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☛ Details: Legislative Audit Bureau Report 07-8: An Audit: Wisconsin Lottery, Department of Revenue

(FORM UPDATED: 08/11/2010)

## WISCONSIN STATE LEGISLATURE ... PUBLIC HEARING - COMMITTEE RECORDS

**2007-08**

(session year)

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\* Contents organized for archiving by: Stefanie Rose (LRB) (October 2012)



STATE OF WISCONSIN

Legislative Audit Bureau

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Janice Mueller  
State Auditor

DATE: June 25, 2007

TO: Lewis Rosser and Pamela Matthews  
Committee Clerks to the Joint Legislative Audit Committee

FROM: Bryan Naab, Deputy State Auditor for Financial Audit *BN*  
Kate Wade, Program Evaluation Director *KW*

SUBJECT: Report 07-8: An Audit: Wisconsin Lottery

Enclosed is our audit of the Wisconsin Lottery, which is a Division within the Department of Revenue. The report contains our annual financial audit and biennial program evaluation, both of which are required by s.13.94(1)(em), Wis. Stats. We issued an unqualified opinion on the Wisconsin Lottery's financial statements for fiscal years (FY) 2005-06 and 2004-05.

Sales increased from \$427.6 million in FY 2001-02 to \$509.0 million in FY 2005-06, an increase of 19.0 percent. During this same five-year period, operating expenses increased from \$305.3 million to \$358.2 million, or by 17.3 percent. Net proceeds from the Wisconsin Lottery provided \$133.3 million in property tax relief in FY 2005-06. Although lottery officials project that sales will decline to \$489.7 million in FY 2006-07, they currently project total sales to reach \$504.7 million in FY 2007-08.

In our 2005 biennial evaluation (report 05-8), we noted that the Lottery could strengthen its annual review of GTECH Corporation, the firm with which the Lottery has a seven-year contract for both instant and on-line ticket services and telecommunications. Through FY 2005-06, GTECH has received \$24.1 million under the current contract. The first formal annual performance review, completed in March 2007, noted numerous unresolved programming changes, most of which GTECH has agreed to address by July 2007.

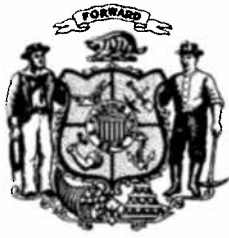
As we recommended in report 05-8, the Lottery has strengthened its game management by implementing an evaluation tool to analyze instant game costs and revenues. Lottery staff manage the mix of games in order to maximize sales and the net proceeds available for property tax relief. From FY 2001-02 through FY 2005-06, the number of higher-priced games introduced each year has increased from four instant games priced at \$5 or more to 15 games at \$5 or more, including two \$20 games. The Lottery has also continued to generate somewhat higher revenues for games affiliated with well-known or popular products.

In report 02-9, we reviewed the Retailer Performance program, which pays incentives to retailers who sell lottery tickets. Lottery officials estimate that one of the three incentives, short-term incentives, generated an additional \$4.4 million in sales in FY 2005-06. It also appears the Retailer Performance program has been more effective in retailer retention than in increasing the number of retail locations selling lottery tickets, as the number of retail locations has decreased from 4,255 in 2000 to 4,236 in 2006.

The report will be released on Tuesday, June 26, at 9:00 a.m. Please contact us if you have any questions.

KW/BN/kc

Enclosures

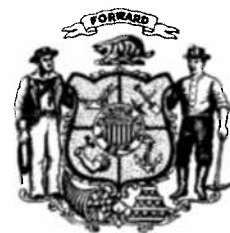


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**Report 07-8  
June 2007**

An Audit

# **Wisconsin Lottery**

*Department of Revenue*

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Reports are submitted to the Joint Legislative Audit Committee and made available to other committees of the Legislature and to the public. The Audit Committee may arrange public hearings on the issues identified in a report and may introduce legislation in response to the audit recommendations. However, the findings, conclusions, and recommendations in the report are those of the Legislative Audit Bureau. For more information, write the Bureau at 22 E. Mifflin Street, Suite 500, Madison, WI 53703, call (608) 266-2818, or send e-mail to [leg.audit.info@legis.wisconsin.gov](mailto:leg.audit.info@legis.wisconsin.gov). Electronic copies of current reports are available on line at [www.legis.wisconsin.gov/lab](http://www.legis.wisconsin.gov/lab).

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State Auditor – Janice Mueller

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From the Department of Revenue	
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Janice Mueller  
State Auditor

June 26, 2007

Senator Jim Sullivan and  
Representative Suzanne Jeskewitz, Co-chairpersons  
Joint Legislative Audit Committee  
State Capitol  
Madison, Wisconsin 53702

Dear Senator Sullivan and Representative Jeskewitz:

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. We have issued an unqualified opinion on financial statements prepared by the Wisconsin Lottery for fiscal year (FY) 2005-06 and FY 2004-05.

Over the past five years, total sales increased 19.0 percent, from \$427.6 million in FY 2001-02 to \$509.0 million in FY 2005-06. Net lottery proceeds provided \$133.3 million in property tax relief in FY 2005-06.

To maximize revenue from sales and increase the net proceeds available to fund property tax relief, the Wisconsin Lottery seeks to maintain player interest by offering a variety of games at different prices. It has improved its instant game development and management practices since our 2005 evaluation (report 05-8) and modified the Retailer Performance program, which provides performance-based incentives to retailers.

The annual product information budget for the Wisconsin Lottery has been \$4.6 million since FY 1990-91. Proposals are pending in the Legislature to increase the product information budget to \$7.5 million annually.

We appreciate the courtesy and cooperation extended to us by Wisconsin Lottery staff in the Department of Revenue. The Department's response follows the appendices.

Respectfully submitted,

Janice Mueller  
State Auditor

JM/KW/ss



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## Report Highlights ■

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***We have issued an unqualified opinion on the Wisconsin Lottery's financial statements for FY 2005-06 and FY 2004-05.***

***In FY 2005-06, ticket sales totaled \$509.0 million.***

***In FY 2005-06, the Wisconsin Lottery provided \$133.3 million in property tax relief.***

***Game management practices have been improved.***

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 sold at more than 4,200 retailer locations in Wisconsin, and net lottery proceeds provided \$133.3 million in property tax relief in fiscal year (FY) 2005-06.

We have completed both a financial audit and a program evaluation of the Wisconsin Lottery, as directed by s. 13.94(1)(em), Wis. Stats., and have issued an unqualified opinion on its financial statements for the years ended June 30, 2006 and 2005. As part of our financial audit, we evaluated internal controls, substantiated account balances, and tested for compliance with state laws and regulations. To complete our program evaluation, we also reviewed:

- trends in lottery sales and operating expenses;
- responses to our prior recommendations related to contracting for certain lottery operations;
- the development and management of "instant" pull-tab and scratch-off games, which generate the largest share of lottery revenue; and
- the Retailer Performance program, which provides up to 1.0 percent of gross lottery sales revenues as incentives to increase retailer participation and ticket sales.

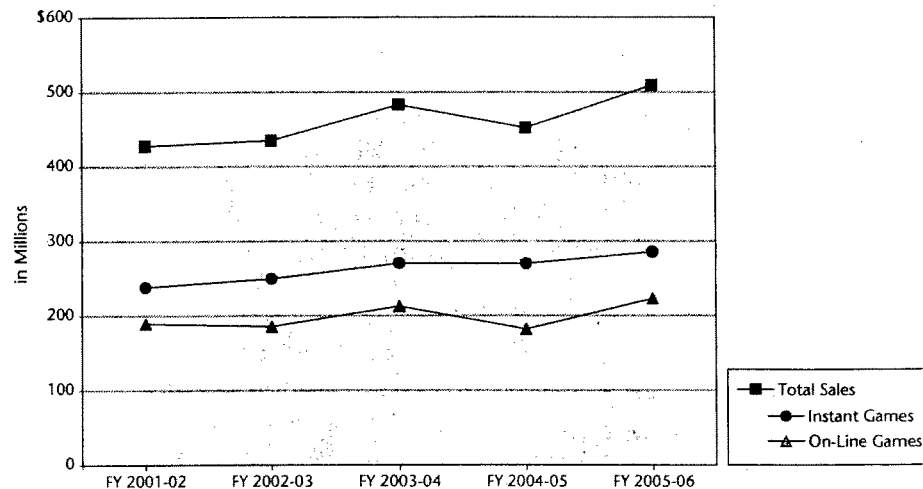
## Revenues and Expenses

Ticket sales are the Wisconsin Lottery's primary revenue source. They totaled \$509.0 million in FY 2005-06, when total operating revenues were \$509.2 million.

Total ticket sales have increased 19.0 percent over the past five fiscal years, although on-line game sales have fluctuated, as shown in Figure 1. Sales of instant scratch-off and pull-tab game tickets increased 19.9 percent, from \$238.2 million in FY 2001-02 to \$285.7 million in FY 2005-06. For on-line games, ticket sales increased 17.9 percent, from \$189.4 million to \$223.3 million.

Figure 1

### Lottery Sales



Wisconsin was one of two midwestern states in which per capita lottery sales declined from FY 2003-04 to FY 2004-05. It was fifth among seven midwestern states in per capita lottery sales in both years, which are the most recent for which comparative data were available at the time of our fieldwork.

In FY 2005-06, the Wisconsin Lottery's operating expenses totaled \$358.2 million. They include prizes paid to winning ticket holders; retailer compensation, including commissions and incentives; game development and production costs; administrative expenses, including the costs of staffing and supplies; and the costs of product information services provided by an advertising firm.

Over the past five fiscal years, operating expenses increased 17.3 percent, primarily because of increases in prizes and retailer compensation, which rose as sales increased. Administrative expenses have not exceeded the statutory limit of 10.0 percent of gross revenues and have declined annually since FY 2001-02.

### **Operations Contract**

One of the Wisconsin Lottery's largest expenses is a seven-year contract with GTECH Corporation for telecommunications and instant and on-line ticket validation and tracking. Through FY 2005-06, GTECH has been paid \$24.1 million under a contract that took effect in June 2004.

The current contract includes provisions for ongoing performance monitoring and a formal annual review. However, the Wisconsin Lottery did not establish annual performance review criteria for GTECH in a timely manner, as we had recommended in 2005, and did not complete its first formal performance evaluation until March 2007.

Performance grades for calendar year 2006 varied from "fair" in resolving software defects to "excellent" in network availability. The evaluation noted that as of October 2006, GTECH had not resolved 125 requests for programming changes. In its response, GTECH indicated that a software update in July 2007 would reduce the number of outstanding programming changes to 25.

### **Game Development and Management**

Effective game development and management help to maximize sales revenue and increase the net proceeds available to fund property tax relief. To maintain player interest, the Wisconsin Lottery has increasingly introduced new instant games: 60 new games were introduced in FY 2005-06, compared to 48 in FY 2001-02.

The number of higher-priced games has also increased over the past five years. In FY 2001-02, four instant games were priced at \$5 or more. In FY 2005-06, 15 higher-priced games were introduced, including two instant games priced at \$20.

Instant games affiliated with certain well-known or popular products typically involve special prize opportunities that are intended to generate player interest. To develop and sell these affiliated games, the Wisconsin Lottery must obtain licensing rights and must compensate the owners of copyrighted or trademarked

property, either through fees or by purchasing merchandise to be used as prizes. It also enters into partnership agreements with entities such as the Wisconsin State Fair, to create related games and engage in joint advertising opportunities.

We found that from FY 2001-02 through FY 2005-06, average per game sales were somewhat higher for affiliated games than for unaffiliated games. As we recommended in 2005, the Wisconsin Lottery has implemented an evaluation tool to analyze instant game costs and revenues, and thereby improve its game development and management.

### **Retailer Compensation**

By statute, retailers that sell Wisconsin Lottery tickets receive commissions of 5.5 percent of on-line ticket sales and 6.25 percent of instant ticket sales. In addition, the Wisconsin Lottery's Retailer Performance program offers retailers up to 1.0 percent of gross lottery sales revenue as performance-based incentives. The program has three components: a winning ticket incentive, short-term incentives, and a sales goals incentive.

In FY 2005-06, retailers were paid \$4.6 million in incentives, an increase of 15.0 percent from the previous fiscal year. Wisconsin Lottery officials estimate that in FY 2005-06, short-term incentives generated \$4.4 million in additional sales.

### **2007-09 Budget Considerations**

The Wisconsin Lottery is constitutionally prohibited from spending public funds or revenues derived from its operations for promotional advertising. However, providing information about the chances of winning lottery games, their prize structures, and other product information is permitted.

The annual product information budget has been \$4.6 million since FY 1990-91. As part of 2007-09 biennial budget deliberations, the Legislature is considering a proposed increase to \$7.5 million annually.

■■■■