COLORADO LOTTERY

FINANCIAL AND COMPLIANCE AUDIT
June 30, 2009 and 2008

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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, 2009. 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, 2009

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COLORADO LOTTERY
REPORT SUMMARY
Years Ended June 30, 2009 and 2008

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, 2009. 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, 2009.

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, 2009, 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, 2009.
- To evaluate progress in implementing the prior audit recommendations.

Summary of Major Audit Comments

Audit Findings and Financial Statement Audit Report Section

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

- The Lottery has contracted with Scientific-Games, Inc., (SGI or Scientific-Games) for on-line games and related accounting services, and converted to the new system in May 2005. Under the terms of the Lottery's contract with SGI, the contractor was required to provide a number of reports that would enable the Lottery to perform various reconciliations. However, since the conversion, the Lottery has had to manually reconcile some of the daily system balancing reports because SGI has not been able to provide these reports. In the current year, the Lottery did not have the required reports from SGI related to retailer billing or tax reporting.

- Information technology controls include policies and procedures that relate to many applications and support the efficient and effective functions of application controls by ensuring the continued proper operation of information systems. Such controls include physical access security controls over data center and network operations and logical access controls over applications and supporting operating systems. Failure to ensure adequate controls are in place and operating effectively could impact proper operation of information systems and could allow improper access to programs and data. As such, the Lottery should strengthen its information technology controls by removing all generic administrator accounts, ensuring terminated employees' access is removed timely and establishing minimum password parameters in accordance with approved security policies.

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

Audit Opinions and Reports

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

Auditors' Communication to Legislative Audit Committee

The auditors' communication to the Legislative Audit Committee describes the auditors' responsibility under auditing standards generally accepted in the United States of America and significant management judgments and estimates. It also notes that there were no proposed audit adjustments for the year ending June 30, 2009. This communication is located on page 64.

Summary of Progress in Implementing Prior Year Audit Recommendations

The audit report for the year ended June 30, 2008, contained four recommendations. Of the 2008 recommendations, three were implemented and the other one was not implemented. The Disposition of Prior Year Audit Recommendations begins on page 10.

COLORADO LOTTERY
RECOMMENDATION LOCATOR
Years Ended June 30, 2009 and 2008

Recommendation Number	Page Number	Recommendation Summary	Response	Implementation Date
1	5	The Colorado Lottery (the Lottery) should ensure that the new back office system being implemented provides all necessary reconciliation processes and reports.	Agree	July 2009
2	8	The Lottery should strengthen its information technology controls by removing all generic administrator accounts, ensuring terminated employees' access is removed timely and establishing minimum password parameters in accordance with approved security policies.	Partially agree	September 2009 through January 2010

COLORADO LOTTERY
BACKGROUND
Years Ended June 30, 2009 and 2008

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

During fiscal year 2009, the Lottery employed 119 employees in its headquarters in Pueblo and branch offices in Denver, Fort Collins and Grand Junction.

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

The Lottery's enabling legislation requires that no less than 50% of the total revenue from sales of lottery tickets be for prizes. The legislation also provides guidelines for distribution of net proceeds to beneficiary agencies. "Net lottery proceeds" (that is, proceeds after the payment of prizes and lottery expenses and a reserve for future operations) are to be distributed to the Conservation Trust Fund, the Division of Parks and Outdoor Recreation and the Great Outdoors Colorado Trust Fund (GOCO). The amount distributed to GOCO is limited by a constitutional cap. As of fiscal year 2002 through fiscal year 2007, amounts exceeding the GOCO cap (the spill-over) are distributed to the State Public School Fund Contingency Reserve. As of fiscal year 2008, these spill-over funds shall be transferred to the Lottery Proceeds Contingency Reserve Fund. As of fiscal year 2009, these spill-over funds shall be transferred to the Public School Capital Construction Assistance Fund. Prior to 2002, spill-over funds were distributed to the State General Fund.

System Balancing Reports

The Lottery converted to a new vendor, Scientific-Games, Inc., for its on-line games on May 2, 2005. As part of an independent test to gain assurance regarding the integrity and reliability of the new vendor's system, a third-party firm found that some reports required for reconciling the on-line system and the Lottery's internal system, which were specified as deliverables by the Lottery in its contracts with the new on-line vendor, were not being produced. In addition, other reports did not balance to the corresponding information in the Lottery's system. Therefore, in the audits for fiscal years 2005 through 2008, it was recommended that the Lottery work with Scientific-Games to ensure that all reports required as part of the contract are provided and that all reports are accurate and complete.

During the audit for fiscal year 2006, the auditors found that 17 system balancing reports were still unavailable to the Lottery. During the audit for fiscal year 2007, the auditors found that much of this reporting had improved, however, reporting for two systems, the retailer billing and tax reporting, were still lacking. For fiscal years 2008 and 2009, it was found again that reporting for two systems, the retailer billing and tax reporting, were still lacking.

The reconciliation process is critical to ensure the accuracy and completeness of the transactions reported by the Lottery and on the State's accounting system. These two systems (WANG and Scientific-Games) process critical and time sensitive data which include, but are not limited to, billing to retailers, scratch inventory and tax reporting. As long as the Lottery must rely on manual balancing systems and an interface of transaction activity between Scientific-Games and the WANG systems, a risk of the loss of data integrity or corruption will always be present.

Lottery's response to address this deficiency included the migration of the Wang legacy system and a plan to move the retailer billing and tax reporting systems to a new system. This migration occurred in July 2009 the next fiscal year.

Recommendation No. 1

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

Once the Lottery migrates the retailer billing and tax reporting systems to the new back office system, the Lottery should ensure that this system provides the necessary reconciliation processes and reports.

Colorado Lottery Response: Agree

In October 2008, the Lottery contracted with Technical and Business Consulting (TBC) to provide a replacement of the Wang-based back office system including moving the retailer billing and tax reporting systems to the new Lottery back office system. Since that time, the contract with Scientific Games has been amended to reflect that retailer billing and tax reporting are no longer required as deliverables of that contract.

During the development of the new back office system, the Lottery worked to obtain all required reports. The new back office system was implemented in July 2009. The Lottery will ensure the accuracy and completeness of the new system by verification performed in the daily balancing, auditing and reconciliation processes. The Lottery believes that all system monitoring and reporting is now implemented; however, modifications are in process to improve and simplify this reporting.

Implementation Date: July 2009

Information Technology Controls

Information technology controls include policies and procedures that relate to many applications and support the efficient and effective functions of application controls by ensuring the continued proper operation of information systems. Such controls include physical access security controls over data center and network operations and logical access controls over applications and supporting operating systems.

The scope of our review of the Lottery's information technology controls included the following systems at Lottery:

- WANG back office system (WANG): Records a variety of activity, including accounting transactions related to sales, redemptions and claims, and ticket inventories. It is also used in the automated systems balancing process to ensure that the third-party service provider's systems are in balance with Colorado Lottery's systems.

- Internal Control System (ICS): Receives validation data and ensures the validation of the draw. Draw results are reconciled to the Games Management System (see below) and the Transaction Processing Engine (see below) calculated results. If difference exists, an error report is generated and the difference is investigated and resolved.

In addition, we reviewed the information technology controls at the Lottery's third-party service provider, Scientific-Games (SGI). The systems at SGI subject to our review included the following systems:

- AEGIS Games Management System (GMS): Responsible for point of sale. All ticket transactions, histories, etc. are maintained in this system. The system also interacts real-time with the Transaction Processing Engine (TXE) to process instant tickets. GMS acts with the TXE to transfer the summaries of all on-line games and validations. The GMS is the application interface used by operational staff.

- Transaction Processing Engine (TXE): Processes online games and prizes. TXE processes the transaction requests and originates the appropriate response. All on-line games are logged and processed on the TXE. Additionally, the TXE interfaces to GMS to transfer information to/from its database.

- Internal Control System (SGICS): Serves as the secondary internal control system to the Lottery's ICS.

Our scope also included reviewing logical access controls of the supporting operating systems including Linux and Windows operating systems at both the Lottery and SGI offices. Logical access controls are controls that limit users' access to only information that has been authorized and is applicable to their roles and responsibilities. Physical access controls were reviewed at the Lottery data center, SGI Pueblo data center and the SGI Colorado Springs data center. Physical access controls are necessary to prevent unauthorized access to sensitive IT equipment, such as network devices.

During our review of information technology controls, we noted the following deficiencies:

Insufficient Access Restrictions

- Privileged access to the Windows domain at SGI and at the Lottery was not appropriately restricted. Both systems had active default administrator accounts that had not been removed or the name of the accounts was not modified from the default name. Leading industry practices for default administrator accounts include either renaming the account or removing this account. By not changing the name or removing the access, it is easier to exploit the account to engage in malicious activity.

- Passwords to prize claims terminals are posted on the inside of the terminal. In one instance, the password was "12345". Although there are compensating controls through post-audit and reconciliation of claims and valid tickets must be present to issue payments, security best practices strongly recommend complex passwords and against posting of passwords on or near the system they are used to access.

Password Definitions, Terminated Employees, and Generic Accounts

- The Linux Operating system at SGI had one active account for a terminated employee. Potentially, the account could be used for unauthorized system access.

- The Security Plan to which SGI is to adhere requires passwords to be changed every 30 days and be eight characters long. SGI did not configure TXE to comply with all aspects of the Security Plan. Specifically, the system allows a password length of five characters which expire every 35 days. Lastly, seven user accounts have not changed their passwords in over one year.

- No password retention policy, such as requiring unique passwords for one year, is established on the Linux operating systems (that supports the Lottery ICS). This occurred because the system default had not been changed. The system default allowed users to change their password and then utilize the original password when another change was requested by the system.

- The established minimum password length on the WANG, which belongs to the Lottery, was five characters; yet, the State of Colorado Cyber Security policies require a minimum of eight characters.

- Two unnecessary, generic accounts existed in the ICS system. Such generic accounts reduce the ability of management to establish accountability for actions taken on or with information systems.

Failure to ensure adequate controls are in place and operating effectively could impact proper operation of information systems, including allowing improper access to programs and data.

Recommendation No. 2

The Lottery should strengthen its information technology controls by:

a. Renaming or removing the Window domain administrator accounts at both the Lottery and at SGI. In addition, passwords should be changed on all terminals and the notices posted on the terminals displaying the passwords should be removed.

b. Ensuring password configurations (including those at SGI) are complex and adhere to industry standards and state policy for password retention and length, strengthening policy that ensures all user accounts for terminated employees on all systems are removed in a timely manner after termination, and removing all unnecessary, generic accounts in order to establish accountability for actions take on information systems.

Colorado Lottery Response: Partially Agree

a. Lottery system: The Lottery will rename the Windows Domain Administrator account.
Implementation Date: January 2010

Passwords to Lottery's prize claim terminals have been changed to passwords selected by a random number generator. In addition, notices posted on the terminal displaying the passwords have been removed.
Implementation Date: September 2009

SGI system: On the SGI system, there are needed services which are dependent upon the Administrator account. SGI attempted to rename the administrator account during the IV&V prior to go-live in 2005. This action caused the system to crash. Ciber, the entity performing the IV&V, witnessed the outcome and agreed the account should not be renamed.
Implementation Date: None provided

b. Lottery system: Lottery systems will adhere to State Access Control Policy P-CCSP-008, all unnecessary generic accounts have been removed, and Lottery system administrators inspect Active Directory for account inconsistencies on a monthly basis.
Implementation Date: September 2009

SGI system: On SGI's TXE system, password configurations are complex and adhere to industry standards where possible. Updating the password routine is a complex and time consuming process that poses significant risk to the Lottery and violates other security rules. To comply with State policy for password retention and length, the Lottery will work with SGI to implement a policy that requires employees to change their password every 30 days or less and use a minimum of 8 characters. In addition, all user accounts for terminated employees will be removed in a timely manner after termination.
Implementation Date: September 2009 through January 2010

COLORADO LOTTERY
DISPOSITION OF PRIOR YEAR AUDIT RECOMMENDATIONS
Year Ended June 30, 2009

Fiscal Year 2008 Recommendations

Number	Recommendation	Disposition
1	The Colorado Lottery should continue to work with Scientific-Games to ensure that all reports required as part of the contract are provided and that the reports contain accurate and complete information.	Not implemented, See Recommendation No. 1 in current report.
2	The Lottery should have an annual SAS 70 Type II examination performed on both its internal information system and on the system of its vendor, Scientific-Games for at least a nine month period beginning July 1 of each year.	Implemented
3	The Lottery should perform quarterly audits on invoices from Cactus Communications to ensure they are accurate and proper.	Implemented
4	The Lottery should further scrutinize the financial status of noncompliant annuity contract holders, consider the impact to the financial statements and review and revise its policy to include reinsurance for current and future annuity contracts.	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, 2009 and 2008, which collectively comprise the Colorado Lottery's basic financial statements as listed in the table of contents. These financial statements are the responsibility of Colorado Lottery's management. Our responsibility is to express opinions on these financial statements based on our 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, 2009 and 2008, 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, 2009 and 2008, and the changes in financial position and, where applicable, cash flows 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, 2009 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 13 through 25 are not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our 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, 2009

Colorado Lottery

Management's Discussion and Analysis

Years Ended June 30, 2009 and 2008

This discussion and analysis of the Colorado Lottery's financial performance provides an overview of financial activities for the fiscal years ended June 30, 2009 and 2008. 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 $493.4 million was the second highest sales year in Lottery history. The highest sales year was achieved in fiscal year 2008 with sales of $505.8 million. Overall sales for fiscal year 2009 reflected a $12.4 million decrease from fiscal year 2008 sales and fiscal year 2008 reflected a $49.9 million increase from fiscal year 2007 sales of $455.9 million. The overall decrease in sales in 2009 was the result of a decrease in both scratch and Powerball sales. Scratch sales decreased by $7.7 million from $336.0 million in fiscal year 2008 to $328.3 million in fiscal year 2009. The Lottery attributes the decrease in scratch sales to the state of the economy. Fiscal year 2008 scratch sales increased by $38.9 million over scratch sales for fiscal year 2007 which totaled $297.1 million, the third highest scratch sales year ever. The decrease in the Powerball sales of $8.9 million can be attributed to the fact that Powerball sales are highly dependent on the size of the Powerball jackpots. In fiscal year 2008, the two highest jackpots reached heights of $300 million and $275 million as compared to fiscal year 2009 whose two highest jackpots reached levels of only $222 million and $200 million. Powerball sales for fiscal years 2009 and 2008 totaled $100.7 million and $109.6 million, respectively. The highest Powerball jackpot attained in fiscal year 2007 was $240 million. Powerball sales for fiscal year 2007 totaled $101.6 million.

  Fiscal year 2009 saw an increase in sales from fiscal year 2008 for each of its other two products. Cash5 sales hit a record high in fiscal year 2009 with sales increasing by $1.7 million from fiscal year 2008 and Lotto sales saw an increase of $2.5 million from the prior fiscal year sales.

  Cash 5 sales for fiscal year 2009 showed another increase for the seventh year in a row and for the seventh year in a row produced record sales. Sales increased by 8.8 percent to a total of $20.8 million from $19.1 million in fiscal year 2008. This followed a 10.0 percent increase in sales in fiscal year 2008 from fiscal year 2007, whose sales totaled $17.4 million.

  Lotto sales increased slightly from the prior two fiscal years with sales of $43.5 million. Fiscal years 2008 and 2007 reflected Lotto sales of $41.1 million and $39.8 million, respectively.

- Funds distributed or available for distribution from 2009 sales decreased from fiscal year 2008 in conjunction with the overall decrease in sales. Fiscal year 2009 produced a total of $119.6 million in funds distributions, a decrease of $2.7 million from fiscal year 2008 with distributions of $122.3 million. The $119.6 million in funds distributions for fiscal year 2009 represents the third highest year of distributions in the Lottery's history. Fiscal year 2007 had the fourth highest year of distributions totaling $119.0 million. Fiscal year 2009 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, the spill-over, by statute, 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 $5.5 million and $8.0 million for fiscal years 2009 and 2008, respectively. The spill-over amount for fiscal year 2007 was $8.2 million. A spill-over occurs when the distribution cap for GOCO is reached in any one year. The cap for GOCO is the 1992 base year amount of $35 million as adjusted for the annual change in the cost of living increase for the Denver-Boulder area. The total amount of the spill-over during the six-year period totals $50.6 million.

- Gross profit as a percent of sales for fiscal year 2009 increased by 1.1 percent over fiscal year 2008, a reflection of the 0.9 percent decrease in prize expense as a percentage of sales. Gross profit as a percent of sales decreased by 1.9 percent between fiscal years 2007 and 2008, a reflection of the increase in prize expense of 1.6 percent. The overall prize expense percentage decreased from 62.3 percent to 61.1 percent for the fiscal years ended June 30, 2008 and 2009, respectively. The decrease was the result of reductions in prize expense for the scratch, lotto and Cash5 products. The reduction in the scratch prize expense of 1.2 percent is the result of a conscious effort to slightly reduce the prize percentage payouts on all scratch games. The lotto prize expense was lowered by a reduction in the number of jackpot hits. In fiscal year 2008, the jackpot was won a total of eight times, as compared to five times in fiscal year 2009. In addition, the overall prize expense percentage for the on-line games decreased slightly from 49.5 percent to 48.5 percent for the fiscal years ended June 30, 2008 and 2009, respectively. Another contributing factor to the 1.1 percent increase in gross profit as a percent of sales in fiscal year 2009 and to the 0.9 percent decrease in gross profit as a percent of sales in fiscal year 2008 was a 0.2 percent decrease as a percentage of sales in fiscal year 2009 and a 0.2 percent increase as a percent of sales in fiscal year 2008 in commissions and bonuses paid to our retailers to sell and promote our products. Commissions and bonuses as a percentage of sales were 7.4 percent, 7.6 percent and 7.4 percent for the fiscal years ended June 30, 2007, 2008 and 2009, respectively. Cost of tickets sold and vendor fees as a percentage of sales increased slightly from 2.0 percent to 2.1 percent for fiscal years ended June 30, 2008 and 2009, respectively. Cost of tickets sold and vendor fees as a percentage of sales was 1.8 percent for the fiscal year ended June 30, 2007. Changes in the billing rate for vendor fees was the major factor contributing to the upward trend in the percentage of cost of tickets sold and vendor fees as a percentage of sales. The billing rate for fiscal year 2007 was 1.458 percent of sales. The billing rate paid to vendors for fiscal year 2008 was 1.458 percent of sales for July through November and 1.718 percent of sales from December through June. The billing rate for fiscal year 2009 was 1.718 percent. Vendor fees totaled $5,957,142, $7,394,112 and $7,825,356 for fiscal years ended June 30, 2007, 2008 and 2009, respectively. Unclaimed prizes increased by more than $200,000 from fiscal year 2008 to fiscal year 2009 and by more than $500,000 from fiscal year 2007 to fiscal year 2008. A change in the number of scratch games reaching their final claims date within a fiscal year and the randomness in the design of how on-line prizes can be won, both contribute to fluctuations in unclaimed prizes.

Games Offered by the Colorado Lottery

Currently, the Lottery offers two different ways to play: scratch games and on-line games (Powerball, Lotto and Cash 5). Scratch games consist of pre-printed tickets that may be purchased for various prices ($1, $2, $3, $5, $10 and $20) at any Lottery retailer. When scratched, they provide immediate knowledge if the ticket is a winner and can be cashed immediately at the retailer level if the amount of the winnings is $599 or less. Prizes $600 and over must be redeemed at the Lottery offices.

On-line games, however, require a longer playing time. Tickets are also purchased at the Lottery retailers and are printed on ticket stock as the purchase is made. Each ticket contains one or more playing boards. Each board consists of a set of numbers, the combination of numbers required for play varying by game. The winning numbers for each game are posted after their respective draw nights with drawings held on every night of the week, excluding Sunday. Players must check their numbers against the numbers drawn for each respective game to determine if they have a winning ticket. The tickets may also be cashed at the retailer level if the amounts of the winnings are $599 or less. Prizes $600 and over must be redeemed at the Lottery offices.

Using this Annual Report

This annual report consists of a series of financial statements. The statement of net assets provides information about the Lottery's assets and liabilities and reflects the Lottery's financial position as of June 30, 2009 and 2008. The statement of revenues, expenses and changes in net assets reports the activity of selling the Lottery products and the expenses related to such activity for the years ended June 30, 2009 and 2008. Finally, the statement of cash flows outlines the cash inflows and outflows related to the activity of selling the Lottery products for the years ended June 30, 2009 and 2008.

Statements of Net Assets

The statements of net assets presents a financial snapshot of the Lottery at June 30, 2009, and 2008. It presents the fiscal resources of the Lottery (assets), the claims against those resources (liabilities) and the residual available for future operations (net assets). Assets and liabilities are classified by liquidity as either current or noncurrent. Net assets are classified by the ways in which they may be used for future operations.

Colorado Lottery

Management's Discussion and Analysis

Years Ended June 30, 2009 and 2008

Condensed Statements of Net Assets

June 30, 2009, 2008 and 2007

	2009	2008	2007
Assets			
Current assets	$ 57,535,254	$ 50,368,307	$ 52,318,926
Restricted assets	5,417,337	5,687,849	5,822,526
Capital assets	2,759,701	498,156	696,916
Total assets	$ 65,712,292	$ 56,554,312	$ 58,838,368
Liabilities			
Current liabilities	$ 60,062,604	$ 53,249,984	$ 55,507,616
Long-term liabilities	995,069	913,886	906,065
Total liabilities	$ 61,057,673	$ 54,163,870	$ 56,413,681
Net Assets			
Investment in capital assets	$ 2,759,701	$ 498,156	$ 696,916
Restricted – Licensed Agent Recovery Reserve	388,771	443,139	426,058
Restricted – Operating Reserve	1,100,000	1,300,000	1,500,000
Unrestricted	406,147	149,147	(198,287)
Total net assets	$ 4,654,619	$ 2,390,442	$ 2,424,687

The Lottery's total assets at June 30, 2009 were $65.7 million. Assets consisted primarily of cash and investments with the State Treasury, including restricted balances, of $36.8 million, Prepaid Prize Expense with Multi-State Lottery (MUSL) of $3.9 million, receivables from Lottery retailers for the sale of Lottery products of $20.5 million and a net investment in fixed assets of $2.8 million.

Comparable figures at June 30, 2008 were $56.6 million in total assets, including $32.3 million in cash and investments with the State Treasury, Prepaid Prize Expense with MUSL of $3.9 million, receivable from retailers of $18.8 million and a net investment in fixed assets of $0.5 million.

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

The Lottery's total assets, increased by $9.1 million from fiscal year 2008 to fiscal year 2009. This increase was primarily caused by the $4.5 increase in cash and investments, $1.7 million increase in receivables from retailers and a $2.3 million increase in the net investment in fixed assets. Both the $4.5 million increase in cash and investments and the $1.7 million increase in receivables from retailers can be attributed to the increase in size of the Powerball estimated jackpot at the close of the fiscal year. The estimated jackpot at the close of fiscal year 2008 was $25 million as compared to $75 million at the close of fiscal year 2009. The $2.3 million increase in the net investment in fixed assets was the result of the capitalization of the development of the back office computer system. Total assets decreased from fiscal year 2007 to fiscal year 2008 by $2.2 million. The decrease was a result of the decrease in cash and investments of $2.9 million. Again, the Powerball estimated jackpot can be noted as the major contributor to this decrease. The Powerball jackpot near the close of fiscal year 2007 was $103 million compared to $75 million at the close of fiscal year 2008.

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

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

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

The Lottery's total liabilities increased by $6.9 million from fiscal year 2008 to fiscal year 2009. This increase was primarily the result of a $0.9 million increase in proceeds distributions due to recipients and a $5.3 million increase in prize liability on Lottery products. The $0.9 million increase in proceeds distributions was the result of a higher net profit for the fourth quarter of fiscal year 2009 versus the fourth quarter of fiscal year 2008. The $5.3 million increase in the prize liability on Lottery products from fiscal year 2008 to fiscal year 2009 was the result of the increase in the Powerball estimated jackpot as mentioned above and of the increase of scratch games being offered for sale. At the close of fiscal year 2008, the number of active scratch games was 51 versus 60 at the close of fiscal year 2009. The Lottery's total liabilities decreased from fiscal year 2007 to fiscal year 2008 by $2.2 million. This decrease was primarily the result of a decrease of $1.5 million in proceeds distributions and a decrease of $2.0 million in prize liability of Lottery products. Again, the decrease in proceeds distributions was a result of a decrease in the fourth quarter net profit from fiscal year 2007 to fiscal year 2008 and the decrease in the prize liability on Lottery products was a result of the decrease in the Powerball estimated jackpot from $103 million to $75 million from fiscal year 2007 to fiscal year 2008. These decreases were offset by an increase of $0.9 million in accounts payable to vendors from fiscal year 2007 to fiscal year 2008.

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 restricted for the funds held by the Lottery in an operating reserve as mandated by Senate Bill 04-204 (see "Cash and Investments – Operating Reserve");

and 4) 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, 2008 to June 30, 2009 consisted of a increase in investment in capital assets from $.5 million to $2.8 million, a decrease in the bonding reserve from $443,139 to $388,771, a decrease in the operating reserve from $1.3 million to $1.1 million and a net increase in unrealized gain and losses on investments of $257,000 resulting from a net increase in the adjustments on State Treasury investments.

Following is a schedule of net assets for fiscal years 2009 and 2008:

	2009	2008	Change
Investment in capital assets	$ 2,759,701	$ 498,156	$ 2,261,545
Bonding reserve	388,771	443,139	(54,368)
Operating reserve	1,100,000	1,300,000	(200,000)
Unrestricted - unrealized gain (loss) on investments	406,147	149,147	257,000
Total net assets	$ 4,654,619	$ 2,390,442	$ 2,264,177

The change in net assets from June 30, 2007 to June 30, 2008 consisted of a decrease in investment in capital assets from $0.7 million to $0.5 million, an increase in the bonding reserve from $426,058 to $443,139, a decrease in the operating reserve from $1.5 million to $1.3 million and a net increase in unrealized gain and losses on investments of $347,434 resulting from a net increase in the adjustments on State Treasury investments.

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

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

Statements of Revenues, Expenses and Changes in Net Assets

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

Colorado Lottery

Management's Discussion and Analysis

Years Ended June 30, 2009 and 2008

Condensed Statements of Revenues, Expenses and Changes in Net Assets For the Fiscal Years Ended June 30, 2009, 2008 and 2007

	2009	2008	2007
Operating Revenues	$493,364,094	$505,814,066	$455,916,812
Direct Operating Expenses	348,679,448	363,280,175	318,684,531
Gross Profit on Sale of Tickets	144,684,646	142,533,891	137,232,281
Other Operating Expenses			
Marketing and communications	11,914,439	8,892,973	8,886,036
Wages and benefits	8,527,025	8,841,445	8,603,295
Other operating expenses	4,070,286	5,327,843	3,512,986
Total other operating expenses	24,511,750	23,062,261	21,002,317
Operating Income	120,172,896	119,471,630	116,229,964
Nonoperating Revenues (Expenses)			
Other revenue	267,188	428,513	665,162
Investment income	1,427,948	2,365,744	2,169,983
Proceeds distributions	(119,603,855)	(122,300,132)	(118,995,450)
Total nonoperating expenses	(117,908,719)	(119,505,875)	(116,160,305)
Increase (Decrease) in Net Assets	2,264,177	(34,245)	69,659
Net Assets, Beginning of Year	2,390,442	2,424,687	2,355,028
Net Assets, End of Year	$ 4,654,619	$ 2,390,442	$ 2,424,687

Sales Activities

Revenues from the sale of the Lottery products for the fiscal year ended June 30, 2009 were the second highest in the Lottery's 27-year history. As shown in the financial statements, overall sales decreased by 2.5 percent from the prior year's record sales of $505.8 to $493.4 million in the current year fiscal year. Fiscal year 2008 sales of $505.8 million represented an increase of 10.9 percent or $49.9 million from fiscal year 2007 sales of $455.9 million. The decrease in scratch sales from $336.0 million in fiscal year 2008 to $328.3 million in fiscal year 2009 represented a percentage decrease of 2.3 percent, and was reflective of the downturn in the economy. Scratch sales had increased in fiscal year 2008 from fiscal year 2007 by $38.9 million. Fiscal year 2007 scratch sales totaled $297.1 million. Powerball sales decreased from $109.6 million in fiscal year 2008 to $100.7 million in the current fiscal year, which represented a percentage decrease from last year's sales of 8.1 percent. As stated on page 13, the decrease can be attributed to the decrease in the size of the Powerball jackpots. Powerball sales in fiscal year 2007 were $101.6 million. Lotto sales grew slightly in the current fiscal year to $43.5 million, an increase of $2.5 million or 6.0 percent over the prior fiscal year. This was the third year since the start up of Powerball that Lotto sales experienced an increase in sales. In fiscal year 2008 and fiscal year 2007, Lotto sales totaled $41.1 million and $39.8 million, respectively. Cash 5 sales again experienced an increase from $19.1 million in fiscal year 2008 to $20.8 million in the current fiscal year, which represents 8.9 percent increase. Cash 5 sales increased from fiscal year 2007 sales of $17.4 million to $19.1 million in fiscal year 2008, an increase of 10.0 percent.

The following tables compare Lottery product sales between fiscal years.

Product Sales	**2009**	**2008**	**Difference**	**Change**
Scratch	$ 328,254,471	$ 336,038,899	$ (7,784,428)	(2.3)%
Powerball	100,733,520	109,562,516	(8,828,996)	(8.1)
Lotto	43,544,371	41,064,087	2,480,284	6.0
Cash 5	20,831,732	19,148,564	1,683,168	8.8
Total	$ 493,364,094	$ 505,814,066	$ (12,449,972)	(2.5)%

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

Total Revenues

Nonoperating revenues for the years ended June 30, 2009 and June 30, 2008 totaled $1.7 million and $2.8 million, respectively. The decrease included a reduction in interest received from the Treasury of approximately $509,000 from fiscal year 2008 to fiscal year 2009. This decrease occurred as a result of a decrease in interest rates from an average of 4.27 percent in fiscal year 2008 to 2.72 percent in fiscal year 2009. Also contributing to the decrease in nonoperating revenues was a decrease in the interest received from the Multi-State Lottery Association (MUSL). In fiscal year 2008 the total received was a little over $425,000 compared with just $86,000 in fiscal year 2009. The downturn in the economy resulting in a downturn to the return on investments was the major factor contributing to this decrease. The GASB 31 adjustment recording the Lottery's share of the unrealized gains and losses on investments held by the Treasury decreased from $347,434 in fiscal year 2008 to $257,000 in fiscal year 2009. In addition, the royalty income received from MUSL, for the use of the Powerball name decreased from $68,757 in fiscal year 2008 to $25,212 in fiscal year 2009. Other decreases occurred in fines and penalties ($74,710) reflecting a reduction in the assessment of liquidated damages to the on-line vendor and net licensed agent recovery reserve receipts ($71,449), a result of writing off uncollectible receivables in excess of bonding fee collections. An increase occurred in other miscellaneous revenue from $23,509 in fiscal year 2008 to $52,315 in fiscal year 2009 as a result of revenues recorded in conjunction with the scratch vendor contract bidding process.

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

Total revenues were $495.1 million and $508.6 million for the years ended June 30, 2009 and 2008, respectively. As mentioned elsewhere, the major contributing factor to the decrease in total revenues of approximately $13.5 million was a decrease in Lottery sales of $12.4 million. As outlined above, nonoperating revenues decreased by $1.1 million for the same period.

Total revenues for the year ended June 30, 2007 were $458.7 million. The major contributing factor for the increase in total revenues from fiscal year 2007 to 2008 of $49.9 million was an increase in ticket sales of $49.9 million. Non-operating revenues remained steady for the same period.

Major Expenses

Approximately $348.7 million of the Lottery's total expenses of $373.2 million for the fiscal year ended June 30, 2009 were incurred in direct support of the Lottery games. This included prize expense, retailer compensation, money spent to purchase scratch tickets and compensation to the vendor who maintains and supports the on-line gaming system.

In comparison, $363.3 million of the Lottery's total expenses of $386.3 million for the fiscal year ended June 30, 2008, were game-related expenses.

In comparison, $318.7 million of the Lottery's total expenses of $339.7 million for the fiscal year ended June 30, 2007 were game-related expenses.

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

Game-Related Expenses	2009	2008	Difference	Change
Prize expense/ Powerball prize variance	$301,674,566	$314,934,975	$(13,260,409)	(4.2)%
Retailer compensation				
Commissions	32,844,563	33,668,027	(823,464)	(2.4)
Bonuses	3,636,346	4,724,151	(1,087,805)	(23.0)
Ticket costs	2,698,617	2,558,910	139,707	5.5
Vendor fees	7,825,356	7,394,112	431,244	5.8
Total	$348,679,448	$363,280,175	$(14,600,727)	(4.0)%

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

The decrease in the game-related expenses, including prize expense, commission expense and bonus expense (fiscal year 2008 to fiscal year 2009) is reflective of the decrease in product sales. (See the product sales schedule above.) In addition, the prize expense percentage was decreased in fiscal year 2009 from the prize expense percentage in fiscal year 2008 as a result of the conscious effort to slightly lower the prize percentage payouts on all scratch games and as a result of the difference in the number of lotto jackpots won as mentioned on page 14. The decrease in bonus expense from fiscal year 2008 to fiscal year 2009 was mainly the result of the reduction in the marketing performance bonuses paid to retailers. The total marketing performance bonuses paid in fiscal year 2009 and fiscal year 2008 were $1,183,539 and $2,069,385, respectively. A number of retailers were unable to reach the sales levels required to earn the marketing performance bonus as defined by the plan. The increase in ticket costs from fiscal year 2008 to fiscal year 2009 was the result of the Lottery's expansion of licensed property games, which require additional fees to cover the rights to use patented game names, emblems, designs, logos, symbols, characters, still images, artwork, depictions, illustrations, labels, insignia, indicia, trade dress, and any visual representations of any type collectively or individually. The increase in the vendor fees from fiscal year 2008 to fiscal year 2009 was the result of the increase in the vendor fee rate in November 2007, as mentioned on page 14.

Of the $24.5 million in fiscal year 2009 expenses that were non game-related, more than $11.9 million was for promotions and institutional and product advertising and about $8.5 million was for compensation to the Lottery employees.

In comparison, of the fiscal year 2008 non game-related expenses of $23.1 million, nearly $8.9 million was for promotions and institutional and product advertising and $8.8 million was for compensation to the Lottery employees.

The $3.0 million increase in promotions and institutional and product advertising from fiscal year 2008 to fiscal year 2009 was the result of an increase in appropriated funds approved by the Joint Budget Committee to support an effort to increase the overall sales of lottery products. This effort was mitigated by the downturn in the economy in fiscal year 2009, but management believes this will contribute to the future increase of Lottery sales.

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

Distributions to the Proceeds Recipients

The Lottery's efforts generated funds available for distributions of $119.6 million in the current fiscal year. Of these total proceeds, $54.3 million was allocated to the Great Outdoors Colorado Trust Fund, $47.8 million to the Conservation Trust Fund and $12.0 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 $54.3 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 $5.5 million, pursuant to C.R.S. 22-43.7-104(2)(b)(111).

The Lottery's proceeds distributions for the fiscal year 2008, the second highest year ever, totaled $122.3 million. Approximately $53.1 million was distributed to Great Outdoors Colorado, $48.9 million to the Conservation Trust Fund, $12.2 million to the Division of Parks and Outdoor Recreation and a spill-over into the Lottery Proceeds Contingency Reserve Fund of $8.1 million.

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

Capital Assets

The Lottery's investment in capital assets at June 30, 2009, 2008 and 2007 amounted to $2.8 million, $0.5 million and $0.7 million, respectively. The investment in capital assets as of June 30, 2009 includes, computer equipment, servers, drawing equipment, modular furniture, cameras, recorders plus the capitalization of salaries and other costs related to the development of a new back office system (Construction in Progress). The investment in capital assets as of June 30, 2008 and 2007 also included leasehold improvements which have since been abolished. 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, 2009, 2008 and 2007

	2009	2008	2007
Capital Assets			
Equipment	$ 3,144,554	$ 3,159,600	$ 3,772,195
Construction in Progress	2,295,614	-	-
Leasehold Improvements	-	11,978	14,053
Less: Accumulated Depreciation	(2,680,467)	(2,673,422)	(3,089,332)
Net capital assets	$ 2,759,701	$ 498,156	$ 696,916

The new back office system in construction in progress at June 30, 2009, was put into service in July 2009.

Colorado Lottery

Management's Discussion and Analysis

Years Ended June 30, 2009 and 2008

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 2009, the Legislature approved supplemental appropriation adjustments for the Lottery. Supplemental appropriations and department level re-allocations were approved in vendor fees, prizes, Powerball prize variance, retailer compensation, Department of Revenue postage, and capital outlay payments, offset by reductions in payments in ticket costs, personal services and lease space. The final method of funding is special legislation. There was no special legislation affecting the Lottery's budget in fiscal year 2009.

The approved Lottery budget at the beginning of fiscal year 2009 was $429.6 million. Supplemental appropriations and adjustments made in the third quarter increased the budget by $66.0 million, department level allocations approved at the beginning of the fiscal year increased the budget by $2.8 million to an amended total of $498.4 million. Total expenditures and roll-forwards for fiscal year 2009 on a budget basis came to $383.2 million, resulting in excess appropriations (or savings) of more than $115.2 million.

Economic Outlook

- The appropriation for promotions and institutional and product advertising was increased by $3.0 million for fiscal year 2010 in an effort to increase the overall sale of Lottery products.
- The back office system was implemented on July 12, 2009, whose functionality will allow the development of new games and the enhancement of existing games. Plans include the addition of a seventh draw for the Cash 5 game in the November 2009 time range and the introduction of a new online game in early spring of 2010.
- An additional $0.5 million was appropriated to cover the cost of implementing a new courier delivery system for a scratch product expected to come online in November or December 2009.

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 2009 and to demonstrate the Lottery's accountability for the money generated from the sale of the Lottery products. If you have questions about this report or need additional information, contact Barbara Aggson, the Colorado Lottery's Controller, 212 W. 3rd Street, Suite 210, Pueblo, CO 81003.

Colorado Lottery

Statements of Net Assets

June 30, 2009 and 2008

		2009		2008
Current Assets:				
Cash and investments	$	35,337,291	$	30,577,235
Accounts receivable, net of the allowance for doubtful accounts of $182,993 in 2009 and $222,816 in 2008		20,549,443		18,812,076
Consignment inventory, at cost		118,917		94,352
Warehouse inventory, at cost		1,389,571		802,513
Prepaid expenses		140,032		82,131
Total current assets		57,535,254		50,368,307
Reserve and Restricted Assets:				
Cash and investments-Operating reserve		1,100,000		1,300,000
Cash and investments-Licensed agent recovery reserve receipts		388,771		443,139
Prepaid prize expense with MUSL		3,928,566		3,944,710
Total reserve and restricted assets		5,417,337		5,687,849
Capital Assets:				
Construction in progress		2,295,614		-
Equipment		3,144,554		3,159,600
Leasehold improvements		-		11,978
Less accumulated depreciation and amortization		(2,680,467)		(2,673,422)
Total capital assets		2,759,701		498,156
Total assets	$	65,712,292	$	56,554,312

See Notes to Financial Statements.

Current Liabilities:		
Accounts payable	$ 3,357,721	$ 2,588,688
Prize liability	26,950,117	21,630,167
Wages and benefits	722,020	848,606
Accrued annual and sick leave	8,741	14,806
Retailer bonus liability	606,258	704,862
Funds available for distribution	28,090,232	27,155,421
Deferred revenue	327,515	307,434
Total current liabilities	60,062,604	53,249,984
Long-Term Liabilities:		
Accrued annual and sick leave	911,937	819,401
Expired warrants liability	83,132	94,485
Total long-term liabilities	995,069	913,886
Total liabilities	61,057,673	54,163,870
Net Assets		
Investment in capital assets	2,759,701	498,156
Restricted-licensed agent recovery reserve	388,771	443,139
Restricted-operating reserve	1,100,000	1,300,000
Unrestricted-other	406,147	149,147
Total net assets	4,654,619	2,390,442
Total liabilities and net assets	$ 65,712,292	$ 56,554,312

Colorado Lottery

Statements of Revenues, Expenses and Changes in Net Assets

Years Ended June 30, 2009 and 2008

	2009	2008
Operating Revenues		
Gross ticket sales	$ 493,364,094	$ 505,814,066
Direct Operating Expenses		
Prize expense	301,506,498	313,796,804
Powerball prize variance	168,068	1,138,171
Retailer commissions and bonuses	36,480,909	38,392,178
Cost of tickets and vendor fees	10,523,973	9,953,022
Total direct operating expenses	348,679,448	363,280,175
Gross Profit on Sale of Tickets	144,684,646	142,533,891
Other Operating Expenses		
Marketing and communications	11,914,439	8,892,973
Administration fees paid to MUSL	98,250	102,955
Wages and benefits	8,527,025	8,841,445
Professional services	251,587	415,610
State agencies services	161,235	139,926
Department of Revenue services	556,672	458,881
Travel	109,457	112,329
Equipment (including loss on disposition of equipment of $9,916 and $65,893, respectively)	93,528	1,355,526
Depreciation	136,691	149,397
Accrued annual and sick leave	94,725	8,320
Space rental	678,684	692,825
Rents for equipment	29,933	28,116
Motorpool leasing	391,867	350,097
Materials and supplies	86,879	92,541
Telephone	104,912	110,708
On-Line telecommunications	475,801	502,406
Data processing supplies and services	20,040	85,011
Equipment maintenance	316,938	250,676
Postage	67,201	68,745
Printing	7,618	10,171
Other	388,268	393,603
Total other operating expenses	24,511,750	23,062,261

See Notes to Financial Statements.

Colorado Lottery

Statements of Revenues, Expenses and Changes in Net Assets (continued)

Years Ended June 30, 2009 and 2008

	2009	2008
Operating income	120,172,896	119,471,630
Nonoperating Revenues (Expenses)		
Other revenue	267,188	428,513
Investment income	1,427,948	2,365,744
Funds distributed for current year	(91,513,623)	(95,144,711)
Funds available for distribution for current year	(28,090,232)	(27,155,421)
Total nonoperating revenues (expenses)	(117,908,719)	(119,505,875)
Net income (loss)	$ 2,264,177	$ (34,245)
Net assets, beginning of year	2,390,442	2,424,687
Net change in net assets	2,264,177	(34,245)
Net assets, end of year	$ 4,654,619	$ 2,390,442

Colorado Lottery

Statements of Cash Flows

Years Ended June 30, 2009 and 2008

	2009	2008
Operating activities		
Cash received from retailers	$ 490,961,741	$ 505,162,834
Cash paid in prizes	(296,077,156)	(317,267,109)
Cash paid in retailer commissions	(32,844,563)	(33,668,027)
Cash payments to suppliers	(25,841,745)	(22,322,364)
Cash payments to employees for services	(8,538,590)	(8,735,998)
Cash paid in retailer bonus	(3,721,928)	(4,513,389)
Net cash provided by operating activities	123,937,759	118,655,947
Noncapital Financing Activities		
Distribution of net proceeds	(118,669,044)	(123,850,829)
Net cash used by noncapital financing activities	(118,669,044)	(123,850,829)
Capital and related financing activities		
Acquisition of capital assets	(2,190,975)	(16,530)
Net cash used by capital and related financing activities	(2,190,975)	(16,530)
Investing activities		
Interest received	1,170,948	2,018,310
Net cash provided by investing activities	1,170,948	2,018,310
Increase (Decrease) in Cash and Investments	4,248,688	(3,193,102)
Change in Fair Market Value of Investments	257,000	347,434
Cash and investments, Beginning of Year (including $1,743,139 and $1,926,058, respectively, in restricted accounts)	32,320,374	35,166,042
Cash and investments, End of Year, (including $1,488,771 and $1,743,139, respectively, in restricted accounts)	$ 36,826,062	$ 32,320,374

See Notes to Financial Statements.

Colorado Lottery

Statements of Cash Flows (continued)

Years Ended June 30, 2009 and 2008

	2009	2008
Reconciliation of operating income to net cash provided by operating activities		
Operating income	$ 120,172,896	$ 119,471,630
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	136,691	149,397
Loss on disposition of equipment	9,916	65,893
Other revenue	267,188	428,513
(Increase) decrease in prepaid prize expense with MUSL	16,144	(48,242)
Change in:		
Accounts receivable	(1,737,367)	(531,793)
Ticket inventory	(611,623)	(172,671)
Other assets	(57,901)	(7,666)
Liabilities (excluding funds available for distribution)	5,741,815	(699,114)
Net cash provided by operating activities	$ 123,937,759	$ 118,655,947
Statement of Net Assets Classification		
Cash and investments	$ 35,337,291	$ 30,577,235
Cash and investments-Licensed Agent Recovery Reserve	388,771	443,139
Cash and investments-Operating Reserve	1,100,000	1,300,000
	$ 36,826,062	$ 32,320,374

Colorado Lottery
Powerball Annuity Winners Trust Fund
Statements of Fiduciary Net Assets
Year Ended June 30, 2009 and 2008

	2009	2008
ASSETS		
Current assets:		
Investments	$ 9,893,414	$ 9,750,262
Total Assets	$ 9,893,414	$ 9,750,262
NET ASSETS		
Held in Trust for Powerball winner	$ 9,893,414	$ 9,750,262
Total Net Assets	$ 9,893,414	$ 9,750,262

See Notes to Financial Statements.

Colorado Lottery

Powerball Annuity Winners Trust Fund

Statements of Changes in Fiduciary Net Assets

Year Ended June 30, 2009 and 2008

Additions	**2009**	**2008**
Investment income	$ 514,152	$ 360,625
Contribution from Multi-State Lottery Association	-	9,746,637
Total additions	514,152	10,107,262
Deductions		
Prize payment	371,000	357,000
Change in net assets	143,152	9,750,262
Net Assets held in Trust for Powerball winner		
Beginning of Year	9,750,262	-
End of Year	$ 9,893,414	$ 9,750,262

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 and Cash 5.

The financial statements reflect activities of the Lottery, an enterprise fund of the State of Colorado and activities of the Lottery's Powerball Annuity Winners Trust Fund, a private trust fund of the State of Colorado, for the fiscal years ended June 30, 2009 and 2008. 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 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 or expenses are recognized in the accounts and reported in the financial statements. The Lottery accounts for funds using the accrual basis of accounting. Revenues from scratch ticket sales are recognized at the point of ticket pack activation. Revenues from Lotto, Powerball, and Cash 5 ticket sales are recognized using the specific performance method whereby sales are recognized at the point that the play becomes active for the next drawing. Expenses are recognized when they are incurred.

Revenues (additions) are recognized in the Powerball Annuity Winners Trust Fund based on the fair market value of the investment as of June 30, 2009 and 2008. Expenses (deductions) are recognized when payments are remitted to the winner(s).

Budget

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

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

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

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable consist of amounts due from retailers for activated scratch ticket packs and uncollected on-line sales. Accounts receivable are stated at the amount billed to retailers plus scratch ticket packs activated not yet settled. Accounts receivable are ordinarily due seven days after the issuance of the invoice and are electronically transferred from the retailer's accounts into the Lottery's account.

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

The Lottery uses the specific identification method to determine expected uncollectibles. Under the provisions of Section 24-35-219, C.R.S., licensed agent recovery reserve receipts are collected from the retailers to cover uncollectible accounts. The accounts receivable and the licensed agent recovery reserve are shown net of estimated uncollectible receivables of $182,993 and $222,816 as of June 30, 2009 and 2008, 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.

Prepaid Prize Expense

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

Capital Assets

Capital assets, which include construction-in-progress for 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 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 creates a liability for accrued wages at June 30, 2009 and 2008 of $712,619 and $704,570, 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 $5,167,085 for the fiscal year ended June 30, 2009 and $5,012,478 for the fiscal year ended June 30, 2008.

Payments of cumulative online prize amounts of $150 or less on a single ticket may be made at the Lottery or at the retail outlet; payment of cumulative prize amounts of $151 to $599 on a single ticket may be made at the retailer level at the option of the retailer or at the Lottery. Payment of cumulative prize amounts of $600 or more on a single ticket must be made at the Lottery. Retailers are given credit for prize payments they make on a daily basis. Online prizes may be claimed up to 180 days after the date of the drawing. After the final claim date, unclaimed online prizes will result in a decrease to prize expense so long as the aggregate prize expense of all games exceeds or equals the statutory 50% of sales. In the event that the expiration of an unclaimed prize would result in the aggregate prize expense of all games to fall below the statutory 50% level, the unclaimed prize amount would remain in prize expense and be paid out to players as a guaranteed additional prize. Unclaimed online prizes resulted in a decrease to prize expense of $4,045,662 for the fiscal year ended June 30, 2009 and $4,023,101 for the fiscal year ended June 30, 2008.

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.

Retailer Bonus Liability

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

> *". . .the Director may provide such additional compensation to licensees as is deemed appropriate by the Director to further the sale of lottery tickets, so long as such additional compensation is made equally available to all licensees and does not exceed a total of Seven Tenths Percent (.7%) for Lotto, Sixty-five Hundredths Percent (.65%) for Powerball, Ninety-six Hundredths Percent (.96%) for Cash ,and a total of Five-Tenths Percent (.5%) plus One Percent of all scratch prizes up to and including $599.99 for Scratch."*

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

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

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

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, 2009 and June 30, 2008, the Lottery has restricted net assets of $388,771 and $443,139, respectively, for the licensed Agent Recovery Reserve. It is the Lottery's policy to utilize restricted net assets before utilizing 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 will be reviewed annually and adjusted accordingly. The annual reviews were completed in September 2007 and 2008 and the reserve was reduced to $1.3 million and $1.1 million, respectively, in accordance with the reviews.

Equipment Expense

Included in the Statement of Revenues, Expenses, and Changes in Fund Net Assets is an expense account titled equipment. This account reports the book value of assets which are disposed of during the year, fixed asset purchases under the capitalizable threshold (see Note 3 – Schedule of Changes in Fixed Assets, page 45), 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:

	June 30, 2008	Increases	Decreases	June 30, 2009	Due Within One Year
Annual Leave	$ 691,339	$ 596,937	$ (517,137)	$ 771,139	$ 8,448
Sick Leave	140,969	44,746	(40,289)	145,426	293
Total annual and sick leave	832,308	641,683	(557,426)	916,565	8,741
Compensatory time	1,899	13,593	(11,379)	4,113	-
Total compensated leave	$ 834,207	$ 655,276	$ (568,805)	$ 920,678	$ 8,741

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. For fiscal years ending June 30, 2009 and 2008, there were no requests made and received from the Unclaimed Property Fund.

Deferred Revenue

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

A detail of deferred revenue at June 30, 2009 and 2008, is as follows:

	2009	2008
Advance Play – Lotto	$ 106,900	$ 97,188
Advance Play – Powerball	147,313	138,610
Advance Play – Powerplay	43,640	38,964
Advance Play – Cash 5	29,662	32,672
Total deferred revenue	$ 327,515	$ 307,434

Promotional Activity

The Lottery engages in two types of promotional activities in an attempt to enhance sales and to increase the player base. Specific promotional coupons are distributed to players through special promotions and can be redeemed at any Lottery office for a specified Lottery product. Promotional coupons with a total face value of $8,150 and $10,750 were redeemed in fiscal years ended June 30, 2009 and June 30, 2008, respectively. Scratch tickets for specific games are given away as a more direct approach to introduce players to lottery games. During the fiscal years ended June 30, 2009 and 2008, scratch tickets with a total face value of $171,917 and $94,003, respectively, were given away. Scratch ticket and coupon promotions are valued at cost. For the fiscal years ended June 30, 2009 and 2008, $116,441 and $68,432, 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, 2009 and 2008 is as follows:

	2009	2008
Petty cash	$ 800	$ 800
Change funds	70,000	70,000
Imprest fund	693,000	722,000
Depository accounts	30,000	30,000
Cash on deposit with State Treasurer	34,543,491	29,754,435
Total unrestricted cash and investments	35,337,291	30,577,235
Restricted cash and investments – Licensed Agent Recovery Reserve Receipts on deposit with State Treasurer	388,771	443,139
Operating Reserve on deposit with State Treasurer	1,100,000	1,300,000
Total restricted cash and investments	1,488,771	1,743,139
Total cash and investments	$ 36,826,062	$ 32,320,374

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 2009 and 2008 was 2.72% and 4.27%, 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 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 U.S. 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 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.

	2009		2008	
Investment Type	**Fair Value**	**Weighted Average Maturity (in years)**	**Fair Value**	**Weighted Average Maturity (in years)**
U. S. Treasury Investments	$ 3,898,685	16.66	$ 4,000,284	15.95
U.S. Aid Bonds	3,408,892	8.76	3,262,263	9.81
Resolution Fund Corp Strips	2,585,837	14.44	2,487,715	15.54
	$ 9,893,414		$ 9,750,262	

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.

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, 2009 and 2008 are the Resolution Funding Corporation Strips which represent 26.1% and 25.5%, respectively, of the total investment.

Statements of Cash Flows

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

Note 3: Schedule of Changes in Fixed Assets

	June 30, 2008	Increases	Decreases	June 30, 2009
Construction in Progress - not depreciated	$ —	$ 2,295,614	$ —	$ 2,295,614
Capital assets being depreciated:				
Equipment	3,159,600	112,538	(127,584)	3,144,554
Leasehold improvements	11,978	—	(11,978)	—
Total capital assets	3,171,578	2,408,152	(139,562)	3,144,554
Less accumulated depreciation for equipment	(2,662,642)	(136,691)	118,866	(2,680,467)
Leasehold improvements	(10,780)	—	10,780	—
Total accumulated depreciation	(2,673,422)	(136,691)	129,646	(2,680,467)
Total capital assets, net	$ 498,156	$ 2,271,461	$ (9,916)	$ 2,759,701

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

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.

Denver

Office – The Lottery occupied office and warehouse space in the Galleria Towers Building in Denver. The lease agreement, which began on October 30, 1990, was amended on May 14, 1999 and extended the ending date for the lease from June 30, 1999 to June 30, 2006. On March 10, 2006 the Lottery entered into a second amendment to the lease agreement with Galleria extending the original lease for a thirty-six month period ending on June 30, 2009. The amended lease included a five-year renewal option. On February 23, 2009, the Lottery entered into a new lease agreement, which will begin on the date of substantial completion of required improvements and expire on June 30, 2019. The Lottery entered into a first amendment to the lease on June 23, 2009 which will begin on July 1, 2009 and will expire upon the commencement of the original lease agreement. The lease contains an option to renew the lease for two (2) consecutive additional periods of five years each. There are no other provisions for extension or renewal.

Warehouse – The Lottery entered into a lease agreement with Yukon Denver Valley, Inc. to occupy warehouse space. The lease agreement began on September 1, 1999 and expired on August 31, 2004. On June 11, 2004, the Lottery exercised its option to extend the lease through August 31, 2009.

Fort Collins

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

Colorado Lottery
Notes to Financial Statements
June 30, 2009 and 2008

Grand Junction

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

Colorado Springs

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

Operating lease expense incurred for the fiscal years ended June 30, 2009 and 2008 and future minimum lease payments for fiscal years ending June 30, 2010 through 2014 and later years are as follows:

LOCATION			FUTURE MINIMUM LEASE PAYMENTS					
	2008	2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	LATER YEARS
Pueblo Office	$234,207	$228,306	$223,292	$ 229,909	$236,526	$243,482	$250,607	$ 258,072
Pueblo Warehouse	114,596	107,405	142,249	145,549	-	-	-	-
CoSprgs Warehouse	13,440	13,455	5,215	-	-	-	-	-
Denver	179,456	185,149	169,741	175,722	181,703	187,684	193,665	1,058,040
Denver Warehouse	101,473	99,621	15,961	-	-	-	-	-
Fort Collins	39,288	35,829	-	-	-	-	-	-
Grand Junction	7,981	6,902	-	-	-	-	-	-
	$ 690,441	$ 676,667	$556,458	$ 551,180	$418,229	$431,166	$444,272	$ 1,316,112

Note 5: Other Revenue

A schedule of other revenue for the fiscal years ended June 30, 2009 and 2008 follows:

	2009	2008
License fees	$ 66,988	$ 65,616
Fines and penalties	176,140	250,850
Assignment fees	901	2,700
Net Licensed Agent Recovery Reserve Receipts (Payments)	(54,368)	17,081
Royalty Income	25,212	68,757
Other	52,315	23,509
Total	$ 267,188	$ 428,513

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 into the Public School Capital Construction Assistance Fund as set forth in section 22-43.7-104 (2)(b)(111) C.R.S.

Income available for distribution at June 30:

	2009	2008
Operating Income	$120,172,896	$119,471,630
Plus: Other Revenue	267,188	428,513
Investment Income	1,427,948	2,365,744
Income before distributions	121,868,032	122,265,887
Change in licensed agent recovery reserve	54,368	(17,081)
Change in fair market value of investments	(257,000)	(347,434)
Change in Operating Reserve	200,000	200,000
Changes in capital assets	(2,261,545)	198,760
Income available for distribution	119,603,855	122,300,132
Less distributions prior to year-end	(91,513,623)	(95,144,711)
Income available for distribution	$ 28,090,232	$ 27,155,421

	Accrued at June 30, 2008	Proceeds Distributions Expenses	Distributions Paid	Accrued at June 30, 2009
Great Outdoors Colorado	$ 5,532,016	$ 54,267,191	$ (51,288,830)	$ 8,510,377
Lottery Proceeds Contingency Reserve Fund	8,045,692	-	(8,045,692)	-
Public School Capital Construction Assistance Fund	-	5,534,736	-	5,534,736
Conservation Trust Fund	10,862,169	47,841,542	(47,467,618)	11,236,093
Division of Parks and Outdoor Recreation	2,715,544	11,960,386	(11,866,904)	2,809,026
	$ 27,155,421	$119,603,855	$(118,669,044)	$ 28,090,232

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

Note 7: Pension Plan

Plan Description

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

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

Beginning on July 1, 2009, the administration of the state's defined contribution retirement plan will be transferred to PERA. New non-higher education employees will have the choice of participating in either the PERA defined benefit or the PERA defined contribution plan. Existing plan members will become participants in the PERA defined contribution plan and retain their current vesting schedule on employer contributions.

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

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

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

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

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

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

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

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

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

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

Funding Policy

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

Most employees contribute 8% (10% for state troopers) of their salary, as defined in CRS 24-51-101(42), to an individual account in the plan. From July 1, 2008, to December 31, 2008, the state contributed 12.05% (14.75% for state troopers and 15.56% for the judicial branch) of the employee's salary. From January 1, 2009 through June 30, 2009 the state contributed 12.95 % (15.65 % for state troopers and 16.46 % for the Judicial Branch). During all of Fiscal Year 2009, 1.02% of the employees total salary was allocated to the Health Care Trust Fund.

Per Colorado Revised Statutes, an amortization period of 30 years is deemed actuarially sound. At December 31, 2007, the division of PERA in which the state participates was underfunded with an infinite amortization period, which means that the unfunded actuarially accrued liability would never be fully funded at the current contribution rate.

In the 2004 legislative session, the general assembly authorized an Amortization Equalization Disbursement (AED) to address a pension-funding shortfall. The AED requires PERA employers to pay an additional .5% of salary beginning January 1, 2006, another 0.5% of salary in 2007, and subsequent year increases of 0.4% of salary until the additional payment reaches 3% in 2012.

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

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

The Lottery's contributions to the Defined Benefit Plan and the Health Care Trust Fund for the fiscal years ended June 30, 2009, 2008, and 2007, were $797,259, $759,314, and $720,894, respectively. These contributions met the contribution requirement for each year.

Note 8: Voluntary Tax-deferred Retirement Plans

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

Note 9: Post Employment Benefits and Life Insurance

Health Care Program

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

After the PERA subsidy, the benefit recipient pays any remaining amount of that premium through an automatic deduction from the monthly retirement benefit. Monthly premium costs for participants depend on the health care plan selected, the PERA subsidy amount, Medicare eligibility, and the number of persons covered. Effective July 1, 2000, the maximum monthly subsidy is $230.00 per month for benefit recipients who are under 65 years of age and who are not entitled to Medicare; and $115.00 per month for benefit recipients who are 65 years of age or older or who are under 65 years of age and entitled to Medicare. The maximum subsidy is based on the recipient having 20 years of service credit, and is subject to reduction by 5% for each year less than 20 years.

Employees are not required to contribute to the Health Care Trust Fund, which is maintained by employer's contributions as discussed above. Beginning July 1, 2004, state agencies are required to contribute 1.02 % of gross covered wages to the Health Care Trust Fund. The Lottery contributed $65,160, $66,734, and $67,494 as required by statute in Fiscal Years 2009, 2008 and 2007, respectively. In each year the amount contributed was 100 % 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, 2008, there were 45,888 enrolled participants, including spouses and dependents, from all contributors to the plan. At December 31, 2008, the Health Care Trust Fund had an unfunded actuarial accrued liability of $1.11 billion, a funded ratio of 18.7 %, and a 39-year amortization period.

Note 10: Contingencies and Commitments

Prize Annuities

The Lottery purchases annuity contracts in the name of individual jackpot prize winners. Although the annuity contracts are in the name of the individual winners, the Lottery retains title to the annuity contracts. The Lottery remains liable for the payment of the guaranteed minimum prizes in the event the insurance companies issuing the annuity contracts default. The following guaranteed minimum prize payments for which annuity contracts have been purchased are due in varying amounts through April 3, 2030.

Specified prize payments	$412,803,690
Lifetime prize payments	38,755,000
Total guaranteed minimum prize payments	$451,558,690

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 $19,272,000 as of June 30, 2009.

Self-insurance

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

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

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

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

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

Medical and Disability Benefits

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

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

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

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

Furniture and Equipment

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

Gaming Operations Commitments

The Lottery has entered into long-term contracts with certain significant vendors related to providing scratch tickets and online data processing services in support of the Lottery's gaming operations. The online data processing contract expires on October 31, 2012 per the contract amendment dated January 26, 2005. Renewal options include one additional two-year period and two additional periods of ninety days for conversion and turnover purposes. Per Option Letter #12, the amended total cost of the initial contract period is not to exceed $72,122,925.

The Lottery entered into two contracts with the scratch vendors on January 9 and 13, 2006. The contracts expired on November 30, 2007. The State, in its sole discretion, could require continued performance for three additional twelve (12) month periods on both contracts. In addition, in the event that a contract with a successor contractor cannot be signed prior to the expiration or termination date of this contract, the State reserves the right to extend this contract for maximum of one hundred eighty (180) days or until a new contract is executed. There are no other provisions for extension or renewal. The total costs of the contracts for the initial contract period were not to exceed $5,666,667 each for the respective contracts. In May 2007, one scratch vendor (purchaser) purchased the other scratch vendor (purchasee). A novation agreement was signed assigning all of the rights of the purchasee to the purchaser. On November 17, 2007, the state exercised its option to extend the contract with the purchaser for an additional twelve month period starting on December 1, 2007 and ending on November 30, 2008. On October 17, 2008, the state exercised its remaining options to extend the contract for an additional two year period starting on December 1, 2008 and ending on November 30, 2010. The maximum amount available to cover both the original contract period and the extensions is $23,479,002. The maximum amount available to cover costs for fiscal year 2009, which ended on June 30, 2009, was $4,000,000.

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. The total amount to be contributed by the Lottery to the prize reserves as of June 30, 2009 is $3,656,050 and is based on a percentage of sales. The total amount of the prize reserves funded as of June 30, 2009 and 2008 was $3,928,566 and $3,944,710, respectively, shown as prepaid prize expense – MUSL on the statements of net assets. MUSL reserves the right to hold funds which do not exceed 110% of the required balance. If the actual balance in the reserves should exceed 110% of the required balance, MUSL will refund any funds in excess of the 110% threshold.

Other Major Vendor Commitments

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

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. The total cost of the initial contract period is $4,098,480. See further information in Note 13 – Subsequent Event.

Litigation

In fiscal year 2001, a plaintiff filed a class action suit claiming that the Lottery breached its contract with players by continuing to sell instant tickets in games in which the top prize had already been claimed. In fiscal year 2006, the District Court found in favor of the Lottery. The Colorado Court of Appeals upheld the decision of the District Court as it related to the Lottery. The case was again appealed and heard orally by the Colorado Supreme Court on December 6, 2007. The decision was rendered on March 24, 2008 and upheld the decision of the Court of Appeals. The decision is now final and non-appealable and the case has been closed.

Note 11: Tax, Spending and Debt Limitations

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

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

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

Note 12: Related Party Transactions

The Lottery, as an agency of the State of Colorado, paid fees to other agencies of the state for auditing, legal and other services and vehicle and office rent. The Lottery also pays fees to the Department of Revenue for indirect costs. Interagency charges were $1,152,460 and $996,105 for the fiscal years ended June 30, 2009 and 2008, respectively.

Note 13: Subsequent Event

The construction in progress identified on the balance sheet represents costs associated with the development of a new back office system. The conversion to the new system was completed on July 11, 2009.

Supplementary Information

Colorado Lottery

Schedule of Revenue and Costs for Scratch and On-line Games

For Fiscal Year Ended June 30, 2009

(With Comparative Totals for the Fiscal Year Ended June 30, 2008)

	Games in Progress				Fiscal Year 2009 Total	Fiscal Year 2008 Scratch and Online
		Online Games				
	Scratch	Lotto	Powerball	Cash 5		
Gross ticket sales	$ 328,254,471	$ 43,544,371	$ 100,733,520	$ 20,831,732	$ 493,364,094	$ 505,814,066
Prize expense	(221,618,604)	(21,830,159)	(47,221,636)	(10,836,099)	(301,506,498)	(313,796,804)
Powerball prize variance	—	—	(168,068)	—	(168,068)	(1,138,171)
Net revenue after prizes	106,635,867	21,714,212	53,343,816	9,995,633	191,689,528	190,879,091
Commissions, bonuses, ticket costs and vendor fees						
Retailer commission	(22,936,292)	(2,613,734)	(6,044,814)	(1,249,723)	(32,844,563)	(33,668,027)
Retailer bonus	(2,501,168)	(285,537)	(656,297)	(193,344)	(3,636,346)	(4,724,151)
Cost of tickets sold	(2,698,617)	—	—	—	(2,698,617)	(2,558,910)
Telecomm Reimbursements	489,229	64,898	150,133	31,047	735,307	716,819
Online vendor fees	(5,687,541)	(758,793)	(1,752,405)	(361,924)	(8,560,663)	(8,110,931)
Total	(33,334,389)	(3,593,166)	(8,303,383)	(1,773,944)	(47,004,882)	(48,345,200)
Gross profit on sale of tickets	$ 73,301,478	$ 18,121,046	$ 45,040,433	$ 8,221,689	$ 144,684,646	$ 142,533,891
Average daily ticket sales	$ 899,327	$ 119,300	$ 275,982	$ 57,073	$ 1,351,682	$ 1,382,006

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 Fiscal Year Ended June 30, 2009

	Games in Progress					
	Scratch	Lotto	Powerball	Cash 5	Powerball Prize Variance	Fiscal Year 2009 Total
Prize expense	$ 221,618,604	$ 21,830,159	$ 47,221,636	$ 10,836,099	$ 168,068	$ 301,674,566
Ticket sales	328,254,471	43,544,371	100,733,520	20,831,732	—	493,364,094
Prize %	67.51%	50.13%	46.88%	52.02%		61.15%

Colorado Lottery

Budgetary Comparison

For Fiscal Year Ended June 30, 2009

	Fiscal Year 2009 Original Budget	Supplemental Allocations and Internal Transfers	Fiscal Year 2009 Final Budget	Fiscal year 2009 Actual Expenditures	Under Expended	Percent Under Expended
Personal services	$ 8,718,974	$ 190,141	$ 8,909,115	$ 8,174,474	$ 734,641	8.25%
Amortization equalization	—	121,243	121,243	110,147	11,096	9.15%
Supplemental amort. equal.	—	56,835	56,835	51,504	5,331	9.38%
Workmen's compensation	—	63,645	63,645	63,645	—	0.00%
Health and life	—	635,126	635,126	630,328	4,798	0.76%
Short term disability	—	9,851	9,851	9,108	743	7.54%
Operating	1,203,156	—	1,203,156	1,181,797	21,359	1.78%
DOR postage allocation	—	9,885	9,885	4,869	5,016	50.74%
Variable vehicle	—	124,200	124,200	124,200	—	0.00%
Leased space	—	711,981	711,981	671,782	40,199	5.65%
Grand Junction-leased space	—	6,902	6,902	6,902	—	0.00%
Risk management	—	30,453	30,453	30,453	—	0.00%
Vehicle lease payments	—	146,003	146,003	127,303	18,700	12.81%
Capital outlay	—	32,482	32,842	32,546	296	0.90%
Travel	113,498	—	113,498	109,457	4,041	3.56%
Purch. serv. comp. center	—	3,128	3,128	3,128	—	0.00%
Marketing, communications and sales	11,671,710	—	11,671,710	11,664,439	7,271	0.06%
Communications services	—	2,034	2,034	2,034	—	0.00%
Payments to MNT	—	374,676	374,676	374,676	—	0.00%
Payments to other agencies	239,410	—	239,410	141,733	97,677	40.80%
Legal services	—	35,364	35,364	19,502	15,862	44.85%
Indirect costs	556,672	—	556,672	556,672	—	0.00%
Ticket costs-Scratch	7,529,350	(2,858,470)	4,670,880	2,763,037	1,907,843	40.85%
Research	250,000	—	250,000	250,000	—	0.00%
Vendor fees	10,875,511	1,591,978	12,467,489	8,659,163	3,808,326	30.55%
Prize payments	336,721,380	55,859,560	392,580,940	301,506,498	91,074,442	23.20%
Retailer compensation	41,773,750	6,316,410	48,090,160	36,480,909	11,609,251	24.14%
Multi-State lottery fund	177,433	—	177,433	101,002	76,431	43.08%
Powerball prize variable	9,752,000	2,956,000	12,708,000	7,289,207	5,418,793	42.64%
Lottery systems	—	2,415,000	2,415,000	2,073,949	341,051	14.12%
TOTAL	$ 429,582,844	$ 68,834,787	$ 498,417,631	$ 383,214,464	$ 115,203,167	23.11%
FY09 Staffing (FTE)	126.0	(Appropriated)	118.6	(Actual)		

*Certain amounts may not tie due to rounding.

Colorado Lottery
Budgetary Comparison (continued)
for the Fiscal Year Ended June 30, 2009

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	$ 301,506,498
Powerball prize variance	168,068
Commissions and bonuses	36,480,909
Cost of tickets and vendor fees	10,523,973
Operating expenses	24,511,750
Total Expenses per Statement of Revenues, Expenses and Changes in Net Assets	373,191,198
Plus: Powerball variance classified as revenue	7,121,139
Telecommunications offset classified as revenue	735,307
Less: Non-appropriated expenses	
Depreciation	(136,691)
Accrued annual and sick leave	(94,725)
Book value of assets written off	(9,916)
Subtotal	380,806,312
Plus: Capitalized purchases	2,010,767
Capitalized wages	397,385
	$ 383,214,464

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, 2009, which collectively comprise the Colorado Lottery's basic financial statements and have issued our report thereon dated September 9, 2009. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Colorado Lottery's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the 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 control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Lottery's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Lottery's financial statements that is more than inconsequential will not be prevented or detected by the Lottery's internal control.

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

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies 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 we reported to management of the Lottery in the Findings and Recommendations section (Findings 1 and 2) of this report.

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

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

Clifton Gunderson LLP

Greenwood Village, Colorado
September 9, 2009

Clifton Gunderson LLP
Certified Public Accountants & Consultants

Required Communications to the Legislative Audit Committee

September 9, 2009

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, 2009.

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 an opinion 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 were no misstatements detected as a result of audit procedures and corrected by management that were material, either individually or in the aggregate, to the financial statements taken as a whole.

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 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