

Colorado Lottery

Financial and Compliance Audit

June 30, 2005 and 2004

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Contract Auditors



August 16, 2005

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, 2005 and 2004. 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**

Colorado Lottery
June 30, 2005 and 2004

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Colorado Lottery

Report Summary

Year Ended June 30, 2005

Purposes and Scope of Audit

Authority, Purpose and Scope

The audit of the Colorado Lottery (the Lottery) was performed under authority of Section 24-35-211, C.R.S., which requires the State Auditor to conduct an annual audit of the Lottery Fund. The purpose of the audit was to express an opinion on the financial statements of the Lottery for the year ended June 30, 2005.

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, 2005, 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, 2005.
- 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 contracted with a new vendor, Scientific-Games, Inc., for on-line games and related accounting services and converted to the new system in May 2005. After the conversion, the Lottery noted that game settlements and collections of ticket revenue from retailers were not occurring as expected, which caused Lottery's accounts receivable to be larger at fiscal year end than the prior years. This lack of timely collections was due to an error in the new system related to scratch games. The Lottery should work with its vendor to correct the system error, collect outstanding accounts receivable and perform monthly analytical reviews with the vendor's system to identify and resolve errors timely.
- As stated above, the Colorado Lottery converted to a new on-line system in May 2005. The Lottery contracted for an independent review of the new vendor's system prior to the implementation date. The review noted problems related to the reports from the new system intended to assist with reconciling accounting information between the vendor's system and the Lottery's system; our audit noted similar problems. The Lottery should work with its vendor to ensure that reports required by the contract are provided and contain accurate and complete information.

Colorado Lottery

Report Summary (continued)

Year Ended June 30, 2005

- The Lottery has complex information systems and significant reliance is placed on this system and the supporting controls. To reduce the risk of errors in the system, the Lottery should obtain an independent review of the Lottery's internal system. In addition, the Lottery should contract for an independent annual SAS 70, Type II Audit performed of its third-party vendor.

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

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, 2005. This communication is located on page 54.

Summary of Progress in Implementing Prior Year Audit Recommendations

The audit report for the year ended June 30, 2004 contained three recommendations for the 2004 fiscal year and one for the 2003 fiscal year. Of the 2004 recommendations, two were implemented and one was no longer applicable. The remaining parts of the recommendation from the 2003 fiscal year are scheduled to be implemented in fiscal year 2006. The Disposition of Prior Year Audit Recommendations is on page 11.

Colorado Lottery
Recommendation Locator
Year Ended June 30, 2005

Recommendation Number	Page Number	Recommendation Summary	Response	Implementation Date
1	6	The Lottery should ensure that its accounts receivable controls are adequate by performing monthly analytical reviews, collecting outstanding accounts receivable and working with its new vendor to correct the system error.	Agree	December 2005
2	8	The Lottery should work with its new on-line vendor to obtain all reports required by the contract and ensure that the reports contain accurate and complete information.	Agree	June 2006
3	9	The Lottery should have an independent examination performed on its internal system and a SAS 70, Type II Audit performed on its third-party vendor.	Agree	September 2006

Colorado Lottery

Background

Year Ended June 30, 2005

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 2005, the Lottery employed 116 employees in its headquarters in Pueblo and branch offices in Denver, Fort Collins and Grand Junction.

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

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, 2005

Correct System Error and Collect Accounts Receivable

During fiscal year 2005, the Lottery had gross tickets sales across all games of approximately \$417 million. Most tickets are worth \$1, \$5 or \$10, which means that Lottery has a large number of low-dollar transactions occurring on a daily basis. Lottery has established internal controls intended to ensure that transactions recorded in various automated systems are reconciled and that financial activity is reported accurately and completely. As part of these controls, in prior years the Lottery and its outside vendor for on-line games maintained parallel systems for tracking ticket sales and the related accounts receivable from retailers, and the two systems were balanced on a daily basis and balanced to general ledger on a monthly basis. Lottery maintained inventory data for game tickets on its internal system.

In November of 2004, the Lottery contracted with a new vendor, Scientific-Games, Inc. Under the new contract, Scientific-Games was to be responsible for tracking accounting transactions, such as ticket sales and accounts receivable, and inventory transactions for the tickets. Lottery staff report that during the development phase of the on-line conversion, Scientific-Games experienced difficulties producing some of the Lottery's reconciliation reports for inventory and retailer accounting activity. Therefore, the Lottery continued to track this information on its internal system and planned to reconcile this information to the new vendor's system. The Lottery converted to the new Scientific-Games system in May 2005.

At the conversion to the new system, Lottery was able to reconcile its accounts receivable in a timely manner with the vendor's system. However, it did not have analytical procedures in place that would have enabled it to detect variances in its accounts receivable. As a result, Lottery did not detect an error in the new system that affected its settlements and collections of accounts receivable from retailers until mid-July, after the end of the fiscal year on June 30, 2005. Specifically, the Lottery determined that its records reflected approximately \$10 million in accounts receivable that should have been settled, approximately \$9 million of which should have been collected prior to year-end.

The system error is related to the settlement, or billing, of tickets sold by retailers for scratch game tickets. When Lottery's field representative delivers a pack of scratch tickets to a retailer, the retailer must activate the pack in order to begin selling the tickets. Upon activation of the pack, the value of the tickets is posted to an accounts receivable for "Packs Activated Not Settled." Under the terms of Lottery's agreement with retailers, amounts in the "Packs Activated Not Settled" account cannot be collected by the Lottery until the pack has been transferred to the "Packs Settled" receivable account. In order to move a pack of tickets from "Packs Activated Not Settled" to "Packs Settled" one of the following four events must occur: (1) the retailer elects to settle the pack upon activation (this option is generally used only by large retailers), (2) 90% of the low-tier prizes in the pack have been paid out, (3) 120 days have passed since the pack has been activated or (4) a manual settlement initiated by the Lottery. When one of the criteria is met and the value of the pack is transferred into an accounts receivable for "Settled Packs" amounts recorded in the "Settled Packs" receivable are automatically swept by an electronic funds transfer from the retailer's bank account to the Lottery's bank account in the following week.

Colorado Lottery

Auditors' Findings and Recommendations (continued)

Year Ended June 30, 2005

The Lottery found that the new system did not have percent settlements related to the second criteria for the low-tier tickets based on the correct value of the prizes for these games in the system. Therefore, packs for scratch games had to hit a higher dollar threshold than they should have in order to settle under that criteria. Thus, packs that should have been settled and the related funds collected by the Lottery remained as an outstanding receivable in the "Packs Activated Not Settled" at year-end.

After the Lottery identified the specific games affected by the system error, the Lottery developed a plan to collect the accounts receivable from the affected retailers. Under the plan, collections are to occur over approximately a nine-week period from mid-July to the end of September. As a result of this lag in collections, Lottery funds will not earn as much interest as they would have, if collections had been made on a timely basis. These earnings are part of the distributions made to beneficiaries such as the Conservation Trust Fund and Great Outdoors Colorado. In addition, the Lottery has a risk that retailers will not have sufficient funds to settle these games because the monies have been used for other purposes.

The Lottery should ensure that monthly reconciliations between its internal system and the on-line system are performed and any errors identified are corrected timely. Due to the high volume of transactions processed by the Lottery on a daily basis, it is critical that problems be addressed promptly. Lack of timely reconciliations and settlements of accounts receivable increases the risk of errors and irregularities. In addition, the Lottery should work with Scientific-Games to correct the system error related to scratch games.

Recommendation No. 1

The Colorado Lottery should ensure controls over the collection of accounts receivable for on-line games are adequate by:

- a. Completing monthly analytical reviews of accounts receivables and correcting problems on a timely basis.
- b. Following up and settling outstanding receivables related to the system error in accordance with the established schedule.
- c. Working with Scientific-Games to correct the system error.

Colorado Lottery Response: Agree

- a. The Lottery will develop analytical review processes and supplementary reporting as needed to detect irregularities in accounts receivable balances and correct identified problems on a timely basis.

Implementation Date: November 2005

Colorado Lottery
Auditors' Findings and Recommendations (continued)
Year Ended June 30, 2005

- b. On September 29, 2005, the Lottery completed the settlement and billing of outstanding scratch game packs identified when the system error was discovered.

Implementation Date: September 2005

- c. The Lottery is working with Scientific-Games to correct the root problem that caused the system error to occur. In the interim, the Lottery implemented alternate methods to identify incorrect settlements and billings and to make timely corrections.

Implementation Date: December 2005

Colorado Lottery

Auditors' Findings and Recommendations (continued)

Year Ended June 30, 2005

System Balancing Reports

As noted above, the Lottery converted to a new vendor for its on-line games on May 2, 2005. In our audit for fiscal year 2003, we recommended that the Lottery obtain an independent test and examination of the new vendor system prior to the go-live date to gain assurance regarding the integrity and reliability of the new system and that the appropriate balancing, or reconciliation capabilities were in place. In order to ensure that Lottery accurately and completely tracks revenues, receivables, and collections related to the sale of lottery tickets, it must have controls in place to reconcile the on-line system with its internal system.

The Lottery contracted for a firm to perform an independent test of the new system, which was conducted throughout the implementation of the new system and was concluded on May 3, 2005, or the day after the new system was implemented. The firm issued a report on the basis of its examination and noted seven reportable conditions related to the reports required for reconciling the on-line system and the Lottery's internal system. The firm found that some reports that had been specified as deliverables by the Lottery in its contract with the new on-line vendor were not being produced, and other reports did not balance to the corresponding information in the Lottery's system.

We selected a sample of reports from the new on-line system to test the reconciliation process. Our testing noted results similar to the independent test. We found instances where some reports were either "not available" on the on-line database or did not balance to what the Lottery internally reported. The Lottery indicated that many of the reports that were not available were not critical to the balancing of the system. Per discussion with management, these reports are considered balancing tools and do not reflect actual transactions being transmitted. For the reports we identified that did not balance to the Lottery reports, Lottery indicated that it is working with the vendor to determine the source of the problems and correct the information generated.

The reconciliation process is critical to ensure the accuracy and completeness of the transactions reported by the Lottery and on the State's accounting system. The Lottery should continue efforts to ensure that the reporting function in the new on-line system that supports the reconciliation process fulfills the requirements agreed upon as part of the vendor's contract.

Recommendation No. 2

The Colorado Lottery should continue to work with Scientific-Games to ensure that all reports required as part of the contract are provided and that the reports contain accurate and complete information.

Colorado Lottery Response: Agree

The Colorado Lottery continues to work with Scientific-Games on the scheduling, testing and implementation of system updates to ensure that all reports required as part of the contract are provided. The Lottery will verify that the reports contain accurate and complete information through verification performed in the acceptance testing process and through the daily systems balancing process in production.

Implementation Date: June 2006

Colorado Lottery

Auditors' Findings and Recommendations (continued)

Year Ended June 30, 2005

Independent Reviews of Systems

During our 2003 audit, we recommended that the Lottery have an annual independent examination performed of the internal system used to record and track ticket sales. At that time, we also recommended that the Lottery request an independent SAS 70, Type II Audit of its external service provider. With the conversion of the computer system in 2005, it is even more urgent that the Lottery seek this independent review of the systems. Prior to the conversion, Lottery's internal information system was used to record and track gross ticket sales. With the new conversion, the new vendor, Scientific-Games, is now responsible for maintaining the transaction data received from the retailers and then transmitting this information into Lottery's internal (WANG) system. The WANG system then records the revenue and tracks and records the accounts receivable information. In fiscal year 2005, the Lottery had gross ticket sales of approximately \$417,000,000. Because of the large number of transactions and high volume of activity, the Lottery has significant risk associated with the operations of the WANG system and the third-party vendor system with Scientific-Games.

The information that is obtained from both systems is critical to the information reported on Lottery's financial statements and the internal controls of the Lottery's operation. The Lottery has not had an independent examination performed on its WANG system, and it has not had a SAS 70, Type II Audit on its external service provider. A SAS 70, Type II Audit, Report on Controls Placed in Operation and Tests of Operating Effectiveness, focuses on testing a service organization's controls over processing transactions to ensure information is accurate and complete. Through testing, controls are evaluated as to whether they are operating with sufficient effectiveness to provide a reasonable, but not absolute, assurance that the control objectives were achieved for a period specified.

Due to the complexity and the high dollar volume of the transactions at both the Lottery and its vendors, there is significant risk related to information system controls, internal controls over financial processing and safeguarding of the Lottery's assets. Third-party independent audits can be a mechanism to help identify weaknesses in the software and the internal control system at both the third-party vendors and internally within the Lottery's system. This testing would help ensure there are quality controls and systems in place and that they are operating effectively to help reduce the risk of loss to the Lottery and to the State of Colorado.

Recommendation No. 3

The Colorado Lottery should minimize risks related to information system control, internal controls over financial processing and safeguarding of assets by performing:

- a. An annual independent examination of the internal system used to record and track ticket sales.
- b. An independent SAS 70, Type II Audit on the external service provider and its subcontractor annually.

Colorado Lottery
Auditors' Findings and Recommendations (continued)
Year Ended June 30, 2005

Colorado Lottery Response: Agree

- a. The Lottery agrees with this recommendation but will defer the implementation and related costs since we plan to migrate off the current internal (WANG) system in mid-2006. After the migration occurs, major functions currently performed by the Wang System, including recording ticket sales revenue, recording and tracking accounts receivable, and doing associated retailer billings will become the responsibility of Scientific Games. The Lottery will re-assess the need for an annual independent examination of the internal system if the migration is delayed.

Implementation Date: September 2006

- b. The Lottery recently contracted with an independent auditor to perform a SAS 70, Type II Audit on its on-line vendor and its subcontractor. This audit is currently underway, and will be done annually in the future.

Implementation Date: March 2006

Colorado Lottery
Disposition of Prior Year Audit Recommendations
Year Ended June 30, 2005

Fiscal Year 2003 Recommendation

Number	Recommendation	Disposition
1	The Lottery should minimize risks related to information system control, internal controls over financial processing and safeguarding of assets by:	
	a) Performing an annual independent examination of the internal system used to record and track ticket sales.	Not implemented – See Finding No. 3
	b) Performing specific independent testing and examinations as part of the systems reconfiguration to assure reliability prior to activating the new system.	Implemented
	c) Requesting an independent SAS 70, Type II Audit on the external service provider and its subcontractor as the new system is being established and annually thereafter.	Not implemented – See Finding No. 3

Fiscal Year 2004 Recommendations

1	The Lottery should strengthen controls over third-tier prizes and third-tier drawings.	Implemented
2	The Lottery should pursue statutory changes if it should decide to continue with prizes that include a contribution to a not-for-profit entity.	No longer applicable
3	The Lottery should calculate the operating requirements for the following year in order to reserve the appropriate amount at year-end.	Implemented
	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.	Implemented



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 June 30, 2005 and 2004, 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 applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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, 2005 and 2004, 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 16, 2005, 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 grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing 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.

Members of the Legislative Audit Committee

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying supplementary information 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 audits 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 16, 2005

Colorado Lottery

Management's Discussion and Analysis

Year Ended June 30, 2005

This discussion and analysis of the Lottery financial performance provides an overview of financial activities for the fiscal year ended June 30, 2005. 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 2005 Financial Highlights

- The Lottery's overall sales performance of \$417 million reflected a \$15.7 million increase from last year and replaced fiscal year 2002, whose sales totaled \$407 million, as the highest sales year since the Lottery's start-up in 1983. Fiscal years 2003 and 2004 sales totaled \$391.5 million and \$401.3 million, respectively, and rank as the third- and fourth-highest sales years ever.

Scratch sales hit a record high for the second year in a row with scratch sales totaling \$282.7 million. The second highest sales were in fiscal year 2004, with scratch sales totaling \$260.9 million. Fiscal year 2003 scratch sales totaling \$254.3 million ranks fourth in total scratch sales with fiscal year 2002 holding the third position with scratch sales totaling \$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, but at a slower rate than in fiscal year 2004. Fiscal year 2005 Lotto sales of \$38.3 million reflect a decrease of \$2.5 million from the previous year sales of \$40.8 million. Fiscal year 2004 Lotto sales totaling \$40.8 million reflected a \$7.5 million decrease from the prior fiscal year 2003 sales of \$48.3 million.

Powerball sales for fiscal year 2005 also experienced a slight decrease of \$4.1 million from the prior fiscal year. Powerball sales for fiscal year 2005 totaled \$80.9 million as compared to the prior year's record-breaking sales of \$85 million. Fiscal year 2003 Powerball sales totaled \$75.7 million.

Cash 5 sales for fiscal year 2005 again showed an unexpected increase. Sales increased nearly 4% to a total of \$15.1 million from \$14.5 million in fiscal year 2004. This followed a more than 9% increase in sales in fiscal year 2004 from fiscal year 2003 whose sales totaled \$13.2 million.

- Proceeds distributions fell slightly, totaling \$103.7 million, as compared to \$104.1 million in fiscal year 2004 and \$104.8 million in fiscal year 2003. This included, for the fourth time, a spill-over into the State Public School Fund Contingency Reserve; in fiscal year 2005 the spill-over was \$1.7 million. A spill-over occurs when the distribution cap for GOCO is reached in any one year. The cap for GOCO is the 1992 base year amount of \$35 million as adjusted for the annual change in the cost of living increase for the Denver-Boulder area. The total amount of the spill-over during the four-year period totals \$16.3 million.

Colorado Lottery

Management's Discussion and Analysis

Year Ended June 30, 2005

- Gross profit as a percent of sales decreased by .9% a reflection of the increase in the prize costs from 59% (\$236,602,960) to 59.8% (\$249,502,651) of sales. Fiscal year 2004 prize expense was slightly lower due to a greater reduction in prize expense from the absorption of unclaimed prizes. Two expiring unclaimed Lotto jackpots contributed to the higher amount of unclaimed prizes. Gross profit as a percent of sales decreased by .8% between fiscal years 2003 and 2004, a reflection of the increase in the prize costs from 58% (\$226,917,410) to 59% (\$236,602,960) 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.

Games Offered by the Colorado Lottery

Currently, the Lottery offers two different ways to play: scratch games and on-line 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. Prizes over \$600 must be redeemed at Lottery offices.

On-line 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, 2005 and 2004. 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, 2005 and 2004. 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, 2005 and 2004.

Statements of Net Assets

The statements of net assets is a financial snapshot of the Lottery at June 30, 2005 and 2004. 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 noncurrent. Net assets are classified by the ways in which they may be used for future operations.

Colorado Lottery
Management's Discussion and Analysis
Year Ended June 30, 2005

Colorado Lottery
Condensed Statements of Net Assets
June 30, 2005, 2004 and 2003

	2005	2004	2003
Assets			
Current assets	\$ 49,400,246	\$ 39,951,270	\$ 47,485,313
Restricted assets	6,089,238	5,024,418	3,003,518
Capital assets	<u>861,066</u>	<u>1,029,114</u>	<u>1,427,326</u>
Total assets	<u>\$ 56,350,550</u>	<u>\$ 46,004,802</u>	<u>\$ 51,916,157</u>
Liabilities			
Current liabilities	\$ 52,415,997	\$ 43,576,344	\$ 48,061,451
Long-term liabilities	<u>965,078</u>	<u>782,863</u>	<u>958,754</u>
Total liabilities	<u>\$ 53,381,075</u>	<u>\$ 44,359,207</u>	<u>\$ 49,020,205</u>
Net Assets			
Investment in capital assets	\$ 861,066	\$ 1,029,114	\$ 1,427,326
Restricted – Licensed Agent Recovery Reserve	479,238	469,424	460,638
Unrestricted – Operating Reserve	1,700,000	—	—
Unrestricted	<u>(70,829)</u>	<u>147,057</u>	<u>1,007,988</u>
Total net assets	<u>\$ 2,969,475</u>	<u>\$ 1,645,595</u>	<u>\$ 2,895,952</u>

The Lottery's total assets at June 30, 2005 were \$56 million. Assets consisted primarily of cash and investments with the State Treasury of \$28.7 million, Prepaid Prize Expense with Multi-State Lottery (MUSL) of \$3.9 million, receivables from Lottery retailers for the sale of Lottery products of \$21.5 million and a net investment in fixed assets of \$.9 million.

Comparable figures at June 30, 2004 were \$46 million in total assets, including \$25.4 million in cash and investments with the State Treasury, Prepaid Prize Expense with MUSL of \$3.5 million, receivable from retailers of \$14.7 million and a net investment in fixed assets of \$1 million.

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 \$6.8 million increase in receivables from retailers between fiscal year 2004 and fiscal year 2005 was partly the result of an undetected problem in the new on-line system, whereby billings of receivables to retailers were delayed. The error was detected in mid-July and is currently being resolved.

Colorado Lottery

Management's Discussion and Analysis

Year Ended June 30, 2005

The Lottery's total liabilities at June 30, 2005 totaled approximately \$53 million, consisting primarily of proceeds distributions due to recipients of \$27.8 million and prize liability on all Lottery products of about \$17.1 million.

The Lottery's total liabilities at June 30, 2004 totaled \$44.4 million, which consisted primarily of proceeds distributions due 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; 3) an amount representing the funds held by the Lottery in an operating reserve as mandated by Senate Bill 204 (See "Cash and Investments – Operating Reserve") on the statements of net assets; and 4) 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, 2004 to June 30, 2005 consisted of a decrease in investment in capital assets from \$1 million to \$.9 million, a minor increase in the bonding reserve from \$469,424 to \$479,238, the establishment of the operating reserve of \$1.7 million, and a net decrease in unrealized gain and losses on investments of (\$217,886) resulting from a net decrease in the adjustments on State Treasury investments.

Following is a schedule of net assets for fiscal years 2005 and 2004:

	<u>2005</u>	<u>2004</u>	<u>Change</u>
Investment in capital assets	\$ 861,066	\$ 1,029,114	\$ (168,048)
Bonding reserve	479,238	469,424	9,814
Operating reserve	1,700,000	—	1,700,000
Unrealized gain (loss) on investments	<u>(70,829)</u>	<u>147,057</u>	<u>(217,886)</u>
Total net assets	<u>\$ 2,969,475</u>	<u>\$ 1,645,595</u>	<u>\$ 1,323,880</u>

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 \$1.0 million, a minor increase in the bonding reserve from \$460,638 to \$469,424, and a net decrease in unrealized gains and losses on investments of \$860,931 resulting from a net decrease in the adjustments on State Treasury investments.

Colorado Lottery
Management's Discussion and Analysis
Year Ended June 30, 2005

Following is a schedule of net assets for fiscal years 2004 and 2003:

	<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>

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, 2005, 2004 and 2003**

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Operating Revenues	\$ 416,966,782	\$ 401,250,971	\$ 391,473,640
Direct Operating Expenses	<u>291,083,679</u>	<u>276,512,227</u>	<u>266,444,993</u>
Gross Profit on Sale of Tickets	<u>125,883,103</u>	<u>124,738,744</u>	<u>125,028,647</u>
Other Operating Expenses			
Marketing and communications	8,559,774	8,643,422	9,093,013
Wages and benefits	7,941,537	7,881,363	8,055,900
Other operating expenses	<u>6,022,481</u>	<u>5,550,032</u>	<u>5,142,879</u>
Total operating expenses	<u>22,523,792</u>	<u>22,074,817</u>	<u>22,291,792</u>
Operating Income	<u>103,359,311</u>	<u>102,663,927</u>	<u>102,736,855</u>
Nonoperating Revenues (Expenses)			
Other revenue	953,328	156,990	303,134
Investment income	747,176	184	1,958,747
Proceeds distributions	<u>(103,735,935)</u>	<u>(104,071,458)</u>	<u>(104,779,061)</u>
Total nonoperating revenue (expenses)	<u>(102,035,431)</u>	<u>(103,914,284)</u>	<u>(102,517,180)</u>
Increase (Decrease) in Net Assets	1,323,880	(1,250,357)	219,675
Net Assets, Beginning of Year	<u>1,645,595</u>	<u>2,895,952</u>	<u>2,676,277</u>
Net Assets, End of Year	<u>\$ 2,969,475</u>	<u>\$ 1,645,595</u>	<u>\$ 2,895,952</u>

Colorado Lottery
Management's Discussion and Analysis
Year Ended June 30, 2005

Sales Activities

Revenues from the sale of Lottery products for the fiscal year ended June 30, 2005 were the highest in the Lottery's 23-year history. As shown in the financial statements, overall sales increased by 3.9% from the prior year, from \$401.3 million in fiscal year ended June 30, 2004 to \$417 million in the current year and increased by 2.5% over the second highest sales year of \$407 million in fiscal year 2002. The increase in scratch sales from \$260.9 million to \$282.7 million represented a larger percentage increase of 8.4%. Powerball finished its third full year of sales with a slight decrease of 4.8% in sales from the prior year, a result of fewer large Powerball jackpots. Lotto sales suffered another off year statistically, resulting in a 6.1% reduction in sales. This was the third-consecutive year that Lotto experienced a large percentage reduction in sales. In fiscal year 2004, Lotto sales reflected a 15.5% decrease from fiscal year 2003.

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

Product Sales	2005	2004	Difference	Percentage
Scratch	\$ 282.7	\$ 260.9	\$ 21.8	8.4%
Powerball	80.9	85.0	(4.1)	(4.8)
Lotto	38.3	40.8	(2.5)	(6.1)
Cash 5	<u>15.1</u>	<u>14.5</u>	<u>.6</u>	<u>4.1</u>
Total	<u>\$ 417.0</u>	<u>\$ 401.2</u>	<u>\$ 15.8</u>	<u>3.9%</u>

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)	(15.5)
Cash 5	<u>14.5</u>	<u>13.2</u>	<u>1.3</u>	<u>9.8</u>
Total	<u>\$ 401.2</u>	<u>\$ 391.5</u>	<u>\$ 9.7</u>	<u>2.5%</u>

Colorado Lottery

Management's Discussion and Analysis

Year Ended June 30, 2005

Total Revenues

Nonoperating revenues for the year ended June 30, 2005 totaled \$1.7 million as compared with \$.2 million for the year ended June 30, 2004 and \$2.3 million for the year ended June 30, 2003. Two major factors contributed to the increase from fiscal year 2004 to fiscal year 2005. 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 cash held at the State Treasurer as compared to a net loss of only \$217,886 in the current fiscal year. Second, other income in fiscal year 2005 included reimbursements from the on-line vendor of approximately \$855,000. These reimbursements relate to amounts owed by the new vendor relating to the delay in the conversion. 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 a reduction in the actual allocated annual yield from 4.52% to 3.17%. In addition, Senate Bill 03-300, required that, for fiscal year 2004, 15% of the Lottery's Treasury interest be sent to the General Fund.

Total revenues were \$418.7 million and \$401.4 million for the years ended June 30, 2005 and 2004, respectively. As mentioned elsewhere, the two major contributors to the increase of approximately \$17.2 million were an increase in Lottery sales of \$15.7 million and an increase in nonoperating revenues of \$1.5 million.

Total revenues for the year ended June 30, 2003 were \$393.7 million. The major contributing factor was the increase in total revenues from fiscal year 2003 to 2004 of \$7.7 million, was an increase in ticket sales of \$9.8 million. This was offset by a decrease in nonoperating revenues of \$2.1 million.

Major Expenses

Approximately \$291.1 million of the Lottery's total expenses of \$313.6 for the fiscal year ended June 30, 2005, were 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 on-line gaming system.

In comparison, \$276.5 million of the Lottery's total expenses of \$298.6 million for the fiscal year ended June 30, 2004, were game-related expenses.

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.

Colorado Lottery
Management's Discussion and Analysis
Year Ended June 30, 2005

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

Game-Related Expenses	2005	2004	Difference	Percentage
Prize expense/Powerball prize variance	\$ 249.5	\$ 236.6	\$ 12.9	5.4%
Retailer compensation				
Commissions	27.8	26.6	1.2	4.5
Bonuses	3.9	3.6	.3	8.3
Ticket costs	3.2	3.0	.2	6.7
Vendor fees	<u>6.7</u>	<u>6.7</u>	<u>.0</u>	<u>.0</u>
Total	\$ <u>291.1</u>	\$ <u>276.5</u>	\$ <u>14.6</u>	<u>5.3%</u>

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	.6	2.3
Bonuses	3.6	3.5	.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 2005 over the prize expense percentage in fiscal year 2004, as the prize expense percentage in fiscal year 2004 had been reduced by the expiration of two unclaimed Lotto jackpots. Also, 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 included the absorption of an unclaimed Powerball jackpot.

Of the \$22.5 million in fiscal year 2005 expenses that were non game-related, nearly \$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 2004 non game-related expenses of \$22.1 million, more than \$8.6 million was for promotions and institutional and product advertising, and \$7.9 million was for compensation to Lottery employees.

Colorado Lottery

Management's Discussion and Analysis

Year Ended June 30, 2005

In comparison, of the fiscal year 2003 non game-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 \$103.7 million in the current fiscal year, the fourth-highest year ever. Of these total proceeds, nearly \$50.2 million was allocated to the Great Outdoors Colorado Trust Fund, \$41.5 million to the Conservation Trust Fund and \$10.3 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 \$50.2 million, pursuant to C.R.S. 33-60-104(1)(c) and 33-60-104(2), was reached, thus creating a spill-over into the State Public School Fund Contingency Reserve of \$1.7 million, pursuant to C.R.S. 22-54-117(1.6)(a).

The Lottery's proceeds distributions for the prior year was the third-highest year on record, totaling \$104.1 million. Approximately \$49.7 million was distributed to Great Outdoors Colorado, \$41.6 million to the Conservation Trust Fund, \$10.4 million to the Division of Parks and Outdoor Recreation and a spill-over into the State's Public School Fund Contingency Reserve of nearly \$2.4 million.

The Lottery's proceeds distributions for the fiscal year 2003 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 (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 2005, the Legislature approved supplemental appropriation adjustments for the Lottery. Supplemental appropriations were approved in communication services, telecommunications, Multi-use Network Task Force payments, workmen's compensation, Grand Junction lease space, vendor fees and the Computer Migration lines, offset by reductions in the vehicle lease payments, personnel services, operating expenses, payments to the computer center, risk management, travel expenses, marketing and communications and ticket costs. The final method of funding is special legislation. There was no special legislation affecting the Lottery's budget in fiscal year 2005.

Colorado Lottery

Management's Discussion and Analysis

Year Ended June 30, 2005

The approved Lottery budget at the beginning of fiscal year 2005 was \$354 million. Department level allocations approved at the beginning of the fiscal year increased the budget by \$0.8 million. Supplemental appropriations and adjustments made in the third quarter decreased the budget by \$0.1 million to an amended total of \$354.7 million. Total expenditures and roll-forwards for fiscal year 2005 on a budget basis came to \$317 million, resulting in excess appropriations (or savings) of more than \$37.6 million.

Economic Factors and Next Year's Budget

The Lottery considered several factors when setting the revenue estimates and the fiscal year 2006 budget. On-line sales (Powerball, Lotto and Cash 5) are expected to decrease slightly overall as sales for on-line games naturally decrease over the life cycle of each game.

Fiscal year 2006 revenue estimates total \$410.5 million, a \$6.5 million decrease from fiscal year 2005 actual sales due primarily to a projected decrease in Powerball sales as the game matures. Powerball sales are projected to be \$74 million for fiscal year 2006 compared to actual Powerball sales of \$80.9 million for fiscal year 2005. Lotto and Cash 5 projections for fiscal year 2006 are near 2005 actuals.

Scratch sales for fiscal year 2005 were up approximately \$7.7 million from projections, finishing at \$282.7 million as the best Scratch sales ever. Therefore, the Lottery is projecting that fiscal year 2006 sales will be comparable to or slightly higher than fiscal year 2005.

The Lottery does not expect major changes in costs in fiscal year 2006 other than normal increases in costs.

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 2005 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, 212 W. 3rd Street, Suite 210, Pueblo, CO 81003.

Colorado Lottery
Statements of Net Assets
June 30, 2005 and 2004

Assets

	<u>2005</u>	<u>2004</u>
Current Assets		
Cash and investments	\$ 26,580,839	\$ 23,920,655
Accounts receivable, net of the allowance for doubtful accounts; 2005 – \$79,044 and 2004 – \$70,846	21,543,586	14,671,184
Game prizes inventory, at cost	22,560	120,323
Consignment ticket inventory, at cost	170,900	157,705
Warehouse ticket inventory, at cost	1,039,705	1,043,264
Prepaid expenses	<u>42,656</u>	<u>38,139</u>
Total current assets	<u>49,400,246</u>	<u>39,951,270</u>
Restricted Assets		
Cash and investments – Licensed Agent Recovery Reserve	479,238	469,424
Cash and investments – Operating Reserve	1,700,000	1,029,114
Prepaid prize expense – Multi-State Lottery Association	<u>3,910,000</u>	<u>3,525,880</u>
Total restricted assets	<u>6,089,238</u>	<u>5,024,418</u>
Capital Assets		
Equipment	3,883,759	4,455,227
Leasehold improvements	14,053	327,287
Less accumulated depreciation and amortization	<u>(3,036,746)</u>	<u>(3,753,400)</u>
Total capital assets	<u>861,066</u>	<u>1,029,114</u>
Total assets	<u>\$ 56,350,550</u>	<u>\$ 46,004,802</u>

Liabilities

	<u>2005</u>	<u>2004</u>
Current Liabilities		
Accounts payable	\$ 5,460,542	\$ 1,987,162
Prize liability	17,067,680	13,975,136
Payable to MUSL	142,962	129,377
Wages and benefits	694,337	725,844
Accrued annual and sick leave	12,030	78,211
Retailer bonus liability	1,104,390	576,370
Funds available for distribution	27,779,840	25,805,521
Deferred revenue	<u>154,216</u>	<u>298,723</u>
Total current liabilities	<u>52,415,997</u>	<u>43,576,344</u>
Long-term Liabilities		
Accrued annual and sick leave	835,856	653,670
Expired warrants liability	<u>129,222</u>	<u>129,193</u>
Total long-term liabilities	<u>965,078</u>	<u>782,863</u>
Total liabilities	<u>53,381,075</u>	<u>44,359,207</u>
Net Assets		
Investment in capital assets	861,066	1,029,114
Restricted – Licensed Agent Recovery Reserve	479,238	469,424
Unrestricted – Operating Reserve	1,700,000	—
Unrestricted	<u>(70,829)</u>	<u>147,057</u>
Total net assets	<u>2,969,475</u>	<u>1,645,595</u>
Total liabilities and net assets	<u>\$ 56,350,550</u>	<u>\$ 46,004,802</u>

Colorado Lottery
Statements of Revenues, Expenses and Changes in Net Assets
Years Ended June 30, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Operating Revenues		
Gross ticket sales	\$ <u>416,966,782</u>	\$ <u>401,250,971</u>
Direct Operating Expenses		
Prize expense	248,809,641	238,427,919
Powerball prize variance	693,010	(1,824,959)
Retailer commissions and bonuses	31,674,967	30,255,251
Cost of tickets and vendor fees	<u>9,906,061</u>	<u>9,654,016</u>
Total direct operating expenses	<u>291,083,679</u>	<u>276,512,227</u>
Gross Profit on Sale of Tickets	<u>125,883,103</u>	<u>124,738,744</u>
Other Operating Expenses		
Marketing and communications	8,559,774	8,643,422
Administration fees paid to MUSL	117,286	134,839
Wages and benefits	7,941,537	7,881,363
Professional services	956,988	559,685
State agencies services	215,969	405,910
Department of Revenue services	309,814	330,926
Travel	80,795	111,983
Equipment (including \$149,445 and \$21,116, respectively, of loss on disposition of equipment)	1,231,910	99,455
Depreciation	193,227	489,609
Space rental	766,063	746,806
Rents for equipment	252,285	690,126
Motorpool leasing	250,302	276,191
Materials and supplies	121,720	141,202
Telephone	161,262	190,334
On-line telecommunications	567,189	725,728
Data processing supplies and services	31,427	55,413
Equipment maintenance	284,248	280,227
Postage	40,593	73,219
Printing	20,243	34,796
Other	<u>421,160</u>	<u>203,583</u>
Total other operating expenses	<u>22,523,792</u>	<u>22,074,817</u>
Operating Income	<u>103,359,311</u>	<u>102,663,927</u>

Colorado Lottery
Statements of Revenues, Expenses and Changes in Net Assets (continued)
Years Ended June 30, 2005 and 2004

	2005	2004
Operating Income	<u>103,359,311</u>	<u>102,663,927</u>
Nonoperating Revenues (Expenses)		
Other revenue	953,328	156,990
Investment income	747,176	184
Funds distributed for current year	(75,956,095)	(78,265,937)
Funds available for distribution for current year	<u>(27,779,840)</u>	<u>(25,805,521)</u>
Total nonoperating revenues (expenses)	<u>(102,035,431)</u>	<u>(103,914,284)</u>
Increase (Decrease) in Net Assets	1,323,880	(1,250,357)
Net Assets, Beginning of Year	<u>1,645,595</u>	<u>2,895,952</u>
Net Assets, End of Year	<u>\$ 2,969,475</u>	<u>\$ 1,645,595</u>

Colorado Lottery
Statements of Cash Flows
Years Ended June 30, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Operating Activities		
Cash received from retailers	\$ 411,122,036	\$ 400,528,775
Cash paid in prizes	(246,822,873)	(242,453,240)
Cash paid in retailer commissions	(27,804,768)	(26,620,204)
Cash payments to suppliers	(21,274,511)	(22,597,775)
Cash payments to employees for services	(7,735,836)	(7,990,304)
Cash received from Lotto subscription sales	—	463,239
Cash paid in retailer bonus	(3,351,226)	(3,640,176)
Cash received – other	<u>389,626</u>	<u>29,380</u>
Net cash provided by operating activities	<u>104,522,448</u>	<u>97,719,695</u>
Noncapital Financing Activities		
Distribution of net proceeds	<u>(101,761,616)</u>	<u>(103,678,870)</u>
Capital and Related Financing Activities		
Sale of capital assets	7,500	—
Acquisition of capital assets	<u>(174,624)</u>	<u>(112,513)</u>
Net cash provided by operating activities	<u>(167,124)</u>	<u>(112,513)</u>
Investing Activities		
Interest received	<u>965,062</u>	<u>861,115</u>
Increase in Cash and Investments	3,558,770	(5,210,573)
Change in Fair Market Value of Investments	(217,886)	(860,931)
Cash and Investments, Beginning of Year (Including \$469,424 and \$464,096, Respectively, in Restricted Accounts)	<u>25,419,193</u>	<u>31,490,697</u>
Cash and Investments, End of Year (Including \$2,179,238 and \$1,498,538, Respectively, in Restricted Accounts)	<u>\$ 28,760,077</u>	<u>\$ 25,419,193</u>

Colorado Lottery
Statements of Cash Flows (continued)
Years Ended June 30, 2005 and 2004

	2005	2004
Reconciliation of Operating Income to Net Cash Provided by		
Operating Activities		
Operating income	\$ 103,359,311	\$ 102,663,927
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	193,227	489,609
Loss of disposal of equipment	141,946	21,117
Other revenue	953,327	156,990
Change in		
Accounts receivable	(6,872,402)	590,495
Ticket inventory	(9,636)	(152,237)
Prepaid prize expense with MUSL	(384,120)	(983,000)
Other assets	93,246	(13,619)
Liabilities (excluding funds available for distribution)	<u>7,047,549</u>	<u>(5,053,587)</u>
Net cash provided by operating activities	<u>\$ 104,522,448</u>	<u>\$ 97,719,695</u>
Statement of Net Assets Classification		
Cash and investments	\$ 26,580,839	\$ 23,920,655
Cash and investments – Licensed Agent Recovery Reserve	479,238	469,424
Cash and investments – Operating Reserve	<u>1,700,000</u>	<u>1,029,114</u>
	<u>\$ 28,760,077</u>	<u>\$ 25,419,193</u>

Colorado Lottery
Notes to Financial Statements
June 30, 2005 and 2004

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, 2005 and 2004. 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, 2005 and 2004

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 Budgeting and/or the Legislature.

Colorado Lottery
Notes to Financial Statements
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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 \$79,044 and \$70,846 as of June 30, 2005 and 2004, 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.

Colorado Lottery

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June 30, 2005 and 2004

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.

Prepaid Prize Expense

As part of the Lottery's agreement with Multi-State Lottery Association (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, 2003. 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 ensure that they were fully depreciated by the end of their useful lives 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 an additional \$154,427 of depreciation related to the PES terminals has been recorded and presented on the Lottery's financial statements.

Accrued Wages and Benefits

The State has deferred the last pay date in the fiscal year June 30 to July 1 for most State employees. For the Lottery, this created a liability for accrued wages at June 30, 2005 and 2004 of \$694,337 and \$725,844, respectively.

Colorado Lottery

Notes to Financial Statements

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Prize Liability and Prize Expense

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

All scratch, on-line and special drawing prizes are accounted for using the accrual basis of accounting. The liability for scratch prizes and on-line 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 \$3,706,845 for the fiscal year ended June 30, 2005 and \$4,867,069 for the fiscal year ended June 30, 2004. During the fiscal year ended June 30, 2005, there were a total of 36 games ended, as compared with 33 games ended through fiscal year ended June 30, 2004.

Payments of cumulative on-line 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. On-line prizes may be claimed up to 180 days after the date of the drawing. After the final claim date, unclaimed on-line 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 on-line prizes resulted in a decrease to prize expense of \$5,694,443 for the fiscal year ended June 30, 2005 and \$10,313,756 for the fiscal year ended June 30, 2004.

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.

Colorado Lottery

Notes to Financial Statements

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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.”

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 Department of Revenue and are reviewed on an annual basis. Retailers have the option to obtain private surety bond coverage at a rate of \$2,000 surety coverage per outlet at their discretion. In 2005 and 2004, the Lottery has reserved \$479,238 and \$469,424, 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. In April 2005, the Lottery set up a separate operating reserve independent of the net capital asset reserve in the amount of \$1.7 million. The amount held in this operating reserve will be reviewed annually and adjusted accordingly. This reserve is reported as restricted cash on the statements of net assets.

Equipment Expense

Colorado Lottery
Notes to Financial Statements
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Included in the statement of revenues, expenses and changes in fund net assets is an account titled equipment. This account reports the book value of assets which are disposed of during the year, fixed asset purchases made during the year which are not capitalized (see Fixed Asset Footnote, page 32), software purchases and other miscellaneous equipment transactions. During fiscal year 2005, significant expenses were incurred related to the new on-line and scratch vendor, Scientific-Games.

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:

	June 30, 2005	June 30, 2004	Increase
Annual leave	\$ 696,620	\$ 593,570	\$ 103,050
Sick leave	<u>146,684</u>	<u>135,078</u>	<u>11,606</u>
Total annual and sick leave	843,304	728,648	114,656
Compensatory time	<u>4,582</u>	<u>3,233</u>	<u>1,349</u>
Total compensated leave	<u>\$ 847,886</u>	<u>\$ 731,881</u>	<u>\$ 116,005</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.

Colorado Lottery
Notes to Financial Statements
June 30, 2005 and 2004

Deferred Revenue

The Lottery offers two methods of purchasing on-line 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 on-line tickets good for up to 13 weeks. 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. Subscription plays were suspended indefinitely with the last subscription plays being recognized as of September 26, 2004. 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, 2005 and 2004 is as follows:

	2005	2004
Subscription	\$ —	\$ 114,843
Advance Play – Lotto	66,749	97,477
Advance Play – Powerball	55,795	56,042
Advance Play – Powerplay	14,979	13,283
Advance Play – Cash 5	16,693	17,078
Total deferred revenue	\$ 154,216	\$ 298,723

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, 2005 and 2004, 640 and 51,375 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, 2005 and 2004, \$43,624 and \$70,168 worth of free scratch tickets were given away, respectively. Scratch tickets and coupons are valued at cost. For the fiscal years ended June 30, 2005 and 2004, \$29,334 and \$80,591, 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.

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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, 2005 and 2004 is as follows:

	<u>2005</u>	<u>2004</u>
Petty cash	\$ 800	\$ 800
Change funds	70,000	70,300
Imprest fund	706,000	350,000
Depository accounts	30,000	30,000
Cash on deposit with State Treasurer	<u>25,774,039</u>	<u>23,469,555</u>
Total unrestricted cash and investments	<u>26,580,839</u>	<u>23,920,655</u>
Restricted cash and investments – Licensed Agent Recovery Reserve Receipts on deposit with State Treasurer	479,238	469,424
Operating Reserve on deposit with State Treasurer	<u>1,700,000</u>	<u>1,029,114</u>
Total restricted cash and investments	<u>2,179,238</u>	<u>1,498,538</u>
Total cash and investments	<u>\$ 28,760,077</u>	<u>\$ 25,419,193</u>

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 2005 and 2004 was 3.18% and 3.17%, 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.

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Deposits

Custodial credit risk is the risk that in the event of a bank failure, a government's deposits may not be returned to it. The Lottery's deposit policy for custodial credit risk requires compliance with the provisions of state law.

State law requires collateralization of all deposits with federal depository insurance; bonds and other obligations of the U.S. Treasury, U.S. agencies or instrumentalities or the State of Colorado; bonds of any city, county, school district or special road district of the State of Colorado; bonds of any state; or a surety bond having an aggregate value at least equal to the amount of the deposits.

At June 30, 2005 and 2004, respectively, \$641,744 and \$365,936 of the Lottery's bank balances of \$741,744 and \$365,936, respectively, were exposed to custodial credit risk as follows:

	2005	2004
Uninsured and uncollateralized	\$ 641,744	\$ 265,936
Uninsured and collateral held by pledging financial institution	100,000	100,000
	\$ 741,744	\$ 365,936

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.

The cash deposits bank balance of \$741,744 is categorized as follows as of June 30, 2005:

Category 1	\$	100,000
Category 2	\$	641,744

For Cash on Deposit with State Treasurer, the State Treasurer's investments as of June 30, 2005 are Category 1 investments and its cash deposits are principally Category 2 deposits.

Colorado Lottery
Notes to Financial Statements
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Note 3: Schedule of Changes in Fixed Assets

Capital assets being depreciated:

	June 30, 2004	Increases	Decreases	June 30, 2005
Equipment	\$ 4,455,227	\$ 174,624	\$ (746,092)	\$ 3,883,759
Leasehold improvements	<u>327,287</u>	<u>—</u>	<u>(313,234)</u>	<u>14,053</u>
Total capital assets being depreciated	<u>4,782,514</u>	<u>174,624</u>	<u>(1,059,326)</u>	<u>3,897,812</u>
Less accumulated depreciation for equipment	(3,516,924)	(178,664)	671,489	(3,024,099)
Leasehold improvements	<u>(236,476)</u>	<u>(14,563)</u>	<u>238,392</u>	<u>(12,647)</u>
Total accumulated depreciation	<u>(3,753,400)</u>	<u>(193,227)</u>	<u>909,881</u>	<u>(3,036,746)</u>
Total capital assets, being depreciated, net	<u>\$ 1,029,114</u>	<u>\$ (18,603)</u>	<u>\$ (149,445)</u>	<u>\$ 861,066</u>

	June 30, 2003	Increases	Decreases	June 30, 2004
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>

Colorado Lottery
Notes to Financial Statements
June 30, 2005 and 2004

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 occupied 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 expired on June 30, 2005. The Lottery entered into an agreement with Midtown RLLLP on April 19, 2005. The lease agreement began on June 27, 2005 and expires on June 30, 2015. The lease contains an option to renew for two additional five-year terms commencing on July 1, 2015. There are no other provisions for extension or renewal.

Warehouse – The Lottery leases primary warehouse space from Santa Fe 250 LLC. The Lottery entered into a lease 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 12-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 expired on October 31, 2004. There are no other provisions for extension or renewal (see Note 10).

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 exercised the option to extend the lease through August 31, 2009 on June 11, 2004.

Fort Collins

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

Colorado Lottery
Notes to Financial Statements
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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, 2005 and 2004 and future minimum lease payments for fiscal years ending June 30, 2006 through 2011+ are as follows:

Location	Expense		Future Minimum Lease Payments					
	2004	2005	2006	2007	2008	2009	2010	2011 +
Pueblo office	\$ 275,900	\$ 293,553	\$ 218,013	\$ 218,013	\$ 218,013	\$ 218,013	\$ 218,013	\$ 1,192,201
Pueblo warehouse	85,885	96,218	91,052	78,623	—	—	—	—
Interlott	652,389	217,404	—	—	—	—	—	—
Colorado Springs warehouse	11,728	12,040	12,466	—	—	—	—	—
Denver office	203,354	209,833	215,316	—	—	—	—	—
Denver warehouse	107,039	102,937	95,652	98,553	101,473	104,486	17,499	—
Fort Collins	36,720	34,298	—	—	—	—	—	—
Grand Junction	4,557	6,637	—	—	—	—	—	—
	<u>\$ 1,377,572</u>	<u>\$ 972,920</u>	<u>\$ 632,499</u>	<u>\$ 395,189</u>	<u>\$ 319,486</u>	<u>\$ 322,499</u>	<u>\$ 235,512</u>	<u>\$ 1,192,201</u>

Note 5: Other Revenue

A schedule of other revenue for the fiscal years ended June 30, 2005 and 2004 follows:

	2005	2004
License fees	\$ 50,824	\$ 61,047
On-line vendor reimbursements	855,421	—
Fines and penalties	209	24,600
Assignment fees	4,219	7,012
Net Licensed Agent Recovery Reserve Receipts	9,814	8,786
Reimbursement excess budget/production cost of game show from MUSL	21,943	9,808
Other	10,898	45,737
Total	<u>\$ 953,328</u>	<u>\$ 156,990</u>

Colorado Lottery
Notes to Financial Statements
June 30, 2005 and 2004

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 for 1992, 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>2005</u>	<u>2004</u>
Income before distributions	\$ 105,059,815	\$ 102,821,101
Change in Licensed Agent Recovery Reserve	(9,814)	(8,786)
Change in fair market value of investments	217,886	860,931
Change in Operating Reserve	(1,700,000)	0
Other changes in net assets	<u>168,048</u>	<u>398,212</u>
Income available for distribution	103,735,935	104,071,458
Less distributions prior to year-end	<u>(75,956,095)</u>	<u>(78,265,937)</u>
Income available for distribution	<u>\$ 27,779,840</u>	<u>\$ 25,805,521</u>

	<u>Accrued at June 30, 2004</u>	<u>Proceeds Distributions Expenses</u>	<u>Distributions Paid</u>	<u>Accrued at June 30, 2005</u>
Great Outdoors Colorado	\$ 10,506,324	\$ 50,176,516	\$ (48,484,373)	\$ 12,198,467
State Public School Fund	2,396,438	1,691,454	(2,396,438)	1,691,454
Conservation Trust Fund	10,322,209	41,494,373	(40,704,647)	11,111,935
Division of Parks and Outdoor Recreation	<u>2,580,550</u>	<u>10,373,592</u>	<u>(10,176,158)</u>	<u>2,777,984</u>
	<u>\$ 25,805,521</u>	<u>\$ 103,735,935</u>	<u>\$ (101,761,616)</u>	<u>\$ 27,779,840</u>

	<u>Accrued at June 30, 2003</u>	<u>Proceeds Distributions Expenses</u>	<u>Distributions Paid</u>	<u>Accrued at June 30, 2004</u>
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>

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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.

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 five 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 five 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 state troopers 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 salary, as defined in CRS 24-51-101(42), to an individual account in the plan.

During fiscal year 2005, the State contributed 10.15% (12.85% for state troopers and 13.66% for the judicial branch) of the employee's salary. Effective July 1, 2004, 1.02% of the total contribution was allocated to the Health Care Trust Fund.

Salary subject to PERA contribution is gross earnings less any reduction in pay to offset employer contributions to the State-sponsored IRC 125 plan established under Section 125 of the Internal Revenue Code. 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, 2005, 2004 and 2003, were \$622,597, \$656,365 and \$659,854, respectively. These contributions met the contribution requirement for each year.

Colorado Lottery
Notes to Financial Statements
June 30, 2005 and 2004

Note 8: Voluntary Tax-deferred Retirement Plans

PERA offers a voluntary 401(k) 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 403(b) or 401(a) plans. Members who contribute to any of these plans also receive the State match, when available.

In January 2001, the MatchMaker Program established a State match for PERA member's voluntary contributions to tax-deferred retirement plans. The PERA Board sets the level of the match annually based on the actuarial funding of the defined benefit pension plan. The match is only available when the actuarial value of the defined benefit pension plan assets is 110% of actuarially accrued plan liabilities. This condition was not met during fiscal year 2005.

The Lottery's contributions to the Program described above for the fiscal years ended June 30, 2004 and 2003 were \$77,307, and \$138,919, respectively. No contribution was made to this program in fiscal year 2005.

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, 2005, 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 with several health maintenance organizations providing services within Colorado. As of December 31, 2004, there were 39,668 enrollees, including spouses and dependents, from all contributors to the plan.

Life Insurance Program

During fiscal year 2005 and 2004, PERA provided its members access to two group decreasing term life insurance plans offered by Prudential Insurance Company and Anthem Life. Effective April 1, 2005, PERA consolidated the two plans, and UnumProvident became the administrator. Members who transition to the new plan may continue coverage into retirement. Premiums are collected by monthly payroll deductions or other means.

Colorado Lottery
Notes to Financial Statements
June 30, 2005 and 2004

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 September 10, 2028.

Specified prize payments	\$ 544,588,288
Lifetime prize payments	<u>44,115,000</u>
 Total guaranteed minimum prize payments	 <u>\$ 588,703,288</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.

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

Colorado Lottery

Notes to Financial Statements

June 30, 2005 and 2004

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.

A new chapter for employee benefits began on July 1, 2005. The State returned to self-funding through a relationship with a new vendor, Great-West Healthcare, and an existing vendor, Delta Dental. The State also moved the benefits cycle to the fiscal year to better align with the State's budgetary process. The new plan year will be from July 1 through June 30. Payment of premiums is still a shared expense between the State, whose contribution is set by statute, and the employee.

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% 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, 2005 and 2004

Gaming Operations Commitments – The Lottery has entered into long-term contracts with certain significant vendors related to providing scratch tickets and on-line data processing services in support of the Lottery’s gaming operations. The on-line data processing contract expired October 31, 2004. The total amount to be paid on the on-line data contract was not to exceed \$51,800,000 over the period of the contract. The Lottery entered into a new on-line data processing contract with a new vendor on May 13, 2003. The initial contract period began on June 1, 2003 and will expire on October 31, 2012, per the contract amendment dated January 26, 2005. These contracts overlapped in order for the new vendor to set up the new system. Renewal options include one additional two-year period and two additional periods of ninety days for conversion and turnover purposes. The total cost of the initial contract period is not to exceed \$70,616,975. The scratch ticket contracts expired on June 30, 2004 with one annual renewal available on each contract. The renewal options were exercised extending the contracts through June 30, 2005. On May 16, 2005, the Lottery received approval to extend both of the scratch ticket contracts for a six-month period ending December 31, 2005 to complete the RFP process and execute new contracts. The total cost of both contracts for the extended contract period is \$1,950,000. Ticket rates are based upon ticket volume, physical size and design. The total costs of the contracts for the initial contract period plus the extension period shall not exceed \$15,745,184 and \$6,950,000 for the respective contracts.

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 MUSL 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, 2005 is \$3,910,000 and is based on a percentage of sales. The total amount of the prize reserves funded as of June 30, 2005 was \$3,910,000 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 was not to 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 was not to exceed \$8,500,000 in fiscal year 2003 and not to 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.

Colorado Lottery

Notes to Financial Statements

June 30, 2005 and 2004

Litigation – In fiscal year 2001, a plaintiff 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.

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 \$836,683 and \$985,613 for the fiscal years ended June 30, 2005 and 2004, respectively.

Supplementary Information

Colorado Lottery
Schedule of Revenue and Costs for Scratch and On-line Games
For the Fiscal Year Ended June 30, 2005
(With Comparative Totals for the Fiscal Year Ended June 30, 2004)

	Games in Progress				Fiscal Year 2005	Fiscal Year 2004
	Scratch	Lotto	Powerball	Cash 5	Total	Scratch and On-line
Gross ticket sales	\$ 282,735,729	\$ 38,266,117	\$ 80,912,668	\$ 15,052,268	\$ 416,966,782	\$ 401,250,971
Prize expense	(184,675,937)	(19,194,938)	(36,659,174)	(8,279,592)	(248,809,641)	(238,427,919)
Powerball prize variance	—	—	(693,010)	—	(693,010)	1,824,959
Net revenue after prizes	98,059,792	19,071,179	43,560,484	6,772,676	167,464,131	164,648,011
Commissions, bonuses, ticket costs and vendor fees						
Retailer commission	(19,759,638)	(2,287,161)	(4,854,855)	(903,114)	(27,804,768)	(26,620,204)
Retailer bonus	(2,949,619)	(248,721)	(530,834)	(141,025)	(3,870,199)	(3,635,047)
Cost of tickets sold	(3,174,878)	—	—	—	(3,174,878)	(2,987,133)
In-lane vendor fees	—	—	—	—	—	(34,078)
On-line vendor fees	(1,640,725)	(1,532,276)	(2,950,689)	(607,493)	(6,731,183)	(6,632,805)
Total	(27,524,860)	(4,068,158)	(8,336,378)	(1,651,632)	(41,581,028)	(39,909,267)
Gross profit on sale of tickets	\$ 70,534,932	\$ 15,003,021	\$ 35,224,106	\$ 5,121,044	\$ 125,883,103	\$ 124,738,744
Average daily ticket sales	\$ 774,618	\$ 104,839	\$ 221,679	\$ 41,239	\$ 1,142,375	\$ 1,096,315

Colorado Lottery
Schedule of Percent of Prize Expense to Gross Ticket Sales
For the Fiscal Year Ended June 30, 2005

	<u>Games in Progress</u>				Powerball Prize Variance	Subtotal	Coupons/Free Plays	Fiscal Year 2005 Total
	Scratch	Lotto	Powerball	Cash 5				
Prize expense	\$ 184,675,937	\$ 19,194,938	\$ 36,659,174	\$ 8,279,592	\$ 693,010	\$ 249,502,651	\$ (384)	\$ 249,502,267
Ticket sales before coupons	<u>282,735,729</u>	<u>38,266,177</u>	<u>80,912,668</u>	<u>15,052,268</u>	<u>—</u>	<u>416,966,842</u>	<u>(640)</u>	<u>416,966,202</u>
Prize %	<u>65.32%</u>	<u>50.16%</u>	<u>45.31%</u>	<u>55.01%</u>			<u>60.00%</u>	<u>59.84%</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, 2005

	Fiscal Year 2005 Original Budget	Supplementals Pots Allocations and Internal Transfers	Fiscal Year 2005 Final Budget	Fiscal Year 2005 Actual Expenditures	Under Expended	Percent Under Expended
Personal services	\$ 7,983,034	\$ 80,070	\$ 8,063,104	\$ 7,456,970	\$ 606,134	7.52%
Operating	1,594,794	(62,748)	1,532,046	1,525,623	6,423	0.42
Vehicle lease payments	163,666	(37,880)	125,786	124,131	1,655	1.32
Purchase of Services –						
Computer Center	8,898	(4,010)	4,888	4,864	24	0.49
Communications services	—	1,560	1,560	1,560	—	0.00
Telecommunications	132,471	84,338	216,809	176,203	40,606	18.73
MNT payments	—	218,440	218,440	218,440	—	0.00
Payments to other agencies	340,488	—	340,488	193,028	147,460	43.31
Legal services	40,944	—	40,944	22,941	18,003	43.97
Workers' compensation	—	98,540	98,540	98,540	—	0.00
Unemployment benefits	—	1,967	1,967	—	1,967	100.00
Health and life	—	302,095	302,095	286,305	15,790	5.23
Short-term disability	—	10,759	10,759	9,215	1,544	14.35
Leased space	797,239	—	797,239	787,492	9,747	1.22
Grand Junction –						
leased space	4,557	2,080	6,637	6,637	—	0.00
Risk management	—	18,686	18,686	18,686	—	0.00
Travel expenses	119,941	(6,443)	113,498	80,543	32,955	29.04
Marketing and						
communications	9,097,225	(453,805)	8,643,420	8,559,774	83,646	0.97
Indirect costs	309,814	—	309,814	309,814	—	0.00
Ticket costs	3,991,040	(286,990)	3,704,050	3,174,873	529,177	14.29
Vendor fees	7,886,689	318,840	8,205,529	7,641,575	563,954	6.87
Prizes	280,095,384	—	280,095,384	248,809,641	31,285,743	11.17
Powerball prize variance	4,610,000	—	4,610,000	4,389,286	220,714	4.79
Retailer compensation	35,566,840	—	35,566,840	31,674,971	3,891,869	10.94
Computer migration	1,088,931	365,000	1,453,931	1,278,363	175,568	12.08
Multi-State Lottery fees	177,433	—	177,433	172,519	4,914	2.77
Total	\$354,009,388	\$ 650,499	\$354,659,887	\$ 317,021,994	\$ 37,637,893	10.61%

Fiscal year 2005 staffing
(FTE) 126.00 (Appropriated) 116.2 (Actual)

*Certain amounts may not tie due to rounding.

Colorado Lottery
Budgetary Comparison (continued)
For the Fiscal Year Ended June 30, 2005

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	\$ 248,809,641
Powerball prize variance	693,010
Commissions and bonuses	31,674,967
Cost of tickets and vendor fees	9,906,061
Other operating expenses	<u>22,523,792</u>
Total operating expenses per statement of revenues, expenses and changes in fund net assets	313,607,471
Plus Powerball variance classified as revenue	3,696,276
Less: Non-appropriated expenses	
Depreciation	(193,227)
Accrued annual and sick leave	(121,205)
Book value of assets written-off	<u>(141,945)</u>
	<u>316,847,370</u>
Plus capitalized fixed assets	<u>174,624</u>
	<u>\$ 317,021,994</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 Lottery as of and for the year ended June 30, 2005, and have issued our report thereon dated August 16, 2005. 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 16, 2005



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, 2005, 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 30, 2005.

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.

/s/ **BKD, LLP**

Colorado Springs, Colorado
August 16, 2005

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