State of Washington

Joint Legislative Audit and Review Committee (JLARC)

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JOINT LEGISLATIVE AUDIT AND REVIEW COMMITTEE
REGULAR COMMITTEE MEETING MINUTES

COMMITTEE BUSINESS

- Senator Pridemore, JLARC Chair, called the meeting to order at 6:00 p.m.
- Senator Pridemore asked if there were any corrections, additions, or objections to the December 1, 2011, meeting minutes. Seeing none, he noted the meeting minutes were approved as submitted.

REPORTS, PRESENTATIONS, DISCUSSIONS

Lottery Marketing & Incentive Pay: Jackpot and Economy, Not Advertising or Beneficiary Change, Appear to Impact Ticket Sales — Preliminary Report

Peter Heineccius and Stephanie Hoffman from the JLARC staff presented the preliminary report for the Lottery Marketing & Incentive Pay study. In 2010, the Legislature changed the primary beneficiary of Lottery revenue from school construction to higher education scholarships and early learning. The 2011-13 operating budget directed JLARC to analyze the impact on ticket sales caused by this recent beneficiary change, as well as the impact of advertising in general on sales. JLARC found that jackpot amounts and economic conditions were the strongest predictors of ticket sales in the last biennium, while advertising and the beneficiary change did not appear to have an impact on sales. JLARC recommends that Washington's Lottery report to the Lottery Commission with a plan on how to evaluate and improve the effectiveness of its advertising budget in generating ticket sales. In addition, JLARC reviewed Lottery's incentive pay program for sales representatives and found that it is currently limited in size and shares some similar characteristics with other state lotteries.

Representative Haigh commented the analysis seems to show that people buy lottery tickets when they see there is a large pot of money to win. She asked if staff had looked at other states to see if they do any regular marketing related to having larger jackpots. JLARC staff explained that the jackpot amount is determined by whether or not there is a winner and so would not be a regular event to plan for in an advertising campaign.

Senator Pridemore invited representatives from the Washington State Lottery to come before the Committee (Jean Flynn, Director of Marketing, and Arlen Harris, External/Stakeholder Affairs Liaison).

Lottery's Liaison thanked JLARC staff for conducting a thorough and fair audit. He indicated the agency's belief that marketing matters. He noted the study asks a question that industries have long pondered about whether advertising influences consumers to buy a product. He identified the amounts of money companies are willing to pay to advertise during the Superbowl and indicted that these companies would not spend this much money if advertising did not increase sales and create an emotional bond with consumers that leads to long-term brand loyalty. He stated that marketing matters on TV, radio, billboards, and point of sale awareness at retailers, and that without advertising and promotion, sales of Lottery products would suffer and deposits to the Washington Opportunities Pathway Account would diminish.

Lottery's Director of Marketing noted that trying to assess the impact of marketing and advertising on sales is not an easy task. She agreed with the study conclusions that economic conditions impact base sales and that high jackpots drive incremental sales. She reported that Lottery has just completed a player segmentation study which indicated that 12 percent of eligible Washingtonians only play when the jackpots are high; she explained that these sales are thus not predictable because we do not know when or how many jackpots will be high enough to pull these people into the game. She said Lottery believes its base or core sales have been built over the long term, and that marketing has been an important component in building its current business. She added that lottery agencies across the country share this belief. She reported that connecting a brand to a consumer is something that takes time and that, once connected, the product must stay relevant in the consumer's life. She indicated that Lottery has a commitment to tracking its business and its marketing results to ensure that the agency continues to create sales and make maximum beneficiary contributions. She closed by indicating that Lottery's official response to the JLARC study will include examples of the risk to sales if major changes are made to the budgets for marketing.

Representative Orcutt questioned the applicability of the Superbowl example and asked who the Lottery views as its competitor in stores. Lottery staff answered that its competitor is anything one would see in a convenience store when the consumer has an extra dollar to spend. Representative Orcutt commented that the consumer is not choosing between the Washington lottery and lotteries in other states. He observed that this is different from other products in a store where there are different brands of products to choose from, using different brands of beer as an example. Lottery staff responded that there are people who come in to a store with a plan to purchase a Lottery product, and there are others whose purchase is an impulse buy. Lottery staff added that some of Lottery's expenditures are for jackpot awareness – making sure that the person who comes into the store is aware of what the jackpots are. Lottery staff reiterated their view of the importance of Lottery to retain an emotional bond with consumers about the Lottery brand.

Senator Pridemore asked if Lottery concurs with the JLARC staff conclusion that the change in the beneficiary did not have an impact on ticket sales. Lottery staff said yes, they do, explaining further that Lottery has a tracking study that it conducts about players. Lottery staff reported that, for 70 percent of players, what matters is winning and playing rather than where the money goes. They added that the beneficiary does matter to 30 percent of players and that most players in that 30 percent are satisfied where the money goes, while six percent are unsatisfied.

Senator Pridemore confirmed that Lottery did advertise that there had been a change in beneficiary and that this did not have an impact on sales. Lottery staff indicated that there had been no immediate impact but that it is important for all Washingtonians to understand where the money is going, whether they play or not. Senator Pridemore noted that the fiscal note for the bill that made the beneficiary change projected a $30 million increase in ticket sales and wanted to confirm that the $30 million increase did not happen. Lottery staff confirmed that Senator Pridemore was correct.

Representative Orcutt noted his interest in knowing whether the Lottery incentive pay program impacts ticket sales. He asked if there is information on whether this program is effective and paying for itself. Lottery staff explained the duties of the sales representatives, visiting about 12 retailers per day. Lottery staff explained that the representatives can take steps to try to drive sales at the individual retailer level, which retailers like, and that the representatives build relationships and partnerships with the retailers. Lottery staff said they believe this is valuable in encouraging sales. Representative Orcutt asked if there is any data available to support this, for example, differences in ticket sales in stores where this happens versus stores where it does not. Lottery staff indicted they would provide information on this.

Lodging Tax Revenues: About Eight Percent of Funds Sponsor Nonprofit Events and Facilities, But Information is Inadequate to Estimate Economic Impact — Preliminary Report

Mark Fleming from the JLARC staff presented the preliminary report for the Lodging Tax Revenues study. Substitute Senate Bill 5647, enacted in 2007, authorizes local governments to use lodging tax revenues to support events and facilities sponsored by certain nonprofit organizations. The legislation includes a June 30, 2013, termination date and requires JLARC to evaluate the economic impact of lodging tax expenditures. JLARC's review finds that many local governments have not reported on their use of lodging tax revenues and those expenditures' impact on tourism. As a result, JLARC cannot evaluate the economic impact of local government use of lodging tax revenue. However, review of reported data shows that approximately 8 percent of lodging tax revenues was used to support nonprofit events and facilities. Although reporting can be improved, fully evaluating the economic impact of lodging tax revenues will impose costs and burdens on local governments and state agencies.

JLARC's Evaluation Plan for the Unemployment Insurance Training Benefits Program — Briefing Report

Nina Oman and John Woolley from the JLARC staff presented the Evaluation Plan for the Unemployment Insurance Training Benefits Program briefing report. Engrossed House Bill 1091 (2011) directs JLARC to conduct a thorough review and evaluation of the Unemployment Insurance Training Benefits Program, managed by the Employment Security Department. JLARC's study approach leverages existing resources and has three tiers: 1) a process evaluation; 2) a gross impact analysis; and 3) a net impact evaluation with a cost-benefit analysis. A full report evaluating the program is scheduled to be presented to the Legislature in December 2015.

Representative Haigh commented on some information she recently received on an incentive program that encourages the community and technical colleges to push students to completion rather than letting them drop out. She added it may be possible to establish incentives like this in other areas as well.

Senator Pridemore asked if the additional funds identified in the report would be presented to the Legislature as JLARC budget requests. Staff responded that yes, they would.

Microenterprise Development Program Meets Statutory Objectives But Department of Commerce Oversight is Inadequate — Proposed Final Report

Fara Daun from the JLARC staff presented the proposed final report for the Microenterprise Development Program Study. JLARC evaluated the state's microenterprise development program and concluded that the Washington State Microenterprise Association (WSMA) provides business development services and grants to Microenterprise Development Organizations (MDOs). These organizations in turn provide business development services to entrepreneurs and leverage state funds to attract non-state dollars. JLARC found that the Department of Commerce is not complying with its statutory obligation to provide organizational support to WSMA, and that its current contract reporting and verification process is inadequate. The report makes two recommendations to improve these areas.

Senator Pridemore invited representatives from the Washington State Microenterprise Association (Teresa Lemmons, Executive Director) and the Department of Commerce (Nick Demerice, Government Affairs Director) to come before the Committee.

The WSMA Director told the Committee that the microenterprise sector accounts for 86 percent of all the businesses in Washington, with more than 580,000 microbusinesses in the state. She indicated that the sector had been under-recognized in its potential for economic development and that the Legislature responded by creating the program that is the subject of the review today. She said that they have spent the last four years successfully implementing the program to help small businesses expand and grow across Washington. She reported information from the MDOs in 2010 indicating they helped create 345 businesses and 648 jobs. She also reported that the demand for these services has increased. She thanked the Legislature for its timely and foresighted action to create the program. She indicated that, since the release of the preliminary report, she has had early conversations with Commerce on improving the reporting criteria and the process, but that she is looking forward to having more concerted and pointed conversations with Commerce in the future to improve in the areas the audit recommends.

Representative Orcutt asked at what rate we are graduating people from the program, getting them to increase in size to six employees or more. He asked if there are goals for getting people off of the program and getting them out of microenterprise and over the six-employee threshold. The WSMA Director answered that every organization serves its clients a little differently, with different services and different target populations. She explained that individuals typically come into an MDO for a particular service, such as an entrepreneurial development training class or one-on-one technical assistance to help them grow their businesses, rather than there being a long-term component to the service. She added that some individuals do not plan to expand their businesses beyond a small operation.

Department of Commerce staff commented on what a great job WSMA has done with this program and stated the agency was proud to have been involved with it. He indicated the agency's biggest concern is with the title of the JLARC report indicating that Commerce's oversight is inadequate. He indicated that this program is small in size compared to the agency's overall portfolio and that an agency does have to prioritize and assess risk in determining adequate oversight. He noted the report shows the important role Commerce played early on in the development of this program and in providing organizational support. He added that this helped Commerce learn the character of the organization and provided the agency with comfort that the level of oversight the agency has been providing is sufficient. He noted that the report did not find instances of malfeasance or misuse of state funds, and he stated that it is not just chance that this happened. He stated that organizational support is important to the agency but that the agency made a conscious decision in the face of budget cuts to cut organizational support rather than cutting pass-through dollars to the organization. With regard to the idea that the agency should have come back and had the organizational support provision striken from statute, he said there are a lot of places in the agency's statutes that he would like to have cleaned up due to budget cuts.

Commerce staff partially agreed with the recommendations on performance, indicating that all of their contracts could be more performance-based. He indicated there have been and will continue to be conversations with WSMA on how to make the performance measures stronger. He commented that the Department has to make decisions every day about how many resources it can put against certain contracts and the level of oversight. He said the amount the agency chooses has to do with the track record of those organizations as well as the agency's risk assessments. He explained that the agency receives 3 percent of the pass-through dollars for administration and oversight of this program.

Senator Pridemore noted that the Legislature directed Commerce to provide organizational support and oversight to this program, and he asked if the agency feels its decisions are superior to those of the Legislature. Commerce staff said no and that he did not mean to imply that; he said that when Commerce was handed a budget cut, it had to determine where to take that cut, and it chose to make that cut internally rather than cutting the funds to the organization. He added that the relationship between Commerce and this organization has eroded but that he and the Director have now reconnected and that he hopes she would now know who to call for assistance.

Senator Pridemore noted this is the second report this evening where it looks like Commerce is not doing what the Legislature intended, with the drop in lodging tax reports each year and no follow-up by the agency. He indicated that it is not Commerce's decision about whether to follow the Legislature's directives and that, if the agency is not able to do so with the resources the Legislature makes available, the agency needs to come back to the Legislature and tell us. Commerce staff responded that its assignment in lodging tax was significantly different than in this case.

Representative Haigh made a motion to approve for distribution the Microenterprise Development Program Meets Statutory Objectives But Department of Commerce Oversight is Inadequate proposed final report, and the motion was seconded. Representative Haigh then made a motion to include the following Addendum to the report that was developed by JLARC's Executive Committee:

> *The Committee is concerned that the Department of Commerce does not intend to comply with statutory direction to continue providing organizational support to the Washington State Microenterprise Association. The Committee finds that it is necessary for the Department to either comply with statute by providing organizational support or submit agency request legislation to change the requirement. The Committee expects the Department to communicate its response to either comply with statute or request a change in statute at a time that would allow legislation action during the 2012 Legislative Session.*

The motion to include the Committee Addendum was seconded and carried unanimously. The Committee then approved unanimously the motion to approve for distribution the report with the Addendum.

2011 Tax Preference Performance Reviews — Proposed Final Report

Mary Welsh, Dana Lynn, and John Woolley from the JLARC staff presented the proposed final report for the Tax Preference Performance Reviews. In 2006, the Legislature mandated ongoing annual audit reviews of Washington's tax preferences. JLARC reviewed 25 tax preferences in 2011. The reviews are provided in a single volume and include a summary of highlights from each review, and comments on the reviews adopted by the Citizen Commission for Performance Measurement of Tax Preferences. All tax preference performance reviews place an emphasis on whether the preference has met its public policy objectives. The reviews include recommendations as to whether each preference should be continued, reviewed and clarified, terminated, or allowed to expire.

Senator Pridemore invited Citizen Commission Chair William Longbrake to come before the Committee. The Commission Chair thanked the Legislature for amending the Commission's operative statute last year [Senate Bill 5044]; he explained that the changes will help streamline the scheduling of tax preference reviews in the future and will improve the efficient use of scarce staff resources. He reported that he had had the opportunity for an extensive interview with Pew Charitable Trusts, which is conducting a study on what various states are doing with regard to tax preferences, and he further reported that Washington is a trailblazer in this area. He added that a draft of the Pew report is due out in the spring.

The Commission Chair shared that the Commission has continued to be able to operate by consensus. He reiterated a Commission request from last year that the Legislature include whenever possible a statement of intent or purpose when enacting new tax preferences. He explained that this year's report also has a general recommendation, this one pertaining to the use of expiration or termination dates in a tax preference statute. He said it would be helpful for the Legislature to clarify the intent of an expiration date in the statute or to provide commentary in the legislative record that clarifies the intent. He indicated that this Commission recommendation is because the inclusion of an expiration date can have different meanings;, for example, to trigger a review or because the Legislature intends the preference to be a time-limited response to temporary, short-term industry or economic circumstances.

Senator Pridemore, having observed the Commission at its meetings this year as a non-voting member, indicated how impressed he was with the caliber of the people who are serving on the Commission, calling out their dedication and the work that they do. He thanked the Commission Chair for his service to the state. Senator Pridemore also reported that he had just introduced a bill that requires a statement of legislative intent for tax preferences and that mandates automatic five-year terminations if the Legislature does not specify a different timeframe [Senate Bill 6088].

Representative Orcutt said he is not sure he agrees with all of the Citizen Commission recommendations or with all of the JLARC staff recommendations, so he will be voting against the motion to approve the final report for distribution.

Representative Haigh made a motion to approve for distribution the 2011 Tax Preference Performance Reviews proposed final report. Motion was seconded and carried with one dissenting vote (Representative Orcutt).

With no further business before the Committee, the Chair adjourned the meeting.

ATTENDANCE

JLARC Members Present: Senators Nick Harper, Jeanne Kohl-Welles, Janéa Holmquist Newbry, Sharon Nelson, Linda Evans Parlette, and Craig Pridemore; Representatives Kathy Haigh, Troy Kelley, Ed Orcutt, Derek Stanford, and Hans Zeiger.

JLARC Staff Present: Keenan Konopaski, Legislative Auditor; John Woolley, Deputy Legislative Auditor, Linda Byers, Stephanie Hoffman, Peter Heineccius, Mark Fleming, Fara Daun, Nina Oman, Mary Welsh, Dana Lynn, Lisa Hennessy, and Suzanne Kelly.

ADJOURNMENT

The meeting was adjourned at 7:40 p.m.

CHAIR

VICE CHAIR