

An Audit

Wisconsin Lottery

Department of Revenue

2011-2012 Joint Legislative Audit Committee Members

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Janice Mueller
State Auditor

May 11, 2011

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

Dear Senator Cowles and Representative Kerkman:

As required by s. 13.94(1)(em), Wis. Stats., we have completed our annual financial audit and biennial program evaluation of the Wisconsin Lottery, which is administered by the Department of Revenue (DOR). We have issued an unqualified opinion on the Wisconsin Lottery's fiscal year (FY) 2009-10 and FY 2008-09 financial statements.

Sales of instant game and lotto tickets decreased 5.5 percent over the past five years, from \$509.1 million in FY 2005-06 to \$480.9 million in FY 2009-10. However, largely because of the introduction of a new multi-state lotto game, total sales increased 1.6 percent in FY 2009-10. From FY 2005-06 through FY 2009-10, gaming-related proceeds funded \$699.3 million in property tax relief.

As a management tool, the Wisconsin Lottery calculates ticket sales for each instant game for the first 12 weeks after its introduction, as well as each game's net sales, which reflect both ticket sales and the costs of production and prizes paid, but not product information expenditures. When we included product information expenditures, we found that net sales for 12 instant games that were introduced in FY 2008-09 were lower than net sales for 36 unpublicized games introduced during the same period. We include a recommendation that the Wisconsin Lottery report to the Joint Legislative Audit Committee later this year on how it proposes to measure the effects of its product information expenditures.

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

Respectfully submitted,

Janice Mueller
State Auditor

JM/DS/ss

Report Highlights

In FY 2009-10, Wisconsin Lottery ticket sales totaled \$480.9 million.

Lottery proceeds provided \$699.3 million in property tax relief in the past five years.

Fewer new instant games have been introduced than in prior years.

The Wisconsin Lottery should specify how it will measure the effectiveness of product information efforts.

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 in 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 4,000 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 directed by s. 13.94(1)(em), Wis. Stats., we have completed an annual financial audit and biennial program evaluation of the Wisconsin Lottery. For the financial audit, we evaluated internal controls, substantiated account balances, and verified compliance with certain state laws and regulations. We issued an unqualified opinion on the Wisconsin Lottery's financial statements for the years ended June 30, 2010 and 2009.

For 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 Wisconsin Lottery's oversight of the private firm that provides it with product information services.

Revenues and Expenses

As shown in Table 1, Wisconsin Lottery sales increased from \$473.4 million in fiscal year (FY) 2008-09 to \$480.9 million in FY 2009-10, primarily in response to the introduction of the multi-state Mega Millions lotto game in January 2010. However, over the past five years sales declined 5.5 percent. Sales of instant games declined from \$285.8 million in FY 2005-06 to \$273.3 million in FY 2009-10, or 4.4 percent, while sales of lotto games declined from \$223.3 million to \$207.6 million, or 7.0 percent.

Table 1

Wisconsin Lottery Sales (in millions)

Fiscal Year	Amount
2005-06	\$509.1
2006-07	492.8
2007-08	494.7
2008-09	473.4
2009-10	480.9

Wisconsin was one of three midwestern states to experience a decline in per capita lottery sales. In contrast, per capita sales increased in four other midwestern states from FY 2007-08 to FY 2008-09, the latest year for which comparable information is available.

In FY 2009-10, the Wisconsin Lottery's operating expenses totaled \$337.3 million and included \$273.0 million in prizes paid to winning ticket holders. Retailer compensation, game development and production costs, product information costs, staff salaries and fringe benefits, and other costs represented less than 20.0 percent of operating expenses. Operating expenses declined from FY 2008-09 to FY 2009-10, largely because of lower prize expenses.

Property Tax Relief

The Wisconsin Constitution requires that net proceeds from the Wisconsin Lottery be used only for property tax relief, provided to owners of primary residences in Wisconsin and to certain farmland owners. From FY 2005-06 through FY 2009-10, Wisconsin Lottery proceeds provided \$699.3 million in property tax relief.

Statutes require that each year at least 50.0 percent of Wisconsin Lottery sales be returned to players as prize payments. In FY 2009-10, the prize payout percentage was 56.8 percent, which was a decline from 59.1 percent in the prior year.

Statutes limit certain Wisconsin Lottery administrative expenses to 10.0 percent of gross operating revenues. Administrative expenses increased from FY 2006-07 to FY 2007-08 as the result of increased product information expenditures. However, they decreased slightly in FY 2009-10, when they were 6.4 percent of gross operating revenues.

Game Development and Management

Effective game development and management help to maximize sales revenue and increase net proceeds available to fund property tax relief. To maximize game sales, the Wisconsin Lottery continually reviews the number and types of instant games it offers. Product information funds appropriated by the Legislature are used to publicize games.

The Wisconsin Lottery introduced 63 new instant games in FY 2009-10, a decline from 66 in FY 2008-09 and 74 in FY 2007-08. Fewer new games are being introduced in order to manage instant games more effectively, ensure that an assortment of games is available, and focus staff resources on developing new game styles. However, the Wisconsin Lottery has indicated it will continue to introduce higher-priced games in response to players' demand. For example, a \$15 game was introduced for the first time in FY 2008-09.

Product Information

The Wisconsin Lottery contracts with Hoffman York, a Milwaukee-based advertising firm, for product information services that publicize lottery games. From FY 1990-91 through FY 2006-07, its annual product information budget was \$4.6 million. 2007 Wisconsin Act 20 increased the product information budget to \$7.5 million, which has been the amount appropriated annually

since FY 2007-08. Almost all of these funds are paid to Hoffman York, which received \$7.3 million in FY 2009-10 for product information services.

Wisconsin's product information expenditures represented 1.6 percent of lottery sales in FY 2008-09. This rate was broadly similar to those of six other midwestern states, although Wisconsin spent less than the other six states.

DOR had estimated that increasing the Wisconsin Lottery's annual product information budget to \$7.5 million would result in \$15.0 million in additional sales in each year of the 2007-09 biennium. However, this did not occur. In five surrounding midwestern states, changes in advertising expenditures during the same period also did not typically correlate with changes in lottery sales.

In 2008 (report 08-13), we found that the Wisconsin Lottery had not completed formal annual evaluations of Hoffman York, as required by contract. In response to our recommendation, it did so in March 2009 and May 2010. The contract with Hoffman York executed in July 2010 no longer requires annual evaluations, but the Wisconsin Lottery indicated that it intends to continue them.

To aid in the development and management of instant games, the Wisconsin Lottery has implemented an evaluation tool that calculates each instant game's 12-week ticket sales and its net sales, which are total ticket sales less game production costs and game prizes paid. In 2008, we recommended that this tool be modified to include the costs of publicizing individual games.

The evaluation tool now notes the amounts spent to publicize particular games, but the Wisconsin Lottery continues to exclude product information expenditures in its calculations of a game's net sales. When we included product information expenditures in the evaluation tool, we found that net sales for 12 instant games that were introduced in FY 2008-09 were lower than net sales for 36 unpublicized games introduced during the same period.

The Wisconsin Lottery believes that product information expenditures cannot be easily or accurately associated with any one game's resulting ticket sales and that publicity increases awareness of the Wisconsin Lottery in general, and likely increases sales of unpublicized games. However, the Legislature increased its product information budget, in part, because of assurances that doing so would increase sales. If the Wisconsin Lottery no longer believes the effects of the increased product information budget can be measured by ticket sales, it should provide the Legislature with a better way of measuring the effectiveness of the \$7.5 million it spends annually to publicize games.

Recommendations

We include recommendations for the Wisconsin Lottery to:

- ☑ continue to complete annual evaluations of its product information contractor ([p. 24](#)); and
- ☑ report to the Joint Legislative Audit Committee by November 11, 2011, on how it proposes to measure the effects of its product information expenditures ([p. 27](#)).

■ ■ ■ ■

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 from the Wisconsin Lottery, and compliance with certain state laws and regulations.

Wisconsin Lottery Ticket Sales

Wisconsin Lottery sales increased 1.6 percent in FY 2009-10.

The Wisconsin Lottery's total ticket sales fluctuated from year to year, as shown in Table 2. Ticket sales decreased 5.5 percent over the past five years, from \$509.1 million in FY 2005-06 to \$480.9 million in FY 2009-10. However, FY 2009-10 ticket sales increased 1.6 percent compared to the prior year.

While sales of lotto games had been declining since FY 2005-06, lotto sales increased 5.6 percent in FY 2009-10 compared to the prior year. This increase is primarily because of the addition of Mega Millions, which the Wisconsin Lottery introduced on January 31, 2010, to increase lotto sales and remain competitive with bordering states that also offer this multi-state game. Sales of instant games, including scratch-off and pull-tab games, which totaled \$273.3 million in FY 2009-10, declined 4.4 percent over the past five years.

Table 2

Wisconsin Lottery Ticket Sales
(in millions)

Fiscal Year	Instant Games	Lotto Games	Total Sales	Percentage Change from Prior Year
2005-06	\$285.8	\$223.3	\$509.1	–
2006-07	284.1	208.7	492.8	(3.2)%
2007-08	287.4	207.3	494.7	0.4
2008-09	276.8	196.6	473.4	(4.3)
2009-10	273.3	207.6	480.9	1.6

Lottery sales increased in four of seven midwestern states from FY 2005-06 through FY 2008-09.

As shown in Table 3, lottery sales in four midwestern states increased from FY 2005-06 through FY 2008-09, the latest year for which comparable information is available from other states, but they decreased in Wisconsin and two other states. Iowa discontinued the use of video lottery terminals in May 2006, which helps to explain the significant decrease in lottery sales in FY 2006-07 in that state. Ohio and Michigan both offer keno games, which the Wisconsin Constitution prevents the Wisconsin Lottery from offering. Although the Wisconsin Lottery attributes the decline in lottery sales from FY 2007-08 to FY 2008-09 to the economic recession, sales in four other midwestern states increased during this two-year period.

As shown in Table 4, Wisconsin's per capita lottery sales ranked sixth among seven midwestern states in both FY 2007-08 and FY 2008-09. During that two-year period, per capita lottery sales declined 5.7 percent in Wisconsin. Wisconsin's per capita lottery sales of \$83 in FY 2008-09 were significantly lower than the national average. Among the 42 states that operated lotteries in that year, Wisconsin ranked 30th in per capita lottery sales.

Table 3
Midwestern States' Lottery Sales
(in millions)

	FY 2005-06	FY 2006-07	FY 2007-08	FY 2008-09	Percentage Change from FY 2005-06 to FY 2008-09
Ohio ¹	\$2,220.9	\$2,259.4	\$2,325.1	\$2,417.7	8.9%
Michigan ¹	2,212.4	2,342.6	2,330.2	2,377.4	7.5
Minnesota	449.7	422.6	461.5	481.3	7.0
Illinois	1,964.3	1,999.0	2,057.3	2,077.2	5.7
Wisconsin	509.1	492.8	494.7	473.4	(7.0)
Indiana	816.4	789.1	822.9	732.7	(10.3)
Iowa	339.5	235.1	249.2	243.3	(28.3)

¹ Includes keno game sales.

Source: La Fleur's 2008 and 2009 World Lottery Almanacs.

Table 4
Midwestern States' per Capita Lottery Sales

State	FY 2007-08	FY 2008-09	Percentage Change
Michigan	\$233	\$238	2.1%
Ohio	202	210	4.0
<i>National Average</i>	187	184	(1.6)
Illinois	159	161	1.3
Indiana	129	114	(11.6)
Minnesota	89	91	2.2
Wisconsin	88	83	(5.7)
Iowa	83	81	(2.4)

Source: La Fleur's 2009 World Lottery Almanac.

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

Differences in available payment and ticket ordering methods may also account for variations in states' 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. Allowing purchases by debit card or check may result in increased sales, but some state lottery officials believe these payment methods can increase problem gambling. Mail subscriptions make it easier for customers to play consistently but may make it more difficult to ensure that individuals under 18 years of age do not play.

Wisconsin Lottery Operating Expenses

Operating expenses decreased 5.8 percent from FY 2005-06 through FY 2009-10.

As shown in Table 5, the Wisconsin Lottery's operating expenses include prizes paid to winning ticket holders; retailer compensation, including commissions and incentives; game development and production costs, including instant game ticket printing and delivery costs and payments to a vendor that supports a gaming network; product information costs; and other costs, such as staff salaries and fringe benefits. Operating expenses decreased from \$358.2 million in FY 2005-06 to \$337.3 million in FY 2009-10, or 5.8 percent. Most of the decline can be attributed to lower prize expenses because of lower ticket sales.

While game development and production expenses had been fairly consistent over the past four years, these expenses declined 4.9 percent during FY 2009-10. This decline is primarily the result of lower contractual payments to GTECH Corporation to maintain a gaming network for which the Wisconsin Lottery paid \$11.2 million during FY 2009-10. Under the terms of a 2009 amendment to the Wisconsin Lottery's contract with GTECH, the corporation agreed to accept a \$1.0 million annual reduction in payment beginning on July 1, 2009, in exchange for the Wisconsin Lottery's exercise of a renewal option to extend the contract expiration date an additional two years to June 22, 2013.

Table 5

Wisconsin Lottery Operating Expenses
(in millions)

Expense Type	FY 2005-06	FY 2006-07	FY 2007-08	FY 2008-09	FY 2009-10
Prizes	\$293.9	\$292.1	\$286.4	\$279.9	\$273.0
Retailer Compensation	35.2	34.1	34.3	32.4	33.3
Game Development and Production ¹	16.4	16.5	16.7	16.2	15.4
Product Information	4.6	4.5	7.4	7.4	7.5
Other ²	8.1	8.0	8.8	8.6	8.1
Total	\$358.2	\$355.2	\$353.6	\$344.5	\$337.3

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

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

Staffing Levels

The Wisconsin Lottery has 92.20 full-time equivalent authorized positions.

As shown in Table 6, the number of full-time equivalent (FTE) positions authorized for the Wisconsin Lottery decreased from 97.85 in July 2006 to 92.20 in July 2010. Some of the Wisconsin Lottery's authorized positions are actually located in other areas of DOR, such as the Secretary's office and the budget office, and spend part of their time supporting the Wisconsin Lottery's operations. In July 2010, for example, 14.25 of the 79.55 filled positions were located outside of the Wisconsin Lottery.

Table 6

Wisconsin Lottery Staffing Levels
(FTE Positions)

	Authorized Positions	Vacant Positions	Percentage Vacant
July 2006	97.85	12.20	12.5%
July 2007	97.85	15.15	15.5
July 2008	97.85	12.80	13.1
July 2009	92.20	9.00	9.8
July 2010	92.20	12.65	13.7

Property Tax Credits

Lottery proceeds provided \$699.3 million in property tax relief from FY 2005-06 through FY 2009-10.

The Wisconsin Constitution requires that net proceeds from the Wisconsin Lottery be used only for property tax relief, which is provided to owners of primary residences in Wisconsin through the Lottery and Gaming Tax Credit and to certain farmland owners in Wisconsin through the Farmland Tax Relief Credit. The Wisconsin Lottery has provided nearly \$3.1 billion in property tax relief from its inception in 1988 through FY 2009-10. As shown in Table 7, Lottery proceeds provided \$699.3 million in property tax relief from FY 2005-06 through FY 2009-10.

Table 7

Wisconsin Property Tax Relief¹ (in millions)

Fiscal Year	Lottery and Gaming Tax Credit	Farmland Tax Relief Credit	Total Distributed
2005-06	\$119.8	\$13.5	\$133.3
2006-07	144.6	15.4	160.0
2007-08	129.6	16.9	146.5
2008-09	117.8	14.6	132.4
2009-10	112.8	14.3	127.1
Total	\$624.6	\$74.7	\$699.3

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.

In October 2010, pursuant to s. 79.10(11)(b), Wis. Stats., the Department of Administration and the Joint Committee on Finance authorized the use of \$146.6 million in Wisconsin Lottery proceeds for property tax relief in FY 2010-11, including \$131.6 million for the Lottery and Gaming Tax Credit. In FY 2010-11, Wisconsin Lottery proceeds of \$14.9 million will be used to fund the School Levy Tax Credit instead of the Farmland Tax Relief Credit, as directed by 2009 Wisconsin Act 28. The School Levy Tax Credit provides property tax relief in the form of state credits on individual property tax bills.

Statutory Requirements

The Wisconsin Lottery returned 56.8 percent of sales to players as prize payments in FY 2009-10.

State statutes and legislative action impose limitations on certain types of lottery expenses. For example, section 25.75(3)(a), Wis. Stats., requires that at least 50.0 percent of Wisconsin Lottery sales be returned to players as prize payments. As shown in Table 8, 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, are expected to fluctuate more than payouts for instant games. The lower FY 2009-10 prize payout was attributed to fewer SuperCash! winners during FY 2009-10 compared to the prior year.

Table 8

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

Fiscal Year	Prize Expenses	Ticket Sales	Percentage of Ticket Sales
2005-06	\$293.9	\$509.1	57.7%
2006-07	292.1	492.8	59.3
2007-08	286.4	494.7	57.9
2008-09	279.9	473.4	59.1
2009-10	273.0	480.9	56.8

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

Section 25.75(3)(b), Wis. Stats., limits certain administrative expenses to no more than 10.0 percent of gross operating revenues. Statutory administrative expenses include all costs except prize payments and retailer compensation. As shown in Table 9, the Wisconsin Lottery's administrative expenses have remained within the statutory limit. Administrative expenses increased from FY 2006-07 to FY 2007-08 as the result of increased product information expenses authorized by 2007 Wisconsin Act 20, the 2007-09 Biennial Budget Act. However, administrative expenses decreased slightly in both FY 2008-09 and FY 2009-10.

Table 9

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

Fiscal Year	Statutorily Defined Administrative Expenses	Gross Operating Revenues	Percentage of Gross Operating Revenues
2005-06	\$29.1	\$509.2	5.7%
2006-07	28.9	493.4	5.9
2007-08	32.8	495.2	6.6
2008-09	32.2	473.7	6.8
2009-10	31.0	481.1	6.4

The Wisconsin Lottery provided 0.9 percent of ticket sales for the retailer performance program in FY 2009-10.

State statutes establish maximum compensation rates for basic commissions and performance program payments to retailers who sell lottery tickets. Basic commission rates are currently 5.5 percent of the retail price for lotto tickets and 6.25 percent for instant tickets. According to s. 565.02(4)(g), Wis. Stats., performance program payments to eligible retailers may not exceed 1.0 percent of total ticket sales. As shown in Table 10, the Wisconsin Lottery's retailer performance program payments have remained within the statutory limit for the past five fiscal years and were 0.9 percent of ticket sales during FY 2009-10.

Table 10

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

Fiscal Year	Retailer Performance Program Payments	Ticket Sales	Percentage of Ticket Sales
2005-06	\$4.6	\$509.1	0.9%
2006-07	4.5	492.8	0.9
2007-08	4.5	494.7	0.9
2008-09	4.0	473.4	0.8
2009-10	4.5	480.9	0.9

Lottery Game Management

Effective game development and management help to increase the net proceeds available to fund 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 game sales, the Wisconsin Lottery continuously reviews the number and types of instant games it offers, and it uses product information funds appropriated by the Legislature to publicize games. We reviewed the availability and sales of lottery games in FY 2008-09 and FY 2009-10, evaluated how the Wisconsin Lottery oversees the private firm that provides it with product information services, and analyzed how the Wisconsin Lottery evaluates the performance of instant games.

Game Availability and Sales

As shown in Table 11, sales of lotto games totaled \$207.6 million and represented 43.2 percent of total game sales in FY 2009-10, and sales of scratch-off games totaled \$269.4 million and represented 56.0 percent of total game sales. There were a total of 118 games available for sale at some point during that fiscal year, compared to 134 in FY 2008-09.

Lotto Games

Wisconsin participates in two lotto games administered by the Multi-State Lottery Association: Powerball, which is played in 42 states, and Mega Millions, which is played in 41 states. As shown in Table 12, the Wisconsin Lottery also offers five other lotto games, which are sold only in Wisconsin.

Table 11

Lottery Game Availability and Sales¹

Game Type	FY 2008-09			FY 2009-10		
	Number of Games	Total Sales (in millions)	Percentage of Total	Number of Games	Total Sales (in millions)	Percentage of Total
Lotto	6	\$196.6	41.5%	7	\$207.6	43.2%
Instant						
Scratch-off	116	271.9	57.5	96	269.4	56.0
Pull-tab	12	4.9	1.0	15	3.9	0.8
Subtotal	128	276.8	58.5	111	273.3	56.8
Total	134	\$473.4	100.0%	118	\$480.9	100.0%

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

Table 12

Wisconsin Lottery Lotto Games

Game	Date of Introduction	Drawing Frequency	Odds of Winning Maximum Prize	FY 2008-09 Sales (in millions)	FY 2009-10 Sales (in millions)
Powerball	April 19, 1992	Twice Weekly	1:195.2 million	\$85.4	\$89.3
SuperCash!	February 4, 1991	Daily	1:1.6 million	27.4	27.2
Pick 3	September 21, 1992	Daily	1:1,000	26.3	26.2
Badger 5	February 17, 2003	Daily	1:170,000	24.8	23.7
Megabucks	June 20, 1992	Twice Weekly	1:7.0 million	20.7	18.8
Pick 4	September 15, 1997	Daily	1:10,000	12.0	12.2
Mega Millions	January 31, 2010	Twice Weekly	1:175.7 million	n/a	10.3 ¹

¹ Includes only a partial year of sales.

In January 2009, the Multi-State Lottery Association modified Powerball to make winning the jackpot more difficult and to increase the likelihood of larger jackpots. By increasing the main pool of balls from 55 to 59 and reducing the number of Powerballs from 42 to 39, the odds of winning the jackpot decreased from 1 in 146.1 million to 1 in 195.2 million.

Instant Games

Introductions of new instant games increased from FY 2005-06 through FY 2007-08 but then decreased in the following two years.

As shown in Table 13, introductions of new instant games increased from FY 2005-06 through FY 2007-08 but then decreased in the following two years. The Wisconsin Lottery indicated that to manage instant games more effectively, it has decided to introduce fewer new games, ensure that an assortment of games is available at each price, and focus staff resources on developing new game styles such as combined scratch-off and pull-tab games. However, the Wisconsin Lottery indicated that it continues to introduce higher-priced instant games in response to players’ demand, including a \$15 game that it introduced for the first time in FY 2008-09.

Table 13

Number of New Instant Lottery Games Introduced

Game Price	FY 2005-06	FY 2006-07	FY 2007-08	FY 2008-09	FY 2009-10
\$1	19	18	16	16	13
\$2	19	20	17	18	16
\$3	8	13	18	11	13
\$5	10	14	17	14	14
\$10	3	4	4	5	4
\$15	0	0	0	1	1
\$20	2	1	2	1	2
Total	61	70	74	66	63

The Wisconsin Lottery believes that a key element in maximizing instant game sales is providing a wide selection that offers a variety of different play styles and game prices. 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.

Product Information

The Wisconsin Constitution prohibits the expenditure of public funds or of revenues derived from lottery operations for promotional advertising, and it directs any advertising to provide information about the chances of winning and the prize structure. State statutes further specify that an advertisement is not promotional if it is informational and, for example, describes a lottery game's prize structure, explains where to purchase lottery tickets, or identifies winning lottery game numbers.

Product Information Contract

The Wisconsin Lottery contracts with a private firm for product information services.

In July 2010, the Wisconsin Lottery entered into a two-year product information contract with Hoffman York, a Milwaukee-based advertising firm that has held similar contracts since 1992. The current contract allows for three optional one-year renewal periods by mutual agreement. With input from Wisconsin Lottery staff, Hoffman York annually creates a plan for providing information about the Wisconsin Lottery and individual games through print, radio, television, and other media. Typically, new games or game features that are most likely to interest players, such as a new style of play, a holiday theme, or a special offer, are publicized. However, not all new games or game features are publicized. Hoffman York also helps to design the product information, and it purchases space in newspapers and air time on radio and television. It should be noted that the firm changed its name to HY Connect in April 2011.

From FY 1990-91 through FY 2006-07, the Wisconsin Lottery's annual product information budget was \$4.6 million. 2007 Wisconsin Act 20, the 2007-09 Biennial Budget Act, increased this budget to \$7.5 million, which has been the amount appropriated annually since FY 2007-08. Each year, Hoffman York has been paid almost the entire

appropriated amount, although a small amount is spent on printing and other costs. Costs incurred by Wisconsin Lottery staff for product information tasks they perform are not paid through the annual product information budget but are instead covered by the Wisconsin Lottery’s general operations funds.

The Wisconsin Lottery paid Hoffmann York approximately \$7.2 million in FY 2008-09 and \$7.3 million in FY 2009-10 for product information services. The firm used these funds primarily to purchase media time and space to publicize Wisconsin Lottery games.

In FY 2009-10, almost one-half of all product information expenditures were for lotto games.

As shown in Table 14, almost one-half of all product information expenditures in FY 2009-10 were for lotto games. Product information expenditures for Mega Millions and Powerball increased from \$1.6 million in FY 2008-09 to \$2.9 million in FY 2009-10, or by 81.3 percent. In contrast, product information expenditures for instant games declined by 17.8 percent over the two-year period.

Table 14

Product Information Expenditures, by Game Type

Game Type	FY 2008-09		FY 2009-10	
	Amount	Percentage of Total	Amount	Percentage of Total
Lotto	\$2,855,200	38.8%	\$3,717,500	49.8%
Instant	3,962,500	53.8	3,257,200	43.6
Other ¹	547,400	7.4	494,600	6.6
Total	\$7,365,100	100.0%	\$7,469,300	100.0%

¹ Includes expenditures for promoting responsible gaming, printing, and product information efforts at Lambeau Field and Miller Park.

As shown in Table 15, television advertisements accounted for most product information expenditures in both FY 2008-09 and FY 2009-10. Product information expenditures may fluctuate among media formats because of changing priorities. For example, the increase in outdoor advertising expenditures in FY 2009-10 occurred, in part, because the Wisconsin Lottery used digital, rather than traditional, billboards.

Table 15

Product Information Expenditures, by Media Format

Media Format	FY 2008-09	FY 2009-10	Percentage Change
Television	\$4,402,200	\$3,982,900	(9.5)%
Outdoor ¹	579,900	1,033,700	78.3
Radio	1,447,800	896,400	(38.1)
Internet	321,700	616,400	91.6
Other ²	367,200	673,900	83.5
Print	246,300	266,000	8.0
Total	\$7,365,100	\$7,469,300	1.4

¹ Represents billboard costs.

² Includes product information efforts at Lambeau Field and Miller Park.

In FY 2008-09, Wisconsin's product information expenditures were 1.6 percent of lottery sales.

As shown in Table 16, Wisconsin's product information expenditures represented 1.6 percent of lottery sales in FY 2008-09. This rate was broadly similar to several other midwestern states' rates. Wisconsin spent less on product information than six other states spent to advertise their lotteries.

DOR had originally estimated in budget documents that increasing the Wisconsin Lottery's product information budget to \$7.5 million would result in \$15.0 million in additional lottery sales annually during the 2007-09 biennium. This did not occur. The Wisconsin Lottery believes that the recent economic recession contributed to the sales decline, which it asserts would have been even larger if the Legislature had not increased its product information budget.

Table 16

Midwestern States' Lottery Sales and Advertising Expenditures¹
 FY 2008-09
 (in millions)

	Lottery Sales	Advertising Expenditures	Advertising Expenditures as a Percentage of Sales
Iowa	\$ 243.3	\$ 7.5	3.1%
Minnesota	481.3	8.0	1.7
Wisconsin	473.4	7.4	1.6
Indiana	732.7	11.3	1.5
Michigan ²	2,377.4	27.0	1.1
Ohio ²	2,417.7	21.3 ³	0.9
Illinois	2,077.2	17.9	0.9

¹ Reflects product information expenditures in Wisconsin, where promotional advertising is prohibited.

² Includes keno sales and advertising expenditures.

³ Budgeted.

Source: La Fleur's 2009 World Lottery Almanac and states' annual lottery reports.

In five surrounding midwestern states, changes in advertising expenditures from FY 2007-08 through FY 2008-09 typically did not correlate with changes in lottery sales. We found that:

- in Indiana and Iowa, advertising expenditures increased but lottery sales decreased;
- in Illinois and Minnesota, advertising expenditures decreased but lottery sales increased; and
- in Michigan, both advertising expenditures and lottery sales increased.

Evaluating Contractor Performance

In report 08-13, we found that although the Wisconsin Lottery was contractually required to formally evaluate its contractor—Hoffman York—annually, it had not done so. Instead of completing written evaluations, the Wisconsin Lottery indicated it evaluated the firm in other ways, such as by providing verbal feedback about the firm’s performance during annual meetings to discuss product information plans for the upcoming year. Because such feedback did not replace the benefits of the formal, contractually required annual evaluations, our report included a recommendation that the Wisconsin Lottery annually evaluate its product information contractor.

In August 2008, the Wisconsin Lottery began developing an evaluation form that allows it to review Hoffman York’s performance in five areas—media planning and delivery, account management and communications, creative services, production services, and minority business partnership—and it completed annual evaluations of the firm in March 2009 and May 2010. In the latest evaluation, the Wisconsin Lottery rated Hoffman York “very good/above average” in four of the five performance areas and “average” in creative services. The evaluation noted that the firm could improve its creative services by ensuring all concepts focus on the Wisconsin Lottery’s product and by being receptive to Wisconsin Lottery concerns and suggestions about creative execution. In addition to the two annual evaluations, the Wisconsin Lottery completed five quarterly evaluations of Hoffman York from June 2009 through August 2010.

The Wisconsin Lottery’s contract for product information services no longer requires annual evaluations.

Although the Wisconsin Lottery indicated to us that the annual evaluations have been an effective way to provide critical feedback to Hoffman York, the current product information contract that took effect in July 2010 no longer requires annual evaluations. The Wisconsin Lottery indicated that although it removed the relevant provisions as part of an overall effort to simplify the contract, it intends to continue to evaluate the firm annually.

Recommendation

We recommend the Wisconsin Lottery continue to complete annual evaluations of its product information contractor, to ensure effective oversight.

Tracking Studies Contract

Another measure the Wisconsin Lottery uses to evaluate Hoffman York's performance and guide its product information plans is a quarterly survey of Wisconsin residents, to gauge awareness of and opinions about the Wisconsin Lottery and to determine survey respondents' levels of participation and ability to recall product information. In May 2007, the Wisconsin Lottery executed a two-year contract for \$68,000 with Wilson Research Strategies, Inc., a Washington, D.C.-based research firm, to conduct the quarterly surveys of 350 Wisconsin residents and complete tracking studies that summarize the survey results. In February 2009, the Wisconsin Lottery instructed the firm to cease contract work and withheld \$19,500 in payments because it was unable to resolve various issues with the firm, including allegations that the firm did not always provide accurate information within specified deadlines.

To help ensure the selection of a qualified replacement firm, the Wisconsin Lottery's July 2009 request for proposal required firms to have considerable survey experience. In January 2010, the Wisconsin Lottery executed a two-year contract with Advantage Research, Inc., a Detroit-based research firm. Under the terms of that contract, it paid that firm \$10,300 in FY 2009-10.

Evaluating Instant Games

An evaluation tool helps the Wisconsin Lottery to develop and manage instant games.

In report 05-08, we recommended that the Wisconsin Lottery develop a written methodology to analyze instant game costs and revenues. 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 key features, such as its theme and play style; provides a justification for each game, showing how it complements other games currently available for sale; and estimates development costs and sales. The evaluation tool is used:

- to identify factors that may have influenced a game's sales, such as the theme, play style, or whether similar Wisconsin Lottery games were sold during the same period; and
- to calculate a game's initial 12-week ticket sales and its net sales, which are total ticket sales less game production costs and game prizes paid.

Initial 12-week sales and net sales provide the Wisconsin Lottery with two different but complementary measures from which to draw conclusions about game performance. Initial 12-week sales data allow a game’s popularity to be compared to that of other games introduced in the same fiscal year and at the same price. According to the Wisconsin Lottery, sales for most instant games are highest immediately after introduction and decrease steadily over time. Analyzing net sales allows the Wisconsin Lottery to review game costs, evaluate trends in sales over a game’s life, determine which games are most profitable, and identify strategies to increase the success of future games.

While the evaluation tool is an effective way to evaluate instant games and determine which have and have not been successful, as well as the reasons for those outcomes, it did not initially take into account product information costs. Therefore, we recommended in report 08-13 that the evaluation tool include those costs. In its written response to our report, the Wisconsin Lottery indicated that it agreed with our recommendation.

In our current audit, we found that the evaluation tool now notes the amounts spent to publicize particular games. However, the Wisconsin Lottery continues to exclude product information expenditures in its calculations of a game’s net sales. It believes that product information expenditures cannot be easily or accurately associated with any one game’s resulting ticket sales, and that publicity increases awareness of the Wisconsin Lottery in general and likely increases sales of unpublicized games.

Net sales for 12 publicized instant games were lower than net sales for 36 unpublicized games.

When we included product information expenditures in the evaluation tool, we found that net sales for 12 instant games that were introduced in FY 2008-09 were lower than net sales for 36 unpublicized games, as shown in Table 17.

Table 17

Average Sales and Net Sales of Instant Games Introduced in FY 2008-09¹

	Number	Average Sales per Game	Average Net Sales per Game ²
Games Publicized	12	\$3,793,000	\$1,028,300
Games Not Publicized	36	3,742,800	1,296,700

¹ Information was unavailable for 18 games introduced in FY 2008-09.

² Net sales are total ticket sales less game production costs, game prizes paid, and any costs of publicizing a game.

We found that 1 of the 12 publicized games introduced in FY 2008-09 cost more than its total ticket sales. The Funjet Vacations instant game had as a top prize a trip for two to a Cancun resort. Ticket sales were lower than anticipated, and the game’s net sales were \$398,100, excluding the costs to publicize it. However, when the \$407,300 that was spent to publicize the game is taken into account, the game actually “lost” \$9,200. This occurred, in part, because the Wisconsin Lottery’s costs for publicizing the game were 84.1 percent of the estimated net sales. For ten other instant games introduced in FY 2008-09, publicity costs did not exceed 40.0 percent of estimated net sales. In FY 2009-10, the Wisconsin Lottery introduced Caribbean Cash, an instant game with a prize structure similar to that of the Funjet Vacations game. Because Funjet Vacations ticket sales had been lower than anticipated, the Wisconsin Lottery spent less to publicize Caribbean Cash. Caribbean Cash net sales were \$336,300, after including the amount spent to publicize the game.

Assessing the impact of product information expenditures is difficult. The amount spent to publicize a given lottery game likely affects not only that game’s ticket sales, but also ticket sales of games not publicized. However, other factors also affect ticket sales. For example, the Wisconsin Lottery believes that the recent economic recession caused ticket sales to decline. The Legislature increased the Wisconsin Lottery’s product information budget, in part, because of assurances that overall ticket sales would increase. If the Wisconsin Lottery no longer believes the effects of the increased product information budget can be measured by ticket sales, it should provide the Legislature with a better way of measuring the effectiveness of the \$7.5 million it spends annually to publicize games.

Recommendation

We recommend the Wisconsin Lottery report to the Joint Legislative Audit Committee by November 11, 2011, on how it proposes to measure the effects of its product information expenditures.



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, 2010 and 2009, as listed in the table of contents. These financial statements are the responsibility of the Wisconsin Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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


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

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Wisconsin Lottery as of June 30, 2010 and 2009, 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 April 25, 2011, on our consideration of the Wisconsin Lottery's internal control over financial reporting; our tests of its compliance with certain provisions of laws, regulations, and contracts; and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Our audits were conducted for the purpose of forming an opinion on the financial statements of the Wisconsin Lottery. The supplementary information, including Management's Discussion and Analysis and Schedules 1, 2, and 3, is presented for purposes of additional analysis and is not a required part of the financial statements. The schedules on pages 70 through 72 have been subjected to the auditing procedures applied in the audits of the financial statements and, in our opinion, are fairly stated in all material respects in relation to the financial statements taken as a whole. For Management's Discussion and Analysis on pages 31 through 39, we have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

April 25, 2011

LEGISLATIVE AUDIT BUREAU
by 
Sherry Haakenson
Audit Director

Management's Discussion and Analysis

Prepared by Wisconsin Lottery Management

This section of the Wisconsin Lottery's financial statements presents the Wisconsin Lottery management's discussion and analysis of the financial performance of the Wisconsin Lottery for the fiscal years ending June 30, 2010, and June 30, 2009, with comparative information from the fiscal year ending June 30, 2008. 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

Wisconsin Lottery sales continue to track the economy as a whole. FY 2009-10 ticket sales were up \$7.5 million, or 1.6 percent, over FY 2008-09, as the economy slowly improved. Sales have not returned to pre-recession levels; however, the Lottery's ability to generate funds for property tax relief remains strong.

- Operating revenues generated from ticket sales for the Wisconsin Lottery were \$480.9 million in FY 2009-10 and \$473.4 million in FY 2008-09. The increase in ticket sales during FY 2009-10 is attributable to the addition of the Mega Millions game and an increase in Powerball sales.
- Operating expenses for FY 2009-10 decreased \$7.2 million, or 2.1 percent, primarily as a result of reduced prize expenses and a reduction in the cost of the gaming system contract upon renewal and extension through June 2013. For FY 2008-09, operating expenses decreased \$9.1 million, or 2.6 percent.

- Net income before transfers was \$145.4 million for FY 2009-10, compared to \$129.4 million in FY 2008-09, mainly due to increased sales and lower expenses.
- In July 2009, the 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. In addition, GTECH is providing, at no additional cost, a remote, hot-site backup of the system and a data feed for the development of a data warehouse.
- Administrative expenses, as defined in s. 25.73(3)(b), Wis. Stats., remained well below the statutory maximum of 10.0 percent of gross operating revenues. Total statutory administrative expenses (which include not only the administrative expenses on the financial statements but also all program expenses except prizes and retailer compensation) were \$31.0 million in FY 2009-10, a decline of \$1.2 million from \$32.2 million in FY 2008-09, and statutory administrative expenses as a percentage of operating revenue decreased slightly to 6.4 percent in FY 2009-10, compared to 6.8 percent in FY 2008-09.

Overview of the Financial Statements

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

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

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 2009-10 and FY 2008-09. Table A presents these data in a condensed form for the past three fiscal years. The relationship of assets to liabilities and resulting net assets is one indicator of the financial condition of the Wisconsin Lottery.

Table A

Net Assets (in millions)

	June 30, 2010	June 30, 2009	Change	June 30, 2008	Change
Investments	\$ 64.0	\$ 72.0	\$(8.0)	\$ 85.3	\$(13.3)
Capital Assets (Net of Accumulated Depreciation)	0.1	0.1	0.0	0.1	0.0
Other Assets	67.7	55.1	12.6	55.5	(0.4)
Total Assets	131.8	127.2	4.6	140.9	(13.7)
Current Liabilities	38.8	45.7	(6.9)	45.8	(0.1)
Noncurrent Liabilities	46.0	51.8	(5.8)	61.5	(9.7)
Total Liabilities	84.8	97.5	(12.7)	107.3	(9.8)
Net Assets:					
Invested in Capital Assets	0.1	0.1	0.0	0.1	0.0
Restricted for MUSL Reserves	4.0	4.0	0.0	3.9	0.1
Restricted for Investment Fair Market Value Adjustment	10.0	8.5	1.5	9.4	(0.9)
Restricted for Property Tax Relief	32.9	17.1	15.8	20.2	(3.1)
Total Net Assets	<u>\$ 47.0</u>	<u>\$ 29.7</u>	<u>\$17.3</u>	<u>\$ 33.6</u>	<u>\$(3.9)</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 \$131.8 million at the end of FY 2009-10, compared to \$127.2 million at the end of FY 2008-09 and \$140.9 million at the end of FY 2007-08. The increase in assets is due primarily to higher net income in FY 2009-10. No winners chose annuities during FY 2009-10 and FY 2008-09, so there were no additions to investments for prize annuities, and there continued to be decreases to that account as investments matured and were paid out to existing annuitants.

Liabilities

Current liabilities consist primarily of accrued prizes payable, annuity prizes payable, and accounts payable due to suppliers. Noncurrent liabilities consist primarily of annuity prizes payable more than a year beyond the date of the Statement of Net Assets. As noted, no winners during FY 2009-10 and FY 2008-09 chose to receive their winnings in the form of an annuity. Therefore, total annuity prizes payable decreased in both years as existing annuitants continued to receive their annual payments, and as a result, total liabilities declined. At the end of FY 2009-10, the Wisconsin Lottery had total liabilities of \$84.8 million, compared with total liabilities of \$97.5 million at the end of FY 2008-09 and \$107.3 million at the end of FY 2007-08.

Net Assets

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

Changes in Net Assets

The Wisconsin Lottery's total net assets were \$47.0 million as of the end of FY 2009-10, a \$17.3 million increase from the prior year. During FY 2008-09, total net assets decreased \$3.9 million, to \$29.7 million. They were \$33.6 million in FY 2007-08.

The Statement of Revenues, Expenses, and Changes in Fund Net Assets provides detailed information on the nature and financial impact of the Wisconsin Lottery's operations for FY 2009-10 and FY 2008-09. Table B presents data for the past three fiscal years in a condensed form.

Table B

Changes in Net Assets
(in millions)

	FY 2009-10	FY 2008-09	Change	FY 2007-08	Change
Revenues					
Operating Revenues:					
Ticket sales	\$480.9	\$473.4	\$7.5	\$494.7	\$(21.3)
Retailer fees and miscellaneous revenue	0.1	0.3	(0.2)	0.5	(0.2)
Nonoperating Revenues:					
Investment income (loss)	1.6	0.1	1.5	5.9	(5.8)
Miscellaneous revenue	0.1	0.1	0.0	0.1	0.0
Total Revenues	482.7	473.9	8.8	501.2	(27.3)
Expenses					
Program Expenses:					
Prize expenses	273.0	279.9	(6.9)	286.4	(6.5)
Retailer commissions and incentives	33.3	32.4	0.9	34.3	(1.9)
Instant and lotto vendor services	11.2	12.0	(0.8)	12.4	(0.4)
Other game-related expenses	11.7	11.6	0.1	11.7	(0.1)
Office Administration Expenses	8.1	8.6	(0.5)	8.8	(0.2)
Total Expenses	337.3	344.5	(7.2)	353.6	(9.1)
Net Income Before Transfers	145.4	129.4	16.0	147.6	(18.2)
Operating Transfers					
Transfer for Property Tax Relief	(127.1)	(132.4)	5.3	(146.5)	14.1
Transfer In from General Fund	0.2	0.2	0.0	0.3	(0.1)
Transfer for Compulsive Gambling Programs	(0.4)	(0.4)	0.0	(0.4)	0.0
Transfer for Law Enforcement	(0.4)	(0.3)	(0.1)	(0.3)	0.0
Transfer for Lottery Credit Administration	(0.3)	(0.3)	0.0	(0.3)	0.0
Transfer Out to General Fund	(0.1)	(0.1)	0.0	(0.1)	0.0
Change in Net Assets	<u>\$ 17.3</u>	<u>\$ (3.9)</u>	<u>\$21.2</u>	<u>\$ 0.3</u>	<u>\$ (4.2)</u>

Operating Revenues

Operating revenues are generated almost entirely from ticket sales. Ticket sales for the Wisconsin Lottery were \$480.9 million in FY 2009-10 and \$473.4 million in FY 2008-09. As previously stated, the sales increase in FY 2009-10 was due to the addition of the Mega Millions game and increased Powerball sales.

Table C compares ticket sales for each game category for FY 2009-10, FY 2008-09, and FY 2007-08.

Table C
Wisconsin Lottery Ticket Sales
(in millions)

	FY 2009-10	FY 2008-09	Change	FY 2007-08	Change
Instant					
Scratch-off	\$269.3	\$271.9	\$(2.6)	\$284.3	\$(12.4)
Pull-tab	3.9	4.9	(1.0)	3.1	1.8
Lotto					
SuperCash!	27.2	27.4	(0.2)	27.9	(0.5)
Powerball	89.3	85.4	3.9	93.7	(8.3)
Wisconsin's Very Own Megabucks	18.8	20.7	(1.9)	19.0	1.7
Daily Pick 3	26.2	26.3	(0.1)	25.8	0.5
Daily Pick 4	12.2	12.0	0.2	11.9	0.1
Badger 5	23.7	24.8	(1.1)	25.3	(0.5)
Mega Millions ¹	10.3	0.0	10.3	0.0	0.0
Raffle Games ²	0.0	0.0	0.0	3.7	(3.7)
Total	<u>\$480.9</u>	<u>\$473.4</u>	<u>\$7.5</u>	<u>\$494.7</u>	<u>\$(21.3)</u>

¹ The Lottery began selling Mega Millions on January 31, 2010.

² Raffle games were not offered during FY 2009-10 and FY 2008-09.

Instant scratch-off ticket sales decreased \$2.6 million during FY 2009-10, after decreasing \$12.4 million during FY 2008-09. 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 \$1.0 million in FY 2009-10, following a \$1.8 million increase in FY 2008-09.

Lotto game sales increased by \$11.1 million during FY 2009-10, primarily due to the addition of the Mega Millions game and increased Powerball sales. In previous financial statements "lotto games" were referred to as "online games." In order to avoid confusion with Internet gambling (which is prohibited by the Wisconsin Constitution), "lotto" (a term widely used in the lottery industry) is now used.

Expenses

Expenses consist of amounts paid in prizes, retailer commissions and incentives, fees paid to the Lottery's gaming system vendor (instant and lotto vendor services), other game-related expenses, and administrative expenses. In FY 2009-10, total expenses were \$337.3 million, a decline of \$7.2 million from FY 2008-09 expenses of \$344.5 million, which also declined from FY 2007-08 expenses of \$353.6 million.

Prizes are the Lottery's largest expense. Table D compares ticket prize awards for each lottery game category for FY 2009-10, FY 2008-09, and FY 2007-08.

Table D

Wisconsin Lottery Ticket Prize Awards
(in millions)

	FY 2009-10	FY 2008-09	Change	FY 2007-08	Change
Instant					
Scratch-off	\$170.1	\$174.5	\$(4.4)	\$183.8	\$(9.3)
Pull-tab	2.5	3.0	(0.5)	2.0	1.0
Super 2 nd Chance ¹	0.3	0.4	(0.1)	0.3	0.1
Lotto					
SuperCash!	12.7	18.5	(5.8)	12.0	6.5
Powerball	42.1	41.1	1.0	44.8	(3.7)
Wisconsin's Very Own Megabucks	9.8	10.9	(1.1)	9.9	1.0
Daily Pick 3	12.3	13.6	(1.3)	13.0	0.6
Daily Pick 4	6.1	5.4	0.7	5.6	(0.2)
Badger 5	11.5	12.1	(0.6)	12.4	(0.3)
Mega Millions	5.3	0.0	5.3	0.0	0.0
Raffle Games	0.0	0.0	0.0	2.3	(2.3)
Super 2 nd Chance ¹	0.3	0.4	(0.1)	0.3	0.1
Total	<u>\$273.0</u>	<u>\$279.9</u>	<u>\$(6.9)</u>	<u>\$286.4</u>	<u>\$(6.5)</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 original purchase of the scratch-off and lotto tickets.

Generally, prizes awarded are a function of ticket sales: higher ticket sales will result in greater prize expense, while lower sales will result in lower prize expense. Thus, prizes for instant tickets declined along with sales. However, in FY 2009-10, prizes for lotto ticket sales were also down, even though sales were up. This is primarily due to the prize payouts for SuperCash! returning closer to theoretical levels. In FY 2008-09, there were significantly more winners of SuperCash! prizes than would be mathematically expected, resulting in a prize payout of 67.3 percent, as compared to its mathematically expected payout of 52.8 percent. During FY 2009-10, there were slightly fewer winners than would be mathematically expected, resulting in a prize payout of 46.6 percent. Overall, sales increased \$7.5 million in FY 2009-10 and overall prize awards declined \$6.9 million. Schedule 3 after the notes to the financial statements shows a multi-year summary of ticket sales and their related prize expenses.

Expenses for retailer commissions are also a function of sales. In FY 2009-10, retailers were paid \$33.3 million in commissions and incentives, up from \$32.4 million in FY 2008-09. In FY 2007-08, retailer commissions and incentives were \$34.3 million.

The Wisconsin Lottery contracted with GTECH Corporation for an integrated gaming computer system and services (instant and lotto vendor services). In FY 2009-10, payments to GTECH were \$11.2 million. In FY 2008-09 and FY 2007-08, these payments were \$12.0 million and \$12.4 million respectively. Initially, the Lottery paid GTECH 2.54 percent of total net ticket sales. In July 2009, the 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 Lottery paid GTECH 2.54 percent of sales, less \$1.0 million. In addition, GTECH is providing, at no additional cost, a remote, hot-site backup of the system and a data feed for the development of a data warehouse.

Net Income and Transfer for Property Tax Relief

Net income before transfers was \$145.4 million in FY 2009-10, up from \$129.4 million in FY 2008-09. Net income before transfers was \$147.6 million for FY 2007-08.

As can be seen in Table B, the amount transferred out for property tax relief differs from net income. This is because the transfers occur before the end of the fiscal year and are based on an estimate of the total funds that will be available for distribution. The operating transfer out for property tax relief decreased by \$5.3 million, or 4.0 percent, during FY 2009-10, while it decreased by \$14.1 million, or 9.6 percent, during FY 2008-09.

Contacting the Wisconsin Lottery's Financial Management

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

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

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

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

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

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Financial Statements

Statement of Net Assets

June 30, 2010 and 2009

	June 30, 2010	June 30, 2009
ASSETS		
Current Assets:		
Cash and cash equivalents (Note 3)	\$ 39,689,012	\$ 28,033,035
Investments for prize annuities (Note 3)	9,681,260	13,265,489
Accounts receivable (Note 4)	20,147,993	19,272,789
Due from other state programs (Note 4)	203,592	226,624
Ticket inventory	1,802,438	1,678,613
MUSL reserve accounts (Note 9)	1,290,759	1,377,338
Prepaid expenses (Note 20)	561,632	329,594
Interest receivable	5,021	6,863
Total Current Assets	<u>73,381,707</u>	<u>64,190,345</u>
Noncurrent Assets:		
Investments for prize annuities (Note 3)	54,346,978	58,766,905
MUSL reserve accounts (Note 9)	4,023,428	4,045,087
Prepaid expense (Note 20)	0	50,320
Capital assets: (Note 10)		
Equipment	779,680	774,680
Leasehold improvements	159,724	159,724
Accumulated depreciation	(836,334)	(788,124)
Total Noncurrent Assets	<u>58,473,476</u>	<u>63,008,592</u>
TOTAL ASSETS	<u>131,855,183</u>	<u>127,198,937</u>
LIABILITIES		
Current Liabilities:		
Annuity prizes payable (Note 5)	9,505,276	14,251,996
Prizes payable	24,688,243	24,916,067
Accounts payable (Note 4)	2,322,189	3,634,889
Due to other state programs (Note 4)	831,546	638,557
Lottery association payable	601,595	999,551
Unearned revenue	645,522	904,007
Due to other governments (Note 4)	54,768	52,621
Accrued payroll	128,368	120,468
Compensated absences (Note 17)	8,120	152,866
Total Current Liabilities	<u>38,785,627</u>	<u>45,671,022</u>
Noncurrent Liabilities:		
Annuity prizes payable (Note 5)	45,079,927	51,059,062
Compensated absences (Note 17)	571,797	441,451
Other postemployment benefits (Note 16)	394,548	297,448
Total Noncurrent Liabilities	<u>46,046,272</u>	<u>51,797,961</u>
TOTAL LIABILITIES	<u>84,831,899</u>	<u>97,468,983</u>
NET ASSETS		
Net Assets:		
Invested in capital assets (Note 10)	103,070	146,280
Restricted for MUSL reserves (Note 14)	4,023,428	4,045,087
Restricted for investment fair market value adjustment (Note 14)	9,981,733	8,520,083
Restricted for property tax relief (Note 14)	32,915,053	17,018,504
TOTAL NET ASSETS	<u>\$ 47,023,284</u>	<u>\$ 29,729,954</u>

The accompanying notes are an integral part of this statement.

Statement of Revenues, Expenses, and Changes in Fund Net Assets for the Years Ended June 30, 2010 and 2009

	Year Ended June 30, 2010	Year Ended June 30, 2009
OPERATING REVENUES		
Instant Ticket Sales (Net of allowances of \$512,149 and \$596,687, respectively) (Note 7)	\$ 273,271,670	\$ 276,797,708
Lotto Ticket Sales (Net of ticket discounts of \$148,003 and \$256,232, respectively) (Note 7)	207,670,334	196,616,546
Retailer Fees	54,455	65,045
Miscellaneous Revenue	72,723	194,172
Total Operating Revenues	481,069,182	473,673,471
OPERATING EXPENSES		
Program Expenses:		
Instant prize expense (Note 8)	172,832,182	177,966,273
Lotto prize expense (Note 8)	100,155,657	101,918,329
Retailer commissions and incentives	33,320,017	32,409,023
Instant and lotto vendor services	11,226,345	11,961,907
Product information costs	7,469,890	7,373,563
Instant ticket printing costs	3,465,809	3,492,915
Instant ticket delivery costs	689,449	722,908
Donated prize expense (Note 12)	57,902	89,417
Total Program Expenses	<u>329,217,251</u>	<u>335,934,335</u>
Administrative Expenses:		
Salaries and fringe benefits	5,670,783	5,980,062
Supplies and services	2,411,988	2,571,973
Depreciation expense	48,210	41,409
Total Administrative Expenses	<u>8,130,981</u>	<u>8,593,444</u>
Total Operating Expenses	337,348,232	344,527,779
NET OPERATING INCOME	143,720,950	129,145,692
NONOPERATING REVENUES (EXPENSES) AND OPERATING TRANSFERS		
Investment Income (Loss) (Note 6)	1,596,195	142,207
Miscellaneous Revenue (Note 12)	57,902	89,417
Net Income Before Transfers	145,375,047	129,377,316
Transfers:		
Transfers of lottery proceeds for property tax relief (Note 15)	(127,116,472)	(132,367,700)
Transfers in from General Fund (Note 18)	192,856	208,077
Transfer to Department of Health Services for compulsive gambling programs	(396,000)	(400,000)
Transfer to Department of Justice for law enforcement	(355,723)	(349,092)
Transfer to Department of Revenue for lottery credit administration	(275,752)	(272,854)
Transfers out to General Fund (Note 19)	(130,626)	(121,250)
CHANGE IN NET ASSETS	17,293,330	(3,925,503)
Total Net Assets—Beginning of the Year	<u>29,729,954</u>	<u>33,655,457</u>
Total Net Assets—End of the Year	<u>\$ 47,023,284</u>	<u>\$ 29,729,954</u>

The accompanying notes are an integral part of this statement.

Statement of Cash Flows for the Years Ended June 30, 2010 and 2009

	Year Ended June 30, 2010	Year Ended June 30, 2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash Received from Retailers	\$ 478,511,512	\$ 477,075,171
Cash Paid for Prizes	(287,768,471)	(294,846,631)
Cash Paid for Retailer Commissions and Incentives	(32,535,021)	(33,048,803)
Cash Paid/Received for MUSL Reserve Accounts	143,754	(106,187)
Cash Paid to Employees	(5,609,753)	(5,899,335)
Cash Paid to Suppliers	(26,440,141)	(25,865,646)
Net Cash Provided by Operating Activities	126,301,880	117,308,569
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Transfers of Proceeds for Property Tax Credit	(127,100,513)	(132,617,566)
Transfer of Proceeds for Law Enforcement	(346,079)	(348,400)
Transfer of Proceeds for Lottery Credit Administration	(281,632)	(267,547)
Transfer of Proceeds for Compulsive Gambling Programs	(396,000)	(400,000)
Transfers to the General Fund	(130,626)	(121,250)
Transfers from the General Fund	208,077	306,648
Net Cash Used by Noncapital Financing Activities	(128,046,773)	(133,448,115)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Cash Paid for Purchase of Equipment	(5,000)	(88,554)
Net Cash Used by Capital and Related Financing Activities	(5,000)	(88,554)
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest Received	100,870	979,515
Cash Received for Redemption of Bonds	13,305,000	17,125,059
Net Cash Provided by Investing Activities	13,405,870	18,104,574
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	11,655,977	1,876,474
Cash and Cash Equivalents—Beginning of the Year	28,033,035	26,156,561
Cash and Cash Equivalents—End of the Year	<u>\$ 39,689,012</u>	<u>\$ 28,033,035</u>

The accompanying notes are an integral part of this statement.

	Year Ended June 30, 2010	Year Ended June 30, 2009
RECONCILIATION OF NET OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Net Operating Income	\$ 143,720,950	\$ 129,145,692
Adjustments to Reconcile Net Operating Income to Net Cash Provided by Operating Activities:		
Depreciation expense	48,210	41,409
Noncash donated prize expense	57,902	89,417
Changes in assets and liabilities:		
Decrease (Increase) in receivables	(875,203)	2,658,735
Decrease (Increase) in MUSL reserve accounts	143,754	(106,187)
Decrease (Increase) in ticket inventory	(123,825)	(297,821)
Decrease (Increase) in prepaid expenses	(181,719)	(22,069)
Decrease (Increase) in Due from other state programs	7,811	83,696
Increase (Decrease) in prizes payable	(14,792,874)	(14,767,979)
Increase (Decrease) in unearned revenue	(258,485)	56,001
Increase (Decrease) in Due to other state programs	175,262	45,021
Increase (Decrease) in accounts payable	(1,314,726)	472,350
Increase (Decrease) in Lottery Association payable	(397,956)	(196,997)
Increase (Decrease) in Due to other governments	2,178	(21,513)
Increase (Decrease) in accrued payroll	7,901	(144,172)
Increase (Decrease) in compensated absences	(14,400)	118,848
Increase (Decrease) in other postemployment benefits	97,100	154,138
Total Adjustments	<u>(17,419,070)</u>	<u>(11,837,123)</u>
Net Cash Provided by Operating Activities	<u>\$ 126,301,880</u>	<u>\$ 117,308,569</u>
Noncash Activities:		
Net change in unrealized gains and losses	\$ 1,461,650	\$ (836,288)
Increase in fair market value of investments for prize annuities and annuities payable due to amortization	3,839,194	4,733,444

The accompanying notes are an integral part of this statement.

Notes to the Financial Statements

1. DESCRIPTION OF THE WISCONSIN LOTTERY

On April 7, 1987, by a 65 percent to 35 percent margin, Wisconsin voters ratified a constitutional amendment authorizing the creation of a lottery. The Wisconsin Lottery was created in December 1987 and is administered by the Lottery Division within the Department of Revenue. During FY 2009-10 and FY 2008-09, the Wisconsin Lottery administered scratch-off, pull-tab, and lotto games. Lotto games are games in which tickets are produced from a terminal located at a retailer's place of business (e.g., Powerball, Badger 5). In previous financial statements, "lotto games" were referred to as "online games." In order to avoid confusion with Internet gambling, which is prohibited by the Wisconsin Constitution, the term "lotto" is now used. The Wisconsin Constitution requires that the net proceeds from Wisconsin Lottery operations be used to provide local property tax relief.

The Wisconsin Lottery joined the Multi-State Lottery Association in June 1989. In FY 2009-10 and FY 2008-09, as a member of MUSL, the Wisconsin Lottery participated in two MUSL lotto games: Powerball (start date April 19, 1992) and Mega Millions (start date January 31, 2010). See Note 9 for information about MUSL.

During FY 2009-10 and FY 2008-09, the Wisconsin Lottery also sold tickets for five other lotto games: SuperCash! (start date February 4, 1991), Wisconsin's Very Own Megabucks (start date June 20, 1992), Daily Pick 3 (start date September 21, 1992), Daily Pick 4 (start date September 15, 1997), and Badger 5 (start date February 17, 2003).

In prior years, the Wisconsin Lottery has offered raffle-style games. However, the Wisconsin Lottery did not offer any raffle-style games during either FY 2009-10 or FY 2008-09.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Financial Reporting Entity and Basis of Presentation

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

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

B. Measurement Focus and Basis of Accounting

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

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

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

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

C. Cash and Cash Equivalents

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

D. Investments for Prize Annuities

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

E. Accounts Receivable

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

F. Due To or From Other State Programs

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

G. Ticket Inventory

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

H. Capital Assets

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

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

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

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

K. Compensated Absences

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

L. Ticket Sales Revenue Recognition

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

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

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

Ticket revenues for lotto games are recognized at the time the related drawings are held. The Wisconsin Lottery occasionally features lotto game promotions that offer bonus tickets, such as six tickets for the price of five. Revenue is recognized for all tickets sold, and a sales discount is used to record the value of the bonus tickets.

M. Prize Expenses

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

N. Retailer Commissions

Retailer commissions, which are classified as program expenses, were 5.5 percent for lotto ticket sales and 6.25 percent for instant scratch-off and instant pull-tab tickets during FY 2009-10 and FY 2008-09. Nonprofit organizations receive higher commissions.

O. Retailer Performance Program

In addition to the retailer commissions discussed in Note 2(N), the Wisconsin Lottery administers an incentive program for retailers that meet certain performance goals identified by the Wisconsin Lottery. This program began on January 1, 2000. Retailers must be in good standing and sell instant tickets to participate in the program, which in FY 2009-10 and FY 2008-09 had a winning ticket component, a short-term incentive component, and a sales goals incentive component. The total compensation provided to all retailers under the components of the program may not exceed 1.0 percent of gross revenues from the sale of instant and lotto lottery tickets and lottery shares, which are multiple-draw lotto tickets.

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

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

The sales goals incentive component allows participating retailers to earn additional commissions based on increased sales. Subject to certain restrictions and allowances, retailers earned up to 2.0 percent of the increase in quarterly sales compared to sales of the previous quarter for instant tickets and certain lotto non-jackpot games (SuperCash!, Daily Pick 3, Daily Pick 4, and Badger 5). Retailers also earn up to 10.0 percent of the increase in annual sales over the previous year. The 2.0 percent incentive payments are made quarterly, and the 10.0 percent payments are made annually. Because of the unpredictable nature of the lotto jackpot games (Wisconsin's Very Own Megabucks, Mega Millions, and Powerball) and raffle-style games, sales goals incentive program payments for them are calculated and made annually. The annual payments may be limited to ensure that total performance program payments are within the performance program cap of 1.0 percent of ticket revenues.

P. Administrative Expenses

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

Q. Disbursement of Lottery Proceeds for Property Tax Relief

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

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

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

R. Use of Estimates

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

3. DEPOSITS AND INVESTMENTS

The Wisconsin Lottery's cash and cash equivalents balance consists of cash deposited in the State's bank and shares in the State Investment Fund. The carrying amount of shares in the State Investment Fund, which approximates fair market value, was \$39,689,000 as of June 30, 2010, and \$28,033,000 as of June 30, 2009.

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

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

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. While the Wisconsin Lottery does not have a formal policy regarding its investments for prize annuities, it has chosen to follow MUSL's policy that requires all investments for prize annuities to be in the form of securities backed by the full faith and credit of the United States government or its agencies. All of the Lottery's total investments for prize annuities balance as of June 30, 2010, and June 30, 2009, consist of these types of securities.

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

Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the Wisconsin Lottery would not be able to recover the value of investments that are in possession of an outside party. As of June 30, 2010, and June 30, 2009, all of the assets in investments for prize annuities were held by the State's agent, U.S. Bank, in the State's name. Therefore, the investments are not considered to have custodial credit risk. Further, State Investment Fund shares included in the balance of cash and cash equivalents were not exposed to custodial credit risk as of June 30, 2010, or June 30, 2009.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of an investor's holdings in a single issuer. In accordance with MUSL's policies, all of the Wisconsin Lottery's investments for prize annuities as of June 30, 2010, and June 30, 2009, consisted of U.S. Treasury or Agency securities. In addition, concentration of credit risk requirements do not apply to pooled investments such as the State Investment Fund.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment or a deposit. Typically, this risk is higher in debt securities with longer maturities. The Wisconsin Lottery manages this risk by holding investments for prize annuities to maturity, at which time the fair value of the investment is equal to its stated maturity value. If an annuitant requests premature termination of an annuity that would necessitate an investment be redeemed prior to maturity, any loss or gain due to market fluctuations is passed through to the redeeming annuitant. Therefore, the Wisconsin Lottery has minimal interest rate risk exposure related to these investments, which consisted of U. S. Treasury and Agency investments with the following maturities as of June 30, 2010 and 2009:

<u>Maturity</u>	<u>Fair Value as of June 30, 2010</u>	<u>Fair Value as of June 30, 2009</u>
Less than 1 Year	\$ 9,681,260	\$13,265,489
1 to 5 Years	25,842,224	28,567,356
6 to 10 Years	21,100,396	21,433,604
More than 10 Years	<u>7,404,358</u>	<u>8,765,945</u>
Total	<u>\$64,028,238</u>	<u>\$72,032,394</u>

The State Investment Fund uses the weighted average maturity method to analyze interest rate risk. Its investment guidelines mandate that the weighted average maturity for the entire portfolio not exceed one year. The weighted average maturity of the entire State Investment Fund as of June 30, 2010, and June 30, 2009, complied with the investment guidelines.

4. ACCOUNTS RECEIVABLE AND ACCOUNTS PAYABLE BALANCES

Accounts receivable and accounts payable balances are disaggregated as follows:

A. Accounts Receivable

	<u>June 30, 2010</u>	<u>June 30, 2009</u>
Accounts Receivable:		
Retailers	\$20,145,493	\$19,247,381
Miscellaneous	<u>2,500</u>	<u>25,408</u>
Total Accounts Receivable	<u>\$20,147,993</u>	<u>\$19,272,789</u>
Due from Other State Programs:		
Transfers for Gaming	\$ 192,856	\$ 208,077
Miscellaneous	<u>10,736</u>	<u>18,547</u>
Total Due from Other State Programs	<u>\$ 203,592</u>	<u>\$ 226,624</u>

B. Accounts Payable

	<u>June 30, 2010</u>	<u>June 30, 2009</u>
Accounts Payable:		
Vendors	\$2,070,733	\$3,402,441
Prizes	235,279	55,300
Withholding on Prizes	(78,707)	89,729
Lottery Credit Administration	56,761	50,937
Law Enforcement	6,986	6,366
Miscellaneous	<u>31,137</u>	<u>30,116</u>
Total Accounts Payable	<u>\$2,322,189</u>	<u>\$3,634,889</u>
Due to Other State Programs:		
Farmland Tax Relief Credit	\$ 171,478	\$ 155,518
Employee Fringe Benefits	78,012	95,175
Withholding on Prizes	269,610	328,820
Lottery Credit Administration	5,919	10,327
Law Enforcement	16,848	10,673
Other State Programs	<u>289,679</u>	<u>38,044</u>
Total Due to Other State Programs	<u>\$ 831,546</u>	<u>\$ 638,557</u>
Due to Other Governments:		
Employee Fringe Benefits	\$ 45,230	\$ 47,471
Withholding on Prizes	4,417	0
Lottery Credit Administration	2,016	2,432
Law Enforcement	<u>3,105</u>	<u>2,718</u>
Total Due to Other Governments	<u>\$ 54,768</u>	<u>\$ 52,621</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 \$3,839,194 for FY 2009-10 and \$4,733,444 for FY 2008-09.

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

<u>Fiscal Year</u>	<u>FY 2009-10</u> <u>Total Payments</u>	<u>FY 2008-09</u> <u>Total Payments</u>
2009-10	\$ 0	\$14,563,529
2010-11	9,747,351	9,747,351
2011-12	7,284,396	7,284,396
2012-13	7,350,520	7,350,520
2013-14	6,304,983	6,304,983
2014-15	6,273,871	6,273,871
Subsequent Years	<u>38,923,707</u>	<u>38,923,707</u>
Total Future Prize Payments	75,884,828	90,448,357
Less: Present Value Adjustment	<u>21,299,625</u>	<u>25,137,299</u>
Present Value of Future Prize Payments	<u>\$54,585,203</u>	<u>\$65,311,058</u>

Annuity prizes payable activity for the fiscal years ended June 30, 2010, and June 30, 2009, 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>
2009-10	\$65,311,058	\$3,839,194	\$(14,565,049)	\$54,585,203	\$ 9,505,276
2008-09	77,555,373	4,733,444	(16,977,759)	65,311,058	14,251,996

6. INVESTMENT INCOME (LOSS)

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

	<u>FY 2009-10</u>	<u>FY 2008-09</u>
<u>Change in Fair Market Value:</u>		
Net Increase (Decrease) in Fair Market Value of Annuity Investments	\$5,300,844	\$3,897,156
Less: The Portion of the Increase (Decrease) in Fair Market Value of Annuity Investments Offset by the Increase in Annuity Prizes Payable from Amortization	<u>(3,839,194)</u>	<u>(4,733,444)</u>
Net Increase (Decrease) in Fair Market Value Recognized as Investment Income	<u>1,461,650</u>	<u>(836,288)</u>
<u>Interest Income:</u>		
Interest from State Investment Fund	88,412	832,941
Interest from MUSL Reserve Accounts	35,516	33,575
Miscellaneous Interest	<u>10,617</u>	<u>111,979</u>
Total Interest Income	<u>134,545</u>	<u>978,495</u>
Total Investment Income (Loss)	<u>\$1,596,195</u>	<u>\$ 142,207</u>

GASB Statement No. 31 requires investments to be reported at fair market value, with the increases or decrease in fair market value recognized as investment income (loss). In addition, the Wisconsin Lottery earns interest on its shares invested in the State Investment Fund and on its share of the MUSL reserve accounts. For additional information on MUSL reserve accounts, see Note 9.

7. INSTANT AND LOTTO TICKET SALES

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

	<u>FY 2009-10</u>	<u>FY 2008-09</u>
Instant Ticket Sales:		
Scratch-off	\$269,371,319	\$271,901,512
Pull-tab	<u>3,900,351</u>	<u>4,896,196</u>
Total Instant Ticket Sales	<u>\$273,271,670</u>	<u>\$276,797,708</u>
Lotto Ticket Sales:		
SuperCash!	\$ 27,235,898	\$ 27,408,417
Powerball	89,302,882	85,402,245
WI Very Own Megabucks	18,819,605	20,740,168
Daily Pick 3	26,197,958	26,264,605
Daily Pick 4	12,153,612	11,972,648
Badger 5	23,718,687	24,834,908
Mega Millions	10,254,569	0
General Sales and Discounts	<u>(12,877)</u>	<u>(6,445)</u>
Total Lotto Ticket Sales	<u>\$207,670,334</u>	<u>\$196,616,546</u>

8. INSTANT AND LOTTO PRIZE EXPENSE

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

	<u>FY 2009-10</u>	<u>FY 2008-09</u>
Instant Prize Expense:		
Scratch-off	\$170,121,896	\$174,497,499
Pull-tab	2,450,286	3,043,774
Super 2 nd Chance	<u>260,000</u>	<u>425,000</u>
Total Instant Prize Expense	<u>\$172,832,182</u>	<u>\$177,966,273</u>
Lotto Prize Expense:		
SuperCash!	\$ 12,703,446	\$ 18,452,849
Powerball	42,097,333	41,099,006
WI Very Own Megabucks	9,830,744	10,859,864
Daily Pick 3	12,287,480	13,611,750
Daily Pick 4	6,143,800	5,414,500
Badger 5	11,494,780	12,069,360
Raffle Games	0	1,000
Mega Millions	5,338,074	0
Super 2 nd Chance	<u>260,000</u>	<u>410,000</u>
Total Lotto Prize Expense	<u>\$100,155,657</u>	<u>\$101,918,329</u>

9. MULTI-STATE LOTTERY ASSOCIATION

A. Joint Venture Association

The Wisconsin Lottery is a member of the Multi-State Lottery Association, a nonprofit, government-benefit voluntary association. MUSL was established September 16, 1987, and has 33 member lotteries from 31 states, the District of Columbia, and the U.S. Virgin Islands. It is owned and operated by the member lotteries, which sell one or more games administered by the association. The association is controlled by its Board of Directors, consisting of the director or chief executive officer of each member lottery. Each MUSL member sells tickets through its licensed retailers and makes weekly wire transfers to MUSL in an amount equivalent to the member lottery's share of the weekly prize liability less the actual low-tier prize liability for tickets sold by the respective lottery. Until 2010, the Wisconsin Lottery participated in one MUSL game: Powerball. In 2010, 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. Multi-State Lottery Association Financial Position and Activity

The following schedule presents the summarized audited financial position and activity of MUSL as of June 30, 2010 and 2009, as audited by other auditors.

	<u>June 30, 2010</u>	<u>June 30, 2009</u>
Total Assets	<u>\$736,287,105</u>	<u>\$816,489,735</u>
Total Liabilities	\$735,783,000	\$815,695,384
Total Unrestricted Net Assets	<u>504,105</u>	<u>794,351</u>
Total Liabilities and Net Assets	<u>\$736,287,105</u>	<u>\$816,489,735</u>
Total Revenues	\$ 3,711,818	\$ 4,818,549
Total Expenses	(4,002,064)	(3,620,598)
Distribution to Member Lotteries	<u>0</u>	<u>(678,781)</u>
Increase (Decrease) in Unrestricted Net Assets	<u>\$ (290,246)</u>	<u>\$ 519,170</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. MUSL Reserve Accounts

The Wisconsin Lottery participates in two MUSL games: Powerball and Mega Millions. For Powerball, participating lotteries are required to transfer 50.0 percent of ticket sales to MUSL for a prize pool used to fund the payment of Powerball prizes and various Powerball contingencies. For Mega Millions, participating lotteries are also required to transfer 50.0 percent of ticket sales to MUSL for a prize pool. However, to fund contingencies, MUSL required participating lotteries to transfer an additional 1.0 percent of Mega Millions sales, excluding sales of the Megaplier, which is an additional feature of Mega Millions that players may purchase for a chance to multiply their winnings.

Prior to January 7, 2009, 56.5771 percent of the total Powerball prize pool funded the grand prize pool and 39.4229 percent funded the low-tier prize pool. Effective January 7, 2009, 61.0577 percent of the total Powerball prize pool funds the grand prize pool and 34.9423 percent funds the low-tier prize pool. The remaining 4.0 percent of the pool is used to fund contingencies. The 4.0 percent is first used to fund the Powerball set-aside reserve account until it reaches its cap of \$7.5 million. The 4.0 percent is next distributed to the Powerball Set Prize Reserve Account (SPRA) and the Powerball Prize Reserve Account (PRA) until they reach their caps of \$25 million and \$100 million, respectively (the Powerball PRA cap was raised from \$75 million to \$100 million effective January 7, 2009). When these caps are met, the 4.0 percent is added to the Powerball grand prize pool. For some drawings, the Powerball SPRA and PRA accounts are reduced when the actual prizes won are greater than the amounts available in the prize pools.

For Mega Millions, 63.60 percent of the total Mega Millions prize pool funds the grand prize pool and 36.40 percent funds the low-tier prize pool. The additional 1.0 percent of Mega Millions sales has been used to fund a Mega Millions PRA.

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 unreserved account (which also earns interest on its balance) and may be withdrawn by member lotteries.

The Wisconsin Lottery has the right to a refund of Wisconsin's share of PRA and SPRA balances if it withdraws from MUSL. The Wisconsin Lottery does not have the right to a refund of its share of the set-aside reserve account. Because the PRA and SPRA are refundable only upon withdrawal from MUSL, it is the practice of the Wisconsin Lottery to report the prize reserve balances as a restricted noncurrent asset (MUSL Reserve Accounts—Noncurrent). The total MUSL Reserve Accounts balances (current and noncurrent) are made up of the following:

	<u>June 30, 2010</u>	<u>June 30, 2009</u>
Powerball Prize Reserve Account	\$3,039,745	\$3,039,745
Mega Millions Prize Reserve Account	(29,565)	0
Powerball Set Prize Reserve Account	<u>1,013,248</u>	<u>1,005,342</u>
MUSL Reserve Accounts—Noncurrent	4,023,428	4,045,087
Balance of Unreserved Account (MUSL Reserve Accounts—Current)	<u>1,290,759</u>	<u>1,377,338</u>
Total MUSL Reserve Accounts	<u>\$5,314,187</u>	<u>\$5,422,425</u>

There was a negative balance in the Mega Millions PRA as of June 30, 2010, because prize payouts to Mega Millions winners were higher than anticipated during FY 2009-10. As a result, MUSL increased its requirement to transfer an additional amount to fund the Mega Millions PRA, from 1.0 percent of Mega Millions sales excluding Megaplier sales, to 2.5 percent of all Mega Millions sales including Megaplier sales effective December 1, 2010.

10. CAPITAL ASSETS

Capital asset activity for the fiscal year ended June 30, 2010, was as follows:

	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
Leasehold Improvements	\$159,724	\$ 0	\$ 0	\$159,724
Equipment	<u>774,680</u>	<u>5,000</u>	<u>0</u>	<u>779,680</u>
Total Capital Assets	<u>934,404</u>	<u>5,000</u>	<u>0</u>	<u>939,404</u>
Less Accumulated Depreciation for:				
Leasehold Improvements	91,149	12,071	0	103,220
Equipment	<u>696,975</u>	<u>36,139</u>	<u>0</u>	<u>733,114</u>
Total Accumulated Depreciation	<u>788,124</u>	<u>48,210</u>	<u>0</u>	<u>836,334</u>
Total Capital Assets, Net	<u>\$146,280</u>	<u>\$(43,210)</u>	<u>\$ 0</u>	<u>\$103,070</u>

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

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

11. OPERATING LEASES

The Wisconsin Lottery occupied a facility in Madison for storage and instant ticket operations under an operating lease during FY 2009-10 and FY 2008-09. The following schedule summarizes the future minimum lease payments required under the operating lease for this facility, which was initially a five-year lease that ran until August 31, 2009, with two optional three-year extensions. The Wisconsin Lottery exercised the first of these renewals effective February 2009, extending the lease through August 21, 2012.

	<u>June 30, 2010</u>	<u>June 30, 2009</u>
Fiscal Year Ending June 30, 2010	\$ 0	\$146,993
2011	148,267	148,267
2012	149,580	149,580
2013	<u>24,967</u>	<u>24,967</u>
Total Minimum Payments Required	<u>\$322,814</u>	<u>\$469,807</u>

Total operating lease expense amounted to \$146,993 for the fiscal year ended June 30, 2010, and \$145,756 for the fiscal year ended June 30, 2009.

12. DONATIONS

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

The total value of these items was \$57,902 for FY 2009-10 and \$89,417 for FY 2008-09. All donated items received in FY 2009-10 and FY 2008-09 were used as game prizes or at special events and are recorded as donated prize expense and nonoperating miscellaneous revenue on the financial statements.

13. CONTRACTUAL OBLIGATIONS

A. Scratch-off Tickets

The Wisconsin Lottery had an original contract for the period July 1, 2004, through June 30, 2006, with Scientific Games International, Inc., to print scratch-off tickets. This contract was renewed through June 30, 2009, and then extended through October 30, 2009. Under the contract, the Wisconsin Lottery purchased approximately \$3.1 million in scratch-off tickets in FY 2008-09. In October 2009, the Wisconsin Lottery signed new contracts for printing services with three vendors: Scientific Games International, Inc.;

GTECH Holdings Corporation; and Pollard Banknote Ltd. These three contracts are for the period November 1, 2009, through October 30, 2011, and the Wisconsin Lottery has three one-year renewal options for each contract. The Wisconsin Lottery purchased ticket printing services worth approximately \$3.1 million in FY 2009-10 under these contracts.

B. Pull-tab Tickets

The Wisconsin Lottery had original contracts for the period July 1, 2004, through June 30, 2006, with Pollard Banknote Ltd. and Scientific Games International, Inc., to print pull-tab tickets. These contracts were renewed through June 30, 2009, and then extended through October 30, 2009. Under these contracts, the Wisconsin Lottery purchased approximately \$393,500 in pull-tab tickets in FY 2008-09. 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 30, 2011, and the Wisconsin Lottery has three one-year renewal options for each contract. The Wisconsin Lottery purchased approximately \$222,500 in printing services in FY 2009-10 under these three contracts.

C. Gaming System Vendor

The Wisconsin Lottery has a contract with GTECH Holdings Corporation that supports a network of approximately 4,000 locations where lottery games are sold. The expiration date in the original contract was June 25, 2011, and provided the Wisconsin Lottery the option to extend the contract for two one-year renewal periods. On July 1, 2009, the Wisconsin Lottery exercised the option to extend the contract for two additional one-year periods through June 22, 2013. During FY 2008-09, GTECH received 2.54 percent of the price of each ticket sold, offset by claims for liquidated damages due to the Wisconsin Lottery. Liquidated damages are discussed further in Note 20. Expenses under this contract were approximately \$12.0 million in FY 2008-09. As part of the contract renewal, beginning on July 1, 2009, GTECH received 2.54 percent of total net sales of lotto and instant tickets, less \$1.0 million per each fiscal year, and offset by any claims for liquidated damages due to the Wisconsin Lottery. Expenses under this contract were approximately \$11.2 million in FY 2009-10.

D. Product Information Costs

The Wisconsin Lottery had a contract with Hoffman York, Inc., to provide informational advertising services through April 9, 2008, which was renewed through April 9, 2011. However, this contract was terminated early when the Lottery signed a new two-year contract with Hoffman York starting July 12, 2010, with an option to renew for three additional one-year periods. Under the combination of these contracts, the Wisconsin Lottery spent \$7.3 million during FY 2009-10, and \$7.2 million during FY 2008-09 on information advertising.

14. RESTRICTED NET ASSETS

The Wisconsin Lottery has restricted net assets related to capital assets of \$103,070 as of June 30, 2010, and \$146,280 as of June 30, 2009. The portion of restricted net assets related to capital assets is reported in detail in Note 10.

The Wisconsin Lottery has also restricted net assets related to the MUSL reserves as reported in detail in Note 9. Restricted net assets related to the MUSL reserves were \$4,023,428 as of June 30, 2010, and \$4,045,087 as of June 30, 2009.

In addition, the Wisconsin Lottery has restricted net assets for fair market value adjustments of investments of \$9,981,732 as of June 30, 2010, and \$8,520,083 as of June 30, 2009. The Wisconsin Lottery does not realize gains or losses from the change in fair market value of its annuity investments because it holds the investments until maturity to pay the annual annuity prize payments. Therefore, fair market value adjustments recognized as investment income as a result of applying GASB Statement No. 31, and any cash held for annuity prize payments, are restricted and are not available for distribution as property tax credits.

Finally, the Wisconsin Constitution requires net proceeds from the operations of the Wisconsin Lottery to be used to provide local property tax relief. In addition, balances from other gaming-related appropriations, including racing and charitable bingo operations, are transferred to the Lottery Fund for distribution in the form of property tax relief. The net proceeds and gaming-related transfers available for property tax relief make up the remainder of the restricted net assets and were \$32,915,053 as of June 30, 2010, and \$17,018,504 as of June 30, 2009.

15. DISTRIBUTION OF NET PROCEEDS

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

	<u>FY 2009-10</u>	<u>FY 2008-09</u>
Lottery and Gaming Tax Credit	\$112,785,815	\$117,796,949
Farmland Tax Relief Credit	<u>14,330,657</u>	<u>14,570,751</u>
Total Property Tax Relief Credits	<u>\$127,116,472</u>	<u>\$132,367,700</u>

16. EMPLOYEE RETIREMENT PLAN AND OTHER POSTEMPLOYMENT BENEFITS

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

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

The retirement plan requires employee contributions equal to specified percentages of qualified earnings based on the employee’s classification, plus employer contributions at a rate determined annually. The Wisconsin Lottery’s contributions to the plan were \$443,331 for FY 2009-10 and \$450,162 for FY 2008-09. The relative position of the Wisconsin Lottery in the Wisconsin Retirement System is not available because the Wisconsin Retirement System is a statewide, multi-employer plan.

In accordance with the provisions of GASB Statement No. 45, the State is required to report other postemployment benefit (OPEB) expenses, which the Wisconsin Lottery reports as part of salaries and fringe benefits expenses, and related liabilities in the financial statements and notes. OPEBs include such items as the implicit rate subsidy of retiree health insurance present in the contribution rates for existing employees under the State’s health insurance program, and the postemployment coverage in the State’s life insurance program. OPEB activity for the fiscal years ended June 30, 2010, and June 30, 2009, 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>
2009-10	\$297,448	\$ 97,100	\$0	\$394,548	\$0
2008-09	143,310	154,138	0	297,448	0

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

17. COMPENSATED ABSENCES

Compensated absence activity for the fiscal years ended June 30, 2010, and June 30, 2009, 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>
2009-10	\$594,317	\$138,467	\$(152,867)	\$579,917	\$ 8,120
2008-09	475,469	271,715	(152,867)	594,317	152,866

18. TRANSFERS IN FROM GENERAL FUND

Under Wisconsin Statutes, the unencumbered balances and related interest for the following appropriations are to be transferred to the Lottery Fund at the end of the fiscal year: the appropriation under s. 20.435(7)(kg), Wis. Stats., renumbered s. 20.435(5)(kg), Wis. Stats., for FY 2009-10, for the Department of Health Services' compulsive gambling awareness campaign; the appropriation under s. 20.455(2)(g), Wis. Stats., for the Department of Justice's gaming law enforcement; and the appropriations under ss. 20.505(8)(g) and 20.505(8)(jm), Wis. Stats., for general operations of the Department of Administration's Division of Gaming related to racing and bingo. The Wisconsin Lottery received \$192,856 from these transfers in FY 2009-10 and \$208,077 from these transfers in FY 2008-09.

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 \$130,626 in FY 2009-10 and \$121,250 in FY 2008-09 for this purpose.

20. LIQUIDATED DAMAGES

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

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

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

Of that \$250,000 credit for future upgrades, \$96,160 remained as of July 1, 2009, all of which was subsequently used during FY 2008-09 and FY 2009-10, as follows:

<u>Fiscal Year</u>	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>	<u>Used within One Year</u>
2009-10	\$58,240	\$0	\$(58,240)	\$ 0	\$ 0
2008-09	96,160	0	(37,920)	58,240	7,920

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Supplementary Information

Reconciliation of Lottery General Operations Expenses to the Budgetary Basis of Accounting for the Years Ended June 30, 2010 and 2009

	Year Ended June 30, 2010	Year Ended June 30, 2009
SALARIES AND FRINGE BENEFITS		
Per Financial Statement	\$ 5,670,783	\$ 5,980,062
Adjustments to Financial Statement Balance:		
Cash paid in FY 2008-09 but expensed in FY 2007-08	0	731,151
Cash paid in FY 2009-10 but expensed in FY 2008-09	1,021,707	(1,021,707)
Cash paid in FY 2010-11 but expensed in FY 2009-10	(1,113,978)	0
Reclassified fringe benefits to transfer out to General Fund	116,263	107,691
Budgetary Basis—Salaries and Fringe Benefits	<u>\$ 5,694,775</u>	<u>\$ 5,797,197</u>
SUPPLIES AND SERVICES AND PERMANENT PROPERTY		
Per Financial Statement:		
Product information costs	\$ 7,469,890	\$ 7,373,563
Instant ticket printing costs	3,465,809	3,492,915
Instant ticket delivery costs	689,449	722,908
Donated prize expense	57,902	89,417
Supplies and services	2,411,988	2,571,973
Depreciation expense	48,210	41,409
Total per Financial Statement	14,143,248	14,292,185
Adjustments to Financial Statement Balance:		
Depreciation expense	(48,210)	(41,409)
Donated prize expense	(57,902)	(89,417)
Cash paid in FY 2008-09 but expensed in FY 2007-08	0	(1,633,145)
Cash paid in FY 2009-10 but expensed in FY 2008-09	(1,620,514)	1,620,514
Cash paid in FY 2010-11 but expensed in FY 2009-10	1,751,492	0
Compulsive gambling payment not included above	396,000	400,000
Banking fees paid with Department of Administration's banking fees appropriation	0	(25,818)
Capitalized permanent property less disposals	5,000	88,554
Budgetary Basis—Supplies and Services and Permanent Property	<u>\$ 14,569,114</u>	<u>\$ 14,611,464</u>

Statutorily Defined Lottery Administrative Expenses for the Years Ended June 30, 2008 through 2010

	Year Ended June 30, 2010	Year Ended June 30, 2009	Year Ended June 30, 2008
ADMINISTRATIVE EXPENSES			
Instant and Online Vendor Services	\$ 11,226,345	\$ 11,961,907	\$ 12,366,125
Product Information Costs	7,469,890	7,373,563	7,415,528
Instant Ticket Printing Costs	3,465,809	3,492,915	3,564,913
Instant Ticket Delivery Costs	689,449	722,908	689,388
Donated Prize Expense	57,902	89,417	59,650
Salaries and Fringe Benefits	5,670,783	5,980,062	5,752,566
Supplies and Services	2,411,988	2,571,973	2,937,315
Depreciation Expense	48,210	41,409	41,586
Total Administrative Expenses as Determined in Accordance with s. 25.75(3)(b), Wis. Stats.	<u>\$ 31,040,376</u>	<u>\$ 32,234,154</u>	<u>\$ 32,827,071</u>
Gross Lottery Operating Revenues	<u>\$ 481,069,182</u>	<u>\$ 473,673,471</u>	<u>\$ 495,184,974</u>
Administrative Expenses as a Percentage of Lottery Operating Revenues	6.45%	6.81%	6.63%

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

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

Summary of Prize Expenses for the Years Ended June 30, 2006 through 2010

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

	Fiscal Year 2009-10		
	Prize Expense	Ticket Sales	Prize Expense as a Percentage of Sales
Instant Games	\$ 172,832,182	\$ 273,271,670	63.2%
Online Games	100,155,657	207,670,334	48.2
Total for Fiscal Year	\$ 272,987,839	\$ 480,942,004	56.8

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

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

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

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

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

Report on 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, 2010 and 2009, and have issued our report thereon dated April 25, 2011. 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

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

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

the Wisconsin Lottery's financial statements will not be prevented or will not be detected and corrected on a timely basis.

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


COMPLIANCE AND OTHER MATTERS

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

We noted certain matters pertaining to errors in the financial reporting process that we reported to the Wisconsin Lottery in a separate letter dated March 7, 2011.

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

April 25, 2011

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

May 3, 2011

Janice Mueller, State Auditor
Legislative Audit Bureau
22 East Mifflin St., Suite 500
Madison, WI 53703

Dear Ms. Mueller:

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

The Lottery accepts the program evaluation recommendations relating to measuring the effect of product information expenditures and to continuing the annual evaluation of its product information contractor.

I am pleased to note that since the Lottery became a part of the Department of Revenue in 1996 every financial audit has found the Lottery's financial statements in order without any material weaknesses in internal controls.

Again, thank you for your review of the finances and operations of the Lottery.

Sincerely,

A handwritten signature in cursive script that reads 'Richard G. Chandler'.

Richard G. Chandler
Secretary of Revenue

cc: Dean Swenson
Sherry Haakenson
Michael Edmonds