

**Report 17-15
August 2017**

Wisconsin Lottery

Fiscal Year 2015-16

STATE OF WISCONSIN



Legislative Audit Bureau ■

Wisconsin Lottery

Fiscal Year 2015-16

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STATE OF WISCONSIN | Legislative Audit Bureau

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Joe Chrisman
State Auditor

August 29, 2017

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 a financial audit of the Wisconsin Lottery, which is administered by the Wisconsin Department of Revenue. We have provided an unmodified opinion on the Wisconsin Lottery's fiscal year (FY) 2015-16 and FY 2014-15 financial statements.

Sales of instant and lotto tickets increased from \$574.6 million in FY 2014-15 to \$627.1 million in FY 2015-16, or by 9.1 percent. This increase is primarily attributed to a record Powerball jackpot in January 2016. As ticket sales increase, Wisconsin Lottery expenses also increase. Operating expenses increased from \$415.4 million in FY 2014-15 to \$451.9 million in FY 2015-16, or by 8.8 percent.

The Wisconsin Constitution requires that net proceeds from the Wisconsin Lottery be used exclusively for property tax relief for Wisconsin residents. During FY 2015-16, lottery proceeds used for property tax relief totaled \$158.1 million. In September 2016, the Wisconsin Department of Administration and the Legislature's Joint Committee on Finance authorized the use of \$185.3 million in Wisconsin Lottery proceeds for property tax relief during FY 2016-17.

We identified a significant deficiency in the Department of Administration's centralized cash reconciliations, which are relied upon by the Department of Revenue for the Wisconsin Lottery. This issue is included in our Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters, which is on page 59.

We appreciate the courtesy and cooperation extended to us by Department of Revenue staff in completing this audit.

Respectfully submitted,

A handwritten signature in cursive script, appearing to read 'Joe Chrisman'.

Joe Chrisman
State Auditor

JC/KE/ss

Introduction ■

The Wisconsin Lottery began operations in September 1988, after Wisconsin voters adopted a constitutional amendment in 1987 that allowed the Legislature to create a state lottery with net proceeds to be distributed for property tax relief. Since 1995, the Department of Revenue has managed the Wisconsin Lottery. As required by s. 13.94 (1) (em), Wis. Stats., we have completed a financial audit of the Wisconsin Lottery and have provided an unmodified opinion on its financial statements for the years ended June 30, 2016, and June 30, 2015. We reviewed ticket sales, operating expenses, property tax relief funded by net proceeds available from the Wisconsin Lottery, and compliance with selected statutory provisions.

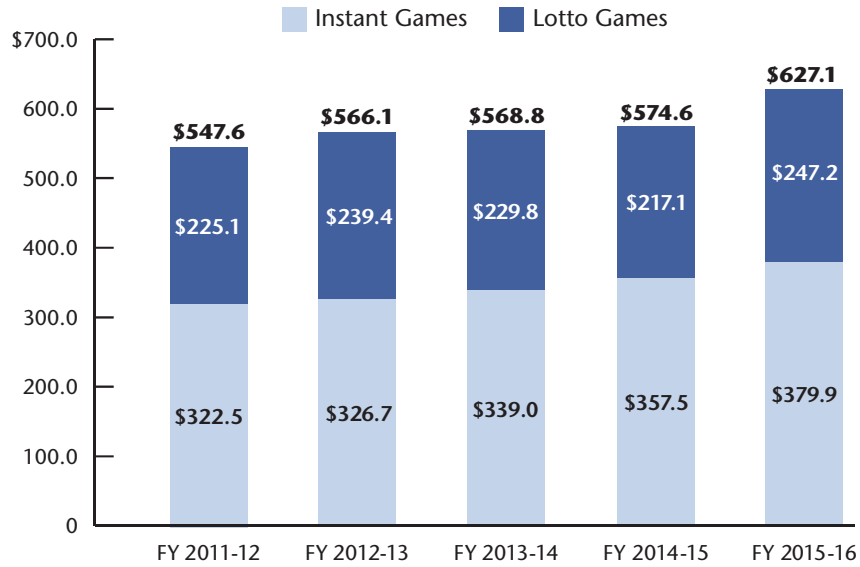
Wisconsin Lottery Ticket Sales

From FY 2014-15 to FY 2015-16, ticket sales increased by 9.1 percent to \$627.1 million.

As shown in Figure 1, the Wisconsin Lottery's ticket sales increased from \$574.6 million in fiscal year (FY) 2014-15 to \$627.1 million in FY 2015-16, or by 9.1 percent. Sales of instant tickets, which are scratch-off and pull-tab tickets, increased by \$22.4 million, or by 6.3 percent. Lotto sales increased \$30.1 million, or 13.9 percent, which was primarily the result of the record jackpot of \$1.5 billion for Powerball in January 2016.

Figure 1

Wisconsin Lottery Ticket Sales
(in millions)



Wisconsin Lottery Operating Expenses

From FY 2014-15 to FY 2015-16, the Wisconsin Lottery's operating expenses increased by 8.8 percent to \$451.9 million.

The Wisconsin Lottery's largest expenses are prizes and retailer compensation, which includes commissions and incentives that are paid to retailers to promote higher ticket sales. As shown in Table 1, the Wisconsin Lottery's operating expenses increased from \$415.4 million in FY 2014-15 to \$451.9 million in FY 2015-16, or by 8.8 percent, primarily because expenses for instant and lotto prizes increased as instant and lotto ticket sales increased.

Table 1

Wisconsin Lottery Operating Expenses
(in millions)

Operating Expense Type	FY 2011-12	FY 2012-13	FY 2013-14	FY 2014-15	FY 2015-16
Prize Expenses	\$320.1	\$329.2	\$336.7	\$342.4	\$372.5
Retailer Compensation	38.2	39.2	38.4	39.6	43.5
Game Development and Production	17.4	18.2	18.0	17.8	19.4
Product Information	7.5	7.5	7.5	7.5	7.5
Other ¹	8.0	8.2	8.1	8.1	9.0
Total	\$391.2	\$402.3	\$408.7	\$415.4	\$451.9

¹ Includes staff salaries, fringe benefits, supplies and services, and depreciation.

Game development and production expenses include donated prize expense, instant game ticket printing and delivery costs, and payments to IGT Global Solutions Corporation (IGT), which provides an integrated gaming computer system to account for instant and lotto game activity and to network with retailer terminals. Although game development and production expenses did decrease slightly in FY 2013-14 and FY 2014-15, game development and production expenses have generally increased as ticket sales have increased. The Wisconsin Lottery paid IGT approximately \$12.8 million in FY 2014-15 and \$14.5 million in FY 2015-16.

In FY 2015-16, the Wisconsin Lottery spent \$7.5 million to provide information about its products.

The Wisconsin Constitution prohibits public funds or revenues derived from lottery operations from being spent for promotional advertising and requires that any advertising provide only information about the prize structures and chances of winning. The Wisconsin Lottery's annual product information budget, which is established through the State's biennial budget, has remained unchanged at \$7.5 million since FY 2007-08. The Wisconsin Lottery spent \$7.5 million on product information in both FY 2014-15 and FY 2015-16.

Property Tax Relief

From its inception in 1988 through FY 2015-16, the Wisconsin Lottery has provided \$4.0 billion in property tax relief.

The Wisconsin Constitution requires that net proceeds from the Wisconsin Lottery be used exclusively for property tax relief. The proceeds are largely distributed to owners of primary residences in Wisconsin through the Lottery and Gaming Tax Credit. In FY 2015-16, \$158.1 million in lottery proceeds were used to fund the Lottery and Gaming Tax Credit, as shown in Table 2. The Department of Administration and the Legislature's Joint Committee on Finance authorized in September 2016 the use of \$185.3 million in Wisconsin Lottery proceeds for the FY 2016-17 Lottery and Gaming Tax Credit. From its inception in 1988 through FY 2015-16, the Wisconsin Lottery has provided \$4.0 billion in property tax relief.

Table 2

Property Tax Relief¹ (in millions)

Fiscal Year	Lottery and Gaming Tax Credit	Farmland Tax Relief Credit ²	School Levy Tax Credit ³	Total Distributed
2011-12	\$135.0	\$0.0	\$14.9	\$149.9
2012-13	141.0	0.0	14.9	155.9
2013-14	168.4	0.0	0.0	168.4
2014-15	166.4	0.0	0.0	166.4
2015-16	158.1	0.0	0.0	158.1
Total	\$768.9	\$0.0	\$29.8	\$798.7

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.

² Use of Wisconsin Lottery proceeds for this program was discontinued after December 2009. Small payments continue as taxpayers amend or file late tax returns.

³ General purpose revenue replaced the use of Wisconsin Lottery proceeds to fund this program beginning in FY 2013-14. Use of Wisconsin Lottery proceeds for this program was limited to FY 2011-12 and FY 2012-13.

The total distributed for property tax relief increased between FY 2011-12 and FY 2013-14, partly due to increased ticket sales. However, the total distributed for property tax relief decreased in both FY 2014-15 and FY 2015-16. The total distributed for property tax relief is authorized early in the fiscal year and is based on an estimate of proceeds that will be available for distribution. Fewer proceeds were anticipated to be available for distribution in both

FY 2014-15 and FY 2015-16, and the property tax relief therefore decreased in each of those years.

Statutory Requirements

State statutes impose limitations on certain types of lottery expenses. For example, s. 25.75 (3) (a), Wis. Stats., requires that at least 50 percent of lottery sales be used as prize payments to players. As shown in Table 3, the Wisconsin Lottery's prize expenses have exceeded 50 percent of ticket sales, in compliance with the statutory requirement, from FY 2011-12 through FY 2015-16. Prize expenses have fluctuated because of changes in the types of games offered and played. Lotto game prize payments, which are dependent on jackpot amounts and the frequency of winners claiming prizes, tend to fluctuate more than payments for instant games.

Table 3

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

Fiscal Year	Prize Expenses	Ticket Sales	Prize Expenses as a Percentage of Ticket Sales
2011-12	\$320.1	\$547.6	58.5%
2012-13	329.2	566.1	58.2
2013-14	336.7	568.8	59.2
2014-15	342.4	574.6	59.6
2015-16	372.5	627.1	59.4

The Wisconsin Lottery's administrative expenses were below the statutory limit from FY 2011-12 through FY 2015-16.

Section 25.75 (3) (b), Wis. Stats., provides that certain administrative expenses may not exceed 10 percent of gross lottery revenues. Gross lottery revenues for this calculation are statutorily defined to consist of instant and lotto ticket sales and retailer fees. Statutory administrative expenses include most expenses and transfers, except prize payments; retailer compensation; transfers to property tax relief; and transfers to the Wisconsin Department of Justice for lottery-related law enforcement activities. As shown in Table 4, the Wisconsin Lottery's administrative expenses remained below the statutory limit from FY 2011-12 through FY 2015-16.

Table 4

Administrative Expenses as a Percentage of Lottery Revenues¹
(in millions)

Fiscal Year	Statutorily Defined Administrative Expenses	Lottery Revenues ²	Percentage of Lottery Revenues
2011-12	\$33.6	\$547.7	6.1%
2012-13	34.6	566.2	6.1
2013-14	34.3	568.9	6.0
2014-15	34.1	574.7	5.9
2015-16	36.6	627.2	5.8

¹ Section 25.75 (3) (b), Wis. Stats., provides that certain administrative expenses may not exceed 10 percent of gross lottery revenues.

² Lottery revenues represent the total operating revenues net of allowances and discounts, which is an approximate but smaller amount than the amount to be used in this calculation as defined by s. 25.75 (3) (b), Wis. Stats.

***The Wisconsin Lottery
spent \$6.0 million in
Retailer Performance
Program payments in
FY 2015-16.***

Statutes establish maximum compensation rates for basic commissions and performance program payments to retailers who sell lottery tickets. Basic commission rates, as established in s. 565.10 (14) (b), Wis. Stats., are currently 5.5 percent of the retail price for lotto tickets and 6.25 percent for instant tickets. In addition, s. 565.02 (4) (g), Wis. Stats., authorizes a performance program to provide incentives to retailers and requires that payments not exceed 1.0 percent of gross revenues from the sale of lottery tickets. Table 5 shows the Wisconsin Lottery's Retailer Performance Program payments from FY 2011-12 through FY 2015-16. The Wisconsin Lottery spent \$6.0 million in Retailer Performance Program payments in FY 2015-16.

Table 5

Retailer Performance Program Payments as a Percentage of Ticket Sales¹
(in millions)

Fiscal Year	Retailer Performance Program Payments	Ticket Sales ²	Payments as a Percentage of Ticket Sales
2011-12	\$5.5	\$547.6	1.0% ³
2012-13	5.2	566.1	0.9
2013-14	4.4	568.8	0.8
2014-15	5.1	574.6	0.9
2015-16	6.0	627.1	1.0

¹ Section 565.02 (4) (g), Wis. Stats., authorizes a performance program to provide incentives to retailers and requires that payments not exceed 1.0 percent of gross revenues from the sale of lottery tickets.

² Ticket sales represent the total ticket sales net of allowances and discounts, which is an approximate but smaller amount than the amount to be used in this calculation as defined by s. 565.02 (4) (g), Wis. Stats.

³ In FY 2011-12, the Wisconsin Lottery exceeded the statutory limit on payments under the Retailer Performance Program by \$54,800, or less than 0.01 percent.

The Retailer Performance Program includes a bonus for retailers that sell winning tickets, short-term incentives for retailers that increase ticket sales of certain games for specific time periods, and sales incentives for retailers that increase ticket sales. During FY 2015-16, performance payments for the sales incentives accounted for 73.5 percent of the total incentive payments, followed by winning ticket bonuses and short-term incentives accounting for 19.1 percent and 7.4 percent, respectively. The Wisconsin Lottery offered seven short-term incentives during FY 2015-16. Total payments for each of these short-term incentives ranged from \$934 to \$143,850, and the number of retailers who participated in each of these short-term incentives ranged from 168 retailers to all retailers, which is approximately 3,700.

In addition to limitations on certain types of lottery expenses, state statutes prescribe various transfers to and from the Wisconsin Lottery. Unencumbered balances and related interest for the following appropriations are to be transferred to the Wisconsin Lottery at the end of the fiscal year: the appropriation for the Department of Health Services' compulsive gambling awareness campaigns, under s. 20.435 (5) (kg), Wis. Stats.; the appropriation for the Department of Justice's gaming law enforcement, under s. 20.455 (2) (g), Wis. Stats.; and the appropriations for general

operations of the Department of Administration's Division of Gaming related to racing and bingo, under s. 20.505 (8) (g) and (jm), Wis. Stats. The Wisconsin Lottery received \$23,505 from these transfers in FY 2014-15 and \$557 from these transfers in FY 2015-16. In addition, the Wisconsin Lottery is required to transfer amounts to the General Fund related to annual appropriation bonds issued by the State of Wisconsin to pay off certain unfunded liabilities in the pension and other employee benefit programs. The Wisconsin Lottery transferred \$216,849 in FY 2015-16 for this purpose.

Events Subsequent to FY 2015-16

Beginning in May 2017, IGT began to provide multiple services under a new contract, including a new integrated gaming computer system; the printing, storage, and delivery of certain instant tickets and supplies; and customer service, technical support, and sales support services for retailers. These services had previously been provided under multiple contracts with a variety of vendors or by Wisconsin Lottery staff. The seven-year contract requires the Wisconsin Lottery to pay IGT 2.57 percent of total net sales each year. The Wisconsin Lottery discusses contractual obligations in Note 10 to the financial statements on page 47.

In June 2017, two individuals pleaded guilty to illegal activities related to a 2007 drawing for the Wisconsin's Megabucks lotto game. The Wisconsin Lottery discusses this matter, and the steps it has taken to address it, within its Management's Discussion and Analysis, which begins on page 17.

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Audit Opinion ■



Independent Auditor's Report on the Financial Statements and Other Reporting Required by *Government Auditing Standards*

Senator Robert Cowles and
Representative Samantha Kerkman, Co-chairpersons
Joint Legislative Audit Committee

Mr. Richard G. Chandler, Secretary
Ms. Cindy Polzin, Lottery Administrator
Department of Revenue

Report on the Financial Statements

We have audited the accompanying financial statements and the related notes of the Wisconsin Lottery as of and for the years ended June 30, 2016, and June 30, 2015, as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management of the Department of Revenue and the Wisconsin Lottery are responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America. This includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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*, which is 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes

evaluating the appropriateness of the accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion on these financial statements.

Opinion

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, 2016, and June 30, 2015, and the respective changes in its financial position and its cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphases of Matter

As discussed in Note 2A to the financial statements, 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 as of June 30, 2016, and June 30, 2015, the changes in its financial position, or where applicable, its cash flows for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

As discussed in Note 2B to the financial statements, the Wisconsin Lottery implemented Governmental Accounting Standards Board (GASB) Statement Number 72, *Fair Value Measurement and Application*, which addresses accounting and reporting issues related to fair value measurements.

Our opinion is not modified with respect to these matters.

Other Matters

Required Supplementary Information—Accounting principles generally accepted in the United States of America require that the Management’s Discussion and Analysis, which is on pages 17 through 26, be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by GASB, which considers it to be essential for placing the financial statements in an appropriate operational, economic, or historical context. In accordance with auditing standards generally accepted in the United States of America, we have applied certain limited procedures to the required supplementary information that included inquiries of management about the methods of preparing the information. We further compared the information for consistency with management’s responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to do so.

Accompanying Information—Our audits for the years ended June 30, 2016, and June 30, 2015, were conducted for the purpose of forming an opinion on the financial statements of the Wisconsin Lottery. Schedules 1 and 2 on pages 54 through 55, are presented for purposes of additional analyses and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and

certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.


We also previously audited, in accordance with auditing standards generally accepted in the United States of America, the financial statements of the Wisconsin Lottery as of and for the years ended June 30, 2014, June 30, 2013, and June 30, 2012 (not presented herein), and issued reports thereon dated July 7, 2015 (report 15-9) and August 15, 2014 (report 14-10), which contained unmodified opinions on the respective financial statements of the Wisconsin Lottery. In this report, Schedule 1, on page 54, for the year ended June 30, 2014, and Schedule 2, on page 55, for the years ended June 30, 2014, June 30, 2013, and June 30, 2012, are presented for purposes of additional analyses and are not a required part of the financial statements.

Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements for the years ended June 30, 2014, June 30, 2013, and June 30, 2012. The information has been subjected to the auditing procedures applied in the audits of those financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare those financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole for the years ended June 30, 2014, June 30, 2013, and June 30, 2012.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued a report dated August 23, 2017, on our consideration of the Department of Revenue's and 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 used when considering the Department of Revenue's and Wisconsin Lottery's internal control over financial reporting and compliance.

LEGISLATIVE AUDIT BUREAU



Joe Chrisman
State Auditor

August 23, 2017

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 ended June 30, 2016, and June 30, 2015, with comparative information from the fiscal year ended June 30, 2014. 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 the Department of Revenue and Wisconsin Lottery management.

Financial Highlights

In fiscal year (FY) 2015-16, the Wisconsin Lottery implemented GASB Statement No. 72, *Fair Value Measurement and Application*. This statement addresses accounting and financial reporting issues related to fair value measurements. The definition of fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This statement provides guidance for determining a fair value measurement for financial reporting purposes. This statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements.

In FY 2015-16, the Lottery had its fifth record sales year in a row. Operating revenues generated from ticket sales for the Wisconsin Lottery were \$627.1 million in FY 2015-16 versus \$574.6 million in FY 2014-15, an increase of 9.1 percent. During FY 2015-16, Powerball sales were stimulated by an estimated annuity

jackpot exceeding \$1.5 billion. Instant scratch tickets and lotto tickets each had their highest annual sales in Wisconsin Lottery history.

Operating expenses for FY 2015-16 increased \$36.5 million, or by 8.8 percent, primarily as a result of increased prize expenses, which rise with increased sales. Office administration expenses (salaries, fringe benefits, and supplies) rose to \$9.0 million in FY 2015-16, which is an increase of 10.0 percent from the \$8.1 million in FY 2014-15. Net income before transfers was \$175.1 million for FY 2015-16, compared to \$158.1 million in FY 2014-15.

Administrative expenses, as defined in s. 25.75 (3) (b), Wis. Stats., were 5.84 percent of gross lottery revenues in FY 2015-16, well below the statutory maximum of 10.0 percent. Total statutory administrative expenses, which include administrative expenses reported in the financial statements, all program expenses except prizes and retailer compensation, and certain transfers out were \$36.6 million in FY 2015-16. This was an increase of \$2.5 million from the FY 2014-15 total of \$34.1 million.

Understanding the Financial Statements

The Wisconsin Constitution requires that net proceeds from the operations of the Wisconsin Lottery be used to provide property tax relief. The Wisconsin Lottery is accounted for as an enterprise activity, a type of proprietary fund that reports on all of the activity's assets and liabilities using the accrual basis of accounting, much like a private business entity.

This report consists of a series of comparative financial statements, along with explanatory notes to the financial statements and supplemental schedules. The financial statements are comprised of three components:

- **Statement of Net Position**—provides detailed information on the nature and amount of the Wisconsin Lottery's assets, deferred outflows, liabilities, deferred inflows, and net position as of June 30, 2016, and June 30, 2015;
- **Statement of Revenues, Expenses, and Changes in Net Position**—reports the revenues and expenses incurred in relation to the sale of lottery products, as well as other non-gaming related activity for FY 2015-16 and FY 2014-15; and
- **Statement of Cash Flows**—outlines the cash inflows and outflows related to the sale of lottery products and other business-related activities for FY 2015-16 and FY 2014-15.

To assess the Wisconsin Lottery's financial position and financial health, the reader of these statements should pay particular attention to the changes in the components of assets and liabilities as set forth in the Statement of Net Position,

and to changes in income and expenses as set forth in the Statement of Revenues, Expenses, and Changes in Net Position, as well as the Statement of Cash Flows.

Overview of Financial Position

The Statement of Net Position provides detailed information on the nature and amount of the Wisconsin Lottery's assets, deferred outflows, liabilities, deferred inflows, and net position at the close of FY 2015-16 and FY 2014-15. Table A presents these data in a condensed form for the past three fiscal years. The relationship of assets and deferred outflows to liabilities and deferred inflows and the resulting net position is one indicator of the financial condition of the Wisconsin Lottery.

Table A
Statement of Net Position
(in millions)

	June 30, 2016	Change	June 30, 2015	Change	June 30, 2014
Assets					
Investments	\$ 30.8	\$ (4.8)	\$ 35.6	\$(5.5)	\$ 41.1
Capital Assets (net of accumulated depreciation)	0.2	0.2	0.0	(0.1)	0.1
Other Assets	86.4	3.3	83.1	5.1	78.0
Total Assets	117.4	(1.3)	118.7	(0.5)	119.2
Total Deferred Outflows of Resources	2.7	2.1	0.6	0.6	0.0
Liabilities					
Current Liabilities	46.3	(12.2)	58.5	12.2	46.3
Noncurrent Liabilities	22.3	(4.0)	26.3	(4.0)	30.3
Total Liabilities	68.6	(16.2)	84.8	8.2	76.6
Total Deferred Inflows of Resources	1.1	1.1	0.0	0.0	0.0
Net Position					
Invested in Capital Assets	0.2	0.2	0.0	(0.1)	0.1
Restricted for Pensions	0.0	(0.8)	0.8	0.8	0.0
Restricted for MUSL Reserves	5.2	(0.2)	5.4	(0.4)	5.8
Restricted for Investment Fair Value Adjustment	4.4	(0.5)	4.9	(1.2)	6.1
Restricted for Property Tax Relief	40.6	17.2	23.4	(7.2)	30.6
Total Net Position	<u>\$ 50.4</u>	<u>\$ 15.9</u>	<u>34.5</u>	<u>\$(8.1)</u>	<u>\$ 42.6</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 \$117.4 million at the end of FY 2015-16, compared to \$118.7 million at the end of FY 2014-15, and \$119.2 million at the end of FY 2013-14. Noncurrent assets primarily consist of investments for prize annuities expected to mature more than a year beyond the date of the Statement of Net Position. Since 2007, no winners have chosen to receive their winnings in the form of an annuity, therefore no new investments are being added. The investment balance continues to decrease each year as investments mature and annuitants receive their annual payments.

Liabilities

At the end of FY 2015-16, the Wisconsin Lottery had total liabilities of \$68.6 million, compared with total liabilities of \$84.8 million at the end of FY 2014-15 and \$76.6 million at the end of FY 2013-14. Current liabilities consist primarily of accrued prizes payable, annuity prizes payable, and accounts payable due to suppliers. The prizes payable balance at the end of FY 2014-15 included a \$22.5 million liability for a Wisconsin's Very Own Megabucks winner who had not yet claimed the prize. Noncurrent liabilities consist primarily of annuity prizes payable more than a year beyond the date of the Statement of Net Position. Since 2007, no winners have chosen to receive their winnings in the form of an annuity. As a result, total annuity prizes payable continues to decrease each year as existing annuitants receive their annual payments.

Net Position

The Wisconsin Lottery's total net position was \$50.4 million at the end of FY 2015-16, a \$15.9 million increase from the prior year's amount. The total net position at the end of FY 2014-15 was \$34.5 million, an \$8.1 million decrease from FY 2013-14. Total net position was \$42.6 million at the end of FY 2013-14.

The Wisconsin Lottery's net position is generally available for property tax relief unless restricted for other uses. There are currently four other uses of the Wisconsin Lottery's net position. Amounts invested in capital assets cannot be used to provide property tax relief. Amounts restricted for pensions are those that must be used to fund future pension obligations. Reserve accounts held by MUSL are not currently available for property tax relief. Unrealized gains or losses related to the change in the fair value of investments are not available for property tax relief because investments have been purchased for the payment of annuity prizes payable and are generally held to maturity. All remaining net position is available for property tax relief.

The Statement of Revenues, Expenses, and Changes in Net Position provides detailed information on the nature and financial impact of the Wisconsin Lottery's operations for FY 2015-16 and FY 2014-15. Table B presents data for the past three fiscal years in a condensed form.

Table B
Statement of Revenues, Expenses, and Changes in Net Position
(in millions)

	FY 2015-16	Change	FY 2014-15	Change	FY 2013-14
Revenues					
Operating Revenues:					
Ticket sales	\$627.1	\$52.5	\$574.6	\$5.8	\$568.8
Retailer fees and miscellaneous revenue	0.1	0.0	0.1	0.0	0.1
Nonoperating Revenues:					
Investment income (loss)	(0.2)	1.0	(1.2)	0.3	(1.5)
Total Revenues	627.0	53.5	573.5	6.1	567.4
Expenses					
Program Expenses:					
Prize expenses	372.5	30.1	342.4	5.7	336.7
Retailer commissions and incentives	43.5	3.9	39.6	1.2	38.4
Instant and lotto vendor services	14.5	1.6	12.9	(0.5)	13.4
Other game-related expenses	12.4	0.0	12.4	0.3	12.1
Office Administration Expenses	9.0	0.9	8.1	0.0	8.1
Total Expenses	451.9	36.5	415.4	6.7	408.7
Net Income Before Transfers	175.1	17.0	158.1	(0.6)	158.7
Transfers					
Transfers for Property Tax Relief	(158.1)	8.3	(166.4)	2.0	(168.4)
Transfer for Compulsive Gambling Programs	(0.4)	0.0	(0.4)	0.0	(0.4)
Transfer for Law Enforcement	(0.3)	0.1	(0.4)	0.0	(0.4)
Transfer for Lottery Credit Administration	(0.2)	0.0	(0.2)	0.0	(0.2)
Transfers Out to General Fund	(0.2)	(0.1)	(0.1)	0.0	(0.1)
Change in Net Position	<u>\$ 15.9</u>	<u>\$ 25.3</u>	<u>\$ (9.4)</u>	<u>\$ 1.4</u>	<u>\$ (10.8)</u>

Revenues

Operating revenues are generated almost entirely from ticket sales. Ticket sales for the Wisconsin Lottery were \$627.1 million in FY 2015-16, \$574.6 million in FY 2014-15, and \$568.8 million in FY 2013-14. Table C compares ticket sales for each game category for FY 2015-16, FY 2014-15, and FY 2013-14.

Table C

Wisconsin Lottery Ticket Sales (in millions)

	FY 2015-16	Change	FY 2014-15	Change	FY 2013-14
Instant					
Scratch-off	\$378.8	\$22.4	\$356.4	\$18.7	\$337.7
Pull-tab	1.1	0.0	1.1	(0.2)	1.3
Total Instant Ticket Sales	379.9	22.4	357.5	18.5	339.0
Lotto					
SuperCash!	24.8	0.5	24.3	(0.2)	24.5
Powerball	112.5	41.6	70.9	(16.0)	86.9
Wisconsin's Megabucks	13.2	(11.9)	25.1	9.0	16.1
Wisconsin's Megabucks EZ match	1.7	(0.6)	2.3	0.4	1.9
Daily Pick 3	24.0	(0.1)	24.1	(0.4)	24.5
Daily Pick 4	12.8	0.1	12.7	0.2	12.5
Badger 5	25.5	4.2	21.3	(2.5)	23.8
Mega Millions	25.4	(1.5)	26.9	(7.0)	33.9
5 Card Cash ¹	6.5	(2.2)	8.7	4.0	4.7
Raffle Games	0.8	0.0	0.8	(0.2)	1.0
Total Lotto Ticket Sales	247.2	30.1	217.1	(12.7)	229.8
Total Sales	<u>\$627.1</u>	<u>\$52.5</u>	<u>\$574.6</u>	<u>\$ 5.8</u>	<u>\$568.8</u>

¹ The Wisconsin Lottery began 5 Card Cash on April 6, 2014.

The sales increase in FY 2015-16 was driven by a 58.7 percent increase in the sale of Powerball tickets. This growth came largely as a result of an estimated annuity jackpot over \$1.5 billion in January 2016. Lotto game sales increased by \$30.1 million during FY 2015-16 following a \$12.7 million decrease in FY 2014-15. Instant scratch-off ticket sales increased \$22.4 million during FY 2015-16, after increasing \$18.7 million during FY 2014-15. Pull-tab sales remained stable in FY 2015-16, following a \$0.2 million decrease in FY 2014-15.

Expenses

Expenses consist of amounts paid in prizes, retailer commissions and incentives, fees paid to the Wisconsin Lottery's gaming system vendor (instant and lotto vendor services), other game-related expenses, and administrative expenses. In FY 2015-16, total operating expenses were \$451.9 million, an increase of \$36.5 million from FY 2014-15 expenses of \$415.4 million, which had increased from FY 2013-14 expenses of \$408.7 million. The increase in expenses during recent years is primarily a result of increased prize expense driven by the increase in sales.

Prizes are the Wisconsin Lottery's largest expense. Table D compares ticket prize awards for each lottery game category for FY 2015-16, FY 2014-15, and FY 2013-14.

Table D

Wisconsin Lottery Ticket Prize Awards (in millions)

	FY 2015-16	Change	FY 2014-15	Change	FY 2013-14
Instant					
Scratch-off	\$249.0	\$13.5	\$235.5	\$14.9	\$220.6
Pull-tab	0.7	0.0	0.7	0.0	0.7
Super 2nd Chance ¹	0.3	0.0	0.3	0.0	0.3
Total Instant Prize Awards	250.0	13.5	236.5	14.9	221.6
Lotto					
SuperCash!	13.7	2.8	10.9	(2.8)	13.7
Powerball	54.1	19.3	34.8	(7.2)	42.0
Wisconsin's Megabucks	7.5	(5.7)	13.2	4.7	8.5
Wisconsin's Megabucks EZ Match	1.0	(0.4)	1.4	0.2	1.2
Daily Pick 3	11.4	0.9	10.5	(2.2)	12.7
Daily Pick 4	5.7	(0.4)	6.1	0.5	5.6
Badger 5	12.5	2.1	10.4	(1.1)	11.5
Mega Millions	12.4	(0.6)	13.0	(3.0)	16.0
5 Card Cash ²	3.5	(1.4)	4.9	1.7	3.2
Raffle Games	0.4	0.0	0.4	0.0	0.4
Super 2nd Chance ¹	0.3	0.0	0.3	0.0	0.3
Total Lotto Prize Awards	122.5	16.6	105.9	(9.2)	115.1
Total	<u>\$372.5</u>	<u>\$30.1</u>	<u>\$342.4</u>	<u>\$ 5.7</u>	<u>\$336.7</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 sale of the scratch-off and lotto tickets.

² The Wisconsin Lottery began 5 Card Cash on April 6, 2014.

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. The change in prize expense, however, is not always perfectly proportional to sales. Each individual game has a unique prize structure so as sales shift between the different games being offered, prize expenses can fluctuate more or less than would be expected based on the change in sales. In FY 2015-16, ticket sales across all games increased \$52.5 million, while prize expense increased \$30.1 million. In FY 2014-15, ticket sales increased \$5.8 million, while prize expense increased \$5.7 million. Schedule 2, which follows the Notes to the Financial Statements, shows a multi-year summary of ticket sales and their related prize expenses.

Since expenses for retailer commissions and incentives are a function of sales, they typically rise and fall with sales. In FY 2015-16, retailers were paid \$43.5 million in commissions and incentives, up \$3.9 million from the \$39.6 million paid in FY 2014-15. In FY 2013-14, retailer commissions and incentives were \$38.4 million.

The Wisconsin Lottery contracted with IGT Global Solutions Corporation (formerly known as GTECH Corporation) for an integrated gaming computer system and services (instant and lotto vendor services). In FY 2015-16, payments to IGT Global Solutions Corporation were \$14.5 million. In FY 2014-15, payments to GTECH Corporation were \$12.8 million. Initially, the Wisconsin Lottery paid GTECH Corporation 2.54 percent of total net ticket sales. In July 2009, the Wisconsin Lottery extended its contract with GTECH Corporation through June 2013. In consideration for that extension, GTECH Corporation reduced the cost of the contract by \$1.0 million per year. Therefore, beginning with FY 2009-10, the Wisconsin Lottery paid GTECH Corporation 2.54 percent of net sales, less \$1.0 million. In addition, GTECH Corporation provides, at no additional cost, a remote, hot-site backup of the system and a data feed which can be used for business analytics. The Wisconsin Lottery further extended its contract with GTECH Corporation through June 25, 2016. On October 1, 2015, GTECH Corporation changed its name to IGT Global Solutions Corporation. IGT Global Solutions Corporation will fulfill the remaining term of the current contract, which was subsequently extended to May 13, 2017. The payment terms for FY 2014-15 and FY 2015-16 were 2.54 percent of the total net sales, less \$1,750,000.

Net Income and Transfer for Property Tax Relief

Net income before transfers was \$175.1 million in FY 2015-16, up from the amount of \$158.1 million in FY 2014-15. Net income before transfers was \$158.7 million in FY 2013-14.

As shown 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 transfers out for property tax relief decreased by \$8.3 million, or by 5.0 percent, during FY 2015-16, after decreasing by \$2.0 million, or by 1.2 percent, during FY 2014-15.

Potential Factors Impacting Future Results

The Wisconsin Lottery's success is dependent upon its ability to effectively gauge the market for its products. The Wisconsin Lottery regularly changes its product offerings in response to consumer preferences. The Wisconsin Lottery is engaged in a long-term growth strategy for instant scratch sales by meeting consumer demand for more games at higher price points. Sales continue to build for tickets priced \$10 and higher. While the Wisconsin Lottery makes every effort to ensure the success of its products, overall sales will be adversely affected if the Wisconsin Lottery misjudges the market.

Approximately 22.0 percent of all ticket sales in FY 2015-16 came from the two MUSL jackpot games, Powerball and Mega Millions. The sales of these games can be volatile as they are driven by the size and frequency of large jackpots, which occur randomly. For example, Powerball sales decreased during FY 2014-15 by 18.4 percent only to see a significant rise in FY 2015-16 of 58.7 percent. The volatility of jackpot games makes forecasting ticket sales difficult. The Wisconsin Lottery has established a range to forecast future performance based upon past performance, but that range is broad and jackpot game sales can vary from year to year by tens of millions of dollars from estimates.

Lottery tickets are a discretionary purchase. Consequently, the Lottery's performance is subject to economic conditions and their impact on consumer spending. Some factors influencing consumer spending include unemployment, fuel costs, the cost of essential goods such as food, clothing, and shelter, and consumer confidence in the economy. Consumer purchases of discretionary items, such as lottery tickets, generally decline during periods when disposable income is adversely affected or when there is a lack of consumer confidence in the economy.

In September 2015, the Wisconsin Lottery asked the Wisconsin Department of Justice to review the December 29, 2007 Wisconsin's Megabucks drawing to determine if any illegal activity may have occurred in Wisconsin. The Wisconsin Lottery made this request because an individual previously employed by MUSL had access to Wisconsin's random number generators (RNGs) and was convicted of fraud in Iowa. Suspected fraud related to this individual was also being investigated in Colorado, Kansas, and Oklahoma. The Wisconsin Department of Justice's investigation resulted in two individuals pleading guilty to fraud related charges. The plea agreement includes restitution to the Wisconsin Lottery. Sentencing will take place in September 2017.

The Wisconsin Lottery purchased new RNGs from a third party independent of MUSL and had them forensically examined by security experts prior to implementation. Since then, a strict protocol has been implemented that requires all updates to the RNGs go through this forensic examination process prior to being implemented. Additional security measures have also been implemented to insure and protect the integrity of the Wisconsin Lottery.

Contacting the Wisconsin Lottery's Financial Management

These 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 these financial statements, or need additional financial information, please 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, please 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 Position

June 30, 2016, and June 30, 2015

	June 30, 2016	June 30, 2015
ASSETS		
Current Assets:		
Cash and Cash Equivalents (Note 3)	\$ 53,909,819	\$ 49,839,930
Investments for Prize Annuities (Note 3)	6,140,751	6,070,396
Accounts Receivable (Note 4)	24,219,365	23,862,969
Due from Other State Programs (Note 4)	38,418	32,012
Ticket Inventory	1,829,218	2,153,219
MUSL Reserve Accounts (Note 5)	342,437	355,273
Prepaid Expenses	806,965	684,703
Interest Receivable	0	4,039
Total Current Assets	87,286,973	83,002,541
Noncurrent Assets:		
Investments for Prize Annuities (Note 3)	24,671,233	29,514,086
MUSL Reserve Accounts (Note 5)	5,249,991	5,382,829
Net Pension Asset	0	758,965
Capital Assets:		
Equipment	680,345	546,963
Leasehold Improvements	113,288	113,288
Accumulated Depreciation	(623,711)	(607,646)
Total Noncurrent Assets	30,091,146	35,708,485
TOTAL ASSETS	117,378,119	118,711,026
DEFERRED OUTFLOWS OF RESOURCES (Note 6)	2,671,397	637,916
LIABILITIES		
Current Liabilities:		
Annuity Prizes Payable (Note 7)	6,131,917	5,981,083
Prizes Payable	35,912,960	48,517,927
Accounts Payable	1,839,464	1,668,411
Due to Other State Programs	637,203	454,268
MUSL Payable	543,836	541,365
Unearned Revenue	898,075	966,783
Due to Other Governments	43,344	58,682
Accrued Payroll	111,907	174,186
Compensated Absences	166,152	189,506
Total Current Liabilities	46,284,858	58,552,211
Noncurrent Liabilities:		
Annuity Prizes Payable (Note 7)	20,691,842	25,208,426
Compensated Absences	483,122	518,586
Other Postemployment Benefits	588,684	553,306
Net Pension Liability	510,345	0
Total Noncurrent Liabilities	22,273,993	26,280,318
TOTAL LIABILITIES	68,558,851	84,832,529
DEFERRED INFLOWS OF RESOURCES (Note 6)	1,083,965	9,467
NET POSITION		
Net Position: (Note 12)		
Invested in Capital Assets	169,922	52,605
Restricted for Pensions	0	758,965
Restricted for MUSL Reserves	5,249,990	5,382,829
Restricted for Investment Fair Value Adjustment	4,381,836	4,857,205
Restricted for Property Tax Relief	40,604,952	23,455,342
TOTAL NET POSITION	\$ 50,406,700	\$ 34,506,946

The accompanying notes are an integral part of this statement.

Statement of Revenues, Expenses, and Changes in Net Position for the Years Ended June 30, 2016, and June 30, 2015

	Year Ended June 30, 2016	Year Ended June 30, 2015
OPERATING REVENUES		
Instant Ticket Sales (Net of Allowances of \$3,561,224 and \$714,051, respectively) (Note 8)	\$ 379,930,973	\$ 357,463,506
Lotto Ticket Sales (Net of Ticket Discounts of \$0 and \$264,130, respectively) (Note 8)	247,233,964	217,167,877
Retailer Fees	61,255	53,905
Miscellaneous Revenue	55,135	57,472
Total Operating Revenues	627,281,327	574,742,760
OPERATING EXPENSES		
Program Expenses:		
Instant Prize Expense (Note 9)	249,991,398	236,549,274
Lotto Prize Expense (Note 9)	122,567,099	105,892,045
Retailer Commissions and Incentives	43,526,786	39,595,888
Instant and Lotto Vendor Services	14,462,323	12,843,263
Product Information Costs	7,484,216	7,496,263
Instant Ticket Printing Costs	3,995,818	3,987,424
Instant Ticket Delivery Costs	941,898	892,125
Donated Prize Expense	3,704	3,408
Total Program Expenses	442,973,242	407,259,690
Administrative Expenses:		
Salaries and Fringe Benefits	6,138,848	5,675,474
Supplies and Services	2,816,720	2,454,104
Depreciation Expense	16,065	13,292
Total Administrative Expenses	8,971,633	8,142,870
Total Operating Expenses	451,944,875	415,402,560
NET OPERATING INCOME	175,336,452	159,340,200
NONOPERATING REVENUES (EXPENSES) AND TRANSFERS		
Investment Income (Loss)	(249,881)	(1,259,865)
Miscellaneous Revenue	3,704	3,408
Net Income Before Transfers	175,090,275	158,083,743
Transfers:		
Transfers of Lottery Proceeds for Property Tax Relief (Note 13)	(158,087,726)	(166,433,326)
Transfers In from General Fund	557	23,505
Transfer to Department of Health Services for Compulsive Gambling Programs	(357,582)	(396,000)
Transfer to Department of Justice for Law Enforcement	(343,074)	(382,905)
Transfer to Department of Revenue for Lottery Credit Administration	(185,847)	(241,632)
Transfers Out to General Fund	(216,849)	(143,020)
CHANGE IN NET POSITION	15,899,754	(9,489,635)
NET POSITION		
Net Position—Beginning of the Year	34,506,946	42,636,970
Prior Period Adjustment (Note 14)	0	1,359,611
Net Position—End of the Year	\$ 50,406,700	\$ 34,506,946

The accompanying notes are an integral part of this statement.

Statement of Cash Flows for the Years Ended June 30, 2016, and June 30, 2015

	Year Ended June 30, 2016	Year Ended June 30, 2015
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash Received from Retailers	\$ 624,706,101	\$ 572,745,574
Cash Paid for Prizes	(390,115,824)	(334,294,422)
Cash Paid for Retailer Commissions and Incentives	(42,733,774)	(39,132,448)
Cash Paid/Received for MUSL Reserve Accounts	147,417	424,189
Cash Paid to Employees	(5,862,568)	(5,620,130)
Cash Paid to Suppliers	(29,064,691)	(28,575,008)
Net Cash Provided by Operating Activities	157,076,661	165,547,755
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Transfers of Proceeds for Property Tax Credit	(158,087,880)	(166,433,173)
Transfer of Proceeds for Law Enforcement	(348,583)	(369,081)
Transfer of Proceeds for Lottery Credit Administration	(249,684)	(228,853)
Transfer of Proceeds for Compulsive Gambling Programs	(357,582)	(396,000)
Transfers to the General Fund	(216,849)	(143,020)
Transfers from the General Fund	21,822	45,514
Net Cash Used by Noncapital Financing Activities	(159,238,756)	(167,524,613)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Cash Paid for Purchase of Equipment	(133,382)	0
Net Cash Used by Capital and Related Financing Activities	(133,382)	0
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest Received	227,784	65,455
Cash Received for Redemption of Bonds	6,137,582	6,291,000
Net Cash Provided by Investing Activities	6,365,366	6,356,455
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		
Cash and Cash Equivalents—Beginning of the Year	49,839,930	45,460,333
Cash and Cash Equivalents—End of the Year	<u>\$ 53,909,819</u>	<u>\$ 49,839,930</u>

The accompanying notes are an integral part of this statement.

	Year Ended June 30, 2016	Year Ended June 30, 2015
RECONCILIATION OF NET OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Net Operating Income	\$ 175,336,452	\$ 159,340,200
Adjustments to Reconcile Net Operating Income to Net Cash		
Provided by Operating Activities:		
Depreciation Expense	16,065	13,292
Noncash Donated Prize Expense	3,704	3,408
Changes in Assets, Liabilities, and Deferreds:		
Decrease (Increase) in Accounts Receivable	(356,396)	(292,273)
Decrease (Increase) in MUSL Reserve Accounts	147,417	424,189
Decrease (Increase) in Ticket Inventory	324,000	(463,718)
Decrease (Increase) in Prepaid Expenses	(122,262)	467,773
Decrease (Increase) in Net Pension Asset and Related Deferred Outflows	(1,274,517)	(37,269)
Decrease (Increase) in Due from Other State Programs	(27,670)	(6,776)
Increase (Decrease) in Prizes Payable	(18,811,170)	6,809,643
Increase (Decrease) in Unearned Revenue	(68,708)	50,886
Increase (Decrease) in Due to Other State Programs	203,971	(288,338)
Increase (Decrease) in Accounts Payable	218,014	(731,129)
Increase (Decrease) in MUSL Payable	2,471	425,028
Increase (Decrease) in Due to Other Governments	(13,834)	(256,953)
Increase (Decrease) in Accrued Payroll	(62,279)	57,002
Increase (Decrease) in Compensated Absences	(58,817)	18,292
Increase (Decrease) in Other Postemployment Benefits	35,378	5,031
Increase (Decrease) in Net Pension Liability and Related Deferred Inflows	1,584,842	9,467
Total Adjustments	(18,259,791)	6,207,555
Net Cash Provided by Operating Activities	\$ 157,076,661	\$ 165,547,755
Noncash Activities:		
Increase (decrease) in fair value of investments	\$ 1,365,085	\$ 813,258
Amortization of long-term annuity prize liability	1,840,454	2,142,054

The accompanying notes are an integral part of this statement.

Notes to the Financial Statements ■

1. DESCRIPTION OF THE WISCONSIN LOTTERY

Wisconsin voters authorized the creation of a lottery by the passage of a constitutional amendment, by a 65 percent to 35 percent margin, on April 7, 1987. The Wisconsin Constitution requires that the net proceeds from Wisconsin Lottery operations be used to provide local property tax relief. The Wisconsin Lottery was created in December 1987 and sold its first ticket on September 14, 1988. The Lottery is administered by the Lottery Division within the Department of Revenue. During FY 2015-16 and FY 2014-15, the Wisconsin Lottery sold instant games, including scratch-off and pull-tab tickets, and lotto games. Lotto games have drawings to determine winning tickets, which include raffle tickets and tickets produced from a terminal located at a retailer's place of business (e.g., Powerball, Badger 5).

Since June 1989, the Wisconsin Lottery has been a member of the Multi-State Lottery Association (MUSL). In FY 2015-16 and FY 2014-15, as a member of MUSL, the Wisconsin Lottery participated in two national lotto games: Powerball (start date April 19, 1992) and Mega Millions (start date January 31, 2010). See Note 5 for information about MUSL.

During FY 2015-16 and FY 2014-15, the Wisconsin Lottery also sold tickets for six Wisconsin lotto games: SuperCash! (start date February 4, 1991), Wisconsin's Megabucks (start date June 20, 1992), Daily Pick 3 (start date September 21, 1992), Daily Pick 4 (start date September 15, 1997), Badger 5 (start date February 17, 2003), and 5 Card Cash (start date April 6, 2014). The EZ Match feature for Megabucks was added on April 3, 2011.

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 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 Net Position as "Transfers Out."

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, deferred outflows of resources, liabilities, and deferred inflows of resources associated with the operation of the Wisconsin Lottery are included on the Statement of Net Position. 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 Net Position 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, administrative 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.

In FY 2014-15, the Wisconsin Lottery implemented GASB Statement No. 68, *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27*, and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date—an amendment of GASB Statement No. 68*. These statements establish standards for reporting a net pension liability or asset, pension expense, and deferred inflows and outflows of resources related to pensions. These statements revise accounting and financial reporting for pensions by state and local governments.

In FY 2015-16, the Wisconsin Lottery implemented GASB Statement No. 72, *Fair Value Measurement and Application*. As a result, the notes to the financial statements include enhanced disclosures about fair value measurement, the level of fair value hierarchy, and valuation techniques.

C. Cash and Cash Equivalents

Cash and cash equivalents reported on the Statement of Net Position and on the Statement of Cash Flows include cash deposited in the State's bank and the Wisconsin 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. Balances pooled in the State Investment Fund are restricted to legally stipulated investments valued consistent with GASB Statement No. 72.

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. The securities finance jackpot prizes that are payable as annuities over a 20-year, 25-year or 30-year period and are scheduled to mature near the time prize payments become payable to winners. Investments of the Wisconsin Lottery are reported at fair value consistent with the provisions of GASB Statement No. 72, *Fair Value Measurement and Application*. Increases or decreases in fair value are recognized as investment income (loss).

E. Accounts Receivable

Accounts receivable balances primarily represent amounts due from Wisconsin Lottery retailers. Receivables are recorded when instant tickets are sold to retailers. The receivable balance is shown net of amounts due to retailers. These amounts include commissions, performance incentives, winning ticket incentives, and ticket redemption amounts. Payments for instant ticket orders are typically due in four weeks, except for nonprofit organizations that typically have payments due within a week. Receivables are recorded for lotto games when retailers sell lotto tickets and have payments due within a week. The Wisconsin Lottery collects receivables weekly from retailer deposit accounts.

Retailers have the right to return unsold instant scratch-off tickets to the Wisconsin Lottery for a refund at any time prior to the game end date. Therefore, receivables and cash collected in advance of these tickets being sold represent a contingent liability of the Wisconsin Lottery. A sales allowance 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 a reduction of the

receivable balance. For additional information about accounts receivable, see Note 4.

F. 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 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.

G. Capital Assets

Tangible assets purchased for \$5,000 or more and intangible assets that have a cost or value greater than \$1,000,000 are capitalized and recorded at historic cost. As applicable, assets are 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

H. Deferred Outflows and Deferred Inflows of Resources

For purposes of measuring the net pension liability (asset), deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the Wisconsin Retirement System (WRS) and additions to or deductions from the WRS' fiduciary net position have been determined on the same basis as they are reported by the WRS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value. For additional information on deferred outflows and inflows of resources, see Note 6.

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 7.

J. Unearned Revenue

Depending on the game, lotto tickets may be 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

Ticket sales 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.

Revenues for pull-tab games are recognized upon sale of the tickets to the retail sales agents. Retail sales agents have the right to return full packs of unsold tickets for a full refund, however, pull-tab ticket sales are not reduced using a sales allowance estimate as historically the amounts are insignificant.

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 s. 25.75 (3) (a), Wis. Stats., at least 50 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 2.

N. Retailer Commissions and Incentives

Retailer commissions, which are classified as program expenses, are set by statute and are 5.5 percent for lotto ticket sales and 6.25 percent for instant scratch-off and instant pull-tab tickets. Nonprofit organizations receive higher commissions.

In addition to the retailer commissions, 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 has 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 lotto and instant 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. In the event of a pari-mutuel drawing with a large jackpot shared by multiple winning tickets, retailers can earn total compensation up to a maximum of \$300,000. Winning ticket incentive payments are made weekly.

Short-term incentives are 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. The aggregate amount of payments to retailers for a short-term incentive is limited to \$300,000 per incentive.

The sales goals incentive allows participating retailers to earn additional commissions based on increased sales. Subject to certain restrictions and allowances, retailers earn up to 2 percent of the increase in quarterly sales compared to sales of the previous quarter for instant tickets and certain non-jackpot lotto games (SuperCash!, Daily Pick 3, Daily Pick 4, Badger 5, and 5 Card Cash). These payments are made quarterly. Retailers also earn up to 10 percent of the increase in annual sales over the previous year. Due to variability of sales of jackpot lotto games (Wisconsin's Megabucks, Mega Millions, and Powerball) and raffle games, sales goals incentive payments for these games are made annually. The annual payments may be limited to ensure that total payments do not exceed the statutory cap of 1.0 percent of gross instant and lotto ticket sales.

O. Administrative Expenses

Section 25.75 (3) (b), Wis. Stats., limits 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 1.

P. Disbursement of Lottery Proceeds for Property Tax Relief

The Department of Revenue disburses net lottery proceeds through two statutory credits: the Lottery and Gaming Tax Credit and the Farmland Tax Relief Credit. The Department of Administration, with

the approval 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. However, the amount to be disbursed is determined by November, well before the end of the fiscal year. The credit is based on the prior year's balance carryover and estimated proceeds for the current year.

The Farmland Tax Relief Credit is distributed to eligible individual and corporate taxpayers by the Department of Revenue. Payments are disbursed throughout the year. The Farmland Tax Relief Credit was discontinued for taxable years after December 31, 2009, as per s. 20.835 (2) (q), Wis. Stats. However, claims are still being processed on amended returns and late returns.

Q. 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. CASH 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, 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. The State Investment Fund is not registered with the Securities and Exchange Commission. The carrying amount of shares in the State Investment Fund, which approximates fair value, was \$54.2 million as of June 30, 2016, and \$49.8 million as of June 30, 2015.

The types of securities in which the State Investment Fund may invest are enumerated in s. 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 Investment Board's 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, 25-year, or 30-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, which are not considered to have credit risk. All of the Wisconsin Lottery’s total investments for prize annuities balance as of June 30, 2016, and June 30, 2015, 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 type based on the minimum credit ratings as issued by nationally recognized statistical rating organizations.

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, 2016, and June 30, 2015:

<u>Maturity</u>	<u>Fair Value as of June 30, 2016</u>	<u>Fair Value as of June 30, 2015</u>
Less than 1 Year	\$ 6,140,751	\$ 6,070,396
1 to 5 Years	17,281,265	19,445,236
6 to 10 Years	6,203,918	8,794,384
More than 10 Years	<u>1,186,050</u>	<u>1,274,466</u>
Total	<u>\$30,811,984</u>	<u>\$35,584,482</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 State Investment Fund was 67 days as of June 30, 2016, and 80 days as of June 30, 2015.

Fair Value Measurements—Investments of the Wisconsin Lottery are reported at fair value as defined by GASB Statement Number 72—*Fair Value Measurement and Application* and are categorized based on the investment valuation hierarchy established by GASB. The hierarchy is based on the valuation inputs used to measure the fair value of the assets. Level 1 inputs are quoted prices in active markets for identical assets. Level 2 inputs are significant other observable inputs. Level 3 inputs are significant unobservable inputs.

The Wisconsin Lottery has the following recurring fair value measurements as of June 30, 2016:

<u>Investments</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>NAV</u>
U.S. Government and Agency Securities	\$0	\$30,811,984	\$0	\$ 0
State Investment Fund	0	0	0	54,195,000
Total Investments at Fair Value	<u>\$0</u>	<u>\$30,811,984</u>	<u>\$0</u>	<u>\$54,195,000</u>

The Wisconsin Lottery has the following recurring fair value measurements as of June 30, 2015:

<u>Investments</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>NAV</u>
U.S. Government and Agency Securities	\$0	\$35,584,482	\$0	\$ 0
State Investment Fund	0	0	0	49,839,000
Total Investments at Fair Value	<u>\$0</u>	<u>\$35,584,482</u>	<u>\$0</u>	<u>\$49,839,000</u>

Debt securities are categorized as Level 2 and are valued by third-party pricing services using the matrix-pricing technique that values securities based on their relationship to quoted market prices for securities with similar interest rates, maturities and credit ratings.

The fair value of the investment in the State Investment Fund is based on net asset value (NAV) per share (or its equivalent), as of June 30, 2016. This is a commingled fund with the investment objective of safety of principal and liquidity while earning a competitive money market rate of return. The valuation of the underlying investments of the State Investment Fund depends on asset class and maturity date. Repurchase agreements and non-negotiable certificates of deposit are valued at cost. All other short-term debt investments with remaining maturities of up to ninety days are valued

at amortized cost. Finally, all other short-term investments with remaining maturities of over ninety days are valued at fair value by third-party pricing services using a matrix-pricing technique. There are no unfunded commitments relating to the State Investment Fund, and shares of the State Investment Fund can be fully redeemed at any time with no notice or other restrictions. Further information about the investments in the State Investment Fund can be obtained from the separately issued *State Investment Fund Annual Financial Report* for the fiscal year ended June 30, 2016.

4. ACCOUNTS RECEIVABLE

Accounts receivable balances are disaggregated as follows:

	<u>June 30, 2016</u>	<u>June 30, 2015</u>
Accounts Receivable:		
Retailers—Ticket Sales and Contract Fees	\$38,301,724	\$32,992,088
Retailers—Commissions and Incentives	(3,932,460)	(3,285,390)
Retailers—Ticket Redemptions	(7,160,398)	(5,844,152)
Allowance for Returns	(3,004,116)	0
Miscellaneous	<u>14,615</u>	<u>423</u>
Total Accounts Receivable	<u>\$24,219,365</u>	<u>\$23,862,969</u>
Due from Other State Programs:		
Transfers for Gaming	\$ 0	\$ 21,264
Miscellaneous	<u>38,418</u>	<u>10,748</u>
Total Due from Other State Programs	<u>\$ 38,418</u>	<u>\$ 32,012</u>

5. MULTI-STATE LOTTERY ASSOCIATION

A. Joint Venture Association

The Wisconsin Lottery is a member of MUSL, a nonprofit, government-benefit voluntary association. As of June 30, 2016, MUSL had 37 member lotteries from 34 states, the District of Columbia, the U.S. Virgin Islands, and Puerto Rico. MUSL is owned and operated by the member lotteries, which sell one or more games administered by MUSL. MUSL 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. The Wisconsin Lottery participates in two MUSL games: Powerball and Mega Millions.

B. MUSL Financial Position and Activity

The following schedule presents the summarized audited financial position and activity of MUSL as of June 30, 2016, and June 30, 2015, as audited by other auditors.

	<u>June 30, 2016</u>	<u>June 30, 2015</u>
Total Assets	<u>\$566,835,946</u>	<u>\$401,081,678</u>
Total Liabilities	\$559,893,543	\$392,621,480
Total Unrestricted Net Assets	<u>6,942,403</u>	<u>8,460,198</u>
Total Liabilities and Net Assets	<u>\$566,835,946</u>	<u>\$401,081,678</u>
Total Revenues	\$ 4,617,665	\$ 3,513,813
Total Expenses	<u>(6,135,460)</u>	<u>(5,256,492)</u>
Increase (Decrease) in Unrestricted Net Assets	<u>\$ (1,517,795)</u>	<u>\$ (1,742,679)</u>

Complete separate financial statements for MUSL may be obtained from:

Multi-State Lottery Association
 Attention: Bret Toyne
 4400 NW Urbandale Drive
 Urbandale, Iowa 50322

C. Wisconsin Lottery’s MUSL Balances

Lotteries participating in Powerball and Mega Millions transfer 50.0 percent of ticket sales, less actual low-tier prizes, to MUSL for prize pools and reserve accounts for each game.

Participating lotteries do not have rights to balances in the prize pool. Therefore, these funds are not reported as assets on the Wisconsin Lottery’s financial statements. However, member lotteries have the right to a refund of their share of Prize Reserve Account balances if they withdraw from MUSL. The Wisconsin Lottery reports the total of its MUSL Prize Reserve Accounts as a restricted noncurrent asset (MUSL Reserve Accounts—Noncurrent).

In addition, each member lottery has an Unreserved Account, which accumulates interest earned on MUSL Prize Reserve Accounts and the Unreserved Account in excess of MUSL’s administrative expenses. Unreserved Accounts may be withdrawn by member lotteries at any time, and the Wisconsin Lottery records its share of the balance of this account as an unrestricted current asset (MUSL Reserve Accounts—Current).

The total MUSL Reserve and Unreserved Account balances are made up of the following:

	<u>June 30, 2016</u>	<u>June 30, 2015</u>
Powerball Set Prize Reserve Account	\$1,179,317	\$1,195,077
Powerball Prize Reserve Account	2,712,428	2,729,946
Mega Millions Prize Reserve Account	1,139,295	1,179,626
Designated for Patent Acquisition	218,951	278,180
Unreserved Account	<u>342,437</u>	<u>355,273</u>
Total MUSL Accounts	<u>\$5,592,428</u>	<u>\$5,738,102</u>

In FY 2012-13, the Wisconsin Lottery designated \$396,313 of its Unreserved Account balance to pay MUSL for its allocated share of acquisitions costs related to a patent obtained by MUSL. Because these funds are reserved for a specific purpose, the Wisconsin Lottery records this amount as a restricted noncurrent asset (MUSL Reserve Accounts—Noncurrent). At the end of FY 2015-16, the Wisconsin Lottery's remaining share of the cost was \$218,951.

6. DEFERRED OUTFLOWS AND DEFERRED INFLOWS OF RESOURCES

At June 30, 2016, all of the Wisconsin Lottery's deferred outflows of resources and deferred inflows of resources were related to pensions. The Wisconsin Lottery reported deferred outflows of resources and deferred inflows of resources from the following sources:

Deferred Outflows (Inflows) of Resources Related to Pensions

<u>Fiscal Year 2016</u>	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	\$ 80,826	\$(1,075,644)
Net differences between projected and actual earnings on pension plan investments	2,073,574	-
Change in Pension Assumptions	357,602	-
Employer contributions subsequent to the measurement date	143,442	-
Changes in proportion and differences between employer contributions and proportionate share of contributions	<u>15,953</u>	<u>(8,321)</u>
Total	<u>\$2,671,397</u>	<u>\$(1,083,965)</u>

<u>Fiscal Year 2015</u>	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Differences between expected and actual experience	\$106,427	–
Net differences between projected and actual earnings on pension plan investments	355,505	–
Change in Pension Assumptions	–	–
Employer contributions subsequent to the measurement date	155,753	–
Changes in proportion and differences between employer contributions and proportionate share of contributions	<u>20,231</u>	<u>\$(9,467)</u>
Total	<u>\$637,916</u>	<u>\$(9,467)</u>

7. 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 \$1,840,454 for FY 2015-16 and \$2,142,054 for FY 2014-15.

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

<u>Fiscal Year Ended June 30</u>	<u>Future Payments as of June 30, 2016</u>
2017	\$ 6,313,129
2018	5,576,639
2019	4,566,071
2020	4,116,098
2021	3,735,771
Subsequent Years	<u>8,405,579</u>
Total Future Prize Payments	32,713,287
Less: Present Value Adjustment	<u>5,889,528</u>
Present Value of Future Prize Payments	<u>\$26,823,759</u>

Annuity prizes payable activity for the fiscal years ended June 30, 2016, and June 30, 2015, was as follows:

Fiscal Year	Beginning Balance	Increases	Decreases	Ending Balance	Due within One Year
2015-16	\$31,189,509	\$1,840,454	\$(6,206,204)	\$26,823,759	\$6,131,917
2014-15	35,323,516	2,142,054	(6,276,061)	31,189,509	5,981,083

8. INSTANT AND LOTTO TICKET SALES

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

	FY 2015-16	FY 2014-15
Instant Ticket Sales:		
Scratch-off	\$378,800,170	\$356,370,186
Pull-tab	<u>1,130,803</u>	<u>1,093,320</u>
Total Instant Ticket Sales	<u>\$379,930,973</u>	<u>\$357,463,506</u>
Lotto Ticket Sales:		
SuperCash!	\$ 24,835,293	\$ 24,550,611
Powerball	112,531,971	70,929,191
Wisconsin's Megabucks	13,157,515	25,159,740
Wisconsin's Megabucks EZ Match	1,674,385	2,257,641
Daily Pick 3	24,019,178	24,137,868
Daily Pick 4	12,787,200	12,747,663
Badger 5	25,508,473	21,326,318
Mega Millions	25,451,101	26,891,270
5 Card Cash	6,515,232	8,677,636
Raffle Games	759,542	761,265
General Sales and Discounts	<u>(5,926)</u>	<u>(271,326)</u>
Total Lotto Ticket Sales	<u>\$247,233,964</u>	<u>\$217,167,877</u>

9. INSTANT AND LOTTO PRIZE EXPENSE

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

	<u>FY 2015-16</u>	<u>FY 2014-15</u>
Instant Prize Expense:		
Scratch-off	\$249,016,245	\$235,601,007
Pull-tab	711,153	688,267
Super 2nd Chance ¹	<u>264,000</u>	<u>260,000</u>
Total Instant Prize Expense	<u>\$249,991,398</u>	<u>\$236,549,274</u>
Lotto Prize Expense:		
SuperCash!	\$13,695,350	\$10,890,786
Powerball	54,099,222	34,765,010
Wisconsin's Megabucks	7,506,688	13,224,342
Wisconsin's Megabucks EZ Match	1,009,699	1,376,272
Daily Pick 3	11,399,060	10,479,010
Daily Pick 4	5,713,100	6,153,200
Badger 5	12,526,888	10,394,277
Mega Millions	12,445,379	13,054,328
5 Card Cash	3,538,542	4,920,487
Raffle Games	369,171	374,333
Super 2nd Chance ¹	<u>264,000</u>	<u>260,000</u>
Total Lotto Prize Expense	<u>\$122,567,099</u>	<u>\$105,892,045</u>

¹ There are no sales for the Super 2nd Chance drawing. Players enter the drawing by submitting non-winning tickets. Prizes are funded from the original sale of tickets.

10. CONTRACTUAL OBLIGATIONS

A. Scratch-off Tickets

In October 2009, the Wisconsin Lottery signed contracts for scratch-off ticket printing services with three vendors: Scientific Games International, Inc.; GTECH Printing Corporation; and Pollard Banknote Ltd. These three contracts were for the period November 1, 2009, through October 31, 2011, with three one-year renewal options for each contract. Each of these contracts had been renewed through October 31, 2015. In November 2015, the Wisconsin Lottery obtained sole source purchasing approval to extend the contracts with GTECH Printing and Pollard Banknote until the new lottery gaming system is in place. These contracts have been extended through May 13, 2017. The Wisconsin Lottery completed a request for bid and awarded a contract for scratch-off ticket printing services to Scientific Games for

the period November 1, 2015, through October 31, 2020. The Wisconsin Lottery purchased ticket printing services of approximately \$3.4 million in FY 2015-16 and approximately \$3.7 million in FY 2014-15 under these contracts.

B. Pull-tab Tickets

In October 2009, the Wisconsin Lottery signed contracts for pull-tab ticket printing services with International Gamco, Inc. and Pollard Banknote Ltd. to print pull-tab tickets. These two contracts were for the period November 1, 2009, through October 31, 2011, with three one-year renewal options for each contract. Both contracts were renewed (or extended) through October 31, 2014. The Wisconsin Lottery subsequently entered into a new two-year contract with Pollard Banknote Ltd. that expired on February 28, 2017, but includes four one-year renewal options. The Wisconsin Lottery exercised their right to renew this contract, which now has an expiration date of February 28, 2018. The Wisconsin Lottery did not purchase any ticket printing services for pull-tabs in FY 2015-16 or FY 2014-15 under these contracts.

C. Gaming System Vendor

The Wisconsin Lottery originally signed a contract with GTECH Corporation that supported a network of approximately 4,000 locations where lottery games are sold. The expiration date in the original contract was June 25, 2011, and the Wisconsin Lottery exercised its option to renew the contract for two one-year periods through June 25, 2013. Subsequently, the Wisconsin Lottery amended and extended the current contract through May 13, 2017.

During FY 2015-16, GTECH Corporation received 2.54 percent of the price of each ticket sold, less \$1,750,000, offset by liquidated damages due to the Wisconsin Lottery. The Wisconsin Lottery may 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). GTECH Corporation gives the Wisconsin Lottery credit on the next month’s invoice for any liquidated damages of the previous month. Net payments to GTECH Corporation (now called IGT Global Solutions Corporation) under this contract were approximately \$14.5 million in FY 2015-16 and approximately \$12.8 million in FY 2014-15.

On April 7, 2015, GTECH S.p.A., the parent company of GTECH Corporation, completed its acquisition of International Game Technology. In connection with such acquisition, GTECH S.p.A. was merged into International Game Technology PLC. GTECH Corporation remained a subsidiary of the merged entity until October 1, 2015, at

which time its name was changed to IGT Global Solutions Corporation. IGT Global Solutions Corporation will fulfill the remaining term of the current contract. On February 16, 2016, the Wisconsin Lottery entered into a new contract with IGT Global Solutions Corporation for an integrated gaming computer system anticipated to be implemented in May 2017. The initial terms of this contract will be for seven years from the operational start date. The new contract will require the Wisconsin Lottery to pay IGT Global Solutions Corporation 2.57 percent of total net sales. This new contract includes the lottery gaming system, instant scratch-off ticket printing, warehousing, distribution, and telemarketing services.

D. Product Information Costs

The Wisconsin Lottery primarily contracts with HY Connect to provide informational advertising services. The Wisconsin Lottery signed a two-year contract with HY Connect starting July 12, 2010, with an option to renew for three additional one-year periods. This contract was renewed through July 11, 2015. The Wisconsin Lottery has signed another two-year contract with HY Connect that will run from July 12, 2015, through June 30, 2017, with four one-year options for renewal. Payments to HY Connect were approximately \$7.3 million during both FY 2015-16 and FY 2014-15, and total spending on product information costs was approximately \$7.5 million during both FY 2015-16 and FY 2014-15.

11. EMPLOYEE RETIREMENT PLAN

Permanent employees of the Wisconsin Lottery are participants in WRS. The WRS is a cost-sharing multiple-employer defined benefit pension plan and is established by chapter 40 of the Wisconsin Statutes. Eligible state and local government public employees are entitled to an annual formula retirement benefit based on the employee's final average earnings, years of creditable service, and 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 WRS is considered part of the State of Wisconsin's financial reporting entity.

Required contributions are determined by an annual actuarial valuation in accordance with chapter 40 of the Wisconsin Statutes. The employee required contribution is one-half of the actuarially determined contribution rate for general category employees, including teachers, and executives and elected officials. Required contributions for protective employees are the same rate as general employees. Employers are required to contribute the remainder of the actuarially determined contribution rate. The employer may not pay the employee required contribution unless provided for by an existing collective bargaining agreement. The WRS recognized contributions from the

Wisconsin Lottery of \$272,468 in calendar year 2014 and \$287,120 in calendar year 2015.

As of June 30, 2016, the Wisconsin Lottery reported a liability of \$510,345 for its proportionate share of the net pension liability. The net pension liability was measured as of December 31, 2015, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of December 31, 2014, rolled forward to December 31, 2015. No material changes in assumptions or benefit terms occurred between the actuarial valuation date and the measurement date. The Wisconsin Lottery's proportion of the net pension liability was based on the Wisconsin Lottery's share of contributions to the pension plan relative to the contributions of all participating employers. As of December 31, 2015, the Wisconsin Lottery's proportion was .03 percent, which was the same as its proportion measured as of December 31, 2014. As of June 30, 2015, the Wisconsin Lottery reported an asset of \$758,965 for its proportionate share of the net pension asset.

The Wisconsin Lottery recognized pension expense of \$323,127 and \$630,115 for the fiscal years ended June 30, 2015, and June 30, 2016, respectively.

12. RESTRICTED NET POSITION

The Wisconsin Lottery has a restricted net position related to capital assets of \$169,922 as of June 30, 2016, and \$52,605 as of June 30, 2015.

The Wisconsin Lottery has a restricted net position for pensions of \$0 on June 30, 2016, and \$758,965 on June 30, 2015.

The Wisconsin Lottery also has a restricted net position related to the MUSL reserves as described in Note 5. The restricted net position related to the MUSL reserves was \$5,249,990 as of June 30, 2016, and \$5,382,829 as of June 30, 2015.

In addition, the Wisconsin Lottery has a restricted net position for fair value adjustments of investments of \$4,381,836 as of June 30, 2016, and \$4,857,205 as of June 30, 2015. The Wisconsin Lottery does not realize gains or losses from the change in fair value of its annuity investments because it holds the investments until maturity to pay the annual annuity prize payments. Therefore, fair value adjustments recognized as investment income 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 position and were \$40,604,952 as of June 30, 2016, and \$23,455,342 as of June 30, 2015.

13. DISTRIBUTION OF NET PROCEEDS

Wisconsin Lottery net proceeds and other gaming-related proceeds were used for the following purposes, as discussed in Note 2P:

	<u>FY 2015-16</u>	<u>FY 2014-15</u>
Lottery and Gaming Tax Credit	\$158,086,831	\$166,433,304
Farmland Tax Relief Credit	<u>895</u>	<u>22</u>
Total Property Tax Relief Credits	<u>\$158,087,726</u>	<u>\$166,433,326</u>

14. PRIOR PERIOD ADJUSTMENT

The FY 2014-15 Statement of Revenues, Expenses, and Changes in Net Position includes the following prior period adjustment:

<u>Account Affected</u>	<u>Amount</u>	<u>Explanation</u>
Net Pension Asset	\$1,359,611	Implementation of GASB Statement No. 68 and GASB Statement No. 71
Net Position	(1,359,611)	

There was not a prior period adjustment or any other restatements for FY 2015-16.

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Supplementary Schedules ■

Statutorily Defined Lottery Administrative Expenses for the Years Ended June 30, 2016, June 30, 2015, and June 30, 2014

	Year Ended June 30, 2016	Year Ended June 30, 2015	Year Ended June 30, 2014
ADMINISTRATIVE EXPENSES			
Instant and Lotto Vendor Services	\$ 14,462,323	\$ 12,843,263	\$ 13,422,691
Product Information Costs	7,484,216	7,496,263	7,487,472
Instant Ticket Printing Costs	3,995,818	3,987,424	3,813,054
Instant Ticket Delivery Costs	941,898	892,125	804,297
Salaries and Fringe Benefits	6,138,848	5,675,474	5,470,323
Supplies and Services	2,816,720	2,454,104	2,559,805
Depreciation Expense	16,065	13,292	19,792
Transfer to Department of Health Services for Compulsive Gambling Programs	357,582	396,000	396,000
Transfer to Department of Revenue for Lottery Credit Administration	185,847	241,632	182,801
Transfers Out to General Fund	216,849	143,020	169,665
Total Administrative Expenses as Determined in Accordance with s. 25.75 (3) (b), Wis. Stats.	<u>\$ 36,616,166</u>	<u>\$ 34,142,597</u>	<u>\$ 34,325,900</u>
Gross Lottery Revenues per s. 25.75 (1) (b), Wis. Stats.	<u>\$ 627,226,192</u>	<u>\$ 574,685,288</u>	<u>\$ 568,872,610</u>
Administrative Expenses as a Percentage of Gross Lottery Revenues	5.84%	5.94%	6.03%

Section 25.75 (3) (b), Wis. Stats., limits the Wisconsin Lottery's administrative expenses to 10 percent of gross lottery revenues. Gross lottery revenues, as defined in s. 25.75 (1) (b), Wis. Stats., include lottery ticket sales and retailer fees. Administrative expenses, as defined in s. 25.75 (3) (b), Wis. Stats., do not include retailer commissions and incentives and transfers to the Department of Justice for law enforcement.

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

Summary of Prize Expenses for the Years Ended June 30, 2012, through June 30, 2016

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 2015-16		
	Prize Expense	Ticket Sales	Prize Expense as a Percentage of Sales
Instant Games	\$ 249,991,398	\$ 379,930,973	65.8%
Lotto Games	122,567,099	247,233,964	49.6
Total for Fiscal Year	\$ 372,558,497	\$ 627,164,937	59.4

	Fiscal Year 2014-15		
	Prize Expense	Ticket Sales	Prize Expense as a Percentage of Sales
Instant Games	\$ 236,549,274	\$ 357,463,506	66.2%
Lotto Games	105,892,045	217,167,877	48.8
Total for Fiscal Year	\$ 342,441,319	\$ 574,631,383	59.6

	Fiscal Year 2013-14		
	Prize Expense	Ticket Sales	Prize Expense as a Percentage of Sales
Instant Games	\$ 221,635,297	\$ 338,960,811	65.4%
Lotto Games	115,059,226	229,876,604	50.1
Total for Fiscal Year	\$ 336,694,523	\$ 568,837,415	59.2

	Fiscal Year 2012-13		
	Prize Expense	Ticket Sales	Prize Expense as a Percentage of Sales
Instant Games	\$ 211,185,530	\$ 326,725,747	64.6%
Lotto Games	118,016,139	239,376,954	49.3
Total for Fiscal Year	\$ 329,201,669	\$ 566,102,701	58.2

	Fiscal Year 2011-12		
	Prize Expense	Ticket Sales	Prize Expense as a Percentage of Sales
Instant Games	\$ 208,922,382	\$ 322,482,041	64.8%
Lotto Games	111,192,993	225,158,693	49.4
Total for Fiscal Year	\$ 320,115,375	\$ 547,640,734	58.5

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.

Auditor's Report ■



Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters

Senator Robert Cowles and
Representative Samantha Kerkman, Co-chairpersons
Joint Legislative Audit Committee

Mr. Richard G. Chandler, Secretary
Ms. Cindy Polzin, Lottery Administrator
Department of Revenue

We have audited the financial statements and the related notes of the Wisconsin Lottery as of and for the years ended June 30, 2016, and June 30, 2015, and have issued our report thereon dated August 23, 2017. 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*, which is issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

Management of the Department of Revenue and the Wisconsin Lottery are responsible for establishing and maintaining effective internal control over financial reporting (internal control). In planning and performing our audits of the financial statements, we considered the Department of Revenue's and Wisconsin Lottery's internal control to determine the audit procedures that are appropriate in the circumstances 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 Department of Revenue's and Wisconsin Lottery's internal control. Accordingly, we do not express an opinion on the effectiveness of the Department of Revenue's and 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 misstatements, 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 that a material misstatement will not be detected and corrected on a timely basis. *A significant deficiency* is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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 material weaknesses or significant deficiencies, and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, we identified a significant deficiency with controls over the reconciliation of cash at the Department of Administration (DOA), which we believe should be reported to the users of the financial statements.

DOA is responsible for performing certain centralized internal control functions related to cash. State agencies, including the Department of Revenue and the Wisconsin Lottery, rely on these controls. As part of our separate audit of DOA, we identified a significant deficiency in the centralized controls related to cash. This weakness relates to the lack of complete and timely reconciliations of cash reported by the bank with cash balances reported in the State's central accounting system, STAR. This control is important to ensure cash balances are accurate and to ensure all receipts and disbursements have been properly recorded. Due to the pervasiveness of the deficiency and its effects on state agencies and programs, this deficiency is reported to the users of the financial statements. We communicated this weakness to DOA, which agreed with the finding. DOA's response was included in our separate report related to the State's *FY 2015-16 Comprehensive Annual Financial Report* (report 17-4). We did not request a response from the management of the Department of Revenue or the Wisconsin Lottery since DOA is responsible for corrective action.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Wisconsin Lottery's financial statements are free from material misstatement, we performed tests of 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*.

Purpose of This Report

This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Department of Revenue's and the Wisconsin Lottery's internal control and compliance. The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the Department of Revenue's and the Wisconsin Lottery's internal control or on compliance. Accordingly, this report is not suitable for any other purpose.

LEGISLATIVE AUDIT BUREAU



Joe Chrisman
State Auditor

August 23, 2017