

An Audit:

Wisconsin Lottery

Department of Revenue

May 2011

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
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Key Facts and Findings

From FY 2005-06 through FY 2009-10, ticket sales declined 5.5 percent.

Revenues and Expenses

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.

Wisconsin's per capita lottery sales ranked sixth among seven midwestern states in FY 2008-09.

The Wisconsin Lottery contracts for product information and operations services.

The Legislature annually appropriates \$7.5 million to the Wisconsin Lottery for product information.

The Wisconsin Lottery uses an evaluation tool to help develop and manage instant games.

Wisconsin Lottery Sales (in millions)	
<u>Fiscal Year</u>	<u>Amount</u>
2005-06	\$509.1
2006-07	492.8
2007-08	494.7
2008-09	473.4
2009-10	480.9

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.

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](#)).

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