

Colorado Lottery

Financial and Compliance Audit

June 30, 2004 and 2003

**LEGISLATIVE AUDIT COMMITTEE
2004 MEMBERS**

Effective as of August 2, 2004

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Colorado Lottery
June 30, 2004 and 2003

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August 12, 2004

Members of the Legislative Audit Committee:

We have completed the financial statement audits of the Lottery as of and for the years ended June 30, 2004 and 2003. Our audits were conducted in accordance with auditing standards generally accepted in the United States of America.

We were engaged to conduct our audit pursuant to Section 24-35-211, C.R.S., which authorizes 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.

\s\ **BKD, LLP**

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Colorado Lottery

Report Summary

Year Ended June 30, 2004

Purposes and Scope of Audit

Authority, Purpose and Scope

The audit of the Colorado Lottery (the Lottery) was done under authority of Section 24-35-211, C.R.S., which requires the State Auditor to conduct an annual audit of the Lottery Fund. The purpose of the audit was to express an opinion on the financial statements of the Lottery for the year ended June 30, 2004.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. We obtained our information by reviewing documents, interviewing staff, analyzing data and performing other audit procedures as we deemed necessary.

The purposes and scope of this audit were:

- To express an opinion on the financial statements of the Lottery as of and for the year ended June 30, 2004, 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, 2004.
- To evaluate progress in implementing the prior audit recommendations.

Summary of Major Audit Comments

Audit Findings and Financial Statement Audit Report Section

The auditors' findings and recommendations section contains the following recommendations:

- The Lottery conducts nonstatewide drawings for relatively low-value prizes, referred to as third-tier drawings. The Lottery should strengthen its internal controls surrounding third-tier drawings by considering the Commission's approval of a general rule regarding third-tier prizes. This should include outlining threshold amounts associated with the prizes.
- The Lottery promoted and offered a game in which the winner would receive a prize and a nonprofit of the winner's choice would receive a contribution. No statute currently supports this activity. The Lottery should pursue statutory changes if it elects to continue conducting games in this manner.
- The Lottery should determine the appropriate amount of reserve required to continue its operations for the following year. In making this determination, the Lottery should calculate on an annual basis the amount of this reserve based on the economic and budgetary factors present at year-end. In addition, the Lottery should consider the impact of unrealized gains and losses on the calculation of net lottery proceeds.

The recommendations and the responses from the Lottery can be found in the recommendation locator.

Colorado Lottery
Report Summary (continued)
Year Ended June 30, 2004

Audit Opinions and Reports

The independent accountants' 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.

Auditors' Communication to Legislative Audit Committee

The auditors' communication to the Legislative Audit Committee describes the auditors' responsibility under auditing standards generally accepted in the United States of America and significant management judgments and estimates. It also notes that there were no proposed audit adjustments for the year ending June 30, 2004. This communication is located on page 52.

Summary of Progress in Implementing Prior Audit Recommendations

The audit report for the year ended June 30, 2003 contained two recommendations. Of those recommendations, one was fully implemented in the current fiscal year and the other is scheduled to be implemented in 2005. The Disposition of Prior Audit Recommendations is on page 10.

Colorado Lottery
Recommendation Locator
Year Ended June 30, 2004

Recommendation Number	Page Number	Recommendation Summary	Response	Implementation Date
1	5	The Lottery should strengthen controls over third-tier prizes and third-tier drawings.	Agree	January 2005
2	7	The Lottery should pursue statutory changes if it should decide to continue with prizes that include a contribution to a nonprofit entity.	Agree	November 2004
3	8	The Lottery should calculate the operating requirements for the following year in order to reserve the appropriate amount at year-end.	Agree	March 31, 2005
		In addition, the Lottery should consider the effect the change in fair market value of investments has on its net proceeds available for distribution calculation.	Agree	June 30, 2005

Colorado Lottery

Background

Year Ended June 30, 2004

The Lottery was created as a division within the Department of Revenue with the passage of Senate Bill 119 on April 30, 1982. The Lottery began operations on July 1, 1982 and sold its first lottery ticket on January 24, 1983.

During fiscal year 2004, the Lottery employed 120 employees in its headquarters in Pueblo and branch offices in Denver, Fort Collins and Grand Junction.

The Lottery is governed 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. The Commission's responsibilities are stated in Section 24-35-208, C.R.S., and include:

- Promulgation of rules and regulations to govern the Lottery operations.
- Carrying on a continuous study and investigation of the Lottery to determine the need for changes in statutes, rules or regulations or in the administration and operation of the Lottery.

The Lottery's enabling legislation 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, the Division of Parks and Outdoor Recreation, and the Great Outdoors Colorado Trust Fund (GOCO). The amount distributed to GOCO is limited by a constitutional cap. As of fiscal year 2002, amounts exceeding the GOCO cap (the spill over) are distributed to the State Public School Fund Contingency Reserve. Prior to 2002, spill over funds were distributed to the State General Fund.

Colorado Lottery

Auditors' Findings and Recommendations

Year Ended June 30, 2004

The operations of the Colorado Lottery are governed by Title 24, Article 25, Part 2 of the Colorado Revised Statutes (C.R.S.). During our fiscal year 2004 financial audit, two matters concerning the Lottery games and adherence to statutory requirements came to our attention. The first issue concerns the question of which types of games are subject to observation by an independent certified public accountant (CPA), and the second issue concerns the question of whether the Commission has the authority to establish prizes that include donations to a nonprofit organization.

Observation of Drawings

Section 24-35-208(2)(d), C.R.S., states in part that all drawings shall be witnessed by an independent certified public accountant, and all drawing equipment used in such public drawings must be examined prior to and after each public drawing by an independent public accountant. The Colorado Lottery awards different prizes based on the type of game. According to Lottery staff, there are three tiers or categories of games and associated prizes:

- First tier: These are the large, statewide drawings that require the purchase of a ticket to participate. The Lottery Commission approves the games and drawing guidelines, which include prizes awarded and prize structures, for these contests. First-tier prizes typically range between \$1 and \$5,000,000 and are awarded as cash or instant merchandise prizes in the scratch games, Lotto, Cash 5 or Powerball games. During fiscal year 2004, total prizes awarded in this category totaled approximately \$242 million.
- Second tier: These are statewide contests in which prizes are awarded through second-chance drawings. These are drawings where a participant can send or enter a non-winning ticket to the Lottery to enter into another drawing. Prizes include such items as a Harley Davidson motorcycle or a trip. Similar to the first tier, the Lottery Commission approves the games and drawing guidelines, including prizes awarded and prize structures. The total amount of second-tier or second-chance prizes awarded during fiscal year 2004 was about \$1.2 million.
- Third tier: According to the Lottery, third-tier promotional prize drawings may or may not be statewide contests and are referred to as special prize drawings. Unlike the other two tiers, guidelines and prizes for these contests are established by the Lottery Director, not by the Lottery Commission. These drawings may take place at a grocery store, radio station, sporting event, or other arena, and the prizes are typically smaller. For example, current and past prizes have included pairs of sporting event tickets valued at about \$80 per pair; prize packs consisting of Lottery Bucks and ski lift tickets valued at about \$250 in total; a \$500 shopping spree, and a \$3,400 prize package provided to local television stations. The total amount awarded during fiscal year 2004 in this category was about \$42,000.

Colorado Lottery

Auditors' Findings and Recommendations

Year Ended June 30, 2004

While the drawings for prizes in the first and second tier have been routinely observed by an independent CPA in accordance with statutes, third-tier drawings conducted by the Lottery are not observed by an independent CPA. In our discussions with Lottery, management stated that third-tier drawings do not require the purchase of a ticket to enter (although drawings may be done from second-chance tickets in some instances) and the value of prizes awarded in this category are relatively minimal. Drawings may or may not be statewide and are held at events such as the opening of a grocery store or a sports event. These drawings have taken place since the early years of the Lottery, which began operations in 1983. According to management, these games are viewed as ways to promote awareness of the Lottery. Due to the limited value of the prizes, management has considered the third-tier drawings not to be the types of drawings contemplated by the statutes and therefore they are not subject to the same rule-setting procedures and independent observations as required for the first and second tier. In addition, management believes that the expense of having third-tier drawings observed by an independent CPA would make them too costly to operate.

The Office of the State Auditor requested that the Office of Legislative Legal Services (OLLS) provide an opinion concerning whether all drawings, including third-tier drawings, are subject to the observation requirement described in Section 24-35-208(2)(d), C.R.S. In its response, OLLS stated that the provisions of Section 24-35-208(2)(d), C.R.S., do not appear to apply to promotional drawings for prizes of low dollar value or so-called third-tier drawings.

While the third-tier drawings may not be subject to the observation requirements described in statutes, we believe that management should strengthen the controls over these smaller drawings. For example, management has not set a limit for the dollar value of individual prizes that may be awarded as third-tier prizes and these drawings are not approved by the Commission since they are under the purview of the Lottery Director. In order to ensure that prizes are appropriately limited in value, the Lottery should establish a limit for individual prizes. In addition, the Lottery should provide a report to the Lottery Commission annually on the number of drawings and types and value of prizes given for tier drawings that have occurred.

Recommendation No. 1:

The Colorado Lottery should strengthen controls for third-tier drawings by establishing a limit on the dollar value of individual prizes and reporting annually to the Lottery Commission on the number of drawings and types and value of prizes awarded in this category.

Colorado Lottery Response:

Agree

The Colorado Lottery has established a limit for its low-tier promotional drawings of prizes below \$599. The Lottery will formalize this limit in a rule amendment to be presented to the Colorado Lottery Commission. The Lottery will report annually to the Commission the number of these drawings and the types and value of prizes awarded.

Implementation date: January 2005

Colorado Lottery

Auditors' Findings and Recommendations

Year Ended June 30, 2004

Assigning Prizes to Nonprofit Entities

The second issue related to statutory compliance that came to our attention was that the Colorado Lottery was promoting and offering a game called Lucky Dog under which the winner receives a cash prize and, as part of the prize, Lottery makes a cash contribution to the winner's favorite nonprofit entity.

Lottery statutes do not specifically address prizes that include making a donation to a nonprofit organization. Section 24-35-208(2)(j), C.R.S., states that rules promulgated by the Commission shall include, but shall not be limited to the allocation of the total revenues accruing from the sale of lottery tickets or shares and from all other sources among (I) the payment of prizes to the holders of winning tickets or shares; and (II) the payment of costs incurred in the operation and administration of the Lottery. Section 24-35-210, C.R.S., defines the types of expenses and prizes that can be paid from the Lottery Fund and specifies that net proceeds are to be distributed to the various beneficiaries. Under current state law, these include the Conservation Trust Fund, the Division of Parks and Outdoor Recreation, Great Outdoors Colorado and the Contingency Reserve of the State Public School Fund. In our discussions with Lottery, management stated that the Lottery Commission has the authority to set the rules for the games, which include the structure of the prizes. The cash contribution to the nonprofit entity is viewed as part of the structure of the prize and the back of the tickets for the game details the prize structure, including information about how the prize would be divided between the winner and the nonprofit organization.

The Office of the State Auditor requested clarification from the Office of Legislative Legal Services (OLLS) on whether the Lottery is authorized under to pay a portion of a prize to someone or some entity other than the winner as stated under Section 24-35-208 (2)(j), C.R.S., and Section 24-35-210, C.R.S.

In its reply, OLLS stated that there is nothing in the statutory provisions governing the Lottery that appears to authorize the Lottery to pay a prize to a person or entity other than the winner. OLLS stated that Section 24-35-208 (2)(j), C.R.S., appears to authorize the payment of prize money only to the holders of winning tickets or shares, i.e., the person who purchased the winning ticket or share. OLLS also noted that Section 24-35-212 (1), C.R.S., states that the right of the person to a prize is not assignable except in certain cases which are defined in that section and do not include allocating part of the prize to a nonprofit entity. These provisions indicate that the General Assembly intended to strictly control the assignability or transferability of rights in prizes.

Accordingly, the Lottery should seek statutory clarification from the General Assembly if it intends to offer games in which the prizes will include making payments to parties other than the winner, unless specifically provided for in statutes. At the conclusion of our audit, management indicated that it may choose not to offer these types of games in the future.

Colorado Lottery

Auditors' Findings and Recommendations

Year Ended June 30, 2004

Recommendation No. 2:

The Colorado Lottery should pursue statutory clarification if it decides to operate games with prize structures that include a contribution to an entity other than the winner.

Colorado Lottery Response

Agree

At this time, the Colorado Lottery does not intend to operate future games with prize structures that include a contribution to an entity other than the winner. Lottery game design procedures will be modified to ensure that if future circumstances indicate that such a game may be optimal, the Lottery will pursue statutory clarification before offering such a game.

Implementation date: November 2004

Operating Reserve of the Lottery

Section 24-35-210 (4.1) (a), C.R.S., states 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 fiscal year 1989, the Lottery Commission established a policy to maintain a reserve of \$1 million of the Lottery's fund balance to meet this statutory requirement.

Effective as of fiscal year 2003, the Governmental Accounting Standards Board (GASB), which establishes accounting standards for state and local governmental entities, promulgated a new reporting model under GASB Statement No. 34. Among other things, the Statement changed the name of the fund balance to "net assets," and it required that an enterprise, such as the Lottery, report on a separate line within its net assets the amount invested in capital assets, net of depreciation and any related debt. As a result, in June 2002 the Commission changed its policy and determined that as of fiscal year 2003 the reserve would be the amount of net assets "equal to net value of the Lottery's capital assets." Similarly, as of the end of fiscal year 2004 the operating reserve was \$1,029,114, or the net assets invested in capital assets.

During the 2004 Session, Senate Bill 04-204 was enacted by the General Assembly, which made a number of changes to the Lottery effective as of fiscal year 2005. One of the changes requires that the Lottery's operating reserve be held in cash and investments. As a result, the Commission will need to establish a new policy for determining how the operating reserve will be calculated. The Lottery should assist the Commission by performing an analysis of its historical cash flows, current economic conditions, and other relevant factors to establish the basis for determining the appropriate amount of cash and investments to be held in reserve at fiscal year-end.

Colorado Lottery

Auditors' Findings and Recommendations

Year Ended June 30, 2004

Lottery should also consider the impact of unrealized gains and losses on investments with respect to how it treats these gains and losses in the calculation of net lottery proceeds. These unrealized gains and losses are related to investments held on Lottery's behalf by the State Treasurer. The amount is based on the fair market value at year-end and is recorded only for financial reporting purposes. It has been Lottery's policy not to include either the unrealized gains or losses when calculating the net lottery proceeds to be distributed to beneficiaries. In other words, unrealized gains are not distributed as part of net proceeds, and unrealized losses are not deducted from net proceeds. However, as a result of not deducting unrealized losses of \$860,931 from distributions for fiscal year 2004, Lottery's investments decreased by that amount and its unrestricted net assets decreased to \$147,057 at the end of fiscal year 2004 from \$1,007,988 at the end of fiscal year 2003. If unrealized losses were to exceed \$147,057 in fiscal year 2005, Lottery would have a negative balance in unrestricted net assets and there would be a corresponding decrease in investments. Because of these impacts, particular attention should be paid to how unrealized gains and losses are handled with respect to calculating distributions.

Recommendation 3:

The Lottery should analyze historical cash flow needs and other relevant factors and provide this information to the Commission for use in determining the appropriate amount of operating reserves to maintain. The methodology developed for establishing operating reserves should be periodically reevaluated. In addition, Lottery should consider the treatment of unrealized gains and losses with respect to determining net lottery proceeds in view of potential negative impacts on investments and unrestricted net assets.

Colorado Lottery Response

Agree

The first component of this recommendation suggests that the Lottery should work with the Commission in establishing a basis for determining the appropriate amount of cash and investments to be held in the operating reserve. The Lottery will evaluate possible alternatives for establishing a suitable reserve balance and will work closely with the Lottery Commission and the Executive Director of the Department of Revenue to ensure that the appropriate reserve is recorded.

Implementation date: March 31, 2005

The second component of this recommendation asks the Lottery to consider the impact of unrealized gains and losses when calculating net proceeds distributions. In the future, the Lottery's Fiscal Office will include information about unrealized gains and losses to assist the Commission in determining the appropriate operating reserve and resulting distribution.

Implementation date: June 30, 2005

Colorado Lottery

Disposition of Prior Year Audit Recommendations Year Ended June 30, 2004

Number	Recommendation	Disposition
1	<p>The Lottery should minimize risks related to information system control, internal controls over financial processing and safeguarding of assets by:</p> <p>a) Performing an annual independent examination of the internal system used to record and track ticket sales.</p> <p>b) Performing specific independent testing and examinations as part of the systems reconfiguration to assure reliability prior to activating the new system.</p> <p>c) Requesting an independent SAS 70, Type II, examination on the external service provider and its subcontractor as the new system is being established and annually thereafter.</p>	<p>Deferred Scheduled fiscal year 2005</p> <p>Although the implementation date is after the period of our report date, the Department of Revenue is expecting to complete the conversion by November 1, 2004. If they do not meet that conversion date, the Department will extend its contract with the current vendor as decided by October 8, 2004.</p> <p>Deferred Scheduled fiscal year 2005</p>
2	<p>The Lottery should annually obtain and internally review Multi-State Lottery Association (MUSL) financial statements to monitor the financial condition and capacity of MUSL and to specifically monitor the asset valuation of the reserve deposits.</p>	<p>Implemented</p>



Independent Accountants' Report on Financial Statements and Supplementary Information

Members of the Legislative Audit Committee:

We have audited the accompanying basic financial statements of the Colorado Lottery as of and for the years ended June 30, 2004 and 2003, as listed in the table of contents. These financial statements are the responsibility of the Lottery's management. 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 for 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Lottery as of June 30, 2004 and 2003, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 12, 2004, on our consideration of the Lottery's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The accompanying management's discussion and analysis as listed in the table of contents is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Colorado Lottery
Members of the Legislative Audit Committee

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Lottery's basic financial statements. The accompanying supplementary information, as listed in the table of contents, is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

\s\ **BKD, LLP**

August 12, 2004

Colorado Lottery

Management's Discussion and Analysis

Year Ended June 30, 2004

This discussion and analysis of the Lottery financial performance provides an overview of financial activities for the fiscal year ended June 30, 2004. Please read it in conjunction with the Lottery's financial statements, which begin on page 22. These financial statements reflect only activities of the Colorado Lottery, a proprietary fund of the State of Colorado.

Fiscal Year 2004 Financial Highlights

- The Lottery's overall sales performance of \$401.3 million reflected a \$9.8 million increase from last year and replaced fiscal year 2003 as the second largest sales year since the Lottery's start-up in 1983. Our highest overall sales year was fiscal year 2002, with sales totaling \$407 million.

Scratch sales totaled \$260.9 million to capture the highest year of scratch sales ever, with the second highest honors going to fiscal year 2002, with scratch sales of \$257.2 million. An increase in marketing efforts including offering a broader range of price points, additional games and an overall upgrade to the look of our scratch tickets, contributed to this increase in scratch sales.

Lotto sales continue to decline since the introduction of Powerball in fiscal year 2002. Fiscal year 2004 Lotto sales of \$40.8 million reflect a decrease of \$7.5 million from the previous year sales of \$48.3 million.

On the other hand, large Powerball jackpots helped Powerball sales for fiscal year 2004 increase by \$9.3 million over the prior fiscal year. Powerball sales for fiscal year 2004 totaled \$85 million as compared to prior year sales of \$75.7 million.

Cash 5 sales for fiscal year 2004 showed an unexpected increase. Sales increased more than 9% to a total of \$14.5 million from \$13.2 million in fiscal year 2003.

- Proceeds distributions fell slightly, totaling \$104.1 million, as compared to \$104.8 million in fiscal year 2003. This included, for the third time, a spill-over into the State Public School Fund Contingency Reserve which was \$2.4 million in fiscal year 2004. 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 adjusted for the annual change in the cost of living increase for the Denver-Boulder area.
- For the fifth year in a row, the Lottery received a Certificate of Achievement from the Government Finance Officers Association. This Certificate is the highest honor awarded for governmental accounting and financial reporting.
- Gross profit as a percent of sales decreased by .2 percent, a reflection of the increase in the prize costs from 58% (\$227,514,771) to 59% (\$239,427,919) of sales. Fiscal year 2003 prize expense was slightly lower due to a decrease in Powerball prize expense from the absorption of an unclaimed Powerball jackpot.

Colorado Lottery

Management's Discussion and Analysis

Year Ended June 30, 2004

Games Offered by the Colorado Lottery

Currently, the Lottery offers two different ways to play: scratch games and online games (Powerball, Lotto and Cash 5). Scratch games consist of pre-printed tickets that may be purchased for various prices (\$1, \$2, \$3, \$5 and \$10) 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.

Online games, however, require a longer playing time. Tickets are also purchased at Lottery retailers and are printed on ticket stock as the purchase is made. Each ticket contains one or more playing boards. Each board consists of a set of numbers, the combination of numbers required for play varying by game. The winning numbers for each game are posted after their respective draw nights with drawings held on every night of the week, excluding Sunday. 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 \$600 must be redeemed at Lottery offices.

Using this Annual Report

This annual report consists of a series of financial statements. The statement of net assets provides information about the Lottery's assets and liabilities and reflects the Lottery's financial position as of June 30, 2004 and 2003. The statement of revenues, expenses, and changes in net assets reports the activity of selling Lottery products and the expenses related to such activity for the years ended June 30, 2004 and 2003. Finally, the statement of cash flows outlines the cash inflows and outflows related to the activity of selling Lottery products for the years ended June 30, 2004 and 2003.

Colorado Lottery
Management's Discussion and Analysis
Year Ended June 30, 2004

Statements of Net Assets

The statements of net assets is a financial snapshot of the Lottery at June 30, 2004 and 2003. It presents the fiscal resources of the Lottery (assets), the claims against those resources (liabilities) and the residual available for future operations (net assets). Assets and liabilities are classified by liquidity as either current or non-current. Net assets are classified by the ways in which they may be used for future operations.

Colorado Lottery
Condensed Statements of Net Assets
June 30, 2004 and 2003

	2004	2003
Assets		
Current assets	\$ 39,951,270	\$ 47,485,313
Restricted assets	5,024,418	3,003,518
Capital assets	<u>1,029,114</u>	<u>1,427,326</u>
Total assets	<u>46,004,802</u>	<u>51,916,157</u>
Liabilities		
Current liabilities	43,576,344	48,061,451
Long-term liabilities	<u>782,863</u>	<u>958,754</u>
Total liabilities	<u>44,359,207</u>	<u>49,020,205</u>
Net Assets		
Investment in capital assets	1,029,114	1,427,326
Restricted-Licensed Agent Recovery Reserve	469,424	460,638
Unrestricted	<u>147,057</u>	<u>1,007,988</u>
Total net assets	<u>\$ 1,645,595</u>	<u>\$ 2,895,952</u>

The Lottery's total assets at June 30, 2004 were \$46 million. Assets consisted primarily of cash and investments with the State Treasury of \$25.4 million, Prepaid Prize Expense with MUSL of \$3.5 million, receivables from Lottery retailers for the sale of Lottery products of \$14.7 million, and a net investment in fixed assets of \$1 million.

Colorado Lottery
Management's Discussion and Analysis
Year Ended June 30, 2004

Comparable figures at June 30, 2003 were \$51.9 million in total assets, including \$31.5 million in cash and investments with the State Treasury, Prepaid Prize Expense with MUSL of \$2.5 million, receivable from retailers of \$15.3 million, and a net investment in fixed assets of \$1.4 million.

The Lottery's total liabilities at June 30, 2004 totaled approximately \$44.4 million, consisting primarily of proceeds distributions due to recipients of \$25.8 million and prize liability on all Lottery products of about \$14 million.

The Lottery's total liabilities at June 30, 2003 totaled \$49 million, which consisted primarily of proceeds distributions due of \$25.4 million and prize liability on all Lottery products of about \$18.6 million.

Components of the Lottery's net assets 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 assets); 2) a Licensed Agent Recovery Reserve (bonding reserve) funded by retailers to cover any uncollectible receivable accounts; and 3) 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 assets from June 30, 2003 to June 30, 2004 consisted of a decrease in investment in capital assets from \$1.4 million to \$1 million, a minor increase in the bonding reserve from \$460,638 to \$469,424 and a net decrease in unrealized gain on investments of \$860,931 resulting from a net decrease in the adjustments on State Treasury investments.

Following is a schedule of net assets:

	<u>2004</u>	<u>2003</u>	<u>Change</u>
Investment in capital assets	\$ 1,029,114	\$ 1,427,326	\$ (398,212)
Bonding reserve	469,424	460,638	8,786
Unrealized gain on investments	<u>147,057</u>	<u>1,007,988</u>	<u>(860,931)</u>
Total net assets	<u>\$ 1,645,595</u>	<u>\$ 2,895,952</u>	<u>\$ (1,250,357)</u>

Colorado Lottery
Management's Discussion and Analysis
Year Ended June 30, 2004

Statements of Revenues, Expenses and Changes in Net Assets

The statements of revenues, expenses and changes in net assets presents 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 Assets
For the Fiscal Years Ended June 30, 2004 and 2003**

	<u>2004</u>	<u>2003</u>
Operating Revenues	\$ 401,250,971	\$ 391,473,640
Direct Operating Expenses	<u>276,512,227</u>	<u>266,444,993</u>
Gross Profit on Sale of Tickets	<u>124,738,744</u>	<u>125,028,647</u>
Other Operating Expenses		
Marketing and communications	8,643,422	9,093,013
Wages and benefits	7,881,363	8,055,900
Other operating expenses	<u>5,550,032</u>	<u>5,142,879</u>
Total operating expenses	<u>22,074,817</u>	<u>22,291,792</u>
Operating Income	<u>102,663,927</u>	<u>102,736,855</u>
Nonoperating Revenues (Expenses)		
Other revenue	156,990	303,134
Investment income	184	1,958,747
Proceeds distributions	<u>(104,071,458)</u>	<u>(104,779,061)</u>
Total nonoperating revenue (expenses)	<u>(103,914,284)</u>	<u>(102,517,180)</u>
Increase (Decrease) in Net Assets	(1,250,357)	219,675
Net Assets, Beginning of Year	<u>2,895,952</u>	<u>2,676,277</u>
Net Assets, End of Year	<u>\$ 1,645,595</u>	<u>\$ 2,895,952</u>

Colorado Lottery

Management's Discussion and Analysis

Year Ended June 30, 2004

Sales Activities

Revenues from the sale of Lottery products for the fiscal year ended June 30, 2004 were the second highest in the Lottery's 22-year history. As shown in the financial statements, overall sales increased slightly by 2.5% from the prior year, from \$391.5 million in fiscal year ended June 30, 2003 to \$401.3 million in the current year. The increase in scratch sales from \$254.3 million to \$260.9 represented a slightly larger percentage increase of 2.6%. Powerball finished its second full year of sales with more than a 12.3% increase in sales from the prior year, a result of large Powerball jackpots. Lotto sales suffered an off year statistically, as addressed on page 1, resulting in a 15.5% reduction in sales. This was the second consecutive year that Lotto experienced a large percentage reduction in sales. In fiscal year 2003, Lotto sales reflected a 16.2% decrease from fiscal year 2002.

The following table compares Lottery product sales between fiscal years. All sales are presented in millions of dollars:

Product Sales	2004	2003	Difference	Percentage
Scratch	\$ 260.9	\$ 254.3	\$ 6.6	2.6%
Powerball	85.0	75.7	9.3	12.3
Lotto	40.8	48.3	(7.5)	(15.6)
Cash 5	<u>14.5</u>	<u>13.2</u>	<u>1.3</u>	<u>9.9</u>
Total	<u>\$ 401.2*</u>	<u>\$ 391.5</u>	<u>\$ 9.7</u>	<u>2.5%</u>

*Certain amounts may not foot due to rounding.

Total Revenues

Nonoperating revenues for the year ended June 30, 2004 totaled \$.2 million as compared with \$2.3 million for the year ended June 30, 2003. Two major factors contributed to the decrease from fiscal year 2003 to fiscal year 2004. First, investment income for fiscal year 2004 included a net loss of \$860,931 to record the Lottery's share of unrealized gains and losses on investments as mandated by GASB 31. In contrast, a \$398,543 net gain from the Lottery's share of unrealized gains and losses was included in investment income for fiscal year 2003. Second, interest received from the treasury and other sources was down by nearly \$700,000 due to lower interest rates in a sluggish economy. In addition, C.R.S. 24-36-114 required that, for fiscal year 2004, 15% of the Lottery's Treasury interest be sent to the General Fund.

Total revenues were \$401.4 million and \$393.7 million for the years ended June 30, 2004 and 2003, respectively. As mentioned elsewhere, the two major contributors to the increase of approximately \$7.7 million were an increase in Lottery sales of \$9.8 million offset by a decrease in nonoperating revenues of \$2.1 million.

Colorado Lottery
Management's Discussion and Analysis
Year Ended June 30, 2004

Major Expenses

Approximately \$276.5 million of the Lottery's total expenses of \$298.6 million for the fiscal year ended June 30, 2004 was incurred in direct support of Lottery games. This included prize expense, retailer compensation, money spent to purchase scratch tickets and compensation to the vendor who maintains and supports the online gaming system.

In comparison, \$266.4 million of the Lottery's total expenses of \$288.7 million for the fiscal year ended June 30, 2003, were game-related expenses.

Following is a table comparing the game-related expenses between fiscal years. All expenses are presented in millions of dollars.

Game-Related Expenses	2004	2003	Difference	Percentage
Prize expense/Powerball prize variance	\$ 236.6	\$ 226.9	\$ 9.7	4.3%
Retailer compensation				
Commissions	26.6	26.0	0.6	2.3
Bonuses	3.6	3.5	0.1	2.9
Ticket costs	3.0	3.2	(0.2)	(6.3)
Vendor fees	<u>6.7</u>	<u>6.8</u>	<u>(0.1)</u>	<u>(1.5)</u>
Total	<u>\$ 276.5</u>	<u>\$ 266.4</u>	<u>\$ 10.1</u>	<u>3.8%</u>

The increase in the game-related expenses, including prize expense, Commission expense and bonus expense, is reflective of the increase in product sales. See the product sales schedule above. In addition, the prize expense percentage was further increased in fiscal year 2004 over the prize expense percentage in fiscal year 2003, as the prize expense percentage in fiscal year 2003 had been reduced by the expiration of an unclaimed Powerball jackpot.

Of the \$22.1 million in fiscal year 2004 expenses that were not game-related, more than \$8.6 million was for promotions and institutional and product advertising and \$7.9 million in compensation to Lottery employees. In comparison, of the fiscal year 2003 nongame-related expenses of \$22.3 million, just under \$9.1 million was for promotions and institutional and product advertising, and \$8.0 million was for compensation to Lottery employees.

Distributions to Proceeds Recipients

The Lottery's efforts generated proceeds distributions of \$104.1 million in the current fiscal year, the third highest year ever. Of these total proceeds, nearly \$49.7 million was allocated to the Great Outdoors Colorado Trust Fund, \$41.6 million to the Conservation Trust Fund, and \$10.4 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 \$49.7 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 State Public School Fund Contingency Reserve of \$2.4 million, pursuant to C.R.S. 22-54-117 (1.6) (a).

Colorado Lottery

Management's Discussion and Analysis

Year Ended June 30, 2004

The Lottery's proceeds distributions for the prior year was the second highest year on record, totaling \$104.8 million. Approximately \$48.7 million was distributed to Great Outdoors Colorado, \$41.9 million to the Conservation Trust Fund, \$10.5 million to the Division of Parks and Outdoor Recreation and a spill-over into the State's Public School Fund Contingency Reserve of nearly \$3.7 million.

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 (called the Long Bill), which determines budgets for every agency within the State. 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. In the third quarter of fiscal year 2004, the Legislature approved supplemental appropriations to adjust for changes in estimated sales levels and other unforeseen needs/adjustments. Supplemental appropriations were approved in operating expenses, Multi-use Network Task Force payments, legal services, ticket costs and retailer compensation lines, offset by reductions in the vehicle lease payments, telecommunications, risk management, indirect costs, vendor fees, prizes and Powerball prize variance. The final method of funding is special legislation. There was no special legislation affecting the Lottery's budget in fiscal year 2004.

The approved Lottery budget at the beginning of fiscal year 2004 was \$355.4 million. Department level allocations approved at the beginning of the fiscal year increased the budget by \$0.4 million. Supplemental appropriations and adjustments made in the third quarter decreased the budget by \$6.9 million to an amended total of \$348.9 million. Total expenditures and roll-forwards for fiscal year 2004 came to \$304.4 million, resulting in excess appropriations (or savings) of more than \$44.5 million.

Economic Factors and Next Year's Budget

The Lottery considered several factors when setting the revenue estimates and the fiscal year 2005 budget. Online sales (Powerball, Lotto and Cash 5) are expected to decrease slightly overall as sales for Online games naturally decrease over the life cycle of each game.

Scratch sales for fiscal year 2004 were up approximately \$6.6 million from projections, finishing at \$260.9 million as the best Scratch sales ever. Therefore, the Lottery is projecting that fiscal year 2005 sales will be comparable or slightly higher than fiscal year 2004.

Fiscal year 2005 revenue estimates total \$392.5 million, an \$8.7 million decrease from fiscal year 2004 actual sales due primarily to a projected decrease in Powerball sales as the game matures. Powerball sales are projected to be \$72 million for fiscal year 2005 compared to actual Powerball sales of \$85 million for fiscal year 2004. Further, these are projected Lotto sales of \$45.5 million for fiscal year 2005 compared to actual Lotto sales of \$40.8 million in fiscal year 2004.

In addition to normal increases in costs, there will be one other major change in costs in fiscal year 2005, which will decrease online system-related costs due to a new online contract.

Colorado Lottery
Management's Discussion and Analysis
Year Ended June 30, 2004

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 2004 and to demonstrate the Lottery's accountability for the money generated from the sale of Lottery products. If you have questions about this report or need additional information, contact Barbara Aggson, the Colorado Lottery's Controller, 201 West 8th Street, Suite 600, Pueblo, CO 81003.

Colorado Lottery
Statements of Net Assets
June 30, 2004 and 2003

Assets

	<u>2004</u>	<u>2003</u>
Current Assets		
Cash and investments	\$ 23,920,655	\$ 31,030,059
Accounts receivable, net of the allowance for doubtful accounts; 2004 – \$70,846 and 2003 – \$77,833	14,671,184	15,261,679
Game prizes inventory, at cost	120,323	—
Consignment ticket inventory, at cost	157,705	131,703
Warehouse ticket inventory, at cost	1,043,264	917,029
Prepaid expenses	<u>38,139</u>	<u>144,843</u>
Total current assets	<u>39,951,270</u>	<u>47,485,313</u>
Restricted Assets		
Cash and investments – Licensed Agent Recovery Reserve		
Receipts	469,424	460,638
Cash and investments – Operating Reserve	1,029,114	—
Prepaid prize expense – Multi-State Lottery Association	<u>3,525,880</u>	<u>2,542,880</u>
Total restricted assets	<u>5,024,418</u>	<u>3,003,518</u>
Capital Assets		
Equipment	4,455,227	5,559,322
Leasehold improvements	327,287	330,936
Less accumulated depreciation and amortization	<u>(3,753,400)</u>	<u>(4,462,932)</u>
Total capital assets	<u>1,029,114</u>	<u>1,427,326</u>
Total assets	<u>\$ 46,004,802</u>	<u>\$ 51,916,157</u>

Liabilities

	<u>2004</u>	<u>2003</u>
Current Liabilities		
Accounts payable	\$ 1,987,162	\$ 1,590,977
Prize liability	13,975,136	18,565,011
Payable to MUSL	129,377	678,159
Wages and benefits	725,844	671,966
Accrued annual and sick leave	78,211	142,254
Retailer bonus liability	576,370	574,247
Funds available for distribution	25,805,521	25,412,933
Deferred revenue	<u>298,723</u>	<u>425,904</u>
Total current liabilities	<u>43,576,344</u>	<u>48,061,451</u>
Long-term Liabilities		
Accrued annual and sick leave	653,670	829,541
Expired warrants liability	<u>129,193</u>	<u>129,213</u>
Total long-term liabilities	<u>782,863</u>	<u>958,754</u>
Total liabilities	<u>44,359,207</u>	<u>49,020,205</u>
Net Assets		
Investment in capital assets	1,029,114	1,427,326
Restricted – Licensed Agent Recovery Reserve	469,424	460,638
Unrestricted	<u>147,057</u>	<u>1,007,988</u>
Total net assets	<u>1,645,595</u>	<u>2,895,952</u>
Total liabilities and net assets	<u>\$ 46,004,802</u>	<u>\$ 51,916,157</u>

Colorado Lottery
Statements of Revenues, Expenses and Changes in Net Assets
Years Ended June 30, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Operating Revenues		
Gross ticket sales	\$ <u>401,250,971</u>	\$ <u>391,473,640</u>
Direct Operating Expenses		
Prize expense	238,427,919	227,514,771
Powerball prize variance	(1,824,959)	(597,361)
Retailer commissions and bonuses	30,255,251	29,528,971
Cost of tickets and vendor fees	<u>9,654,016</u>	<u>9,998,612</u>
Total direct operating expenses	<u>276,512,227</u>	<u>266,444,993</u>
Gross Profit on Sale of Tickets	<u>124,738,744</u>	<u>125,028,647</u>
Other Operating Expenses		
Marketing and communications	8,643,422	9,093,013
Administration fees paid to MUSL	134,839	114,766
Wages and benefits	7,881,363	8,055,900
Professional services	559,685	314,768
State agencies services	405,910	257,947
Department of Revenue services	330,926	372,155
Travel	111,983	104,985
Equipment (including \$21,117 and \$23,124, respectively, of loss on disposition of equipment)	99,455	108,330
Depreciation	489,609	463,742
Space rental	746,806	718,649
Rents for equipment	690,126	689,546
Motorpool leasing	276,191	284,947
Materials and supplies	141,202	89,984
Telephone	190,334	148,466
Online telecommunications	725,728	801,383
Data processing supplies and services	55,413	65,850
Equipment maintenance	280,227	264,729
Postage	73,219	74,468
Printing	34,796	69,513
Other	<u>203,583</u>	<u>198,651</u>
Total other operating expenses	<u>22,074,817</u>	<u>22,291,792</u>
Operating Income	<u>102,663,927</u>	<u>102,736,855</u>

Colorado Lottery
Statements of Revenues, Expenses and Changes in Net Assets (continued)
Years Ended June 30, 2004 and 2003

	2004	2003
Operating Income	<u>102,663,927</u>	<u>102,736,855</u>
Nonoperating Revenues (Expenses)		
Other revenue	156,990	303,134
Investment income	184	1,958,747
Funds distributed for current year	(78,265,937)	(79,366,128)
Funds available for distribution for current year	<u>(25,805,521)</u>	<u>(25,412,933)</u>
Total nonoperating revenues (expenses)	<u>(103,914,284)</u>	<u>(102,517,180)</u>
(Decrease) Increase in Net Assets	(1,250,357)	219,675
Net Assets, Beginning of Year	<u>2,895,952</u>	<u>2,676,277</u>
Net Assets, End of Year	<u>\$ 1,645,595</u>	<u>\$ 2,895,952</u>

Colorado Lottery
Statements of Cash Flows
Years Ended June 30, 2004 and 2003

	2004	2003
Operating Activities		
Cash received from retailers	\$ 400,528,775	\$ 390,853,822
Cash paid in prizes	(242,453,240)	(227,822,348)
Cash paid in retailer commissions	(26,620,204)	(25,965,985)
Cash payments to suppliers	(22,597,775)	(21,858,289)
Cash payments to employees for services	(7,990,304)	(7,319,796)
Cash received from Lotto subscription sales	463,239	654,617
Cash paid in retailer bonus	(3,640,176)	(3,625,433)
Cash received – other	<u>29,380</u>	<u>17,128</u>
Net cash provided by operating activities	<u>97,719,695</u>	<u>104,933,716</u>
Noncapital Financing Activities		
Distribution of net proceeds	<u>(103,678,870)</u>	<u>(101,305,142)</u>
Capital and Related Financing Activities		
Acquisition of capital assets	<u>(112,513)</u>	<u>(311,456)</u>
Investing Activities		
Interest received	<u>861,115</u>	<u>1,560,204</u>
Increase in Cash and Investments	(5,210,573)	4,877,322
Change in Fair Market Value of Investments	(860,931)	398,543
Cash and Investments, Beginning of Year (Including \$460,638 and \$464,096, Respectively, in Restricted Accounts)	<u>31,490,697</u>	<u>26,214,832</u>
Cash and Investments, End of Year (Including \$1,498,538 and \$460,638, Respectively, in Restricted Accounts)	<u>\$ 25,419,193</u>	<u>\$ 31,490,697</u>

Colorado Lottery
Statements of Cash Flows (continued)
Years Ended June 30, 2004 and 2003

	2004	2003
Reconciliation of Operating Income to Net Cash Provided by		
Operating Activities		
Operating income	\$ 102,663,927	\$ 102,736,855
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	489,609	463,742
Loss of disposal of equipment	21,117	23,124
Other revenue	156,990	303,134
Change in		
Accounts receivable	590,495	(1,551,606)
Ticket inventory	(152,237)	377,246
Prepaid prize expense with MUSL	(983,000)	(1,084,753)
Other assets	(13,619)	475,315
Liabilities (excluding funds available for distribution)	<u>(5,053,587)</u>	<u>3,190,659</u>
Net cash provided by operating activities	<u>\$ 97,719,695</u>	<u>\$ 104,933,716</u>

Colorado Lottery
Notes to Financial Statements
June 30, 2004 and 2003

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, Lotto, Powerball and Cash 5.

The financial statements reflect only activities of the Lottery, an enterprise fund of the State of Colorado, for the fiscal years ended June 30, 2004 and 2003. 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 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 assets, revenues and expenditures.

Colorado Lottery

Notes to Financial Statements

June 30, 2004 and 2003

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. As permitted by Governmental Accounting Standards Board Statement No. 20, *Accounting and Financial Reporting Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Lottery has elected to apply only those applicable Financial Accounting Standards Board Statements and interpretations issued prior to November 30, 1989.

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

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 counts 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 and subscription ticket sales are recognized using the specific performance method whereby sales are recognized at the point that the play becomes active for the next drawing. Expenses are recognized when they are incurred.

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.

Colorado Lottery
Notes to Financial Statements
June 30, 2004 and 2003

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable consist of amounts due from retailers for activated ticket packets. Accounts receivable are stated at the amount billed to retailers. Accounts receivable are ordinarily due seven days after the issuance of the invoice and are electronically transferred from the retailers accounts into the Lottery's account.

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, 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 are shown net of estimated uncollectible receivables of \$70,846 and \$77,833 as of June 30, 2004 and 2003, respectively.

Game Prizes Inventory

Game Prizes Inventory represents merchandise prizes connected to certain scratch games that, as of the statements of net assets date, have not been claimed.

Consignment Inventory

Inventory on consignment represents non-activated ticket inventory in the possession of retailers who act as agents of the Lottery. The Lottery retains title to these tickets since retailers have the right to return non-activated tickets; therefore, the tickets are included in the inventory and reported on the statements of net assets. 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 assets.

Colorado Lottery

Notes to Financial Statements

June 30, 2004 and 2003

Prepaid Prize Expense

As part of the Lottery's agreement with MUSL, for the Powerball game, a certain percentage of sales must be paid to MUSL for set prize and grand prize reserves.

Fixed Assets

Equipment and leasehold improvements are stated at cost. Beginning September 1, 1996, equipment may be capitalized if the cost exceeds \$5,000 and has a useful life of more than one year, however, a state agency may select a minimum acquisition cost or useful life which is less than the stated criteria for capitalization. Accordingly, the Lottery capitalized equipment with a cost of \$1,000 or more that has a useful life of more than one year. In addition, the Lottery capitalized all personal computers, regardless of their cost. Beginning January 1, 2004, the Lottery changed its policy and capitalizes equipment only if the cost exceeds \$5,000 and has a useful life of more than one year. Lottery did not make the change for July 1 — December 31, 2004. Depreciation for equipment is computed on the straight-line method over estimated useful lives ranging from three to ten years. Leasehold improvements are depreciated over the shorter of the lease term or the estimated useful lives of the improvements. 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.

The Lottery made the decision in May of 2003 to remove the Player Express Terminals (PES) from all retailers by the end of January 31, 2004. In accordance with accounting standards generally accepted in the United States of America, the monthly depreciation on these PES terminals was adjusted (accelerated) to insure that they were fully depreciated by the end of their useful life on January 31, 2004. The accelerated depreciation increased the regular monthly depreciation on these PES terminals from \$30,000 per month to \$52,061 per month for the affected months – May 2003 through January 2004. For fiscal year 2004 and 2003, an additional \$154,427 and \$44,121, respectively, of depreciation related to the PES terminals has been recorded and presented on the Lottery's financial statements.

Accrued Wages and Benefits

During the fiscal year ending June 30, 2004 and 2003, the state changed the pay date for the month of June for most state employees, deferring the date from June 30 to July 1. For the Lottery, this created a liability for accrued wages at June 30, 2004 and 2003 of \$725,844 and \$645,329, 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).

Colorado Lottery

Notes to Financial Statements

June 30, 2004 and 2003

All scratch, online and special drawing prizes are accounted for using the accrual basis of accounting. The liability for scratch prizes and online prizes is recognized at the point of retail sale. The liability for special drawing prizes is accrued on the first day of sales.

Payments of scratch prize amounts of \$150 or less may be done at the Lottery or at the retail outlet; payment of scratch prize amounts of \$151 to \$599 may be done 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 \$4,867,069 for the fiscal year ended June 30, 2004 and \$4,857,072 for the fiscal year ended June 30, 2003. During the fiscal year ended June 30, 2004, there were a total of 33 games ended, as compared with 36 games ended through fiscal year 2003.

Payments of cumulative online prize amounts of \$150 or less on a single ticket may be done at the Lottery or at the retail outlet; payment of cumulative prize amounts of \$151 to \$599 on a single ticket may be done 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 done at the Lottery. Retailers are given credit for prize payments they make on a daily basis. Online prizes may be claimed up to 180 days after the date of the drawing. After the final claim date, unclaimed online 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 online prizes resulted in a decrease to prize expense of \$10,313,756 for the fiscal year ended June 30, 2004 and \$9,433,114 for the fiscal year ended June 30, 2003.

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 the Multi-State Lottery Association (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.

Retailer Bonus Liability

Under provisions 5.10 and 10.10 of the Colorado Lottery Commission Rules and Regulations effective as of July 1, 1997:

“ . . .the Director may provide such additional compensation to licensees as is deemed appropriate by the Director to further the sale of lottery tickets, so long as such additional compensation is made equally available to all licensees and does not exceed a total of One and Thirteen Hundredths Percent (1.13%) for scratch, Seven Tenths Percent (.7%) for Lotto, Sixty-five Hundredths Percent (.65%) for Powerball, and Ninety-six Hundredths Percent (.96%) for Cash 5.”

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A portion of the additional compensation shall be used to pay each licensee, as a bonus, an amount (cashing bonus) equal to one percent (1%) of each prize paid by the licensee up to and including \$599.99.

At the Director's discretion, the residual resulting after paying the cashing bonuses may be used to provide additional compensation to licensees and/or to decrease the bonus expense by reverting the excess amount.

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 result in a reduction of bonus expense.

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 Lottery Commission 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. In 2004 and 2003, the Lottery has reserved \$469,424 and \$460,638, respectively.

Lottery Fund Net Assets

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." The Lottery Commission approved a reserve of \$1 million of the net assets for fiscal year 1989. This remained in effect until the implementation of GASB 34 which required a net asset balance sufficient to cover the net value of an agency's capital assets. Accordingly, at the June 2002 Commission meeting, the Lottery Commission approved a balance in net assets "equal to net value of the Lottery's capital assets". Effective July 1, 2004, under Senate Bill 04-204, this reserve is required to be held in cash and investments. This reserve is reported as restricted cash on the statements of net assets.

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:

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	June 30, 2004	June 30, 2003	(Decrease)
Annual leave	\$ 593,570	\$ 776,768	\$ (183,198)
Sick leave	<u>135,078</u>	<u>192,701</u>	<u>(57,623)</u>
Total annual and sick leave	728,648	969,469	(240,821)
Compensatory time	<u>3,233</u>	<u>2,326</u>	<u>907</u>
Total compensated leave	<u>\$ 731,881</u>	<u>\$ 971,795</u>	<u>\$ (239,914)</u>

Expired Warrants Liability

Expired warrants liability represents the expiration of aged uncashed warrants and imprest checks over one (1) year old 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.

Deferred Revenue

The Lottery offers two methods of purchasing online tickets for future draws. One method is that tickets are purchased through the terminal, referred to as Advance Play, which allows the player to purchase online tickets good for up to 10 draws. The second method is restricted to Lotto tickets only and is purchased through the mail via a preprinted form, referred to as subscription, which allows the player to purchase Lotto tickets good for up to 104 draws. The revenues generated from both methods are recognized as the draws occur. Revenues for future draws are classified as a liability.

A detail of deferred revenue at June 30, 2004 and 2003, is as follows:

	2004	2003
Subscription	\$ 114,843	\$ 238,160
Advance Play – Lotto	97,477	84,643
Advance Play – Powerball	56,042	68,889
Advance Play – Powerplay	13,283	15,918
Advance Play – Cash 5	<u>17,078</u>	<u>18,294</u>
Total deferred revenue	<u>\$ 298,723</u>	<u>\$ 425,904</u>

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Promotional Activity

The Lottery engages in two types of promotional activities in an attempt to enhance sales and to increase the player base. Specific promotional coupons and Lottery Bucks coupons are distributed to players through special promotions and can be redeemed at any retailer for a lottery product. During the fiscal years ended June 30, 2004 and 2003, 51,375 and 16,285 coupons were redeemed, respectively. Scratch 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, 2004 and 2003, \$70,168 and \$63,008 worth of free scratch tickets were given away, respectively. Scratch tickets and coupons are valued at cost. For the fiscal years ended June 30, 2004 and 2003, \$80,591 and \$51,453, respectively, in promotional ticket expense was recorded as Marketing and Communications expense in the statements of revenues, expenses and changes in fund net assets for coupons redeemed and scratch 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, 2004 and 2003 is as follows:

	<u>2004</u>	<u>2003</u>
Petty cash	\$ 800	\$ 1,950
Change funds	70,300	50,300
Imprest fund	350,000	305,258
Depository accounts	30,000	15,000
Cash on deposit with State Treasurer	<u>23,469,555</u>	<u>30,657,551</u>
Total unrestricted cash and investments	<u>23,920,655</u>	<u>31,030,059</u>
Restricted cash and investments – Licensed Agent Recovery Reserve Receipts on deposit with State Treasurer	469,424	460,638
Operating Reserve on deposit with State Treasurer	<u>1,029,114</u>	<u>—</u>
Total restricted cash and investments	<u>1,498,538</u>	<u>460,638</u>
Total cash and investments	<u>\$ 25,419,193</u>	<u>\$ 31,490,697</u>

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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 monthly basis. Actual interest payments are determined by the State Treasurer. The actual allocated interest rate for fiscal years 2004 and 2003 was 3.17% and 4.52%, respectively.

In addition, the State Treasurer pools these deposits and invests them in securities approved by Section 24-75-601.1, C.R.S. 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.

Insured and Collateralized Deposits

The Lottery has one imprest and two depository accounts with banking institutions. The depository account is used for the purpose of depositing daily collections throughout the state and transferring the collections to the State Treasurer in a timely manner.

The Public Deposit Protection Act requires financial institutions to collateralize any uninsured public deposits. At June 30, 2004, the Lottery had cash with a carrying value of \$380,000 and a bank balance of \$365,936 on deposit with banking institutions. Of the bank balance, \$100,000 is insured by federal insurance (FDIC); the amount not insured is covered by collateral held in the pledging institution's trust department in the State's name.

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.

Categorization of Deposits and Investments

The Lottery's total bank balances are classified in the following three categories of credit risk:

Category 1 – Insured or collateralized with securities held by the Lottery or by its agent in the Lottery's name

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Category 2 – Collateralized with securities held by the pledging financial institution’s trust department or agent in the Lottery’s name

Category 3 – Uncollateralized, including any bank balance that is collateralized with securities held by the pledging financial institution, or by its trust department or agent but not in the Lottery’s name

Additionally, the Lottery classifies its investments in the following three categories of credit risk:

Category 1 – Insured or registered, or securities held by the Lottery or its agent in the Lottery’s name

Category 2 – Uninsured and unregistered, with securities held by the counterparty’s trust department or agent in the Lottery’s name

Category 3 – Uninsured and unregistered, with securities held by the counterparty; or by its trust department or agent but not in the Lottery’s name, including the portion of the carrying amount of any repurchase agreement that exceeds the market value of the underlying securities, if any

The cash deposits bank balance of \$365,936 is categorized as follows as of June 30, 2004:

Category 1	\$	100,000
Category 2	\$	265,936

For Cash on Deposit with State Treasurer, the State Treasurer’s investments as of June 30, 2004 are Category 1 investments and its cash deposits are principally Category 2 deposits.

Note 3: Schedule of Changes in Fixed Assets

Capital assets being depreciated:

	<u>June 30, 2003</u>	<u>Increases</u>	<u>Decreases</u>	<u>June 30, 2004</u>
Equipment	\$ 5,559,322	\$ 112,513	\$ (1,216,608)	\$ 4,455,227
Leasehold improvements	<u>330,936</u>	<u>—</u>	<u>(3,649)</u>	<u>327,287</u>
Total capital assets being depreciated	<u>5,890,258</u>	<u>112,513</u>	<u>(1,220,257)</u>	<u>4,782,514</u>
Less accumulated depreciation for equipment	(4,237,420)	(475,046)	1,195,542	(3,516,924)
Leasehold improvements	<u>(225,512)</u>	<u>(14,563)</u>	<u>3,599</u>	<u>(236,476)</u>
Total accumulated depreciation	<u>(4,462,932)</u>	<u>(489,609)</u>	<u>1,199,141</u>	<u>(3,753,400)</u>
Total capital assets, being depreciated, net	<u>\$ 1,427,326</u>	<u>\$ (377,096)</u>	<u>\$ (21,116)</u>	<u>\$ 1,029,114</u>

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	<u>June 30, 2002</u>	<u>Increases</u>	<u>Decreases</u>	<u>June 30, 2003</u>
Equipment	\$ 5,356,715	\$ 311,456	\$ (108,849)	\$ 5,559,322
Leasehold improvements	<u>330,936</u>	<u>—</u>	<u>—</u>	<u>330,936</u>
Total capital assets being depreciated	<u>5,687,651</u>	<u>311,456</u>	<u>(108,849)</u>	<u>5,890,258</u>
Less accumulated depreciation for equipment	(3,873,966)	(449,179)	85,725	(4,237,420)
Leasehold improvements	<u>(210,949)</u>	<u>(14,563)</u>	<u>—</u>	<u>(225,512)</u>
Total accumulated depreciation	<u>(4,084,915)</u>	<u>(463,742)</u>	<u>85,725</u>	<u>(4,462,932)</u>
 Total capital assets, being depreciated, net	 <u>\$ 1,602,736</u>	 <u>\$ (152,286)</u>	 <u>\$ (23,124)</u>	 <u>\$ 1,427,326</u>

Note 4: Operating Leases

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

Pueblo

Office – The Lottery occupies office space in the Wells Fargo Bank Building in Pueblo. The lease agreement with 200 South Broadway Limited Partnership began on July 1, 1995 and expires on June 30, 2005. There is no provision for renewal.

Warehouse – The Lottery leases primary warehouse space from Santa Fe 250 LLC. The Lottery entered into a lease extension agreement, which began September 1, 2002 and expires June 30, 2007. There is no provision for renewal.

Interlott – The Lottery entered into a rental agreement with International Lottery, Inc., subsequently purchased by G-Tech, to rent Scratch Ticket Vending Machines (STVMs). The agreement covered the period from July 1, 2000 through June 30, 2002. The Lottery had the option to exercise two twelve-month extensions. On June 3, 2002, the Lottery entered into a contract with Interlott to exercise both 12-month extensions plus an additional four-month extension which will expire on October 31, 2004. There are no other provisions for extension or renewal.

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Denver

Office – The Lottery occupies office and warehouse space in the Galleria Towers Building in Denver. The lease agreement, which began on October 30, 1990, was amended on May 14, 1999 and extended the ending date for the lease from June 30, 1999 to June 30, 2006. There is no provision for renewal.

Warehouse – The Lottery entered into a lease agreement with Yukon Denver Valley, Inc. to occupy warehouse space. The lease agreement began on September 1, 1999 and expires on August 31, 2004. The Lottery has the option to extend the lease through August 31, 2009.

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 Capital Complex Division for lease payments.

Colorado Springs

The Lottery occupies warehouse space in a building located at 2818 Janitell Road in Colorado Springs, Colorado. The lease agreement, which began on August 1, 2003, expires on June 30, 2006. The Lottery has the option to exercise two 12-month extensions under the new lease, extending the lease through June 30, 2008. There are no other provisions for renewal.

Operating lease expense incurred for the fiscal years ended June 30, 2004 and 2003 and future minimum lease payments for fiscal years ending June 30, 2005 through 2007 are as follows:

Location	Expense		Future Minimum Lease Payments		
	2003	2004	2005	2006	2007
Pueblo office	\$ 262,692	\$ 275,900	\$ 289,773	\$ —	\$ —
Pueblo warehouse	74,654	85,885	88,398	91,052	78,623
Interlott	651,273	652,389	217,800	—	—
Colorado Springs warehouse	13,812	11,728	12,000	12,466	—
Denver office	197,373	203,354	209,335	215,316	—
Denver warehouse	103,622	107,039	16,844	—	—
Fort Collins	36,720	36,720	—	—	—
Grand Junction	4,063	4,557	—	—	—
	<u>\$ 1,344,209</u>	<u>\$ 1,377,572</u>	<u>\$ 834,150</u>	<u>\$ 318,834</u>	<u>\$ 78,623</u>

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Note 5: Other Revenue

A schedule of other revenue for the fiscal years ended June 30, 2004 and 2003 follows:

	<u>2004</u>	<u>2003</u>
License fees	\$ 61,047	\$ 56,376
Fines and penalties	24,600	16,250
Assignment fees	7,012	10,803
Net Licensed Agent Recovery Reserve Receipts	8,786	(3,458)
Reimbursement production cost of game show from MUSL	9,808	190,802
Other	<u>45,737</u>	<u>32,361</u>
Total	<u>\$ 156,990</u>	<u>\$ 303,134</u>

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 as a contingency reserve set forth in Section 22-54-117(1.6)(a), C.R.S.

Income available for distribution at June 30:

	<u>2004</u>	<u>2003</u>
Income before distributions	\$ 102,821,101	\$ 104,998,736
Change in licensed agent recovery reserve	(8,786)	3,458
Change in fair market value of investments	860,931	(398,543)
Other changes in net assets	<u>398,212</u>	<u>175,410</u>
Income available for distribution	104,071,458	104,779,061
Less distributions prior to year-end	<u>(78,265,937)</u>	<u>(79,366,128)</u>
Income available for distribution	<u>\$ 25,805,521</u>	<u>\$ 25,412,933</u>

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	Accrued at June 30, 2003	Proceeds Distributions Expenses	Distributions Paid	Accrued at June 30, 2004
Great Outdoors Colorado	\$ 9,016,090	\$ 49,639,294	\$ (48,149,060)	\$ 10,506,324
State Public School Fund	3,690,377	2,396,438	(3,690,377)	2,396,438
Conservation Trust Fund	10,165,173	41,628,583	(41,471,547)	10,322,209
Division of Parks and Outdoor Recreation	<u>2,541,293</u>	<u>10,407,143</u>	<u>(10,367,886)</u>	<u>2,580,550</u>
	<u>\$ 25,412,933</u>	<u>\$ 104,071,458</u>	<u>\$ (103,678,870)</u>	<u>\$ 25,805,521</u>

	Accrued at June 30, 2002	Proceeds Distributions Expenses	Distributions Paid	Accrued at June 30, 2003
Great Outdoors Colorado	\$ 2,469,568	\$ 48,699,156	\$ (42,152,634)	\$ 9,016,090
State Public School Fund	8,499,940	3,690,377	(8,499,940)	3,690,377
Conservation Trust Fund	8,775,605	41,911,625	(40,522,057)	10,165,173
Division of Parks and Outdoor Recreation	<u>2,193,901</u>	<u>10,477,903</u>	<u>(10,130,511)</u>	<u>2,541,293</u>
	<u>\$ 21,939,014</u>	<u>\$ 104,779,061</u>	<u>\$ (101,305,142)</u>	<u>\$ 25,412,933</u>

Note 7: Pension Plan

Plan Description

Virtually all Lottery 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 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 1300 Logan Street, Denver, Colorado 80203, by calling PERA at 303 832-9550 or 800 729-PERA (7372) or by visiting www.copera.org.

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Plan members vest after five years of service and are eligible for retirement benefits at age 50 with 30 years of service, age 60 with 20 years of service or at age 65 with 5 years of service. Members are also eligible for retirement benefits, without a reduction for early retirement, if they are at least 55 and have a minimum of 5 years of service credit and their age plus years of service equals 80 or more. State troopers and judges comprise a small percentage of plan members but have higher contribution rates and are eligible for retirement benefits at different ages and years of service. Monthly benefits are calculated as a percentage of highest average salary (HAS). HAS is 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.

Members 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 spouse or their eligible children under the age of 18 (23 if a full-time student) are entitled to monthly benefit payments. If there is no eligible spouse, financially-dependent parents will receive a survivor's benefit.

Funding Policy

Most employees contribute 8% (10% for state troopers) of their gross covered wages to an individual account in the plan.

During fiscal year 2004, the state contributed 10.15% (12.85% for state troopers and 12.66% for the judicial branch) of the employee's gross covered wages. Effective January 1, 2003, 1.1% of the total contribution was allocated to the Health Care Trust Fund. Through May 31, 2004, the amount needed to meet the match requirement established by the PERA Board was allocated to the Matchmaker Program (see Note 8). The balance remaining after allocations to the Matchmaker Program and the Health Care Trust Fund was allocated to the defined benefit plan.

The annual gross covered wages subject to PERA is the 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. The contribution requirements of plan members and their employers are established, and may be amended, by the General Assembly.

The Lottery's contributions to the three programs described above for the fiscal years ended June 30, 2004, 2003 and 2002, were \$656,365, \$659,854, and \$623,072, respectively. These contributions met the contribution requirement for each year.

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Note 8: Voluntary Tax-deferred Retirement Plans

Beginning on January 1, 2001, the Matchmaker Program established a state match for PERA members' voluntary contributions to tax-deferred retirement plans. For calendar years 2001 and 2002, the match was 100% of up to 3% of employees' gross covered wages paid during the month (7% for judges in the judicial branch). For calendar year 2003, the match was 100% of up to 2% of employee's gross covered wages paid during the month (6% for judges in the judicial branch). For calendar year 2004 through May 31, 2004, the match was 100% of up to 1% of employee's gross covered wages paid during the month (5% for judges in the judicial branch). The PERA Board sets the level of the match with 2% of gross salary plus 50% of any reduction in the overall contribution rate due to overfunding of the pension plan available for the match. While the plan was not overfunded in the current year, the maximum one-year change in the match rate is statutorily limited to 1%, and therefore, the match changed from 2% to 1% on January 1, 2004. Legislation passed in the 2004 session of the General Assembly terminated the match for pay periods ending after May 31, 2004. The match will resume when the actuarial value of the defined benefit plan assets are 110% of actuarially accrued plan liabilities.

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 a 403b plan. Members who contribute to any of these plans also receive the state match.

The Lottery's contributions to the Program described above for the fiscal years ended June 30, 2004, 2003 and 2002 were \$77,307, \$138,919 and \$156,897, respectively.

Note 9: Post Retirement Health Care and Life Insurance Benefits

PERACare, formerly known as the PERA Health Care Program (the 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 Trust Fund. Under this program, PERA subsidizes a portion of the monthly premium for health care coverage. The benefit recipient pays any remaining amount of that premium through an automatic deduction from the monthly retirement benefit. During the fiscal year ended June 30, 2004, the premium subsidy was \$115.00 for those with 20 years of service credit (\$230.00 for members under age 65 and not eligible for Medicare), and it was reduced by 5% for each year of service fewer than 20.

The Health Care Trust Fund is maintained by an employer's contribution as discussed above in Note 7.

Monthly premium costs for participants depend on the health care plan selected, the number of persons being covered, Medicare eligibility and the number of years of service credit. PERA contracts with a major medical indemnity carrier to administer claims for self-insured medical and prescription benefit plans and several health maintenance organizations providing services within Colorado. As of December 31, 2003, there were 37,067 enrollees, including spouses and dependents, from all contributors to the plan.

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Life Insurance Program

PERA provides its members access to two group life insurance plans offered by Prudential Insurance Company and Anthem Life (formerly known as Rocky Mountain Life Insurance Company). Members may join one or both plans, and they may continue coverage into retirement. Premiums are collected monthly by payroll deduction or other means.

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 October 27, 2027.

Specified prize payments	\$ 575,114,261
Lifetime prize payments	<u>45,723,000</u>
 Total guaranteed minimum prize payments	 <u>\$ 620,837,261</u>

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 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 Pinnacol Assurance (formerly Colorado Compensation Insurance Authority), a related party, to administer its plan. The state reimburses Pinnacol Assurance 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.

Colorado Lottery
Notes to Financial Statements
June 30, 2004 and 2003

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

Medical and Disability Benefits

The Group Benefit Plans Fund is a Pension and Other Employee Benefits Fund established for the purpose of risk financing employee and state-official medical claims. The fund includes several medical plan options ranging from provider of choice to managed care. Before January 1, 2000, the state offered a variety of medical plans; some of the plans were fully insured while others were self-insured using Anthem Blue Cross Blue Shield as the plan administrator. After January 1, 2000, self-insured plans were no longer offered, and the state and its employees paid premiums for insurance purchased to cover medical claims. Through fiscal year 2001-2002, the Group Benefit Plans Fund continued to cover claims originating before January 1, 2000. The state's contribution to the premium is fixed in statute; state employees pay the difference between the statutory contribution and the premium set by the insurer.

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 program provides an employee with 60 percent of their pay beginning after 30 days of disability or the exhaustion of the employee's 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 and a termination premium that is 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 while deficits are carried forward.

Furniture and Equipment – The State of Colorado carries a \$15,000 deductible replacement policy on all state owned furniture and equipment. For each loss incurred, the Lottery is responsible for the first \$1,000 of the deductible and the State of Colorado is responsible for the next \$14,000. Any loss in excess of \$15,000 is covered by the insurance carrier up to replacement cost.

Colorado Lottery

Notes to Financial Statements

June 30, 2004 and 2003

Gaming Operations Commitments – The Lottery has entered into long-term contracts with certain significant vendors related to providing scratch tickets and online data processing services in support of the Lottery’s gaming operations. The online data processing contract expires October 31, 2004. The total amount to be paid on the online data contract shall not exceed \$51,800,000 over the period of the contract. The Lottery entered into a new online data processing contract with a new vendor on May 13, 2003. The contract period began in June 1, 2003 and will expire on October 31, 2010. These contracts overlap in order for the new vendor to set up the new system. Renewal options include two additional two-year periods and two additional periods of ninety days for conversion and turnover purposes. The total cost of the initial contract period is not to exceed \$56,235,000. The scratch ticket contract expires June 30, 2004 with one annual renewal available on the contract. The renewal option was exercised extending the contract through June 30, 2005. Ticket rates are based upon ticket volume, physical size and design. The total costs of the contract for the initial contract period shall not exceed \$14,445,184 and \$2,600,000 for the extension period.

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. The total amount to be contributed by the Lottery to the prize reserves as of June 30, 2004 is \$3,728,493 and is based on a percentage of sales. The total amount of the prize reserves funded as of June 30, 2004 was \$3,525,880 shown as prepaid prize expense – MUSL on the statements of net assets.

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 provided for expiration on June 30, 2002 with an option to renew up to three additional years through June 30, 2005. The total cost of the initial contract period shall not exceed \$16,320,000. On May 15, 2002, the Lottery exercised its option to renew the contract for a period of two years, extending it until June 30, 2004. The maximum cost shall not exceed \$8,500,000 in fiscal year 2003 and shall not exceed \$17,000,000 for the extended contract period. On June 10, 2004, the Lottery entered into a new long-term contract with the same agency. The contract period began on July 1, 2004 and expires on June 30, 2006 with an option to renew up to three additional one year periods through June 30, 2009. The total cost of the initial contract period is not to exceed \$9,000,000 for each year.

Litigation – In fiscal year 2001, a plaintiff has filed a class action suit claiming that the Lottery breached its contract with players by continuing to sell instant tickets in games in which the top prize had already been claimed. Although litigation continues, it is the opinion of Lottery’s management that the ultimate outcome of this matter will not have a material impact on the Lottery’s financial statements.

Colorado Lottery
Notes to Financial Statements
June 30, 2004 and 2003

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 \$985,613 and \$955,627 for the fiscal years ended June 30, 2004 and 2003, respectively.

Supplementary Information

Colorado Lottery
Schedule of Revenue and Costs for Scratch and Online Games
for the Fiscal Year Ended June 30, 2004
(With Comparative Totals for the Fiscal Year Ended June 30, 2003)

	Games in Progress				Fiscal Year 2004	Fiscal Year 2003
	Scratch	Lotto	Powerball	Cash 5	Total	Scratch and Online
Gross ticket sales	\$ 260,901,964	\$ 40,811,438	\$ 85,030,889	\$ 14,506,680	\$ 401,250,971	\$ 391,473,640
Prize expense	(168,211,132)	(22,403,120)	(39,584,517)	(8,229,150)	(238,427,919)	(227,514,771)
Powerball prize variance	—	—	1,824,959	—	1,824,959	597,361
Net revenue after prizes	<u>92,690,832</u>	<u>18,408,318</u>	<u>47,271,331</u>	<u>6,277,530</u>	<u>164,648,011</u>	<u>164,556,230</u>
Commissions, bonuses, ticket costs and vendor fees						
Retailer commission	(18,231,795)	(2,416,392)	(5,101,578)	(870,439)	(26,620,204)	(25,965,985)
Retailer bonus	(2,678,063)	(263,910)	(557,049)	(136,025)	(3,635,047)	(3,562,986)
Cost of tickets sold	(2,987,133)	—	—	—	(2,987,133)	(3,175,336)
In-lane vendor fees	—	(9,910)	(20,646)	(3,522)	(34,078)	(202,633)
Online vendor fees	<u>(1,012,205)</u>	<u>(1,677,512)</u>	<u>(3,327,928)</u>	<u>(615,160)</u>	<u>(6,632,805)</u>	<u>(6,620,643)</u>
Total	<u>(24,909,196)</u>	<u>(4,367,724)</u>	<u>(9,007,201)</u>	<u>(1,625,146)</u>	<u>(39,909,267)</u>	<u>(39,527,583)</u>
Gross profit on sale of tickets	<u>\$ 67,781,636</u>	<u>\$ 14,040,594</u>	<u>\$ 38,264,130</u>	<u>\$ 4,652,384</u>	<u>\$ 124,738,744</u>	<u>\$ 125,028,647</u>
Average daily ticket sales	<u>\$ 712,847</u>	<u>\$ 111,507</u>	<u>\$ 232,325</u>	<u>\$ 39,636</u>	<u>\$ 1,096,315</u>	<u>\$ 1,072,531</u>

Colorado Lottery
Schedule of Percent of Prize Expense to Gross Ticket Sales
for the Fiscal Year Ended June 30, 2004

	<u>Games in Progress</u>				Powerball Prize Variance	Coupons/Free Plays	Fiscal Year 2004 Total
	Scratch	Lotto	Powerball	Cash 5			
Prize expense	\$ 168,242,838	\$ 22,403,120	\$ 39,584,517	\$ 8,229,150	\$ (1,824,959)	\$ (31,706)	\$ 236,602,960
Ticket sales before coupons	<u>260,935,369</u>	<u>40,818,461</u>	<u>85,041,776</u>	<u>14,508,537</u>	<u>—</u>	<u>(53,172)</u>	<u>401,250,971</u>
Prize %	<u>64.48%</u>	<u>54.88%</u>	<u>46.55%</u>	<u>56.72%</u>		<u>59.63%</u>	<u>58.97%</u>

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

Colorado Lottery
Budgetary Comparison
for the Fiscal Year Ended June 30, 2004

	Fiscal Year 2004 Original Budget	Supplementals Pots Allocations and Internal Transfers	Fiscal Year 2004 Final Budget	Fiscal Year 2004 Actual Expenditures	Under Expended	Percent Under Expended
Personal services	\$ 7,999,032	\$ 7,338	\$ 8,006,370	\$ 7,842,729	\$ 163,641	2.04%
Operating	1,946,974	90,470	2,037,444	1,953,800	83,664	4.11
Vehicle lease payments	181,492	(29,320)	152,172	152,171	1	0.00
Purch. Serve. Comp. Cen.	8,834	—	8,834	8,834	0	0.00
Telecommunications	397,412	(80,000)	317,412	252,725	64,687	20.38
MNT payments	—	74,625	74,625	74,625	0	0.00
Payments to other agencies	340,488	—	340,488	340,488	0	0.00
Legal services	40,425	12,158	52,583	33,511	19,072	36.27
Worker's compensation	—	43,391	43,391	43,391	0	0.00
Unemployment benefits	—	1,867	1,867	—	1,867	100.00
Health and life	—	275,346	275,346	259,119	16,227	5.89
Short-term disability	—	13,482	13,482	9,328	4,154	30.81
Leased space	774,513	—	774,513	766,482	8,031	1.04
Grand Junction – leased space	4,557	—	4,557	4,557	0	0.00
Risk management	—	26,590	26,590	26,590	0	0.00
Travel expenses	119,941	—	119,941	*111,351	8,590	7.16
Marketing and communications	9,097,225	—	9,097,225	8,643,422	453,803	4.99
Indirect costs	384,804	(53,878)	330,926	330,926	0	0.00
Ticket costs	3,991,040	98,640	4,089,680	2,987,133	1,102,547	26.96
Vendor fees	8,185,514	(78,666)	8,106,848	*7,208,951	897,897	11.08
Prizes	280,095,384	(7,047,864)	273,047,520	238,427,919	34,619,601	12.68
Powerball prize variance	4,610,000	(45,000)	4,565,000	4,098,836	466,164	10.21
Retailer compensation	35,566,840	187,020	35,753,860	30,255,251	5,498,609	15.38
Computer migration	1,460,795	—	1,460,795	371,865	1,088,930	74.54
Multi-State Lottery fees	<u>177,433</u>	<u>—</u>	<u>177,433</u>	<u>156,999</u>	<u>20,414</u>	<u>11.51</u>
Total	<u>\$355,382,703</u>	<u>\$ (6,503,801)</u>	<u>\$348,878,902</u>	<u>\$ 304,361,003</u>	<u>\$ 44,517,899</u>	<u>12.76%</u>
Fiscal year 2003 staffing (FTE)	<u>128.00</u>	(Appropriated)	<u>120.014</u>	(Actual)		

*Certain amounts may not tie due to rounding.

Colorado Lottery
Budgetary Comparison (continued)
for the Fiscal Year Ended June 30, 2004

Reconciliation of expenses per “statements of revenues, expenses and changes in fund net assets” to budgeted expenditures:

Operating Expenses Per Statement of Revenues, Expenses and Changes in Fund Net Assets

Prize expense	\$ 238,427,919
Powerball prize variance	(1,824,959)
Commissions and bonuses	30,255,251
Cost of tickets and vendor fees	9,654,016
Other operating expenses	<u>22,074,817</u>
Total operating expenses per statement of revenues, expenses and changes in fund net assets	298,587,044
Plus Powerball variance classified as revenue	5,923,795
Less: non-appropriated expenses	
Depreciation	(489,609)
Accrued annual and sick leave	248,377
Book value of assets written-off	<u>(21,117)</u>
	<u>304,248,490</u>
Plus capitalized fixed assets	<u>112,513</u>
	<u>\$ 304,361,003</u>



Independent Accountants' Report on Compliance and Internal Control Over Financial Reporting Based on the Audit of Financial Statements in Accordance with *Government Auditing Standards*

Members of the Legislative Audit Committee:

We have audited the financial statements of the Colorado Lottery (the Lottery) as of and for the year ended June 30, 2004, and have issued our report thereon dated August 12, 2004. We conducted our audit 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.

Compliance

As part of obtaining reasonable assurance about whether the Lottery's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Lottery's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

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

\s\ **BKD, LLP**

Colorado Springs, Colorado
August 12, 2004

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Members of the Legislative Audit Committee:

As part of our audit of the financial statements of the Lottery as of and for the year ended June 30, 2004, we wish to communicate the following to you.

Auditor's Responsibility under Generally Accepted Auditing Standards

An audit performed in accordance with auditing standards generally accepted in the United States of America (GAAS) is designed to obtain reasonable, rather than absolute, assurance about the financial statements. In performing GAAS procedures, we establish scopes of audit tests in relation to the financial statements taken as a whole. Our engagement does not include a detailed audit of every transaction. Our engagement letter more specifically describes our responsibilities.

Significant Accounting Policies

The Lottery's significant accounting policies are described in Footnote 1 of the financial statements.

Management Judgments and Accounting Estimates

Accounting estimates are an integral part of financial statement preparation by management, based on its judgments. The following areas involve significant areas of such estimates for which we are prepared to discuss management's estimation process and our procedures for testing the reasonableness of those estimates:

- Allowance for doubtful accounts
- Fair value of investments
- Prize liability
- Useful lives of capital assets
- Compensated absence liability

Audit Adjustments

During the course of any audit, an auditor may propose adjustments to financial statement amounts. Management evaluates our proposals and records those adjustments that, in its judgment, are required to prevent the financial statements from being materially misstated. We did not propose adjustments for the year ended June 20, 2004.

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

\\ BKD, LLP

Colorado Springs, Colorado
August 12, 2004

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