

**COLORADO LOTTERY**  
**FINANCIAL AND COMPLIANCE AUDIT**  
**June 30, 2008 and 2007**

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***Clifton Gunderson LLP***  
**Contract Auditors**



**Members of the Legislative Audit Committee:**

We have completed the financial statement audit of the Colorado Lottery as of and for the year ended June 30, 2008. Our audit was conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. The basic financial statements of the Colorado Lottery as of and for the year ended June 30, 2007, were audited by other auditors whose report dated September 4, 2007, expressed an unqualified opinion on those statements.

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.

*Clifton Gunderson LLP*

Greenwood Village, Colorado  
September 8, 2008

## Table of Contents

	Page
<b>Contents</b>	
<b>Report Summary .....</b>	<b>1</b>
<b>Recommendation Locator .....</b>	<b>4</b>
<b>Background .....</b>	<b>5</b>
<b>Auditors' Findings and Recommendations .....</b>	<b>6</b>
<b>Disposition of Prior Year Audit Recommendations .....</b>	<b>12</b>
<b>Independent Auditor's Report on Financial Statements and Supplementary Information .....</b>	<b>13</b>
<b>Management's Discussion and Analysis .....</b>	<b>15</b>
<b>Basic Financial Statements</b>	
Statements of Net Assets .....	26
Statements of Revenues, Expenses and Changes in Net Assets .....	28
Statements of Cash Flows .....	30
Fiduciary Fund Statements	
Statement of Fiduciary Net Assets .....	32
Statement of Changes in Fiduciary Net Assets .....	33
Notes to Financial Statements .....	34
<b>Supplementary Information</b>	
Schedule of Revenue and Costs for Scratch and On-line Games .....	56
Schedule of Percent of Prize Expense to Gross Ticket Sales .....	57
Budgetary Comparison .....	58
<b>Independent Auditor's Report on Compliance and Internal Control Over Financial Reporting Based on the Audit of Financial Statements in Accordance with Government Auditing Standards .....</b>	<b>60</b>
<b>Independent Auditor's Communication to Legislative Audit Committee .....</b>	<b>62</b>
<b>Audit Report Distribution Information .....</b>	<b>64</b>

**COLORADO LOTTERY  
REPORT SUMMARY  
Years Ended June 30, 2008 and 2007**

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**Purposes and Scope of Audit**

***Authority, Purpose and Scope***

The Office of the State Auditor, State of Colorado, engaged Clifton Gunderson LLP to conduct the financial audit of the Colorado Lottery for the fiscal year ended June 30, 2008. 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, 2008.

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

The purposes and scope of this audit were:

- To express an opinion on the financial statements of the Lottery as of and for the year ended June 30, 2008, 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, 2008.
- 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 has contracted with Scientific-Games, Inc., (SGI or Scientific-Games) for on-line games and related accounting services, and converted to the new system in May 2005. Under the terms of the Lottery's contract with SGI, the contractor was required to provide a number of reports that would enable the Lottery to perform various reconciliations. However, since the conversion, the Lottery has had to manually reconcile some of the daily system balancing reports because SGI has not been able to provide these reports. In the current year, the Lottery did not have the required reports from SGI related to retailer billing or tax reporting.
- The Lottery places significant reliance on both its internal system (WANG) and the third-party information system. To reduce the risk of errors in both systems, the Lottery should have annual SAS 70 type II reviews performed.

- The Lottery contracted with Cactus Marketing Communications (Cactus) to provide marketing services. Under the terms of the contract a Colorado Lottery fiscal representative may conduct quarterly audits of the invoices and related charges. To minimize risks related to inaccurate billings, the Lottery should conduct quarterly audits of the marketing charges that are allowed under the contract.
- The Lottery bids out annuity contracts for Grand Prize winners to qualified insurance companies on a regular basis. The Lottery has identified requirements that insurance companies must meet in order to bid on the annuity contracts. If the annuity holder was to default, the Lottery would be responsible for continuing the specified payments. As of June 30, 2008, 6 out of the 14 companies holding annuities for the Lottery are not in compliance with their qualification policy. The Lottery should further scrutinize the financial status of these companies, consider possible adjustments to or disclosures in the financial statements, and review and revise its qualification policy to include reinsurance for current and future annuity contracts.

**COLORADO LOTTERY  
REPORT SUMMARY  
Years Ended June 30, 2008 and 2007**

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

**Audit Opinions and Reports**

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

**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, 2008. This communication is located on page 62.

**Summary of Progress in Implementing Prior Year Audit Recommendations**

The audit report for the year ended June 30, 2007, contained two recommendations for fiscal year 2007. Of the 2007 recommendations one was partially implemented and the other was not implemented. The Disposition of Prior Year Audit Recommendations begins on page 12.

**COLORADO LOTTERY  
RECOMMENDATION LOCATOR  
Years Ended June 30, 2008 and 2007**

Recommendation Number	Page Number	Recommendation Summary	Response	Implementation Date
1	6	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.	Agree	June 30, 2009
2	8	The Lottery should have an annual SAS 70 Type II examination performed on both its internal information system and on the system of its vendor, Scientific-Games for at least a nine month period beginning July 1 of each year.	Partially agree	June 2009 and June 2010
3	9	The Lottery should perform quarterly audits on invoices from Cactus Communications to ensure they are accurate and proper.	Agree	November 2008
4	11	The Lottery should further scrutinize the financial status of noncompliant annuity contract holders, consider the impact to the financial statements and review and revise its policy to include reinsurance for current and future annuity contracts.	Partially Agree	June 2009



**COLORADO LOTTERY**  
**BACKGROUND**  
**Years Ended June 30, 2008 and 2007**

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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 2008, the Lottery employed 119 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. As of fiscal year 2008, these spill-over funds shall be transferred to the Lottery Proceeds Contingency Reserve Fund. Prior to 2002, spill-over funds were distributed to the State General Fund.

**COLORADO LOTTERY**  
**AUDITORS' FINDINGS AND RECOMMENDATIONS**  
**Years Ended June 30, 2008 and 2007**

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**System Balancing Reports**

The Lottery converted to a new vendor, Scientific-Games, Inc., for its on-line games on May 2, 2005. For the audit for fiscal year 2003, the auditors 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.

The Lottery contracted with a firm to perform an independent test of the new system. The evaluation 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. In its report, the firm found that some reports required for reconciling the on-line system and the Lottery's internal system, which were specified as deliverables by the Lottery in its contract with the new on-line vendor, were not being produced. In addition, other reports did not balance to the corresponding information in the Lottery's system. Therefore, in the audits for fiscal years 2005, 2006 and 2007, it was recommended that the Lottery work with Scientific-Games to ensure that all reports required as part of the contract are provided and that all reports are accurate and complete.

During the audit for fiscal year 2006, the auditors found that 17 system balancing reports were still unavailable to the Lottery. During the audit for fiscal year 2007, the auditors found that much of this reporting had improved, however, reporting for two systems, the retailer billing and tax reporting, were still lacking. For fiscal year 2008, it was found again that reporting for two systems, the retailer billing and tax reporting, were still lacking.

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. These two systems (WANG and Scientific-Games) process critical and time sensitive data which include, but are not limited to, billing to retailers, scratch inventory and tax reporting. As long as the Lottery must rely on manual balancing systems and an interface of transaction activity between Scientific-Games and the WANG systems, a risk of the loss of data integrity or corruption will always be present. 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. 1**

The 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**

As a result of Department of Revenue executive management directive, the Lottery contracted with North Highland to provide an analysis of the Lottery's back office system and recommended solutions for migrating of systems currently residing on the Wang, including the retailer billing and tax reporting systems. After the completion of the North Highland report, the Lottery contracted with Technical and Business Consulting (TBC) to provide a business process review and improvement analysis recommended by North Highland. TBC was asked to provide

**COLORADO LOTTERY**  
**AUDITORS' FINDINGS AND RECOMMENDATIONS**  
**Years Ended June 30, 2008 and 2007**

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a business process review of the Lottery's operations and develop the system requirements for replacement of the Wang-based back office system. TBC delivered their final report in June 2008. This report included an action plan for the migration of the Wang legacy system, and included a plan to move the retailer billing and tax reporting systems to the new Lottery back office system. During implementation of the systems, the Lottery will work to obtain all required reports and 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 2009

**Independent Reviews of Information Systems**

The Lottery reporting system places significant reliance on both internal and third-party information systems used to process data and transactions. During the fiscal year 2003-2007 audits, the auditors recommended that the Lottery have an annual independent examination (commonly referred to as a SAS 70 review) performed of the WANG internal information system used to record and track ticket sales. During the audit in 2005, the Lottery stated that it would reassess the need for an independent review if the planned migration of the WANG system to on-line Scientific-Games, which was to occur in September of 2006, was implemented as planned. As of June 30, 2008, the full migration had not occurred. The Lottery is planning on completing the full migration from its WANG system to a new platform during fiscal year 2009.

As of the end of our fiscal year 2008 audit, tax reporting, retailer billing and sales reporting were still tracked on the WANG system. With the conversion of the on-line games to the new system in the May 2005, the new vendor, Scientific-Games, became responsible for maintaining the transaction data received from the retailers and then transmitting this information into the Lottery's internal WANG system. The WANG system then records the revenue and tracks and records the accounts receivable information and transmits this information to the State's accounting system. With the current reporting system, it continues to be critical that the Lottery seek an independent review of the WANG system.

In fiscal years 2008 and 2007, the Lottery had gross ticket sales of approximately \$506,000,000 and \$456,000,000, respectively. Because of the large number of transactions, high volume of activity and the fact that Scientific-Games maintains and transmits transaction data to the WANG system, the Lottery continues to have significant reliance on and risk associated with the operations of both the WANG system and the system used by Scientific-Games.

The information that is recorded in these systems is critical to the information reported on the Lottery's financial statements and the internal controls of the Lottery's operations. Through an independent examination, controls are evaluated and tested 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. Third-party independent audits can be a mechanism to help identify weaknesses in the software and the internal control system internally within the Lottery's system and with the third-party vendor, Scientific-Games.

**COLORADO LOTTERY**  
**AUDITORS' FINDINGS AND RECOMMENDATIONS**  
**Years Ended June 30, 2008 and 2007**

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In February 2008, a SAS 70 type II review was performed on the Scientific-Games system covering the period from September 1, 2007 through February 29, 2008. Even though the SAS 70 type II review was performed on the Scientific-Games system as recommended in prior years, we believe that the Lottery should have the SAS 70 type II audit performed for the period of July 1, 2008, the beginning of the Lottery fiscal year, through March 31, 2009, and annually thereafter. When a report covers only a portion of the year it is necessary to obtain a bridging letter from the service provider for the period not covered in the SAS 70 report. In the case of the Scientific-Games SAS 70 report this required an update for a period prior to the SAS 70 and after the SAS 70 was issued. This update and evaluation of the internal control over the service provider prior to the issuance of the SAS 70 could be avoided if the SAS 70 was initiated at the beginning of the Lottery's fiscal year.

***Recommendation No. 2***

The Lottery should minimize risks related to information system controls, 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, and
- b) initiating a SAS 70 type II audit on the Scientific-Games system at the beginning of the Lottery fiscal year and covering at least the first three quarters of the Lottery's fiscal year.

***Colorado Lottery Response: Partially Agree***

The Lottery agrees to require an annual examination of the controls in place at the third-party vendor in fiscal year 2009, and will once again require a SAS 70 review of the on-line vendor performed for a nine month period for all years, thereafter. The Lottery also agrees with performing an annual independent examination of the internal system used to record and track ticket sales; however, the Lottery will defer the implementation and related costs since the systems that currently process ticket sales transactions on the internal system (Wang) will be migrated to a new back office system. Based on the timing of the migration of the retailer billing and tax reporting systems and the availability of funding, the Lottery will reassess the need for an annual independent examination of the internal system after the migration is complete and the new system is stable.

Implementation Date: SAS 70 Audit of 7/1/08-3/31/09 Scientific-Games – June 2009  
Independent Examination of Internal System – June 2010

**COLORADO LOTTERY**  
**AUDITORS' FINDINGS AND RECOMMENDATIONS**  
**Years Ended June 30, 2008 and 2007**

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**Compliance with Cactus Marketing Communications Contract**

During Fiscal Year 2008 the Lottery contracted Cactus Marketing Communications (Cactus) to provide the Lottery with advertising, marketing and public relations services from September 1, 2007 through June 30, 2010. The contract authorized up to \$7,500,000 for services to be paid to Cactus during fiscal year 2008 and up to \$25,100,000 over the life of the contract. This represents approximately one-third of the Lottery's non-game related annual operating budget. Cactus bills the Lottery by identifying the project and total amount due for each project. The invoices Lottery receives do not contain full support for the charges incurred by Cactus. The contract allows a Colorado Lottery Fiscal representative to conduct quarterly audits of the invoices and related charges.

As of August, 2008, the Lottery had yet to conduct an audit of the invoices and related charges submitted for payment by Cactus. As this is a large contract and represents nearly one-third of all non-gaming related operating expenses, it is critical that the Lottery ensure that invoices from Cactus are accurate and contain only charges that are consistent with the approved contract.

***Recommendation No. 3***

The Colorado Lottery should minimize risks related to inaccurate billings from Cactus Marketing Communications by performing quarterly audits of invoices and related charges as allowed under the contract with Cactus.

***Colorado Lottery Response: Agree***

The Lottery will perform quarterly audits of invoices and related charges as allowed under the contract with Cactus Marketing Communications.

Implementation Date: First Quarter Audit 7/1/08-9/30/08 - November 2008

**Annual Review of Annuity Holders**

When the Colorado Lottery began in 1982, the only payout option available to Grand Prize lottery winners was through annuities. The Lottery introduced the cash payout option for Lotto and scratch ticket games prize winners as an alternative to the annuity option. The cash payout option has grown increasingly popular among Lottery winners and is the preferred method of payout for the majority of the Lottery winners. At the end of fiscal year 2008 there were 289 annuities being paid, for a total of \$489,029,430 outstanding future guaranteed minimum prize payments. The Lottery purchases the annuities from qualified insurance companies and the insurance companies handle the administrative function of the annuity contracts. The Lottery does not carry the liability of the future payment on its books since the annuities become the responsibility of the insurance companies. However, in each of the annuity contracts issued, the Lottery remains responsible for the payment if the insurance companies issuing the annuity

**COLORADO LOTTERY**  
**AUDITORS' FINDINGS AND RECOMMENDATIONS**  
**Years Ended June 30, 2008 and 2007**

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contract defaults. In order to mitigate this risk, the Lottery established a qualification policy with requirements for insurance companies that hold annuities for the Lottery. The companies must meet the following requirements:

- Three of the four major ratings within the following guidelines:
  - An A++, A+ rating from A.M. Best is required and counts as one of the three required ratings.
  - Ratings within the following guidelines with two of the three major rating agencies:
    - Fitch Ratings: AAA, AA+, AA
    - Moody's Ratings: Aaa, Aa1, Aa2
    - S& P ratings: AAA, AA+, AA
- An A.M. Best Financial Size Category (FSC) of VIII or above. A company with an FSC VIII has \$100,000,000 to \$250,000,000 in reported policyholders' surplus conditional reserve funds.
- A risk-based capital (RBC) ratio of 125 or above.
- A minimum of 5 years experience.

During our fiscal year 2008 audit, during the Lottery's annual review of their annuity holders it was noted that 6 out of the 14 insurance companies holding annuity contracts worth \$81,622,812 for the Lottery are not in compliance with the qualification policy. Although it is the Lottery's policy to no longer use the non-compliant companies for future annuity contracts, it does not discontinue the use of the insurance company if it subsequently fails to meet the requirements of the qualification policy. In these cases, the risk is heightened for the annuities held by the subsequently non-complaint companies that the Lottery would be required to fund the prize payments in the event the insurance company defaults on the annuity contract. In addition, we noted during the audit that some companies merged with other insurance companies, specifically First Colony Life Insurance merged into Genworth Life Insurance Company. The Lottery's review, however, did not consider the merge of these companies. When situations like this arise, Lottery should monitor the new organizational structure and reanalyze the qualification status based on the new organization. Due to these risks, we recommend that the Lottery perform annual reviews of annuity holders, as required by its qualification policy. For those that are found to be in non-compliance, the Lottery should scrutinize these companies' financial status, and determine if further action is needed.

**COLORADO LOTTERY**  
**AUDITORS' FINDINGS AND RECOMMENDATIONS**  
**Years Ended June 30, 2008 and 2007**

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**Recommendation No. 4**

The Colorado Lottery should minimize risks of default by insurance companies holding its annuities by:

- a) Annually monitoring the financial status of insurance companies holding the Lottery's annuities against the Lottery policy requirements.
- b) Evaluating possible adjustments or disclosures to the Lottery's financial statements annually as a result of this analytical review.
- c) Reviewing and revising the qualification policy to address action needed for non-compliant insurance companies. This policy should include the possibility of requiring non-compliant insurance companies to obtain reinsurance of annuities.
- d) For future annuity contracts, include measures to protect the State from liability, such as requiring the insurance companies to maintain reinsurance on all annuity contracts with the Lottery.

***Colorado Lottery Response: Partially Agree***

- a) The Lottery will continue to perform the annual review of insurance companies holding the Lottery's annuities which monitors the financial status of those companies against the Lottery requirements.
- b) For those annuity holders found not to be in compliance with the Lottery policy, the Lottery will scrutinize these companies' financial status and determine if further action is needed and will evaluate whether possible adjustments or disclosures to financial statements are warranted.
- c) The Lottery will also review the qualification policy to determine when action is needed in cases where an insurance company becomes non-compliant. At present, it is unknown whether the Lottery can require insurance companies with outstanding Lottery annuity contracts to acquire reinsurance. If it is possible, the Lottery will make reinsurance a requirement in these contracts if the additional cost is reasonable.
- d) The Lottery also agrees to explore requirement insurance companies to maintain reinsurance on future annuity contracts if it is not cost prohibitive and if insurance companies are willing to bid on Lottery annuities that would include this new requirement.

Implementation Date: June 2009

**COLORADO LOTTERY  
DISPOSITION OF PRIOR YEAR AUDIT RECOMMENDATIONS  
Year Ended June 30, 2008**

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**Fiscal Year 2007 Recommendations**

<b>Number</b>	<b>Recommendation</b>	<b>Disposition</b>
1	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.	Not implemented, See Recommendation No. 1 in current report.
2	The Lottery should minimize risks related to information system controls, internal controls over financial processing and safeguarding of assets by performing an annual SAS 70 Type II examination on both its internal system used to record and track ticket sales and on the system of its vendor, Scientific-Games.	Partially implemented, See Recommendation No. 2 in current report.



## Independent Auditor's Report

Members of the Legislative Audit Committee

We have audited the accompanying financial statements of the major fund and remaining fund information of the Colorado Lottery, an enterprise fund and private purpose fund of the State of Colorado as of and for the year ended June 30, 2008, which collectively comprise the Colorado Lottery's basic financial statements as listed in the table of contents. These financial statements are the responsibility of Colorado Lottery's management. Our responsibility is to express opinions on these financial statements based on our audit. The basic financial statements of the Colorado Lottery as of June 30, 2007, were audited by other auditors whose report dated September 4, 2007, expressed an unqualified opinion on those basic financial statements.

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. 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 audit provides a reasonable basis for our opinions.

As discussed in Note 1 – Nature of Operations and Summary of Significant Accounting Policies, the financial statements of the Colorado Lottery are intended to present the financial position, results of operations and, where applicable, cash flows for only that portion of the financial reporting entity, State of Colorado, that is attributable to the transactions of the Colorado Lottery. They do not purport to, and do not present fairly, the financial position of the State of Colorado as of June 30, 2008 and 2007, and the changes in its financial position and its cash flows, where applicable, for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the major fund and remaining fund information of the Colorado Lottery as of June 30, 2008, and the respective changes in financial position and, where applicable, cash flows thereof for the year 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 September 8, 2008 on our consideration of the Colorado Lottery's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts 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 management's discussion and analysis on pages 15 through 25 are not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. 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.

Our audit was conducted for the purpose of forming opinions on the basic financial statements that collectively comprise the Colorado Lottery's basic financial statements. The accompanying supplementary information is presented for purposes of additional analysis and is not a required part of the financial statements. Such information for the year ended June 30, 2008 has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole. The Colorado Lottery's financial statements for the year ended June 30, 2007, which are not presented with the accompanying financial statements, were audited by other auditors whose report thereon dated September 4, 2007, expressed unqualified opinions on the respective financial statements of the major fund. Their report on the 2007 scratch and online total information stated that, in their opinion, such information was fairly stated in all material respects in relation to the basic financial statements for the year ended June 30, 2007, taken as a whole.

*Clifton Henderson LLP*

Greenwood Village, Colorado  
September 8, 2008

# Colorado Lottery

## Management's Discussion and Analysis

### Years Ended June 30, 2008 and 2007

This discussion and analysis of the Colorado Lottery's financial performance provides an overview of financial activities for the fiscal years ended June 30, 2008 and 2007. Please read it in conjunction with the Lottery's financial statements, which begin on page 26. These financial statements reflect only activities of the Colorado Lottery, a proprietary fund of the State of Colorado.

#### ***Financial Highlights***

- The Lottery's overall sales performance of \$505.8 million in fiscal year 2008 was the highest sales year in Lottery history. The record sales reflected a \$49.9 million increase from last year's sales of \$455.9 million and a \$37.0 million increase from fiscal year 2006 sales totaling \$468.8 million, the second largest overall sales performance. The overall increase in sales was mainly the result of an increase in scratch sales of \$38.9 million. The introduction of the \$20 scratch ticket plus an overall focus on managing the scratch product contributed to the increase. An \$8.0 million increase in Powerball sales from \$101.6 million in fiscal year 2007 to \$109.6 million in fiscal year 2008, also was a major contributing factor to the overall increase. Powerball sales are highly dependent on the size of the Powerball jackpots. In fiscal year 2008, the two highest jackpots reached heights of \$300 million and \$275 million. The highest Powerball jackpot attained in fiscal year 2007 was \$240 million. Powerball sales for fiscal year 2006 totaled \$119.8 million.

Fiscal year 2008 also saw an increase in sales from fiscal year 2007 for each of its other two products. Cash5 sales hit a record high in fiscal year 2008 with sales increasing by \$1.7 million from fiscal year 2007 and Lotto sales saw an increase of \$1.2 million from the prior fiscal year sales and were the highest sales since fiscal year 2004.

Scratch sales hit a record high for the fifth year in a row with scratch sales totaling \$336 million in fiscal year 2008. The second highest sales were in fiscal year 2007, with scratch sales totaling \$297.1 million. Fiscal year 2006 scratch sales totaling \$293.8 million ranks third in total scratch sales. Continuing marketing efforts, including offering a broader range of price points, innovative display cases, additional games and an overall upgrade to the look of our scratch tickets, contributed to this increase in scratch sales.

Lotto sales increased slightly in fiscal year 2008 from the prior two fiscal years with sales of \$41.1 million. Fiscal years 2007 and 2006 reflected Lotto sales of \$39.8 million and \$38.3 million, respectively.

Cash 5 sales for fiscal year 2008 showed another increase for the sixth year in a row and for the sixth year in a row produced record sales. Sales increased by 10.0 percent to a total of \$19.1 million from \$17.4 million in fiscal year 2007. This followed a 3.2 percent increase in sales in fiscal year 2007 from fiscal year 2006, whose sales totaled \$16.9 million.

# Colorado Lottery

## Management's Discussion and Analysis

### Years Ended June 30, 2008 and 2007

- Funds distributed or available for distribution from 2008 sales increased from fiscal year 2007 in conjunction with the overall increase in sales. Fiscal year 2008 produced a total of \$122.3 million in funds distributions, an increase of \$3.3 million from fiscal year 2007 distributions of \$119.0 million. The \$122.3 million in funds distributions for fiscal year 2008 represents the second highest year of distributions in the Lottery's history. Fiscal year 2006 had the highest year of funds distributions totaling \$125.6 million. Fiscal year 2008 included a spill-over of funds in excess of the GOCO cap. During the prior six fiscal years this spill-over was distributed into the State Public School Fund Contingency Reserve. Starting in fiscal year 2008; the spill-over, by statute, will be distributed to the Lottery Contingency Reserve Fund. The spill-over totaled \$8.0 million for fiscal year 2008. The spill-over amounts for fiscal years 2007 and 2006 were \$8.2 million and \$12.5 million, respectively. The spill-over for fiscal year 2008 was the fourth largest one-year spill-over since the first spill-over occurred in fiscal year 2002. 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 seven year period totals \$45.1 million.
  
- Gross profit as a percent of sales decreased by 1.9 percent, a reflection of the 1.6 percent increase in prize expense as a percentage of sales of 60.7 percent to 62.3 percent for the fiscal years ended June 30, 2007 and 2008, respectively. The increase was the result of offering a larger number of higher price point scratch games including the introduction of the first \$20 price point scratch games, which by design carry a higher prize percentage payout. In addition, the overall prize expense percentage for the on-line games increased slightly from 48.6 percent to 49.5 percent for the fiscal years ended June 30, 2007 and 2008, respectively. Another contributing factor to the 1.9 percent decrease in gross profit as a percent of sales was a .2 percent increase as a percentage of sales in commissions and bonuses paid to our retailers to sell and promote our products. Commissions and bonuses as a percentage of sales were 7.6 percent and 7.4 percent for the fiscal years ended June 30, 2008 and 2007, respectively. The remaining .1 percent decrease in gross profit can be attributed to an increase in vendor fees due to an increase in the billing rate in November 2007 from 1.458 percent to 1.718 percent of sales. Vendor fees totaled \$5,957,142 and \$7,394,112 for fiscal years ended June 30, 2007 and June 30, 2008, respectively. Unclaimed prizes increased by more than \$500,000 from fiscal year 2007 to fiscal year 2008. An increase in overall sales leads to more prizes won; thus more prizes went unclaimed. Gross profit as a percent of sales decreased by .4 percent between fiscal years 2006 and 2007, a reflection of the increase in prize expense of .6 percent. The .6 percent increase in prize expense was offset by a reduction in vendor fees as a result of a reduction in the billing rate from 1.713 percent to 1.458 percent of sales in June 2006. This reduction lowered vendor fees from \$6,819,796 in fiscal year 2006 to \$5,957,142 in fiscal year 2007.

# **Colorado Lottery**

## **Management's Discussion and Analysis**

### **Years Ended June 30, 2008 and 2007**

#### ***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, \$10 and \$20) at any Lottery retailer. When scratched, they provide immediate knowledge if the ticket is a winner and can be cashed immediately at the retailer level if the amount of the winnings is \$599 or less. Prizes over \$600 must be redeemed at the Lottery offices.

On-line games, however, require a longer playing time. Tickets are also purchased at the Lottery retailers and are printed on ticket stock as the purchase is made. Each ticket contains one or 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 the 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, 2008 and 2007. The statement of revenues, expenses and changes in net assets reports the activity of selling the Lottery products and the expenses related to such activity for the years ended June 30, 2008 and 2007. Finally, the statement of cash flows outlines the cash inflows and outflows related to the activity of selling the Lottery products for the years ended June 30, 2008 and 2007.

#### ***Statements of Net Assets***

The statements of net assets presents a financial snapshot of the Lottery at June 30, 2008, and 2007. 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**  
**Years Ended June 30, 2008 and 2007**

**Condensed Statements of Net Assets**  
**June 30, 2008, 2007 and 2006**

	<b>2008</b>	<b>2007</b>	<b>2006</b>
<b>Assets</b>			
Current assets	\$ 50,368,307	\$ 52,318,926	\$ 45,946,060
Restricted assets	5,687,849	5,822,526	5,706,844
Capital assets	498,156	696,916	754,051
Total assets	\$ 56,554,312	\$ 58,838,368	\$ 52,406,955
<b>Liabilities</b>			
Current liabilities	\$ 53,249,984	\$ 55,507,616	\$ 49,104,926
Long-term liabilities	913,886	906,065	947,001
Total liabilities	\$ 54,163,870	\$ 56,413,681	\$ 50,051,927
<b>Net Assets</b>			
Investment in capital assets	\$ 498,156	\$ 696,916	\$ 754,051
Restricted – Licensed Agent			
Recovery Reserve	443,139	426,058	398,064
Unrestricted – Operating Reserve	1,300,000	1,500,000	1,600,000
Unrestricted	149,147	(198,287)	(397,087)
Total net assets	\$ 2,390,442	\$ 2,424,687	\$ 2,355,028

The Lottery's total assets at June 30, 2008 were \$56.6 million. Assets consisted primarily of cash and investments with the State Treasury of \$32.3 million, Prepaid Prize Expense with Multi-State Lottery (MUSL) of \$3.9 million, receivables from Lottery retailers for the sale of Lottery products of \$18.8 million and a net investment in fixed assets of \$.5 million.

Comparable figures at June 30, 2007 were \$58.8 million in total assets, including \$35.2 million in cash and investments with the State Treasury, Prepaid Prize Expense with MUSL of \$3.9 million, receivable from retailers of \$18.3 million and a net investment in fixed assets of \$.7 million.

Comparable figures at June 30, 2006 were \$52.4 million in total assets, including \$31.2 million in cash and investments with the State Treasury, Prepaid Prize Expense with MUSL of \$3.7 million, receivable from retailers of \$15.8 million and a net investment in fixed assets of \$.8 million.

The Lottery's total liabilities at June 30, 2008 totaled approximately \$54.2 million, consisting primarily of proceeds distributions due to recipients of \$27.2 million and prize liability on all the Lottery products of about \$21.6 million.

The Lottery's total liabilities at June 30, 2007 totaled approximately \$56.4 million, which consisted primarily of proceeds distributions due of \$28.7 million and prize liability on all the Lottery products of about \$23.6 million.

## Colorado Lottery

### Management's Discussion and Analysis

#### Years Ended June 30, 2008 and 2007

The Lottery's total liabilities at June 30, 2006 totaled \$50.1 million, which consisted primarily of proceeds distributions due of \$28.8 million and prize liability on all the Lottery products of about \$17.1 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 04-204 (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, 2007 to June 30, 2008 consisted of a decrease in investment in capital assets from \$.7 million to \$.5 million, an increase in the bonding reserve from \$426,058 to \$443,139, a decrease in the operating reserve from \$1.5 million to \$1.3 million and a net increase in unrealized gain and losses on investments of \$347,434 resulting from a net increase in the market value adjustments on State Treasury investments.

Following is a schedule of net assets for fiscal years 2008 and 2007:

	<b>2008</b>	<b>2007</b>	<b>Change</b>
Investment in capital assets	\$ 498,156	\$ 696,916	\$ (198,760)
Bonding reserve	443,139	426,058	17,081
Operating reserve	1,300,000	1,500,000	(200,000)
Unrealized gain (loss) on investments	<u>149,147</u>	<u>(198,287)</u>	<u>347,434</u>
Total net assets	<u>\$ 2,390,442</u>	<u>\$ 2,424,687</u>	<u>\$ (34,245)</u>

The change in net assets from June 30, 2006 to June 30, 2007 consisted of a decrease in investment in capital assets from \$.8 million to \$.7 million, an increase in the bonding reserve from \$398,064 to \$426,058, a decrease in the operating reserve from \$1.6 million to \$1.5 million and a net increase in unrealized gain and losses on investments of \$198,800 resulting from a net increase in the market value on State Treasury investments.

Following is a schedule of net assets for fiscal years 2007 and 2006:

	<b>2007</b>	<b>2006</b>	<b>Change</b>
Investment in capital assets	\$ 696,916	\$ 754,051	\$ (57,135)
Bonding reserve	426,058	398,064	27,994
Operating reserve	1,500,000	1,600,000	(100,000)
Unrealized gain (loss) on investments	<u>(198,287)</u>	<u>(397,087)</u>	<u>198,800</u>
Total net assets	<u>\$ 2,424,687</u>	<u>\$ 2,355,028</u>	<u>\$ 69,659</u>

**Colorado Lottery**  
**Management's Discussion and Analysis**  
**Years Ended June 30, 2008 and 2007**

***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, 2008, 2007 and 2006**

	<b>2008</b>	<b>2007</b>	<b>2006</b>
<b>Operating Revenues</b>	\$ 505,814,066	\$ 455,916,812	\$ 468,761,808
<b>Direct Operating Expenses</b>	<u>363,280,175</u>	<u>318,684,531</u>	<u>325,992,891</u>
<b>Gross Profit on Sale of Tickets</b>	<u>142,533,891</u>	<u>137,232,281</u>	<u>142,768,917</u>
<b>Other Operating Expenses</b>			
Marketing and communications	8,892,973	8,886,036	8,893,150
Wages and benefits	8,841,445	8,603,295	8,195,004
Other operating expenses	<u>5,327,843</u>	<u>3,512,986</u>	<u>3,624,150</u>
Total other operating expenses	<u>23,062,261</u>	<u>21,002,317</u>	<u>20,712,304</u>
<b>Operating Income</b>	<u>119,471,630</u>	<u>116,229,964</u>	<u>122,056,613</u>
<b>Nonoperating Revenues (Expenses)</b>			
Other revenue	428,513	665,162	1,761,259
Investment income	2,365,744	2,169,983	1,118,781
Proceeds distributions	<u>(122,300,132)</u>	<u>(118,995,450)</u>	<u>(125,551,100)</u>
Total nonoperating expenses	<u>(119,505,875)</u>	<u>(116,160,305)</u>	<u>(122,671,060)</u>
<b>Increase (Decrease) in Net Assets</b>	(34,245)	69,659	(614,447)
<b>Net Assets, Beginning of Year</b>	<u>2,424,687</u>	<u>2,355,028</u>	<u>2,969,475</u>
<b>Net Assets, End of Year</b>	<u>\$ 2,390,442</u>	<u>\$ 2,424,687</u>	<u>\$ 2,355,028</u>



# Colorado Lottery

## Management's Discussion and Analysis

### Years Ended June 30, 2008 and 2007

#### Sales Activities

Revenues from the sale of the Lottery products for the fiscal year ended June 30, 2008 were the highest in the Lottery's 26-year history. As shown in the financial statements, overall sales increased by 10.9 percent from the prior year, from \$455.9 million in fiscal year ended June 30, 2007 to \$505.8 million in the current year. Current year sales represented an increase of 7.9 percent or \$37 million from fiscal year 2006 sales of \$468.8 million. The increase in scratch sales from \$297.1 million in fiscal year 2007 to \$336 million in fiscal year 2008 represented a percentage increase of 13.1 percent. Scratch sales had also increased in fiscal year 2007 from fiscal year 2006 by \$3.3 million. Fiscal year 2006 scratch sales totaled \$293.8 million. Powerball sales increased from \$101.6 million in fiscal year 2007 to \$109.6 million in the current fiscal year, which represented a percentage increase from last year's sales of 7.9 percent. Powerball sales in fiscal year 2006 were \$119.8 million. Lotto sales grew slightly in the current fiscal year to \$41.1 million, an increase of \$1.2 million or 3.1 percent over the prior fiscal year. This was the second year since the start up of Powerball that Lotto sales experienced an increase in sales. In fiscal year 2007 and fiscal year 2006, Lotto sales totaled \$39.8 million and \$38.3 million, respectively. Cash 5 sales again experienced an increase from \$17.4 million in fiscal year 2007 to \$19.1 million in the current fiscal year, which represents nearly a 10 percent increase.

The following tables compare Lottery product sales between fiscal years.

Product Sales	2008	2007	Difference	Change
Scratch	\$ 336,038,899	\$ 297,112,493	\$ 38,926,406	13.1%
Powerball	109,562,516	101,561,395	8,001,121	7.9
Lotto	41,064,087	39,835,761	1,228,326	3.1
Cash 5	<u>19,148,564</u>	<u>17,407,163</u>	<u>1,741,401</u>	<u>10.0</u>
Total	<u>\$505,814,066</u>	<u>\$455,916,812</u>	<u>\$49,897,254</u>	<u>10.9%</u>

Product Sales	2007	2006	Difference	Change
Scratch	\$ 297,112,493	\$ 293,812,628	\$ 3,299,865	1.1%
Powerball	101,561,395	119,757,642	(18,196,247)	(15.2)
Lotto	39,835,761	38,332,996	1,502,765	3.9
Cash 5	<u>17,407,163</u>	<u>16,858,542</u>	<u>548,621</u>	<u>3.3</u>
Total	<u>\$455,916,812</u>	<u>\$468,761,808</u>	<u>\$(12,844,996)</u>	<u>(2.7)%</u>

# Colorado Lottery

## Management's Discussion and Analysis

### Years Ended June 30, 2008 and 2007

#### **Total Revenues**

Nonoperating revenues for the years ended June 30, 2008 and June 30, 2007 both totaled \$2.8 million, although the factors contributing to the totals differed. First, interest received from the treasury increased by approximately \$50,000 from fiscal year 2007 to fiscal year 2008. This increase occurred in spite of a decrease in interest rates from an average of 4.70 percent in fiscal year 2007 to 4.27 percent in fiscal year 2008. The increase is attributable to higher cash balances resulting from the increase in ticket sales. The GASB 31 adjustment recording the Lottery's share of the unrealized gains and losses on investments held by the Treasury increased from fiscal year 2007 to 2008 by a total of \$148,634. In addition, the Lottery received for the first time royalty income from MUSL in the amount of \$68,757, for the use of the Powerball name. Offsetting these increases, interest received from the Multi-state Lottery Association decreased slightly by a little over \$2,500. Other decreases occurred in fines and penalties (\$133,900) reflecting a reduction in the assessment of liquidated damages to the on-line vendor, MUSL reimbursements (\$55,000), a reflection of a new billing method, whereby, the lottery pays their share of the MUSL expenses at the close of the fiscal year versus paying an estimated amount at the beginning of the fiscal year with a reimbursement for over billing, and MUSL reimbursement of an Unclaimed Bonus Prize in fiscal year 2007 for approximately \$79,000.

Several factors contributed to the approximate \$100,000 decrease from fiscal year 2006 to fiscal year 2007. First, interest received from the treasury increased by approximately \$402,000 from fiscal year 2006 to fiscal year 2007. This increase was a result of an increase in interest rates from an average of 3.92 percent in fiscal year 2006 to 4.70 percent in fiscal year 2007. Interest received from the Multi-state Lottery Association increased by approximately \$121,000 and the GASB 31 adjustment recording the Lottery's share of the unrealized gains and losses on investments held by the Treasury increased from fiscal year 2006 to 2007 by a total of \$525,000. Offsetting these increases, other income in fiscal year 2007 included reimbursements from the on-line vendor of approximately \$385,000 as compared to approximately \$1,570,000 in fiscal year 2006. The reimbursements for both fiscal years relates to fines and penalties assessed for non or delayed performance.

Total revenues were \$508.6 million and \$458.7 million for the years ended June 30, 2008 and 2007, respectively. As mentioned elsewhere, the major contributing factor to the increase in total revenues of approximately \$49.9 million was a increase in Lottery sales of \$49.9 million. Non operating revenues remained steady for the same period.

Total revenues for the year ended June 30, 2006 were \$471.6 million. The major contributing factor for the decrease in total revenues from fiscal year 2006 to 2007 of \$12.9 million was a decrease in ticket sales of \$12.9 million. Non-operating revenues remained relatively stable.

**Colorado Lottery**  
**Management's Discussion and Analysis**  
**Years Ended June 30, 2008 and 2007**

**Major Expenses**

Approximately \$363.3 million of the Lottery's total expenses of \$386.3 for the fiscal year ended June 30, 2008 were incurred in direct support of the 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, \$318.7 million of the Lottery's total expenses of \$339.7 million for the fiscal year ended June 30 2007, were game-related expenses.

In comparison, \$326.0 million of the Lottery's total expenses of \$346.7 million for the fiscal year ended June 30, 2006 were game-related expenses.

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

<b>Game-Related Expenses</b>	<b>2008</b>	<b>2007</b>	<b>Difference</b>	<b>Change</b>
Prize expense/Powerball prize variance	\$314,934,975	\$276,916,405	\$38,018,570	13.7%
Retailer compensation				
Commissions	33,668,027	30,292,703	3,375,324	11.1
Bonuses	4,724,151	3,375,679	1,348,472	39.9
Ticket costs	2,558,910	2,142,602	416,308	19.4
Vendor fees	<u>7,394,112</u>	<u>5,957,142</u>	<u>1,436,970</u>	<u>24.1</u>
Total	<u>\$363,280,175</u>	<u>\$318,684,531</u>	<u>\$44,595,644</u>	<u>14.0%</u>

<b>Game-Related Expenses</b>	<b>2007</b>	<b>2006</b>	<b>Difference</b>	<b>Change</b>
Prize expense/Powerball prize variance	\$276,916,405	\$281,594,245	\$(4,677,840)	(1.7)%
Retailer compensation				
Commissions	30,292,703	31,038,482	(745,779)	(2.4)
Bonuses	3,375,679	3,632,434	(256,755)	(7.1)
Ticket costs	2,142,602	2,907,934	(765,332)	(26.3)
Vendor fees	<u>5,957,142</u>	<u>6,819,796</u>	<u>(862,654)</u>	<u>(12.6)</u>
Total	<u>\$318,684,531</u>	<u>\$325,992,891</u>	<u>\$(7,308,360)</u>	<u>(2.2)%</u>

The increase in the game-related expenses, including prize expense, commission expense and bonus expense (fiscal year 2007 to fiscal year 2008) is reflective of the increase in product sales. (See the product sales on a previous schedule.) In addition, the prize expense percentage was increased in fiscal year 2008 over the prize expense percentage in fiscal year 2007 as a result of the higher price point games including the introduction of a \$20 game as stated above. The increase in bonus expense from fiscal year 2007 to fiscal year 2008 is the result of the

# **Colorado Lottery**

## **Management's Discussion and Analysis**

### **Years Ended June 30, 2008 and 2007**

implementation of a new retailer marketing bonus plan, making it easier for retailers to achieve full bonus. The new plan was only in effect for the last three quarters of fiscal year 2008. The increase in ticket costs and vendor fees from fiscal year 2007 to fiscal year 2008 was a direct result of the increase in sales.

Of the \$23.1 million in fiscal year 2008 expenses that were non game-related, nearly \$8.9 million was for promotions and institutional and product advertising and about \$8.8 million was for compensation to the Lottery employees.

In comparison, of the fiscal year 2007 non game-related expenses of \$21.0 million, nearly \$8.9 million was for promotions and institutional and product advertising and \$8.6 million was for compensation to the Lottery employees.

In comparison, of the fiscal year 2006 non game-related expenses of \$20.7 million, more than \$8.9 million was for promotions and institutional and product advertising and \$8.2 million was for compensation to Lottery employees.

#### ***Distributions to the Proceeds Recipients***

The Lottery's efforts generated funds available for distributions of \$122.3 million in the current fiscal year, the second highest year ever. Of these total proceeds, \$53.1 million was allocated to the Great Outdoors Colorado Trust Fund, \$48.9 million to the Conservation Trust Fund and \$12.2 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 \$53.1 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 Lottery Proceeds Contingency Reserve Fund of \$8.0 million, pursuant to C.R.S. 22-54-117(1.6)(a).

The Lottery's proceeds distributions for the fiscal year 2007 totaled \$119.0 million. Approximately \$51.3 million was distributed to Great Outdoors Colorado, \$47.6 million to the Conservation Trust Fund, \$11.9 million to the Division of Parks and Outdoor Recreation and a spill-over into the State's Public School Fund Contingency Reserve of \$8.2 million.

The Lottery's proceeds distributions for fiscal year 2006, the highest year ever, totaled \$125.6 million. Approximately \$50.2 million was distributed to Great Outdoors Colorado, \$50.2 million to the Conservation Trust Fund, \$12.6 million to the Division of Parks and Outdoor Recreation and a spill-over into the State's Public School Fund Contingency Reserve of nearly \$12.5 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 2008, the Legislature approved supplemental appropriation adjustments for the Lottery. Supplemental

# **Colorado Lottery**

## **Management's Discussion and Analysis**

### **Years Ended June 30, 2008 and 2007**

appropriations and department level re-allocations were approved in vendor fees, prizes, Powerball prize variance, retailer compensation, purchased services from the computer center and Multi Use Network Taskforce payments, offset by reductions in payments in ticket costs, workmen's compensation, risk management, vehicle lease payments, and communications services. The final method of funding is special legislation. There was no special legislation affecting the Lottery's budget in fiscal year 2008.

The approved Lottery budget at the beginning of fiscal year 2008 was \$382.2 million. Supplemental appropriations and adjustments made in the third quarter increased the budget by \$40.1 million, department level allocations approved at the beginning of the fiscal year increased the budget by \$2.5 million to an amended total of \$424.8 million. Total expenditures and roll-forwards for fiscal year 2008 on a budget basis came to \$393.8 million, resulting in excess appropriations (or savings) of more than \$31.0 million.

#### ***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 2008 and to demonstrate the Lottery's accountability for the money generated from the sale of the Lottery products. If you have questions about this report or need additional information, contact Barbara Aggson, the Colorado Lottery's Controller, 212 W. 3<sup>rd</sup> Street, Suite 210, Pueblo, CO 81003.

**Colorado Lottery**  
**Statements of Net Assets**  
**June 30, 2008 and 2007**

**ASSETS**

	<b>2008</b>	<b>2007</b>
<b>Current Assets:</b>		
Cash and investments	\$ 30,577,235	\$ 33,239,984
Accounts receivable, net of the allowance for doubtful accounts of \$222,816 in 2008 and \$246,492 in 2007	18,812,076	18,280,283
Consignment inventory, at cost	94,352	110,587
Warehouse inventory, at cost	802,513	613,607
Prepaid expenses	82,131	74,465
Total current assets	50,368,307	52,318,926
<b>Reserve and Restricted Assets:</b>		
Cash and investments-Operating reserve	1,300,000	1,500,000
Cash and investments-Licensed agent recovery reserve receipts	443,139	426,058
Prepaid prize expense with MUSL	3,944,710	3,896,468
Total reserve and restricted assets	5,687,849	5,822,526
<b>Capital Assets:</b>		
Equipment	3,159,600	3,772,195
Leasehold improvements	11,978	14,053
Less accumulated depreciation and amortization	(2,673,422)	(3,089,332)
Total capital assets	498,156	696,916
Total assets	\$ 56,554,312	\$ 58,838,368

## LIABILITIES

### Current Liabilities:

Accounts payable	\$ 2,588,688	\$ 1,692,606
Prize liability	21,630,167	23,624,628
Wages and benefits	848,606	745,042
Accrued annual and sick leave	14,806	26,777
Retailer bonus liability	704,862	484,295
Funds available for distribution	27,155,421	28,706,118
Deferred revenue	307,434	228,150

Total current liabilities	<u>53,249,984</u>	<u>55,507,616</u>
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### Long-Term Liabilities:

Accrued annual and sick leave	819,401	805,547
Expired warrants liability	<u>94,485</u>	<u>100,518</u>

Total long-term liabilities	<u>913,886</u>	<u>906,065</u>
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Total liabilities	<u>54,163,870</u>	<u>56,413,681</u>
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### Net Assets

Investment in capital assets	498,156	696,916
Restricted-licensed agent recovery reserve	443,139	426,058
Unrestricted-Operating reserve	1,300,000	1,500,000
Unrestricted-Other	<u>149,147</u>	<u>(198,287)</u>

Total net assets	<u>2,390,442</u>	<u>2,424,687</u>
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Total liabilities and net assets	<u>\$ 56,554,312</u>	<u>\$ 58,838,368</u>
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**Colorado Lottery**  
**Statements of Revenues, Expenses and Changes in Net Assets**  
**Years Ended June 30, 2008 and 2007**

	2008	2007
<b>Operating Revenues</b>		
Gross ticket sales	\$ 505,814,066	\$ 455,916,812
<b>Direct Operating Expenses</b>		
Prize expense	313,796,804	280,000,739
Powerball prize variance	1,138,171	(3,084,334)
Retailer commissions and bonuses	38,392,178	33,668,382
Cost of tickets and vendor fees	9,953,022	8,099,744
Total direct operating expenses	363,280,175	318,684,531
<b>Gross Profit on Sale of Tickets</b>	142,533,891	137,232,281
<b>Other Operating Expenses</b>		
Marketing and communications	8,892,973	8,886,036
Administration fees paid to MUSL	102,955	95,884
Wages and benefits	8,841,445	8,603,295
Professional services	415,610	240,397
State agencies services	139,926	143,461
Department of Revenue services	458,881	358,373
Travel	112,329	77,175
Equipment (including loss on disposition of equipment of \$65,894 and \$24,947, respectively)	1,355,526	232,215
Depreciation	149,397	156,948
Accrued annual and sick leave	8,320	(23,243)
Space rental	692,825	638,065
Rents for equipment	28,116	26,536
Motorpool leasing	350,097	328,051
Materials and supplies	92,541	130,657
Telephone	110,708	103,663
On-Line telecommunications	502,406	283,539
Data processing supplies and services	85,011	43,409
Equipment maintenance	250,676	221,477
Postage	68,745	49,465
Printing	10,171	25,939
Other	393,603	380,975
Total other operating expenses	23,062,261	21,002,317



**Colorado Lottery**  
**Statements of Revenues, Expenses and Changes in Net Assets (continued)**  
**Years Ended June 30, 2008 and 2007**

	2008	2007
<b>Operating income</b>	119,471,630	116,229,964
<b>Nonoperating Revenues (Expenses)</b>		
Other revenue	428,513	665,162
Investment income	2,365,744	2,169,983
Funds distributed for current year	(95,144,711)	(90,289,332)
Funds available for distribution for current year	(27,155,421)	(28,706,118)
Total nonoperating revenues (expenses)	(119,505,875)	(116,160,305)
<b>Net (income) loss</b>	\$ (34,245)	\$ 69,659
<b>Net assets, beginning of year</b>	2,424,687	2,355,028
<b>Net change in net assets</b>	(34,245)	69,659
<b>Net assets, end of year</b>	\$ 2,390,442	\$ 2,424,687

**Colorado Lottery**  
**Statements of Cash Flows**  
**Years Ended June 30, 2008 and 2007**

	<b>2008</b>	<b>2007</b>
<b>Operating activities</b>		
Cash received from retailers	\$ 505,162,834	\$ 453,554,927
Cash paid in prizes	(317,267,109)	(270,701,601)
Cash paid in retailer commissions	(33,668,027)	(30,292,703)
Cash payments to suppliers	(22,322,364)	(19,478,242)
Cash payments to employees for services	(8,735,998)	(8,645,285)
Cash paid in retailer bonus	(4,513,389)	(3,291,900)
Cash received (used) - Other	-	(172,053)
	<u>118,655,947</u>	<u>120,973,143</u>
<b>Noncapital Financing Activities</b>		
Distribution of net proceeds	(123,850,829)	(119,085,636)
Net cash used by noncapital financing activities	<u>(123,850,829)</u>	<u>(119,085,636)</u>
<b>Capital and related financing activities</b>		
Acquisition of capital assets	(16,530)	(124,760)
	<u>(16,530)</u>	<u>(124,760)</u>
Net cash used by capital and related financing activities	<u>(16,530)</u>	<u>(124,760)</u>
<b>Investing activities</b>		
Interest received	2,018,310	1,971,183
Net cash provided by investing activities	<u>2,018,310</u>	<u>1,971,183</u>
<b>Increase (Decrease) in Cash and Investments</b>	(3,193,102)	3,733,930
<b>Change in Fair Market Value of Investments</b>	347,434	198,800
<b>Cash and investments, Beginning of Year (including \$1,926,058 and \$1,998,064, respectively, in restricted accounts)</b>	<u>35,166,042</u>	<u>31,233,312</u>
<b>Cash and investments, End of Year, (including \$1,743,139 and \$1,926,058, respectively, in restricted accounts)</b>	<u>\$ 32,320,374</u>	<u>\$ 35,166,042</u>

**Colorado Lottery**  
**Statements of Cash Flows (continued)**  
**Years Ended June 30, 2008 and 2007**

	<b>2008</b>	<b>2007</b>
<b>Reconciliation of operating income to net cash provided by operating activities</b>		
Operating income	\$ 119,471,630	\$ 116,229,964
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	149,397	156,948
Loss on disposition of equipment	65,894	24,947
Other revenue	428,513	665,162
(Increase) decrease in prepaid prize expense with MUSL	(48,243)	(187,688)
Change in:		
Accounts receivable	(531,793)	(2,440,226)
Ticket inventory	(172,671)	101,341
Other assets	(7,666)	(29,245)
Liabilities (excluding funds available for distribution)	(699,114)	6,451,940
	<b>\$ 118,655,947</b>	<b>\$ 120,973,143</b>
<b>Statement of Net Assets Classification</b>		
Cash and investments	\$ 30,577,235	\$ 33,239,984
Cash and investments- Licensed Agent Recovery Reserve	443,139	426,058
Cash and investments- Operating Reserve	1,300,000	1,500,000
	<b>\$ 32,320,374</b>	<b>\$ 35,166,042</b>

**Colorado Lottery**  
**Powerball Annuity Winners Trust Fund**  
**Statement of Fiduciary Net Assets**  
**Year Ended June 30, 2008**

**ASSETS**

**Current assets:**

Investments \$ 9,750,262

**Total Assets** \$ 9,750,262

**NET ASSETS**

Held in Trust for Powerball winner \$ 9,750,262

**Total Net Assets** \$ 9,750,262

**Colorado Lottery**  
**Powerball Annuity Winners Trust Fund**  
**Statement of Changes in Fiduciary Net Assets**  
**Year Ended June 30, 2008**

**Additions**

Investment income	\$	360,625
Contribution from Multi-State Lottery Association		<u>9,746,637</u>

<b>Total additions</b>		<u>10,107,262</u>
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**Deductions**

Prize payment		<u>357,000</u>
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<b>Change in net assets</b>		9,750,262
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<b>Net Assets held in Trust for Powerball winner</b>		
<b>Beginning of year</b>		<u>-</u>

<b>End of Year</b>	\$	<u><u>9,750,262</u></u>
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**Colorado Lottery**  
**Notes to Financial Statements**  
**June 30, 2008 and 2007**

**Note 1: Nature of Operations and Summary of Significant Accounting Policies**

***Nature of Operations***

The Colorado Lottery (the Lottery) began operations July 1, 1982 under the provisions of Section 24-35-202, C.R.S. The Lottery operates under a commission and provides operation and service of lottery games as authorized by the statute. The Lottery's revenues are predominantly earned from the sale of lottery products, including scratch games, Lotto, Powerball and Cash 5.

The financial statements reflect activities of the Lottery, an enterprise fund of the State of Colorado and activities of the Lottery's Powerball Annuity Winners Trust Fund, a private trust fund of the State of Colorado, for the fiscal years ended June 30, 2008 and 2007. The Lottery is an agency of the State of Colorado. The financial statements are intended to present the financial position and results of operations and cash flows of only that portion of the State of Colorado that is attributable to the transactions of the Lottery and the Lottery's Powerball Annuity Winners Trust Fund in accordance with accounting principles generally accepted in the United States of America.

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

***Use of Estimates***

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

***Fund Accounting***

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

# Colorado Lottery

## Notes to Financial Statements

### June 30, 2008 and 2007

#### ***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.

#### ***Private Trust Fund***

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

#### ***Basis of Accounting***

Basis of accounting refers to when revenues, expenditures or expenses are recognized in the accounts and reported in the financial statements. The Lottery accounts for funds using the accrual basis of accounting. Revenues from scratch ticket sales are recognized at the point of ticket pack activation. Revenues from Lotto, Powerball, and Cash 5 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.

Revenues (Additions) are recognized in the Powerball Annuity Winners Trust Fund based on the amortization of the original investment over the life of the annuity. Expenses (Deductions) are recognized when payments are remitted to the winner(s).

#### ***Budget***

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

**Colorado Lottery**  
**Notes to Financial Statements**  
**June 30, 2008 and 2007**

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

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

***Accounts Receivable and Allowance for Doubtful Accounts***

Accounts receivable consist of amounts due from retailers for activated scratch ticket packs and uncollected on-line sales. Accounts receivable are stated at the amount billed to retailers plus scratch ticket packs activated not yet settled. Accounts receivable are ordinarily due seven days after the issuance of the invoice and are electronically transferred from the retailer's 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 \$222,816 and \$246,492 as of June 30, 2008 and 2007, respectively.

***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**

## **Notes to Financial Statements**

### **June 30, 2008 and 2007**

#### ***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 January 1, 2004, the Lottery adopted the state policy of capitalizing equipment only if the cost exceeds \$5,000 and has a useful life of more than one year. Depreciation for equipment 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.

#### ***Accrued Wages and Benefits***

During each fiscal year, the state changes the pay date for the month of June for all state employees, deferring the date from the last working day of June to the first working day of July. For the Lottery, this created a liability for accrued wages at June 30, 2008 and 2007 of \$848,606 and \$745,042, respectively.

#### ***Prize Liability and Prize Expense***

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

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

Payments of scratch prize amounts of \$150 or less may be made at the Lottery or at the retail outlet; payment of scratch prize amounts of \$151 to \$599 may be made at the retailer level at the option of the retailer or at the Lottery. Scratch prizes of \$600 or more are paid by the Lottery. Retailers are given credit for prize payments they make on a daily basis. Prizes may be claimed up to 180 days after game-end. After the final claim date, any unclaimed scratch prizes will result in a decrease to prize expense and any prizes claimed in excess of the liability accrued will result in

# Colorado Lottery

## Notes to Financial Statements

### June 30, 2008 and 2007

an increase to prize expense. Net unclaimed scratch prizes resulted in a decrease to prize expense of \$5,012,478 for the fiscal year ended June 30, 2008 and \$4,204,859 for the fiscal year ended June 30, 2007.

Payments of cumulative online prize amounts of \$150 or less on a single ticket may be made at the Lottery or at the retail outlet; payment of cumulative prize amounts of \$151 to \$599 on a single ticket may be made at the retailer level at the option of the retailer or at the Lottery. Payment of cumulative prize amounts of \$600 or more on a single ticket must be made at the Lottery. Retailers are given credit for prize payments they make on a daily basis. Online prizes may be claimed up to 180 days after the date of the drawing. After the final claim date, unclaimed online prizes will result in a decrease to prize expense so long as the aggregate prize expense of all games exceeds or equals the statutory 50% of sales. In the event that the expiration of an unclaimed prize would result in the aggregate prize expense of all games to fall below the statutory 50% level, the unclaimed prize amount would remain in prize expense and be paid out to players as a guaranteed additional prize. Unclaimed online prizes resulted in a decrease to prize expense of \$4,023,101 for the fiscal year ended June 30, 2008 and \$4,269,402 for the fiscal year ended June 30, 2007.

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

#### **Retailer Bonus Liability**

Under provisions 5.10 and 10.10 of the Colorado Lottery Commission Rules and Regulations effective as of July 1, 1997 and as amended in 2008:

*“ . . .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 Seven Tenths Percent (.7%) for Lotto, Sixty-five Hundredths Percent (.65%) for Powerball, Ninety-six Hundredths Percent (.96%) for Cash ,and a total of Five-Tenths Percent (.5%) plus One Percent of all scratch prizes up to and including \$599.99 for Scratch.”*

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.

**Colorado Lottery**  
**Notes to Financial Statements**  
**June 30, 2008 and 2007**

***Licensed Agent Recovery Reserve***

Under the provisions of Section 24-35-219, C.R.S., a Licensed Agent Recovery Reserve was established on January 1, 1988 to maintain surety bond receipts collected from Lottery retailers. Billing rates are established by the Executive Director of the Department of Revenue and are reviewed on an annual basis. Retailers have the option to obtain private surety bond coverage at a rate of \$2,000 surety coverage per outlet at their discretion. As of June 30, 2008 and June 30, 2007, the Lottery has reserved \$443,139 and \$426,058, 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. The annual review was completed in September 2007 and the reserve was reduced to \$1.3 million in accordance with the review.

***Equipment Expense***

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 on a previous page), software purchases and other miscellaneous equipment transactions.

***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:

**Colorado Lottery**  
**Notes to Financial Statements**  
**June 30, 2008 and 2007**

	<u>June 30, 2008</u>	<u>June 30, 2007</u>	<u>Increase</u>
Annual leave	\$ 691,339	\$ 691,042	\$ 297
Sick leave	<u>140,969</u>	<u>139,686</u>	<u>1,283</u>
Total annual and sick leave	832,308	830,728	1,580
Compensatory time	<u>1,899</u>	<u>1,596</u>	<u>303</u>
Total compensated leave	834,207	832,324	\$ <u>1,883</u>
Less current portion	<u>14,806</u>	<u>26,777</u>	
Long-term portion	\$ <u>819,401</u>	\$ <u>805,547</u>	

***Expired Warrants Liability***

Expired warrants liability represents the expiration of aged uncashed warrants and imprest checks over one (1) year old which expired on or before June 30, 2003. In accordance with Section 15-12-914 (2), C.R.S., recipients are entitled to claim payment up to 21 years after original date of issue. Pursuant to Section 24-35-212 (2), C.R.S., the amount of these uncashed warrants shall remain in the Lottery fund. Pursuant to the Unclaimed Property Act, Section 38-13-113, C.R.S., the funds to cover the liability for any uncashed warrants, which expire after June 30, 2003 are transferred to the Unclaimed Property Fund. The Lottery must request reimbursement from the Unclaimed Property Fund for any warrants presented for payment that expired after June 30, 2003.

***Deferred Revenue***

The Lottery offers players the option to purchase online tickets for draws in advance. The tickets are purchased through the terminal, referred to as Advance Play, and allows the player to purchase online tickets good for up to 13 weeks. The revenues generated from these advance plays are recognized as the draws occur. Revenues for future draws are classified as a liability.

A detail of deferred revenue at June 30, 2008 and 2007, is as follows:

	<u>2008</u>	<u>2007</u>
Advance Play - Lotto	\$ 97,188	\$ 79,071
Advance Play – Powerball	138,610	102,407
Advance Play – Powerplay	38,964	27,364
Advance Play – Cash 5	<u>32,672</u>	<u>19,308</u>
Total deferred revenue	\$ <u>307,434</u>	\$ <u>228,150</u>

**Colorado Lottery**  
**Notes to Financial Statements**  
**June 30, 2008 and 2007**

**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 are distributed to players through special promotions and can be redeemed at any lottery office for a specified lottery product. Promotional coupons with a total face value of \$10,750 and \$9,300 were redeemed in fiscal years ended June 30, 2008 and June 30, 2007, 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, 2008 and 2007, scratch tickets with a total face value of \$94,003 and \$97,786, respectively, were given away. Scratch ticket and coupon promotions are valued at cost. For the fiscal years ended June 30, 2008 and 2007, \$68,432 and \$75,120, respectively, were recorded as costs related to free tickets and coupons. These costs were included in Marketing and Communications expense in the statements of revenues, expenses and changes in fund net assets for coupons redeemed and scratch tickets given away.

**Note 2: Cash and Investments**

**Cash**

Cash includes petty cash, change funds, an imprest fund, two depository accounts and cash on deposit with the State Treasurer. A detail of cash at June 30, 2008 and 2007 is as follows:

	<u>2008</u>	<u>2007</u>
Petty cash	\$ 800	\$ 800
Change funds	70,000	70,000
Imprest fund	722,000	732,000
Depository accounts	30,000	30,000
Cash on deposit with State Treasurer	<u>29,754,435</u>	<u>32,407,184</u>
 Total unrestricted cash and investments	 <u>30,577,235</u>	 <u>33,239,984</u>
 Restricted cash and investments – Licensed Agent Recovery Reserve Receipts on deposit with State Treasurer	 443,139	 426,058
Operating Reserve on deposit with State Treasurer	<u>1,300,000</u>	<u>1,500,000</u>
 Total restricted cash and investments	 <u>1,743,139</u>	 <u>1,926,058</u>
Total cash and investments	<u>\$ 32,320,374</u>	<u>\$ 35,166,042</u>

# Colorado Lottery

## Notes to Financial Statements

### June 30, 2008 and 2007

#### ***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 2008 and 2007 was 4.27% and 4.70%, 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.

#### ***Deposits***

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

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

The Lottery accounts are held in Public Deposit Protection Act (PDPA) qualified institutions, thus balances held in the Lottery's accounts in excess of \$100,000 per institution are secured through PDPA with guaranteed securities.

#### ***Investments***

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

**Colorado Lottery**  
**Notes to Financial Statements**  
**June 30, 2008 and 2007**

Agency Term Obligation Receipts, Government Loan Trust, Class 1-Z, Government Trust Certificates, JOB Certificates, Principal Treasury Receipts, Resolution Funding Corporation Strips, Stripped Government Receipts, Treasury Investment Growth Receipts, Treasury Bond Receipts, United States Agency for International Development bonds, United States Treasury Coupon Under Book Entry, United States Treasury Bills, United States Treasury Securities Stripped, Physical Coupon Treasury Strips, Zero Coupon Treasury Obligations, Government Loan Trusts, and USAID Bonds.

***Custodial Credit Risk - Investments***

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

***Interest Rate Risk - Investments***

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. MUSL manages its exposure to interest rate risk by purchasing only securities which are either explicitly or implicitly guaranteed by the United States Government and by holding these investments to maturity. There were no investments in these areas for 2007.

<b>Investment Type</b>	<b><u>Fair Value</u></b>	<b><u>2008</u> Weighted Average Maturity (in years)</b>
U. S. Treasury Investments	\$ 4,000,284	15.95
Israel USAID Bonds	3,262,263	9.81
Resolution Funding Corp Strips	<u>2,487,715</u>	15.54
	<u>\$ 9,750,262</u>	

***Credit Risk - Investments***

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. The Resolution Funding Corporation Strips carry a AAA rating under the Moody's rating system.

**Colorado Lottery**  
**Notes to Financial Statements**  
**June 30, 2008 and 2007**

**Concentration of Credit Risk - Investments**

Investment in any one issuer (other than U.S. Treasury securities, mutual funds, and external investment pools) that represent 5% or more of the total investment as of June 30, 2008 are the Resolution Funding Corporation Strips which represent 25.5% of the total investment.

**Statements of Cash Flows**

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

**Note 3: Schedule of Changes in Fixed Assets**

Capital assets being depreciated:

	<u>June 30, 2007</u>	<u>Increases</u>	<u>Decreases</u>	<u>June 30, 2008</u>
Equipment	\$ 3,772,194	\$ 16,530	\$ (629,124)	\$ 3,159,600
Leasehold improvements	<u>14,053</u>	<u>—</u>	<u>(2,075)</u>	<u>11,978</u>
Total capital assets, being depreciated	<u>3,786,247</u>	<u>16,530</u>	<u>(631,199)</u>	<u>3,171,578</u>
Less accumulated depreciation				
Equipment	(3,076,684)	(149,397)	563,439	(2,662,642)
Leasehold improvements	<u>(12,647)</u>	<u>—</u>	<u>1,867</u>	<u>(10,780)</u>
Total accumulated depreciation	<u>(3,089,331)</u>	<u>(149,397)</u>	<u>565,306</u>	<u>(2,673,422)</u>
Total capital assets, being depreciated, net	<u>\$ 696,916</u>	<u>\$ (132,867)</u>	<u>\$ (65,893)</u>	<u>\$ 498,156</u>



**Colorado Lottery**  
**Notes to Financial Statements**  
**June 30, 2008 and 2007**

	<u>June 30, 2006</u>	<u>Increases</u>	<u>Decreases</u>	<u>June 30, 2007</u>
Equipment	\$ 3,902,715	\$ 124,760	\$ (255,281)	\$ 3,772,194
Leasehold improvements	<u>14,053</u>	<u>—</u>	<u>—</u>	<u>14,053</u>
Total capital assets, being depreciated	<u>3,916,768</u>	<u>124,760</u>	<u>(255,281)</u>	<u>3,786,247</u>
Less accumulated depreciation				
Equipment	(3,150,070)	(156,948)	230,334	(3,076,684)
Leasehold improvements	<u>(12,647)</u>	<u>—</u>	<u>—</u>	<u>(12,647)</u>
Total accumulated depreciation	<u>(3,162,717)</u>	<u>(156,948)</u>	<u>230,334</u>	<u>(3,089,331)</u>
Total capital assets, being depreciated, net	<u>\$ 754,051</u>	<u>\$ (32,188)</u>	<u>\$ (24,947)</u>	<u>\$ 696,916</u>

**Note 4: Operating Leases**

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

***Pueblo***

*Office* – The Lottery 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 expired June 30, 2007. A second amendment to the lease was signed on April 12, 2007 extending the lease for two additional years effective July 1, 2007 and expiring on June 30, 2009. There are no other provisions for extension or renewal.

***Denver***

*Office* – The Lottery occupied 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. On March 10, 2006 the Lottery entered into a second amendment to the lease agreement with Galleria extending the original lease for a thirty-six month period ending on June 30, 2009. The amended lease includes a five-year renewal option. There are no other provisions for extension or renewal.

**Colorado Lottery**  
**Notes to Financial Statements**  
**June 30, 2008 and 2007**

*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 expired on August 31, 2004. On June 11, 2004, the Lottery exercised its option to extend the lease through August 31, 2009.

**Fort Collins**

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

**Grand Junction**

The Lottery occupies space in the Grand Junction State Services Building and is responsible for reimbursing the Capital Complex Division for lease payments.

**Colorado Springs**

The Lottery occupies warehouse space in a building located at 2818 Janitell Road in Colorado Springs, Colorado. The lease agreement, which began on August 1, 2003, expired on June 30, 2006. The Lottery had the option to exercise two 12-month extensions under the new lease, extending the lease through June 30, 2008. On May 27, 2007, the Lottery exercised its second option to extend the lease through June 30, 2008. On June 10, 2008, the Lottery entered into a third amendment to the lease to extend the lease for a twelve month period ending June 30, 2009. The amended lease includes two one year renewal options. There are no other options for renewal.

Operating lease expense incurred for the fiscal years ended June 30, 2008 and 2007 and future minimum lease payments for fiscal years ending June 30, 2009 through 2013 and later years are as follows:

<u>LOCATION</u>			<u>FUTURE</u>	<u>MINIMUM</u>	<u>LEASE</u>	<u>PAYMENTS</u>		<u>LATER</u> <u>YEARS</u>
	<u>2007</u>	<u>2008</u>	<u>FY 2009</u>	<u>FY 2010</u>	<u>FY 2011</u>	<u>FY 2012</u>	<u>FY 2013</u>	
Pueblo Office	\$233,095	\$234,207	\$218,013	\$ 218,013	\$224,630	\$231,247	\$238,203	\$498,122
Pueblo Warehouse	102,153	114,596	114,596	0	0	0	0	0
CoSprgs Warehouse	13,016	13,440	13,887	0	0	0	0	0
Denver	141,339	179,456	191,392	0	0	0	0	0
Denver Warehouse	98,553	101,473	104,486	17,499	0	0	0	0
Fort Collins	39,288	39,288	0	0	0	0	0	0
Grand Junction	<u>6,945</u>	<u>7,981</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
	<u>\$ 634,389</u>	<u>\$ 690,441</u>	<u>\$642,374</u>	<u>\$ 235,512</u>	<u>\$224,630</u>	<u>\$231,247</u>	<u>\$238,203</u>	<u>\$498,122</u>

**Colorado Lottery**  
**Notes to Financial Statements**  
**June 30, 2008 and 2007**

**Note 5: Other Revenue**

A schedule of other revenue for the fiscal years ended June 30, 2008 and 2007 follows:

	<b>2008</b>	<b>2007</b>
License fees	\$ 65,616	\$ 62,022
Fines and penalties	250,850	384,750
Assignment fees	2,700	2,749
Net Licensed Agent Recovery Reserve Receipts	17,081	27,994
Reimbursements from MUSL/Budget	0	55,096
Reimbursements from MUSL/Unclaimed Bonus Prizes	0	78,663
Royalty Income	68,757	0
Other	23,509	53,888
Total	\$ 428,513	\$ 665,162

**Note 6: Distribution of Net Proceeds**

In accordance with Section 33-60-104, C.R.S., distributions of net proceeds shall be made on a quarterly basis. The State Treasurer shall distribute net lottery proceeds as follows: forty percent (40%) to the Conservation Trust Fund, ten percent (10%) to the Division of Parks and Outdoor Recreation and all the remaining net lottery proceeds in trust to the State Board of the Great Outdoors Colorado Trust Fund up to the statutory limit. Under Section 33-60-104(2), C.R.S., the limit is \$35 million as adjusted annually based on the consumer price index. Any excess over the limit shall be transferred to the State Public School Fund. Starting in fiscal year 2008, any excess shall be transferred to the Lottery Proceeds Contingency Reserve Fund per Section 22-54-117 (1.6)(a), C.R.S.

Income available for distribution at June 30:

	<b>2008</b>	<b>2007</b>
Operating Income	\$ 119,471,630	\$ 116,229,964
Plus: Other Revenue	428,513	665,162
Investment Income	2,365,744	2,169,983
Income before distributions	\$ 122,265,887	\$ 119,065,109
Change in licensed agent recovery reserve	(17,081)	(27,994)
Change in fair market value of investments	(347,434)	(198,800)
Change in Operating Reserve	200,000	100,000
Other changes in net assets	198,760	57,135
Income available for distribution	122,300,132	118,995,450
Less distributions prior to year-end	(95,144,711)	(90,289,332)
Income available for distribution	\$ 27,155,421	\$ 28,706,118

**Colorado Lottery**  
**Notes to Financial Statements**  
**June 30, 2008 and 2007**

	<b>Accrued at June 30, 2007</b>	<b>Proceeds Distributions Expenses</b>	<b>Distributions Paid</b>	<b>Accrued at June 30, 2008</b>
Great Outdoors Colorado State Public School Fund	\$ 6,133,152	\$ 53,104,374	\$ (53,705,510)	\$ 5,532,016
Contingency Reserve	8,219,905	-	(8,219,905)	-
Lottery Proceeds				
Contingency Reserve Fund	-	8,045,692	-	8,045,692
Conservation Trust Fund	11,482,448	48,920,053	(49,540,332)	10,862,169
Division of Parks and Outdoor Recreation	<u>2,658,076</u>	<u>12,230,013</u>	<u>(12,172,545)</u>	<u>2,715,544</u>
	<u>\$ 28,706,118</u>	<u>\$ 122,300,132</u>	<u>\$ (123,850,829)</u>	<u>\$ 27,155,421</u>

	<b>Accrued at June 30, 2006</b>	<b>Proceeds Distributions Expenses</b>	<b>Distributions Paid</b>	<b>Accrued at June 30, 2007</b>
Great Outdoors Colorado State Public School Fund	\$ 1,852,837	\$ 51,277,820	\$ (46,997,505)	\$ 6,133,152
Contingency Reserve	12,545,316	8,219,905	(12,545,316)	8,219,905
Conservation Trust Fund	11,518,521	47,598,180	(47,634,253)	11,482,448
Division of Parks and Outdoor Recreation	<u>2,879,630</u>	<u>11,899,545</u>	<u>(11,908,562)</u>	<u>2,658,076</u>
	<u>\$ 28,796,304</u>	<u>\$ 118,995,450</u>	<u>\$ (119,085,636)</u>	<u>\$ 28,706,118</u>

**Note 7: Pension Plan**

***Plan Description***

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

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

# **Colorado Lottery**

## **Notes to Financial Statements**

### **June 30, 2008 and 2007**

employment to elect to participate in a defined contribution plan administered by PERA rather than the defined benefit plan.

Prior to legislation passed during the 2006 session, higher education employees may have participated in social security, PERA's defined benefit plan, or the institution's optional retirement plan. Currently, higher education employees, except for community college employees, are required to participate in their institution's optional plan, if available, unless they are active or inactive member of PERA with at least one year of service credit. In that case, they may elect either PERA or their institution's optional plan. Community college employees hired after January 1, 2008, are required to become members of PERA and must elect either PERA's defined benefit or defined contribution plan with 60 days, unless they had been a PERA member within the prior twelve months. In that case, they are required to remain in the PERA plan in which they participated previously.

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

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

- Hired before July 1, 2005 – age 50 with 30 years of service, age 60 with 20 years of service or at age 65 with 5 years of service.
- Hired between July 1, 2005 and December 31, 2006 - any age with 35 years of service, at age 55 with 30 years of service, at age 60 with 20 years of service, or at age 65 with 5 years of service.
- Hired on or after January 1, 2007 – any age with 35 years of service, age 55 with 30 years of service, age 60 with 25 years of service, or age 65 with 5 years of service.

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

- Hired before January 1, 2007 - age 55 with a minimum of 5 years of service credit and age plus years of service equals 80 or more.
- Hired on or after January 1, 2007 – age 55 with a minimum of 5 years of service credit and age plus years of service equals 85 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.

Members automatically receive the higher of the defined retirement benefit or money purchase benefit at retirement. Defined benefits are calculated as 2.5 percent times the number of years of

# **Colorado Lottery**

## **Notes to Financial Statements**

### **June 30, 2008 and 2007**

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

Retiree benefits are increased annually based on their original hire date as follows:

- Hired before July 1, 2005 – 3.5 percent, compounded annually.
- Hired between July 1, 2005 and December 31, 2006 – the lesser of 3 percent of the actual increase in the national Consumer Price Index.
- Hired on or after January 1, 2007 – the lesser of 3 percent or the actual increase in the national Consumer Price Index, limited to a 10 percent reduction in a reserve established for cost of living increases related strictly to those hired on or after January 1, 2007. (The reserve is funded by 1 percentage point of salaries contributed by employers for employees hired on or after January 1, 2007.)

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 eligible children under the age of 18 (23 if a full-time student) or their spouse may be entitled to a single payment or monthly benefit payments. If there is no eligible child or spouse then financially dependent parents, beneficiaries, or the member's estate, may be entitled to a survivor's benefit.

#### ***Funding Policy***

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

Most employees contribute 8% (10% for state troopers) of their salary, as defined in CRS 24-51-101(42), to an individual account in the plan. From July 1, 2007, to December 31, 2007, the state contributed 11.15% (13.85% for state troopers and 14.66% for the judicial branch) of the employee's salary. From January 1, 2008 through June 30, 2008 the state contributed 12.05 percent (14.75 percent for state troopers and 15.56 percent for the Judicial Branch). During all of Fiscal Year 2008, 1.02% of the employees total salary was allocated to the Health Care Trust Fund.

Per Colorado Revised Statutes, an amortization period of 30 years is deemed actuarially sound. At December 31, 2006, the division of PERA in which the state participates was underfunded with an infinite amortization period, which means that the unfunded actuarially accrued liability would never be fully funded at the current contribution rate.

# **Colorado Lottery**

## **Notes to Financial Statements**

### **June 30, 2008 and 2007**

In the 2004 legislative session, the general assembly authorized an Amortization Equalization Disbursement (AED) to address a pension-funding shortfall. The AED requires PERA employers to pay an additional .5% of salary beginning January 1, 2006, another .5% of salary in 2007, and subsequent year increases of .4% of salary until the additional payment reaches 3% in 2012.

In the 2006 legislative session, the general assembly authorized a Supplemental Amortization Equalization Disbursement (SAED) that requires PERA employers to pay an additional one half percentage point of total salaries paid beginning January 1, 2008. The SAED is scheduled to increase by one-half percentage point through 2013 resulting in a cumulative increase of three percentage points. For state employers, each year's one half percentage point increase in the SAED will be deducted from the amount of changes to state employees' salaries and used by the employer to pay the SAED. Both the AED and SAED will terminate when funding levels reach 100%.

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

The Lottery's contributions to the Defined Benefit Plan and the Health Care Trust Fund for the fiscal years ended June 30, 2008, 2007, and 2006, were \$759,314, \$720,894, and \$651,980, respectively. These contributions met the contribution requirement for each year.

#### **Note 8: Voluntary Tax-deferred Retirement Plans**

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

#### **Note 9: Post Employment Benefits**

##### ***HEALTH CARE PROGRAM***

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

After the PERA subsidy, the benefit recipient pays any remaining amount of that premium through an automatic deduction from the monthly retirement benefit. Monthly premium costs for participants depend on the health care plan selected, the PERA subsidy amount, Medicare eligibility, and the number of persons covered. Effective July 1, 2000, the maximum monthly subsidy is \$230.00 per month for benefit recipients who are under 65 years of age and who are not

# Colorado Lottery

## Notes to Financial Statements

### June 30, 2008 and 2007

entitled to Medicare; and \$115.00 per month for benefit recipients who are 65 years of age or older or who are under 65 years of age and entitled to Medicare. The maximum subsidy is based on the recipient having 20 years of service credit, and is subject to reduction by 5% for each year less than 20 years.

Employees are not required to contribute to the Health Care Trust Fund, which is maintained by employer's contributions as discussed above. Beginning July 1, 2004, state agencies are required to contribute 1.02 percent of gross covered wages to the Health Care Trust Fund. The agency contributed \$66,734, \$67,494, and \$65,540 as required by statute in Fiscal Years 2008, 2007 and 2006 respectively. In each year the amount contributed was 100 percent of the required contribution.

The Health Care Trust Fund offers two general types of plans: fully-insured plans offered through health care organizations and self-insured plans administered for PERA by third party vendors. As of December 31, 2007, there were 44,214 enrolled participants, including spouses and dependents, from all contributors to the plan. At December 31, 2007, the Health Care Trust Fund had an unfunded actuarial accrued liability of \$1.045 billion, a funded ratio of 19.9 percent, and a 38 year amortization period.

#### **Note 10: Contingencies and Commitments**

Prize Annuities – The Lottery purchases annuity contracts in the name of individual jackpot prize winners. Although the annuity contracts are in the name of the individual winners, the Lottery retains title to the annuity contracts. The Lottery remains liable for the payment of the guaranteed minimum prizes in the event the insurance companies issuing the annuity contracts default. The following guaranteed minimum prize payments for which annuity contracts have been purchased are due in varying amounts through October 10, 2036.

Specified prize payments	\$ 449,399,430
Lifetime prize payments	<u>39,630,000</u>
Total guaranteed minimum prize payments	<u>\$ 489,029,430</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, worker's 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.



**Colorado Lottery**  
**Notes to Financial Statements**  
**June 30, 2008 and 2007**

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:

<b>Liability</b>	<b>Limits of Liability</b>
General and automobile	Each person \$150,000 Each occurrence \$600,000

***Medical and Disability Benefits***

The Group Benefit Plans Fund is a Pension and Other Employee Benefits Fund established for the purpose of risk financing employee and state-official medical claims. The fund includes several medical plan options ranging from provider of choice to managed care. Before January 1, 2000, the State offered a variety of medical plans; some of the plans were fully insured while others were self-insured using Anthem Blue Cross Blue Shield as the plan administrator. Between January 1, 2000 and June 30, 2005, self-insured plans were no longer offered, and the state and its employees paid premiums for insurance purchased to cover medical claims. After June 30, 2005, the state once again became self-insured for certain employee and state-official medical claims. The State's contribution to the premium is subject to approval of the legislature each year and state employees pay the difference between the state's contribution and the premium set. The premiums set by the state are intended to cover claims and include a fee to offset the costs of administering the plan. Plan costs include developing plan offerings, maintaining the online benefits system, and communicating benefit provisions to employee. Employee healthcare premiums are allowed on a pretax basis under the State's flexible spending account benefits plan.

Effective July 1, 2005. The State terminated the Anthem Blue Cross Blue Shield plans and began offering five self-funded plan options administered by Great-West Healthcare, in addition to the fully insured Kaiser HMO plan and the San Luis Valley HMO plan, as well as, three self-funded dental options administered by Delta Dental Plan of Colorado. On July 1, 2006 the state discontinued one of the self-funded medical plan options due to low enrollment.

# **Colorado Lottery**

## **Notes to Financial Statements**

### **June 30, 2008 and 2007**

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

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

**Furniture and Equipment** – The State of Colorado carries a \$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.

**Gaming Operations Commitments** – The Lottery has entered into long-term contracts with certain significant vendors related to providing scratch tickets and online data processing services in support of the Lottery's gaming operations. The online data processing contract expires on October 31, 2012 per the contract amendment dated January 26, 2005. 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 \$70,291,500.

The Lottery entered into two contracts with the scratch vendors on January 9 and 13, 2006. The contracts expired on November 30, 2007. The State, in its sole discretion, may require continued performance for three additional twelve (12) month periods on both contracts. In addition, in the event that a contract with a successor contractor cannot be signed prior to the expiration or termination date of this contract, the State reserves the right to extend this contract for maximum of one hundred eighty (180) days or until a new contract is executed. There are no other provisions for extension or renewal. The total costs of the contracts for the initial contract period were not to exceed \$5,666,667 each for the respective contracts. In May 2007, one scratch vendor (purchaser) purchased the other scratch vendor (purchaser). A novation agreement was signed assigning all of the rights of the purchasee to the purchaser. The state exercised its option to extend the contract with the purchaser for an additional twelve month period starting on December 1, 2007 and ending on November 30, 2008. The maximum amount available to cover both the original contract period and the extension for fiscal year 2008, which ends on June 30, 2008, is \$3,862,335.33.

The Lottery was approved as a member of the MUSL on February 26, 2001 and thus entered into an agreement with MUSL on June 6, 2001 to become a member and participate in Powerball games. As a member, the Lottery agrees to abide by the terms of the Multi-State Agreement dated September 16, 1987 and to any amendments to that agreement duly made by the board. The Lottery will remain a member indefinitely. Pursuant to this agreement, the Lottery will make

# Colorado Lottery

## Notes to Financial Statements

### June 30, 2008 and 2007

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, 2008 is \$3,586,100 and is based on a percentage of sales. The total amount of the prize reserves funded as of June 30, 2008 was \$3,944,710 shown as prepaid prize expense – MUSL on the statements of net assets. MUSL reserves the right to hold funds which do not exceed 110% of the required balance. If the actual balance in the reserves should exceed 110% of the required balance, MUSL will refund any funds in excess of the 110% threshold.

**Other Major Vendor Commitments** – The Lottery entered into a long-term contract with an advertising agency to provide advertising services to promote the Lottery’s products. The contract period began on September 1, 2007 and will expire on June 30, 2010. The Lottery has the option to renew the contract for two (2) additional twelve-month periods. The total cost of the initial contract period is not to exceed \$25,100,000.

**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. In fiscal year 2006, the District Court found in favor of the Lottery. The case was appealed and heard orally by the Colorado Supreme Court on December 6, 2007. The decision was rendered on March 24, 2008 and upheld the decision of the Court of Appeals. The decision is now final and non-appealable and the case has been closed.

#### **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 \$996,105 and \$875,407 for the fiscal years ended June 30, 2008 and 2007, respectively.

## **Supplementary Information**

**Colorado Lottery**  
**Schedule of Revenue and Costs for Scratch and On-line Games**  
**for the Fiscal Year Ended June 30, 2008**  
**(With Comparative Totals for the Fiscal Year Ended June 30, 2007)**

	Games in Progress				Fiscal Year 2008	Fiscal Year 2007
	Scratch	Lotto	Powerball	Cash 5	Total	Scratch and Online
Gross ticket sales	\$ 336,038,899	\$ 41,064,087	\$ 109,562,516	\$ 19,148,564	\$ 505,814,066	\$ 455,916,812
Prize expense	(230,874,880)	(22,086,122)	(50,462,779)	(10,373,023)	(313,796,804)	(280,000,739)
Powerball prize variance	—	—	(1,138,171)	—	(1,138,171)	3,084,334
Net revenue after prizes	<u>105,164,019</u>	<u>18,977,965</u>	<u>57,961,566</u>	<u>8,775,541</u>	<u>190,879,091</u>	<u>179,000,407</u>
Commissions, bonuses, ticket costs and vendor fees						
Retailer commission	(23,476,115)	(2,465,397)	(6,576,799)	(1,149,716)	(33,668,027)	(30,292,703)
Retailer bonus	(3,562,333)	(268,028)	(716,171)	(177,619)	(4,724,151)	(3,375,679)
Cost of tickets sold	(2,558,910)	—	—	—	(2,558,910)	(2,142,602)
Telecomm Reimbursements	476,221	58,205	155,257	27,136	716,819	691,716
Online vendor fees	(5,396,364)	(652,950)	(1,754,061)	(307,556)	(8,110,931)	(6,648,858)
Total	<u>(34,517,501)</u>	<u>(3,328,170)</u>	<u>(8,891,774)</u>	<u>(1,607,755)</u>	<u>(48,345,200)</u>	<u>(41,768,126)</u>
Gross profit on sale of tickets	<u>\$ 70,646,518</u>	<u>\$ 15,649,795</u>	<u>\$ 49,069,792</u>	<u>\$ 7,167,786</u>	<u>\$ 142,533,891</u>	<u>\$ 137,232,281</u>
Average daily ticket sales	<u>\$ 918,139</u>	<u>\$ 112,218</u>	<u>\$ 299,351</u>	<u>\$ 52,318</u>	<u>\$ 1,382,026</u>	<u>\$ 1,249,087</u>

**Colorado Lottery**  
**Schedule of Percent of Prize Expense to Gross Ticket Sales**  
**for the Fiscal Year Ended June 30, 2008**

	<b>Games in Progress</b>				<b>Powerball Prize Fiscal Year 2008</b>	
	<b>Scratch</b>	<b>Lotto</b>	<b>Powerball</b>	<b>Cash 5</b>	<b>Variance</b>	<b>Total</b>
Prize expense	\$ 230,874,880	\$ 22,086,122	\$ 50,462,779	\$ 10,373,023	\$ 1,138,171	\$ 314,934,975
Ticket sales	<u>336,038,899</u>	<u>41,064,087</u>	<u>109,562,516</u>	<u>19,148,564</u>	<u>—</u>	<u>505,814,066</u>
Prize %	<u>68.70%</u>	<u>53.78%</u>	<u>46.06%</u>	<u>54.17%</u>		<u>62.26%</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, 2008**

	Fiscal Year 2008 Original Budget	Supplementals Pots Allocations and Internal Transfers	Fiscal Year 2008 Final Budget	Fiscal Year 2008 Actual Expenditures	Under Expended	Percent Under Expended
Personal services	\$8,476,115	\$347,306	\$8,823,421	\$8,522,935	\$300,486	3.41%
Amortization equalization	0	86,110	86,110	80,712	5,398	6.27%
Supplemental amort. equal.	0	17,940	17,940	16,986	954	5.32%
Workmen's compensation	0	52,018	52,018	52,018	0	0.00%
Unemployment benefits	0	976	976	821	155	15.88%
Health and life	0	521,660	521,660	521,660	0	0.00%
Short term disability	0	8,811	8,811	8,079	732	8.31%
Operating	1,203,156	0	1,203,156	1,201,047	2,109	0.18%
DOR postage allocation	0	25,619	25,619	25,619	0	0.00%
Variable vehicle	0	155,734	155,734	155,734	0	0.00%
Leased space	0	725,755	725,755	684,844	40,911	5.64%
Grand Junction - Leased space	0	7,981	7,981	7,981	0	0.00%
Risk management	0	24,152	24,152	24,152	0	0.00%
Vehicle lease payments	0	130,002	130,002	125,781	4,221	3.25%
Travel	113,498	0	113,498	112,329	1,169	1.03%
Purch. serv. comp. center	0	3,252	3,252	3,252	0	0.00%
Marketing, communications & sales	8,643,420	0	8,643,420	8,642,971	449	0.01%
Communications services	0	1,851	1,851	1,851	0	0.00%
Payments to MNT	0	362,552	362,552	362,552	0	0.00%
Payments to other agencies	239,410	0	239,410	121,335	118,075	49.32%
Legal services	0	34,636	34,636	18,591	16,045	46.32%
Indirect costs	458,880	0	458,880	458,880	0	0.00%
Ticket costs-Scratch	3,549,040	(19,690)	3,529,350	2,558,910	970,440	27.50%
Research	250,000	0	250,000	250,000	0	0.00%
Vendor fees	9,811,513	1,063,998	10,875,511	9,363,475	1,512,036	13.90%
Prize payments	306,413,810	30,307,570	336,721,380	313,796,804	22,924,576	6.81%
Retailer compensation	38,609,220	3,164,530	41,773,750	38,392,178	3,381,572	8.09%
Multi-State lottery fund	177,433	0	177,433	161,811	15,622	8.80%
CMAC project	10,697	0	10,697	3,000	7,697	71.95%
Powerball prize variance	4,220,000	5,532,000	9,752,000	8,047,280	1,704,720	17.48%
Rollforward	37,695	0	37,695	37,695	0	0.00%
<b>TOTAL</b>	<b><u>\$382,213,887</u></b>	<b><u>\$42,554,763</u></b>	<b><u>\$424,768,650</u></b>	<b><u>\$393,761,283</u></b>	<b><u>\$31,007,367</u></b>	<b><u>7.30%</u></b>

FY08 Staffing (FTE) 126.0 (Appropriated) 118.6 (Actual)

\*Certain amounts may not tie due to rounding.

**Colorado Lottery**  
**Budgetary Comparison (continued)**  
**for the Fiscal Year Ended June 30, 2008**

Reconciliation of Expenses per "Statement of Revenues, Expenses and Changes in Net Assets" to Budgeted Expenditures:

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

Prize expense	\$ 313,796,804
Powerball prize variance	1,138,171
Commissions and bonuses	38,392,178
Cost of tickets & vendor fees	9,953,022
Operating expenses	<u>23,062,261</u>
 Total Expenses per Statement of Revenues, Expenses and Changes in Net Assets	 386,342,436
Plus: Powerball variance classified as revenue	6,909,109
Telecommunications offset classified as revenue	716,819
Less: Non-appropriated expenses	
Depreciation	(149,397)
Accrued annual and sick leave	(8,320)
Book value of assets written off	<u>(65,894)</u>
Sub-Total	393,744,753
Plus: Capitalized fixed assets	16,530
	<u><u>\$ 393,761,283</u></u>



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

Members of the Legislative Audit Committee

We have audited the financial statements of the major fund and remaining fund information of the Colorado Lottery, an enterprise fund and private purpose fund of the State of Colorado as of and for the year ended June 30, 2008, which collectively comprise the Colorado Lottery's basic financial statements and have issued our report thereon dated September 8, 2008. 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.

**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered the Colorado Lottery's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the entity's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies described in the accompanying schedule of findings and responses to be significant deficiencies in internal control over financial reporting (Findings 3 and 4).

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that none of the significant deficiencies described above is a material weakness.

### **Compliance and Other Matters**

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

Colorado Lottery's responses to the findings identified in our audit are described in the auditors' findings and recommendations section of this report. We did not audit the Colorado Lottery's responses and, accordingly, we express no opinion on them.

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

*Clifton Henderson LLP*

Greenwood Village, Colorado  
September 8, 2008

## Required Communications to the Legislative Audit Committee

September 8, 2008

Members of the Legislative Audit Committee

This letter is to provide you with information about significant matters related to our audit of the financial statements of the Colorado Lottery for the year ended June 30, 2008.

The following are our observations arising from the audit that are relevant to your responsibilities in overseeing the financial reporting process.

**Auditor's Responsibilities Under Generally Accepted Auditing Standards.** Our audit was performed for the purpose of forming and expressing an opinion about whether the financial statements, that we have assisted in the preparation of with management and your oversight, are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America. Our audit does not relieve you or management of your responsibilities.

**Other Information in Documents Containing Audited Financial Statements.** In connection with the Colorado Lottery's financial statements, we did not perform any procedures or corroborate other information included in the report. However, we read management's discussion and analysis of financial conditions and results of operations and considered whether the information or the manner in which it was presented was materially inconsistent with information or the manner of presentation of the financial statements. Based on our reading, we concluded that the information did not require revision.

**Significant Issues Discussed With Management Prior to Retention.** We discuss various matters with management prior to retention as the Colorado Lottery's auditors. These discussions occur in the normal course of our professional relationship. There were no significant issues, including the application of accounting principles and auditing standards, which were discussed with management prior to our retention as auditors.

**Consultations with Other Accountants.** We were informed by management that they made no consultations with other accountants on the application of generally accepted accounting principals or generally accepted auditing standards.

### **Qualitative Aspects of Accounting Practices.**

#### *Accounting Policies*

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the Colorado Lottery are described in Note 1 to the financial statements. There were no significant accounting policies or their application which were either initially selected or changed during the year.

We noted no transactions in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.

There were no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

#### *Accounting Estimates*

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

The following is management's description of the process utilized in forming an estimate for prize expense and corresponding liability.

Prize expense and corresponding liability is calculated based on the anticipated payout approved by the Lottery Commissioners. The prize expense and corresponding liability is incurred as tickets are activated by Lottery approved retailers.

#### *Financial Statement Disclosures*

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. There were no particularly sensitive financial statement disclosures.

**Difficulties Encountered in Performing the Audit.** We encountered no significant difficulties in dealing with management related to the performance of our audit.

**Representations from Management.** We have requested representations from management.

**Disagreements With Management.** There were no disagreements with management on financial accounting and reporting matters, auditing procedures, or other matters which would be significant to the Lottery's financial statements or our report on those financial statements.

Please contact Mark Elmshauser if you have any questions regarding the matters included in this letter.

*Clifton Gunderson LLP*

The electronic version of this report is available on the Web site of the  
Office of the State Auditor  
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