

Colorado Lottery

Financial and Compliance Audit

June 30, 2007 and 2006

**LEGISLATIVE AUDIT COMMITTEE
2007 MEMBERS**

Senator Stephanie Takis
Chairman

Representative James Kerr
Vice-Chair

Representative Dorothy Butcher
Senator Jim Isgar
Representative Rosemary Marshall
Representative Victor Mitchell
Senator Nancy Spence
Senator Jack Taylor

Office of the State Auditor Staff

Sally Symanski
State Auditor

Dianne Ray
Deputy State Auditor

Cynthia Hochmiller
Legislative Auditor

BKD, LLP
Contract Auditors



September 4, 2007

Members of the Legislative Audit Committee

We have completed the financial statement audits of the Colorado Lottery as of and for the years ended June 30, 2007 and 2006. Our audits were conducted in accordance with auditing standards generally accepted in the United States of America.

We were engaged to conduct our audit pursuant to Section 24-35-211, C.R.S., which authorizes the State Auditor to audit the Lottery Fund. The reports we have issued as a result of this engagement are set forth in the table of contents which follows.

BKD, LLP

Colorado Lottery
June 30, 2007 and 2006

Contents

Report Summary	1
Recommendation Locator	3
Background	4
Auditors' Findings and Recommendations.....	5
Disposition of Prior Year Audit Recommendations.....	9
Independent Accountants' Report on Financial Statements and Supplementary Information.....	10
Management's Discussion and Analysis.....	12
Financial Statements	
Statements of Net Assets	23
Statements of Revenues, Expenses and Changes in Net Assets	24
Statements of Cash Flows	26
Notes to Financial Statements.....	28
Supplementary Information	
Schedule of Revenue and Costs for Scratch and Online Games	49
Schedule of Percent of Prize Expense to Gross Ticket Sales	50
Budgetary Comparison	51
Independent Accountants' Report on Compliance and Other Matters and Internal Control Over Financial Reporting Based on the Audit of Financial Statements in Accordance with <i>Government Auditing Standards</i>	53
Independent Accountants' Communication to Legislative Audit Committee.....	54
Audit Report Distribution Information.....	55

Colorado Lottery

Report Summary

Years Ended June 30, 2007 and 2006

Purposes and Scope of Audit

Authority, Purpose and Scope

The audit of the Colorado Lottery (the Lottery) was performed under authority of Section 24-35-211, C.R.S., which requires the State Auditor to conduct an annual audit of the Lottery Fund. The purpose of the audit was to express an opinion on the financial statements of the Lottery for the year ended June 30, 2007.

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

The purposes and scope of this audit were:

- To express an opinion on the financial statements of the Lottery as of and for the year ended June 30, 2007, 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, 2007.
- To evaluate progress in implementing the prior audit recommendations.

Summary of Major Audit Comments

Audit Findings and Financial Statement Audit Report Section

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

- The Lottery contracted with a new vendor, Scientific-Games, Inc., (SGI or Scientific-Games) for online 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 systems balancing reports because SGI has not been able to provide these reports. In the current year, we found that while reporting had improved, the Lottery did not have required reports from SGI related to retailer billing or tax reporting.
- The Lottery has a complex internal information system and significant reliance is placed on this system and the supporting controls. To reduce the risk of errors in the system, the Lottery should obtain an annual SAS 70 type II review of both the Lottery's internal information system and the system of the third-party vendor, Scientific-Games.

Colorado Lottery

Report Summary

Years Ended June 30, 2007 and 2006

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

Audit Opinions and Reports

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

Auditors' Communication to Legislative Audit Committee

The auditors' communication to the Legislative Audit Committee describes the auditors' responsibility under auditing standards generally accepted in the United States of America and significant management judgments and estimates. It also notes that there were no proposed audit adjustments for the year ending June 30, 2007. This communication is located on page 54.

Summary of Progress in Implementing Prior Year Audit Recommendations

The audit report for the year ended June 30, 2006, contained three recommendations for fiscal year 2006. Of the 2006 recommendations, one was partially implemented, one was deferred and one was fully implemented. The Disposition of Prior Year Audit Recommendations is on page 9.

Colorado Lottery
Recommendation Locator
Years Ended June 30, 2007 and 2006

Recommendation Number	Page Number	Recommendation Summary	Response	Implementation Date
1	6	The Colorado Lottery should continue to work with Scientific-Games to ensure that all reports required as part of the contract are provided and that the reports contain accurate and complete information.	Agree	June 30, 2009
2	8	The Lottery should have an annual SAS 70 type II examination performed on both its internal information system and on the system of its vendor, Scientific-Games.	Partially Agree	SAS 70 SGI June 30, 2008; Independent Review of Internal System June 30, 2009

Colorado Lottery

Background

Years Ended June 30, 2007 and 2006

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 2007, the Lottery employed 124 employees in its headquarters in Pueblo and branch offices in Denver, Fort Collins and Grand Junction.

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

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

Colorado Lottery

Auditors' Findings and Recommendations

Years Ended June 30, 2007 and 2006

In planning and performing our audit of the financial statements of the Colorado Lottery (the Lottery) as of and for the year ended June 30, 2007, in accordance with auditing standards generally accepted in the United States of America, we considered the Lottery's internal control over financial reporting (internal control) 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. Accordingly, we do not express an opinion on the effectiveness of the Lottery's internal control. As such, our consideration of internal control would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses.

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 of the Lottery's financial statements on a timely basis. A control deficiency in design exists when a control necessary to meet a control objective is missing or an existing control is not properly designed so that, even if the control operates as designed, a control objective is not always met. A control deficiency in operation exists when a properly designed control does not operate as designed or when the person performing the control does not possess the necessary authority or qualifications to perform the control effectively.

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 (GAAP) 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 controls.

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

We observed the following matters that we consider to be control deficiencies.

System Balancing Reports

The Lottery converted to a new vendor, Scientific-Games, Inc., for its online games on May 2, 2005. In our audit for fiscal year 2003, we recommended that the Lottery obtain an independent test and examination of the new vendor system, prior to the go-live date, to gain assurance regarding the integrity and reliability of the new system and that the appropriate balancing or reconciliation capabilities were in place.

The Lottery contracted with a firm to perform an independent test of the new system. The evaluation was conducted throughout the implementation of the new system and was concluded on May 3, 2005, or the day after the new system was implemented. In its report, the firm found that some reports required for reconciling the online system and the Lottery's internal system, which were specified as deliverables by the Lottery in its contract with the new online vendor, were not being produced. In addition, other reports did not balance to the corresponding information in the Lottery's system. Therefore, in our audits for fiscal years 2005 and 2006, we 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 our audit for fiscal year 2006, we found that 17 system balancing reports were still unavailable to the Lottery. During our audit for fiscal year 2007, we found that much of this reporting had improved, however, 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 process critical and time sensitive data which include, but are not limited to, billing to retailers, scratch inventory and tax reporting. As long as the Lottery must rely on manual balancing systems and an interface of transaction activity between Scientific-Games and the WANG systems, a risk of the loss of data integrity or corruption will always be present. The Lottery should continue efforts to ensure that the reporting function in the new online system that supports the reconciliation process fulfills the requirements agreed upon as part of the vendor's contract.

Recommendation No. 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.

Colorado Lottery Response: Agree

Implementation Date: June 2009

As a result of a Department of Revenue (DOR) executive management directive, the Lottery contracted with North Highland to provide an analysis of the Lottery's back office system and recommend solutions for migration of systems currently residing on the WANG, including the retailer billing and tax reporting systems. After the completion of the North Highland report, the Lottery will determine its approach for the conversion of the retailer billing and tax reporting systems. The solution for the retailer billing and tax reporting systems may be to use an external, outsourced entity or to migrate these systems to the Lottery's new Oracle platform. The Lottery will pursue any action necessary to successfully and efficiently migrate these systems from the WANG environment to new systems. During implementation of the new systems, the Lottery will work to obtain all required reports and will verify that the reports contain accurate and complete information through verification performed in the acceptance testing process and through the daily systems balancing process in production.

Colorado Lottery

Auditors' Findings and Recommendations (continued)

Years Ended June 30, 2007 and 2006

Independent Reviews of Information Systems

The Lottery reporting system places significant reliance on both internal and third-party information systems used to process data and transactions. During our 2003, 2004, 2005 and 2006 audits, we recommended that the Lottery have an annual independent examination performed of the WANG internal information system used to record and track ticket sales (commonly referred to as a SAS 70 audit.) During our audit for 2005, the Lottery stated that it would reassess the need for an independent review if the planned migration of the WANG to online Scientific-Games, which was planned to occur in September of 2006, was implemented as planned. As of June 30, 2007, the full migration has not occurred.

As of the end of our fiscal year 2007 audit, tax reporting, retailer billing and sales reporting were still tracked on the WANG system. With the conversion of the online games to a new system in fiscal year 2005, the new vendor, Scientific-Games, became responsible for maintaining the transaction data received from the retailers and then transmitting this information into the Lottery's internal WANG system. The WANG system then records the revenue and tracks and records the accounts receivable information and transmits this information to the State's accounting system. As of August 2007, no date has been set for migration of the remaining systems. With the current reporting system, it continues to be critical that the Lottery seek an independent review of the WANG system.

In March 2006, a SAS 70 audit was completed on the Scientific-Games system and on September 19, 2006, a security audit was performed on the system. The security report provides an evaluation of security on both Scientific-Games and the Lottery systems. In contrast, a SAS 70 report is a comprehensive report that is transactional based and evaluates control more thoroughly. Even though there was a security audit performed in the current fiscal year with no significant findings, we continue to believe that the Lottery should have a SAS 70 type II audit performed in the fiscal year 2008 and annually thereafter. Results of the security audit included recommendations regarding the patching and updating of production servers; network and host-based technology; and access control. The Department is working with Scientific-Games to follow up on the recommendations in the security audit.

In fiscal years 2007 and 2006, the Lottery had gross ticket sales of approximately \$456,000,000 and \$469,000,000, respectively. Because of the large number of transactions, high volume of activity and the fact that Scientific-Games has taken over maintaining and transmitting transaction data to the WANG system, the Lottery continues to have significant reliance on and risk associated with the operations of both the WANG system and the system used by Scientific-Games.

The information that is recorded in these systems is critical to the information reported on the Lottery's financial statements and the internal controls of the Lottery's operation. By delaying the independent reviews, the Lottery continues to be at risk for recording and reporting inaccurate or incomplete financial information on its own financial statements and the State's financial statements. Through an independent examination, controls are evaluated and tested as to whether they are operating with sufficient effectiveness to provide a reasonable, but not absolute, assurance that the control objectives were achieved for a period specified. Third-party independent audits can be a mechanism to help identify weaknesses in the software and the internal control system internally within the Lottery's system and with the third-party vendor, Scientific-Games.

Colorado Lottery
Auditors' Findings and Recommendations (continued)
Years Ended June 30, 2007 and 2006

Recommendation No. 2

The Colorado Lottery should minimize risks related to information system controls, internal controls over financial processing and safeguarding of assets by performing an annual SAS 70 type II examination on both its internal system used to record and track ticket sales and on the system of its vendor, Scientific-Games.

Colorado Lottery Response: Partially Agree

Implementation Date: SAS 70 Audit of Scientific-Games – Fiscal Year 2008
Independent Review of Internal System – Fiscal Year 2009

The Lottery agrees to require an annual examination of the controls in place at the third-party vendor and in fiscal year 2008, will once again require a SAS 70 audit of Scientific-Games. The Lottery also agrees with performing an annual independent examination of the internal system used to record and track ticket sales; however, the Lottery will defer the implementation and related costs since migration of the systems that currently process ticket sales transactions on the internal system (WANG) will occur once an approach is identified as a result of recommendations included in the North Highland report. Based on the timing of the migration of the retailer billing and tax reporting systems and the availability of funding, the Lottery will reassess the need for an annual independent examination of the internal system

Colorado Lottery
Disposition of Prior Year Audit Recommendations
Year Ended June 30, 2006

Fiscal Year 2006 Recommendations

Number	Recommendation	Disposition
1	The Lottery should continue to work with Scientific-Games to ensure that all reports required as part of the contract are provided and that the reports contain accurate and complete information.	Partially implemented, See Recommendation No. 1 in current report
2	The Lottery should minimize risks related to information system control, internal controls over financial processing and safeguarding of assets by performing an annual independent examination of the internal system used to record and track ticket sales.	Deferred, See Recommendation No. 2 in current report
3	The Lottery should ensure that its online vendor, Scientific-Games, implements an "end of game" process, which allows for the accounting and destruction of all expired tickets. The Colorado Lottery should also work with Scientific-Games to implement a reasonable timeline for the completion of this process.	Implemented



Independent Accountants' Report on Financial Statements and Supplementary Information

Members of the Legislative Audit Committee

We have audited the accompanying basic financial statements of the Colorado Lottery (the Lottery), an enterprise fund of the State of Colorado, as of and for the years ended June 30, 2007 and 2006, as listed in the table of contents. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Colorado Lottery, an enterprise fund of the State of Colorado, as of June 30, 2007 and 2006, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1, the financial statements present only the enterprise fund and do not purport to, and do not, present fairly the financial position of the State of Colorado, as of June 30, 2007, the changes in its financial position, or, where applicable, its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 4, 2007, on our consideration of the Lottery's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Members of the Legislative Audit Committee

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

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying supplementary information is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

BKD, LLP

September 4, 2007

Colorado Lottery

Management's Discussion and Analysis

Years Ended June 30, 2007 and 2006

This discussion and analysis of the Colorado Lottery financial performance provides an overview of financial activities for the fiscal years ended June 30, 2007 and 2006. Please read it in conjunction with the Lottery's financial statements, which begin on page 23. 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 \$455.9 million reflected a \$12.9 million decrease from last year's sales of \$468.8 million. The overall decrease in sales was solely the result of the decrease in sales of the Powerball product from \$119.8 million in fiscal year 2006 to \$101.6 million in fiscal year 2007. Powerball sales are highly dependent on the size of the Powerball jackpots. In fiscal year 2006, a matrix change implemented in August 2005 allowed the Powerball jackpot to reach record heights twice of \$340 million and \$365 million. The highest Powerball jackpot attained in fiscal year 2007 was \$240 million. Even though overall sales were down from fiscal year 2006, fiscal year 2007 overall sales were still the second highest overall sales in the history of the Lottery. Fiscal year 2005 sales totaled \$417 million and ranks as the third-highest sales year ever.

In contrast with the decrease of Powerball sales, fiscal year 2007 saw an increase in sales for each of its other three products from fiscal year 2006. Both Scratch and Cash5 sales hit record sales years in fiscal year 2007 and Lotto sales were the highest since fiscal year 2004.

Scratch sales hit a record high for the fourth year in a row with scratch sales totaling \$297.1 million. The second highest sales were in fiscal year 2006, with scratch sales totaling \$293.8 million. Fiscal year 2005 scratch sales totaling \$282.7 million ranks third in total scratch sales. Continuing marketing efforts, including offering a broader range of price points, innovative display cases, additional games and an overall upgrade to the look of our scratch tickets, contributed to this increase in scratch sales.

Lotto sales increased slightly from the prior two fiscal years with sales of \$39.8 million. Fiscal years 2006 and 2005 both reflected Lotto sales of \$38.3 million.

Cash 5 sales for fiscal year 2007 showed another increase for the fifth year in a row and for the fifth year in a row produced record sales. Sales increased nearly 3% to a total of \$17.4 million from \$16.9 million in fiscal year 2006. This followed a nearly 12% increase in sales in fiscal year 2006 from fiscal year 2005, whose sales totaled \$15.1 million.

Colorado Lottery

Management's Discussion and Analysis

Years Ended June 30, 2007 and 2006

- Funds distributed or available for distribution from 2007 sales decreased from fiscal year 2006 in conjunction with the overall decrease in sales. Fiscal year 2007 produced a total of \$119 million in funds distributions, a decrease of \$6.6 million from fiscal year 2006's record high distributions of \$125.6 million. The \$119 million in funds distributions for fiscal year 2007 represents the second highest year of distributions in the Lottery's history. Fiscal year 2005 had distributions totaling \$103.7 million. Fiscal year 2007 included, for the sixth time, a spill-over into the State Public School Fund Contingency Reserve; in the amount of \$8.2 million and was the third largest one-year spill-over since the first spill-over occurred in fiscal year 2002. A spill-over occurs when the distribution cap for GOCO is reached in any one year. The cap for GOCO is the 1992 base year amount of \$35 million as adjusted for the annual change in the cost of living increase for the Denver-Boulder area. The cap for fiscal year 2007 was \$51.3 million. The total amount of the spill-over during the six-year period totals \$37 million.
- Gross profit as a percent of sales decreased slightly by about 0.4%, a reflection of the 0.6% increase in prize expense. Prize expense as a percentage of sales increased from 60.1 % to 60.7 % for the fiscal years ended June 30, 2006 and 2007, respectively. The increase was the result of offering a larger number of higher price point scratch games, which by design carry a higher prize percentage payout. Offsetting the increase contributed to the prize expense percentage by the scratch product, the overall prize expense percentage for the online games decreased from 50.2% to 48.6% for the fiscal years ended June 30, 2006 and 2007 respectively. The 0.6% increase in the prize expense percentage was further offset by a reduction in vendor fees as a result of a reduction in the billing rate from 1.713% to 1.458% of sales in June of 2006. This reduction lowered vendor fees from \$6,819,796 in fiscal year 2006 to \$5,957,142 in fiscal year 2007. Unclaimed prizes dropped by more than \$1.3 million from fiscal year 2006 to fiscal year 2007. Lower Powerball sales led to fewer prizes won, thus fewer prizes went unclaimed. In addition, fiscal year 2006 included the expiration of a bonus prize for the Powerball Game of \$853,492. Gross profit as a percent of sales increased by 0.3% between fiscal years 2005 and 2006, a reflection of the decrease in the scratch ticket costs and vendors fees from 2.4% (\$9,906,061) to 2.1% (\$9,727,730) of sales. A reduction in scratch ticket costs resulted from the implementation of new contracts with the scratch ticket vendors, lowering the cost to purchase tickets. Fiscal year 2006 vendor fees were slightly lower due to a full year under a new contract, which began on May 1, 2005.

Games Offered by the Colorado Lottery

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

Colorado Lottery

Management's Discussion and Analysis

Years Ended June 30, 2007 and 2006

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

Using this Annual Report

This annual report consists of a series of financial statements. The statement of net assets provides information about the Lottery's assets and liabilities and reflects the Lottery's financial position as of June 30, 2007 and 2006. 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, 2007 and 2006. 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, 2007 and 2006.

Statements of Net Assets

The statements of net assets is a financial snapshot of the Lottery at June 30, 2007 and 2006. 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, 2007 and 2006

Condensed Statements of Net Assets
June 30, 2007, 2006 and 2005

	2007	2006	2005
Assets			
Current assets	\$ 52,318,926	\$ 45,946,060	\$ 49,400,246
Restricted assets	5,822,526	5,706,844	6,089,238
Capital assets	<u>696,916</u>	<u>754,051</u>	<u>861,066</u>
Total assets	<u>\$ 58,838,368</u>	<u>\$ 52,406,955</u>	<u>\$ 56,350,550</u>
Liabilities			
Current liabilities	\$ 55,507,616	\$ 49,104,926	\$ 52,415,997
Long-term liabilities	<u>906,065</u>	<u>947,001</u>	<u>965,078</u>
Total liabilities	<u>\$ 56,413,681</u>	<u>\$ 50,051,927</u>	<u>\$ 53,381,075</u>
Net Assets			
Investment in capital assets	\$ 696,916	\$ 754,051	\$ 861,066
Restricted – Licensed Agent			
Recovery Reserve	426,058	398,064	479,238
Unrestricted – Operating Reserve	1,500,000	1,600,000	1,700,000
Unrestricted	<u>(198,287)</u>	<u>(397,087)</u>	<u>(70,829)</u>
Total net assets	<u>\$ 2,424,687</u>	<u>\$ 2,355,028</u>	<u>\$ 2,969,475</u>

The Lottery's total assets at June 30, 2007, were \$58.8 million. Assets consisted primarily of cash and investments with the State Treasury of approximately \$35.2 million, Prepaid Prize Expense with Multi-State Lottery (MUSL) of almost \$3.9 million, receivables from Lottery retailers for the sale of Lottery products of almost \$18.3 million and a net investment in fixed assets of approximately \$.7 million.

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

Comparable figures at June 30, 2005, were \$56.4 million in total assets, including \$28.7 million in cash and investments with the State Treasury, Prepaid Prize Expense with MUSL of \$3.9 million, receivable from retailers of \$21.5 million and a net investment in fixed assets of \$.9 million.

There was a \$6.8 million increase in receivables from retailers between fiscal year 2004 and fiscal year 2005 that was partly the result of an undetected problem in the new online system, whereby billings of receivables to retailers were delayed. The error was detected in mid-July 2005 and was resolved in fiscal year 2006.

Colorado Lottery

Management's Discussion and Analysis

Years Ended June 30, 2007 and 2006

The Lottery's total liabilities at June 30 2007, were \$56.4 million, consisting primarily of proceeds distributions due to recipients of \$28.7 million and prize liability on all of the Lottery products of approximately \$23.6 million.

The Lottery's total liabilities at June 30, 2006, were approximately \$50.1 million, which consisted primarily of proceeds distributions due of almost \$28.8 million and prize liability on all of the Lottery products of about \$17.1 million.

The Lottery's total liabilities at June 30, 2005, were \$53.4 million, which consisted primarily of proceeds distributions due of \$27.8 million and prize liability on all of the Lottery products of about \$17.1 million.

Components of the Lottery's net assets are: 1) an amount to represent the Lottery's net investment in capital assets as required by the reporting model under GASB 34, (see "Total Capital Assets" on the statements of net assets); 2) a Licensed Agent Recovery Reserve (bonding reserve) funded by retailers to cover any uncollectible receivable accounts; 3) an amount representing the funds held by the Lottery in an operating reserve as mandated by Senate Bill 04-204 (see "Cash and Investments – Operating Reserve" on the statements of net assets); and 4) an adjustment made by the Lottery to reflect its share of unrealized gains or losses on investments held by the State Treasurer.

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

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

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

The change in net assets from June 30, 2005 to June 30, 2006, consisted of a decrease in investment in capital assets from \$.9 million to \$.8 million, a decrease in the bonding reserve from \$479,238 to \$398,064, a decrease in the operating reserve from \$1.7 million to \$1.6 million and a net decrease in unrealized gains and losses on investments of \$326,258 resulting from a net decrease in the adjustments on State Treasury investments.

Colorado Lottery
Management's Discussion and Analysis
Years Ended June 30, 2007 and 2006

Following is a schedule of net assets for fiscal years 2006 and 2005:

	<u>2006</u>	<u>2005</u>	<u>Change</u>
Investment in capital assets	\$ 754,051	\$ 861,066	\$ (107,015)
Bonding reserve	398,064	479,238	(81,174)
Operating reserve	1,600,000	1,700,000	(100,000)
Unrealized gain on investments	<u>(397,087)</u>	<u>(70,829)</u>	<u>(326,258)</u>
Total net assets	<u>\$ 2,355,028</u>	<u>\$ 2,969,475</u>	<u>\$ (614,447)</u>

Statements of Revenues, Expenses and Changes in Net Assets

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

**Condensed Statements of Revenues, Expenses and
Changes in Net Assets
For the Fiscal Years Ended June 30, 2007, 2006 and 2005**

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Operating Revenues	\$ 455,916,812	\$ 468,761,808	\$ 416,966,782
Direct Operating Expenses	<u>318,684,531</u>	<u>325,992,891</u>	<u>291,083,679</u>
Gross Profit on Sale of Tickets	<u>137,232,281</u>	<u>142,768,917</u>	<u>125,883,103</u>
Other Operating Expenses			
Marketing and communications	8,886,036	8,893,150	8,559,774
Wages and benefits	8,603,295	8,195,004	7,941,537
Other operating expenses	<u>3,512,986</u>	<u>3,624,150</u>	<u>6,022,481</u>
Total other operating expenses	<u>21,002,317</u>	<u>20,712,304</u>	<u>22,523,792</u>
Operating Income	<u>116,229,964</u>	<u>122,056,613</u>	<u>103,359,311</u>
Nonoperating Revenues (Expenses)			
Other revenue	665,162	1,761,259	953,328
Investment income	2,169,983	1,118,781	747,176
Proceeds distributions	<u>(118,995,450)</u>	<u>(125,551,100)</u>	<u>(103,735,935)</u>
Total nonoperating expenses	<u>(116,160,305)</u>	<u>(122,671,060)</u>	<u>(102,035,431)</u>
Increase (Decrease) in Net Assets	69,659	(614,447)	1,323,880
Net Assets, Beginning of Year	<u>2,355,028</u>	<u>2,969,475</u>	<u>1,645,595</u>
Net Assets, End of Year	<u>\$ 2,424,687</u>	<u>\$ 2,355,028</u>	<u>\$ 2,969,475</u>

Colorado Lottery
Management's Discussion and Analysis
Years Ended June 30, 2007 and 2006

Sales Activities

Revenues from the sale of the Lottery products for the fiscal year ended June 30, 2007, were the second highest in the Lottery's 25-year history, second only to fiscal year ended June 30, 2006. As shown in the financial statements, overall sales decreased by 2.8% from the prior year, from \$468.8 million in fiscal year ended June 30, 2006, to \$455.9 million in the current year. Current year sales represented an increase of 9.3% or \$38.9 million from fiscal year 2005 sales of \$417 million. The increase in scratch sales from \$293.8 million in fiscal year 2006 to \$297.1 million in fiscal year 2007 represented a percentage increase of 1.1%. Scratch sales had also increased in the prior year from fiscal year 2005 sales of \$282.7 million. Powerball sales decreased from \$119.8 million in fiscal year 2006 to approximately \$101.6 million in the current fiscal year, which represented a percentage decrease from last year's sales of 15.2%. Powerball sales in fiscal year 2005 were \$80.9 million. Lotto sales grew slightly in the current fiscal year to \$39.8 million, an increase of \$1.5 million or 3.9% over the prior fiscal year. This was the first year since the start up of Powerball that Lotto sales experience an increase in sales. In fiscal year 2006 and fiscal year 2005, Lotto sales remained steady at \$38.3 million. Cash 5 sales again experienced a slight increase from \$16.9 million in fiscal year 2006 to \$17.4 million in the current fiscal year.

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

Product Sales	2007	2006	Difference	Change
Scratch	\$ 297.1	\$ 293.8	\$ 3.3	1.1%
Powerball	101.6	119.8	(18.2)	(15.2)
Lotto	39.8	38.3	1.5	3.9
Cash 5	<u>17.4</u>	<u>16.9</u>	<u>.5</u>	<u>3.0</u>
Total	\$ <u>455.9</u>	\$ <u>468.8</u>	\$ <u>(12.9)</u>	<u>(2.8)%</u>

Product Sales	2006	2005	Difference	Change
Scratch	\$ 293.8	\$ 282.7	\$ 11.1	3.9%
Powerball	119.8	80.9	38.9	48.1
Lotto	38.3	38.3	0.0	0.0
Cash 5	<u>16.9</u>	<u>15.1</u>	<u>1.8</u>	<u>11.9</u>
Total	\$ <u>468.8</u>	\$ <u>417.0</u>	\$ <u>51.8</u>	<u>12.4%</u>

Colorado Lottery

Management's Discussion and Analysis

Years Ended June 30, 2007 and 2006

Total Revenues

Nonoperating revenues for the year ended June 30, 2007, totaled \$2.8 million as compared with \$2.9 million for the year ended June 30, 2006. Several factors contributed to the \$.1 million decrease from fiscal year 2006 to fiscal year 2007. First, interest received from the Treasury increased by approximately \$402,000 from fiscal year 2006 to fiscal year 2007. This increase was a result of an increase in interest rates from an average of 3.92% in fiscal year 2006 to 4.70% in fiscal year 2007. Interest received from the Multi-state Lottery Association increased by approximately \$121,000 and the GASB 31 adjustment recording the Lottery's share of the unrealized gains and losses on investments held by the Treasury increased investment income by a total of \$525,000. Offsetting these increases, other income in fiscal year 2007 included reimbursements from the online vendor of approximately \$385,000, as compared to approximately \$1,570,000 in fiscal year 2006. The reimbursements for both fiscal years relates to fines and penalties assessed for non or delayed performance.

Two major factors contributed to the increase in non-operating revenues of \$1.7 million in fiscal year 2005 to \$2.9 million in fiscal year 2006. First, interest received from the Treasury increased by approximately \$317,000 from fiscal year 2005 to fiscal year 2006. This increase was a result of carrying larger cash balances resulting from the large increase in sales, as well as, an increase in interest rates from an average of 3.18% in fiscal year 2005 to 3.92% in fiscal year 2006. Second, other income in fiscal year 2006 included reimbursements from the online vendor of approximately \$1,570,000, as compared to approximately \$855,000 in fiscal year 2005. The fiscal year 2006 reimbursements relates to fines and penalties assessed to the on-line vendor for non or delayed performance. The fiscal year 2005 reimbursements relates to amounts owed by the new vendor relating to the delay in the conversion of the online gaming system.

Total revenues were \$458.7 million and \$471.6 million for the years ended June 30, 2007 and 2006, respectively. As mentioned elsewhere, the major contributing factor to the decrease in total revenues of approximately \$12.9 million was a decrease in Lottery sales of \$12.9. Non-operating revenues remained relatively stable.

Total revenues for the year ended June 30, 2005, were \$418.7 million. The major contributing factor for the increase in total revenues from fiscal year 2005 to 2006 of \$52.9 million, was an increase in ticket sales of \$51.8 million. Non-operating revenues increased by \$1.2 million for the same period.

Major Expenses

Approximately \$318.7 million of the Lottery's total expenses of \$339.7 for the fiscal year ended June 30, 2007, 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 online gaming system.

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

Colorado Lottery

Management's Discussion and Analysis

Years Ended June 30, 2007 and 2006

In comparison, \$291.1 million of the Lottery's total expenses of \$313.6 million for the fiscal year ended June 30, 2005, were game-related expenses.

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

Game-Related Expenses	2007	2006	Difference	Change
Prize expense/Powerball prize variance	\$ 276.9	\$ 281.6	\$ (4.7)	(1.7)%
Retailer compensation				
Commissions	30.3	31.1	(.8)	(2.6)
Bonuses	3.4	3.6	(.2)	(5.6)
Ticket costs	2.1	2.9	(.8)	(27.6)
Vendor fees	<u>6.0</u>	<u>6.8</u>	<u>(.8)</u>	<u>(11.8)</u>
Total	\$ <u>318.7</u>	\$ <u>326.0</u>	\$ <u>(7.3)</u>	<u>(2.2)%</u>

Game-Related Expenses	2006	2005	Difference	Change
Prize expense/Powerball prize variance	\$ 281.6	\$ 249.5	\$ 32.1	12.9%
Retailer compensation				
Commissions	31.1	27.8	3.3	11.9
Bonuses	3.6	3.9	(.3)	(7.7)
Ticket costs	2.9	3.2	(.3)	(9.4)
Vendor fees	<u>6.8</u>	<u>6.7</u>	<u>.1</u>	<u>1.5</u>
Total	\$ <u>326.0</u>	\$ <u>291.1</u>	\$ <u>34.9</u>	<u>12.0%</u>

The decrease in the game-related expenses, including prize expense, commission expense and bonus expense (fiscal year 2006 to fiscal year 2007) is reflective of the decrease in product sales. (See the product sales schedule on previous page). The decrease in bonus expense from fiscal year 2006 to fiscal year 2007, is the result of the implementation for a full year of a new retailer marketing bonus plan, making it more difficult for retailers to achieve full bonus. The plan was only in effect for the last half of fiscal year 2006 and the last half of fiscal year 2007. The decrease in ticket costs from fiscal year 2006 to fiscal year 2007 was a result of the implementation of new contracts with the scratch ticket vendors, which reduced the cost to purchase tickets.

Of the \$21 million in fiscal year 2007, expenses that were non game-related, nearly \$8.9 million was for promotions and institutional and product advertising and about \$8.6 million in compensation to the Lottery employees.

Colorado Lottery

Management's Discussion and Analysis

Years Ended June 30, 2007 and 2006

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

In comparison, of the fiscal year 2005 non game-related expenses of \$22.5 million, more than \$8.5 million was for promotions and institutional and product advertising and \$7.9 million was for compensation to Lottery employees.

Distributions to the Proceeds Recipients

The Lottery's efforts generated funds available for distributions of \$119 million in the current fiscal year, the second highest year ever. Of these total proceeds, approximately \$51.3 million was allocated to the Great Outdoors Colorado Trust Fund, almost \$47.6 million to the Conservation Trust Fund and almost \$11.9 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 \$51.3 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 State Public School Fund Contingency Reserve of \$8.2 million, pursuant to C.R.S. 22-54-117(1.6)(a).

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

The Lottery's proceeds distributions for fiscal year 2005 totaled \$103.7 million. Approximately \$50.2 million was distributed to Great Outdoors Colorado, \$41.5 million to the Conservation Trust Fund, \$10.3 million to the Division of Parks and Outdoor Recreation and a spill-over into the State's Public School Fund Contingency Reserve of nearly \$1.7 million.

Budgetary Highlights

The Lottery's budget is determined by a variety of methods. The majority of the budget is set by the annual appropriations bill (the Long Bill), which determines budgets for every agency within the State. The Long Bill and department level allocations are approved shortly before the start of each fiscal year. Agencies may also request a supplemental appropriation during the fiscal year to cover unexpected expenses (or a negative supplemental for less than expected expenses), as well as year-end transfers of spending authority, if needed. In the third quarter of fiscal year 2007, the Legislature approved supplemental appropriation adjustments for the Lottery. Supplemental appropriations and department level re-allocations were approved in personal services, vendor fees, prizes, Powerball prize variance, retailer compensation, offset by reductions in payments to other agencies and ticket costs lines. The final method of funding is special legislation. There was no special legislation affecting the Lottery's budget in fiscal year 2007.

Colorado Lottery

Management's Discussion and Analysis

Years Ended June 30, 2007 and 2006

The approved Lottery budget at the beginning of fiscal year 2007 was \$382 million. Supplemental appropriations and adjustments made in the third quarter increased the budget by \$29.4 million, department level allocations approved at the beginning of the fiscal year increased the budget by \$2.1 million to an amended total of \$413.5 million. Total expenditures and roll-forwards for fiscal year 2007 on a budget basis came to \$350.7 million, resulting in excess appropriations (or savings) of more than \$62.8 million.

Contacting the Lottery's Financial Management

This management discussion and analysis report is designed to provide Colorado citizens, Colorado government officials, our players, retailers and other interested parties with a general overview of the Lottery's financial activity for fiscal year 2007 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.

Liabilities

	<u>2007</u>	<u>2006</u>
Current Liabilities		
Accounts payable	\$ 1,692,606	\$ 1,610,794
Prize liability	23,624,628	17,148,271
Payable to MUSL	—	125,926
Wages and benefits	745,042	780,257
Accrued annual and sick leave	26,777	—
Retailer bonus liability	484,295	409,318
Funds available for distribution	28,706,118	28,796,304
Deferred revenue	<u>228,150</u>	<u>234,056</u>
Total current liabilities	<u>55,507,616</u>	<u>49,104,926</u>
Long-term Liabilities		
Accrued annual and sick leave	805,547	839,099
Expired warrants liability	<u>100,518</u>	<u>107,902</u>
Total long-term liabilities	<u>906,065</u>	<u>947,001</u>
Total liabilities	<u>56,413,681</u>	<u>50,051,927</u>
Net Assets		
Investment in capital assets	696,916	754,051
Restricted – Licensed Agent Recovery Reserve	426,058	398,064
Unrestricted – Operating Reserve	1,500,000	1,600,000
Unrestricted	<u>(198,287)</u>	<u>(397,087)</u>
Total net assets	<u>2,424,687</u>	<u>2,355,028</u>
Total liabilities and net assets	<u>\$ 58,838,368</u>	<u>\$ 52,406,955</u>

Colorado Lottery
Statements of Revenues, Expenses and Changes in Net Assets
Years Ended June 30, 2007 and 2006

	<u>2007</u>	<u>2006</u>
Operating Revenues		
Gross ticket sales	\$ 455,916,812	\$ 468,761,808
Direct Operating Expenses		
Prize expense	280,000,739	279,953,707
Powerball prize variance	(3,084,334)	1,640,538
Retailer commissions and bonuses	33,668,382	34,670,916
Cost of tickets and vendor fees	<u>8,099,744</u>	<u>9,727,730</u>
Total direct operating expenses	<u>318,684,531</u>	<u>325,992,891</u>
Gross Profit on Sale of Tickets	<u>137,232,281</u>	<u>142,768,917</u>
Other Operating Expenses		
Marketing and communications	8,886,036	8,893,150
Administration fees paid to MUSL	95,884	114,104
Wages and benefits	8,580,052	8,195,004
Professional services	240,397	198,979
State agencies services	143,461	197,312
Department of Revenue services	358,373	312,057
Travel	77,175	68,750
Equipment (including loss on disposition of equipment of \$24,947 and \$5,846, respectively)	232,215	162,446
Depreciation	156,948	182,055
Space rental	638,065	752,350
Rents for equipment	26,536	26,342
Motorpool leasing	328,051	337,438
Materials and supplies	130,657	150,042
Telephone	103,663	122,986
Online telecommunications	283,539	346,912
Data processing supplies and services	43,409	23,834
Equipment maintenance	221,477	218,886
Postage	49,465	49,182
Printing	25,939	17,988
Other	<u>380,975</u>	<u>342,487</u>
Total other operating expenses	<u>21,002,317</u>	<u>20,712,304</u>
Operating Income	<u>116,229,964</u>	<u>122,056,613</u>

Colorado Lottery

Statements of Revenues, Expenses and Changes in Net Assets (continued) Years Ended June 30, 2007 and 2006

	<u>2007</u>	<u>2006</u>
Operating Income	<u>116,229,964</u>	<u>122,056,613</u>
Nonoperating Revenues (Expenses)		
Other revenue	665,162	1,761,259
Investment income	2,169,983	1,118,781
Funds distributed for current year	(90,289,332)	(96,754,796)
Funds available for distribution for current year	<u>(28,706,118)</u>	<u>(28,796,304)</u>
Total nonoperating expenses	<u>(116,160,305)</u>	<u>(122,671,060)</u>
Increase (Decrease) in Net Assets	69,659	(614,447)
Net Assets, Beginning of Year	<u>2,355,028</u>	<u>2,969,475</u>
Net Assets, End of Year	<u>\$ 2,424,687</u>	<u>\$ 2,355,028</u>

Colorado Lottery
Statements of Cash Flows
Years Ended June 30, 2007 and 2006

	<u>2007</u>	<u>2006</u>
Operating Activities		
Cash received from retailers	\$ 453,554,927	\$ 476,625,977
Cash paid in prizes	(270,701,601)	(282,138,724)
Cash paid in retailer commissions	(30,292,703)	(31,038,482)
Cash payments to suppliers	(19,478,242)	(25,158,060)
Cash payments to employees for services	(8,645,285)	(8,112,380)
Cash paid in retailer bonus	(3,291,900)	(4,336,059)
Cash paid – other	<u>(172,053)</u>	<u>127,705</u>
Net cash provided by operating activities	<u>120,973,143</u>	<u>125,969,977</u>
Noncapital Financing Activities		
Distribution of net proceeds	<u>(119,085,636)</u>	<u>(124,534,636)</u>
Capital and Related Financing Activities		
Acquisition of capital assets	<u>(124,760)</u>	<u>(80,887)</u>
Net cash used by financing activities	<u>(124,760)</u>	<u>(80,887)</u>
Investing Activities		
Interest received	<u>1,971,183</u>	<u>1,445,039</u>
Increase in Cash and Investments	3,733,930	2,799,493
Change in Fair Market Value of Investments	198,800	(326,258)
Cash and Investments, Beginning of Year (Including \$2,179,238 and \$1,998,064, Respectively, in Restricted Accounts)	<u>31,233,312</u>	<u>28,760,077</u>
Cash and Investments, End of Year (Including \$1,998,064 and \$1,926,058, Respectively, in Restricted Accounts)	<u>\$ 35,166,042</u>	<u>\$ 31,233,312</u>

Colorado Lottery
Statements of Cash Flows (continued)
Years Ended June 30, 2007 and 2006

	2007	2006
Reconciliation of Operating Income to Net Cash Provided by		
Operating Activities		
Operating income	\$ 116,229,964	\$ 122,056,613
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	156,948	182,055
Loss of disposal of equipment	24,947	5,847
Other revenue	665,162	1,761,259
Changes in		
Accounts receivable	(2,440,226)	5,875,131
Ticket inventory	101,341	385,070
Prepaid prize expense with MUSL	(187,688)	201,220
Other assets	(29,245)	19,996
Liabilities (excluding funds available for distribution)	6,451,940	(4,517,214)
Net cash provided by operating activities	<u>\$ 120,973,143</u>	<u>\$ 125,969,977</u>
Statement of Net Assets Classification		
Cash and investments	\$ 33,239,984	\$ 29,235,248
Cash and investments – Licensed Agent Recovery Reserve	426,058	398,064
Cash and investments – Operating Reserve	1,500,000	1,600,000
	<u>\$ 35,166,042</u>	<u>\$ 31,233,312</u>

Colorado Lottery
Notes to Financial Statements
June 30, 2007 and 2006

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

Nature of Operations

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

The financial statements reflect only activities of the Lottery, an enterprise fund of the State of Colorado, for the fiscal years ended June 30, 2007 and 2006. The Lottery is an agency of the State of Colorado. The financial statements are intended to present the financial position and results of operations and cash flows of only that portion of the State of Colorado that is attributable to the transactions of the Lottery in accordance with accounting principles generally accepted in the United States of America.

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

Use of Estimates

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

Fund Accounting

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

Colorado Lottery

Notes to Financial Statements

June 30, 2007 and 2006

Enterprise Fund

The Lottery accounts for its operations as an enterprise fund. The intent of the State of Colorado Legislature is that the Lottery's cost (expenses, including depreciation) of providing goods or services to the general public on a continuing basis, be financed or recovered primarily through user charges. As permitted by Governmental Accounting Standards Board Statement No. 20, *Accounting and Financial Reporting Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Lottery has elected to apply only those applicable Financial Accounting Standards Board Statements and interpretations issued prior to November 30, 1989.

The Lottery defines operating revenues as those earned as a direct result of the fund's principal ongoing operations, *i.e.*, the sale of lottery products. Operating expenses include expenses incurred in earning those revenues such as the cost of tickets, vendor fees, retailer commissions and bonuses, administrative expenses and depreciation on capital assets. All revenues and expenses not meeting these definitions are reported as nonoperating revenues and expenses.

Basis of Accounting

Basis of accounting refers to when revenues, expenditures or expenses are recognized in the accounts and reported in the financial statements. The Lottery 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.

Budget

By October 24 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, the Office of State Planning and/or Budgeting and the Legislature.

Colorado Lottery
Notes to Financial Statements
June 30, 2007 and 2006

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable consist of amounts due from retailers for activated scratch ticket packs and uncollected online 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 \$246,492 and \$227,823 as of June 30, 2007 and 2006, 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.

Colorado Lottery

Notes to Financial Statements

June 30, 2007 and 2006

Prepaid Prize Expense

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

Fixed Assets

Equipment and leasehold improvements are stated at cost. Beginning January 1, 2004, the Lottery adopted the state policy of capitalizing equipment only if the cost exceeds \$5,000 and has a useful life of more than one year. Depreciation for equipment is computed on the straight-line method over estimated useful lives ranging from three to ten years. Leasehold improvements are depreciated over the shorter of the lease term or the estimated useful lives of the improvements. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts, and resulting gains or losses are recognized in current operations.

Accrued Wages and Benefits

During each fiscal year, the State changes the pay date for the month of June, for all State employees, deferring the date from the last working day of June to the first working day of July. For the Lottery, this created a liability for accrued wages at June 30, 2007 and 2006, of \$745,042 and \$780,257, 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 \$4,204,859 for the fiscal year ended June 30, 2007, and \$4,227,000 for the fiscal year ended June 30, 2006. During the fiscal year ended June 30, 2007, there were a total of 43 games ended, as compared with 45 games ended through the fiscal year ended June 30, 2006.

Colorado Lottery

Notes to Financial Statements

June 30, 2007 and 2006

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 \$4,269,402 for the fiscal year ended June 30, 2007, and \$5,556,042 for the fiscal year ended June 30, 2006.

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

Retailer Bonus Liability

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

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

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

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

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

Colorado Lottery
Notes to Financial Statements
June 30, 2007 and 2006

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, 2007 and June 30, 2006, the Lottery has reserved \$426,058 and \$398,064, respectively.

Lottery Fund Net Assets

In accordance with Section 24-35-210 (4.1)(a), C.R.S., the Lottery Commission shall reserve "sufficient monies, as of the end of the fiscal year, to ensure the operation of the Lottery for the ensuing year." The Lottery Commission approved a reserve of \$1 million of the net assets for fiscal year 1989. This remained in effect until the implementation of GASB 34, which required a net asset balance sufficient to cover the net value of an agency's capital assets. Accordingly, at the June 2002 Commission meeting, the Lottery Commission approved a balance in net assets "equal to net value of the Lottery's capital assets." Effective July 1, 2004, under Senate Bill 04-204, this reserve is required to be held in cash and investments. In April 2005, the Lottery set up a separate operating reserve independent of the net capital asset reserve in the amount of \$1.7 million. The amount held in this operating reserve will be reviewed annually and adjusted accordingly. The annual review was completed in September 2006 and the reserve was reduced to \$1.5 million in accordance with the review.

Equipment Expense

Included in "The Statement of Revenues, Expenses and Changes in Fund Net Assets" is an account titled equipment. This account reports the book value of assets which are disposed of during the year, fixed asset purchases made during the year which are not capitalized (see Fixed Asset Footnote, page 37), software purchases and other miscellaneous equipment transactions.

Compensated Leave

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

	<u>June 30, 2007</u>	<u>June 30, 2006</u>	<u>Decrease</u>
Annual leave	\$ 691,042	\$ 718,215	\$ (27,173)
Sick leave	<u>139,686</u>	<u>118,548</u>	<u>21,138</u>
Total annual and sick leave	830,728	836,763	(6,035)
Compensatory time	<u>1,596</u>	<u>2,336</u>	<u>(740)</u>
Total compensated leave	<u>\$ 832,324</u>	<u>\$ 839,099</u>	<u>\$ (6,775)</u>

Colorado Lottery
Notes to Financial Statements
June 30, 2007 and 2006

Expired Warrants Liability

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

Deferred Revenue

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

A detail of deferred revenue at June 30, 2007 and 2006, is as follows:

	2007	2006
Advance Play – Lotto	\$ 79,071	\$ 88,710
Advance Play – Powerball	102,407	101,915
Advance Play – Powerplay	27,364	27,510
Advance Play – Cash 5	19,308	15,921
Total deferred revenue	\$ 228,150	\$ 234,056

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 \$9,300 and \$0 were redeemed in fiscal years ended June 30, 2007 and 2006, 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, 2007 and 2006, scratch tickets with a total face value of \$97,786 and \$79,650, respectively, were given away. Scratch tickets and coupon promotions are valued at cost. For the fiscal years ended June 30, 2007 and 2006, \$75,120 and \$47,442, 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.

Colorado Lottery
Notes to Financial Statements
June 30, 2007 and 2006

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, 2007 and 2006, is as follows:

	2007	2006
Petty cash	\$ 800	\$ 800
Change funds	70,000	70,000
Imprest fund	732,000	722,000
Depository accounts	30,000	24,382
Cash on deposit with State Treasurer	32,407,184	28,418,066
Total unrestricted cash and investments	33,239,984	29,235,248
Restricted cash and investments – Licensed Agent Recovery Reserve Receipts on deposit with State Treasurer	426,058	398,064
Operating Reserve on deposit with State Treasurer	1,500,000	1,600,000
Total restricted cash and investments	1,926,058	1,998,064
Total cash and investments	\$ 35,166,042	\$ 31,233,312

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 2007 and 2006 was 4.70% and 3.92%, 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.

Colorado Lottery
Notes to Financial Statements
June 30, 2007 and 2006

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 district of the State of Colorado; bonds of any state; or a surety bond having an aggregate value at least equal to the amount of the deposits.

At June 30, 2007 and 2006, \$677,786 and \$647,069, respectively of the Lottery's bank balances of \$777,786 and \$747,069, respectively, were on deposit, as follows:

	2007	2006
Uninsured and collateralized (see below)	\$ 677,786	\$ 647,069
Uninsured and collateral held by pledging financial institution	100,000	100,000
	\$ 777,786	\$ 747,069

The Lottery accounts are held in Public Deposit Protection Act (PDPA) qualified institutions, thus balances held in the Lottery's accounts in excess of \$100,000 are secured through PDPA with guaranteed securities and are not subject to custodial credit risk.

Statements of Cash Flows

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

Colorado Lottery
Notes to Financial Statements
June 30, 2007 and 2006

Note 3: Schedule of Changes in Fixed Assets

Capital assets being depreciated:

	<u>June 30, 2006</u>	<u>Increases</u>	<u>Decreases</u>	<u>June 30, 2007</u>
Equipment	\$ 3,902,715	\$ 124,760	\$ (255,281)	\$ 3,772,194
Leasehold improvements	<u>14,053</u>	<u>—</u>	<u>—</u>	<u>14,053</u>
Total capital assets being depreciated	<u>3,916,768</u>	<u>124,760</u>	<u>(255,281)</u>	<u>3,786,247</u>
Less accumulated depreciation for equipment	(3,150,070)	(156,948)	230,334	(3,076,684)
Leasehold improvements	<u>(12,647)</u>	<u>—</u>	<u>—</u>	<u>(12,647)</u>
Total accumulated depreciation	<u>(3,162,717)</u>	<u>(156,948)</u>	<u>230,334</u>	<u>(3,089,331)</u>
Total capital assets, being depreciated, net	<u>\$ 754,051</u>	<u>\$ (32,188)</u>	<u>\$ (24,947)</u>	<u>\$ 696,916</u>
	<u>June 30, 2005</u>	<u>Increases</u>	<u>Decreases</u>	<u>June 30, 2006</u>
Equipment	\$ 3,883,759	\$ 80,887	\$ (61,931)	\$ 3,902,715
Leasehold improvements	<u>14,053</u>	<u>—</u>	<u>—</u>	<u>14,053</u>
Total capital assets being depreciated	<u>3,897,812</u>	<u>80,887</u>	<u>(61,931)</u>	<u>3,916,768</u>
Less accumulated depreciation for equipment	(3,024,099)	(182,055)	56,084	(3,150,070)
Leasehold improvements	<u>(12,647)</u>	<u>—</u>	<u>—</u>	<u>(12,647)</u>
Total accumulated depreciation	<u>(3,036,746)</u>	<u>(182,055)</u>	<u>56,084</u>	<u>(3,162,717)</u>
Total capital assets, being depreciated, net	<u>\$ 861,066</u>	<u>\$ (101,168)</u>	<u>\$ (5,847)</u>	<u>\$ 754,051</u>

Colorado Lottery
Notes to Financial Statements
June 30, 2007 and 2006

Note 4: Operating Leases

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

Pueblo

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

Warehouse – The Lottery leases primary warehouse space from Santa Fe 250 LLC. The Lottery entered into a lease extension agreement, which began September 1, 2002, and expired June 30, 2007. A second amendment to the lease was signed on April 12, 2007, extending the lease for two additional years effective July 1, 2007, and expiring on June 30, 2009. There are no other provisions for extension or renewal.

Denver

Office – The Lottery occupied office and warehouse space in the Galleria Towers Building in Denver. The lease agreement, which began on October 30, 1990, was amended on May 14, 1999, and extended the ending date for the lease from June 30, 1999, to June 30, 2006. On March 10, 2006, the Lottery entered into a second amendment to the lease agreement with Galleria extending the original lease for a thirty-six month period ending on June 30, 2009. The amended lease includes a five-year renewal option. There are no other provisions for extension or renewal.

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

Fort Collins

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

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 Lottery
Notes to Financial Statements
June 30, 2007 and 2006

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.

Operating lease expense incurred for the fiscal years ended June 30, 2007 and 2006, and future minimum lease payments for fiscal years ending June 30, 2008 through 2012, are as follows:

Location	Future Minimum Lease Payments							Later Years
	2006	2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	
Pueblo Office	\$265,764	\$233,095	\$218,013	\$218,013	\$218,013	\$224,630	\$231,247	\$736,324
Pueblo Warehouse	99,072	102,153	114,596	114,596	—	—	—	—
Colorado Springs Warehouse	12,438	13,016	13,482	—	—	—	—	—
Denver	219,180	141,339	179,430	191,392	—	—	—	—
Denver Warehouse	100,046	98,553	101,473	104,486	17,499	—	—	—
Fort Collins	40,378	39,288	—	—	—	—	—	—
Grand Junction	6,717	6,945	—	—	—	—	—	—
	<u>\$743,595</u>	<u>\$634,389</u>	<u>\$626,994</u>	<u>\$628,487</u>	<u>\$235,512</u>	<u>\$224,630</u>	<u>\$231,247</u>	<u>\$736,324</u>

Note 5: Other Revenue

A schedule of other revenue for the fiscal years ended June 30, 2007 and 2006, follows:

	2007	2006
License fees	\$ 62,022	\$ 71,819
Fines and penalties	384,750	1,580,015
Assignment fees	2,749	2,414
Net Licensed Agent Recovery Reserve Receipts	27,994	(81,174)
Reimbursements from MUSL/Budget	55,096	28,460
Reimbursement from MUSL/Unclaimed Bonus Prizes	78,663	106,242
Other	<u>53,888</u>	<u>53,483</u>
Total	<u>\$ 665,162</u>	<u>\$ 1,761,259</u>

Colorado Lottery
Notes to Financial Statements
June 30, 2007 and 2006

Note 6: Distribution of Net Proceeds

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

Income available for distribution at June 30:

	2007	2006
Operating income	\$ 116,229,964	\$ 122,056,613
Plus other revenue	665,162	1,761,259
Investment income	2,169,983	1,118,781
Income before distributions	119,065,109	124,936,653
Change in licensed agent recovery reserve	(27,994)	81,174
Change in fair market value of investments	(198,800)	326,258
Change in Operating Reserve	100,000	100,000
Other changes in net assets	57,135	107,015
Income available for distribution for fiscal year	118,995,450	125,551,100
Less distributions prior to year-end	(90,289,332)	(96,754,796)
Income available for distribution payable at June 30	\$ 28,706,118	\$ 28,796,304

	Accrued at June 30, 2006	Proceeds Distributions Expenses	Distributions Paid During Fiscal Year 2007	Accrued at June 30, 2007
Great Outdoors Colorado	\$ 1,852,837	\$ 51,277,820	\$ (46,997,505)	\$ 6,133,152
State Public School Fund	12,545,316	8,219,905	(12,545,316)	8,219,905
Conservation Trust Fund	11,518,521	47,598,180	(47,634,253)	11,482,448
Division of Parks and Outdoor Recreation	2,879,630	11,899,545	(11,908,562)	2,870,613
	\$ 28,796,304	\$ 118,995,450	\$ (119,085,636)	\$ 28,706,118

Colorado Lottery
Notes to Financial Statements
June 30, 2007 and 2006

	Accrued at June 30, 2005	Proceeds Distributions Expenses	Distributions Paid	Accrued at June 30, 2006
Great Outdoors Colorado	\$ 12,198,467	\$ 50,230,238	\$ (60,575,868)	\$ 1,852,837
State Public School Fund	1,691,454	12,545,316	(1,691,454)	12,545,316
Conservation Trust Fund	11,111,935	50,220,437	(49,813,851)	11,518,521
Division of Parks and Outdoor Recreation	<u>2,777,984</u>	<u>12,555,109</u>	<u>(12,453,463)</u>	<u>2,879,630</u>
	<u>\$ 27,779,840</u>	<u>\$ 125,551,100</u>	<u>\$ (124,534,636)</u>	<u>\$ 28,796,304</u>

Note 7: Pension Plan

Plan Description

Most of the Lottery's employees participate in a defined benefit pension plan (the Plan). The Plan's purpose is to provide income to members and their families at retirement or in case of death or disability. The Plan is a cost-sharing multiple-employer Plan administered by the Public Employees' Retirement Association (PERA). PERA was established by state statute in 1931. Responsibility for the organization and administration of the Plan is placed with the Board of Trustees of PERA. Changes to the Plan require legislation by the General Assembly. The State Plan and other divisions' plans are included in PERA's financial statements, which may be obtained by writing PERA at PO Box 5800, Denver, CO 80217, by calling PERA at 1.800.759.PERA (7372) or by visiting www.copera.org.

Prior to January 1, 2006, State employees and employees of local school districts were members of the combined State and School Division of PERA. On January 1, 2006, that combined division was segregated into a State Division and a separate School Division. PERA's financial statements at December 31, 2005, presented the State and school portions of the trust as a single division.

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.

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.

Colorado Lottery

Notes to Financial Statements

June 30, 2007 and 2006

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% 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% of the employer contributions for this population)

Colorado Lottery

Notes to Financial Statements

June 30, 2007 and 2006

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, 2006, to December 31, 2006, the state contributed 10.65% (13.35% for State troopers and 14.16% for the judicial branch) of the employee's salary. From January 1, 2007 through June 30, 2007, the State contributed 11.15% (13.85% for state troopers and 14.66% for the Judicial Branch). During all of fiscal year 2007, 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, 2005, 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 .5% of salary in 2007, and subsequent year increases of .4% of salary until the additional payment reaches 3% in 2012.

In the 2006 legislative session, the general assembly authorized a Supplemental Amortization Equalization Disbursement (SAED) that requires PERA employers to pay an additional .5% of total salaries paid beginning January 1, 2008. The SAED is scheduled to increase by .5% through 2013 resulting in a cumulative increase of 3% 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, 2007, 2006 and 2005, were \$720,894, \$651,980 and \$622,597, respectively. These contributions met the contribution requirement for each year.

Colorado Lottery
Notes to Financial Statements
June 30, 2007 and 2006

Note 8: Voluntary Tax-deferred Retirement Plans

PERA offers a voluntary 401k plan entirely separate from the defined benefit pension plan. The State offers a 457 deferred compensation plan and certain agencies and institutions of the state offer a 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. Under this program, PERA subsidizes a portion of the monthly premium for health care coverage. The benefit recipient pays any remaining amount of that premium through an automatic deduction from the monthly retirement benefit. 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.

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

Monthly premium costs for participants depend on the health care plan selected, the number of persons covered, Medicare eligibility and the number of years of service credit. PERA contracts with a major medical indemnity carrier to administer claims for self-insured medical benefit plans and another carrier for prescription benefits, and with several health maintenance organizations providing services within Colorado. As of December 31, 2006 and 2005, there were 42,433 and 41,080 enrollees in the plan respectively.

Life Insurance Program

During fiscal year 2006, PERA provided its members access to a group decreasing term life insurance plan offered by Unum Provident in which 41,101 members participated. Active members may join the Unum Provident Plan and continue coverage into retirement. Premiums are collected by monthly payroll deduction or other means. In addition, PERA maintained coverage for 12,790 members under closed group plans underwritten by Anthem Life, Prudential and New York Life.

Colorado Lottery
Notes to Financial Statements
June 30, 2007 and 2006

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	\$ 484,933,101
Lifetime prize payments	<u>41,360,000</u>
 Total guaranteed minimum prize payments	 <u>\$ 526,293,101</u>

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

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

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

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

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

Colorado Lottery

Notes to Financial Statements

June 30, 2007 and 2006

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. The State's contribution to the premium is fixed in statute; State employees pay the difference between the statutory contribution and the premium set by the insurer. 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. After July 1, 2005, the State will continue to offer 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.

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

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

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

Colorado Lottery

Notes to Financial Statements

June 30, 2007 and 2006

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 90 days for conversion and turnover purposes. The total cost of the initial contract period is not to exceed \$70,616,975. The scratch ticket contracts expired on June 30, 2004, with one annual renewal available on each contract. The renewal options were exercised extending the contracts through June 30, 2005. On May 16, 2005, the Lottery received approval to extend both of the scratch ticket contracts for a six-month period ending December 31, 2005, to complete the RFP process and execute new contracts. The total cost of the extended contract period is \$1,950,000. Ticket rates are based upon ticket volume, physical size and design. The total costs of the contracts for the initial contract period, plus the extension period, were not to exceed \$15,745,184 and \$6,950,000 for the respective contracts.

The Lottery entered into two new contracts with the scratch vendors on January 9 and 16, 2006. The contracts expire on November 30, 2007. The State, in its sole discretion, may require continued performance for three additional twelve (12) month periods on both contracts. In addition, in the event that a contract with a successor contractor cannot be signed prior to the expiration or termination date of this contract, the State reserves the right to extend this contract for maximum of one hundred eighty (180) days or until a new contract is executed. There are no other provisions for extension or renewal. The total costs of the contracts for the initial contract period are not to exceed \$5,666,667 each for the respective contracts.

The Lottery was approved as a member of the Multi-State Lottery (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, 2007, is \$3,981,000 and is based on a percentage of sales. The total amount of the prize reserves funded as of June 30, 2007, was \$3,896,468 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 July 1, 2004, and expired on June 30, 2006, with an option to renew up to three additional one year periods through June 30, 2009. On February 7, 2006, the Lottery exercised its option to extend the contract until June 30, 2007. The total cost of the initial contract period and the extension is not to exceed \$9,000,000 for each year. On May 21, 2007, a contract amendment was signed extending the contract up to two (2) months, terminating when the new contract was executed by the State Controller or his delegate. Payment terms and conditions were to remain the same as the original contract. No maximum cost was designated.

Colorado Lottery

Notes to Financial Statements

June 30, 2007 and 2006

The Lottery is in the process of entering into a new contract with Cactus Communications, Inc, d/b/a Cactus Marketing Communications. The contract period will begin on September 1, 2007, and expire on June 30, 2010, with 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. The Lottery is working under a purchase order for the month of August 2007 until the long-term contract can be executed.

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. After exhausting the appeals process, the plaintiffs filed, and were granted, a petition for *certiorari* by the Colorado Supreme Court. The parties are currently briefing the case. At the present time, it is not possible to predict the outcome of this action.

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 \$875,407 and \$892,025 for the fiscal years ended June 30, 2007 and 2006, respectively.

Supplementary Information

Colorado Lottery

Schedule of Revenue and Costs for Scratch and Online Games for the Fiscal Year Ended June 30, 2007 (With Comparative Totals for the Fiscal Year Ended June 30, 2006)

	Games in Progress				Fiscal Year 2007	Fiscal Year 2006
	Scratch	Lotto	Powerball	Cash 5	Total	Scratch and Online
Gross ticket sales	\$ 297,112,493	\$ 39,835,761	\$ 101,561,395	\$ 17,407,163	\$ 455,916,812	\$ 468,761,808
Prize expense	(199,723,388)	(20,676,053)	(50,392,567)	(9,208,731)	(280,000,739)	(279,953,707)
Powerball prize variance	<u>—</u>	<u>—</u>	3,084,334	<u>—</u>	3,084,334	(1,640,538)
Net revenue after prizes	<u>97,389,105</u>	<u>19,159,708</u>	<u>54,253,162</u>	<u>8,198,432</u>	<u>179,000,407</u>	<u>187,167,563</u>
Commissions, bonuses, ticket costs and vendor fees						
Retailer commission	(20,764,240)	(2,389,567)	(6,094,263)	(1,044,633)	(30,292,703)	(31,038,482)
Retailer bonus	(2,292,545)	(260,973)	(659,379)	(162,782)	(3,375,679)	(3,632,434)
Cost of tickets sold	(2,142,602)	—	—	—	(2,142,602)	(2,907,934)
Telecomm reimbursements	450,778	60,439	154,089	26,410	691,716	738,310
Online vendor fees	<u>(4,333,327)</u>	<u>(580,665)</u>	<u>(1,480,906)</u>	<u>(253,960)</u>	<u>(6,648,858)</u>	<u>(7,558,106)</u>
Total	<u>(29,081,936)</u>	<u>(3,170,766)</u>	<u>(8,080,459)</u>	<u>(1,434,965)</u>	<u>(41,768,126)</u>	<u>(44,398,646)</u>
Gross profit on sale of tickets	<u>\$ 68,307,169</u>	<u>\$ 15,988,942</u>	<u>\$ 46,172,703</u>	<u>\$ 6,763,467</u>	<u>\$ 137,232,281</u>	<u>\$ 142,768,917</u>
Average daily ticket sales	<u>\$ 814,007</u>	<u>\$ 109,139</u>	<u>\$ 278,250</u>	<u>\$ 47,691</u>	<u>\$ 1,249,087</u>	<u>\$ 1,284,279</u>

Colorado Lottery

Schedule of Percent of Prize Expense to Gross Ticket Sales for the Fiscal Year Ended June 30, 2007

	Games in Progress				Powerball Prize Fiscal Year 2007	
	Scratch	Lotto	Powerball	Cash 5	Variance	Total
Prize expense	\$ 199,723,388	\$ 20,676,053	\$ 50,392,567	\$ 9,208,731	\$ (3,084,334)	\$ 276,916,405
Ticket sales before coupons	<u>297,112,493</u>	<u>39,835,761</u>	<u>101,561,395</u>	<u>17,407,163</u>	<u>—</u>	<u>455,916,812</u>
Prize %	<u>67.22%</u>	<u>51.90%</u>	<u>49.62%</u>	<u>52.90%</u>		<u>60.74%</u>

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

Colorado Lottery
Budgetary Comparison
for the Fiscal Year Ended June 30, 2007

	Fiscal Year 2007 Original Budget	Supplementals, Pots, Allocations and Internal Transfers	Fiscal Year 2007 Final Budget	Fiscal Year 2007 Actual Expenditures	Under Expended	Percent Under Expended
Personal services	\$ 8,240,949	\$ 250,352	\$ 8,491,301	\$ 8,255,326	\$ 235,975	2.78%
Amortization equalization disbursement	—	48,931	48,931	48,931	0	0.00
Operating	1,203,156	156,441	1,359,597	1,358,882	715	0.05
Vehicle lease payments	—	110,768	110,768	99,698	11,070	9.99
Purch. Serve. Comp. Cen.	—	1,787	1,787	1,787	0	0.00
Communications services	—	2,315	2,315	2,315	0	0.00
MNT payments	—	278,414	278,414	278,414	0	0.00
Payments to other agencies	340,488	(101,078)	239,410	119,290	120,120	50.17
Legal services	—	24,123	24,123	24,123	0	0.00
Administrative Law Judge	—	824	824	824	0	0.00
Capital outlay	—	22,945	22,945	22,945	0	0.00
Research	250,000	—	250,000	249,852	148	0.06
Worker's compensation	—	57,408	57,408	57,408	0	0.00
Unemployment benefits	—	1,958	1,958	—	1,958	100.00
Health and life	—	420,725	420,725	420,725	0	0.00
Short-term disability	—	10,094	10,094	7,033	3,061	30.32
Leased space	—	797,239	797,239	631,120	166,119	20.84
Grand Junction – leased space	—	6,945	6,945	6,945	0	0.00
Risk management	—	33,884	33,884	33,884	0	0.00
Travel expenses	113,498	—	113,498	76,442	37,056	32.65
Marketing and communications	8,643,420	—	8,643,420	8,636,184	7,236	0.08
Indirect costs	358,373	—	358,373	358,373	0	0.00
Ticket costs	3,549,040	(58,300)	3,490,740	2,142,602	1,348,138	38.62
Vendor fees	9,811,513	854,514	10,666,027	6,656,479	4,009,548	37.59
Prizes	306,413,810	21,430,565	327,844,375	280,000,739	47,843,636	14.59
Powerball prize variance	4,220,000	3,922,000	8,142,000	7,264,940	877,060	10.77
Retailer compensation	38,609,220	3,256,160	41,865,380	33,668,382	8,196,998	19.58
CMAC Project-Cap Construction	88,947	—	88,947	78,251	10,696	12.03
Multi-State Lottery fees	177,433	—	177,433	172,275	5,158	2.91
Roll forward	19,776	—	19,776	19,776	0	0.00
Total	\$ 382,039,623	\$ 31,529,014	\$ 413,568,637	\$ 350,693,945	\$ 62,874,692	15.20%

Fiscal year 2007 staffing
(FTE) 126.00 (Appropriated) 123.8 (Actual)

*Certain amounts may not tie due to rounding.

Colorado Lottery
Budgetary Comparison (continued)
for the Fiscal Year Ended June 30, 2007

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

Operating Expenses Per Statement of Revenues, Expenses and Changes in Fund Net Assets	
Prize expense	\$ 280,000,739
Powerball prize variance	(3,084,334)
Commissions and bonuses	33,668,382
Cost of tickets and vendor fees	8,099,744
Other operating expenses	<u>21,002,317</u>
 Total operating expenses per statement of revenues, expenses and changes in fund net assets	 339,686,848
 Plus Powerball variance classified as revenue	 10,349,274
Excess accrued annual and sick leave	23,243
Telecommunications offset classified as revenue	691,715
 Less: non-appropriated expenses	
Depreciation	(156,948)
Book value of assets written-off	<u>(24,947)</u>
	<u>350,569,185</u>
 Plus capitalized fixed assets	 <u>124,760</u>
 Total fiscal year 2007 expenditures	 <u>\$ 350,693,945</u>



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

Members of the Legislative Audit Committee

We have audited the financial statements of the Colorado Lottery (the Lottery) as of and for the year ended June 30, 2007, and have issued our report thereon dated September 4, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

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*.

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

BKD, LLP

September 4, 2007

Colorado Springs, Colorado

111 S. Tejon Street, Suite 800 Colorado Springs, CO 80903-2286 719 471-4290 Fax 719 632-8087



Members of the Legislative Audit Committee

As part of our audit of the financial statements of the Lottery as of and for the year ended June 30, 2007, we wish to communicate the following to you.

Auditor's Responsibility under Auditing Standards Generally Accepted in the United States of America

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

Significant Accounting Policies

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

Management Judgments and Accounting Estimates

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

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

Audit Adjustments

During the course of any audit, an auditor may propose adjustments to financial statement amounts. Management evaluates our proposals and records those adjustments which, in its judgment, are required to prevent the financial statements from being materially misstated. We did not propose adjustments for the year ended June 30, 2007.

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

BKD, LLP

Colorado Springs, Colorado
September 4, 2007

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.