

AN AUDIT

Wisconsin Lottery

Department of Revenue

99-11

August 1999

1999-2000 Joint Legislative Audit Committee Members

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State of Wisconsin \ LEGISLATIVE AUDIT BUREAU

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August 9, 1999

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

Dear Senator George and Representative Kelso:

As required by s. 13.94(1)(em), Wis. Stats., we have completed our annual 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 fiscal year (FY) 1997-98 and FY 1996-97 financial statements. As also required by s. 13.94(1)(em), Wis. Stats., we are completing a biennial performance audit of the Wisconsin Lottery, with a report expected to be released later this summer.

During FY 1997-98, the Wisconsin Lottery implemented Governmental Accounting Standards Board Statement 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, which requires that investments be reported at fair value. Also, a new accounting standard requires the Wisconsin Lottery to include information on its year 2000 readiness, which is found in Schedule IV of the supplementary information.

Property tax credits for 1996 were not distributed during FY 1996-97 because of a court ruling that determined the method used to distribute property tax credits was unconstitutional. Provisions to address the constitutionality issues were enacted as part of 1997 Wisconsin Act 27. Therefore, the FY 1997-98 transfer of lottery proceeds for property tax credit effectively included two years of property tax credits. A total of \$216,895,949 in Wisconsin Lottery proceeds was transferred to provide local property tax relief in FY 1997-98.

We appreciate the courtesy and cooperation extended to us by the Department of Revenue staff during the audit.

Respectfully submitted,

Janice Mueller
State Auditor

JM/DA/ao

INDEPENDENT AUDITOR'S REPORT ON THE FINANCIAL STATEMENTS OF THE WISCONSIN LOTTERY

We have audited the accompanying balance sheet of the Wisconsin Lottery as of June 30, 1998 and 1997, and the related statement of revenues, expenses, and changes in retained earnings and statement of cash flows for the years then ended. These financial statements are the responsibility of Wisconsin Lottery management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards 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 audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements are intended to present the financial position, results of operations, and cash flows of proprietary fund types of only that portion of the Lottery Fund that is attributable to the transactions of the Wisconsin Lottery. The financial statements are not intended to present fairly the financial position of the State of Wisconsin and the results of its operations and changes in financial position of its proprietary fund types in conformity with generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Wisconsin Lottery as of June 30, 1998 and 1997, and the results of its operations and cash flows for the years then ended in conformity with generally accepted accounting principles.

The Wisconsin Lottery implemented Governmental Accounting Standards Board Statement 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, during fiscal year 1997-98, as discussed in Note 3 to the financial statements.

Our audits were made for the purpose of forming an opinion on the financial statements taken as a whole. The accompanying financial information listed as Supplementary Information—Schedules I, II, and III in the table of contents is presented for the purposes of additional analysis and is not a required part of the financial statements of the Wisconsin Lottery. Such information has been subjected to the auditing procedures applied in the audits of the financial statements and, in our opinion, is fairly presented in all material respects in relation to the financial statements taken as a whole.

The required supplementary information on year 2000 in Schedule IV is not a required part of the basic financial statements but is supplementary information required by Governmental Accounting Standards Board technical bulletin 99-1. 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 do not express an opinion on it. In addition, we do not provide assurance that the Wisconsin Lottery is or will become year 2000 compliant, that the Wisconsin Lottery's year 2000 remediation efforts will be successful in whole or in part, or that parties with which the Wisconsin Lottery does business are or will become year 2000 compliant.

In accordance with *Government Auditing Standards*, we have also issued a report dated July 21, 1999, and provided on page 29, on our consideration of the Wisconsin Lottery's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts.

LEGISLATIVE AUDIT BUREAU

July 21, 1999 by

Diann Allsen
Audit Director

Wisconsin Lottery
Balance Sheet
June 30, 1998 and 1997

	<u>June 30, 1998</u>	<u>June 30, 1997</u>
Assets		
Current Assets:		
Cash and Cash Equivalents	\$69,834,291	\$150,172,557
Investments for Prize Annuities	24,026,458	23,968,614
Accounts Receivable	5,539,279	8,144,991
Grand Prize Deposit	9,681,343	8,733,344
Prepaid Expenses	1,401,064	68,457
Ticket Inventory	1,911,154	1,201,528
Interest Receivable	308,104	655,648
Due from Other State Programs	932,391	530,167
Total Current Assets	113,634,084	193,475,306
Noncurrent Assets:		
Investments for Prize Annuities	240,567,253	227,974,325
Equipment (net of accumulated depreciation)	747,497	1,245,332
Leasehold Improvements (net of accumulated depreciation)	90,926	128,519
Total Noncurrent Assets	241,405,676	229,348,176
Total Assets	<u>\$355,039,760</u>	<u>\$422,823,482</u>
Liabilities and Equity		
Current Liabilities:		
Annuity Prizes Payable	\$24,288,163	\$24,267,648
Prizes Payable	6,957,122	8,003,344
Accounts Payable	2,422,643	5,393,886
Lottery Association Payable	1,202,073	295,247
Due to Other State Programs	10,111,963	2,547,253
Deferred Revenue	801,454	607,820
Due to Other Governments	239,912	35,865
Accrued Payroll	190,821	151,762
Compensated Absences	126,495	97,073
Total Current Liabilities	46,340,646	41,399,898
Long-Term Liabilities:		
Annuity Prizes Payable	219,947,414	224,513,050
Total Liabilities	266,288,060	265,912,948
Equity:		
Contributed Capital	50,751	50,751
Retained Earnings:		
Unreserved	62,529,626	145,984,251
Reserved for Investment Fair Market Value Adjustment	26,171,323	10,875,532
Total Liabilities and Equity	<u>\$355,039,760</u>	<u>\$422,823,482</u>

The accompanying notes are an integral part of this statement.

Wisconsin Lottery
Statement of Revenues, Expenses, and Changes in Retained Earnings
for the Years Ended June 30, 1998 and 1997

Operating Revenues	<u>June 30, 1998</u>	<u>June 30, 1997</u>
Instant Ticket Sales	\$252,915,444	\$273,413,635
On-Line Ticket Sales	165,724,843	157,677,534
Retailer Fees	112,760	35,320
Miscellaneous Revenue	99,774	20,297
Total Operating Revenues	<u>418,852,821</u>	<u>431,146,786</u>
Operating Expenses		
Program Expenses:		
Instant Prize Expense	157,853,848	171,935,017
On-Line Prize Expense	80,548,332	72,085,236
Retailer Commissions	24,632,014	24,500,237
Total Program Expenses	<u>263,034,194</u>	<u>268,520,490</u>
Administrative Expenses:		
Instant and On-Line Vendor Services	11,659,039	6,943,013
Salaries and Fringe Benefits	3,538,468	2,780,335
On-Line Telecommunication Charges	3,532,029	4,997,895
Supplies and Services	4,363,801	7,020,129
Product Information	4,347,039	4,477,771
Ticket Costs	2,560,351	3,129,469
Depreciation Expense	625,710	615,702
Total Administrative Expenses	<u>30,626,437</u>	<u>29,964,314</u>
Total Operating Expenses	<u>293,660,631</u>	<u>298,484,804</u>
Net Operating Income	<u>125,192,190</u>	<u>132,661,982</u>
Non-Operating Revenues (Expenses)		
Investment Income	24,676,120	10,569,463
Loss on Disposal of Fixed Assets	<u>(18,254)</u>	<u>(12,153)</u>
Net Income Before Transfers	<u>149,850,056</u>	<u>143,219,292</u>
Operating Transfers:		
Transfers of Lottery Proceeds for Property Tax Credit	(216,895,949)	(13,287,938)
Transfer to Department of Revenue for Lottery Precertification	0	(626,874)
Transfer to Department of Justice for Law Enforcement	(229,587)	(227,467)
Transfer to Department of Revenue for Lottery Credit Administration	<u>(54,628)</u>	<u>(124,671)</u>
Net Income (Loss)	<u>(67,330,108)</u>	<u>128,952,342</u>
Retained Earnings		
Retained Earnings, Beginning of Year as Previously Stated	156,859,784	22,519,537
Change in Accounting for Investments for Prize Annuities	0	5,387,905
Change in Accounting for Investments for State Investment Fund Investments	<u>(828,727)</u>	<u>0</u>
Retained Earnings, Beginning of Year Adjusted	<u>156,031,057</u>	<u>27,907,442</u>
Retained Earnings, End of Year	<u>\$ 88,700,949</u>	<u>\$156,859,784</u>

The accompanying notes are an integral part of this statement.

Wisconsin Lottery
Statement of Cash Flows
for the Years Ended June 30, 1998 and 1997

	<u>June 30, 1998</u>	<u>June 30, 1997</u>
Cash Flows from Operating Activities		
Cash Received from Retailers	426,757,689	427,018,493
Cash Paid for Prizes	(257,978,432)	(251,974,838)
Cash Paid for Grand Prize Deposit	(367,339)	739,316
Cash Paid to Suppliers and Employees	(34,965,968)	(26,302,770)
Cash Paid for Retailer Commissions	(25,061,025)	(24,137,130)
Net Cash Provided by Operating Activities	<u>108,384,925</u>	<u>125,343,071</u>
Cash Flows from Non-Capital Financing Activities		
Transfer of Proceeds for Property Tax Credit	(216,240,198)	(14,986,775)
Transfer of Proceeds for Lottery Precertifications	0	(626,873)
Transfer of Proceeds for Law Enforcement	(229,587)	(227,467)
Transfer of Proceeds for Lottery Credit Administration	(54,628)	(124,671)
Net Cash Provided (Used) by Non-Capital Financing Activities	<u>(216,524,413)</u>	<u>(15,965,786)</u>
Cash Flows from Capital and Related Financing Activities		
Cash Paid for Purchase of Equipment	(357,489)	(264,077)
Cash Received from Sale of Equipment	1,935	7,214
Net Cash Provided (Used) by Capital and Related Financing Activities	<u>(355,554)</u>	<u>(256,863)</u>
Cash Flows from Investing Activities		
Interest Received	6,996,048	3,997,598
Cash Received for Redemption of Bonds	28,754,355	22,325,292
Cash Paid for Purchase of Bonds	(7,593,627)	(12,634,788)
Net Cash Provided by Investing Activities	<u>28,156,776</u>	<u>13,688,102</u>
Net Increase (Decrease) in Cash and Cash Equivalents	(80,338,266)	122,808,524
Cash and Cash Equivalents, Beginning of Year	<u>150,172,557</u>	<u>27,364,033</u>
Cash and Cash Equivalents, End of Year	<u><u>69,834,291</u></u>	<u><u>150,172,557</u></u>

The accompanying notes are an integral part of this statement.

Statement of Cash Flows
for the Years Ended June 30, 1998 and 1997

(Reconciliation of Net Operating Income to
Net Cash Provided by Operations)

	<u>June 30, 1998</u>	<u>June 30, 1997</u>
Net Operating Income	<u>125,192,190</u>	<u>132,661,982</u>
Adjustments to Reconcile Net Operating Income to Net Cash Provided by Operating Activities		
Depreciation Expense	625,710	615,702
Changes In Assets and Liabilities		
Decrease (Increase) in Receivables	2,605,712	(610,870)
Decrease (Increase) in Grand Prize Deposit	(367,339)	739,316
Decrease (Increase) in Ticket Inventory	(709,626)	1,421,959
Decrease (Increase) in Prepaid Expenses	(1,332,608)	(16,306)
Decrease (Increase) in Due from Other State Programs	(402,224)	454,478
Increase (Decrease) in Prizes Payable	(22,784,612)	(10,682,793)
Increase (Decrease) in Deferred Revenue	193,635	80,466
Increase (Decrease) in Due to Other State Programs	6,908,958	(851,398)
Increase (Decrease) in Accounts Payable	(2,724,224)	2,090,158
Increase (Decrease) in Lottery Association Payable	906,826	(541,492)
Increase (Decrease) in Due to Other Governments	204,047	437
Increase (Decrease) in Accrued Payroll	39,058	28,484
Increase (Decrease) in Compensated Absences	29,422	(47,052)
Total Adjustments	<u>(16,807,265)</u>	<u>(7,318,911)</u>
Net Cash Provided by Operating Activities	<u><u>108,384,925</u></u>	<u><u>125,343,071</u></u>

The accompanying notes are an integral part of this statement.

NOTES TO FINANCIAL STATEMENTS

1. Description of the Wisconsin Lottery

The Wisconsin Lottery, which was created in December 1987, manages scratch-off and pull-tab instant ticket games and on-line ticket games. During fiscal year (FY) 1997-98, the Wisconsin Lottery administered 78 active scratch-off, 8 active pull-tab, and 7 active on-line games.

The Wisconsin Lottery voted to join the Multi-State Lottery Association (MUSL) in June 1989. The Wisconsin Lottery, as a member of MUSL, participated in three on-line MUSL games called Powerball (start date April 19, 1992), Daily Millions (start date September 16, 1996, end date March 29, 1998), and Cash 4 Life (start date March 30, 1998).

During FY 1997-98, the Lottery also sold tickets for four other on-line 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), and Daily Pick 4 (start date September 15, 1997).

The Wisconsin Lottery is accounted for within the Lottery Fund, which is part of the State of Wisconsin financial reporting entity. Effective July 1, 1996, the Wisconsin Lottery was transferred from the Wisconsin Gaming Commission to the Wisconsin Department of Revenue.

2. Summary of Significant Accounting Policies

A. Fund Accounting and Basis of Presentation—The financial statements of the Wisconsin Lottery have been prepared in conformance with generally accepted accounting principles for proprietary funds as prescribed by the Governmental Accounting Standards Board (GASB). Proprietary funds are accounted for on the accrual basis of accounting, with revenues recognized when earned and expenses recognized when incurred. Enterprise funds, which are a type of proprietary fund, account for operations that are financed and operated in a manner similar to private business enterprises in which the costs, including depreciation, of providing goods or services to the general public are financed through user charges (sales). The accompanying financial statements were prepared based upon the flow of economic resources focus and full accrual basis of accounting.

The State of Wisconsin monitors expenditures and records financial transactions using both the budgetary basis and the accrual basis of accounting. A reconciliation between the budgetary basis and the accrual basis of accounting is shown in Schedule I.

- B. Revenue Recognition—Sales of instant scratch-off, instant pull-tab, and on-line 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 full refunds. See Note 2(H) 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 on-line games are recognized at the time the related drawings are held.

- C. Cash and Cash Equivalents—All cash is deposited with the State of Wisconsin Treasurer and is required to be invested in the State Investment Fund. The State Investment Fund 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. Since shares in the State Investment Fund are purchased in \$1,000 increments, Wisconsin Lottery cash balances below \$1,000 are deposited in the State's bank. The State Investment Fund is not registered with the Securities and Exchange Commission as an investment company.
- D. Retailer Commissions—Retailer commissions, which are classified as program expenses, were 5.5 percent for on-line ticket sales during FY 1997-98 and FY 1996-97. Retailer commissions were 5.5 percent for instant scratch and instant pull-tab tickets ordered during the period from July 1, 1996 through December 31, 1997, and were increased to 6.25 percent for instant scratch and instant pull-tab tickets ordered during the period January 1, 1998 through June 30, 1998.
- E. Administrative Expenses—Prior to FY 1997-98, Wisconsin Statutes limited lottery administrative expenses to 15 percent of gross lottery revenues and required that retailer commissions and instant and on-line vendor fees be included as administrative expenses in the calculation. Beginning in FY 1997-98, the administrative expense limit was reduced to 10 percent of gross lottery revenues, but retailer commissions are no longer included as an administrative expense in the calculation.

Instant and on-line vendor service fees represent payments to a vendor who receives a contractual fixed amount and a percentage of the revenues generated through the instant and on-line network maintained by the vendor.

A summary of the administrative expenses and related calculation of the administrative expense limit are included in Schedule II.

- F. Prizes—In accordance with Wisconsin Statutes, at least 50 percent of lottery revenues must be returned in the form of prizes. Prizes may be claimed for a period of 180 days after the drawing for on-line games, or 180 days from the declaration of the end of a game for instant games. A summary of prize payments is shown in Schedule III.
- G. Ticket Inventory—Ticket inventory consists of instant tickets for games in progress that have not yet been sold or shipped, and tickets for new games. The tickets are valued at cost using the specific identification method. The cost of tickets sold is charged to operations. Unused tickets are charged to operations in the fiscal year the game ends.
- H. Deferred Revenue—Until instant scratch-off tickets are sold to the public, retailers have the right to return unsold tickets to the Wisconsin Lottery for a refund. Therefore, receivables and cash collected in advance of sales of these tickets represent a liability to the Wisconsin Lottery. Deferred revenue is estimated and recorded based on historical information of unsold tickets returned by the retailers.

On-line Powerball and Wisconsin’s Very Own Megabucks tickets are sold for up to two drawings. On-line Supercash!, Cash 4 Life, Daily Pick 3, and Daily Pick 4 tickets are sold for the next seven drawings. On-line ticket revenues are recognized at the time the related drawings are held. All ticket sales for future drawings are recorded as deferred revenue.

- I. Equipment and Leasehold Improvements—Fixed assets purchased for \$5,000 or greater are recorded at historic cost and are depreciated using the straight-line method according to the following schedule:

<u>Estimated Lives</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 – Acquired during FY 1997-98 and thereafter	4 years

- J. **Employee 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. **Due to (from) Other State Programs**—During the course of operations, numerous transactions for goods provided or services rendered occur among individual state programs. The balance sheet classifies these receivables and payables as “Due from Other State Programs” or “Due to Other State Programs.”
- L. **Investment Valuation**—Pool shares of the State Investment Fund are bought and redeemed at \$1.00 based on the amortized cost of the investments in the Fund. Income calculations are based on the amortized cost of average pool balances. Where possible, investments in the State Investment Fund are reported at fair value for financial reporting purposes and are based on quoted market prices. Fair value determinations not based on quoted market prices include matrix pricing models or are calculated as the net present value of expected future cash flows. Nonparticipating contracts are valued at cost because these investments do not capture interest rate changes, while other investments are valued at par, which approximates fair value.

Fair value of investments for prize annuities are based on quoted market prices.

3. Accounting Changes

In FY 1997-98, the Wisconsin Lottery implemented GASB Statement 31: *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, which requires the Wisconsin Lottery to report its investments at fair value on its balance sheet and to include changes in fair value in investment income. See Note 7 for current year changes included in the comparative statements.

The FY 1996-97 financial statements have been restated to report investments for annuities at fair value; the cumulative effect of applying this statement for periods prior to FY 1996-97 for investments for annuities is shown as a restatement of the beginning balance of retained earnings as of July 1, 1996, in the amount of \$5,387,905.

The Wisconsin Lottery did not restate the FY 1996-97 financial statement balances for its pool shares in the State Investment Fund, as this information was not readily available, but first applied this statement to FY 1997-98. The cumulative effect of applying this statement for periods prior to FY 1997-98 for cash and cash equivalents is shown as a restatement of the beginning balance of retained earnings as of July 1, 1997, in the amount of negative (-) \$828,727.

4. Deposits

GASB Statement 3 requires deposits with financial institutions to be categorized to indicate the level of risk assumed by the State. At June 30, 1998, the Lottery had a balance of \$862 in the State's bank, which meets the criteria for risk category 1 because it is covered by federal depository insurance.

5. Investments

Investments for prize annuities are required to be in the form of United States zero-coupon treasury securities, securities guaranteed by the United States government, or investment instruments issued by various brokerage firms secured by United States Treasury bonds held by custodial banks. These investments have been purchased to finance the jackpot prizes that are payable as annuities over the 20-year or 25-year period. See Note 6 for information related to the annuity prizes payable. The investments are scheduled to mature near the time prize payments become payable to winners. The State's custodial bank held investments for prize annuities with a fair value of \$264,593,711 as of June 30, 1998, and a fair value of \$251,942,939 as of June 30, 1997.

Investments sufficient to finance the Cash 4 Life prize annuity payments for Wisconsin Lottery Cash 4 Life prize winners are held by MUSL; therefore, they are not shown as an asset or a liability on the Wisconsin Lottery financial statements.

The various types of securities in which the State Investment Fund may invest are enumerated in ss. 25.17(3)(b), (ba), and (bd), Wis. Stats., and include direct obligations of the United States and Canada, securities guaranteed by the United States government, securities of federally chartered corporations, unsecured notes of financial and industrial issuers, Yankee/Eurodollar issues, certificates of deposit issued by banks in the United States and solvent financial institutions in this state, and bankers' acceptances. The State of Wisconsin Investment Board's Trustees may approve other prudent investments. The Board of Trustees has given standing authority to the Board to invest in resale agreements, financial futures contracts, options, and interest rate swaps.

GASB Statement 3 requires investments to be categorized to indicate the level of risk assumed by the Wisconsin Lottery. As of June 30, 1998, all of the assets in investments for prize annuities meet the criteria for risk category 1, because the investments are insured or registered, or are held by the State or its agent in the State's name. The Wisconsin Lottery's State Investment Fund shares are not categorized.

6. Annuity Prizes Payable

The Wisconsin Lottery has an unconditional obligation to pay all jackpot prize winners the future value of the prize. The reported value of future 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. Each year, an adjustment to the Annuity Prizes Payable account is made to amortize the reported value using the effective interest method. The present value adjustment was \$17,193,268 for FY 1997-98 and \$16,009,249 for FY 1996-97. See Note 5 for information related to the investments for prize annuities. The reported value of future prize payment obligations were as follows:

<u>Fiscal Year</u>	<u>FY 1997-98</u>			<u>FY 1996-97</u>		
	<u>Current Payments</u>	<u>Long-Term Payments</u>	<u>Total Payments</u>	<u>Current Payments</u>	<u>Long-Term Payments</u>	<u>Total Payments</u>
1997-98	-	-	-	\$24,729,671	-	\$ 24,729,671
1998-99	\$ 24,737,194	-	\$24,737,194	-	\$ 24,883,580	24,883,580
1999-00	-	\$ 24,912,988	24,912,988	-	25,043,182	25,043,182
2000-01	-	25,095,286	25,095,286	-	25,208,689	25,208,689
2001-02	-	25,284,330	25,284,330	-	25,380,321	25,380,321
2002-03	-	25,480,366	25,480,366	-	-	-
Subsequent Years	-	<u>294,754,176</u>	<u>294,754,176</u>	-	<u>310,881,403</u>	<u>310,881,403</u>
Future Prize Payments	24,737,194	395,527,146	420,264,340	24,729,671	411,397,175	436,126,846
Less: Present Value Adjustment	<u>449,031</u>	<u>175,579,732</u>	<u>176,028,763</u>	<u>462,023</u>	<u>186,884,125</u>	<u>187,346,148</u>
Present Value of Future Prize Payments as of Year End	<u>\$ 24,288,163</u>	<u>\$219,947,414</u>	<u>\$244,235,577</u>	<u>\$24,267,648</u>	<u>\$224,513,050</u>	<u>\$248,780,698</u>

7. Investment Income

The investment income shown on the financial statements consists of several elements, as shown below:

	<u>FY 1997-98</u>	<u>FY 1996-97</u>
Interest from State Investment Fund	\$ 7,967,175	\$ 4,550,678
Net Increase in Fair Value of Annuity Investments	33,811,499	21,496,876
Decrease for Amortization of Annuity Investments	(17,193,268)	(16,009,249)
Net Decrease in Fair Value of State Investment Fund	(493,712)	-
Interest from MUSL Prize Reserve Accounts	580,660	525,694
Miscellaneous Interest	<u>3,766</u>	<u>5,464</u>
Total Investment Income	<u>\$ 24,676,120</u>	<u>\$ 10,569,463</u>

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 8. As the result of implementing GASB Statement 31, which requires investments to be reported at fair value, the net increases or decreases in fair value of investments for prize annuities and shares in the State Investment Fund are recognized as investment income. See Note 3 for further discussion of the implementation of GASB Statement 31. Before implementation of GASB Statement 31, investments for prize annuities had been amortized with a corresponding amortization adjustment to annuity prizes payable. Because investments are now required to be reported at fair value, the amortization of annuity prizes payable is included as a reduction to investment income.

8. Grand Prize Deposit

A grand prize deposit fund has been established by MUSL to indemnify states participating in the Powerball and Cash 4 Life games should a winning ticket not be properly paid. The combined Powerball and Cash 4 Life grand prize deposit for the State of Wisconsin was \$9,681,343 at June 30, 1998, and \$8,733,344 at June 30, 1997.

- A. For Powerball, the total prize pool equals 50 percent of sales for each Powerball drawing. Of the total prize pool, 58.39 percent funds the grand prize pool, and 41.61 percent funds the low-tier prize pool. After the grand prize pool reaches the annuitized amount of \$5 million, then 2 percent of draw sales is distributed to the Prize Reserve Account (PRA) and Set Prize Reserve Account (SPRA) until they reach their caps of \$52 million and \$30 million, respectively. Interest earned on these accounts is deposited to the Unreserved Account. For some draws,

the PRA and SPRA are reduced when the actual prizes won are greater than the amounts available in the prize pools. The Wisconsin Lottery has the right to a refund of the Wisconsin PRA and SPRA balances if it withdraws from MUSL. The Powerball Grand Prize Deposit is made up of the following:

	<u>June 30, 1998</u>	<u>June 30, 1997</u>
Prize Reserve Account (PRA)	\$5,514,054	\$5,265,110
Balance of Unreserved Account	1,273,125	692,465
Set Prize Reserve Account (SPRA)	<u>1,947,728</u>	<u>2,215,201</u>
Total Powerball Grand Prize Deposit	\$8,734,907	\$8,172,776

Because the PRA and SPRA are refundable upon withdrawal from MUSL, it is the practice of the Wisconsin Lottery to report the prize reserve balances as a receivable (Grand Prize Deposit) and to reduce Prize Expense by the same amount when the reserves are increased. The Wisconsin Lottery increases the Grand Prize Deposit and reports interest revenue in the period when the interest in the Unreserved Account is increased by MUSL.

- B. For Cash 4 Life, the total prize pool equals 50 percent of sales for each Cash 4 Life drawing. Currently, 2 percent of total sales are transferred to MUSL on trust as its proportionate share of the PRA. A cap for the Cash 4 Life Prize Reserve Account has not yet been set. The Wisconsin Lottery has the right to a refund of the Cash 4 Life prize deposit for the State of Wisconsin.

When Daily Millions ceased on March 29, 1998, the balance of the Daily Millions Prize Reserve Account totaling \$872,578, was transferred to the Cash 4 Life Prize Reserve Account. At June 30, 1998, MUSL held \$946,436 as a Cash 4 Life prize deposit for the State of Wisconsin.

Because the Cash 4 Life prize reserve is refundable upon withdrawal from MUSL, it is the practice of the Wisconsin Lottery to report the prize reserve balances as a receivable (Grand Prize Deposit) and to reduce Prize Expense by the same amount when the reserves are increased.

9. Commitments

Operating Leases—The Wisconsin Lottery occupied office, warehouse, and storage facilities in Madison and Milwaukee under operating leases during FY 1997-98. The lease for the Madison facility expires March 31, 2000. The lease for the Milwaukee facility expires June 30, 2004.

The following schedule summarizes the future minimum lease payments required under operating leases having a remaining noncancelable lease term in excess of one year:

		<u>June 30, 1998</u>	<u>June 30, 1997</u>
Fiscal year ending	1998	-	\$652,467
	1999	\$ 747,489	428,623
	2000	691,307	-
	2001	368,198	-
	2002	379,244	-
	Thereafter	<u>792,962</u>	<u>-</u>
Total minimum payments required		\$2,979,200	\$1,081,090

Total lease expenses for the Wisconsin Lottery amounted to \$677,685 for the fiscal year ended June 30, 1998, and \$662,617 for the fiscal year ended June 30, 1997.

10. Prize Expense and Prizes Payable

The Wisconsin Lottery is required by law to honor winning tickets up to 180 days after the end of a game for instant games and 180 days after a drawing for on-line games. After the 180-day period, the prize expense is adjusted for those winners who did not redeem their tickets.

Scratch ticket prizes include low-tier prizes (below \$50), high-tier prizes (\$50 and above), and grand prizes (amounts won through the televised “Money Game Show”). All pull-tab ticket prizes are considered low-tier prizes.

Powerball and Megabucks tickets may be purchased with either the annuity payment or cash payment option. All other on-line games’ jackpot prizes are paid in one lump sum, except for the Cash 4 Life jackpot, where the winner receives \$1,000 per week for life and no cash option is available.

On-line ticket prizes vary, depending on the on-line game:

- A. Powerball—The prize structure for Powerball includes a guaranteed minimum jackpot of \$10 million divided equally among all valid game plays that match five of five numbers plus the Powerball. Set prizes are paid for valid tickets matching eight other number combinations.

The Powerball prize pool for all prize categories consists of 50 percent of each draw period’s sales. The Wisconsin Lottery recognizes as prize expense its share of the prize pool at the time the related drawing is held. The Wisconsin Lottery transfers to MUSL money equal to its share of the prize pool, less the amount required to pay the non-jackpot

prize winners and the first annual payment for any jackpot prize winners purchasing tickets from the Wisconsin Lottery. The amounts withheld from MUSL to pay these prize winners are reported as prizes payable until the winners redeem their tickets.

In the event the Wisconsin Lottery sells a valid annuity payment option winning ticket for the jackpot prize for Powerball, MUSL will purchase investments to finance the prize annuity. The investments are transferred to the State of Wisconsin, and the State assumes the related annuity prizes payable liability. No additional prize expense is reported for the jackpot winners, since the investments are purchased from the prize pool contributed by all states participating in MUSL. During FY 1996-97, the Wisconsin Lottery acquired annuity investments of \$15,593,133 and assumed annuity prize liability of the same amount. No annuity investments were acquired and no prize liabilities were assumed in FY 1997-98.

For jackpot prize winning tickets purchased with the cash payment option, MUSL transfers to the Wisconsin Lottery money equal to the cash jackpot. The Wisconsin Lottery then pays this amount to the prize winner. No additional prize expense is reported for the jackpot winners, since the prizes are paid from the prize pool contributed by all states participating in MUSL.

- B. Wisconsin's Very Own Megabucks—The prize structure for Wisconsin's Very Own Megabucks on-line lotto game includes a guaranteed minimum jackpot of \$1 million divided equally among all game plays that match, in any order, six of six numbers drawn, along with set prizes for game plays matching three, four, and five of the six numbers drawn. The number of winners in each of these categories, multiplied by the set prize amount for that category, is equal to the prize expense for the Wisconsin's Very Own Megabucks game, with an adjustment made in the event there is no jackpot winner for the last draw of the year. Prizes expensed are reported as prizes payable until the winners redeem their tickets.

In the event there is a Wisconsin's Very Own Megabucks annuity payment option jackpot winner, the Wisconsin Lottery contracts with MUSL to purchase prize annuities. The investments funded by the Wisconsin Lottery are transferred to the State of Wisconsin, and the State assumes the related annuity prizes payable liability. The Wisconsin Lottery acquired annuity investments of \$7,778,914 in FY 1997-98 and \$13,022,713 in FY 1996-97, and assumed annuity prize liabilities of the same amounts.

The Wisconsin Lottery makes one direct cash payment to Megabucks jackpot prize winners who elect the cash payment option at the time of ticket purchase.

- C. Supercash!—The prize structure for the Supercash! daily game includes a set top prize of \$250,000 for each play on a valid game ticket correctly matching, in any order, six of six numbers drawn. However, if there are more than 20 plays on valid game tickets correctly matching, in any order, six of the six winning numbers in the drawing, then \$5,000,000 is to be divided equally among the winning plays. Set prizes are paid for valid tickets matching four and five of the six numbers drawn. The number of winners in each of these categories, multiplied by the prize amount for that category, is equal to the prize expense for the Supercash! game. Prizes expensed are reported as prizes payable until the winners redeem their tickets.
- D. Daily Pick 3—The prize structure for the Daily Pick 3 game includes a set top prize of \$500 for each play on a valid game ticket correctly matching three of three numbers drawn in correct order. The play options available are straight, box, and straight/box. Prizes vary based on the type of play category. The number of winners in each of these categories, multiplied by the prize amount for that category, is equal to the prize expense for the Daily Pick 3 game. Prizes expensed are reported as prizes payable until the winners redeem their tickets.
- E. Daily Pick 4—The prize structure for the Daily Pick 4 game includes a set top prize of \$5,000 for each play on a valid game ticket correctly matching four of four numbers drawn in correct order. The play options available are straight plays and 24-, 12-, 6-, and 4-way box plays. The selection of numbers determines the box type. Prizes vary based on the type of play category. The number of winners in each of these categories, multiplied by the prize amount for that category, is equal to the prize expense for the Daily Pick 4 game. Prizes expensed are reported as prizes payable until the winners redeem their tickets.
- F. Cash 4 Life—The prize structure for the Cash 4 Life game includes a set top prize of \$1,000 per week for life for each play on a valid game ticket correctly matching four of four numbers drawn in the top prize group. Each play consists of 15 sets of 4 two-digit numbers. One set of four numbers for the top prize group may be selected by the player or may be randomly selected, at the player's option. The remaining 14 sets of numbers are selected randomly. The number of winners in each of the prize categories, multiplied by the prize amount for that category, is equal to the prize expense for the Cash 4 Life game. Prizes expensed are reported as prizes payable until the winners redeem their tickets.

Unlike other grand prize games, the prizes payable liability and the related investments to pay Cash 4 Life prize winners are held by MUSL, and are therefore not included in the financial statements of the Wisconsin Lottery. MUSL transfers weekly prize payments to the Wisconsin Lottery, which are then paid by the Wisconsin Lottery to the eligible top prize winners.

- G. Daily Millions—The on-line Daily Millions game ended March 29, 1998. While the game was active, the prize pool for all prize categories consisted of 50 percent of each draw period's sales. Players won by matching 2, 3, 4, 5, or 6 numbers, by color, to win \$2, \$5, \$100, \$5,000, or the top prize of \$1,000,000. The top prize was paid in one installment. If there were more than 10 winning plays for the top prize, \$10,000,000 was shared equally among winning plays.

The Wisconsin Lottery recognized as prize expense its share of the prize pool at the time the related Daily Millions drawing was held. The number of winners in each prize category, multiplied by the prize amount for that category, was the amount of prize expense for the Daily Millions game. The Wisconsin Lottery transferred to MUSL money equal to its share of the prize pool, less the amount required to pay the non-top prize winners. The amounts withheld from MUSL to pay these prize winners were reported as prizes payable until the winners redeemed their tickets.

11. Reserved Retained Earnings

The Wisconsin Lottery has reserved retained earnings for fair value adjustments of investments of \$26,171,323 as of June 30, 1998 and \$10,875,532 as of June 30, 1997. The Wisconsin Lottery does not realize gains or losses from the change in fair value of its annuity investments because it holds the investments until maturity to pay the annual prize payments. Therefore, fair value adjustments recognized as investment income as a result of applying GASB Statement 31 will not be available for distribution as property tax credits.

12. Contributed Capital

Between October 1, 1992 and September 30, 1995, costs associated with the purchase of commonly used fixed assets were allocated among the Lottery, Racing, Indian Gaming, and Charitable Gaming programs administered by the Gaming Commission. When the Lottery program transferred from the Gaming Commission to the Department of Revenue (DOR), the commonly used fixed assets purchased jointly were divided between the Lottery program at DOR, and the programs that remained with the Gaming Commission. The assets allocated to the Lottery program resulted in contributed capital of \$50,751.

13. Employee Retirement Plan

Permanent, full-time employees of the Wisconsin Lottery are participants in the Wisconsin Retirement System, a cost-sharing, multiple-employer, defined benefit plan governed by Chapter 40 of Wisconsin Statutes. It was established to provide retirement pension benefits for state and local government public employees at a rate influenced by: 1) the employee's final average earnings,

2) years of creditable service, and 3) a formula factor. The Wisconsin Retirement System is considered part of the State of Wisconsin's financial reporting entity. Copies of the separately issued financial report that includes financial statements and required supplementary information for the year ending December 31, 1998, may be obtained by writing to:

Department of Employee Trust Funds
P.O. Box 7931
Madison, WI 53707-7931

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 are amortized over 40 years, beginning January 2, 1990. 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 \$392,714 for FY 1997-98 and \$304,312 for FY 1996-97. 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.

14. Distribution of Net Proceeds

The Wisconsin Constitution requires proceeds from the operations of the Wisconsin Lottery to be used to provide local property tax relief. For FY 1997-98, a total of \$216,895,949 in Wisconsin Lottery proceeds was used for the following purposes: \$205,777,240 for Lottery Tax Credits and \$11,118,709 for Farmland Tax Relief Credits. For FY 1996-97, a total of \$13,287,938 in Wisconsin Lottery proceeds was used for the following purposes: \$348,766 for Lottery Tax Credits and \$12,939,172 for Farmland Tax Relief Credits.

On October 29, 1996, the Dane County Circuit Court ruled that the method of distributing lottery property tax credit at the time violated the Wisconsin Constitution. As a result, \$126 million available for 1996 lottery property tax credits were not distributed in FY 1996-97. Provisions were enacted in the 1997-99 biennial budget, 1997 Wisconsin Act 27, to distribute available lottery proceeds for property tax credits in FY 1997-98, which effectively resulted in the distribution of two years' of property tax credits in that fiscal year.

15. Disclosure of Contingencies

The Wisconsin Lottery is a defendant in one lawsuit filed by a jackpot prize winner. The general counsel for the Lottery estimates that the potential claims against the Lottery will not materially affect the financial condition of the Wisconsin Lottery.

Schedule I

Reconciliation of Lottery Expenses to the Budgetary Basis of Accounting
FY 1997-98

Salaries and Fringe Benefits	
Per Financial Statement	\$3,538,468
Adjustments to Financial Statement Balance:	
Cash paid in FY 1997-98 but expensed in FY 1996-97	158,837
Cash paid in FY 1998-99 but expensed in FY 1997-98	(218,403)
Budgetary Basis	<u>\$3,478,902</u>

Supplies and Services	
Per Financial Statement:	
On-line telecommunication charges	\$3,532,029
Product information	4,347,039
Ticket costs	2,560,351
Supplies and services	4,363,801
Depreciation expense	<u>625,710</u>
Total per Financial Statement	15,428,930
Adjustments to Financial Statement Balance:	
Depreciation	(625,710)
Cash paid in FY 1996-97 but expensed in FY 1997-98	(1,201,528)
Cash paid in FY 1997-98 but expensed in FY 1996-97	142,312
Cash paid in FY 1997-98 but expensed in FY 1998-99	1,926,149
Cash paid in FY 1998-99 but expensed in FY 1997-98	(171,406)
Budgetary Basis	<u>\$15,498,747</u>

Permanent Property	
Per Financial Statement	\$ 0
Adjustments to Financial Statement Balance:	
FY 1997-98 net permanent property capitalized	(626)
FY 1997-98 disposal of permanent property	111,097
Cash paid in FY 1997-98 but expensed in FY 1996-97	108,050
Cash paid in FY 1998-99 but expensed in FY 1997-98	(60,609)
Budgetary Basis	<u>\$157,912</u>

Schedule II

Lottery Administrative Expenses

	Fiscal Year Ended <u>June 30, 1996</u>	Fiscal Year Ended <u>June 30, 1997</u>	Fiscal Year Ended <u>June 30, 1998</u>
Administrative Expenses			
Instant and On-line Vendor Services	\$ 7,484,238	\$ 6,943,013	\$ 11,659,039
Salaries and Fringe Benefits	3,622,658	2,780,335	3,538,468
Supplies and Services	4,180,988	7,020,129	4,363,801
Product Information	4,491,519	4,477,771	4,347,039
Ticket Costs	3,974,768	3,129,469	2,560,351
On-line Telecommunication Charges	5,503,969	4,997,895	3,532,029
Depreciation Expense	<u>620,448</u>	<u>615,702</u>	<u>625,710</u>
Total Administrative Expenses as Determined in Accordance with s. 25.75 (3)(b), Wis. Stats.	<u>\$ 29,878,588</u>	<u>\$ 29,964,314</u>	<u>\$ 30,626,437</u>
Gross Lottery Operating Revenues	<u>\$ 482,212,642</u>	<u>\$ 431,146,786</u>	<u>\$ 418,852,821</u>
Administrative Expenses as a Percentage of Lottery Revenues	6.20%	6.95%	7.31%
Under Prior Law:			
Retailer Commissions	<u>26,966,657</u>	<u>24,500,237</u>	
Total Administrative Expenses	<u>\$ 56,845,245</u>	<u>\$ 54,464,551</u>	
Administrative Expenses as a Percentage of Lottery Revenues	11.79%	12.63%	

In FY 1995-96 and FY 1996-97, s. 25.75(3)(b), Wis. Stats., limited the Lottery's administrative expenses to 15 percent of gross lottery revenues. Gross lottery revenues include lottery ticket sales and retailer fees. The statutes required retailer commissions to be included as an administrative expense along with general lottery expenses in determining compliance with the 15 percent limit. Beginning in FY 1997-98, the administrative expense limit was reduced to 10 percent of gross lottery revenues, but retailer commissions are no longer included as an administrative expense in the calculation. This schedule has been restated to show prior years' data and using the new law for comparative purposes with the current year. Below this comparative data is the prior year information as previously presented under the rules of the law in effect during those fiscal years.

Schedule III

Summary of Prize Expenses

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 on-line games, are summarized below.

Fiscal Year 1997-98			
	<u>Prize Expense</u>	<u>Ticket Sales</u>	<u>Prize Expense as a Percentage of Sales</u>
Instant Games	\$157,853,848	\$252,915,444	62.4%
On-Line Games	<u>80,548,332</u>	<u>165,724,843</u>	48.6
Total for Fiscal Year	\$238,402,180	\$418,640,287	56.9

Fiscal Year 1996-97			
	<u>Prize Expense</u>	<u>Ticket Sales</u>	<u>Prize Expense as a Percentage of Sales</u>
Instant Games	\$171,935,017	\$273,413,635	62.9%
On-Line Games	<u>72,085,236</u>	<u>157,677,534</u>	45.7
Total for Fiscal Year	\$244,020,253	\$431,091,169	56.6

Fiscal Year 1995-96			
	<u>Prize Expense</u>	<u>Ticket Sales</u>	<u>Prize Expense as a Percentage of Sales</u>
Instant Games	\$194,635,387	\$310,401,692	62.7%
On-Line Games	<u>82,330,739</u>	<u>171,722,268</u>	47.9
Total for Fiscal Year	\$276,966,126	\$482,123,960	57.4

Fiscal Year 1994-95			
	<u>Prize Expense</u>	<u>Ticket Sales</u>	<u>Prize Expense as a Percentage of Sales</u>
Instant Games	\$200,351,918	\$320,356,094	62.5%
On-Line Games	<u>98,465,771</u>	<u>198,558,877</u>	49.6
Total for Fiscal Year	\$298,817,689	\$518,914,971	57.6

Fiscal Year 1993-94			
	<u>Prize Expense</u>	<u>Ticket Sales</u>	<u>Prize Expense as a Percentage of Sales</u>
Instant Games	\$173,941,451	\$285,317,450	61.0%
On-Line Games	<u>99,748,968</u>	<u>210,203,461</u>	47.5
Total for Fiscal Year	\$273,690,419	\$495,520,911	55.2

NOTE: The above amounts are based on an accrual basis of accounting, with adjustments made to prize expenses 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.

Schedule IV

Year 2000 Readiness

The year 2000 (Y2K) issue refers to the fact that many computer programs use only the last two digits to refer to a year (i.e., 1999 uses 99). When the year 2000 arrives, using the last two digits “00” may cause computer programs, data files, and electronic equipment with computer chips to fail or create errors.

The Wisconsin Department of Administration (DOA) is requiring state agencies to report monthly on efforts to ensure operation of critical business functions within the agency, progress made on information technology systems supporting those critical business functions, and efforts to address issues related to equipment with embedded microprocessors that support critical business functions. The reporting on information technology systems measures progress in four stages: (1) awareness, (2) assessment, (3) remediation, and (4) validation/testing.

The Wisconsin Lottery is subjecting its critical systems to the following process to address Y2K compliance:

- **awareness stage** -establishing a budget and project plan for dealing with the Y2K issue;
- **assessment stage** -identifying the systems and components for which Y2K compliance work is needed;
- **remediation stage** -making changes to systems and equipment; and
- **validation/testing stage** -validating and testing the changes that were made during the remediation stage.

The Wisconsin Lottery’s critical systems are in the following stages of work. C means complete, P means in process, and A means still needs to be addressed.

<u>Critical Systems</u>	<u>Awareness</u>	<u>Assessment</u>	<u>Remediation</u>	<u>Validation/Testing</u>
PRO:SYS	C	C	C	P
Internal Control System (ICS)	C	C	C	P
WiSMART	C	C	C	C
Personal Computers	C	C	C	C

The Wisconsin Lottery has not, to date, identified any significant Y2K consequences or unbudgeted costs to make the critical business applications Y2K compliant. The costs to the Wisconsin Lottery to become Y2K compliant have been and will continue to be

absorbed within the existing base operating budget because most Y2K compliance work is being completed by the Wisconsin Lottery as part of ongoing maintenance and upgrades previously identified and budgeted for by the Wisconsin Lottery.

In addition, the following is a summary of efforts currently being undertaken by the Wisconsin Lottery:

- The Governor issued Executive Order 341 on July 27, 1998, which directs all state agencies to make Y2K compliance activities their top technology priority. In addition, Executive Order 341 created a blue ribbon commission to recommend ways to enhance communication and coordination between public and private efforts to address Y2K issues.
- The Wisconsin Lottery has followed the Department of Revenue Y2K workplan, including hardware/software inventory, vendor inventory, interface assessment, and testing to verify the effectiveness of Y2K compliance activities. The Wisconsin Lottery is also required by the Multi-State Lottery Association (MUSL) to have an independent assessment of Y2K readiness. If the independent assessment is not completed prior to September 9, 1999, MUSL potentially may prohibit the Lottery from selling on-line tickets until the testing is completed.
- The Wisconsin Lottery has prepared a Year 2000 Contingency Plan designed to address possible problems arising from failures of information technology systems or other disruptions of business problems.

The Wisconsin Lottery has contacted GTECH, Firststar Bank, Ameritech, Speedee Delivery, Scientific Games, Oberthur Gaming Technology, and Pollard Bank Note and has been informed by each of these vendors that they intend to be Y2K compliant by the fourth quarter of calendar year 1998. The Wisconsin Lottery will continue to monitor these compliance activities and take appropriate steps to ensure timely compliance, as needed.

The Wisconsin Lottery cannot provide absolute assurances that all Y2K problems will be corrected by January 1, 2000, nor that all information technology systems will continue to work efficiently on January 1, 2000. There remains a possibility that some Y2K problems will not be identified or corrected by January 1, 2000. However, the actions that the Wisconsin Lottery is currently completing should minimize such potential problems, especially for critical business applications.

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE AND INTERNAL CONTROL OVER FINANCIAL REPORTING 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, 1998 and 1997, and have issued our report thereon dated July 21, 1999. We conducted our audits in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

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 that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Wisconsin Lottery's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements, and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that we will report to the management of the Wisconsin Lottery in a separate letter.

This report is intended for the information of the Wisconsin Lottery management and the Wisconsin Legislature's Joint Legislative Audit Committee. This restriction is not intended to limit the distribution of this report, which, upon submission to the Joint Legislative Audit Committee, is a matter of public record.

LEGISLATIVE AUDIT BUREAU

July 21, 1999 by

Diann Allsen
Audit Director