Report 16-7 July 2016

Wisconsin Lottery Fiscal Year 2014-15

STATE OF WISCONSIN







Legislative Audit Bureau

Wisconsin Lottery Fiscal Year 2014-15

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Joe Chrismai State Audito

July 20, 2016

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 a financial audit of the Wisconsin Lottery, which is administered by the Wisconsin Department of Revenue (DOR). We have provided an unmodified opinion on the Wisconsin Lottery's fiscal year (FY) 2014-15 and FY 2013-14 financial statements.

Sales of instant and lotto tickets increased from \$568.8 million in FY 2013-14 to \$574.6 million in FY 2014-15, or by 1.0 percent. Operating expenses increased from \$408.7 million in FY 2013-14 to \$415.4 million in FY 2014-15, or by 1.6 percent. During FY 2014-15, lottery proceeds used for property tax relief totaled \$166.4 million. In October 2015, the Wisconsin Department of Administration and the Legislature's Joint Committee on Finance authorized the use of \$161.4 million in Wisconsin Lottery proceeds for property tax relief during FY 2015-16.

Subsequent to FY 2014-15, the Wisconsin Lottery learned that an individual previously employed by the Multi-State Lottery Association, of which the Wisconsin Lottery is a member, was convicted of fraud in Iowa and was suspected of fraud in other states' lotteries. This individual also had access to random number generators used in Wisconsin to determine the winning numbers for lotto games. In September 2015, the Wisconsin Lottery requested that the Wisconsin Department of Justice review a 2007 drawing for the Wisconsin's Megabucks lotto game to determine if any illegal activity may have occurred. This review was ongoing at the time of our audit.

The Wisconsin Lottery has taken some steps to address our prior concerns with controls over administering retailer accounts and plans further improvements when it implements a new integrated gaming computer system, which is anticipated in May 2017.

We appreciate the courtesy and cooperation extended to us by DOR staff in completing this audit.

Respectfully submitted,

*J*oe Chrisman State Auditor

JC/KE/ss

Wisconsin Lottery Ticket Sales
Wisconsin Lottery Operating Expenses
Property Tax Relief
Statutory Requirements
Events Subsequent to FY 2014-15

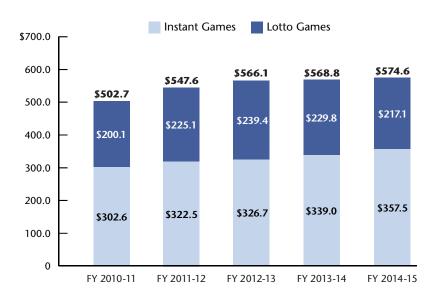
Introduction **•**

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 1995, the Department of Revenue has managed the Wisconsin Lottery. As required by s. 13.94 (1) (em), Wis. Stats., we have completed a financial audit of the Wisconsin Lottery and have provided an unmodified opinion on its financial statements for the years ended June 30, 2015, and June 30, 2014. We reviewed ticket sales, operating expenses, property tax relief funded by net proceeds available from the Wisconsin Lottery, and compliance with selected statutory provisions.

Wisconsin Lottery Ticket Sales

From FY 2013-14 to FY 2014-15, ticket sales increased by 1.0 percent to \$574.6 million. As shown in Figure 1, the Wisconsin Lottery's ticket sales increased slightly from \$568.8 million in fiscal year (FY) 2013-14 to \$574.6 million in FY 2014-15, or by 1.0 percent. Sales of instant tickets, which are scratch-off and pull-tab tickets, increased by \$18.5 million, or by 5.5 percent. That increase was largely offset by a decrease of \$12.7 million, or 5.5 percent, in sales of lotto tickets, which are tickets with prizes based on the results of a drawing. This decrease was primarily the result of lower Powerball ticket sales due to fewer record jackpots than in the prior year.

Figure 1
Wisconsin Lottery Ticket Sales
(in millions)



Wisconsin Lottery Operating Expenses

From FY 2013-14 to FY 2014-15, the Wisconsin Lottery's operating expenses increased by 1.6 percent to \$415.4 million. The Wisconsin Lottery's largest expenses are prizes and retailer compensation, which includes commissions and incentives that are paid to retailers to promote higher ticket sales. As shown in Table 1, the Wisconsin Lottery's operating expenses increased from \$408.7 million in FY 2013-14 to \$415.4 million in FY 2014-15, or by 1.6 percent, primarily because expenses for instant prizes increased as instant ticket sales increased.

Table 1
Wisconsin Lottery Operating Expenses
(in millions)

Other ¹	8.2	8.0	8.2	8.1	8.1
Product Information	7.4	7.5	7.5	7.5	7.5
Game Development and Production	16.5	17.4	18.2	18.0	17.8
Retailer Compensation	35.3	38.2	39.2	38.4	39.6
Prize Expenses	\$292.7	\$320.1	\$329.2	\$336.7	\$342.4
Operating Expense Type	FY 2010-11	FY 2011-12	FY 2012-13	FY 2013-14	FY 2014-15

¹ Includes staff salaries, fringe benefits, supplies and services, and depreciation.

Game development and production expenses include donated prize expense, instant game ticket printing and delivery costs, and payments to GTECH Corporation, which provides an integrated gaming computer system to account for instant and lotto game activity and to network with retailer terminals. In recent years, game development and production expenses have generally increased as ticket sales have increased. However, despite continuing increases in ticket sales, game development and production expenses decreased slightly in FY 2013-14 due to a reduction of instant game ticket printing costs, and decreased again in FY 2014-15 due to a change in the contract terms with GTECH. Specifically, the Wisconsin Lottery paid GTECH approximately \$13.4 million in FY 2013-14 and, under the revised contract terms, paid approximately \$12.8 million in FY 2014-15.

In FY 2014-15, the Wisconsin Lottery spent \$7.5 million to provide information about its products.

The Wisconsin Constitution prohibits public funds or revenues derived from lottery operations from being spent for promotional advertising and requires that any advertising provide only information about the prize structures and chances of winning. The Wisconsin Lottery's annual product information budget, which is established through the State's biennial budget, has remained unchanged at \$7.5 million since FY 2007-08. The Wisconsin Lottery spent \$7.5 million on product information in both FY 2013-14 and FY 2014-15.

Property Tax Relief

From its inception in 1988 through FY 2014-15, the Wisconsin Lottery has provided \$3.8 billion in property tax relief.

The Wisconsin Constitution requires that net proceeds from the Wisconsin Lottery be used exclusively for property tax relief. The proceeds are largely distributed to owners of primary residences in Wisconsin through the Lottery and Gaming Tax Credit. In FY 2014-15, \$166.4 million in lottery proceeds were used for funding of the Lottery and Gaming Tax Credit, as shown in Table 2. In October 2015, the Department of Administration and the Legislature's Joint Committee on Finance authorized the use of \$161.4 million in Wisconsin Lottery proceeds for the FY 2015-16 Lottery and Gaming Tax Credit. From its inception in 1988 through FY 2014-15, the Wisconsin Lottery has provided \$3.8 billion in property tax relief.

Table 2

Property Tax Relief¹
(in millions)

Total	\$739.9	\$0.9	\$44.7	\$785.5
2014-15	166.4	0.0	0.0	166.4
2013-14	168.4	0.0	0.0	168.4
2012-13	141.0	0.0	14.9	155.9
2011-12	135.0	0.0	14.9	149.9
2010-11	\$129.1	\$0.9	\$14.9	\$144.9
Fiscal Year	Lottery and Gaming Tax Credit	Farmland Tax Relief Credit ²	School Levy Tax Credit ³	Total Distributed

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.

The total distributed for property tax relief increased between FY 2010-11 and FY 2013-14, partly due to increased ticket sales. However, the total distributed for property tax relief decreased from \$168.4 million in FY 2013-14 to \$166.4 million in FY 2014-15, or by 1.2 percent. The total distributed for property tax relief is authorized early in the fiscal year and is based on an estimate of proceeds that will be available for distribution. Fewer proceeds were anticipated

² Use of Wisconsin Lottery proceeds for this program was discontinued after December 2009. Small payments continue as taxpayers amend or file late tax returns.

³ General purpose revenue replaced the use of Wisconsin Lottery proceeds to fund this program beginning in FY 2013-14. Use of Wisconsin Lottery proceeds for this program was limited to FY 2010-11, FY 2011-12, and FY 2012-13.

to be available for distribution in FY 2014-15, and the property tax relief therefore decreased from FY 2013-14 to FY 2014-15. Proceeds declined in FY 2014-15 partly because of increases in prize expenses and retailer compensation.

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 lottery sales be used as prize payments to players. As shown in Table 3, the Wisconsin Lottery's prize expenses have exceeded 50 percent of ticket sales, in compliance with the statutory requirement, from FY 2010-11 through FY 2014-15. Prize expenses have fluctuated because of changes in the types of games offered and played. Lotto game prize payments, which are dependent on jackpot amounts and the frequency of winners claiming prizes, tend to fluctuate more than payments for instant games.

Table 3

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

Drizo Evpopos	Ticket Sales	Prize Expenses as a Percentage of Ticket Sales
Prize Expenses	TICKEL Sales	TICKEL Sales
\$292.7	\$502.7	58.2%
320.1	547.6	58.5
329.2	566.1	58.2
336.7	568.8	59.2
342.4	574.6	59.6
	320.1 329.2 336.7	\$292.7 \$502.7 320.1 547.6 329.2 566.1 336.7 568.8

The Wisconsin Lottery's administrative expenses were below the statutory limit from FY 2010-11 through FY 2014-15.

Section 25.75 (3) (b), Wis. Stats., provides that certain administrative expenses may not exceed 10 percent of gross lottery revenues. Gross lottery revenues for this calculation are statutorily defined to 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 property tax relief; and transfers to the Wisconsin 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 2010-11 through FY 2014-15.

Table 4

Administrative Expenses as a Percentage of Lottery Revenues (in millions)

Fiscal Year	Statutorily Defined Administrative Expenses	Lottery Revenues ¹	Percentage of Lottery Revenues
2010-11	\$32.9	\$502.7	6.5%
2011-12	33.6	547.7	6.1
2012-13	34.6	566.2	6.1
2013-14	34.3	568.9	6.0
2014-15	34.1	574.7	5.9

¹ Lottery revenues represent the total operating revenues net of allowances and discounts, which is an approximate but smaller amount than the amount to be used in this calculation as defined by s. 25.75 (3) (b), Wis. Stats.

The Wisconsin Lottery spent \$5.1 million in Retailer Performance Program payments in FY 2014-15.

Statutes establish maximum compensation rates for basic commissions and performance program payments to retailers who sell lottery tickets. Basic commission rates, as established in s. 565.10 (14) (b), Wis. Stats., are currently 5.5 percent of the retail price for lotto tickets and 6.25 percent for instant tickets. In addition, s. 565.02 (4) (g), Wis. Stats., authorizes a performance program to provide incentives to retailers and requires that payments not exceed 1.0 percent of gross revenues from the sale of lottery tickets. Table 5 shows the Wisconsin Lottery's Retailer Performance Program payments from FY 2010-11 through FY 2014-15. The Wisconsin Lottery spent \$5.1 million in Retailer Performance Program payments in FY 2014-15.

Table 5

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

Fiscal Year	Retailer Performance Program Payments	Ticket Sales ¹	Payments as a Percentage of Ticket Sales
2010 11	65.1	¢502.7	1.00/
2010-11	\$5.1 5.5	\$502.7 547.6	1.0% 1.0 ²
2012-13	5.2	566.1	0.9
2013-14	4.4	568.8	0.8
2014-15	5.1	574.6	0.9

¹ Ticket sales represent the total ticket sales net of allowances and discounts, which is an approximate but smaller amount than the amount to be used in this calculation as defined by s. 565.02 (4) (g), Wis. Stats.

The Retailer Performance Program includes a bonus for retailers that sell winning tickets, short-term incentives for retailers that increase ticket sales of certain games for specific time periods, and sales incentives for retailers that increase ticket sales. During FY 2014-15, performance payments for the sales incentive accounted for 74.4 percent of the total incentive payments, followed by winning ticket bonuses and short-term incentives accounting for 17.6 percent and 8.0 percent, respectively. The Wisconsin Lottery offered seven short-term incentives during FY 2014-15. Total payments for each of these short-term incentives ranged from \$1,562 to \$213,835, and the number of retailers who participated in each of these short-term incentives ranged from 25 retailers to all retailers, which is approximately 3,700.

In addition to limitations on certain types of lottery expenses, state statutes prescribe various transfers to and from the Wisconsin Lottery. 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 for the Department of Health Services' compulsive gambling awareness campaigns, under s. 20.435 (5) (kg), Wis. Stats.; the appropriation for the Department of Justice's gaming law enforcement, under s. 20.455 (2) (g), Wis. Stats.; and the appropriations for general operations of the Department of Administration's Division of Gaming related to racing and bingo, under s. 20.505 (8) (g) and (jm), Wis. Stats. The Wisconsin Lottery received \$23,505 from these transfers in FY 2014-15.

² In FY 2011-12, the Wisconsin Lottery exceeded the statutory limit on payments under the Retailer Performance Program by \$54,800, or less than 0.01 percent.

In addition, the Wisconsin Lottery is required to transfer amounts to the General Fund related to annual appropriation bonds issued by the State of Wisconsin to pay off certain unfunded liabilities in the pension and other employee benefit programs. The Wisconsin Lottery transferred \$143,020 in FY 2014-15 for this purpose.

Events Subsequent to FY 2014-15

In September 2015, the
Wisconsin Lottery
requested that the
Wisconsin Department
of Justice review
a 2007 drawing for the
Wisconsin's Megabucks
lotto game.

The Wisconsin Lottery uses random number generators (RNGs) to determine the winning numbers for lotto game drawings, including drawings for Wisconsin's Megabucks. During FY 2014-15, the Wisconsin Lottery used RNGs it purchased from the Multi-State Lottery Association (MUSL), which is a nonprofit, governmentbenefit voluntary association of which the Wisconsin Lottery is a member. The Wisconsin Lottery subsequently learned that an individual previously employed by MUSL was convicted of fraud in Iowa and suspected of fraud in other states' lotteries. This individual also had access to Wisconsin's RNGs. In September 2015, the Wisconsin Lottery requested that the Wisconsin Department of Justice (DOJ) review a 2007 drawing for the Wisconsin's Megabucks lotto game to determine if any illegal activity may have occurred. At the time of our audit, DOJ's review was ongoing. The Wisconsin Lottery discusses this and other steps it has taken within its Management's Discussion and Analysis on page 25.

The Wisconsin Lottery entered into a contract for a new integrated gaming computer system and other services, which will begin in May 2017.

In October 2015, GTECH Corporation changed its name to IGT Global Solutions Corporation, subsequent to a merger in April 2015. In February 2016, the Wisconsin Lottery entered into a contract with IGT Global Solutions Corporation to provide multiple services beginning in May 2017, including a new integrated gaming computer system; the printing, storage, and delivery of certain instant tickets and supplies; and customer service, technical support, and sales support services for retailers. The services that will be provided by IGT Global Solutions Corporation under the new contract are currently provided under multiple contracts with a variety of vendors or by Wisconsin Lottery staff. The Wisconsin Lottery extended the contract for the current integrated gaming computer system to May 2017, when the new system is anticipated to be implemented. The Wisconsin Lottery discusses contractual obligations in Note 10 to the financial statements on page 46.

Audit Opinion





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Joe Chrisman State Auditor

Independent Auditor's Report on the Financial Statements and Other Reporting Required by *Government Auditing Standards*

Senator Robert Cowles and Representative Samantha Kerkman, Co-chairpersons Joint Legislative Audit Committee

Mr. Richard G. Chandler, Secretary Ms. Pat Lashore, Lottery Administrator Department of Revenue

Report on the Financial Statements

We have audited the accompanying financial statements and the related notes of the Wisconsin Lottery as of and for the years ended June 30, 2015, and June 30, 2014, as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management of the Department of Revenue and the Wisconsin Lottery are responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America. This includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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*, which is 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the

circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of the accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion on these financial statements.

Opinion

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, 2015, and June 30, 2014, and the respective changes in its financial position and its cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 2 to the financial statements, 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 as of June 30, 2015, and June 30, 2014, the changes in its financial position, or where applicable, its cash flows for the year then ended, in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information—Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 17 through 26 be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board, which considers it to be essential for placing the financial statements in an appropriate operational, economic, or historical context. In accordance with auditing standards generally accepted in the United States of America, we have applied certain limited procedures to the required supplementary information that included inquiries of management about the methods of preparing the information. We further compared the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to do so.

Accompanying Information—Our audits for the years ended June 30, 2015, and June 30, 2014, were conducted for the purpose of forming an opinion on the financial statements of the Wisconsin Lottery. Schedules 1, 2, and 3 on pages 52 through 54, are presented for purposes of additional analyses and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements for the years ended June 30, 2015, and June 30, 2014, and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other

records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

We also previously audited, in accordance with auditing standards generally accepted in the United States of America, the financial statements of the Wisconsin Lottery as of and for the years ended June 30, 2013, June 30, 2012, and June 30, 2011 (not presented herein), and issued reports thereon dated August 15, 2014 (report 14-10), and July 8, 2013 (report 13-11), which contained unmodified opinions on the respective financial statements of the Wisconsin Lottery. Schedule 2, on page 53, for the year ended June 30, 2013, and Schedule 3, on page 54, for the years ended June 30, 2013, June 30, 2012, and June 30, 2011, are presented for purposes of additional analyses and are not a required part of the financial statements.

Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements for the years ended June 30, 2013, June 30, 2012, and June 30, 2011. The information has been subjected to the auditing procedures applied in the audits of those financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare those financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole for the years ended June 30, 2013, June 30, 2012, and June 30, 2011.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued a report dated July 15, 2016, on our consideration of the Department of Revenue's and 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 used when considering the Department of Revenue's and Wisconsin Lottery's internal control over financial reporting and compliance.

LEGISLATIVE AUDIT BUREAU

Joe Chrisman State Auditor

July 15, 2016

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, 2015, and June 30, 2014, with comparative information from the fiscal year ended June 30, 2013. 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 the Department of Revenue and Wisconsin Lottery management.

Financial Highlights

In fiscal year (FY) 2014-15, the Wisconsin Lottery implemented the Governmental Accounting Standards Board (GASB) Statement No. 68, *Accounting and Financial Reporting for Pensions—an Amendment of GASB Statement No.* 27, and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date—an Amendment of GASB Statement No.* 68, which establish standards for reporting a net pension liability or asset, pension expense, and deferred inflows and outflows of resources related to pensions. These statements revise accounting and financial reporting for pensions by state and local governments. As part of this implementation, the Wisconsin Lottery included a prior period adjustment in the FY 2014-15 financial statements to reflect the cumulative total of pension activity that occurred from the inception of the Lottery in 1988 through June 30, 2014.

For the fourth year in a row, the Wisconsin Lottery had record sales. Operating revenues generated from ticket sales for the Wisconsin Lottery were \$574.6 million

in FY 2014-15 versus \$568.8 million in FY 2013-14, an increase of 1.0 percent. During FY 2014-15, lotto sales were not stimulated by large jackpots, but the Wisconsin Lottery was able to achieve record sales with increased sales of scratch-off tickets. Since scratch-off tickets carry a higher prize expense, the increase in operating revenues did not result in an increase of net income. Operating expenses for FY 2014-15 increased \$6.7 million, or by 1.6 percent, primarily as a result of increased prize expenses, which rise with increased sales. Office administration expenses (salaries, fringe benefits, and supplies) remained relatively constant at \$8.1 million in both FY 2014-15 and FY 2013-14. Net income before transfers was \$158.1 million for FY 2014-15, compared to \$158.7 million in FY 2013-14.

Administrative expenses, as defined in s. 25.75 (3) (b), Wis. Stats., were 5.94 percent of gross lottery revenues in FY 2014-15, well below the statutory maximum of 10.0 percent. Total statutory administrative expenses, which include administrative expenses reported in the financial statements, all program expenses except prizes and retailer compensation, and certain transfers out were \$34.1 million in FY 2014-15. This was a decrease of \$0.2 million from the FY 2013-14 total of \$34.3 million.

Understanding 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 that reports on all of the activity's assets and liabilities using the accrual basis of accounting, much like a private business entity.

This report consists of a series of comparative financial statements, along with explanatory notes to the financial statements and supplemental schedules. The financial statements are comprised of three components:

- Statement of Net Position—provides detailed information on the nature and amount of the Wisconsin Lottery's assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position as of June 30, 2015, and June 30, 2014;
- Statement of Revenues, Expenses, and Changes in Net Position—reports the revenues and expenses incurred in relation to the sale of lottery products, as well as other non-gaming related activity for FY 2014-15 and FY 2013-14; and
- Statement of Cash Flows—outlines the cash inflows and outflows related to the sale of lottery products and other business-related activities for FY 2014-15 and FY 2013-14.

To assess the Wisconsin Lottery's financial position and financial health, the reader of these statements should pay particular attention to the changes in the

components of assets and liabilities as set forth in the Statement of Net Position, and to changes in income and expenses as set forth in the Statement of Revenues, Expenses, and Changes in Net Position, as well as the Statement of Cash Flows.

Overview of Financial Position

The Statement of Net Position provides detailed information on the nature and amount of the Wisconsin Lottery's assets, liabilities, and net position at the close of FY 2014-15 and FY 2013-14. Table A presents these data in a condensed form for the past three fiscal years. The relationship of assets to liabilities and resulting net position is one indicator of the financial condition of the Wisconsin Lottery.

Table A

Statement of Net Position
(in millions)

	June 30, 2015	Change	June 30, 2014	Change	June 30, 2013
	Julie 30, 2013	Change	June 30, 2014	Change	Julie 30, 2013
Accets					
Assets					
Investments	\$ 35.6	\$(5.5)	\$ 41.1	\$ (5.4)	\$ 46.5
Capital Assets	0.0	(0.4)	0.1		0.1
(net of accumulated depreciation)	0.0	(0.1)	0.1	0.0	0.1
Other Assets	83.1	5.1	78.0	(20.1)	98.1
Total Assets	118.7	(0.5)	119.2	(25.5)	144.7
Total Deferred Outflows of Resources	0.6	0.6	0.0	0.0	0.0
Liabilities					
Current Liabilities	58.5	12.2	46.3	(10.9)	57.2
Noncurrent Liabilities	26.3	(4.0)	30.3	(3.8)	34.1
Total Liabilities	84.8	8.2	76.6	(14.7)	91.3
Total Deferred Inflows of Resources	0.0	0.0	0.0	0.0	0.0
Net Position					
Invested in Capital Assets	0.0	(0.1)	0.1	0.0	0.1
Restricted for Pensions	0.8	0.8	0.0	0.0	0.0
Restricted for MUSL Reserves	5.4	(0.4)	5.8	0.4	5.4
Restricted for Investment					
Fair Value Adjustment	4.9	(1.2)	6.1	(1.6)	7.7
Restricted for Property Tax Relief	23.4	(7.2)	30.6	(9.6)	40.2
Total Net Position	<u>\$ 34.5</u>	<u>\$(8.1)</u>	<u>\$ 42.6</u>	<u>\$(10.8)</u>	<u>\$ 53.4</u>

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 \$118.7 million at the end of FY 2014-15, compared to \$119.2 million at the end of FY 2013-14, and \$144.7 million at the end of FY 2012-13. Noncurrent assets primarily consist of investments for prize annuities expected to mature more than a year beyond the date of the Statement of Net Position. Since 2007, no winners have chosen to receive their winnings in the form of an annuity, therefore no new investments are being added. The investment balance continues to decrease each year as investments mature and annuitants receive their annual payments.

Liabilities

At the end of FY 2014-15, the Wisconsin Lottery had total liabilities of \$84.8 million, compared with total liabilities of \$76.6 million at the end of FY 2013-14 and \$91.3 million at the end of FY 2012-13. Current liabilities consist primarily of accrued prizes payable, annuity prizes payable, and accounts payable due to suppliers. The prizes payable balance at the end of FY 2014-15 included a \$22.5 million liability for a Wisconsin's Very Own Megabucks winner who had not yet claimed the prize. Noncurrent liabilities consist primarily of annuity prizes payable more than a year beyond the date of the Statement of Net Position. Since 2007, no winners have chosen to receive their winnings in the form of an annuity. As a result, total annuity prizes payable continues to decrease each year as existing annuitants receive their annual payments.

Net Position

The Wisconsin Lottery's total net position was \$34.5 million at the end of FY 2014-15, an \$8.1 million decrease from the prior year. The decrease in net position during the current year was primarily the result of the increase in current liabilities of \$12.2 million and the decrease in investments of \$5.5 million. The total net position for FY 2013-14 was \$42.6 million, a \$10.8 million decrease from FY 2012-13. Total net position was \$53.4 million at the end of FY 2012-13.

The Wisconsin Lottery's net position is generally available for property tax relief unless restricted for other uses. There are currently four other uses of the Wisconsin Lottery's net position. Amounts invested in capital assets cannot be used to provide property tax relief. Amounts restricted for pensions are those that must be used to fund future pension obligations. Reserve accounts held by MUSL are not currently available for property tax relief. Unrealized gains or losses related to the change in the fair value of investments are not available for property tax relief because investments have been purchased for the payment of annuity prizes payable and are generally held to maturity. All remaining net position is available for property tax relief.

The Statement of Revenues, Expenses, and Changes in Net Position provides detailed information on the nature and financial impact of the Wisconsin Lottery's operations for FY 2014-15 and FY 2013-14. Table B presents data for the past three fiscal years in a condensed form.

Table B Statement of Revenues, Expenses, and Changes in Net Position (in millions)

	FY 2014-15	Change	FY 2013-14	Change	FY 2012-13
P					
Revenues					
Operating Revenues:					
Ticket sales	\$574.6	\$5.8	\$568.8	\$ 2.7	\$566.1
Retailer fees and miscellaneous revenue	0.1	0.0	0.1	0.0	0.1
Nonoperating Revenues:					
Investment income (loss)	(1.2)	0.3	(1.5)	1.1	(2.6)
Miscellaneous revenue	0.0	0.0	0.0	0.0	0.0
Total Revenues	573.5	6.1	567.4	3.8	563.6
Expenses					
Program Expenses:					
Prize expenses	342.4	5.7	336.7	7.5	329.2
Retailer commissions and incentives	39.6	1.2	38.4	(0.7)	39.1
Instant and lotto vendor services	12.9	(0.5)	13.4	0.0	13.4
Other game-related expenses	12.4	0.3	12.1	(0.3)	12.4
Office Administration Expenses	8.1	0.0	8.1	(0.1)	8.2
Total Expenses	415.4	6.7	408.7	6.4	402.3
Net Income Before Transfers	158.1	(0.6)	158.7	(2.6)	161.3
Transfers					
Transfers for Property Tax Relief	(166.4)	2.0	(168.4)	(12.5)	(155.9)
Transfers In from General Fund	0.0	0.0	0.0	(0.1)	0.1
Transfer for Compulsive Gambling Programs	(0.4)	0.0	(0.4)	0.0	(0.4)
Transfer for Law Enforcement	(0.4)	0.0	(0.4)	0.0	(0.4)
Transfer for Lottery Credit Administration	(0.2)	0.0	(0.2)	0.0	(0.2)
Transfers Out to General Fund	(0.1)	0.0	(0.1)	0.0	(0.1)
Change in Net Position	<u>\$ (9.4)</u>	<u>\$ 1.4</u>	<u>\$ (10.8)</u>	<u>\$(15.2)</u>	<u>\$ 4.4</u>

Revenues

Operating revenues are generated almost entirely from ticket sales. Ticket sales for the Wisconsin Lottery were \$574.6 million in FY 2014-15, \$568.8 million in FY 2013-14, and \$566.1 million in FY 2012-13. Table C compares ticket sales for each game category for FY 2014-15, FY 2013-14, and FY 2012-13.

Table C
Wisconsin Lottery Ticket Sales
(in millions)

	FY 2014-15	Change	FY 2013-14	Change	FY 2012-13
Instant					
Scratch-off	\$356.4	\$ 18.7	\$337.7	\$13.7	\$324.0
Pull-tab	1.1	(0.2)	1.3	(1.4)	2.7
Total Instant Ticket Sales	357.5	18.5	339.0	12.3	326.7
1.44.					
Lotto					
SuperCash!	24.3	(0.2)	24.5	(1.1)	25.6
Powerball	70.9	(16.0)	86.9	(26.9)	113.8
Wisconsin's Megabucks	25.1	9.0	16.1	1.2	14.9
Wisconsin's Megabucks EZ Match	2.3	0.4	1.9	(0.1)	2.0
Daily Pick 3	24.1	(0.4)	24.5	0.7	23.8
Daily Pick 4	12.7	0.2	12.5	0.2	12.3
Badger 5	21.3	(2.5)	23.8	(0.6)	24.4
Mega Millions	26.9	(7.0)	33.9	12.3	21.6
5 Card Cash ¹	8.7	4.0	4.7	4.7	0.0
Raffle Games	0.8	(0.2)	1.0	0.0	1.0
Total Lotto Ticket Sales	217.1	(12.7)	229.8	(9.6)	239.4
Total Sales	<u>\$574.6</u>	<u>\$ 5.8</u>	<u>\$568.8</u>	<u>\$ 2.7</u>	<u>\$566.1</u>

¹ The Wisconsin Lottery began selling 5 Card Cash on April 6, 2014.

The sales increase in FY 2014-15 was driven by a 5.5 percent increase in the sale of scratch-off tickets. Instant scratch-off ticket sales increased \$18.7 million during FY 2014-15, after increasing \$13.7 million during FY 2013-14. Pull-tab sales decreased \$0.2 million in FY 2014-15, following a \$1.4 million decrease in FY 2013-14. Lotto game sales decreased by \$12.7 million during FY 2014-15 following a \$9.6 million decrease in FY 2013-14.

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 2014-15, total operating expenses were \$415.4 million, an increase of \$6.7 million from FY 2013-14 expenses of \$408.7 million, which had increased from FY 2012-13 expenses of \$402.3 million. The increase in expenses during recent years is primarily a result of increased prize expense driven by the increase in scratch-off ticket sales, which have a higher prize expense than lotto tickets.

Prizes are the Wisconsin Lottery's largest expense. Table D compares ticket prize awards for each lottery game category for FY 2014-15, FY 2013-14, and FY 2012-13.

Table D Wisconsin Lottery Ticket Prize Awards (in millions)

	FY 2014-15	Change	FY 2013-14	Change	FY 2012-13
Instant					
Scratch-off	\$235.5	\$14.9	\$220.6	\$11.3	\$209.3
Pull-tab	0.7	0.0	0.7	(0.9)	1.6
Super 2nd Chance ¹	0.3	0.0	0.3	0.0	0.3
Total Instant Prize Awards	236.5	14.9	221.6	10.4	211.2
Lotto					
SuperCash!	10.9	(2.8)	13.7	0.6	13.1
Powerball	34.8	(7.2)	42.0	(13.6)	55.6
Wisconsin's Megabucks	13.2	4.7	8.5	0.7	7.8
Wisconsin's Megabucks EZ Match	1.4	0.2	1.2	0.0	1.2
Daily Pick 3	10.5	(2.2)	12.7	1.2	11.5
Daily Pick 4	6.1	0.5	5.6	0.1	5.5
Badger 5	10.4	(1.1)	11.5	(0.8)	12.3
Mega Millions	13.0	(3.0)	16.0	5.8	10.2
5 Card Cash ²	4.9	1.7	3.2	3.2	0.0
Raffle Games	0.4	0.0	0.4	(0.1)	0.5
Super 2nd Chance ¹	0.3	0.0	0.3	0.0	0.3
Total Lotto Prize Awards	105.9	(9.2)	115.1	(2.9)	118.0
Total	<u>\$342.4</u>	<u>\$ 5.7</u>	<u>\$336.7</u>	<u>\$ 7.5</u>	<u>\$329.2</u>

¹ 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 sale of the scratch-off and lotto tickets.

² The Wisconsin Lottery began 5 Card Cash on April 6, 2014.

Generally, prizes awarded are a function of ticket sales: higher ticket sales will result in greater prize expense and lower sales will result in lower prize expense. The change in prize expense, however, is not always perfectly proportional to sales. Each individual game has a unique prize structure, so as sales shift between the different games being offered, prize expenses can fluctuate more or less than would be expected based on the change in sales. Since FY 2014-15 saw increased sales in scratch-off tickets and lower sales in lotto tickets, the overall prize expense rose significantly compared to overall sales. In FY 2014-15, ticket sales increased \$5.8 million while prize expense increased \$5.7 million. In FY 2013-14, ticket sales increased \$2.7 million while prize expense increased \$7.5 million. Schedule 3, which follows the Notes to the Financial Statements, shows a multi-year summary of ticket sales and their related prize expenses.

Since expenses for retailer commissions and incentives are a function of sales, they typically rise and fall with sales. In FY 2014-15, retailers were paid \$39.6 million in commissions and incentives, up \$1.2 million from the \$38.4 million paid in FY 2013-14. In FY 2012-13, retailer commissions and incentives were \$39.1 million.

The Wisconsin Lottery contracted with GTECH Corporation for an integrated gaming computer system and services (instant and lotto vendor services). In FY 2014-15, payments to GTECH Corporation were \$12.8 million. In both FY 2013-14 and FY 2012-13, payments to GTECH Corporation were \$13.4 million. Initially, the Wisconsin Lottery paid GTECH Corporation 2.54 percent of total net ticket sales. In July 2009, the Wisconsin Lottery extended its contract with GTECH Corporation through June 2013. In consideration for that extension, GTECH Corporation reduced the cost of the contract by \$1.0 million per year. Therefore, beginning with FY 2009-10, the Wisconsin Lottery paid GTECH Corporation 2.54 percent of total net sales, less \$1.0 million. In addition, GTECH Corporation is providing, at no additional cost, a remote, hot-site backup of the system and a data feed, which can be used for business analytics. The Wisconsin Lottery further extended its contract with GTECH Corporation through June 25, 2016. On October 1, 2015, GTECH Corporation changed their name to IGT Global Solutions Corporation. IGT Global Solutions Corporation will fulfill the remaining term of the current contract, which was subsequently extended to May 13, 2017. The payment terms for FY 2014-15 were 2.54 percent of the total net sales, less \$1,750,000. These are the payment terms that will continue to be followed in FY 2015-16.

Net Income and Transfer for Property Tax Relief

Net income before transfers was \$158.1 million in FY 2014-15, down from \$158.7 million in FY 2013-14. Net income before transfers was \$161.3 million in FY 2012-13.

As shown 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 decreased by \$2.0 million, or by 1.2 percent, during FY 2014-15, while they increased by \$12.5 million, or by 8.0 percent, during FY 2013-14.

Potential Factors Impacting Future Results

The Wisconsin Lottery's success is dependent upon its ability to effectively gauge the market for its products. The Wisconsin Lottery regularly changes its product offerings in response to consumer preferences. The Wisconsin Lottery is engaged in a long-term growth strategy for instant scratch-off sales by meeting consumer demand for more games at higher price points. Sales continue to build for tickets priced \$10 and higher. While the Wisconsin Lottery makes every effort to ensure the success of its products, overall sales will be adversely affected if the Wisconsin Lottery misjudges the market.

Approximately 17.0 percent of all ticket sales in FY 2014-15 came from two MUSL jackpot games: Powerball and Mega Millions. The sales of these games can be volatile as they are driven by the size and frequency of large jackpots, which occur randomly. For example, Mega Millions ticket sales rose 56.9 percent in FY 2013-14, only to drop 20.6 percent in FY 2014-15. The volatility of jackpot games makes forecasting ticket sales difficult. The Wisconsin Lottery has established a range to forecast future performance based upon past performance, but that range is broad and jackpot game sales can vary from year to year by tens of millions of dollars from estimates.

Lottery tickets are a discretionary purchase. Consequently, the Wisconsin Lottery's performance is subject to economic conditions and their impact on consumer spending. Some factors influencing consumer spending include unemployment, fuel costs, the cost of essential goods such as food, clothing, and shelter, and consumer confidence in the economy. Consumer purchases of discretionary items, such as lottery tickets, generally decline during periods when disposable income is adversely affected or when there is a lack of consumer confidence in the economy.

In September 2015, the Wisconsin Lottery asked the Wisconsin Department of Justice to review the December 29, 2007, Wisconsin's Megabucks drawing to determine if any illegal activity may have occurred in Wisconsin. The Lottery made this request because an individual previously employed by MUSL had access to Wisconsin's random number generators (RNGs) and was convicted of fraud in Iowa. The individual is appealing this conviction. Suspected fraud related to this individual is also being investigated in Colorado, Kansas, and Oklahoma. The Wisconsin Department of Justice's investigation is still ongoing and a completion date for the investigation is not yet known.

Although the RNGs used in the 2007 drawing had been replaced, the RNGs used during FY 2014-15 had also been purchased from MUSL. In June 2015, the three RNGs used by the Wisconsin Lottery were forensically examined by Digital Intelligence and found to be free of any malicious programming or activity. As a precaution, in January 2016, the Wisconsin Lottery received approval to replace the RNGs through an emergency procurement with a vendor independent of MUSL. The new RNGs were operational in April 2016 after a forensic examination by security experts.

Contacting the Wisconsin Lottery's Financial Management

These 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 these financial statements, or need additional financial information, please 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, please contact:

Wisconsin Department of Revenue Attention: Administrator of the Wisconsin Lottery Post Office Box 8941 Madison, Wisconsin 53708-8941 Telephone (608) 267-4500

Financial Statements

Statement of Net Position June 30, 2015, and June 30, 2014

	June 30, 2015	
ASSETS		
Current Assets:		
Cash and Cash Equivalents (Note 3)	\$ 49,839,930	\$ 45,460,333
Investments for Prize Annuities (Note 3)	6,070,396	6,276,986
Accounts Receivable (Note 4)	23,862,969	23,570,696
Due from Other State Programs (Note 4)	32,012	47,248
Ticket Inventory	2,153,219	1,689,501
MUSL Reserve Accounts (Note 5)	355,273	365,342
Prepaid Expenses	684,703	1,152,476
Interest Receivable	4,039	1,665
Total Current Assets	83,002,541	78,564,247
Noncurrent Assets:	20.54 / 20.6	2.4 = 2.5 = 2.2
Investments for Prize Annuities (Note 3)	29,514,086	34,785,238
MUSL Reserve Accounts (Note 5)	5,382,829	5,795,845
Net Pension Asset	758,965	0
Capital Assets:		
Equipment	546,963	500,527
Leasehold Improvements	113,288	159,724
Accumulated Depreciation	(607,646)	(594,354)
Total Noncurrent Assets	35,708,485_	40,646,980
TOTAL ASSETS	118,711,026	119,211,227
DEFERRED OUTFLOWS OF RESOURCES (Note 6)	637,916	0
LIABILITIES		
Current Liabilities:	5 001 002	(002 722
Annuity Prizes Payable (Note 7)	5,981,083	6,092,733
Prizes Payable	48,517,927	35,432,224
Accounts Payable	1,668,411	2,393,418
Due to Other State Programs	454,268	722,565
MUSL Payable	541,365	116,336
Unearned Revenue	966,783	915,898
Due to Other Governments	58,682	315,041
Accrued Payroll	174,186	117,184
Compensated Absences	189,506	178,372
Total Current Liabilities	58,552,211	46,283,771
Noncurrent Liabilities:	25 200 427	20 220 702
Annuity Prizes Payable (Note 7)	25,208,426	29,230,783
Compensated Absences	518,586	511,428
Other Postemployment Benefits	553,306	548,275
Total Noncurrent Liabilities	26,280,318	30,290,486
TOTAL LIABILITIES	84,832,529	76,574,257
DEFERRED INFLOWS OF RESOURCES (Note 6)	9,467	0
NET POSITION		
Net Position: (Note 12)	52,605	45 007
Invested in Capital Assets	•	65,897
Restricted for Pensions	758,965 5 383 830	0 5 705 945
Restricted for MUSL Reserves	5,382,829	5,795,845
Restricted for Investment Fair Value Adjustment	4,857,205	6,186,000
Restricted for Property Tax Relief	23,455,342	30,589,228
TOTAL NET POSITION	<u>\$ 34,506,946</u>	\$ 42,636,970

Statement of Revenues, Expenses, and Changes in Net Position for the Years Ended June 30, 2015, and June 30, 2014

OPERATING REVENUES		Year Ended une 30, 2015		Year Ended une 30, 2014
Instant Ticket Sales (Net of Allowances of \$714,051 and \$621,272, respectively) (Note 8) Lotto Ticket Sales (Net of Ticket Discounts of \$264,130 and \$156,224, respectively) (Note 8) Retailer Fees Miscellaneous Revenue	\$	357,463,506 217,167,877 53,905 57,472	\$	338,960,811 229,876,604 35,195 38,969
Total Operating Revenues		574,742,760		568,911,579
OPERATING EXPENSES				
Program Expenses: Instant Prize Expense (Note 9) Lotto Prize Expense (Note 9) Retailer Commissions and Incentives Instant and Lotto Vendor Services Product Information Costs Instant Ticket Printing Costs Instant Ticket Delivery Costs Donated Prize Expense	_	236,549,274 105,892,045 39,595,888 12,843,263 7,496,263 3,987,424 892,125 3,408	_	221,635,297 115,059,226 38,444,174 13,422,691 7,487,472 3,813,054 804,297 4,551
Total Program Expenses		407,259,690		400,670,762
Administrative Expenses: Salaries and Fringe Benefits Supplies and Services Depreciation Expense		5,675,474 2,454,104 13,292		5,470,323 2,559,805 19,792
Total Administrative Expenses		8,142,870		8,049,920
Total Operating Expenses		415,402,560		408,720,682
NET OPERATING INCOME		159,340,200		160,190,897
NONOPERATING REVENUES (EXPENSES) AND TRANSFERS				
Investment Income (Loss) Miscellaneous Revenue	_	(1,259,865) 3,408		(1,483,003) 4,551
Net Income Before Transfers		158,083,743		158,712,445
Transfers: Transfers of Lottery Proceeds for Property Tax Relief (Note 13) Transfers In from General Fund Transfer to Department of Health Services for Compulsive Gambling Programs Transfer to Department of Justice for Law Enforcement Transfer to Department of Revenue for Lottery Credit Administration		(166,433,326) 23,505 (396,000) (382,905) (241,632)		(168,372,540) 43,274 (396,000) (375,078) (182,801)
Transfers Out to General Fund		(143,020)		(169,665)
CHANGE IN NET POSITION		(9,489,635)		(10,740,365)
NET POSITION Net Position—Beginning of the Year		42,636,970 1,359,611		53,377,335 0
Prior Period Adjustment (Note 14)	_	1,001,101		

Statement of Cash Flows for the Years Ended June 30, 2015, and June 30, 2014

	Year Ended June 30, 2015	Year Ended June 30, 2014
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash Received from Retailers	\$ 572,745,574	\$ 566,619,804
Cash Paid for Prizes	(334,294,422)	(337,458,156)
Cash Paid for Retailer Commissions and Incentives	(39,132,448)	(38,988,914)
Cash Paid/Received for MUSL Reserve Accounts	424,189	(341,048)
Cash Paid to Employees	(5,620,130)	(5,441,864)
Cash Paid to Suppliers	(28,575,008)	(29,205,035)
Net Cash Provided by Operating Activities	165,547,755	155,184,787
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Transfers of Proceeds for Property Tax Credit	(166,433,173)	(183,222,540)
Transfer of Proceeds for Law Enforcement	(369,081)	(397,038)
Transfer of Proceeds for Lottery Credit Administration	(228,853)	(182,148)
Transfer of Proceeds for Compulsive Gambling Programs	(396,000)	(396,000)
Transfers to the General Fund	(143,020)	(169,665)
Transfers from the General Fund	45,514	91,178
Net Cash Used by Noncapital Financing Activities	(167,524,613)	(184,276,213)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Cash Paid for Purchase of Equipment	0	0
Net Cash Used by Capital and Related Financing Activities	0	0
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest Received	65,455	68,083
Cash Received for Redemption of Bonds	6,291,000	6,272,000
Net Cash Provided by Investing Activities	6,356,455	6,340,083
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	4,379,597	(22,751,343)
Cash and Cash Equivalents—Beginning of the Year	45,460,333	68,211,676
Cash and Cash Equivalents—End of the Year	\$ 49,839,930	\$ 45,460,333

RECONCILIATION OF NET OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES	Year Ended June 30, 2015	Year Ended June 30, 2014
Net Operating Income	\$ 159,340,200	\$ 160,190,897
Adjustments to Reconcile Net Operating Income to Net Cash		
Provided by Operating Activities:		
Depreciation Expense	13,292	19,792
Noncash Donated Prize Expense	3,408	4,551
Changes in Assets, Liabilities, and Deferreds:		
Decrease (Increase) in Accounts Receivable	(292,273)	(2,515,338)
Decrease (Increase) in MUSL Reserve Accounts	424,189	(341,048)
Decrease (Increase) in Ticket Inventory	(463,718)	65,699
Decrease (Increase) in Prepaid Expenses	467,773	39,169
Decrease (Increase) in Net Pension Asset and Related Deferred Outflows	(37,269)	0
Decrease (Increase) in Due from Other State Programs	(6,776)	36,424
Increase (Decrease) in Prizes Payable	6,809,643	(1,095,300)
Increase (Decrease) in Unearned Revenue	50,886	161,636
Increase (Decrease) in Due to Other State Programs	(288,338)	112,091
Increase (Decrease) in Accounts Payable	(731,129)	(1,181,271)
Increase (Decrease) in MUSL Payable	425,028	(551,277)
Increase (Decrease) in Due to Other Governments	(256,953)	206,932
Increase (Decrease) in Accrued Payroll	57,002	(730)
Increase (Decrease) in Compensated Absences	18,292	(5,438)
Increase (Decrease) in Other Postemployment Benefits	5,031	37,998
Increase (Decrease) in Net Pension Liability and Related Deferred Inflows	9,467	0
Total Adjustments	6,207,555	(5,006,110)
Net Cash Provided by Operating Activities	\$ 165,547,755	\$ 155,184,787
Noncash Activities:		
Net Change in Unrealized Gains and Losses	\$ 1,328,796	\$ (1,551,197)
Increase in Fair Value of Investments for Prize Annuities and	.,525,770	÷ (1,551,177)
Annuities Payable Due to Amortization	2,142,054	2,417,332

Notes to the Financial Statements -

1. Description of the Wisconsin Lottery

Wisconsin voters authorized the creation of a lottery by the passage of a constitutional amendment, by a 65 percent to 35 percent margin, on April 7, 1987. The Wisconsin Constitution requires that the net proceeds from Wisconsin Lottery operations be used to provide local property tax relief. The Wisconsin Lottery was created in December 1987 and sold its first ticket on September 14, 1988. The Lottery is administered by the Lottery Division within the Department of Revenue. During FY 2014-15 and FY 2013-14, the Wisconsin Lottery sold instant games, including scratch-off and pull-tab tickets, and lotto games. Lotto games have drawings to determine winning tickets, which include raffle tickets and tickets produced from a terminal located at a retailer's place of business (e.g., Powerball, Badger 5).

Since June 1989, the Wisconsin Lottery has been a member of the Multi-State Lottery Association (MUSL). In FY 2014-15 and FY 2013-14, as a member of MUSL, the Wisconsin Lottery participated in two national lotto games: Powerball (start date April 19, 1992) and Mega Millions (start date January 31, 2010). See Note 5 for information about MUSL.

During FY 2014-15 and FY 2013-14, the Wisconsin Lottery also sold tickets for six Wisconsin 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), Badger 5 (start date February 17, 2003), and 5 Card Cash (start date April 6, 2014). The EZ Match feature for Megabucks was added on April 3, 2011.

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 Net Position as "Transfers Out."

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, deferred outflows of resources, liabilities, and deferred inflows of resources associated with the operation of the Wisconsin Lottery are included on the Statement of Net Position. 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 Net Position 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, administrative 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.

GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*, effective beginning in FY 2013-14. The objective of this statement is to either (a) properly classify certain items that were previously reported as assets and liabilities as deferred outflows of

resources or deferred inflows of resources, or (b) recognize certain items that were previously reported as assets and liabilities as outflows of resources or inflows of resources.

In FY 2014-15, the Wisconsin Lottery implemented GASB Statement No. 68, Accounting and Financial Reporting for Pensions—an Amendment of GASB Statement No. 27, and GASB Statement No. 71, Pension Transition for Contributions Made Subsequent to the Measurement Date—an Amendment of GASB Statement No. 68. These statements establish standards for reporting a net pension liability or asset, pension expense, and deferred inflows and outflows of resources related to pensions. These statements revise accounting and financial reporting for pensions by state and local governments.

C. Cash and Cash Equivalents

Cash and cash equivalents reported on the Statement of Net Position and on the Statement of Cash Flows include 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. Balances pooled in the State Investment Fund are restricted to legally stipulated investments valued consistent with GASB Statement No. 31.

Investments for Prize Annuities D.

Investments for prize annuities consist entirely of securities backed by the full faith and credit of the United States government or its agencies. The securities finance jackpot prizes that are payable as annuities over a 20-year or 25-year period and are scheduled to mature near the time prize payments become payable to winners. GASB Statement No. 31 requires investments to be reported at fair value, with the increases or decreases in fair value recognized as investment income (loss). Fair value is determined using quoted market prices.

E. **Accounts Receivable**

The accounts receivable balance primarily represents amounts due from Wisconsin Lottery retailers. Receivables are recorded when instant tickets are sold to retailers. The receivable balance is shown net of amounts due to retailers. These amounts include commissions, performance incentives, winning ticket incentives, and ticket redemption amounts. Payments for instant ticket orders are typically due in four weeks, except for nonprofit organizations that typically have payments due within a week. Receivables are recorded for lotto games when retailers sell lotto tickets and have payments due within a week. The Wisconsin Lottery collects receivables weekly from retailer deposit accounts. For additional information about accounts receivable, see Note 4.

F. Ticket Inventory

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

G. Capital Assets

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 straightline method according to the following schedule:

	Estimated Life
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

H. Deferred Outflows and Deferred Inflows of Resources

For purposes of measuring the net pension liability (asset), deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the Wisconsin Retirement System (WRS) and additions to or deductions from the WRS' fiduciary net position have been determined on the same basis as they are reported by the WRS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value. For additional information on deferred outflows and inflows of resources, see Note 6.

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 7.

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 may be 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**

Ticket sales 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 2J 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. 25.75 (3) (a), Wis. Stats., at least 50 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.

Retailer Commissions and Incentives N.

Retailer commissions, which are classified as program expenses, are set by statute and are 5.5 percent for lotto ticket sales and 6.25 percent for instant scratch-off and instant pull-tab tickets. Nonprofit organizations receive higher commissions.

In addition to the retailer commissions, 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 has 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 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 percent commission of the prize award, up to a maximum of \$100,000 per winning ticket. In the event of a pari-mutuel drawing with a large jackpot shared by multiple winning tickets, retailers can earn total compensation up to a maximum of \$300,000. Winning ticket incentive payments are made weekly.

Short-term incentives are 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 allows participating retailers to earn additional commissions based on increased sales. Subject to certain restrictions and allowances, retailers earn up to 2 percent of the increase in quarterly sales compared to sales of the previous quarter for instant tickets and certain non-jackpot lotto games (SuperCash!, Daily Pick 3, Daily Pick 4, Badger 5, and 5 Card Cash). These payments are made quarterly. Retailers also earn up to 10 percent of the increase in annual sales over the previous year. Due to variability of sales of jackpot lotto games (Wisconsin's Megabucks, Mega Millions, and Powerball) and raffle games, sales goals incentive payments for these games are made annually. The annual payments may be limited to ensure that total payments do not exceed the statutory cap of 1.0 percent of gross instant and lotto ticket sales.

O. 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.

P. Disbursement of Lottery Proceeds for Property Tax Relief

The Department of Revenue disburses net lottery proceeds through two statutory credits: the Lottery and Gaming Tax Credit and the Farmland Tax Relief Credit. The disbursement of net lottery proceeds through a third credit, the School Levy Tax Credit, ended in FY 2012-13. The Department of Administration, with the approval 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. However, the amount to be disbursed is determined by November, well before the end of the fiscal year. The credit is based on the prior year's balance carryover and estimated proceeds for the current year.

The Farmland Tax Relief Credit is distributed to eligible individual and corporate taxpayers by the Department of Revenue. Payments are disbursed throughout the year. The Farmland Tax Relief Credit was discontinued for taxable years after December 31, 2009, as per s. 20.835 (2) (q), Wis. Stats. However, claims are still being processed on amended returns and late returns.

O. **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. **CASH AND INVESTMENTS**

The Wisconsin Lottery's cash and cash equivalents balance consists of cash deposited in the State's bank and shares in the State Investment Fund, which is a short-term pool of state and local funds managed by the State of Wisconsin Investment Board (SWIB) with oversight by its Board of Trustees. The carrying amount of shares in the State Investment Fund, which approximates fair value, was \$49.8 million as of June 30, 2015, and \$45.5 million as of June 30, 2014.

The State Investment Fund is not registered with the U.S. Securities and Exchange Commission. The various types of securities in which the State Investment Fund may invest are enumerated in s. 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. SWIB 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. Although 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, 2015, and June 30, 2014, 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 type based on the minimum credit ratings as issued by nationally recognized statistical rating organizations.

Interest Rate Risk—Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment or a deposit. Typically, this risk is higher in debt securities with longer maturities. The Wisconsin Lottery manages this risk by holding investments for prize annuities to maturity, at which time the fair value of the investment is equal to its stated maturity value. If an annuitant requests premature termination of an annuity that would necessitate an investment be redeemed prior to maturity, any loss or gain due to market fluctuations is passed through to the redeeming annuitant. Therefore, the Wisconsin Lottery has minimal interest rate risk exposure related to these investments, which consisted of U.S. Treasury and agency investments with the following maturities as of June 30, 2015, and June 30, 2014:

Maturity	Fair Value as of June 30, 2015	Fair Value as of June 30, 2014
Less than 1 Year	\$ 6,070,396	\$ 6,276,986
1 to 5 Years	19,445,236	21,625,586
6 to 10 Years	8,794,384	11,728,621
More than 10 Years	1,274,466	1,431,031
Total	<u>\$35,584,482</u>	<u>\$41,062,224</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 80 days as of June 30, 2015, and 88 days as of June 30, 2014.

4. **ACCOUNTS RECEIVABLE**

Accounts receivable balances are disaggregated as follows:

	June 30, 2015	June 30, 2014
Accounts Receivable:		
Retailers—Ticket Sales and Contract Fees	\$32,992,088	\$31,089,125
Retailers—Commissions and Incentives	(3,285,390)	(2,968,494)
Retailers—Ticket Redemptions	(5,844,152)	(4,551,539)
Miscellaneous	423	<u> 1,604</u>
Total Accounts Receivable	<u>\$23,862,969</u>	<u>\$23,570,696</u>
Due from Other State Programs:		
Transfers for Gaming	\$21,264	\$43,274
Miscellaneous	10,748	<u>3,974</u>
Total Due from Other State Programs	<u>\$32,012</u>	<u>\$47,248</u>

5. MULTI-STATE LOTTERY ASSOCIATION

A. **Joint Venture Association**

The Wisconsin Lottery is a member of the Multi-State Lottery Association (MUSL), a nonprofit, government-benefit voluntary association. As of June 30, 2015, MUSL had 37 member lotteries from 34 states, the District of Columbia, the U.S. Virgin Islands, and Puerto Rico. MUSL is owned and operated by the member lotteries, which sell one or more games administered by MUSL. MUSL 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. The Wisconsin Lottery participates in two multi-state games: Powerball and Mega Millions.

B. MUSL Financial Position and Activity

The following schedule presents the summarized audited financial position and activity of MUSL as of June 30, 2015, and June 30, 2014, as audited by other auditors.

	June 30, 2015	June 30, 2014
Total Assets	<u>\$401,081,678</u>	\$706,151,292
Total Liabilities Total Unrestricted Net Assets Total Liabilities and Net Assets	\$392,621,480 <u>8,460,198</u> \$401,081,678	\$695,948,415 10,202,877 \$706,151,292
Total Revenues Total Expenses Increase (Decrease) in Unrestricted Net Assets	\$ 3,513,813 _(5,256,492) \$(1,742,679)	\$ 3,170,118 _(4,991,276) \$(1,821,158)

Complete separate financial statements for MUSL may be obtained from:

Multi-State Lottery Association Attention: Bret Toyne 4400 NW Urbandale Drive Urbandale, Iowa 50322

C. Wisconsin Lottery's MUSL Balances

Lotteries participating in Powerball and Mega Millions transfer 50.0 percent of ticket sales, less actual low-tier prizes, to MUSL for prize pools and reserve accounts for each game. Member lotteries were required to transfer an additional 1.5 percent of Mega Millions sales until April 2, 2013, when MUSL reduced the additional transfer to 1.0 percent of Mega Millions sales (excluding Megaplier sales). Beginning April 1, 2014, this additional transfer requirement was eliminated.

Participating lotteries do not have rights to balances in the prize pool. Therefore, these funds are not reported as assets on the Wisconsin Lottery's financial statements. However, member lotteries have the right to a refund of their share of Prize Reserve Account balances if they withdraw from MUSL. The Wisconsin Lottery reports the total of its MUSL Prize Reserve Accounts as a restricted noncurrent asset (MUSL Reserve Accounts—Noncurrent).

In addition, each member lottery has an Unreserved Account, which accumulates interest earned on MUSL Prize Reserve Accounts and the Unreserved Account in excess of MUSL's administrative expenses. Unreserved Accounts may be withdrawn by member lotteries at any time and the Wisconsin Lottery records its share of the balance of this account as an unrestricted current asset (MUSL Reserve Accounts—Current).

The total MUSL Reserve and Unreserved Accounts balances are made
up of the following:

	June 30, 2015	<u>June 30, 2014</u>
Powerball Set Prize Reserve Account	\$1,195,077	\$1,291,909
Powerball Prize Reserve Account	2,729,946	2,830,648
Mega Millions Prize Reserve Account	1,179,626	1,336,042
Unreserved Account	633,453	702,588
Total MUSL Reserve Accounts	<u>\$5,738,102</u>	<u>\$6,161,187</u>

In FY 2012-13, the Wisconsin Lottery designated \$396,313 of its Unreserved Account balance to pay MUSL for its allocated share of acquisitions costs related to a patent obtained by MUSL. Because these funds are reserved for a specific purpose, the Wisconsin Lottery records this amount as a restricted noncurrent asset (MUSL Reserve Accounts—Noncurrent). At the end of FY 2014-15, the Wisconsin Lottery's remaining share of the cost was \$278,179.

6. **DEFERRED OUTFLOWS AND DEFERRED INFLOWS OF RESOURCES**

As of June 30, 2015, all of the Wisconsin Lottery's deferred outflows of resources and deferred inflows of resources related to pensions. The Wisconsin Lottery reported deferred outflows of resources and deferred inflows of resources from the following sources:

Deferred Outflows (Inflows) of Resources related to Pensions	FY 2014-15
Differences between expected and actual experience	\$106,427
Net differences between projected and actual earnings on pension plan investments	355,505
Employer contributions subsequent to the measurement date	155,753
Changes in proportion and differences between employer contributions and proportionate share of contributions	10,764
Total	<u>\$628,449</u>

7. **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

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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 \$2,142,054 for FY 2014-15 and \$2,417,332 for FY 2013-14.

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

Fiscal Year Ended June 30	Future Payments as of June 30, 2015	Future Payments as of June 30, 2014
2015	\$ O	\$ 6,273,871
2016	6,149,499	6,149,499
2017	6,343,036	6,343,036
2018	5,607,653	5,607,653
2019	4,566,071	4,566,071
2020	4,116,098	4,116,098
Subsequent Years	<u>12,141,350</u>	12,141,350
Total Future Prize Payments	38,923,707	45,197,578
Less: Present Value Adjustment	7,734,198	9,874,062
Present Value of Future Prize Payments	<u>\$31,189,509</u>	<u>\$35,323,516</u>

Annuity prizes payable activity for the fiscal years ended June 30, 2015, and June 30, 2014, was as follows:

Fiscal <u>Year</u>	Beginning <u>Balance</u>	<u>Increases</u>	<u>Decreases</u>	Ending <u>Balance</u>	Due within One Year
2014-15	\$35,323,516	\$2,142,054	\$(6,276,061)	\$31,189,509	\$5,981,083
2013-14	39,230,957	2,417,332	(6,324,773)	35,323,516	6,092,733

8. INSTANT AND LOTTO TICKET SALES

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

	FY 2014-15	FY 2013-14
Instant Ticket Sales:		
Scratch-off	\$356,370,186	\$337,699,578
Pull-tab	1,093,320	1,261,233
Total Instant Ticket Sales	<u>\$357,463,506</u>	\$338,960,811

	FY 2014-15	FY 2013-14
Lotto Ticket Sales:		
SuperCash!	\$ 24,550,611	\$ 24,520,298
Powerball	70,929,191	86,902,617
Wisconsin's Megabucks	25,159,740	16,122,233
Wisconsin's Megabucks EZ Match	2,257,641	1,937,581
Daily Pick 3	24,137,868	24,493,344
Daily Pick 4	12,747,663	12,561,236
Badger 5	21,326,318	23,829,788
Mega Millions	26,891,270	33,943,178
5 Card Cash	8,677,636	4,843,422
Raffle Games	761,265	886,140
General Sales and Discounts	(271,326)	(163,233)
Total Lotto Ticket Sales	<u>\$217,167,877</u>	<u>\$229,876,604</u>

INSTANT AND LOTTO PRIZE EXPENSE 9.

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

	FY 2014-15	FY 2013-14
Instant Prize Expense:		
Scratch-off	\$235,601,007	\$220,611,369
Pull-tab	688,267	763,928
Super 2nd Chance ¹	260,000	260,000
Total Instant Prize Expense	<u>\$236,549,274</u>	<u>\$221,635,297</u>
Lotto Prize Expense:		
SuperCash!	\$ 10,890,786	\$ 13,721,364
Powerball	34,765,010	41,947,640
Wisconsin's Megabucks	13,224,342	8,506,112
Wisconsin's Megabucks EZ Match	1,376,272	1,181,531
Daily Pick 3	10,479,010	12,713,550
Daily Pick 4	6,153,200	5,625,200
Badger 5	10,394,277	11,539,882
Mega Millions	13,054,328	15,989,257
5 Card Cash	4,920,487	3,193,970
Raffle Games	374,333	380,720
Super 2nd Chance ¹	260,000	260,000
Total Lotto Prize Expense	<u>\$105,892,045</u>	<u>\$115,059,226</u>

¹ There are no sales for the Super 2nd Chance drawing. Players enter the drawing by submitting non-winning tickets. Prizes are funded from the original sale of tickets.

10. CONTRACTUAL OBLIGATIONS

A. Scratch-off Tickets

In October 2009, the Wisconsin Lottery signed contracts for scratch-off ticket printing services with three vendors: Scientific Games International, Inc.; GTECH Printing Corporation; and Pollard Banknote Ltd. These three contracts were for the period November 1, 2009, through October 31, 2011, with three one-year renewal options for each contract. Each of these contracts had been renewed through October 31, 2015. In November 2015, the Wisconsin Lottery obtained sole source purchasing approval to extend the contracts with GTECH Printing Corporation and Pollard Banknote Ltd. until the new lottery gaming system is in place. These contracts have been extended through May 13, 2017. The Wisconsin Lottery completed a request for bid and awarded a contract for scratch-off ticket printing services to Scientific Games International, Inc., for the period November 1, 2015, through October 31, 2020. Scratch-off ticket printing services will also be provided under the new contract with IGT Global Solutions Corporation signed on February 16, 2016, as discussed in Note 10C. The Wisconsin Lottery purchased ticket printing services of approximately \$3.7 million in FY 2014-15 and approximately \$3.6 million in FY 2013-14 under these contracts.

B. Pull-tab Tickets

In October 2009, the Wisconsin Lottery signed contracts for pull-tab ticket printing services with International Gamco, Inc. and Pollard Banknote Ltd. to print pull-tab tickets. These two contracts were for the period November 1, 2009, through October 31, 2011, with three one-year renewal options for each contract. Both contracts were renewed (or extended) through October 31, 2014. The Wisconsin Lottery subsequently entered into a new two-year contract with Pollard Banknote Ltd. that expires on February 28, 2017, but includes four one-year renewal options. The Wisconsin Lottery did not purchase any ticket printing services for pull-tabs in FY 2014-15 compared with approximately \$29,388 in FY 2013-14 under these contracts.

C. Gaming System Vendor

The Wisconsin Lottery originally signed a contract with GTECH Corporation that supported a network of approximately 4,000 locations where lottery games are sold. The expiration date in the original contract was June 25, 2011, and the Wisconsin Lottery exercised its option to renew the contract for two one-year periods through June 25, 2013. Subsequently, the Wisconsin Lottery amended the current contract, extending it through May 13, 2017.

During FY 2014-15, GTECH Corporation received 2.54 percent of total net sales, less \$1,750,000, offset by 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). GTECH Corporation gives the Wisconsin Lottery credit on the next month's invoice for any liquidated damages of the previous month. Net payments to GTECH Corporation under this contract were approximately \$12.8 million in FY 2014-15 and approximately \$13.4 million in FY 2013-14.

On April 7, 2015, GTECH S.p.A., the parent company of GTECH Corporation, completed its acquisition of International Game Technology. In connection with such acquisition, GTECH S.p.A. was merged into International Game Technology PLC. GTECH Corporation remained a subsidiary of the merged entity until October 1, 2015, at which time the name was changed to IGT Global Solutions Corporation. IGT Global Solutions Corporation will fulfill the remaining term of the current contract. On February 16, 2016, the Wisconsin Lottery entered into a new contract with IGT Global Solutions Corporation for an integrated gaming computer system anticipated to be implemented in FY 2016-17. The initial terms of this contract will be for seven years from the operational start date. The new contract will require the Wisconsin Lottery to pay IGT Global Solutions Corporation 2.57 percent of total net sales. This new contract includes the lottery gaming system, instant scratch-off ticket printing, warehousing, distribution, and telemarketing services.

D. **Product Information Costs**

The Wisconsin Lottery primarily contracts with HY Connect to provide informational advertising services. The Wisconsin Lottery signed a two-year contract with HY Connect starting July 12, 2010, with an option to renew for three additional one-year periods. This contract was renewed through July 11, 2015. The Wisconsin Lottery has signed another two-year contract with HY Connect that will run from July 12, 2015, through June 30, 2017, with four one-year options for renewal. Payments to HY Connect were approximately \$7.3 million during both FY 2014-15 and FY 2013-14 and total spending on product information costs was approximately \$7.5 million during both FY 2014-15 and FY 2013-14.

11. EMPLOYEE RETIREMENT PLAN

Permanent employees of the Wisconsin Lottery are participants in the Wisconsin Retirement System (WRS). The WRS is a cost-sharing multipleemployer defined benefit pension plan and is established by chapter 40 of the Wisconsin Statutes. Eligible state and local government public employees are entitled to an annual formula retirement benefit based on the employee's final average earnings, years of creditable service, and 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 WRS is considered part of the State of Wisconsin's financial reporting entity.

Required contributions are determined by an annual actuarial valuation in accordance with chapter 40 of the Wisconsin Statutes. The employee required contribution is one-half of the actuarially determined contribution rate for general category employees, including teachers, and executives and elected officials. Required contributions for protective employees are the same rate as general employees. Employers are required to contribute the remainder of the actuarially determined contribution rate. The employer may not pay the employee required contribution unless provided for by an existing collective bargaining agreement. For calendar year 2014, the WRS recognized \$272,468 in contributions from the Wisconsin Lottery.

As of June 30, 2015, the Wisconsin Lottery reported an asset of \$758,965 for its proportionate share of the net pension asset. The net pension asset was measured as of December 31, 2014, and the total pension liability used to calculate the net pension asset was determined by an actuarial valuation as of December 31, 2013, rolled forward to December 31, 2014. No material changes in assumptions or benefit terms occurred between the actuarial valuation date and the measurement date. The Wisconsin Lottery's proportion of the net pension asset was based on the Wisconsin Lottery's share of contributions to the pension plan relative to the contributions of all participating employers. As of December 31, 2014, the Wisconsin Lottery's proportion was 0.03 percent, which was the same as its proportion measured as of December 31, 2013.

For the fiscal year ended June 30, 2015, the Wisconsin Lottery recognized pension expense of \$323,127.

12. RESTRICTED NET POSITION

The Wisconsin Lottery has a restricted net position related to capital assets of \$52,605 as of June 30, 2015, and \$65,897 as of June 30, 2014.

The Wisconsin Lottery has a restricted net position for pensions of \$758,965 as of June 30, 2015. These amounts must be used to fund future pension obligations.

The Wisconsin Lottery also has a restricted net position related to the MUSL reserves as described in Note 5. Restricted net position related to the MUSL reserves was \$5,382,829 as of June 30, 2015, and \$5,795,845 as of June 30, 2014.

In addition, the Wisconsin Lottery has a restricted net position for fair value adjustments of investments of \$4,857,205 as of June 30, 2015, and \$6,186,000 as of June 30, 2014. The Wisconsin Lottery does not realize gains or losses from the change in fair value of its annuity investments because it holds the investments until maturity to pay the annual annuity prize payments. Therefore, fair 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 position and were \$23,455,342 as of June 30, 2015, and \$30,589,228 as of June 30, 2014.

13. DISTRIBUTION OF NET PROCEEDS

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

	FY 2014-15	FY 2013-14
Lottery and Gaming Tax Credit Farmland Tax Relief Credit	\$166,433,304 22	\$168,365,817 6,723
Total Property Tax Relief Credits	<u>\$166,433,326</u>	<u>\$168,372,540</u>

14. PRIOR PERIOD ADJUSTMENT

The June 30, 2015 Statement of Revenues, Expenses, and Changes in Net Position includes the following prior period adjustment:

Account Affected	<u>Amount</u>	<u>Explanation</u>
Net Pension Asset Net Position	\$1,359,611 (1,359,611)	Implementation of GASB Statement No. 68 and GASB Statement No. 71

The June 30, 2014 Statement of Net Position does not include a prior period adjustment or any other restatements.

Supplementary Schedules

Schedule 1

Reconciliation of Lottery General Operations Expenses to the Budgetary Basis of Accounting for the Years Ended June 30, 2015, and June 30, 2014

SALARIES AND FRINGE BENEFITS	Year Ended ne 30, 2015	Year Ended June 30, 2014	
Per Financial Statement	\$ 5,675,474	\$	5,470,323
Adjustments to Financial Statement Balance:	(22.222)		(22.5(1)
Salaries and Benefits Expensed in One Year but Paid in the Next Adjustment to Pension Expense Due to Implementation of GASB 68	(23,322) 27,802		(32,561) 0
Reclassified Fringe Benefits to Transfer Out to General Fund	127,189		150,947
Budgetary Basis—Salaries and Fringe Benefits	\$ 5,807,143	\$	5,588,709
Per Financial Statement: Product Information Costs Instant Ticket Printing Costs Instant Ticket Delivery Costs Donated Prize Expense	\$ 7,496,263 3,987,424 892,125 3,408	\$	7,487,472 3,813,054 804,297 4,551
Supplies and Services Depreciation Expense	2,454,104 13,292		2,559,805 19,792
Total per Financial Statement	14,846,616		14,688,971
Adjustments to Financial Statement Balance:			
Depreciation Expense	(13,292)		(19,792)
Donated Prize Expense	(3,408)		(4,551)
Supplies and Services Expensed in One Year but Paid in Another	(29,227)		172,483
FY 2013-14 Expense Incorrectly Recorded Net of Revenue in WISMART Compulsive Gambling Payment Not Included Above	0 396,000		(9,378) 396,000
Budgetary Basis—Supplies and Services and Permanent Property	\$ 15,196,689	\$	15,223,733

Schedule 2

Statutorily Defined Lottery Administrative Expenses for the Years Ended June 30, 2015, June 30, 2014, and June 30, 2013

A DAMINIST DATING EXPENSES	Year Ended June 30, 2015	Year Ended June 30, 2014	Year Ended June 30, 2013
ADMINISTRATIVE EXPENSES			
Instant and Lotto Vendor Services	\$ 12,843,263	\$ 13,422,691	\$ 13,355,439
Product Information Costs	7,496,263	7,487,472	7,483,570
Instant Ticket Printing Costs	3,987,424	3,813,054	4,043,739
Instant Ticket Delivery Costs	892,125	804,297	803,383
Salaries and Fringe Benefits	5,675,474	5,470,323	5,602,465
Supplies and Services	2,454,104	2,559,805	2,631,356
Depreciation Expense	13,292	19,792	1,829
Transfer to Department of Health Services for			
Compulsive Gambling Programs	396,000	396,000	396,000
Transfer to Department of Revenue for Lottery			
Credit Administration	241,632	182,801	154,044
Transfers Out to General Fund	143,020	169,665	153,560
Total Administrative Expenses as Determined in			
Accordance with s. 25.75 (3) (b), Wis. Stats.	\$ 34,142,597	\$ 34,325,900	\$ 34,625,385
Gross Lottery Revenues per s. 25.75 (1) (b), Wis. Stats.	\$ 574,685,288	\$ 568,872,610	\$ 566,180,856
Administrative Expenses as a Percentage			
of Gross Lottery Revenues	5.94%	6.03%	6.12%

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

Summary of Prize Expenses for the Years Ended June 30, 2011, through June 30, 2015

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

	 Fiscal Year 2014-15				
	 Prize Expense		Ticket Sales	Prize Expense as a Percentage of Sales	
Instant Games Lotto Games	\$ 236,549,274 105,892,045	\$	357,463,506 217,167,877	66.2% 48.8	
Total for Fiscal Year	\$ 342,441,319	\$	574,631,383	59.6	

	 Fiscal Year 2013-14				
	 Prize Expense		Ticket Sales	Prize Expense as a Percentage of Sales	
Instant Games Lotto Games	\$ 221,635,297 115,059,226	\$	338,960,811 229,876,604	65.4% 50.1	
Total for Fiscal Year	\$ 336,694,523	\$	568,837,415	59.2	

	Fiscal Year 2012-13					
		Prize Expense	Ticket Sales		Prize Expense as a Percentage of Sales	
Instant Games Lotto Games	\$	211,185,530 118,016,139	\$	326,725,747 239,376,954	64.6% 49.3	
Total for Fiscal Year	\$	329,201,669	\$	566,102,701	58.2	

	Fiscal Year 2011-12				
		Prize Expense		Ticket Sales	Prize Expense as a Percentage of Sales
Instant Games	<u> </u>	208,922,382	•	322,482,041	64.8%
Lotto Games		111,192,993		225,158,693	49.4
Total for Fiscal Year	\$	320,115,375	\$	547,640,734	58.5

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

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.

Auditor's Report ■



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Joe Chrisman State Auditor

Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters

Senator Robert Cowles and Representative Samantha Kerkman, Co-chairpersons Joint Legislative Audit Committee

Mr. Richard G. Chandler, Secretary Ms. Pat Lashore, Lottery Administrator Department of Revenue

Report 16-7

We have audited the financial statements and the related notes of the Wisconsin Lottery as of and for the years ended June 30, 2015, and June 30, 2014, and have issued our report thereon dated July 15, 2016. 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*, which is issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

Management of the Department of Revenue and the Wisconsin Lottery are responsible for establishing and maintaining effective internal control over financial reporting (internal control). In planning and performing our audits of the financial statements, we considered the Department of Revenue's and Wisconsin Lottery's internal control to determine the audit procedures that are appropriate in the circumstances 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 Department of Revenue's and Wisconsin Lottery's internal control.

Accordingly, we do not express an opinion on the effectiveness of the Department of Revenue's and 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 misstatements, 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 that a material misstatement will not be detected and corrected on a timely basis. A *significant deficiency* is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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 material weaknesses or significant deficiencies. Given these limitations, we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Wisconsin Lottery's financial statements are free from material misstatement, we performed tests of 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*.

Purpose of This Report

This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Department of Revenue's and the Wisconsin Lottery's internal control and compliance. The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the Department of Revenue's and the Wisconsin Lottery's internal control or on compliance. Accordingly, this report is not suitable for any other purpose.

LEGISLATIVE AUDIT BUREAU

Joe Chrisman State Auditor

July 15, 2016