

## Wisconsin Lottery

Department of Revenue

July 2013

# Report Highlights ■

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

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

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

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

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

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

In conducting the program evaluation, we:

- examined trends in sales, operating revenues, and operating expenses;
- evaluated the development and management of instant games, which generate the largest share of lottery revenue; and
- evaluated the compensation paid to lottery retailers through commissions and the Retailer Performance Program.

## Revenues and Expenses

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

### Key Facts and Findings

*In FY 2011-12, the Wisconsin Lottery spent \$7.5 million to provide information about its products.*

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

*The Wisconsin Lottery continues to introduce higher-priced instant games, including a planned \$30 game in FY 2013-14.*

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

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

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

<b>Wisconsin Lottery Sales (in millions)</b>	
<u>Fiscal Year</u>	<u>Amount</u>
2007-08	\$494.7
2008-09	473.4
2009-10	480.9
2010-11	502.7
2011-12	547.6

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

In FY 2011-12, the Wisconsin Lottery's operating expenses totaled \$391.2 million and included \$320.1 million in prizes paid to winning ticket holders. Operating expenses increased by 8.6 percent from FY 2010-11 to FY 2011-12 because expenses generally increase as ticket sales increase.

Other expenses included retailer compensation, game development and production costs, product information costs, and staff salaries and fringe benefits. The number of full-time equivalent (FTE) positions authorized for the Wisconsin Lottery decreased from 97.85 in July 2008 to 82.70 in July 2012. However, an additional 4.0 FTE positions were authorized by 2013 Wisconsin Act 20, the 2013-15 Biennial Budget Act.

## **Property Tax Relief**

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

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

## **Lottery Game Management**

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

To improve instant game management, the Wisconsin Lottery decided to sell fewer games concurrently, ensure that an assortment of games is available at a number of different prices, and focus staff resources on developing new game styles, such as combining scratch-off and pull-tab games. The Wisconsin Lottery also continues to introduce higher-priced instant games in response to player demand. In FY 2013-14, the Wisconsin Lottery plans to introduce a \$30 scratch-off ticket for the first time.

Periodically, the Wisconsin Lottery pays licensing fees for the use of trademarked or copyrighted properties. These fees totaled \$710,900 for eight games it introduced from FY 2007-08 through FY 2009-10. We found that six of eight instant games for which the Wisconsin Lottery paid a license fee generated less net sales revenue than the average net sales revenue generated by games that sold for the same price during the same fiscal year but for which no license fee was paid.

While all lottery games generate revenue to be used for property tax relief, we question whether the additional expenses associated with trademarked and copyrighted properties maximizes the net revenue available for this purpose.

## **Retailer Compensation**

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

Retailers that sell Wisconsin Lottery tickets are compensated at statutorily established commission rates and through the Retailer Performance Program. The Retailer Performance Program has three components: a bonus for retailers that sell winning tickets, short-term incentives for retailers that purchase a certain number of tickets or upgrade the lottery products they offer, and sales incentives for retailers that increase their sales.

In FY 2011-12, the Wisconsin Lottery paid retailers \$32.7 million in commissions and a total of \$5.5 million through the Retailer Performance Program: \$4.2 million in sales incentives, \$1.1 million in winning ticket bonuses, and \$194,000 in short-term incentives.

Section 565.02(4)(g), Wis. Stats., requires that Retailer Performance Program payments not exceed 1.0 percent of total ticket sales. In FY 2011-12, the Wisconsin Lottery exceeded the statutory limit by \$54,800, or 0.01 percent.

Wisconsin Lottery officials attributed the overpayment to administrative and procedural errors and have taken steps to reduce the chance an overpayment occurs in the future by improving the reconciliation process between Wisconsin Lottery records and the State's accounting system.

Although it is difficult to quantify the effect of winning ticket bonuses and sales incentives on Wisconsin Lottery sales, each short-term incentive is developed with specific goals and estimates for return on expense. Wisconsin

Lottery officials calculate the return on expense as the increase in sales above what would have been expected if an incentive had not been offered. They indicated that a return on expense ratio of 3:1 is the minimum return a short-term incentive must generate for it to recover its costs and not affect the proceeds available for property tax relief.

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

## Recommendations

We include recommendations for the Wisconsin Lottery to:

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

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