, which could result in lost revenue.

Additionally, the division's IT staff is scheduled to transition to the Governor's Office of Information Technology (OIT) due to the consolidation of department IT staff into OIT. This transition of IT staff out of the division leaves the division unable to maintain the current back-office system in-house in the future.

Other states. Out of the 45 state-run lotteries, only two states, including Colorado, maintain their own back-office system. The rest of the states utilize a vendor to provide back-office system services. According to the department, at least eight other states (Arizona, Minnesota, Missouri, Nebraska, South Dakota, Texas, Washington, and Wisconsin) use systems that are directly comparable to what Colorado would be adding.

Cost-benefit analysis. The department determined that upgrading the current back-office system would cost approximately \$310,000 for hardware upgrades, \$34,000 for annual licensing and software costs, and \$14,000 for service maintenance. However, according to the department, this is not the ideal solution given the end-of-life status of the system hardware and the transition of IT staff out of the division.

The division can realize several benefits by utilizing a third-party vendor for the provision of back-office services, including using the vendor's dedicated research and development resources. The vendor will also be responsible for liquidated damages in the event of Lottery service downtime.

Cash funds. The Lottery Fund, created in Section 44-40-111, C.R.S., pays for all expenses of the division and is funded with Lottery revenues not earlier paid as prizes, and all liquidated damages.

Cost estimates. Based on responses to a Request for Information issued in March 2018, the department has assumed the vendor fees to be 0.34 percent of total sales revenue. However, the exact amount will be determined as part of the final contract negotiation.

Program Information

In FY 2016-17, the Colorado Lottery generated \$556 million in revenue and \$131 million in net proceeds for its beneficiaries, which include Great Outdoors Colorado (GOCO), the Conservation Trust Fund, Colorado Parks and Wildlife, and the Building Excellent Schools Today (BEST) program, through the sale of jackpot and scratch games at 3,100 retailers across Colorado. The Lottery operates as a self-sustained enterprise.

Options for Committee Action

The JTC has three options for committee action when it provides a technical review of an operating budget request to the JBC. The JTC can:

- recommend the request to the JBC for funding with no concerns, as outlined in the JTC Staff Analysis section;
- recommend the request to the JBC for funding with concerns; or
- not recommend the request for funding with concerns.