

An Audit

Wisconsin Lottery

Department of Revenue

2009-2010 Joint Legislative Audit Committee Members

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Janice Mueller
State Auditor

May 26, 2010

Senator Kathleen Vinehout and
Representative Peter Barca, Co-chairpersons
Joint Legislative Audit Committee
State Capitol
Madison, Wisconsin 53702

Dear Senator Vinehout and Representative Barca:

As required by s. 13.94(1)(em), Wis. Stats., we have completed our financial audit of the Wisconsin Lottery, which is administered by the Department of Revenue. We have issued an unqualified opinion on the Wisconsin Lottery's financial statements for fiscal year (FY) 2008-09 and FY 2007-08, and we found that the Wisconsin Lottery was in compliance with statutory spending limitations related to prizes, informational advertising, retailer compensation, and administrative expenses.

Ticket sales totaled \$473.4 million in FY 2008-09 but decreased \$21.3 million, or 4.3 percent, from the prior year. Wisconsin Lottery staff attribute this decline to the economic downturn and the timing of large Powerball jackpots, which have a significant effect on sales.

Total operating expenses were \$344.5 million in FY 2008-09, which is 2.5 percent less than in FY 2007-08. This decrease in operating expenses is less than the decrease in ticket sales because some expenses do not fluctuate with sales. Since FY 2007-08, informational advertising expenses have been permitted to total no more than \$7.5 million annually, which is an increase of \$2.9 million from prior years.

Lottery proceeds used for property tax relief totaled \$132.4 million in FY 2008-09. In October 2009, the Department of Administration and the Legislature's Joint Committee on Finance authorized the use of \$130.2 million in Wisconsin Lottery proceeds for property tax relief in FY 2009-10, including \$115.5 million for the Lottery and Gaming Tax Credit and \$14.7 million for the Farmland Tax Relief Credit.

We appreciate the courtesy and cooperation extended to us by Wisconsin Lottery staff in the Department of Revenue.

Respectfully submitted,

Janice Mueller
State Auditor

JM/SH/ss

Introduction ■

***The Wisconsin Lottery
sells instant and online
game tickets.***

The Wisconsin Lottery began operations in September 1988, after Wisconsin voters adopted a constitutional amendment in 1987 that allowed the Legislature to create a state lottery with net proceeds to be distributed for property tax relief. Since August 1995, the Department of Revenue has managed the Wisconsin Lottery, which is permitted to sell tickets for instant and online games. Instant games are tickets that reveal a prize when consumers remove scratch-off or pull-tab coverings, while online games generally involve players picking numbers from an automated system, with winning numbers selected in drawings held at intervals ranging from daily to twice a week.

We completed a financial audit of the Wisconsin Lottery to fulfill our audit responsibilities under s. 13.94(1)(em), Wis. Stats., and have issued an unqualified opinion on its financial statements for the years ended June 30, 2009 and 2008. As part of our financial audit, we reviewed the Wisconsin Lottery's ticket sales, operating expenses, and property tax relief distributions through fiscal year (FY) 2008-09. We also assessed compliance with statutory requirements related to prizes and other costs.

Wisconsin Lottery Ticket Sales

***Wisconsin Lottery sales
declined 4.3 percent in
FY 2008-09.***

The Wisconsin Lottery derives more than 99 percent of its operating revenues from instant and online ticket sales. During the past five fiscal years, instant ticket sales increased 2.6 percent, online game

sales increased 8.0 percent, and the net increase in total ticket sales was 4.8 percent. However, as shown in Table 1, total sales declined 4.3 percent from FY 2007-08 to FY 2008-09. During that one-year period, instant ticket sales declined 3.7 percent and online game sales declined 5.2 percent. The national economic downturn affected lottery sales. In addition, online sales fluctuate with the value of jackpots. For example, during FY 2008-09, Powerball sales declined \$8.3 million in response to lower jackpots.

Table 1

Wisconsin Lottery Ticket Sales
(in millions)

Fiscal Year	Instant Games	Online Games	Total Sales	Percentage Change from Prior Year
2004-05	\$269.9	\$182.0	\$451.9	–
2005-06	285.8	223.3	509.1	12.7%
2006-07	284.1	208.7	492.8	(3.2)
2007-08	287.4	207.3	494.7	0.4
2008-09	276.8	196.6	473.4	(4.3)

Wisconsin Lottery Operating Expenses

Operating expenses increased 7.1 percent from FY 2004-05 to FY 2008-09.

As shown in Table 2, the Wisconsin Lottery's operating expenses include prizes paid to winning ticket holders; retailer compensation, including commissions and incentives; game development and production costs, including instant game ticket printing and delivery costs and payments to a vendor that supports a gaming network; product information costs; and other costs, such as staff salaries and fringe benefits. Operating expenses increased from \$321.8 million in FY 2004-05 to \$344.5 million in FY 2008-09, or 7.1 percent. However, they declined 2.5 percent from FY 2007-08 to FY 2008-09.

Table 2

Wisconsin Lottery Operating Expenses
(in millions)

Expense Type	FY 2004-05	FY 2005-06	FY 2006-07	FY 2007-08	FY 2008-09
Prizes	\$262.1	\$293.9	\$292.1	\$286.4	\$279.9
Retailer Compensation	31.4	35.2	34.1	34.3	32.4
Game Development and Production ¹	14.4	16.4	16.5	16.7	16.2
Product Information	4.6	4.6	4.5	7.4	7.4
Other ²	9.3	8.1	8.0	8.7	8.6
Total	\$321.8	\$358.2	\$355.2	\$353.5	\$344.5

¹ Includes instant game ticket printing and delivery expenses, vendor payments for a gaming network, and donated prizes.

² Includes staff salaries, fringe benefits, supplies and services, and depreciation expenses.

Game development and production expenses increased by \$1.8 million, or 12.5 percent, over the past five fiscal years. The increase is primarily the result of payments to GTECH Corporation for maintenance of a gaming network. The Wisconsin Lottery paid GTECH \$12.4 million in FY 2007-08 and \$12.0 million in FY 2008-09, or 3.2 percent less, to maintain the instant and online gaming network and provide telecommunications services to retailers.

The Wisconsin Constitution prohibits public funds or revenues derived from lottery operations from being expended for promotional advertising and directs that any promotional advertising should provide information about the chances of winning and prize structures. The annual product information budget is established through the biennial budget process, and it was increased from \$4.6 million in FY 2006-07 to \$7.5 million beginning in FY 2007-08 as a result of legislative action to increase the Wisconsin Lottery's total budget under 2007 Wisconsin Act 20. Wisconsin Lottery management had estimated that this increase would generate an additional \$15.0 million in annual ticket sales, which did not occur. However, it may be too early to assess its effectiveness given the recent economic decline.

We plan to review the Wisconsin Lottery's product information expenditures as part of the biennial program evaluation that is expected to be released in 2011.

Property Tax Relief Distributions

Lottery proceeds have provided nearly \$3.1 billion in property tax relief since 1988.

The Wisconsin Constitution requires that net proceeds from the Wisconsin Lottery be used only for property tax relief, which is provided to owners of primary residences in Wisconsin through the Lottery and Gaming Tax Credit and to certain farmland owners in Wisconsin through the Farmland Tax Relief Credit. The Wisconsin Lottery has provided nearly \$3.1 billion in property tax relief from its inception in 1988 through April 2010. As shown in Table 3, \$132.4 million in property tax relief was funded by net proceeds from the Wisconsin Lottery in FY 2008-09.

Table 3

Wisconsin Property Tax Relief¹ (in millions)

Fiscal Year	Lottery and Gaming Tax Credit	Farmland Tax Relief Credit	Total Distributed
2005-06	\$119.8	\$13.5	\$133.3
2006-07	144.6	15.4	160.0
2007-08	129.6	16.9	146.5
2008-09	117.8	14.6	132.4
2009-10 ²	113.3	13.1	126.4
Total	\$625.1	\$73.5	\$698.6

¹ Property tax relief is funded by net proceeds from the Wisconsin Lottery and by transfers from other gaming-related appropriations, including racing and charitable bingo operations.

² Unaudited information through April 30, 2010. The Lottery and Gaming Tax Credit is distributed to municipalities in March, while the Farmland Tax Relief Credit is disbursed as it is claimed on state tax returns.

In October 2009, pursuant to s. 79.10(11)(b), Wis. Stats., the Department of Administration and the Joint Committee on Finance authorized the use of \$130.2 million in Wisconsin Lottery proceeds for property tax relief in FY 2009-10, including \$115.5 million for the Lottery and Gaming Tax Credit and \$14.7 million for the Farmland Tax Relief Credit. As was shown in Table 3, a total of \$126.4 million has been expended through April 2010.

Statutory Requirements

State statutes and legislative action impose limitations on certain types of lottery expenses. We found that the Wisconsin Lottery is in compliance with each of the limitations.

The Wisconsin Lottery returned 59.1 percent of sales to players as prize payments in FY 2008-09.

Section 25.75(3)(a), Wis. Stats., requires that at least 50.0 percent of Wisconsin Lottery sales be returned to players as prize payments. As shown in Table 4, the Wisconsin Lottery's prize expenses have complied with the statutory requirement, although they have fluctuated because of changes in the types of games offered and played. Online game prize payouts, which are dependent on jackpot amounts and the frequency of winners claiming prizes, are expected to fluctuate more than payouts for instant games. The higher FY 2008-09 prize payout was attributed, in part, to an increase in the number of SuperCash! winners.

Table 4

Prize Expenses as a Percentage of Ticket Sales
(in millions)

Fiscal Year	Prize Expenses	Ticket Sales	Percentage of Ticket Sales
2004-05	\$262.1	\$451.9	58.0%
2005-06	293.9	509.1	57.7
2006-07	292.1	492.8	59.3
2007-08	286.4	494.7	57.9
2008-09	279.9	473.4	59.1

Administrative expenses have remained within a statutory limit of 10.0 percent of gross operating revenues.

Section 25.75(3)(b), Wis. Stats., limits certain administrative expenses to no more than 10.0 percent of gross operating revenues. Statutory administrative expenses include all costs except prize payments and retailer compensation. As shown in Table 5, the Wisconsin Lottery's administrative expenses have remained within the statutory limit. Administrative expenses increased to 6.6 percent of gross operating revenues in FY 2007-08 and 6.8 percent of gross operating revenues in FY 2008-09 as the result of increased product information expenses authorized by 2007 Wisconsin Act 20, the 2007-09 Biennial Budget Act.

Table 5

Statutorily Defined Administrative Expenses as a Percentage of Gross Operating Revenues
(in millions)

Fiscal Year	Total Statutorily Defined Administrative Expenses	Gross Operating Revenues	Percentage of Total Gross Operating Revenues
2004-05	\$28.3	\$452.0	6.3%
2005-06	29.1	509.2	5.7
2006-07	28.9	493.4	5.9
2007-08	32.8	495.2	6.6
2008-09	32.2	473.7	6.8

The Wisconsin Lottery provided 0.8 percent of ticket sales for the retailer performance program in FY 2008-09.

State statutes establish maximum compensation rates for basic commissions and performance program payments to retailers who sell lottery tickets. Basic commission rates are currently 5.5 percent of the retail price for online tickets and 6.25 percent for instant tickets. According to s. 565.02(4)(g), Wis. Stats., performance program payments to eligible retailers may not exceed 1.0 percent of total ticket sales. As shown in Table 6, the Wisconsin Lottery's retailer performance program payments have remained within the statutory limit for the past five fiscal years and were 0.8 percent of ticket sales during FY 2008-09.

Table 6

Retailer Performance Program Payments as a Percentage of Ticket Sales
(in millions)

Fiscal Year	Retailer Performance Program Payments	Ticket Sales	Percentage of Ticket Sales
2004-05	\$4.0	\$451.9	0.9%
2005-06	4.6	509.1	0.9
2006-07	4.5	492.8	0.9
2007-08	4.5	494.7	0.9
2008-09	4.0	473.4	0.8

Audit Opinion ■

Independent Auditor's Report on the Financial Statements of the Wisconsin Lottery

We have audited the accompanying financial statements of the Wisconsin Lottery as of and for the years ended June 30, 2009 and 2008, as listed in the table of contents. These financial statements are the responsibility of the Wisconsin Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 2, the financial statements referred to in the first paragraph present only the Wisconsin Lottery and do not purport to, and do not, present fairly the financial position of the State of Wisconsin and the changes in its financial position and its cash flows, where applicable, in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Wisconsin Lottery as of

June 30, 2009 and 2008, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the financial statements of the Wisconsin Lottery. The supplementary information, including Management's Discussion and Analysis and Schedules 1, 2, and 3, is presented for purposes of additional analysis and is not a required part of the financial statements. For Management's Discussion and Analysis on pages 11 through 18, we have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it. The schedules on pages 46 through 48 have been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, are fairly stated in all material respects in relation to the financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued a report dated May 18, 2010, on our consideration of the Wisconsin Lottery's internal control over financial reporting; our tests of its compliance with certain provisions of laws, regulations, and contracts; and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

May 18, 2010

LEGISLATIVE AUDIT BUREAU
by 
Sherry Haakenson
Audit Director

Management's Discussion and Analysis ■

Prepared by Wisconsin Lottery Management

This section of the Wisconsin Lottery's financial statements presents the Wisconsin Lottery management's discussion and analysis of the financial performance of the Wisconsin Lottery for the fiscal years ending June 30, 2009, and June 30, 2008, with comparative information from the fiscal year ending June 30, 2007. This discussion should be read in conjunction with the accompanying financial statements and notes. The financial statements, notes, and this discussion are the responsibility of Wisconsin Lottery management.

Financial Highlights

The conventional wisdom is that lotteries are recession-proof: sales will increase during an economic downturn as people look to change their fortunes overnight. However, the current economic recession has made a myth of the conventional wisdom, as Wisconsin Lottery sales have been affected, although not as much as other sectors of the economy. While not recession-proof, the Wisconsin Lottery appears to be recession-resistant; its sales outlook and its ability to generate funds for property tax relief programs remain strong.

- Operating revenues generated from ticket sales for the Wisconsin Lottery were \$473.4 million in FY 2008-09 and \$494.7 million in FY 2007-08. The sales decline was due primarily to a drop in consumer spending associated with the recession and lower Powerball sales due to low jackpots.

- Operating expenses for FY 2008-09 decreased \$9.1 million, or 2.6 percent, primarily as a result of lower prize expense associated with lower sales. For FY 2007-08, operating expenses decreased \$1.6 million, or 0.5 percent.
- Net income before transfers was \$129.4 million for FY 2008-09, down from \$147.6 million in FY 2007-08, mainly due to lower ticket sales.
- Administrative expenses, as defined in s. 25.73(3)(b), Wis. Stats., remained well below the statutory maximum of 10.0 percent of gross operating revenues. Total statutory administrative expenses (which include not only the administrative expenses on the financial statements but also all program expenses except prizes and retailer compensation) were \$32.2 million in FY 2008-09, down \$0.6 million from \$32.8 million in FY 2007-08, while the percentage of operating revenues increased slightly to 6.8 percent in FY 2008-09 from 6.6 percent in FY 2007-08.

Overview of the Financial Statements

The Wisconsin Lottery is accounted for as an enterprise activity, a type of proprietary fund, reporting on all of the activity's assets and liabilities using the accrual basis of accounting, much like a private business entity. The Wisconsin Constitution requires that net proceeds from the operations of the Wisconsin Lottery be used to provide property tax relief. In addition, balances from other gaming-related appropriations that are not administered by the Department of Revenue (Lottery), including racing and charitable bingo operations, are transferred to the Lottery Fund for distribution in the form of property tax relief. The net assets of the Wisconsin Lottery consist of capital assets (equipment), restricted deposits for Powerball reserves, restricted income related to unrealized fair market value adjustments to investments, and restricted net assets for property tax relief.

This report consists of a series of financial statements, along with explanatory notes to the financial statements and supplemental schedules. To assess the Wisconsin Lottery's financial position and financial health, the reader of these statements should pay particular attention to changes in the components of assets and liabilities as set forth in the Statement of Net Assets, and to changes in income and expenses as set forth in the Statement of Revenues, Expenses, and Changes in Fund Net Assets and the Statement of Cash Flows.

Net Assets

The Statement of Net Assets provides detailed information on the nature and amount of the Wisconsin Lottery's assets, liabilities, and net assets at the close of FY 2008-09 and FY 2007-08. Table A presents these data in a condensed form for the

past three fiscal years. The relationship of assets to liabilities and resulting net assets is one indicator of the financial condition of the Wisconsin Lottery.

Table A
Net Assets
(in millions)

	June 30, 2009	June 30, 2008	Change	June 30, 2007 ¹	Change
Investments	\$ 72.0	\$ 85.3	\$(13.3)	\$ 93.4	\$(8.1)
Capital Assets (Net of Accumulated Depreciation)	0.1	0.1	0.0	0.1	0.0
Other Assets	55.1	55.5	(0.4)	51.2	4.3
Total Assets	127.2	140.9	(13.7)	144.7	(3.8)
Current Liabilities	45.7	45.8	(0.1)	38.8	7.0
Noncurrent Liabilities	51.8	61.5	(9.7)	72.6	(11.1)
Total Liabilities	97.5	107.3	(9.8)	111.4	(4.1)
Net Assets:					
Invested in Capital Assets	0.1	0.1	0.0	0.1	0.0
Restricted for MUSL Powerball Reserves	4.0	3.9	0.1	3.9	0.0
Restricted for Investment Fair Market Value Adjustment	8.5	9.4	(0.9)	6.2	3.2
Restricted for Property Tax Relief	17.1	20.2	(3.1)	23.1	(2.9)
Total Net Assets	<u>\$ 29.7</u>	<u>\$ 33.6</u>	<u>\$(3.9)</u>	<u>\$ 33.3</u>	<u>\$ 0.3</u>

¹ FY 2006-07 "Other Assets" was restated from \$50.9 million to \$51.2 million and "Net Assets Restricted for Property Tax Relief" was restated from \$33.0 million to \$33.3 million (see Note 21).

Assets

The Wisconsin Lottery's assets consist primarily of cash and cash equivalents, investments for prize annuities, accounts receivable, grand prize deposits, and instant ticket inventory. As shown in Table A, total assets were \$127.2 million at the end of FY 2008-09, compared to \$140.9 million at the end of FY 2007-08 and \$144.7 million at the end of FY 2006-07. The decline in assets is due primarily to the trend among winners to elect to receive their winnings in cash, rather than in the form of an annuity. No winners chose annuities during FY 2008-09 and FY 2007-08, so there were no additions to investments to prize annuities, and there continued to be decreases to that account as investments matured and were paid out to existing annuitants.

Liabilities

Current liabilities consist primarily of accrued prizes payable, annuity prizes payable, and accounts payable due to suppliers. Noncurrent liabilities consist primarily of annuity prizes payable more than a year beyond the date of the Statement of Net Assets. As noted in the "Assets" discussion, no winners during FY 2008-09 and FY 2007-08 chose to receive their winnings in the form of an annuity. Therefore, total annuity prizes payable decreased in both years as existing annuitants continued to receive their annual payments, and these decreases were the main cause of the decline in total liabilities. At the end of FY 2008-09, the Wisconsin Lottery had total liabilities of \$97.5 million, compared with total liabilities of \$107.3 million at the end of FY 2007-08 and \$111.4 million at the end of FY 2006-07.

Net Assets

The Wisconsin Lottery's net assets are generally available for property tax relief unless restricted for other uses. There are currently three restricted uses of the Wisconsin Lottery's net assets. Amounts invested in capital assets cannot be used to provide property tax relief, just as Powerball reserve deposits held by the Multi-State Lottery Association (MUSL) are not currently available for property tax relief. Unrealized gains or losses related to the change in the fair market value of investments are reported as a restricted net asset, since investments have been purchased for the payment of annuity prizes payable and are generally held to maturity. Therefore, the change in the fair market value of these investments is restricted and is not available for property tax relief. All remaining net assets are available for property tax relief.

Changes in Net Assets

The Wisconsin Lottery's total net assets were \$29.7 million as of the end of FY 2008-09, a \$3.9 million decline from the prior year. During FY 2007-08, total net assets increased \$0.3 million, to \$33.6 million. They were \$33.3 million in FY 2006-07.

The Statement of Revenues, Expenses, and Changes in Fund Net Assets provides detailed information on the nature and financial impact of the Wisconsin Lottery's operations for FY 2008-09 and FY 2007-08. Table B presents data for the past three fiscal years in a condensed form.

Table B

Changes in Net Assets
(in millions)

	FY 2008-09	FY 2007-08	Change	FY 2006-07	Change
Revenues					
Operating Revenues:					
Ticket sales	\$473.4	\$494.7	\$(21.3)	\$492.8	\$ 1.9
Retailer fees and miscellaneous revenue	0.3	0.5	(0.2)	0.6	(0.1)
Nonoperating Revenues:					
Investment income (loss)	0.1	5.9	(5.8)	3.6	2.3
Miscellaneous revenue	0.1	0.1	0.0	0.1	0.0
Total Revenues	473.9	501.2	(27.3)	497.1	4.1
Expenses					
Program Expenses:					
Prize expenses	279.9	286.4	(6.5)	292.1	(5.7)
Retailer commissions and incentives	32.4	34.3	(1.9)	34.1	0.2
Instant and online vendor services	12.0	12.4	(0.4)	12.4	0.0
Other game-related expenses	11.6	11.7	(0.1)	8.6	3.1
Office Administration Expenses	8.6	8.8	(0.2)	8.0	0.8
Total Expenses	344.5	353.6	(9.1)	355.2	(1.6)
Net Income Before Transfers	129.4	147.6	(18.2)	141.9	5.7
Operating Transfers					
Transfer for Property Tax Relief	(132.4)	(146.5)	14.1	(160.0)	13.5
Transfer In from General Fund	0.2	0.3	(0.1)	0.3	0.0
Transfer for Compulsive Gambling Programs	(0.4)	(0.4)	0.0	(0.3)	(0.1)
Transfer for Law Enforcement	(0.3)	(0.3)	0.0	(0.3)	0.0
Transfer for Lottery Credit Administration	(0.3)	(0.3)	0.0	(0.3)	0.0
Transfer Out to General Fund	(0.1)	(0.1)	0.0	(0.1)	0.0
Change in Net Assets	\$ (3.9)	\$ 0.3	\$ (4.2)	\$(18.8)	\$19.1

Operating Revenues

Operating revenues are generated almost entirely from ticket sales. Ticket sales for the Wisconsin Lottery were \$473.4 million in FY 2008-09 and \$494.7 million in FY 2007-08. As previously stated, the sales decline in FY 2008-09 was primarily due to a drop in consumer spending associated with the recession and lower Powerball sales due to low jackpots.

Table C compares ticket sales for each game category for FY 2008-09, FY 2007-08, and FY 2006-07.

Table C
Wisconsin Lottery Ticket Sales
(in millions)

	FY 2008-09	FY 2007-08	Change	FY 2006-07	Change
Instant					
Scratch-off	\$271.9	\$284.3	\$ (12.4)	\$280.0	\$4.3
Pull-tab	4.9	3.1	1.8	4.1	(1.0)
Online					
SuperCash!	27.4	27.9	(0.5)	28.1	(0.2)
Powerball	85.4	93.7	(8.3)	88.1	5.6
Wisconsin's Very Own Megabucks	20.7	19.0	1.7	28.4	(9.4)
Daily Pick 3	26.3	25.8	0.5	25.9	(0.1)
Daily Pick 4	12.0	11.9	0.1	11.7	0.2
Badger 5	24.8	25.3	(0.5)	23.1	2.2
Raffle Games ¹	0.0	3.7	(3.7)	3.4	0.3
Total	<u>\$473.4</u>	<u>\$494.7</u>	<u>\$(21.3)</u>	<u>\$492.8</u>	<u>\$1.9</u>

¹ Raffle games were not offered during FY 2008-09.

Instant scratch-off ticket sales decreased \$12.4 million during FY 2008-09, after increasing \$4.3 million during FY 2007-08. Sales of \$1 tickets as a percentage of total sales continued to decline, while sales of higher-priced instant games increased. The Wisconsin Lottery continues to strategically focus on higher-priced instant games through marketing and higher prize payouts on those games. Pull-tab sales increased \$1.8 million in FY 2008-09, following a \$1.0 million decrease in FY 2007-08.

Online game sales decreased by \$10.7 million during FY 2008-09, primarily due to weak Powerball sales attributable to low jackpots. They were down \$1.4 million during FY 2007-08, primarily due to low Megabucks jackpots.

Expenses

Expenses consist of amounts paid in prizes, retailer commissions and incentives, fees paid to the Lottery's gaming system vendor (instant and online vendor services), other game-related expenses, and administrative expenses. In FY 2008-09, total

expenses were \$344.5 million, down \$9.1 million from FY 2007-08 expenses of \$353.6 million, which were down only slightly from FY 2006-07 expenses of \$355.2 million.

Prizes are the Lottery's largest expense. Table D compares ticket prize awards for each lottery game category for FY 2008-09, FY 2007-08, and FY 2006-07.

Table D
Wisconsin Lottery Ticket Prize Awards
 (in millions)

	FY 2008-09	FY 2007-08	Change	FY 2006-07	Change
Instant					
Scratch-off	\$174.5	\$183.8	\$(9.3)	\$180.4	\$3.4
Pull-tab	3.0	2.0	1.0	2.6	(0.6)
Super 2 nd Chance ¹	0.4	0.3	0.1	0.3	0.0
Online					
SuperCash!	18.5	12.0	6.5	19.0	(7.0)
Powerball	41.1	44.8	(3.7)	42.1	2.7
Wisconsin's Very Own Megabucks	10.9	9.9	1.0	14.9	(5.0)
Daily Pick 3	13.6	13.0	0.6	13.6	(0.6)
Daily Pick 4	5.4	5.6	(0.2)	5.2	0.4
Badger 5	12.1	12.4	(0.3)	11.2	1.2
Raffle Games	0.0	2.3	(2.3)	2.5	(0.2)
Super 2 nd Chance ¹	0.4	0.3	0.1	0.3	0.0
Total	<u>\$279.9</u>	<u>\$286.4</u>	<u>\$(6.5)</u>	<u>\$292.1</u>	<u>\$(5.7)</u>

¹ Super 2nd Chance prizes are awarded through drawings to players who send in non-winning scratch-off and online tickets. The prizes are funded from the original purchase of the scratch-off and online tickets.

Generally, prizes awarded are a function of ticket sales: higher ticket sales will result in greater prize expense, while lower sales will result in lower prize expense. For example, when overall sales declined \$21.3 million in FY 2008-09, overall prize awards declined \$6.5 million. Schedule 3 after the notes to the financial statements shows a multi-year summary of ticket sales and their related prize expenses.

Expenses for retailer commissions are also a function of sales. In FY 2008-09, retailers were paid \$32.4 million in commissions and incentives, down from \$34.3 million in FY 2007-08. In FY 2006-07, retailer commissions and incentives were \$34.1 million.

The Wisconsin Lottery contracted with GTECH Corporation for an integrated gaming computer system and services (instant and online vendor services). In FY 2008-09, payments to GTECH were \$12.0 million. In FY 2007-08 and FY 2006-07, these payments were \$12.4 million. The Lottery pays GTECH 2.54 percent of total net ticket sales. Consequently, these payments also fluctuate in relation to sales.

Net Income and Transfer for Property Tax Relief

Net income before transfers was \$129.4 million in FY 2008-09, down from \$147.6 million in FY 2007-08, mainly due to the decline in consumer spending associated with the recession and low Powerball jackpots. Net income before transfers was \$141.9 million for FY 2006-07.

As can be seen in Table B, the amount transferred out for property tax relief differs from net income. This is because the transfers occur before the end of the fiscal year and are based on an estimate of the total funds that will be available for distribution. The operating transfer out for property tax relief decreased by \$14.1 million, or 9.6 percent, during FY 2008-09, while it decreased by \$13.5 million, or 8.4 percent, during FY 2007-08.

Contacting the Wisconsin Lottery's Financial Management

The financial statements are designed to provide the Legislature and the executive branch of government, the public, and other interested parties with an overview of the financial results of the Wisconsin Lottery's activities, and to show the Wisconsin Lottery's accountability for the money it receives.

If you have questions about the financial statements or need additional financial information, contact:

Wisconsin Department of Revenue
Attention: Director, Bureau of Financial Management Services
Post Office Box 8931
Mailstop 6-261
Madison, Wisconsin 53708-8931
Telephone (608) 266-8469

If you have questions concerning general program information relating to the Wisconsin Lottery, contact:

Wisconsin Department of Revenue
Attention: Director of the Wisconsin Lottery
Post Office Box 8941
Madison, Wisconsin 53708-8941
Telephone (608) 261-8800

Financial Statements ■

Statement of Net Assets

June 30, 2009 and 2008

	<u>June 30, 2009</u>	<u>June 30, 2008</u>
ASSETS		
Current Assets:		
Cash and cash equivalents (Note 3)	\$ 28,033,035	\$ 26,156,561
Investments for prize annuities (Note 3)	13,265,489	16,954,759
Accounts receivable (Note 4)	19,272,789	21,931,525
Due from other state programs (Note 4)	226,624	408,891
Ticket inventory	1,678,613	1,380,792
Grand prize deposit (Note 9)	1,377,338	1,343,763
Prepaid expenses (Note 20)	329,594	284,844
Interest receivable	6,863	41,458
Total Current Assets	<u>64,190,345</u>	<u>68,502,593</u>
Noncurrent Assets:		
Investments for prize annuities (Note 3)	58,766,905	68,305,538
Grand prize deposit (Note 9)	4,045,087	3,938,900
Prepaid expense (Note 20)	50,320	73,000
Capital assets: (Note 10)		
Equipment	774,680	766,678
Leasehold improvements	159,724	159,724
Accumulated depreciation	(788,124)	(827,268)
Total Noncurrent Assets	<u>63,008,592</u>	<u>72,416,572</u>
TOTAL ASSETS	<u>127,198,937</u>	<u>140,919,165</u>
LIABILITIES		
Current Liabilities:		
Annuity prizes payable (Note 5)	14,251,996	16,573,916
Prizes payable	24,916,067	22,702,287
Accounts payable (Note 4)	3,634,889	3,150,924
Due to other state programs (Note 4)	638,557	847,477
Lottery association payable	999,551	1,196,547
Unearned revenue	904,007	848,007
Due to other governments (Note 4)	52,621	75,674
Accrued payroll	120,468	264,640
Compensated absences (Note 17)	152,866	150,833
Total Current Liabilities	<u>45,671,022</u>	<u>45,810,305</u>
Noncurrent Liabilities:		
Annuity prizes payable (Note 5)	51,059,062	60,985,457
Compensated absences (Note 17)	441,451	324,636
Other postemployment benefits (Note 16)	297,448	143,310
Total Noncurrent Liabilities	<u>51,797,961</u>	<u>61,453,403</u>
TOTAL LIABILITIES	<u>97,468,983</u>	<u>107,263,708</u>
NET ASSETS		
Net Assets:		
Invested in capital assets (Note 10)	146,280	99,134
Restricted for MUSL Powerball reserves (Note 14)	4,045,087	3,938,900
Restricted for investment fair market value adjustment (Note 14)	8,520,083	9,356,371
Restricted for property tax relief (Note 14)	17,018,504	20,261,052
TOTAL NET ASSETS	<u>\$ 29,729,954</u>	<u>\$ 33,655,457</u>

The accompanying notes are an integral part of this statement.

Statement of Revenues, Expenses, and Changes in Fund Net Assets for the Years Ended June 30, 2009 and 2008

	Year Ended June 30, 2009	Year Ended June 30, 2008
OPERATING REVENUES		
Instant Ticket Sales (Net of allowances of \$596,687 and \$497,747, respectively) (Note 7)	\$ 276,797,708	\$ 287,429,285
Online Ticket Sales (Net of ticket discounts of \$256,232 and \$1,276,368, respectively) (Note 7)	196,616,546	207,297,783
Retailer Fees	65,045	42,885
Miscellaneous Revenue	194,172	415,021
Total Operating Revenues	473,673,471	495,184,974
OPERATING EXPENSES		
Program Expenses:		
Instant prize expense (Note 8)	177,966,273	186,102,698
Online prize expense (Note 8)	101,918,329	100,309,477
Retailer commissions and incentives	32,409,023	34,282,915
Instant and online vendor services	11,961,907	12,366,125
Product information costs	7,373,563	7,415,528
Instant ticket printing costs	3,492,915	3,564,913
Instant ticket delivery costs	722,908	689,388
Donated prize expense (Note 12)	89,417	59,650
Total Program Expenses	335,934,335	344,790,694
Administrative Expenses:		
Salaries and fringe benefits	5,980,062	5,752,566
Supplies and services	2,571,973	2,937,315
Depreciation expense	41,409	41,586
Total Administrative Expenses	8,593,444	8,731,467
Total Operating Expenses	344,527,779	353,522,161
NET OPERATING INCOME	129,145,692	141,662,813
NONOPERATING REVENUES (EXPENSES) AND OPERATING TRANSFERS		
Investment Income (Loss) (Note 6)	142,207	5,949,156
Miscellaneous Revenue (Note 12)	89,417	59,650
Net Income Before Transfers	129,377,316	147,671,619
Transfers:		
Transfers of lottery proceeds for property tax relief (Note 15)	(132,367,700)	(146,501,605)
Transfers in from General Fund (Note 18)	208,077	306,648
Transfer to Department of Health Services for compulsive gambling programs	(400,000)	(400,000)
Transfer to Department of Justice for law enforcement	(349,092)	(344,739)
Transfer to Department of Revenue for lottery credit administration	(272,854)	(254,333)
Transfers out to General Fund (Note 19)	(121,250)	(118,281)
CHANGE IN NET ASSETS	(3,925,503)	359,309
Total Net Assets—Beginning of the Year	33,655,457	33,296,148
Total Net Assets—End of the Year	<u>\$ 29,729,954</u>	<u>\$ 33,655,457</u>

The accompanying notes are an integral part of this statement.

Statement of Cash Flows for the Years Ended June 30, 2009 and 2008

	Year Ended June 30, 2009	Year Ended June 30, 2008
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash Received from Retailers	\$ 477,075,171	\$ 473,202,337
Cash Paid for Prizes	(294,846,631)	(296,141,867)
Cash Paid for Retailer Commissions and Incentives	(33,048,803)	(32,790,891)
Cash Paid/Received for Grand Prize Deposit	(106,187)	(106,280)
Cash Paid to Employees	(5,899,335)	(5,357,998)
Cash Paid to Suppliers	(25,865,646)	(25,869,649)
Net Cash Provided by Operating Activities	117,308,569	112,935,652
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Transfers of Proceeds for Property Tax Credit	(132,617,566)	(147,121,052)
Transfer of Proceeds for Law Enforcement	(348,400)	(358,103)
Transfer of Proceeds for Lottery Credit Administration	(267,547)	(208,341)
Transfer of Proceeds for Compulsive Gambling Programs	(400,000)	(400,000)
Transfers to the General Fund	(121,250)	(118,281)
Transfers from the General Fund	306,648	320,906
Net Cash Used by Noncapital Financing Activities	(133,448,115)	(147,884,871)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Cash Paid for Purchase of Equipment	(88,554)	0
Net Cash Used by Capital and Related Financing Activities	(88,554)	0
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest Received	979,515	2,835,411
Cash Received for Redemption of Bonds	17,125,059	16,988,301
Net Cash Provided by Investing Activities	18,104,574	19,823,712
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	1,876,474	(15,125,507)
Cash and Cash Equivalents—Beginning of the Year	26,156,561	41,282,068
Cash and Cash Equivalents—End of the Year	\$ 28,033,035	\$ 26,156,561

The accompanying notes are an integral part of this statement.

	Year Ended June 30, 2009	Year Ended June 30, 2008
RECONCILIATION OF NET OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Net Operating Income	\$ 129,145,692	\$ 141,662,813
Adjustments to Reconcile Net Operating Income to Net Cash Provided by Operating Activities:		
Depreciation expense	41,409	41,586
Noncash donated prize expense	89,417	59,650
Changes in assets and liabilities:		
Decrease (Increase) in receivables	2,658,735	(19,835,563)
Decrease (Increase) in grand prize deposit	(106,187)	(106,280)
Decrease (Increase) in ticket inventory	(297,821)	(46,866)
Decrease (Increase) in prepaid expenses	(22,069)	320,606
Decrease (Increase) in Due from other state programs	83,696	(101,840)
Increase (Decrease) in prizes payable	(14,767,979)	(9,960,805)
Increase (Decrease) in unearned revenue	56,001	393,757
Increase (Decrease) in Due to other state programs	45,021	(1,403,640)
Increase (Decrease) in accounts payable	472,350	819,789
Increase (Decrease) in Lottery Association payable	(196,997)	825,852
Increase (Decrease) in Due to other governments	(21,513)	22,836
Increase (Decrease) in accrued payroll	(144,172)	60,389
Increase (Decrease) in compensated absences	118,848	40,058
Increase (Decrease) in other postemployment benefits	154,138	143,310
Total Adjustments	<u>(11,837,123)</u>	<u>(28,727,161)</u>
Net Cash Provided by Operating Activities	<u>\$ 117,308,569</u>	<u>\$ 112,935,652</u>
Noncash Activities:		
Net change in unrealized gains and losses	\$ (836,288)	\$ 3,147,637
Increase in fair market value of investments for prize annuities and annuities payable due to amortization	4,733,444	5,679,106

The accompanying notes are an integral part of this statement.

Notes to the Financial Statements ■

1. DESCRIPTION OF THE WISCONSIN LOTTERY

On April 7, 1987, by a 65 percent to 35 percent margin, Wisconsin voters ratified a constitutional amendment authorizing the creation of a lottery. The Wisconsin Lottery was created in December 1987 and is administered by the Lottery Division within the Department of Revenue. During FY 2008-09 and FY 2007-08, the Wisconsin Lottery administered scratch-off, pull-tab, and online games. The Wisconsin Constitution requires that the net proceeds from Wisconsin Lottery operations be used to provide local property tax relief.

Online games (also known as lotto games) are games in which tickets are produced from a terminal located at a retailer's place of business (e.g. Powerball, Badger 5). The term online games should not be confused with Internet-based games which, although widely available, are prohibited by the Wisconsin Constitution.

The Wisconsin Lottery joined the Multi-State Lottery Association in June 1989. In FY 2008-09 and FY 2007-08, as a member of MUSL, the Wisconsin Lottery participated in one MUSL online game, Powerball (start date April 19, 1992). See Note 9 for information about MUSL.

During FY 2008-09 and FY 2007-08, the Wisconsin Lottery also sold tickets for five other online games: SuperCash! (start date February 4, 1991), Wisconsin's Very Own Megabucks (start date June 20, 1992), Daily Pick 3 (start date September 21, 1992), Daily Pick 4 (start date September 15, 1997), and Badger 5 (start date February 17, 2003).

In addition, during FY 2007-08 the Wisconsin Lottery sold tickets for an online, limited-term raffle-style game known as Holiday Millions (start date

November 4, 2007). This follows the Wisconsin Lottery's first raffle-style game, Million Dollar Draw (start date March 4, 2007). The Wisconsin Lottery did not offer any raffle-style games during FY 2008-09.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Financial Reporting Entity and Basis of Presentation

The financial statements of the Wisconsin Lottery have been prepared in conformance with generally accepted accounting principles (GAAP) for proprietary funds as prescribed by the Governmental Accounting Standards Board (GASB). These statements present the financial position and results of operations of only the activity of the Wisconsin Lottery and are not intended to present the financial activity for the State of Wisconsin as a whole. The Wisconsin Lottery is accounted for within the Lottery Fund, which is part of the State of Wisconsin financial reporting entity. The Wisconsin Lottery's stand-alone financial statements do not include the Lottery Fund appropriations from which the property tax credit disbursements are made. However, funding for these appropriations is reported on the Statement of Revenues, Expenses, and Changes in Fund Net Assets as operating transfers out.

The Wisconsin Lottery applies all GASB pronouncements, as well as the following pronouncements issued on or before November 30, 1989, unless these pronouncements conflict with or contradict GASB pronouncements: Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedure.

B. Measurement Focus and Basis of Accounting

The accompanying financial statements were prepared based upon the flow of economic resources and full accrual basis of accounting. With this measurement focus, all assets and liabilities associated with the operation of the Wisconsin Lottery are included on the Statement of Net Assets. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recognized when incurred.

The Statement of Revenues, Expenses, and Changes in Fund Net Assets classifies the Wisconsin Lottery's activities as either operating or nonoperating. Because the Lottery Fund is an enterprise fund, which is a type of proprietary fund, it accounts for operations in a manner similar to private businesses in which operating revenues are derived from exchange transactions, such as sales. Operating expenses include the costs of sales, administration expenses, and depreciation on capital assets.

Certain revenues and expenses that are not related to the Wisconsin Lottery's primary purpose, such as investment income, are reported as nonoperating revenues and expenses.

The State of Wisconsin monitors and records financial transactions on the State's central accounting system using the budgetary basis of accounting. A reconciliation between the budgetary basis and the accrual basis of accounting for the Wisconsin Lottery's general operations expenses is shown in Schedule 1.

C. Cash and Cash Equivalents

Cash and cash equivalents reported on the Statement of Net Assets and in the Statement of Cash Flows includes cash deposited in the State's bank and the Lottery's pro rata share of the State Investment Fund, which is a short-term pool of state and local funds managed by the State of Wisconsin Investment Board with oversight by its Board of Trustees and in accordance with Wisconsin Statutes. Balances pooled in the State Investment Fund are restricted to legally stipulated investments valued consistent with GASB Statement No. 31, *Accounting and Financial Reporting for Investments and for External Investment Pools*.

D. Investments for Prize Annuities

Investments for prize annuities consist entirely of securities backed by the full faith and credit of the United States government or its agencies purchased to finance jackpot prizes that are payable as annuities over a 20-year or 25-year period, so the investments scheduled to mature near the time prize payments become payable to winners. These investments are reported at fair market value consistent with the provisions of GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, and fair market value information is determined using quoted market prices.

E. Due To or From Other State Programs

During the course of operations, numerous transactions for goods provided or services rendered occur among individual state programs. The Statement of Net Assets classifies these receivables and payables as "due from other state programs" or "due to other state programs."

F. Ticket Inventory

Ticket inventory consists of ticket printing costs and related royalty fees for instant tickets of games in progress that have not yet been sold or shipped, and tickets for new games. The tickets are valued at cost using the first in–first out (FIFO) method. The cost of tickets sold is charged to operations. Unused tickets are charged to operations in the fiscal year the game ends or at the end of ticket distribution for a given game, whichever occurs first.

G. Capital Assets

Assets purchased for \$5,000 or more and certain other assets are capitalized and recorded at historic cost and depreciated using the straight-line method according to the following schedule:

	<u>Estimated Life</u>
Leasehold Improvements	10 years
Office Furniture and Security Equipment	10 years
Printing and Microfilming Equipment	7 years
Office, Computer, and Data Processing Equipment	5 years
Personal Computers	4 years

H. Prizes Payable and Annuity Prizes Payable

For online games, a liability is recognized at the time the drawing is held. For instant ticket games, a liability is recognized at the time tickets are sold to retailers. For additional information on annuity prizes payable, see Note 5.

I. Unearned Revenue

Retailers have the right to return unsold instant scratch-off tickets to the Wisconsin Lottery for a refund. Therefore, receivables and cash collected in advance of these ticket sales represent a contingent liability of the Wisconsin Lottery. An estimate is made for the portion of the tickets that may be returned based on historical information on unsold tickets returned by the retailers and is reported as unearned revenue.

Depending on the game, online tickets are sold for up to eight future drawings. Online ticket revenue is recognized at the time the related drawings are held. All ticket sales for future drawings are reported as unearned revenue.

J. Compensated Absences

The Wisconsin Lottery's compensated absence liability consists of accumulated unpaid leave, compensatory time, personal holiday hours, and Saturday/legal holiday hours earned and vested as of June 30.

K. Ticket Sales Revenue Recognition

Sales of instant scratch-off, instant pull-tab, and online tickets are made to the public through licensed retail sales agents.

Instant scratch-off ticket revenues are recognized when tickets are sold to the retailers. Retail sales agents have the right to return unsold instant scratch-off tickets for a full refund. Consequently, instant scratch-off ticket sales are reduced through a sales allowance estimate, based on historical information of unsold tickets returned by the retailers. See Note 2(I) for information about accounting for the retailers' right to return scratch-off tickets.

Revenues for pull-tab games are recognized upon sale of the tickets to the retail sales agents. No right of return exists for instant pull-tab tickets.

Ticket revenues for online games are recognized at the time the related drawings are held. The Wisconsin Lottery occasionally features online game promotions that offer bonus tickets, such as six tickets for the

price of five. Revenue is recognized for all tickets sold, and a sales discount is used to record the value of the bonus tickets.

L. Prize Expenses

In accordance with Wisconsin Statutes, at least 50.0 percent of Wisconsin Lottery sales must be returned in the form of prizes. Prizes may be claimed for a period of 180 days after the drawing for online games, or 180 days from the declaration of the end of a game for instant games. A summary of prize expenses is shown in Schedule 3.

M. Retailer Commissions

Retailer commissions, which are classified as program expenses, were 5.5 percent for online ticket sales and 6.25 percent for instant scratch-off and instant pull-tab tickets during FY 2008-09 and FY 2007-08. Nonprofit organizations receive higher commissions.

N. Retailer Performance Program

In addition to the retailer commissions discussed in Note 2(M), the Wisconsin Lottery administers an incentive program for retailers that meet certain performance goals identified by the Wisconsin Lottery. This program began on January 1, 2000. Retailers must be in good standing and sell instant tickets to participate in the program, which in FY 2008-09 and FY 2007-08 had a winning ticket component, a short-term incentive component, and a sales goals incentive component. The total compensation provided to all retailers under the components of the program may not exceed 1.0 percent of gross revenues from the sale of instant and online lottery tickets and lottery shares, which are multiple-draw online tickets.

Under the winning ticket component, participating retailers that sell a winning scratch-off or online game ticket of \$600 or more receive a 2.0 percent commission of the prize award, up to a maximum of \$100,000 per winning ticket. Winning ticket incentive payments are made weekly.

Short-term incentives may be offered throughout the year for predefined periods. They focus on supporting one product or category of ticket products. Each incentive has a predetermined goal, which lottery retailers must achieve to receive additional compensation. Short-term incentive payments are limited to a total of \$300,000 per short-term incentive.

The sales goals incentive component allows participating retailers to earn additional commissions based on increased sales. Subject to certain restrictions and allowances, through the third quarter of FY 2007-08 retailers earned up to 2.0 percent of the increase in quarterly sales over sales for the same quarter of the previous year for instant tickets and certain online non-jackpot games (SuperCash!, Daily Pick 3, Daily Pick 4, and Badger 5). During the last quarter of FY 2007-08 and

through FY 2008-09, the Wisconsin Lottery elected to compare the current quarter's sales with those of the previous quarter in calculating this increase. Retailers also earn up to 10.0 percent of the increase in annual sales over the previous year. The 2.0 percent incentive payments are made quarterly, and the 10.0 percent payments are made annually. Because of the unpredictable nature of the online jackpot games (Wisconsin's Very Own Megabucks and Powerball) and raffle-style games (Million Dollar Draw and Holiday Millions Raffle), sales goals incentive program payments for them are calculated and made annually. The annual payments may be limited to ensure that total performance program payments are within the performance program cap of 1.0 percent of ticket revenues.

O. Administrative Expenses

State statutes limit the Wisconsin Lottery's statutory administrative expenses to 10.0 percent of gross lottery revenues. A summary of statutory administrative expenses and related calculations of the administrative expense limit is included in Schedule 2.

P. Disbursement of Lottery Proceeds for Property Tax Relief

The State of Wisconsin disburses net lottery proceeds through two means: the Lottery and Gaming Tax Credit and the Farmland Tax Relief Credit.

The Department of Administration, with the concurrence of the Legislature's Joint Committee on Finance, determines the annual amount available for distribution as the Lottery and Gaming Tax Credit in a given fiscal year. The Department of Revenue is notified of this amount by November 1. The Lottery and Gaming Tax Credit is paid to municipalities on the fourth Monday in March of the same fiscal year. Therefore, the credit is based on a combination of the prior year's balance carryover and the current year's estimated performance and is distributed in advance of the end of the current fiscal year.

The Farmland Tax Relief Credit is determined by statute and is distributed to eligible individual and corporate taxpayers through the administration of the Department of Revenue's individual and corporate tax processes. The date of distribution of the Farmland Tax Relief Credit is determined by the dates that eligible claims for the credit are processed. Therefore, disbursement of Farmland Tax Relief Credit payments occurs throughout the year.

Q. Use of Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities as of the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Accordingly, actual results could differ from those estimates.

3. DEPOSITS AND INVESTMENTS

The Wisconsin Lottery's cash and cash equivalents balance consists of cash deposited in the State's bank and shares in the State Investment Fund, which is a short-term pool of state and local funds managed by the State of Wisconsin Investment Board with oversight by its Board of Trustees in accordance with Wisconsin Statutes. The carrying amount of shares in the State Investment Fund, which approximates fair market value, was \$28,033,000 as of June 30, 2009, and \$26,154,000 as of June 30, 2008.

The State Investment Fund is not registered with the Securities and Exchange Commission. The various types of securities in which the State Investment Fund may invest are enumerated in ss. 25.17(3)(b), (ba), (bd), and (dg), Wis. Stats., and include direct obligations of the United States or its agencies, corporations wholly owned by the United States or chartered by an act of Congress, securities guaranteed by the United States, unsecured notes of financial and industrial issuers, direct obligations of or guaranteed by the government of Canada, certificates of deposit issued by banks in the United States and solvent financial institutions in Wisconsin, and bankers acceptances. The State of Wisconsin Investment Board's Board of Trustees may specifically approve other prudent legal investments.

The Wisconsin Lottery manages its investments for prize annuities separate from the cash and investment activities of the State Investment Fund. The investments held by the Wisconsin Lottery have been purchased to finance jackpot prizes that are payable as annuities over a 20-year or 25-year period and consist entirely of securities backed by the full faith and credit of the United States government or its agencies. These investments are held by the Wisconsin Lottery and are scheduled to mature near the time prize payments become payable to winners.

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. While the Wisconsin Lottery does not have a formal policy regarding its investments for prize annuities, it has chosen to follow MUSL's policy that requires all investments for prize annuities to be in the form of securities backed by the full faith and credit of the United States government or its agencies. All of the Lottery's total investments for prize annuities balance as of June 30, 2009, and June 30, 2008, consist of these types of securities.

The shares of the State Investment Fund classified as cash and cash equivalents are unrated; however, the State Investment Fund's investment guidelines establish specific maximum exposure limits by security types based on the minimum credit ratings as issued by nationally recognized statistical rating organizations.

Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the Lottery would not be able to recover the value of investments that are in possession of an outside party. As of

June 30, 2009, and June 30, 2008, all of the assets in investments for prize annuities were held by the State’s agent, U.S. Bank, in the State’s name. Therefore, the investments are not considered to have custodial credit risk. Further, State Investment Fund shares included in the balance of cash and cash equivalents were not exposed to custodial credit risk as of June 30, 2009, or June 30, 2008.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of an investor’s holdings in a single issuer. In accordance with MUSL’s policies, all of the Wisconsin Lottery’s investments for prize annuities as of June 30, 2009, and June 30, 2008, consisted of U.S. Treasury or Agency securities. In addition, concentration of credit risk requirements do not apply to pooled investments such as the State Investment Fund.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment or a deposit. Typically, this risk is higher in debt securities with longer maturities. The Wisconsin Lottery manages this risk by holding investments for prize annuities to maturity, at which time the fair value of the investment is equal to its stated maturity value. If an annuitant requests premature termination of an annuity that would necessitate an investment be redeemed prior to maturity, any loss or gain due to market fluctuations is passed through to the redeeming annuitant. Therefore, the Wisconsin Lottery has minimal interest rate risk exposure related to these investments, which consisted of U. S. Treasury and Agency investments with the following maturities as of June 30, 2009 and 2008:

<u>Maturity</u>	<u>Fair Value as of June 30, 2009</u>	<u>Fair Value as of June 30, 2008</u>
Less than 1 Year	\$13,265,489	\$16,954,759
1 to 5 Years	28,567,356	34,668,060
6 to 10 Years	21,433,604	22,425,732
More than 10 Years	<u>8,765,945</u>	<u>11,211,746</u>
Total	<u>\$72,032,394</u>	<u>\$85,260,297</u>

The State Investment Fund uses the weighted average maturity method to analyze interest rate risk. Its investment guidelines mandate that the weighted average maturity for the entire portfolio not exceed one year. The weighted average maturity of the entire State Investment Fund as of June 30, 2009, and June 30, 2008, complied with the investment guidelines.

4. ACCOUNTS RECEIVABLE AND ACCOUNTS PAYABLE BALANCES

Accounts receivable and accounts payable balances are disaggregated as follows:

A. Accounts Receivable

	<u>June 30, 2009</u>	<u>June 30, 2008</u>
Accounts Receivable:		
Retailers	\$19,247,381	\$21,555,978
Miscellaneous	<u>25,408</u>	<u>375,547</u>
Total Accounts Receivable	<u>\$19,272,789</u>	<u>\$21,931,525</u>
Due from Other State Programs:		
Transfers for Gaming	\$ 208,077	\$ 306,648
Miscellaneous	<u>18,547</u>	<u>102,243</u>
Total Due from Other State Programs	<u>\$ 226,624</u>	<u>\$ 408,891</u>

B. Accounts Payable

	<u>June 30, 2009</u>	<u>June 30, 2008</u>
Accounts Payable:		
Vendors	\$3,402,441	\$3,054,435
Prizes	55,300	11,475
Withholding on Prizes	89,729	11,499
Lottery Credit Administration	50,937	45,457
Law Enforcement	6,366	232
Miscellaneous	<u>30,116</u>	<u>27,826</u>
Total Accounts Payable	<u>\$3,634,889</u>	<u>\$3,150,924</u>
Due to Other State Programs:		
Farmland Tax Credit	\$ 155,518	\$ 405,385
Employee Fringe Benefits	95,175	97,077
Withholding on Prizes	328,820	182,343
Lottery Credit Administration	10,327	10,252
Law Enforcement	10,673	14,822
Other State Programs	<u>38,044</u>	<u>137,598</u>
Total Due to Other State Programs	<u>\$ 638,557</u>	<u>\$ 847,477</u>
Due to Other Governments:		
Employee Fringe Benefits	\$ 47,471	\$ 68,983
Lottery Credit Administration	2,432	2,680
Law Enforcement	<u>2,718</u>	<u>4,011</u>
Total Due to Other Governments	<u>\$ 52,621</u>	<u>\$ 75,674</u>

5. ANNUITY PRIZES PAYABLE

The Wisconsin Lottery has an unconditional obligation to pay all prize winners the future value of their prizes. The present value of future jackpot prize payment obligations is included in the financial statements as “annuity prizes payable.” To finance the annuity prize payments, the Wisconsin Lottery purchases, or has acquired from MUSL, investments scheduled to mature near the time prize payments become payable to the winners. See Note 3 for information related to the investments for prize annuities. Each year, an adjustment to the annuity prizes payable account is made using the effective interest method. The amortization of annuity adjustment was \$4,733,444 for FY 2008-09 and \$5,679,106 for FY 2007-08.

Future prize payments and the present value of those payments are as follows:

<u>Fiscal Year</u>	<u>FY 2008-09 Total Payments</u>	<u>FY 2007-08 Total Payments</u>
2008-09	\$ -	\$ 16,978,178
2009-10	14,563,529	14,563,529
2010-11	9,747,351	9,747,351
2011-12	7,284,396	7,284,396
2012-13	7,350,520	7,350,520
2013-14	6,304,983	6,304,983
Subsequent Years	<u>45,197,578</u>	<u>45,197,578</u>
Future Prize Payments	90,448,357	107,426,535
Less: Present Value Adjustment	<u>25,137,299</u>	<u>29,867,162</u>
Present Value of Future Prize Payments	<u>\$65,311,058</u>	<u>\$77,559,373</u>

Annuity prizes payable activity for the fiscal years ended June 30, 2009, and June 30, 2008, was as follows:

<u>Fiscal Year</u>	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>	<u>Due within One Year</u>
2008-09	\$77,555,373	\$4,733,444	\$(16,977,759)	\$65,311,058	\$14,251,996
2007-08	88,855,454	5,679,106	(16,975,187)	77,559,373	16,573,916

6. INVESTMENT INCOME (LOSS)

The investment income (loss) shown on the financial statements consists of several elements, as follows:

	<u>FY 2008-09</u>	<u>FY 2007-08</u>
<u>Change in Fair Market Value:</u>		
Net Increase (Decrease) in Fair Market Value of Annuity Investments	\$ 3,897,156	\$8,826,743
Less: The Portion of the Increase (Decrease) in Fair Market Value of Annuity Investments Offset by the Increase in Annuity Prizes Payable from Amortization	<u>(4,733,444)</u>	<u>(5,679,106)</u>
Net Increase (Decrease) in Fair Market Value Recognized as Investment Income	<u>(836,288)</u>	<u>3,147,637</u>
<u>Interest Income:</u>		
Interest from State Investment Fund	832,941	2,713,843
Interest from MUSL Prize Reserve Accounts	33,575	82,489
Miscellaneous Interest	<u>111,979</u>	<u>5,187</u>
Total Interest Income	<u>978,495</u>	<u>2,801,519</u>
Total Investment Income (Loss)	<u>\$ 142,207</u>	<u>\$5,949,156</u>

GASB Statement 31 requires investments to be reported at fair market value, with the increases or decrease in fair market value recognized as investment income (loss). In addition, the Wisconsin Lottery earns interest on its shares invested in the State Investment Fund and on its share of the grand prize deposit fund established through MUSL, which is discussed in Note 9.

7. INSTANT AND ONLINE TICKET SALES

Lottery instant and online ticket sales shown on the financial statements consist of the following:

	<u>FY 2008-09</u>	<u>FY 2007-08</u>
<u>Instant Ticket Sales:</u>		
Scratch-off	\$271,901,512	\$284,255,001
Pull-tab	<u>4,896,196</u>	<u>3,174,284</u>
Total Instant Ticket Sales	<u>\$276,797,708</u>	<u>\$287,429,285</u>
<u>Online Ticket Sales:</u>		
Supercash!	\$ 27,408,417	\$ 27,867,415
Powerball	85,402,245	93,672,570
WI Very Own Megabucks	20,740,168	18,997,258
Daily Pick 3	26,264,605	25,841,532
Daily Pick 4	11,972,648	11,866,324
Badger 5	24,834,908	25,375,192
Raffle Games	0	3,684,770
General Sales and Discounts	<u>(6,445)</u>	<u>(7,278)</u>
Total Online Ticket Sales	<u>\$196,616,546</u>	<u>\$207,297,783</u>

8. INSTANT AND ONLINE PRIZE EXPENSE

Lottery instant and online prize expenses shown on the financial statements consist of the following:

	<u>FY 2008-09</u>	<u>FY 2007-08</u>
Instant Prize Expense:		
Scratch-off	\$174,497,499	\$183,808,185
Pull-tab	3,043,774	2,014,513
Super 2 nd Chance	<u>425,000</u>	<u>280,000</u>
Total Instant Prize Expense	<u>\$177,966,273</u>	<u>\$186,102,698</u>
Online Prize Expense:		
Supercash!	\$ 18,452,849	\$ 11,982,314
Powerball	41,099,006	44,819,123
WI Very Own Megabucks	10,859,864	9,913,592
Daily Pick 3	13,611,750	13,037,870
Daily Pick 4	5,414,500	5,597,000
Badger 5	12,069,360	12,400,368
Raffle Games	1,000	2,299,000
Lotto*America Megabucks	0	210
Super 2 nd Chance	<u>410,000</u>	<u>260,000</u>
Total Online Prize Expense	<u>\$101,918,329</u>	<u>\$100,309,477</u>

9. MULTI-STATE LOTTERY ASSOCIATION**A. Joint Venture Association**

The Wisconsin Lottery is a member of the Multi-State Lottery Association, a nonprofit, government-benefit voluntary association. MUSL was established September 16, 1987, and has 33 member lotteries from 31 states, the District of Columbia, and the U.S. Virgin Islands. It is owned and operated by the member lotteries, which sell one or more games administered by the association. The association is controlled by its Board of Directors, consisting of the director or chief executive officer of each member lottery. Each MUSL member sells tickets through its licensed retailers and makes weekly wire transfers to MUSL in an amount equivalent to the member lottery's share of the weekly prize liability less the actual low-tier prize liability for tickets sold by the respective lottery.

B. Multi-State Lottery Association Financial Position and Activity

The following schedule presents the summarized audited financial position and activity of MUSL as of June 30, 2009 and 2008, as audited by other auditors.

	<u>June 30, 2009</u>	<u>June 30, 2008</u>
Total Assets	<u>\$816,489,735</u>	<u>\$899,702,496</u>
Total Liabilities	\$815,695,384	\$899,427,315
Total Unrestricted Net Assets	<u>794,351</u>	<u>275,181</u>
Total Liabilities and Net Assets	<u>\$816,489,735</u>	<u>\$899,702,496</u>
Total Revenues	\$ 4,818,549	\$ 11,167,862
Total Expenses	(3,620,598)	(4,125,761)
Distribution to Member Lotteries	<u>(678,781)</u>	<u>(6,964,312)</u>
Increase (Decrease) in Unrestricted Net Assets	<u>\$ 519,170</u>	<u>\$ 77,789</u>

Complete separate financial statements for MUSL may be obtained from:

Multi-State Lottery Association
Attention: Charles Strutt
4400 NW Urbandale Drive
Urbandale, Iowa 50322

C. Powerball Grand Prize Deposit

The Wisconsin Lottery participates in the MUSL Powerball game. The Powerball total prize pool equals 50.0 percent of sales for each Powerball drawing. Prior to January 7, 2009, 56.5771 percent of the total prize pool funded the grand prize pool and 39.4229 percent funded the low-tier prize pool. Effective January 7, 2009, 61.0577 percent of the total prize pool funds the grand prize pool and 34.9423 percent funds the low-tier prize pool.

In addition, MUSL has established several reserve funds to be used for various contingencies. The remaining 4.0 percent of the total prize pool is used to fund these reserve accounts until the accounts reach their predetermined balances, at which point the 4.0 percent is added to the grand prize pool. The 4.0 percent is first used to fund the set-aside reserve account until it reaches its cap of \$7.5 million. The 4.0 percent is next distributed to the Set Prize Reserve Account (SPRA) and the Prize Reserve Account (PRA) until they reach their caps of \$25 million and \$100 million, respectively (the PRA cap was raised from \$75 million to \$100 million effective January 7, 2009). For some drawings, these accounts are reduced when the actual prizes won are greater than the amounts available in the prize pools. Interest earned on these accounts is utilized first to offset the MUSL expenses associated with operating Powerball. The remaining interest, if any, is deposited to the unreserved account and may be withdrawn by member lotteries.

The Wisconsin Lottery has the right to a refund of Wisconsin's share of PRA and SPRA balances if it withdraws from MUSL. The Wisconsin Lottery does not have the right to a refund of its share of the set-aside reserve account. Because the PRA and SPRA are refundable only upon withdrawal from MUSL, it is the practice of the Wisconsin Lottery to

report the prize reserve balances as a restricted noncurrent asset (grand prize deposit). The Powerball grand prize deposit is made up of the following:

	<u>June 30, 2009</u>	<u>June 30, 2008</u>
Prize Reserve Account (PRA)	\$3,039,745	\$2,954,175
Set Prize Reserve Account (SPRA)	<u>1,005,342</u>	<u>984,725</u>
Grand Prize Deposit—Noncurrent	4,045,087	3,938,900
Balance of Unreserved Account	<u>1,377,338</u>	<u>1,343,763</u>
Total Powerball Grand Prize Reserve Deposit	<u>\$5,422,425</u>	<u>\$5,282,663</u>

10. CAPITAL ASSETS

Capital asset activity for the fiscal year ended June 30, 2009, was as follows:

	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
Leasehold Improvements	\$159,724	\$ 0	\$ 0	\$ 159,724
Equipment	<u>766,678</u>	<u>88,555</u>	<u>(80,553)</u>	<u>774,680</u>
Total Capital Assets	<u>926,402</u>	<u>88,555</u>	<u>(80,553)</u>	<u>934,404</u>
Less Accumulated Depreciation for:				
Leasehold Improvements	79,079	12,070	0	91,149
Equipment	<u>748,189</u>	<u>29,339</u>	<u>(80,553)</u>	<u>696,975</u>
Total Accumulated Depreciation	<u>827,268</u>	<u>41,409</u>	<u>(80,553)</u>	<u>788,124</u>
Total Capital Assets, Net	<u>\$ 99,134</u>	<u>\$47,146</u>	<u>\$ 0</u>	<u>\$146,280</u>

Capital asset activity for the fiscal year ended June 30, 2008, was as follows:

	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
Leasehold Improvements	\$159,724	\$ 0	\$ 0	\$ 159,724
Equipment	<u>766,678</u>	<u>0</u>	<u>0</u>	<u>766,678</u>
Total Capital Assets	<u>926,402</u>	<u>0</u>	<u>0</u>	<u>926,402</u>
Less Accumulated Depreciation for:				
Leasehold Improvements	67,009	12,070	0	79,079
Equipment	<u>718,673</u>	<u>29,516</u>	<u>0</u>	<u>748,189</u>
Total Accumulated Depreciation	<u>785,682</u>	<u>41,586</u>	<u>0</u>	<u>827,268</u>
Total Capital Assets, Net	<u>\$140,720</u>	<u>\$(41,586)</u>	<u>\$ 0</u>	<u>\$ 99,134</u>

11. OPERATING LEASES

The Wisconsin Lottery occupied a facility in Madison for storage and instant ticket operations under an operating lease during FY 2008-09 and FY 2007-08.

The following schedule summarizes the future minimum lease payments required under the operating lease for this facility, which was initially a five-year lease that ran until August 31, 2009, with two optional three-year extensions. The Wisconsin Lottery exercised the first of these renewals effective February 2009, extending the lease through August 21, 2012.

	<u>June 30, 2009</u>	<u>June 30, 2008</u>
Fiscal Year Ending June 30, 2009	\$ 0	\$145,756
2010	146,993	24,326
2011	148,267	0
2012	149,580	0
2013	<u>24,967</u>	<u>0</u>
Total Minimum Payments Required	<u>\$469,807</u>	<u>\$170,082</u>

Total operating lease expense amounted to \$145,756 for the fiscal year ended June 30, 2009, and \$144,555 for the fiscal year ended June 30, 2008.

12. DONATIONS

Periodically, the Wisconsin Lottery executes agreements with vendors that provide, as part of those agreements, items to the Lottery at no additional charge. For example, the Wisconsin Lottery may agree to use a vendor’s name in the marketing of its games, and in turn, the vendors may provide donated items, which the Wisconsin Lottery uses for game prizes or special events. Other items that could be provided include brochures, posters, and various other marketing materials that are used to support a game.

The total value of these items was \$89,417 for FY 2008-09 and \$59,650 for FY 2007-08. All donated items received in FY 2007-08 and FY 2008-09 were used as game prizes or at special events and are recorded as donated prize expense and nonoperating miscellaneous revenue on the financial statements.

13. CONTRACTUAL OBLIGATIONS

A. Scratch-off Tickets

The Wisconsin Lottery had an original contract for the period July 1, 2004, through June 30, 2006, with Scientific Games International, Inc., to print scratch tickets. This contract was renewed through June 30, 2009, and then extended through October 30, 2009. Under the contract, the Wisconsin Lottery purchased approximately \$3.1 million in scratch-off tickets in FY 2008-09, and \$3.4 million in scratch-off tickets in FY 2007-08. In October 2009, the Wisconsin Lottery signed new contracts with three vendors: Scientific Games International Inc.; GTECH Holdings Corporations; and Pollard Banknote Ltd. These three contracts to print scratch-off tickets are for the period November 1, 2009, through October 30, 2011, and each contract has three one-year renewal options.

B. Pull-tab Tickets

The Wisconsin Lottery had original contracts for the period July 1, 2004, through June 30, 2006, with Pollard Banknotes Ltd. and Scientific Games to print pull-tab tickets. These contracts were renewed through June 30, 2009, and then extended through October 30, 2009. Under these contracts, the Wisconsin Lottery purchased approximately \$393,500 in pull-tab tickets in FY 2008-09 and \$489,700 in FY 2007-08. In October 2009, the Wisconsin Lottery signed new contracts with three vendors: Arrow International; International Gamco, Inc.; and Pollard Banknote Ltd. These three contracts to print pull-tab tickets are for the period November 1, 2009, through October 30, 2011, and each contract has three one-year renewal options.

C. Gaming System Vendor

The Wisconsin Lottery has a contract with GTECH Holdings Corporation that supports a network of approximately 4,065 online locations where traditional online lottery games are sold. The original contract expires on June 25, 2011, and contains the option to extend the contract for two one-year renewal periods. On July 1, 2009, the Wisconsin Lottery exercised the option to extend the contract for two additional one-year periods through June 22, 2013. During FY 2008-09 and FY 2007-08, GTECH received 2.54 percent of the price of each ticket sold, offset by claims for liquidated damages due to the Wisconsin Lottery. Liquidated damages are discussed further in Note 20. Expenses under this contract were approximately \$12.0 million in FY 2008-09 and \$12.4 million in FY 2007-08. As part of the contract renewal, beginning on July 1, 2009, GTECH will receive 2.54 percent of total net sales of online and instant tickets, less \$1,000,000 per each fiscal year, and offset by any claims for liquidated damages due to the Wisconsin Lottery.

D. Product Information Costs

The Wisconsin Lottery had a contract with Hoffman York, Inc., to provide informational advertising services through April 9, 2008. This contract has been renewed through April 9, 2011. The Wisconsin Lottery spent \$7.2 million annually under the contract during FY 2008-09 and FY 2007-08.

E. Audit of Financial Statements

The Wisconsin Lottery has a contract with the Legislative Audit Bureau for auditing of the Wisconsin Lottery's annual financial statements and providing odds verification services. The current contract was signed on December 11, 2009, and ends on June 30, 2010. It includes the financial audit of the Wisconsin Lottery's financial statements for the periods July 1, 2008, through June 30, 2009. Total fees for these services are not expected to exceed \$62,250. During FY 2007-08, the Legislative Audit Bureau provided the aforementioned services as well as a biennial performance evaluation at a total contract cost of \$117,030.

14. RESTRICTED NET ASSETS

The Wisconsin Lottery has restricted net assets related to capital assets of \$146,280 as of June 30, 2009, and \$99,134 as of June 30, 2008. The portion of restricted net assets related to capital assets is reported in detail in Note 10.

The Wisconsin Lottery has also restricted net assets related to the MUSL Powerball reserves as reported in detail in Note 9. Restricted net assets related to the MUSL deposit were \$4,045,087 as of June 30, 2009, and \$3,938,900 as of June 30, 2008.

In addition, the Wisconsin Lottery has restricted net assets for fair market value adjustments of investments of \$8,520,083 as of June 30, 2009, and \$9,356,371 as of June 30, 2008. The Wisconsin Lottery does not realize gains or losses from the change in fair market value of its annuity investments because it holds the investments until maturity to pay the annual annuity prize payments. Therefore, fair market value adjustments recognized as investment income as a result of applying GASB Statement 31, and any cash held for annuity prize payments, are restricted and are not available for distribution as property tax credits

Finally, the Wisconsin Constitution requires net proceeds from the operations of the Wisconsin Lottery to be used to provide local property tax relief. In addition, balances from other gaming-related appropriations, including racing and charitable bingo operations, are transferred to the Lottery Fund for distribution in the form of property tax relief. The net proceeds and gaming-related transfers available for property tax relief make up the remainder of the restricted net assets and were \$17,018,504 as of June 30, 2009, and \$20,261,052 as of June 30, 2008.

15. DISTRIBUTION OF NET PROCEEDS

Wisconsin Lottery net proceeds and other gaming-related proceeds were used for the following purposes:

	<u>FY 2008-09</u>	<u>FY 2007-08</u>
Lottery and Gaming Tax Credit	\$117,796,949	\$129,601,636
Farmland Tax Relief Credit	<u>14,570,751</u>	<u>16,899,969</u>
Total Property Tax Relief Credits	<u>\$132,367,700</u>	<u>\$146,501,605</u>

16. EMPLOYEE RETIREMENT PLAN AND OTHER POSTEMPLOYMENT BENEFITS

Permanent employees of the Wisconsin Lottery are participants in the Wisconsin Retirement System, a cost-sharing, multiple-employer, defined benefit plan governed by ch. 40, Wis. Stats. State and local government public employees are entitled to an annual formula retirement benefit based on: 1) the employee's final average earnings, 2) years of creditable service, and 3) a formula factor. If an employee's contributions, matching employer's

contributions, and interest credited to the employee’s account exceed the value of the formula benefit, the retirement benefit may instead be calculated as a money purchase benefit. The Wisconsin Retirement System is considered part of the State of Wisconsin’s financial reporting entity.

Generally, the State’s policy is to fund retirement contributions on a level-percentage-of-payroll basis to meet normal and prior service costs of the retirement system. Prior service costs were amortized over 40 years beginning January 2, 1990. However, in December 2003 the State issued bonds and subsequently fully liquidated its prior service liability balance as of January 2003. In addition, state agencies are required to make future contributions to fund the bond’s debt service.

The retirement plan requires employee contributions equal to specified percentages of qualified earnings based on the employee’s classification, plus employer contributions at a rate determined annually. The Wisconsin Lottery’s contributions to the plan were \$450,162 for FY 2008-09 and \$447,112 for FY 2007-08. The relative position of the Wisconsin Lottery in the Wisconsin Retirement System is not available because the Wisconsin Retirement System is a statewide, multi-employer plan.

In June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions*, effective beginning for FY 2007-08. In accordance with the provisions of GASB Statement No. 45, the State is required to report other postemployment benefit (OPEB) expenses, which the Wisconsin Lottery reports as part of salaries and fringe benefits expenses, and related liabilities in the financial statements and notes. OPEBs include such items as the implicit rate subsidy of retiree health insurance present in the contribution rates for existing employees under the State’s health insurance program, and the postemployment coverage in the State’s life insurance program.

Copies of the separately issued financial reports of the Wisconsin Retirement System and the life insurance program are available on the Department of Employee Trust Funds’ Web site, <http://etf.wi.gov>. The disclosures for the health insurance plan are included in the State’s Comprehensive Annual Financial Report, available on the Department of Administration’s Web site, <http://www.doa.wi.gov>.

17. COMPENSATED ABSENCES

Compensated absence activity for the fiscal years ended June 30, 2009, and June 30, 2008, was as follows:

<u>Fiscal Year</u>	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>	<u>Due within One Year</u>
2008-09	\$475,469	\$271,715	\$(152,867)	\$594,317	\$152,866
2007-08	435,411	189,509	(149,451)	475,469	150,833

18. TRANSFERS IN FROM GENERAL FUND

Under Wisconsin Statutes, the unencumbered balances and related interest for the following appropriations are to be transferred to the Lottery Fund at the end of the fiscal year: the appropriation under s. 20.435(7)(kg), Wis. Stats., for the Department of Health Services' compulsive gambling awareness campaign; the appropriation under s. 20.455(2)(g), Wis. Stats., for the Department of Justice's gaming law enforcement; and the appropriations under ss. 20.505(8)(g) and 20.505(8)(jm), Wis. Stats., for general operations of the Department of Administration's Division of Gaming related to racing and bingo. The Wisconsin Lottery received \$208,077 from these transfers in FY 2008-09 and \$306,648 in FY 2007-08. Section 20.435(7)(kg), Wis. Stats., is renumbered s. 20.435(5)(kg) for FY 2009-10.

19. TRANSFERS OUT TO GENERAL FUND

Sections 9101(9) and (9q) of 2003 Wisconsin Act 33, gave the State of Wisconsin authority to issue annual appropriation bonds to pay off certain unfunded liabilities in the pension and other employee benefit programs, resulting in cost savings to the State. Section 16.529, Wis. Stats., requires state agencies to make certain transfers to the General Fund. The Wisconsin Lottery transferred \$121,250 in FY 2008-09 and \$118,281 in FY 2007-08 for this purpose.

20. LIQUIDATED DAMAGES

The current contract between the Wisconsin Lottery and GTECH Holdings Corporation allows the Wisconsin Lottery to assess liquidated damages for various processing complications, such as computer failures or "downtime" for the Wisconsin Lottery or its retailers, failure to install new games in a timely manner, and computer system reports not being available in a timely manner. Liquidated damage amounts are determined based on specific criteria set forth in the contract. Damages may be assessed on a per minute basis for critical functions, such as computer downtime, or on a per day basis for less-significant functions, such as late reports. GTECH gives the Wisconsin Lottery credit on the next month's invoice for any liquidated damages of the previous month.

In addition to the typical monthly liquidated damages, there were significant liquidated damages during GTECH's implementation of the Wisconsin Lottery gaming system's communications system. Wisconsin Lottery staff calculated liquidated damages from July to September 2004 at \$722,363. Through negotiations, the Wisconsin Lottery received benefits with a value of \$822,363 in FY 2004-05, which is \$100,000 more than the damage assessment. GTECH agreed to:

- reduce its charges during FY 2004-05 for additional software upgrades from \$600,000 to \$375,000;
- reduce its October 2004 invoice for routine monthly processing and services by \$347,363; and
- provide a \$250,000 credit to be used for future upgrades.

Of that \$250,000 credit for future upgrades, \$114,840 was used during FY 2005-06 and FY 2006-07. The remaining balance of the credit as of June 30, 2009, and June 30, 2008, is reflected below and as part of the balance of prepaid expenses on the Statement of Net Assets. The Wisconsin Lottery estimates the portion of this credit that will be used within the next year. All activity related to this credit for the fiscal years ended June 30, 2009, and June 30, 2008, was as follows:

<u>Fiscal Year</u>	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>	<u>Used within One Year</u>
2008-09	\$ 96,160	\$ 0	\$(37,920)	\$58,240	\$ 7,920
2007-08	135,160	0	(39,000)	96,160	37,920

21. RESTATEMENT OF FY 2006-07 FINANCIAL STATEMENTS

An adjustment was made to the FY 2006-07 financial statements to recognize a late distribution of \$307,254 in MUSL dividends. The FY 2006-07 financial statements reported miscellaneous operating revenue of \$262,200. Accordingly, miscellaneous operating revenue for FY 2006-07 has been restated to \$569,454. This adjustment changed the beginning net assets for FY 2007-08 from \$32,988,894, as previously stated, to \$33,296,148.

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Supplementary Information ■

Reconciliation of Lottery General Operations Expenses to the Budgetary Basis of Accounting for the Years Ended June 30, 2009 and 2008

	Year Ended June 30, 2009	Year Ended June 30, 2008
SALARIES AND FRINGE BENEFITS		
Per Financial Statement	\$ 5,980,062	\$ 5,752,566
Adjustments to Financial Statement Balance:		
Cash paid in FY 2007-08 but expensed in FY 2006-07	0	523,479
Cash paid in FY 2008-09 but expensed in FY 2007-08	731,151	(731,151)
Cash paid in FY 2009-10 but expensed in FY 2008-09	(1,021,707)	0
Reclassified fringe benefits to transfer out to General Fund	107,691	105,813
Budgetary Basis—Salaries and Fringe Benefits	\$ 5,797,197	\$ 5,650,707
SUPPLIES AND SERVICES AND PERMANENT PROPERTY		
Per Financial Statement:		
Product information costs	\$ 7,373,563	\$ 7,415,528
Instant ticket printing costs	3,492,915	3,564,913
Instant ticket delivery costs	722,908	689,388
Donated prize expense	89,417	59,650
Supplies and services	2,571,973	2,937,315
Depreciation expense	41,409	41,586
Total per Financial Statement	14,292,185	14,708,380
Adjustments to Financial Statement Balance:		
Depreciation expense	(41,409)	(41,586)
Donated prize expense	(89,417)	(59,650)
Cash paid in FY 2006-07 but expensed in FY 2007-08	0	(1,555,136)
Cash paid in FY 2008-09 but expensed in FY 2007-08	(1,633,145)	1,633,145
Cash paid in FY 2009-10 but expensed in FY 2008-09	1,620,514	0
Compulsive gambling payment not included above	400,000	400,000
Banking fees paid with Department of Administration's banking fees appropriation	(25,818)	(22,028)
Post WISMART prior year adjustments	0	280,915
Capitalized permanent property less disposals	88,554	0
Budgetary Basis—Supplies and Services and Permanent Property	\$ 14,611,464	\$ 15,344,040

Statutorily Defined Lottery Administrative Expenses for the Years Ended June 30, 2007 through 2009

	Year Ended June 30, 2009	Year Ended June 30, 2008	Restated Year Ended June 30, 2007
ADMINISTRATIVE EXPENSES			
Instant and Online Vendor Services	\$ 11,961,907	\$ 12,366,125	\$ 12,428,020
Product Information Costs	7,373,563	7,415,528	4,512,191
Instant Ticket Printing Costs	3,492,915	3,564,913	3,422,112
Instant Ticket Delivery Costs	722,908	689,388	640,032
Donated Prize Expense	89,417	59,650	0
Salaries and Fringe Benefits	5,980,062	5,752,566	5,487,777
Supplies and Services	2,571,973	2,937,315	2,412,304
Depreciation Expense	41,409	41,586	44,173
Total Administrative Expenses as Determined in Accordance with s. 25.75(3)(b), Wis. Stats.	<u>\$ 32,234,154</u>	<u>\$ 32,827,071</u>	<u>\$ 28,946,609</u>
Gross Lottery Operating Revenues	<u>\$ 473,673,471</u>	<u>\$ 495,184,974</u>	<u>\$ 493,419,786</u>
Administrative Expenses as a Percentage of Lottery Operating Revenues	6.81%	6.63%	5.87%

Section 25.75(3)(b), Wis. Stats., limits the Wisconsin Lottery's administrative expenses to 10 percent of gross lottery revenues. Gross lottery revenues include lottery ticket sales and retailer fees. As defined in state statutes, retailer commissions are not included as an administrative expense in the calculation.

NOTE: The above amounts are based on the accrual basis of accounting.

Summary of Prize Expenses for the Years Ended June 30, 2005 through 2009

Section 25.75(3)(a), Wis. Stats., requires that at least 50 percent of each year's revenues from the sale of lottery tickets be returned as prizes to the holders of winning lottery tickets. The amounts expensed for winning lottery tickets for the past five years, for both instant and online games, are summarized below.

	Fiscal Year 2008-09		
	Prize Expense	Ticket Sales	Prize Expense as a Percentage of Sales
Instant Games	\$ 177,966,273	\$ 276,797,708	64.3%
Online Games	101,918,329	196,616,546	51.8
Total for Fiscal Year	\$ 279,884,602	\$ 473,414,254	59.1

	Fiscal Year 2007-08		
	Prize Expense	Ticket Sales	Prize Expense as a Percentage of Sales
Instant Games	\$ 186,102,698	\$ 287,429,285	64.7%
Online Games	100,309,477	207,297,783	48.4
Total for Fiscal Year	\$ 286,412,175	\$ 494,727,068	57.9

	Fiscal Year 2006-07		
	Prize Expense	Ticket Sales	Prize Expense as a Percentage of Sales
Instant Games	\$ 183,279,333	\$ 284,131,772	64.5%
Online Games	108,835,614	208,646,840	52.2
Total for Fiscal Year	\$ 292,114,947	\$ 492,778,612	59.3

	Fiscal Year 2005-06		
	Prize Expense	Ticket Sales	Prize Expense as a Percentage of Sales
Instant Games	\$ 183,201,056	\$ 285,757,651	64.1%
Online Games	110,711,493	223,299,704	49.6
Total for Fiscal Year	\$ 293,912,549	\$ 509,057,355	57.7

	Fiscal Year 2004-05		
	Prize Expense	Ticket Sales	Prize Expense as a Percentage of Sales
Instant Games	\$ 171,269,091	\$ 269,904,836	63.5%
Online Games	90,914,744	181,967,204	50.0
Total for Fiscal Year	\$ 262,183,835	\$ 451,872,040	58.0

NOTE: The above amounts are based on the accrual basis of accounting, with adjustments made to prize expense for unclaimed winning tickets and reserve accounts. For each game, the prize structure represents the number, value, and odds of winning for each prize and is used to estimate the expected amounts to be paid to lottery winners. The games' actual prizes (prize expense) may be less than the games' structure because of unclaimed winning tickets and deposits in reserve accounts.

Report on Control and Compliance ■

***Independent Auditor's Report on Internal Control over
Financial Reporting and on Compliance and Other Matters
Based on an Audit of Financial Statements Performed in
Accordance with Government Auditing Standards***

We have audited the financial statements of the Wisconsin Lottery as of and for the years ended June 30, 2009 and 2008, and have issued our report thereon dated May 18, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit, we considered the Wisconsin Lottery's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Wisconsin Lottery's internal control. Accordingly, we do not express an opinion on the effectiveness of the Wisconsin Lottery's internal control.

A *deficiency* in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or to detect and correct misstatements on a timely basis. A *material weakness* is a deficiency or a combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the Wisconsin Lottery's financial statements will not be prevented or will not be detected and corrected on a timely basis.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses as defined in the preceding paragraph.

COMPLIANCE AND OTHER MATTERS

As part of obtaining reasonable assurance about whether the Wisconsin Lottery's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This independent auditor's report is intended solely for the information and use of the Wisconsin Lottery's staff, the Department of Revenue's management, and the Wisconsin Legislature. This report is a matter of public record and its distribution is not limited. However, because we do not express an opinion on the effectiveness of the Wisconsin Lottery's internal control or on compliance, this report is not intended to be used by anyone other than these specified parties.

May 18, 2010

LEGISLATIVE AUDIT BUREAU
by 
Sherry Haakenson
Audit Director