

Compliance audit, financial statements and report  
of independent certified public accountants

[Colorado Lottery](#)

June 30, 2001 and 2000

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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, 2001

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**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, 2001.

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.

**Financial Audit Opinion**

We have issued an unqualified opinion dated August 17, 2001 (except for Note 14, as to which the date is August 24, 2001), on the Colorado Lottery's June 30, 2001, financial statements.

**Current Year  
Finding and Recommendation**

There is one current year recommendation, which is a restatement of a fiscal year ended June 30, 2000 recommendation that was partially implemented during fiscal year ended June 30, 2001. The recommendation relates to the service organization contractor, currently GTECH Corporation, who provides the Lottery an extensive computerized wagering system, including primary and back-up central computer systems, communications equipment and retailer sales terminals used for Lotto and Cash 5 games. Specifically, the recommendation is that the Colorado Lottery obtain annually a service auditor's report on the service organization's system of internal controls that may be relevant to the Lottery's internal control, in accordance with Statement on Auditing Standards (SAS) No. 70, *Reports on the Processing of Transactions by Service Organizations*. The Lottery agrees with this recommendation.

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

The prior report for the year ended June 30, 2000 included one recommendation. This recommendation has been partially implemented as discussed above. Also, there was one recommendation contained in the Office of the State Auditor's October 1999 financial review of the Colorado Lottery's use of coupons, which was only partially implemented as of June 30, 2000. This recommendation was fully implemented during the year ended June 30, 2001.

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RECOMMENDATION LOCATOR  
THE COLORADO LOTTERY  
AND THE LOTTERY COMMISSION

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| Rec. No. | Page No. | Recommendation Summary  | Agency Addressed | Agency Response | Implementation Date                         |
|----------|----------|---|------------------|-----------------|---|
| 1        | 9/10     | The Colorado Lottery should require that an independent certified public accounting firm perform an annual audit of the system of internal controls, that may be relevant to the Lottery's internal control, of the service organization contractor that provides the Lottery an extensive computerized wagering system. The audit should be performed in accordance with Statement on Auditing Standards (SAS) No. 70, <i>Reports on the Processing of Transactions by Service Organizations</i> . This audit requirement should be incorporated into any future contracts with such service organization providers. | Colorado Lottery | Agree           | During the fiscal year ending June 30, 2002 |

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## DESCRIPTION OF THE COLORADO LOTTERY AND THE LOTTERY COMMISSION

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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 2001, 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, and the Great Outdoors Colorado Trust Fund (GOCO). The amount distributed to GOCO is limited by a constitutional cap. Amounts exceeding the GOCO cap (the spill over) are distributed to the State's General Fund.

**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**FOR THE FISCAL YEAR ENDED JUNE 30, 2001**

This discussion and analysis of the Lottery's financial performance provides an overview of financial activities for the year ended June 30, 2001. Please read it in conjunction with the Lottery's financial statements, which begin on page 14.

**FISCAL YEAR 2001 FINANCIAL HIGHLIGHTS**

- The Lottery's overall sales performance decreased by \$20.3 million. A decrease in Lotto sales of \$36.5 million from the previous year was partly offset by record high Scratch sales of \$249.2 million, a \$15.2 million increase from the previous year, and by an increase in Cash 5 sales when two additional draws per week were added. These additional draws increased Cash 5 sales by \$1 million from the previous year.
- The decrease in Lotto sales affected proceeds distributions, which declined by \$10.2 million from the prior year's distributions. In all, the Lottery distributed \$79.3 million to the proceeds' recipients.
- Gross profit as a percent of sales decreased by .9 percent, a reflection of the increase in the prize fund from 60.3% to 61.2% of sales.

**USING THIS ANNUAL REPORT**

This annual report consists of a series of financial statements. The balance sheets provide information about the Lottery's assets and liabilities and reflect the Lottery's financial position as of June 30, 2001 and June 30, 2000. The statements of revenues, expenses, and changes in retained earnings report the activity of selling lottery products and the expenses related to such activity for the twelve month periods ended June 30, 2001 and June 30, 2000. And finally, the statements of cash flows outline the cash inflows and outflows related to the activity of selling lottery products for the same twelve-month periods.

**SALES ACTIVITIES**

Revenues from the sale of lottery products for the fiscal year ended June 30, 2001 were the sixth highest in the Lottery's nineteen-year history. As shown in the financial statements, sales decreased 5.5% from the prior year, from \$370.9 million in fiscal year ended June 30, 2000 to \$350.6 million in the current year. The increases in Scratch and Cash 5 sales were not large enough to offset a significant decrease in Lotto sales. Lotto sales are highly dependent on large jackpots. The current fiscal year had fewer large jackpots than recent years.

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

| <i>Product Sales</i> | <u>2001</u> | <u>2000</u> | <i>Difference</i> | <i>Percentage</i> |
|----------------------|-------------|-------------|-------------------|-------------------|
| Scratch              | \$249.2     | \$234.0     | \$15.2            | 6.5%              |
| Lotto                | 88.9        | 125.4       | -36.5             | -29.1%            |
| Cash 5               | 12.5        | 11.5        | 1.0               | 8.7%              |
| Total                | \$350.6     | \$370.9     | -\$20.3           | -5.5%             |

## **MAJOR EXPENSES**

Approximately \$251.1 million of the Lottery's total expenses of \$273.1 million for the fiscal year ended June 30, 2001, were incurred in direct support of Lottery games. These included prize expense, retailer compensation, money spent to purchase scratch tickets, and compensation to the vendor who maintains and supports the entire on-line gaming system.

In comparison, more than \$262.4 million of the Lottery's total expenses of \$283.4 million for the fiscal year ended June 30, 2000, were game-related expenses.

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

| <i>Game Related Expenses</i> | <u>2001</u> | <u>2000</u> | <i>Difference</i> | <i>Percentage</i> |
|------------------------------|-------------|-------------|-------------------|-------------------|
| Prize Expense                | \$214.4     | \$223.5     | -\$9.1            | -4.1%             |
| Retailer Compensation:       |             |             |                   |                   |
| Commissions                  | 23.5        | 24.5        | -1.0              | -4.1%             |
| Bonuses                      | 3.4         | 3.5         | -0.1              | -2.9%             |
| Ticket Costs                 | 3.2         | 3.7         | -0.5              | -13.5%            |
| Vendor Fees                  | 6.6         | 7.2         | -0.6              | -8.3%             |
| Total                        | \$251.1     | \$262.4     | -\$11.3           | -4.3%             |

The decrease in all game-related expenses is reflective of the decrease in product sales. See the product sales schedule above. The large percentage decrease in ticket costs is a result of contract changes, which lowered the overall cost of purchasing tickets. The large percentage decrease in vendor fees results from the decline in Lotto sales.

Of the \$22 million in fiscal year 2001 expenses that were not game-related, close to \$9.4 million was used to advertise and promote Lottery and its games, and \$7.4 million was used to compensate Lottery employees. In comparison, of the remaining \$21 million in fiscal year 2000 expenses, just over \$8.4 million was used to advertise and promote the Lottery, and \$7.3 million was used to compensate Lottery employees. The increase in advertising and promotion expenses occurred because a large capital investment was made using marketing funds in fiscal year 2000 which is being expensed over five years beginning in fiscal year 2001.



## **OTHER FINANCIAL INFORMATION**

The Lottery's total assets at year end June 30, 2001 were \$41.4 million. Assets consisted primarily of cash and investments with the State Treasury of more than \$25 million, receivables from Lottery retailers for the sale of Lottery products of \$12.5 million, and a net investment in fixed assets of \$2.2 million.

Comparable figures at June 30, 2000, were \$37.6 million in total assets, including nearly \$23 million in cash and investments with the State Treasury, \$10.6 million in receivables from retailers, and \$2.5 million net investment in fixed assets.

The Lottery's total liabilities at June 30, 2001 totaled \$39.6 million, consisting primarily of proceeds distributions due to recipients of \$20 million and prize liability on all Lottery products of \$15.1 million.

The Lottery's total liabilities at the prior year end totaled \$36.4 million, which consisted primarily of proceeds distributions of \$17.9 million and prize liability on all Lottery products of \$14.9 million.

Components of the Lottery's net assets are a bonding reserve funded by retailers to cover any uncollectible receivable accounts and a reserve of \$1 million set aside by the Lottery Commission and are adjusted by the Lottery's share of unrealized gains or losses on investments held by the State Treasurer. The change in net assets between fiscal year 2000 and fiscal year 2001 consisted of a minor increase in the bonding reserve from \$361,143 to \$411,629 and the net effect of unrealized gains on investments of \$607,612.

Following is a schedule of net assets as of June 30,:

|  | <u>2001</u>        | <u>2000</u>        |
|--|--------------------|--------------------|
| Reserve approved by the Lottery Commission | \$1,000,000        | \$1,000,000        |
| Unrealized Gain (Loss) on Investments      | 391,544            | (216,068)          |
| Bonding Reserve                            | <u>411,629</u>     | <u>361,143</u>     |
| Total Net Assets                           | <u>\$1,803,173</u> | <u>\$1,145,075</u> |

## **DISTRIBUTIONS TO PROCEEDS' RECIPIENTS**

The Lottery's efforts generated net proceeds distributions of \$79.3 million in the current fiscal year. Of these total proceeds, \$39.7 million was allocated to Great Outdoors Colorado Trust Fund, \$31.7 million to the Conservation Trust Fund, and \$7.9 million to the Division of State Parks and Recreation per the distribution formula stated in the Colorado Revised Statutes (C.R.S.) 24-35-210. The maximum distribution to Great Outdoors Colorado of \$44.8 million pursuant to C.R.S. 33-60-104 (1) (c) and 33-60-104 (2) was not reached, thus no spill over into the State's General Fund occurred.

The Lottery's proceeds distributions for the prior year totaled \$89.5 million. The maximum of \$43.5 million was distributed to Great Outdoors Colorado, \$35.8 million to the Conservation Trust Fund, and \$8.9 million to the Division of State Parks and Recreation. A spill over of \$1.3 million from the Great Outdoors Colorado share went to the State's General Fund.

### **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 (called the Long Bill) which determines budgets for every agency within the state. Agencies may also request a supplemental appropriation during the fiscal year to cover unexpected expenses. In the third quarter of fiscal year 2001, the Legislature approved supplemental appropriations to adjust for changes in estimated sales levels and other unforeseen needs. Supplemental appropriations were approved in personal services, indirect costs, and vendor fees, offset by reductions in the operating, vehicle lease payments, ticket costs, and retailer compensation lines. The final method of funding is special legislation. In 2001, the Legislature approved an allocation of \$400,000 for multi-state gaming development through special legislation (Senate Bill 84) to cover the initial start-up costs associated with joining a multi-state lottery group. The legislation was necessary to allow the Lottery to comply with the voters' wishes in passing Referendum E in the November 2000 election. This funding allows the Lottery to participate in multi-state gaming starting early in fiscal year 2002.

The approved Lottery budget at the beginning of the year was \$308.4 million. Supplemental appropriations and adjustments made in the third quarter increased the budget by \$750,000 to a total of \$309.1 million. Total expenditures and roll-forwards for fiscal year 2001 came to \$272.8 million, resulting in excess appropriations or savings of more than \$36.3 million.

### **ECONOMIC FACTORS AND NEXT YEAR'S BUDGET**

The Lottery considered several factors when setting the revenue estimates and the fiscal year 2002 budget. Recently, Colorado has experienced significant population growth and a strong economy. Although the economy has slowed, Colorado continues to experience relatively low unemployment and to support a highly educated and well-paid work force. The strong performance of Scratch games, stable sales of Cash 5, and the introduction of a new on-line multi-state game, Powerball, give the Lottery confidence that fiscal year 2002 sales will improve. Fiscal year 2002 revenue estimates total \$408.4 million, a \$57.8 million increase over fiscal year 2001 actual sales.

In addition to normal increases in costs, there will be three other major changes in costs in fiscal year 2002 which will include increased legal service costs, unanticipated multi-state game costs, and cost savings in the leasing of scratch ticket vending machines.

## **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 2001 and to demonstrate the Lottery's accountability for the money it received from the sale of lottery products. If you have questions about this report or need additional information, contact the Colorado Lottery's Chief Financial Officer, 201 West 8<sup>th</sup> Street, Suite 600, Pueblo, Colorado 81003.

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## FINDING AND RECOMMENDATION

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### EVALUATION OF CONTROLS OVER CONTRACTOR'S EXTERNAL COMPUTER SYSTEMS

The Colorado Lottery currently 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. 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.

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. 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, Lottery has additional controls relating to the financial data processed by GTECH, using a 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 large volume of information that is processed by GTECH for the Lottery, the need exists to evaluate, on an annual basis, 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 internal controls are suitably designed to achieve specified control objectives, are placed in operation, and are operating with sufficient effectiveness to ensure that control objectives were achieved during the period specified. In addition, a SAS 70 audit could identify weaknesses in GTECH's controls that may need to be corrected or improved in order to prevent system problems and potential lost sales for the Lottery. Because audits under SAS 70 address specific time frames being audited and the fact that control systems do change, a SAS 70 audit should be conducted annually. In the event GTECH is replaced with another service organization contractor, this recommendation would also be applicable to that successor contractor.

The Colorado Lottery engaged Jefferson Wells International (JWI), an international professional services consulting firm, to perform certain professional information technology (IT) audit services related to GTECH Colorado's system of internal controls for the fiscal year ended June 30, 2001. Procedures performed by JWI were designed to identify and report security problems, if any, in GTECH Colorado's Systems. Procedures performed/areas tested by JWI included external penetration testing, dial-up networking, review network topology and management, open VMS operating system, review the Unix server, review the security parameters for NT servers, review network infrastructure components, the firewall and maintenance procedures, review security and transaction controls, review data security policies and procedures and review business continuity and environmental controls. JWI's report contains certain recommendations that the Lottery will be addressing during fiscal year ending June 30, 2002. A SAS 70 audit would both assess the status of implementation of those recommendations while also focusing on other control features as required under that pronouncement.

A SAS 70 audit results in an opinion being expressed by the auditor as to whether the service organization's controls that may be relevant to the Lottery as it relates to an audit of its financial statements are properly described, suitably designed to provide reasonable assurance that the control objectives would be achieved if those controls were complied with satisfactorily, and that the controls are placed in operation as of a specified date. The auditor must identify causative factors for exceptions, determine the current status of corrective actions, and provide other relevant qualitative information about exceptions noted.

**Recommendation No. 1**

The Colorado Lottery should require that an independent certified public accounting firm perform an annual audit of the system of internal controls, that may be relevant to the Lottery's internal control, of the service organization contractor that provides the Lottery an extensive computerized wagering system. The audit should be performed in accordance with Statement on Auditing Standards (SAS) No. 70, *Reports on the Processing of Transactions by Service Organizations*. This audit requirement should be incorporated into any future contracts with such service organization providers.

**Colorado Lottery Response**

Agree. This recommendation will be implemented during the fiscal year ending June 30, 2002.

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## DISPOSITION OF PRIOR AUDIT RECOMMENDATIONS

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The prior report for the year ended June 30, 2000 included the following recommendation (#1). Recommendation #2 was contained in the Office of the State Auditor's October 1999 financial review of the Colorado Lottery's use of coupons and was only partially implemented at June 30, 2000. We have incorporated herein these recommendations in order to provide their disposition.

| <b>Recommendation No.</b>   | <b>Disposition</b>  |
|---|---|
| 1. 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. | Partially implemented-The Colorado Lottery engaged Jefferson Wells International, an international professional services consulting firm, to perform certain professional information technology audit services for GTECH Colorado. The Lottery believes the procedures performed by Jefferson Wells International were sufficient to provide assurance on the sufficiency of internal controls at GTECH Colorado for the fiscal year ended June 30, 2001. See Recommendation No. 1. on pages 9 and 10. |
| 2. 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.   | Implemented – The Colorado Lottery worked with the Lottery Commission to make two rules which established 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 and became effective in fiscal year 2001.  |

## 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, 2001 and 2000, 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, 2001 and 2000, 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 17, 2001, 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 audit.

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, 2001 and 2000. 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 17, 2001 (except for note 14, as to which  
the date is August 24, 2001)



COLORADO LOTTERY  
BALANCE SHEETS  
JUNE 30, 2001 AND 2000

| ASSETS   | <u>2001</u>              | <u>2000</u>              |
|--|--------------------------|--------------------------|
| Current Assets:  |                          |                          |
| Cash and Investments   | \$ 25,127,648            | \$ 22,596,097            |
| Accounts Receivable, net of allowance for doubtful accounts of<br>\$109,012 in 2001 and \$85,939 in 2000 | 12,531,904               | 10,567,742               |
| Game Prizes Inventory, at Cost   | 100,950                  | -                        |
| Consignment Inventory, at Cost   | 112,029                  | 224,134                  |
| Warehouse Inventory, at Cost   | 933,844                  | 1,279,447                |
| Prepaid Expenses   | <u>36,233</u>            | <u>30,237</u>            |
| <br>Total Current Assets   | <br><u>38,842,608</u>    | <br><u>34,697,657</u>    |
| Restricted Assets:   |                          |                          |
| Cash and Investments-Licensed Agent Recovery<br>Reserve Receipts   | <u>411,629</u>           | <u>361,143</u>           |
| <br>Total Restricted Assets  | <br><u>411,629</u>       | <br><u>361,143</u>       |
| Fixed Assets:  |                          |                          |
| Equipment  | 5,909,997                | 5,993,933                |
| Leasehold Improvements   | 330,936                  | 330,936                  |
| Less Accumulated Depreciation and Amortization   | <u>(4,062,156)</u>       | <u>(3,806,353)</u>       |
| <br>Total Fixed Assets   | <br><u>2,178,777</u>     | <br><u>2,518,516</u>     |
| <br>TOTAL ASSETS   | <br><u>\$ 41,433,014</u> | <br><u>\$ 37,577,316</u> |
| <br>LIABILITIES & RETAINED EARNINGS  |                          |                          |
| Liabilities:   |                          |                          |
| Accounts Payable   | \$ 2,247,404             | \$ 1,498,802             |
| Wages and Benefits   | 284,667                  | 305,642                  |
| Funds Available for Distribution   | 20,049,451               | 17,906,300               |
| Prize Liability  | 15,131,994               | 14,920,709               |
| Retailer Bonus Liability   | 553,574                  | 516,783                  |
| Deferred Revenue   | 442,683                  | 423,012                  |
| Accrued Annual and Sick Leave  | 801,016                  | 746,110                  |
| Expired Warrants Liability   | <u>119,052</u>           | <u>114,883</u>           |
| <br>Total Liabilities  | <br><u>39,629,841</u>    | <br><u>36,432,241</u>    |
| Retained Earnings:   |                          |                          |
| Unreserved   | 1,391,544                | 783,932                  |
| Reserved   |                          |                          |
| Licensed Agent Recovery Reserve  | <u>411,629</u>           | <u>361,143</u>           |
| <br>Total Retained Earnings  | <br><u>1,803,173</u>     | <br><u>1,145,075</u>     |
| <br>TOTAL LIABILITIES & RETAINED EARNINGS  | <br><u>\$ 41,433,014</u> | <br><u>\$ 37,577,316</u> |

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, 2001 AND 2000

|   | <u>2001</u>         | <u>2000</u>         |
|---|---------------------|---------------------|
| GROSS TICKET SALES                                | \$ 350,632,668      | \$ 370,956,348      |
| PRIZE EXPENSE                                     | (214,416,164)       | (223,575,542)       |
| COMMISSIONS, BONUSSES, AND TICKET COSTS           |                     |                     |
| Retailer Commissions and Bonuses                  | (26,826,812)        | (27,969,521)        |
| Cost of Tickets and Vendor Fees                   | <u>(9,810,954)</u>  | <u>(10,884,493)</u> |
| GROSS PROFIT ON SALE OF TICKETS                   | <u>99,578,738</u>   | <u>108,526,792</u>  |
| OPERATING EXPENSES                                |                     |                     |
| Marketing and Communications                      | 9,354,947           | 8,409,545           |
| Wages and Benefits                                | 7,413,304           | 7,259,948           |
| Professional Services                             | 412,281             | 329,238             |
| State Agencies Services                           | 209,766             | 94,658              |
| Department of Revenue Services                    | 347,686             | 334,800             |
| Travel  | 135,314             | 129,596             |
| Equipment   | 172,310             | 116,910             |
| Depreciation                                      | 603,190             | 570,489             |
| Accrued Annual and Sick Leave                     | 54,668              | (5,417)             |
| Space Rental                                      | 622,187             | 561,304             |
| Rents for Equipment                               | 637,838             | 1,061,459           |
| Motorpool Leasing                                 | 346,191             | 299,050             |
| Materials and Supplies                            | 84,621              | 105,102             |
| Telephone   | 172,486             | 159,586             |
| On-Line Telecommunications                        | 797,693             | 970,125             |
| Data Processing Supplies and Services             | 107,455             | 35,839              |
| Equipment Maintenance                             | 268,942             | 253,782             |
| Postage   | 76,415              | 63,465              |
| Printing  | 58,247              | 76,589              |
| Other   | <u>164,298</u>      | <u>166,364</u>      |
| TOTAL OPERATING EXPENSES                          | <u>22,039,839</u>   | <u>20,992,432</u>   |
| OPERATING INCOME                                  | 77,538,899          | 87,534,360          |
| Other Revenue                                     | 175,861             | 165,397             |
| Interest Income                                   | <u>2,227,777</u>    | <u>1,639,980</u>    |
| INCOME BEFORE OTHER EXPENSES                      | 79,942,537          | 89,339,737          |
| LESS PROCEEDS DISTRIBUTIONS:                      |                     |                     |
| Funds Distributed for Current Year                | (59,234,988)        | (71,570,479)        |
| Funds Available for Distribution for Current Year | <u>(20,049,451)</u> | <u>(17,906,300)</u> |
| NET INCOME (LOSS)                                 | <u>658,098</u>      | <u>(137,042)</u>    |
| RETAINED EARNINGS, BEGINNING OF YEAR              | 1,145,075           | 1,282,117           |
| Net Income (Loss)                                 | <u>658,098</u>      | <u>(137,042)</u>    |
| RETAINED EARNINGS, END OF YEAR                    | <u>\$ 1,803,173</u> | <u>\$ 1,145,075</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, 2001 AND 2000

|   | <u>2001</u>          | <u>2000</u>          |
|---|----------------------|----------------------|
| Cash flows from operating activities:   |                      |                      |
| Cash received from retailers  | \$ 347,998,331       | \$ 371,732,451       |
| Cash paid in prizes   | (214,263,303)        | (222,312,979)        |
| Cash paid in retailer commissions   | (23,448,954)         | (24,514,940)         |
| Cash payments to suppliers  | (22,627,794)         | (24,067,210)         |
| Cash payments to employees for services   | (7,241,345)          | (7,050,784)          |
| Cash received from Lotto subscription sales   | 786,519              | 798,721              |
| Cash paid in retailer bonus   | (3,350,384)          | (3,461,530)          |
| Cash received (used) - other  | <u>(56,854)</u>      | <u>25,478</u>        |
| Net cash provided by operating activities   | <u>77,796,216</u>    | <u>91,149,207</u>    |
| Cash flows from noncapital financing activities:  |                      |                      |
| Distribution of net proceeds  | <u>(77,141,288)</u>  | <u>(89,070,960)</u>  |
| Cash flows from capital and related financing activities:   |                      |                      |
| Acquisition of capital assets   | <u>(300,668)</u>     | <u>(1,018,811)</u>   |
| Cash flows from investing activities:   |                      |                      |
| Interest received   | 1,620,165            | 1,827,572            |
| Unrealized gain (loss) on investments   | <u>607,612</u>       | <u>(187,592)</u>     |
| Net cash provided by investing activities   | <u>2,227,777</u>     | <u>1,639,980</u>     |
| Net increase in cash and investments  | 2,582,037            | 2,699,416            |
| Cash and investments, Beginning of Year (including \$361,143 and \$310,593, respectively, in restricted accounts) | <u>22,957,240</u>    | <u>20,257,824</u>    |
| Cash and investments, End of Year (including \$411,629 and \$361,143, respectively, in restricted accounts)       | <u>\$ 25,539,277</u> | <u>\$ 22,957,240</u> |
| <i>Reconciliation of operating income to net cash provided by operating activities:</i>                           |                      |                      |
| <i>Operating income</i>   | \$ 77,538,899        | \$ 87,534,360        |
| <i>Adjustments to reconcile operating income to net cash provided by operating activities</i>                     |                      |                      |
| <i>Depreciation</i>   | 603,190              | 570,489              |
| <i>Loss on disposition of equipment</i>   | 37,217               | 52,588               |
| <i>Other revenue</i>  | 175,861              | 165,397              |
| <i>Change in:</i>   |                      |                      |
| <i>Accounts Receivable</i>  | (1,964,162)          | 2,323,489            |
| <i>Ticket Inventory</i>   | 457,708              | 137,449              |
| <i>Other Assets</i>   | (106,946)            | (11,329)             |
| <i>Liabilities (excluding funds available for distribution)</i>   | <u>1,054,449</u>     | <u>376,764</u>       |
| <i>Net cash provided by operating activities</i>  | <u>\$ 77,796,216</u> | <u>\$ 91,149,207</u> |

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

**COLORADO LOTTERY  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2001 AND 2000**

**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, 2001 and 2000. 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 provisions 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 \$109,012 and \$85,939 as of June 30, 2001 and June 30, 2000, 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 provisions 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 11).

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 \$5,131,470 for the fiscal year ended June 30, 2001 and \$3,274,498 for the fiscal year ended June 30, 2000. The fiscal year 2001 increase in net unclaimed scratch prizes from fiscal year 2000 was the result of an increase in the number of scratch games ended. In fiscal year ended June 30, 2001, there was a total of thirty-nine games ended as compared with twenty-seven games ended in fiscal year 2000.

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 \$5,029,929 for the fiscal year ended June 30, 2001 and \$2,901,608 for the fiscal year ended June 30, 2000. The fiscal year 2001 increase in net unclaimed on-line prizes from fiscal year 2000 was primarily the result of an unclaimed Lotto jackpot of \$2,250,000, which expired in February 2001.

#### K. 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, 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, 2001</u> | <u>June 30, 2000</u> | <u>Increase/<br/>(Decrease)</u> |
|---------------------------|----------------------|----------------------|---------------------------------|
| Annual Leave              | \$ 636,961           | \$ 590,746           | \$ 46,215                       |
| Sick Leave                | <u>161,187</u>       | <u>152,734</u>       | <u>8,453</u>                    |
| Total Annual & Sick Leave | 798,148              | 743,480              | 54,668                          |
| Compensatory Time         | <u>2,868</u>         | <u>2,630</u>         | <u>238</u>                      |
| Total Compensated Leave   | <u>\$ 801,016</u>    | <u>\$ 746,110</u>    | <u>\$ 54,906</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. 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, 2001 and 2000, is as follows:

|                        | <u>2001</u>       | <u>2000</u>       |
|------------------------|-------------------|-------------------|
| Subscription           | \$ 279,710        | \$ 280,122        |
| Advance play-Lotto     | 149,721           | 127,944           |
| Advance play-Cash 5    | <u>13,252</u>     | <u>14,946</u>     |
| Total Deferred Revenue | <u>\$ 442,683</u> | <u>\$ 423,012</u> |

P. 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 promotions and can be redeemed at any retailer for a lottery product. During the fiscal years ended June 30, 2001 and 2000, 17,778 and 5,059 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, 2001 and 2000, 73,304 and 111,600 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, 2001 and 2000, \$60,315 and \$81,854, 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.

## 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, 2001 and 2000 is as follows:

|   | <u>2001</u>              | <u>2000</u>              |
|---|--------------------------|--------------------------|
| Petty Cash  | \$ 1,550                 | \$ 1,550                 |
| Change Funds  | 90,300                   | 90,025                   |
| Imprest Fund  | 278,649                  | 350,000                  |
| Depository Account  | 18,621                   | 18,447                   |
| Cash on Deposit with State Treasurer                              | <u>24,738,528</u>        | <u>22,136,075</u>        |
| <br>TOTAL UNRESTRICTED CASH                                       | <br><u>25,127,648</u>    | <br><u>22,596,097</u>    |
| <br>Cash Restricted - Licensed Agent Recovery<br>Reserve Receipts | <br><u>411,629</u>       | <br><u>361,143</u>       |
| <br>TOTAL RESTRICTED CASH   | <br><u>411,629</u>       | <br><u>361,143</u>       |
| <br>TOTAL CASH  | <br><u>\$ 25,539,277</u> | <br><u>\$ 22,957,240</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 2000-01 was approximately 6.03 percent. The current yield is approximately 5.54 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, 2001 the Colorado Lottery had cash with a carrying value of \$297,270, and a bank balance of \$337,580 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

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, 2000</u> | <u>Additions</u>    | <u>Deletions</u>  | <u>June 30, 2001</u> |
|------------------------|----------------------|---------------------|-------------------|----------------------|
| Equipment              | \$ 5,993,933         | \$ 300,668          | \$ 384,604        | \$ 5,909,997         |
| Leasehold Improvements | <u>330,936</u>       | <u>0</u>            | <u>0</u>          | <u>330,936</u>       |
| TOTAL                  | <u>\$ 6,324,869</u>  | <u>\$ 300,668</u>   | <u>\$ 384,604</u> | <u>\$ 6,240,933</u>  |
|                        | <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>  |

#### **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 Wells Fargo 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, 2001 through June 30, 2003. 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, 2001 and 2000 and future minimum lease payments are as follows:

| Location           | Expense            |                    | Future Minimum Lease Payments |                  |                  |                  |                  |
|--------------------|--------------------|--------------------|-------------------------------|------------------|------------------|------------------|------------------|
|                    | 2000               | 2001               | FY 2002                       | FY 2003          | FY 2004          | FY 2005          | FY 2006          |
| Pueblo Office      | \$226,978          | \$ 238,318         | \$ 250,336                    | \$262,692        | \$275,900        | \$289,773        | \$ 0             |
| Pueblo Warehouse   | 32,637             | 32,637             | 32,637                        | 0                | 0                | 0                | 0                |
| Interlott          | 1,028,696          | 589,104            | 653,500                       | 0                | 0                | 0                | 0                |
| Co Sprgs Warehouse | 12,065             | 12,612             | 13,196                        | 13,812           | 0                | 0                | 0                |
| Denver Office      | 185,445            | 185,411            | 191,392                       | 197,373          | 203,354          | 209,335          | 215,316          |
| Denver Warehouse   | 61,644             | 107,049            | 94,997                        | 97,805           | 100,612          | 16,844           | 0                |
| Fort Collins       | 14,793             | 20,966             | 0                             | 0                | 0                | 0                | 0                |
| Grand Junction     | <u>5,886</u>       | <u>4,883</u>       | <u>0</u>                      | <u>0</u>         | <u>0</u>         | <u>0</u>         | <u>0</u>         |
|                    | <u>\$1,568,144</u> | <u>\$1,190,980</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, 2001 and 2000 follows:

|                             | <u>2001</u>       | <u>2000</u>       |
|-----------------------------|-------------------|-------------------|
| License Fees                | \$ 45,519         | \$ 47,374         |
| Fines & Penalties           | 27,450            | 32,100            |
| Assignment Fees             | 10,033            | 8,302             |
| Net Licensed Agent Recovery |                   |                   |
| Reserve Receipts            | 50,486            | 50,550            |
| Ended Game Revenue          | 0                 | 11,763            |
| Other                       | <u>42,373</u>     | <u>15,308</u>     |
| Total                       | <u>\$ 175,861</u> | <u>\$ 165,397</u> |

## 6. LOTTERY FUND RETAINED EARNINGS

In accordance with C.R.S. 24-35-210(4.1) (a), the Lottery Commission shall, reserve "...sufficient moneys, as of the end of the fiscal year, 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, 2001 and June 30, 2000 are composed of the following:

|   | <u>2001</u>         | <u>2000</u>       |
|---|---------------------|-------------------|
| Reserve approved by Commission              | \$ 1,000,000        | \$ 1,000,000      |
| Plus: Unrealized Gain (Loss) on Investments | <u>391,544</u>      | <u>(216,068)</u>  |
|   | <u>\$ 1,391,544</u> | <u>\$ 783,932</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 of the State of Colorado as set forth in 33-60-104 (1) (c) and 33-60-104 (2).

Income Available for Distribution at June 30:

|  | <u>2001</u>          | <u>2000</u>          |
|--|----------------------|----------------------|
| Income Before Other Expenses                         | \$ 79,942,537        | \$ 89,339,737        |
| Less: Increase in licensed agent<br>recovery reserve | (50,486)             | (50,550)             |
| Plus: Unrealized (gains) losses on investments       | <u>(607,612)</u>     | <u>187,592</u>       |
| Income Available for Distribution                    | 79,284,439           | 89,476,779           |
| Less: Prior Distributions                            | <u>(59,234,988)</u>  | <u>(71,570,479)</u>  |
| Income Available for Distribution                    | <u>\$ 20,049,451</u> | <u>\$ 17,906,300</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:

|   | Accrued at<br><u>June 30, 2000</u> | Proceeds<br>Distributions<br><u>Expense</u> | Distributions<br><u>Paid</u> | Accrued at<br><u>June 30, 2001</u> |
|---|------------------------------------|---|------------------------------|------------------------------------|
| Great Outdoors Colorado                   | \$ 7,702,861                       | \$ 39,642,222                               | \$ (37,320,357)              | \$ 10,024,726                      |
| General Fund                              | 1,250,290                          | 0   | (1,250,290)                  | 0                                  |
| Conservation Trust Fund                   | 7,162,520                          | 31,713,775                                  | (30,856,514)                 | 8,019,781                          |
| Division of Parks & Outdoor<br>Recreation | <u>1,790,629</u>                   | <u>7,928,442</u>                            | <u>(7,714,127)</u>           | <u>2,004,944</u>                   |
|   | <u>\$ 17,906,300</u>               | <u>\$ 79,284,439</u>                        | <u>\$ (77,141,288)</u>       | <u>\$ 20,049,451</u>               |
|   | Accrued at<br><u>June 30, 1999</u> | Operating<br><u>Transfers Out</u>           | Distributions<br><u>Paid</u> | Accrued at<br><u>June 30, 2000</u> |
| Great Outdoors Colorado                   | \$ 8,750,242                       | \$ 43,488,104                               | \$ (44,535,485)              | \$ 7,702,861                       |
| General Fund                              | 0                                  | 1,250,290                                   | 0                            | 1,250,290                          |
| Conservation Trust Fund                   | 7,000,192                          | 35,790,712                                  | (35,628,384)                 | 7,162,520                          |
| Division of Parks & Outdoor<br>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>               |

## 8. 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. Members are also eligible for retirement benefits without a reduction for early retirement if they are at least 55 and have a minimum of 5 years of service credit, and their age plus years of service equals 80 or more. 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. 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.

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 gross covered wages to an individual account in the plan.

During FY 00-01, the state contributed 10.4 percent (13.1 percent for state troopers and 14.0 percent for the Judicial Branch) of the employee's gross covered wages, which was allocated by PERA before January 1, 2001, as follows:

- 1.1 percent was allocated to the Health Care Trust Fund.
- 9.3 percent was allocated to the defined benefit plan.

After January 1, 2001, the state contribution was allocated to three separate programs by PERA according to a statutory change in funding policy:

- 1.42 percent was allocated to the Health Care Trust Fund.
- The amount needed to meet the match requirement established by the PERA Board was allocated to the Matchmaker Program (See Note 9 below).
- The balance remaining after allocations to the Matchmaker Program and the Health Care Trust Fund was allocated to the defined benefit plan.

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 the three programs described above for the fiscal years ended June 30, 2001, 2000, and 1999, were \$611,262, \$646,744, and \$623,831, respectively. These contributions met the contribution requirement for each year.



## **9. VOLUNTARY TAX-DEFERRED RETIREMENT PLANS**

Beginning on January 1, 2001, the Matchmaker Program established a state match for PERA members' voluntary contributions to tax-deferred retirement plans. The match was 100 percent of up to 3 percent of employees' gross covered wages paid during the month (7 percent for judges in the Judicial Branch). The PERA Board sets the level of the match annually based on the actuarial funding of the defined benefit pension plan. Two percent of gross salary plus fifty percent of any reduction in the overall contribution rate due to overfunding of the pension plan was available for the match. PERA offers a voluntary 401(k) plan entirely separate from the defined benefit pension plan. The state offers a 457 deferred compensation plan and certain agencies and institutions of the state offer a 403(b) plan. Members who contribute to any of these plans also receive the state match.

## **10. POST RETIREMENT HEALTH CARE AND LIFE INSURANCE BENEFITS**

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. 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 the fiscal year ended June 30, 2001, the premium subsidy was \$115.00 for those with 20 years of service credit (\$230.00 for members under age 65), and it was reduced by 5 percent for each year of service fewer than 20. Medicare eligibility also affects the premium subsidy.

The Health Care Trust Fund is maintained by an employer's contribution as discussed above in note 8.B.

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. As of December 31, 2000 there were approximately 35,162 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.

## 11. 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 November 2, 2024.

|   |                          |
|---|--------------------------|
| Specified prize payments                    | \$648,160,289            |
| Lifetime prize payments                     | <u>50,005,000</u>        |
| <br>Total guaranteed minimum prize payments | <br><u>\$698,165,289</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 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<br>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 (SEOGI) 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. In fiscal year 2000, SEOGI began purchasing insurance to address the continuing decrease in the medical reserve fund equity. 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 SEOGI, 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. 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, 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 contracts expire June 30, 2004 with one annual renewal available on each contract. Ticket rates are based upon ticket volume, physical size and design. The total costs of the contracts for the initial contract period shall not exceed \$13,000,000 and \$3,000,000, respectively.

The Colorado Lottery was approved as a member of the Multi-State Lottery Association (MUSL) on February 26, 2001 and thus entered into an agreement with MUSL on June 6, 2001 to become a member. As a member, the Colorado Lottery agrees to abide by the terms of the Multi-State Agreement and to any amendments to that agreement duly made by the board. The Colorado Lottery will remain a member indefinitely. Pursuant to this agreement the Colorado Lottery will make payments to MUSL for administrative fees, Powerball Game Show production costs, weekly prize expenses, promotional purchases, miscellaneous reimbursements and assessments and contributions to the prize reserves. The amounts to be paid are undeterminable as of June 30, 2001.

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.

## **12. 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.

## **13. 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 \$947,762 and \$736,675 for the fiscal years ended June 30, 2001 and June 30, 2000, respectively.

## **14. SUBSEQUENT EVENTS**

The Colorado Lottery, as a member of the Multi-State Lottery Association, sold its first Powerball Scratch Ticket tied to the Powerball Game Show on July 16, 2001. The first ticket for the Powerball on-line game sold in Colorado on August 2, 2001, with the first Powerball drawing including Colorado being held on August 4, 2001. As of the close of business on August 24, 2001 Powerball on-line and scratch game sales exceeded \$17 million, which after the payment of game costs such as prizes, commissions, vendor fees, and retailer bonuses, contributed nearly \$5 million to the gross profit of the Lottery.

With the sale of the first Powerball on-line ticket on August 2, 2001, the Lottery was required to start transferring funds to MUSL in payment of the Colorado Lottery's share of the Powerball on-line game cash reserves. These cash reserves represent potential prize payments, which are held in trust to be used in unusual and unforeseen circumstances for the payment of prizes. If the Colorado Lottery chooses to leave the MUSL organization in the future, the Lottery's share of the balances in the cash reserve accounts will be refunded. The total amount to be paid over a twenty four (24) month period starting August 2001, is approximately \$5.1 million.

## 15. 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, 2001 are as follows:

| FTE: 123.56                          | Long Bill/<br>Roll Forward<br>Augmenting<br>Revenue | Supplemental<br>Appropriations,<br>Potted Funds,<br>& Adjustments | Total<br>Appropriations/<br>Augmenting<br>Revenue | Expenditures         | Roll-<br>Forward | Excess<br>Appropriations |
|--------------------------------------|---|---|---|----------------------|------------------|--------------------------|
| Personal Services                    | \$ 6,877,428  | \$ 438,710  | \$ 7,316,138                                      | \$ 7,262,754         | \$ -             | \$ 53,384                |
| Operating                            | 2,036,902   | (110,496)   | 1,926,406   | 1,899,162            | 21,159           | 6,085                    |
| Vehicle Lease Payments               | 299,365   | (79,294)  | 220,071   | 214,894              | -                | 5,177                    |
| Purchased Services - Computer Center | 3,748   | -   | 3,748   | 3,234                | -                | 514                      |
| Telecommunications                   | 529,189   | -   | 529,189   | 306,970              | -                | 222,219                  |
| Payments to Other Agencies           | 173,688   | -   | 173,688   | 160,401              | -                | 13,287                   |
| Legal Services                       | 37,114  | -   | 37,114  | 37,114               | -                | -                        |
| Workers' Compensation                | -   | 49,918  | 49,918  | 49,918               | -                | -                        |
| Unemployment Benefits                | -   | 1,823   | 1,823   | 1,823                | -                | -                        |
| Health and Life                      | -   | 278,213   | 278,213   | 278,213              | -                | -                        |
| Short Term Disability                | -   | 2,214   | 2,214   | 2,214                | -                | -                        |
| Leased Space                         | 681,455   | 8,797   | 690,252   | 641,514              | -                | 48,738                   |
| Leased Space - Grand Junction        | 5,480   | -   | 5,480   | 4,883                | -                | 597                      |
| Risk Management                      | -   | 16,639  | 16,639  | 16,639               | -                | -                        |
| Info Tech Asset Maintenance          | -   | 44,350  | 44,350  | 44,350               | -                | -                        |
| Travel Expenses                      | 119,941   | -   | 119,941   | 118,623              | -                | 1,318                    |
| Marketing, Communications, & Sales   | 9,160,352   | -   | 9,160,352   | 9,158,520            | -                | 1,832                    |
| Indirect Costs                       | 282,770   | 64,916  | 347,686   | 347,686              | -                | -                        |
| Ticket Costs - Scratch               | 4,327,577   | (334,777)   | 3,992,800   | 3,185,928            | -                | 806,872                  |
| Vendor Fees                          | 8,425,861   | 28,572  | 8,454,433   | 7,139,828            | -                | 1,314,605                |
| Prize Payments                       | 241,354,411   | -   | 241,354,411                                       | 214,416,164          | -                | 26,938,247               |
| Retailer Compensation                | 33,796,740  | (59,580)  | 33,737,160  | 26,826,811           | -                | 6,910,349                |
| IT Re-engineering Project            | 250,000   | -   | 250,000   | 249,657              | -                | 343                      |
| Multi-State Game Costs               | -   | 400,000   | 400,000   | 317,458              | 35,416           | 47,126                   |
| Denver Warehouse Rollforward         | 14,605  | -   | 14,605  | 14,604               | -                | 1                        |
| <b>TOTAL</b>                         | <b>\$308,376,626</b>                                | <b>\$ 750,005</b>   | <b>\$ 309,126,631</b>                             | <b>\$272,699,362</b> | <b>\$56,575</b>  | <b>\$ 36,370,694</b>     |

### 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                 | \$214,416,164     |
| Commissions and Bonuses       | 26,826,812        |
| Cost of Tickets & Vendor Fees | 9,810,954         |
| Operating Expenses            | <u>22,039,839</u> |

Total Expenses per Statement of Revenues, Expenses and Changes in Retained Earnings 273,093,769

|                                  |                 |
|----------------------------------|-----------------|
| Less: Non-appropriated expenses  |                 |
| Depreciation                     | (603,190)       |
| Accrued Annual and Sick Leave    | (54,668)        |
| Book Value of Assets Written-Off | <u>(37,217)</u> |

Sub-Total 272,398,694

|                                |                      |
|--------------------------------|----------------------|
| Plus: Capitalized Fixed Assets | <u>300,668</u>       |
|                                | <u>\$272,699,362</u> |

SUPPLEMENTARY

SCHEDULES

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, 2001, and have issued our report thereon dated August 17, 2001. 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 17, 2001



COLORADO LOTTERY  
SUMMARY OF REQUIRED COMMUNICATIONS  
FISCAL YEAR ENDED JUNE 30, 2001

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 17, 2001, 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, 2001:

**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.

**Auditors' 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. No such adjustments were identified during our audit.

### **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.

## Distribution

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d.b.a. General Support Services  
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**Report Control No. 1358**