

COMPLIANCE AUDIT, FINANCIAL
STATEMENTS AND REPORT OF
INDEPENDENT CERTIFIED PUBLIC
ACCOUNTANTS

COLORADO LOTTERY

JUNE 30, 2000 AND 1999

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COLORADO LOTTERY FINANCIAL STATEMENTS

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REPORT SUMMARY
COLORADO LOTTERY
FINANCIAL AND COMPLIANCE AUDIT
FISCAL YEAR ENDED JUNE 30, 2000

Authority, Purpose and Scope

The audit of the Colorado Lottery was done under authority of Section 24-35-211, C.R.S., which requires an annual audit of the Lottery Fund. The purpose of the audit was to express an opinion on the financial statements of the Colorado Lottery for the year ended June 30, 2000.

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. Audit work was performed from May through September 2000.

Financial Audit Opinion

We have issued an unqualified opinion dated August 16, 2000, on the Colorado Lottery's June 30, 2000, financial statements.

**Current Year
Findings and Recommendations**

There is one current year recommendation which concerns the need for the Colorado Lottery to obtain an audit report on one of its major service providers, GTECH Corporation, in accordance with Statement on Auditing Standards (SAS) No. 70, *Reports on the Processing of Transactions by Service Organizations*. See page 4 for the Recommendation Locator.

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

There were seven recommendations contained in the Office of the State Auditor's October 1999 financial review of the Colorado Lottery's use of coupons. These recommendations have been evaluated and either implemented or partially implemented during the year ended June 30, 2000. See pages 10 and 11 for a discussion regarding the disposition of these prior audit recommendations.

Required Communications

The following specific matters are required to be discussed with the Audit Committee in accordance with Statement on Auditing Standards No. 61, *Communication with Audit Committees*. The matters discussed herein are those that we have noted as of August 16, 2000, and we have not updated our procedures regarding these matters since that date to the current date. Accordingly, we advise you of the following with respect to the Colorado Lottery (Lottery) for the year ended June 30, 2000:

Auditors' Responsibility Under Auditing Standards Generally Accepted in the United States of America and Government Auditing Standards

Our responsibility, as prescribed by auditing standards generally accepted in the United States of America promulgated by the American Institute of Certified Public Accountants and *Government Auditing Standards* issued by the Comptroller General of the United States, is to plan and perform our audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. An audit in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards* does not provide absolute assurance or guarantee the accuracy of the financial statements and is subject to the inherent risk that errors or fraud (or illegal acts), or noncompliance with the provisions of laws, regulations, contracts and grants, if existing, have not been detected. Such standards also require that we obtain a sufficient understanding of the Lottery's internal controls to plan the audit. However, such understanding and any tests performed with respect to such internal controls, or as to compliance with laws, regulations, contracts and grants, were for the purpose of expressing our opinion on the Lottery's financial statements and not to opine or provide any assurance concerning such internal controls or compliance.

Our Responsibility for Other Information in Documents Containing Audited Financial Statements

Pursuant to professional standards, the auditors' responsibility for other information in documents containing the Lottery's audited financial statements does not extend beyond the financial information identified in the audit report, and the auditor is not required to perform procedures to corroborate such other information. However, in accordance with such standards, we are required to read the information in such documents and consider whether such information, or the manner of its presentation, is materially inconsistent with its presentation in the financial statements. Our responsibility also includes calling to management's attention any information which we believe is a material misstatement of fact. No such inconsistencies or misstatements came to our attention.

Significant Audit Adjustments

For purposes of these required communications, professional standards define an audit adjustment, whether or not recorded, as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. The definition includes adjustments that were not recorded by the Lottery because they are not material to the current financial statements, but might be potentially material to future financial statements. The Lottery's management has represented to us that they believe uncorrected financial statement misstatements, as reported to the Office of the State Auditor on Attestation Memo – Section D – Audit Differences, are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

Disagreements with Management

For purposes of these required communications, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter which could be significant to the Lottery's financial statements or the audit report. We are pleased to report that no such disagreements arose during the course of our audit.

RECOMMENDATION LOCATOR

Rec. No.	Page No.	Recommendation Summary	Agency Addressed	Agency Response	Implementation Date
1	8	The Colorado Lottery should either contract with an independent certified public accounting firm or have GTECH Corporation contract with such a firm to perform an audit of GTECH Corporation's system of internal controls over its computerized processing of the Lottery's financial data in accordance with Statement on Auditing Standards (SAS) No. 70, <i>Reports on the Processing of Transactions by Service Organizations</i> .	Colorado Lottery	Agree pending budget approval or other contractual arrangements for the costs of such an audit.	At the latest, fiscal year ending June 30, 2003, pending budget approval.

DESCRIPTION OF THE COLORADO LOTTERY AND THE LOTTERY COMMISSION

The Colorado 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 2000, the Lottery employed 124 Full-Time-Equivalent employees in its headquarters in Pueblo and branch offices in Denver, Fort Collins and Grand Junction.

The Lottery is governed by a Commission of five members appointed by the Governor. 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 Commission's responsibilities are stated in Section 24-35-208, C.R.S., and include:

Promulgation of rules and regulations to govern Lottery operations.

Carrying on a continuous study and investigation of the Lottery to determine the need for changes in statutes, rules or regulations or in the administration and operation of the Lottery.

The Lottery's enabling legislation requires that no less than 50 percent 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 State Division of Parks and Outdoor Recreation, Capital Construction for the State, and the Great Outdoors Colorado Trust Fund. The final distribution to Capital Construction for the State was made during the year ended June 30, 1999.

On May 29, 1999, sales of the Perfecto on-line game were terminated. Elimination of Perfecto did not alter the distribution method used by the Lottery in allocating earnings.

COLORADO LOTTERY
FINANCIAL HIGHLIGHTS
\$ IN MILLIONS
For the fiscal years ended June 30, 2000 and 1999

The table included below and the graphs included on page 7 present certain summarized operating results of the Colorado Lottery for the fiscal years ended June 30, 2000 and 1999, and should be read in conjunction with the financial statements presented herein. The graphs included on page 7 are presented for the purpose of demonstrating the Colorado Lottery's compliance with certain statutes that pertain to its operations.

	Fiscal year ended June 30,			
	2000		1999	
	Total	Actual Percent	Total	Actual Percent
INCOME				
Gross Ticket Sales	\$ 370.96		\$ 368.40	
Other Income	<u>1.80</u>		<u>2.07</u>	
TOTAL INCOME	372.76		370.47	
LESS:				
PRIZES	223.58	60.3% (1)	224.94	61.1% (1)
RETAILER COMMISSIONS AND BONUS	27.97	7.5% (1)	27.79	7.5% (1)
ADMINISTRATIVE COSTS				
Ticket Costs	10.88		10.76	
Operating Expenses	<u>20.99</u>		<u>22.48</u>	
TOTAL ADMINISTRATIVE COSTS (Note 3)	<u>31.87</u>	8.6% (2)	<u>33.24</u>	9.0% (2)
INCOME BEFORE PROCEEDS DISTRIBUTIONS	89.34		84.50	
NET INCOME (LOSS)	<u>(0.14)</u>		<u>(0.18)</u>	
PROCEEDS DISTRIBUTION	<u>\$ 89.48</u>	24.0% (2)	<u>\$ 84.68</u>	22.9% (2)

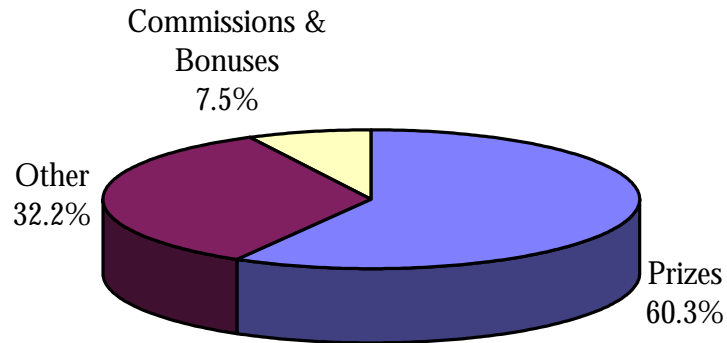
Note 1: Percent of gross ticket sales.

Note 2: Percent of total income.

Note 3: Total operating expenses per the statement of revenues, expenses and changes in retained earnings includes unappropriated expenses such as depreciation and accrued annual and sick leave. The actual administrative costs percentage would be slightly lower if they were removed from the calculation.

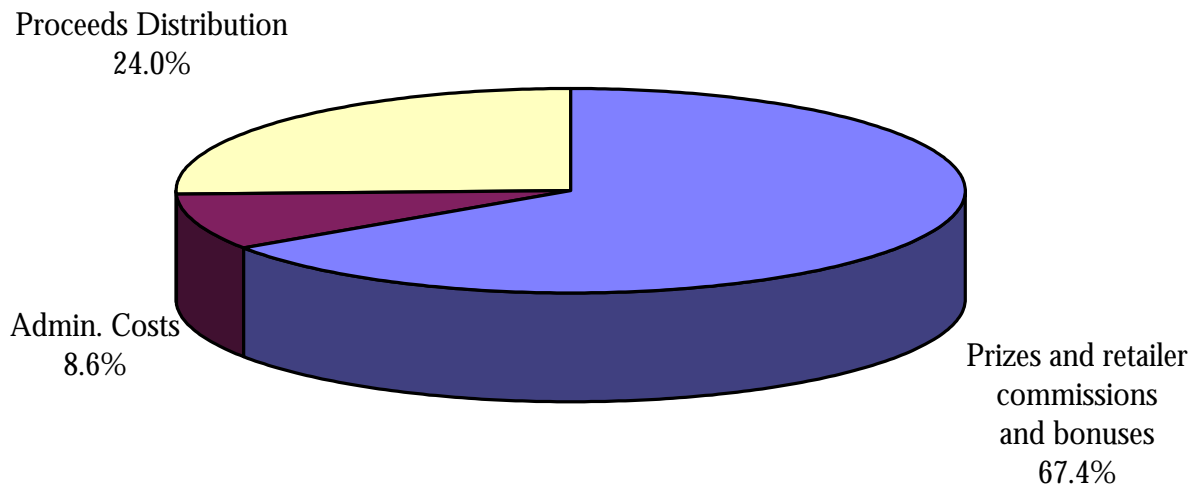
COLORADO LOTTERY
SUPPLEMENT TO FINANCIAL HIGHLIGHTS
For the fiscal year ended June 30, 2000

PERCENT OF GROSS TICKET SALES



To depict compliance with the 50% prize payment statute and the commission/bonus rules.

PERCENT OF TOTAL INCOME



To depict status of administrative expenditures to date.

FINDINGS AND RECOMMENDATIONS

EVALUATION OF CONTROLS OVER CONTRACTOR'S EXTERNAL COMPUTER SYSTEMS

The Colorado Lottery contracts with GTECH Corporation for comprehensive on-line and scratch ticket gaming products and services. Pursuant to this contract, GTECH has implemented and operates for the Lottery an extensive computerized wagering system, including primary and back-up central computer systems, communications equipment and retailer sales terminals used for the Lottery's Lotto and Cash 5 games and game ticket validations. Essentially GTECH's system processes a very large portion of the Lottery's financial data, including all daily sales data for the Lotto and Cash 5 on-line games, whose combined revenue totaled approximately \$136 million and \$132 million for the years ended June 30, 2000 and 1999, respectively.

Per the terms of the Lottery's contract with GTECH, the Lottery can assess liquidated damages against GTECH for varying levels of central computer or other network malfunctions, failure to properly maintain retailer terminals, degraded performance of the system, and unauthorized use of system software. For instance, in December 1998 the Lottery assessed approximately \$200,000 in liquidated damages against GTECH due to system malfunctions, though there have been no other similarly large penalties against GTECH during the year ended June 30, 2000. These contract provisions serve as an incentive for GTECH to properly control and operate the system so as to minimize the loss of sales for the Lottery and financial penalties for itself. Also, part of the Lottery's system of internal controls relating to the financial data processed by GTECH, is the daily systems balancing process. This process basically reconciles all daily sales information between the GTECH and Lottery systems, which interface frequently on a daily basis, before the information is recorded in the Lottery's accounting records.

Due to the critical nature and tremendous amount of information that is processed by GTECH for the Lottery, the need exists to periodically evaluate GTECH's system of internal controls and its related effectiveness over the processing of such data. Because Lottery officials are not able to thoroughly analyze and oversee the operations of GTECH's internal systems on a frequent basis, an audit performed in accordance with Statement on Auditing Standards (SAS) No. 70, *Reports on the Processing of Transactions by Service Organizations*, could accomplish this objective. A SAS 70 audit would provide the Lottery with reasonable assurance that GTECH's system of internal controls are suitably designed, are placed in operation, and are functioning satisfactorily to ensure the proper processing of the Lottery's financial data and could identify any weaknesses in GTECH's controls that may need to be corrected or improved in order to prevent future system problems and lost sales for the Lottery.

Recommendation

The Colorado Lottery should either contract with a certified public accounting firm or have GTECH Corporation contract with such a firm to perform an audit of GTECH's system of internal controls over its computerized processing of the Lottery's financial data in accordance with SAS No. 70.

Colorado Lottery's Response:

The Colorado Lottery agrees with the recommendation pending budget approval or other contractual arrangements for the costs of such an audit.

DISPOSITION OF PRIOR AUDIT RECOMMENDATIONS

The following are the recommendations that were contained in the Office of the State Auditor's October 1999 financial review of the Colorado Lottery's use of coupons. We have incorporated herein these recommendations in order to provide their disposition.

Recommendation No.	Disposition
1. The Colorado Lottery should account for all expenses associated with the use of free tickets and coupons within its appropriated marketing line item.	Implemented.
2. The Lottery should work with the General Assembly to determine whether the dollars spent outside of its appropriation authority should be paid back to the Lottery Fund beneficiaries, and if so, to determine an appropriate method for reimbursement.	Implemented. In its fiscal year 2000 budget, the JBC staff proposed that the Lottery appropriation for Marketing and Communications be reduced in order to pay back the dollars spent outside of its appropriation authority. This plan was rejected by the Joint Budget Committee.
3. The State Controller's Office should periodically review state agencies' spending authority and expenses to ensure that agencies are spending dollars from the proper appropriated line items.	Ongoing.
4. The Colorado Lottery should work with the Lottery Commission to develop and set limitations on the volume and appropriate uses of coupons, Lottery Bucks, and free tickets as promotional tools.	Partially implemented – The Colorado Lottery has worked with the Lottery Commission to make two rules which establish guidelines for the use of coupons, Lottery Bucks, and free tickets. These rules were approved by the Lottery Commission in May 2000 for the number and total dollar value of coupons. The rules are effective in Fiscal Year 2001.

(Continued)

Recommendation No.	Disposition
5. The Colorado Lottery should implement procedures for tracking coupons as it would any other ticket inventory, including development of databases that track the number of coupons printed, distributed, and redeemed by promotion.	Implemented.
6. The Colorado Lottery should ensure that it follows both the Procurement Code and State Fiscal Rules for contracting in promotions involving co-sponsors and ensure that the interests of the State are protected.	Implemented.
7. The Colorado Lottery should work with the State Controller's Office to determine the appropriate method for valuing and recording its non-monetary transactions involving coupons, free tickets, and Lottery Bucks.	Implemented.

Report of Independent Certified Public Accountants

Members of The Legislative Audit Committee

We have audited the accompanying balance sheets of the Colorado Lottery (Lottery) as of June 30, 2000 and 1999, and the related statements of revenues, expenses and changes in retained earnings and cash flows for the years then ended. 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.

As discussed in Note 1, the financial statements present only the Colorado Lottery, an enterprise fund of the State of Colorado. The financial statements are intended to present the financial position and the results of operations and cash flows of only that portion of the State of Colorado that is attributable to the transactions of the Colorado Lottery in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Colorado Lottery as of June 30, 2000 and 1999, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 16, 2000, on our consideration of the Lottery's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audits.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole of the Colorado Lottery for the years ended June 30, 2000 and 1999. The supplementary schedules listed in the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements. These supplementary schedules have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Colorado Springs, Colorado
August 16, 2000

COLORADO LOTTERY
BALANCE SHEETS
JUNE 30, 2000 AND 1999

ASSETS	2000	1999
Current Assets:		
Cash and Investments	\$ 22,596,097	\$ 19,947,231
Accounts Receivable, net of allowance for doubtful accounts of \$85,939 in 2000 and \$93,831 in 1999	10,567,742	12,891,231
Consignment Inventory, at Cost	224,134	212,328
Warehouse Inventory, at Cost	1,279,447	1,428,702
Prepaid Expenses	30,237	18,908
Total Current Assets	34,697,657	34,498,400
Restricted Assets:		
Cash and Investments-Licensed Agent Recovery Reserve Receipts	361,143	310,593
Total Restricted Assets	361,143	310,593
Fixed Assets:		
Equipment	5,993,933	5,411,782
Leasehold Improvements	330,936	254,508
Less Accumulated Depreciation and Amortization	(3,806,353)	(3,543,508)
Total Fixed Assets	2,518,516	2,122,782
TOTAL ASSETS	\$ 37,577,316	\$ 36,931,775
LIABILITIES & RETAINED EARNINGS		
Liabilities:		
Accounts Payable	\$ 1,498,802	\$ 2,701,711
Wages & Benefits	305,642	13,360
Funds Available for Distribution	17,906,300	17,500,481
Prize Liability	14,920,709	13,594,311
Retailer Bonus Liability	516,783	512,661
Deferred Revenue	423,012	465,141
Accrued Annual and Sick Leave	746,110	751,623
Expired Warrants Liability	114,883	110,370
Total Liabilities	36,432,241	35,649,658
Retained Earnings:		
Unreserved	783,932	971,524
Reserved		
Licensed Agent Recovery Reserve	361,143	310,593
Total Retained Earnings	1,145,075	1,282,117
TOTAL LIABILITIES & RETAINED EARNINGS	\$ 37,577,316	\$ 36,931,775

The accompanying notes are an integral part of these financial statements.

COLORADO LOTTERY
STATEMENTS OF REVENUES, EXPENSES AND
CHANGES IN RETAINED EARNINGS
FOR THE FISCAL YEARS ENDED JUNE 30, 2000 AND 1999

	<u>2000</u>	<u>1999</u>
GROSS TICKET SALES	\$ 370,956,348	\$ 368,404,165
PRIZE EXPENSE	(223,575,542)	(224,940,615)
COMMISSIONS, BONUS, AND TICKET COSTS		
Retailer Commission and Bonus	(27,969,521)	(27,787,798)
Cost of Tickets & Vendor Fees	<u>(10,884,493)</u>	<u>(10,764,251)</u>
GROSS PROFIT ON SALE OF TICKETS	<u>108,526,792</u>	<u>104,911,501</u>
OPERATING EXPENSES		
Marketing and Communications	8,409,545	10,056,698
Wages and Benefits	7,259,948	6,834,326
Professional Services	329,238	316,531
State Agencies Services	94,658	154,845
Department of Revenue Services	334,800	304,811
Travel	129,596	135,808
Equipment	116,910	100,717
Depreciation	570,489	446,087
Accrued Annual and Sick Leave	(5,417)	64,575
Space Rental	561,304	426,156
Rents for Equipment	1,061,459	1,060,342
Motorpool Leasing	299,050	284,739
Materials and Supplies	105,102	253,044
Telephone	159,586	151,887
On-Line Telecommunications	970,125	1,204,768
Data Processing Supplies and Services	35,839	55,387
Equipment Maintenance	253,782	315,015
Postage	63,465	89,818
Printing	76,589	92,664
Other	<u>166,364</u>	<u>134,519</u>
TOTAL OPERATING EXPENSES	<u>20,992,432</u>	<u>22,482,737</u>
OPERATING INCOME	87,534,360	82,428,764
Other Revenue	165,397	405,508
Interest Income	<u>1,639,980</u>	<u>1,669,947</u>
INCOME BEFORE OTHER EXPENSES	89,339,737	84,504,219
LESS PROCEEDS DISTRIBUTIONS:		
Funds Distributed for Current Year	(71,570,479)	(67,183,618)
Funds Available for Distribution for Current Year	<u>(17,906,300)</u>	<u>(17,500,481)</u>
NET LOSS	<u>(137,042)</u>	<u>(179,880)</u>
RETAINED EARNINGS, BEGINNING OF YEAR	1,282,117	1,461,997
Net Loss	<u>(137,042)</u>	<u>(179,880)</u>
RETAINED EARNINGS, END OF YEAR	<u>\$ 1,145,075</u>	<u>\$ 1,282,117</u>

The accompanying notes are an integral part of these financial statements.

COLORADO LOTTERY
STATEMENTS OF CASH FLOWS
FOR THE FISCAL YEARS ENDED JUNE 30, 2000 AND 1999

	2000	1999
Cash flows from operating activities:		
Cash received from retailers	\$ 371,732,451	\$ 365,310,978
Cash paid in prizes	(222,312,979)	(230,446,735)
Cash paid for commissions	(24,514,940)	(24,358,312)
Cash payments to suppliers	(24,067,210)	(23,356,400)
Cash payments to employees for services	(7,050,784)	(6,856,748)
Cash received from Lotto subscription sales	798,721	817,761
Cash paid in retailer bonus	(3,461,530)	(3,581,123)
Cash received (used) - other	25,478	35,805
	91,149,207	77,565,226
Cash flows from noncapital financing activities:		
Distribution of net proceeds	(89,070,960)	(85,145,126)
Decrease in funds held for Conservation Trust Fund	-	(2,132,639)
	(89,070,960)	(87,277,765)
Cash flows from capital and related financing activities:		
Acquisition of capital assets	(1,018,811)	(401,511)
Cash flows from investing activities:		
Interest received	1,827,572	1,901,988
Unrealized losses on investments	(187,592)	(250,487)
	1,639,980	1,651,501
Net increase (decrease) in cash and investments	2,699,416	(8,462,549)
Cash and investments, Beginning of Year (including \$310,593 and \$2,389,322, respectively, in restricted accounts)	20,257,824	28,720,373
Cash and investments, End of Year (including \$361,143 and \$310,593, respectively, in restricted accounts)	\$ 22,957,240	\$ 20,257,824
<i>Reconciliation of operating income to net cash provided by operating activities:</i>		
<i>Operating income</i>	\$ 87,534,360	\$ 82,428,764
<i>Adjustments to reconcile operating income to net cash provided by operating activities</i>		
<i>Depreciation</i>	570,489	446,087
<i>Loss on disposition of equipment</i>	52,588	36,436
<i>Other revenue</i>	165,397	405,508
<i>Change in:</i>		
<i>Accounts Receivable</i>	2,323,489	2,319,842
<i>Ticket Inventory</i>	137,449	(246,745)
<i>Other Assets</i>	(11,329)	14,119
<i>Liabilities (excluding funds available for distribution)</i>	376,764	(7,838,785)
	91,149,207	77,565,226
<i>Net cash provided by operating activities</i>	\$ 91,149,207	\$ 77,565,226

The accompanying notes are an integral part of these financial statements.

COLORADO LOTTERY
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2000 AND 1999

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

The Colorado Lottery was incorporated April 30, 1982, under the provisions of C.R.S. 24-35-202. The Colorado Lottery operates under a Commission and provides operation and service of lottery games as authorized by the statute. The Colorado Lottery's revenues are predominately earned from the sale of lottery products including scratch, Lotto, and Cash 5.

The financial statements reflect activities of the Colorado Lottery, a proprietary fund of the State of Colorado, for the fiscal years ended June 30, 2000 and 1999. The Colorado Lottery is an agency of the State of Colorado. The financial statements present only the Colorado Lottery, an enterprise fund 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 Colorado Lottery in accordance with accounting principles generally accepted in the United States of America.

The accounting policies of the Colorado 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:

A. 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, fund equity, revenues, and expenditures.

B. Enterprise Fund

The Colorado Lottery accounts for its operations as an enterprise fund. The intent of the State of Colorado Legislature is that the 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 for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Colorado Lottery has elected to apply only those applicable Financial Accounting Standards Board Statements and interpretations issued prior to November 30, 1989.

C. 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 Colorado 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 ticket, Cash 5 ticket, and subscription 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.

D. Budget

By October 24th of each year, the Department 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 statute 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 Legislature, the State Controller, and the Office of State Planning and Budgeting.

E. Allowance for Doubtful Accounts

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 can be reasonably estimated.

The Colorado Lottery uses the specific identification method to determine expected uncollectibles. Under the provision of C.R.S. 24-35-219, 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 \$85,939 and \$93,831 as of June 30, 2000 and June 30, 1999, respectively.

F. Consignment Inventory

Inventory on consignment represents non-activated ticket inventory in the possession of retailers who act as agents of the Colorado Lottery. The Colorado 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 balance sheet. Consignment inventory is stated at cost using the specific identification method.

G. Warehouse Inventory

Warehouse inventory represents unsold tickets in possession of the Colorado Lottery and is stated at cost using the specific identification method.

H. Supplies Inventory

The State of Colorado's threshold for recording supplies inventories is \$35,000 per location. The supplies inventory of the Colorado Lottery consistently falls below the \$35,000 threshold per location. Accordingly, no supplies inventory appears on the balance sheet.

I. Fixed Assets

Equipment, and leasehold improvements are stated at cost. Beginning September 1, 1996, equipment may be capitalized if the cost exceeds \$5,000 and has a useful life of more than one year, however, a state agency may select a minimum acquisition cost or useful life which is less than the stated criteria for capitalization. Accordingly, the Colorado Lottery capitalizes equipment with a cost of \$1,000 or more that 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 eight 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.

J. Prize Liability and Prize Expense

Under the provision of C.R.S. 24-35-210, the Colorado 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 8).

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

The Colorado Lottery enables all retailers to pay scratch prizes on barcoded games of less than \$600 by validating them through the on-line terminal. Payment of scratch prizes of \$600 or more must be done by the Lottery. Prizes may be claimed up to 180 days after game-end. After the final claim date, any unclaimed scratch prizes will result in a decrease to prize expense and any prizes claimed in excess of the liability accrued will result in an increase to prize expense. Net unclaimed scratch prizes resulted in a decrease to prize expense of \$3,274,498 for the fiscal year ended June 30, 2000 and \$4,138,169 for the fiscal year ended June 30, 1999.

Payments of cumulative on-line prize amounts of \$150 or less on a single ticket may be done at the Lottery or at the retail outlet; payment of cumulative prize amounts of \$151 to \$600 on a single ticket may be done at the retailer level at the option of the retailer, or at the Lottery. Payment of cumulative prize amounts of \$600 or more on a single ticket must be done at the Lottery. Retailers are given credit for prize payments they make on a daily basis. On-line prizes may be claimed up to 180 days after the date of the drawing. After the final claim date, unclaimed on-line prizes will result in a decrease to prize expense so long as the aggregate prize expense exceeds or equals the statutory fifty percent of sales. Unclaimed on-line prizes resulted in a decrease to prize expense of \$2,901,608 for the fiscal year ended June 30, 2000 and \$5,121,282 for the fiscal year ended June 30, 1999.

K. Retailer Bonus Liability

Under provision 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, 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 results in a reduction of bonus expense.

L. Licensed Agent Recovery Reserve

Under the provisions of C.R.S. 24-35-219, a licensed agent recovery reserve was established on July 1, 1988 to maintain surety bond receipts collected from Colorado Lottery retailers. Billing rates are established by the Colorado Lottery Commission 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.

M. Compensated Leave

All permanent employees of the Colorado 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, 2000</u>	<u>June 30, 1999</u>	<u>Increase/ (Decrease)</u>
Annual Leave	\$590,746	\$557,926	\$ 32,820
Sick Leave	<u>152,734</u>	<u>190,971</u>	<u>(38,237)</u>
Total Annual & Sick Leave	743,480	748,897	(5,417)
Compensatory Time	<u>2,630</u>	<u>2,726</u>	<u>(96)</u>
Total Compensated Leave	<u>\$746,110</u>	<u>\$751,623</u>	<u>\$ (5,513)</u>

N. Expired Warrants Liability

Expired Warrants Liability represents the expiration of aged uncashed warrants and imprest checks over one (1) year old. In accordance with C.R.S. 15-12-914, recipients are entitled to claim payment up to 21 years after original date of issue.

O. Pension Plan

a. *Plan Description*

Virtually all of the Colorado Lottery's employees participate in a defined benefit pension plan. The plan's purpose is to provide income to members and their families at retirement or in case of death or disability. The plan is a cost-sharing multiple-employer plan administered by the Public Employees' Retirement Association (PERA). PERA was established by state statute in 1931. Responsibility for the organization and administration of the plan is placed with the Board of Trustees of PERA. Changes to the plan require legislation by the General Assembly. The state plan and other divisions' plans are included in PERA's financial statements which may be obtained by writing PERA at 1300 Logan Street, Denver, Colorado 80203.

Plan members vest after five years of service and most are eligible for retirement benefits at age 50 with 30 years of service, age 60 with 20 years of service, or at age 65 with 5 years of service. State troopers and judges comprise a small percentage of plan members but have higher contribution rates and are eligible for retirement benefits at different ages and years of service.

House Bill 00-1458, passed in the 2000 legislative session, changed the retirement eligibility of some state workers. Members who are 55 years of age or older and retiring June 1, 2000, or later, with age plus years of service totaling 80 or more, may retire without a reduction for early retirement. The reduction for early retirement for some members with age plus years of service totaling less than 80 was also lowered. In addition, beginning March 1, 2000, the annual increase for PERA benefits will be 3.5 percent compounded annually, and it will no longer be tied to the Consumer Price Index. Currently, the increase is the lower of the actual rate of inflation or a cumulative annual rate of 3.5 percent since retirement.

Monthly benefits are calculated as a percentage of highest average salary (HAS). HAS is one-twelfth of the average of the highest salaries on which contributions were paid, associated with three periods of 12 consecutive months of service credit.

Reduced service retirement benefits are available at the following age and years of service; 50-25, 55-20, and 60-5. The benefit is calculated similarly to a service retirement benefit, however, it is reduced by percentages that vary from 0.25 to 0.5, depending on age and years of service, for each month before the eligible date for the full service retirement.

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

b. Funding Policy

Most employees contribute 8.0 percent (10.0 percent for state troopers) of their annual gross covered wages to an individual account in the plan. The State contributes 10.3 percent (12.0 percent for state troopers) of the employee's gross covered wages. The annual gross covered wages subject to PERA is the gross earnings less any reduction in pay to offset employer contributions to the state sponsored IRC 125 plan established under Section 125 of the Internal Revenue Code. The contribution requirements of plan members and their employers are established, and may be amended, by the General Assembly.

The Colorado Lottery's contributions to PERA for the fiscal years ended June 30, 2000, 1999 and 1998, were \$646,744, \$623,831 and \$601,917, respectively. These contributions were equal to the required contributions for each year.

P. Post Retirement Health Care and Life Insurance Benefits

Health Care Program

The PERA Health Care Program began covering benefit recipients and qualified dependents on July 1, 1986. This benefit was developed after legislation in 1985 established the Program and the Health Care Fund. Under this program, PERA subsidizes a portion of the monthly premium for health care coverage. The benefit recipient pays any remaining amount of that premium through an automatic deduction from the monthly retirement benefit. During 1999, the subsidy was \$115.00 for those with 20 years of service credit and reduced by \$5.75 for each year under 20.

The Health Care Fund is maintained by an employer's contribution of 1.1 percent (0.8 percent prior to fiscal year ended June 30, 2000) of covered salary. During fiscal years ended June 30, 2000, 1999 and 1998, the Colorado Lottery paid \$62,833, \$44,070 and \$42,000, respectively, into this Fund.

Monthly premium costs for participants depend on the health care plan selected, the number of persons being covered, Medicare eligibility and the number of years of service credit. PERA contracts with a major medical indemnity carrier to administer claims for self-insured plans, and with health maintenance organizations providing services within Colorado. During 1999 there were approximately 38,265 participants, including spouses and dependents from all contributors to the plan.

Life Insurance Program

PERA provides its members access to two group life insurance plans offered by Prudential and Rocky Mountain Life. Members may join one or both plans and they may continue coverage into retirement. Premiums are collected monthly by payroll deduction or other means.

Q. Deferred Revenue

The Colorado Lottery offers two methods of purchasing on-line tickets for future draws. One is purchased through the terminal, referred to as Advance Play, and allows the player to purchase on-line tickets good for up to 10 draws. The second method is restricted to Lotto tickets only and is purchased through the mail via a pre-printed form, referred to as subscription, and allows the player to purchase Lotto tickets good for up to 104 draws. The revenues generated from both methods are recognized as the draws occur. Revenues for future draws are classified as a liability.

A detail of Deferred Revenue at June 30, 2000 and 1999, is as follows:

	<u>2000</u>	<u>1999</u>
Subscription	\$280,122	\$285,895
Advance play-Lotto	127,944	160,749
Advance play-Cash 5	<u>14,946</u>	<u>18,497</u>
Total Deferred Revenue	<u>\$423,012</u>	<u>\$465,141</u>

R. Promotional Activity

The Colorado Lottery engages in two types of promotional activities in an attempt to enhance sales and to increase the player base. Specific promotional coupons and Lottery Bucks coupons are distributed to players through special promos and can be redeemed at any retailer for a lottery product. During the fiscal years ended June 30, 2000 and 1999, 5,059 and 1,048,045 coupons were redeemed, respectively. Scratch tickets for specific games are given away as a more direct approach to introduce players to lottery games. During the fiscal years ended June 30, 2000 and 1999, 111,600 and 416,134 dollars worth of free scratch tickets were given away, respectively. Scratch tickets and coupons are valued at cost. For the fiscal years ended June 30, 2000 and 1999, approximately \$80,000 and \$900,000, respectively, was recorded as Marketing and Communications expense in the statements of revenues, expenses, and changes in retained earnings for coupons redeemed and scratch tickets given away.

S. Reclassifications

Certain reclassifications have been made to the June 30, 1999 financial statements to conform to the June 30, 2000 presentation.

2. CASH AND INVESTMENTS

A. Cash

Cash includes petty cash, change funds, an imprest fund, a depository account, and cash on deposit with the State Treasurer. A detail of cash at June 30, 2000 and 1999 is as follows:

	<u>2000</u>	<u>1999</u>
Petty Cash	\$ 1,550	\$ 1,550
Change Funds	90,025	90,025
Imprest Fund	350,000	350,000
Depository Account	18,447	15,000
Cash on Deposit with State Treasurer	<u>22,136,075</u>	<u>19,490,656</u>
TOTAL UNRESTRICTED CASH	<u>22,596,097</u>	<u>19,947,231</u>
Cash Restricted - Licensed Agent Recovery		
Reserve Receipts	<u>361,143</u>	<u>310,593</u>
TOTAL RESTRICTED CASH	<u>361,143</u>	<u>310,593</u>
TOTAL CASH	<u>\$22,957,240</u>	<u>\$20,257,824</u>

B. Cash on Deposit with State Treasurer

Under the provisions of C.R.S. 24-35-210, the State Treasurer shall invest the moneys of the Colorado 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 average annual yield on the average daily cash balance during Fiscal Year 1999-00 was approximately 5.92 percent. The current yield is approximately 6.09 percent.

In addition, the State Treasurer pools these deposits and invests them in securities approved by C.R.S. 24-75-601.1. The Colorado 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.

C. Insured and Collateralized Deposits

The Colorado Lottery has one imprest and one depository account with banking institutions. The depository account is used for the purpose of depositing daily collections throughout the state and transferring the collections to the State Treasurer in a timely manner.

The Public Deposit Protection Act requires financial institutions to collateralize any uninsured public deposits. At June 30, 2000 the Colorado Lottery had cash with a carrying value of \$368,447, and a bank balance of \$324,546 on deposit with banking institutions. Of the bank balance, \$100,000 is insured by federal insurance (FDIC); the amount not insured is covered by collateral held in the pledging institution's trust department in the State's name.

D. Statement of Cash Flows

The statement 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 account 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.

3. SCHEDULE OF CHANGES IN FIXED ASSETS

	<u>June 30, 1999</u>	<u>Additions</u>	<u>Deletions</u>	<u>June 30, 2000</u>
Equipment	\$5,411,782	\$ 942,383	\$360,232	\$5,993,933
Leasehold Improvements	<u>254,508</u>	<u>76,428</u>	<u>0</u>	<u>330,936</u>
TOTAL	<u>\$5,666,290</u>	<u>\$1,018,811</u>	<u>\$360,232</u>	<u>\$6,324,869</u>
	<u>June 30, 1998</u>	<u>Additions</u>	<u>Deletions</u>	<u>June 30, 1999</u>
Equipment	\$5,150,527	\$ 401,511	\$140,256	\$5,411,782
Leasehold Improvements	<u>254,508</u>	<u>0</u>	<u>0</u>	<u>254,508</u>
TOTAL	<u>\$5,405,035</u>	<u>\$ 401,511</u>	<u>\$140,256</u>	<u>\$5,666,290</u>

4. OPERATING LEASES

The Colorado 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 Colorado Lottery occupies office space in the Norwest Bank Building in Pueblo. The lease agreement with 200 South Broadway Limited Partnership began on July 1, 1995 and expires on June 30, 2005. There is no provision for renewal.

Warehouse - The Colorado Lottery leases primary warehouse space from the City of Pueblo. The Lottery entered into a lease extension agreement, which began July 1, 1997 and expires on June 30, 2002. There is no provision for renewal. The Lottery leases additional warehouse space from Musso & Cardinale. The Lottery entered into a lease extension agreement, which began July 1, 1997 and expires on June 30, 2002. There is no provision for renewal.

Interlott - The Colorado Lottery entered into a rental agreement with International Lottery, Inc. to rent Scratch Ticket Vending Machines (STVMs). The agreement covers the period from July 1, 2000 through June 30, 2002. The Lottery has the option to exercise two twelve-month extensions. There are no other provisions for extension or renewal.

Denver

Office - The Colorado Lottery occupies office and warehouse space in the Galleria Towers Building in Denver. The lease agreement which began on October 30, 1990, was amended on May 14, 1999 and extended the ending date for the lease from June 30, 1999 to June 30, 2006. There is no provision for renewal.

Warehouse – The Colorado Lottery entered into a lease agreement with Yukon Denver Valley, Inc. to occupy warehouse space. The lease agreement began on September 1, 1999 and expires on August 31, 2004. The Lottery has the option to extend the lease through August 31, 2009.

Fort Collins

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

Grand Junction

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

Colorado Springs

The Colorado Lottery occupies warehouse space in a building located at 2818 Janitell Rd. in Colorado Springs, Colorado. The lease agreement, which began on April 22, 1999, expires on June 30, 2003. There is no provision for renewal.

Operating lease expense incurred for the fiscal years ended June 30, 2000 and 1999 and future minimum lease payments are as follows:

Location	Expense		Future Minimum Lease Payments					LATER YEARS
	1999	2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	
Pueblo Office	\$220,891	\$ 226,978	\$ 238,318	\$ 250,336	\$262,692	\$275,900	\$289,773	\$ 0
Pueblo Warehouse	32,637	32,637	32,637	32,637	0	0	0	0
Interlott	1,031,065	1,028,696	653,500	653,500	0	0	0	0
Co Sprgs Warehouse	1,923	12,065	12,612	13,196	13,812	0	0	0
Denver Office	147,152	185,445	185,411	191,392	197,373	203,354	209,335	215,316
Denver Warehouse	0	61,644	92,190	94,997	97,805	100,612	16,844	0
Fort Collins	14,749	14,793	0	0	0	0	0	0
Grand Junction	<u>4,444</u>	<u>5,886</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
	<u>\$1,452,861</u>	<u>\$1,568,144</u>	<u>\$1,214,668</u>	<u>\$1,236,058</u>	<u>\$571,682</u>	<u>\$579,866</u>	<u>\$515,952</u>	<u>\$215,316</u>

5. OTHER REVENUE

A schedule of other revenue for the fiscal years ended June 30, 2000 and 1999 follows:

	<u>2000</u>	<u>1999</u>
License Fees	\$ 47,374	\$ 46,691
Fines & Penalties	32,100	242,600
Assignment Fees	8,302	20,453
Net Licensed Agent Recovery		
Reserve Receipts	50,550	70,606
Ended Game Revenue	11,763	18,038
Other	<u>15,308</u>	<u>7,120</u>
Total	<u>\$165,397</u>	<u>\$405,508</u>

6. LOTTERY FUND RETAINED EARNINGS

In accordance with C.R.S. 24-35-210(g), (l), the Lottery Commission shall, reserve "...sufficient moneys to ensure the operation of the Lottery for the ensuing year." Under the provision, the Lottery Commission approved a reserve of \$1 million of retained earnings for Fiscal Year 1989 and has not changed it since then. The unreserved retained earnings balances for the fiscal years ended June 30, 2000 and June 30, 1999 are composed of the following:

	<u>2000</u>	<u>1999</u>
Reserve approved by Commission	\$1,000,000	\$1,000,000
Less: Unrealized Loss on Investments	<u>(216,068)</u>	<u>(28,476)</u>
	<u>\$ 783,932</u>	<u>\$ 971,524</u>

7. DISTRIBUTION OF NET PROCEEDS

Under the provisions of C.R.S. 24-35-210, as amended effective September 1, 1998, beginning with the first quarter of Fiscal Year 1998-99, distributions shall be made on a quarterly basis in accordance with the provisions of section 33-60-104, C.R.S. with the distribution of net lottery proceeds for the first quarter occurring on December 1 of such fiscal year, distribution of net lottery proceeds for the second quarter occurring on March 1 of such fiscal year, distribution of net lottery proceeds for the third quarter occurring on June 1 of such fiscal year, and distribution of net lottery proceeds for the fourth quarter occurring on September 1 following the close of such fiscal year. For the first quarter of Fiscal Year 1999-00 and for each quarter thereafter, 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 trust fund board to be split between the

Great Outdoors Colorado Trust Fund, and any excess to the General Fund as set forth in 33-60-104 (1) (c) and 33-60-104 (2).

Income Available for Distribution at June 30:

	<u>2000</u>	<u>1999</u>
Income Before Other Expenses	\$89,339,737	\$84,504,219
Less: Increase in licensed agent recovery reserve	(50,550)	(70,607)
Plus: Unrealized losses on investments	<u>187,592</u>	<u>250,487</u>
Income Available for Distribution	\$89,476,779	\$84,684,099
Less: Prior Distributions	<u>(71,570,479)</u>	<u>(67,183,618)</u>
Income Available for Distribution	<u>\$17,906,300</u>	<u>\$17,500,481</u>

The following is a schedule of funds available for distribution for the fiscal year end, the proceeds distributions expense by fund for the fiscal year end, and distributions paid by fund for the fiscal year end:

	<u>Accrued at June 30, 1999</u>	<u>Proceeds Distributions Expense</u>	<u>Distributions Paid</u>	<u>Accrued at June 30, 2000</u>
Great Outdoors Colorado	\$ 8,750,242	\$ 43,488,104	\$ (44,535,485)	\$ 7,702,861
General Fund	-	1,250,290	-	1,250,290
Conservation Trust Fund	7,000,192	35,790,712	(35,628,384)	7,162,520
Division of Parks & Outdoor Recreation	<u>1,750,047</u>	<u>8,947,673</u>	<u>(8,907,091)</u>	<u>1,790,629</u>
	<u>\$ 17,500,481</u>	<u>\$ 89,476,779</u>	<u>\$ (89,070,960)</u>	<u>\$ 17,906,300</u>
	<u>Accrued at June 30, 1998</u>	<u>Operating Transfers Out</u>	<u>Distributions Paid</u>	<u>Accrued at June 30, 1999</u>
Capital Construction	\$ 7,504,477	\$ 11,091,795	\$ (18,596,272)	\$ -
Great Outdoors Colorado	1,476,277	31,231,743	(23,957,778)	8,750,242
Conservation Trust Fund	7,184,603	33,895,855	(34,080,266)	7,000,192
Division of Parks & Outdoor Recreation	<u>1,796,151</u>	<u>8,464,706</u>	<u>(8,510,810)</u>	<u>1,750,047</u>
	<u>\$ 17,961,508</u>	<u>\$ 84,684,099</u>	<u>\$ (85,145,126)</u>	<u>\$ 17,500,481</u>

8. **CONTINGENCIES AND COMMITMENTS**

Prize Annuities - The Colorado 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 Colorado Lottery retains title to the annuity contracts. The Colorado 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 March 10, 2024.

Specified Prize Payments	\$675,318,006
Lifetime prize payments	<u>51,479,000</u>
Total guaranteed minimum prize payments	<u>\$726,797,006</u>

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

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

The Colorado 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 the Colorado Governmental Immunity Act, section 24-10-101 are as follows:

<u>Liability</u>	<u>Limits of Liability</u>
General & Automobile	Each person \$150,000 Each occurrence \$600,000

During Fiscal Years 1999 (most recent information available), 1998, and 1997, medical claims against the State Employees and Officials Insurance Fund exceeded the premiums collected. This resulted in decreases in the medical reserve fund equity of approximately \$4.7 million, \$3.8 million and \$6.5 million, respectively. The fund includes several medical plan options ranging from provider of choice to managed care.

The fund also provides an employer paid short-term disability plan. This program provides employees with 60 percent 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.

There were no significant reductions or changes in insurance coverage from the prior year. With the exception of the short-term disability program of the State Employees and Officials Insurance Fund, settlements did not exceed insurance coverage in any of the past three fiscal years.

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 Colorado Lottery is responsible for the first \$1,000 of the deductible and the State of Colorado is responsible for the next \$14,000 of the deductible. Any loss in excess of \$15,000 is covered by the insurance carrier up to replacement cost.

Gaming Operations Commitments - The Colorado Lottery has entered into long term contracts with certain significant vendors related to providing scratch tickets and on-line data processing services in support of the Colorado Lottery's gaming operations. The on-line data processing contract expires October 31, 2000. The Colorado Lottery has exercised its option to extend the initial contract until October 31, 2004. The total amount to be paid on the on-line data contract shall not exceed \$51,800,000 over the period of the contract. The scratch ticket contract expires June 30, 2004 with one annual renewal available. Ticket rates are based upon ticket volume, physical size and design. The total cost of the contract for the initial contract period shall not exceed \$13,000,000.

Other Major Vendor Commitments - The Colorado Lottery entered into a long-term contract with an advertising agency to provide advertising services to promote the Colorado Lottery's products. The contract expires on June 30, 2002 with an option to renew up to three additional years through June 30, 2005. The total cost of the initial contract period shall not exceed \$16,320,000.

Litigation - A plaintiff has filed a class action suit claiming that the Colorado Lottery breached its contract with players by continuing to sell instant tickets in games in which the top prize has already been claimed. In the opinion of Lottery's management, the ultimate outcome of this matter will not have a material impact on the Lottery's financial statements.

9. 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 C.R.S. 24-77-102(17)(b)(ix), that the net proceeds from the Colorado 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 Colorado Lottery believes it is in compliance with both of these constitutional amendments.

10. RELATED PARTY TRANSACTIONS

The Colorado 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 Colorado Lottery also pays fees to the Department of Revenue for indirect costs. Interagency charges were \$736,675 and \$761,918 for the fiscal years ending June 30, 2000 and June 30, 1999, respectively.

11. APPROPRIATIONS

The details of appropriations legislated by the Colorado General Assembly (the Long Bill) and related expenditures by the Colorado Lottery for the year ended June 30, 2000 are as follows:

<u>FTE: 124.046</u>	Long Bill/ Roll Forward Augmenting Revenue	Supplemental Appropriations, Potted Funds, & Adjustments	Total Appropriations/ Augmenting Revenue	Expenditures	Roll- Forward	Excess Appropriations
Fixed Costs	\$ 10,329,608	\$ (109,799)	\$ 10,219,809	\$ 9,776,350	\$ -	\$ 443,459
Health and Life	-	249,304	249,304	246,456	-	2,848
Short Term Disability	-	16,165	16,165	12,130	-	4,035
Risk Management	-	17,023	17,023	17,023	-	-
Workmen's Compensation	-	56,899	56,899	56,899	-	-
Unemployment Insurance	-	1,823	1,823	939	-	884
Travel	137,720	-	137,720	129,596	-	8,124
Leased Space	662,390	-	662,390	575,051	-	87,339
Leased Space-Grand Junction	7,156	-	7,156	5,886	-	1,270
Indirect Costs	249,710	85,090	334,800	334,800	-	-
Marketing, Communications, & Sales	9,160,352	-	9,160,352	9,159,545	-	807
Ticket Costs-Scratch	4,327,577	414,823	4,742,400	3,675,208	-	1,067,192
Fund 461 - A/C Unit	100,000	-	100,000	76,428	-	23,572
IV & V Services	-	104,690	104,690	104,689	-	1
Info Tech Asset Maintenance	-	50,804	50,804	50,330	-	474
Roll Forward-Tech Review	97,500	-	97,500	97,500	-	-
Capital Outlay	102,000	-	102,000	47,901	14,605	39,494
Retailer Compensation	28,852,632	6,265,488	35,118,120	27,969,521	-	7,148,599
Prize Payments	241,354,411	-	241,354,411	223,575,542	-	17,778,869
Vendor Fees	<u>8,135,861</u>	<u>835,095</u>	<u>8,970,956</u>	<u>7,911,345</u>	-	<u>1,059,611</u>
TOTAL	<u>\$303,516,917</u>	<u>\$ 7,987,405</u>	<u>\$ 311,504,322</u>	#####	<u>\$14,605</u>	<u>\$ 27,666,578</u>

Reconciliation of Expenses per "Statement of Revenues, Expenses and Changes in Retained Earnings" to Budgeted Expenditures:

Expenses Per Statement of Revenues, Expenses and Changes in Retained Earnings

Prize Expense	#####
Commissions and Bonuses	27,969,521
Cost of Tickets & Vendor Fees	10,884,493
Operating Expenses	<u>20,992,432</u>
Total Expenses per Statement of Revenues, Expenses and Changes in Retained Earnings	283,421,988
Less: Non-appropriated expenses	
Depreciation	(570,489)
Accrued Annual and Sick Leave	5,417
Book Value of Assets Written-Off	<u>(52,588)</u>
Sub-Total	282,804,328
Plus: Capitalized Fixed Assets	<u>1,018,811</u>
	#####

SUPPLEMENTARY
SCHEDULES

COLORADO LOTTERY
SCHEDULE OF REVENUE AND COSTS FOR SCRATCH AND ON-LINE GAMES
FOR THE FISCAL YEAR ENDED JUNE 30, 2000

	Games in Progress			FY99-00	FY 98-99
	Scratch	Lotto	Cash 5	Total	Scratch and On-Line
GROSS TICKET SALES (Note 1)	\$233,999,764	\$ 125,474,093	\$ 11,482,491	\$ 370,956,348	\$ 368,404,165
PRIZE EXPENSE (Note 1)	<u>(151,278,145)</u>	<u>(65,725,357)</u>	<u>(6,572,040)</u>	<u>(223,575,542)</u>	<u>(224,940,615)</u>
NET REVENUE AFTER PRIZES	<u>82,721,619</u>	<u>59,748,736</u>	<u>4,910,451</u>	<u>147,380,806</u>	<u>143,463,550</u>
COMMISSIONS, BONUS, TICKET COSTS & VENDOR FEES (Note 2)					
Retailer Commission	(16,344,125)	(7,482,069)	(688,746)	(24,514,940)	(24,358,312)
Retailer Bonus	(2,529,663)	(818,282)	(106,636)	(3,454,581)	(3,429,486)
Cost of Tickets Sold	(3,675,210)	N/A	N/A	(3,675,210)	(3,944,446)
In-Lane Vendor Fees	(212,505)	(113,948)	(10,428)	(336,881)	(28,502)
On-Line Vendor Fees	<u>(1,086,873)</u>	<u>(5,231,644)</u>	<u>(553,885)</u>	<u>(6,872,402)</u>	<u>(6,791,303)</u>
TOTAL	<u>(23,848,376)</u>	<u>(13,645,943)</u>	<u>(1,359,695)</u>	<u>(38,854,014)</u>	<u>(38,552,049)</u>
GROSS PROFIT ON SALE OF TICKETS	<u>\$ 58,873,243</u>	<u>\$ 46,102,793</u>	<u>\$ 3,550,756</u>	<u>\$ 108,526,792</u>	<u>\$ 104,911,501</u>
AVERAGE DAILY TICKET SALES	<u>\$ 639,344</u>	<u>\$ 342,825</u>	<u>\$ 31,373</u>	<u>\$ 1,013,542</u>	<u>\$ 1,009,326</u>

Note 1: Gross ticket sales and prize expense excludes coupons

Note 2: Administrative costs of Lottery operations, including wages, advertising and other expenses are not shown.

COLORADO LOTTERY
SCHEDULE OF PERCENT OF PRIZE EXPENSE TO GROSS TICKET SALES
FOR THE FISCAL YEAR ENDED JUNE 30, 2000

	Games in Progress				FY 99-00
	Scratch	Lotto	Cash 5	Coupons	Total
Prize Expense	\$151,281,079	\$65,725,357	\$6,572,040	(\$2,934)	\$223,575,542
(/)/Ticket Sales before coupons	<u>234,002,955</u>	<u>125,475,804</u>	<u>11,482,648</u>	<u>(5,059)</u>	<u>370,956,348</u>
Prize %	<u>64.65%</u>	<u>52.38%</u>	<u>57.23%</u>	<u>58.00%</u>	<u>60.27%</u>

Report of Independent Certified Public Accountants
on Compliance and on Internal Control Over
Financial Reporting Based on an Audit of
Financial Statements Performed in Accordance
with *Government Auditing Standards*

Members of The Legislative Audit Committee

We have audited the financial statements of the Colorado Lottery (Lottery) as of and for the year ended June 30, 2000, and have issued our report thereon dated August 16, 2000. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Compliance

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

Internal Control Over Financial Reporting

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

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

Colorado Springs, Colorado
August 16, 2000

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d.b.a. General Support Services
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