

AN EVALUATION

Wisconsin Lottery

Department of Revenue

99-14

September 1999

1999-2000 Joint Legislative Audit Committee Members

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September 17, 1999

Senator Gary R. George and
Representative Carol Kelso, Co-chairpersons
Joint Legislative Audit Committee
State Capitol
Madison, Wisconsin 53702

Dear Senator George and Representative Kelso:

We have completed our fifth biennial program evaluation of the Wisconsin Lottery, as required by s. 13.94(1)(em), Wis. Stats. Since the Wisconsin Lottery began operations in September 1988, it has been under the management of three state agencies: the Lottery Board, the Gaming Commission, and, since August 1995, the Department of Revenue.

From the Lottery's inception through fiscal year (FY) 1998-99, ticket sales have provided approximately \$1.5 billion in net proceeds for property tax relief. However, from FY 1994-95 through FY 1997-98, ticket sales declined by \$100.4 million. Sales increased by \$9.8 million, or 2.3 percent, during FY 1998-99, but it is not clear that the previous decline in sales has been permanently reversed.

In response to declining ticket sales, the 1997-99 Biennial Budget Act provided the Department with 18 additional marketing positions and authorized 12 telemarketing sales representative positions to be reclassified to improve retailer support. However, not all of the positions granted by the Legislature have been filled in a timely manner, and the number of retailers selling lottery tickets has continued to decline.

Nationwide, lottery sales in states with lotteries have tended to decline over time. The Department's efforts to increase sales have emphasized frequent introductions of new scratch games. For example, during a one-year period we reviewed, 35 new scratch games were introduced and 39 older games were also offered for sale. Our analysis of sales data confirmed that the new games sell significantly better than older games do.

We appreciate the courtesy and cooperation extended to us by the Department of Revenue. The Department's response is Appendix IV.

Respectfully submitted,

Janice Mueller
State Auditor

JM/PS/ao

SUMMARY

Since it began operations in September 1988, the Wisconsin Lottery has been under the management of three state agencies: the Lottery Board (until October 1992), the Gaming Commission (until August 1995), and the Department of Revenue. From the Lottery's inception through fiscal year (FY) 1998-99, ticket sales have provided approximately \$1.5 billion in net proceeds for property tax relief.

The Wisconsin Lottery sells both instant and on-line games. In FY 1998-99, sales of instant games represented 53.9 percent of all ticket sales. The number of instant games varies, but in FY 1998-99, 88 instant games were available in Wisconsin. Of the six on-line games currently offered for sale, two are part of a multi-state consortium and four were developed for sale exclusively in Wisconsin.

The Wisconsin Constitution indicates that net proceeds from the Lottery shall be used for property tax relief, which has been provided as property tax credits, credits to owners of farmland, payments for district attorney salaries, and school aids. Beginning in FY 1999-2000, based on a change to the state constitution, only Wisconsin residents will receive lottery proceeds for property tax relief; revenues from pari-mutuel racing and bingo now are also designated solely for property tax relief.

In FY 1998-99, ticket sales represented almost 99 percent of the Wisconsin Lottery's revenues. Overall sales declined by \$100.4 million from FY 1994-95 through FY 1997-98, but they increased by \$9.8 million, or 2.3 percent, in FY 1998-99, primarily because of a significant increase in on-line Powerball sales in July 1998 and June 1999. Instant ticket sales have declined each year since FY 1994-95. In FY 1997-98, Wisconsin ranked 27th in per capita ticket sales among 38 jurisdictions with lotteries, and 5th among the 7 midwestern states.

In order to maximize sales of instant tickets, which represent the largest category of tickets sold by the Wisconsin Lottery, the Department of Revenue introduces new instant games frequently. Thirty-five new instant scratch games were introduced in the 12-month period ending on April 1, 1999. We found that from April 1, 1998, through March 31, 1999, sales of new games were four to eight times greater than sales of older games.

The number of retailers selling tickets has declined from 5,135 in April 1994 to 4,253 in April 1999, or by 17.2 percent over this period. To increase the number of retailers selling tickets, and thereby increase sales, the Department's 1999-2001 biennial budget request includes a

proposal to direct 1 percent of all ticket sales revenue to an incentive program that would provide bonuses to retailers who increase their ticket sales and who sell winning tickets. If such a proposal had been in effect, \$4.3 million would have been available for retailer incentives in FY 1998-99. The Joint Committee on Finance has approved the Department's proposal as part of the biennial budget that is currently pending before the Legislature.

Wisconsin Lottery program expenditures, including prizes paid to winning ticket holders, staff salaries, commissions paid to ticket retailers, contracts for on-line vendor services, and other administrative costs, declined from \$333.2 million in FY 1993-94 to \$293.6 million in FY 1998-99. Two major reasons account for the decline. First, expenditures are driven by ticket sales, which have decreased in all but two years: FY 1994-95 and FY 1998-99. Second, expenditures for staff salaries have declined because of high vacancy rates during some of this period. However, we found that despite declining revenues, administrative expenses have increased slightly over time and have represented an increasing percentage of gross revenues.

To assist in reversing the trend in declining sales, during the 1997-99 biennial budget process the Department requested and the Legislature granted a total of 18.0 full-time equivalent (FTE) marketing positions in addition to the 32.0 FTE positions included in the Governor's 1997-99 budget proposal. In addition, in an attempt to foster the hiring and retention of telemarketing staff, the Legislature approved the reclassification of 12.0 FTE telemarketing positions, which increased their salaries by \$5,100 annually.

The success of the Department's efforts to use these positions to increase sales has been mixed. Through March 1999, 1.0 of 18.0 retailer field support positions had never been filled, and 5.0 positions were vacant. In addition, we found delays in the recruitment process. The Department did not begin recruitment for these positions until January 1998, or three months after the 1997-99 budget was signed into law. Other than two supervisors, who were hired in August 1998, no retailer field support staff were hired until one year after these positions were authorized. Similarly, although the Department was provided with the authority to reclassify the 12.0 FTE telemarketing positions in October 1997, delays occurred in two recruitment efforts to fill these positions, and 3.0 of the 12.0 positions are currently vacant. Department officials attribute the delay in filling positions to a number of factors, including the need to develop employe classifications for the new positions created, the desire to hire supervisors before other staff, and the difficulty associated with hiring staff in the current labor market.

Although performance goals have been established for retailer field support staff, officials in the Department indicate they did not develop performance goals for telemarketing staff in the past because of differences among lottery ticket retailers and the difficulty in forecasting ticket sales. However, an obstacle to the development of telemarketing staff performance goals appears to be that telemarketing staff have not been assigned to specific retailers or regions of the state. Department officials believe that the performance goals developed for retailer field support staff could be applied to both staff groups eventually when the Department's marketing staff have been integrated into teams as planned.

We believe the development of measurable performance goals could foster improved telemarketing operations and may reduce the rate at which retailers drop out of the program. We include a recommendation for the Department to report to the Joint Legislative Audit Committee by December 1, 1999, on its plans for filling all vacant marketing positions and for developing measurable performance goals for its telemarketing staff.

The Department's extensive use of limited-term employees, which was noted as a concern in the past, has declined substantially. It dropped by 71.1 percent over a three-year period, from 15.9 FTE positions in July 1996 to 4.6 FTE positions in July 1999.

In addition, during the 1997-99 biennial budget process, the Legislature granted authority for the Department to use one lottery position in the Secretary's office. However, since January 1999, there have been two staff persons whose positions are allocated to the Lottery but who work within the Secretary's office. One of these staff persons, the Department's public information officer, estimated he spent only 10 percent of his time on lottery activities. Officials have indicated that to address the situation this staff person was assigned a new department position number for FY 1999-2000 and will no longer be funded by the Wisconsin Lottery.

Finally, we question personnel transactions related to the Lottery's former acting administrator. The Department awarded this individual two discretionary compensation adjustments totaling \$11,500. Discretionary compensation adjustments are intended to enable state agencies to recognize significant and permanent changes in job duties or increased competencies, or to address pay equity or retention needs.

Department officials indicate that these lump-sum payments were awarded for two reasons. First, the payments were made in recognition of the acting administrator's expanded duties, which were assumed in April 1997 and entailed a broader scope and greater complexity than his prior responsibilities. Second, officials indicate that payments were made based on equity principles, because the predecessor of the acting

director had been paid more at the time of her resignation than the acting director was paid during his tenure in that role. However, the acting director announced his resignation in May 1999, and a permanent director was appointed on June 14, 1999. It is unusual that the first of these payments was not made until one month after the acting director announced his resignation, and that the second was not made until after the start of the new fiscal year.

We also reviewed the way in which both the federal government and Wisconsin have attempted to control the proliferation of gambling activities on the Internet, as well as the recent growth in Indian gaming activities. Concerns have been raised about the effects of such gambling on state lotteries. Current federal law limits Internet gambling to some extent, and Wisconsin law appears to be even more restrictive. In addition, Congress is currently considering a law to strengthen federal prohibitions on Internet gambling.

While the current Indian gaming compacts, entered into for a five-year period beginning February 1999, increased the number of allowable casinos, it did not broaden the types of Class III gambling already permitted. Although expansion of the types of gambling permitted in Wisconsin would require a constitutional change, an increase in the number of casinos is possible under existing compacts. Some believe that the addition of casinos would reduce the amount of money spent on the Wisconsin Lottery, because more casinos would provide additional opportunities to gamble. However, others believe any additional casinos that may be established are unlikely to have a substantial effect on lottery sales.

INTRODUCTION

Lottery ticket sales have provided approximately \$1.5 billion in property tax relief.

Since it began operations in September 1988, the Wisconsin Lottery has been under the management of three state agencies: the Lottery Board (until October 1992), the Gaming Commission (until August 1995), and the Department of Revenue. From the Lottery's inception through fiscal year (FY) 1998-99, ticket sales have provided approximately \$1.5 billion in net proceeds for property tax relief.

The Legislative Audit Bureau is required by s. 13.94(1)(em), Wis. Stats., to conduct a biennial program evaluation of the Wisconsin Lottery. This report is the fifth such evaluation. It focuses on lottery operations since our 1997 evaluation and includes a review of:

- program revenue and expenditure trends;
- the types of games offered by the Wisconsin Lottery and an analysis of the effectiveness of frequent introductions of new games;
- recent staffing changes; and
- available information on the effects of Internet gambling and Indian gaming on lottery sales.

In conducting our evaluation, we reviewed documents and other financial information provided by the Department of Revenue and interviewed members of its staff, as well as staff in the Department of Justice and representatives of national organizations that research lottery and other gaming issues.

Types of Games

The Wisconsin Lottery sells instant games and on-line games.

The Wisconsin Lottery is currently permitted to sell two types of games: instant games and on-line games. Instant games can be divided into two groups: "scratch games," in which purchasers scratch off protective coatings on tickets to reveal prizes, and "pull-tabs," in which purchasers pull off perforated ticket coverings to reveal prizes. Pull-tab tickets are typically sold in taverns and by not-for-profit organizations. Instant games are developed for sale exclusively in Wisconsin, although ticket themes and presentations are sometimes similar to those used in other states.

On-line games use automated systems to print lottery tickets that show a series of numbers selected by participants or randomly generated by a computer. Winning numbers are determined in drawings. On-line games either may be developed exclusively for Wisconsin or may be part of a larger, multi-state effort.

During FY 1998-99, the Wisconsin Lottery sold 88 types of instant games, including 81 scratch games and 7 pull-tab games. Department of Revenue officials estimate that approximately 18 different instant games are currently offered for sale.

Six on-line games are offered, two of which are also sold in other states.

In addition, six on-line games are currently available; two of the six are offered as part of a multi-state consortium. While the games vary in the quantity of numbers that are selected for play, all of the games offer purchasers the option of choosing the numbers themselves or having the numbers automatically generated by a retailer's computer, which is linked to the Wisconsin Lottery's computer system. Appendix I provides information on the six on-line games.

Wisconsin Lottery Property Tax Credit

The Wisconsin Lottery was created to provide property tax relief.

The impetus in creating a lottery in Wisconsin was to provide property tax relief, and the Wisconsin Constitution indicates that net proceeds from the Lottery shall be used for property tax relief. To calculate the net proceeds available for property tax relief, the following amounts are deducted from Wisconsin Lottery revenues:

- prizes, which must equal at least 50 percent of each year's revenues from the sale of lottery tickets; and
- expenses for the operation and administration of the Lottery, such as staff salaries, game development, ticket printing and warehousing costs, and amounts paid to vendors for on-line services and supplies. Total administrative expenses may not exceed 10 percent of gross lottery revenues without legislative approval.

As lottery ticket sales have declined, funds available for property tax relief have also declined.

As shown in Table 1, the Lottery funded approximately \$1.5 billion in property tax relief since FY 1988-89. However, over time, amounts available for property tax relief have declined as the result of declining lottery ticket sales.

Table 1

Wisconsin Lottery Property Tax Relief*
(in Millions)

<u>Fiscal Year</u>	<u>Amount Distributed</u>
1988-89	\$ 69.4
1989-90	87.9
1990-91	25.0**
1991-92	236.7
1992-93	199.8
1993-94	169.2
1994-95	151.9
1995-96	171.3
1996-97	13.3**
1997-98	216.9
1998-99	<u>153.9***</u>
Total	\$1,495.3

* Includes all types of distributions of Wisconsin Lottery proceeds for property tax relief made since FY 1988-89, including the farmland tax relief credit, district attorney salaries, and school equalization aid payments.

** Because of court rulings that affected the distribution of property tax credits, these payments primarily reflect farmland tax relief credits.

*** Estimate of distribution as of June 30, 1999.

Lottery property tax relief has been provided in a variety of forms.

During the history of the Lottery, a number of factors have affected the amount of proceeds either paid directly for costs that taxpayers otherwise would have paid or applied to property tax bills. For example:

- During FY 1988-89 and FY 1989-90, the first two years of the Wisconsin Lottery, tax relief was distributed through school equalization aid payments and the payment of district attorney salaries, with a smaller amount being provided directly to farm owners as farmland tax relief credits.

- After a delay in distributing the FY 1990-91 property tax credits and a May 1992 court ruling that all Wisconsin Lottery tax relief must be provided directly to property owners, tax relief from FY 1991-92 through FY 1995-96 was distributed solely through property tax credits to Wisconsin residents for their primary homes and as farmland tax credits.
- In FY 1996-97, little revenue was distributed through credits because an October 1996 circuit court decision found the method of distributing the credits only to Wisconsin residents for their primary homes to be in violation of the state constitution.
- As a result of the delay in distributing FY 1996-97 credits, proceeds from that year and the next were distributed in FY 1997-98 to owners of all taxable properties. In FY 1998-99, credits were again distributed to owners of all taxable properties. In FY 1998-99, over 90 percent of the total Wisconsin Lottery credit consisted of property tax credits paid to owners of all taxable property in the state, while the remainder was distributed as farmland tax relief.

The future distribution of lottery tax credits will change based on a 1999 change to the state constitution.

In April 1999, voters passed a resolution to amend the Wisconsin Constitution. The amendment changed three provisions related to the distribution of lottery and other gaming-related proceeds. Specifically, the amendment:

- subjects the distribution of property tax relief to two conditions: the distribution may not be based on the recipient's age or income, and distribution is limited to properties used as Wisconsin residents' primary homes;
- defines state revenues available for property tax relief to include investment earnings on lottery, pari-mutuel betting, and bingo revenues; and
- provides that all monies received from bingo games and pari-mutuel on-track betting, other than money used for the regulation and enforcement of laws relating to these activities, shall be used for property tax relief.

1999 Wisconsin Act 5 provides that only Wisconsin residents are eligible to receive tax credits funded by gaming revenues.

In response to these changes to the state constitution, the Legislature passed 1999 Senate Bill 114, which was recently signed into law by the Governor as 1999 Wisconsin Act 5. Act 5:

- incorporates pari-mutuel and bingo revenues into the funds available for distribution as property tax relief;
- defines as eligible for the lottery and gaming credit those properties that serve as Wisconsin residents' principal dwellings; and
- changes the calculation of the farmland tax relief credit from a maximum of \$1,000—based on 10 percent of up to \$10,000 in net property taxes—to a maximum of \$1,500. The calculation of the amount available will be based on a percentage of property taxes owed as determined by the Department, with a total of \$15.0 million available for this purpose statewide.

Current estimates are that the lottery and gaming tax credit will total \$112.4 million for FY 1999-2000, and \$105.7 million for FY 2000-01, with an additional \$15.0 million available in each year for the farmland tax relief credit. The amounts available for distribution in the future will depend upon revenues generated through sales of instant and on-line game tickets.

WISCONSIN LOTTERY REVENUES

Wisconsin Lottery's revenues are generated through the sale of instant and on-line game tickets. As ticket sales have declined, a trend experienced by many lotteries nationwide, the Department of Revenue has implemented a number of strategies to maintain interest in the lottery and to reverse this decline. These strategies include introducing new instant scratch games frequently and requesting that the Legislature approve additional incentives for retailers to sell lottery tickets.

Ticket Sales

Except for a small amount of interest earnings, the Lottery derives its revenues from ticket sales almost exclusively. As shown in Table 2, ticket sales represented almost 99 percent of revenues in FY 1998-99.

Table 2

Wisconsin Lottery Revenues
FY 1997-98 and FY 1998-99
(in Millions)

Type	<u>FY 1997-98</u>	<u>Percentage of Total</u>	<u>FY 1998-99</u>	<u>Percentage of Total</u>
Ticket Sales	\$418.5	98.0%	\$428.3	98.8%
Interest Income	8.6	2.0	5.2	1.2
Retailer Application Fees and Miscellaneous Revenue	<u>0.1</u>	<u><0.1</u>	<u>0.2</u>	<u><0.1</u>
Total	\$427.2	100.0%	\$433.7	100.0%

As shown in Table 3, total lottery sales declined each year from FY 1994-95 through FY 1997-98. This decline totaled \$100.4 million. However, total sales increased by \$9.8 million, or 2.3 percent, during FY 1998-99 as the result of higher on-line game sales. Instant ticket

sales declined by \$89.5 million, or 27.9 percent, between FY 1994-95 and FY 1998-99. Ticket sales for on-line games showed no clear trend during this same five-year period.

Table 3

Wisconsin Lottery Sales by Type of Game
 FY 1988-89 through FY 1998-99
 (in Millions)

<u>Fiscal Year</u>	<u>Instant Games</u>	<u>On-line Games</u>	<u>Total</u>	<u>Change from Previous Year</u>
1988-89	\$230.4	—	\$230.4	—
1989-90	182.7	\$126.9	309.6	34.4%
1990-91	230.7	160.7	391.4	26.4
1991-92	289.7	159.4	449.1	14.7
1992-93	310.9	184.2	495.1	10.2
1993-94	285.3	210.2	495.5	0.1
1994-95	320.3	198.6	518.9	4.7
1995-96	310.4	171.7	482.1	-7.1
1996-97	273.4	157.7	431.1	-10.6
1997-98	252.8	165.7	418.5	-2.9
1998-99*	230.8	197.5	428.3	2.3

* Final year-end adjustments are not included.

Sales for on-line games are closely related to the size of jackpots.

Sales of on-line games are, to a great extent, related to the size of available jackpots. As the amount of money in a jackpot increases, so do on-line ticket sales. In July 1998, when the Powerball jackpot reached \$295.7 million, its highest level in the history of the Wisconsin Lottery, total on-line ticket sales increased by 711.6 percent over the previous month. In addition, from May through June 1999, Powerball sales increased by 231.5 percent as the jackpot increased to \$150 million on June 30, 1999. The factors associated with the sale of instant games are less clear, largely because the amount that can be won does not depend upon sales or the number of other ticket winners within a fixed period of time.

In our 1997 evaluation of the Wisconsin Lottery (report 97-2), we noted that per capita sales for FY 1995-96 were approximately 60 percent of the national average, placing Wisconsin 25th in per capita sales among the 38 jurisdictions with lotteries, and 5th among 7 midwestern states. As shown in Appendix II, Wisconsin's per capita lottery sales for FY 1997-98 were 42.9 percent of the national average, placing the state 27th in per capita sales among the 38 jurisdictions with lotteries and, again, 5th among 7 midwestern states. In both FY 1995-96 and FY 1997-98, the most recent years for which national data are available, Wisconsin Lottery sales were well below the national median, which was \$139 for FY 1995-96, when Wisconsin's per capita sales were \$94, and \$136 for FY 1997-98, when Wisconsin's per capita sales were \$80.

The Department of Revenue's lottery sales estimates traditionally have been optimistic.

Although the trend in sales has generally been downward since FY 1994-95, the Department of Revenue continues to include optimistic sales projections in its budget requests, which are modified during the later stages of the budget process in consultation with the Legislative Fiscal Bureau and the Department of Administration. For example, the 1997-99 Biennial Budget Act included projected sales of \$463.8 million for FY 1997-98, and \$487.0 million for FY 1998-99. Actual FY 1997-98 sales totaled \$418.5 million, or 9.8 percent less than the amount projected; final sales for FY 1998-99 are estimated at \$428.3 million, or 12.1 percent less than originally projected. Without the added revenue for the two large Powerball jackpots that boosted sales during July 1998 and June 1999, we estimate sales would likely have totaled only \$393.0 million, or 19.3 percent less than originally projected.

Addressing Declining Revenues

To address the decline in ticket sales, the Department has:

- developed a strategy to maintain interest in the Lottery by continuing to introduce instant games frequently; and
- requested that the Legislature change the way in which retailers are paid so that retailers' incentives to sell Wisconsin Lottery tickets are maximized.

Scratch Game Development and Marketing Strategies

Instant scratch games represent the majority of Wisconsin Lottery tickets sold.

Instant scratch games represent the largest category of tickets sold by the Wisconsin Lottery and continue to generate the most revenue, even though their sales have declined every year since FY 1994-95. Because the factors that affect the sale of instant games are less clear than those that affect on-line games, we analyzed the Lottery's management of its instant games. As shown in Table 4, scratch games accounted for \$224.9 million, or 52.5 percent, of total sales in FY 1998-99. In contrast, pull-tabs accounted for only \$5.9 million, or 1.4 percent, of total sales.

Table 4

Number and Sales of Games FY 1997-98 and FY 1998-99

Game Type	FY 1997-98			FY 1998-99		
	Number of Games	Total Sales (millions)	Percentage of Total	Number of Games	Total Sales (millions)	Percentage of Total
On-line	6	\$165.7	39.6%	6	\$197.5	46.1%
Instant						
Scratch	74	246.5	58.9	81	224.9	52.5
Pull-tab	<u>7</u>	<u>6.3</u>	<u>1.5</u>	<u>7</u>	<u>5.9</u>	<u>1.4</u>
Subtotal	81	252.8	60.4	88	230.8	53.9
Total	87	\$418.5	100.0%	94	\$428.3	100.0%

The Department believes introducing new games frequently increases ticket sales.

Department officials indicate, and representatives of national lottery organizations agree, that in order to keep ticket purchasers interested, new instant games should be introduced frequently and a variety of games should be offered. In addition, the Department believes that lottery sales can be enhanced by associating games with familiar names or products. However, there has been little in-depth research to verify the optimal approach to instant game sales, and the Department has not fully analyzed whether development and other costs associated with the introduction of new instant games might outweigh the benefits of increased sales. Therefore, using available information, we attempted to evaluate the cost-effectiveness of the Department's practices.

As noted, scratch games are developed for sale exclusively in Wisconsin, but they may adopt themes and presentations used by other states. We identified four basic themes the Wisconsin Lottery tends to use for its scratch games:

- games tied to common gambling motifs, including card games, slot machines, and bingo, which have included recent Wisconsin Lottery scratch games such as Straight Poker, Hot Slots, and Wild Scratch Bingo;
- games tied to specific times of the year, holidays, or events, such as Beat the Heat, Lucky Clover Doubler, and Jack O'Lantern Cash;
- games that use the names of familiar products, companies, and television shows in their titles, such as Pepsi, Harley-Davidson, and Star Trek; and
- games with themes intended to be comical or otherwise appealing, such as Moola Mania, Double Dip, and Heavenly Hogs.

The largest category of scratch games introduced tends to have a gambling-related theme. In deciding which type of theme to use, lottery officials consider the time of year the game will be introduced, the type of player they are trying to attract, the number and other types of games currently available for sale, the odds of winning that should be applied to the game, the prizes that should be offered, and the types of games that are doing well in other states.

Lottery officials believe that their strategy of introducing scratch games frequently and ensuring that at any point in time a wide variety of scratch games is available for purchase produces more revenue than would a strategy that attempts to limit development, printing, and inventory costs by focusing on the production and sale of a large number of tickets with one or two specific themes. The Department does not track expenditures in a manner that permits a comprehensive analysis of costs associated with the development of specific games. Therefore, we analyzed data on all scratch games that were available for sale between April 1998 and March 1999—the most recent 12-month period for which complete data were available during our review—to determine if the Lottery's strategy was cost-effective.

On average, the Wisconsin Lottery introduces three new scratch games each month.

During this one-year period, a total of 74 scratch games were available for sale. Of these, 39 had been introduced in a prior period and were still available for sale, while 35 were newly introduced. One of these 35, Vegas Nights, had the same name as a previous game but was reissued with a substantially modified format. During this 12-month period, three games were typically introduced each month. However, six games were introduced in May, and only one new game was introduced in August. Appendix III shows all of the instant scratch games introduced from April 1998 through March 1999, their month of introduction, average weekly sales, and total annual sales.

The odds of winning a prize increase with the cost of the scratch game ticket.

The odds of winning vary to some extent from game to game; however, the actual odds for each game are predetermined before the tickets are printed. In FY 1998-99, the odds of winning a prize ranged from one in three to one in five. However, it should be noted that the odds of winning a prize increase with the price of the ticket. For example, the chance of winning a prize with a \$1 ticket is one in five; with a \$2 ticket it is one in four, and with a \$5 ticket one in three. In addition, higher-priced tickets also provided a chance to win prizes with higher dollar values. Although the chance of winning is not increased if individuals purchase tickets for new games rather than for older games, lottery officials indicate retailers have told them buyers consistently prefer the newer games because they seek to “find their lucky game.”

On average, new games sell better than older games.

The Department does not maintain information on ticket sales to consumers, but it does maintain data on sales to retailers, and it keeps an inventory of unsold tickets. Because games are introduced at different times, and because sales vary according to the season, we analyzed inventory levels for games offered during 4 of the 12 months included in our review period: June 1998, September 1998, December 1998, and March 1999. Using the inventory levels for each game, we estimated sales to retailers during these months and confirmed that new games sell significantly better than older games do. As shown in Table 5, revenues generated through the sale of new games were, on average, between four and eight times greater than revenues generated by the sale of older games in each month reviewed.

Table 5

Comparison of New Games Sales

<u>Month</u>	<u>Average per Game Sales for New Games*</u>	<u>Average per Game Sales for Older Games</u>	<u>New Game Sales as a Percentage of Old Game Sales</u>
March 1999	\$1,592,267	\$371,185	429.0%
December 1998	1,110,260	202,328	548.7
September 1998	1,038,109	150,135	691.5
June 1998	1,088,247	133,538	814.9

* Includes games that have been available for sale for no more than three months.

New games may also sell better than older games because of advertising and marketing.

While the Department attributes the success of new games to the desire for new and different games, other factors may also affect a game's success. For example, 9 of the 14 informational advertisements for scratch games on radio and television between April 1998 and March 1999 were for new games, and 5 were for older games. Consequently, new games may sell better than older games because they are more highly publicized. In addition, Wisconsin Lottery telemarketing staff may influence sales to retailers by emphasizing newer games.

Although the Department does not determine the costs associated with each specific game, costs that are incurred in the development and introduction of new games do not appear to be substantially greater than costs incurred for older games. For example, the costs of printing tickets are incurred for both old and new games and, over time, the Lottery has adjusted quantities to ensure it prints only as many as are likely to be sold. Similarly, costs are incurred to warehouse tickets for both new and old games. The costs incurred in the development and introduction of new games, therefore, appear to be offset by substantially higher sales, regardless of the reason for the higher sales. The Department may wish to analyze, on a continuing basis, the costs incurred in the development and introduction of new games in order to ensure that the trends we found continue. If costs increase, the Department will need to modify its strategies to ensure they are cost-effective.

The Money Game Show - “The Money Game Show” is a televised program on which winners from some instant lottery games are able to win additional prizes. Prizes won on this show are funded from ticket sales for these games. In the past, the Department has stated that the popularity of “The Money Game Show” had declined, in part because of the odd hours at which it is broadcast. However, department managers now contend that the show is popular in the Milwaukee area, where it has been broadcast at times of high television viewership. Because the Department does not pay other television stations to broadcast this program, officials believe they cannot compel stations to broadcast it at a specific time. While the approximately \$300,000 paid to the Milwaukee television station for the program’s production and broadcast does not appear to be excessive, the instant tickets that include an appearance on “The Money Game Show” as a prize option do not appear to attract more consumers than other games do. Specifically, during the 12 months from April 1998 through March 1999, the 15 instant scratch tickets that included an appearance as a prize had average sales that were 19.0 percent less than the average sales of all other scratch tickets.

Increasing Reimbursement for Retailers

Without a large number of retailers to sell Wisconsin Lottery tickets, individuals who wish to purchase tickets will have limited access and sales may decline. Two past attempts to expand the number of retailers selling lottery tickets by increasing retailer compensation appear to have had little effect. However, the Department’s 1999-2001 biennial budget proposal includes an additional strategy it believes will be more effective in providing incentives to retailers and will result in an increase in the number of retailers selling lottery tickets.

Increasing retailer compensation did not increase the number of retailers selling lottery tickets.

In September 1995, based on approval granted by the Legislature in 1995 Wisconsin Act 27, the basic retailer compensation rate for all ticket sales was increased from 5.0 percent to 5.5 percent of the ticket sales price. In addition, 1997 Act 27, the 1997-99 biennial budget, increased retailer compensation for instant ticket sales from 5.5 percent to 6.25 percent of the ticket sales price. It appears that these efforts did not have the desired effect because, as shown in Table 6, the number of retailers selling any type of lottery ticket has declined every year since 1993, and the number of retailers selling instant scratch games continued to decline even after retailer commissions were increased in 1997.

Table 6

Number of On-Line, Scratch, and Pull-Tab Retailers
(April of Each Year)

<u>Ticket Type</u>	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>
On-Line	2,196	2,810	2,978	3,029	3,076	3,079	3,084	3,060
Scratch	4,677	4,649	4,540	4,385	4,278	3,939	3,606	3,570
Pull-Tab	1,933	1,929	1,849	1,735	1,642	1,485	1,296	1,280
Total Retailers*	5,178	5,189	5,135	4,961	4,840	4,621	4,317	4,253

* Non-duplicated count of retailers selling lottery tickets.

Wisconsin's retailer incentive is not currently based on the value of winning tickets.

In an attempt to increase sales nationally, all of the 38 jurisdictions with lotteries have developed strategies to provide retailers with incentives to sell tickets. As of 1998, 35 jurisdictions provided incentives that included added reimbursement to retailers who sold winning tickets. For example, some states offer a commission on the value of winning tickets redeemed or sold by the retailers. In contrast, Wisconsin currently provides retailers the same fixed percentage of the sales price of each ticket sold, regardless of whether the ticket results in a prize.

The Department has proposed a new retailer incentive program.

In response to both the continued decline in ticket sales and concerns raised by retailers about their fixed commissions, the Department has proposed to direct 1 percent of ticket sales revenue to a retailer incentive program. In FY 1998-99, \$4.3 million would have been available for retailer incentives if the program had been in effect. The Department's proposal provides that bonuses be made available in two ways. First, one-half of the 1 percent would be distributed to "high ticket sellers," which are those retailers that meet or exceed a minimum sales increase that will be established by the Department. Bonuses would be indexed in increments of \$500, based on increased sales of at least 3 percent. Therefore, a retailer whose sales increased by \$1,500 would receive a bonus three times as large as a retailer whose sales increased by only \$500. The actual value of the bonus awarded would be determined at the end of each fiscal year, when available funds would be distributed to successful retailers proportionately based on the extent to which their sales increased.

Second, the remaining one-half of the 1 percent set aside for the program would be awarded to retailers that sold both instant and on-line tickets with prizes of \$600 and above. These retailers would receive an award of 1 percent of the value of the winning ticket, with a maximum bonus of \$100,000 per fiscal year.

The Department believes a new retailer incentive program will increase sales by 2 percent in FY 1999-2000.

On the basis of FY 1997-98 sales of \$418.5 million, research on other states' retailer incentive programs, and the pattern of ticket sales in Wisconsin, the Department estimates that providing these additional incentives will increase ticket sales by 2 percent during FY 1999-2000, and by 4 percent during FY 2000-01. Based on this increase, the Legislative Fiscal Bureau has estimated that ticket sales will be \$419.2 million in FY 1999-2000, and \$427.4 million in FY 2000-01.

The Department believes that when retailers recognize they can earn more than 6.25 percent of the value of each ticket sold, they will more actively encourage the sale of lottery tickets. In addition, the Department believes that the program will result in an increase in the number of retailers who sell tickets, further increasing ticket sales. There are, however, financial risks involved in the proposed program. The Legislative Fiscal Bureau estimates that if sales do not increase by at least 1.5 percent in FY 1999-2000 and by 3.0 percent in FY 2000-01, property tax credits will not increase appreciably, and they may decline because costs associated with bonuses paid to retailers would not be offset with an equivalent or greater amount of revenue generated through increased ticket sales.

In April 1999, the Joint Committee on Finance both approved the Department's proposal for the incentive program as part of the biennial budget that is currently pending before the Legislature and required the Department to provide the Committee with a performance plan before the program takes effect on January 1, 2000.

WISCONSIN LOTTERY EXPENDITURES

Wisconsin statutes limit the percentage of administrative expenditures that the Lottery may incur as compared to its gross revenues. We found that despite declining revenues, administrative expenses have increased slightly. The Legislature also limits product information expenditures to \$4.6 million annually, and pending legislation would place additional limits on the publication and use of such information.

Program Expenditures

Declining expenditures are the result of lower ticket sales and position vacancies.

Wisconsin Lottery expenditures include prizes paid to winning ticket holders, staff salaries, commissions paid to ticket retailers, contracts for on-line vendor services, and other administrative costs. As shown in Table 7, expenditures declined in almost every year since FY 1993-94. There are two major reasons for the decline. First, as noted, expenditures are driven by ticket sales, which also declined during most of this period. Second, expenditures for staff salaries have declined because of a high number of vacancies over portions of this period. The high vacancy rate was partially a result of uncertainty during 1997-99 biennial budget deliberations about whether various Wisconsin Lottery activities would be privatized. A number of employees left the Lottery during this period, and their vacant positions were not filled.

Table 7

Wisconsin Lottery Expenditures
 FY 1993-94 through FY 1998-99
 (in Millions)

<u>Fiscal Year</u>	<u>Expenditures</u>	<u>Percentage Change</u>
1993-94	\$333.2	Not Applicable
1994-95	358.7	7.7%
1995-96	333.1	-7.1
1996-97	295.9	-11.2
1997-98	297.1	0.4
1998-99*	<u>293.6</u>	-1.2
Total	\$1,911.6	

* Represents unadjusted expenditures reported through August 16, 1999.

The Legislature has established a cap on Wisconsin Lottery administrative expenses as a percentage of gross revenues. Until July 1, 1997, the Lottery's administrative expenses were limited to no more than 15 percent of its gross operating revenues, which included commissions paid to retailers that sell lottery tickets. 1997 Wisconsin Act 27 reduced the Lottery's allowable percentage of administrative expenses to 10 percent of gross operating revenues but also directed that retailer commissions be excluded from this calculation.

Administrative expenses account for an increasing percentage of gross revenues.

As shown in Table 8, although revenues have declined over time, administrative expenses have increased slightly. If retailer commissions are included in the calculation for each year, administrative expenses as a percentage of gross revenues increased from 11.8 percent in FY 1995-96 to 13.4 percent in FY 1998-99. If retailer commissions are excluded from each year, administrative expenses as a percentage of gross revenues increased from 6.2 percent to 7.3 percent during the same period.

Table 8

Administrative Expenses as a Percentage of Gross Operating Revenues
(in Millions)

	<u>FY 1995-96</u>	<u>FY 1996-97</u>	<u>FY 1997-98</u>	<u>FY 1998-99*</u>
Expenses				
Vendor Services**	\$7.4	\$7.0	\$11.7	\$11.7
Salaries and Fringe Benefits	3.7	2.8	3.5	4.0
Supplies and Services**	18.2	18.1	15.5	14.5
Permanent Property	0.2	0.4	0.2	0.6
Depreciation	0.6	0.6	0.6	0.6
Subtotal	30.1	28.9	31.5	31.4
Retailer Commissions	<u>27.0</u>	<u>24.5</u>	<u>24.7</u>	<u>25.9</u>
Total Administrative Expenses	\$57.1	\$53.4	\$56.2	\$57.3
Gross Lottery Operating Revenues	\$482.2	\$431.1	\$418.6	\$428.3***
Administrative Expenses as a Percentage of Lottery Revenues (Including Commissions)	11.8%	12.4%	13.4%	13.4%
Administrative Expenses as a Percentage of Lottery Revenues (Excluding Commissions)	6.2%	6.7%	7.5%	7.3%

* Represents unadjusted expenditures reported on August 16, 1999.

** In FY 1995-96 and FY 1996-97, expenses for instant game vendor services were included in supplies and services.

*** Includes only ticket sales revenues, which average 98 percent of all revenues.

Note: Expenditures in this table differ somewhat from those in Legislative Audit Bureau report 99-11 because these expenditures are presented on a cash basis, rather than the accrual basis used in our financial audits of the Wisconsin Lottery.

Product Information Expenditures

From FY 1994-95 through FY 1995-96, product information expenditures increased by 9.3 percent.

The Wisconsin Constitution prohibits the expenditure of public funds, including Wisconsin Lottery revenues, for promotional advertising but permits informational advertising. In FY 1998-99, the Wisconsin Lottery spent \$4.6 million on product information, representing 1.6 percent of total expenditures. As shown in Table 9, informational advertising expenditures increased by 9.3 percent from FY 1994-95 through FY 1995-96 and have remained relatively stable since that time, largely because of legislative action that has limited these expenditures to \$4.6 million annually since FY 1990-91.

Table 9

Product Information Expenditures FY 1993-94 through 1997-98 (in Millions)

<u>Fiscal Year</u>	<u>Expenditures</u>	<u>Percentage Change</u>
1993-94	\$ 4.5	—
1994-95	4.3	-4.4%
1995-96	4.7*	9.3
1996-97	4.5	-4.3
1997-98	4.6	2.2
1998-99	<u>4.6</u>	0.0
Total	\$27.2	

* Includes expenditures made in FY 1995-96 from funds encumbered in FY 1994-95.

For FY 1998-99, Department of Revenue officials entered into a \$4.6 million contract with an advertising agency. Approximately \$1.0 million of that contract was for development and coordination of radio, television, and print advertising. In conducting these activities, the agency concluded that it is not necessary to promote all games, because it believes informational advertising for some games increases sales for others that have not been advertised, particularly when the advertised games are associated with a product with which consumers

are already familiar. For example, in FY 1997-98, three of the seven instant-scratch games for which informational advertising was done on television were associated with trademarked products.

1999 Assembly Bill 270, which is awaiting committee action in September 1999, would change the way in which the Wisconsin Lottery may advertise its games by limiting informational advertising to signs posted at lottery retail ticket outlets. In the fiscal note that accompanies this bill, the Department indicates it believes such a restriction would reduce lottery sales by 10 percent in FY 1999-2000 and by 25 percent in FY 2000-01.

WISCONSIN LOTTERY STAFFING

In recent years, concerns have been raised about the large number of lottery positions that have remained vacant for an extended period. As of January 1997, 82.5 of 130.0 authorized positions were unfilled, representing a vacancy rate of 63.5 percent. Department officials attributed this to proposals to privatize some Wisconsin Lottery functions. In 1995 and 1996, the Department allowed the staff vacancy rate to grow because it expected the major lottery functions to be privatized, and fewer state staff to be needed as a result. However, the Department did not receive suitable bids for a contract to privatize warehousing of tickets and retailer support services in FY 1996-97, and the privatization effort was eventually abandoned.

The Legislature granted the Department additional marketing positions in order to increase sales.

During the 1997-99 biennial budget process, the Governor proposed reducing the number of authorized positions. In 1997 Wisconsin Act 27, the Legislature agreed to restore 18.0 of these positions, provided they would be used to enhance marketing efforts and increase ticket sales. However, not all of the positions targeted for marketing activities have been filled. In addition, there have been significant delays in filling some positions.

Wisconsin Lottery Reorganization

In 1995, discussions began to shift both the operation and the administration of the Wisconsin Lottery to the Department of Revenue and to privatize three major areas of its administration: operating the on-line ticket computer system; processing instant tickets; and providing warehousing and retailer support services. 1995 Wisconsin Act 27, the 1995-97 Biennial Budget Act, transferred lottery functions, including 130.0 full-time equivalent (FTE) positions, from the Gaming Commission to the Department of Revenue effective July 1, 1996. The Legislature intended this transfer to include one year for planning, during which time the Joint Committee on Finance would review and approve components of a transition plan, including issues associated with privatization. However, this provision was vetoed by the Governor. After a memorandum of understanding between the Gaming Commission and the Department of Revenue was signed on August 17, 1995, the administration and operation of the Wisconsin Lottery was assumed immediately by the Department of Revenue.

The Department of Revenue has reduced the Lottery's vacancy rate.

In the 1997-99 Executive Budget, the Governor recommended a 37.5 FTE reduction in the Lottery's position authority, from 130.0 positions to 92.5 positions, as part of the continuing initiative to privatize lottery operations. Efforts to privatize lottery functions resulted in high staff vacancy rates, which reached 63.5 percent in January 1997, adversely affected lottery operations, and contributed to reduced lottery ticket sales. As shown in Table 10, the vacancy rate had fallen to 18.6 percent by January 1999. However, as of March 1999, 21.5 positions were vacant, representing a vacancy rate of 19.5 percent.

Table 10

Full-Time Equivalent Wisconsin Lottery Positions
(1992 through 1999)

	<u>Authorized Positions</u>	<u>Vacant Positions</u>	<u>Percentage Vacant</u>
January 1992	147.0	18.0	12.2%
January 1993	151.0	31.0	20.5
January 1994	145.0	25.0	17.2
January 1995	147.0	34.0	23.1
January 1996	130.0	70.5	54.2
January 1997	130.0	82.5	63.5
January 1998	110.5	38.0	34.4
January 1999	110.5	20.5	18.6

In April 1997, once it was decided to maintain warehousing and retailer support services within the Lottery, the Department requested that the Legislature restore an additional 37.0 positions, plus the 92.5 positions included in the Governor's proposed budget. Included in this request were positions to improve the Lottery's marketing efforts with its retailers, in order to increase sales. The request included:

- an additional 27.0 senior customer service specialist positions, which were intended to assist retailers in maximizing ticket sales by developing business plans for retailers, training new retailers and providing information about new lottery products, and working with retailers on the placement of and budgeting for point-of-sale materials and displays;

- an additional 10.0 entry-level customer service specialist positions, which were intended to perform telemarketing services by taking telephone orders for lottery tickets and other supplies, informing and assisting retailers concerning lottery policies and procedures, and working with retailers on marketing techniques; and
- the reclassification of 12.0 existing lottery positions to entry-level customer service specialist positions that would also perform telemarketing services.

The Legislature approved an additional 18.0 marketing positions.

The Legislature eventually approved a total of 18.0 FTE marketing positions in addition to the 32.0 positions included in the Governor's 1997-99 budget proposal, bringing the total number of authorized positions to 110.5. In addition, the Legislature approved the reclassification of 12.0 FTE positions from telemarketing sales representatives to entry-level customer service specialists in order to foster the hiring and retention of telemarketing staff.

Retailer Field Support Staff

Although the Department argued it needed staff to improve its marketing efforts, and it was provided with the authority to hire 18.0 FTE marketing positions, which it decided to fill as retailer field support staff, most of the staff were not hired until October 1998. Five positions were vacant as of March 1999, and one of the positions has not yet been filled.

Retailer field support staff, who are based in Madison, are each assigned approximately 300 retailers to whom they provide services during on-site visits. These services include helping retailers to determine which games to sell, repositioning ticket dispensers and sales posters to improve visibility, and installing and maintaining ticket displays and dispensers. Retailer field support staff do not, however, deliver lottery tickets to retailers, nor are they required to make a specific number of weekly or monthly retailer contacts. On average, the Lottery reports that retailer field support staff made 1,531 retailer contacts per month from January through April 1999, or 133 contacts per month per staff person. Each retailer is contacted about every 2.3 months.

The Department has established performance goals for the retailer field support staff.

The Department has also established a retail support operational plan that sets out seven goals for the retailer field support staff:

- creating and developing a field marketing and sales organization;
- maintaining total lottery sales to a minimum of FY 1997-98 sales, or \$418.5 million;
- maintaining instant ticket sales to a minimum of FY 1997-98 sales, or \$252.8 million;
- maintaining on-line sales to a minimum of FY 1997-98 sales, or \$165.7 million;
- retaining the current number of retailers and reducing the turnover rate by one-third by June 30, 1999;
- recruiting a total of 312 new lottery retailers by June 30, 1999; and
- integrating field marketing sales, telemarketing, and retailer management sections so that each section can easily communicate with the others and respond to retailer requests and concerns.

Progress in meeting established retailer field support goals has been mixed.

To date, the Department's progress in meeting these goals has been mixed. While FY 1998-99 ticket sales exceeded FY 1997-98 figures, sales have not yet increased to the degree the Department anticipated and, as noted, the number of retailers selling tickets has continued to decline. Furthermore, while some efforts have been made to integrate marketing functions of the field and telemarketing staffs—such as hiring a consultant to develop a marketing plan that includes both aspects of ticket sales, and developing software for tracking retailer ticket purchases—a substantial amount of additional planning is needed before integration can be achieved. For example, a plan to survey and visit all retailers in the state in order to develop individual retailer marketing plans has not yet been completed. In addition, computer software designed to allow field support staff to exchange marketing data with telemarketing staff has yet to be installed. However, because most of the retail field support staff were not hired until October 1998, and a full schedule of retailer visits did not begin until January 1999, it may be too early to expect substantial progress in this area.

Retailer Field Support Staff Hiring Process

The Department did not fill the retail field support positions in a timely manner.

1997 Wisconsin Act 27 was enacted in October 1997, at which point the Department knew the 18.0 FTE retailer field support staff positions had been approved. However, as shown in Table 11, the Department did not approve a recruitment plan for the retailer field support positions until January 1998, and an announcement did not appear in the Current Opportunities Bulletin until February 1998. The process could have been more timely if, for example, the Department had approved the recruitment for these positions in October 1997 and issued an announcement the following month. Had the recruitment process started earlier, staff could have been hired by spring 1998.

Table 11

Retailer Field Support Staff Recruitment Timeline*

<u>Activity</u>	<u>Date</u>
Funding Available	January 1, 1998
Department Approval for Recruitment	January 26, 1998
Current Opportunities Bulletin Announcement	February 16, 1998
Application Deadline	March 6, 1998
Certification of Qualified Candidates	July 29 and August 18, 1998
Candidates Hired	October 1998

* Does not include the recruitment history for two supervisory staff. That process followed the dates above, and the two positions were filled in August 1998.

No permanent staff were performing retailer field support functions for the ten-month period from October 1997 through July 1998, and at no time were all available positions filled. In March 1999, 18 months from the time the positions were approved, the vacancy rate was 27.8 percent. Department officials attribute the delay in filling positions to a number of factors, including the need to develop employee classifications for the new positions created, the desire to hire supervisors before other staff, and the difficulty associated with hiring staff in the current labor market.

In taking action to increase the number of positions allocated to the Wisconsin Lottery, compared to the number proposed by the Governor, the Legislature expected that the Department would fill all positions on a timely basis and that, based on the Department's belief that marketing staff were essential to increase ticket sales, the decline in ticket sales would be reversed. Until the Lottery's new administrator was appointed in June 1999, the Lottery planned to leave 2.0 retailer field support staff positions unfilled, based on the belief that there were not enough lottery retailers to justify all 18 positions. However, the newly appointed administrator believes that the positions are needed to encourage more retailers to sell tickets, thereby increasing sales. It should be noted that the Department has also recently chosen to use one of the vacant retailer field support staff positions as a full-time program assistant position, believing that a program assistant is needed to provide administrative support to the retailer field support staff.

Telemarketing Staff

**In March 1999,
25 percent of
telemarketing staff
positions were vacant.**

To foster the hiring and retention of telemarketing staff, the 1997-99 biennial budget also provided the Department with the authority to reclassify 12.0 FTE telemarketing sales representatives from pay range 9 to pay range 12, with an annual salary increase of \$5,100. The Department began the recruitment process for telemarketing staff more quickly than it did for the retailer field support staff positions because it already had authority to recruit for these positions and could use an available list of candidates to hire staff immediately after the budget was signed into law. However, the Department has had difficulty maintaining telemarketing staffing levels. As of March 1999, 9.0 of the 12.0 FTE positions were filled, representing a vacancy rate of 25.0 percent.

Telemarketing staff, who are based in Madison, are required to call between 80 and 120 retailers per day in order to take ticket orders and to maintain regular contact between the Lottery and retailers. Staff taking ticket orders are able to identify an individual retailer's sales history through the Department's computerized data base and to discuss the retailer's specific ticket needs based on this history. In addition, they provide retailers with information about the availability of different Wisconsin Lottery games, display materials, and informational posters. They also discuss ticket sales and payment procedures when making calls or when retailers call the telemarketing staff with questions and concerns. Although field staff visit each retailer every few months, retailers may have their questions answered immediately by contacting telemarketing staff directly. Unlike field staff, telemarketing staff are not currently assigned to particular regions or retailers. However, the Department plans to survey all retailers and to develop individual retailer marketing plans, after which telemarketing staff will be assigned to specific regions and retailers.

No performance goals have been developed for telemarketing staff.

Department officials indicated they did not develop performance goals for telemarketing staff in the past because of differences among lottery ticket retailers and the difficulty in forecasting ticket sales. However, a more likely obstacle to the development of telemarketing staff performance goals appears to have been the fact that telemarketing staff have not been assigned to specific retailers or regions of the state. Department officials believe that the performance goals developed for retailer field support staff are applicable to telemarketing staff and can eventually be applied to both staff groups once the Department's telemarketing staff have been integrated into teams as planned.

The development of measurable performance goals could improve telemarketing operations. Once staff are assigned to specific retailers and regions, goals for telemarketing staff could be developed to include:

- specific sales goals;
- retaining the current number of retailers and reducing the rate at which retailers drop out of the program;
- recruiting a specific number of new retailers; and
- working to integrate field marketing sales, telemarketing, and retailer management sections for easier communication among sections and in responding to retailers.

Team performance goals could also be developed.

Another approach would be for the Department to create teams composed of retail field support and telemarketing staff and to establish goals for each team that take into account the different types of retailers, their geographic locations, and any other factors that may affect goal achievement. Regardless of the approach taken, the development of performance goals may assist the Department in achieving its goal of increasing ticket sales. Therefore, *we recommend the Department of Revenue establish performance goals for its telemarketing staff and report to the Joint Legislative Audit Committee by December 1, 1999, on the goals that have been established.*

Telemarketing Staff Hiring Process

As noted, the Department was able to begin recruitment for the reclassified telemarketing positions sooner than it began recruitment for retailer field support staff positions because it already had position authority for telemarketing staff. As a result of the initial recruitment process, which was underway prior to the additional authority to hire staff at the reclassified level, 5.5 positions were filled in

November 1997, one through transfer and 4.5 by hiring new employees. In addition, a supervisor was hired in January 1998, bringing the total telemarketing staff to 6.5. Table 12, shows the time line for the Department's second recruitment effort to fill telemarketing staff positions.

Table 12

Telemarketing Staff Recruitment Time Line

<u>Activity</u>	<u>Date</u>
Funding Available	November 1, 1997
Department Approval for Recruitment	September 29, 1998
Current Opportunities Bulletin Announcement	September 7, 1998
Application Deadline	September 23, 1998
Certification of Qualified Candidates	September 30 and October 22, 1998
Candidates Hired	September 1998 to present

After several positions were filled, the telemarketing staff hiring process was delayed.

There was no further action taken to fill the remaining 5.5 positions from January through June 1998. Department officials indicate that they delayed the hiring process because:

- they waited for four individuals who were transferred in June 1998 from other positions within the Department;
- they did not believe the remaining applicants from the August 1997 certified list were qualified; and
- the reductions in the number of retailers selling lottery tickets lowered the demand for telemarketing staff services.

Once the individuals were transferred from other duties to telemarketing services, there was a total of 10.5 filled telemarketing staff positions. When staff left 2.5 positions in September 1998, the Department again began the recruitment process.

Although the Legislature provided the Department with the authority to hire 12.0 telemarketing staff at a higher level, 1.5 of those positions were never filled. The number of unfilled positions increased to 3.0 in March 1999. If the Legislature determines all 12.0 positions continue to be needed, the Department should make every effort to fill them in a timely manner. To ensure that the Legislature has all the relevant information needed to make a decision on future staffing, we recommend the Department of Revenue report to the Joint Legislative Audit Committee by December 1, 1999, on its plans for filling all vacant retailer field support and telemarketing staff positions.

Additional Staffing Issues

In the past, the Department had typically hired limited-term employe (LTE) staff in lieu of permanent staff. Hiring LTEs does not create a cohesive staff base because these staff are not permanent and are intended to remain employed in a position for a maximum of 1,044 hours. During our 1997 review, we noted that as lottery positions became vacant through voluntary departures or transfers, most positions remained vacant or were filled with LTEs.

The Department has reduced its use of limited-term employes.

Since then, the Department has been successful in reducing its use of LTEs. As shown in Table 13, the number of LTEs decreased from 15.9 in July 1996 to 4.6 in July 1999, or by 71.1 percent.

Table 13

Limited-Term Employes on Wisconsin Lottery Staff
(Calculated on a Full-Time Equivalent Basis)

<u>Type of Staff</u>	<u>July 1996</u>	<u>July 1997</u>	<u>July 1998</u>	<u>July 1999</u>
General Operations	10.9	12.3	5.9	1.0
Telemarketing	3.9	4.6	0.3	0.3
Other Marketing	<u>1.1</u>	<u>5.4</u>	<u>0.0</u>	<u>3.3</u>
Total	15.9	22.3	6.2	4.6

During the 1997-99 biennial budget process, the Legislature granted authority for the Department to use one lottery position in the Secretary's office. However, since January 1999, there have been two staff persons whose positions are allocated to the Lottery but who work within the Secretary's office. One of these staff persons, the Department's public information officer, estimated he spent only 10 percent of his time on lottery activities. To address the situation, officials have indicated that this staff person was assigned a new department position number for FY 1999-2000 and will no longer be funded by proceeds from the Wisconsin Lottery.

Finally, we note two unusual personnel transactions related to the Lottery's former acting administrator. In June 1999, the Department awarded this individual two discretionary compensation adjustments—one for \$5,800 paid July 1, 1999, and a second for \$5,700 that has been approved but that department staff indicate will be paid once the 1999-2001 biennial budget is enacted. Discretionary compensation adjustments are intended to enable state agencies to recognize significant and permanent changes in job duties or increased competencies, or to address pay equity or retention needs.

Department officials indicate that these lump-sum payments were awarded for two reasons. First, the payments were made in recognition of the acting administrator's expanded duties, which were assumed in April 1997 and had a broader scope and entailed greater complexity than his prior responsibilities. Second, officials indicate that payments were made based on equity principles, because the predecessor of the acting director had been paid more at the time of her resignation than the acting director was paid during his tenure in that role. However, the acting director announced his resignation in May 1999, and a permanent director was appointed on June 14, 1999. It is unusual that the first of these payments was not made until one month after the acting director announced his resignation, and the second was not made until after the start of the new fiscal year.

Concerns have been raised about the effect of Internet gambling and Indian gaming on lottery sales.

The proliferation of gambling activities available on the Internet and the recent growth in Indian gaming activities have raised concerns about the effects of such gambling on state lotteries. In particular, states that operate lotteries are concerned that these expanded gambling opportunities may decrease lottery revenues. Both federal and state laws place some restrictions on Indian gaming and on Internet gambling, and strategies to restrict Internet gambling are currently under discussion at the national level. However, without further action by the federal government, it appears unlikely that access to Internet gambling can be effectively restricted. Indian gaming is currently regulated through tribal-state compacts. Most individuals with whom we spoke believe recent negotiations of the gaming compacts are not likely to have a substantial effect on Wisconsin Lottery sales.

Internet Gambling

Both federal and state laws address Internet gambling.

Both the federal government and states have expressed concern that increased access to the Internet has provided individuals with easy access to uncontrolled and unregulated gambling activities. Current federal laws address Internet gambling to some extent, as do Wisconsin's laws. Because of the difficulty in regulating Internet gambling sites, which cross state lines, action to strengthen and better enforce existing laws is currently under review on the national level. Although we were unable to identify any studies on the effects of Internet gambling on state lottery revenues, some lottery proponents believe that the increase in the number of gambling sites on the Internet could eventually reduce lottery revenues further.

Current Law

A 1961 federal law commonly known as the Wire Communications Act prohibits gambling operators from receiving illegal bets over interstate and international communication wires. However, some argue that the federal law does not apply to those who use the Internet to place bets because "wire communication" potentially exempts satellite connections used for Internet transmissions.

Wisconsin law places more restrictions on Internet gambling than federal law does.

Wisconsin law is more restrictive than federal law. Section 945.03(7), Wis. Stats., establishes as a felony both the receiving and the transmission of a bet using a “wire communication facility.” Section 945.01(6), Wis. Stats., defines a wire communication facility as anything using wire, cable, microwave, or other types of connections to forward or deliver writings, signs, pictures, and sounds. In addition, s. 945.02, Wis. Stats., provides that anyone who makes a bet is guilty of a misdemeanor.

State officials believe that as soon as an on-line company advertises a gaming activity to a person located in Wisconsin, Wisconsin laws are violated and the company may be prosecuted under Wisconsin law. The Wisconsin Department of Justice has successfully prosecuted several entities, claiming that their Internet gaming companies were in violation of state law. Florida and other states have targeted the financial institutions that on-line gamblers use to send and receive gambling funds, as well as Internet service providers, in an attempt to close down on-line gambling sites.

Proposed Federal Changes to Gambling Laws

Federal legislation currently under consideration would further restrict Internet gambling.

There is ongoing congressional effort to identify and correct ambiguity and perceived loopholes in current federal law through legislation that would specifically outlaw Internet gambling; to clarify that all types of gambling—including sports betting and casino games—are illegal over the Internet; to broaden the class of potential violators to include gamblers as well as operators; and to specifically include satellite technology under the constraints of wire communication, making illegal any transmissions to place bets or wagers by, for example, cellular telephones. A current proposal, the Internet Gambling Prohibition Act of 1999, also allows for specific enforcement action, such as requiring Internet service providers to shut off service, and broad language that would include authority over future technology by making illegal any transmission that traditionally would have been conducted by wire communication.

A federal report indicates it is difficult for states to monitor and regulate Internet gambling.

In addition, the nine-member National Gambling Impact Study Commission, which was created by Congress in 1996 and consisted of proponents and opponents of gambling, released a report in June 1999 indicating that because Internet gambling crosses state lines, it is difficult for states to monitor and regulate such gambling. Therefore, the Commission’s report includes a recommendation that the federal government prohibit Internet gambling not already authorized within the United States. The report raises additional issues that are currently not addressed by the bill being discussed in Congress, including:

- considering a moratorium on the spread of all types of gambling;
- restricting legal gambling to those who are at least 21 years of age;
- regulating new technologies, such as satellites and other nontraditional forms of communication that can be used for Internet gambling; and
- prohibiting credit card companies from authorizing use of their cards for online wagering.

Indian Compacts

Indian gaming is controlled by state and tribal compacts.

The federal Indian Gaming Regulatory Act (IGRA) became law in 1988 and provides that “Indian tribes have the exclusive right to regulate gaming activity on Indian lands if the gaming activity is not specifically prohibited by Federal law and is conducted within a State which does not . . . prohibit such gaming activity.” In conformance with IGRA, Wisconsin has entered into Indian gaming compacts with 11 tribes and bands. Both IGRA and the compacts define the parameters within which gaming activities may be conducted. In both Wisconsin and around the country, there have been concerns that a broad interpretation of the federal law could increase the allowable types and amount of Indian gaming, resulting in lower sales for state-run lotteries.

IGRA defines three types of gaming activities, specifies which types of gaming are subject to specific jurisdictions and levels of regulation, and establishes the requirements for compacts between states and Indian tribes. Gaming is defined according to three classes:

- Class I consists of social games solely for prizes of minimal value or traditional forms of Indian gaming played as part of or in connection with tribal ceremonies or celebrations that, when played on Indian lands, are regulated solely by the tribes and bands.

- Class II consists of games commonly known as bingo and includes, if played at the same location, pull-tabs, punch boards, instant bingo, and other games similar to bingo. Class II gaming on Indian lands is also within the jurisdiction of Indian tribes but is subject to federal provisions under IGRA; Class II gaming can, therefore, include card games that are authorized by the laws of a state or that are not expressly prohibited by the laws of a state, but it does not include any banking card games, in which a player plays against the “house” rather than other players.
- Class III includes all forms of gaming not defined as Class I or II games, such as casino games, video games, and slot machines. Class III gaming may be conducted on Indian lands if certain conditions are met, including allowing only those games not prohibited by a State’s constitution and requiring a state and the tribe or band to enter into a state-tribal compact.

Wisconsin’s compacts allow Indian tribes and bands to operate bingo, raffles, slot machines, blackjack, and pull-tab ticket games.

While the current compacts, entered into for a five-year period beginning February 1999, increased the number of allowable casinos, it did not broaden the types of Class III gambling already permitted. Although a constitutional change would be required to expand the types of gambling permitted in Wisconsin, an increase in the number of casinos is possible under existing compacts. Some believe that the addition of casinos would reduce the amount of money spent on the Wisconsin Lottery, because more casinos would provide additional opportunities to gamble. However, others believe that any additional casinos that may be established are unlikely to have a substantial effect on lottery sales.

APPENDIX I

Description of On-Lines Games Currently Sold in Wisconsin

<u>Game</u>	<u>Description</u>
Powerball	This game provides a jackpot of at least \$10 million that continues to grow until a winning ticket matches five different numbers from 1 through 49; in addition, a sixth number, known as the powerball, is selected from a different set of numbers ranging from 1 through 42. The game is available in 19 other states and the District of Columbia. Drawings are held on Wednesdays and Saturdays.
Cash 4 Life	This game provides a top prize of \$1,000 a week for life, with a minimum payout of ten years. Players select 15 sets of four 2-digit numbers from 00 to 99. The purchaser or the computer chooses the top prize set of numbers, and the computer selects the remaining sets. When grouped together, different sets of numbers determine eligibility to win a number of different prizes. Cash 4 Life is available in eight other states and the District of Columbia. Drawings are held on Wednesdays and Saturdays.
Wisconsin's Very Own Megabucks	This game provides a jackpot of at least \$1 million that continues to grow until a winning ticket matches six numbers between 1 and 49. Prizes are awarded for matching three or more of the six numbers. Drawings are held on Wednesdays and Saturdays.
Supercash!	This game provides a top jackpot of \$250,000. Six numbers between 1 and 36 are selected, and prizes are awarded for matching four or more of the six numbers. Drawings are held daily.
Daily Pick 4	This game provides two levels of maximum jackpots, either \$1,200 or \$5,000. Four numbers between 0 and 9 are selected. Prizes depend on one of two types of play the purchaser may choose and on the amount wagered. A player may choose "straight play," which requires that all four numbers match the order in which the four numbers are drawn, and which has a maximum prize of \$5,000. Alternatively, a player may choose "box play," which allows different combinations of two or more of the numbers to appear in any order and has a maximum prize of \$1,200. Drawings are held daily.
Daily Pick 3	This game provides different levels of maximum jackpots. Three numbers between 0 and 9 are selected. Prizes depend on one of three types of play the purchaser may choose and on the amount wagered. First, a purchaser may choose "straight play," which requires that all three numbers match the order in which three numbers are drawn, and which has a maximum prize of \$500. Second, a player may choose "box play," which allows combinations of two or three numbers to appear in any order and has a maximum prize of \$160. Finally, players may also choose to play a combination of box and straight play, for which the maximum prize is \$330. Drawings are held daily.

APPENDIX II

National Lottery Sales

<u>Jurisdiction</u>	<u>Year Lottery Operations Began</u>	<u>FY 1997-98 Sales (in millions)</u>	<u>FY 1997-98 per Capita Sales</u>	<u>FY 1997-98 per Capita Sales Rank</u>
Arizona	1981	\$ 250.7	\$ 53.7	35
California	1985	2,294.4	70.2	32
Colorado	1983	374.3	94.3	25
Connecticut	1972	805.6	246.1	6
Delaware	1975	447.2	601.0	3
District of Columbia	1982	226.4	432.8	5
Florida	1988	2050.0	137.4	19
Georgia	1993	1,672.9	218.9	7
Idaho	1989	89.6	73.0	31
Illinois	1974	1,577.0	130.9	21
Indiana	1989	648.2	109.9	24
Iowa	1985	173.9	60.7	34
Kansas	1987	192.0	73.0	30
Kentucky	1989	585.0	148.6	17
Louisiana	1991	292.9	67.0	33
Maine	1974	148.9	119.7	23
Maryland	1973	1,072.6	208.9	10
Massachusetts	1972	3,199.3	521.8	4
Michigan	1972	1,637.6	166.8	14
Minnesota	1990	382.9	78.9	29
Missouri	1986	494.3	90.9	26
Montana	1987	29.8	33.8	38
Nebraska	1993	73.8	44.4	37
New Hampshire	1964	183.8	155.1	16
New Jersey	1970	1,630.3	200.9	11
New Mexico	1996	84.9	48.9	36
New York	1967	3,943.1	217.0	9
Ohio	1974	2,195.8	195.9	12
Oregon	1985	717.9	218.9	8
Pennsylvania	1972	1,668.4	139.0	18
Rhode Island	1974	634.1	634.0	2
South Dakota	1987	555.3	750.4	1
Texas	1992	3,090.0	156.4	15

<u>Jurisdiction</u>	<u>Year Lottery Operations Began</u>	<u>FY 1997-98 Sales (in millions)</u>	<u>FY 1997-98 per Capita Sales</u>	<u>FY 1997-98 per Capita Sales Rank</u>
Vermont	1997	\$ 74.1	\$125.4	22
Virginia	1988	914.2	134.6	20
W. Virginia	1986	305.1	168.6	13
Washington	1982	454.7	79.9	28
Wisconsin	1988	418.5	80.1	27
AVERAGE		\$936.6	\$186.5	

Source: *LaFleur's 1999 World Lottery Almanac*

APPENDIX III

**New Instant Scratch Games Introduced from
April 1998 through March 1999**

<u>Game</u>	<u>Month Introduced</u>	<u>Weekly Average Sales</u>	<u>Total Sales</u>
Vegas Nights	April 1998	\$431,020	\$21,982,000
Beat the Heat	June 1998	325,782	7,167,200
Wild Scratch Bingo	June 1998	167,883	6,883,200
Pepsi and Cash	August 1998	196,684	6,097,200
Monte Carlo	January 1999	568,300	5,683,600
Triple Moola	September 1998	212,100	5,090,400
Holiday Harley	November 1998	243,350	4,867,000
Lucky Joker	July 1998	222,905	4,325,200
Double Lucky 7's	May 1998	280,080	4,201,200
Heavenly Hogs	January 1999	599,314	4,195,200
Hot Slots	April 1998	90,765	4,175,200
Straight Poker	July 1998	320,431	4,165,600
Money Game Mania	November 1998	296,914	4,156,800
Fat Cat Cash	May 1998	94,364	4,152,000
Cash Blast	July 1998	205,580	4,111,600
On a Roll	October 1998	252,850	4,045,600
Summer Sizzler	May 1998	89,164	4,012,400
Pocket Change	July 1998	200,380	4,007,600
3 Card Cash	October 1998	242,725	3,993,600
Jack O'Lantern Cash	September 1998	140,314	3,928,800
Lucky Streak	May 1998	178,564	3,928,400
The Birthday Game	September 1998	206,168	3,917,200
Double Dip	May 1998	256,000	3,840,000
Fast Money	May 1998	87,237	3,751,200
Give Me Five	December 1998	370,360	3,703,600
Drive for Show	June 1998	90,078	3,693,200
Red Hot Cash	December 1998	461,300	3,690,400
Hot Hand	April 1998	84,924	3,566,800
Lucky Clover Doubler	February 1999	580,800	3,484,800
Bonus Blackjack	February 1999	679,600	3,398,000
Moola Mania	February 1999	410,950	3,287,600
Tic Tac Bucks	October 1998	318,840	3,188,400
Sweetheart Cash	January 1999	527,467	3,164,800
Lucky Shake	March 1999	832,600	2,497,800
Money in the Bank	March 1999	110,200	110,200



State of Wisconsin • DEPARTMENT OF REVENUE

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Tommy G. Thompson
Governor

Cate Zeuske
Secretary of Revenue

September 14, 1999

Janice Mueller
State Auditor
Legislative Audit Bureau
131 West Wilson Street
Madison, WI 53703

Dear Auditor Mueller:

On behalf of the Wisconsin Lottery, I wish to thank the Legislative Audit Bureau for its thoroughness and sense of fairness in compiling this audit. The Department and its Lottery Division regard the audit as a constructive management tool; one that will improve services that the Lottery offers to its customers and the tax-paying public.

As affirmed by the Wisconsin electorate, the lottery is an important source of local property tax relief. Those funds are raised voluntarily in competition for the discretionary income of customers who value the lottery as a source of entertainment.

The Department's goal is to manage the Wisconsin Lottery within the bounds of constitutional and statutory guidelines as an efficient business, with the integrity and creative imagination essential to its success.

Again, I appreciate your efforts.

Sincerely,

Cate Zeuske
Secretary of Revenue