

Iowa Lottery Authority

Performance Report

Performance Results Achieved
Fiscal Year 2008



Introduction

I am pleased to present the Iowa Lottery Authority's performance report for fiscal year 2008 (July 1, 2007 through June 30, 2008). This report contains information about the activities of the Iowa Lottery Authority during the past fiscal year.

Strong sales of instant-scratch and Powerball tickets helped the Iowa Lottery raise more than \$56 million for state programs in fiscal year 2008, but record high fuel prices, a weakened U.S. economy, and widespread storm damage and flooding dampened Lottery sales in the final months of the period. Here are some key financial highlights from fiscal year 2008:

- Lottery sales totaled \$249.2 million in fiscal year 2008, which ended June 30. That mark is the highest combined sales total for lotto, scratch and pull-tab games since the Lottery's start in 1985 and a 6.0 percent increase from fiscal year 2007's lottery sales of \$235 million.
- Sales of scratch tickets, the first product introduced by the Lottery and always one of its top-selling product lines, rose over 10 percent to a record \$137.9 million in fiscal year 2008. The Lottery's previous record for scratch sales had been set in fiscal year 2007, when \$125.1 million in scratch tickets were sold.
- Powerball sales continued at a strong rate in the Lottery's latest year, totaling \$63.8 million, a 3.6 percent increase from the prior fiscal year. However, five of the Lottery's products, including the Powerball and Hot Lotto games, saw sales decreases in June 08 compared to the same month a year earlier. That came amidst widespread storm and flood damage and gasoline prices near \$4 per gallon.
- Lottery proceeds for state programs were over \$56.5 million for fiscal year 2008, a decrease of about 2.8 percent from profits in the year before. This decrease primarily resulted from the following factors: 1) A large portion of lottery profits in its latest fiscal year came from scratch games, which have smaller profit margins than lotto games. Lotto games had accounted for a greater percentage of lottery sales in fiscal year 2007 than in fiscal year 2008, resulting in higher profits in the earlier period. 2) The Governmental Accounting Standards Board (GASB) statement number 16 requires reporting for the recently implemented Sick Leave Insurance Program (SLIP). The Lottery was informed on September 8, 2008, that GASB 16 liabilities were to be reported on the fiscal year 2008 financial statements. Including the liability for SLIP in the financial statements increased our expenses and liabilities by approximately \$661,000 and decreased our net income and transfer to the state by the same amount.
- Since the Lottery's inception in 1985, more than \$2.2 billion has been awarded in prizes and over \$1.1 billion has been raised for state programs.

Sincerely,

Kenneth A. Brickman
Acting 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 \$2.2 billion in prizes and has raised more than \$1.1 billion 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 an 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 was guided by the leadership of Dr. Edward Stanek, Chief Executive Officer through his retirement on October 31, 2007, and then by Kenneth A. Brickman, Acting Chief Executive Officer, and the Iowa Lottery Board during fiscal year 2008. 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 scratch 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 115 employees separated into: security, finance, operations, sales, marketing, and external relations. Approximately 50 employees are assigned to Lottery Headquarters at 2323 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 promotional efforts, and perform accounting, information technology, and data processing duties. The Lottery also maintains a warehouse facility in Ankeny. The remaining employees are sales representatives, regional managers, and support staff who work out of four regional offices in Storm Lake, Council Bluffs, Cedar Rapids and Mason City. Employees for the Lottery's fifth regional office, Des Moines, work out of the Lottery Headquarters building.

The Lottery offers three separate product lines: Scratch, Pull-tab and Lotto games. Scratch games generally have a scratch-off latex covering that is removed by the player to identify

winning tickets. For Pull-tab tickets, players open tabs to reveal whether a prize has been won. Lotto games are “numbers” games where computerized tickets are generated from a terminal.

The Lottery’s customer market is those 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 in place to inform legislators about new games and public service programs. Legislators are shown how the Lottery complies with laws and regulations and are reminded how the Lottery helps the state of Iowa and maintains the dignity and welfare of its people.

Lottery products (Scratch, Pull-tab and Lotto tickets) are sold through licensed retail outlets throughout the state. Each outlet carries computer equipment for ticket validation that is linked through an intricate communications network to a central ticket system operated by the Lottery’s on-line 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 22 ½ hours a day.

The Lottery has about 2,500 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.

In 2003 the Legislature recognized that as an entrepreneurial entity, the Iowa Lottery could operate more efficiently and established the Iowa Lottery Authority, a public instrumentality of the state. As a result of that change, combined sales for the Lottery’s traditional products have continued to climb in the fiscal years since then.

In fiscal year 2008, the Iowa Lottery had a record combined sales total of \$249.2 million for its lotto, scratch and pull-tab games and provided more than \$56.5 million in profits to the state coffers. The Lottery expended \$13.1 million in operations and \$7.3 million in advertising in fiscal year 2008.

The Iowa Lottery discusses three core functions in this report: sales; distribution and resource management; and enforcement and investigation.

Performance Plan Results

CORE FUNCTION

Name: Sales & Distribution

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 are doing this: To generate revenues in order to provide financial support for state services.

What we're doing 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.

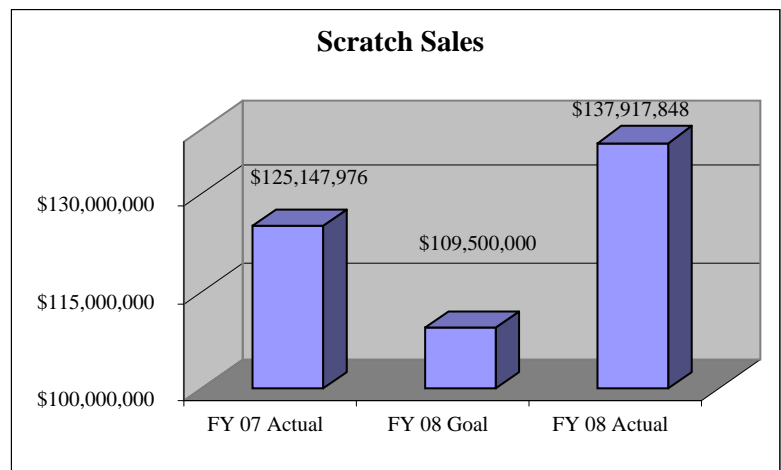
Results

Performance Measure: Sales of scratch tickets

Performance Target: \$109.5 million

What was achieved: \$137.9 million

Data Source: Iowa Lottery Authority accounting records

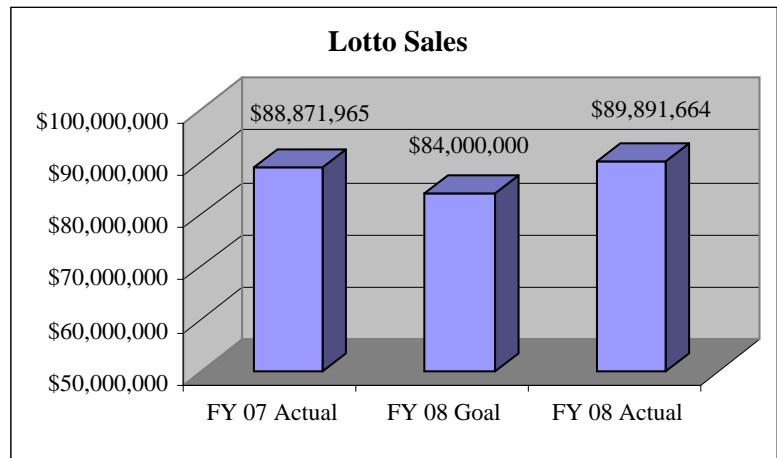


Performance Measure: Sales of lotto game tickets

Performance Target: \$84.0 million

What was achieved: \$89.9 million

Data Source: Iowa Lottery Authority accounting records

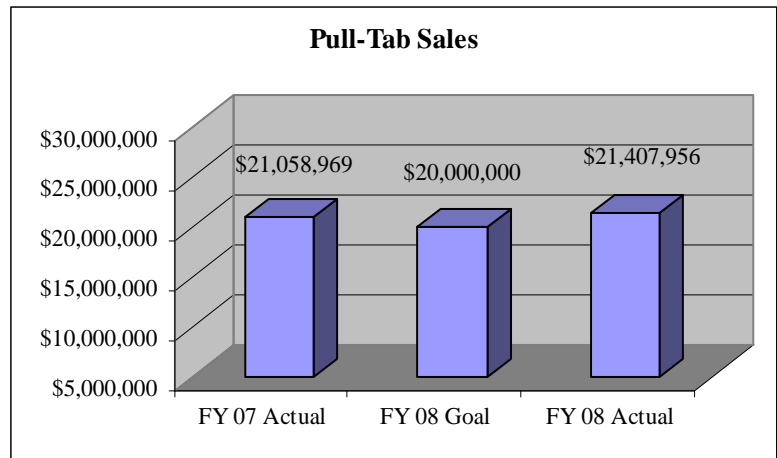


Performance Measure: Sales of pull-tab tickets

Performance Target: \$20.0 million

What was achieved: \$21.4 million

Data Source: Iowa Lottery Authority accounting records



Data Reliability: The Lottery's central computer system for lotto, scratch and pull-tab products, 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 fiscal year 2008, scratch ticket sales exceeded \$137.9 million, pull-tab sales were over \$21.4 million, and lotto ticket sales were nearly \$89.9 million.

Analysis of Results: Overall Lottery sales for fiscal year 2008 were up 6 percent, at \$249.2 million, compared to \$235.0 million for fiscal year 2007. Sales from scratch tickets, the Lottery's traditional sales leader, increased by more than 10 percent to a record level of over

\$137.9 million. Pick 3, Pick 4 and Pull-tab sales also saw sales increases. Powerball sales continued at a strong rate with FY08 totaling \$63.8 million, a 3.6 increase from the prior fiscal year.

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 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 is used to gauge product acceptance.

Resources Used: In fiscal year 2008, the Lottery spent \$13.1 million on administrative expenses, over \$7.3 million on advertising, and had approximately 115 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, lawmakers, and the public closely scrutinize the actions of the Lottery. Because the Lottery's profits support state programs, 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 its findings to the Lottery's Board. The sales and validation 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 sales and validation 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.

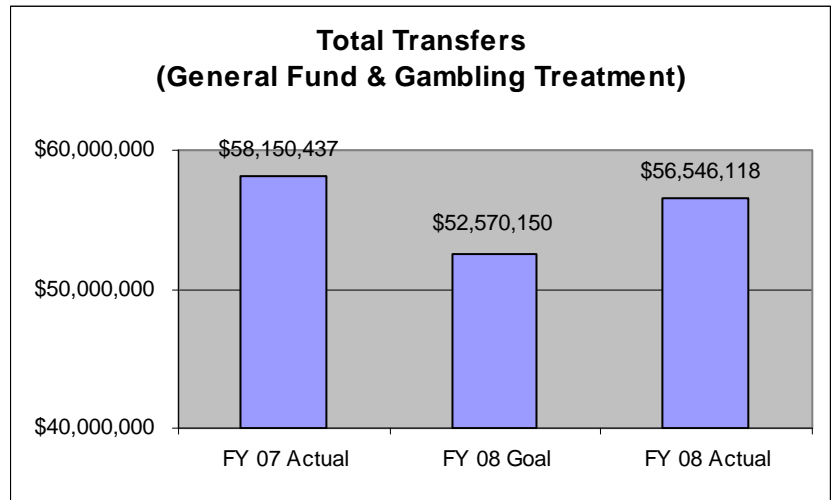
Results

Performance Measure: Total transfers to the state, including the General Fund & Gambling Treatment Fund

Performance Target: \$52.6 million

What was achieved: \$56.5 million

Data Sources: Iowa Lottery Authority accounting records



Data Reliability: The Lottery's central computer system for lotto, scratch and pull-tab products, 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. The Lottery must ensure its resources are managed wisely in order to achieve maximum benefits for the state as a whole.

What Was Achieved: The Lottery transferred a total of over \$56.5 million in fiscal year 2008. This total included nearly \$55.3 million in General Fund transfers and over \$1.2 million in transfers to the Gambling Treatment Fund.

Analysis of Results: Lottery proceeds for state programs decreased 2.8 percent from the previous year. The Lottery's record for proceeds to the state from the sale of lotto, scratch and pull-tab games was set in fiscal year 1995, when \$58.1 million was raised for state programs.

Factors Affecting Results: Lottery sales for fiscal year 2008 were up 6 percent, as compared to fiscal year 2007. Because of the overall increase in Lottery sales, the Lottery's transfers to the Gambling Treatment Fund were also up for fiscal year 2008 to \$1.25 million from \$1.2 million in fiscal year 2007; however, transfers to the State General Fund were down for fiscal year 2008 to \$55.3 from \$57.0 in the previous fiscal year. As noted in the financial highlights, the decrease resulted from several factors, including an increase in scratch sales which have a higher prize payout and the addition of approximately \$661,000 in Sick Leave Insurance expense and liability.

Resources Used: In fiscal year 2008, the Lottery spent \$13.1 million on administrative expenses, \$7.3 million on advertising and had approximately 115 employees on staff. All these resources contributed to the total transfers made by the lottery.

Performance Plan Results

CORE FUNCTION

Name: Enforcement and Investigation

Description: Enhance the safety and well being of the public through the enforcement of state laws and to investigate those incidences where laws may have been violated. Activities include investigating complaints of minors buying tickets and taking action to suspend or revoke licenses where justified.

Why We Do This: To help prevent the sale of Lottery tickets to minors and ensure the integrity of the Lottery's products and operation.

What We Do To Achieve Results: The Lottery's security division investigates all complaints of underage persons illegally purchasing lottery tickets and initiates actions to suspend or revoke the licenses of retailers for which the complaints have been substantiated.

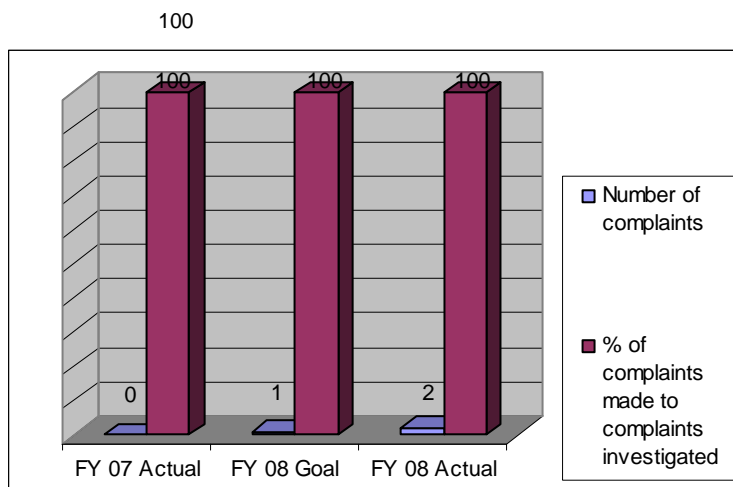
Results

Performance Measure: Percent of complaints filed to complaints investigated

Performance Target: 100%

What was achieved: Two complaints were filed for 2008

Data Sources: Iowa Lottery Authority security records



Data Reliability: All complaints are sent to a central point of contact within the Lottery's security department, the investigative supervisor. The supervisor ensures that all complaints are assigned for investigation, monitors the progress of each investigation and makes

recommendations to the Vice President of Security, as appropriate, to suspend or revoke licenses. The data obtained is 100% reliable.

Why We Use This Measure: Iowa Code 99G.30 requires that "a ticket or share shall not be sold to a person who has not reached the age of twenty-one." The Lottery employs continued vigilance to prevent sales to minors by investigating 100% of all complaints of minors buying tickets and taking action to suspend or revoke licenses where justified.

What Was Achieved: During fiscal year 2008, there were two complaints of underage persons illegally buying lottery games. Both complaints were investigated and found to be unsubstantiated.

Analysis of Results: The lottery has provided the necessary sales training for its retailers. The lottery has approximately 2,500 licensed retail outlets that sell lottery tickets for its lotto, scratch and pull-tab tickets. The two unsubstantiated complaints represent less than 0.1% of the Lottery's retailers.

Factors Affecting Results: During fiscal year 2008 there were two complaints of underage persons buying lottery games illegally. Both complaints were unsubstantiated.

Resources Used: In addition to other duties, the Lottery's three investigators, one investigative supervisor and VP of Security were responsible for investigating complaints of minors purchasing Lottery tickets.

Resource Reallocations

No adjustments were made during fiscal year 2008.

Iowa Lottery Authority Contact Information

Iowa Lottery Authority
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www.ialottery.com

Iowa Lottery Board Members

Mary Junge, Cedar Rapids, Chairperson
Timothy Clausen, Sioux City, Chairperson through April 30, 2008
Elaine Baxter, Burlington
Mike Klappholz, Cedar Rapids
Tom Rial, Des Moines
Brad Schroeder, Pleasant Hill, effective May 1, 2008
Treasurer of State Michael L. Fitzgerald, ex-officio member

Key Iowa Lottery Staff for Fiscal Year 2008

Dr. Edward Stanek, Chief Executive Officer through 10/31/07
Ken Brickman, Acting Chief Executive 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
Marci Tooman, Assistant Vice President of Legal Affairs
Tina Potthoff, Public Affairs Manager

For questions or comments regarding this document, please contact Marci Tooman at the address or phone number listed above, or email mtooman@ialottery.com.