

Report 13-11
July 2013

Wisconsin Lottery

Department of Revenue

STATE OF WISCONSIN



Legislative Audit Bureau ■

Wisconsin Lottery

Department of Revenue

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

Response

From the Department of Revenue



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Joe Chrisman
State Auditor

July 23, 2013

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 authorized by s. 13.94(1)(em), Wis. Stats., we have completed an annual financial audit and a biennial program evaluation of the Wisconsin Lottery, which is administered by the Department of Revenue (DOR). We have provided an unqualified opinion on the Wisconsin Lottery's fiscal year (FY) 2011-12 and FY 2010-11 financial statements.

Sales of instant and lotto tickets increased 10.7 percent over the past five years, from \$494.7 million in FY 2007-08 to \$547.6 million in FY 2011-12. The Wisconsin Constitution requires that net proceeds from the Wisconsin Lottery be used exclusively for property tax relief for Wisconsin residents. From FY 2007-08 through FY 2011-12, lottery proceeds funded \$700.8 million in property tax relief.

Because instant game ticket sales account for the majority of the Wisconsin Lottery's revenues, we reviewed the process to develop instant games, including those associated with trademarked and copyrighted properties. While all lottery games generate revenue to be used for property tax relief, we question whether the additional expenses associated with trademarked or copyrighted properties maximized the net revenue available for this purpose. Therefore, we recommend the Wisconsin Lottery consider discontinuing the introduction of instant games for which it must pay license fees. In addition, we found the Wisconsin Lottery overestimated the success of certain short-term retailer incentives, and we recommend it consider all relevant factors when assessing the effects of these incentives on sales.

We appreciate the courtesy and cooperation extended to us by Wisconsin Lottery staff in DOR. DOR's response follows our report.

Respectfully submitted,

Joe Chrisman
State Auditor

JC/PS/SH/ss

Report Highlights ■

We provide an unqualified opinion on the Wisconsin Lottery's FY 2010-11 and FY 2011-12 financial statements.

Wisconsin Lottery sales increased 10.7 percent from FY 2007-08 through FY 2011-12.

From FY 2007-08 through FY 2011-12, Wisconsin Lottery proceeds provided \$700.8 million in property tax relief.

We question whether the Wisconsin Lottery has maximized revenue generated from the sale of certain instant games.

A 1987 amendment to the Wisconsin Constitution allowed the Legislature to create a state lottery and required that its net proceeds be distributed for property tax relief. The Wisconsin Lottery began operations the following year and has been managed by the Department of Revenue (DOR) since 1995. Lottery tickets are the Wisconsin Lottery's primary revenue source and are sold at more than 3,600 retailer locations in Wisconsin. The Wisconsin Lottery offers "instant games," which include both scratch-off and pull-tab tickets, and "lotto games," which were formerly known as online games.

As authorized by s. 13.94(1)(em), Wis. Stats., we have completed a financial audit and program evaluation of the Wisconsin Lottery. In conducting the financial audit, we considered internal controls, substantiated account balances, and verified compliance with certain laws and regulations. We have provided an unqualified opinion on the Wisconsin Lottery's financial statements for the years ended June 30, 2012, and June 30, 2011.

In conducting the program evaluation, we:

- examined trends in sales, operating revenues, and operating expenses;
- evaluated the development and management of instant games, which generate the largest share of lottery revenue; and

- evaluated the compensation paid to lottery retailers through commissions and the Retailer Performance Program.

Revenues and Expenses

As shown in Table 1, Wisconsin Lottery sales increased from \$494.7 million in fiscal year (FY) 2007-08 to \$547.6 million in FY 2011-12, or by 10.7 percent. Increases in ticket sales in the last several years resulted primarily from increases in the sales of instant games priced at \$20 per ticket; the addition of the Mega Millions lotto game, which had a record jackpot in March 2012; and an increase in the price of a Powerball ticket from \$1 to \$2 in January 2012.

Table 1

Wisconsin Lottery Sales
(in millions)

Fiscal Year	Amount
2007-08	\$494.7
2008-09	473.4
2009-10	480.9
2010-11	502.7
2011-12	547.6

Lottery ticket sales vary by county. In FY 2011-12, lottery sales ranged from less than \$200,000 in Menominee County to more than \$100 million in Milwaukee County. We also found that FY 2011-12 per capita sales ranged from \$59 per adult in Menominee County to \$200 per adult in Marinette County.

In FY 2011-12, the Wisconsin Lottery’s operating expenses totaled \$391.2 million and included \$320.1 million in prizes paid to winning ticket holders. Operating expenses increased by 8.6 percent from FY 2010-11 to FY 2011-12 because expenses generally increase as ticket sales increase. Other expenses included retailer compensation, game development and production costs, product information costs, and staff salaries and fringe benefits. The number of full-time equivalent (FTE) positions authorized for the Wisconsin Lottery

decreased from 97.85 in July 2008 to 82.70 in July 2012. However, an additional 4.0 FTE positions were authorized by 2013 Wisconsin Act 20, the 2013-15 Biennial Budget Act.

Property Tax Relief

The Wisconsin Constitution requires that net proceeds from the Wisconsin Lottery be used exclusively for property tax relief for Wisconsin residents. From FY 2007-08 through FY 2011-12, Wisconsin Lottery proceeds provided \$700.8 million in property tax relief.

Statutes require that each year at least 50 percent of Wisconsin Lottery sales be returned to players as prize payments. In FY 2011-12, the prize payout percentage was 58.5 percent, which increased from 58.2 percent in the prior year. Statutes limit certain Wisconsin Lottery administrative expenses to no more than 10 percent of gross lottery revenues. FY 2011-12 administrative expenses were 6.1 percent of gross lottery revenues.

Lottery Game Management

Effective game development and management help to maximize sales revenue and increase the net proceeds available to fund property tax relief. To maximize net proceeds, the Wisconsin Lottery regularly reviews the number and types of instant games it offers, and uses product information funds appropriated by the Legislature to publicize its games. To improve instant game management, the Wisconsin Lottery decided to sell fewer games concurrently, ensure that an assortment of games is available at a number of different prices, and focus staff resources on developing new game styles, such as combining scratch-off and pull-tab games. The Wisconsin Lottery also continues to introduce higher-priced instant games in response to player demand. In FY 2013-14, the Wisconsin Lottery plans to introduce a \$30 scratch-off ticket for the first time.

Periodically, the Wisconsin Lottery pays licensing fees for the use of trademarked or copyrighted properties. These fees totaled \$710,900 for eight games it introduced from FY 2007-08 through FY 2009-10. We found that six of eight instant games for which the Wisconsin Lottery paid a license fee generated less net sales revenue than the average sales revenue generated by games that sold for the same price during the same fiscal year but for which no license fee was paid. While all lottery games generate revenue to be used for property tax relief, we question whether the additional expenses associated with trademarked and copyrighted properties maximizes the net revenue available for this purpose.

Retailer Compensation

Wisconsin Lottery tickets are sold in numerous types of retail outlets. Convenience stores represented 64.1 percent of all lottery retailers and accounted for 69.0 percent of total FY 2011-12 lottery ticket sales. As of September 2012, 3,690 retailers sold lottery tickets in Wisconsin, and the statewide average was 1,075 adults per lottery retailer.

Retailers that sell Wisconsin Lottery tickets are compensated at statutorily established commission rates and through the Retailer Performance Program. The Retailer Performance Program has three components: a bonus for retailers that sell winning tickets, short-term incentives for retailers that purchase a certain number of tickets or upgrade the lottery products they offer, and sales incentives for retailers that increase their sales. In FY 2011-12, the Wisconsin Lottery paid retailers \$32.7 million in commissions and a total of \$5.5 million through the Retailer Performance Program: \$4.2 million in sales incentives, \$1.1 million in winning ticket bonuses, and \$194,000 in short-term incentives.

Section 565.02(4)(g), Wis. Stats., requires that Retailer Performance Program payments not exceed 1.0 percent of total ticket sales. In FY 2011-12, the Wisconsin Lottery exceeded the statutory limit by \$54,800, or 0.01 percent. Wisconsin Lottery officials attributed the overpayment to administrative and procedural errors and have taken steps to reduce the chance an overpayment occurs in the future by improving the reconciliation process between Wisconsin Lottery records and the State's accounting system.

Although it is difficult to quantify the effect of winning ticket bonuses and sales incentives on Wisconsin Lottery sales, each short-term incentive is developed with specific goals and estimates for return on expense. Wisconsin Lottery officials calculate the return on expense as the increase in sales above what would have been expected if an incentive had not been offered. They indicated that a return on expense ratio of 3:1 is the minimum return a short-term incentive must generate for it to recover its costs and not affect the proceeds available for property tax relief.

The Wisconsin Lottery offered five short-term incentives in FY 2011-12 and estimated that these incentives significantly exceeded the 3:1 return on expense ratio, with an overall ratio of 43:1. However, we determined that Wisconsin Lottery officials overestimated the return ratio for at least two of the incentives.

Recommendations

We include recommendations for the Wisconsin Lottery to:

- ☑ consider discontinuing the introduction of instant games for which it must pay license fees and report to the Joint Legislative Audit Committee by March 3, 2014, on its future plans (*p. 25*); and
- ☑ consider all relevant factors in assessing the effects of short-term incentives on lottery sales (*p. 35*).

■ ■ ■ ■

Introduction ■

Because ticket sales are the Wisconsin Lottery's primary revenue source, we reviewed sales data for both instant and lotto games during the past five fiscal years and compared them to the most recent lottery sales data available for other midwestern states. We also reviewed operating expenses, property tax relief funded by net proceeds available from the Wisconsin Lottery, lottery game management, and the Wisconsin Lottery's program for providing performance incentives to retailers.

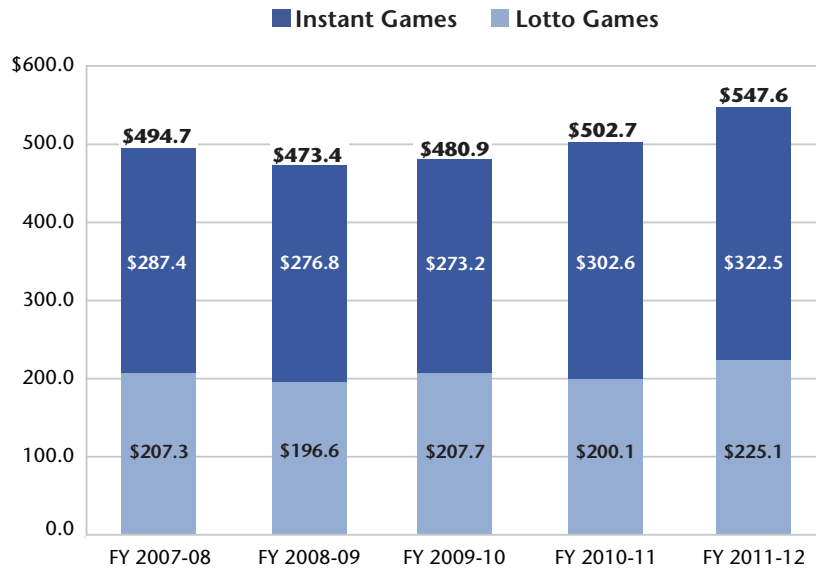
Wisconsin Lottery Ticket Sales

***Ticket sales increased
8.9 percent from
FY 2010-11 to
FY 2011-12.***

As shown in Figure 1, the Wisconsin Lottery's total ticket sales increased from \$494.7 million in FY 2007-08 to \$547.6 million in FY 2011-12, or by 10.7 percent. The largest increase occurred from FY 2010-11 to FY 2011-12, during which time ticket sales increased 8.9 percent largely due to a \$25.0 million increase in lotto sales. Sales grew because the price of a Powerball ticket increased from \$1 to \$2 in January 2012 and the Mega Millions game had a record jackpot in March 2012. Instant ticket sales grew \$19.9 million largely because of an increase in the sales of those games priced at \$20 per ticket.

Figure 1

Wisconsin Lottery Ticket Sales
(in millions)



In FY 2011-12, Wisconsin Lottery sales exceeded \$100 million in Milwaukee County.

In FY 2011-12, lottery ticket sales varied by county and ranged from less than \$200,000 in Menominee County to more than \$100 million in Milwaukee County. The five most populous counties—Milwaukee, Dane, Waukesha, Brown, and Racine—represented almost 39 percent of total FY 2011-12 lottery sales. On a per capita basis, FY 2011-12 lottery sales ranged from \$59 per adult in Menominee County to \$200 per adult in Marinette County. As shown in Figure 2, certain counties with small populations, such as Iron and Rusk, had greater per capita sales, while certain counties with large populations, such as Dane and Brown, had low per capita sales.

Table 2

Lottery Sales in Midwestern States
(in millions)

State	FY 2007-08	FY 2008-09	FY 2009-10	FY 2010-11	Percentage Change from FY 2007-08 to FY 2010-11
Ohio ¹	\$2,325.1	\$2,417.7	\$2,490.2	\$2,601.0	11.9%
Illinois	2,057.3	2,077.2	2,191.4	2,264.7	10.1
Minnesota	461.5	481.3	499.0	504.4	9.3
Iowa	249.2	243.3	256.3	271.4	8.9
Wisconsin	494.7	473.4	480.9	502.7	1.6
Michigan ¹	2,330.2	2,377.4	2,359.2	2,340.0	0.4
Indiana	822.9	732.7	740.3	791.5	(3.8)

¹ Includes keno game sales.

Source: *La Fleur's 2012 World Lottery Almanac*

In FY 2010-11, Wisconsin ranked 33rd in per capita lottery sales.

Each year, La Fleur's publishes a lottery almanac that includes state lottery statistics, such as per capita sales based on each state's total population, rather than its adult population. Wisconsin's per capita lottery sales of \$88 in FY 2010-11 were significantly lower than the national average. Among the 43 states that operated lotteries in that year, Wisconsin ranked 33rd in per capita lottery sales, and it ranked last among midwestern states, as shown in Table 3.

Table 3

Per Capita Lottery Sales in Midwestern States
FY 2010-11

State	Per Capita Sales
Michigan	\$237
Ohio	225
<i>National Average</i>	187
Illinois	176
Indiana	121
Minnesota	94
Iowa	89
Wisconsin	88

Source: *La Fleur's 2012 World Lottery Almanac*

Per capita lottery sales vary among states for a number of reasons. First, lottery sales are affected by whether Indian gaming or other types of gambling are offered within a state or in neighboring states. Second, nonresidents may purchase lottery tickets in states with high levels of tourism. Third, states offer various lottery products that are designed to appeal to players with different interests. For example, Wisconsin is one of eleven states that offer pull-tab tickets.

In Wisconsin, lottery tickets must be purchased using cash at a retailer.

Differences in available payment and ticket ordering methods may also account for variations in per capita lottery sales. Wisconsin requires tickets to be purchased with cash, in person, and directly from a retailer. In some states, there are fewer restrictions on acceptable payment methods for residents who wish to purchase lottery tickets. For example, Minnesota allows the purchase of lotto tickets over the internet if purchasers provide their bank account information, while Illinois allows the purchase of lotto tickets over the internet using a credit card. However, allowing purchases by credit card or over the internet may increase problem gambling and may make it more difficult to ensure that individuals under the age of 18 do not play.

Wisconsin Lottery Operating Expenses

From FY 2010-11 through FY 2011-12, operating expenses increased to \$391.2 million, or by 8.6 percent.

As shown in Table 4, the Wisconsin Lottery's operating expenses increased from \$360.1 million in FY 2010-11 to \$391.2 million in FY 2011-12, or by 8.6 percent, primarily because prize expenses and retailer compensation increased as ticket sales increased.

Table 4

Wisconsin Lottery Operating Expenses (in millions)

Expense Type	FY 2007-08	FY 2008-09	FY 2009-10	FY 2010-11	FY 2011-12
Prize Expenses	\$286.4	\$280.2	\$274.0	\$292.7	\$320.1
Retailer Compensation	34.3	32.4	33.3	35.3	38.2
Game Development and Production	16.7	16.2	15.4	16.5	17.4
Product Information	7.4	7.4	7.5	7.4	7.5
Other ¹	8.8	8.6	8.2	8.2	8.0
Total	\$353.6	\$344.8	\$338.4	\$360.1	\$391.2

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

Game development and production expenses include instant game ticket printing and delivery costs and payments to GTECH Corporation, which maintains a central information system to account for instant and lotto game activity and to network with retailer terminals. Game development and production expenses increased in FY 2010-11 and FY 2011-12 as ticket sales increased. The Wisconsin Lottery paid GTECH Corporation \$11.8 million in FY 2010-11 and \$12.8 million in FY 2011-12. The Wisconsin Lottery's contract with GTECH Corporation was to expire in June 2013. However, the Wisconsin Lottery received approval from the Department of Administration to extend the contract to June 25, 2015, as it develops specifications for an official bid.

In FY 2011-12, 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 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. In FY 2011-12, the Wisconsin Lottery spent \$7.5 million on product information.

The Wisconsin Lottery and other DOR staff developed an economic model to evaluate the effect of product information expenditures.

In report 11-6, we recommended the Wisconsin Lottery report to the Joint Legislative Audit Committee on how it will measure the effects of its product information expenditures. As a result, and in conjunction with staff from DOR's Division of Research and Policy, the Wisconsin Lottery developed a model to assess the effect of product information expenditures on total lottery sales. The model is based on preliminary work by the Lottery's product information contractor that reviewed the effects of economic variables on Wisconsin Lottery instant ticket sales. Lottery staff believe the model may be helpful in evaluating the effect of product information expenditures on sales, but its eventual usefulness as a management tool is unknown because of limited experience with the model to date. Lottery staff indicated the model will be reviewed and updated on an annual basis.

In report 11-6, we also recommended the Wisconsin Lottery continue to complete annual evaluations of its product information contractor. We reviewed the Wisconsin Lottery's efforts and found that evaluations had been completed for both 2010 and 2011. These evaluations determined the work of the contractor to be "very good" based on receiving a score of four on a five-point scale, as established by the Wisconsin Lottery.

Staffing Levels

In July 2012, the Wisconsin Lottery was authorized 82.70 FTE positions, of which 75.05 were filled.

As shown in Table 5, the number of FTE positions authorized for the Wisconsin Lottery decreased from 97.85 in July 2008 to 82.70 in July 2012. Some of the Wisconsin Lottery's authorized positions are located in other divisions within DOR. These positions, including staff in DOR's budget office, spend part of their time supporting the operation of the Wisconsin Lottery. In July 2012, 13.25 FTE positions of 75.05 FTE filled positions were located in divisions other than the Wisconsin Lottery. 2013 Wisconsin Act 20, the 2013-15 Biennial Budget Act, authorized an additional 4.0 FTE administrative positions for the Wisconsin Lottery.

Table 5

Wisconsin Lottery Full-time Equivalent Positions As of July

	Authorized Positions ¹	Vacant Positions	Percentage Vacant
2008	97.85	12.80	13.1%
2009	92.20	9.00	9.8
2010	92.20	12.65	13.7
2011	82.70	6.25	7.6
2012	82.70	7.65	9.3

¹ Includes positions authorized for the operation of the Wisconsin Lottery as well as the administration of the Lottery and Gaming Tax Credit.

Property Tax Credits

From its inception through FY 2011-12, the Wisconsin Lottery has provided nearly \$3.3 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 and the School Levy Tax Credit. From its inception in 1988 through FY 2011-12, the Wisconsin Lottery provided nearly \$3.3 billion in property tax relief. As shown in Table 6, lottery proceeds provided \$700.8 million in property tax relief from FY 2007-08 through FY 2011-12.

Table 6

Wisconsin Property Tax Relief¹
(in millions)

Fiscal Year	Lottery and Gaming Tax Credit	Farmland Tax Relief Credit ²	School Levy Tax Credit	Total Distributed
2007-08	\$129.6	\$16.9	\$ 0.0	\$146.5
2008-09	117.8	14.6	0.0	132.4
2009-10	112.8	14.3	0.0	127.1
2010-11	129.1	0.9	14.9	144.9
2011-12	135.0	–	14.9	149.9
Total	\$624.3	\$46.7	\$29.8	\$700.8

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

² Use of Wisconsin Lottery proceeds for this program was discontinued after December 2009. Subsequent payments were made as taxpayers amended or filed late tax returns.

As directed by 2009 Wisconsin Act 28, the 2009-11 Biennial Budget Act, Wisconsin Lottery proceeds began funding \$14.9 million of the School Levy Tax Credit instead of the Farmland Tax Relief Credit, which was restructured. As part of 2013 Wisconsin Act 20, general purpose revenues replaced the \$14.9 million in lottery proceeds used to fund the School Levy Tax Credit. As a result, all lottery proceeds will be used for the Lottery and Gaming Tax Credit beginning in FY 2013-14.

Statutory Requirements

State statutes and legislative action 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 returned to players as prize payments. As shown in Table 7, the Wisconsin Lottery's prize expenses have complied with the statutory requirement, although they have fluctuated because of changes in the types of games offered and played. Lotto game prize payouts, which are dependent on jackpot amounts and the frequency of winners claiming prizes, tend to fluctuate more than payouts for instant games.

Table 7

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

Fiscal Year	Prize Expenses	Ticket Sales	Prizes as a Percentage of Ticket Sales
2007-08	\$286.4	\$494.7	57.9%
2008-09	280.2	473.4	59.2
2009-10	274.0	480.9	57.0
2010-11	292.7	502.7	58.2
2011-12	320.1	547.6	58.5

The Wisconsin Lottery's administrative expenses remained within statutory limits from FY 2007-08 through FY 2011-12.

Section 25.75(3)(b), Wis. Stats., limits certain administrative expenses to no more than 10 percent of gross lottery revenues. Statutory gross lottery revenues consist of instant and lotto ticket sales and retailer fees. Statutory administrative expenses include most expenses and transfers, except prize payments; retailer compensation; transfers to property tax relief; and transfers to the Department of Justice for lottery-related law enforcement activities. As shown in Table 8, the Wisconsin Lottery's administrative expenses remained within the statutory limit from FY 2007-08 through FY 2011-12.

Table 8

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

Fiscal Year	Statutorily Defined Administrative Expenses	Statutorily Defined Gross Lottery Revenues	Percentage of Gross Lottery Revenues
2007-08	\$33.5	\$494.6	6.8%
2008-09	32.9	473.5	7.0
2009-10	31.8	481.0	6.6
2010-11	32.9	502.7	6.5
2011-12	33.6	547.7	6.1

Statutes establish maximum compensation rates for basic commissions and performance program payments to retailers who sell lottery tickets. Basic commission rates are currently 5.5 percent of the retail price for lotto tickets and 6.25 percent for instant tickets. Section 565.02(4)(g), Wis. Stats., requires that performance program payments not exceed 1.0 percent of total ticket sales. Table 9 shows the Wisconsin Lottery’s Retailer Performance Program payments from FY 2007-08 through FY 2011-12.

In FY 2011-12 the Wisconsin Lottery exceeded the statutory limit on payments under the Retailer Performance Program by \$54,800, or 0.01 percent. Lottery officials attributed the overpayment to administrative and procedural errors and have taken steps to reduce the chance an overpayment occurs in the future by improving the reconciliation process between Wisconsin Lottery records and the State’s accounting system.

Table 9

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

Fiscal Year	Retailer Performance Program Payments	Ticket Sales	Payments as a Percentage of Ticket Sales
2007-08	\$4.5	\$494.7	0.9%
2008-09	4.0	473.4	0.8
2009-10	4.5	480.9	0.9
2010-11	5.1	502.7	1.0
2011-12 ¹	5.5	547.6	1.0

¹ In FY 2011-12, the Wisconsin Lottery exceeded the statutory limit on payments under the Retailer Performance Program by \$54,800, or 0.01 percent.



Lottery Game Management ■

Effective game development and management help to maximize net proceeds available for property tax relief.

Effective game development and management help to maximize sales revenue and increase the net proceeds available to fund property tax relief. To maximize net proceeds, the Wisconsin Lottery regularly reviews the number and types of instant games it offers, and uses product information funds appropriated by the Legislature to publicize its games. We reviewed the availability and sales of lottery games and assessed their performance based on available information.

Game Availability and Sales

As shown in Table 10, sales of lotto games totaled \$225.1 million and represented 41.1 percent of total game sales in FY 2011-12. Sales of instant scratch-off games totaled \$320.1 million and represented 58.5 percent of total game sales.

Lotto Games

Wisconsin participates in two lotto games administered by the Multi-State Lottery Association (MUSL): Powerball and Mega Millions. These games are played in 43 states, including Wisconsin, as well as Washington, D.C., and the U.S. Virgin Islands. As shown in Table 11, the Wisconsin Lottery also offers five other lotto games, which are sold only in Wisconsin.

Table 10

Lottery Game Availability and Sales

Game Type	FY 2010-11			FY 2011-12		
	Number of Games ¹	Total Sales (in millions)	Percentage of Total	Number of Games ¹	Total Sales (in millions)	Percentage of Total
Lotto	9 ²	\$200.1	39.8%	9 ²	\$225.1	41.1%
Instant						
Scratch-off	137	299.1	59.5	136	320.1	58.5
Pull-tab	19	3.5	0.7	19	2.4	0.4
Subtotal	156	302.6	60.2	155	322.5	58.9
Total	165	\$502.7	100.0%	164	\$547.6	100.0%

¹ The number of games represents games available for sale during at least one point of the fiscal year.

² Includes EZ Match, which is available for \$1 when purchasing a Megabucks ticket, as well as raffle tickets sold through the Wisconsin Lottery.

Table 11

Wisconsin Lottery Lotto Games¹

Game	Date of Introduction	Drawing Frequency	Odds of Winning Maximum Prize	FY 2010-11 Sales (in millions)	FY 2011-12 Sales (in millions)
Powerball ²	April 19, 1992	Twice Weekly	1:175,223,510	\$65.1	\$78.2
Mega Millions ²	January 31, 2010	Twice Weekly	1:175,711,536	28.7	37.0
SuperCash!	February 4, 1991	Daily	1:1,631,312	25.9	25.4
Daily Pick 3	September 21, 1992	Daily	1:1,000	24.8	24.1
Badger 5	February 17, 2003	Daily	1:169,911	24.5	22.2
Wisconsin's Megabucks	June 20, 1992	Twice Weekly	1:6,991,908	16.9	21.6
Daily Pick 4	September 15, 1997	Daily	1:10,000	12.1	12.2

¹ Excludes EZ Match and raffle tickets.

² These games are administered by MUSL and played in 43 states, including Wisconsin, as well as Washington, D.C., and the U.S. Virgin Islands.

In January 2012, MUSL modified Powerball by increasing the price of a ticket from \$1 to \$2, and increasing the odds of winning the jackpot from 1 in 195.2 million to 1 in 175.2 million.

Instant Games

The Wisconsin Lottery continues to introduce higher-priced instant games.

As shown in Table 12, introductions of instant games decreased from 74 in FY 2007-08 to 63 in FY 2009-10 but then increased. To improve instant game management, the Wisconsin Lottery indicated it sells fewer games concurrently, ensures that an assortment of games is available at each price, and focuses staff resources on developing new game styles, such as combined scratch-off and pull-tab games. In response to player demand, the Wisconsin Lottery also indicated that it continues to introduce higher-priced instant games. For example, it plans to introduce a \$30 instant game in FY 2013-14.

Table 12

Number of Instant Games Introduced

Game Price	FY 2007-08	FY 2008-09	FY 2009-10	FY 2010-11	FY 2011-12
\$1	16	16	13	18	13
\$2	17	18	16	14	15
\$3	18	11	13	14	14
\$5	17	14	14	15	15
\$10	4	5	4	7	7
\$15	0	1	1	1	0
\$20	2	1	2	3	6
Total	74	66	63	72	70

Game management decisions are based on multiple factors, including:

- weekly sales of instant games currently available;
- whether all of the top prizes of an instant game have been won;
- ticket inventories of instant games currently available for sale;

- scheduled introductions of other instant games; and
- the mix of instant games currently available based on price, play style, and theme.

The sales performance of instant games currently available may hasten or delay the scheduled introduction of new instant games. As a result, the instant game introduction schedule requires frequent adjustments. Most instant games are available for at least 12 weeks, although some may be available for a shorter period if they are seasonal, such as a game with a holiday theme.

Evaluation of Instant Games

Starting in FY 2005-06, the Wisconsin Lottery began to evaluate the performance of its instant games.

In report 05-8, we recommended that the Wisconsin Lottery develop a written methodology to ensure the Wisconsin Lottery conducts consistent analyses of the costs and revenues associated with instant games. In FY 2005-06, the Wisconsin Lottery implemented an evaluation tool to help it develop and manage instant games. The tool identifies each instant game's features, such as theme and play style; provides a justification for each game, including showing how it complements other games currently available for sale; and estimates development costs and sales. The evaluation tool has been effective in providing management information on the performance of individual games because it allows the financial performance of games with similar features and costs to be compared.

Six of eight games for which license fees were paid generated less net sales revenue than similar games for which no license fees were paid.

Periodically, the Wisconsin Lottery pays license fees for the use of a trademarked or copyrighted property in the hope of generating interest among those individuals who typically do not purchase lottery tickets. While all lottery games generate revenue to be used for property tax relief, we analyzed whether the benefits gained through the name recognition associated with trademarked or copyrighted properties exceeded the additional license fees that were paid to obtain permission to use these properties for games introduced from FY 2007-08 through FY 2009-10.

The cost of licensing fees for the use of trademarked or copyrighted properties varies. The license fees paid by the Wisconsin Lottery for these eight trademarked or copyrighted games introduced from FY 2007-08 through FY 2009-10 totaled \$710,900 and ranged from \$22,100 for "Tetris" to \$260,000 for the "Packers" game. As shown in Table 13, six of eight instant games for which the Wisconsin Lottery paid a license fee generated less net sales revenue than the average net sales revenue generated by games that sold for the same price during the same fiscal year but for which no license fee was paid. In

recent years, the Wisconsin Lottery has introduced fewer games that require the payment of a significant license fee. The Wisconsin Lottery introduced two licensed games in FY 2010-11 and one licensed game in FY 2011-12, but it had not completed end-of-game evaluations for these three games at the time of our fieldwork because prizes could still be claimed.

Table 13

Comparison of Licensed and Non-licensed Instant Game Sales¹

Instant Game	Price per Ticket	Fiscal Year Introduced	Per Licensed Game		Non-licensed Games	
			License Fee Paid	Net Sales Revenue ²	Average Net Sales Revenue ³	Difference
Pac Man Cash	\$3	2007-08	\$ 28,800	\$ 875,800	\$1,145,200	\$(269,400)
Tetris	3	2007-08	22,100	1,049,500	1,145,200	(95,700)
Monopoly	3	2007-08	36,000	1,272,000	1,145,200	126,800
Deal or No Deal	5	2007-08	254,600	1,849,600	1,874,900	(25,300)
Pink Panther	2	2008-09	24,000	973,300	850,500	122,800
Space Invaders	3	2008-09	28,800	733,700	1,214,700	(481,000)
Scrabble	3	2008-09	56,600	917,000	1,214,700	(297,700)
Packers	10	2009-10	260,000	2,059,900	2,100,700	(40,800)

¹ Excludes those games for which the amount of fees paid was minimal.

² Net sales revenue is the amount of revenue remaining for each game after expenses, such as the game’s production costs, prize expenses, and license fees, have been deducted.

³ Represents the average net sales for instant games that sold for the same price during the same fiscal year, but for which no license fees were paid.

Wisconsin Lottery officials raised several concerns with these comparisons. For example, because crossword games are frequently introduced and are consistently among the Wisconsin Lottery’s best-selling instant games, Wisconsin Lottery officials believe crossword games should be excluded from our analysis of instant game sales. However, we do not believe it is appropriate to eliminate one type of non-licensed game from our analysis based on its popularity.

Wisconsin Lottery officials also note that one licensed game—Pac Man Cash—was discontinued after approximately six months because the top prizes had been claimed and the shortened time period for the sale of game tickets makes comparison of its sales

with those of non-licensed games problematic. However, non-licensed games may also be withdrawn early when their top prizes are claimed, and some non-licensed games sold for an even shorter period of time. For example, Pac Man Cash sold for \$3, was introduced in FY 2007-08, and was available for sale for 187 days. In that same year, three non-licensed games sold for the same price and were available for purchase for a fewer number of days, but each generated net sales revenue that was at least \$390,000 greater than Pac Man Cash. We believe that the potential for early withdrawal of lottery games is an additional risk associated with the sale of licensed games. When licensed games are withdrawn early because the top prizes have been claimed, the Wisconsin Lottery may generate less net revenue based on the license fees they must pay for these games.

From FY 2007-08 through FY 2009-10, 91.2 percent of licensed game tickets were sold compared to 93.7 percent of the non-licensed game tickets.

In addition, for some licensed games the Wisconsin Lottery prints fewer tickets than for some non-licensed games, in part because license fees for certain games are based on the number of tickets printed. Among licensed games, the number of tickets printed ranged from 810,000 for Packers to 1.2 million for Monopoly. Among non-licensed games, the number printed ranged from 716,010 for Diamond Ice to 1.5 million for Blue Line Tripler Crossword. Although the number of tickets printed can have a direct effect on the amount of net revenue generated, we found that the percentage of tickets sold among all that were printed was lower for licensed games than for non-licensed games. From FY 2007-08 through FY 2009-10, 91.2 percent of the tickets printed for licensed games were sold compared to 93.7 percent of the non-licensed game tickets.

Finally, Wisconsin Lottery officials assert that the sale of licensed games results in ticket sales among individuals who would not otherwise purchase lottery tickets and that the sale of licensed games may actually increase overall ticket sales. For example, they believe that offering tickets involving a professional sports team encourages ticket purchases among sports fans who would not otherwise purchase lottery tickets. However, they were unable to provide data to support this assertion. In addition, they indicated that they conducted an analysis showing total lottery sales during weeks in which a licensed game was available for purchase exceeded weeks in which no licensed game was available. Because a number of factors could account for this difference, we do not believe it is appropriate to attribute increased sales to the availability of a licensed game.

Based on our analysis of instant game sales and costs, we question whether the additional expenses associated with trademarked or copyrighted properties maximized net revenue from instant game sales.

Recommendation

We recommend the Wisconsin Lottery:

- *consider discontinuing the introduction of instant games for which it must pay license fees in order to maximize available revenue for property tax relief; and*
- *report to the Joint Legislative Audit Committee by March 3, 2014, on its future plans.*

■ ■ ■ ■

Retailer Compensation ■

Retailers that sell Wisconsin Lottery tickets are compensated at statutorily established commission rates and through the Retailer Performance Program that provides additional incentives, including sales incentives for retailers that increase their sales, a bonus for retailers that sell winning tickets, and short-term incentives for retailers that purchase a certain number of tickets or upgrade the lottery products they offer. We reviewed commission rates relative to other states, as well as the effectiveness of the Retailer Performance Program.

Retailers Selling Lottery Tickets

In June 2012, lottery products were sold by 3,682 retailers and 374 nonprofit organizations.

The Wisconsin Lottery contracts with two types of vendors: retailers and nonprofit organizations. In general, a retailer may sell all lottery products while a nonprofit organization may sell only pull-tabs. In June 2012, Wisconsin Lottery products were sold by 3,682 retailers and 374 nonprofit organizations. Because more than 90 percent were retailers, we focused our review on them.

In FY 2011-12, convenience stores represented 64.1 percent of all retailers and accounted for 69.0 percent of lottery ticket sales.

Wisconsin Lottery tickets are sold in numerous types of retail outlets. We reviewed available data on active retailers, but the data did not include historical information. Therefore, we reviewed data for the 3,690 active Wisconsin Lottery retailers in September 2012. As shown in Table 14, convenience stores represented 64.1 percent of all retailers and accounted for 69.0 percent of total FY 2011-12 lottery ticket sales.

Table 14

Wisconsin Lottery Sales by Type of Retailer
September 2012

Retailer Type	Number of Retailers	Percentage of Retailers	Percentage of FY 2011-12 Sales
Convenience Store	2,365	64.1%	69.0%
Grocery Store	565	15.3	18.6
Gas Station	250	6.8	7.6
Liquor Store	226	6.1	2.8
Other	284	7.7	2.0
Total	3,690	100.0%	100.0%

As of September 2012, there were 1,075 adults per lottery retailer in Wisconsin.

As shown in Table 15, the largest number of Wisconsin Lottery retailers were located in the ten most populous counties. For the most populous counties, the number of adults per retailer ranged from 1,077 in Racine County to 1,750 in Dane County. Among all counties, the number of adults per retailer ranged from 379 in Iron County to 1,816 in Calumet County. The statewide average was 1,075 adults per lottery retailer.

Table 15

Number of Lottery Retailers in the Most Populous Counties
September 2012

County	Population (Age 18 and over)	Number of Retailers	Number of Adults per Retailer
Milwaukee	715,352	641	1,116
Dane	390,320	223	1,750
Waukesha	298,908	192	1,557
Brown	189,313	139	1,362
Racine	147,518	137	1,077
Outagamie	133,968	114	1,175
Winnebago	131,811	93	1,417
Marathon	101,875	76	1,340
Kenosha	124,968	96	1,302
Rock	120,869	100	1,209

Payments to Retailers

The Wisconsin Lottery provides two types of compensation to retailers: commissions based on ticket sales and payments through the Retailer Performance Program, which provides compensation based on several factors.

Retailer Commissions

Section 565.10(14)(b), Wis. Stats., specifies that retailers receive commission rates of 5.5 percent of lotto ticket sales and 6.25 percent of instant ticket sales. In FY 2011-12, the Wisconsin Lottery paid retailers \$32.7 million in commissions. The commission rates have been increased twice since 1995:

- 1995 Wisconsin Act 27, the 1995-97 Biennial Budget Act, increased the rate from 5.0 percent to 5.5 percent for all ticket sales; and
- 1997 Wisconsin Act 27, the 1997-99 Biennial Budget Act, increased the rate from 5.5 percent to 6.25 percent exclusively for instant ticket sales.

In FY 2010-11, Wisconsin's overall rate of retailer compensation was 7.0 percent of total lottery sales.

As shown in Table 16, total retailer compensation as a percentage of lottery sales for the seven midwestern states we reviewed ranged from 7.2 percent in Michigan to 4.9 percent in Illinois. Wisconsin's retailer compensation was 7.0 percent of total lottery sales in FY 2010-11.

In addition to sales commissions, which lotteries in all midwestern states provide, other midwestern states offer additional incentives to their retailers. As shown in Table 17, these incentives include:

- a cashing bonus, which is typically a one- or two-percent bonus paid to the retailer for redeeming winning tickets with a value up to \$600;
- a winning ticket bonus, which is typically up to a two-percent bonus paid to a retailer for selling a winning ticket; and
- a sales incentive award, which is a payment to a retailer for an increase in sales over a specified period of time.

Table 16

Retailer Compensation in Midwestern States
FY 2010-11

State	Sales Commission as a Percentage of Sales	Total Lottery Sales (in millions)	Total Retailer Compensation (in millions)	Retailer Compensation as a Percentage of Lottery Sales
Michigan	6.0 percent	\$2,340.0	\$168.4	7.2%
Indiana	Instant—5.5 percent Lotto—6.0 percent	791.5	56.2	7.1
Wisconsin	Instant—6.25 percent Lotto—5.5 percent	502.7	35.3¹	7.0
Iowa	Instant—5.5 percent Lotto—5.5 percent Pull-tab—5.0 percent	271.4	17.3	6.4
Ohio	5.5 percent	2,601.0	161.3	6.2
Minnesota	5.5 percent	504.4	30.4	6.0
Illinois	5.0 percent	2,264.7	111.9	4.9

¹ Includes commissions and additional payments made through the Retailer Performance Program.

Source: *La Fleur's 2012 World Lottery Almanac* and the Iowa Lottery website.

Table 17

Retailer Compensation Programs in Midwestern States

State	Commissions	Cashing Bonus	Winning Ticket Bonus	Sales Incentive Award
Wisconsin¹	✓		✓	✓
Illinois	✓	✓	✓	
Indiana	✓	✓	✓	✓
Iowa ²	✓		✓	✓
Michigan	✓	✓		
Minnesota	✓	✓	✓	
Ohio	✓	✓	✓	

¹ Wisconsin also provides short-term incentives to retailers.

² Iowa also provides peak sales bonuses to retailers for Powerball and Mega Millions.

Retailer Performance Program

In addition to sales commissions, the Wisconsin Lottery uses up to 1.0 percent of gross sales revenue to provide incentives to retailers.

In Wisconsin, retailer compensation other than sales commissions is provided through the Retailer Performance Program, which is authorized by s. 565.02(4)(g), Wis Stats. The program was created by the Wisconsin Lottery in January 2000 in response to declining sales and a declining number of retailers selling lottery tickets. The program, which uses up to 1.0 percent of gross sales revenue to provide incentives to retailers, has three components: a bonus for retailers that sell winning tickets, short-term incentives for retailers that purchase a certain number of tickets or upgrade the lottery products they offer, and sales incentives for retailers that increase their sales.

Table 18 shows the Wisconsin Lottery's payments to retailers through the Retailer Performance Program from FY 2007-08 through FY 2011-12. Although the majority of incentives were paid in cash, some of the short-term incentives were provided as merchandise, such as promotional hats and shirts. After a decline in payments to retailers in FY 2008-09, payments under the program increased from FY 2009-10 through FY 2011-12 as lottery sales increased.

Table 18

Retailer Performance Program Incentives

Fiscal Year	Amount	Percentage Change
2007-08	\$4,538,300	–
2008-09	3,962,000	(12.7)%
2009-10	4,501,000	13.6
2010-11	5,057,500	12.4
2011-12	5,531,200	9.4

Wisconsin retailers receive a bonus for selling a winning ticket with a prize of \$600 or more.

Winning Ticket Bonuses

Before July 2005, retailers that sold a winning lottery ticket with a prize of \$600 or more received a bonus payment equal to 2.0 percent of the prize, up to \$100,000. In July 2005, the Wisconsin Lottery changed the payment structure for the winning ticket bonus to a maximum of \$300,000 per prize level per drawing. This change was made to limit bonus payments if a large number of winning jackpot tickets were sold in Wisconsin or other large prizes were won in a

single drawing for lotto games, such as Powerball. With this change, if more than three retailers sell winning jackpot tickets, \$300,000 is divided among the retailers, instead of each retailer receiving the maximum possible amount.

Because the bonus payment is dependent on the sale of a winning ticket with a large prize from either instant or lotto games, payments to retailers have fluctuated from year to year, as shown in Table 19. In FY 2011-12, the Wisconsin Lottery paid \$1.1 million in winning ticket bonuses, an increase of 38.7 percent from the previous year.

Table 19

Winning Ticket Bonuses Paid to Retailers

Fiscal Year	Amount	Percentage Change
2007-08	\$ 968,400	–
2008-09	909,100	(6.1)%
2009-10	1,036,800	14.0
2010-11	790,800	(23.7)
2011-12	1,097,000	38.7

Short-Term Incentives

Short-term incentives provide compensation to retailers who satisfy a specific, short-term performance expectation. Short-term incentives are intended to support specific lottery products, enhance sales during certain periods of the year, or encourage retailers to take other actions. For example, a short-term incentive may be used to encourage retailers to review training material on upcoming changes to Wisconsin Lottery games, help reduce the ticket inventory for certain games, or support seasonal lottery products. Unlike other incentives, some short-term incentives are provided as merchandise rather than cash.

Table 20 shows the number of short-term incentives offered by the Wisconsin Lottery from FY 2007-08 through FY 2011-12. Wisconsin Lottery officials indicated changes in the schedule for the release of games may affect their use of short-term incentives as they manage the number and type of games available to retailers.

Table 20

Short-term Incentives Paid to Retailers

Fiscal Year	Number of Short-term Incentives	Amount	Percentage Change
2007-08	6	\$653,900	–
2008-09	8	611,900	(6.4)%
2009-10	8	319,000	(47.9)
2010-11	6	313,800	(1.6)
2011-12	5	194,000	(38.2)

Sales Incentives

The sales incentive component of the Retailer Performance Program provides payments to retailers that increase their sales of instant games and lotto games. The Wisconsin Lottery makes sales incentive payments after paying winning ticket bonuses and short-term incentives, and it may suspend or reduce sales incentive payments to ensure that spending authority for the program does not exceed the statutory limit of 1.0 percent of gross sales revenue.

Sales incentives paid to retailers increased from \$2.9 million in FY 2007-08 to \$4.2 million in FY 2011-12.

As shown in Table 21, sales incentives paid to retailers increased from \$2.9 million in FY 2007-08 to \$4.2 million in FY 2011-12.

Table 21

Sales Incentives Paid to Retailers

Fiscal Year	Amount	Percentage Change
2007-08	\$2,916,000	–
2008-09	2,441,000	(16.3)%
2009-10	3,145,200	28.8
2010-11	3,952,900	25.7
2011-12	4,240,200	7.3

Effect of Short-term Incentives on Sales

The effect of incentives on the sale of Wisconsin Lottery tickets is difficult to quantify.

Although it is difficult to quantify the effect of winning ticket bonuses and sales incentives on Wisconsin Lottery sales, each short-term incentive is developed with specific goals and estimates for return on expense. Wisconsin Lottery officials calculate the return on expense as the increase in sales above what would have been expected if an incentive had not been offered. In doing so, they use historical sales data from similarly priced games to project game sales in the absence of an incentive. They indicated that a return on expense ratio of 3:1 is the minimum return a short-term incentive must generate for it to recover its costs and not affect the proceeds available for property tax relief.

As shown in Table 22, the Wisconsin Lottery offered five short-term incentives in FY 2011-12. Wisconsin Lottery officials estimate that these incentives generated \$8.2 million in sales above what is likely to have been generated without them. On an individual basis, all five short-term incentives significantly exceeded the 3:1 return on expense ratio, with an overall ratio of 43:1. However, we determined that Wisconsin Lottery officials overestimated the return ratio for at least two of the incentives.

Table 22

Estimated Return on Expense Amounts for Short-Term Incentives FY 2011-12

Incentive Name	Incentive Expense	Additional Return ¹	Return on Expense Ratio
\$500 Touchdown	\$ 15,900	\$1,896,500	119:1
Holiday 2011 Incentive	82,400	3,029,500	37:1
Packers Raffle	48,200	314,600	7:1
Wisconsin Lottery Black	43,700	843,100	19:1
Powerball Website	3,800	2,165,900	570:1
Total	\$194,000	\$8,249,600	43:1

¹ Represents sales above the amount that is estimated to have occurred without the retailer incentives.

First, all sales from the Packers Raffle were attributed to the short-term incentive because no similar game had been offered in the past to be used as a basis for comparison. This greatly overestimated the effect of the incentives because the Wisconsin Lottery used a base of zero when calculating sales performance. Second, the increase in Powerball sales of \$2.2 million occurred during the same time as a large Powerball jackpot. Because sales increase when large jackpots are available, it is difficult to identify what, if any, sales increase resulted from the incentive rather than the size of the jackpot. In the future, the Wisconsin Lottery should exclude these types of cases when calculating the return on expense ratio.

Recommendation

We recommend the Wisconsin Lottery consider all relevant factors in assessing the effects of short-term incentives on Lottery sales.

■ ■ ■ ■

Audit Opinion ■

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

We have audited the accompanying financial statements of the Wisconsin Lottery as of and for the years ended June 30, 2012, and June 30, 2011, as listed in the table of contents. These financial statements are the responsibility of the Wisconsin Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

As discussed in Note 2, the financial statements referred to in the first paragraph present only the Wisconsin Lottery and do not purport to, and do not, present fairly the financial position of the State of Wisconsin as of June 30, 2012, or June 30, 2011, the changes in its financial position, or where applicable, its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Wisconsin Lottery as of June 30, 2012, and June 30, 2011, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated July 8, 2013, on our consideration of the Wisconsin Lottery's internal control over financial reporting; our tests of its compliance with certain provisions of laws, regulations, and contracts; and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

Our audits for the years ended June 30, 2012, and June 30, 2011, were conducted for the purpose of forming an opinion on the financial statements of the Wisconsin Lottery. Schedules 1, 2, and 3 on pages 80 through 82 for the years ended June 30, 2012, and June 30, 2011, are presented for purposes of additional analysis 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, 2012, and June 30, 2011, 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 for the years ended June 30, 2012, and June 30, 2011.

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, 2010, June 30, 2009, and June 30, 2008, and issued reports thereon dated, April 25, 2011 (report 11-6), and May 18, 2010 (report 10-8), which contained unqualified opinions on the respective financial statements. Schedule 2, on page 81, for the year ended June 30, 2010, and Schedule 3, on page 82, for the years ended June 30, 2010, June 30, 2009, and June 30, 2008, are presented for purposes of additional analysis 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, 2010, June 30, 2009, and June 30, 2008. 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, 2010, June 30, 2009, and June 30, 2008.

The supplementary information included as Management's Discussion and Analysis on pages 41 through 49 is presented for purposes of additional analysis and is not a required part of the financial statements. We have applied certain limited procedures to the information, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audits 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 express an opinion or provide any assurance.

July 8, 2013

LEGISLATIVE AUDIT BUREAU

by 
Sherry Haakenson
Audit Director

Management's Discussion and Analysis ■

Prepared by Wisconsin Lottery Management

This section of the Wisconsin Lottery's financial statements presents the Wisconsin Lottery Management's Discussion and Analysis of the financial performance of the Wisconsin Lottery for the fiscal years ended June 30, 2012, and June 30, 2011, with comparative information from the fiscal year ended June 30, 2010. This discussion should be read in conjunction with the accompanying financial statements and notes. The financial statements, notes, and this discussion are the responsibility of Wisconsin Lottery management.

Financial Highlights

The Wisconsin Lottery had its highest sales year in its history in FY 2011-12. Operating revenues generated from ticket sales for the Wisconsin Lottery were \$547.6 million in FY 2011-12 versus \$502.7 million in FY 2010-11, an increase of 8.9 percent. The Wisconsin Lottery's ability to generate funds for property tax relief remains strong.

- Operating expenses for FY 2011-12 increased \$31.2 million, or by 8.6 percent, primarily as a result of increased prize expenses and retailer commission and incentives, both of which rise with increased sales. Office Administration Expenses (salaries, fringe benefits, and supplies) remained relatively constant at \$8.0 million in FY 2011-12 versus \$8.2 million in FY 2010-11.

- Administrative expenses, as defined in s. 25.75(3)(b), Wis. Stats., were 6.1 percent of gross lottery revenues in FY 2011-12, 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 \$33.6 million in FY 2011-12, an increase of \$0.7 million from \$32.9 million in FY 2010-11.
- Net income before transfers was \$158.3 million for FY 2011-12, compared to \$141.6 million in FY 2010-11, mainly due to increased instant and lotto ticket sales as well as increased investment income.

Overview of the Financial Statements

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

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

Summary of Net Assets

The Statement of Net Assets provides detailed information on the nature and amount of the Wisconsin Lottery's assets, liabilities, and net assets at the close of FY 2011-12 and FY 2010-11. Table A presents these data in a condensed form for the past three fiscal years. The relationship of assets to liabilities and resulting net assets is one indicator of the financial condition of the Wisconsin Lottery.

Table A

Wisconsin Lottery Net Assets
(in millions)

	June 30, 2012	June 30, 2011	Change	June 30, 2010	Change
Investments	\$ 54.0	\$ 56.5	\$(2.5)	\$ 64.0	\$(7.5)
Capital Assets (Net of Accumulated Depreciation)	0.1	0.1	0.0	0.1	0.0
Other Assets	77.1	70.3	6.8	67.7	2.6
Total Assets	131.2	126.9	4.3	131.8	(4.9)
Current Liabilities	44.5	43.5	1.0	40.1	3.4
Noncurrent Liabilities	37.7	41.9	(4.2)	46.0	(4.1)
Total Liabilities	82.2	85.4	(3.2)	86.1	(0.7)
Net Assets:					
Invested in Capital Assets	0.1	0.1	0.0	0.1	0.0
Restricted for MUSL Reserves	5.0	4.7	0.3	4.0	0.7
Restricted for Investment Fair Value Adjustment	10.6	8.8	1.8	10.0	(1.2)
Restricted for Property Tax Relief	33.3	27.9	5.4	31.6	(3.7)
Total Net Assets	<u>\$ 49.0</u>	<u>\$ 41.5</u>	<u>7.5</u>	<u>\$ 45.7</u>	<u>\$(4.2)</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 \$131.2 million at the end of FY 2011-12, compared to \$126.9 million at the end of FY 2010-11, and \$131.8 million at the end of FY 2009-10. The increase in assets in FY 2011-12 is due to an increase in cash and cash equivalents of \$11.1 million, from \$39.2 million at the end of FY 2010-11 to \$50.3 million at the end of FY 2011-12, as a result of a higher net income for the year. The decrease in assets in FY 2010-11 was due to investments being used for annuity payments while no new annuity-related investments have been made, as no winners have chosen annuities during the last three years.

Liabilities

Current liabilities consist primarily of accrued prizes payable, annuity prizes payable, and accounts payable due to suppliers. Noncurrent liabilities consist primarily of annuity prizes payable more than a year beyond the date of the Statement of Net Assets. As previously noted, no winners during the past three years chose to receive their winnings in the form of an annuity. Therefore, total annuity prizes payable decreased each year as existing annuitants continued to receive their annual payments and, as a result, total liabilities declined. At the end of FY 2011-12, the Wisconsin Lottery had total liabilities of \$82.2 million, compared with total liabilities of \$85.4 million at the end of FY 2010-11 and \$86.1 million at the end of FY 2009-10.

Net Assets

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

Revenues, Expenses, and Changes in Net Assets

The Wisconsin Lottery's total net assets were \$49.0 million at the end of FY 2011-12, a \$7.5 million increase from the prior year. During FY 2010-11, total net assets decreased by \$4.2 million to \$41.5 million. Total net assets were \$45.7 million at the end of FY 2009-10.

The Statement of Revenues, Expenses, and Changes in Net Assets provides detailed information on the nature and financial impact of the Wisconsin Lottery's operations for FY 2011-12 and FY 2010-11. Table B presents data for the past three fiscal years in a condensed form.

Table B

Wisconsin Lottery Changes in Net Assets
(in millions)

	FY 2011-12	FY 2010-11	Change	FY 2009-10	Change
Revenues					
Operating Revenues:					
Ticket sales	\$547.6	\$502.7	\$44.9	\$480.9	\$21.8
Retailer fees and miscellaneous revenue	0.1	0.1	0.0	0.1	0.0
Nonoperating Revenues:					
Investment income (loss)	1.8	(1.1)	2.9	1.6	(2.7)
Miscellaneous revenue	0.0	0.0	0.0	0.1	(0.1)
Total Revenues	549.5	501.7	47.8	482.7	19.0
Expenses					
Program Expenses:					
Prize expenses	320.1	292.7	27.4	274.0	18.7
Retailer commissions and incentives	38.2	35.3	2.9	33.3	2.0
Instant and lotto vendor services	12.8	11.8	1.0	11.2	0.6
Other game-related expenses	12.1	12.1	0.0	11.7	0.4
Office Administration Expenses	8.0	8.2	(0.2)	8.2	0.0
Total Expenses	391.2	360.1	31.1	338.4	21.7
Net Income Before Transfers	158.3	141.6	16.7	144.3	(2.7)
Transfers					
Transfers for Property Tax Relief	(149.9)	(144.9)	5.0	(127.1)	17.8
Transfers In from General Fund	0.1	0.1	0.0	0.2	(0.1)
Transfer for Compulsive Gambling Programs	(0.4)	(0.4)	0.0	(0.4)	0.0
Transfer for Law Enforcement	(0.3)	(0.3)	0.0	(0.3)	0.0
Transfer for Lottery Credit Administration	(0.2)	(0.2)	0.0	(0.3)	(0.1)
Transfers Out to General Fund	(0.1)	(0.1)	0.0	(0.1)	0.0
Change in Net Assets	<u>\$ 7.5</u>	<u>\$ (4.2)</u>	<u>\$11.7</u>	<u>\$ 16.3</u>	<u>\$(20.5)</u>

Operating Revenues

Operating revenues are generated almost entirely from ticket sales. Ticket sales for the Wisconsin Lottery were \$547.6 million in FY 2011-12, \$502.7 million in FY 2010-11, and \$480.9 million in FY 2009-10. Table C compares ticket sales for each game category for FY 2011-12, FY 2010-11, and FY 2009-10.

Table C

Wisconsin Lottery Ticket Sales (in millions)

	FY 2011-12	FY 2010-11	Change	FY 2009-10	Change
Instant					
Scratch-off	\$320.1	\$299.1	\$21.0	\$269.3	\$29.8
Pull-tab	2.4	3.5	(1.1)	3.9	(0.4)
Total Instant Ticket Sales	322.5	302.6	19.9	273.2	29.4
Lotto					
SuperCash!	25.4	25.9	(0.5)	27.2	(1.3)
Powerball	78.2	65.1	13.1	89.3	(24.2)
Wisconsin's Megabucks	21.6	16.9	4.7	18.8	(1.9)
Wisconsin's Megabucks EZ Match ¹	3.2	1.6	1.6	0.0	1.6
Daily Pick 3	24.1	24.8	(0.7)	26.2	(1.4)
Daily Pick 4	12.2	12.1	0.1	12.2	(0.1)
Badger 5	22.2	24.5	(2.3)	23.7	0.8
Mega Millions ²	37.0	28.7	8.3	10.3	18.4
Raffle Games ³	1.2	0.5	0.7	0.0	0.5
Total Lotto Ticket Sales	225.1	200.1	25.0	207.7	(7.6)
Total Sales	<u>\$547.6</u>	<u>\$502.7</u>	<u>\$44.9</u>	<u>\$480.9</u>	<u>\$21.8</u>

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

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

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

As previously stated, the sales increase in FY 2011-12 was due to an increase in the sales of instant scratch-off tickets and lotto tickets. In FY 2010-11, the sales increase was due mainly to an increase in the sales of instant scratch-off tickets. In March 2011, the Wisconsin Lottery introduced a new product, Game Book, consisting of six \$5 scratch-off games bound in a book retailing for \$20. Instant scratch-off ticket sales increased \$21.0 million during FY 2011-12, after increasing \$29.8 million during FY 2010-11. The Wisconsin Lottery continues to strategically focus on higher-priced instant games through marketing and higher prize payouts on those games. Pull-tab sales decreased \$1.1 million in FY 2011-12, following a \$0.4 million decrease in FY 2010-11.

Lotto game sales increased by \$25.0 million during FY 2011-12, following a \$7.6 million decrease in FY 2010-11. The increase in FY 2011-12 was primarily due to higher sales of three of the Wisconsin Lottery's jackpot games: Powerball, Mega Millions, and Wisconsin's Megabucks. Sales of these games are dependent upon the size of the jackpot and, as a result, can be highly variable.

Expenses

Expenses consist of amounts paid in prizes, retailer commissions and incentives, fees paid to the Wisconsin Lottery's gaming system vendor (instant and lotto vendor services), other game-related expenses, and administrative expenses. In FY 2011-12, total expenses were \$391.2 million, an increase of \$31.1 million from FY 2010-11 expenses of \$360.1 million, which had increased from FY 2009-10 expenses of \$338.4 million. An increase in expenses is expected when revenues increase. The bulk of the Wisconsin Lottery's expenses are tied to sales; more sales mean more tickets printed, more prizes paid to players, increased commissions for retailers, and higher fees paid to the gaming system vendor.

Prizes are the Wisconsin Lottery's largest expense. Table D compares ticket prize awards for each lottery game category for FY 2011-12, FY 2010-11, and FY 2009-10.

Table D

Wisconsin Lottery Ticket Prize Awards
(in millions)

	FY 2011-12	FY 2010-11	Change	FY 2009-10	Change
Instant					
Scratch-off	\$207.2	\$192.2	\$15.0	\$171.1	\$21.1
Pull-tab	1.4	2.2	(0.8)	2.5	(0.3)
Super 2nd Chance ¹	0.3	0.3	0.0	0.3	0.0
Total Instant Prize Awards	208.9	194.7	14.2	173.9	20.8
Lotto					
SuperCash!	13.4	13.2	0.2	12.7	0.5
Powerball	37.0	30.6	6.4	42.1	(11.5)
Wisconsin's Megabucks	11.3	8.9	2.4	9.8	(0.9)
Wisconsin's Megabucks EZ Match	1.9	1.0	0.9	0.0	1.0
Daily Pick 3	11.2	11.5	(0.3)	12.3	(0.8)
Daily Pick 4	6.0	5.4	0.6	6.1	(0.7)
Badger 5	11.3	12.2	(0.9)	11.5	0.7
Mega Millions	18.1	14.7	3.4	5.3	9.4
Raffle Games	0.7	0.2	0.5	0.0	0.2
Super 2nd Chance ¹	0.3	0.3	0.0	0.3	0.0
Total Lotto Prize Awards	111.2	98.0	13.2	100.1	(2.1)
Total	<u>\$320.1</u>	<u>\$292.7</u>	<u>\$27.4</u>	<u>\$274.0</u>	<u>\$18.7</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.

Generally, prizes awarded are a function of ticket sales: higher ticket sales will result in greater prize expense, while lower sales will result in lower prize expense. In FY 2011-12, ticket sales increased \$44.9 million while prize awards increased \$27.4 million, and ticket sales increased \$21.8 million in FY 2010-11 while prize awards increased \$18.7 million. Schedule 3, which follows the notes to the financial statements, shows a multi-year summary of ticket sales and their related prize expenses.

Expenses for retailer commissions are also a function of sales. In FY 2011-12, retailers were paid \$38.2 million in commissions and incentives, up from \$35.3 million in FY 2010-11. In FY 2009-10, retailer commissions and incentives were \$33.3 million.

The Wisconsin Lottery contracted with GTECH Corporation for an integrated gaming computer system and services (instant and lotto vendor services). In

FY 2011-12, payments to GTECH were \$12.8 million. In FY 2010-11 and FY 2009-10, these payments were \$11.8 million and \$11.2 million, respectively. Initially, the Wisconsin Lottery paid GTECH 2.54 percent of total net ticket sales. In July 2009, the Wisconsin Lottery extended its contract with GTECH through June 2013. In consideration for that extension, GTECH reduced the cost of the contract by \$1.0 million per year, beginning in FY 2009-10. Therefore, beginning with FY 2009-10, the Wisconsin Lottery paid GTECH 2.54 percent of sales, less \$1.0 million. In addition, GTECH is providing, at no additional cost, a remote, hot-site backup of the system and a data feed which can be used for business analytics and the development of a data warehouse.

Net Income and Transfer for Property Tax Relief

Net income before transfers was \$158.3 million in FY 2011-12, up from \$141.6 million in FY 2010-11. Net income before transfers was \$144.3 million in FY 2009-10.

As can be seen in Table B, the amount transferred out for property tax relief differs from net income. This is because the transfers occur before the end of the fiscal year and are based on an estimate of the total funds that will be available for distribution. The transfers out for property tax relief increased by \$5.0 million, or by 3.5 percent, during FY 2011-12, while they increased by \$17.8 million, or by 14.0 percent, during FY 2010-11.

Contacting the Wisconsin Lottery's Financial Management

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

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

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

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

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

Financial Statements ■

Statement of Net Assets

June 30, 2012, and June 30, 2011

	June 30, 2012	June 30, 2011
ASSETS		
Current Assets:		
Cash and Cash Equivalents (Note 3)	\$ 50,318,388	\$ 39,239,187
Investments for Prize Annuities (Note 3)	7,356,486	7,205,387
Accounts Receivable (Note 4)	18,832,337	22,985,980
Due from Other State Programs (Note 4)	122,123	131,999
Ticket Inventory	1,615,584	1,845,961
MUSL Reserve Accounts (Note 9)	344,846	1,115,236
Prepaid Expenses	834,133	331,121
Interest Receivable	4,730	(1,493)
Total Current Assets	<u>79,428,627</u>	<u>72,853,378</u>
Noncurrent Assets:		
Investments for Prize Annuities (Note 3)	46,603,683	49,239,775
MUSL Reserve Accounts (Note 9)	5,045,267	4,692,716
Capital Assets: (Note 10)		
Equipment	799,778	805,798
Leasehold Improvements	159,724	159,724
Accumulated Depreciation	(893,406)	(870,076)
Total Noncurrent Assets	<u>51,715,046</u>	<u>54,027,937</u>
TOTAL ASSETS	<u>131,143,673</u>	<u>126,881,315</u>
LIABILITIES		
Current Liabilities:		
Annuity Prizes Payable (Note 5)	7,128,427	7,079,983
Prizes Payable	30,657,637	31,404,460
Accounts Payable (Note 4)	3,712,575	2,461,785
Due to Other State Programs (Note 4)	540,303	576,025
Lottery Association Payable	1,369,963	626,928
Unearned Revenue	692,098	905,879
Due to Other Governments (Note 4)	96,725	75,367
Accrued Payroll	115,291	142,255
Compensated Absences (Note 17)	160,192	208,334
Total Current Liabilities	<u>44,473,211</u>	<u>43,481,016</u>
Noncurrent Liabilities:		
Annuity Prizes Payable (Note 5)	36,731,862	41,065,921
Compensated Absences (Note 17)	496,426	363,530
Other Postemployment Benefits (Note 16)	485,570	489,002
Total Noncurrent Liabilities	<u>37,713,858</u>	<u>41,918,453</u>
TOTAL LIABILITIES	<u>82,187,069</u>	<u>85,399,469</u>
NET ASSETS		
Net Assets: (Note 14)		
Invested in Capital Assets	66,096	95,446
Restricted for MUSL Reserves	5,045,267	4,692,716
Restricted for Investment Fair Value Adjustment	10,546,576	8,800,267
Restricted for Property Tax Relief	33,298,665	27,893,417
TOTAL NET ASSETS	<u>\$ 48,956,604</u>	<u>\$ 41,481,846</u>

The accompanying notes are an integral part of this statement.

Statement of Revenues, Expenses, and Changes in Net Assets for the Years Ended June 30, 2012, and June 30, 2011

	Year Ended June 30, 2012	Year Ended June 30, 2011
OPERATING REVENUES		
Instant Ticket Sales (Net of Allowances of \$598,903 and \$559,374, Respectively) (Note 7)	\$ 322,482,041	\$ 302,521,074
Lotto Ticket Sales (Net of Ticket Discounts of \$29,096 and \$0, Respectively) (Note 7)	225,158,693	200,130,712
Retailer Fees	38,475	37,340
Miscellaneous Revenue	54,986	62,101
Total Operating Revenues	547,734,195	502,751,227
OPERATING EXPENSES		
Program Expenses:		
Instant Prize Expense (Note 8)	208,922,382	194,621,768
Lotto Prize Expense (Note 8)	111,192,993	98,035,772
Retailer Commissions and Incentives	38,215,505	35,247,289
Instant and Lotto Vendor Services	12,828,631	11,816,299
Product Information Costs	7,497,836	7,445,141
Instant Ticket Printing Costs	3,766,851	3,918,131
Instant Ticket Delivery Costs	776,016	743,065
Donated Prize Expense (Note 12)	3,853	12,677
Total Program Expenses	<u>383,204,067</u>	<u>351,840,142</u>
Administrative Expenses:		
Salaries and Fringe Benefits	5,356,653	5,638,566
Supplies and Services	2,624,039	2,544,692
Depreciation Expense	36,615	43,678
Total Administrative Expenses	<u>8,017,307</u>	<u>8,226,936</u>
Total Operating Expenses	391,221,374	360,067,078
NET OPERATING INCOME	156,512,821	142,684,149
NONOPERATING REVENUES (EXPENSES) AND TRANSFERS		
Investment Income (Loss) (Note 6)	1,831,952	(1,059,312)
Miscellaneous Revenue (Note 12)	3,853	12,677
Net Income Before Transfers	158,348,626	141,637,514
Transfers:		
Transfers of Lottery Proceeds for Property Tax Relief (Note 15)	(149,949,305)	(144,865,023)
Transfers In from General Fund (Note 18)	102,317	125,546
Transfer to Department of Health Services for Compulsive Gambling Programs	(396,000)	(396,000)
Transfer to Department of Justice for Law Enforcement	(348,304)	(357,934)
Transfer to Department of Revenue for Lottery Credit Administration	(151,371)	(237,780)
Transfers Out to General Fund (Note 19)	(131,205)	(137,165)
CHANGE IN NET ASSETS	7,474,758	(4,230,842)
Total Net Assets—Beginning of the Year	41,481,846	45,712,688
Total Net Assets—End of the Year	<u>\$ 48,956,604</u>	<u>\$ 41,481,846</u>

The accompanying notes are an integral part of this statement.

Statement of Cash Flows for the Years Ended June 30, 2012, and June 30, 2011

	Year Ended June 30, 2012	Year Ended June 30, 2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash Received from Retailers	\$ 554,096,472	\$ 498,007,591
Cash Paid for Prizes	(329,929,205)	(295,543,435)
Cash Paid for Retailer Commissions and Incentives	(38,273,642)	(34,350,970)
Cash Paid/Received for MUSL Reserve Accounts	423,466	(484,532)
Cash Paid to Employees	(5,316,125)	(5,538,013)
Cash Paid to Suppliers	(26,358,954)	(26,354,386)
Net Cash Provided by Operating Activities	154,642,012	135,736,255
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Transfers of Proceeds for Property Tax Credit	(149,963,131)	(145,025,508)
Transfer of Proceeds for Law Enforcement	(349,323)	(374,373)
Transfer of Proceeds for Lottery Credit Administration	(148,224)	(240,272)
Transfer of Proceeds for Compulsive Gambling Programs	(396,000)	(396,000)
Transfers to the General Fund	(131,205)	(137,165)
Transfers from the General Fund	125,546	192,856
Net Cash Used by Noncapital Financing Activities	(150,862,337)	(145,980,462)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Cash Paid for Purchase of Equipment	(7,265)	(36,053)
Net Cash Used by Capital and Related Financing Activities	(7,265)	(36,053)
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest Received	73,791	119,435
Cash Received for Redemption of Bonds	7,233,000	9,711,000
Net Cash Provided by Investing Activities	7,306,791	9,830,435
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	11,079,201	(449,825)
Cash and Cash Equivalents—Beginning of the Year	39,239,187	39,689,012
Cash and Cash Equivalents—End of the Year	<u>\$ 50,318,388</u>	<u>\$ 39,239,187</u>

The accompanying notes are an integral part of this statement.

	Year Ended June 30, 2012	Year Ended June 30, 2011
RECONCILIATION OF NET OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Net Operating Income	\$ 156,512,821	\$ 142,684,149
Adjustments to Reconcile Net Operating Income to Net Cash Provided by Operating Activities:		
Depreciation Expense	36,615	43,678
Noncash Donated Prize Expense	3,853	12,677
Changes in Assets and Liabilities:		
Decrease (Increase) in Receivables	4,153,643	(2,837,987)
Decrease (Increase) in MUSL Reserve Accounts	423,466	(484,531)
Decrease (Increase) in Ticket Inventory	230,377	(43,523)
Decrease (Increase) in Prepaid Expenses	(503,011)	230,511
Decrease (Increase) in Due from Other State Programs	(3,031)	5,510
Increase (Decrease) in Prizes Payable	(8,034,134)	(4,343,067)
Increase (Decrease) in Unearned Revenue	(213,781)	260,356
Increase (Decrease) in Due to Other State Programs	(37,897)	(88,634)
Increase (Decrease) in Accounts Payable	1,253,284	150,052
Increase (Decrease) in Lottery Association Payable	743,036	25,333
Increase (Decrease) in Due to Other Governments	22,415	21,444
Increase (Decrease) in Accrued Payroll	(26,965)	13,887
Increase (Decrease) in Compensated Absences	84,754	(8,054)
Increase (Decrease) in Other Postemployment Benefits	(3,433)	94,454
Total Adjustments	<u>(1,870,809)</u>	<u>(6,947,894)</u>
Net Cash Provided by Operating Activities	<u>\$ 154,642,012</u>	<u>\$ 135,736,255</u>
Noncash Activities:		
Net Change in Unrealized Gains and Losses	\$ 1,746,310	\$ (1,181,466)
Increase in Fair Value of Investments for Prize Annuities and Annuities Payable Due to Amortization	3,001,697	3,309,390

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 2011-12 and FY 2010-11, the Wisconsin Lottery sold scratch-off, pull-tab, raffle, and lotto games. Lotto games are games in which tickets are produced from a terminal located at a retailer's place of business (e.g., Powerball, Badger 5).

Since June 1989, the Wisconsin Lottery has been a member of the Multi-State Lottery Association (MUSL). In FY 2011-12 and FY 2010-11, 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 9 for information about MUSL.

During FY 2011-12 and FY 2010-11, the Wisconsin Lottery also sold tickets for five 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), and Badger 5 (start date February 17, 2003). The EZ Match feature for Megabucks was added on April 3, 2011.

The Wisconsin Lottery offered raffle games in FY 2011-12 and FY 2010-11.

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 Assets as transfers out.

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

B. Measurement Focus and Basis of Accounting

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

The Statement of Revenues, Expenses, and Changes in Net Assets classifies the Wisconsin Lottery's activities as either operating or nonoperating. Because the Lottery Fund is an enterprise fund, which is a type of proprietary fund, it accounts for operations in a manner similar to private businesses in which operating revenues are derived from exchange transactions, such as sales. Operating expenses include the costs of sales, administration expenses, and depreciation on capital assets. Certain revenues and expenses that are not related to the Wisconsin Lottery's primary purpose, such as investment income, are reported as nonoperating revenues and expenses.

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

C. Cash and Cash Equivalents

Cash and cash equivalents reported on the Statement of Net Assets and on the Statement of Cash Flows includes cash deposited in the State's bank and the Wisconsin Lottery's pro rata share of the State Investment Fund, which is a short-term pool of state and local funds managed by the State of Wisconsin Investment Board. Balances pooled in the State Investment Fund are restricted to legally stipulated investments valued consistent with GASB Statement Number 31.

D. Investments for Prize Annuities

Investments for prize annuities consist entirely of securities backed by the full faith and credit of the United States government or its agencies. 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. These investments are reported at fair value consistent with the provisions of GASB Statement Number 31. Fair value is determined using quoted market prices.

E. Accounts Receivable

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

F. Due to or from Other State Programs

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

G. Ticket Inventory

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

H. Capital Assets

Tangible assets purchased for \$5,000 or more and intangible assets that have a cost or value greater than \$100,000 are capitalized and recorded at historic cost. As applicable, assets are depreciated using the straight-line method according to the following schedule:

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

I. Prizes Payable and Annuity Prizes Payable

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

J. Unearned Revenue

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

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

K. Compensated Absences

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

L. Ticket Sales Revenue

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. 27.75(3)(a), Wis. Stats., at least 50.0 percent of Wisconsin Lottery sales must be returned in the form of prizes. Prizes may be claimed for a period of 180 days after the drawing for lotto games, or 180 days from the declaration of the end of a game for instant games. A summary of prize expenses is shown in Schedule 3.

N. Retailer Commissions

Retailer commissions, which are classified as program expenses, 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.

O. Retailer Performance Program

In addition to the retailer commissions discussed in Note 2N, 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 2.0 percent commission of the prize award, up to a maximum of \$100,000 per winning ticket. Winning ticket incentive payments are made weekly.

Short-term incentives 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 2.0 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, and Badger 5). These payments are made quarterly. Retailers also earn up to 10.0 percent of the increase in annual sales over the previous year. These incentive payments are made annually. 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 ticket revenues.

P. Administrative Expenses

Section 25.75(3)(b), Wis. Stats., limits the Wisconsin Lottery's statutory administrative expenses to 10.0 percent of gross lottery revenues. A summary of statutory administrative expenses and related calculations of the administrative expense limit is included in Schedule 2.

Q. Disbursement of Lottery Proceeds for Property Tax Relief

The Department of Revenue disburses net lottery proceeds through three statutory credits: the Lottery and Gaming Tax Credit, the Farmland Tax Relief Credit, and the School Levy Tax Credit. 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 in November, well before the end of the fiscal year. The credit is based the prior year's balance carryover and estimated sales 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.

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

R. Use of Estimates

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

3. DEPOSITS AND INVESTMENTS

The Wisconsin Lottery's cash and cash equivalents balance consists of cash deposited in the State's bank and shares in the State Investment Fund. The carrying amount of shares in the State Investment Fund, which approximates fair value, was \$50,318,000 as of June 30, 2012, and \$39,239,000 as of June 30, 2011.

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 ss. 25.17(3)(b), (ba), (bd), and (dg), Wis. Stats., and include direct obligations of the United States or its agencies, corporations wholly owned by the United States or chartered by an act of Congress, securities guaranteed by the United States, unsecured notes of financial and industrial issuers, direct obligations of or guaranteed by the government of Canada, certificates of deposit issued by banks in the United States and solvent financial institutions in Wisconsin, and bankers acceptances. The State of Wisconsin Investment Board's Board of Trustees may specifically approve other prudent legal investments.

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

Credit Risk—Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. While the Wisconsin Lottery does not have a formal policy regarding its investments for prize annuities, it has chosen to follow MUSL's policy that requires all investments for prize annuities to be in the form of securities backed by the full faith and credit of the United States government or its agencies, which are not considered to have credit risk. All of the Wisconsin Lottery's total investments for prize annuities balance as of June 30, 2012, and June 30, 2011, consist of these types of securities.

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

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, 2012, and June 30, 2011:

<u>Maturity</u>	<u>Fair Value as of June 30, 2012</u>	<u>Fair Value as of June 30, 2011</u>
Less than 1 Year	\$ 7,356,486	\$ 7,205,387
1 to 5 Years	24,141,321	19,323,233
6 to 10 Years	18,282,665	22,220,780
More than 10 Years	<u>4,179,697</u>	<u>7,695,762</u>
Total	<u>\$53,960,169</u>	<u>\$56,445,162</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 75 days as of June 30, 2012, and 73 days as of June 30, 2011.

4. ACCOUNTS RECEIVABLE AND ACCOUNTS PAYABLE BALANCES

Accounts receivable and accounts payable balances are disaggregated as follows:

A. Accounts Receivable

	<u>June 30, 2012</u>	<u>June 30, 2011</u>
Accounts Receivable:		
Retailers	\$18,832,270	\$22,983,961
Miscellaneous	<u>67</u>	<u>2,019</u>
Total Accounts Receivable	<u>\$18,832,337</u>	<u>\$22,985,980</u>
Due from Other State Programs:		
Transfers for Gaming	\$103,071	\$125,546
Miscellaneous	<u>19,052</u>	<u>6,453</u>
Total Due from Other State Programs	<u>\$122,123</u>	<u>\$131,999</u>

B. Accounts Payable

	<u>June 30, 2012</u>	<u>June 30, 2011</u>
Accounts Payable:		
Vendors	\$3,648,509	\$2,390,901
Lottery Credit Administration	45,860	48,814
Law Enforcement	521	60
Miscellaneous	<u>17,685</u>	<u>22,010</u>
Total Accounts Payable	<u>\$3,712,575</u>	<u>\$2,461,785</u>
Due to Other State Programs:		
Farmland Tax Relief Credit	\$ 7,963	\$ 12,220
Employee Fringe Benefits	68,484	62,898
Withholding on Prizes	182,547	167,909
Lottery Credit Administration	11,922	5,259
Law Enforcement	8,894	9,878
Other State Programs	<u>260,493</u>	<u>317,861</u>
Total Due to Other State Programs	<u>\$540,303</u>	<u>\$576,025</u>
Due to Other Governments:		
Employee Fringe Benefits	\$35,412	\$65,767
Withholding on Prizes	56,995	5,324
Lottery Credit Administration	690	1,252
Law Enforcement	2,528	3,024
Supplies	<u>1,100</u>	<u>0</u>
Total Due to Other Governments	<u>\$96,725</u>	<u>\$75,367</u>

5. ANNUITY PRIZES PAYABLE

The Wisconsin Lottery has an unconditional obligation to pay all prize winners the future value of their prizes. The present value of future jackpot prize payment obligations is included in the financial statements as “annuity prizes payable.” To finance the annuity prize payments, the Wisconsin Lottery purchases, or has acquired from MUSL, investments scheduled to mature near the time prize payments become payable to the winners. See Note 3 for information related to the investments for prize annuities. Each year, an adjustment to the annuity prizes payable account is made using the effective interest method. The amortization of annuity adjustment was \$3,001,697 for FY 2011-12 and \$3,309,390 for FY 2010-11.

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

<u>Fiscal Year</u>	<u>FY 2011-12 Total Payments</u>	<u>FY 2010-11 Total Payments</u>
2011-12	\$ 0	\$ 7,284,396
2012-13	7,350,520	7,350,520
2013-14	6,304,982	6,304,982
2014-15	6,273,871	6,273,871
2015-16	6,149,499	6,149,499
2016-17	6,343,036	6,343,036
Subsequent Years	<u>26,431,172</u>	<u>26,431,172</u>
Total Future Prize Payments	58,853,080	66,137,476
Less: Present Value Adjustment	<u>14,992,791</u>	<u>17,991,572</u>
Present Value of Future Prize Payments	<u>\$43,860,289</u>	<u>\$48,145,904</u>

Annuity prizes payable activity for the fiscal years ended June 30, 2012, and June 30, 2011, was as follows:

<u>Fiscal Year</u>	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>	<u>Due within One Year</u>
2011-12	\$48,145,904	\$3,001,697	\$(7,287,312)	\$43,860,289	\$7,128,427
2010-11	54,585,203	3,309,390	(9,748,689)	48,145,904	7,079,983

6. INVESTMENT INCOME (LOSS)

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

	<u>FY 2011-12</u>	<u>FY 2010-11</u>
<u>Change in Fair Value:</u>		
Net Increase (Decrease) in Fair Value of Annuity Investments	\$4,748,007	\$2,127,924
Less: The Portion of the Increase (Decrease) in Fair Value of Annuity Investments Offset by the Increase in Annuity Prizes Payable from Amortization	<u>(3,001,697)</u>	<u>(3,309,390)</u>
Net Increase (Decrease) in Fair Value Recognized as Investment Income	<u>1,746,310</u>	<u>(1,181,466)</u>
<u>Interest Income:</u>		
Interest from State Investment Fund	75,706	108,934
Interest from MUSL Reserve Accounts	5,627	9,233
Miscellaneous Interest	<u>4,309</u>	<u>3,987</u>
Total Interest Income	<u>85,642</u>	<u>122,154</u>
Total Investment Income (Loss)	<u>\$1,831,952</u>	<u>\$(1,059,312)</u>

GASB Statement Number 31 requires investments to be reported at fair value, with the increases or decreases in fair value recognized as investment income (loss). In addition, the Wisconsin Lottery earns interest on its shares invested in the State Investment Fund and on its share of the MUSL reserve accounts. For additional information on MUSL reserve accounts, see Note 9.

7. INSTANT AND LOTTO TICKET SALES

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

	<u>FY 2011-12</u>	<u>FY 2010-11</u>
Instant Ticket Sales:		
Scratch-off	\$320,131,401	\$299,052,121
Pull-tab	<u>2,350,640</u>	<u>3,468,953</u>
Total Instant Ticket Sales	<u>\$322,482,041</u>	<u>\$302,521,074</u>
Lotto Ticket Sales:		
SuperCash!	\$ 25,413,981	\$ 25,868,046
Powerball	78,210,302	65,132,048
Wisconsin's Megabucks	21,613,346	16,925,087
Wisconsin's Megabucks EZ Match	3,217,933	1,570,412
Daily Pick 3	24,134,837	24,768,176
Daily Pick 4	12,169,248	12,143,923
Badger 5	22,246,971	24,519,888
Mega Millions	36,989,315	28,708,710
Raffle Games	1,199,022	500,000
General Sales and Discounts	<u>(36,262)</u>	<u>(5,578)</u>
Total Lotto Ticket Sales	<u>\$225,158,693</u>	<u>\$200,130,712</u>

8. INSTANT AND LOTTO PRIZE EXPENSE

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

	<u>FY 2011-12</u>	<u>FY 2010-11</u>
Instant Prize Expense:		
Scratch-off	\$207,219,016	\$192,220,195
Pull-tab	1,443,366	2,136,573
Super 2nd Chance ¹	<u>260,000</u>	<u>265,000</u>
Total Instant Prize Expense	<u>\$208,922,382</u>	<u>\$194,621,768</u>
Lotto Prize Expense:		
SuperCash!	\$ 13,397,449	\$13,190,281
Powerball	36,999,713	30,601,501
Wisconsin's Megabucks	11,291,229	8,880,867
Wisconsin's Megabucks EZ Match	1,949,744	991,662
Daily Pick 3	11,243,120	11,492,970
Daily Pick 4	6,005,800	5,405,000
Badger 5	11,274,283	12,216,272
Mega Millions	18,125,067	14,744,419
Raffle Games	646,588	247,800
Super 2nd Chance ¹	<u>260,000</u>	<u>265,000</u>
Total Lotto Prize Expense	<u>\$111,192,993</u>	<u>\$98,035,772</u>

¹There 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.

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

The Wisconsin Lottery is a member of MUSL, a nonprofit, government-benefit voluntary association. MUSL was established on September 16, 1987, and has 33 member lotteries from 31 states, the District of Columbia, and the U.S. Virgin Islands. It is owned and operated by the member lotteries, which sell one or more games administered by the association. The association is controlled by its Board of Directors, consisting of the director or chief executive officer of each member lottery. Each MUSL member sells tickets through its licensed retailers and makes weekly wire transfers to MUSL in an amount equivalent to the member lottery's share of the weekly prize liability less the actual low-tier prize liability for tickets sold by the respective lottery. Until FY 2009-10, the Wisconsin Lottery participated in one MUSL game: Powerball. During FY 2009-10, MUSL entered into an agreement with the consortium of states that own the Mega Millions game that allows the consortium and MUSL to sell the other's game. The Wisconsin Lottery began selling Mega Millions on January 31, 2010.

B. MUSL Financial Position and Activity

The following schedule presents the summarized audited financial position and activity of MUSL as of June 30, 2012, and June 30, 2011, as audited by other auditors.

	<u>June 30, 2012</u>	<u>June 30, 2011</u>
Total Assets	<u>\$583,164,841</u>	<u>\$641,434,915</u>
Total Liabilities	\$583,009,619	\$641,193,712
Total Unrestricted Net Assets	<u>155,222</u>	<u>241,203</u>
Total Liabilities and Net Assets	<u>\$583,164,841</u>	<u>\$641,434,915</u>
Total Revenues	\$4,783,334	\$4,100,964
Total Expenses	<u>(4,869,315)</u>	<u>(4,363,866)</u>
Increase (Decrease) in Unrestricted Net Assets	<u>\$ (85,981)</u>	<u>\$ (262,902)</u>

Complete separate financial statements for MUSL may be obtained from:

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

C. Powerball Prize Pools and Related MUSL Reserve Accounts

The Powerball game is designed to pay out 50.0 percent of sales in prizes. Therefore, lotteries participating in the Powerball game are required to transfer 50.0 percent of ticket sales, less actual low-tier prizes, to MUSL for the Powerball prize pools and reserve accounts. Prior to January 18, 2012, 61.0577 percent of the required transfer funded the Powerball grand prize pool and 34.9423 percent funded the pool to pay the remaining Powerball prizes. Effective January 18, 2012, 59.9511 percent of the required transfer funds the Powerball grand prize pool and 36.0489 percent funds the pool to pay the remaining Powerball prizes. The remaining 4.0 percent is placed in one or more of the following three accounts: the Powerball Set-Aside Account, the Powerball Set Prize Reserve Account (SPRA), and the Powerball Prize Reserve Account (PRA).

The 4.0 percent is first used to fund the Powerball Set-Aside Account. The Powerball Set-Aside Account is used for under-funded jackpots. An under-funded jackpot occurs when sales are not equal to the amount of the jackpot. This usually occurs when the starting jackpot is won on an early draw. The Powerball Set-Aside Account is funded until it reaches its cap. The cap was raised from \$7.5 million to \$20 million effective October 25, 2011.

The 4.0 percent is next distributed to the Powerball SPRA. The Powerball SPRA funds non-jackpot cash prizes when there are more winners than would be mathematically expected. The Powerball SPRA is funded until it reaches its cap. The cap was raised from \$25 million to \$40 million effective October 25, 2011. Next, funds are allocated to the Powerball PRA until it reaches a cap of \$100 million. The Powerball PRA is used to pay a jackpot in the unlikely event that a winning ticket is not recorded on the software gaming system or other reasons. Any funds remaining after the caps for each of the reserve accounts are met are added to the Powerball grand prize pool.

D. Mega Millions Prize Pools and Related MUSL Reserve Account

The Mega Millions game is designed to pay out 50.0 percent of sales in prizes. Therefore, MUSL lotteries participating in the Mega Millions game are required to transfer 50.0 percent of ticket sales, less actual low-tier prizes, to MUSL for the Mega Millions prize pool. Of this amount, 63.60043 percent funds the Mega Millions grand prize pool, and 36.39957 percent funds the pool to pay the remaining Mega Millions prizes.

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

E. Total MUSL Reserves

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

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

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

	<u>June 30, 2012</u>	<u>June 30, 2011</u>
Powerball Set Prize Reserve Account	\$1,009,754	\$ 794,204
Powerball Prize Reserve Account	3,296,107	3,511,657
Mega Millions Prize Reserve Account	<u>739,406</u>	<u>386,855</u>
MUSL Reserve Accounts—Noncurrent	5,045,267	4,692,716
Balance of Unreserved Account (MUSL Reserve Accounts—Current)	<u>344,846</u>	<u>1,115,236</u>
Total MUSL Reserve Accounts	<u>\$5,390,113</u>	<u>\$5,807,952</u>

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

10. CAPITAL ASSETS

Capital asset activity for the fiscal year ended June 30, 2012, was as follows:

	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
Leasehold Improvements	\$159,724	\$ 0	\$ 0	\$159,724
Equipment	<u>805,798</u>	<u>7,265</u>	<u>(13,285)</u>	<u>799,778</u>
Total Capital Assets at Historical Cost	<u>965,522</u>	<u>7,265</u>	<u>(13,285)</u>	<u>959,502</u>
Less Accumulated Depreciation for:				
Leasehold Improvements	109,926	2,875	0	112,801
Equipment	<u>760,150</u>	<u>33,740</u>	<u>(13,285)</u>	<u>780,605</u>
Total Accumulated Depreciation	<u>870,076</u>	<u>36,615</u>	<u>(13,285)</u>	<u>893,406</u>
Total Capital Assets, Net	<u>\$ 95,446</u>	<u>\$(29,350)</u>	<u>\$ 0</u>	<u>\$ 66,096</u>

Capital asset activity for the fiscal year ended June 30, 2011, was as follows:

	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
Leasehold Improvements	\$159,724	\$ 0	\$ 0	\$159,724
Equipment	<u>779,680</u>	<u>36,053</u>	<u>(9,935)</u>	<u>805,798</u>
Total Capital Assets at Historical Cost	<u>939,404</u>	<u>36,053</u>	<u>(9,935)</u>	<u>965,522</u>
Less Accumulated Depreciation for:				
Leasehold Improvements	103,220	6,706	0	109,926
Equipment	<u>733,114</u>	<u>36,971</u>	<u>(9,935)</u>	<u>760,150</u>
Total Accumulated Depreciation	<u>836,334</u>	<u>43,677</u>	<u>(9,935)</u>	<u>870,076</u>
Total Capital Assets, Net	<u>\$103,070</u>	<u>\$(7,624)</u>	<u>\$ 0</u>	<u>\$ 95,446</u>

11. OPERATING LEASES

The Wisconsin Lottery occupied a facility in Madison for storage and instant ticket operations under an operating lease during FY 2011-12 and FY 2010-11. The following schedule summarizes the future minimum lease payments required under the operating lease for this facility, which was initially a five-year lease that ran until August 31, 2009, with two optional three-year extensions. The Wisconsin Lottery exercised the first of these renewals effective February 2009, extending the lease through August 31, 2012. On June 28, 2012, the lease was amended to extend the term for five years, commencing on September 1, 2012, and ending on August 31, 2017, with an optional five-year extension.

	<u>June 30, 2012</u>	<u>June 30, 2011</u>
Fiscal Year Ending June 30, 2012	\$ 0	\$149,580
2013	146,576	24,967
2014	147,098	
2015	148,532	
2016	150,009	
2017	151,530	
2018	<u>25,297</u>	
Total Minimum Payments Required	<u>\$769,042</u>	<u>\$174,547</u>

Total operating lease expense amounted to \$149,580 for the fiscal year ended June 30, 2012, and \$148,267 for the fiscal year ended June 30, 2011.

12. DONATIONS

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

The total value of these items was \$3,853 for FY 2011-12 and \$12,677 for FY 2010-11. All donated items received in FY 2011-12 and FY 2010-11 were used as game prizes, special events, or additional incentives to retailers and are recorded as donated prize expense and nonoperating miscellaneous revenue on the financial statements.

13. CONTRACTUAL OBLIGATIONS

A. Scratch-off Tickets

The Wisconsin Lottery had a contract for the period July 1, 2004, through October 30, 2009, with Scientific Games International, Inc., to print scratch-off tickets. In October 2009, the Wisconsin Lottery signed new contracts for printing services with three vendors: Scientific Games International, Inc.; GTECH Printing Corporation; and Pollard Banknote Ltd. These three contracts are for the period November 1, 2009, through October 31, 2011, with three one-year renewal options for each contract. Each of these contracts has been renewed through October 31, 2013. The Wisconsin Lottery purchased ticket printing services of approximately \$3.4 million in FY 2011-12 and approximately \$3.5 million in FY 2010-11 under these contracts.

B. Pull-tab Tickets

The Wisconsin Lottery had a contract for the period July 1, 2004, through October 30, 2009, with Pollard Banknote Ltd., to print pull-tab tickets. In October 2009, the Wisconsin Lottery signed new contracts for printing services with three vendors: Arrow International; International Gamco, Inc.; and Pollard Banknote Ltd. These three contracts to print pull-tab tickets are for the period November 1, 2009, through October 31, 2011, with three one-year renewal options for each contract. The contracts with International Gamco, Inc., and Pollard Banknote Ltd., have been renewed through October 31, 2013. The Wisconsin Lottery purchased ticket printing services of approximately \$119,200 in FY 2011-12 and approximately \$238,300 in FY 2010-11 under these contracts.

C. Gaming System Vendor

The Wisconsin Lottery has a contract with GTECH Holdings Corporation that supports a network of approximately 4,000 locations where lottery games are sold. The expiration date in the original contract was June 25, 2011, and the Wisconsin Lottery exercised its option to renew the contract for two one-year periods. Subsequently, the Wisconsin Lottery extended its contract for two additional years through June 25, 2015.

Under the contract, during FY 2011-12 and FY 2010-11, GTECH received 2.54 percent of the price of each ticket sold, less \$1.0 million per each fiscal year, 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 gives the Wisconsin Lottery credit on the next month’s invoice for any liquidated damages of the previous month. Net payments to GTECH under this contract were approximately \$12.8 million in FY 2011-12 and approximately \$11.8 million in FY 2010-11.

D. Product Information Costs

The Wisconsin Lottery primarily contracts with HY Connect (formerly Hoffman York) to provide informational advertising services. The Wisconsin Lottery had a contract with HY Connect through April 9, 2008, which was renewed through April 9, 2011. However, this contract was terminated early when the Wisconsin Lottery signed a new two-year contract with HY Connect starting July 12, 2010, with an option to renew for three additional one-year periods. This contract has been renewed through July 11, 2014. Payments under the combination of these contracts were \$7.3 million during FY 2011-12 and FY 2010-11 and total spending on product information costs was \$7.5 million during FY 2011-12 and \$7.4 million during FY 2010-11.

14. RESTRICTED NET ASSETS

The Wisconsin Lottery has restricted net assets related to capital assets of \$66,096 as of June 30, 2012, and \$95,446 as of June 30, 2011. The portion of restricted net assets related to capital assets is reported in detail in Note 10.

The Wisconsin Lottery also has restricted net assets related to the MUSL reserves as reported in detail in Note 9. Restricted net assets related to the MUSL reserves were \$5,045,267 as of June 30, 2012, and \$4,692,716 as of June 30, 2011.

In addition, the Wisconsin Lottery has restricted net assets for fair value adjustments of investments of \$10,546,576 as of June 30, 2012, and \$8,800,266 as of June 30, 2011. 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 Number 31, and any cash held for annuity prize payments, are restricted and are not available for distribution as property tax credits.

Finally, the Wisconsin Constitution requires net proceeds from the operations of the Wisconsin Lottery to be used to provide local property tax relief. In addition, balances from other gaming-related appropriations, including racing and charitable bingo operations, are transferred to the Lottery Fund for distribution in the form of property tax relief. The net proceeds and gaming-related transfers available for property tax relief make up the remainder of the restricted net assets and were \$33,298,665 as of June 30, 2012, and \$27,893,417 as of June 30, 2011.

15. DISTRIBUTION OF NET PROCEEDS

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

	<u>FY 2011-12</u>	<u>FY 2010-11</u>
Lottery and Gaming Tax Credit	\$135,009,414	\$129,129,638
Farmland Tax Relief Credit	89,891	885,385
School Levy Tax Credit	<u>14,850,000</u>	<u>14,850,000</u>
Total Property Tax Relief Credits	<u>\$149,949,305</u>	<u>\$144,865,023</u>

16. EMPLOYEE RETIREMENT PLAN AND OTHER POSTEMPLOYMENT BENEFITS

Permanent employees of the Wisconsin Lottery are participants in the Wisconsin Retirement System, a cost-sharing, multiple-employer, defined benefit plan governed by ch. 40, Wis. Stats. State and local government public employees are entitled to an annual formula retirement benefit based on: 1) the employee’s final average earnings, 2) years of creditable service, and 3) a formula factor. If an employee’s contributions, matching employer’s contributions, and interest credited to the employee’s account exceed the value of the formula benefit, the retirement benefit may instead be calculated as a money purchase benefit. The Wisconsin Retirement System is considered part of the State of Wisconsin’s financial reporting entity.

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

Required employee and employer contributions, which are equal to specified percentages of qualified earnings based on the employee's classification, are determined annually. Effective the first day of the first pay period on or after June 29, 2011, the Wisconsin Lottery is no longer permitted to pay any portion of the employee contributions. The Wisconsin Lottery's contributions to the plan were \$277,062 for FY 2011-12 and \$455,121 for FY 2010-11. The relative position of the Wisconsin Lottery in the Wisconsin Retirement System is not available because the Wisconsin Retirement System is a statewide, multi-employer plan.

In accordance with the provisions of GASB Statement Number 45, the State is required to report other postemployment benefit (OPEB) expenses, which the Wisconsin Lottery reports as part of salaries and fringe benefits expenses, and related liabilities in the financial statements and notes. OPEBs include such items as the implicit rate subsidy of retiree health insurance present in the contribution rates for existing employees under the State's Health Insurance Program, and the postemployment coverage in the State's Life Insurance Program. Health insurance OPEB activity for the fiscal years ended June 30, 2012, and June 30, 2011, was as follows:

<u>Fiscal Year</u>	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>	<u>Due within One Year</u>
2011-12	\$489,002	\$ 0	\$(3,432)	\$485,570	\$0
2010-11	394,548	94,454	0	489,002	0

The portion of contributions to the State's Life Insurance Program attributable to the Wisconsin Lottery is not readily determinable because this is a statewide, multiple-employer plan. Copies of the separately issued financial reports of the Wisconsin Retirement System and the State's Life Insurance Program are available on the Department of Employee Trust Funds' website, <http://etf.wi.gov>. The disclosures for the State's Health Insurance Program are included in the State's Comprehensive Annual Financial Report, available on the Department of Administration's website, <http://www.doa.wi.gov>.

17. COMPENSATED ABSENCES

Compensated absence activity for the fiscal years ended June 30, 2012, and June 30, 2011, was as follows:

<u>Fiscal Year</u>	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>	<u>Due within One Year</u>
2011-12	\$571,864	\$293,088	\$(208,334)	\$656,618	\$160,192
2010-11	579,917	67	(8,120)	571,864	208,334

18. TRANSFERS IN FROM GENERAL FUND

Under Wisconsin Statutes, the unencumbered balances and related interest for the following appropriations are to be transferred to the Wisconsin Lottery at the end of the fiscal year: the appropriation under s. 20.435(5)(kg), Wis. Stats., for the Department of Health Services' compulsive gambling awareness campaigns; the appropriation under s. 20.455(2)(g), Wis. Stats., for the Department of Justice's gaming law enforcement; and the appropriations under ss. 20.505(8)(g) and 20.505(8)(jm), Wis. Stats., for general operations of the Department of Administration's Division of Gaming related to racing and bingo. The Wisconsin Lottery received \$102,317 from these transfers in FY 2011-12 and \$125,546 from these transfers in FY 2010-11.

19. TRANSFERS OUT TO GENERAL FUND

Sections 9101(9) and (9q) of 2003 Wisconsin Act 33 gave the State of Wisconsin authority to issue annual appropriation bonds to pay off certain unfunded liabilities in the pension and other employee benefit programs. Section 16.529, Wis. Stats., requires state agencies to make certain transfers to the General Fund. The Wisconsin Lottery transferred \$131,205 in FY 2011-12 and \$137,165 in FY 2010-11 for this purpose.

■ ■ ■ ■

Supplementary Information ■

Reconciliation of Lottery General Operations Expenses to the Budgetary Basis of Accounting for the Years Ended June 30, 2012, and June 30, 2011

	Year Ended June 30, 2012	Year Ended June 30, 2011
SALARIES AND FRINGE BENEFITS		
Per Financial Statement	\$ 5,356,653	\$ 5,638,566
Adjustments to Financial Statement Balance:		
Cash Paid in FY 2010-11 but Expensed in FY 2009-10	0	1,113,978
Cash Paid in FY 2011-12 but Expensed in FY 2010-11	1,217,788	(1,217,788)
Cash Paid in FY 2012-13 but Expensed in FY 2011-12	(1,142,188)	0
Reclassified Fringe Benefits to Transfer Out to General Fund	116,225	121,875
Budgetary Basis—Salaries and Fringe Benefits	<u>\$ 5,548,478</u>	<u>\$ 5,656,631</u>
SUPPLIES AND SERVICES AND PERMANENT PROPERTY		
Per Financial Statement:		
Product Information Costs	\$ 7,497,836	\$ 7,445,141
Instant Ticket Printing Costs	3,766,851	3,918,131
Instant Ticket Delivery Costs	776,016	743,065
Donated Prize Expense	3,853	12,677
Supplies and Services	2,624,039	2,544,692
Depreciation Expense	36,615	43,678
Total per Financial Statement	14,705,210	14,707,384
Adjustments to Financial Statement Balance:		
Depreciation Expense	(36,615)	(43,678)
Donated Prize Expense	(3,853)	(12,677)
Cash Paid in FY 2009-10 but Expensed in FY 2010-11	0	(1,751,492)
Cash Paid in FY 2010-11 but Expensed in FY 2011-12	(1,919,514)	1,919,514
Cash Paid in FY 2011-12 but Expensed in FY 2012-13	1,959,516	0
Compulsive Gambling Payment Not Included Above	396,000	396,000
Capitalized Permanent Property Less Disposals	7,265	36,053
Budgetary Basis—Supplies and Services and Permanent Property	<u>\$ 15,108,009</u>	<u>\$ 15,251,104</u>

Statutorily Defined Lottery Administrative Expenses for the Years Ended June 30, 2012, June 30, 2011, and June 30, 2010

ADMINISTRATIVE EXPENSES	<u>Year Ended June 30, 2012</u>	<u>Year Ended June 30, 2011</u>	<u>Year Ended June 30, 2010</u>
Instant and Lotto Vendor Services	\$ 12,828,631	\$ 11,816,299	\$ 11,226,345
Product Information Costs	7,497,836	7,445,141	7,469,890
Instant Ticket Printing Costs	3,766,851	3,918,131	3,465,809
Instant Ticket Delivery Costs	776,016	743,065	689,449
Salaries and Fringe Benefits	5,356,653	5,638,566	5,670,783
Supplies and Services	2,624,039	2,544,692	2,411,988
Depreciation Expense	36,615	43,678	48,210
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	151,371	237,780	275,752
Transfers Out to General Fund	<u>131,205</u>	<u>137,165</u>	<u>130,626</u>
Total Administrative Expenses as Determined in Accordance with s. 25.75(3)(b), Wis. Stats.	<u>\$ 33,565,217</u>	<u>\$ 32,920,517</u>	<u>\$ 31,784,852</u>
Gross Lottery Revenues per s. 25.75(1)(b), Wis. Stats.	<u>\$ 547,679,209</u>	<u>\$ 502,689,126</u>	<u>\$ 480,996,459</u>
Administrative Expenses as a Percentage of Lottery Operating Revenues	6.13%	6.55%	6.61%

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

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

Summary of Prize Expenses for the Years Ended June 30, 2008, through June 30, 2012

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 expended for winning lottery tickets for the past five years, for both instant and lotto games, are summarized below.

	Fiscal Year 2011-12		
	Prize Expense	Ticket Sales	Prize Expense as a Percentage of Sales
Instant Games	\$ 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	\$ 194,621,768	\$ 302,521,074	64.3%
Lotto Games	98,035,772	200,130,712	49.0
Total for Fiscal Year	\$ 292,657,540	\$ 502,651,786	58.2

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

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

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

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' structures because of unclaimed winning tickets and deposits in reserve accounts.

Report on Internal Control and Compliance ■

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

We have audited the financial statements of the Wisconsin Lottery as of and for the years ended June 30, 2012, and June 30, 2011, and have issued our report thereon dated July 8, 2013. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

INTERNAL CONTROL OVER FINANCIAL REPORTING

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

A *deficiency* in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or to detect and correct misstatements on a timely

basis. A *material weakness* is a deficiency or a combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the Wisconsin Lottery's financial statements will not be prevented or will not be detected and corrected on a timely basis.

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


COMPLIANCE AND OTHER MATTERS

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

We noted certain additional matters related to the Wisconsin Lottery's segregation of duties in administering retailer accounts that we reported to the Wisconsin Lottery in a separate communication dated May 17, 2013. In its written response, the Wisconsin Lottery's management agreed with our recommendations and planned to take steps to address the issue. We did not audit the Wisconsin Lottery's response and, accordingly, express no opinion on it.

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

July 8, 2013

LEGISLATIVE AUDIT BUREAU
by 
Sherry Haakenson
Audit Director



State of Wisconsin • DEPARTMENT OF REVENUE

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Scott Walker
Governor

Richard G. Chandler
Secretary of Revenue

July 12, 2013

Mr. Joe Chrisman
State Auditor, Legislative Audit Bureau
22 E. Mifflin Street, Suite 500
Madison, WI 53703

Dear Mr. Chrisman:

The Department of Revenue wishes to thank you and your staff for the combined financial and program audit of the Wisconsin Lottery. Your staff was professional, thorough, and independent.

The Lottery has generated more than \$3 billion in property tax relief for Wisconsin residents over the last 25 years. In each of the last two fiscal years, the Lottery has set new records in overall sales and instant scratch sales.

The program audit reviewed the performance of instant scratch tickets which use a trademarked property. The audit analyzed the net sales for the trademarked games and concluded that six of the eight games generated less net sales than games at the same price point for which there was no license fee paid. In spite of the Lottery's record sales, the audit "question(s) whether the additional expenses associated with trademarked or copyrighted properties maximized revenue from instant games." It recommends "the Wisconsin Lottery consider discontinuing the introduction of instant games for which it must pay license fees in order to maximize revenue and report to the Joint Legislative Audit Committee by March 3, 2014, on its future plans."

No one factor can be used to evaluate the performance of a lottery scratch game. The Lottery considers the number of tickets printed, the rate of sales, the availability of top prizes and the playstyle when measuring one game's success against another. Prior to deciding whether to purchase a license, the Lottery also analyzes each trademarked property, considering multiple factors, some of which are difficult to quantify. In addition to potential sales, consideration is given to brand leverage – the ability to which the Lottery's brand equity is improved by associating with another brand, the potential to attract new players, and the ability of the brand to attract attention in a crowded marketplace.

Recently, the Lottery analyzed weekly sales for \$3 games from July 1, 2007 until June 1, 2013 and found that, during the weeks in which the Lottery was selling a trademarked game, sales were 8.5% percent higher than the weeks when there was no trademarked game for sale. While not all of that increase can be attributed to trademarked games, a regression analysis confirms that the use of these games has a positive impact on sales of \$3 games. This data suggests that eliminating trademarked games from the product line will negatively impact property tax relief.

The Lottery produces approximately 70 scratch tickets per year; three or four of those tickets carry a licensed trademark. The games enhance the Lottery's own brand, ensuring that it remains current and relevant in the marketplace. All of the eight games analyzed by the audit were profitable. The modest use of trademarked games is a small but important part of an overall strategy to increase sales and provide more property tax relief.

Finally, the program audit also analyzed the short-term incentives paid to Lottery retailers. While each incentive had a positive return on investment (ROI), the audit concluded that the Lottery over-estimated the ROI on two incentives. The Lottery accepts this conclusion and the recommendation that the Lottery "consider all relevant factors in assessing the effects of short-term incentives on Lottery sales."

Once again, thank you for the work done by you and your staff.

Sincerely,

A handwritten signature in black ink, appearing to read "Jack Jablonski". The signature is fluid and cursive, with a prominent initial "J".

Jack Jablonski, Deputy Secretary
Wisconsin Department of Revenue