COLORADO LOTTERY

FINANCIAL AND COMPLIANCE AUDIT

June 30, 2011 and 2010

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Members of the Legislative Audit Committee:

We have completed the financial statement audit of the Colorado Lottery as of and for the year ended June 30, 2011. Our audit was conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

We were engaged to conduct our audit pursuant to Section 24-35-211, C.R.S., which 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 9, 2011

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COLORADO LOTTERY

REPORT SUMMARY

Years Ended June 30, 2011 and 2010

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, 2011. 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 opinions on the financial statements of the Lottery for the year ended June 30, 2011.

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 opinions on the financial statements of the Lottery as of and for the year ended June 30, 2011, 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, 2011.
- 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:

- Maximizing the return of Lottery proceeds to beneficiaries

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

COLORADO LOTTERY
REPORT SUMMARY
Years Ended June 30, 2011 and 2010

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 was one proposed audit adjustment for the year ending June 30, 2011. This communication is located on page 65.

Summary of Progress in Implementing Prior Year Audit Recommendations

The audit report for the year ended June 30, 2010, contained three recommendations. As of our Fiscal Year 2011 audit, we determined that two of the Fiscal Year 2010 recommendations were implemented and one was not implemented. The Disposition of Prior Year Audit Recommendations begins on page 8.

COLORADO LOTTERY

RECOMMENDATION LOCATOR

Years Ended June 30, 2011 and 2010

Fiscal Year 2011 Recommendations

Recommendation Number	Page Number	Recommendation Summary	Response	Implementation Date
1	7	The Colorado Lottery should ensure it is maximizing the amount of lottery revenue available to beneficiaries by reevaluating its current games structure, payout percentages, and operating expenses.	Agree	Ongoing

COLORADO LOTTERY
BACKGROUND
Years Ended June 30, 2011 and 2010

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

During Fiscal Year 2011, the Lottery employed 117 employees in its headquarters in Pueblo and branch offices in Denver, Fort Collins and Grand Junction.

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

Colorado Revised Statutes (C.R.S.) Section 24-35-210(9), requires that no less than 50% of the total revenue from sales of lottery tickets be for prizes. The legislation also provides guidelines for distribution of net proceeds to beneficiary agencies. “Net lottery proceeds” (that is, proceeds after the payment of prizes and lottery expenses and a reserve for future operations) are to be distributed to the Conservation Trust Fund, 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. Prior to 2002, amounts exceeding the GOCO cap (the spillover) were distributed to the State General Fund. For Fiscal Years 2002 through 2007, the spillover funds were distributed to the State Public School Fund Contingency Reserve. For Fiscal Year 2008, the spillover funds were transferred to the Lottery Proceeds Contingency Reserve Fund. For Fiscal Years 2009 through 2011, the spillover funds were required to be transferred to the Public School Capital Construction Assistance Fund.

Maximizing the return of Lottery proceeds to beneficiaries

The Colorado Lottery was created as a division within the Department of Revenue in 1982 with the passage of Senate Bill 119. The legislation provides requirements for distribution of net proceeds of lottery ticket sales to beneficiary agencies. These beneficiary agencies include Division of Parks and Outdoor Recreation, State Board of the Great Outdoors Colorado Trust Fund, Conservation Trust Fund, and Public School Capital Construction Assistance Fund. The Lottery generated $518 million in gross ticket sales and distributed $113 million to beneficiary agencies in Fiscal Year 2011.

What was the purpose of the audit work?

The purpose of the audit work was to ensure maximum return of lottery revenues from lottery ticket sales to the beneficiaries of Colorado Lottery proceeds, as designated by the State Constitution and related state statutes.

What audit work was performed and how were results measured?

We evaluated the return of lottery ticket revenues to the beneficiaries of Colorado Lottery proceeds in accordance with applicable state statutes. The Colorado Lottery Commission defines one of its primary goals as maximizing the return of lottery ticket sales revenue to beneficiaries. To ensure maximum return of lottery ticket revenues to the beneficiaries of Colorado Lottery proceeds, we compared the distributions to the gross revenue collected for the past five years. In performing our analysis we expected as lottery ticket sales increase, distributions available to beneficiaries would increase proportionately.

What problem did the audit work identify?

The distributions available to beneficiaries did not increase proportionately with the sales. During the past five years the percentage of gross sales available for distribution to beneficiaries has decreased from 26 percent in Fiscal Year 2007 to nearly 22 percent in Fiscal Year 2011 as shown in the table below.

Historical Sales, Expenses, and Distributions

	2011	2010	2009	2008	2007
Gross Revenue	$ 518,920,841	$ 501,197,409	$ 493,364,094	$ 505,814,066	$ 455,916,812
Cost of Sales	(377,243,191)	(359,229,539)	(348,679,448)	(363,280,175)	(318,684,531)
Gross Profit	141,677,650	141,967,870	144,684,646	142,533,891	137,232,281
Operating Expenses	(29,123,156)	(28,914,141)	(24,511,750)	(23,062,261)	(21,002,317)
Other Nonoperating Revenues	745,026	1,494,727	1,695,136	2,794,257	2,835,145
Other Changes in Statement of Net Assets	61,473	(1,606,889)	(2,264,177)	34,245	(69,659)
Net Available for Distribution	$ 113,360,993	$ 112,941,567	$ 119,603,855	$ 122,300,132	$ 118,995,450
Percentage of Distributions to Gross Revenue	21.8%	22.5%	24.2%	24.2%	26.1%

Although the Colorado Lottery increased total ticket sales over the five year period by $63 million, the distributions available to beneficiaries in Fiscal Year 2011 were $5.6 million less than in Fiscal Year 2007. The cost of sales increased from Fiscal Year 2007 to Fiscal 2011 by nearly $58.6 million. In isolating just the increase in sales and related cost of sales between those two Fiscal Years, the increase in sales generated only $4.4 million in additional gross profit. In comparing the operating expenses during that same period, Fiscal Year 2011 was $29.1 million and Fiscal Year 2007 was $21 million. The majority of the increase related to marketing and communications which accounted for $5.9 million of the $8.1 million increase.

Why did the problem occur?

The Colorado Lottery has significantly expanded their games over the past few years. The structure and payout percentages of some of these games may not be consistent with one of the Colorado Lottery's primary goals, to maximize returns to beneficiaries. For example, the recently added draw game Matchplay has a prize payout of 58 percent, which is significantly higher than other draw games such as Powerball that only pays 50 percent of sales as prizes. In addition, the change in the average payout percentage for scratch games increased for the last three years from 67.5 percent in Fiscal Year 2009 to 68.8 percent in Fiscal Year 2011 to support buying behavior. These expansions have significantly increased the marketing and communications, as well as other operating expenses over the last five years, as management has overall increased efforts to market and promote the Colorado Lottery. Although the increase in sales revenues is significant over the past five years, the amount available for distribution to beneficiaries has been flat or declining over that same period. The associated increase in cost of sales and marketing and communications expense to increase sales from Fiscal Year 2007 to Fiscal Year 2011 in fact left less money available for distribution to beneficiaries.

Why does this problem matter?

The ticket sales increases have not translated into corresponding increases to beneficiaries. This matters because one of the Colorado Lottery's primary goals is to ensure maximum return of lottery ticket sales revenue to the beneficiaries of Colorado Lottery proceeds. The Colorado Lottery should review its current games structure and payout percentages to ensure alignment with this primary goal. This could include studies of prize payout modifications to determine the effect of the changes on sales and revenue. This information could be used in designing future games and prize structures to maximize both ticket sales and revenue available to beneficiary agencies.

(Classification of Finding: Not an Internal Control Issue.)

Recommendation No. 1:

The Colorado Lottery should ensure it is maximizing the amount of lottery revenue available to beneficiaries by reevaluating its current games structure, payout percentages, and operating expenses.

Colorado Lottery Response:

Response: Agree – The Lottery is always cognizant of maximizing the amount of proceeds to beneficiaries and continuously evaluates the games and prize payout percentages, as well as operating expenses. One of the goals in the Lottery's strategic plan is to grow Lottery sales and profits to ensure recipients are receiving optimum funding levels. As part of this goal, the Lottery analyzes game-related and overhead costs ensuring expenses do not outpace sales leading to a shortfall in proceeds distributions.

To enhance profitability, the Lottery is planning several changes to boost sales of our more profitable jackpot games. Powerball and Mega Millions are the Lottery's most profitable games. On January 15, 2012, the Powerball game will undergo several changes including an increase to the price from $1 to $2 per play. This change is expected to increase Powerball sales substantially, as well as Mega Millions sales to a lesser extent by continuing to provide a $1 play alternative for a multi-state jackpot game. The Lottery is also evaluating the games and marketing strategies of the entire jackpot game portfolio to maximize overall contributions from these products.

With Scratch games being the Lottery's most popular product, the Lottery will continue to monitor Scratch game prize payouts and overall net revenue by striving to maintain the proper balance between player appeal and profitability.

The Lottery will also evaluate its operating expenses on an ongoing basis while being mindful of investment in critical infrastructure in order to address future business needs and meet its goals.

Implementation Date: Ongoing.

COLORADO LOTTERY
DISPOSITION OF PRIOR YEAR AUDIT RECOMMENDATIONS
Year Ended June 30, 2011

Fiscal Year 2010 Recommendations

Number	Recommendation	Disposition
1	The Colorado Lottery (the Lottery) should ensure that all contract provisions for the development of the Comprehensive Lottery Administrative Support System (CLASS) are adhered to by enforcing contract requirements and through the preparation of a detailed plan to complete unfulfilled contract requirements.	Implemented
2	The Lottery should perform the end of game inventory reconciliation within 30-60 days of the end of the claim period in accordance with current Lottery practice, and should establish written policies regarding end of game inventory reconciliation.	Not Implemented – Implementation in Process, repeated in management letter
3	The Lottery should develop a plan to ensure the institutional knowledge of key personnel is not lost and that the Controller's Office has the experience and capacity to prepare accurate and timely financial statements.	Implemented

Clifton Gunderson LLP
Certified Public Accountants & Consultants

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 years ended June 30, 2011 and 2010, which collectively comprise the Colorado Lottery's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Colorado Lottery's management. Our responsibility is to express opinions on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our 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 and the changes in financial position and, where applicable, cash flows for only that portion of the financial reporting entity, the State of Colorado, that is attributable to the transactions of the Colorado Lottery. They do not purport to, and do not, present fairly the financial position of the State of Colorado as of June 30, 2011 and 2010, and the changes in its financial position, or, where applicable, its cash flows, for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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, 2011 and 2010, and the respective changes in financial position and cash flows, where applicable, thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 9, 2011 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 11 through 25 is 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 audits were conducted for the purpose of forming opinions on the financial statements that collectively comprise the Colorado Lottery's basic financial statements. The accompanying supplementary information as listed in the table of contents is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

Clifton Gunderson LLP

Greenwood Village, Colorado
September 9, 2011

Colorado Lottery
Management's Discussion and Analysis
Years Ended June 30, 2011 and 2010

This discussion and analysis of the Colorado Lottery's financial performance provides an overview of financial activities for the fiscal years ended June 30, 2011 and 2010. 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 $518.9 million was the highest sales year in Lottery history. The second highest sales year was achieved in fiscal year 2008 with sales of $505.8 million and the third highest in fiscal year 2010 with $501.2 million. Overall sales for fiscal year 2011 reflected a $17.7 million increase from fiscal year 2010. In turn, fiscal year 2010 reflected a $7.8 million increase from fiscal year 2009 sales of $493.4 million. The overall increase in sales in 2011 was mainly the result of increased scratch sales of $16.8 million from $328.1 million in fiscal year 2010 to $344.9 million in fiscal year 2011 with a slight increase of $0.9 million in online products. The increase in sales in fiscal year 2010 over fiscal year 2009 was chiefly due to the introduction of two new on-line games – MatchPlay and Mega Millions, with a slight overall decrease of $0.8 million in sales of the other existing products. MatchPlay, introduced in February 2010, had sales of $6.2 million and Mega Millions, introduced in May 2010, had sales of $2.4 million in fiscal year 2010.

  Fiscal year 2011 showed an increase in sales from fiscal year 2010 in both Mega Millions and MatchPlay, mainly due to a full year of sales for both products compared to partial year sales in fiscal year 2010 when the games were introduced. Mega Millions sales increased by $22.7 million from $2.4 million in fiscal year 2010 to $25.1 million in fiscal year 2011. MatchPlay sales increased by $5.2 million, from $6.2 million in fiscal year 2010 to $11.4 million in fiscal year 2011. Online sales in fiscal year 2011 also included an additional $9.0 million with the introduction of a new online game – Raffle.

  Fiscal year 2011 saw a decrease in sales from fiscal year 2010 for each of its other three existing online products due to a larger variety of games to choose from in fiscal year 2011. Powerball sales decreased by $31.5 million from $101.6 million in fiscal year 2010 to $70.1 million in fiscal year 2011, with an associated drop in the average Powerball jackpot from $141.4 million in fiscal year 2010 to $100.2 million in fiscal year 2011. Lotto sales in fiscal year 2011 dropped by $2.4 million from $41.6 million in fiscal year 2010 to $39.2 million in fiscal year 2011. Cash 5 sales decreased from $21.3 million in fiscal year 2010 to $19.2 million in fiscal year 2011 for a $2.1 million decrease.

- Funds distributed or available for distribution from 2011 sales increased slightly from fiscal year 2010. Fiscal year 2011 produced a total of $113.4 million in funds distributions, an increase of $0.5 million from fiscal year 2010 distributions of $112.9 million. The $113.4 for fiscal year 2011 represented the fifth highest year of distributions in the Lottery's history. Fiscal year 2011 included a spill-over of funds in excess of the Great Outdoors Colorado (GOCO) cap. During the fiscal years 2002-2007 this spill-over was distributed into the State Public School Fund Contingency Reserve. In fiscal year 2008, this spill-over was distributed to the Lottery Contingency Reserve Fund. Starting in fiscal year 2009, the spill-over, by statute, is distributed to the Public School Capital Construction Assistance Fund. The spill-over totaled $662,230 and $88,550 for fiscal years 2011 and 2010, respectively. A spill-over occurs when the distribution cap for GOCO is reached in any one year. The cap for GOCO is the 1992 base year amount of $35 million as adjusted for the annual change in the cost of living increase for the Denver-Boulder area. The total amount of the spill-over during the most recent ten-year period totals $51.4 million.

- Gross profit as a percent of sales for fiscal year 2011 decreased by 1.0 percent from fiscal year 2010, a reflection of the 1.1 percent increase in prize expense as a percentage of sales. Gross profit as a percent of sales decreased by 1.0 percent between fiscal years 2009 to 2010, mainly due to the 0.8 percent increase in prize expense as a percentage of sales and a 0.2 percent increase in retailer commissions and bonuses as a percentage of sales. The overall prize expense as a percentage of sales increased from 61.9 to 63.0 percent for the fiscal years ended June 30, 2010 and 2011, respectively. Prize expense for scratch products increased from 68.4 percent to 68.8 percent, while prize expense for online products increased from 49.6 percent to 51.4 percent. The increase in prize expense was offset by an increase in unclaimed prizes of $2.5 million from fiscal year 2010 to fiscal year 2011. The overall prize expense percentage increased from 61.1 percent in fiscal year 2009 to 61.9 percent in fiscal year 2010, consisting of an increase in prize expense for both the scratch products from 67.5 percent to 68.4 percent and online products from 48.4 percent to 49.6 percent. In addition, fiscal year 2010 showed a decrease in unclaimed prizes of nearly $892,000 from fiscal year 2009 contributing to the increase in prize expense. Commissions and bonuses as a percentage of sales were 7.4 percent, 7.6 percent and 7.6 percent for the fiscal years ended June 30, 2009, 2010 and 2011, respectively. Cost of tickets sold and vendor fees as a percentage of sales remained steady at 2.1 percent for fiscal years ended 2009, 2010 and 2011. Vendor fees totaled $7,825,356, $7,653,391, and $7,892,197 for fiscal years ended June 30, 2009, 2010 and 2011, respectively.

Games Offered by the Colorado Lottery

Currently, the Lottery offers two different ways to play: scratch games and online games (Powerball, Lotto, Cash 5, MatchPlay, Mega Millions, and Raffle). 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 $600 and over must be redeemed at the Lottery offices.

Online games, on the other hand, require a longer playing time. Tickets are also purchased at the Lottery retailers and are printed on ticket stock as the purchase is made. Each ticket contains one or possibly more playing boards for one draw or up to thirteen weeks of draws. Each board consists of a set of numbers, the combination of numbers required for play varying by game. For the Raffle game, newly introduced in fiscal year 2011, a pre-determined number of tickets are numbered and issued sequentially upon each sale until the maximum number of tickets is sold out or the last day of sales is reached, whichever comes first. The winning numbers for each game are posted after their respective draw nights with drawings held on every night of the week. Players must check their numbers against the numbers drawn for each respective game to determine if they have a winning ticket. The tickets may also be cashed at the retailer level if the amounts of the winnings are $599 or less. Prizes $600 and over must be redeemed at the Lottery offices.

Colorado Lottery
Management's Discussion and Analysis
Years Ended June 30, 2011 and 2010

Using this Annual Report

This annual report consists of a series of financial statements. The statements of net assets provide information about the Lottery's assets and liabilities and reflect the Lottery's financial position as of June 30, 2011 and 2010. The statements of revenues, expenses and changes in net assets report the activity of selling the Lottery products and the expenses related to such activity for the years ended June 30, 2011 and 2010. Finally, the statements of cash flows outline the cash inflows and outflows related to the activity of selling the Lottery products for the years ended June 30, 2011 and 2010.

Statements of Net Assets

The statements of net assets present a financial snapshot of the Lottery at June 30, 2011 and 2010. 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.

Condensed Statements of Net Assets
June 30, 2011, 2010 and 2009

	2011	2010	2009
Assets			
Current assets	$ 57,902,172	$ 61,950,762	$ 57,535,254
Restricted assets	6,232,920	5,499,120	5,417,337
Capital assets	3,782,655	3,830,221	2,759,701
Total assets	$ 67,917,747	$ 71,280,103	$ 65,712,292
Liabilities			
Current liabilities	$ 60,841,890	$ 63,991,689	$ 60,062,604
Long-term liabilities	875,822	1,026,906	995,069
Total liabilities	$ 61,717,712	$ 65,018,595	$ 61,057,673
Net Assets			
Investment in capital assets	$ 3,782,655	$ 3,830,221	$ 2,759,701
Restricted – Licensed Agent Recovery Reserve	402,793	370,801	388,771
Restricted – Operating Reserve	1,400,000	1,200,000	1,100,000
Unrestricted	614,587	860,486	406,147
Total net assets	$ 6,200,035	$ 6,261,508	$ 4,654,619

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

The Lottery's total assets at June 30, 2011 were $67.9 million. Assets consisted primarily of cash and investments with the State Treasury, including restricted balances, of $39.2 million, Prepaid Prize Expense with Multi-State Lottery (MUSL) of $4.4 million, receivables from Lottery retailers for the sale of Lottery products of $19.2 million and a net investment in fixed assets of $3.8 million.

Comparable figures at June 30, 2010 were $71.3 million in total assets, principally including $42.4 million in cash and investments with the State Treasury, $3.9 million Prepaid Prize Expense with MUSL, $19.8 million receivable from retailers and $3.8 million net investment in fixed assets.

Comparable figures at June 30, 2009 were $65.7 million in total assets, principally including cash and investments with the State Treasury of $36.8 million, Prepaid Prize Expense with MUSL of $3.9 million, receivable from retailers of $20.5 million and a net investment in fixed assets of $2.8 million.

The Lottery's total assets decreased by $3.4 million from fiscal year 2010 to fiscal year 2011. This decrease was primarily caused by the $3.2 decrease in cash and investments and the $0.6 million decrease in receivables from Lottery retailers, offset by the $0.5 million increase in prepaid prize expense with MUSL. The $3.2 million decrease in cash and investments was primarily the result of a corresponding decrease of $3.1 million in current liabilities. The $0.6 million decrease in receivables from Lottery retailers was due the timing of the billing week-ending date and the fiscal year end date. The prepaid prize expense with MUSL increased by $0.5 million due to an increase to the Mega Millions prize reserve funded from a portion of the prize percentage of sales approved and due to MUSL each draw. MUSL has currently not set a limit on the Mega Millions prize reserve. The Lottery's total assets increased by $5.6 million from fiscal year 2009 to fiscal year 2010. This increase was primarily caused by the $5.6 million increase in cash and investments and the $1.0 million increase in the net investment in fixed assets offset by a $0.8 million decrease in receivables from retailers and a slight decrease of $0.2 million in ticket inventories. The $5.6 million increase in cash and investments was the result of the increased sales in the final months of fiscal year 2010 compared to fiscal 2009 due to the introduction of the two new online games. The $1.0 increase in the net investment in fixed assets was the result of the capitalization of the Phase II development of the back office computer system. The decrease in receivables from retailers was primarily caused by the May 2010 completion of the Lottery's planned effort to reduce the number of days at which retailers must pay for scratch tickets being sold from 120 days to 60 days, resulting in a drop in outstanding scratch receivables due from retailers.

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

The Lottery's total liabilities at June 30, 2010 totaled approximately $65.0 million, consisting primarily of prize liability on all the Lottery products of about $29.7 million and proceeds distributions due to recipients of $30.3 million.

The Lottery's total liabilities at June 30, 2009 totaled approximately $61.1 million, which consisted primarily of prize liability on all the Lottery products of about $27.0 million and proceeds distributions due to recipients of $28.1 million.

The Lottery's total liabilities decreased from fiscal year 2010 to fiscal year 2011 by $3.3 million. The decrease was primarily the result of a $4.6 million decrease in proceeds distributions due to recipients and a $0.8 million decrease in the amount due to vendors, offset by a $2.4 million increase in the in prize liability on Lottery products. The $4.6 million decrease in proceeds distributions due to recipients was the result of increases in prize and operating expenses incurred in the 4th quarter of 2011 compared to the same quarter in 2010, resulting in a lower net profit in 2011. The increase in prize liability of $2.4 million was due to the June 30th draw of the Raffle II game where prizes could not be claimed until after July 1, 2011. The Lottery's total liabilities increased from fiscal year 2009 to fiscal year 2010 by $4.0 million. This increase was primarily the result of a $2.7 million increase in prize liability on Lottery products, a $2.2 million increase in proceeds distributions due to recipients and an increase of $0.4 million in retailer bonus liability, offset by a decrease in accounts payable of $1.3 million. Both the $2.7 million increase in the prize liability and the $2.2 million increase in proceeds distributions from fiscal year 2009 to fiscal year 2010 was the result of higher sales experienced in the final months of 2010 due to the introduction of the two new online games of MatchPlay and Mega Millions.

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) remaining unrestricted net assets, which represents an adjustment made by the Lottery to reflect its share of unrealized gains or losses on investments held by the State Treasurer.

The change in net assets from June 30, 2010 to June 30, 2011 consisted of a slight decrease in investment in capital assets of $47,566, a small increase in the bonding reserve from $370,801 to $402,793, an increase in the operating reserve from $1.2 million to $1.4 million and a net decrease in unrealized gain and losses on investments of $245,899 resulting from a net decrease in the adjustments on State Treasury investments.

Following is a schedule of net assets for fiscal years 2011 and 2010:

	2011	2010	Change
Investment in capital assets	$ 3,782,655	$ 3,830,221	$ (47,566)
Bonding reserve	402,793	370,801	31,992
Operating reserve	1,400,000	1,200,000	200,000
Unrestrictied -unrealized gain (loss) on investments	614,587	860,486	(245,899)
Total net assets	$ 6,200,035	$ 6,261,508	$ (61,473)

The change in net assets from June 30, 2009 to June 30, 2010 consisted of an increase in investment in capital assets from $2.8 million to $3.8 million, a decrease in the bonding reserve from $388,771 to $370,801, a increase in the operating reserve from $1.1 million to $1.2 million and a net increase in unrealized gain and losses on investments of $454,339 resulting from a net increase in the adjustments on State Treasury investments.

Following is a schedule of net assets for fiscal years 2010 and 2009:

	2010	2009	Change
Investment in capital assets	$ 3,830,221	$ 2,759,701	$ 1,070,520
Bonding reserve	370,801	388,771	(17,970)
Operating reserve	1,200,000	1,100,000	100,000
Unrestricted -unrealized gain (loss) on investments	860,486	406,147	454,339
Total net assets	$ 6,261,508	$ 4,654,619	$ 1,606,889

Statements of Revenues, Expenses and Changes in Net Assets

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

Condensed Statements of Revenues, Expenses and Changes in Net Assets For the Fiscal Years Ended June 30, 2011, 2010 and 2009

	2011	2010	2009
Operating Revenues	$ 518,920,841	$ 501,197,409	$ 493,364,094
Direct Operating Expenses	377,243,191	359,229,539	348,679,448
Gross Profit on Sale of Tickets	141,677,650	141,967,870	144,684,646
Other Operating Expenses			
Marketing and communications	14,823,254	14,849,003	11,914,439
Wages and benefits	8,636,669	8,139,527	8,527,025
Other operating expenses	5,663,233	5,925,611	4,070,286
Total other operating expenses	29,123,156	28,914,141	24,511,750
Operating Income	112,554,494	113,053,729	120,172,896
Nonoperating Revenues (Expenses)			
Other revenue	184,871	177,641	267,188
Investment income	560,155	1,317,086	1,427,948
Proceeds distributions	(113,360,993)	(112,941,567)	(119,603,855)
Total nonoperating expenses	(112,615,967)	(111,446,840)	(117,908,719)
Increase (Decrease) in Net Assets	(61,473)	1,606,889	2,264,177
Net Assets, Beginning of Year	6,261,508	4,654,619	2,390,442
Net Assets, End of Year	$ 6,200,035	$ 6,261,508	$ 4,654,619

Sales Activities

Revenues from the sales of the Lottery products for the fiscal year ended June 30, 2011 were the highest in the Lottery's 29-year history. As shown in the financial statements, overall sales increased by 3.5 percent or $17.7 million from fiscal year 2010 sales of $501.2 million to $518.9 million in fiscal year 2011. Fiscal year 2010 sales of $501.2 represented an increase of 1.6 percent or $7.8 million from fiscal year 2009 sales of $493.4. Fiscal year 2011 scratch sales of $344.9 million represented a $16.8 million increase or 5.1 percent over the prior year scratch sales of $328.1 million. The increase in scratch sales may be attributed to several factors: 1) the number of individual scratch tickets sold increased by 1.3 percent from 97.3 million tickets to 98.5 million tickets over the previous year with the average ticket price also increasing from $3.37 in fiscal year 2010 to $3.50 in fiscal year 2011; 2) the full courier system, implemented in September 2011, resulted in better availability of scratch tickets to the players; and 3) the perceived improvement of the economy in Colorado with increased spending on Lottery products. Fiscal year 2010 scratch sales of $328.1 million remained nearly the same as the prior year with a slight decrease of only $0.2 million from the prior year sales of $328.3 million.

Total online game sales remained virtually the same in fiscal year 2011 from fiscal year 2010. A slight sales increase from $173.1 million in fiscal year 2010 sales to $174.0 million in fiscal year 2011 represented an increase of $0.9 million or 0.5 percent. With Mega Millions and MatchPlay available for sale the entire 2011 fiscal year and with the introduction of the new $20 Raffle game in September 2011, online players appear to have shifted their dollars to the newer games from the existing ones. Powerball sales in fiscal year 2011 were $70.1 million, a decrease of $31.5 million or 31.0 percent from fiscal year 2010 sales of $101.6 million. The decrease can be attributed to not only the reason mentioned above but to an overall decrease in the average size of the Powerball jackpots from $141.4 million in fiscal year 2010 to $100.2 million in fiscal year 2011. Powerball sales in fiscal year 2010 were $101.6 million, a slight increase of $0.8 million or 0.8 percent over the prior fiscal year sales of $100.7 million. Lotto sales decreased in the current fiscal year to $39.2 million, a decrease of $2.4 million or 5.7 percent from the prior fiscal year sales of $41.6 million. Lotto sales decreased in fiscal year 2010 to $41.6 million, a decrease of $1.9 million or 4.4 percent from fiscal year 2009 sales of $43.5 million. Cash 5 sales showed a 10.1 percent decrease of $2.1 million from fiscal year 2010 sales of $21.3 million to fiscal year 2011 sales of 19.2 million. Cash 5 sales experienced an increase from $20.8 million in fiscal year 2009 to $21.3 million in fiscal year 2010. With a full fiscal year of sales, Mega Millions added $25.1 million to 2011 overall sales, an increase of $22.7 million over the $2.4 million sold in fiscal year 2010 when the game was introduced. MatchPlay added $11.4 million to fiscal year 2011 total sales, an increase of $5.2 million over its sales in its fiscal year 2010 launch. The introduction of the two new online games MatchPlay and Mega Millions in fiscal year 2010 added $8.6 million to 2010 overall sales or 1.7 percent of fiscal year 2010 total sales. Fiscal year 2011 saw the introduction of a new Raffle game with two separate draws held on January 1, 2011 and June 30, 2011. Total sales for the two Raffle draws added $9.0 million or 1.7 percent of the 2011 overall sales.

The following tables compare Lottery product sales between fiscal years.

Product Sales	2011	2010	Difference	Change
Scratch	$ 344,945,609	$ 328,108,741	$ 16,836,868	5.1%
Powerball	70,046,464	101,568,085	(31,521,621)	(31.0)
Lotto	39,257,377	41,620,408	(2,363,031)	(5.7)
Mega Millions	25,126,942	2,403,216	22,723,726	945.6
Cash 5	19,153,751	21,309,593	(2,155,842)	(10.1)
MatchPlay	11,418,378	6,187,366	5,231,012	84.5
Raffle	8,972,320	---	8,972,320	---
Total	$518,920,841	$ 501,197,409	$17,723,432	3.5%

Product Sales	2010	2009	Difference	Change
Scratch	$ 328,108,741	$ 328,254,471	$ (145,730)	(0.0)%
Powerball	101,568,085	100,733,520	834,565	0.8
Lotto	41,620,408	43,544,371	(1,923,963)	(4.4)
Cash 5	21,309,593	20,831,732	477,861	2.3
MatchPlay	6,187,366	---	6,187,366	---
Mega Millions	2,403,216	---	2,403,216	---
Total	$501,197,409	$ 493,364,094	$7,833,315	1.6%

Nonoperating Revenues

Nonoperating revenues for the years ended June 30, 2011 and June 30, 2010 totaled $0.7 million and $1.5 million, respectively. The major reason for the decrease was due to the GASB 31 adjustment recording the Lottery's share of the unrealized gains and losses on investments held by the Treasury decreasing from a $454,339 gain in fiscal year 2010 to a $245,899 loss in fiscal year 2011. In addition, continued decline in interest rates paid on investments in fiscal year 2011 played a role in the decline of nonoperating revenues. The amount of interest received from the treasury decreased approximately $34,000 from fiscal year 2010 to fiscal year 2011, the result of a drop in the average interest rate of 2.30 percent in fiscal year 2010 to 1.95 percent in fiscal year 2011. The interest received from the Multi-State Lottery Association (MUSL) also decreased in fiscal year 2011. The total received was approximately $46,000 compared with $69,000 in fiscal year 2010. Finally the revenue received from MUSL representing Powerball royalties decreased by approximately $21,000 from the prior fiscal year to the current.

Nonoperating revenues for the years ended June 30, 2010 and June 30, 2009 totaled $1.5 million and $1.7 million, respectively. The decrease included a reduction in interest received from the treasury of approximately $284,000 from fiscal year 2009 to fiscal year 2010. This decrease occurred as a result of a decrease in interest rates from an average of 2.72 percent in fiscal year 2009 to 2.30 percent in fiscal year 2010. Also contributing to the decrease in nonoperating revenues was a drop in the interest received from the Multi-State Lottery Association (MUSL). In fiscal year 2009, the total interest received was approximately $86,000 compared with $69,000 in fiscal year 2010. The revenue received from fines and penalties decreased by $147,240, reflecting a reduction in the assessment of liquidated damages to the online vendor. Offsetting these decreases, the GASB 31 adjustment recording the Lottery's share of the unrealized gains and losses on investments held by the Treasury increased from $257,000 in fiscal year 2009 to $454,339 in fiscal year 2010.

Total Revenues

Total revenues were $519.7 million and $502.7 million for the years ended June 30, 2011 and 2010, respectively. As mentioned elsewhere, the major contributing factor to the increase in total revenues of approximately $17.0 million was the 5.1 percent increase in scratch sales and the modest 0.5 percent in total online sales totaling $17.7 million in the current fiscal year. This increase was offset by the approximately $0.7 million reduction of nonoperating revenues mentioned above.

Total revenues were $502.7 million and $495.1 million for the years ended June 30, 2010 and 2009, respectively. As mentioned elsewhere, the major contributing factor to the increase in total revenues of approximately $7.6 million was the introduction of two new on-line games, Matchplay and Mega Millions, with total sales of $8.6 million for fiscal year 2010. This increase was offset by a $0.8 million reduction in sales of the existing products and nonoperating revenues decreased by $0.2 million as mentioned above.

Major Expenses

Approximately $377.2 million of the Lottery's total expenses of $406.4 million for the fiscal year ended June 30, 2011 were incurred in direct support of the Lottery games. These expenses include prize expense, retailer compensation, money spent to purchase scratch tickets and compensation to the vendor who maintains and supports the on-line gaming system. Of the $377.2 million spent in fiscal year 2011 for direct support of the Lottery games, $326.7 million or 86.6% was for prize expense associated with those games.

In comparison, $359.2 million of the Lottery's total expenses of $388.1 million for the fiscal year ended June 30, 2010 were game-related expenses. Of the $359.2 million spent in fiscal year 2010 for direct support of the Lottery games, $310.4 million or 86.4% was spent for prize expense associated with those games.

In comparison, $348.7 million of the Lottery's total expenses of $373.2 million for the fiscal year ended June 30, 2010 were game-related expenses. Of the $348.7 million spent in fiscal year 2009 for direct support of the Lottery games, $301.7 million or 86.5% was spent for prize expense associated with those games.

Prize expense in fiscal year 2011 increased $16.3 million over fiscal year 2010. Generally, prize expense will increase or decrease in conjunction with the increase or decrease in product sales. In fiscal year 2011, $11.0 million of the $16.3 million was a reflection of the increase in sales of $17.7 million. The remaining $5.3 million increase was due to other factors. Three reasons have been identified for this increase.

First, the Lottery saw a shift in product sales mix in fiscal year 2011 accounting for $3.8 million of the $5.3 million increase in prize expense. The shift in product sales mix can be broken down into three components. 1) In fiscal year 2010 scratch sales accounted for 65.5 percent of total sales and the remaining 34.5 percent were online sales. In fiscal year 2011, scratch sales increased by 1.0 percent to 66.5 percent of total sales with a corresponding decrease to the online sales percentage to 33.5 percent. With a higher prize expense compared to online products, the shift to scratch resulted in a $1.1 million increase in prize expense in fiscal year 2011 compared to fiscal year 2010. 2) The scratch game prize expense increase of 0.4 percent in fiscal year 2011 compared to fiscal year 2010 was the result of a shift in sales from the lower price point games ($1 and $2 games) to the higher price point games ($3, $5, $10 and $20). The higher priced tickets carry a higher prize expense percentage causing the overall scratch prize expense increase from 68.4 percent in fiscal year 2010 to 68.8 percent in fiscal years 2011. This shift accounted for $1.3 million of the increase in prize expense. 3) The Lottery also saw a product mix change within the online group itself, with a large shift from the more profitable Powerball game to less profitable newer games accounting for a $1.4 million increase in prize expense.

Next, $1.1 million of the $5.3 million increase in prize expense was attributable to the fact that sales for the second Raffle game fell short of management's expectations. With the first Raffle game selling out, a second game with added bonus features to encourage sales was offered to Lottery players. Unfortunately, the second Raffle game was not as well received by the players, which resulted in lower sales and a higher prize expense as a percentage of sales due to the fixed prize payout feature of the game.

Finally, online games are designed to return a certain percentage of prizes based on sales over the long run. In the short run, this amount can be higher or lower due to the luck of the draw. In fiscal year 2011, total prizes won by online players including jackpot prizes were higher than in fiscal year 2010 resulting in an increase in prize expense of $0.4 million.

The increase in the other game-related expenses from fiscal year 2011 from fiscal year 2010, including retailer commission expense, ticket costs and vendor fees was reflective of the increase in product sales with virtually no overall change in these expenses as a percentage of sales.

Following are tables comparing the game-related expenses between fiscal years 2011 and 2010.

Game-Related Expenses	2011	% of Sales	2010	% of Sales	Difference	Change in % of Sales
Prize Expense including Powerball and Mega Millions prize variances						
Scratch	$237,372,938	68.8%	$224,567,596	68.4%	$12,805,342	0.4%
Powerball	32,694,312	46.7	48,358,921	47.6	(15,664,609)	(0.9)
Lotto	20,768,717	52.9	21,843,486	52.5	(1,074,769)	0.4
Mega Millions	12,754,477	50.8	1,275,005	53.1	11,479,472	(2.3)
Cash 5	10,483,126	54.7	11,081,335	52.0	(598,209)	2.7
MatchPlay	6,967,421	61.0	3,238,067	52.3	3,729,354	8.7
Raffle	5,698,000	63.5	--	--	5,698,000	N/A
Total Prize expense	$326,738,991	63.0%	$310,364,410	61.9%	$16,374,581	1.1%
Retailer compensation						
Commissions	34,531,189	6.6%	33,293,526	6.6%	1,237,663	0.0
Bonuses	5,052,899	1.0	4,853,249	1.0	199,650	0.0
Ticket costs	3,027,915	0.6	3,064,963	0.6	(37,048)	0.0
Vendor fees	7,892,197	1.5	7,653,391	1.5	238,806	0.0
Total	$377,243,191	72.7%	$359,229,539	71.6%	$18,013,652	1.1%

The increase of $8.7 million in prize expense in fiscal year 2010 over fiscal year 2009 was reflective of the corresponding increase in product sales of $7.8 million and also a general increase in prize expense as a percentage of product sales. Of the $8.7 million prize expense increase, $4.8 million was due to the increase in product sales. The remaining $3.9 million increase can also be attributed to the reasons explained above. An increase in overall online prize expense of 0.4 percent from fiscal year 2009 to fiscal year 2010 equated to a $1.6 million increase in prize expense. Specifically, the 2.4 percent increase in Lotto prizes as a percentage of sales was the main contributor to the increase. A shift within the scratch product group to the higher price point tickets from fiscal year 2009 to fiscal year 2010 resulted in a $3.0 million increase in prize expense. Offsetting these increases was a $0.7 million decrease in prize expense attributed to the shift from scratch to the more profitable new online games introduced in fiscal year 2010, MatchPlay and Megamillions. In fiscal year 2009, scratch sales accounted for 66.5 percent of total sales and the remaining 33.5 percent were online sales. In fiscal year 2010, scratch sales decreased by 1.0 percent to 65.5 percent of total sales with a corresponding increase to the online sales percentage to 34.5 percent.

Retailer bonus expense increased by 0.3 percent as a percentage of sales from fiscal years 2009 to 2010 due a change in the marketing performance bonus plan effective January 1, 2010, resulting in increased bonus amounts paid to retailers. The total marketing performance bonuses paid in fiscal year 2010 and fiscal year 2009 were $2,401,421 and $1,183,539, respectively. In addition, the increase in ticket costs from fiscal year 2009 to fiscal year 2010 was the result of the lottery's continued use of licensed property games, which require additional fees to cover the rights to use patented game names, emblems, designs, logos, symbols, characters.

Following are tables comparing the game-related expenses between fiscal years 2010 and 2009.

Game-Related Expenses	2010	% of Sales	2009	% of Sales	Difference	Change in % of Sales
Prize Expense including Powerball and Mega Millions prize variances						
Scratch	$224,567,596	68.4%	$221,618,604	67.5%	$2,948,992	0.9%
Powerball	48,358,921	47.6	47,389,704	47.0	969,217	0.6
Lotto	21,843,486	52.5	21,830,159	50.1	13,327	2.4
Mega Millions	1,275,005	53.1	0	--	1,275,005	N/A
Cash 5	11,081,335	52.0	10,836,099	52.0	245,236	0.0
MatchPlay	3,238,067	52.3	0	--	3,238,067	N/A
Total Prize expense	$310,364,410	61.9%	$301,674,566	61.1%	$8,689,844	0.8%
Retailer compensation						
Commissions	33,293,526	6.6%	32,844,563	6.7%	448,963	(0.1)
Bonuses	4,853,249	1.0	3,636,346	0.7	1,216,903	0.3
Ticket costs	3,064,963	0.6	2,698,617	0.6	366,346	(0.1)
Vendor fees	7,653,391	1.5	7,825,356	1.6	(171,965)	0.0
Total	$359,229,539	71.6%	$348,679,448	70.7%	$10,550,091	0.9%

Of the $29.1 million expenses that were non game-related in fiscal year 2011, more than $14.8 million, a slight drop from the previous year, was for promotions and institutional and product advertising. About $8.6 million, a $0.5 million increase over fiscal year 2010, was for compensation to the Lottery employees. The increase in employee compensation was the result of hiring several employees to fill vacant positions, the discontinuation of the capitalization of salaries and benefits associated with the completion of the back office computer system project, and the furlough program that was used in 2010 but not in 2011. This increase in compensation was offset by a $0.2 million decrease in accrued annual and sick leave due to Lottery retirements. Delivery expense increased by $0.7 million due to the implementation of the full-courier scratch ticket delivery system in fiscal year 2011. Depreciation expense increased by $0.2 million due to the start of depreciating Phase I of the back office computer system project in fiscal year 2011.

Of the $28.9 million in fiscal year 2010 expenses that were non game-related, more than $14.9 million ($2.9 million increase) was for promotions and institutional and product advertising and about $8.1 million ($0.4 million decrease) was for compensation to the Lottery employees.

The $2.9 million increase in promotions and institutional and product advertising from fiscal year 2009 to fiscal year 2010 was the result of an increase in appropriated funds approved in the annual appropriations bill to support an effort to increase the overall sale of lottery products. Of this amount, $2.2 million was used in the promotion and advertising of the new MatchPlay and Mega Millions on-line games. The $0.4 million decrease in compensation for lottery employees was a combination of the capitalization of salaries for the back office computer system project and mandatory furlough days taken by all lottery staff as mandated by the governor.

In comparison, of the fiscal year 2009 non game-related expenses of $24.5 million, more than $11.9 million was for promotions and institutional and product advertising and $8.5 million was for compensation to the Lottery employees.

Distributions to the Proceeds Recipients

The Lottery's efforts generated funds available for distributions of $113.4 million in the current fiscal year. Of these total proceeds, $56.0 million was allocated to the Great Outdoors Colorado Trust Fund, $45.3 million to the Conservation Trust Fund and $11.3 million to the Division of Parks and Outdoor Recreation per the distribution formula stated in Colorado Revised Statutes (C.R.S.) 24-35-210. The maximum distribution to Great Outdoors Colorado of $56.0 million, pursuant to C.R.S. 33-60-104(1)(c) and 33-60-104(2), was reached, thus creating a spill-over into the Public School Capital Construction Assistance Fund of $662,230, pursuant to C.R.S. 22-43.7-104 (2)(b)(III).

The Lottery's proceeds distributions for fiscal year 2010 totaled $112.9 million. Approximately $56.4 million was distributed to Great Outdoors Colorado, $45.2 million to the Conservation Trust Fund, $11.3 million to the Division of Parks and Outdoor Recreation and a spill-over into the Public School Capital Construction Assistance Fund of $88,550.

The Lottery's proceeds distributions for the fiscal year 2009, the third highest year ever, totaled $119.6 million. Approximately $54.3 million was distributed to Great Outdoors Colorado, $47.8 million to the Conservation Trust Fund, $12.0 million to the Division of Parks and Outdoor Recreation and a spill-over into the Lottery Contingency Reserve Fund of $5.5 million.

Capital Assets

The Lottery's investment in capital assets at June 30, 2011, 2010 and 2009 amounted to $3.8 million, $3.8 million and $2.8 million, respectively. The investment in capital assets as of June 30, 2011 included computer equipment, servers, back office computer system, drawing equipment, modular furniture, cameras, and recorders with the addition of approximately $65,000 in leasehold improvements. The investment in capital as of June 30, 2010 included the capitalization of salaries and other costs related to the development of a new back office system. The investment in capital assets as of June 30, 2009 also included the capitalization of salaries and other costs related to the development of the new back office system prior to its implementation classified as Construction in Progress. Capital assets are shown on the Statement of Net Assets at the cost on the day of acquisition. Analysis of changes in capital assets is as follows:

Capital Assets as of
June 30, 2011, 2010 and 2009

	2011	2010	2009
Capital Assets			
Equipment and software	$ 6,378,722	$ 6,724,664	$ 3,144,554
Construction in Progress	---	---	2,295,614
Leasehold Improvements	64,711	---	---
Less: Accumulated Depreciation	(2,660,778)	(2,894,443)	(2,680,467)
Net capital assets	$ 3,782,655	$ 3,830,221	$ 2,759,701

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

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 2011, the Legislature approved supplemental appropriation adjustments for the Lottery. Supplemental appropriations and department level re-allocations were approved in ticket costs, prizes, vendor fees, retailer compensation, health-dental-life, DOR postage allocation, and leased space, offset by reductions in appropriations for Powerball prize variance, legal services, and vehicle lease payments. The final method of funding is special legislation. There was no special legislation affecting the Lottery's budget in fiscal year 2011.

The approved Lottery budget at the beginning of fiscal year 2011 was $511.5 million. Supplemental appropriations and adjustments made in the third quarter increased the budget by $22.9 million; department level allocations approved at the beginning of the fiscal year increased the budget by $82,542 to an amended total of $534.4 million. Total expenditures and roll-forwards for fiscal year 2011 on a budget basis came to $414.6 million, resulting in excess appropriations (or savings) of more than $119.8 million.

Economic Outlook

- Starting January 15, 2012, (January 18, 2012 first drawing) the approved changes to the Powerball game will take effect. The Powerball ticket price will go from the current price of $1 per ticket to $2. The Power Play multiplier feature will continue to be an additional dollar per play. Along with the price change, players will see better odds of winning with a reduced range of numbers from which to choose the Powerball number, bigger jackpot amounts and a change from a variable multiplier to a fixed multiplier when the Power Play option is chosen.

- During first and second quarter of fiscal year 2012, marketing tactics will be heavily geared towards the Mega Millions game with continued emphasis on scratch games. Increasing the awareness of the Mega Millions game will be crucial for those players who prefer the $1 price level of play once the $2 Powerball game starts.

- Management has tentatively planned to eliminate the MatchPlay game due to less than expected sales. In addition, the Lottery will not implement a Raffle game in fiscal year 2012, but may implement one in fiscal year 2013 looking for the return of player enthusiasm for the game, as demonstrated in the first Raffle.

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 2011 and to demonstrate the Lottery's accountability for the money generated from the sale of the Lottery products. If you have questions about this report or need additional information, contact John Caligaris, the Colorado Lottery's Controller, 212 W. 3rd Street, Suite 210, Pueblo, CO 81003.

COLORADO LOTTERY
STATEMENTS OF NET ASSETS
June 30, 2011 and 2010

	2011	2010
Current Assets:		
Cash and investments	$ 37,353,939	$ 40,859,238
Accounts receivable, net of the allowance for doubtful accounts of $169,428 in 2011 and $216,501 in 2010	19,236,806	19,766,854
Consignment inventory, at cost	132,308	119,866
Warehouse inventory, at cost	1,100,188	1,150,213
Prepaid expenses	78,931	54,591
Total current assets	57,902,172	61,950,762
Reserve and Restricted Assets:		
Cash and investments - Operating reserve	1,400,000	1,200,000
Cash and investments - Licensed agent recovery reserve receipts	402,793	370,801
Prepaid prize expense with MUSL	4,430,127	3,928,319
Total reserve and restricted assets	6,232,920	5,499,120
Capital Assets:		
Equipment	6,378,722	6,724,664
Leasehold Improvements	64,711	-
Less accumulated depreciation and amortization	(2,660,778)	(2,894,443)
Total capital assets	3,782,655	3,830,221
Total assets	67,917,747	71,280,103

	2011	2010
Current Liabilities:		
Accounts payable	1,252,207	2,030,841
Prize liability	32,042,529	29,684,061
Payable to MUSL	255,935	221,937
Wages and benefits	843,900	753,220
Accrued annual and sick leave	24,835	23,347
Retailer bonus liability	809,699	1,023,998
Funds available for distribution	25,612,785	30,254,285
Total current liabilities	60,841,890	63,991,689
Long-Term Liabilities:		
Accrued annual and sick leave	807,224	952,451
Expired warrants liability	68,598	74,455
Total long-term liabilities	875,822	1,026,906
Total liabilities	61,717,712	65,018,595
Net Assets		
Investment in capital assets	3,782,655	3,830,221
Restricted-Licensed Agent Recovery Reserve	402,793	370,801
Restricted-Operating Reserve	1,400,000	1,200,000
Unrestricted-Other	614,587	860,486
Total net assets	$ 6,200,035	$ 6,261,508

See Notes to Financial Statements.

COLORADO LOTTERY
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
Years Ended June 30, 2011 and 2010

	2011	2010
Operating Revenues		
Gross ticket sales	$ 518,920,841	$ 501,197,409
Direct Operating Expenses		
Prize expense	326,624,241	313,724,135
Powerball prize variance	792,467	(3,525,004)
Megamillions prize variance	(677,717)	165,279
Retailer commissions and bonuses	39,584,088	38,146,775
Cost of tickets and vendor fees	10,920,112	10,718,354
Total direct operating expenses	377,243,191	359,229,539
Gross Profit on Sale of Tickets	141,677,650	141,967,870
Other Operating Expenses		
Marketing and communications	14,823,254	14,849,003
Administration fees paid to MUSL	116,175	103,370
Wages and benefits	8,636,669	8,139,527
Professional services	614,802	307,618
State agencies services	129,813	143,828
Department of Revenue services	528,542	528,898
Travel	146,229	105,120
Equipment (including loss on disposition of equipment of $110,479 and $40,157, respectively)	198,071	1,303,569
Depreciation	795,467	621,027
Accrued annual and sick leave	(144,923)	34,300
Space rental	704,995	699,423
Rents for equipment	32,046	23,935
Motorpool leasing	352,785	310,100
Materials and supplies	152,417	129,792
Telephone	143,733	112,923
On-Line telecommunications	372,579	499,321
Data processing supplies and services	32,899	71,844
Equipment maintenance	365,071	453,841
Postage	65,786	51,210
Printing	6,097	6,919
Delivery expense	963,827	289,778
Other	86,822	128,795
Total other operating expenses	29,123,156	28,914,141

COLORADO LOTTERY
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
(Continued)
Years Ended June 30, 2011 and 2010

	2011	2010
Operating income	112,554,494	113,053,729
Nonoperating Revenues (Expenses)		
Other revenue	184,871	177,641
Investment income	560,155	1,317,086
Funds distributed for current year	(87,748,208)	(82,687,282)
Funds available for distribution for current year	(25,612,785)	(30,254,285)
Total nonoperating revenues (expenses)	(112,615,967)	(111,446,840)
Net income (loss)	$ (61,473)	$ 1,606,889
Net assets, beginning of year	$ 6,261,508	$ 4,654,619
Net change in net assets	(61,473)	1,606,889
Net assets, end of year	$ 6,200,035	$ 6,261,508

See Notes to Financial Statements.

COLORADO LOTTERY
STATEMENTS OF CASH FLOWS
Years Ended June 30, 2011 and 2010

	2011	2010
Operating activities		
Cash received from retailers	$ 518,382,515	$ 505,681,172
Cash paid in prizes	(323,877,300)	(311,074,905)
Cash paid in retailer commissions	(34,531,189)	(33,293,526)
Cash payments to suppliers	(31,051,756)	(31,890,345)
Cash payments to employees for services	(8,544,805)	(8,053,207)
Cash paid in retailer bonus	(5,267,198)	(4,436,959)
Net cash provided by operating activities	115,110,267	116,932,230
Noncapital Financing Activities		
Distribution of net proceeds	(118,002,493)	(110,777,514)
Net cash used by noncapital financing activities	(118,002,493)	(110,777,514)
Capital and related financing activities		
Acquisition of capital assets	(941,236)	(1,867,825)
Net cash used by capital and related financing activities	(941,236)	(1,867,825)
Investing activities		
Interest received	806,054	862,747
Net cash provided by investing activities	806,054	862,747
Increase (Decrease) in Cash and Investments	(3,027,408)	5,149,638
Change in Fair Market Value of Investments	(245,899)	454,339
Cash and investments, Beginning of Year (including $1,570,801 and $1,488,771, respectively, in restricted accounts)	42,430,039	36,826,062
Cash and investments, End of Year, (including $1,802,793 and $1,570,801, respectively, in restricted accounts)	$ 39,156,732	$ 42,430,039

COLORADO LOTTERY
STATEMENTS OF CASH FLOWS (Continued)
Years Ended June 30, 2011 and 2010

	2011	2010
Reconciliation of operating income to net cash provided by operating activities		
Operating income	$ 112,554,494	$ 113,053,729
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	795,467	621,027
Disposition of equipment	112,279	40,157
Other revenue	184,871	177,641
(Increase) decrease in prepaid prize expense with MUSL	(501,808)	247
Change in:		
Accounts receivable	530,048	782,589
Ticket inventory	37,583	238,409
Other assets	(24,340)	85,441
Liabilities (excluding funds available for distribution)	1,421,673	1,932,990
Net cash provided by operating activities	$ 115,110,267	$ 116,932,230
Statement of Net Assets Classification		
Cash and investments	$ 37,353,939	$ 40,859,238
Cash and investments - Licensed Agent Recovery Reserve	402,793	370,801
Cash and investments - Operating Reserve	1,400,000	1,200,000
	$ 39,156,732	$ 42,430,039

See Notes to Financial Statements.

COLORADO LOTTERY
POWERBALL ANNUITY WINNERS TRUST FUND
STATEMENTS OF FIDUCIARY NET ASSETS
June 30, 2011 and 2010

	2011	2010
ASSETS		
Current assets:		
Investments	$ 10,288,210	$ 10,679,081
Total Assets	$ 10,288,210	$ 10,679,081
NET ASSETS		
Held in Trust for Powerball winner	$ 10,288,210	$ 10,679,081
Total Net Assets	$ 10,288,210	$ 10,679,081

See Notes to Financial Statements.

COLORADO LOTTERY
POWERBALL ANNUITY WINNERS TRUST FUND
STATEMENTS OF CHANGES IN FIDUCIARY NET ASSETS
Years Ended June 30, 2011 and 2010

	2011	2010
Additions		
Investment income	$ 10,129	$ 1,171,667
Total additions	10,129	1,171,667
Deductions		
Prize payment	401,000	386,000
Change in net assets	(390,871)	785,667
Net Assets held in Trust for Powerball winner		
Beginning of Year	10,679,081	9,893,414
End of Year	$ 10,288,210	$ 10,679,081

See Notes to Financial Statements.

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

Nature of Operations

The Colorado Lottery (the Lottery) began operations April 30, 1982 under the provisions of Section 24-35-202, C.R.S. The Lottery operates under a commission and provides operation and service of lottery games as authorized by the statute. The Lottery's revenues are predominantly earned from the sale of lottery products, including scratch, Lotto, Powerball, Cash 5, MatchPlay, Mega Millions and, in fiscal year 2011, Raffle.

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, 2011 and 2010. 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.

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

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

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 non-operating 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 fund. Those statements are included herein.

Basis of Accounting

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

Revenues (additions) are recognized in the Powerball Annuity Winners Trust Fund based on the Fair Market Value of the original investment as of June 30, 2011 and 2010. Expenses (deductions) are recognized when payments are remitted to the winner(s).

Budget

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

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

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

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

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

The Lottery uses the specific identification method to determine expected uncollectibles. Under the provisions of Section 24-35-219, C.R.S., licensed agent recovery reserve receipts are collected from the retailers to cover uncollectible accounts. The accounts receivable and the licensed agent recovery reserve receipts are shown net of estimated uncollectible receivables of $169,428 and $216,501 as of June 30, 2011 and 2010, 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.

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.

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

Prepaid Prize Expense

As part of the Lottery's agreement with Multi-State Lottery Association (MUSL), for both the Powerball and Mega Millions games, a certain percentage of sales must be paid to MUSL for set prize and grand prize reserves.

Capital Assets

Capital assets, which include internal use computer software, 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 and internal use computer software 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 and benefits at June 30, 2011 and 2010 of $843,900 and $753,220, 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 an increase to prize expense. Net unclaimed scratch prizes resulted in a decrease to prize expense of $7,277,648 for the fiscal year ended June 30, 2011 and $4,988,409 for the fiscal year ended June 30, 2010.

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

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 $3,573,284 for the fiscal year ended June 30, 2011 and $3,359,247 for the fiscal year ended June 30, 2010.

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

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

Retailer Bonus Liability

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

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

The cashing bonus is accrued as tickets are sold and paid as winning tickets are redeemed. Any cashing bonuses unclaimed at the end of the claim period in fiscal years 2011 and 2010 resulted in a reduction of bonus expense.

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

The marketing performance bonus is accrued monthly and paid to retailers in accordance with the criteria as set out in the calendar year marketing performance plan as approved by the Director. Any excess marketing performance bonus accrued in fiscal years 2011 and 2010 resulted in a reduction of bonus expense.

Licensed Agent Recovery Reserve

Under the provisions of Section 24-35-219, C.R.S., a Licensed Agent Recovery Reserve was established on January 1, 1988 to maintain surety bond receipts collected from Lottery retailers. Billing rates are established by the 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, 2011 and June 30, 2010, the Lottery has reserved $402,793 and $370,801, respectively. The Lottery utilizes restricted net assets before using unrestricted net assets.

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 is reviewed annually and adjusted accordingly. The annual reviews were completed in November 2009 and October 2010. The reserve was increased to $1.2 million and to $1.4 million in fiscal years 2010 and 2011, respectively, in accordance with the reviews.

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 under the capitalization threshold, software purchases under the capitalization threshold, and other miscellaneous equipment transactions that do not qualify for capitalization.

Compensated Leave

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

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

	June 30, 2010	Increases	Decreases	June 30, 2011
Annual leave	$ 823,566	$ 552,164	$ (675,027)	$ 700,703
Sick leave	150,647	43,389	(63,961)	130,075
Total annual and sick leave	974,213	595,553	(738,988)	830,778
Compensatory time	1,585	4,470	(4,774)	1,281
Total compensated leave	$ 975,798	$ 600,023	$ (743,762)	$ 832,059

	June 30, 2009	Increases	Decreases	June 30, 2010
Annual leave	$ 771,139	$ 596,688	$ (544,261)	$ 823,566
Sick leave	145,426	43,031	(37,810)	150,647
Total annual and sick leave	916,565	639,719	(582,071)	974,213
Compensatory time	4,113	16,576	(19,104)	1,585
Total compensated leave	$ 920,678	$ 656,295	$ (601,175)	$ 975,798

The short-term portion of the above accrued annual and sick leave at June 30, 2011 is $24,835 and for June 30, 2010 is $23,347.

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. A request for $308 was made and received for fiscal year ending June 30, 2011 from the Unclaimed Property Fund and no request was made for fiscal year 2010.

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 allow the player to purchase online tickets good for up to 13 weeks. Prior to July 2009, the Lottery recorded deferred revenue from the sale of advance play tickets as a liability and recognized the revenues as draws occurred. Starting in July 2009, the Lottery elected to recognize the revenues from advance play sales immediately upon purchase.

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

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. Specific promotional coupons with a total face value of $6,020 and $0 were redeemed in fiscal years ended June 30, 2011 and June 30, 2010, respectively. A new type of promotional coupon was introduced in 2010. These coupons are in the form of a scratch ticket and can be redeemed at any retailer location for a specified online product. Scratch ticket promotional coupons with a total face value of $22,566 were redeemed in fiscal year ended June 30, 2011 and $27,182 in fiscal year ended June 30, 2010. 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, 2011 and 2010, scratch tickets with a total face value of $219,020 and $179,388, respectively, were given away. Scratch ticket and coupon promotions are valued at cost. For the fiscal years ended June 30, 2011 and 2010, $159,119 and $144,250, 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, 2011 and 2010 is as follows:

	2011	2010
Petty cash	$ 800	$ 800
Change funds	71,000	70,000
Imprest fund	157,000	732,000
Depository accounts	30,000	30,000
Cash on deposit with State Treasurer	37,095,139	40,026,438
Total unrestricted cash and investments	37,353,939	40,859,238
Restricted cash and investments – Licensed Agent Recovery Reserve Receipts on deposit with State Treasurer	402,793	370,801
Operating Reserve on deposit with State Treasurer	1,400,000	1,200,000
Total restricted cash and investments	1,802,793	1,570,801
Total cash and investments	$ 39,156,732	$ 42,430,039

NOTE 2 – CASH AND INVESTMENTS (CONTINUED)

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 2011 and 2010 was 1.95% and 2.30%, 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 $250,000 per institution are secured through PDPA with guaranteed securities.

Investments

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

NOTE 2 – CASH AND INVESTMENTS (CONTINUED)

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

Custodial Credit Risk – Investments

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

Interest Rate Risk – Investments

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

	2011		**2010**	
Investment Type	**Fair Value**	**Weighted Average Maturity (in years)**	**Fair Value**	**Weighted Average Maturity (in years)**
U. S. Treasury Investments	$ 2,708,649	19.53	$ 2,873,855	20.73
Federal Judiciary	1,714,793	8.67	870,658	9.66
Government Trust Certificates	196,390	5.26	185,729	6.26
U.S. Aid Bonds	3,500,856	6.62	3,768,933	6.85
Resolution Funding Corp Strips	2,167,522	14.02	2,979,906	13.54
	$ 10,288,210		$ 10,679,081	

NOTE 2 – CASH AND INVESTMENTS (CONTINUED)

Credit Risk – Investments

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

Concentration of Credit Risk – Investments

Investment in any one issuer (other than U.S. Treasury securities, other investments explicitly guaranteed by the U. S. government, mutual funds, and external investment pools) that represent 5% or more of the total investment as of June 30, 2011 are the Resolution Funding Corporation Strips and the Federal Judiciary Bonds, which represent 21.1% and 16.7%, respectively, of the total investments. Such securities representing 5% or more of the total investment as of June 30, 2010 were the Resolution Funding Corporation Strips and the Federal Judiciary Bonds, which represented 27.9% and 8.2%, respectively, of the total investments.

Statements of Cash Flows

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

NOTE 3 – SCHEDULE OF CHANGES IN CAPITAL ASSETS

	June 30, 2010	Increases	Decreases	June 30, 2011
Capital assets being depreciated:				
Equipment and software	$ 6,724,664	$ 795,469	$ (1,141,411)	$ 6,378,722
Leasehold improvements	-	64,711	-	64,711
Total historical costs	6,724,664	860,180	(1,141,411)	6,443,433
Less accumulated depreciation for equipment	(2,894,443)	(795,467)	1,029,132	(2,660,778)
Less accumulated depreciation for leasehold improvements	-	-	-	-
Total accumulated depreciation	(2,894,443)	(795,467)	1,029,132	(2,660,778)
Total capital assets, being depreciated, net	$ 3,830,221	$ 64,713	$ (112,279)	$ 3,782,655

NOTE 3 – SCHEDULE OF CHANGES IN CAPITAL ASSETS (CONTINUED)

	June 30, 2009	Increases	Decreases	June 30, 2010
Construction in progress-not depreciated	$ 2,295,614	$ -	$ (2,295,614)	$ -
Capital assets being depreciated:				
Equipment and software	3,144,554	4,027,318	(447,208)	6,724,664
Total historical costs	5,440,168	4,027,318	(2,742,822)	6,724,664
Less accumulated depreciation for equipment	(2,680,467)	(621,027)	407,051	(2,894,443)
Total accumulated depreciation	(2,680,467)	(621,027)	407,051	(2,894,443)
Total capital assets, being depreciated, net	$ 2,759,701	$ 3,406,291	$ (2,335,771)	$ 3,830,221

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. A third amendment to the lease was signed on April 8, 2009 extending the lease for two additional years effective July 1, 2009 and expiring on June 30, 2011. A fourth amendment to the lease was signed on August 7, 2009 to lease an additional 6,000 square feet, expiring on June 30, 2011. The Lottery entered into a new lease agreement, which began July 1, 2011 and expires June 30, 2016. The lease contains an option to renew for one additional five-year term commencing on July 1, 2016. The lease also contains a holdover clause where the Lottery will become a month-to-month tenant if the Lottery fails to vacate the premises upon expiration or sooner termination of this lease. The rent to be paid by the Lottery during such continued occupancy shall be the same being paid by the Lottery as of the date of expiration or sooner termination. Landlord and the Lottery each hereby agree to give the other party at least thirty days written notice prior to termination of any holdover tenancy.

NOTE 4 – OPERATING LEASES (CONTINUED)

Denver

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

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

Fort Collins

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

Grand Junction

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

Colorado Springs

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

NOTE 4 – OPERATING LEASES (CONTINUED)

Operating lease expense incurred for the fiscal years ended June 30, 2011 and 2010 and future minimum lease payments for fiscal years ending June 30, 2011 through 2016 and later years are as follows:

LOCATION			FUTURE MINIMUM LEASE PAYMENTS					
	2010	2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	LATER YEARS
Pueblo Office	$ 232,919	$ 236,326	$ 246,748	$ 253,704	$ 260,830	$ 268,295	$ -	$ -
Pueblo Warehouse	150,132	148,523	176,139	176,139	176,139	176,139	176,139	-
CoSprgs Warehouse	13,887	9,688	-	-	-	-	-	-
Denver	169,691	171,222	181,703	187,684	193,665	199,646	205,627	652,767
Denver Warehouse	93,112	90,983	80,287	82,533	85,004	87,811	-	-
Fort Collins	30,770	39,329	-	-	-	-	-	-
Grand Junction	6,996	7,200	-	-	-	-	-	-
	$ 697,507	$ 703,271	$ 684,877	$ 700,060	$ 715,638	$ 731,891	$ 381,766	$ 652,767

NOTE 5 – OTHER REVENUE

A schedule of other revenue for the fiscal years ended June 30, 2011 and 2010 follows:

	2011	2010
License fees	$ 59,577	$ 64,154
Fines and penalties	61,400	28,900
Assignment fees	2,430	3,600
Net licensed agent recovery reserve receipts	31,992	(17,970)
Royalty income	3,395	24,753
Ended game revenue	-	47,867
Other	26,077	26,337
Total	$ 184,871	$ 177,641

NOTE 6 – DISTRIBUTION OF NET PROCEEDS

In accordance with Section 33-60-104, C.R.S., distributions of net proceeds shall be made on a quarterly basis. The State Treasurer shall distribute net lottery proceeds as follows: forty percent (40%) to the Conservation Trust Fund, ten percent (10%) to the Division of Parks and Outdoor Recreation and all the remaining net lottery proceeds in trust to the State Board of the Great Outdoors Colorado Trust Fund up to the statutory limit. Under Section 33-60-104(2), C.R.S., the limit is $35 million as adjusted annually based on the consumer price index. Any excess over the limit shall be transferred to the State Public School Fund. In fiscal year 2008 these proceeds were transferred to the Lottery Proceeds Contingency Reserve Fund as set forth in section 22-54-117(1.6)(a), C.R.S. Starting in fiscal year 2009 these proceeds were transferred to the Public School Capital Construction Assistance Fund as set forth in section 22-43.7-104(2)(b)(III), C.R.S.

NOTE 6 – DISTRIBUTION OF NET PROCEEDS (CONTINUED)

Income available for distribution at June 30:

	2011	2010
Operating income	$112,554,494	$113,053,729
Plus: Other revenue	184,871	177,641
Investment income	560,155	1,317,086
Income before distributions	113,299,520	114,548,456
Change in licensed agent recovery reserve	(31,992)	17,970
Change in fair market value of investments	245,899	(454,339)
Change in operating reserve	(200,000)	(100,000)
Other changes in investment in capital assets	47,566	(1,070,520)
Income available for distribution	113,360,993	112,941,567
Less distributions prior to year-end	(87,748,208)	(82,687,282)
Income available for distribution	$ 25,612,785	$ 30,254,285

	Accrued at June 30, 2010	Proceeds Distributions Expenses	Distributions Paid	Accrued at June 30, 2011
Great Outdoors Colorado	$ 15,038,589	$ 56,018,266	$ (58,912,693)	$ 12,144,162
Public School Capital Construction Assistance Fund	88,550	662,230	(88,550)	662,230
Conservation Trust Fund	12,101,715	45,344,397	(47,200,998)	10,245,114
Division of Parks and Outdoor Recreation	3,025,431	11,336,100	(11,800,252)	2,561,279
	$ 30,254,285	$113,360,993	$(118,002,493)	$ 25,612,785

	Accrued at June 30, 2009	Proceeds Distributions Expenses	Distributions Paid	Accrued at June 30, 2010
Great Outdoors Colorado	$ 8,510,377	$ 56,382,233	$ (49,854,021)	$ 15,038,589
Public School Capital Construction Assistance Fund	5,534,736	88,550	(5,534,736)	88,550
Conservation Trust Fund	11,236,093	45,176,627	(44,311,005)	12,101,715
Division of Parks and Outdoor Recreation	2,809,026	11,294,157	(11,077,752)	3,025,431
	$ 28,090,232	$112,941,567	$(110,777,514)	$ 30,254,285

NOTE 7 – PENSION PLANS

Plan Description

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

New employees, excluding four-year college and university employees, are allowed 60 days to elect to participate in PERA's defined contribution retirement plan. If that election is not made, the employee becomes a member of PERA's defined benefit plan. Prior to legislation passed during the 2006 session, higher education employees may have participated in social security, PERA's defined benefit plan, or the institution's optional retirement plan. Currently, higher education employees, except for community college employees, are required to participate in their institution's optional plan, if available, unless they are active or inactive members of PERA with at least one year of service credit. In that case they may elect either PERA or their institution's optional plan. Community college employees hired after January 1, 2010, are required to become members of PERA's defined benefit or defined contribution plan.

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

Based on changes in the 2010 legislative session slightly different plan requirements were in effect until December 31, 2010. The following requirements were effective at June 30, 2011.

Plan members (except State troopers) are eligible to receive a monthly retirement benefit when they meet age and service requirements based on their original hire date as follows:

Hired before July 1, 2005 – age 50 with 30 years of service, age 60 with 20 years of service, or age 65 with 5 years of service.

- Hired between July 1, 2005 and December 31, 2006 – any age with 35 years of service, age 55 with 30 years of service, age 60 with 20 years of service, or age 65 with 5 years of service.

NOTE 7 – PENSION PLANS (CONTINUED)

- Hired between January 1, 2007 and December 31, 2010 – any age with 35 years of service, age 55 with 30 years of service, age 60 with 25 years of service, or age 65 with 5 years of service. For employees hired before January 1, 2007, age and service requirements increase to those required for members hired between January 1, 2007 and December 31, 2010 if the member has less than five years of service credit as of January 1, 2011.

- Hired between January 1, 2011 and December 31, 2016 – any age with 35 years of service, age 58 with 30 years of service, or age 65 with 5 years of service.

- Hired on or after January 1, 2017 – any age with 35 years of service, age 60 with 30 years of service, or age 65 with 5 years of service.

Members with five years of service credit at January 1, 2011, are also eligible for retirement benefits without a reduction for early retirement based on the original hire date, as follows:

Hired before January 1, 2007 – age 55 and age plus years of service equals 80 or more.

- Hired between January 1, 2007 and December 31, 2010 – age 55 and age plus years of service equals 85 or more. For members hired before January 1, 2007, age plus years of service increase to 85 for members with less than five years of service credit as of January 1, 2011.

- Hired between January 1, 2011 and December 31, 2016 – age 58 and age plus years of service equals 88 or more.

- Hired on or after January 1, 2017 – age 60 and age plus years of service equals 90.

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

Most members automatically receive the higher of the defined retirement benefit or money purchase benefit at retirement. Defined benefits are calculated as 2.5 percent times the number of years of service times the highest average salary (HAS). For retirements before January 1, 2009, HAS is calculated as one-twelfth of the average of the highest salaries on which contributions were paid, associated with three periods of 12 consecutive months of service credit and limited to a 15 percent increase between periods if the salaries used were from the last three years of employment. For retirements after January 1, 2009, four periods are used and are ranked from lowest to highest with the maximum increase between years limited to 15 percent. For members hired on or after January 1, 2007, the maximum increase between ranked periods is 8 percent. Notwithstanding any other provisions, members first eligible for retirement after January 2, 2011 have a maximum increased between periods of 8 percent.

NOTE 7 – PENSION PLANS (CONTINUED)

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

- Hired before July 1, 2007 – the lesser of 2 percent or the average of the monthly Consumer Price Index increases.

- Hired on or after January 1, 2007 – the lesser of 2 percent or the actual increase in the national Consumer Price Index, limited to a 10 percent reduction in a reserve established for cost of living increases related strictly to those hired on or after January 1, 2007. (The reserve is funded by 1 percentage point of salaries contributed by employers for employees hired on or after January 1, 2007.)

- The upper limits on benefits increase by one-quarter percentage point each year when the funded ratio of PERA equals or exceeds 103 percent and declines by one-quarter percentage point when the funded ratio drops below 90 percent after having exceeded 103. percent. The funded ratio increase does not apply for three years when a negative return on investment occurs.

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

Funding Policy

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

Most employees contribute 8.0 percent (10.0 percent for State troopers) of their salary, as defined in CRS 24-51-101(42), to an individual account in the plan. Effective July 1, 2010, Senate Bill 10-146 requires members in the State and Judicial Divisions to pay 2.5 percent additional member contributions through June 30, 2011. Employer contributions for members in these two divisions will be reduced by 2.5 percent. Senate Bill 11-076 continued these contribution rates through June 30, 2012.

From July 1, 2010, to December 31, 2010, the State contributed 11.35 percent (14.05 percent for State troopers and 14.86 percent for the Judicial Branch) of the employee's salary. From January 1, 2011, through June 30, 2011, the State contributed 12.25 percent (14.95 percent for State troopers and 14.86 percent for the Judicial Branch). During all of Fiscal Year 2010-11, 1.02 percent of the employees' total salary was allocated to the Health Care Trust Fund.

NOTE 7 – PENSION PLANS (CONTINUED)

Per Colorado Revised Statutes, an amortization period of 30 years is deemed actuarially sound. At December 31, 2010, the division of PERA in which the State participates has a funded ratio of 62.8 percent and a 47 year amortization period based on current contribution rates. The funded ratio on the market value of assets is lower at 61.3 percent.

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 percent of salary beginning January 1, 2006, another .5 percent of salary in 2007, and subsequent year increases of .4 percent of salary until the additional payment reaches 3.0 percent 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.

In the 2010 legislative session, the General Assembly extended both the AED and SAED. The AED will continue to increase at a rate of 0.4 percent of salary from calendar years 2013 through 2017. The SAED will continue to increase by one-half percentage point from calendar years 2014 through 2017. Both the AED and SAED will be reduced by one-half percent point when funding levels reach 103 percent, and both will be increased by one-half percent point when the funding level subsequently falls below 90 percent. Neither the AED nor the SAED may exceed 5 percent.

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

The Lottery's contributions to the PERA defined benefit plan and/or the defined contribution plan for the fiscal years ending June 30, 2011, 2010, and 2009 were $677,156, $730,534, and $732,099, respectively. These contributions met the contribution requirement for each year.

NOTE 8 – OTHER RETIREMENT PLANS

Defined Contribution Plan

The PERA Defined Contribution Retirement Plan was established January 1, 2006, as an alternative to the defined benefit plan. All employees, with the exception of certain higher education employees, have the option of participating in the plan. New member contributions to the plan vest from 50 percent to 100 percent evenly over 5 years. Participants in the plan are required to contribute 8 percent (10 percent for state troopers) of their salary. For Fiscal Years 2009-10 and 2010-11 the legislature temporarily increased the required contribution rate to 10.5 percent (12.5 percent for State Troopers). At December 31, 2010, the plan had 3,479 participants.

NOTE 8 – OTHER RETIREMENT PLANS (CONTINUED)

Deferred Compensation Plan

The PERA Deferred Compensation Plan (457) was established July 1, 2009, as a continuation of the State's deferred compensation plan which was established for state and local government employees in 1981. At July 1, 2009, the State's administrative functions for the 457 plan were transferred to PERA, where all costs of administration and funding are borne by the plan participants. In calendar year 2010, participants were allowed to make contributions of up to 100 percent of their annual gross salary (reduced by their 8 percent PERA contribution with a temporarily increase to 10.5 percent for Fiscal Years 2010-11 and 2011-12) to a maximum of $16,500. Participants who were age 50 and older and contributing the maximum amount allowable were allowed to make an additional $5,500 contribution in 2010, for total contributions of $22,000. Contributions and earnings are tax deferred. At December 31, 2010, the plan had 18,215 participants.

PERA also offers a voluntary 401k plan entirely separate from the defined benefit pension plan, the deferred compensation plan, and the defined contribution plan. Certain agencies and institutions of the State offered 403(b) or 401(a) plans.

NOTE 9 – OTHER POSTEMPLOYMENT BENEFITS AND LIFE INSURANCE

Health Care Plan

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

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

NOTE 9 – OTHER POSTEMPLOYMENT BENEFITS AND LIFE INSURANCE (CONTINUED)

Employees are not required to contribute to the Health Care Trust Fund, which is maintained by employer's contributions as discussed above in Note 7. Beginning July 1, 2004, State agencies/institutions are required to contribute 1.02 percent of gross covered wages to the Health Care Trust Fund. The Lottery contributed $63,995, $60,171, and $65,160 as required by statute in Fiscal Years 2010-11, 2009-10, and 2008-09, 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, 2010, there were 48,455 enrolled participants, including spouses and dependents, from all contributors to the plan. At December 31, 2010, the Health Care Trust Fund had an unfunded actuarial accrued liability of $1.35 billion, a funded ratio of 17.5 percent, and a 42-year amortization period. The actuarial valuation was based on the entry age cost method, an 8 percent investment rate of return, a 4.5 percent projection of salary increases (assuming a .75 percent inflation rate), a 3.5 percent annual medical claims increase, no post-retirement benefit increases, and a level dollar amortization on an open basis over 30 years.

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 May 27, 2035.

Specified prize payments	$346,024,867
Lifetime prize payments	35,850,000
Total guaranteed minimum prize payments	$381,874,867

Prize Commitment – The Lottery also acts as a transfer agent for the single Powerball Jackpot Winner on October 10, 2007. These funds are held in trust at the MUSL in securities deemed appropriate by the Grand Prize Trust Agreement. The future value of this prize was $18,485,000 as of June 30, 2011.

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

NOTE 10 – CONTINGENCIES AND COMMITMENTS (CONTINUED)

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

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

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

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

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.

NOTE 10 – CONTINGENCIES AND COMMITMENTS (CONTINUED)

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 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. The Lottery has exercised the sole two-year renewal option period extending the contract through October 31, 2014. There are also available renewal options for two additional periods of ninety days for conversion and turnover purposes. Per Amendment 7, the amended total cost of the initial contract period is not to exceed $90,460,975.

The Lottery entered into three contracts with scratch vendors, one starting on February 28, and the other two starting on March 1 2011. All three contracts expire on June 30, 2014. The Lottery may require continued performance for three additional periods of 12 months on all three contracts beyond the expiration date. In addition, in the event that a contract with a successor contractor cannot be signed prior to the expiration or termination date of this contract, the State reserved the right to extend these contracts for a maximum of one hundred eighty (180) days or until a new contract is executed, whichever occurs first. There are no other provisions for extension or renewal. The total costs of the contracts for the initial contract period are not to exceed a total of $12,100,000.

The Lottery was approved as a member of the MUSL on February 26, 2001 and thus entered into an agreement with MUSL on June 6, 2001 to become a member and participate in Powerball games. As a member, the Lottery agrees to abide by the terms of the Multi-State Agreement dated September 16, 1987 and to any amendments to that agreement duly made by the board. The Lottery will remain a member indefinitely. Pursuant to this agreement, the Lottery will make payments to MUSL for administrative fees, weekly prize expenses, promotional purchases, miscellaneous reimbursements and assessments and contributions to the prize reserves. Both the total amount to be contributed and the amount funded by the Lottery to the Powerball prize reserves as of June 30, 2011 is $4,214,113 and is based on a percentage of sales. This amount is 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.

In 2009, the Powerball and Mega Millions governing bodies entered discussions regarding cross-selling the Powerball and Mega Millions games, whereby each state currently selling Mega Millions tickets would also sell Powerball tickets and those states currently selling Powerball tickets would also sell Mega Million tickets. On March 10, 2010, the Lottery commission voted to allow the Colorado Lottery to participate in the cross-selling of the Mega Millions game. The rule became effective as of April 30, 2010 and the first day of ticket sales was May 16, 2010. The Multi-State Lottery Association (MUSL) agreed to undertake the

NOTE 10 – CONTINGENCIES AND COMMITMENTS (CONTINUED)

administrative functions associated with the Mega Millions game for the states currently participating in their Powerball game. MUSL immediately began collecting a percentage of sales to fund the newly formed Mega Millions prize reserve fund. No cap on the reserve had been set as of June 30, 2010. The Colorado Lottery's balance in the reserve as of June 30, 2011 is $216,014.

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 expired on June 30, 2010. The Lottery has the option to renew the contract for two (2) additional twelve-month periods. On June 11, 2010, the Lottery exercised its first option to renew the contract for one (1) additional twelve-month period starting on July 1, 2010, and expiring on June 30, 2011, for a total cost of $14,950,000 for fiscal year 2011. On June 20, 2011, the Lottery exercised its second option to renew the contract for one (1) additional twelve-month period starting on July 1, 2011, and expiring on June 30, 2012 for a total cost of $14,950,000 for the fiscal year 2012. The total cost of the initial contract period including previous amendments plus the two twelve-month extensions is not to exceed $63,850,000.

On November 3, 2008, the Lottery entered into a three year contract with a consulting firm contracted to develop and implement a new back office system including the maintenance and functionality of the Lottery's scratch product. Renewal options include two additional twelve month periods. Task order letter #1 was signed on May 12, 2009, requiring additional services. Task order letter #2 was signed on December 9, 2009, requiring additional services. Task order letter #3 was signed on August 17, 2010, requiring additional services. Amendment #1 was signed on February 17, 2011, clarifying deliverables and requiring additional services. The maximum funds available for fiscal year 2011, which ended on June 30, 2011, were $796,875. The total cost of the initial three year contract period plus the task orders is $4,482,855. The Lottery will determine if any of the renewal options will be exercised to continue the contract past November 2, 2011.

Litigation – Currently, there is no reportable outstanding litigation.

NOTE 11 – TAX, SPENDING AND DEBT LIMITATIONS

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

NOTE 11 – TAX, SPENDING AND DEBT LIMITATIONS (CONTINUED)

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

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

NOTE 12 – RELATED PARTY TRANSACTIONS

The Lottery, as an agency of the State of Colorado, paid fees to other agencies of the state for auditing, legal and other services and vehicle and office rent. The Lottery also pays fees to the Department of Revenue for indirect costs. Interagency charges were $1,049,437 and $1,020,547 for the fiscal years ended June 30, 2011 and 2010, respectively.

SUPPLEMENTARY INFORMATION

COLORADO LOTTERY

SCHEDULE OF REVENUE AND COSTS FOR SCRATCH AND ON-LINE GAMES

FOR THE FISCAL YEAR ENDED JUNE 30, 2011

(With Comparative Totals for the Fiscal Year Ended June 30, 2010)

	Games in Progress								FY 11	FY 10
		On-Line Games								
	Scratch	Lotto	Powerball	Cash 5	Matchplay	Mega Millions	Raffle	Raffle II	Total	Scratch and On-Line
TICKET SALES	$344,945,609	$39,257,377	$70,046,464	$19,153,751	$11,418,378	$25,126,942	$5,600,000	$3,372,320	$518,920,841	$501,197,409
PRIZE EXPENSE	(237,372,938)	(20,768,717)	(31,901,845)	(10,483,126)	(6,967,421)	(13,432,194)	(2,808,000)	(2,890,000)	(326,624,241)	(313,724,135)
MULTI-STATE PRIZE VARIANCES	N/A	N/A	(792,467)	N/A	N/A	677,717	N/A	N/A	(114,750)	3,359,725
NET REVENUE AFTER PRIZES	107,572,671	18,488,660	37,352,152	8,670,625	4,450,957	12,372,465	2,792,000	482,320	192,181,850	190,832,999
COMMISSIONS, BONUSES, TICKET COSTS & VENDOR FEES (Note 1)										
Retailer Commission	(24,106,444)	(2,352,910)	(4,198,424)	(1,147,653)	(683,354)	(1,506,826)	(334,733)	(200,845)	(34,531,189)	(33,293,526)
Retailer Bonus	(3,860,442)	(255,686)	(449,095)	(179,515)	(104,228)	(157,071)	(28,000)	(18,862)	(5,052,899)	(4,853,249)
Cost of Tickets Sold	(3,027,915)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	(3,027,915)	(3,064,963)
Telecomm Reimbursements	505,850	57,569	102,721	28,088	16,745	36,848	8,403	4,946	761,170	748,753
On-Line Vendor Fees	(5,754,648)	(657,420)	(1,172,407)	(320,851)	(191,293)	(409,861)	(90,169)	(56,718)	(8,653,367)	(8,402,144)
TOTAL	(36,243,599)	(3,208,447)	(5,717,205)	(1,619,931)	(962,130)	(2,036,910)	(444,499)	(271,479)	(50,504,200)	(48,865,129)
GROSS PROFIT ON SALE OF TICKETS	$71,329,072	$15,280,213	$31,634,947	$7,050,694	$3,488,827	$10,335,555	$2,347,501	$210,841	$141,677,650	$141,967,870
AVERAGE DAILY TICKET SALES	$945,056	$107,554	$191,908	$52,476	$31,283	$68,841	$139	$9,239	$1,421,701	$1,373,144

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

COLORADO LOTTERY
SCHEDULE OF PERCENT OF PRIZE EXPENSE TO GROSS TICKET SALES
For the Fiscal Year ended June 30, 2011

	Games in Progress									
		On-Line Games							FY 11	
	Scratch	Lotto	Powerball	Cash 5	Matchplay	Mega Millions	Raffle	Raffle	Total	Scratch and Total
Prize Expense *	$237,372,938	$20,768,717	$32,694,312	$10,483,126	$6,967,421	$12,754,477	$2,808,000	$2,890,000	$326,738,991	$310,364,410
(/)Ticket Sales	344,945,609	39,257,377	70,046,464	19,153,751	11,418,378	25,126,942	5,600,000	3,372,320	$518,920,841	501,197,409
Prize %	68.81%	52.90%	46.68%	54.73%	61.02%	50.76%	50.14%	85.70%	62.97%	61.92%

*Net of Multi-State Prize Variances

COLORADO LOTTERY
BUDGETARY COMPARISON
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

	Fiscal Year 2011 Original Budget	Supplementals Allocations & Internal Transfers	Fiscal Year 2011 Final Budget	Fiscal Year 2011 Actual Expenditures	Under (Over) Expended	Percent Under (Over) Expended
Personal Services	$ 8,940,941	$ (9,749)	$ 8,931,192	$ 8,185,856	$ 745,336	8.35%
Amortization Equalization	169,100	-	169,100	159,441	9,659	5.71%
Supplemental Amort. Equal.	121,266	-	121,266	116,157	5,109	4.21%
Workmen's Compensation	48,548	-	48,548	48,548	-	0.00%
Shift Differential	-	9,749	9,749	9,460	289	2.96%
Health and Life	665,501	8,795	674,296	657,110	17,186	2.55%
Short Term Disability	11,283	-	11,283	11,283	-	0.00%
Operating	1,203,156	-	1,203,156	1,046,128	157,028	13.05%
DOR Postage	5,054	(174)	4,880	4,881	(1)	-0.02%
Variable Vehicle	129,168	-	129,168	129,168	-	0.00%
Leased Space	617,105	93,584	710,689	697,795	12,894	1.81%
Grand Junction - Leased Space	7,201	-	7,201	7,200	1	0.01%
Risk Management	5,871	-	5,871	5,871	-	0.00%
Vehicle Lease Payments	139,539	(3,780)	135,759	133,307	2,452	1.81%
Travel	113,498	-	113,498	113,498	-	0.00%
Purch. Serv. Comp. Center	2,133	-	2,133	2,133	-	0.00%
Marketing, Communications & Sales	14,700,000	-	14,700,000	14,615,981	84,019	0.57%
Communications Services	2,118	-	2,118	2,118	-	0.00%
Payments to MNT	230,994	-	230,994	230,994	-	0.00%
Payments to Other Agencies	239,410	-	239,410	118,198	121,212	50.63%
Legal Services	32,473	(20,857)	11,616	11,615	1	0.01%
Indirect Costs	537,749	-	537,749	528,542	9,207	1.71%
Ticket Costs-Scratch	6,284,000	294,000	6,578,000	4,033,841	2,544,159	38.68%
Research	250,000	-	250,000	207,273	42,727	17.09%
Vendor Fees	12,376,154	195,350	12,571,504	8,789,827	3,781,677	30.08%
Prize Payments	400,264,560	23,839,456	424,104,016	328,719,521	95,384,495	22.49%
Retailer Compensation	49,290,600	2,950,750	52,241,350	39,584,088	12,657,262	24.23%
Multi-State Lottery Fund	177,433	-	177,433	116,174	61,259	34.53%
Lottery Systems Migration	1,935,949	-	1,935,949	921,197	1,014,752	52.42%
Powerball Prize Variance	12,960,000	(4,437,000)	8,523,000	5,384,038	3,138,962	36.83%
TOTAL	$ 511,460,804	$ 22,920,124	$ 534,380,928	$ 414,591,243	$ 119,789,685	22.42%

FY11 Staffing (FTE) 126.0 (Appropriated) 113.1 (Actual)

COLORADO LOTTERY
BUDGETARY COMPARISON
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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		$ 326,624,241
Powerball Prize Variance		792,467
Mega Millions Prize Variance		(677,717)
Commissions and Bonuses		39,584,088
Cost of Tickets & Vendor Fees		10,920,112
Operating Expenses		29,123,156
Total Expenses per Statement of Revenues, Expenses and Changes in Net Assets		406,366,347
Plus:	Powerball Prize Variance classified as revenue	4,591,571
	Mega Millions Prize Variance classified as revenue	2,772,997
	Telecommunications offset classified as revenue	761,170
Less:	Non-appropriated expenses	
	Depreciation	(795,467)
	Accrued Annual and Sick Leave	144,923
	Loss on Disposal of Assets	(110,479)
	Sub-Total	413,731,062
Plus:	Capitalized purchases	554,597
	Capitalized wages	305,584
		$ 414,591,243

Clifton Gunderson LLP
Certified Public Accountants & Consultants

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 (the Lottery), an enterprise fund and private purpose fund of the State of Colorado as of and for the year ended June 30, 2011, which collectively comprise the Lottery's basic financial statements and have issued our report thereon dated September 9, 2011. 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 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 Lottery's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Lottery's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

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 internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Lottery's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and 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.*

We noted certain additional matters that were reported to management of the Lottery in a separate letter dated September 9, 2011 and another that we reported in the Finding and Recommendation section (Finding 1) of this report.

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 Gunderson LLP

Greenwood Village, Colorado
September 9, 2011

Clifton Gunderson LLP
Certified Public Accountants & Consultants

Independent Auditor's
Required Communications to the Legislative Audit Committee

September 9, 2011

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, 2011.

The following are our observations arising from the audit that are relevant to management's 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 opinions about whether the financial statements, that have been prepared by management, 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 management of its 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 principles 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.

Corrected Misstatements. There was one misstatement detected as a result of audit procedure and corrected by management that was material, either individually or in the aggregate, to the financial statements taken as a whole. The adjustment was a reclassification entry of $3,860,915 from accounts payable to prize liability.

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 and received 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 Colorado Lottery's financial statements or our report on those financial statements.

Please contact Paul Niedermuller 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
www.state.co.us/auditor

A bound report may be obtained by calling the
Office of the State Auditor
303 869-2800

Please refer to the Report Control Number below when requesting this report.

Report Control No. 2018-11