COLORADO LOTTERY

FINANCIAL AND COMPLIANCE AUDIT
June 30, 2013 and 2012

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Members of the Legislative Audit Committee:

We have completed the financial statement audit of the Colorado Lottery as of and for the year ended June 30, 2013. Our audit was conducted 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*, issued by the Comptroller General of the United States.

We were engaged to conduct our audit pursuant to Section 24-35-211, C.R.S., which requires the State Auditor to audit the Lottery Fund. The reports we have issued as a result of this engagement are set forth in the table of contents which follows.

Eide Bailly LLP

Greenwood Village, Colorado
September 16, 2013

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Table of Contents

COLORADO LOTTERY

REPORT SUMMARY

Years Ended June 30, 2013 and 2012

Purposes and Scope of Audit

Authority, Purpose and Scope

The Office of the State Auditor, State of Colorado, engaged Eide Bailly, LLP to conduct the financial audit of the Colorado Lottery for the Fiscal Year ended June 30, 2013. The audit of the Colorado Lottery (the Lottery) was performed under authority of Section 24-35-211, C.R.S., which requires the State Auditor to conduct an annual audit of the Lottery. The purpose of the audit was to express opinions on the financial statements of the Lottery for the year ended June 30, 2013.

Eide Bailly LLP conducted the audit in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards* issued by the Comptroller General of the United States of America.

The purposes and scope of this audit were:

- To express opinions on the financial statements of the Lottery as of and for the year ended June 30, 2013, including a review of the related systems of internal controls as required by auditing standards generally accepted in the United States of America.
- To review the Lottery's compliance with rules and regulations governing the expenditure of State funds for the year ended June 30, 2013.
- To evaluate progress in implementing the prior audit recommendations.

Summary of Major Audit Comments

Audit Findings and Financial Statement Audit Report Section

The auditor's findings and recommendations section contains the following recommendation:

- The Colorado Lottery should implement monitoring procedures to ensure the accuracy of the financial close process to support the annuity section of the contingent liability footnote included in the Lottery's financial statements. Supporting documents should be reviewed by a supervisor and the final financial information accurately disclosed in the financial statement footnotes as required by Generally Accepted Accounting Principles.

The recommendation and the response from the Lottery can also be found in the recommendation locator.

COLORADO LOTTERY
REPORT SUMMARY
Years Ended June 30, 2013 and 2012

Audit Opinions and Reports

The independent auditor's reports included herein, state that the financial statements of the Lottery are fairly stated, in all material respects, in accordance with accounting principles generally accepted in the United States of America, and that no material weaknesses in internal controls were discovered during the course of the audit.

Auditor's Communication to Legislative Audit Committee

The auditor's communication to the Legislative Audit Committee describes the auditor's responsibility under auditing standards generally accepted in the United States of America and significant management judgments and estimates. This communication is located on page 67.

Summary of Progress in Implementing the Prior Year Audit Recommendations

As of our Fiscal Year 2013 audit, we determined the 2012 prior year recommendation was fully implemented and the 2011 prior year recommendation was partially implemented. The Disposition of Prior Year Audit Recommendations begins on page 8.

COLORADO LOTTERY
RECOMMENDATION LOCATOR
Years Ended June 30, 2013 and 2012
Fiscal Year 2013 Recommendation

Recommendation Number	Page Number	Recommendation Summary	Response	Implementation Date
1	5	The Colorado Lottery should ensure that a) personnel monitor and perform a review of the internal systems report used for the annuity disclosure, b) a supervisory review is performed over the support used to prepare the annuity disclosure for the financial statements to ensure the financial statement footnotes are fairly stated in accordance with Generally Accepted Accounting Principles.	Agree	June 30, 2014

COLORADO LOTTERY
BACKGROUND
Years Ended June 30, 2013 and 2012

In 1980, Colorado voters passed a referendum that added Article XVIII, Section 2(1) to the Colorado Constitution, allowing the establishment of a state-supervised lottery. Senate Bill 82-119 created the Lottery as a division within the Department of Revenue. The Lottery began operations on July 1, 1982 and sold its first lottery ticket on January 24, 1983.

During Fiscal Year 2013, the Lottery employed 120 employees in its headquarters in Pueblo and branch offices in Denver, Fort Collins and Grand Junction.

The Lottery games are governed by rules and regulations established by a Commission of five members appointed by the Governor and approved by the Senate. By statute, Lottery Commission members must include an attorney, a certified public accountant and a law enforcement officer. Members may serve up to two 4-year terms.

Colorado Revised Statutes (C.R.S.) Section 24-35-210(9), requires that no less than 50% of the total revenue from sales of lottery tickets be for prizes. The legislation also provides guidelines for distribution of net proceeds to beneficiary agencies. "Net lottery proceeds" (that is, proceeds after the payment of prizes and lottery expenses and a reserve for future operations) are to be distributed to the Conservation Trust Fund within the Department of Local Affairs, the Division of Parks and Wildlife within the Department of Natural Resources, and the Great Outdoors Colorado Trust Fund (GOCO). The amount distributed to GOCO is limited by a constitutional cap.

Prior to 2002, amounts exceeding the GOCO cap (the spillover) were distributed to the State General Fund. For Fiscal Years 2002 through 2007, the spillover funds were distributed to the State Public School Fund Contingency Reserve. For Fiscal Year 2008, the spillover funds were transferred to the Lottery Proceeds Contingency Reserve Fund. For Fiscal Years 2009 through 2013, the spillover funds were required to be transferred to the Public School Capital Construction Assistance Fund.

Financial Statement Close Process

Background

Over the past 5 years, the Lottery has awarded a total of $64.4 million to Lotto jackpot winners. When a person wins a Lotto jackpot, he or she is able to choose between an annuity option or a lump sum cash payment option. When an annuity option is selected by the Lotto Jackpot winner, the Lottery finances this option by purchasing an annuity from an insurance company. This annuity is purchased in the name of the individual winner; however the Lottery retains title to the annuity contract. In addition, the Lottery remains liable for the payment of each of the guaranteed minimum prizes in the event the insurance company issuing the annuity contract defaults. In accordance with rules and Generally Accepted Accounting Principles (GAAP) guideline, the Lottery is required to disclose the annuity information within its financial statements. Currently, according to Lottery staff, there are about 275 annuities administered by 15 different insurance companies on behalf of the Lottery.

What was the purpose of the audit work?

The purpose of the audit work was to test and review the Lottery's financial statement amounts and footnote disclosures to ensure they are fairly stated and in compliance with GAAP.

What audit work was performed and how were the results measured?

As part of our audit procedures to test the Lottery's financial statement disclosure amounts, we obtained support related to the Lottery's prize annuity contingent liability footnote disclosure (contingent liability disclosure). In order to obtain external assurance that the individual Lotto Jackpot annuities held with insurance companies existed and were recorded at the correct amount in the financial statement footnote, we obtained the Lottery's internal record of annuities for Fiscal Year 2013. Out of that listing of 15 insurance companies, we sent confirmations to 4 insurance companies that administer Lotto Jackpot annuity contracts and compared the Lottery's internal record with those insurance company confirmations received. These four companies administer a combined total value of $206.5 million of annuities.

We also compared the contingent liability disclosure to ensure that it was prepared in accordance with Governmental Accounting Standards Board (GASB) and AICPA Audit and Accounting Guidelines for State and Local Governments related to Special Purpose and State Governments. Specifically, we reviewed the contingent liability disclosure for compliance with the GASB Codification of Governmental Accounting and Financial Standards, Section III, C50, .118 Annuity Contracts and the AICPA Audit and Accounting Guide, Rule 12.122 states that generally, if a purchased annuity is in the name of the prize winner, the state should not recognize a liability or asset because it has discharged the primary liability. However, because the Lottery is still ultimately responsible for payment of the prize winnings, it should disclose the existence of a contingent liability in the financial statements.

In addition, we reviewed the contingent liability disclosure to determine consistency with the following Lottery adopted rules and/or policies:

- The Lottery purchases annuity contracts in the name of individual (Lotto) jackpot prize winners. Although the annuity contracts are in the name of the individual winners, the Lottery retains title to the annuity contracts. The Lottery remains liable for the payment of the guaranteed minimum prizes in the event the insurance companies issuing the annuity contracts default.
- Players who select the annuitized payment shall have the ability to change their prize payment selection from annuitized payment to lump sum payment for up to ninety days from the original date of claim. This period may be extended at the discretion of the Director or the Director's designee. If a player chooses the lump sum payment after the initial annuitized payment is made

to the player by the Lottery, the player will receive the remaining amount of the original cash value prize, less taxes, in a single second payment.

What problem did the audit work identify?

Upon comparison of the insurance company confirmations received to the Lottery's internal financial system report utilized to create the footnote disclosure, we noted that one annuity on the internal system listing could not be confirmed by the insurance company. We discussed this with Lottery staff and noted that Lotto jackpot winners can choose between a cash or annuity option, but all are entered into the Lottery internal system. In this instance, an individual Jackpot winner elected the annuity option to receive his/her prize payout and was entered into the system. When this happened and prior to the Lottery purchasing an annuity, the winner sold the annuity to a company. In order to generate paperwork to document this, Lottery personnel created an incomplete record by including the winner's name into the internal system with no insurance company assigned. By doing this, the internal system should have deleted the first record when the record was updated with the name of the insurance company when the annuity was purchased. However, the first record was not completely deleted from the system; therefore, this incomplete record was included as part of the internal system record and resulted in an extra entry on a year-end report. Because the incomplete record had no name attached to it, the record was displayed with a "cash" elected winner's name, the next name in the database. The annuity value attached to this additional record was $4 million.

As a result of the Lottery's failure to monitor the Lottery's internal report and compare this report with the annuities carried by insurance companies, the contingent liability amount disclosed in the preliminary financial statements disclosures was incorrectly reflected at $305 million rather than the correct amount of approximately $301 million.

Why did the problem occur?

The Lottery personnel did not identify the additional annuity on the internal report due to failure of monitoring annuities after initial set-up in the Lottery's internal financial system. The Lottery's staff responsible for annuities did not communicate with the IT department that the temporary annuity (first annuity created) needed to be removed from the system. The Lottery's internal control over financial reporting failed to identify the error in the financial statement footnotes, as there was not sufficient monitoring of the internal report used to generate the year end contingent liability footnote disclosure. In addition, a supervisory review was not performed over this process.

Why does this problem matter?

Failure to sufficiently review the internal reports used for the footnote and identify inconsistencies with current year events resulted in a misstatement of the Lottery's financial statement disclosure. Even though this misstatement was corrected prior to the audited financial statements being printed, this represents a noncompliance with GAAP requirements for fairly presented financial statements including footnote disclosures. The users of the financial statements rely on the accurate and fair presentation of the Lottery's financial statements in order to make informed decisions and to protect the interests of its constituents.

(Classification of Finding: Significant Deficiency)

Recommendation No.1

The Colorado Lottery should ensure that:

a. personnel monitor and perform a review of the report used to create the annuity contingent liability footnote and agree all annuities issued during the current year to that information being included in the detailed internal system report.

b. individuals responsible for performing a supervisory review of the financial statements should review the analysis performed and either agree with the analysis or request further investigation based on knowledge of current year events. If adjustments are required to be made to the report as a result of the reviews performed, such adjustments should be communicated timely to the IT department.

Colorado Lottery Response:
Agree. Implementation Date: June 30, 2014

Response: The Lottery's annuity manager will perform a review of the report used to create the annuity footnote and agree all annuities issued during the current year to supporting documentation to identify any instances of incorrect annuities being included in the detailed report. The Controller will review the analysis performed and either agree with the analysis or request further investigation based on knowledge of current year events. This process will be implemented starting with the June 30, 2014 financial statements.

COLORADO LOTTERY
DISPOSITION OF PRIOR YEAR AUDIT RECOMMENDATION
Year Ended June 30, 2013

Number	Recommendation	Disposition
2012-1	The Colorado Lottery should ensure that the game prize payout percentage for its on-line game, "Lotto," is managed in accordance with the game rules, as approved by the Lottery Commission, by a) analyzing the projected prize payout percentage and updating the game rules, if appropriate, and b) establishing a policy to perform a similar analysis on a periodic basis, as well as when any significant change is made to the game that may affect the prize payout percentage	Implemented
2011-1	The Colorado Lottery should ensure it is maximizing the amount of lottery revenue available to beneficiaries by reevaluating its current games structure, payout percentages, and operating expenses.	Partially implemented - Since fiscal year 2011 and through fiscal year 2013, the Lottery continues to evaluate operating expenses, make game changes and have developed strategic goals, which have resulted in an increase in the revenue available to beneficiaries as a percentage of total sales (from 21.8% in FY 2011, 22.6% in FY 2012 to 24% in FY 2013). However, certain management changes cannot be realized until fiscal year 2014 and beyond. Accordingly, the comment is considered partially implemented and requires ongoing monitoring.

Independent Auditor's Report

Members of the Legislative Audit Committee
State of Colorado, Department of Revenue, Division of the Lottery
Denver, CO

Report on the Financial Statements
We have audited the accompanying basic financial statements of the major fund and remaining fund information of the Colorado Lottery, an enterprise fund and private purpose fund of the State of Colorado, as of and for the year ended June 30, 2013 and the related notes to the financial statements.

Management's Responsibility for the Financial Statements
Management is 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*, 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 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 audit opinions.

Opinion
In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the major fund and remaining fund information of the Colorado Lottery, as of June 30, 2013, and the respective changes in financial position and cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

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Emphasis of a Matter

Change in Accounting Principles
As described in Note 1 to the financial statements, the Lottery adopted the provisions of GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* and GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position.* The opinion is not modified with the implementation of these GASB Statements.

Other Matters

Relationship with the State of Colorado
As discussed in Note 1 – Nature of Operations and Summary of Significant Accounting Policies, the financial statements of the Colorado Lottery are intended to present the financial position and, where applicable, cash flows for only that portion of the financial reporting entity, the State of Colorado, that is attributable to the transactions of the Colorado Lottery. They do not purport to, and do not, present fairly the financial position of the State of Colorado as of June 30, 2013, and the changes in its financial position, or, where applicable, its cash flows, for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Comparative Statements
The basic financial statements as of June 30, 2012 were audited by other auditors, whose report dated September 24, 2012 expressed an unmodified opinion on those statements.

Required Supplemental Information
Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 12 through 26 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of American, which consisted of inquires of management about the methods or preparing the information and comparing the information for consistency with management's responses to our inquires, the basic financial statements, and other knowledge we obtained during our audit of the basic 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 express an opinion or provide any assurance.

Supplemental Information
Our audit was conducted for the purpose of forming opinions on the financial statements. The Schedule of Revenue and Costs for Scratch and Jackpot Games, Schedule of Percent of Prize Expense to Gross Ticket Sales and Budgetary Comparison are presented for purposes of additional analysis and are not a required part of the financial statements. The Schedule of Revenue and Costs for Scratch and Jackpot Games, Schedule of Percent of Prize Expense to Gross Ticket Sales and Budgetary Comparison is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic 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 audit 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.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued a report dated September 16, 2013 on our consideration of the Colorado Lottery's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, 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 reports is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Colorado Lottery's internal control over financial reporting and compliance.

Eide Bailly LLP

Greenwood Village, CO
September 16 , 2013

Colorado Lottery

Management's Discussion and Analysis

Years Ended June 30, 2013 and 2012

This discussion and analysis of the Colorado Lottery's financial performance provides an overview of financial activities for the fiscal years ended June 30, 2013 and 2012. Please read it in conjunction with the Lottery's financial statements, which begin on page 27. These financial statements reflect only activities of the Colorado Lottery, a proprietary fund of the State of Colorado.

Financial Highlights

- For the third year in a row, the Lottery's current fiscal year's overall sales performance became the highest sales year in the Lottery's history coming in at $566.3 million. Fiscal year 2012 sales of $545.3 million moved to the second highest sales year, with the third highest sales year achieved in fiscal year 2011 with sales of $518.9 million. Overall sales for fiscal year 2013 reflected a $21.0 million increase from fiscal year 2012. In turn, fiscal year 2012 reflected a $26.4 million increase from fiscal year 2011 sales. The increase in sales in fiscal year 2013 was due to the overall increase in jackpot games sales of nearly $16.7 million combined with an increase of $4.3 million in scratch sales. The overall increase in sales in fiscal year 2012 was mainly the result of increased scratch sales of $19.3 million from $344.9 million in fiscal year 2011 to $364.2 million in fiscal year 2012 in addition to an overall increase of $7.1 million in jackpot game products.

  The nearly $16.7 million increase in jackpot games sales in fiscal year 2013 over the previous fiscal year consisted of a $34.9 million or a 42.6 percent increase in Powerball sales, attributed to the two highest jackpots in Powerball history occurring in fiscal year 2013; a $2.0 million increase in the Holiday Raffle game; a $1.9 million increase in the new Pick 3 game, introduced on April 28, 2013; and a $1.8 million increase in the Cash 5 game. These increases were offset by a drop in Mega Millions sales of $13.9 million, the elimination of the MatchPlay game in fiscal year 2013 resulting in a $9.3 million drop in sales, and a slight decrease of $.7 million in Lotto sales.

  The increase in jackpot game sales in fiscal year 2012 was chiefly due to the $12.0 million increase in Mega Millions sales tied to the historic jackpot run in March 2012 to a $656 million annuitized jackpot, the largest in American lottery history and a $11.8 million increase in Powerball sales over the previous year due to the change from a $1 to a $2 ticket in January 2012. Cash 5 sales increased slightly by $0.4 million over the previous year. These sales increases were offset by the $6.0 million and $2.1 million decreases in Lotto and MatchPlay sales, respectively, and the absence of a Raffle game in 2012 compared to the $9.0 million in Raffle sales in 2011.

- Funds distributed or available for distribution from 2013 sales increased by $12.4 million up from $123.2 million in fiscal year 2012 to over $135.6 million in fiscal year 2013. Along with record-breaking sales for the year, the $135.6 million for fiscal year 2013 set the record for the highest distribution amount in a single fiscal year in the Lottery's history, moving the $125.6 million distributed in fiscal year 2006 to the number two spot. Fiscal year 2013 included a spill-over of funds in excess of the Great Outdoors Colorado (GOCO) cap. During the fiscal years 2002-2007 this spill-over was distributed into the State Public School Fund Contingency Reserve. In fiscal year 2008, this spill-over was distributed to the Lottery Contingency Reserve Fund. Starting in fiscal year 2009, the spill-over, by statute, is distributed to the Public

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School Capital Construction Assistance Fund. The spill-over totaled $8.6 million and $4.6 million for fiscal years 2013 and 2012, respectively. A spill-over occurs when the distribution cap for GOCO is reached in any one year. The cap for GOCO is the 1992 base year amount of $35 million as adjusted for the annual change in the cost of living increase for the Denver-Boulder area. Over the most recent five-year period, the spill-over going to the Public School Capital Construction Assistance Fund has totaled $64.6 million.

- Gross profit as a percent of sales for fiscal year 2013 increased by over 1.1 percent from fiscal year 2012, a reflection of the 1.0 percent decrease in prize expense combined with the nearly 0.2 percent decrease in retailer bonuses. All other costs directly tied to the sale of Lottery products as a percentage of sales remained steady or declined slightly. These include commissions, vendor fees and ticket costs. Gross profit as a percent of sales for fiscal year 2012 increased by 0.2 percent from fiscal year 2011, a reflection of the nearly 0.2 percent decrease in prize expense as a percentage of sales while the other costs directly tied to the sale of Lottery products, including bonuses, as a percentage of sales remained steady.

Total prize expense, which includes the Powerball and Mega Millions prize variances, as a percentage of sales for all Lottery products decreased from 62.8 to 61.8 percent in fiscal years 2012 and 2013, respectively, with a slight increase from 69.2 to 69.3 percent for scratch games and a 50.1 to 47.9 percent drop for jackpot games. The overall decrease in prize expense as a percentage of sales in fiscal year 2013 was mainly due to a shift from scratch to jackpot games which have lower prize expense percentages, an increase of $1.5 million in unclaimed Jackpot game prizes, and, in part, to the Lottery's efforts to increase distributions to its proceeds partners by lowering prize percentages by game. The overall prize expense as a percentage of sales decreased from 63.0 to 62.8 percent for the fiscal years ended June 30, 2011 and 2012, respectively. Prize expense for scratch products increased from 68.8 percent to 69.2 percent, while prize expense for jackpot games decreased from 51.4 percent to 50.1 percent. The decrease in prize expense included an increase in unclaimed prizes for all products of $0.5 million from fiscal year 2011 to fiscal year 2012.

Bonuses as a percentage of sales decreased from 1.0 to 0.8 percent for fiscal years 2012 and 2013 respectively while commissions as a percentage of sales remained virtually unchanged. Combined commissions and bonuses as a percentage of sales in fiscal year 2013 were 7.5 percent, a decrease from the 7.6 percent seen in fiscal years 2012 and 2011. The drop in the bonus percentage was due to a change in the retailer incentive bonus plan for fiscal year 2013, a plan that switched the emphasis to and paid bonuses only on jackpot game sales. Cost of tickets sold and vendor fees as a percentage of sales remained at 2.0 percent as a percentage of sales for fiscal year 2013 compared to 2012, down from the 2.1 percent for fiscal year 2011. Vendor fees totaled $7,892,197, $8,258,562, and $8,575,816 for fiscal years ended June 30, 2011, 2012 and 2013, respectively, reflecting an increase only due to the increase in sales seen over the last three fiscal years.

Games Offered by the Colorado Lottery

Currently, the Lottery offers two different ways to play: scratch games and jackpot games which include Powerball, Lotto, Cash 5, Mega Millions, Raffle (first offered in fiscal year 2011 and again in fiscal year 2013) and the new jackpot game Pick 3 (introduced in late April 2013). Scratch games consist of pre-printed tickets that may be purchased for various prices ($1, $2, $3, $5, $10 and $20) at any Lottery retailer. When scratched, they provide immediate knowledge if the ticket is a winner and can be cashed immediately at the retailer level if the amount of the winnings is $599 or less. Prizes over $599 must be redeemed at the Lottery offices.

Jackpot games, on the other hand, require a longer playing time. Tickets are also purchased at the Lottery retailers and are printed on ticket stock as the purchase is made. Each ticket contains one or possibly more playing boards for one draw or up to thirteen weeks of draws. Each board consists of a set of numbers, the combination of numbers required for play varying by game. For the Raffle game, newly introduced in fiscal year 2011, a pre-determined number of tickets are numbered and issued sequentially upon each sale until the maximum number of tickets is sold out or the last day of sales is reached, whichever comes first. The winning numbers for each game are posted after their respective draw nights with drawings held on every night of the week. Players must check their numbers against the numbers drawn for each respective game to determine if they have a winning ticket. The tickets may also be cashed at the retailer level if the amounts of the winnings are $599 or less. Prizes over $599 must be redeemed at the Lottery offices.

Using this Annual Report

This annual report consists of a series of financial statements. The statements of net position provide information about the Lottery's assets and liabilities and reflect the Lottery's financial position as of June 30, 2013 and 2012. The statements of revenues, expenses and changes in fund net position report the activity of selling the Lottery products and the expenses related to such activity for the years ended June 30, 2013 and 2012. Finally, the statements of cash flows outline the cash inflows and outflows related to the activity of selling the Lottery products for the years ended June 30, 2013 and 2012.

Statements of Net Position

The statements of net position present a financial snapshot of the Lottery at June 30, 2013 and 2012. It presents the fiscal resources of the Lottery (assets), the claims against those resources (liabilities) and the residual available for future operations (net position). Assets and liabilities are classified by liquidity as either current or noncurrent. Net position is classified by the ways in which these assets may be used for future operations.

Condensed Statements of Net Position
June 30, 2013, 2012 and 2011

	2013	2012	2011
Assets			
Current assets	$ 64,107,946	$ 52,923,837	$ 57,902,172
Restricted assets	6,630,364	6,645,053	6,232,920
Capital assets	1,900,322	2,831,868	3,782,655
Total assets	$ 72,638,632	$ 62,400,758	$ 67,917,747
Liabilities			
Current liabilities	$ 68,056,857	$ 56,555,518	$ 60,841,890
Long-term liabilities	919,090	897,366	875,822
Total liabilities	$ 68,975,947	$ 57,452,884	$ 61,717,712
Net Position			
Net Investment in capital assets	$ 1,900,322	$ 2,831,868	$ 3,782,655
Restricted – Licensed Agent Recovery Reserve	388,870	351,031	402,793
Restricted – Operating Reserve	1,300,000	1,300,000	1,400,000
Unrestricted	73,493	464,975	614,587
Total net position	$ 3,662,685	$ 4,947,874	$ 6,200,035

The Lottery's total assets at June 30, 2013 were $72.6 million. Assets consisted primarily of cash and investments with the State Treasury of $44.3 million, including restricted balances of $1.7 million, receivables from Lottery retailers for the sale of Lottery products of $20.3 million, Prepaid Prize Expense with Multi-State Lottery Association (MUSL) of $4.9 million, and a net investment in fixed assets of $1.9 million.

Comparable figures at June 30, 2012 were $62.4 million in total assets, principally including cash and investments with the State Treasury of $34.0 million, receivables from retailers of $19.5 million, Prepaid Prize Expense with MUSL of $5.0 million, and a net investment in fixed assets of $2.8 million.

Comparable figures at June 30, 2011 were $67.9 million in total assets, principally including cash and investments with the State Treasury of $39.2 million, receivables from retailers of $19.2 million, Prepaid Prize Expense with MUSL of $4.4 million, and a net investment in fixed assets of $3.8 million.

The Lottery's total assets increased by $10.2 million from fiscal year 2012 to fiscal year 2013. This increase was chiefly due to the increases of $10.3 million in cash and investments and $0.8 million in accounts receivables due from retailers offset by the $0.9 million decrease in capital assets. The increase in cash and investments was the result of a large increase in May's sales due to the record-breaking $590 million Powerball jackpot seen in that month and the resulting undistributed proceeds amount. The $0.8 million

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increase in accounts receivable is a timing difference when amounts become due and the $0.9 million decrease in capital assets was due to normal depreciation. The Lottery's total assets decreased by $5.5 million from fiscal year 2011 to fiscal year 2012. This decrease was primarily caused by the $5.2 million decrease in cash and investments and the $1.0 million decrease in capital assets, offset by the $0.6 million increase in prepaid prize expense with MUSL. The $5.2 million decrease in cash and investments was primarily due to the $119.9 million used to pay net proceeds in fiscal year 2012 compared to the $114.5 million in cash provided from the Lottery's operating activities. The $1.0 million decrease in capital assets was due to the first full-year depreciation of the new back office system reflected in accumulated depreciation. The prepaid prize expense with MUSL increased by $0.6 million due to an increase to the Mega Millions prize reserve funded from a portion of the prize percentage of sales approved by and due to MUSL for each draw.

The Lottery's liabilities at June 30, 2013 totaled approximately $69.0 million, which consisted primarily of prize liability on all the Lottery products of about $25.4 million, proceeds distribution due to recipients of $37.3 million, $2.3 million due to Lottery vendors and $1.4 million due to MUSL.

The Lottery's total liabilities at June 30, 2012 totaled approximately $57.5 million, which consisted primarily of prize liability on all the Lottery products of about $22.6 million, proceeds distributions due to recipients of $29.0 million, $2.0 million due to Lottery vendors and $1.2 million due to MUSL.

The Lottery's total liabilities at June 30, 2011 totaled $61.7 million, which consisted primarily of prize liability on all the Lottery products of $32.0 million, proceeds distributions due of $25.6 million, Lottery vendor payments due of $1.3 million and MUSL payments due of $0.3 million.

The Lottery's total liabilities increased from fiscal year 2012 to fiscal year 2013 by $11.5 million. The increase was primarily the result of an $8.3 million increase in proceeds distributions due to recipients, a nearly $2.8 million increase in prize liability and a $0.3 slight increase in the amount due to vendors. The $8.3 million increase in proceeds distributions due to recipients was the result of the May Powerball jackpot mentioned earlier. The nearly $2.8 million increase in prize liability was primarily due to the climbing $5.5 million Lotto jackpot at June 30, 2013 and, in part, to unclaimed Powerball prizes tied to May's large jackpot. The $0.3 increase in the amount due to vendors is due to the timing of payments from one year to the next.

The Lottery's total liabilities decreased from fiscal year 2011 to fiscal year 2012 by approximately $4.3 million. The decrease was chiefly due to the $9.4 million decrease in prize liability offset by the $3.4 million increase in the proceeds distribution due to recipients, the $1.0 million increase in the amount payable to MUSL and the nearly $0.8 million increase in accounts payable. The decrease in prize liability was primarily due to the $21.2 million scratch liability, the $2.8 million Raffle prize liability, and the $5.7 million Lotto liability recorded at the end of fiscal year 2011 compared to the $18.8 million scratch, $0 Raffle, $1.2 million Lotto prize liabilities recorded at the end of fiscal year 2012. Due to the timing of the introduction of new scratch games and the timing of jackpot game draws and outstanding prizes to be claimed, the prize liability amount can vary greatly at any one point in time. The $3.4 million increase in the proceeds distribution due to recipients was due to the more profitable 4th quarter experienced in fiscal year 2012 compared to the same quarter in fiscal year 2011.

Components of the Lottery's net position are: 1) an amount to represent the Lottery's net investment in capital assets as required by the reporting model under GASB 34, (see "Total Capital Assets" on the statements of net position); 2) a Licensed Agent Recovery Reserve (bonding reserve) funded by retailers to cover any uncollectible receivable accounts; 3) an amount representing the funds held by the Lottery in an operating reserve to ensure the operation of the Lottery for the ensuing year in accordance with Section 24-35-210 (4.1)(a), C.R.S. (see "Cash and Investments – Operating Reserve") on the statements of net position; and 4) remaining unrestricted net assets, which represents an adjustment made by the Lottery to reflect its share of unrealized gains or losses on investments held by the State Treasurer.

The change in net position from June 30, 2012 to June 30, 2013 consisted of a slight increase in the bonding reserve of $37,839 offset by a decrease in investment in capital assets from $2,831,868 to $1,900,322 due to the write off of obsolete property combined with the normal depreciation expense for fiscal year 2013 and a net decrease in unrealized gain and losses on investments of $391,482 held by the State Treasury.

Following is a schedule of net position for fiscal years 2013 and 2012:

	2013	2012	Change
Investment in capital assets	$ 1,900,322	$ 2,831,868	$ (931,546)
Bonding reserve	388,870	351,031	37,839
Operating reserve	1,300,000	1,300,000	-
Unrestricted -unrealized gain (loss) on investments	73,493	464,975	(391,482)
Total net position	$ 3,662,685	$ 4,947,874	$ (1,285,189)

The change in net position from June 30, 2011 to June 30, 2012 consisted of a decrease in investment in capital assets of $950,787 due to the depreciation expense in fiscal year 2012, a decrease in the bonding reserve from $402,793 to $351,031, a decrease in the operating reserve from $1.4 million to $1.3 million and a net decrease in unrealized gain and losses on investments of $149,612 resulting from a net decrease in the adjustments on State Treasury investments.

Following is a schedule of net position for fiscal years 2012 and 2011:

	2012	2011	Change
Investment in capital assets	$ 2,831,868	$ 3,782,655	$ (950,787)
Bonding reserve	351,031	402,793	(51,762)
Operating reserve	1,300,000	1,400,000	(100,000)
Unrestrictied -unrealized gain (loss) on investments	464,975	614,587	(149,612)
Total net position	$ 4,947,874	$ 6,200,035	$ (1,252,161)

Percentages may not calculate and amounts may not add up due to rounding.

Statements of Revenues, Expenses and Changes in Net Position

The statements of revenues, expenses and changes in net position present the financial activity of the Lottery over the fiscal year. The focus is on operating revenues and expenses that have a significant effect on the distributions paid to the proceeds recipients.

Condensed Statements of Revenues, Expenses and Changes in Net Position For the Fiscal Years Ended June 30, 2013, 2012 and 2011

	2013	2012	2011
Operating Revenues	$566,286,598	$545,303,548	$518,920,841
Direct Operating Expenses	403,656,257	395,329,218	377,243,191
Gross Profit on Sale of Tickets	162,630,341	149,974,330	141,677,650
Other Operating Expenses			
Marketing and communications	13,627,884	13,388,426	14,823,254
Wages and benefits	9,166,190	8,950,454	8,636,669
Other operating expenses	5,856,393	6,183,458	5,663,233
Total other operating expenses	28,650,467	28,522,338	29,123,156
Operating Income	133,979,874	121,451,992	112,554,494
Nonoperating Revenues (Expenses)			
Other revenue	289,398	201,559	184,871
Investment income	77,300	343,764	560,155
Proceeds distributions	(135,631,761)	(123,249,476)	(113,360,993)
Total nonoperating expenses	(135,265,063)	(122,704,153)	(112,615,967)
Change in Net Position	(1,285,189)	(1,252,161)	(61,473)
Net Position, Beginning of Year	4,947,874	6,200,035	6,261,508
Net Position, End of Year	$ 3,662,685	$ 4,947,874	$ 6,200,035

Sales Activities

Revenues from the sales of Lottery products for the fiscal year ended June 30, 2013 were the highest in the Lottery's thirty plus year history. As shown in the financial statements, overall sales increased by 3.8 percent or $21.0 million from fiscal year 2012 sales of $545.3 million to $566.3 in fiscal year 2013. Fiscal year 2012 sales of $545.3 million, another record breaking year, represented an increase of 5.1 percent or $26.4 million from fiscal year 2011 sales of $518.9 million. Fiscal year 2013 scratch sales of $368.6 represented a $4.3 million increase or 1.2 percent over the prior year scratch sales of $364.2 million. The increase can be attributed to Lottery players shifting from the lower priced tickets of $1, $2, and $3 to the higher priced tickets of $5, $10 and $20 which have better odds of winning. The average ticket price continued its upward trend from $3.64 in fiscal year 2012 to $3.91 in fiscal year 2013. The smaller percentage increase in scratch sales in fiscal year 2013 compared to recent prior years may be tied to the higher Powerball jackpots and resulting shift to jackpot sales seen in the year.

Fiscal year 2012 scratch sales of $364.2 million represented a $19.3 million or a 5.6 percent increase over the prior fiscal year scratch sales of $344.9 million. As in the prior fiscal year, the sales of scratch tickets continued its upward trend in fiscal year 2012. The number of individual scratch tickets sold increased by 1.5 percent from 98.5 million tickets to 100.0 million tickets over the previous fiscal year with the average ticket price also continuing to move upward from $3.50 in fiscal year 2011 to $3.64 in fiscal year 2012.

Total jackpot game sales in fiscal year 2013 of $197.7 represented an increase of $16.6 million or 9.2 percent over fiscal 2012. Total jackpot game sales in fiscal year 2012 of $181.1 million represented an increase of $7.1 million or 4.1 percent over fiscal year 2011 jackpot game sales of $174.0 million. As mentioned above in the *Financial Highlights* section, the increase in jackpot game sales in fiscal year 2013 was primarily due to the $34.9 million or 42.6 percent increase in Powerball sales tied to overall increase in jackpot amounts in the year and the full year sales of the $2 ticket from the $1 which changed in January 2012. Fiscal year 2013 saw the two highest Powerball jackpots to date, both over $500 million, two jackpots over $300 million and two additional jackpots over $200 million. In addition, Cash 5 sales showed a 9.0 percent or $1.8 million increase. With the reintroduction of a holiday Raffle game and the start of the new Pick 3 game, fiscal year 2013 jackpot game sales increased by $2.0 and $1.9 million, respectively in "new" sales over the previous fiscal year. These sales were offset by a $13.9 million or 37.5 percent decrease in Mega Millions sales, a slight 2.1 percent drop of $0.7 million in Lotto sales and a $9.2 million loss in MatchPlay sales due to the ending of the game at the end of fiscal year 2012. Unlike in the previous record-breaking year, the highest Mega Millions jackpot reached in fiscal year 2013 was $190 million with only one other jackpot over $100 million, causing the sharp drop in sales.

The increase in jackpot games sales in fiscal year 2012 was chiefly due to the $12.0 million increase in Mega Millions sales tied to the historic jackpot run in March 2012 and to the $11.8 million increase in Powerball sales over the previous year due to the change to a $2 ticket from a $1 ticket in January 2012. Cash 5 sales showed a slight increase of $0.4 million or 1.9 percent in fiscal year 2012 over the previous fiscal year. These sales increases were offset by a $9.0 million decrease in Raffle sales due to management's decision to hold off offering the next Raffle game until the fall of fiscal year 2013; by a $6.0 million decrease in Lotto sales due to a decline in the average size of the Lotto jackpots experienced in fiscal year 2012 (the average Lotto jackpot claimed in fiscal year 2011 was $5.8 million compared to $3.7 million in fiscal year 2012); and by a $2.1 million or 18.8 percent decrease in MatchPlay sales.

The following tables compare Lottery product sales between fiscal years.

Product Sales	2013	2012	Difference	Change
Scratch	$368,583,078	$364,244,843	$4,338,235	1.2%
Powerball	116,726,233	81,865,488	34,860,745	42.6
Lotto	32,561,865	33,276,914	(715,049)	(2.1)
Mega Millions	23,217,230	37,122,665	(13,905,435)	(37.5)
Cash 5	21,279,304	19,520,456	1,758,848	9.0
MatchPlay	0	9,273,182	(9,273,182)	(100.0)
Raffle	1,969,010	0	1,969,010	N/A
Pick 3	1,949,878	0	1,949,878	N/A
Total	$566,286,598	$545,303,548	$20,983,050	3.8%

Product Sales	2012	2011	Difference	Change
Scratch	$364,244,843	$344,945,609	$19,299,234	5.6%
Powerball	81,865,488	70,046,464	11,819,024	16.9
Lotto	33,276,914	39,257,377	(5,980,463)	(15.2)
Mega Millions	37,122,665	25,126,942	11,995,723	47.7
Cash 5	19,520,456	19,153,751	366,705	1.9
MatchPlay	9,273,182	11,418,378	(2,145,196)	(18.8)
Raffle	0	8,972,320	(8,972,320)	(100.0)
Total	$545,303,548	$518,920,841	$26,382,707	5.1%

Nonoperating Revenues

Nonoperating revenues for the years ended June 30, 2013 and June 30, 2012 totaled $0.4 million and $0.5 million, respectively. The major reason for the slight decrease was due to the GASB 31 adjustment recording the Lottery's share of the unrealized gains and losses on investments held by the Treasury increasing from a net loss of $149,612 in fiscal year 2012 to a net loss of $391,482 in fiscal year 2013 offset by an increase in Other Revenue of $87,839. In addition, continued decline in interest rates paid on investments in fiscal year 2013 played a role ($24,594 decrease) in the decline of nonoperating revenues.

Nonoperating revenues for the years ended June 30, 2012 and June 30, 2011 totaled $0.5 million and $0.7 million, respectively. The major reason for the decrease was due to the continuing drop in interest rates in fiscal year 2012. The amount of interest received for Lottery investments held by the state treasury decreased approximately $311,000 from fiscal year 2011 to fiscal year 2012, the result of a drop in the average interest rate of 1.95 percent in fiscal year 2011 to 1.36 percent in fiscal year 2012. This decrease was offset by an increase to the GASB 31 adjustment recording the Lottery's share of the unrealized gains and losses on investments held by the treasury decreasing from a net $245,899 loss in fiscal year 2011 to a net $149,612 loss in fiscal year 2012.

Total Revenues

Total revenues were $566.7 million and $545.8 million for the years ended June 30, 2013 and 2012, respectively. The major contributing factor to the increase in total revenues of approximately $20.9 million was primarily due to the 9.2 percent increase in total jackpot game sales and the 1.2 percent increase in scratch game sales totaling $21.0 million in the current fiscal year. This increase was offset by the approximately $0.1 million reduction of nonoperating revenues mentioned above.

Total revenues were $545.8 million and $519.7 million for the years ended June 30, 2012 and 2011, respectively. The major contributing factor to the increase in total revenues of nearly $26.2 million was the overall 5.1 percent increase in Lottery product sales totaling $26.4 million offset by the approximately $0.2 million reduction of nonoperating revenues outlined in the previous section.

Major Expenses

Approximately $403.7 million of the Lottery's total expenses of $432.3 million for the fiscal year ended June 30, 2013 were incurred in direct support of the Lottery games. These expenses include prize expense, retailer compensation, money spent to purchase scratch tickets and compensation to the vendor who maintains and supports the on-line gaming system. Of the $403.7 million spent in fiscal year 2013 for direct support of the Lottery games, $350.3 million or 86.8% was for prize expense associated with those games.

In comparison, $395.3 million of the Lottery's total expenses of $423.9 million for the fiscal year ended June 30, 2012 were game-related expenses. Of the $395.3 million spent in fiscal year 2012 for direct support of the Lottery games, $342.3 million or 86.7% was spent for prize expense associated with those games.

In comparison, $377.2 million of the Lottery's total expenses of $406.4 million for the fiscal year ended June 30, 2011 were game-related expenses. Of the $377.2 million spent in fiscal year 2011 for direct support of the Lottery games, $326.7 million or 86.6% was spent for prize expense associated with those games.

Total prize expense, which includes the Powerball and Mega Millions prize variances, in fiscal year 2013 increased $7.6 million over fiscal year 2012. Generally, an increase would be expected with an associated increase in product sales as was seen in the fiscal year 2013. As a percentage of sales, however, prize expense actually went down from 62.8 percent in fiscal year 2012 to 61.9 percent in fiscal year 2013. The decrease in the prize percentage is equivalent to a $5.6 million reduction in prize expense. The reduction in the prize expense percentage of sales was due to several factors and was in part the direct result of changes implemented by Lottery management to decrease prize expense.

Prize expense in fiscal year 2012 increased $15.9 million over fiscal year 2011. In fiscal year 2012, based on the $26.4 million increase in sales, a $16.6 million increase in prize expense would have been expected. The net $0.7 million reduction in prize expense was also due, in part, to changes implemented by Lottery management to decrease prize expense.

Scratch prize expense as a percentage of sales increased by only 0.1 percent in fiscal year 2013 over the previous year and increased by 0.4 percent in fiscal year 2012 compared to fiscal year 2011. In fiscal year 2012, Lottery management issued a directive to change the prize structure of some of our scratch games and introduce scratch games with lower overall prize payouts. This process is a slow one due to the amount of time it takes for the development, approval and ultimate launch of a scratch game out in the market. The desired results were not fully realized in fiscal year 2012 but were more evident in fiscal year 2013. In both fiscal years, the increase to scratch prize expense would have been even higher if the efforts toward meeting the above stated goal had not been taken. The shift in sales from the lower price point games (the $1, $2 and $3 games) to the higher price point games (the $5, $10 and $20 games) continued into fiscal year 2013 from fiscal year 2012. The higher priced tickets carry a higher prize expense percentage causing the overall scratch prize expense to increase and negating some of the progress made by lowering the prize expense percentages. The $0.9 million drop in unclaimed scratch tickets in fiscal year 2013 (the write off of which lowers prize expense) also accounted for some of the increase in the prize expense as a percentage of sales.

Jackpot game prize expense as a percentage of sales, on the other hand, decreased by an overall 2.2 percent in fiscal year 2013 compared to fiscal year 2012. This resulted in a $4.3 million reduction in jackpot game prize expense from what was expected with the $16.6 million increase in sales. The main reason for this reduction was the shift in sales to the more profitable Powerball game due to the higher jackpots seen in fiscal year 2013. The elimination of the MatchPlay game with a 63.9 percent prize expense late fiscal year 2012 and the ultimate introduction of the new Pick 3 replacement game with an expectant prize payout of 50.3 percent also helped lower the jackpot game prize expense in fiscal year 2013 and should continue to help in future years. Jackpot game prize expense as a percentage of sales decreased by an overall 1.3 percent in fiscal year 2012 compared to fiscal year 2011. This resulted in a $2.3 million reduction in jackpot game prize expense. The main reason for this reduction was the shift in sales to the more profitable mega jackpot games Powerball and Mega Millions from the other jackpot games offered. In an effort to lower controllable aspects of prize expense, the Lottery changed the formula to compute how fast the Lotto jackpot grows by draw in January 2012. This saved the Lottery $0.5 million in prize expense in that first year of the change and an additional $1.0 million in fiscal year 2013.

As a percentage of sales, the Lottery saw a decrease in all other game-related expenses in fiscal year 2013 from fiscal year 2012, including retailer commissions, retailer bonuses, ticket costs and vendor fees; especially in the retailer bonus expense category. This decrease in retailer bonus expense was due to a change in the bonus plan as mentioned earlier. Total other game-related expenses were 9.4 percent of sales in fiscal year 2013 compared to 9.7 percent in fiscal year 2012.

The increase in the other game-related expenses from fiscal year 2012 from fiscal year 2011 was reflective of the increase in product sales with only slight increases and decreases in the individual expenses as a percentage of sales. Total other game-related expenses were 9.7 percent of sales for both fiscal years.

Following are tables comparing the game-related expenses between fiscal years 2013 and 2012.

Game-Related Expenses	2013	% of Sales	2012	% of Sales	Difference	Change in % of Sales
Prize Expense						
Scratch	$255,573,498	69.3%	$251,968,935	69.2%	$ 3,604,563	0.1%
Powerball - including prize variance	54,336,854	46.6	38,347,359	46.8	15,989,495	(0.2)
Lotto	16,289,162	50.0	17,878,569	53.7	(1,589,407)	(3.7)
Mega Millions - including prize variance	10,722,656	46.2	18,183,635	49.0	(7,460,979)	(2.8)
Cash 5	11,554,225	54.3	10,536,969	54.0	1,017,256	0.3
MatchPlay	(128,894)	N/A	5,929,284	63.9	(6,058,178)	N/A
Raffle	1,000,000	50.8	(204,500)	N/A	1,204,500	N/A
Pick 3	912,954	46.8	--	N/A	912,954	N/A
Total Prize expense	$350,260,455	61.9%	$342,640,251	62.8%	$7,620,204	(0.9)%
Retailer compensation						
Commissions	37,596,189	6.6%	36,305,943	6.7%	1,237,663	(0.1)
Bonuses	4,617,754	0.8	5,334,999	1.0	199,650	(0.2)
Ticket costs	2,606,116	0.5	2,789,463	0.5	(37,048)	0.0
Vendor fees	8,575,816	1.5	8,258,562	1.5	238,806	0.0
Total	$403,656,257	71.3%	$395,329,218	72.5%	$18,013,652	(1.2)%

Following are tables comparing the game-related expenses between fiscal years 2012 and 2011.

Game-Related Expenses	2012	% of Sales	2011	% of Sales	Difference	Change in % of Sales
Prize Expense						
Scratch	$251,968,935	69.2%	$237,372,938	68.8%	$14,595,997	0.4%
Powerball - including prize variance	38,347,359	46.8	32,694,312	46.7	5,653,047	0.1
Lotto	17,878,569	53.7	20,768,717	52.9	(2,890,148)	0.8
Mega Millions - including prize variance	18,183,635	49.0	12,754,477	50.8	5,429,158	(1.8)
Cash 5	10,536,969	54.0	10,483,126	54.7	53,843	(0.7)
MatchPlay	5,929,284	63.9	6,967,421	61.0	(1,038,137)	2.9
Raffle	(204,500)	N/A	5,698,000	63.5	(5,902,500)	N/A
Total Prize expense	$342,640,251	62.8%	$326,738,991	63.0%	$15,901,260	(0.2)%
Retailer compensation						
Commissions	36,305,943	6.7%	34,531,189	6.6%	1,774,754	0.1
Bonuses	5,334,999	1.0	5,052,899	1.0	282,100	0.0
Ticket costs	2,789,463	0.5	3,027,915	0.6	(238,452)	(0.1)
Vendor fees	8,258,562	1.5	7,892,197	1.5	366,365	0.0
Total	$395,329,218	72.5%	$377,243,191	72.7%	$18,086,027	(0.2)%

Percentages may not calculate and amounts may not add up due to rounding.

Non game-related expenses totaled $28.6 million in fiscal year 2013 compared to $28.5 million in fiscal year 2012, a slight increase of 0.5 percent or $128,129. Of the $28.6 million expenses in fiscal year 2013, more than $13.6 million, a $0.2 million increase from the previous fiscal year, was for promotions and institutional and product advertising, especially for the new Pick 3 jackpot game. About $9.2 million, also a $0.2 million increase over fiscal year 2012, was for compensation to the Lottery employees. The increase in employee compensation was mainly the result of an increase to employer PERA and health benefit contributions for Lottery employees. Depreciation expense made up $1.0 million of the non game-related expenses with a slight decrease from the prior year, while scratch delivery expense made up $0.9 million of the expenses, a decrease of $54,544 despite the increase in scratch sales seen in fiscal year 2013. As the result of a lawsuit with a party suing for the use of the Powerball "multiplier" feature, a decision was made by the MUSL, which the Lottery is a member, to purchase the intellectual property for this feature. Colorado's share of the purchase was approximately $0.4 million which falls in the "Other" category of the non game-related expenses. On the other hand, with the final payment for the development and implementation of back office system being made in fiscal year 2012, cost savings of approximately $0.6 million were realized in fiscal year 2013 in the professional services, equipment and equipment maintenance categories. This savings along with several smaller cuts in other expenses helped maintain the ten percent cut to the marketing and operating budgets put into place in fiscal year 2012.

Of the $28.5 million expenses that were non game-related in fiscal year 2012, more than $13.4 million, a nearly ten percent drop from the previous year, was for promotions and institutional and product advertising. Approximately $8.9 million, a $0.3 million increase over fiscal year 2011, was for compensation to the Lottery employees. The increase in employee compensation was mainly the result of fewer position vacancies in fiscal year 2012 compared to fiscal year 2011. Depreciation expense made up $1.0 million of non game-related expenses with the first full-year of depreciation of the back office computer system. The increase in equipment maintenance from $365,000 in fiscal year 2011 to $617,000 was chiefly due to the accrued $240,000 final payment of a software license fee tied to the new back office. Overall, with the goal to increase proceeds as a percentage of revenues in fiscal year 2012, the Lottery implemented a ten percent cut to the marketing and operating budgets which resulted in over $1.4 million in savings over the previous fiscal year.

Distributions to the Proceeds Recipients

The Lottery's continued efforts in fiscal year 2013 to increase proceeds as a percentage of revenue generated funds available for distributions of $135.6 million, an increase of $12.4 million or 10.0 percent over fiscal year 2012. As stated earlier, the $135.6 million became the highest distribution amount of any fiscal year in the Lottery's history. This represented an increase of proceeds as a percentage of revenue from 22.6 percent to 23.9 percent for fiscal year 2012 and 2013, respectively. Of these total proceeds, $59.2 million was allocated to the Great Outdoors Colorado Trust Fund, $54.3 million to the Conservation Trust Fund and $13.6 million to the Division of Parks and Outdoor Recreation per the distribution formula stated in Colorado Revised Statutes (C.R.S.) 24-35-210. The maximum distribution to Great Outdoors Colorado of $59.2 million, pursuant to C.R.S. 33-60-104(1)(c) and 33-60-104(2), was reached, thus creating a spill-over into the Public School Capital Construction Assistance Fund of over $8.6 million pursuant to C.R.S. 22-

43.7-104 (2)(b)(III), a nearly 90 percent increase over the $4.5 million allocated in fiscal 2012.

The Lottery's proceeds distributions for fiscal year 2012 totaled $123.3 million. Approximately $57.1 million was distributed to Great Outdoors Colorado, $49.3 million to the Conservation Trust Fund, $12.3 million to the Division of Parks and Outdoor Recreation and a spill-over into the Public School Capital Construction Assistance Fund of $4.5 million.

The Lottery's proceeds distributions for fiscal year 2011 totaled $113.4 million. Approximately $56.0 million was distributed to Great Outdoors Colorado, $45.3 million to the Conservation Trust Fund, $11.3 million to the Division of Parks and Outdoor Recreation and a spill-over into the Public School Capital Construction Assistance Fund of $662,230.

Capital Assets

The Lottery's investment in capital assets at June 30, 2013, 2012 and 2011 amounted to $1.9 million, $2.8 million, and $3.8 million, respectively. The investment in capital assets as of June 30, 2013, 2012 and 2011 included computer equipment, servers, back office computer system, drawing equipment, modular furniture, cameras, recorders and leasehold improvements net of accumulated depreciation. The decrease in equipment from fiscal year 2012 to fiscal year 2013 and from 2011 to fiscal year 2012 was mainly due to the write off of obsolete computer and marketing production equipment. Capital assets are shown on the Statement of Net Position at the cost on the day of acquisition. Analysis of changes in capital assets is as follows:

Capital Assets as of
June 30, 2013, 2012 and 2011

	2013	2012	2011
Capital Assets			
Equipment	$ 5,946,887	$ 6,079,410	$ 6,378,722
Leasehold Improvements	64,711	64,711	64,711
Less: Accumulated Depreciation	(4,111,276)	(3,312,253)	(2,660,778)
Net capital assets	$ 1,900,322	$ 2,831,868	$ 3,782,655

Budgetary Highlights

The Lottery's budget is determined by a variety of methods. The majority of the budget is set by the annual appropriations bill (the Long Bill), which determines budgets for every agency within the State. Many of the appropriation lines in the Long Bill are at the department level, and the department has the discretion to allocate them among each agency within the department. The Long Bill and department level allocations are approved shortly before the start of each fiscal year. Agencies may also request a supplemental appropriation during the fiscal year to cover unexpected expenses (or a negative supplemental for less than expected expenses), as well as year-end transfers of spending authority, if needed. Department level re-allocations were approved in indirect costs, health-dental-life, workmen's compensation, shift differential, variable vehicle, legal services, risk management, and Grand Junction leased space. The final method of funding is special legislation. There was no special legislation affecting the Lottery's budget in fiscal year 2013.

The approved Lottery budget at the beginning of fiscal year 2013 was $524.3 million. Department level reallocations approved throughout the fiscal year increased the budget by $113,603 to an amended total of $524.4 million. Total expenditures and roll-forwards for fiscal year 2013 on a budget basis came to $441.0 million, resulting in excess appropriations (or savings) of more than $83.4 million.

Economic Outlook

- The Lottery is projecting sales will increase from $566.3 million in FY 2013 to $573.0 million in FY 2014. Proceeds are also projected to increase from $135.6 million to $137.5 million.
- The Lottery plans to deploy technology to reach and entertain players on its website and mobile devices by launching an enhanced mobile application in the first quarter of FY 2014 and developing free "play" opportunities/games on the website and for mobile devices.
- The Lottery's Mega Millions game is scheduled to change in October 2013. The game's matrix will change from 5 of 56 / 1 of 46 to 5 of 75 / 1 of 15. This change is expected to enhance the game's sales. Recommendations have been made to management to revamp the current Pick 3 game in fiscal year 2014. The changes are expected to enhance sales and will likely include more types of plays and a second daily drawing.
- The Lottery plans to launch a new branding campaign to energize the Lottery and instill brand loyalty beginning in the third quarter of FY 2014. The campaign is expected to create a local culture of awareness of winners, proceeds, and an overall awareness. This campaign will compliment ongoing specific (Scratch/Jackpot) game advertising.

Contacting the Lottery's Financial Management

This management discussion and analysis report is designed to provide Colorado citizens, Colorado government officials, our players, retailers and other interested parties with a general overview of the Lottery's financial activity for fiscal year 2013 and to demonstrate the Lottery's accountability for the money generated from the sale of the Lottery products. If you have questions about this report or need additional information, contact John Caligaris, the Colorado Lottery's Controller, 225 North Main Street, Pueblo, CO 81003.

COLORADO LOTTERY
STATEMENTS OF NET POSITION
JUNE 30, 2013 and 2012

	2013	2012
ASSETS		
Current Assets:		
Cash and Investments	$42,624,838	$32,331,921
Accounts Receivable, net of the allowance for doubtful accounts of $129,441 in 2013 and $227,135 in 2012	20,260,613	19,491,886
Consignment Inventory, at Cost	107,001	119,406
Warehouse Inventory, at Cost	1,064,149	908,062
Prepaid Expenses	51,345	72,562
Total Current Assets	64,107,946	52,923,837
Reserve and Restricted Assets:		
Cash and Investments-Operating Reserve	1,300,000	1,300,000
Cash and Investments-Licensed Agent Recovery Reserve Receipts	388,870	351,031
Prepaid Prize Expense with MUSL	4,941,494	4,994,022
Total Reserve and Restricted Assets	6,630,364	6,645,053
Capital Assets:		
Equipment	5,946,887	6,079,410
Leasehold Improvements	64,711	64,711
Less Accumulated Depreciation and Amortization	(4,111,276)	(3,312,253)
Total Capital Assets	1,900,322	2,831,868
TOTAL ASSETS	72,638,632	62,400,758

COLORADO LOTTERY
STATEMENTS OF NET POSITION
(Continued)
JUNE 30, 2013 and 2012

	2013	2012
LIABILITIES		
Current Liabilities:		
Accounts Payable	2,349,687	2,025,621
Prize Liability	25,389,816	22,647,331
Payable to MUSL	1,439,549	1,244,205
Wages and Benefits	872,731	842,256
Retailer Bonus Liability	706,712	812,029
Funds Available for Distribution	37,298,362	28,984,076
Total Current Liabilities	68,056,857	56,555,518
Long-Term Liabilities:		
Accrued Annual and Sick Leave	858,365	836,456
Expired Warrants Liability	60,725	60,910
Total Long-Term Liabilities	919,090	897,366
TOTAL LIABILITIES	68,975,947	57,452,884
NET POSITION		
Net Investment in Capital Assets	1,900,322	2,831,868
Restricted-Licensed Agent Recovery Reserve	388,870	351,031
Restricted-Operating Reserve	1,300,000	1,300,000
Unrestricted-Other	73,493	464,975
TOTAL NET POSITION	$3,662,685	$4,947,874

See Notes to Financial Statements

COLORADO LOTTERY
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND NET POSITION
FOR THE YEARS ENDED June 30, 2013 and 2012

	2013	2012
OPERATING REVENUES		
Gross Ticket Sales	$566,286,598	$545,303,548
DIRECT OPERATING EXPENSES		
Prize Expense	345,640,028	347,536,804
Powerball Prize Variance	5,902,283	(5,672,459)
Mega Millions Prize Variance	(1,281,856)	775,906
Retailer Commissions and Bonuses	42,213,870	41,640,942
Cost of Tickets and Vendor Fees	11,181,932	11,048,025
Total direct operating expenses	403,656,257	395,329,218
GROSS PROFIT ON SALE OF TICKETS	162,630,341	149,974,330
OTHER OPERATING EXPENSES		
Marketing and Communications	13,627,884	13,388,426
Administration Fees Paid to MUSL	148,940	137,472
Wages and Benefits	9,166,190	8,950,454
Professional Services	139,806	409,244
State Agencies Services	158,648	128,181
Department of Revenue Services	586,212	495,367
Travel	70,001	110,638
Equipment (including loss on disposition of equipment of $3,411 and $34,093, respectively)	59,522	205,608
Depreciation	977,298	1,048,886
Accrued Annual and Sick Leave	21,224	30,116
Space Rental	728,305	733,444
Rents for Equipment	31,788	33,009
Motor pool Leasing	364,798	387,512
Materials and Supplies	92,032	137,755
Telephone	185,898	156,179
On-Line Telecommunications	415,230	353,216
Data Processing Supplies and Services	53,805	33,077
Equipment Maintenance	286,600	617,332
Postage	9,524	54,789
Printing	23,927	13,066
Delivery Expense	927,943	982,487
Other	574,892	116,080
Total Other Operating Expenses	28,650,467	28,522,338
OTHER OPERATING REVENUE	289,398	201,559

COLORADO LOTTERY
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND NET POSITION
(Continued)
FOR THE YEARS ENDED JUNE 30, 2013 and 2012

	2013	2012
TOTAL OPERATING INCOME	134,269,272	121,653,551
NONOPERATING REVENUES (EXPENSES)		
Investment Income	77,300	343,764
Funds Distributed for Current Year	(98,333,399)	(94,265,400)
Funds Available for Distribution for Current Year	(37,298,362)	(28,984,076)
Total Nonoperating Revenues (Expenses)	(135,554,461)	(122,905,712)
NET INCOME(LOSS)	($1,285,189)	($1,252,161)
NET POSITION, BEGINNING OF YEAR	$4,947,874	$6,200,035
Net Change in Net Position	(1,285,189)	(1,252,161)
NET POSITION, END OF PERIOD	$3,662,685	$4,947,874

See Notes to Financial Statements

COLORADO LOTTERY
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED June 30, 2013 and 2012

	2013	2012
Cash Flows from Operating Activities		
Cash received from retailers	$564,973,271	$544,804,882
Cash paid in prizes	(348,231,797)	(352,131,817)
Cash paid in retailer commissions	(37,596,118)	(36,305,943)
Cash payments to suppliers	(27,664,040)	(27,563,803)
Cash payments to employees for services	(9,135,030)	(8,977,817)
Cash paid in retailer bonus	(4,726,192)	(5,332,669)
Net cash provided by operating activities	137,620,094	114,492,833
Cash Flows from Noncapital Financing Activities		
Distribution of net proceeds	(127,317,475)	(119,878,185)
Net cash used by noncapital financing activities	(127,317,475)	(119,878,185)
Cash Flows from Capital and Related Financing Activities		
Acquisition of capital assets	(49,163)	(132,792)
Proceeds from the sale of capital assets	0	600
Net cash used by capital and related financing activities	(49,163)	(132,192)
Cash Flows from Investing Activities		
Interest received	468,782	493,376
Change in fair market value of investments	(391,482)	(149,612)
Net cash provided by investing activities	77,300	343,764
Increase (Decrease) in Cash and Investments	10,330,756	(5,173,780)
Cash and Investments, Beginning of Year (including $1,651,031 and $1,802,793, respectively, in restricted accounts)	33,982,952	39,156,732
Cash and Investments, End of Period, (including $1,688,870 and $1,651,031, respectively, in restricted accounts)	$44,313,708	$33,982,952

COLORADO LOTTERY
STATEMENTS OF CASH FLOWS (Continued)
FOR THE FISCAL YEARS ENDED JUNE 30, 2013 and 2012

	2013	2012
Reconciliation of Operating Income to Net Cash Provided by Operating Activities		
Operating income	$134,269,272	$121,653,551
Adjustments of reconcile operating income to net cash provided by operating activities		
Depreciation	977,298	1,048,886
Loss (gain) on disposition of equipment	3,411	34,093
Change in:		
Accounts Receivable	(768,727)	(255,080)
Ticket Inventory	(143,682)	205,028
Prepaid Expenses	21,217	6,369
Prepaid Prize Expense with MUSL	52,528	(563,895)
Liabilities (excluding funds available for distribution)	3,208,777	(7,636,119)
Net cash provided by operating activities	$137,620,094	$114,492,833
Reconciliation of Cash and Investments		
Cash and investments	$42,624,838	$32,331,921
Restricted cash and investments- Licensed Agent Recovery Reserve	388,870	351,031
Restricted cash and investments- Operating Reserve	1,300,000	1,300,000
Cash and Investments, End of Period	$44,313,708	$33,982,952

See Notes to Financial Statements

COLORADO LOTTERY
POWERBALL ANNUITY WINNERS TRUST FUND
STATEMENTS OF FIDUCIARY NET POSITION
June 30, 2013 and 2012

	2013	2012
ASSETS		
Current Assets		
Investments	$11,567,677	$12,674,943
Total Assets	$11,567,677	$12,674,943
NET POSITION		
Held in Trust for Powerball winner	$11,567,677	$12,674,943
Total Net Position	$11,567,677	$12,674,943

See Notes to Financial Statements

COLORADO LOTTERY
POWERBALL ANNUITY WINNERS TRUST FUND
STATEMENTS OF CHANGES IN FIDUCIARY NET POSITION
FOR THE YEARS ENDED June 30, 2013 and 2012

	2013	2012
Additions		
Investment income (loss)	($673,266)	$2,803,733
Total additions (loss)	(673,266)	2,803,733
Deductions		
Prize payment	434,000	417,000
Change in Net Position	(1,107,266)	2,386,733
Net Position of Assets Held in Trust for Powerball Winner		
Beginning of Year	12,674,943	10,288,210
End of Year	$11,567,677	$12,674,943

See Notes to Financial Statements

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

The Colorado Lottery (the Lottery) began operations April 30, 1982 under the provisions of Section 24-35-202, C.R.S. The Lottery operates under a commission and provides operation and service of lottery games as authorized by the statute. The Lottery's revenues are predominantly earned from the sale of lottery products, including scratch games and jackpot games including Lotto, Powerball, Cash 5, Mega Millions, Raffle and Pick 3.

The financial statements reflect activities of the Lottery, an enterprise fund of the State of Colorado and activities of the Lottery's Powerball Annuity Winners Trust Fund, a private trust fund of the State of Colorado, for the fiscal years ended June 30, 2013 and 2012. The Lottery is an agency of the State of Colorado. The financial statements are intended to present the financial position and results of operations and cash flows of only that portion of the State of Colorado that is attributable to the transactions of the Lottery and the Lottery's Powerball Annuity Winners Trust Fund in accordance with accounting principles generally accepted in the United States of America.

The accounting policies of the Lottery conform to accounting principles generally accepted in the United States of America as applicable to governments. The following is a summary of the more significant policies.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues, expenses, gains, losses and other changes in net assets during the reporting period. Actual results could differ from those estimates.

Fund Accounting

Government resources are allocated to, and accounted for, in separate sub-entities called funds, based upon the purposes for which the resources are to be spent and the means by which spending activities are controlled. A fund is a fiscal and accounting entity with a self-balancing set of accounts that comprise its assets, liabilities, net position, revenues and expenditures.

Enterprise Fund

The Lottery accounts for its operations as an enterprise fund. The intent of the State of Colorado Legislature is that the Lottery's cost (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges. The Lottery defines operating revenues as those earned as a direct result of the fund's principal ongoing operations, i.e., the sale of lottery products. Operating expenses include expenses incurred in earning those revenues such as the cost of tickets,

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

vendor fees, retailer commissions and bonuses, administrative expenses and depreciation on capital assets. All revenues and expenses not meeting these definitions are reported as non-operating revenues and expenses.

With the implementation of GASB Statement No. 62 *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* effective for financial statements for periods beginning after December 15, 2011, Statement No. 20 was superseded thereby eliminating the election to apply post-November 30, 1989 FASB Statements and Interpretations. The implementation of GASB Statement No. 62 had no effect on the Lottery's financial statement presentation.

Effective July 1, 2012 for Fiscal Year 2013, the Lottery implemented the provisions of GASB Statement No. 63, "Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position". GASB Statement No. 63 provides guidance for reporting deferred outflows and deferred inflows of resources as introduced and defined in GASB Concepts Statement No. 4 "Elements of Financial Statements" (Concepts Statement No. 4). Concepts Statement No. 4 defines a deferred outflow of resources as a consumption of net assets that is applicable to a future reporting period. A deferred inflow of resources is defined as an acquisition of net assets applicable to a future reporting period. The only impact on the Lottery's financial statements has been to replace the term "net assets" with "net position".

Private Trust Fund

The Lottery accounts for Powerball Annuity Prizes in a private trust fund. The prizes are considered awarded when claimed by the winner. The Lottery is placed in a fiduciary situation, whereby it manages the prize funds for the winner. Governmental accounting mandates that a separate Statement of Net Position and Statement of Changes in Net Position be prepared for such fund. Those statements are included herein.

Basis of Accounting

Basis of accounting refers to when revenues, expenditures or expenses are recognized in the accounts and reported in the financial statements. The Lottery accounts for funds using the accrual basis of accounting. Revenues from scratch ticket sales are recognized at the point of ticket pack activation. Revenues from Lotto, Powerball, Cash 5, Mega Millions, Raffle, and Pick 3 ticket sales are recognized when the tickets are sold. Prize expense for scratch tickets is recognized at the point of ticket activation. Prize expense for Lotto, Powerball, Cash 5, Mega Millions, Raffle, and Pick 3 is recognized when tickets are sold. Other operating expenses are recognized when they are incurred. Revenues (additions) are recognized in the Powerball

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Annuity Winners Trust Fund based on the Fair Market Value of the original investment as of June 30, 2013 and 2012. Expenses (deductions) are recognized when payments are remitted to the winner(s).

Budget

By October 24th of each year, the Department of Revenue Executive Director submits to the Office of State Planning and Budgeting a proposed legislative budget for the fiscal year commencing the following July 1. The legislative budget includes proposed expenditures and the means of financing them.

Public hearings are conducted by the Joint Budget Committee to obtain clarification and taxpayer comments. Prior to June 30, the budget is legally enacted through passage of a law referred to as the Long Bill.

During the fiscal year, the approved legislative budget may be modified due to roll-forward authorization, supplemental budget approval or line item transfer authorization. All modifications must be approved by the State Controller and the Office of State Planning and/or Budgeting and the Legislature.

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable consist of amounts due from retailers for activated scratch ticket packs and uncollected jackpot game sales. Billable accounts receivable consist of amounts due from retailers for settled scratch ticket packs and uncollected jackpot game sales. Billable accounts receivable are invoiced weekly and are electronically transferred from the retailer's accounts into the Lottery's account one week following the invoice date.

Allowance for doubtful accounts represents a provision for receivables that will probably not be collected in the future. Consideration of the economic climate, credit-worthiness of individual account debtors, bankruptcy of debtor, discontinuance of debtor's business, and failure of repeated attempts to collect and barring of collection by statute of limitations are factors used in considering when an account becomes uncollectible. The accrual of a loss contingency is required when a loss is probable and/or can be reasonably estimated.

The Lottery uses the specific identification method to determine expected uncollectibles. Under the provisions of Section 24-35-219, C.R.S., licensed agent recovery reserve receipts are collected from the retailers to cover uncollectible accounts. The accounts receivable and the licensed agent recovery reserve receipts are shown net of estimated uncollectible receivables of $129,441 and $227,135 as of June 30, 2013 and 2012, respectively.

Consignment Inventory

Inventory on consignment represents non-activated ticket inventory in the possession of retailers who act as agents of the Lottery. The retailer cannot sell a pack of tickets until the

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

pack is activated by the retailer, which enables the winning tickets to be cashed. The activation is therefore the point at which the transfer of ownership is recognized. Since the Lottery still owns non-activated tickets, the tickets are included in the inventory and reported on the statements of net position. Consignment inventory is stated at cost using the specific identification method.

Warehouse Inventory

Warehouse inventory represents unsold tickets in possession of the Lottery and is stated at cost, using the specific identification method.

Supplies Inventory

The State of Colorado's threshold for recording supplies inventories is $100,000 per location. The supplies inventory of the Lottery consistently falls below the $100,000 threshold per location. Accordingly, no supplies inventory appears on the statements of net position.

Prepaid Prize Expense

As part of the Lottery's agreement with Multi-State Lottery Association (MUSL), for both the Powerball and Mega Millions games, a certain percentage of sales must be paid to MUSL for set prize and grand prize reserves. In late fiscal year 2011 and early fiscal year 2012 from June 30 to August 13, 2011, two percent of Powerball sales (excluding Powerplay sales) totaling $139,361 was paid to MUSL to bring the Powerball grand prize reserve up to the reserve requirement. No further payments were required for the remainder of fiscal year 2012 and no payments were required or made in fiscal year 2013. To date the Mega Millions reserve requirement has not been met, therefore 1.5 percent of Mega Million sales and approximately 3.1 percent of Megaplier sales in fiscal year 2012 and until March 29, 2013 were paid to MUSL to build the Mega Millions reserve. From March 30 to June 30, 2013 these rates were reduced to 1.0 percent and 1.6, respectively. A total of $389,518 and $693,787 and were paid to MUSL for the Mega Millions reserve in fiscal years 2013 and 2012, respectively.

Capital Assets

Capital assets, which include internal use computer software, equipment, vehicles, and leasehold improvements, are stated at cost. The Lottery adopted the state policy of capitalizing equipment only if the cost exceeds $5,000 and has a useful life of more than one year. Depreciation for equipment and internal use computer software is computed on the straight-line method over estimated useful lives ranging from three to ten years. Depreciation for vehicles is computed on the straight-line method over the estimated useful lives of five years. Leasehold improvements are depreciated over the greater of five years or the term of the lease. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts, and resulting gains or losses are recognized in current operations.

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Accrued Wages and Benefits

During each fiscal year, the state changes the pay date for the month of June for all state employees, deferring the date from the last working day of June to the first working day of July for employees paid monthly only. For the Lottery, this created a liability for accrued wages and benefits at June 30, 2013 and 2012 of $872,731 and $842,256, respectively.

Prize Liability and Prize Expense

Under the provisions of Section 24-35-210 (9), C.R.S., the Lottery must pay no less than fifty percent (50%) of total ticket sales as prizes. In the aggregate, all games to date are planned to pay 50% or more of total ticket sales in prizes. Additional prize expense and corresponding liability may be incurred as a result of market fluctuations in the cost of annuities used to pay Lotto jackpots (see Note 10).

All scratch, jackpot game and special drawing prizes are accounted for using the accrual basis of accounting. Scratch prize liability and expense are recognized at the point of ticket pack activation. The liability and expense for jackpot game prizes are recognized at the point of retail sale and are adjusted as the jackpot game draws occur and actual prize liability is determined. The liability for special drawing prizes is accrued on the first day of sales. Prize liability for all games is reduced as prizes are paid to winners. The net prize liability at June 30, 2013 and 2012 was $25,389,816 and $22,647,331, respectively.

Payments of scratch prize amounts of $150 or less may be made at the Lottery or at the retail outlet; payment of scratch prize amounts of $151 to $599 may be made at the retailer level at the option of the retailer or at the Lottery. Scratch prizes of $600 or more are paid by the Lottery. Retailers are given credit for prize payments they make on a daily basis. Prizes may be claimed up to 180 days after game-end. After the final claim date, any unclaimed scratch prizes will result in a decrease to prize expense and any prizes claimed in excess of the liability accrued will result in an increase to prize expense. Net unclaimed scratch prizes resulted in a decrease to prize expense of $6,262,268 for the fiscal year ended June 30, 2013 and $7,160,199 for the fiscal year ended June 30, 2012.

Payments of cumulative jackpot game prize amounts of $150 or less on a single ticket may be made at the Lottery or at the retail outlet; payment of cumulative prize amounts of $151 to $599 on a single ticket may be made at the retailer level at the option of the retailer or at the Lottery. Payment of cumulative prize amounts of $600 or more on a single ticket must be made at the Lottery. Retailers are given credit for prize payments they make on a daily basis. Jackpot game prizes may be claimed up to 180 days after the date of the drawing. After the final claim date, unclaimed jackpot game prizes will result in a decrease to prize expense so long as the aggregate prize expense of all games exceeds or equals the statutory 50% of sales. In the event that the expiration of an unclaimed prize would result in the aggregate prize expense of all games to fall below the statutory 50% level, the unclaimed prize amount would remain in prize expense and be paid out to players as a guaranteed additional prize. Unclaimed jackpot

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

game prizes resulted in a decrease to prize expense of $5,753,658 for the fiscal year ended June 30, 2013 and $4,229,621for the fiscal year ended June 30, 2012.

Powerball Prize Variance expense (revenue) represents a portion of the Powerball 50% prize expense accrual (as mandated by game rule) that is transferred to or received from MUSL. Powerball Prize Variance expense occurs when Colorado's liability, which consists of the low-tier prizes won by Colorado players plus Colorado's contribution to the jackpot, is less than the 50% accrual. If Colorado's Powerball liability, at the end of any interim reporting period, exceeds the 50% accrual, revenue is recognized. In the event that Colorado's total Powerball liability in any week should exceed the 50% accrual, MUSL will reimburse the excess to the Lottery.

Mega Millions Prize Variance expense (revenue) represents a portion of the Mega Millions prize expense accrual (51% through November 30, 2010, 52.5% from December 1, 2010 to June 30, 2011 and 51.5% effective July 1, 2011 to March 29, 2013) and the Megaplier prize expense accrual (50% to November 30, 2010, 52.5% from December 1, 2010 to June 30, 2011 and 51.5% effective July 1, 2011 to March 29, 2013), as mandated by game rule, that is transferred to or received from MUSL as with the Powerball Prize Variance as described above. Effective March 30, 2013 the expense accrual for Mega Millions was 51% and for Megaplier was 50%.

Retailer Bonus Liability

Under provisions 5.17, 10.13 and 14.19 of the Colorado Lottery Commission Rules and Regulations:

"Each licensee shall be entitled to receive a cashing bonus of one percent (1%) of each prize paid by the licensee up to and including $599.99." In addition, *"a marketing performance bonus up to five-tenths of one percent (0.5%) of total product sales may be earned by licensees that meet the criteria set forth by the Lottery Director or their designee. In the event there is a residual from the accrual of the one percent (1%) cashing bonus and/or the five-tenths (0.5%) marketing bonus....the Director may provide additional compensation to licensees... or may revert the excess amount thereby decreasing the bonus expense."*

The cashing bonus is accrued as tickets are sold and paid as winning tickets are redeemed. Any cashing bonuses unclaimed at the end of the claim period in fiscal years 2013 and 2012 resulted in a reduction of bonus expense.

The marketing performance bonus is accrued monthly and paid to retailers in accordance with the criteria as set out in the fiscal year marketing performance plan as approved by the Director. Any excess marketing performance bonus accrued in fiscal years 2013 and 2012 resulted in a reduction of bonus expense.

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Licensed Agent Recovery Reserve

Under the provisions of Section 24-35-219, C.R.S., a Licensed Agent Recovery Reserve was established on January 1, 1988 to maintain surety bond receipts collected from Lottery retailers. Billing rates are established by the Executive Director of the Department of Revenue and are reviewed on an annual basis. Retailers have the option to obtain private surety bond coverage at a rate of $2,000 surety coverage per outlet at their discretion. As of June 30, 2013 and June 30, 2012, the Lottery had reserved $388,870 and $351,031, respectively. The Lottery utilizes restricted net assets before using unrestricted net assets.

Lottery Fund Net Position

In accordance with Section 24-35-210 (4.1)(a), C.R.S., the Lottery Commission shall reserve "sufficient monies, as of the end of the fiscal year, to ensure the operation of the Lottery for the ensuing year." In June 2002 the Lottery Commission approved a balance in net assets "equal to net value of the Lottery's capital assets", and effective July 1, 2004, under Senate Bill 04-204, this reserve was required to be held in cash and investments. As of June 30, 2013 and June 30, 2012, the Lottery had reserved $1,900,322 and $2,831,868, respectively.

In April 2005, the Lottery set up a separate operating reserve independent of the net capital asset reserve in the amount of $1.7 million. The amount held in this operating reserve is reviewed annually and adjusted accordingly. The annual reviews were completed in October 2011 and October 2012. The reserve was decreased to $1.3 million in fiscal year 2012 and remained at $1.3 million in fiscal year 2013, in accordance with the reviews.

Equipment Expense

Included in "The Statement of Revenues, Expenses, and Changes in Fund Net Position" is an account titled equipment. This account reports the book value of assets, which are disposed of during the year, fixed asset purchases under the capitalization threshold, software purchases under the capitalization threshold, and other miscellaneous equipment transactions that do not qualify for capitalization.

Compensated Leave

All permanent employees of the Lottery may accrue annual and sick leave based on length of service subject to certain limitations on the amount that will be paid on termination. In addition, employees who are classified as non-exempt from overtime pay have accumulated overtime which must be taken as compensatory time or paid. The estimated cost of compensated absences for which employees are vested is as follows:

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

	June 30, 2012	Increases	Decreases	June 30, 2013
Annual leave	$ 706,468	$ 643,418	$ (626,522)	$ 723,364
Sick leave	129,591	45,926	(41,599)	133,918
Total annual and sick leave	836,059	689,344	(668,121)	857,282
Compensatory time	397	5,225	(4,539)	1,083
Total compensated leave	$ 836,456	$ 694,569	$ (672,660)	$ 858,365

	June 30, 2011	Increases	Decreases	June 30, 2012
Annual leave	$ 700,703	$ 613,143	$ (607,378)	$ 706,468
Sick leave	130,075	45,075	(45,559)	129,591
Total annual and sick leave	830,778	658,218	(652,937)	836,059
Compensatory time	1,281	2,434	(3,318)	397
Total compensated leave	$ 832,059	$ 660,652	$ (656,255)	$ 836,456

The short-term portion of the above accrued annual and sick leave at June 30, 2013 and June 30, 2012 is $0 as the Lottery was unaware of any current employees planning to retire and cash in their leave balances within the next twelve months.

Expired Warrants Liability

Expired warrants liability represents the expiration of aged uncashed warrants and imprest checks which expired on or before June 30, 2003. In accordance with Section 15-12-914 (2), C.R.S., recipients are entitled to claim payment up to 21 years after original date of issue. Pursuant to Section 24-35-212 (2), C.R.S., the amount of these uncashed warrants shall remain in the Lottery fund. Pursuant to the Unclaimed Property Act, Section 38-13-113, C.R.S., the funds to cover the liability for any uncashed warrants, which expire after June 30, 2003 are transferred to the Unclaimed Property Fund. The Lottery must request reimbursement from the Unclaimed Property Fund for any warrants presented for payment that expired after June 30, 2003. No request for reimbursement was made for fiscal year ending June 30, 2013 from the Unclaimed Property Fund and a request for $209 was made and received for fiscal year 2012.

Promotional Activity

The Lottery engages in three types of promotional activities in an attempt to enhance sales, to increase player awareness and to increase the player base. Specific promotional coupons/tickets are distributed/awarded to players through special promotions and drawings and can be redeemed/claimed at any lottery office for a specified lottery product. Specific promotional coupons/tickets with a total face value of $5,146 and $1,280 were redeemed in fiscal years ended June 30, 2013 and June 30, 2012, respectively. Scratch and jackpot game

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

tickets for specific games are given away as a more direct approach to introduce players to lottery games. During the fiscal years ended June 30, 2013 and 2012, scratch tickets with a total face value of $221,379 and $275,957, respectively, were given away. During the fiscal year ended June 30, 2013, jackpot games tickets (specifically Pick 3) with a total face value of $3,525 were given away at kickoff events for the new game. A new type of promotion tied directly to the online gaming system was introduced in fiscal year 2013. Through these promotions, players are given the opportunity to receive a "free" jackpot ticket when a qualifying purchase is made, for instance buy five Lotto tickets receive a free Pick 3 ticket. During the fiscal year ended June 30, 2013, jackpot games tickets with a total face value of $361,829 were given away through this method. Scratch and jackpot game tickets and coupon promotions are valued at cost. For the fiscal years ended June 30, 2013 and 2012, $352,702 and $178,031, respectively, were recorded as costs related to free tickets and coupons. These costs were included in Marketing and Communications expense in the statements of revenues, expenses and changes in fund net assets for coupons redeemed and scratch and jackpot game tickets given away.

NOTE 2 – CASH AND INVESTMENTS

Cash

Cash includes petty cash, change funds, an imprest fund, two depository accounts and cash on deposit with the State Treasurer. A detail of cash at June 30, 2013 and 2012 is as follows:

	2013	2012
Petty cash	$ 800	$ 800
Change funds	71,000	71,000
Imprest fund	170,000	188,000
Depository accounts	45,000	45,000
Cash on deposit with State Treasurer	42,338,038	32,027,121
Total unrestricted cash and investments	42,624,838	32,331,921
Restricted cash and investments – Licensed Agent Recovery Reserve Receipts on deposit with State Treasurer	388,870	351,031
Operating Reserve on deposit with State Treasurer	1,300,000	1,300,000
Total restricted cash and investments	1,688,870	1,651,031
Total cash and investments	$ 44,313,708	$ 33,982,952

Cash on Deposit with State Treasurer

Under the provisions of Section 24-35-210 (6), C.R.S., the State Treasurer shall invest the monies of the Lottery in excess of operating and prize payment expenses and all authorized transfers. Interest or any other return on investments is paid to the Lottery Fund account on a

NOTE 2 – CASH AND INVESTMENTS (CONTINUED)

monthly basis. Actual interest payments are determined by the State Treasurer. The actual allocated interest rate for fiscal years 2013 and 2012 was 1.07% and 1.36%, respectively.

In addition, the State Treasurer pools these deposits and invests them in securities approved by Section 24-75-601.1; C.R.S. Moneys deposited in the Treasury are invested until the cash is needed. As of June 30, 2013, the Lottery had cash on deposit with the State Treasurer of $44,026,908, which represented approximately 0.6 percent of the total $7,260.8 million fair value of deposits in the State Treasurer's Pool (Pool).

The Lottery reports its share of the Treasurer's unrealized gains and losses based on its participation in the State Treasurer's Pool only at fiscal year-end.

Effective July 1, 1997, with the Lottery's initial adoption of Governmental Accounting Standards Board Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, all of the Treasurer's investments, which include the net Licensed Agent Recovery Reserve Receipts are reported at fair value, which is determined based on quoted market prices. The State Treasurer does not invest any of the pool resources in any external investment pool, and there is no assignment of income related to participation in the Pool. Additional information on the Treasurer's Pool may be obtained in the State of Colorado's Comprehensive Annual Financial Report.

Deposits

Custodial credit risk is the risk that in the event of a bank failure, a government's deposits may not be returned to it. The Lottery's deposit policy for custodial credit risk requires compliance with the provisions of state law. State law requires collateralization of all deposits with federal depository insurance; bonds and other obligations of the U.S. Treasury, U.S. agencies or instrumentalities or the State of Colorado; bonds of any city, county, school district or special road district of the State of Colorado; bonds of any state; or a surety bond having an aggregate value at least equal to the amount of the deposits.

The Lottery accounts are held in Public Deposit Protection Act (PDPA) qualified institutions, thus balances held in the Lottery's accounts in excess of $250,000 per institution are secured through PDPA with guaranteed securities.

Investments

A Private Purpose Trust was established in fiscal year 2008 to record the Lottery's investments, held by MUSL, for the benefit of Colorado's Powerball annuity prize winners (Colorado Winners Trust). An investment policy followed by MUSL governs the purchase of these investments. The policy states that a brokerage firm wishing to submit a bid for the sale of securities to MUSL must first be qualified by 1) providing information to MUSL which substantiates compliance with minimum standards and guidelines as set forth by MUSL and 2) by entering into an agreement with MUSL. In addition, MUSL will purchase from qualifying brokers only securities which are backed by the full faith and credit of the United States Government or its

NOTE 2 – CASH AND INVESTMENTS (CONTINUED)

agencies. The approved securities are Certificates on Government Receipts, Certificates Accrual Treasury Securities, Coupon Treasury Receipts, Easy Growth Treasury Receipts, Government & Agency Term Obligation Receipts, Government Loan Trust, Class 1-Z, Government Trust Certificates, JOB Certificates, Principal Treasury Receipts, Resolution Funding Corporation Strips, Stripped Government Receipts, Treasury Investment Growth Receipts, Treasury Bond Receipts, United States Agency for International Development bonds, United States Treasury Coupon Under Book Entry, United States Treasury Bills, United States Treasury Securities Stripped, Physical Coupon Treasury Strips, Zero Coupon Treasury Obligations, Government Loan Trusts, and AID Bonds.

Custodial Credit Risk – Investments

Custodial credit risk for investments is the risk that in the event of the failure of the counterparty (e.g. broker-dealer) to a transaction, the Lottery will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The Lottery's securities are held by the counterparty in the Lottery's name and therefore, custodial risk is minimal.

Interest Rate Risk – Investments

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value is to changes in market interest rates. MUSL manages its exposure to interest rate risk by purchasing only securities which are either explicitly or implicitly guaranteed by the United States Government and by holding these investments to maturity.

	2013		2012	
Investment Type	Fair Value	Weighted Average Maturity (in years)	Fair Value	Weighted Average Maturity (in years)
U. S. Treasury Investments	$ 3,328,347	19.69	$ 3,855,402	20.17
Federal Judiciary	1,757,404	8.25	1,803,841	9.27
Government Trust Certificates	217,229	3.26	214,785	4.26
U.S. Aid Bonds	3,582,033	5.45	3,941,407	6.01
Resolution Funding Corp Strips	2,682,664	12.42	2,859,508	13.62
	$ 11,567,677		$ 12,674,943	

NOTE 2 – CASH AND INVESTMENTS (CONTINUED)

Credit Risk – Investments

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. The U.S. Aid Bonds carry a AAA rating under the Moody's rating system. The Resolution Funding Corporation Strips, Federal Judiciary and Government Trust Certificates are not rated (NR).

Concentration of Credit Risk – Investments

Investment in any one issuer (other than U.S. Treasury securities, other investments explicitly guaranteed by the U. S. government, mutual funds, and external investment pools) that represent 5% or more of the total investment as of June 30, 2013 are the Resolution Funding Corporation Strips and the Federal Judiciary Bonds, which represent 23.2% and 15.2%, respectively, of the total investments. Such securities representing 5% or more of the total investment as of June 30, 2012 were the Resolution Funding Corporation Strips and the Federal Judiciary Bonds, which represented 22.6% and 14.2%, respectively, of the total investments.

Statements of Cash Flows

The statements of cash flows is prepared under the direct method then adjusted for prize payments and commission and bonus payments to retailers, which are netted from cash received from retailers and applied against accounts receivable balances. For cash flow purposes, cash and investments include restricted cash and investments held by the State Treasurer in its cash and investment pool.

NOTE 3 – SCHEDULE OF CHANGES IN CAPITAL ASSETS

	June 30, 2012	Increases	Decreases	June 30, 2013
Capital assets being depreciated:				
Equipment and software	$ 6,079,410	$ 49,163	$ (181,686)	$ 5,946,887
Leasehold improvements	64,711	-	-	64,711
Total historical costs	6,144,121	49,163	(181,686)	6,011,598
Less accumulated depreciation for equipment	(3,299,311)	(964,356)	178,275	(4,085,392)
Less accumulated depreciation for leasehold improvements	(12,942)	(12,942)	-	(25,884)
Total accumulated depreciation	(3,312,253)	(977,298)	178,275	(4,111,276)
Total capital assets, being depreciated, net	$ 2,831,868	$ (928,135)	$ (3,411)	$ 1,900,322

	June 30, 2011	Increases	Decreases	June 30, 2012
Capital assets being depreciated:				
Equipment and software	$ 6,378,722	$ 132,792	$ (432,104)	$ 6,079,410
Leasehold improvements	64,711	-	-	64,711
Total historical costs	6,443,433	132,792	(432,104)	6,144,121
Less accumulated depreciation for equipment	(2,660,778)	(1,035,944)	397,411	(3,299,311)
Less accumulated depreciation for leasehold improvements	-	(12,942)	-	(12,942)
Total accumulated depreciation	(2,660,778)	(1,048,886)	397,411	(3,312,253)
Total capital assets, being depreciated, net	$ 3,782,655	$ (916,094)	$ (34,693)	$ 2,831,868

NOTE 4 – OPERATING LEASES

The Lottery occupies office and warehouse space in Pueblo, Denver, Grand Junction and Fort Collins and up until July 31, 2012 in Colorado Springs. Rental payments are contingent upon the continuing availability of funds. Specific lease information follows:

Pueblo

Office – The Lottery entered into an agreement with Midtown RLLLP on April 19, 2005 and the lease agreement began on June 27, 2005. The original lease was superseded July 31, 2012 when a new lease agreement was executed. A lease amendment was signed on April 9, 2013 to provide the Lottery with funds to offset the costs of equipment and cabling, moving/relocation, and security equipment connected with acquiring the first and mezzanine floors of the building. The new lease expires on June 30, 2022. The lease contains an option to renew for two additional five-year terms commencing on July 1, 2022. There are no other provisions for extension or renewal.

Warehouse – The Lottery leases primary warehouse space from Santa Fe 250 LLC. The Lottery entered into a lease agreement, which began July 1, 2011 and expires June 30, 2016. A lease amendment was signed August 8, 2012 to reduce monthly rent payments on the warehouse loft space. The lease contains an option to renew for one additional five-year term commencing on July 1, 2016. The lease also contains a holdover clause where the Lottery will become a month-to-month tenant if the Lottery fails to vacate the premises upon expiration or sooner termination of this lease. The rent to be paid by the Lottery during such continued occupancy shall be the same being paid by the Lottery as of the date of expiration or sooner termination. Landlord and the Lottery each hereby agree to give the other party at least thirty days written notice prior to termination of any holdover tenancy.

NOTE 4 – OPERATING LEASES (CONTINUED)

Denver

Office – The Lottery occupies office space in the Galleria Towers Building in Denver. The Lottery entered into a lease agreement, which began July 1, 2009 and expires June 30, 2019. The lease contains an option to renew the lease for two (2) consecutive additional periods of five years each. The lease also contains a holdover provision, whereby if the Lottery fails to vacate the premises upon the expiration or sooner termination of the lease, the Lottery will continue making the same monthly rent payment in effect pursuant to the lease agreement as of the date of expiration or sooner termination of the lease. Galleria Acquisitions, Inc. and the Lottery both agree to give each other thirty (30) days written notice prior to the termination of a holdover tenancy period.

Warehouse – On December 11, 2009, the Lottery entered into a lease agreement with Valley Business Corp., Inc. beginning on December 11, 2009 and expiring on June 30, 2015. The lease contains an option to renew the lease for two (2) consecutive additional periods of five years each. The lease also contains a holdover provision, whereby if the Lottery fails to vacate the premises upon the expiration or sooner termination of the lease, the Lottery will continue making the same monthly rent payment in effect pursuant to the lease agreement as of the date of expiration or sooner termination of the lease. Valley Business Corp. Inc. and the Lottery both agree to give each other thirty (30) days written notice prior to the termination of a holdover tenancy period.

Fort Collins

The Lottery occupies space leased by the Department of Revenue and is responsible for reimbursing the Department of Revenue for lease payments.

Grand Junction

The Lottery occupies space in the Grand Junction State Services Building and is responsible for reimbursing the Capitol Complex Division of the Colorado Department of Personnel and Administration for lease payments.

Colorado Springs

The Lottery occupied space leased by the Department of Revenue and was responsible for reimbursing the Department of Revenue for lease payments up until July 31, 2012 when the space was vacated by the Lottery.

NOTE 4 – OPERATING LEASES (CONTINUED)

Operating lease expense incurred for the fiscal years ended June 30, 2013 and 2012 and future minimum lease payments for fiscal years ending June 30, 2014 through 2018 and later years are as follows:

LOCATION			FUTURE MINIMUM LEASE PAYMENTS					
	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	LATER YEARS
Pueblo Office	$ 242,943	$ 242,456	$ 250,164	$ 257,799	$ 265,433	$ 273,238	$ 353,206	$1,521,251
Pueblo Warehouse	168,679	161,918	156,220	156,220	156,220		-	-
Denver	189,631	194,519	193,665	199,646	205,627	211,608	217,589	223,570
Denver Warehouse	92,920	95,986	85,004	87,811	-	-	-	-
Fort Collins Office	24,411	24,918	-	-	-	-	-	-
Grand Jct Office	6,899	5,434	-	-	-	-	-	-
CoSprgs Warehouse	6,181	529	-	-	-	-	-	-
Parking	1,780	2,545	-	-	-	-	-	-
	$ 733,444	$ 728, 305	$ 685,053	$ 701,476	$ 627,280	$ 484,846	$ 570,795	$1,744,821

NOTE 5 – OTHER REVENUE

A schedule of other revenue for the fiscal years ended June 30, 2013 and 2012 follows:

	2013	2012
License fees	$ 65,436	$ 65,205
Fines and penalties	171,192	69,188
Assignment fees	1,500	1,500
Net licensed agent recovery reserve receipts	37,839	(51,762)
Other	13,431	117,428
Total	$ 289,398	$ 201,559

NOTE 6 – DISTRIBUTION OF NET PROCEEDS

In accordance with Section 33-60-104, C.R.S., distributions of net proceeds shall be made on a quarterly basis. The State Treasurer shall distribute net lottery proceeds as follows: forty percent (40%) to the Conservation Trust Fund, ten percent (10%) to the Division of Parks and Outdoor Recreation and all the remaining net lottery proceeds in trust to the State Board of the Great Outdoors Colorado Trust Fund up to the statutory limit. Under Section 33-60-104(2), C.R.S., the limit is $35 million as adjusted annually based on the consumer price index. Any excess over the limit shall be transferred to the State Public School Fund. In fiscal year 2008 these proceeds were transferred to the Lottery Proceeds Contingency Reserve Fund as set

NOTE 6 – DISTRIBUTION OF NET PROCEEDS (CONTINUED)

forth in section 22-54-117(1.6)(a), C.R.S. Starting in fiscal year 2009 these proceeds were transferred to the Public School Capital Construction Assistance Fund as set forth in section 22-43.7-104(2)(b)(III), C.R.S.

Income available for distribution at June 30:

	2013	2012
Operating income	$133,979,874	$121,451,992
Plus: Other revenue	289,398	201,559
Investment income	77,300	343,764
Income before distributions	134,346,572	121,997,315
Change in licensed agent recovery reserve	(37,839)	51,762
Change in fair market value of investments	391,482	149,612
Change in operating reserve	-	100,000
Other changes in investment in capital assets	931,546	950,787
Income available for distribution	135,631,761	123,249,476
Less distributions prior to year-end	(98,333,399)	(94,265,400)
Income available for distribution	$ 37,298,362	$ 28,984,076

	Accrued at June 30, 2012	Proceeds Distributions Expenses	Distributions Paid	Accrued at June 30, 2013
Great Outdoors Colorado	$ 9,932,879	$ 59,171,757	$ (59,099,578)	$ 10,005,058
Public School Capital Construction Assistance Fund	4,559,159	8,644,124	(4,559,159)	8,644,124
Conservation Trust Fund	11,593,630	54,252,704	(50,926,990)	14,919,344
Division of Parks and Outdoor Recreation	2,898,408	13,563,176	(12,731,748)	3,729,836
	$ 28,984,076	$135,631,761	$(127,317,475)	$ 37,298,362

NOTE 6 – DISTRIBUTION OF NET PROCEEDS (CONTINUED)

	Accrued at June 30, 2011	Proceeds Distributions Expenses	Distributions Paid	Accrued at June 30, 2012
Great Outdoors Colorado	$ 12,144,162	$ 57,065,579	$ (59,276,862)	$ 9,932,879
Public School Capital Construction Assistance Fund	662,230	4,559,159	(662,230)	4,559,159
Conservation Trust Fund	10,245,114	49,299,790	(47,951,274)	11,593,630
Division of Parks and Outdoor Recreation	2,561,279	12,324,948	(11,987,819)	2,898,408
	$ 25,612,785	$123,249,476	$(119,878,185)	$ 28,984,076

NOTE 7 – PENSION PLANS

Plan Description

Most of the Lottery's employees participate in a defined benefit pension plan. The plan's purpose is to provide income to members and their families at retirement or in case of death or disability. The plan is a cost sharing multiple employer plan administered by the Public Employees' Retirement Association (PERA). PERA was established by state statute in 1931. Responsibility for the organization and administration of the plan is placed with the Board of Trustees of PERA. Changes to the plan require an actuarial assessment and legislation by the General Assembly. The state plan and other divisions' plans are included in PERA's financial statements, which may be obtained by writing PERA at PO Box 5800, Denver, Colorado 80217, by calling PERA at 1-800-759-PERA (7372), or by visiting http://www.copera.org.

NOTE 7 – PENSION PLANS (CONTINUED)

Non-higher education employees hired by the State after January 1, 2006 are allowed 60 days to elect to participate in a defined contribution retirement plan administered by the State*Deferred Compensation Committee rather than becoming a member of PERA. If that election is not made, the employee becomes a member of PERA, and the member is allowed 60 days from commencing employment to elect to participate in a defined contribution retirement plan administered by PERA rather than the defined benefit plan.*

Prior to legislation passed during the 2006 session, higher education employees may have participated in social security, PERA's defined benefit plan, or the institution's optional retirement plan. Currently, higher education employees, except for community college employees, are required to participate in their institution's optional plan, if available, unless they are active or inactive members of PERA with at least one year of service credit. In that case they may elect either PERA or their institution's optional plan. Community college employees hired after January 1, 2010, are required to become members of PERA and must elect either PERA's defined benefit or defined contribution plan within 60 days, unless they had been a PERA member within the prior twelve months. In that case, they are required to remain in the PERA plan in which they participated previously.

PERA members electing the defined contribution plan are allowed an irrevocable election between the second and fifth year to use their defined contribution account to purchase service credit and be covered under the defined benefit retirement plan. However, making this election subjects the member to the rules in effect for those hired on or after January 1, 2007, as discussed below. Employer contributions to defined contribution plan is the same as the contributions to the PERA defined benefit plan.

Defined benefit plan members (except state troopers) vest after five years of service and are eligible for full retirement based on their original hire date as follows:

- Hired before July 1, 2005 – age 50 with 30 years of service, age 60 with 20 years of service, or age 65 with 5 years of service.
- Hired between July 1, 2005 and December 31, 2006 – any age with 35 years of service, age 55 with 30 years of service, age 60 with 20 years of service, or age 65 with any years of service.
- Hired between January 1, 2007 and December 31, 2010 – any age with 35 years of service, age 55 with 30 years of service, age 60 with 25 years of service, or age 65 with 5 years of service. For members with less than five years of service credit as of January 1, 2011 age and service requirements increase to those required for members hired between January 1, 2007 and December 31, 2010.
- Hired between January 1, 2011 and December 31, 2016 – any age with 35 years of service, age 58 with 30 years of service, or age 65 with 5 years of service.
- Hired on or after January 1, 2017 – any age with 35 years of service, age 60 with 30 years of service, or age 65 with 5 years of service.

NOTE 7 – PENSION PLANS (CONTINUED)

Members are also eligible for retirement benefits without a reduction for early retirement based on their original hire date as follows:

- Hired before January 1, 2007 – age 55 with a minimum of 5 years of service credit and age plus years of service equals 80 or more.
- Hired between January 1, 2007 and December 31, 2006 – age 55 with a minimum of 5 years of service credit and age plus years of service equals 85 or more. Age plus years of service requirements increase to 85 for members with less than five years of service credit as of January 1, 2011.
- Hired between January 1, 2011 and December 31, 2016 – age 58 and age plus years of service equals 88 or more.
- Hired on or after January 1, 2017 – age 60 and age plus years of service equals 90.

State troopers and judges comprise a small percentage of plan members but have higher contribution rates, and state troopers are eligible for retirement benefits at different ages and years of service.

Members automatically receive the higher of the defined retirement benefit or money purchase benefit at retirement. Defined benefits are calculated as 2.5 percent times the number of years of service times the highest average salary (HAS). For retirements before January 1, 2009, HAS is calculated as one-twelfth of the average of the highest salaries on which contributions were paid, associated with three periods of 12 consecutive months of service credit and limited to a 15 percent increase between periods. For retirements after January 1, 2009, or persons hired on or after January 1, 2007, more restrictive limits are placed on salary increases between periods used in calculating HAS.

Retiree benefits are increased annually in July after one year of retirement based on the member's original hire date as follows:

- Hired before July 1, 2007 – the lesser of 2 percent or the average of the monthly Consumer Price Index increase.
- Hired on or after January 1, 2007 – the lesser of 2 percent or the actual increase in the national Consumer Price Index, limited to a 10 percent reduction in a reserve established for cost of living increases related strictly to those hired on or after January 1, 2007. (The reserve is funded by 1 percentage point of salaries contributed by employers for employees hired on or after January 1, 2007.)
- The upper limits on benefits increase by one-quarter percentage point each year when the funded ratio of PERA equals or exceeds 103 percent and declines by one-quarter percentage point when the funded ratio drops below 90 percent after having exceeded 103 percent. The funded ratio increase does not apply for three years when a negative return on investment occurs.

NOTE 7 – PENSION PLANS (CONTINUED)

Members who are disabled, who have five or more years of service credit, six months of which has been earned since the most recent period of membership, may receive retirement benefits if determined to be permanently disabled. If a member dies before retirement, their eligible children under the age of 18 (23 if a full time student) or their spouse may be entitled to a single payment or monthly benefit payments. If there is no eligible child or spouse, then financially dependent parents, beneficiaries, or the member's estate, may be entitled to a survivor's benefit.

Funding Policy

The contribution requirements of plan members and their employers are established, and may be amended, by the General Assembly. Salary subject to PERA contribution is gross earnings less any reduction in pay to offset employer contributions to the state sponsored IRC 125 plan established under Section 125 of the Internal Revenue Code.

Most employees contribute 8.0 percent (10.0 percent for state troopers) of their salary, as defined in CRS 24-51-101(42), to an individual account in the plan. Effective July 1, 2012, the temporary contribution rate increase of 2.5 percent for members in the State and Judicial Divisions to replace the 2.5 percent reduction in employer contributions effective for Fiscal Years 2010-11 and 2011-12 expired.

From July 1, 2012, to December 31, 2012, the State contributed 15.65 percent (18.35 percent for state troopers and 17.36 percent for the Judicial Branch) of the employee's salary. From January 1, 2013, through June 30, 2013, the state contributed 16.55 percent (19.25 percent for state troopers and 17.36 percent for the Judicial Branch). During all of Fiscal Year 2012-13, 1.02 percent of the employees' total salary was allocated to the Health Care Trust Fund.

Per Colorado Revised Statutes, an amortization period of 30 years is deemed actuarially sound. At December 31, 2012, the division of PERA in which the State participates has a funded ratio of 59.2 percent and a 53 year amortization period based on current contribution rates. The funded ratio on the market value of assets is slightly higher at 60.2 percent.

In the 2004 and 2010 legislative sessions, the General Assembly authorized an Amortization Equalization Disbursement (AED) to address a pension-funding shortfall. The AED requires PERA employers to pay an additional 0.5 percent of salary for calendar years 2006 and 2007, with subsequent year increases of 0.4 percent of salary through 2017, to a maximum of 5 percent (except for the Judicial Division whose AED contribution was frozen at the 2010 level).

In the 2006 and 2010 legislative sessions, the General Assembly authorized a Supplemental Amortization Equalization Disbursement (SAED) that requires PERA employers to pay an additional one half percentage point of total salaries, for calendar years 2008 through 2017, to a maximum of 5 percent (except for the Judicial Division whose SAED contribution was frozen at the 2010 level). The SAED will be deducted from the amount otherwise available to increase State employees' salaries.

At a 103 percent funding ratio, both the AED and the SAED will be reduced by one-half percentage point, and for subsequent declines to below 90 percent funded both the AED and

NOTE 7 – PENSION PLANS (CONTINUED)

SAED will be increased by one-half percentage point. For the Judicial Division, if the funding ratio reaches 90 percent and subsequently declines, the AED and SAED will be increased by one-half percentage point.

Historically members have been allowed to purchase service credit at reduced rates. However, legislation passed in the 2006 session required, that future agreements to purchase service credit be sufficient to fund the related actuarial liability.

The Lottery's contributions to the PERA defined benefit plan and/or the defined contribution plan for the fiscal years ending June 30, 2013, 2012, and 2011 were $958,457, 745,721, and $677,156, respectively. These contributions met the contribution requirement for each year.

NOTE 8 – OTHER RETIREMENT PLANS

Defined Contribution Plan

The PERA Defined Contribution Retirement Plan was established January 1, 2006, as an alternative to the defined benefit plan. All employees, with the exception of certain higher education employees, have the option of participating in the plan. At July 1, 2009, the State's administrative functions for the defined contribution plan were transferred to PERA. New member contributions to the plan vest from 50 percent to 100 percent evenly over 5 years. Participants in the plan are required to contribute 8 percent (10 percent for state troopers) of their salary. The temporary contribution rate increase to 10.5 percent (12.5 percent for State Troopers) effective in Fiscal Years 2010-11 and 2011-12 expired on July 1, 2012. At December 31, 2012, the plan had 4,362 participants.

Deferred Compensation Plan

The PERA Deferred Compensation Plan (457) was established July 1, 2009, as a continuation of the State's deferred compensation plan which was established for the state and local government employees in 1981. At July 1, 2009, the State's administrative functions for the 457 plan were transferred to PERA, where all costs of administration and funding are borne by the plan participants. In calendar year 2012, participants were allowed to make contribution of up to 100 percent of their annual gross salary (reduced by their 8 percent PERA contribution) to a maximum of $17,000. The reduction for the 8 percent PERA contribution reflects the expiration of the temporary contribution rate increase to 10.5 percent effective in Fiscal Years 2010-11 and 2011-12. Participants who are age 50 and older, and contributing the maximum amount allowable, were allowed to make an additional $5,500 contribution in 2012, for total contributions of $22,500. Contributions and earnings are tax deferred. At December 31, 2012, the plan had 17,469 participants.

NOTE 8 – OTHER RETIREMENT PLANS

Voluntary Tax-Deferred Retirement Plans

PERA offers a voluntary 401k plan entirely separate from the defined benefit pension plan. The State offers a 457 deferred compensation plan and certain agencies and institutions of the State offer 403(b) or 401(a) plans.

NOTE 9 – OTHER POSTEMPLOYMENT BENEFITS AND LIFE INSURANCE

Health Care Plan

The PERA Health Care Program began covering benefit recipients and qualified dependents on July 1, 1986. This benefit was developed after legislation in 1985 established the Program and the Health Care Fund; the program was converted to a trust fund in 1999. The plan is a cost-sharing multiple-employer plan under which PERA subsidizes a portion of the monthly premium for health care coverage. The benefits and employer contributions are established in statute and may be amended by the General Assembly. PERA includes the Health Care Trust Fund in its Comprehensive Annual Financial Report, which may be obtained by writing PERA at PO Box 5800, Denver, Colorado 80217, by calling PERA at 1-800-759-PERA (7372), or by visiting http://www.copera.org.

After the PERA subsidy, the benefit recipient pays the balance of the premium through an automatic deduction from the monthly retirement benefit. Monthly premium costs for participants depend on the health care plan selected, the PERA subsidy amount, Medicare eligibility, and the number of persons covered. Effective July 1, 2000, the maximum monthly subsidy is $230 per month for benefit recipients who are under 65 years of age and who are not entitled to Medicare and $115 per month for benefit recipients who are 65 years of age or older or who are under 65 years of age and entitled to Medicare. The maximum subsidy is based on the recipient having 20 years of service credit, and is subject to reduction by 5 percent for each year less than 20 years.

Employees are not required to contribute to the Health Care Trust Fund, which is maintained by employer's contributions as discussed above in Note 7. Beginning July 1, 2004, state agencies/institutions are required to contribute 1.02 percent of gross covered wages to the Health Care Trust Fund. The Lottery contributed $64,806, $65,105, and $63,995 as required by statute in Fiscal Years 2012-13, 2011-12, and 2010-11, respectively. In each year, the amount contributed was 100 percent of the required contribution.

The Health Care Trust Fund offers two general types of plans: fully-insured plans offered through health care organizations and self-insured plans administered for PERA by third party vendors. As of December 31, 2012, there were 51,666 enrolled participants, including spouses and dependents, from all contributors to the plan. At December 31, 2012, the Health Care Trust Fund had an unfunded actuarial accrued liability of $1.43 billion, a funded ratio of 16.5 percent, and a 66-year amortization period.

NOTE 10 – CONTINGENCIES AND COMMITMENTS

Prize Annuities – The Lottery purchases annuity contracts in the name of individual jackpot prize winners. Although the annuity contracts are in the name of the individual winners, the Lottery retains title to the annuity contracts. The Lottery remains liable for the payment of the guaranteed minimum prizes in the event the insurance companies issuing the annuity contracts default. The following guaranteed minimum prize payments for which annuity contracts have been purchased are due in varying amounts through April 11, 2037.

Specified prize payments	$268,937,369
Lifetime prize payments	32,285,000
Total guaranteed minimum prize payments	$301,222,369

Prize Commitment – The Lottery also acts as a transfer agent for the single Powerball Jackpot Winner on October 10, 2007. These funds are held in trust at the MUSL in securities deemed appropriate by the Grand Prize Trust Agreement. The future value of this prize was $17,634,000 as of June 30, 2013.

Self-insurance – The State of Colorado currently self-insures its agencies, officials and employees for the risks of losses to which they are exposed. That includes general liability, motor vehicle liability, workers' compensation and medical claims. The Lottery participates in the Risk Management Fund. State agency premiums are based on an assessment of risk exposure and historical experience. The State Risk Management Fund is a restricted General Fund used for claims adjustment, investigation, defense and authorization for the settlement and payment of claims or judgments against the state except for employee medical claims. The State Employees and Officials Insurance Fund is an Internal Service Fund established for the purpose of risk, financing employees' and officials' medical claims. Property claims are not self-insured; rather, the state has purchased insurance.

Colorado employers are liable for occupational injuries and diseases of their employees. Benefits are prescribed by the Worker's Compensation Act of Colorado for medical expenses and loss of wages resulting from job-related disabilities. The state utilizes the services of BroadspireServices, Inc., a related party, to administer its plan. The state reimburses BroadspireServices, Inc. for the current cost of claims paid and related administrative expenses.

The Lottery participates in the Risk Management Fund. State agency premiums are based on an assessment of risk exposure and historical experience. Liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported. Because actual claims liabilities depend on such complex factors as inflation, changes in legal doctrines and damage awards, the process used in computing claims liability does not necessarily result in an exact amount. Claims liabilities are reevaluated periodically to take into consideration recently settled claims, the frequency of claims and other economic and social factors.

NOTE 10 – CONTINGENCIES AND COMMITMENTS (CONTINUED)

The limits of liability for which the state accepts responsibility pursuant to Section 24-10-114(1), C.R.S., are as follows:

Liability	Limits of Liability
General and automobile	Each person $150,000 Each occurrence $600,000

Before January 1, 1999, the Group Benefit Plans Fund provided an employer-paid short-term disability plan for all employees. On January 1, 1999, PERA began covering short-term disability claims for state employees eligible under its retirement plan. The Group Benefit Plans Fund continues to provide short-term disability coverage for employees not yet qualified for the retirement plan and secondary benefits for employees also covered under the PERA short-term disability plan.

The Group Benefit Plans short-term disability program provides an employee with 60 percent of their pay beginning after 30 days of disability or exhausting their sick leave balance, whichever is later. This benefit expires six months after the beginning of the disability. Although fully insured, the Group Benefit Plans disability program includes a risk-sharing feature that provides experience rating refunds calculated as earned premium less the aggregate of incurred claims, claim reserve, retention charge and refunds paid previously over the term of the contract. Refunds, when applicable, are paid annually.

Furniture and Equipment – The State of Colorado carries a $5,000 deductible replacement policy on all state owned furniture and equipment per Colorado Revised Statutes 24-30-1510.5(3)(a)(IV). For each loss incurred, the Lottery is responsible for the first $5,000 of the deductible. Any loss in excess of $5,000 is covered by the insurance carrier up to replacement cost.

Gaming Operations Commitments – The Lottery entered into long-term contracts with certain significant vendors related to providing online data processing services and scratch tickets in support of the Lottery's gaming operations. The online data processing contract expires on October 31, 2012 per the contract amendment dated January 26, 2005. The Lottery has exercised the sole two-year renewal option period extending the contract through October 31, 2014. There are also available renewal options for two additional periods of ninety days for conversion and turnover purposes. Per Option Letter #14, the amended total cost of this contract is not to exceed $90,971,175. Payments for the online data processing contract were $9,474,512 and $9,345,192 for the fiscal years ended June 30, 2013 and 2012, respectively.

The Lottery entered into three contracts with scratch ticket vendors, one starting on February 28, 2011, one on March 14, 2011 and the other starting on April 1 2011. All three contracts expire on June 30, 2014. The Lottery may require continued performance for three additional periods of 12 months on all three contracts beyond the expiration date. In addition, in the event that a contract with a successor contractor cannot be signed prior to the expiration or

NOTE 10 – CONTINGENCIES AND COMMITMENTS (CONTINUED)

termination date of these contracts, the State reserved the right to extend these contracts for a maximum of one hundred eighty (180) days or until a new contract is executed, whichever occurs first. There are no other provisions for extension or renewal. The total costs of the contracts for the initial contract period are not to exceed a total of $12,100,000. Payments under these contracts were $2,743,261 and $2,603,938 for the fiscal years ended June 30, 2013 and 2012, respectively.

The Lottery was approved as a member of the MUSL on February 26, 2001 and thus entered into an agreement with MUSL on June 6, 2001 to become a member and participate in Powerball games. As a member, the Lottery agrees to abide by the terms of the Multi-State Agreement dated September 16, 1987 and to any amendments to that agreement duly made by the board. The Lottery will remain a member indefinitely. Pursuant to this agreement, the Lottery will make payments to MUSL for administrative fees, weekly prize expenses, promotional purchases, miscellaneous reimbursements and assessments and contributions to the prize reserves. On November 15, 2012, the MUSL Powerball Group unanimously agreed to accept the recommendations of the Finance & Audit Committee and the Executive Committee and set the Prize Reserve Account (PRA) cap to $80 million reduced from the previous $100 million cap. The total amount contributed by the Lottery to the Powerball prize reserves as of June 30, 2013 is $3,852,874 and is based on a percentage of sales. This amount is shown as prepaid prize expense – MUSL on the statements of net position. MUSL reserves the right to hold funds which do not exceed 110% of the required balance. If the actual balance in the reserves should exceed 110% of the required balance, MUSL will refund any funds in excess of the 110% threshold. As of June 30, 2013 the excess funds held by MUSL over Colorado's required reserves is $67,729 with the maximum allowable excess amount calculated at $378,515.

In 2009, the Powerball and Mega Millions governing bodies entered discussions regarding cross-selling the Powerball and Mega Millions games, whereby each state currently selling Mega Millions tickets would also sell Powerball tickets and those states currently selling Powerball tickets would also sell Mega Million tickets. On March 10, 2010, the Lottery commission voted to allow the Colorado Lottery to participate in the cross-selling of the Mega Millions game. The rule became effective as of April 30, 2010 and the first day of ticket sales was May 16, 2010. The Multi-State Lottery Association (MUSL) agreed to undertake the administrative functions associated with the Mega Millions game for the states currently participating in their Powerball game. MUSL immediately began collecting a percentage of sales to fund the newly formed Mega Millions prize reserve fund. On March 22, 2013, the MUSL Mega Millions Game Group set the maximum prize reserve fund at $45 million. The Colorado Lottery's balance in the reserve as of June 30, 2013 is $1,026,395.

In addition, MUSL may deposit and hold any Unreserved Account Funds in trust for the benefit of member lotteries. These funds will not be comingled with any other funds held in trust and can be used only for authorized uses of the unreserved funds. The Colorado Lottery's balance in the unreserved fund held by MUSL as of June 30, 2013 is $62,225.

NOTE 10 – CONTINGENCIES AND COMMITMENTS (CONTINUED)

Other Major Vendor Commitments –The Lottery entered into a long-term contract with an advertising agency to provide advertising services to promote the Lottery's products. The contract period began on July 1, 2012, and expires on June 30, 2015. The Lottery has the option to renew the contract for two (2) additional twelve-month periods. The total cost of the initial contract period, including amendments, is not to exceed $44,850,000. Payments under this contract were $12,573,518 and $12,526,849 for the fiscal years ended June 30, 2013 and 2012, respectively.

Litigation – Currently, there is no reportable outstanding litigation.

NOTE 11 – TAX, SPENDING AND DEBT LIMITATIONS

In November 1992, the Colorado voters passed Section 20, Article X of the Colorado Constitution, commonly known as the Taxpayer's Bill of Rights (TABOR). TABOR contains revenue, spending, tax and debt limitations that apply to the State of Colorado and all local governments. In the same general election, Article XXVII was passed creating the State Board of the Great Outdoors Colorado Trust Fund. The simultaneous passage of these two constitutional amendments raised questions as to whether there are irreconcilable conflicts between the two amendments.

The General Assembly determined in Section 24-77-102 (17) (b) (IX), C.R.S., that the net proceeds from the Lottery are excluded from the scope of "state fiscal year spending" for purposes of TABOR. The Colorado Supreme Court, in response to an interrogatory from the General Assembly, approved that determination.

TABOR is complex and subject to further legislative and judicial interpretation. The Lottery believes it is in compliance with both of these constitutional amendments.

NOTE 12 – RELATED PARTY TRANSACTIONS

The Lottery, as an agency of the State of Colorado, paid fees to other agencies of the state for auditing, legal and other services and vehicle and office rent. The Lottery also pays fees to the Department of Revenue for indirect costs. Interagency charges were $1,176,931 and $1,039,170 for the fiscal years ended June 30, 2013 and 2012, respectively.

NOTE 13 – SUBSEQUENT EVENT

The Lottery went out for bid and has awarded its online games contract to a new vendor to provide a communication network and online data processing service in support of the Lottery's gaming operations effective October 2014. As of the date of this report the contract has not been signed by either party.

SUPPLEMENTARY INFORMATION

COLORADO LOTTERY

SCHEDULE OF REVENUE AND COSTS FOR SCRATCH AND JACKPOT GAMES

FOR THE FISCAL YEAR ENDED JUNE 30, 2013

(With Comparative Totals for the Fiscal Year Ended June 30, 2012)

		Jackpot Games							FY 2013	FY 2012
	Scratch	Lotto	Powerball	Cash 5	Matchplay	Mega Millions	Raffle III (Note 2)	Pick 3 (Note 3)	Total	Scratch and Jackpot Games
TICKET SALES	$368,583,078	$32,561,865	$116,726,233	$21,279,304	-	$23,217,230	$1,969,010	$1,949,878	$566,286,598	$545,303,548
PRIZE EXPENSE	(255,573,498)	(16,289,162)	(48,434,571)	(11,554,225)	128,894	(12,004,512)	(1,000,000)	(912,954)	(345,640,028)	(347,536,804)
MULTI-STATE PRIZE VARIANCES	N/A	N/A	(5,902,283)	N/A	N/A	1,281,856	N/A	N/A	(4,620,427)	4,896,553
NET REVENUE AFTER PRIZES	113,009,580	16,272,703	62,389,379	9,725,079	128,894	12,494,574	969,010	1,036,924	216,026,143	202,663,297
COMMISSIONS, BONUSES, TICKET COSTS & VENDOR FEES (Note 1)										
Retailer Commission	(25,754,874)	(1,950,034)	(6,993,054)	(1,274,204)	-	(1,389,837)	(117,440)	(116,675)	(37,596,118)	(36,305,943)
Retailer Bonus	(3,585,379)	(181,834)	(516,226)	(187,709)	1,182	(120,431)	(11,801)	(15,554)	(4,617,752)	(5,334,999)
Cost of Tickets Sold	(2,606,116)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	(2,606,116)	(2,789,463)
Telecomm Reimbursements	506,138	44,715	160,290	29,222	-	31,883	2,828	2,669	777,745	772,902
On-Line Vendor Fees	(6,085,339)	(537,395)	(1,926,010)	(351,123)	-	(383,121)	(32,489)	(38,084)	(9,353,561)	(9,031,464)
TOTAL	(37,525,570)	(2,624,548)	(9,275,000)	(1,783,814)	1,182	(1,861,506)	(158,902)	(167,644)	(53,395,802)	(52,688,967)
GROSS PROFIT ON SALE OF TICKETS	$75,484,010	$13,648,155	$53,114,379	$7,941,265	$130,076	$10,633,068	$810,108	$869,280	$162,630,341	$149,974,330
AVERAGE DAILY TICKET SALES	$1,009,817	$89,211	$319,798	$58,299	-	$63,609	$5,394	$5,342	$1,551,470	$1,489,900

Note 1: Administrative costs of Lottery operations, including wages, advertising and other expenses are not shown.

Note 2: Raffle III sales began on October 1, 2012 and ended on January 1, 2013

Note 2: Pick 3 sales began on April 28, 2013

COLORADO LOTTERY
SCHEDULE OF PERCENT OF PRIZE EXPENSE TO GROSS TICKET SALES
FOR THE FISCAL YEAR ENDED JUNE 30, 2013

		Jackpot Games							FY 13	FY 12
	Scratch	Lotto	Powerball	Cash 5	Matchplay	Mega Millions	Raffle	Pick 3	Total	Total
Prize Expense *	$255,573,498	$16,289,162	$54,336,854	$11,554,225	($128,894)	$10,722,656	$1,000,000	$912,954	$350,260,455	$342,640,251
(/)Ticket Sales	368,583,078	32,561,865	116,726,233	21,279,304	-	23,217,230	1,969,010	1,949,878	566,286,598	545,303,548
Prize %	69.34%	50.03%	46.55%	54.30%	N/A	46.18%	50.79%	46.82%	61.85%	62.83%

*Net of Multi-State Prize Variances

COLORADO LOTTERY
BUDGETARY COMPARISON
FOR THE FISCAL YEAR ENDED JUNE 30, 2013

	Fiscal Year 2013 Original Budget	Supplementals Allocations & Internal Transfers	Fiscal Year 2013 Final Budget	Fiscal Year 2013 Actual Expenditures	Under Expended	Percent Under Expended
Personal Services	$8,881,413	$0	$8,881,413	$8,003,453	$877,960	9.89%
Amortization Equalization	214,864	0	214,864	206,869	7,995	3.72%
Supplemental Amort. Equal.	184,836	0	184,836	177,825	7,011	3.79%
Workmen's Compensation	66,588	4,947	71,535	71,535	0	0.00%
Health and Life	768,761	53,700	822,461	821,898	563	0.07%
Short Term Disability	11,947	0	11,947	11,560	387	3.24%
Operating	1,203,156	0	1,203,156	1,035,198	167,958	13.96%
DOR Postage	6,895	(6,895)	0	0	0	N/A
Variable Vehicle	192,785	17,800	210,585	210,585	0	0.00%
Leased Space	731,484	0	731,484	722,871	8,613	1.18%
Grand Junction - Leased Space	5,421	12	5,433	5,433	0	0.00%
Risk Management	32,755	7,741	40,496	40,496	0	0.00%
Vehicle Lease Payments	148,659	0	148,659	148,072	587	0.39%
Travel	113,498	0	113,498	70,001	43,497	38.32%
Purch. Serv. Comp. Center	2,386	0	2,386	2,386	0	0.00%
Marketing, Communications & Sales	14,700,000	0	14,700,000	13,732,533	967,467	6.58%
Communications Services	2,514	0	2,514	2,514	0	0.00%
Payments to MNT	262,205	0	262,205	262,205	0	0.00%
Payments to Other Agencies	239,410	0	239,410	133,133	106,277	44.39%
Legal Services	21,030	6,000	27,030	25,829	1,201	4.44%
Indirect Costs	555,914	30,298	586,212	586,212	0	0.00%
Ticket Costs-Scratch	6,578,000	0	6,578,000	3,566,811	3,011,189	45.78%
Research	250,000	0	250,000	133,899	116,101	46.44%
Vendor Fees	12,571,504	0	12,571,504	9,501,461	3,070,043	24.42%
Prize Payments	424,104,016	0	424,104,016	359,216,978	64,887,038	15.30%
Retailer Compensation	52,241,350	0	52,241,350	42,213,870	10,027,480	19.19%
Multi-State Lottery Fund	177,433	0	177,433	148,940	28,493	16.06%
Lottery Systems Migration	2,514	0	2,514	0	2,514	100.00%
COFRS Modernization	35,657	0	35,657	35,657	0	0.00%
TOTAL	$524,306,995	$113,603	$524,420,598	$441,088,224	$83,332,374	15.89%

FY13 Staffing - FTE - (Note 1) 117.0 (Appropriated) 120.5 (Actual)

Reconciliation of Expenses per *Statement of Revenues, Expenses and Changes in Fund Net Position* to Budgeted Expenditures:

Expenses Per Statement of Revenues, Expenses and Changes in Net Position

Prize Expense	$345,640,028
Powerball Prize Variance	5,902,283
Mega Millions Prize Variance	(1,281,856)
Commissions and Bonuses	42,213,870
Cost of Tickets & Vendor Fees	11,181,932
Operating Expenses	28,650,467
Total Expenses per Statement of Revenues, Expenses and Changes in Net Position	432,306,724
Plus: Powerball Prize Variance classified as revenue	5,404,606
Mega Millions Prize Variance classified as revenue	3,551,918
Telecommunications offset classified as revenue	777,745
Less: Non-appropriated expenses	
Depreciation	(977,298)
Accrued Annual and Sick Leave	(21,224)
Book Value of Assets Written Off	(3,411)
Sub-Total	441,039,060
Plus: Capitalized purchases	49,164
	$441,088,224

Note 1 - The Governor's budget office has informed departments that the appropriated FTE can be exceeded by 10% for FY 2013

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Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

Members of the Legislative Audit Committee
State of Colorado, Department of Revenue, Division of the Lottery
Denver, CO

We have audited, 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*, issued by the Comptroller General of the United States, the financial statements of the major fund and remaining fund information of the Colorado Lottery, an enterprise fund and private purpose fund of the State of Colorado as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise Colorado Lottery basic financial statements and have issued our report thereon dated September 16, 2013.

Internal Control over Financial Reporting
In planning and performing our audit of the financial statements, we considered the Colorado Lottery's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Colorado Lottery's internal control. Accordingly, we do not express an opinion on the effectiveness of Colorado 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, or 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 entity's financial statements will not be prevented, or 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 over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not yet been identified. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings and responses that we consider to be a significant deficiency as item 2013 – 1.

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Compliance and Other Matters
As part of obtaining reasonable assurance about whether Colorado Lottery's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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.

Colorado Lottery's Response to Findings
Colorado Lottery's response to the finding identified in our audit is described in Recommendation Number 1 in the Auditor's Finding and Recommendation section of the report. Colorado Lottery's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report
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 entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Eide Bailly LLP

Greenwood Village, CO
September 16, 2013

EideBailly
CPAs & BUSINESS ADVISORS

September 16, 2013

To the Members of the Legislative Audit Committee
State of Colorado, Department of Revenue, Division of the Lottery
Denver, CO

We have audited the accompanying basic financial statements of the major fund and remaining fund information of the Colorado Lottery, an enterprise fund and private purpose fund of the State of Colorado, as of and for the year ended June 30, 2013, and the related notes to the financial statements. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards and *Government Auditing Standards*, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter to you dated May 15, 2013. Professional standards also require that we communicate to you the following information related to our audit.

Significant Audit Findings

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the Colorado Lottery are described in Note 1 to the financial statements. In Fiscal Year 2013 the Lottery implemented GASB Statement 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* and GASB Statement 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position.* The implementation of these GASB statements had no material impact on the Lottery's financial statements. No other new accounting policies were adopted and the application of existing policies was not changed during Fiscal Year 2013. We noted no transactions entered into by the governmental unit during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the Colorado Lottery's financial statements were:

> Management's estimate of the prize expense and the corresponding liability is calculated based on the anticipated payout approved by the Lottery Commissioners. The prize expense and corresponding liability is incurred as tickets are activated by Lottery approved retailers. We evaluated the key factors and assumptions used to develop the prize expense and corresponding liability in determining that it is reasonable in relation to the financial statements taken as a whole.

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosures affecting the financial statements were:

> The disclosure of Cash and Investments in Note 2, Disclosure of Net Proceeds in Note 6, Pension Plans in Note 7, Contingencies and Commitments in Note 10, Tax, Spending and Debt Limitations in Note 11, Related Party Transactions in Note 12 and Subsequent Events in Note 13.

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The financial statement disclosures are neutral, consistent, and clear.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. There were no material adjustments or uncorrected misstatements in fiscal 2013 other than the note disclosure described below.

There was a $4 million error corrected in Note 10, Contingencies and Commitments footnote related to the prize annuities that are held by insurance companies and not included in the statement of net position or the statement of activities. The original footnote was overstated by $4 million and the error has been corrected to reflect the estimated value of future annuities for prize winners.

Disagreements with Management

For purposes of this letter, a disagreement with management is a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated September 16, 2013.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the governmental unit's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Other Matters

With respect to the supplementary information accompanying the financial statements, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

This information is intended solely for the use of the Legislative Audit Committee and management of the Colorado Lottery and is not intended to be, and should not be, used by anyone other than these specified parties.

Sincerely,

Eide Bailly LLP

Greenwood Village, CO

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