

Report 12-12
June 2012

Wisconsin Lottery

Department of Revenue

STATE OF WISCONSIN



Legislative Audit Bureau ■

Wisconsin Lottery

Department of Revenue

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Joe Chrisman
State Auditor

June 15, 2012

Senator Robert Cowles and
Representative Samantha Kerkman, Co-chairpersons
Joint Legislative Audit Committee
State Capitol
Madison, Wisconsin 53702

Dear Senator Cowles and Representative Kerkman:

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) 2010-11 and FY 2009-10 financial statements. We also found that the Wisconsin Lottery was in compliance with statutory spending limitations related to prizes, product information, administrative expenses, and retailer compensation.

During FY 2010-11, the Wisconsin Lottery generated total ticket sales of \$502.7 million, which was 4.5 percent more than FY 2009-10. Instant ticket sales increased \$29.4 million as a result of an increase in sales of \$20 instant scratch-off tickets and an increase in the number and timing of new scratch-off games offered during FY 2010-11. Sales of lotto tickets, which are sold through terminals at lottery retail locations, declined \$7.6 million during FY 2010-11 primarily because there were fewer large Powerball jackpots. As ticket sales increased during FY 2010-11, so did the Wisconsin Lottery's operating expenses.

In FY 2010-11, lottery proceeds used for property tax relief totaled \$144.9 million, which included \$129.1 million for the Lottery and Gaming Tax Credit. On November 1, 2011, the Department of Administration and the Legislature's Joint Committee on Finance authorized the use of \$137.6 million in Wisconsin Lottery proceeds for the Lottery and Gaming Tax Credit for property tax relief in FY 2011-12.

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

Respectfully submitted,

A handwritten signature in cursive script, appearing to read "Joe Chrisman".

Joe Chrisman
State Auditor

JC/SH/ss

Introduction ■

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 lotto games. Instant games are tickets that reveal a prize when consumers remove scratch-off or pull-tab coverings. Lotto games generally involve players picking numbers from an automated system, with winning numbers selected in drawings held at intervals ranging from daily to twice per week.

As required by s. 13.94(1)(em), Wis. Stats., we have completed a financial audit of the Wisconsin Lottery and have issued an unqualified opinion on its financial statements for the years ended June 30, 2011, and June 30, 2010. As part of our financial audit, we reviewed the Wisconsin Lottery's ticket sales, operating expenses, and property tax relief distributions. We also assessed compliance with statutory requirements and spending limitations related to prizes and other expenses.

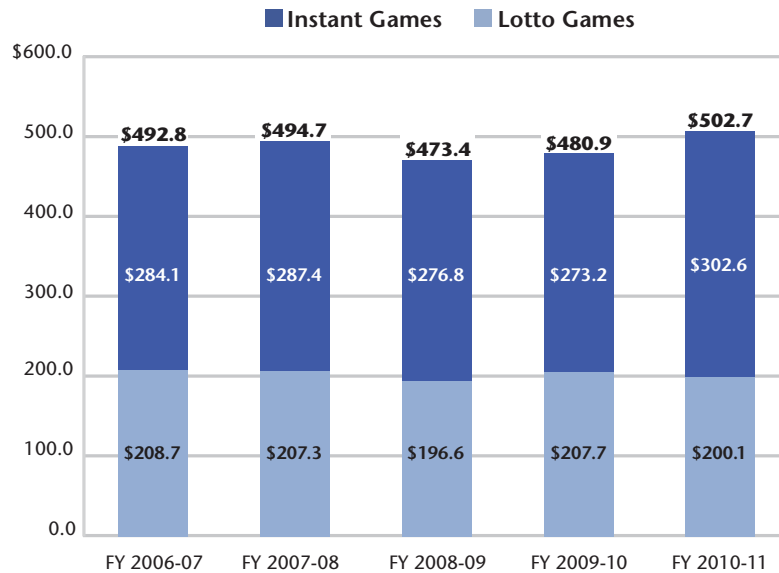
Wisconsin Lottery Ticket Sales

Wisconsin Lottery's ticket sales increased 4.5 percent from FY 2009-10 to FY 2010-11.

The Wisconsin Lottery derives more than 99 percent of its operating revenue from instant and lotto ticket sales. Ticket sales increased 2.0 percent from fiscal year (FY) 2006-07 through FY 2010-11. As shown in Figure 1, FY 2010-11 ticket sales totaled \$502.7 million, which was 4.5 percent more than FY 2009-10. In FY 2010-11, instant ticket sales comprised 60.2 percent of the total ticket sales.

Figure 1

Wisconsin Lottery Ticket Sales (in millions)



After declining during FY 2008-09 and FY 2009-10, instant ticket sales increased \$29.4 million in FY 2010-11, largely due to increased sales of \$20 instant scratch-off tickets and an increase in the number and timing of new scratch-off games offered. A \$7.6 million decline in lotto ticket sales during FY 2010-11 was primarily attributable to fewer large Powerball jackpots.

Wisconsin Lottery Operating Expenses

From FY 2009-10 through FY 2010-11, operating expenses increased to \$360.1 million, or by 6.4 percent.

The Wisconsin Lottery's largest expenses are prizes and retailer compensation, which includes commissions and incentives. As shown in Table 1, the Wisconsin Lottery's operating expenses declined from \$355.2 million in FY 2006-07 to \$338.4 million in FY 2009-10. However, FY 2010-11 operating expenses increased to \$360.1 million, or by 6.4 percent, primarily because prizes and retailer compensation increased as ticket sales increased.

Table 1

Wisconsin Lottery Operating Expenses
(in millions)

Expense Type	FY 2006-07	FY 2007-08	FY 2008-09	FY 2009-10	FY 2010-11
Prizes	\$292.1	\$286.4	\$280.2 ¹	\$274.0 ¹	\$292.7
Retailer Compensation	34.1	34.3	32.4	33.3	35.3
Game Development and Production	16.5	16.7	16.2	15.4	16.5
Product Information	4.5	7.4	7.4	7.5	7.4
Other ²	8.0	8.8	8.6	8.2	8.2
Total	\$355.2	\$353.6	\$344.8¹	\$338.4¹	\$360.1

¹ Reflects a prior-period adjustment from amounts shown in *Wisconsin Lottery* (report 11-6).

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

Game development and production expenses include instant game ticket printing and delivery costs and payments to GTECH Corporation, which maintains a central information system to account for instant and lotto game activity and connect to retailer terminals. Game development and production expenses have been fairly consistent over the last five years. However, expenses were lower in FY 2009-10 because the Wisconsin Lottery negotiated a reduction in contract payments to GTECH Corporation beginning on July 1, 2009. In exchange for the payment reduction, the Wisconsin Lottery exercised a renewal option to extend its contract an additional two years to June 22, 2013. Game development and production expenses increased in FY 2010-11 because contractual payments to GTECH Corporation increased as ticket sales increased. The Wisconsin Lottery paid GTECH Corporation \$11.2 million in FY 2009-10 and \$11.8 million in FY 2010-11.

In FY 2010-11, the Wisconsin Lottery spent \$7.4 million on product information.

The Wisconsin Constitution prohibits public funds or revenues derived from lottery operations from being expended for promotional advertising and directs that any advertising should provide information about the chances of winning and prize structures. The annual product information budget, which is established through the State's biennial budget, increased from \$4.6 million in FY 2006-07 to \$7.5 million in FY 2007-08 and has remained unchanged since then. In FY 2010-11, the Wisconsin Lottery spent \$7.4 million on product information.

Property Tax Credits

Proceeds from the Wisconsin Lottery provided \$710.9 million in property tax relief from FY 2006-07 through FY 2010-11.

The Wisconsin Constitution requires that net proceeds from the Wisconsin Lottery be used only for property tax relief, which was provided to:

- owners of residences in Wisconsin as credits on individual property tax bills through the Lottery and Gaming Tax Credit and the School Levy Tax Credit; and
- certain owners of farmland in Wisconsin through the Farmland Tax Relief Credit.

From its inception in 1988 through FY 2010-11, the Wisconsin Lottery has provided nearly \$3.2 billion in property tax relief. As shown in Table 2, lottery proceeds provided \$710.9 million in property tax relief from FY 2006-07 through FY 2010-11.

Table 2

Wisconsin Property Tax Relief¹ (in millions)

Fiscal Year	Lottery and Gaming Tax Credit	Farmland Tax Relief Credit ²	School Levy Tax Credit	Total Distributed
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	112.8	14.3	–	127.1
2010-11	129.1	0.9	14.9	144.9
Total	\$633.9	\$62.1	\$14.9	\$710.9

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 Use of Wisconsin Lottery proceeds for this program was discontinued after December 2009. Additional payments are expected as taxpayers amend or file late tax returns.

As directed by 2009 Wisconsin Act 28, the 2009-11 Biennial Budget Act, Wisconsin Lottery proceeds of \$14.9 million funded a portion of the School Levy Tax Credit beginning in FY 2010-11. Prior to FY 2010-11, lottery proceeds had funded the Farmland Tax Relief Credit. Under Act 28, the Farmland Tax Relief Credit was eliminated

and this lottery funding was instead used for the School Levy Tax Credit. Act 28 made a corresponding \$14.9 million reduction in general purpose revenue (GPR) funding for the School Levy Tax Credit, and that same amount of GPR was appropriated to fund a portion of the newly created Per Acre Farmland Preservation Tax Credit.

Statutory Requirements

State statutes impose limitations on certain types of lottery expenses. For example, s. 25.75(3)(a), Wis. Stats., requires that at least 50 percent of Wisconsin Lottery sales be returned to players as prize payments. As shown in Table 3, the Wisconsin Lottery's prize expenses complied with the statutory requirement from FY 2006-07 through FY 2010-11, although they have fluctuated because of changes in the types of games offered and played. Lotto 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.

Table 3

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

Fiscal Year	Prize Expenses	Ticket Sales	Percentage of Ticket Sales
2006-07	\$292.1	\$492.8	59.3%
2007-08	286.4	494.7	57.9
2008-09	280.2 ¹	473.4	59.2 ¹
2009-10	274.0 ¹	480.9	57.0 ¹
2010-11	292.7	502.7	58.2

¹ Reflects a prior-period adjustment from amounts shown in *Wisconsin Lottery* (report 11-6).

The Wisconsin Lottery returned 58.2 percent of ticket sales to players as prize payments in FY 2010-11.

The higher prize payout in FY 2010-11 is primarily attributable to higher lotto payouts than expected, including for Mega Millions and for Wisconsin's Megabucks EZ Match, which was introduced on April 3, 2011. Wisconsin's Megabucks EZ Match is an optional add-on game that players may purchase with a Wisconsin's Megabucks lotto ticket, and it has a higher prize payout compared to other lotto games.

From FY 2006-07 through FY 2010-11, administrative expenses remained below the statutory limit of 10.0 percent of gross lottery revenues.

Section 25.75(3)(b), Wis. Stats., limits certain administrative expenses to no more than 10.0 percent of gross lottery revenues. Statutory gross lottery revenues consist of instant and lotto ticket sales and retailer fees. Statutory administrative expenses include most expenses and transfers except prize payments, retailer compensation, transfers to pay property tax relief, and transfers to the Department of Justice for lottery-related law enforcement activities. As shown in Table 4, the Wisconsin Lottery's administrative expenses remained below the statutory limit from FY 2006-07 through FY 2010-11.

Table 4

Statutorily Defined Administrative Expenses as a Percentage of Gross Lottery Revenues¹
(in millions)

Fiscal Year	Statutorily Defined Administrative Expenses	Statutorily Defined Gross Lottery Revenues	Percentage of Gross Lottery Revenues
2006-07	\$29.6	\$492.9	6.0%
2007-08	33.5	494.6	6.8
2008-09	32.9	473.5	7.0
2009-10	31.8	481.0	6.6
2010-11	32.9	502.7	6.5

¹ As restated for a change in the Wisconsin Lottery's calculation methodology, which now considers certain transfers to be administrative expenses. See Schedule 2 for additional detail.

The Wisconsin Lottery provided 1.0 percent of ticket sales for the retailer performance program in FY 2010-11.

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 lotto tickets and 6.25 percent for instant tickets. Section 565.02(4)(g), Wis. Stats., requires that performance program payments to eligible retailers may not exceed 1.0 percent of total ticket sales. As shown in Table 5, the Wisconsin Lottery's retailer performance program payments complied with the statutory limit for the past five fiscal years, although payments reached the statutory maximum in FY 2010-11.

Table 5

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

Fiscal Year	Retailer Performance Program Payments	Ticket Sales	Percentage of Ticket Sales
2006-07	\$4.5	\$492.8	0.9%
2007-08	4.5	494.7	0.9
2008-09	4.0	473.4	0.8
2009-10	4.5	480.9	0.9
2010-11	5.1	502.7	1.0

■ ■ ■ ■

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, 2011, and June 30, 2010, 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 audits.

We conducted our audits 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 audits provide 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, 2011, and June 30, 2010, 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.

In accordance with *Government Auditing Standards*, we have also issued a report dated June 6, 2012, 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.

Our audits were 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. The schedules on pages 52 through 54 have been subjected to the auditing procedures applied in the audits 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. For Management's Discussion and Analysis on pages 13 through 22, 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.

June 6, 2012

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 ended June 30, 2011, and June 30, 2010, with comparative information from the fiscal year ended June 30, 2009. 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 Wisconsin Lottery had the third-highest sales year in its history in FY 2010-11, as sales outperformed the Wisconsin economy as a whole. Operating revenues generated from ticket sales for the Wisconsin Lottery were \$502.7 million in FY 2010-11 versus \$480.9 million in FY 2009-10, an increase of 4.5 percent. In comparison, as reported in the FY 2010-11 Comprehensive Annual Fiscal Report issued by the Wisconsin Department of Administration, total sales and excise taxes in Wisconsin increased by only 2.6 percent. The Wisconsin Lottery's ability to generate funds for property tax relief remains strong.

- Refinement of the instant ticket supply chain, along with the introduction of Game Book, a new instant scratch-off product, resulted in \$302.6 million in instant ticket sales. The last time instant ticket sales were over \$300 million was in 1996.

- Operating expenses for FY 2010-11 increased \$21.7 million, or 6.4 percent, primarily as a result of increased prize expenses and costs for additional ticket printing and delivery, due to increased sales. Office Administration Expenses (salaries, fringe benefits, and supplies) remained relatively constant, \$8.2 million in FY 2010-11 versus \$8.1 million in FY 2009-10.
- Administrative expenses, as defined in s. 25.75(3)(b), Wis. Stats., were 6.5 percent of gross lottery revenues, well below the statutory maximum of 10.0 percent. Total statutory administrative expenses, which include administrative expenses on the financial statements, all program expenses except prizes and retailer compensation, and certain transfers out, were \$32.9 million in FY 2010-11, an increase of \$1.1 million from \$31.8 million in FY 2009-10.
- Net income before transfers was \$141.6 million for FY 2010-11, compared to \$144.3 million in FY 2009-10, mainly due to decreased investment income.

Overview of the Financial Statements

The Wisconsin Constitution requires that net proceeds from the operations of the Wisconsin Lottery be used to provide property tax relief. 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. Balances from other gaming-related appropriations that are not derived from Wisconsin Lottery operations, 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 and leasehold improvements), restricted deposits for Powerball and Mega Millions 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.

Summary of 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 2010-11 and FY 2009-10. 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

Wisconsin Lottery Net Assets (in millions)

	June 30, 2011	June 30, 2010	Change	June 30, 2009	Change
Investments	\$ 56.5	\$ 64.0	\$(7.5)	\$ 72.0	\$(8.0)
Capital Assets (Net of Accumulated Depreciation)	0.1	0.1	0.0	0.1	0.0
Other Assets	70.3	67.7	2.6	55.1	12.6
Total Assets	126.9	131.8	(4.9)	127.2	4.6
Current Liabilities	43.5	40.1 ¹	3.4	46.0 ¹	(5.9)
Noncurrent Liabilities	41.9	46.0	(4.1)	51.8	(5.8)
Total Liabilities	85.4	86.1¹	(0.7)	97.8¹	(11.7)
Net Assets:					
Invested in Capital Assets	0.1	0.1	0.0	0.1	0.0
Restricted for MUSL Reserves	4.7	4.0	0.7	4.0	0.0
Restricted for Investment Fair Market Value Adjustment	8.8	10.0	(1.2)	8.5	1.5
Restricted for Property Tax Relief	27.9	31.6 ¹	(3.7)	16.8 ¹	14.8
Total Net Assets	<u>\$ 41.5</u>	<u>\$ 45.7¹</u>	<u>\$(4.2)</u>	<u>\$ 29.4¹</u>	<u>\$16.3</u>

¹ Amounts adjusted to reflect a prior-period adjustment (see Note 20).

Assets

The Wisconsin Lottery's assets consist primarily of cash and cash equivalents, investments for prize annuities, accounts receivable, Multi-State Lottery Association (MUSL) reserve accounts, and instant ticket inventory. As shown in Table A, total assets were \$126.9 million, compared to \$131.8 million at the end of FY 2009-10 and \$127.2 million at the end of FY 2008-09. The decrease in assets in

FY 2010-11 is due to investments being used for annuity payments while no new annuity-related investments have been made, as no winners have chosen annuities during the last three years. The increase in assets from FY 2008-09 to FY 2009-10 is due to higher net income added to the Wisconsin Lottery's cash and cash equivalents account, which increased by \$11.7 million from \$28.0 million at the end of FY 2008-09 to \$39.7 million at the end of FY 2009-10.

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 previously noted, no winners during the past three years chose to receive their winnings in the form of an annuity. Therefore, total annuity prizes payable decreased each year as existing annuitants continued to receive their annual payments, and as a result, total liabilities declined. At the end of FY 2010-11, the Wisconsin Lottery had total liabilities of \$85.4 million, compared with total liabilities of \$86.1 million at the end of FY 2009-10 (as restated) and \$97.8 million at the end of FY 2008-09 (as restated).

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 reserve accounts held by 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, because 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.

Revenues, Expenses, and Changes in Fund Net Assets

The Wisconsin Lottery's total net assets were \$41.5 million as of the end of FY 2010-11, a \$4.2 million decrease from the prior year. During FY 2009-10, total net assets increased by \$16.3 million to \$45.7 million (as restated). Total net assets were \$29.4 million in FY 2008-09 (as restated).

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 2010-11 and FY 2009-10. Table B presents data for the past three fiscal years in a condensed form.

Table B

Wisconsin Lottery Changes in Net Assets
(in millions)

	FY 2010-11	FY 2009-10	Change	FY 2008-09	Change
Revenues					
Operating Revenues:					
Ticket sales	\$502.7	\$480.9	\$21.8	\$473.4	\$7.5
Retailer fees and miscellaneous revenue	0.1	0.1	0.0	0.3	(0.2)
Nonoperating Revenues:					
Investment income (loss)	(1.1)	1.6	(2.7)	0.1	1.5
Miscellaneous revenue	0.0	0.1	(0.1)	0.1	0.0
Total Revenues	501.7	482.7	19.0	473.9	8.8
Expenses					
Program Expenses:					
Prize expenses	292.7	274.0 ¹	18.7	280.2 ¹	(6.2)
Retailer commissions and incentives	35.3	33.3	2.0	32.4	0.9
Instant and lotto vendor services	11.8	11.2	0.6	12.0	(0.8)
Other game-related expenses	12.1	11.7	0.4	11.6	0.1
Office Administration Expenses	8.2	8.2	0.0	8.6	(0.4)
Total Expenses	360.1	338.4¹	21.7	344.8¹	(6.4)
Net Income Before Transfers	141.6	144.3¹	(2.7)	129.1¹	15.2
Transfers					
Transfers for Property Tax Relief	(144.9)	(127.1)	(17.8)	(132.4)	5.3
Transfers In from General Fund	0.1	0.2	(0.1)	0.2	0.0
Transfer for Compulsive Gambling Programs	(0.4)	(0.4)	0.0	(0.4)	0.0
Transfer for Law Enforcement	(0.3)	(0.3)	0.0	(0.3)	0.0
Transfer for Lottery Credit Administration	(0.2)	(0.3)	0.1	(0.3)	0.0
Transfers Out to General Fund	(0.1)	(0.1)	0.0	(0.1)	0.0
Change in Net Assets	<u>\$ (4.2)</u>	<u>\$ 16.3¹</u>	<u>\$(20.5)</u>	<u>\$ (4.2)¹</u>	<u>\$20.5</u>

¹ Amounts adjusted to reflect a prior-period adjustment (see Note 20).

Operating Revenues

Operating revenues are generated almost entirely from ticket sales. Ticket sales for the Wisconsin Lottery were \$502.7 million in FY 2010-11, \$480.9 million in FY 2009-10, and \$473.4 million in FY 2008-09. Table C compares ticket sales for each game category for FY 2010-11, FY 2009-10, and FY 2008-09.

Table C

Wisconsin Lottery Ticket Sales (in millions)

	FY 2010-11	FY 2009-10	Change	FY 2008-09	Change
Instant					
Scratch-off	\$299.1	\$269.3	\$29.8	\$271.9	\$(2.6)
Pull-tab	3.5	3.9	(0.4)	4.9	(1.0)
Total Instant Ticket Sales	302.6	273.2	29.4	276.8	(3.6)
Lotto					
SuperCash!	25.9	27.2	(1.3)	27.4	(0.2)
Powerball	65.1	89.3	(24.2)	85.4	3.9
Wisconsin's Megabucks	16.9	18.8	(1.9)	20.7	(1.9)
Wisconsin's Megabucks EZ Match ¹	1.6	0.0	1.6	0.0	0.0
Daily Pick 3	24.8	26.2	(1.4)	26.3	(0.1)
Daily Pick 4	12.1	12.2	(0.1)	12.0	0.2
Badger 5	24.5	23.7	0.8	24.8	(1.1)
Mega Millions ²	28.7	10.3	18.4	0.0	10.3
Raffle Games ³	0.5	0.0	0.5	0.0	0.0
Total Lotto Ticket Sales	200.1	207.7	(7.6)	196.6	11.1
Total Sales	<u>\$502.7</u>	<u>\$480.9</u>	<u>\$21.8</u>	<u>\$473.4</u>	<u>\$7.5</u>

¹ The Wisconsin Lottery began selling Wisconsin's Megabucks EZ Match on April 3, 2011. EZ Match is an add-on feature that can only be purchased with Megabucks.

² The Wisconsin Lottery began selling Mega Millions on January 31, 2010.

³ Raffle games were not offered during FY 2009-10 and FY 2008-09.

As previously stated, the sales increase in FY 2010-11 was due to an increase in the sales of instant scratch-off tickets. In March 2011, the Wisconsin Lottery introduced a new product, Game Book, consisting of six \$5 scratch-off games bound in a book retailing for \$20. Instant scratch-off ticket sales increased \$29.8 million during FY 2010-11, after decreasing \$2.6 million during FY 2009-10. The Wisconsin Lottery continues to strategically focus on higher-priced instant games through marketing and higher prize payouts on those games. Pull-tab sales decreased \$0.4 million in FY 2010-11, following a \$1.0 million decrease in FY 2009-10.

Lotto game sales decreased by \$7.6 million during FY 2010-11, following an \$11.1 million increase in FY 2009-10. The decline in FY 2010-11 was primarily due to lower sales of two of the Wisconsin Lottery's jackpot games: Powerball and Wisconsin's Megabucks. Sales of these games are dependent upon the size of the jackpot and, as a result, can be highly variable.

Expenses

Expenses consist of amounts paid in prizes, retailer commissions and incentives, fees paid to the Wisconsin Lottery's gaming system vendor (instant and lotto vendor services), other game-related expenses, and administrative expenses. In FY 2010-11, total expenses were \$360.1 million, an increase of \$21.7 million from FY 2009-10 expenses of \$338.4 million (as restated), which had declined from FY 2008-09 expenses of \$344.8 million (as restated). An increase in expenses is expected when revenues increase. The bulk of the Wisconsin Lottery's expenses are tied to sales; more sales mean more tickets printed, more prizes paid to players, increased commissions for retailers, and higher fees paid to the gaming system vendor.

Prizes are the Wisconsin Lottery's largest expense. Table D compares ticket prize awards for each lottery game category for FY 2010-11, FY 2009-10, and FY 2008-09.

Table D

Wisconsin Lottery Ticket Prize Awards
(in millions)

	FY 2010-11	FY 2009-10	Change	FY 2008-09	Change
Instant					
Scratch-off	\$192.2	\$171.1 ¹	\$21.1	\$174.8 ¹	\$(3.7)
Pull-tab	2.2	2.5	(0.3)	3.0	(0.5)
Super 2nd Chance ²	0.3	0.3	0.0	0.4	(0.1)
Total Instant Prize Awards	194.7	173.9¹	20.8	178.2¹	(4.3)
Lotto					
SuperCash!	13.2	12.7	0.5	18.5	(5.8)
Powerball	30.6	42.1	(11.5)	41.1	1.0
Wisconsin's Megabucks	8.9	9.8	(0.9)	10.9	(1.1)
Wisconsin's Megabucks EZ Match	1.0	0.0	1.0	0.0	0.0
Daily Pick 3	11.5	12.3	(0.8)	13.6	(1.3)
Daily Pick 4	5.4	6.1	(0.7)	5.4	0.7
Badger 5	12.2	11.5	0.7	12.1	(0.6)
Mega Millions	14.7	5.3	9.4	0.0	5.3
Raffle Games	0.2	0.0	0.2	0.0	0.0
Super 2nd Chance ²	0.3	0.3	0.0	0.4	(0.1)
Total Lotto Prize Awards	98.0	100.1	(2.1)	102.0	(1.9)
Total	<u>\$292.7</u>	<u>\$274.0¹</u>	<u>\$18.7</u>	<u>\$280.2¹</u>	<u>\$(6.2)</u>

¹ Amounts adjusted to reflect a prior-period adjustment (see Note 20).

² Super 2nd Chance prizes are awarded through drawings to players who send in non-winning scratch-off and lotto tickets. The prizes are funded from the original purchase of the scratch-off and lotto 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, although there are exceptions. In FY 2010-11, ticket sales increased \$21.8 million while prize awards increased \$18.7 million, but ticket sales increased \$7.5 million in FY 2009-10 while prize awards declined \$6.2 million. Movement of prize expense in the opposite direction of ticket sales can occur because the "luck of the draw" nature of lotto games can affect the amount of prizes paid. For instance, sales for SuperCash! were similar during the last three fiscal years (Table C), yet there were more SuperCash! winners in FY 2008-09 than would be mathematically expected, and the Wisconsin Lottery paid \$5.8 million more in prizes that year than in FY 2009-10 (Table D). Schedule 3, which follows 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 2010-11, retailers were paid \$35.3 million in commissions and incentives, up from \$33.3 million in FY 2009-10. In FY 2008-09, retailer commissions and incentives were \$32.4 million.

The Wisconsin Lottery contracted with GTECH Corporation for an integrated gaming computer system and services (instant and lotto vendor services). In FY 2010-11, payments to GTECH were \$11.8 million. In FY 2009-10 and FY 2008-09, these payments were \$11.2 million and \$12.0 million, respectively. Initially, the Wisconsin Lottery paid GTECH 2.54 percent of total net ticket sales. In July 2009, the Wisconsin Lottery extended its contract with GTECH through June 2013. In consideration for that extension, GTECH reduced the cost of the contract by \$1.0 million per year, beginning in FY 2009-10. Therefore, beginning with FY 2009-10, the Wisconsin Lottery paid GTECH 2.54 percent of sales, less \$1.0 million. In addition, GTECH is providing, at no additional cost, a remote, hot-site backup of the system and a data feed for the development of a data warehouse.

Net Income and Transfer for Property Tax Relief

Net income before transfers was \$141.6 million in FY 2010-11, down from \$144.3 million in FY 2009-10 (as restated). Net income before transfers was \$129.1 million for FY 2008-09 (as restated).

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 transfers out for property tax relief increased by \$17.8 million, or 14.0 percent, during FY 2010-11, while they decreased by \$5.3 million, or 4.0 percent, during FY 2009-10.

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

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Financial Statements ■

Statement of Net Assets

June 30, 2011 and 2010

	June 30, 2011	Restated June 30, 2010
ASSETS		
Current Assets:		
Cash and Cash Equivalents (Note 3)	\$ 39,239,187	\$ 39,689,012
Investments for Prize Annuities (Note 3)	7,205,387	9,681,260
Accounts Receivable (Note 4)	22,985,980	20,147,993
Due from Other State Programs (Note 4)	131,999	203,592
Ticket Inventory	1,845,961	1,802,438
MUSL Reserve Accounts (Note 9)	1,115,236	1,290,759
Prepaid Expenses	331,121	561,632
Interest Receivable	(1,493)	5,021
Total Current Assets	<u>72,853,378</u>	<u>73,381,707</u>
Noncurrent Assets:		
Investments for Prize Annuities (Note 3)	49,239,775	54,346,978
MUSL Reserve Accounts (Note 9)	4,692,716	4,023,428
Capital Assets: (Note 10)		
Equipment	805,798	779,680
Leasehold Improvements	159,724	159,724
Accumulated Depreciation	(870,076)	(836,334)
Total Noncurrent Assets	<u>54,027,937</u>	<u>58,473,476</u>
TOTAL ASSETS	<u>126,881,315</u>	<u>131,855,183</u>
LIABILITIES		
Current Liabilities:		
Annuity Prizes Payable (Note 5)	7,079,983	9,505,276
Prizes Payable	31,404,460	25,998,839
Accounts Payable (Note 4)	2,461,785	2,322,189
Due to Other State Programs (Note 4)	576,025	831,546
Lottery Association Payable	626,928	601,595
Unearned Revenue	905,879	645,522
Due to Other Governments (Note 4)	75,367	54,768
Accrued Payroll	142,255	128,368
Compensated Absences (Note 17)	208,334	8,120
Total Current Liabilities	<u>43,481,016</u>	<u>40,096,223</u>
Noncurrent Liabilities:		
Annuity Prizes Payable (Note 5)	41,065,921	45,079,927
Compensated Absences (Note 17)	363,530	571,797
Other Postemployment Benefits (Note 16)	489,002	394,548
Total Noncurrent Liabilities	<u>41,918,453</u>	<u>46,046,272</u>
TOTAL LIABILITIES	<u>85,399,469</u>	<u>86,142,495</u>
NET ASSETS		
Net Assets:		
Invested in Capital Assets (Note 14)	95,446	103,070
Restricted for MUSL Reserves (Note 14)	4,692,716	4,023,428
Restricted for Investment Fair Market Value Adjustment (Note 14)	8,800,267	9,981,733
Restricted for Property Tax Relief (Note 14)	27,893,417	31,604,457
TOTAL NET ASSETS	<u>\$ 41,481,846</u>	<u>\$ 45,712,688</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, 2011 and 2010

	Year Ended June 30, 2011	Restated Year Ended June 30, 2010
OPERATING REVENUES		
Instant Ticket Sales (Net of Allowances of \$559,374 and \$512,149, Respectively) (Note 7)	\$ 302,521,074	\$ 273,271,670
Lotto Ticket Sales (Net of Ticket Discounts of \$0 and \$148,003, Respectively) (Note 7)	200,130,712	207,670,334
Retailer Fees	37,340	54,455
Miscellaneous Revenue	62,101	72,723
Total Operating Revenues	502,751,227	481,069,182
OPERATING EXPENSES		
Program Expenses:		
Instant Prize Expense (Note 8)	194,621,768	173,852,506
Lotto Prize Expense (Note 8)	98,035,772	100,155,657
Retailer Commissions and Incentives	35,247,289	33,320,017
Instant and Lotto Vendor Services	11,816,299	11,226,345
Product Information Costs	7,445,141	7,469,890
Instant Ticket Printing Costs	3,918,131	3,465,809
Instant Ticket Delivery Costs	743,065	689,449
Donated Prize Expense (Note 12)	12,677	57,902
Total Program Expenses	351,840,142	330,237,575
Administrative Expenses:		
Salaries and Fringe Benefits	5,638,566	5,670,783
Supplies and Services	2,544,692	2,411,988
Depreciation Expense	43,678	48,210
Total Administrative Expenses	8,226,936	8,130,981
Total Operating Expenses	360,067,078	338,368,556
NET OPERATING INCOME	142,684,149	142,700,626
NONOPERATING REVENUES (EXPENSES) AND TRANSFERS		
Investment Income (Loss) (Note 6)	(1,059,312)	1,596,195
Miscellaneous Revenue (Note 12)	12,677	57,902
Net Income Before Transfers	141,637,514	144,354,723
Transfers:		
Transfers of Lottery Proceeds for Property Tax Relief (Note 15)	(144,865,023)	(127,116,472)
Transfers In from General Fund (Note 18)	125,546	192,856
Transfer to Department of Health Services for Compulsive Gambling Programs	(396,000)	(396,000)
Transfer to Department of Justice for Law Enforcement	(357,934)	(355,723)
Transfer to Department of Revenue for Lottery Credit Administration	(237,780)	(275,752)
Transfers Out to General Fund (Note 19)	(137,165)	(130,626)
CHANGE IN NET ASSETS	(4,230,842)	16,273,006
Total Net Assets—Beginning of the Year (Note 20)	45,712,688	29,439,682
Total Net Assets—End of the Year (Note 20)	\$ 41,481,846	\$ 45,712,688

The accompanying notes are an integral part of this statement.

Statement of Cash Flows for the Years Ended June 30, 2011 and 2010

	Year Ended June 30, 2011	Restated Year Ended June 30, 2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash Received from Retailers	\$ 498,007,591	\$ 478,511,512
Cash Paid for Prizes	(295,543,435)	(287,768,471)
Cash Paid for Retailer Commissions and Incentives	(34,350,970)	(32,535,021)
Cash Paid/Received for MUSL Reserve Accounts	(484,532)	143,754
Cash Paid to Employees	(5,538,013)	(5,609,753)
Cash Paid to Suppliers	(26,354,386)	(26,440,141)
Net Cash Provided by Operating Activities	135,736,255	126,301,880
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Transfers of Proceeds for Property Tax Credit	(145,025,508)	(127,100,513)
Transfer of Proceeds for Law Enforcement	(374,373)	(346,079)
Transfer of Proceeds for Lottery Credit Administration	(240,272)	(281,632)
Transfer of Proceeds for Compulsive Gambling Programs	(396,000)	(396,000)
Transfers to the General Fund	(137,165)	(130,626)
Transfers from the General Fund	192,856	208,077
Net Cash Used by Noncapital Financing Activities	(145,980,462)	(128,046,773)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Cash Paid for Purchase of Equipment	(36,053)	(5,000)
Net Cash Used by Capital and Related Financing Activities	(36,053)	(5,000)
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest Received	119,435	100,870
Cash Received for Redemption of Bonds	9,711,000	13,305,000
Net Cash Provided by Investing Activities	9,830,435	13,405,870
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(449,825)	11,655,977
Cash and Cash Equivalents—Beginning of the Year	39,689,012	28,033,035
Cash and Cash Equivalents—End of the Year	<u>\$ 39,239,187</u>	<u>\$ 39,689,012</u>

The accompanying notes are an integral part of this statement.

	Year Ended June 30, 2011	Restated Year Ended June 30, 2010
RECONCILIATION OF NET OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Net Operating Income	\$ 142,684,149	\$ 142,700,626
Adjustments to Reconcile Net Operating Income to Net Cash Provided by Operating Activities:		
Depreciation Expense	43,678	48,210
Noncash Donated Prize Expense	12,677	57,902
Changes in Assets and Liabilities:		
Decrease (Increase) in Receivables	(2,837,987)	(875,203)
Decrease (Increase) in MUSL Reserve Accounts	(484,531)	143,754
Decrease (Increase) in Ticket Inventory	(43,523)	(123,825)
Decrease (Increase) in Prepaid Expenses	230,511	(181,719)
Decrease (Increase) in Due from Other State Programs	5,510	7,811
Increase (Decrease) in Prizes Payable	(4,343,067)	(13,772,550)
Increase (Decrease) in Unearned Revenue	260,356	(258,485)
Increase (Decrease) in Due to Other State Programs	(88,634)	175,262
Increase (Decrease) in Accounts Payable	150,052	(1,314,726)
Increase (Decrease) in Lottery Association Payable	25,333	(397,956)
Increase (Decrease) in Due to Other Governments	21,444	2,178
Increase (Decrease) in Accrued Payroll	13,887	7,901
Increase (Decrease) in Compensated Absences	(8,054)	(14,400)
Increase (Decrease) in Other Postemployment Benefits	94,454	97,100
Total Adjustments	<u>(6,947,894)</u>	<u>(16,398,746)</u>
Net Cash Provided by Operating Activities	<u>\$ 135,736,255</u>	<u>\$ 126,301,880</u>
Noncash Activities:		
Net Change in Unrealized Gains and Losses	\$ (1,181,466)	\$ 1,461,650
Increase in Fair Market Value of Investments for Prize Annuities and Annuities Payable Due to Amortization	3,309,390	3,839,194

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 2010-11 and FY 2009-10, the Wisconsin Lottery sold scratch-off, pull-tab, and lotto games. 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 Wisconsin Constitution requires that the net proceeds from Wisconsin Lottery operations be used to provide local property tax relief.

The Wisconsin Lottery joined the Multi-State Lottery Association (MUSL) in June 1989. In FY 2010-11 and FY 2009-10, as a member of MUSL, the Wisconsin Lottery participated in two MUSL lotto games: Powerball (start date April 19, 1992) and Mega Millions (start date January 31, 2010). See Note 9 for information about MUSL.

During FY 2010-11 and FY 2009-10, the Wisconsin Lottery also sold tickets for five other lotto games: SuperCash! (start date February 4, 1991), Wisconsin's 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). The EZ Match feature for Megabucks was added on April 3, 2011.

The Wisconsin Lottery offered raffle style games in FY 2010-11 but did not offer them during FY 2009-10.

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 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 on the Statement of Cash Flows includes cash deposited in the State's bank and the Wisconsin 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.

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 are 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, and fair market value information is determined using quoted market prices.

E. Accounts Receivable

Accounts receivable balances primarily represent amounts due from Wisconsin Lottery retailers. Receivables are recorded when instant tickets are sold to retailers. These receivables typically have four-week billing terms, except for nonprofit organizations that typically have weekly billing terms. Receivables are recorded for lotto games when retailers sell lotto tickets and have weekly billing terms. The Wisconsin Lottery collects receivable amounts through a weekly process to withdraw amounts due from retailer deposit accounts.

F. 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."

G. 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.

H. Capital Assets

Tangible assets purchased for \$5,000 or more and intangible assets that have a cost or value greater than \$100,000 are capitalized and recorded at historic cost. As applicable, assets are 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

I. Prizes Payable and Annuity Prizes Payable

For lotto 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.

J. Unearned Revenue

Retailers have the right to return unsold instant scratch-off tickets to the Wisconsin Lottery for a refund at any time prior to the game end date. Therefore, receivables and cash collected in advance of these ticket sales represent a contingent liability of the Wisconsin Lottery. A sales allowance 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, lotto tickets are sold for up to eight future drawings. Lotto ticket revenue is recognized at the time the related drawings are held. All ticket sales for future drawings are reported as unearned revenue.

K. 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.

L. Ticket Sales Revenue Recognition

Sales of instant scratch-off, instant pull-tab, and lotto 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(J) 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 lotto games are recognized at the time the related drawings are held. The Wisconsin Lottery occasionally features lotto 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.

M. Prize Expenses

In accordance with s. 27.75(3)(a), Wis. Stats., 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 lotto 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.

N. Retailer Commissions

Retailer commissions, which are classified as program expenses, were 5.5 percent for lotto ticket sales and 6.25 percent for instant scratch-off and instant pull-tab tickets during FY 2010-11 and FY 2009-10. Nonprofit organizations receive higher commissions.

O. Retailer Performance Program

In addition to the retailer commissions discussed in Note 2(N), 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 2010-11 and FY 2009-10 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 lotto and instant lottery tickets and lottery shares, which are multiple-draw lotto tickets.

Under the winning ticket component, participating retailers that sell a winning scratch-off or lotto 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. The aggregate amount of payments to retailers for a short-term incentive is limited to \$300,000 per incentive.

The sales goals incentive component allows participating retailers to earn additional commissions based on increased sales. Subject to certain restrictions and allowances, retailers earned up to 2.0 percent of the increase in quarterly sales compared to sales of the previous quarter for instant tickets and certain lotto non-jackpot games (SuperCash!, Daily Pick 3, Daily Pick 4, and Badger 5). These incentive payments are made quarterly. Retailers also earn up to 10.0 percent of the increase in annual sales over the previous year. These incentive payments are made annually. Because of the unpredictable nature of the lotto jackpot games (Wisconsin's Megabucks, Mega Millions, and Powerball) and raffle-style games, sales goals incentive program payments for these games 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.

P. Administrative Expenses

Section 25.75(3)(b), Wis. Stats., limits 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.

Q. Disbursement of Lottery Proceeds for Property Tax Relief

The State of Wisconsin disburses net lottery proceeds through three means: the Lottery and Gaming Tax Credit, Farmland Tax Relief Credit, and School Levy Tax 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. The Farmland Tax Relief Credit was discontinued, per s. 20.835(2)(q), Wis. Stats., for taxable years beginning after December 31, 2009. However, claims are still being processed on amended returns and late returns.

The School Levy Tax Credit is determined by statute and is paid to municipalities on the fourth Monday in July. Beginning in FY 2010-11, Wisconsin statutes require a specified amount, \$14,850,000, to be transferred from the Lottery Fund to cover a portion of the School Levy Tax Credit.

R. 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. The carrying amount of shares in the State Investment Fund, which approximates fair market value, was \$39,239,000 as of June 30, 2011, and \$39,689,000 as of June 30, 2010.

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 separately 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, which are not considered to have credit risk. All of the Wisconsin Lottery's total investments for prize annuities balance as of June 30, 2011, and June 30, 2010, 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 Wisconsin Lottery would not be able to recover the value of investments that are in possession of an outside party. As of June 30, 2011, and June 30, 2010, 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, 2011, or June 30, 2010. The State Investment Fund does not have a deposit policy specifically for custodial credit risk.

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, 2011, and June 30, 2010, consisted of U.S. Treasury or Agency securities. In addition, concentration of credit risk requirements do not apply to investments guaranteed by the United States government or 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 market 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 market 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, 2011 and 2010:

<u>Maturity</u>	<u>Fair Market Value as of June 30, 2011</u>	<u>Fair Market Value as of June 30, 2010</u>
Less than 1 Year	\$ 7,205,387	\$ 9,681,260
1 to 5 Years	19,323,233	25,842,224
6 to 10 Years	22,220,780	21,100,396
More than 10 Years	<u>7,695,762</u>	<u>7,404,358</u>
Total	<u>\$56,445,162</u>	<u>\$64,028,238</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 was 73 days as of June 30, 2011, and 78 days as of June 30, 2010.

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely impact the fair market value of an investment. The Wisconsin Lottery follows MUSL’s investment policy, which 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. These securities are not considered to have foreign currency risk because they are not denominated in a foreign currency. The State Investment Fund shares included in the balance of cash and cash equivalents were not exposed to foreign currency risk as the State Investment Fund guidelines allow the investment in U.S. dollar denominated issues only.

4. ACCOUNTS RECEIVABLE AND ACCOUNTS PAYABLE BALANCES

Accounts receivable and accounts payable balances are disaggregated as follows:

A. Accounts Receivable

	<u>June 30, 2011</u>	<u>June 30, 2010</u>
Accounts Receivable:		
Retailers	\$22,983,961	\$20,145,493
Miscellaneous	<u>2,019</u>	<u>2,500</u>
Total Accounts Receivable	<u>\$22,985,980</u>	<u>\$20,147,993</u>
Due from Other State Programs:		
Transfers for Gaming	\$ 125,546	\$ 192,856
Miscellaneous	<u>6,453</u>	<u>10,736</u>
Total Due from Other State Programs	<u>\$ 131,999</u>	<u>\$ 203,592</u>

B. Accounts Payable

	<u>June 30, 2011</u>	<u>June 30, 2010</u>
Accounts Payable:		
Vendors	\$2,390,901	\$2,070,733
Prizes	0	235,279
Withholding on Prizes	0	(78,707)
Lottery Credit Administration	48,814	56,761
Law Enforcement	60	6,986
Miscellaneous	<u>22,010</u>	<u>31,137</u>
Total Accounts Payable	<u>\$2,461,785</u>	<u>\$2,322,189</u>
Due to Other State Programs:		
Farmland Tax Relief Credit	\$ 12,220	\$ 171,478
Employee Fringe Benefits	62,898	78,012
Withholding on Prizes	167,909	269,610
Lottery Credit Administration	5,259	5,919
Law Enforcement	9,878	16,848
Other State Programs	<u>317,861</u>	<u>289,679</u>
Total Due to Other State Programs	<u>\$ 576,025</u>	<u>\$ 831,546</u>
Due to Other Governments:		
Employee Fringe Benefits	\$ 65,767	\$ 45,230
Withholding on Prizes	5,324	4,417
Lottery Credit Administration	1,252	2,016
Law Enforcement	<u>3,024</u>	<u>3,105</u>
Total Due to Other Governments	<u>\$ 75,367</u>	<u>\$ 54,768</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 \$3,309,390 for FY 2010-11 and \$3,839,194 for FY 2009-10.

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

<u>Fiscal Year</u>	<u>FY 2010-11</u> <u>Total Payments</u>	<u>FY 2009-10</u> <u>Total Payments</u>
2010-11	\$ 0	\$ 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
2014-15	6,273,871	6,273,871
2015-16	6,149,499	6,149,499
Subsequent Years	<u>32,774,208</u>	<u>32,774,208</u>
Total Future Prize Payments	66,137,477	75,884,828
Less: Present Value Adjustment	<u>17,991,573</u>	<u>21,299,625</u>
Present Value of Future Prize Payments	<u>\$48,145,904</u>	<u>\$54,585,203</u>

Annuity prizes payable activity for the fiscal years ended June 30, 2011, and June 30, 2010, 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>
2010-11	\$54,585,203	\$3,309,390	\$ (9,748,689)	\$48,145,904	\$7,079,983
2009-10	65,311,058	3,839,194	(14,565,049)	54,585,203	9,505,276

6. INVESTMENT INCOME (LOSS)

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

	<u>FY 2010-11</u>	<u>FY 2009-10</u>
<u>Change in Fair Market Value:</u>		
Net Increase (Decrease) in Fair Market Value of Annuity Investments	\$2,127,924	\$5,300,844
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>(3,309,390)</u>	<u>(3,839,194)</u>
Net Increase (Decrease) in Fair Market Value Recognized as Investment Income	<u>(1,181,466)</u>	<u>1,461,650</u>
<u>Interest Income:</u>		
Interest from State Investment Fund	108,934	88,412
Interest from MUSL Reserve Accounts	9,233	35,516
Miscellaneous Interest	<u>3,987</u>	<u>10,617</u>
Total Interest Income	<u>122,154</u>	<u>134,545</u>
Total Investment Income (Loss)	<u>\$(1,059,312)</u>	<u>\$1,596,195</u>

GASB Statement No. 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 MUSL reserve accounts. For additional information on MUSL reserve accounts, see Note 9.

7. INSTANT AND LOTTO TICKET SALES

Instant and lotto ticket sales shown on the financial statements consist of the following:

	<u>FY 2010-11</u>	<u>FY 2009-10</u>
Instant Ticket Sales:		
Scratch-off	\$299,052,121	\$269,371,319
Pull-tab	<u>3,468,953</u>	<u>3,900,351</u>
Total Instant Ticket Sales	<u>\$302,521,074</u>	<u>\$273,271,670</u>
Lotto Ticket Sales:		
SuperCash!	\$ 25,868,046	\$ 27,235,898
Powerball	65,132,048	89,302,882
Wisconsin's Megabucks	16,925,087	18,819,605
Wisconsin's Megabucks EZ Match	1,570,412	0
Daily Pick 3	24,768,176	26,197,958
Daily Pick 4	12,143,923	12,153,612
Badger 5	24,519,888	23,718,687
Mega Millions	28,708,710	10,254,569
Raffle Games	500,000	0
General Sales and Discounts	<u>(5,578)</u>	<u>(12,877)</u>
Total Lotto Ticket Sales	<u>\$200,130,712</u>	<u>\$207,670,334</u>

8. INSTANT AND LOTTO PRIZE EXPENSE

Instant and lotto prize expenses shown on the financial statements consist of the following:

	<u>FY 2010-11</u>	<u>FY 2009-10</u>
Instant Prize Expense:		
Scratch-off	\$192,220,195	\$171,142,220
Pull-tab	2,136,573	2,450,286
Super 2nd Chance	<u>265,000</u>	<u>260,000</u>
Total Instant Prize Expense	<u>\$194,621,768</u>	<u>\$173,852,506</u>
Lotto Prize Expense:		
SuperCash!	\$13,190,281	\$ 12,703,446
Powerball	30,601,501	42,097,333
Wisconsin’s Megabucks	8,880,867	9,830,744
Wisconsin’s Megabucks EZ Match	991,662	0
Daily Pick 3	11,492,970	12,287,480
Daily Pick 4	5,405,000	6,143,800
Badger 5	12,216,272	11,494,780
Mega Millions	14,744,419	5,338,074
Raffle Games	247,800	0
Super 2nd Chance	<u>265,000</u>	<u>260,000</u>
Total Lotto Prize Expense	<u>\$98,035,772</u>	<u>\$100,155,657</u>

9. MULTI-STATE LOTTERY ASSOCIATION

A. Joint Venture Association

The Wisconsin Lottery is a member of MUSL, 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. Until FY 2009-10, the Wisconsin Lottery participated in one MUSL game: Powerball. During FY 2009-10, MUSL entered into an agreement with the consortium of states that own the Mega Millions game that allows the consortium and MUSL to sell the other’s game. The Wisconsin Lottery began selling Mega Millions on January 31, 2010.

B. MUSL Financial Position and Activity

The following schedule presents the summarized audited financial position and activity of MUSL as of June 30, 2011 and 2010, as audited by other auditors.

	<u>June 30, 2011</u>	<u>June 30, 2010</u>
Total Assets	<u>\$641,434,915</u>	<u>\$736,287,105</u>
Total Liabilities	\$641,193,712	\$735,783,000
Total Unrestricted Net Assets	<u>241,203</u>	<u>504,105</u>
Total Liabilities and Net Assets	<u>\$641,434,915</u>	<u>\$736,287,105</u>
Total Revenues	\$ 4,100,964	\$ 3,711,818
Total Expenses	<u>(4,363,866)</u>	<u>(4,002,064)</u>
Increase (Decrease) in Unrestricted Net Assets	<u>\$ (262,902)</u>	<u>\$ (290,246)</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 Prize Pools and Related MUSL Reserve Accounts

The Powerball game is designed to pay out 50.0 percent of sales in prizes. Therefore, lotteries participating in the Powerball game are required to transfer 50.0 percent of its ticket sales to MUSL for the Powerball prize pools and reserve accounts. Of this amount, 61.0577 percent funds the Powerball grand prize pool, 34.9423 percent funds the pool to pay the remaining Powerball prizes, and 4.0 percent is placed in one or more of the following three accounts: the Powerball Set-Aside Account, the Powerball Set Prize Reserve Account (SPRA), and the Powerball Prize Reserve Account (PRA).

The 4.0 percent is first used to fund a third prize pool, the Powerball Set-Aside Account, until it reaches its cap of \$7.5 million. The Set-Aside Account is used for under-funded jackpots. An under-funded jackpot occurs when sales are not equal to the amount of the jackpot. This usually occurs when the starting jackpot is won on the first draw.

The 4.0 percent is next distributed to two reserve accounts. Funds are allocated to the Powerball SPRA until it reaches a cap of \$25 million. The Powerball SPRA funds non-jackpot cash prizes when there are

more winners than would be mathematically expected. Next, funds are allocated to the Powerball PRA until it reaches a cap of \$100 million. The Powerball PRA is used to pay a jackpot in the unlikely event that a winning ticket is not recorded on the software gaming system or other reasons. Finally, funds remaining after the caps for each of the reserve accounts are met are added to the Powerball grand prize pool.

D. Mega Millions Prize Pools and Related MUSL Reserve Account

The Mega Millions game is designed to pay out 50.0 percent of sales in prizes. Therefore, MUSL lotteries participating in the Mega Millions game are required to transfer 50.0 percent of its ticket sales to MUSL for the Mega Millions prize pool. Of this amount, 63.60 percent funds the Mega Millions grand prize pool, and 36.40 percent funds the pool to pay the remaining Mega Millions prizes.

Initially, MUSL required participating lotteries to transfer an additional 1.0 percent of its sales to fund a Mega Millions Prize Reserve Account (PRA), which is used to pay prizes when the actual prizes won are greater than mathematically expected. However, payouts to winners were higher than both the mathematical expectations and the additional 1.0 percent of sales deposited into the Mega Millions PRA. As a result, the Mega Millions PRA had a negative balance at June 30, 2010, and participating lotteries were subsequently required to pay special assessments. On December 1, 2010, MUSL increased the amount participating lotteries were required to transfer to the Mega Millions PRA to 2.5 percent of sales, although, after prize payouts stabilized, MUSL reduced the amount to 1.5 percent of sales on July 1, 2011.

E. Total MUSL Reserves

Interest earned on any balances in the Powerball and Mega Millions reserve accounts is first used to offset the MUSL expenses associated with operating Powerball and Mega Millions. The remaining interest, if any, is deposited to the MUSL Unreserved Account (which also earns interest on its balance). Since the balance of the MUSL Unreserved Account may be withdrawn by member lotteries at any time, the Wisconsin Lottery records its share of the balance of this account as an unrestricted current asset (MUSL Reserve Accounts—Current).

The Wisconsin Lottery has the right to a refund of Wisconsin's share of the Powerball SPRA, Powerball PRA, and Mega Millions PRA balances only if it withdraws from MUSL. Therefore, it is the practice of the Wisconsin Lottery to report the total of these MUSL reserve accounts as a restricted noncurrent asset (MUSL Reserve Accounts—Noncurrent).

The total MUSL Reserve Accounts balances (current and noncurrent) are made up of the following:

	<u>June 30, 2011</u>	<u>June 30, 2010</u>
Powerball Set Prize Reserve Account	\$ 794,204	\$1,013,248
Powerball Prize Reserve Account	3,511,657	3,039,745
Mega Millions Prize Reserve Account	<u>386,855</u>	<u>(29,565)</u>
MUSL Reserve Accounts—Noncurrent	4,692,716	4,023,428
Balance of Unreserved Account (MUSL Reserve Accounts—Current)	<u>1,115,236</u>	<u>1,290,759</u>
Total MUSL Reserve Accounts	<u>\$5,807,952</u>	<u>\$5,314,187</u>

The MUSL Reserve Accounts balances do not include any amounts contributed for prize pools because the Wisconsin Lottery does not have the right to a refund of its share of any of these pools.

10. CAPITAL ASSETS

Capital asset activity for the fiscal year ended June 30, 2011, 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>779,680</u>	<u>36,053</u>	<u>(9,935)</u>	<u>805,798</u>
Total Capital Assets at Historical Cost	<u>939,404</u>	<u>36,053</u>	<u>(9,935)</u>	<u>965,522</u>
Less Accumulated Depreciation for:				
Leasehold Improvements	103,220	6,706	0	109,926
Equipment	<u>733,114</u>	<u>36,971</u>	<u>(9,935)</u>	<u>760,150</u>
Total Accumulated Depreciation	<u>836,334</u>	<u>43,677</u>	<u>(9,935)</u>	<u>870,076</u>
Total Capital Assets, Net	<u>\$103,070</u>	<u>\$ (7,624)</u>	<u>\$ 0</u>	<u>\$ 95,446</u>

Capital asset activity for the fiscal year ended June 30, 2010, 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>774,680</u>	<u>5,000</u>	<u>0</u>	<u>779,680</u>
Total Capital Assets at Historical Cost	<u>934,404</u>	<u>5,000</u>	<u>0</u>	<u>939,404</u>
Less Accumulated Depreciation for:				
Leasehold Improvements	91,149	12,071	0	103,220
Equipment	<u>696,975</u>	<u>36,139</u>	<u>0</u>	<u>733,114</u>
Total Accumulated Depreciation	<u>788,124</u>	<u>48,210</u>	<u>0</u>	<u>836,334</u>
Total Capital Assets, Net	<u>\$146,280</u>	<u>\$(43,210)</u>	<u>\$ 0</u>	<u>\$103,070</u>

11. OPERATING LEASES

The Wisconsin Lottery occupied a facility in Madison for storage and instant ticket operations under an operating lease during FY 2010-11 and FY 2009-10. 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 31, 2012.

	<u>June 30, 2011</u>	<u>June 30, 2010</u>
Fiscal Year Ending June 30, 2011	\$ 0	\$148,267
2012	149,580	149,580
2013	<u>24,967</u>	<u>24,967</u>
Total Minimum Payments Required	<u>\$174,547</u>	<u>\$322,814</u>

Total operating lease expense amounted to \$148,267 for the fiscal year ended June 30, 2011, and \$146,993 for the fiscal year ended June 30, 2010.

12. DONATIONS

Periodically, the Wisconsin Lottery executes agreements with vendors that provide, as part of those agreements, items to the Wisconsin 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, special events, or additional incentives to retailers. 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 \$12,677 for FY 2010-11 and \$57,902 for FY 2009-10. All donated items received in FY 2010-11 and FY 2009-10 were used as game prizes, special events, or additional incentives to retailers 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 a contract for the period July 1, 2004, through October 30, 2009, with Scientific Games International, Inc., to print scratch-off tickets. In October 2009, the Wisconsin Lottery signed new contracts for printing services with three vendors: Scientific Games International, Inc.; GTECH Printing Corporation; and Pollard Banknote Ltd. These three contracts are for the period November 1, 2009, through October 31, 2011, with three one-year renewal options for each contract. Each of these contracts has been renewed through October 31, 2012. The Wisconsin

Lottery purchased ticket printing services of approximately \$3.5 million in FY 2010-11 and approximately \$3.1 million in FY 2009-10 under these contracts.

B. Pull-tab Tickets

The Wisconsin Lottery had a contract for the period July 1, 2004, through October 30, 2009, with Pollard Banknote Ltd. to print pull-tab tickets. In October 2009, the Wisconsin Lottery signed new contracts for printing services 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 31, 2011, with three one-year renewal options for each contract. The contracts with International Gamco, Inc. and Pollard Banknote Ltd. have been renewed through October 31, 2012. The Wisconsin Lottery purchased ticket printing services of approximately \$238,300 in FY 2010-11 and approximately \$222,500 in FY 2009-10 under these contracts.

C. Gaming System Vendor

The Wisconsin Lottery has a contract with GTECH Holdings Corporation that supports a network of approximately 4,000 locations where lottery games are sold. The expiration date in the original contract was June 25, 2011, and provided the Wisconsin Lottery 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.

Per the contract, during FY 2010-11 and FY 2009-10, GTECH received 2.54 percent of the price of each ticket sold, less \$1.0 million per each fiscal year, and offset by claims for liquidated damages due to the Wisconsin Lottery. The Wisconsin Lottery may 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), and GTECH gives the Wisconsin Lottery credit on the next month’s invoice for any liquidated damages of the previous month. Net payments to GTECH under this contract were approximately \$11.8 million in FY 2010-11 and approximately \$11.2 million in FY 2009-10.

D. Product Information Costs

The Wisconsin Lottery had a contract with HY Connect (formerly Hoffman York) to provide informational advertising services through April 9, 2008, which was renewed through April 9, 2011. However, this contract was terminated early when the Wisconsin Lottery signed a new two-year contract with HY Connect starting July 12, 2010, with an option to renew for three additional one-year periods. Under the combination of these contracts, the Wisconsin Lottery spent \$7.3 million during FY 2010-11 and \$7.3 million during FY 2009-10 on informational advertising.

14. RESTRICTED NET ASSETS

The Wisconsin Lottery has restricted net assets related to capital assets of \$95,446 as of June 30, 2011, and \$103,070 as of June 30, 2010. The portion of restricted net assets related to capital assets is reported in detail in Note 10.

The Wisconsin Lottery also has restricted net assets related to the MUSL reserves as reported in detail in Note 9. Restricted net assets related to the MUSL reserves were \$4,692,716 as of June 30, 2011, and \$4,023,428 as of June 30, 2010.

In addition, the Wisconsin Lottery has restricted net assets for fair market value adjustments of investments of \$8,800,267 as of June 30, 2011, and \$9,981,733 as of June 30, 2010. 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 No. 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 \$27,893,417 as of June 30, 2011, and \$31,604,457 as of June 30, 2010.

15. DISTRIBUTION OF NET PROCEEDS

Wisconsin Lottery net proceeds and other gaming-related proceeds were used for the following purposes, as discussed in Note 2(Q):

	<u>FY 2010-11</u>	<u>FY 2009-10</u>
Lottery and Gaming Tax Credit	\$129,129,638	\$112,785,815
Farmland Tax Relief Credit	885,385	14,330,657
School Levy Tax Credit	<u>14,850,000</u>	<u>0</u>
Total Property Tax Relief Credits	<u>\$144,865,023</u>	<u>\$127,116,472</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.

As of June 30, 2011, the retirement plan required 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 \$455,121 for FY 2010-11 and \$443,331 for FY 2009-10. 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 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. OPEB activity for the fiscal years ended June 30, 2011, and June 30, 2010, 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>
2010-11	\$394,548	\$94,454	\$0	\$489,002	\$0
2009-10	297,448	97,100	0	394,548	0

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’ website, <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 website, <http://www.doa.wi.gov>.

17. COMPENSATED ABSENCES

Compensated absence activity for the fiscal years ended June 30, 2011, and June 30, 2010, 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>
2010-11	\$579,917	\$ 67	\$ (8,120)	\$571,864	\$208,334
2009-10	594,317	138,467	(152,867)	579,917	8,120

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 Wisconsin Lottery at the end of the fiscal year: the appropriation under s. 20.435(5)(kg), Wis. Stats., for the Department of Health Services' compulsive gambling awareness campaigns; 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 \$125,546 from these transfers in FY 2010-11 and \$192,856 from these transfers in 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. Section 16.529, Wis. Stats., requires state agencies to make certain transfers to the General Fund. The Wisconsin Lottery transferred \$137,165 in FY 2010-11 and \$130,626 in FY 2009-10 for this purpose.

20. RESTATEMENT OF BEGINNING TOTAL NET ASSETS

Total Net Assets, as of July 1, 2010, have been decreased by \$1,310,596 as the cumulative result of correcting errors for certain instant games that resulted from a system error dating back to 2009. These errors resulted in incorrect amounts reported on the financial statements, but did not result in incorrect prizes paid to lottery winners. The Wisconsin Lottery increased instant prize expense and prizes payable by \$290,272 for FY 2008-09 and \$1,020,324 for FY 2009-10.



Supplementary Information ■

Reconciliation of Lottery General Operations Expenses to the Budgetary Basis of Accounting for the Years Ended June 30, 2011 and 2010

	Year Ended June 30, 2011	Year Ended June 30, 2010
SALARIES AND FRINGE BENEFITS		
Per Financial Statement	\$ 5,638,566	\$ 5,670,783
Adjustments to Financial Statement Balance:		
Cash Paid in FY 2009-10 but Expensed in FY 2008-09	0	1,021,707
Cash Paid in FY 2010-11 but Expensed in FY 2009-10	1,113,978	(1,113,978)
Cash Paid in FY 2011-12 but Expensed in FY 2010-11	(1,217,788)	0
Reclassified Fringe Benefits to Transfer Out to General Fund	121,875	116,263
Budgetary Basis—Salaries and Fringe Benefits	<u>\$ 5,656,631</u>	<u>\$ 5,694,775</u>
SUPPLIES AND SERVICES AND PERMANENT PROPERTY		
Per Financial Statement:		
Product Information Costs	\$ 7,445,141	\$ 7,469,890
Instant Ticket Printing Costs	3,918,131	3,465,809
Instant Ticket Delivery Costs	743,065	689,449
Donated Prize Expense	12,677	57,902
Supplies and Services	2,544,692	2,411,988
Depreciation Expense	43,678	48,210
Total per Financial Statement	14,707,384	14,143,248
Adjustments to Financial Statement Balance:		
Depreciation Expense	(43,678)	(48,210)
Donated Prize Expense	(12,677)	(57,902)
Cash Paid in FY 2008-09 but Expensed in FY 2009-10	0	(1,620,514)
Cash Paid in FY 2009-10 but Expensed in FY 2010-11	(1,751,492)	1,751,492
Cash Paid in FY 2010-11 but Expensed in FY 2011-12	1,919,514	0
Compulsive Gambling Payment Not Included Above	396,000	396,000
Capitalized Permanent Property Less Disposals	36,053	5,000
Budgetary Basis—Supplies and Services and Permanent Property	<u>\$ 15,251,104</u>	<u>\$ 14,569,114</u>

Statutorily Defined Lottery Administrative Expenses for the Years Ended June 30, 2009 through 2011

	Year Ended June 30, 2011	Year Ended June 30, 2010	Year Ended June 30, 2009
ADMINISTRATIVE EXPENSES			
Instant and Lotto Vendor Services	\$ 11,816,299	\$ 11,226,345	\$ 11,961,907
Product Information Costs	7,445,141	7,469,890	7,373,563
Instant Ticket Printing Costs	3,918,131	3,465,809	3,492,915
Instant Ticket Delivery Costs	743,065	689,449	722,908
Salaries and Fringe Benefits	5,638,566	5,670,783	5,980,062
Supplies and Services	2,544,692	2,411,988	2,571,973
Depreciation Expense	43,678	48,210	41,409
Transfer to Department of Health Services for Compulsive Gambling Programs	396,000	396,000	400,000
Transfer to Department of Revenue for Lottery Credit Administration	237,780	275,752	272,854
Transfers Out to General Fund	137,165	130,626	121,250
Total Administrative Expenses as Determined in Accordance with s. 25.75(3)(b), Wis. Stats.	\$ 32,920,517	\$ 31,784,852	\$ 32,938,841
Gross Lottery Revenues per s. 25.75(1)(b), Wis. Stats.	\$ 502,689,126	\$ 480,996,459	\$ 473,479,299
Administrative Expenses as a Percentage of Lottery Operating Revenues	6.55%	6.61%	6.96%
Under Prior Methodology ¹ : Administrative Expenses as a Percentage of Lottery Operating Revenues	N/A	6.45%	6.81%

Section 25.75(3)(b), Wis. Stats., limits the Wisconsin Lottery's administrative expenses to 10 percent of gross lottery revenues. Gross lottery revenues, as defined in s. 25.75(1)(b), Wis. Stats., include lottery ticket sales and retailer fees. Administrative expenses, as defined in s. 25.75(3)(b), Wis. Stats., do not include retailer commissions and incentives and transfers to the Department of Justice for law enforcement.

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

¹ During FY 2010-11, the Wisconsin Lottery revised the methodology for calculating administrative expenses as a percentage of operating revenue. The primary change was adding certain transfers to the calculation of administrative expenses. This schedule has been restated to show prior years' data using the new methodology for comparative purposes with the current year. Below this comparative data is the prior year information as previously presented.

Summary of Prize Expenses for the Years Ended June 30, 2007 through 2011

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 lotto games, are summarized below.

	Fiscal Year 2010-11		
	<u>Prize Expense</u>	<u>Ticket Sales</u>	<u>Prize Expense as a Percentage of Sales</u>
Instant Games	\$ 194,621,768	\$ 302,521,074	64.3%
Lotto Games	98,035,772	200,130,712	49.0
Total for Fiscal Year	\$ 292,657,540	\$ 502,651,786	58.2

	Fiscal Year 2009-10		
	<u>Prize Expense</u>	<u>Ticket Sales</u>	<u>Prize Expense as a Percentage of Sales</u>
Instant Games	\$ 173,852,506 ¹	\$ 273,271,670	63.6% ¹
Lotto Games	100,155,657	207,670,334	48.2
Total for Fiscal Year	\$ 274,008,163 ¹	\$ 480,942,004	57.0 ¹

	Fiscal Year 2008-09		
	<u>Prize Expense</u>	<u>Ticket Sales</u>	<u>Prize Expense as a Percentage of Sales</u>
Instant Games	\$ 178,256,545 ¹	\$ 276,797,708	64.4% ¹
Lotto Games	101,918,329	196,616,546	51.8
Total for Fiscal Year	\$ 280,174,874 ¹	\$ 473,414,254	59.2 ¹

	Fiscal Year 2007-08		
	<u>Prize Expense</u>	<u>Ticket Sales</u>	<u>Prize Expense as a Percentage of Sales</u>
Instant Games	\$ 186,102,698	\$ 287,429,285	64.7%
Lotto 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		
	<u>Prize Expense</u>	<u>Ticket Sales</u>	<u>Prize Expense as a Percentage of Sales</u>
Instant Games	\$ 183,279,333	\$ 284,131,772	64.5%
Lotto Games	108,835,614	208,646,840	52.2
Total for Fiscal Year	\$ 292,114,947	\$ 492,778,612	59.3

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.

¹ Amounts adjusted to reflect a prior-period adjustment (see Note 20).

Report on Internal 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, 2011, and June 30, 2010, and have issued our report thereon dated June 6, 2012. We conducted our audits 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

Management of the Wisconsin Lottery is responsible for establishing and maintaining effective internal control over financial reporting (internal control). In planning and performing our audits, we considered the Wisconsin Lottery's 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*.

We noted certain additional matters related to the Wisconsin Lottery's financial reporting process and a system error in calculating certain payments for the retailer performance program that we reported to the Wisconsin Lottery in a separate communication dated May 3, 2012. In its written response, the Wisconsin Lottery's management agreed with our recommendations and planned to take steps to address these issues.

We did not audit the Wisconsin Lottery's response and, accordingly, express no opinion on it.

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.

June 6, 2012

LEGISLATIVE AUDIT BUREAU
 by 
 Sherry Haakenson
 Audit Director