

An Audit:

Wisconsin Lottery
Department of Revenue

May 2005

Report Highlights ■

From FY 1999-2000 through FY 2003-04, total sales increased 18.7 percent.

We issued an unqualified opinion on the Wisconsin Lottery's financial statements for FY 2002-03 and FY 2003-04.

We make several recommendations for game and contract management.

The Wisconsin Lottery generates most of its revenues from the sale of instant and on-line game tickets. More than 4,100 retailer locations currently sell lottery tickets in Wisconsin. Approximately \$2.2 billion in property tax relief has been provided through the Wisconsin Lottery and other gaming-related proceeds since 1988.

As directed by s. 13.94(1)(em), Wis. Stats., we completed a financial audit and program evaluation of the Wisconsin Lottery. For the financial audit, we evaluated internal controls, substantiated account balances, and verified compliance with state laws and regulations. We issued an unqualified opinion on the Wisconsin Lottery's financial statements for the years ended June 30, 2003 and 2004.

For the program evaluation we:

- examined trends in revenues and expenses;
- reviewed the Wisconsin Lottery's process to award the most recent instant ticket, on-line gaming, telecommunications, and internal control systems contracts;
- reviewed the development and management of instant games offered by the Wisconsin Lottery, focusing on the development of instant games affiliated with copyrighted or trademarked products; and
- assessed participation in a 2003 special prize drawing tied to the Powerball on-line game.

Key Facts and Findings

Approximately \$2.2 billion in property tax relief has been provided through the Wisconsin Lottery and other gaming-related proceeds since 1988.

Lottery ticket sales in FY 2003-04 totaled \$482.9 million.

Games affiliated with copyrighted or trademarked products have higher development costs and generate less revenue than unaffiliated games.

The Wisconsin Lottery lost approximately \$212,000 when it withdrew from a special Powerball prize drawing in 2003.

All contracts should include provisions to protect the Wisconsin Lottery when products are not delivered.

Lottery Revenues and Expenses

Wisconsin's 2002-03 per capita lottery sales were fifth among seven midwestern states. From fiscal year (FY) 1999-2000 to FY 2003-04, total ticket sales increased from \$406.7 million to \$482.9 million, or 18.7 percent. Instant game ticket sales, which have consistently represented over 50 percent of the Wisconsin Lottery's total sales, increased 12.1 percent, while on-line game ticket sales increased 28.4 percent. Revenues from all sources reached \$483.2 million in FY 2003-04.

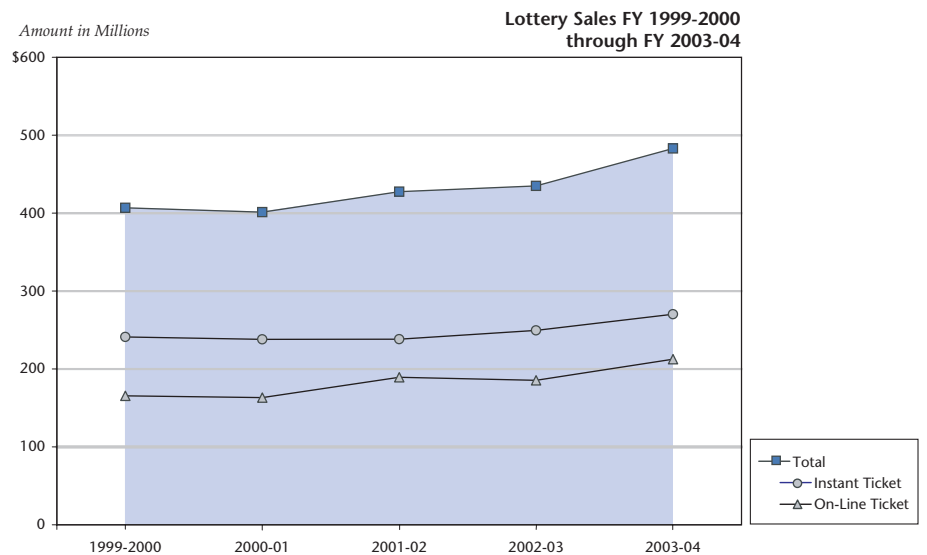
Operating expenses increased 17.0 percent, to \$342.4 million, from FY 1999-2000 to FY 2003-04. Administrative expenses have not exceeded 10 percent of gross revenues, as required by statutes, and the Legislature has limited expenses for

informational advertising to \$4.6 million annually since FY 1990-91.

Contract Award

In November 2003, the Wisconsin Lottery entered into a seven-year systems and services contract with GTECH Corporation. Two requests for proposals were issued for the contract; the first ended after appeals were filed contesting the Wisconsin Lottery's initial decision.

GTECH provides computer systems and services for instant ticket, on-line gaming, telecommunications, and internal control systems. We estimate that in FY 2004-05, payments to GTECH will total \$11.7 million. Under the terms of the previous contract, payments for similar services totaled \$15.9 million in FY 2003-04. All new systems required under



the terms of the current contract with GTECH were functioning in September 2004. However, the Wisconsin Lottery has not yet developed performance criteria for an annual review that is specified in the contract. Our report includes a recommendation for the development of formal review criteria.

Instant Game Development

The number of instant lottery games introduced each year increased from 37 in FY 1999-2000 to 59 in FY 2003-04.

In determining which instant games to develop and sell, the Wisconsin Lottery considers information from different sources, including studies that identify game player preferences, analyses of the effectiveness of informational advertising, in-house testing of potential games, and past sales from comparable games.

However, we found that more could be done to formalize policies and procedures that would improve the game development process, ensure consistent application of policy, and maximize sales of individual games.

Affiliated Instant Lottery Games

As part of its sales strategy, the Wisconsin Lottery sells affiliated instant games that are associated

with copyrighted or trademarked names or products. It must obtain permission from the party that holds the licensing rights to these properties and provide compensation through fees or by purchasing merchandise to be used as prizes.

We found that affiliated instant games are more costly to develop than other instant lottery games. From FY 1998-99 through FY 2002-03, development costs were 56.2 percent higher for affiliated than for unaffiliated games. They averaged \$107,900 for affiliated and \$69,100 for unaffiliated games.

Lottery officials indicate that affiliated games are intended to generate interest and sales by appealing to individuals who may not typically purchase lottery tickets. However, the Wisconsin Lottery does not have formal procedures to analyze costs and revenues associated with affiliated games.

Special Prize Drawing

To generate awareness of the Powerball on-line game, the Wisconsin Lottery decided in 2003 to participate in a special prize drawing to provide ticket and travel packages to the Super Bowl game held in February 2004. It joined 17 other members of the Multi-State Lottery Association (MUSL), a nonprofit organization that operates multi-state on-line lottery games, in the special prize drawing.

However, in response to a cease and desist letter issued by the National Football League to another MUSL member, the Wisconsin Lottery subsequently decided to withdraw from this special prize drawing. It was able to recover some costs it had already incurred, but others could not be recovered and an estimated \$212,000 was lost.

Before deciding to participate in this special prize drawing, the Wisconsin Lottery could have minimized its loss either by ensuring that the third party offering the prize package was contractually required to deliver the tickets, or by purchasing a performance bond to protect itself and its customers. Our report includes a recommendation for all vendor contracts to include guarantees that will protect the Wisconsin Lottery if products are not delivered.

Recommendations

Our recommendations address the need for the Wisconsin Lottery to:

- ☑ develop formal review criteria to evaluate, on an annual basis, GTECH's performance in complying with the current systems and services contract (*p. 20*);
- ☑ develop a written methodology to analyze costs and revenues for all instant games, including affiliated games (*p. 26*); and
- ☑ require all vendor contracts to provide guarantees that will protect it in the case of non-delivery of products (*p. 28*).

Additional Information

Report 05-8 includes a response from the Department of Revenue, call (608) 266-2818 or visit our Web site:



www.legis.state.wi.us/lab

Address questions regarding this report to:

[Julie Gordon](#),
Financial Audit Director

[Kate Wade](#),
Program Evaluation Director

(608) 266-2818

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Legislative Audit Bureau

22 East Mifflin Street
Suite 500
Madison, WI 53703
(608) 266-2818

Janice Mueller
State Auditor