

Iowa Lottery Authority

Performance Report

Performance Results Achieved
Fiscal Year 2004



Introduction

I am pleased to present to the Iowa Lottery Authority's performance report for fiscal year 2004 (July 1, 2003 through June 30, 2004). This report contains information about the activities of the Iowa Lottery Authority during the past fiscal year.

On July 1, 2003, as a result of action by the legislature, the Iowa Lottery Authority came into existence. As a result of strategic marketing and budgeting decisions, it ended its first year of operation with an increase of millions of dollars in profits to the state. In FY 2004, Lottery sales totaled more than \$208.5 million with profits to the state of \$55.8 million. This equates to a sales increase of 11 percent in fiscal year 2004 after a 3.6 percent increase in FY 2003 and a 3.6 percent increase in FY 2002. The Lottery's revenue increase of more than 16 percent in FY 2004 followed revenues that held steady in FY 2003 and had increased 8 percent in FY 2002.

The lottery achieved sales increases in FY 2004 in nearly all of its products. The Lottery's new TouchPlay machines also contributed to the results achieved this year. The creation of the Iowa Lottery Authority, with its accompanying freedom to operate as a business with business-type incentives, has set the stage for future Lottery success.

The proof of the Lottery's renewed business focus is in the results achieved in FY 2004. The result has been greater productivity, which results in benefits to all Iowans. Success of the Lottery means greater resources for the programs that benefit all Iowans, and everyone at the Lottery worked hard in order to achieve the level of support given in FY 2004. With a continued focus on success in FY 2005, we hope to improve our results even more.

Sincerely,

Edward J. Stanek
Chief Executive Officer
Iowa Lottery Authority

Overview of the Iowa Lottery Authority

The Iowa Lottery was established in 1985 and began sales of products on August 22 of that year. The Lottery has always focused on results, and since its inception, has awarded more than \$1.77 billion in prizes and has raised more than \$883 million for state programs. The Lottery's mission is to conduct a statewide lottery in a secure, controlled manner so as to maximize net revenue while maintaining the dignity of the state of Iowa and the welfare of its people.

The guiding principles of the Iowa Lottery are:

- Develop and distribute products that are fun and exciting to Iowans;
- Maintain integrity and security in production and delivery of those products while utilizing the highest level of technology available;
- Educate and motivate the public to play Lottery games responsibly;
- Maintain the dignity of the Lottery through truthful, tasteful, and informative advertising;
- Develop and effective employee workforce that is professional knowledgeable, skilled, and offers maximum service and reliability to retailers and players; and
- Maximize net revenues to the state.

The Lottery is guided by the leadership of Dr. Ed Stanek, Chief Executive Officer, and the five member Iowa Lottery Board. The Board and the CEO have joint responsibility for hiring and retaining key lottery staff members, for entering into major contracts, procuring the printing of instant and pull-tab tickets, for the purchase or lease of equipment or services essential to the operation of Lottery games, and for the purchase or lease of real estate.

The Lottery operates with approximately 112 employees separated into five divisions: security, finance, operations, sales, and marketing. Approximately 50 employees are assigned to Lottery Headquarters, currently located at 2015 Grand Avenue in Des Moines. These associates design games, draft and administer contracts, oversee ticket printing and security, validate and pay winning tickets, plan marketing, public relations, and marketing efforts, and perform accounting, information technology, and data processing duties. The Lottery also maintains several staff members at a warehouse facility in Ankeny. The remaining employees are sales representatives, regional managers, and support staff that work out of five regional offices located in Storm Lake, Council Bluffs, Cedar Rapids, Mason City, and Des Moines.

The Lottery offers four separate product lines. Instant games generally have a scratch-off covering removed to identify winning tickets, although an electronic version of a traditional scratch game is currently being tested by the Iowa Lottery. Pull-tab tickets are played by opening tabs to reveal whether a prize has been won. Online games are "numbers" games where computerized tickets are generated from a terminal. Touch Play tickets are dispensed from vending machines that have video monitors that display the results of the ticket while

entertaining electronic tones indicate whether the ticket has won a prize. The machines do not pay out money and do not build up credit. Players must redeem Touch Play winning tickets at the retail location at which it was bought.

The Lottery's primary customer market is Iowans age 21 and older. The Lottery designs its products to appeal to a variety of demographics. Different game themes, price points, play action, and prize structures are used to broaden the appeal. The Lottery also identifies the legislative body as a customer market. A legislative program is used to educate and gain support from legislators on new games and public service programs. Legislators are shown how the Lottery complies with laws and regulations and are reminded of how the Lottery helps the state of Iowa and maintains the dignity and welfare of its people.

Lottery products are sold through licensed retail outlets located throughout the state. Each outlet carries computer equipment for ticket validation that is linked through an intricate communications network to a central online ticket system operated by the Lottery's online vendor, Scientific Games. The link to the central system records every transaction on the entire network to ensure the integrity of the system. With the data from the system, the Lottery monitors sales and validations, monitors the movement of inventory, collects accounts receivable, and determines retailer commissions. The network operates seven days a week, for approximately 21 ½ hours a day. The Lottery is working with its current online vendor to have 23 ½ hour per day network operation.

The Lottery has 3190 licensed retail outlets, which are visited on a weekly basis by a lottery sales representative. The sales reps make sure that each retailer has an adequate ticket supply, distribute point-of-purchase marketing and informational materials, and provide retailer training.

Despite legislative constraints and increasing competition from riverboats and land-based casinos, the Iowa Lottery averaged \$45.9 million in yearly profits by fiscal year 2003. On July 1, 2004, the legislature recognized that as an entrepreneurial entity, the Iowa Lottery could operate more efficiently by being freed from the bureaucracy associated with state government and lifted some of its prior constraints by establishing the Iowa Lottery Authority, a public instrumentality of the state. As a result, in fiscal year 2004, the Iowa Lottery had sales of \$208.5 million, paid prizes totaling over \$114 million, and turned over \$55.8 million in profits to the state coffers. The Lottery expended \$9,688,686 in operations and \$6 million in advertising in fiscal year 2004.

The Department of Management has identified two core functions for the Iowa Lottery: Sales and Distribution and Resource Management.

Performance Plan Results

CORE FUNCTION

Name: Sales & Distribution

Description: Sell and distribute lottery products.

Why We Do This: To generate revenues to the General Fund in order to provide financial support for state services.

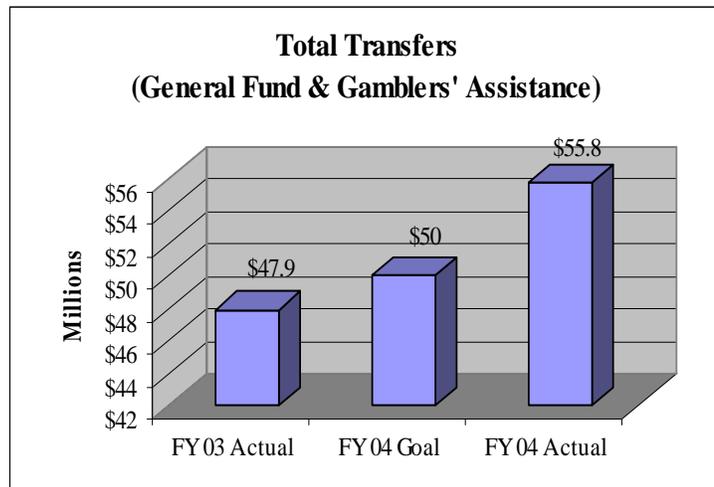
What We Do To Achieve Results: The Lottery strives to maintain an effective sales force, utilizes advertising to build customer awareness, and generates interest in products and specific games via special promotions. Additionally, in late April 2004, statewide rollout began of the Lottery's monitor vending machines, which are being marketed under the brand name "TouchPlay." The vending machines resulted in net receipts of over \$303,000 by the end of FY 2004. More TouchPlay machines continue to be deployed each week.

Results

Performance Measure: Total transfers to the state,* including the General Fund & Gambler's Assistance Fund

Performance Target: \$50 million

Data Source: Iowa Lottery Authority accounting records



**Note: This measure has been moved under "Resource Management in the FY 2005 Performance Plan"*

Data Reliability: The Lottery's central computer system, which is linked to every licensed retailer in the state, records every transaction on the entire network in order to ensure the integrity of the system. The data obtained from this network is 100% reliable.

Why We Use This Measure: Total transfers is the ultimate measure of how well the Lottery is operating because it accounts not only for sales, but also for how well resources are being used. Even though this measure was used in FY 2004 under the Core Function of "Sales & Distribution," the Lottery has determined that it is more applicable to how we are doing in the area of "Resource Management," so that change has been made in the Lottery's FY 2005 Performance Plan.

What Was Achieved: The Lottery transferred \$55.8 million total in fiscal year 2004. This was well above the goal of \$50 million and represents an increase of 17% from FY 2003 transfers.

Analysis of Results: Fiscal year 2004 marked the first year of operations for the Iowa Lottery Authority, which was created with the passage of legislation that reinvented the lottery as a public enterprise based on a business model. The legislation, signed into law in May 2003, gave the Lottery greater flexibility in its day-to-day operating decisions, with the goal of producing greater profits to the state. Under the new law, the Lottery's five-member board has begun approving the enterprise's budget using best-business judgment, allowing the Lottery to accelerate product development focused on entertainment. Under the traditional state budget-setting procedure, the Lottery had to delay some strategic long-term planning while it waited for the completion of the legislative appropriations process, which spanned months and represented lost marketing time for new products.

Factors Affecting Results: In addition to the change in the structure of the Lottery to that of an entrepreneurial enterprise, the Lottery re-engineered its delivery schedule for instant-scratch games to allow for more effective advertising. By delivering new games on a three-week cycle rather than each week, the Lottery was able to strategically focus its advertising on key games for longer periods of time. The Lottery also maintained an advertising focus that gave added attention to scratch games and other products while continuing to emphasize Powerball, the nation's most popular lotto game. As in the past, the Lottery continued to offer its players variety, convenience, and fun in the products offered, and at the same time made strategic business changes internally which led to the increase in profitability in FY 2004. Finally, the Lottery board implemented an incentive program, based on total transfers, to motivate all employees to take actions to maximize Lottery profitability.

Resources Used: In FY 2004, the Lottery spent \$9.7 million on administrative expenses, \$6 million on advertising, and had approximately 112 employees on staff. All these resources contributed to the total transfers that were made to the state.

Performance Plan Results

Services/Products/Activities

Name: Sales & Marketing

Description: The Lottery distributes lottery products throughout the state in a manner that maximizes revenues and recruits and maintains licensed retail outlets to help achieve this goal.

Why We Do This: To generate revenues to the General Fund in order to provide financial support for state services.

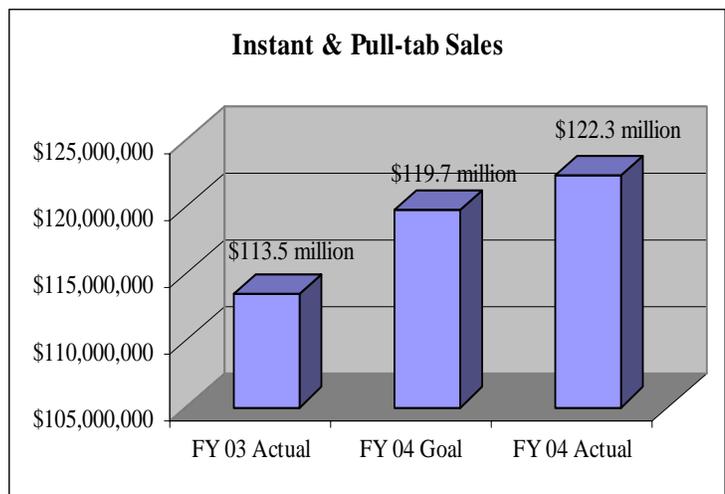
What We Do To Achieve Results: The Lottery strives to maintain an effective sales force, utilizes advertising to build customer awareness, and generates interest in products and specific games via special promotions. Additionally, in late April 2004, statewide rollout began of the Lottery's monitor vending machines, which are being marketed under the brand name "TouchPlay." The vending machines resulted in net receipts of over \$303,000 by the end of FY 2004. More TouchPlay machines continue to be deployed each week.

Results

Performance Measure: Sales of instant tickets, pull-tabs, and Touch Play tickets

Performance Target: \$119.7 million

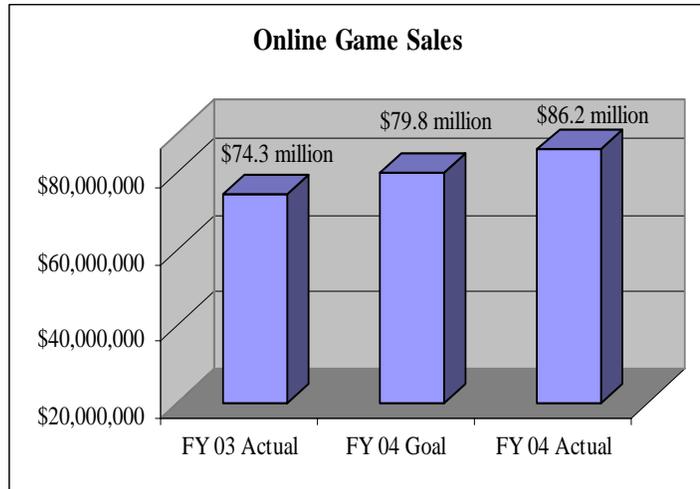
Data Source: Iowa Lottery Authority accounting records



Performance Measure: Sales of online game tickets

Performance Target: \$79.8 million

Data Source: Iowa Lottery Authority accounting records



Data Reliability: The Lottery’s central computer system, which is linked to every licensed retailer in the state, records every transaction on the entire network in order to ensure the integrity of the system. The data obtained from this network is 100% reliable.

Why We Use These Measures: The legislature, the governor, and the public use sales data to generally determine how the Lottery is doing. Sales of different products are compared by the Lottery on a yearly basis in order to assess progress.

What Was Achieved: For FY 2004, instant ticket sales exceeded \$95.2 million, pull-tab sales exceeded \$25.5 million, and online game ticket sales were nearly \$86.2 million.

Analysis of Results: Instant ticket and online game sales in FY 2004 exceeded FY 2003 sales in those areas. Instant tickets, the Lottery’s traditional sales leader, claimed that spot again in FY 2004, with sales increasing by more than 12 percent to \$95.3 million. The introduction of a new online game, Pick 4, resulted in \$1.7 million in sales. Powerball sales for the year were up more than 14 percent to \$66 million, while sales of Hot Lotto, a similar game but with smaller jackpots, increased more than 29 percent to \$7.7 million. However, sales of pull-tabs in FY 2004 were just over \$25.5 million, which is nearly \$3 million less than FY 2003 sales. New competition from non-lottery products in the marketplace is the cause of the decline in pull-tab sales in FY 2004.

Factors Affecting Results: The Lottery designs its games to appeal to a variety of demographic groups. Research plays a significant role in the success of Lottery products and marketing efforts. A yearly baseline study supplies the Lottery with valuable player information, as well as public perceptions about the Lottery. Focus groups keep us attuned to players’ feelings and opinions. Feedback from players and retailers are used to gauge product acceptance.

Resources Used: In FY 2004, the Lottery spent \$9.7 million on administrative expenses, \$6 million on advertising, and had approximately 112 employees on staff. All these resources contributed to the total sales made by the lottery.

Performance Plan Results

CORE FUNCTION

Name: Resource Management

Description: Maintain integrity and security in production and delivery of lottery products while utilizing the highest level of technology available. Also maintain accurate and timely accountings of both incoming revenues and outgoing expenditures.

Why We Do This: The media, the legislature, and the public closely scrutinize the actions of the Lottery. Because the Lottery's profits are deposited into the General Fund, it is essential to ensure that its resources are managed wisely in order to achieve maximum benefits for the state as a whole.

What We Do To Achieve Results: Internal integrity and security is paramount to the Lottery. Background checks are conducted on all potential employees and suppliers of major procurements before they can become members of the Lottery team. Strict licensing requirements, including background checks, ensure that only reputable retailers sell Lottery products. The Lottery's security division conducts retailer reviews and reports their findings to the Lottery's Board. Online game system integrity is tested daily by an internal control system. All drawings are monitored and verified by an independent auditor. All sales reps are required to balance their ticket inventory on a weekly basis.

Periodic performance evaluations and the resulting reports are also a must to ensure that the Lottery's integrity remains intact. The Lottery is subject to annual financial audits by the State Auditor's Office. A major accounting firm conducts an annual performance audit on the Lottery's online game system. Additionally, the Lottery's internal auditor reviews major processes, internal control procedures, and advertising contracts. Post-buy analysis of media plans ensures that advertising has the intended frequency and scope. Reports from all these sources help Lottery management to assess organizational performance and identify areas for improvement in order to ensure that the Lottery's resources are effectively managed.

Results

The Lottery's FY 2004 performance plan called for the establishment of baseline measures in the area of Resource Management. However, in the Lottery's FY 2005 plan, all the services, products, and activities under Resource Management, as well as the associated measures, are

being completely modified. Consequently, there are no results to report under the core function of “Resource Management” for FY 2004.

Resource Reallocations

As of July 1, 2003, the legislature eliminated the Lottery Division of the Iowa Department of Revenue and Finance and replaced it with the Iowa Lottery Authority, a public enterprise based on a business model. With the change, the Iowa Lottery Authority continues to fall under legislative review but is not subject to expense appropriations from the Legislature. Instead, the Lottery Authority Board of Directors has been given more oversight responsibility and now approves or alters the Lottery’s budget. The budgeting change has had one of the biggest effects on the Lottery’s productivity.

The law creating the Iowa Lottery Authority also eliminated the process of classifying some Lottery proceeds as sales tax revenue. The change is revenue-neutral to the state budget, as all Lottery proceeds will now be classified as general Lottery revenues. But for Lottery finance staff, the change eliminates the unnecessary and often confusing process of separating its revenues into two income streams to the state, only to have both deposited in the same fund.

In FY 2004, the Lottery also did its statewide launch of its new product line, Touch Play. Management determined that at least one staff member would be needed to oversee and manage the Touch Play program. Instead of hiring a new employee to take on these responsibilities, the Lottery decided to assign the new responsibilities to an existing position, and also delegate the prior responsibilities of the employee who assumed the new duties in order to assure that all the tasks would continue to be accomplished.

Lottery security staffers also recently developed an innovative plan for addressing the space issues that had developed at the Lottery’s central warehouse. The Lottery leases warehouse space in Ankeny from the Alcoholic Beverages Division and over time, the orders of tickets the Lottery had on hand for delivery were leading to the possibility that the Lottery could run out of warehouse space. Lottery security executives reviewed the situation and reached an innovative solution: the Lottery’s ticket printers now store many of the tickets until closer to a particular game’s release date. Other orders are only delivered half at a time. Both approaches have substantially reduced crowding at the Lottery’s warehouse.

Also, in FY 2004, the Lottery upgraded its electronic billboards with current technology to provide players with timelier jackpot information and improved reliability. The upgrade resulted in a more cost efficient system that is no longer reliant on phone hook-ups for data delivery or electricity to power up light bulbs for the number display.

Iowa Lottery Authority Contact Information

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Iowa Lottery Board Members

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Elaine Baxter, Burlington
William C. Brosnahan, Dubuque
Timothy Clausen, Sioux City
Michael L. McCoy, Des Moines

Key Iowa Lottery Staff

Dr. Edward Stanek, Chief Executive Officer
Ken Brickman, Executive Vice-President & Chief Operating Officer
Steve King, Vice-President of Finance & Chief Financial Officer
Harry Braafhart, Vice-President of Security
Joe Hrdlicka, Vice-President of Marketing
Larry Loss, Vice-President of Sales
Mary Neubauer, Vice-President of External Relations
Brandi Hoffmann, Assistant Vice-President of Legal Affairs

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