

COLORADO LOTTERY
FINANCIAL AND COMPLIANCE AUDIT
June 30, 2010 and 2009

**LEGISLATIVE AUDIT COMMITTEE
2010 MEMBERS**

Senator David Schultheis
Chairman

Senator Lois Tochtrop
Vice-Chair

Senator Morgan Carroll
Representative James Kerr
Representative Frank McNulty
Representative Joe Miklosi
Senator Shawn Mitchell
Representative Dianne Primavera

Office of the State Auditor Staff

Sally Symanski
State Auditor

Dianne Ray
Deputy State Auditor

Cynthia Hochmiller
Legislative Auditor

Clifton Gunderson LLP
Contract Auditors

Members of the Legislative Audit Committee:

We have completed the financial statement audit of the Colorado Lottery as of and for the year ended June 30, 2010. Our audit was conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

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

Clifton Gunderson LLP

Greenwood Village, Colorado
September 10, 2010

Table of Contents

	Page
Contents	
Report Summary	1
Recommendation Locator	3
Background	4
Auditors' Findings and Recommendations	5
Disposition of Prior Year Audit Recommendations	11
Independent Auditor's Report on Financial Statements and Supplementary Information	12
Management's Discussion and Analysis	14
Basic Financial Statements	
Statements of Net Assets	27
Statements of Revenues, Expenses and Changes in Net Assets	29
Statements of Cash Flows	31
Fiduciary Fund Statements	
Statements of Fiduciary Net Assets	33
Statements of Changes in Fiduciary Net Assets	34
Notes to Financial Statements	35
Supplementary Information	
Schedule of Revenue and Costs for Scratch and On-line Games.....	63
Schedule of Percent of Prize Expense to Gross Ticket Sales	64
Budgetary Comparison	65
Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on the Audit of Financial Statements Performed in Accordance with Government Auditing Standards	67
Independent Auditor's Required Communication to Legislative Audit Committee	69
Audit Report Distribution Information	71

COLORADO LOTTERY
REPORT SUMMARY
Years Ended June 30, 2010 and 2009

Purposes and Scope of Audit

Authority, Purpose and Scope

The Office of the State Auditor, State of Colorado, engaged Clifton Gunderson LLP to conduct the financial audit of the Colorado Lottery for the fiscal year ended June 30, 2010. The audit of the Colorado Lottery (the Lottery) was performed under authority of Section 24-35-211, C.R.S., which requires the State Auditor to conduct an annual audit of the Lottery Fund. The purpose of the audit was to express opinions on the financial statements of the Lottery for the year ended June 30, 2010.

Clifton Gunderson LLP conducted the audit in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards* issued by the Comptroller General of the United States of America.

The purposes and scope of this audit were:

- To express opinions on the financial statements of the Lottery as of and for the year ended June 30, 2010, including a review of the related systems of internal controls as required by auditing standards generally accepted in the United States of America.
- To review the Lottery's compliance with rules and regulations governing the expenditure of State funds for the year ended June 30, 2010.
- To evaluate progress in implementing the prior audit recommendations.

Summary of Major Audit Comments

Audit Findings and Financial Statement Audit Report Section

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

- Back office system
- Scratch ticket inventory
- Succession planning

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

COLORADO LOTTERY
REPORT SUMMARY
Years Ended June 30, 2010 and 2009

Audit Opinions and Reports

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

Auditors' Communication to Legislative Audit Committee

The auditors' communication to the Legislative Audit Committee describes the auditors' responsibility under auditing standards generally accepted in the United States of America and significant management judgments and estimates. It also notes that there were no proposed audit adjustments for the year ending June 30, 2010. This communication is located on page 70.

Summary of Progress in Implementing Prior Year Audit Recommendations

The audit report for the year ended June 30, 2009, contained two recommendations. Of the 2009 recommendations, one was implemented and the other one was not implemented. The Disposition of Prior Year Audit Recommendations begins on page 11.

**COLORADO LOTTERY
RECOMMENDATION LOCATOR
Years Ended June 30, 2010 and 2009
Fiscal Year 2010 Recommendations**

Recommendation Number	Page Number	Recommendation Summary	Response	Implementation Date
1	6	The Colorado Lottery (the Lottery) should ensure that all contract provisions for the development of the Comprehensive Lottery Administrative Support System (CLASS) are adhered to by enforcing contract requirements and through the preparation of a detailed plan to complete unfulfilled contract requirements.	Agree	December 31, 2010
2	8	The Lottery should perform the end of game inventory reconciliation within 30-60 days of the end of the claim period in accordance with current Lottery practice, and should establish written policies regarding end of game inventory reconciliation.	Agree	November 30, 2010
3	10	The Lottery should develop a plan to ensure the institutional knowledge of key personnel is not lost and that the Controller's Office has the experience and capacity to prepare accurate and timely financial statements.	Agree	March 31, 2011

COLORADO LOTTERY
BACKGROUND
Years Ended June 30, 2010 and 2009

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

During fiscal year 2010, the Lottery employed 113 employees in its headquarters in Pueblo and branch offices in Denver, Fort Collins and Grand Junction.

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

Colorado Revised Statutes (C.R.S.) Section 24-35-210(9), requires that no less than 50% of the total revenue from sales of lottery tickets be for prizes. The legislation also provides guidelines for distribution of net proceeds to beneficiary agencies. "Net lottery proceeds" (that is, proceeds after the payment of prizes and lottery expenses and a reserve for future operations) are to be distributed to the Conservation Trust Fund, the Division of Parks and Outdoor Recreation and the Great Outdoors Colorado Trust Fund (GOCO). The amount distributed to GOCO is limited by a constitutional cap. For fiscal years 2002 through 2007, amounts exceeding the GOCO cap (the spill-over) were distributed to the State Public School Fund Contingency Reserve. For fiscal year 2008, these spill-over funds were transferred to the Lottery Proceeds Contingency Reserve Fund. As of fiscal year 2009, these spill-over funds shall be transferred to the Public School Capital Construction Assistance Fund. Prior to 2002, spill-over funds were distributed to the State General Fund.

COLORADO LOTTERY
AUDITORS' FINDINGS AND RECOMMENDATIONS
Years Ended June 30, 2010 and 2009

Back Office System

In July 2009, the Lottery implemented a new system called CLASS, Comprehensive Lottery Administrative Support System, that provides back office and Scratch game functionality. The back office system was intended to provide a fully integrated system including retailer management, claims management, inventory control, scratch game validation, retailer and lottery accounting, system balancing, executive information systems, as well as several other functions. The Lottery purchased the system along with the implementation from TB Consulting. CLASS replaces the Wang system, Lottery's previous back office system. With the implementation of the CLASS system the two key project objectives of replacing the Wang system and the ability to begin adding new online games were fulfilled.

What was the purpose of the audit work?

The purpose of the audit work was to evaluate the deliverables of the new CLASS system contract.

What audit work was performed and how were results measured?

The audit included an evaluation of the CLASS system contract with TB Consulting, including ten system balancing and reporting requirements.

What problem did the audit work identify?

During our review of internal controls of the new system, CLASS, we noted that the contract with the consulting firm included ten system balancing and reporting requirements that were to be provided to the Lottery, of which six were not delivered.

As a result of the unfulfilled contract requirements, Lottery established manual systems balancing procedures to ensure the integrity of the accounting data and to complete tasks that should have been automated in the CLASS system. In addition, Lottery contracted with Wyant Data Systems, Inc. (WDS) to complete a CLASS Contract Fulfillment Assessment to determine what contract requirements had not been delivered. WDS issued their report on June 2, 2010, and identified a total of 361 contract deliverables, 194 of which had been delivered. The remaining 167 deliverables were in the following status:

- Partially delivered (47)
- Not delivered (86)
- Developed internally by Lottery IT department (12)
- Work in process (12)
- Cancelled (10)

Why does this problem matter?

Unfulfilled contract requirements result in inefficient processes and increase the overall risks associated with Lottery operations. The lack of automated systems balancing and reporting requires the Lottery to conduct inefficient manual balancing procedures that place additional demands on accounting staff. Additionally, the unfulfilled requirements have cost the Lottery \$29,800 in additional contracting services to identify the missing deliverables in the contract with TB Consulting.

Why did the problem occur?

The unfulfilled contract requirements resulted from a lack of proper monitoring by the Lottery of contract priorities, milestones and requirements resulting in non-completion of 167 out of 361 contract deliverables. In addition, contract penalties were not enforced for these unfulfilled contract deliverables. We noted that the Lottery received similar findings and recommendations related to contract monitoring in the Office of the State Auditor (OSA) 2008 Performance Audit and previous OSA Financial Audits since 2006.

Classification of Finding: Internal Control Over Financial Reporting - Control Deficiency

Recommendation No. 1:

The Colorado Lottery should ensure that all contract provisions are adhered to by enforcing contract penalties and continuing to work with TB Consulting to develop the automated balancing process as well as the completion of the additional systems requirements as noted in the Contract Fulfillment Assessment. This should include a detailed plan to complete the unfulfilled contract requirements, including specific priorities and milestones and amend the contract, if necessary. We also recommend that Lottery enforce all delivery and performance requirements detailed in the contract at no additional cost to the State.

Colorado Lottery Response: Agree

The Lottery acknowledges there are outstanding requirements from the contract with TB Consulting for the CLASS back office system. The Lottery has a plan in place with TB Consulting to complete and obtain the additional system requirements. The Lottery is currently working with DOR to realign the contract deliverables, renegotiate contract provisions and amend the contract with TB Consulting.

Implementation Date: December 31, 2010

COLORADO LOTTERY
AUDITORS' FINDINGS AND RECOMMENDATIONS
Years Ended June 30, 2010 and 2009

Scratch Ticket Inventory

The Colorado Lottery generates approximately \$328 million annually in revenue through the sale of scratch games. The scratch games include scratch ticket inventory; the tickets have limited value until they are activated at the time of sale at retailer terminals. At the conclusion of each scratch game, the remaining ticket inventory is compared to the original inventory minus tickets sold to ensure that all scratch tickets have been accounted for properly. Once the reconciliation is completed, all remaining tickets are destroyed.

What was the purpose of the audit work?

The purpose of the audit work was to assess and test the adequacy of the Lottery's controls over the processing and recording of scratch game sales, including the final reconciliation of unsold ticket inventory.

What audit work was performed and how were results measured?

The audit work included an evaluation and testing of whether the Lottery's reconciliation of the remaining inventory of tickets for scratch games that ended during the year had been completed. The scratch tickets are sold through approximately 3,000 retailers and each retailer is required to return all unsold scratch tickets at the end of the game. Scratch game activity is monitored and recorded in the Lottery's financial systems through an automated interface between Lottery's financial systems and Lottery terminals at each retailer site. Lottery has established an unwritten practice to complete the final reconciliation of the scratch game tickets within 30-60 days following the end of the claim period (180 days after the end date of the game).

What problem did the audit work identify?

The final reconciliation of remaining scratch ticket inventory is not always completed timely. We tested 22 scratch games that were in progress during the year, three of which ended during the year. The final reconciliation of scratch ticket inventory for one of the three concluded games was not completed within the established 30-60 day time frame. The game claim period ended on February 12, 2010 and the final reconciliation had not been completed at the end of the audit, six months after the end of the claim period.

Why does this problem matter?

The final reconciliation of scratch ticket inventory provides assurance that the game ticket inventory has been properly accounted for and minimizes the risk that misuse or misappropriation of ticket inventory will go undetected.

In addition, the final reconciliation of the scratch ticket inventory provides assurance that the automated interfaces are functioning correctly and that scratch game sales recorded in the Lottery's financial systems are accurate and complete.

Why did the problem occur?

Based on discussions with Lottery staff, the end of game ticket inventory reconciliation has been deemed a low priority. Therefore, it is not always completed in accordance with the Lottery's practice of within 30-60 days of the end of the claim period.

Classification of Finding: Internal Control Over Financial Reporting - Control Deficiency

Recommendation No. 2:

The Colorado Lottery should perform the end of game inventory reconciliation within 30-60 days of the end of the claim period in accordance with current Lottery practice. The Lottery should perform the end of game inventory immediately for any games that have been concluded and currently exceed the 30-60 days. Additionally, Lottery should establish written policies regarding end of game inventory reconciliation.

Colorado Lottery Response: Agree

The Lottery is currently conducting research to implement simplified return ticket processes. These process improvements will encompass streamlining the processes related to the end of game inventory reconciliation and will ensure the reconciliation is performed within 30-60 days of the end of the claim period. The Lottery will establish written procedures regarding the new streamlined process for the end of game ticket reconciliation.

The expired game referenced in this finding that had not been reconciled within 30-60 days was audited on August 20, 2010. The Lottery will perform the end of game audit on all games that have expired and have not been reconciled within the 30-60 day period by September 30, 2010.

Implementation Date: November 30, 2010

COLORADO LOTTERY
AUDITORS' FINDINGS AND RECOMMENDATIONS
Years Ended June 30, 2010 and 2009

Succession planning

The Colorado Lottery was created as a division within the Department of Revenue in 1982 with the passage of Senate Bill 119. The legislation provides requirements for distribution of net proceeds to beneficiary agencies. The Lottery generated \$503 million in revenues and distributed \$113 million to beneficiary agencies in Fiscal Year 2010. To properly account for these funds, Lottery requires accurate, complete, and timely financial reporting.

Two of the Lottery's key accounting and financial reporting personnel (Accountant and Controller) are planning to retire within the next several months. Combined, these two individuals have over 40 years of experience with the Colorado Lottery and are instrumental to the financial reporting process. Significant institutional knowledge will be lost with their departure.

Their duties include primary leadership and oversight of the accounting function; preparation of annual and monthly financial statements; reconciliation of Lottery games; ensuring compliance with laws and regulations; preparing accounting adjustments; preparation of State exhibits; preparation of audit schedules; and audit liaison.

What was the purpose of the audit work?

The audit work included an evaluation of the Lottery's internal control structure including the Human Resources aspect of the control environment related to producing accurate, timely and complete financial statements.

What audit work was performed and how were results measured?

During our review of Lottery's internal control structure we noted the planned departure of the two key individuals, as well as three other vacancies within the Lottery Controller's Office. For effective internal control over the accuracy of recording and reporting financial information, the Colorado Lottery requires accounting and financial reporting expertise.

What problem did the audit work identify?

Significant institutional knowledge that is key to the daily functioning of the Lottery Controller's Office, as well as the accurate and timely reporting of financial information of the Colorado Lottery at month- and year-end will be lost once these two key individuals retire. The Lottery has a plan to replace these individuals, but it may not be adequate considering other vacancies in the Lottery Controller's Office. Specifically, the Lottery started cross-training an accountant with approximately 12 years experience in the Lottery Fiscal section in June 2010, and will continue cross-training for several more months until the Accountant's retirement. Additionally, the duties and responsibilities of the controller will be transitioned to the Accountant IV prior to the controller's retirement. The Accountant IV who will be performing the controller's duties until a permanent controller is hired has approximately 15 years of experience in the Lottery Fiscal section.

Why does this problem matter?

Due to the complex nature and sophisticated accounting system of the Lottery, it will likely take a number of years before the new accountant and Controller will have the knowledge and expertise to perform at a level comparable to existing personnel. This lack of experience increases the risk of errors in the financial statements. In addition, entities who receive distributions of Lottery net proceeds, such as the Great Outdoors Colorado Trust Fund and Public School Capital Construction Assistance Fund, may have their funding adversely affected if recording and reporting errors occur or distributions are not timely due to inexperienced staff.

Why did the problem occur?

The problem occurred as a result of the planned retirement of two key fiscal personnel and unfilled accounting positions and the lack of adequate succession planning for these positions. The Lottery is training a replacement for the accountant, and has begun the hiring process for a replacement for the controller, but the Lottery has not developed an adequate plan for transfer of knowledge.

Classification of Finding: Internal Control Over Financial Reporting – Control Deficiency

Recommendation No. 3:

The Colorado Lottery should develop a plan to ensure the institutional knowledge of key personnel is not lost and that the Controller's Office has the experience and capacity to prepare accurate and timely financial statements. This plan should include:

- A thorough, formal evaluation of the existing capabilities and needs in the Lottery Controller's Office.
- Consideration of alternatives to assist with financial reporting during the transition period such as contracting with the retiring individuals to provide training and support to their replacements and hiring qualified temporary employees.
- A timeline and process for hiring qualified permanent staff to fill all open positions in the accounting department.

Colorado Lottery Response: Agree

The Lottery has developed a plan that will provide continuity to the preparation of accurate and timely financial statements. The plan is being implemented by ensuring open positions that are key to the financial reporting process are filled with experienced, knowledgeable and capable personnel and by providing adequate training and knowledge transfer. Training of long-term accounting employees to fill the positions in the transition has been initiated.

The overall staffing plan for the accounting department will take into consideration capabilities of existing staff, staffing needs and consideration of staffing alternatives. Even though the vacant positions referenced are in the accounting department on the Lottery's organization chart, filling of the vacant positions are based on the needs of the Lottery as a whole. The Lottery will work through the Department of Revenue Office of Human Resources and state personnel system to fill positions necessary to ensure the accuracy and timeliness of financial reporting.

Implementation Date: March 31, 2011

**COLORADO LOTTERY
DISPOSITION OF PRIOR YEAR AUDIT RECOMMENDATIONS
Year Ended June 30, 2010**

Fiscal Year 2009 Recommendations

Number	Recommendation	Disposition
1	The Colorado Lottery (the Lottery) should ensure that the new back office system being implemented provides all necessary reconciliation processes and reports.	Not implemented, See Recommendation No. 1 in current report.
2	The Lottery should strengthen its information technology controls by removing all generic administrator accounts, ensuring terminated employees' access is removed timely and establishing minimum password parameters in accordance with approved security policies.	Implemented

Independent Auditor's Report

Members of the Legislative Audit Committee

We have audited the accompanying financial statements of the major fund and remaining fund information of the Colorado Lottery, an enterprise fund and private purpose fund of the State of Colorado as of and for the years ended June 30, 2010 and 2009, which collectively comprise the Colorado Lottery's basic financial statements as listed in the table of contents. These financial statements are the responsibility of Colorado Lottery's management. Our responsibility is to express opinions on these financial statements based on our audits.

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

As discussed in Note 1 – Nature of Operations and Summary of Significant Accounting Policies, the financial statements of the Colorado Lottery are intended to present the financial position and the changes in financial position and, where applicable, cash flows for only that portion of the financial reporting entity, the State of Colorado, that is attributable to the transactions of the Colorado Lottery. They do not purport to, and do not, present fairly the financial position of the State of Colorado as of June 30, 2010 and 2009, and the changes in its financial position, or, where applicable, its cash flows, for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the major fund and remaining fund information of the Colorado Lottery as of June 30, 2010 and 2009, and the respective changes in financial position and cash flows, where applicable, thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 10, 2010 on our consideration of the Colorado Lottery's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the

scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages 14 through 26 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming opinions on the financial statements that collectively comprise the Colorado Lottery's basic financial statements. The accompanying supplementary information as listed in the table of contents is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

Clifton Gunderson LLP

Greenwood Village, Colorado
September 10, 2010

**COLORADO LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS
Years Ended June 30, 2010 and 2009**

This discussion and analysis of the Colorado Lottery's financial performance provides an overview of financial activities for the fiscal years ended June 30, 2010 and 2009. Please read it in conjunction with the Lottery's financial statements, which begin on page 27. These financial statements reflect only activities of the Colorado Lottery, a proprietary fund and private purpose fund of the State of Colorado.

Financial Highlights

- The Lottery's overall sales performance of \$501.2 million was the second highest sales year in Lottery history. The highest sales year was achieved in fiscal year 2008 with sales of \$505.8 million. Overall sales for fiscal year 2010 reflected a \$7.8 million increase from fiscal year 2009 sales of \$493.4 million. In turn, fiscal year 2009 reflected a \$12.4 million decrease from fiscal year 2008 sales of \$505.8 million. The overall increase in sales in 2010 was mainly the result of the introduction of two new on-line games – MatchPlay and Mega Millions, with a slight overall decrease of about \$0.8 million in sales of the other existing products. MatchPlay, introduced in February 2010, had sales of almost \$6.2 million and Mega Millions, introduced in May 2010, had sales of \$2.4 million. The overall \$12.4 million decrease in sales in fiscal year 2009 from fiscal year 2008 was mainly the result of a decrease in both scratch and Powerball sales. Scratch sales decreased by \$7.7 million from \$336.0 million in fiscal year 2008 to \$328.3 million in fiscal year 2009. Powerball sales decreased by \$8.9 million from \$109.6 million in fiscal year 2008 to \$100.7 million in fiscal year 2009. These decreases were offset by an increase in Cash 5 sales for fiscal year 2009 over fiscal year 2008 of \$1.7 million. Cash 5 sales totaled \$19.1 million and \$20.8 million for fiscal years 2008 and 2009, respectively. Lotto also showed an increase of \$2.5 million from fiscal year 2008 to 2009, with sales of \$41.0 million and \$43.5 million, respectively.

Fiscal year 2010 showed an increase in sales from fiscal year 2009 in both Powerball and Cash 5 sales. Powerball sales increased by \$0.9 million from \$100.7 million in fiscal year 2009 to \$101.5 million in fiscal year 2010. Cash 5 sales increased by \$0.5 million from \$20.8 million in fiscal year 2009 to \$21.3 million in fiscal year 2010. With the addition of a Sunday draw in November 2009, Cash 5 sales for fiscal year 2010 produced record sales, showing an increase for the eighth year in a row.

Fiscal year 2010 saw a decrease in sales from fiscal year 2009 for each of its other two existing products. Lotto sales decreased by \$1.9 million from \$43.5 million in fiscal year 2009 to \$41.6 million in fiscal year 2010, with an associated drop in the average Lotto jackpot from \$3.9 to \$3.6. Scratch sales in fiscal year 2010 of \$328.1 million remained nearly the same with a slight decrease of just \$0.2 million from fiscal year 2009 sales of \$328.3 million.

- Funds distributed or available for distribution from 2010 sales decreased from fiscal year 2009. Fiscal year 2010 produced a total of \$112.9 million in funds distributions, a decrease of \$6.7 million from fiscal year 2009 distributions of \$119.6 million. The \$119.6 million in funds distributions for fiscal year 2009 represented the third highest year of distributions in the Lottery's history with fiscal year 2010 distributions ranking fifth highest. Fiscal year 2010 included a spill-over of funds in excess of the Great Outdoors Colorado (GOCO) cap. During the fiscal years 2002-2007 this spill-over was distributed into the State Public School Fund Contingency Reserve. In fiscal year 2008, this spill-over was distributed to the Lottery Contingency Reserve Fund. Starting in fiscal year 2009; the spill-over, by statute, is

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

**COLORADO LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS
Years Ended June 30, 2010 and 2009**

distributed to the Public School Capital Construction Assistance Fund. The spill-over totaled \$88,550 and \$5.5 million for fiscal years 2010 and 2009, respectively. The spill-over amount for fiscal year 2008 was \$8.1 million. A spill-over occurs when the distribution cap for GOCO is reached in any one year. The cap for GOCO is the 1992 base year amount of \$35 million as adjusted for the annual change in the cost of living increase for the Denver-Boulder area. The total amount of the spill-over during the nine-year period totals \$50.7 million.

- Gross profit as a percent of sales for fiscal year 2010 decreased by 1.0 percent from fiscal year 2009, a reflection of the 0.8 percent increase in prize expense as a percentage of sales and a 0.2 percent increase in retailer commissions and bonuses as a percentage of sales. Gross profit as a percent of sales increased by 1.1 percent between fiscal years 2008 and 2009, mainly because of the decrease in prize expense of 0.9 percent between the two fiscal years. The overall prize expense percentage increased from 61.1 percent to 61.9 percent for the fiscal years ended June 30, 2009 and 2010, respectively, consisting of an increase in prize expense for both the scratch products from 67.5 percent to 68.4 percent and online products from 48.5 percent to 49.6 percent. In addition, fiscal year 2010 showed a decrease in unclaimed prizes of nearly \$892,000 from fiscal year 2009 contributing to the increase in prize expense. The overall prize expense percentage decreased from 62.3 percent to 61.1 percent for the fiscal years ended June 30, 2008 and 2009, respectively. The decrease was the result of reductions in prize expense for the scratch, Lotto and Powerball products and an increase of unclaimed prizes by more than \$200,000 from fiscal year 2008 to fiscal year 2009. Commissions and bonuses as a percentage of sales were 7.6 percent, 7.4 percent and 7.6 percent for the fiscal years ended June 30, 2008, 2009 and 2010, respectively. Cost of tickets sold and vendor fees as a percentage of sales remained at 2.1 percent for fiscal years ended June 30, 2009 and 2010 and was approximately 2.0 percent of sales for fiscal year 2008. Vendor fees totaled \$7,394,112, \$7,825,356 and \$7,653,391 for fiscal years ended June 30, 2008, 2009 and 2010, respectively.

Games Offered by the Colorado Lottery

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

On-line games, on the other hand, require a longer playing time. Tickets are also purchased at the Lottery retailers and are printed on ticket stock as the purchase is made. Each ticket contains one or possibly more playing boards for one draw or up to thirteen weeks of draws. Each board consists of a set of numbers, the combination of numbers required for play varying by game. The winning numbers for each game are posted after their respective draw nights with drawings held on every night of the week, including Sundays, with the addition this fiscal year of a Sunday Cash 5 draw. Players must check their numbers against the numbers drawn for each respective game to determine if they have a winning ticket. The tickets may also be cashed at the retailer level if the amounts of the winnings are \$599 or less. Prizes \$600 and over must be redeemed at the Lottery offices.

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

**COLORADO LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS
Years Ended June 30, 2010 and 2009**

Using this Annual Report

This annual report consists of a series of financial statements. The statements of net assets provide information about the Lottery's assets and liabilities and reflect the Lottery's financial position as of June 30, 2010 and 2009. The statements of revenues, expenses and changes in net assets report the activity of selling the Lottery products and the expenses related to such activity for the years ended June 30, 2010 and 2009. Finally, the statements of cash flows outline the cash inflows and outflows related to the activity of selling the Lottery products for the years ended June 30, 2010 and 2009.

**COLORADO LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS
Years Ended June 30, 2010 and 2009**

Statements of Net Assets

The statements of net assets present a financial snapshot of the Lottery at June 30, 2010 and 2009. It presents the fiscal resources of the Lottery (assets), the claims against those resources (liabilities) and the residual available for future operations (net assets). Assets and liabilities are classified by liquidity as either current or noncurrent. Net assets are classified by the ways in which they may be used for future operations.

**Condensed Statements of Net Assets
June 30, 2010, 2009 and 2008**

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Assets			
Current assets	\$ 61,950,762	\$ 57,535,254	\$ 50,368,307
Restricted assets	5,499,120	5,417,337	5,687,849
Capital assets	<u>3,830,221</u>	<u>2,759,701</u>	<u>498,156</u>
Total assets	<u>\$ 71,280,103</u>	<u>\$ 65,712,292</u>	<u>\$ 56,554,312</u>
Liabilities			
Current liabilities	\$ 63,991,689	\$ 60,062,604	\$ 53,249,984
Long-term liabilities	<u>1,026,906</u>	<u>995,069</u>	<u>913,886</u>
Total liabilities	<u>\$ 65,018,595</u>	<u>\$ 61,057,673</u>	<u>\$ 54,163,870</u>
Net Assets			
Investment in capital assets	\$ 3,830,221	\$ 2,759,701	\$ 498,156
Restricted – Licensed Agent			
Recovery Reserve	370,801	388,771	443,139
Restricted – Operating Reserve	1,200,000	1,100,000	1,300,000
Unrestricted	<u>860,486</u>	<u>406,147</u>	<u>149,147</u>
Total net assets	<u>\$ 6,261,508</u>	<u>\$ 4,654,619</u>	<u>\$ 2,390,442</u>

The Lottery's total assets at June 30, 2010 were \$71.3 million. Assets consisted primarily of cash and investments with the State Treasury, including restricted balances, of \$42.4 million, Prepaid Prize Expense with Multi-State Lottery (MUSL) of \$3.9 million, receivables from Lottery retailers for the sale of Lottery products of \$19.8 million and a net investment in capital assets of \$3.8 million.

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

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

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

**COLORADO LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS
Years Ended June 30, 2010 and 2009**

The Lottery's total assets, increased by \$5.6 million from fiscal year 2009 to fiscal year 2010. This increase was primarily caused by the \$5.6 million increase in cash and investments and the \$1.0 million increase in the net investment in capital assets offset by a \$0.8 million decrease in receivables from retailers and a slight decrease of \$0.2 million in ticket inventories. The \$5.6 million increase in cash and investments was the result of the increased sales in the final months of fiscal year 2010 compared to fiscal 2009 due to the introduction of the two new online games. The \$1.0 million increase in the net investment in capital assets was the result of the capitalization of the Phase II development of the back office computer system. The decrease in receivables from retailers was primarily caused by the May 2010 completion of the Lottery's planned effort to reduce the number of days at which retailers must pay for activated scratch tickets from 120 days to 60 days, resulting in a drop in outstanding scratch receivables due from retailers. Total assets increased from fiscal year 2008 to fiscal year 2009 by \$9.1 million. The increase was primarily caused by the \$4.5 million increase in cash and investments, \$1.7 million increase in receivables from retailers, \$0.6 million increase in ticket inventory and a \$2.3 million increase in the net investment in fixed assets. Both the \$4.5 million increase in cash and investments and the \$1.7 million increase in receivables from retailers can be attributed to the increase in size of the Powerball estimated jackpot at the close of the fiscal year. The \$0.6 million increase in ticket inventory was the result of more games being purchased near year end in fiscal year 2009 versus fiscal year 2008. The \$2.3 million increase in the net investment in capital assets was the result of the capitalization of the development of the back office computer system.

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

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

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

The Lottery's total liabilities increased from fiscal year 2009 to fiscal year 2010 by \$4.0 million. This increase was primarily the result of a \$2.7 million increase in prize liability on Lottery products, a \$2.2 million increase in proceeds distributions due to recipients and an increase of \$0.4 million in retailer bonus liability, offset by a decrease in accounts payable of \$1.3 million. Both the \$2.7 million increase in the prize liability and the \$2.2 million increase in proceeds distributions from fiscal year 2009 to fiscal year 2010 was the result of higher sales experienced in the final months of 2010 due to the introduction of the two new online games of MatchPlay and Mega Millions. The Lottery's total liabilities increased from fiscal year 2008 to fiscal year 2009 by \$6.9 million. This increase was primarily the result of a \$5.3 million increase in prize liability on Lottery products and a \$0.9 million increase in proceeds distributions due to recipients. The \$5.3 million increase in the prize liability on Lottery products from fiscal year 2008 to fiscal year 2009 was the result of the increase in the Powerball estimated jackpot as mentioned above and of the increase of scratch games being offered for sale. At the close of fiscal year 2008, the number of active scratch games was 51 versus 60 at the close of fiscal year 2009. The \$0.9 million increase in proceeds distributions was the result of a higher net profit for the fourth quarter of fiscal year 2009 versus the fourth quarter of fiscal year 2008.

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

**COLORADO LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS
Years Ended June 30, 2010 and 2009**

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

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

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

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

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

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

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

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

**COLORADO LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS
Years Ended June 30, 2010 and 2009**

Statements of Revenues, Expenses and Changes in Net Assets

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

**Condensed Statements of Revenues, Expenses and
Changes in Net Assets
For the Fiscal Years Ended June 30, 2010, 2009 and 2008**

	2010	2009	2008
Operating Revenues	\$501,197,409	\$493,364,094	\$505,814,066
Direct Operating Expenses	<u>359,229,539</u>	<u>348,679,448</u>	<u>363,280,175</u>
Gross Profit on Sale of Tickets	<u>141,967,870</u>	<u>144,684,646</u>	<u>142,533,891</u>
Other Operating Expenses			
Marketing and communications	14,849,003	11,914,439	8,892,973
Wages and benefits	8,139,527	8,527,025	8,841,445
Other operating expenses	<u>5,925,611</u>	<u>4,070,286</u>	<u>5,327,843</u>
Total other operating expenses	<u>28,914,141</u>	<u>24,511,750</u>	<u>23,062,261</u>
Operating Income	<u>113,053,729</u>	<u>120,172,896</u>	<u>119,471,630</u>
Nonoperating Revenues (Expenses)			
Other revenue	177,641	267,188	428,513
Investment income	1,317,086	1,427,948	2,365,744
Proceeds distributions	<u>(112,941,567)</u>	<u>(119,603,855)</u>	<u>(122,300,132)</u>
Total nonoperating expenses	<u>(111,446,840)</u>	<u>(117,908,719)</u>	<u>(119,505,875)</u>
Increase (Decrease) in Net Assets	1,606,889	2,264,177	(34,245)
Net Assets, Beginning of Year	<u>4,654,619</u>	<u>2,390,442</u>	<u>2,424,687</u>
Net Assets, End of Year	<u>\$ 6,261,508</u>	<u>\$ 4,654,619</u>	<u>\$ 2,390,442</u>

Sales Activities

Revenues from the sale of the Lottery products for the fiscal year ended June 30, 2010 were the second highest in the Lottery's 28-year history. As shown in the financial statements, overall sales increased by 1.6 percent from fiscal year 2009 sales of \$493.4 to \$501.2 million in fiscal year 2010. Fiscal year 2009 sales of \$493.4 million represented a decrease of 2.5 percent or \$12.4 million from fiscal year 2008 sales of \$505.8 million. Fiscal year 2010 scratch sales of

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

**COLORADO LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS
Years Ended June 30, 2010 and 2009**

\$328.1 million remained nearly the same as the prior year with a slight decrease of only \$0.2 million from the prior year sales of \$328.3 million. The decrease in scratch sales from \$336.0 million in fiscal year 2008 to \$328.3 million in fiscal year 2009 represented a percentage decrease of 2.3 percent, and was reflective of the downturn in the economy. Powerball sales in fiscal year 2010 were \$101.5 million, a slight increase of \$0.8 million or 0.8 percent over the prior fiscal year sales of \$100.7 million. Powerball sales decreased from \$109.6 million in fiscal year 2008 to \$100.7 million in fiscal year 2009, which represented a percentage decrease of 8.1 percent. The decrease could be attributed to the decrease in the size of the Powerball jackpots. Lotto sales decreased in the current fiscal year to \$41.6 million, a decrease of \$1.9 million or 4.4 percent from the prior fiscal year sales of \$43.5 million. Other than a drop in the average Lotto jackpot in fiscal year 2010 compared to fiscal year 2009 and a possible switch by players to other games due to more product options, no specific factor could be identified to explain the drop in sales. Lotto sales grew in fiscal year 2009 to \$43.5 million, an increase of \$2.5 million or 6.0 percent over fiscal year 2008 sales of \$41.0 million. Cash 5 sales again experienced an increase from \$20.8 million in fiscal year 2009 to \$21.3 million in the current fiscal year. As mentioned previously, in November 2009 the Lottery added a Cash 5 draw on Sunday, which contributed to this increase. Cash 5 sales experienced an increase from \$19.1 million in fiscal year 2009 to \$20.8 million in the fiscal year 2008, which represented an 8.8 percent increase. The introduction of the two new online games MatchPlay and Mega Millions in fiscal year 2010 added \$8.6 million to 2010 overall sales or 1.7 percent of fiscal year 2010 total sales. With total sales of the four existing products experiencing a slight overall drop in sales of 0.1 percent the addition of these games was the major contributor to the overall 1.6 percent increase in current year sales over the previous year.

The following tables compare Lottery product sales between fiscal years.

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

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

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

**COLORADO LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS
Years Ended June 30, 2010 and 2009**

Nonoperating Revenues

Nonoperating revenues for the years ended June 30, 2010 and June 30, 2009 totaled \$1.5 million and \$1.7 million, respectively. The decrease included a reduction in interest received from the treasury of approximately \$284,000 from fiscal year 2009 to fiscal year 2010. This decrease occurred as a result of a decrease in interest rates from an average of 2.72 percent in fiscal year 2009 to 2.30 percent in fiscal year 2010. Also contributing to the decrease in nonoperating revenues was a decrease in the interest received from the Multi-State Lottery Association (MUSL). In fiscal year 2010 the total received was approximately \$69,000 compared with \$86,000 in fiscal year 2009. The continuing low return on investments since the downturn in the economy was the major factor contributing to this decrease. In addition, the revenue received from fines and penalties decreased by \$147,240 reflecting a reduction in the assessment of liquidated damages to the on-line vendor. Offsetting these decreases, the GASB 31 adjustment recording the Lottery's share of the unrealized gains and losses on investments held by the Treasury increased from \$257,000 in fiscal year 2009 to \$454,339 in fiscal year 2010. In fiscal year 2010, an increase of \$327,515 in revenue reflected the Lottery's election to recognize revenues from advance play sales immediately upon purchase rather than over the life of the respective draws.

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

Total Revenues

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

**COLORADO LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS
Years Ended June 30, 2010 and 2009**

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

Major Expenses

Approximately \$359.2 million of the Lottery's total expenses of \$388.1 million for the fiscal year ended June 30, 2010 were incurred in direct support of the Lottery games. This included prize expense, retailer compensation, money spent to purchase scratch tickets and compensation to the vendor who maintains and supports the on-line gaming system.

In comparison, \$348.7 million of the Lottery's total expenses of \$373.2 million for the fiscal year ended June 30, 2009, were game-related expenses.

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

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

Game-Related Expenses	2010	2009	Difference	Change
Prize expense/Powerball and Mega Millions prize variance	\$ 310,364,410	\$ 301,674,566	\$ 8,689,844	2.9%
Retailer compensation and Commissions	33,293,526	32,844,563	448,963	1.4
Bonuses	4,853,249	3,636,346	1,216,903	33.5
Ticket costs	3,064,963	2,698,617	366,346	13.6
Vendor fees	<u>7,653,391</u>	<u>7,825,356</u>	<u>(171,965)</u>	(2.2)
Total	<u>\$ 359,229,539</u>	<u>\$ 348,679,448</u>	<u>\$10,550,091</u>	3.0%

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

The increase in game-related expenses, including prize expense, retailer commission expense, and vendor fees (fiscal year 2009 to fiscal year 2010) is reflective of the increase in product sales. (See the product sales schedule above.) Retailer bonus expense increased by 33.5% from fiscal years 2009 to 2010 due to a change in the marketing performance bonus plan . Percentages may not calculate and amounts may not add up due to rounding

**COLORADO LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS
Years Ended June 30, 2010 and 2009**

effective January 1, 2010, resulting in increased bonus amounts paid to retailers. The total marketing performance bonuses paid in fiscal year 2010 and fiscal year 2009 were \$2,401,421 and \$1,183,539, respectively. The marketing performance bonus plan in effect from January 1, 2010 rewarded retailers that achieved a higher sales level in the current year compared to the same period in the prior year with a 6-7% bonus on all sales in excess of the prior year's sales. In addition, the increase in ticket costs from fiscal year 2009 to fiscal year 2010 was the result of the lottery's continued use of licensed property games, which require additional fees to cover the rights to use patented game names, emblems, designs, logos, symbols, characters, still images, artwork, depictions, illustrations, labels, insignia, indicia, trade dress, and any visual representations of any type collectively or individually. The decrease in the game-related expenses from fiscal year 2008 to fiscal year 2009 is reflective of the decrease in product sales. In addition, the prize expense percentage was decreased in fiscal year 2009 from the prize expense percentage in fiscal year 2008 as a result of the conscious effort to slightly lower the prize percentage payouts on all scratch games and as a result of the difference in the number of lotto jackpots won. The increase in ticket costs from fiscal year 2008 to fiscal year 2009 was the result of the lottery's expansion of licensed property games. The increase in the vendor fees from fiscal year 2008 to fiscal year 2009 was the result of the increase in the vendor fee rate in November 2007.

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

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

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

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

Distributions to the Proceeds Recipients

The Lottery's efforts generated funds available for distributions of \$112.9 million in the current fiscal year. Of these total proceeds, \$56.4 million was allocated to the Great Outdoors Colorado Trust Fund, \$45.2 million to the Conservation Trust Fund and \$11.3 million to the Division of Parks and Outdoor Recreation per the distribution formula stated in Colorado Revised Statutes (C.R.S.) 24-35-210. The maximum distribution to Great Outdoors Colorado of \$56.4 million, pursuant to C.R.S. 33-60-104(1)(c) and 33-60-104(2), was reached, thus creating a spill-over into the Public School Capital Construction Assistance Fund of \$88,550, pursuant to C.R.S. 22-43.7-104 (2)(b)(III).

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

**COLORADO LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS
Years Ended June 30, 2010 and 2009**

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

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

Capital Assets

The Lottery's investment in capital assets at June 30, 2010, 2009 and 2008 amounted to \$3.8 million, \$2.8 million and \$0.5 million, respectively. The investment in capital assets as of June 30, 2010 includes, computer equipment, servers, drawing equipment, modular furniture, cameras, recorders plus the capitalization of salaries and other costs related to the development of a new back office system. The investment in capital assets as of June 30, 2009 also included the capitalization of salaries and other costs related to the development of the new back office system prior to its implementation classified as Construction in Progress. The investment in capital assets as of June 30, 2008 also included leasehold improvements which have since been fully amortized. Capital assets are shown on the Statement of Net Assets at the cost on the day of acquisition. Analysis of changes in capital assets is as follows:

**Capital Assets as of
June 30, 2010, 2009 and 2008**

	2010	2009	2008
Capital Assets			
Equipment	\$ 6,724,664	\$ 3,144,554	\$ 3,159,600
Construction in Progress	-	2,295,614	-
Leasehold Improvements	-	-	11,978
Less: Accumulated Depreciation	<u>(2,894,443)</u>	<u>(2,680,467)</u>	<u>(2,673,422)</u>
Net capital assets	<u>\$ 3,830,221</u>	<u>\$ 2,759,701</u>	<u>\$ 498,156</u>

Budgetary Highlights

The Lottery's budget is determined by a variety of methods. The majority of the budget is set by the annual appropriations bill (the Long Bill), which determines budgets for every agency within the State. The Long Bill and department level allocations are approved shortly before the start of each fiscal year. Agencies may also request a supplemental appropriation during the fiscal year to cover unexpected expenses (or a negative supplemental for less than expected expenses), as well as year-end transfers of spending authority, if needed. In the third quarter of fiscal year 2010, the Legislature approved supplemental appropriation adjustments for the Lottery. Supplemental appropriations and department level re-allocations were approved in ticket costs, prizes, Powerball prize variance, and retailer compensation, offset by reductions in

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

**COLORADO LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS
Years Ended June 30, 2010 and 2009**

payments in vendor fees, personal services, purchase services-computer center, workers compensation, risk management, Grand Junction lease space, and vehicle lease payments. The final method of funding is special legislation. There was no special legislation affecting the Lottery's budget in fiscal year 2010.

The approved Lottery budget at the beginning of fiscal year 2010 was \$502.4 million. Supplemental appropriations and adjustments made in the third quarter increased the budget by \$8.2 million; department level allocations approved at the beginning of the fiscal year increased the budget by \$2.4 million to an amended total of \$513.0 million. Total expenditures and roll-forwards for fiscal year 2010 on a budget basis came to \$401.1 million, resulting in excess appropriations (or savings) of more than \$111.9 million.

Economic Outlook

- Plans for the development of new games for fiscal year 2011 include the introduction of a new online "RAFFLE" game in mid September. Unlike other online games, tickets for each Raffle draw will be on sale during a Lottery-specified event period, with a pre-determined maximum number of tickets. Testing began in July 2010.
- With unforeseen delays encountered in the prior fiscal year, the new courier delivery system for the Lottery's scratch product will be fully implemented by September 1st.

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 2010 and to demonstrate the Lottery's accountability for the money generated from the sale of the Lottery products. If you have questions about this report or need additional information, contact Barbara Aggson, the Colorado Lottery's Controller, 212 W. 3rd Street, Suite 210, Pueblo, CO 81003.

**COLORADO LOTTERY
STATEMENTS OF NET ASSETS
June 30, 2010 and 2009**

	2010	2009
Current Assets:		
Cash and investments	\$ 40,859,238	\$ 35,337,291
Accounts receivable, net of the allowance for doubtful accounts of \$216,501 in 2010 and \$182,993 in 2009	19,766,854	20,549,443
Consignment inventory, at cost	119,866	118,917
Warehouse inventory, at cost	1,150,213	1,389,571
Prepaid expenses	54,591	140,032
Total current assets	61,950,762	57,535,254
Reserve and Restricted Assets:		
Cash and investments-Operating reserve	1,200,000	1,100,000
Cash and investments-Licensed agent recovery reserve receipts	370,801	388,771
Prepaid prize expense with MUSL	3,928,319	3,928,566
Total reserve and restricted assets	5,499,120	5,417,337
Capital Assets:		
Construction in progress	-	2,295,614
Equipment	6,724,664	3,144,554
Less accumulated depreciation and amortization	(2,894,443)	(2,680,467)
Total capital assets	3,830,221	2,759,701
Total assets	71,280,103	65,712,292

	<u>2010</u>	<u>2009</u>
Current Liabilities:		
Accounts payable	2,030,841	3,357,721
Prize liability	29,684,061	26,950,117
Payable to MUSL	221,937	-
Wages and benefits	753,220	722,020
Accrued annual and sick leave	23,347	8,741
Retailer bonus liability	1,023,998	606,258
Funds available for distribution	30,254,285	28,090,232
Deferred revenue	<u>-</u>	<u>327,515</u>
Total current liabilities	<u>63,991,689</u>	<u>60,062,604</u>
Long-Term Liabilities:		
Accrued annual and sick leave	952,451	911,937
Expired warrants liability	<u>74,455</u>	<u>83,132</u>
Total long-term liabilities	<u>1,026,906</u>	<u>995,069</u>
Total liabilities	<u>65,018,595</u>	<u>61,057,673</u>
Net Assets		
Investment in capital assets	3,830,221	2,759,701
Restricted-licensed agent recovery reserve	370,801	388,771
Restricted-operating reserve	1,200,000	1,100,000
Unrestricted-other	<u>860,486</u>	<u>406,147</u>
Total net assets	<u>\$ 6,261,508</u>	<u>\$ 4,654,619</u>

See Notes to Financial Statements.

COLORADO LOTTERY
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
Years Ended June 30, 2010 and 2009

	2010	2009
Operating Revenues		
Gross ticket sales	<u>\$ 501,197,409</u>	<u>\$ 493,364,094</u>
Direct Operating Expenses		
Prize expense	313,724,135	301,506,498
Powerball prize variance	(3,525,004)	168,068
Megamillions prize variance	165,279	-
Retailer commissions and bonuses	38,146,775	36,480,909
Cost of tickets and vendor fees	<u>10,718,354</u>	<u>10,523,973</u>
Total direct operating expenses	<u>359,229,539</u>	<u>348,679,448</u>
Gross Profit on Sale of Tickets	<u>141,967,870</u>	<u>144,684,646</u>
Other Operating Expenses		
Marketing and communications	14,849,003	11,914,439
Administration fees paid to MUSL	103,370	98,250
Wages and benefits	8,139,527	8,527,025
Professional services	307,618	251,587
State agencies services	143,828	161,235
Department of Revenue services	528,898	556,672
Travel	105,120	109,457
Equipment (including loss on disposition of equipment of \$40,157 and \$9,916, respectively)	1,303,569	93,528
Depreciation	621,027	136,691
Accrued annual and sick leave	34,300	94,725
Space rental	699,423	678,684
Rents for equipment	23,935	29,933
Motorpool leasing	310,100	391,867
Materials and supplies	129,792	86,879
Telephone	112,923	104,912
On-Line telecommunications	499,321	475,801
Data processing supplies and services	71,844	20,040
Equipment maintenance	453,841	316,938
Postage	51,210	67,201
Printing	6,919	7,618
Delivery Expense	289,778	237,814
Other	<u>128,795</u>	<u>150,454</u>
Total other operating expenses	<u>28,914,141</u>	<u>24,511,750</u>

COLORADO LOTTERY
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
(Continued)
Years Ended June 30, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Operating income	<u>113,053,729</u>	<u>120,172,896</u>
Nonoperating Revenues (Expenses)		
Other revenue	177,641	267,188
Investment income	1,317,086	1,427,948
Funds distributed for current year	(82,687,282)	(91,513,623)
Funds available for distribution for current year	<u>(30,254,285)</u>	<u>(28,090,232)</u>
Total nonoperating revenues (expenses)	<u>(111,446,840)</u>	<u>(117,908,719)</u>
Net income	<u>\$ 1,606,889</u>	<u>\$ 2,264,177</u>
Net assets, beginning of year	4,654,619	2,390,442
Net change in net assets	<u>1,606,889</u>	<u>2,264,177</u>
Net assets, end of year	<u>\$ 6,261,508</u>	<u>\$ 4,654,619</u>

See Notes to Financial Statements.

COLORADO LOTTERY
STATEMENTS OF CASH FLOWS
Years Ended June 30, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Operating activities		
Cash received from retailers	\$ 505,681,172	\$ 490,961,741
Cash paid in prizes	(311,074,905)	(296,077,156)
Cash paid in retailer commissions	(33,293,526)	(32,844,563)
Cash payments to suppliers	(31,890,345)	(25,841,745)
Cash payments to employees for services	(8,053,207)	(8,538,590)
Cash paid in retailer bonus	<u>(4,436,959)</u>	<u>(3,721,928)</u>
Net cash provided by operating activities	<u>116,932,230</u>	<u>123,937,759</u>
Noncapital Financing Activities		
Distribution of net proceeds	<u>(110,777,514)</u>	<u>(118,669,044)</u>
Net cash used by noncapital financing activities	<u>(110,777,514)</u>	<u>(118,669,044)</u>
Capital and related financing activities		
Acquisition of capital assets	<u>(1,867,825)</u>	<u>(2,190,975)</u>
Net cash used by capital and related financing activities	<u>(1,867,825)</u>	<u>(2,190,975)</u>
Investing activities		
Interest received	<u>862,747</u>	<u>1,170,948</u>
Net cash provided by investing activities	<u>862,747</u>	<u>1,170,948</u>
Increase in Cash and Investments	5,149,638	4,248,688
Change in Fair Market Value of Investments	454,339	257,000
Cash and investments, Beginning of Year (including \$1,488,771 and \$1,743,139, respectively, in restricted accounts)	<u>36,826,062</u>	<u>32,320,374</u>
Cash and investments, End of Year, (including \$1,570,801 and \$1,488,771, respectively, in restricted accounts)	<u>\$ 42,430,039</u>	<u>\$ 36,826,062</u>

COLORADO LOTTERY
STATEMENTS OF CASH FLOWS (Continued)
Years Ended June 30, 2010 and 2009

	2010	2009
Reconciliation of operating income to net cash provided by operating activities		
Operating income	\$ 113,053,729	\$ 120,172,896
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	621,027	136,691
Loss on disposition of equipment	40,157	9,916
Other revenue	177,641	267,188
(Increase) decrease in prepaid prize expense with MUSL	247	16,144
Change in:		
Accounts receivable	782,589	(1,737,367)
Ticket inventory	238,409	(611,623)
Other assets	85,441	(57,901)
Liabilities (excluding funds available for distribution)	1,932,990	5,741,815
Net cash provided by operating activities	\$ 116,932,230	\$ 123,937,759
Statement of Net Assets Classification		
Cash and investments	\$ 40,859,238	\$ 35,337,291
Cash and investments-Licensed Agent Recovery Reserve	370,801	388,771
Cash and investments-Operating Reserve	1,200,000	1,100,000
	\$ 42,430,039	\$ 36,826,062

See Notes to Financial Statements.

**COLORADO LOTTERY
POWERBALL ANNUITY WINNERS TRUST FUND
STATEMENTS OF FIDUCIARY NET ASSETS
June 30, 2010 and 2009**

	2010	2009
ASSETS		
Current assets:		
Investments	<u>\$ 10,679,081</u>	<u>\$ 9,893,414</u>
Total Assets	<u>\$ 10,679,081</u>	<u>\$ 9,893,414</u>
 NET ASSETS		
Held in Trust for Powerball winner	<u>\$ 10,679,081</u>	<u>\$ 9,893,414</u>
Total Net Assets	<u>\$ 10,679,081</u>	<u>\$ 9,893,414</u>

See Notes to Financial Statements.

**COLORADO LOTTERY
POWERBALL ANNUITY WINNERS TRUST FUND
STATEMENTS OF CHANGES IN FIDUCIARY NET ASSETS
For the Fiscal Years Ended June 30, 2010 and 2009**

	<u>2010</u>	<u>2009</u>
Additions		
Investment income	\$ <u>1,171,667</u>	\$ <u>514,152</u>
Total additions	<u>1,171,667</u>	<u>514,152</u>
Deductions		
Prize payment	<u>386,000</u>	<u>371,000</u>
Change in net assets	785,667	143,152
Net Assets held in Trust for Powerball winner Beginning of Year	<u>9,893,414</u>	<u>9,750,262</u>
End of Year	<u>\$ 10,679,081</u>	<u>\$ 9,893,414</u>

See Notes to Financial Statements.

COLORADO LOTTERY
NOTES TO FINANCIAL STATEMENTS
June 30, 2010 and 2009

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

Nature of Operations

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

The financial statements reflect activities of the Lottery, an enterprise fund of the State of Colorado and activities of the Lottery's Powerball Annuity Winners Trust Fund, a private trust fund of the State of Colorado, for the fiscal years ended June 30, 2010 and 2009. The Lottery is an agency of the State of Colorado. The financial statements are intended to present the financial position and results of operations and cash flows of only that portion of the State of Colorado that is attributable to the transactions of the Lottery and the Lottery's Powerball Annuity Winners Trust Fund in accordance with accounting principles generally accepted in the United States of America.

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

Use of Estimates

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

Fund Accounting

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

Enterprise Fund

The Lottery accounts for its operations as an enterprise fund. The intent of the State of Colorado Legislature is that the Lottery's cost (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges. As permitted by Governmental Accounting Standards Board Statement

COLORADO LOTTERY
NOTES TO FINANCIAL STATEMENTS
June 30, 2010 and 2009

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

No. 20, *Accounting and Financial Reporting Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Lottery has elected to apply only those applicable Financial Accounting Standards Board Statements and interpretations issued prior to November 30, 1989.

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

Private Trust Fund

The Lottery accounts for Powerball Annuity Prizes in a private trust fund. The prizes are considered awarded when claimed by the winner. The Lottery is placed in a fiduciary situation, whereby it manages the prize funds for the winner. Governmental accounting mandates that a separate Statement of Net Assets and Statement of Changes in Net Assets be prepared for such fund. Those statements are included herein.

Basis of Accounting

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

Revenues (additions) are recognized in the Powerball Annuity Winners Trust Fund based on the Fair Market Value of the original investment as of June 30, 2010 and 2009. Expenses (deductions) are recognized when payments are remitted to the winner(s).

Budget

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

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

COLORADO LOTTERY
NOTES TO FINANCIAL STATEMENTS
June 30, 2010 and 2009

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

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

Accounts Receivable and Allowance for Doubtful Accounts

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

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

The Lottery uses the specific identification method to determine expected uncollectibles. Under the provisions of Section 24-35-219, C.R.S., licensed agent recovery reserve receipts are collected from the retailers to cover uncollectible accounts. The accounts receivable and the licensed agent recovery reserve receipts are shown net of estimated uncollectible receivables of \$216,501 and \$182,993 as of June 30, 2010 and 2009, respectively.

Consignment Inventory

Inventory on consignment represents non-activated ticket inventory in the possession of retailers who act as agents of the Lottery. The Lottery retains title to these tickets since retailers have the right to return non-activated tickets; therefore, the tickets are included in the inventory and reported on the statements of net assets. Consignment inventory is stated at cost using the specific identification method.

Warehouse Inventory

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

Supplies Inventory

The State of Colorado's threshold for recording supplies inventories is \$100,000 per location. The supplies inventory of the Lottery consistently falls below the \$100,000 threshold per location. Accordingly, no supplies inventory appears on the statements of net assets.

COLORADO LOTTERY
NOTES TO FINANCIAL STATEMENTS
June 30, 2010 and 2009

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

Prepaid Prize Expense

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

Capital Assets

Capital assets, which included construction-in-progress for software in fiscal year 2009, equipment, and leasehold improvements, are stated at cost. Beginning January 1, 2004, the Lottery adopted the state policy of capitalizing equipment only if the cost exceeds \$5,000 and has a useful life of more than one year. Depreciation for equipment is computed on the straight-line method over estimated useful lives ranging from three to ten years. Leasehold improvements are depreciated over the shorter of the lease term or the estimated useful lives of the improvements. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts, and resulting gains or losses are recognized in current operations.

Accrued Wages and Benefits

During each fiscal year, the state changes the pay date for the month of June for all state employees, deferring the date from the last working day of June to the first working day of July. For the Lottery, this created a liability for accrued wages and benefits at June 30, 2010 and 2009 of \$753,220 and \$722,020, respectively.

Prize Liability and Prize Expense

Under the provisions of Section 24-35-210 (9), C.R.S., the Lottery must pay no less than fifty percent (50%) of total ticket sales as prizes. In the aggregate, all games to date are planned to pay 50% or more of total ticket sales in prizes. Additional prize expense and corresponding liability may be incurred as a result of market fluctuations in the cost of annuities used to pay Lotto jackpots (see Note 10).

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

Payments of scratch prize amounts of \$150 or less may be made at the Lottery or at the retail outlet; payment of scratch prize amounts of \$151 to \$599 may be made at the retailer level at the option of the retailer or at the Lottery. Scratch prizes of \$600 or more are paid by the Lottery. Retailers are given credit for prize payments they make on a daily basis. Prizes may be claimed up to 180 days after game-end. After the final claim date, any unclaimed scratch prizes will result in a decrease to prize expense and any prizes claimed in excess of the liability accrued will result in an increase to prize expense. Net unclaimed scratch prizes resulted in a decrease to prize expense of \$4,988,409 for the fiscal year ended June 30, 2010 and \$5,167,085 for the fiscal year ended June 30, 2009.

COLORADO LOTTERY
NOTES TO FINANCIAL STATEMENTS
June 30, 2010 and 2009

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

Payments of cumulative online prize amounts of \$150 or less on a single ticket may be made at the Lottery or at the retail outlet; payment of cumulative prize amounts of \$151 to \$599 on a single ticket may be made at the retailer level at the option of the retailer or at the Lottery. Payment of cumulative prize amounts of \$600 or more on a single ticket must be made at the Lottery. Retailers are given credit for prize payments they make on a daily basis. Online prizes may be claimed up to 180 days after the date of the drawing. After the final claim date, unclaimed online prizes will result in a decrease to prize expense so long as the aggregate prize expense of all games exceeds or equals the statutory 50% of sales. In the event that the expiration of an unclaimed prize would result in the aggregate prize expense of all games to fall below the statutory 50% level, the unclaimed prize amount would remain in prize expense and be paid out to players as a guaranteed additional prize. Unclaimed online prizes resulted in a decrease to prize expense of \$3,359,247 for the fiscal year ended June 30, 2010 and \$4,072,551 for the fiscal year ended June 30, 2009.

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

Mega Millions Prize Variance expense (revenue) represents a portion of the Mega Millions 51% prize expense accrual and the Megaplier 50% prize expense accrual (as mandated by game rule) that is transferred to or received from MUSL as with the Powerball Prize Variance as described above.

Retailer Bonus Liability

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

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

The cashing bonus is accrued as tickets are sold and paid as winning tickets are redeemed. Any cashing bonuses unclaimed at the end of the claim period in fiscal years 2010 and 2009 resulted in a reduction of bonus expense.

COLORADO LOTTERY
NOTES TO FINANCIAL STATEMENTS
June 30, 2010 and 2009

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

The marketing performance bonus is accrued monthly and paid to retailers in accordance with the criteria as set out in the calendar year marketing performance plan as approved by the Director. Any excess marketing performance bonus accrued in fiscal years 2010 and 2009 resulted in a reduction of bonus expense.

Licensed Agent Recovery Reserve

Under the provisions of Section 24-35-219, C.R.S., a Licensed Agent Recovery Reserve was established on January 1, 1988 to maintain surety bond receipts collected from Lottery retailers. Billing rates are established by the Executive Director of the Department of Revenue and are reviewed on an annual basis. Retailers have the option to obtain private surety bond coverage at a rate of \$2,000 surety coverage per outlet at their discretion. As of June 30, 2010 and June 30, 2009, the Lottery has reserved \$370,801 and \$388,771, respectively. The Lottery utilizes restricted net assets before using unrestricted net assets.

Lottery Fund Net Assets

In accordance with Section 24-35-210 (4.1)(a), C.R.S., the Lottery Commission shall reserve “sufficient monies, as of the end of the fiscal year, to ensure the operation of the Lottery for the ensuing year.” The Lottery Commission approved a reserve of \$1 million of the net assets for fiscal year 1989. This remained in effect until the implementation of GASB 34, which required a net asset balance sufficient to cover the net value of an agency’s capital assets. Accordingly, at the June 2002 Commission meeting, the Lottery Commission approved a balance in net assets “equal to net value of the Lottery’s capital assets.” Effective July 1, 2004, under Senate Bill 04-204, this reserve is required to be held in cash and investments. In April 2005, the Lottery set up a separate operating reserve independent of the net capital asset reserve in the amount of \$1.7 million. The amount held in this operating reserve will be reviewed annually and adjusted accordingly. The annual reviews were completed in September 2008 and November 2009 and the reserve was reduced in fiscal year 2009 to \$1.1 million and increased in fiscal year 2010 to \$1.2 million in accordance with the reviews.

Equipment Expense

Included in “The Statement of Revenues, Expenses, and Changes in Fund Net Assets” is an account titled equipment. This account reports the book value of assets, which are disposed of during the year, fixed asset purchases under the capitalization threshold, (see Note 3 – Schedule of Changes in Fixed Assets, page 46), software purchases under the capitalization threshold, and other miscellaneous equipment transactions that do not qualify for capitalization.

Compensated Leave

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

COLORADO LOTTERY
NOTES TO FINANCIAL STATEMENTS
June 30, 2010 and 2009

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

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

	<u>June 30, 2008</u>	<u>Increases</u>	<u>Decreases</u>	<u>June 30, 2009</u>
Annual leave	\$ 691,339	\$ 596,937	\$ (517,137)	\$ 771,139
Sick leave	<u>140,969</u>	<u>44,746</u>	<u>(40,289)</u>	<u>145,426</u>
Total annual and sick leave	<u>832,308</u>	<u>641,683</u>	<u>(557,426)</u>	<u>916,565</u>
Compensatory time	<u>1,899</u>	<u>13,593</u>	<u>(11,379)</u>	<u>4,113</u>
Total compensated leave	<u>\$ 834,207</u>	<u>\$ 655,276</u>	<u>\$ (568,805)</u>	<u>\$ 920,678</u>

Expired Warrants Liability

Expired warrants liability represents the expiration of aged uncashed warrants and imprest checks over one (1) year old which expired on or before June 30, 2003. In accordance with Section 15-12-914 (2), C.R.S., recipients are entitled to claim payment up to 21 years after original date of issue. Pursuant to Section 24-35-212 (2), C.R.S., the amount of these uncashed warrants shall remain in the Lottery fund. Pursuant to the Unclaimed Property Act, Section 38-13-113, C.R.S., the funds to cover the liability for any uncashed warrants, which expire after June 30, 2003 are transferred to the Unclaimed Property Fund. The Lottery must request reimbursement from the Unclaimed Property Fund for any warrants presented for payment that expired after June 30, 2003. For fiscal years ending June 30, 2010 and 2009, there were no requests made and received from the Unclaimed Property Fund.

Deferred Revenue

The Lottery offers players the option to purchase online tickets for draws in advance. The tickets are purchased through the terminal, referred to as Advance Play, and allow the player to purchase online tickets good for up to 13 weeks. Prior to July 2009, the Lottery recorded deferred revenue from the sale of advance play tickets as a liability and recognized the revenues as draws occurred. Starting in July 2009, the Lottery elected to recognize the revenues from advance play sales immediately upon purchase. This change resulted in an immediate one time increase to sales revenue of \$327,515.

COLORADO LOTTERY
NOTES TO FINANCIAL STATEMENTS
June 30, 2010 and 2009

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

A detail of deferred revenue at June 30, 2010 and 2009 is as follows:

	<u>2010</u>	<u>2009</u>
Advance Play – Lotto	\$ -	\$ 106,900
Advance Play – Powerball	-	147,313
Advance Play – Powerplay	-	43,640
Advance Play – Cash 5	-	<u>29,662</u>
Total deferred revenue	<u>\$ -</u>	<u>\$ 327,515</u>

Promotional Activity

The Lottery engages in two types of promotional activities in an attempt to enhance sales and to increase the player base. Specific promotional coupons are distributed to players through special promotions and can be redeemed at any lottery office for a specified lottery product. Specific promotional coupons with a total face value of \$0 and \$8,150 were redeemed in fiscal years ended June 30, 2010 and June 30, 2009, respectively. A new type of promotional coupon was introduced in 2010. These coupons are in the form of a scratch ticket and can be redeemed at any retailer location for a specified online product. Scratch ticket promotional coupons with a total face value of \$27,182 were redeemed in fiscal year ended June 30, 2010. Scratch tickets for specific games are given away as a more direct approach to introduce players to lottery games. During the fiscal years ended June 30, 2010 and 2009, scratch tickets with a total face value of \$179,388 and \$171,917, respectively, were given away. Scratch ticket and coupon promotions are valued at cost. For the fiscal years ended June 30, 2010 and 2009, \$144,250 and \$116,441, respectively, were recorded as costs related to free tickets and coupons. These costs were included in Marketing and Communications expense in the statements of revenues, expenses and changes in fund net assets for coupons redeemed and scratch tickets given away.

NOTE 2 – CASH AND INVESTMENTS

Cash

Cash includes petty cash, change funds, an imprest fund, two depository accounts and cash on deposit with the State Treasurer. A detail of cash at June 30, 2010 and 2009 is as follows:

	<u>2010</u>	<u>2009</u>
Petty cash	\$ 800	\$ 800
Change funds	70,000	70,000
Imprest fund	732,000	693,000
Depository accounts	30,000	30,000
Cash on deposit with State Treasurer	<u>40,026,438</u>	<u>34,543,491</u>
Total unrestricted cash and investments	<u>40,859,238</u>	<u>35,337,291</u>

COLORADO LOTTERY
NOTES TO FINANCIAL STATEMENTS
June 30, 2010 and 2009

NOTE 2 – CASH AND INVESTMENTS (CONTINUED)

Restricted cash and investments – Licensed Agent Recovery Reserve Receipts on deposit with State Treasurer	370,801	388,771
Operating Reserve on deposit with State Treasurer	<u>1,200,000</u>	<u>1,100,000</u>
 Total restricted cash and investments	 <u>1,570,801</u>	 <u>1,488,771</u>
Total cash and investments	<u>\$ 42,430,039</u>	<u>\$ 36,826,062</u>

Cash on Deposit with State Treasurer

Under the provisions of Section 24-35-210 (6), C.R.S., the State Treasurer shall invest the monies of the Lottery in excess of operating and prize payment expenses and all authorized transfers. Interest or any other return on investments is paid to the Lottery Fund account on a monthly basis. Actual interest payments are determined by the State Treasurer. The actual allocated interest rate for fiscal years 2010 and 2009 was 2.30% and 2.72%, respectively.

In addition, the State Treasurer pools these deposits and invests them in securities approved by Section 24-75-601.1, C.R.S. The Lottery reports its share of the Treasurer’s unrealized gains and losses based on its participation in the State Treasurer’s pool only at fiscal year-end.

Effective July 1, 1997, with the Lottery’s initial adoption of Governmental Accounting Standards Board Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, all of the Treasurer’s investments, which include the net Licensed Agent Recovery Reserve Receipts, are reported at fair value, which is determined based on quoted market prices. The State Treasurer does not invest any of the pool resources in any external investment pool, and there is no assignment of income related to participation in the pool. Additional information on the Treasurer’s pool may be obtained in the State of Colorado’s Comprehensive Annual Financial Report.

Deposits

Custodial credit risk is the risk that in the event of a bank failure, a government’s deposits may not be returned to it. The Lottery’s deposit policy for custodial credit risk requires compliance with the provisions of state law.

State law requires collateralization of all deposits with federal depository insurance; bonds and other obligations of the U.S. Treasury, U.S. agencies or instrumentalities or the State of Colorado; bonds of any city, county, school district or special road district of the State of Colorado; bonds of any state; or a surety bond having an aggregate value at least equal to the amount of the deposits.

The Lottery accounts are held in Public Deposit Protection Act (PDPA) qualified institutions, thus balances held in the Lottery’s accounts in excess of \$250,000 per institution are secured through PDPA with guaranteed securities.

COLORADO LOTTERY
NOTES TO FINANCIAL STATEMENTS
June 30, 2010 and 2009

NOTE 2 – CASH AND INVESTMENTS (CONTINUED)

Investments

A Private Purpose Trust was established in fiscal year 2008 to record the Lottery's investments, held by MUSL, for the benefit of Colorado's Powerball annuity prize winners (Colorado Winners Trust). An investment policy followed by MUSL governs the purchase of these investments. The policy states that a brokerage firm wishing to submit a bid for the sale of securities to MUSL must first be qualified by 1) providing information to MUSL which substantiates compliance with minimum standards and guidelines as set forth by MUSL and 2) by entering into an agreement with MUSL. In addition, MUSL will purchase from qualifying brokers only securities which are backed by the full faith and credit of the United States Government or its agencies. The approved securities are Certificates on Government Receipts, Certificates Accrual Treasury Securities, Coupon Treasury Receipts, Easy Growth Treasury Receipts, Government & Agency Term Obligation Receipts, Government Loan Trust, Class 1-Z, Government Trust Certificates, JOB Certificates, Principal Treasury Receipts, Resolution Funding Corporation Strips, Stripped Government Receipts, Treasury Investment Growth Receipts, Treasury Bond Receipts, United States Agency for International Development bonds, United States Treasury Coupon Under Book Entry, United States Treasury Bills, United States Treasury Securities Stripped, Physical Coupon Treasury Strips, Zero Coupon Treasury Obligations, Government Loan Trusts, and AID Bonds.

Custodial Credit Risk – Investments

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

Interest Rate Risk – Investments

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

COLORADO LOTTERY
NOTES TO FINANCIAL STATEMENTS
June 30, 2010 and 2009

NOTE 2 – CASH AND INVESTMENTS (CONTINUED)

Investment Type	2010		2009	
	Fair Value	Weighted Average Maturity (in years)	Fair Value	Weighted Average Maturity (in years)
U. S. Treasury Investments	\$ 2,873,855	20.73	\$ 3,898,685	16.66
Federal Judiciary Government Trust Certificates	870,658	9.66	-	-
U.S. Aid Bonds	185,729	6.26	-	-
Resolution Funding Corp Strips	3,768,933	6.85	3,408,892	8.76
	<u>2,979,906</u>	13.54	<u>2,585,837</u>	14.44
	<u>\$ 10,679,081</u>		<u>\$ 9,893,414</u>	

Credit Risk – Investments

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

Concentration of Credit Risk – Investments

Investment in any one issuer (other than U.S. Treasury securities, other investments explicitly guaranteed by the U. S. government, mutual funds, and external investment pools) that represent 5% or more of the total investment as of June 30, 2010 are the Resolution Funding Corporation Strips and the Federal Judiciary Bonds, which represent 27.9% and 8.2%, respectively, of the total investments. Such securities representing 5% or more of the total investment as of June 30, 2009 were the Resolution Funding Corporation Strips, which represented 26.1% of the total investment.

Statements of Cash Flows

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

COLORADO LOTTERY
NOTES TO FINANCIAL STATEMENTS
June 30, 2010 and 2009

NOTE 3 – SCHEDULE OF CHANGES IN CAPITAL ASSETS

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

	<u>June 30, 2008</u>	<u>Increases</u>	<u>Decreases</u>	<u>June 30, 2009</u>
Construction in progress- not depreciated	\$ -	\$ 2,295,614	\$ -	\$ 2,295,614
Capital assets being depreciated:				
Equipment and software	3,159,600	112,538	(127,584)	3,144,554
Leasehold improvements	<u>11,978</u>	<u>-</u>	<u>(11,978)</u>	<u>-</u>
Total historical Costs	<u>3,171,578</u>	<u>2,408,152</u>	<u>(139,562)</u>	<u>5,440,168</u>
Less accumulated depreciation for equipment	(2,662,642)	(136,691)	118,866	(2,680,467)
Leasehold improvements	<u>(10,780)</u>	<u>-</u>	<u>10,780</u>	<u>-</u>
Total accumulated depreciation	<u>(2,673,422)</u>	<u>(136,691)</u>	<u>129,646</u>	<u>(2,680,467)</u>
Total capital assets, being depreciated, net	<u>\$ 498,156</u>	<u>\$ 2,271,461</u>	<u>\$ (9,916)</u>	<u>\$ 2,759,701</u>

NOTE 4 – OPERATING LEASES

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

COLORADO LOTTERY
NOTES TO FINANCIAL STATEMENTS
June 30, 2010 and 2009

NOTE 4 – OPERATING LEASES (CONTINUED)

Pueblo

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

Warehouse –The Lottery leases primary warehouse space from Santa Fe 250 LLC. The Lottery entered into a lease extension agreement, which began September 1, 2002 and expired June 30, 2007. A second amendment to the lease was signed on April 12, 2007 extending the lease for two additional years effective July 1, 2007 and expiring on June 30, 2009. A third amendment to the lease was signed on April 8, 2009 extending the lease for two additional years effective July 1, 2009 and expiring on June 30, 2011. A fourth amendment to the lease was signed on August 7, 2009 to lease an additional 6,000 square feet, expiring on June 30, 2011.

Denver

Office – The Lottery occupied office and warehouse space in the Galleria Towers Building in Denver. The lease agreement, which began on October 30, 1990, was amended on May 14, 1999 and extended the ending date for the lease from June 30, 1999 to June 30, 2006. On March 10, 2006 the Lottery entered into a second amendment to the lease agreement with Galleria extending the original lease for a thirty-six month period ending on June 30, 2009. The amended lease included a five-year renewal option. On February 23, 2009, the Lottery entered into a new lease agreement, which began on the date of substantial completion of required improvements or no later than December 31, 2009 and will expire on June 30, 2019. The lease contains an option to renew the lease for two (2) consecutive additional periods of five years each. There are no other provisions for extension or renewal.

Warehouse – The Lottery entered into a lease agreement with Yukon Denver Valley, Inc. to occupy warehouse space. The lease agreement began on September 1, 1999 and expired on August 31, 2004. On June 11, 2004, the Lottery exercised its option to extend the lease through August 31, 2009. On September 1, 2009, the Lottery entered a holdover period from September 1, 2009 to the commencement date of the new lease, making monthly rent payments equal to the August 2009 rent payment. On December 11, 2009, the Lottery entered a new lease agreement with Valley Business Corp., Inc. (Formally known as Yukon Denver Valley, Inc.) beginning on December 11, 2009 and expiring on June 30, 2015. The lease contains an option to renew the lease for two (2) consecutive additional periods of five years each. The lease also contains a holdover provision, whereby if the Lottery fails to vacate the premises upon the expiration or sooner termination of the lease, the Lottery will continue making the same monthly rent payment in effect pursuant to the lease agreement as of the date of expiration or sooner termination of the lease. Valley Business Corp. Inc. and the Lottery both agree to give each other thirty (30) days written notice prior to the termination of a holdover tenancy period. There are no other provisions for extension or renewal.

**COLORADO LOTTERY
NOTES TO FINANCIAL STATEMENTS
June 30, 2010 and 2009**

NOTE 4 – OPERATING LEASES (CONTINUED)

Fort Collins

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

Grand Junction

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

Colorado Springs

The Lottery occupies warehouse space in a building located at 2818 Janitell Road in Colorado Springs, Colorado. The lease agreement, which began on August 1, 2003, expired on June 30, 2006. The Lottery had the option to exercise two 12-month extensions under the new lease, extending the lease through June 30, 2008. On May 27, 2007, the Lottery exercised its second option to extend the lease through June 30, 2008. On June 10, 2008, the Lottery entered into a third amendment to the lease to extend the lease for a twelve month period ending June 30, 2009. The amended lease includes two one year renewal options. The Lottery entered into an informal agreement with the Landlord to rent the space on a month to month basis. Initially expecting to vacate the space by November 30, 2009, the Lottery extended the lease on a month to month basis and now expects to vacate the space by no later than October 1, 2010. There are no other options for renewal.

Operating lease expense incurred for the fiscal years ended June 30, 2010 and 2009 and future minimum lease payments for fiscal years ending June 30, 2011 through 2015 and later years are as follows:

<u>LOCATION</u>	<u>FUTURE MINIMUM LEASE PAYMENTS</u>							<u>LATER YEARS</u>
	<u>2009</u>	<u>2010</u>	<u>FY 2011</u>	<u>FY 2012</u>	<u>FY 2013</u>	<u>FY 2014</u>	<u>FY 2015</u>	
Pueblo Office	\$ 228,306	\$ 232,919	\$ 229,909	\$ 236,526	\$ 243,482	\$ 250,607	\$ 258,072	\$ -
Pueblo Warehouse	107,405	150,132	145,549	-	-	-	-	-
CoSprgs Warehouse	13,455	13,887	3,472	-	-	-	-	-
Denver	185,149	169,691	175,722	181,703	187,684	193,665	199,646	858,394
Denver Warehouse	99,621	93,112	77,929	80,287	82,533	85,004	87,811	-
Fort Collins	35,829	30,770	-	-	-	-	-	-
Grand Junction	<u>6,902</u>	<u>6,996</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
	<u>\$ 676,667</u>	<u>\$ 697,507</u>	<u>\$ 632,581</u>	<u>\$ 498,516</u>	<u>\$ 513,699</u>	<u>\$ 529,276</u>	<u>\$ 545,529</u>	<u>\$ 858,394</u>

COLORADO LOTTERY
NOTES TO FINANCIAL STATEMENTS
June 30, 2010 and 2009

NOTE 5 – OTHER REVENUE

A schedule of other revenue for the fiscal years ended June 30, 2010 and 2009 follows:

	<u>2010</u>	<u>2009</u>
License fees	\$ 64,154	\$ 66,988
Fines and penalties	28,900	176,140
Assignment fees	3,600	901
Net licensed agent recovery reserve receipts	(17,970)	(54,368)
Royalty income	24,753	25,212
Ended game revenue	47,867	0
Other	<u>26,337</u>	<u>52,315</u>
Total	<u>\$ 177,641</u>	<u>\$ 267,188</u>

NOTE 6 – DISTRIBUTION OF NET PROCEEDS

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

Income available for distribution at June 30:

	<u>2010</u>	<u>2009</u>
Operating income	\$113,053,729	\$120,172,896
Plus: Other revenue	177,641	267,188
Investment income	<u>1,317,086</u>	<u>1,427,948</u>
Income before distributions	\$114,548,456	\$121,868,032
Change in licensed agent recovery reserve	17,970	54,368
Change in fair market value of investments	(454,339)	(257,000)
Change in operating reserve	(100,000)	200,000
Other changes in investment in capital assets	<u>(1,070,520)</u>	<u>(2,261,545)</u>
Income available for distribution	112,941,567	119,603,855
Less distributions prior to year-end	<u>(82,687,282)</u>	<u>(91,513,623)</u>
Income available for distribution	<u>\$ 30,254,285</u>	<u>\$ 28,090,232</u>

**COLORADO LOTTERY
NOTES TO FINANCIAL STATEMENTS
June 30, 2010 and 2009**

NOTE 6 – DISTRIBUTION OF NET PROCEEDS (CONTINUED)

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

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

NOTE 7 – PENSION PLANS

Plan Description

Most of the department/institution's employees participate in a defined benefit (DB) pension plan, however all employees have the option of participating in the state's defined contribution (DC) plan instead. The DB plan's purpose is to provide benefits to members and their dependents at retirement or in the event of death or disability. The plan, a cost-sharing multiple-employer defined benefit plan, is administered by the Public Employees' Retirement Association (PERA). PERA was established by state statute in 1931. Changes to the plan require an actuarial assessment and legislation by the General Assembly as specified in Title 24, Article 51 of the Colorado Revised Statutes. The state plan and the other divisions' plans are included in PERA's financial statements, which may be obtained by writing PERA at P.O. Box 5800, Denver, CO 80217-5800 or by calling the PERA Infoline at 1-800-759-7372, or by visiting <http://www.copera.org>.

COLORADO LOTTERY
NOTES TO FINANCIAL STATEMENTS
June 30, 2010 and 2009

NOTE 7 – PENSION PLANS (CONTINUED)

All employees who work in a position eligible for Colorado PERA membership must be covered by Colorado PERA, except for employees who are hired into a position that makes them eligible for choice between enrolling in the PERA Defined Benefit Plan or the PERA Defined Contribution Plan. This eligibility applies to certain new employees of State Agencies and Departments and Community Colleges

During the 2010 legislative session, several bills that impacted Colorado PERA were passed by the Legislature and were signed into law. The major provisions of this legislation modified future annual increases in benefit payments, future employer and employee contribution rates, early retirement reduction factors, highest average salary calculations, indexing of benefits, vesting period for employer matching contributions, service retirement eligibility, suspension of benefits in certain situations, and contributions for retirees working during retirement.

Prior to legislation passed during the 2006 session, higher education employees may have participated in social security, PERA's defined benefit plan, or the institution's optional retirement plan. Currently, higher education employees, except for community college employees, are required to participate in their institution's optional plan, if available, unless they are active or inactive members of PERA with at least one year of service credit. In that case they may elect either PERA or their institution's optional plan.

If an eligible employee does not make a choice of which plan he or she would like to participate in within 60 days of the starting date of employment, the employee is automatically enrolled in the plan to which he last contributed or, if there was no prior participation, the PERA Defined Benefit Plan. During years two and five of participation in the plan of their choice, employees may make a one-time irrevocable election to switch their original election. After the fifth year of participation in their plan of choice, this option to switch no longer exists. Employer contributions to both defined contribution plans are the same amount as the contributions to the PERA defined benefit plan.

Defined Retirement Benefits

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

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

COLORADO LOTTERY
NOTES TO FINANCIAL STATEMENTS
June 30, 2010 and 2009

NOTE 7 – PENSION PLANS (CONTINUED)

State troopers and Colorado Bureau of Investigation (CBI) officers are eligible for retirement benefits at the following age and years of service; any age – 30, 50 – 25, 55 – 20 and 65 – 5. Reduced service benefits are calculated in the same manner as a service retirement benefit; however, the benefit is reduced by percentages that vary from 0.25 to 0.5, depending on age and years of service, for each month before the eligible date for the full service retirement. For members not eligible to retire as of January 1, 2011, an actuarial reduction will be applied to the reduced service retirement benefit.

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

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

In addition to the above requirements, the following changes were made in 2010 to age and service credit requirements for a full service retirement:

- Members with less than five years of service credit as of January 1, 2011 – age and service must add to 85 with a minimum age of 55.
- New members first covered under the plan between January 1, 2011 and 2017 – age and service must add to 88 with a minimum age of 58.
- New members first covered under the plan on or after January 1, 2017 – age and service must add to 90 with a minimum age of 60.

Monthly benefits are calculated as 2.5 percent times the number of years of services times the highest average salary (HAS). For retirements before January 1, 2009, HAS is calculated as one-twelfth of the average of the highest annual salaries on which contributions were paid that are associated with three periods (one period for judges) of 12 consecutive months of service credit and limited to a 15 percent increase between periods.

For retirements after January 1, 2009, the HAS is calculated based on original hire date as follows:

- Hired before January 1, 2007 – HAS is calculated based on three periods of service credit and is limited to a 15 percent increase between periods; the lowest salary of four periods is used as a base for determining the maximum allowable 15 percent increase.
- Hired on or after January 1, 2007 – HAS is calculated based on three periods of service credit and is limited to an 8 percent increase between periods; the lowest salary of four periods is used as a base for determining the maximum allowable 8 percent increase.

The benefit is limited to 100 percent (40 years) and cannot exceed the maximum amount allowed by federal law.

COLORADO LOTTERY
NOTES TO FINANCIAL STATEMENTS
June 30, 2010 and 2009

NOTE 7 – PENSION PLANS (CONTINUED)

PERA retirement and survivor benefits are increased annually based on original hire date as follows:

- Hired before January 1, 2007 – 2 percent unless PERA has a negative investment year in which case, for the next three years, the annual increase becomes the lesser of 2 percent or the average of the monthly Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) amounts for the prior calendar year.
- Hired on or after January 1, 2007 – the lesser of 2 percent or the average of the monthly CPI-W amounts for the prior calendar year. In no case can the sum of annual increases paid to a division's benefit recipients exceed 10 percent of the divisional reserve for annual increases.

If PERA's overall funded status is at or above 103 percent, the annual increase cap of 2 percent will increase by 0.25 percent per year. If after PERA's overall funded status reaches 103 percent and it subsequently drops below 90 percent, the 2 percent annual increase cap will decrease by 0.25 percent per year, but will never drop below 2 percent.

Money Purchase Retirement Benefit

A money purchase benefit is determined by the member's life expectancy and the value of the member's contribution account plus a matching amount as of the date of retirement. The matching amount is 100 percent of the member's contributions and accrued interest at the time of retirement. Retiring members who are age 65 and have less than five years of service credit and less than 60 payroll postings will receive a service retirement benefit under the money purchase formula only.

Service Requirement and Termination

Plan members who terminate PERA-covered employment may request a member contribution account refund or leave the account with PERA; a refund cancels a former PERA member's rights to future PERA benefits. Members who withdraw their accounts before reaching retirement eligibility or before reaching age 65 receive a refund of their contributions, interest on their contributions, plus an additional 50 percent of their contribution and interest. If the withdrawing member has reached age 65 or is retirement eligible, the matching payment increases to 100 percent. Statutes authorize the PERA Board to set the interest paid to member contribution accounts but limits the rate to a maximum of 5 percent. Effective January 1, 2009 the rate was set at 3 percent.

Disability and Survivor Benefits

PERA provides a two-tiered disability program for most members. Disabled members who have five or more years of service credit may apply for disability benefits through a third party insurance carrier. If the member is not totally and permanently disabled, they are provided reasonable income replacement (maximum 60 percent of PERA includable salary for 22 months).

If the member is totally and permanently disabled they receive disability retirement benefits based on HAS and earned, purchased, and in some circumstances, projected service credit. There is no earned service requirement for judges, and the earned service requirement may be waived for State Troopers who become disabled as the result of injuries in the line of duty.

COLORADO LOTTERY
NOTES TO FINANCIAL STATEMENTS
June 30, 2010 and 2009

NOTE 7 – PENSION PLANS (CONTINUED)

If a member has at least one year of earned service and dies before retirement, their qualified survivors are entitled to a single payment or monthly benefits depending on their status as defined in statute. The member's spouse may be eligible to receive the higher of the money purchase benefit or the defined benefit, but not less than 25 percent of HAS. The order of payment to survivors is dependent on the years of service and retirement eligibility of the deceased member. Under various conditions, survivors include qualified children under 18 (23 if a full-time student), the member's spouse, qualified children over 23, financially dependent parents, named beneficiaries, and the member's estate. The earned service requirement is waived if a member's death is job-incurred.

FUNDING POLICY

Members and employers are required to contribute to PERA at a rate set by statute. The contribution requirements of plan members and affiliated employers are established under Title 24, Article 51, Part 4 of the Colorado Revised Statutes as amended. Prior to July 1, 2010, members were required to contribute 8 percent of their gross covered wages, except for state troopers and Colorado Bureau of Investigation officers, who contributed 10 percent. From July 1, 2010 through June 30, 2011, member contributions will be increased by 2.5 percent of gross covered wages. Annual gross covered wages subject to PERA are 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.

From July 1, 2009, to December 31, 2009, the state contributed 12.95 percent (15.65 percent for state troopers and 16.46 percent for the Judicial Branch) of the employee's salary. From January 1, 2010, through June 30, 2010, the state contributed 13.85 percent (16.55 for state troopers and 17.36 percent for the Judicial Branch). During all of Fiscal Year 2009-10, 1.02 percent of the employee's total salary was allocated to the Health Care Trust Fund.

In the 2004 legislative session, the general assembly established the Amortization Equalization Disbursement (AED) to address a pension-funding shortfall. The AED requires PERA employers to pay an additional 0.5 percent of salary beginning January 1, 2006, another 0.5 percent of salary in 2007, and subsequent year increases of 0.4 percent of salary until the additional payment reaches 5.0 percent in 2017. The contribution table above reflects the increase required by the AED legislation.

The Fiscal Year 2009-10 contribution was allocated by PERA according to statute as follows:

- 1.02 percent was allocated to the Health Care Trust Fund throughout the fiscal year,
- From July 1, 2009, to December 31, 2009, 11.93 percent was allocated to the defined benefit plan, and
- From January 1, 2010, to June 30, 2010, 12.83 percent was allocated to the defined benefit plan.

COLORADO LOTTERY
NOTES TO FINANCIAL STATEMENTS
June 30, 2010 and 2009

NOTE 7 – PENSION PLANS (CONTINUED)

Per Colorado Revised Statutes, an amortization period of 30 years is deemed actuarially sound. At December 31, 2009, the State Division of PERA had a funded ratio of 67.0 percent and a 43 year amortization period based on current contribution rates. The funded ratio on the market value of assets is lower at 58.0 percent. In the 2006 legislative session, along with other provisions affecting the plan, the general assembly authorized a Supplemental Amortization Equalization Disbursement (SAED) that requires PERA employers to pay an additional one-half percentage point of total salaries paid beginning January 1, 2008. The SAED is scheduled to increase by one-half percentage point through 2017 resulting in a cumulative increase of five percentage points. However, if the funding ratio reaches 103%, both the AED and SAED will be reduced by 0.5 percent of pay each. For state employers, each year's one-half percentage point increase in the SAED will be deducted from the amount available for increases in state employees' salaries, and used by the employer to pay the SAED.

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

The Lottery's contributions to PERA the fiscal years ending June 30, 2010, 2009, and 2008 were \$790,705, \$797,259 and \$759,314, respectively. These contributions met the contribution requirement for each year.

Employee Deferred Compensation Plan

The Colorado PERA Deferred Compensation Plan (457) was established July 1, 2009, as a continuation of the State Deferred Compensation Plan which was established for state and local government employees in 1981. At July 1, 2009, the administrative functions were transferred from the State of Colorado to Colorado PERA, and all costs of administration and funding are borne by the plan participants. The 457 plan allows for voluntary participation to provide additional benefits at retirement and all employees may contribute to the 457 plan. In calendar year 2009, participants were allowed to make contributions of up to 100 percent of their annual gross salary (reduced by their 8 percent PERA contribution) to a maximum of \$16,500. Participants who are age 50 and older, and contributing the maximum amount allowable, can make an additional \$5,500 in 2009, for total contributions of \$22,000. Contributions and earnings are tax deferred. The assets of the plan are not assets of the state, but are held in trust for the exclusive benefit of plan participants and their beneficiaries. Fund equity of the plan was million and \$377.5 million at June 30, 2009, and June 30, 2008, respectively. The state has no liability for losses under the plan but does have the duty of due care that is required of a fiduciary agent.

PERA 401k Plan

The Public Employees' Retirement Association (PERA) offers a voluntary 401(k) plan entirely separate from the 457 and defined benefit plans. In calendar year 2009 PERA members were allowed to make contributions of up to 100 percent of their annual gross salary (reduced by their 8 percent PERA contribution) to a maximum of \$16,500. Participants who are age 50 and older, and contributing the maximum amount allowable, can make an additional \$5,500 in 2009, for a total contribution of \$22,000 in 2009. Contributions and earnings are tax deferred. On December 31, 2009, the plan had net assets of \$1,674.9 million and 75,819 accounts.

COLORADO LOTTERY
NOTES TO FINANCIAL STATEMENTS
June 30, 2010 and 2009

NOTE 7 – PENSION PLANS (CONTINUED)

PERA Defined Contribution Retirement Plan

The Defined Contribution Retirement Plan was established January 1, 2006, as a defined contribution alternative to Colorado PERA's Defined Benefit Plan. The plan is available to certain new state employees hired after January 1, 2006. Through June 30, 2009, these employees had the option of joining the PERA defined benefit plan, the PERA defined contribution plan, or a defined contribution plan administered by the Deferred Compensation Committee of the state. On July 1, 2009, participants of the State Defined Contribution plan became participants of the PERA defined contribution plan, and newly hired eligible employees after June 30, 2009 have the option to choose either Colorado PERA's defined benefit plan or defined contribution plan. At December 31, 2009, the plan had net assets of \$37.5 million and 3,039 accounts.

NOTE 8 – OTHER POSTEMPLOYMENT BENEFITS

Actuarial valuations of an ongoing OPEB plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future.

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point.

PERA Health Care Trust Fund

The PERA Health Care Program is a cost-sharing multiple employer plan. It began covering benefit recipients and qualified dependents on July 1, 1986. This benefit was developed after legislation in 1985 established the Program and the Health Care Fund. Legislation enacted during the 1999 session established the Health Care Trust Fund effective July 1, 1999. Under this program, PERA subsidizes a portion of the monthly premium for health care coverage. The benefit recipient pays any remaining amount of that premium through an automatic deduction from the monthly retirement benefit.

Effective July 1, 2000, the maximum monthly subsidy is \$230 per month for benefit recipients who are under 65 years of age and who are not entitled to Medicare, and \$115 per month for benefit recipients who are 65 years of age or older or who are under 65 years of age and entitled to Medicare. The maximum subsidy is based on the recipient having 20 years of service credit, and is subject to reduction by 5 percent for each year less than 20 years.

An additional implicit subsidy exists for participating retirees not eligible for Medicare Part A. This occurs because state statute prohibits PERA from charging different rates to retirees based on their Medicare Part A coverage, notwithstanding that the premium is calculated assuming that the participants have Medicare Part A coverage. At December 31, 2009, the Health Care Trust Fund had an unfunded actuarial accrued liability of \$1.50 billion, a funded ratio of 14.8 percent, and a 53-year amortization period.

**COLORADO LOTTERY
NOTES TO FINANCIAL STATEMENTS
June 30, 2010 and 2009**

NOTE 8 – OTHER POSTEMPLOYMENT BENEFITS (CONTINUED)

Beginning July 1, 2004, the state agencies/institutions are required to contribute 1.02 percent of gross covered wages to the Health Care Trust Fund. The Lottery contributed \$60,171, \$65,160, and \$66,734 as required by statute in Fiscal Years 2009-10, 2008-09 and 2007-08, respectively. In each year the amount contributed was 100 percent of the required contribution. Monthly premium costs for participants depend on the health care plan selected, the PERA subsidy amount, Medicare eligibility, and the number of persons covered.

The Health Care Trust Fund offers two general types of plans – fully insured plans offered through healthcare organizations and self-insured plans administered for PERA by third party vendors. In addition, two of PERA’s insurance carriers offered high deductible health care plans in 2009. As of December 31, 2009, there were 46,985 participants, including spouses and dependent, from all contributors to the plan.

The Health Care Trust Fund began providing dental and vision plans to its participants in 2001. The participants pay the premiums for the coverage, and there is no subsidy provided for the dental and vision plans.

NOTE 9 – CONTINGENCIES AND COMMITMENTS

Prize Annuities – The Lottery purchases annuity contracts in the name of individual jackpot prize winners. Although the annuity contracts are in the name of the individual winners, the Lottery retains title to the annuity contracts. The Lottery remains liable for the payment of the guaranteed minimum prizes in the event the insurance companies issuing the annuity contracts default. The following guaranteed minimum prize payments for which annuity contracts have been purchased are due in varying amounts through May 20, 2033.

Specified prize payments	\$ 376,430,493
Lifetime prize payments	<u>37,193,000</u>
Total guaranteed minimum prize payments	<u><u>\$ 413,623,493</u></u>

Prize Commitment – The Lottery also acts as a transfer agent for the single Powerball Jackpot Winner on October 10, 2007. These funds are held in trust at the MUSL in securities deemed appropriate by the Grand Prize Trust Agreement. The future value of this prize was \$18,886,000 as of June 30, 2010.

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 LOTTERY
NOTES TO FINANCIAL STATEMENTS
June 30, 2010 and 2009**

NOTE 9 – CONTINGENCIES AND COMMITMENTS (CONTINUED)

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

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

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

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

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

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

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

COLORADO LOTTERY
NOTES TO FINANCIAL STATEMENTS
June 30, 2010 and 2009

NOTE 9 – CONTINGENCIES AND COMMITMENTS (CONTINUED)

Gaming Operations Commitments – The Lottery entered into long-term contracts with certain significant vendors related to providing scratch tickets and online data processing services in support of the Lottery's gaming operations. The online data processing contract expires on October 31, 2012 per the contract amendment dated January 26, 2005. Renewal options include one additional two-year period and two additional periods of ninety days for conversion and turnover purposes. Per Option Letter #13, the amended total cost of the initial contract period is not to exceed \$71,860,975.

The Lottery entered into two contracts with scratch vendors on January 9 and 13, 2006. The contracts expired on November 30, 2007. The State, in its sole discretion, required continued performance for three additional twelve (12) month periods on both contracts. In addition, in the event that a contract with a successor contractor could not be signed prior to the expiration or termination date of this contract, the State reserved the right to extend this contract for maximum of one hundred eighty (180) days or until a new contract was executed. There were no other provisions for extension or renewal. The total costs of the contracts for the initial contract period were not to exceed \$5,666,667 each for the respective contracts. In May 2007, one scratch vendor (purchaser) purchased the other scratch vendor (purchaser). A novation agreement was signed assigning all of the rights of the purchaser to the purchaser. On November 17, 2007, the state exercised its option to extend both contracts with the purchaser for an additional twelve month period starting on December 1, 2007 and ending on November 30, 2008. On October 17, 2008, the state exercised its remaining options to extend both contracts for an additional two year period starting on December 1, 2008 and ending on November 30, 2010. The maximum amount available to cover both the original contract period and the extensions is \$25,615,870.33. The maximum amount available to cover costs for fiscal year 2010, which ended on June 30, 2010, was \$4,884,000.

The Lottery was approved as a member of the MUSL on February 26, 2001 and thus entered into an agreement with MUSL on June 6, 2001 to become a member and participate in Powerball games. As a member, the Lottery agrees to abide by the terms of the Multi-State Agreement dated September 16, 1987 and to any amendments to that agreement duly made by the board. The Lottery will remain a member indefinitely. Pursuant to this agreement, the Lottery will make payments to MUSL for administrative fees, weekly prize expenses, promotional purchases, miscellaneous reimbursements and assessments and contributions to the prize reserves. The total amount to be contributed by the Lottery to the Powerball prize reserves as of June 30, 2010 is \$3,656,050 and is based on a percentage of sales. The total amount of the Powerball prize reserves funded as of June 30, 2010 was \$3,944,710 shown as prepaid prize expense – MUSL on the statements of net assets. MUSL reserves the right to hold funds which do not exceed 110% of the required balance. If the actual balance in the reserves should exceed 110% of the required balance, MUSL will refund any funds in excess of the 110% threshold.

COLORADO LOTTERY
NOTES TO FINANCIAL STATEMENTS
June 30, 2010 and 2009

NOTE 9 – CONTINGENCIES AND COMMITMENTS (CONTINUED)

In 2009, the Powerball and Mega Millions governing bodies entered discussions regarding cross-selling the Powerball and Mega Millions games, whereby each state currently selling Mega Millions tickets would also sell Powerball tickets and those states currently selling Powerball tickets would also sell Mega Million tickets. On March 10, 2010, the Lottery commission voted to allow the Colorado Lottery to participate in the cross-selling of the Mega Millions game. The rule became effective as of April 30, 2010 and the first day of ticket sales was May 16, 2010. The Multi-State Lottery Association (MUSL) agreed to undertake the administrative functions associated with the Mega Millions game for the states currently participating in their Powerball game. MUSL immediately began collecting a percentage of sales to fund the newly formed Mega Millions prize reserve fund. No cap on the reserve had been set as of June 30, 2010. The Colorado Lottery's balance in the reserve as of June 30, 2010 was \$(16,391).

Other Major Vendor Commitments – The Lottery entered into a long-term contract with an advertising agency to provide advertising services to promote the Lottery's products. The contract period began on September 1, 2007 and expired on June 30, 2010. The Lottery has the option to renew the contract for two (2) additional twelve-month periods. On June 11, 2010, the Lottery exercised its first option to renew the contract for one (1) additional twelve-month period starting on July 1, 2010 and expiring on June 30, 2011 for a total cost of \$14,950,000 for fiscal year 2011. The maximum funds available for fiscal year 2010, which ended on June 30, 2010, were \$14,950,000. The total cost of the initial contract period including previous amendments plus the twelve-month extension is not to exceed \$48,900,000.

On November 3, 2008, the Lottery entered into a three year contract with a consulting firm contracted to develop and implement a new back office system including the maintenance and functionality of the Lottery's scratch product. Renewal options include two additional twelve month periods. Task order letter #1 was signed on May 12, 2009, requiring additional services. Task order letter #2 was signed on December 9, 2009, requiring additional services. The maximum funds available for fiscal year 2010, which ended on June 30, 2010, were \$1,402,600. The total cost of the initial three year contract period plus task orders #1 and #2 is \$4,348,480.

Litigation – Currently, there is no reportable outstanding litigation.

COLORADO LOTTERY
NOTES TO FINANCIAL STATEMENTS
June 30, 2010 and 2009

NOTE 10 – TAX, SPENDING AND DEBT LIMITATIONS

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

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

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

NOTE 11 – RELATED PARTY TRANSACTIONS

The Lottery, as an agency of the State of Colorado, paid fees to other agencies of the state for auditing, legal and other services and vehicle and office rent. The Lottery also pays fees to the Department of Revenue for indirect costs. Interagency charges were \$1,020,547 and \$1,152,460 for the fiscal years ended June 30, 2010 and 2009, respectively.

SUPPLEMENTARY INFORMATION

COLORADO LOTTERY
SCHEDULE OF REVENUE AND COSTS FOR SCRATCH AND ON-LINE GAMES
FOR THE FISCAL YEAR ENDED JUNE 30, 2010
(With Comparative Totals for the Fiscal Year Ended June 30, 2009)

	<u>Games in Progress</u>						Fiscal Year 2010 Total	Fiscal Year 2009 Scratch and On-Line
	<u>Scratch</u>	<u>On-Line</u>						
		<u>Lotto</u>	<u>Powerball</u>	<u>Cash 5</u>	<u>Matchplay</u>	<u>Mega Millions</u>		
Ticket sales	\$ 328,108,741	\$ 41,620,408	\$ 101,568,085	\$ 21,309,593	\$ 6,187,366	\$ 2,403,216	\$ 501,197,409	\$ 493,364,094
Prize expense	(224,567,596)	(21,843,486)	(51,883,925)	(11,081,335)	(3,238,067)	(1,109,726)	(313,724,135)	(301,506,498)
Multi-State prize variances	N/A	N/A	3,525,004	N/A	N/A	(165,279)	3,359,725	(168,068)
Net revenue after prizes	<u>103,541,145</u>	<u>19,776,922</u>	<u>53,209,164</u>	<u>10,228,258</u>	<u>2,949,299</u>	<u>1,128,211</u>	<u>190,832,999</u>	<u>191,689,528</u>
Commissions, bonuses, ticket costs and vendor fees (Note 1)								
Retailer Commission	(22,934,831)	(2,489,638)	(6,077,125)	(1,275,085)	(371,237)	(145,610)	(33,293,526)	(32,844,563)
Retailer Bonus	(3,652,698)	(272,537)	(656,382)	(197,496)	(58,691)	(15,445)	(4,853,249)	(3,636,346)
Cost of Tickets Sold	(3,064,963)	N/A	N/A	N/A	N/A	N/A	(3,064,963)	(2,698,617)
Telecomm Reimbursements	490,172	62,178	151,735	31,835	9,243	3,590	748,753	735,307
On-Line Vendor Fees	<u>(5,525,328)</u>	<u>(693,591)</u>	<u>(1,683,201)</u>	<u>(357,023)</u>	<u>(102,770)</u>	<u>(40,231)</u>	<u>(8,402,144)</u>	<u>(8,560,663)</u>
Total	<u>(34,687,648)</u>	<u>(3,393,588)</u>	<u>(8,264,973)</u>	<u>(1,797,769)</u>	<u>(523,455)</u>	<u>(197,696)</u>	<u>(48,865,129)</u>	<u>(47,004,882)</u>
Gross profit on sale of tickets	<u>\$ 68,853,497</u>	<u>\$ 16,383,334</u>	<u>\$ 44,944,191</u>	<u>\$ 8,430,489</u>	<u>\$ 2,425,844</u>	<u>\$ 930,515</u>	<u>\$ 141,967,870</u>	<u>\$ 144,684,646</u>
Average daily ticket sales	<u>\$ 898,928</u>	<u>\$ 114,029</u>	<u>\$ 278,269</u>	<u>\$ 58,382</u>	<u>\$ 47,595</u>	<u>\$ 52,244</u>	<u>\$ 1,373,144</u>	<u>\$ 1,351,682</u>

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

**COLORADO LOTTERY
SCHEDULE OF PERCENT OF PRIZE EXPENSE TO GROSS TICKET SALES
FOR THE FISCAL YEAR ENDED JUNE 30, 2010**

	<u>Games in Progress</u>						<u>Multi-State Games</u>	<u>Fiscal Year</u>
	<u>Scratch</u>	<u>Lotto</u>	<u>Powerball</u>	<u>Cash 5</u>	<u>Matchplay</u>	<u>Mega Millions</u>	<u>Prize Variances</u>	<u>2010 Total</u>
Prize Expense	\$ 224,567,596	\$ 21,843,486	\$ 51,883,925	\$ 11,081,335	\$ 3,238,067	\$ 1,109,726	\$ (3,359,725)	\$ 310,364,410
(/)Ticket Sales	<u>328,108,741</u>	<u>41,620,408</u>	<u>101,568,085</u>	<u>21,309,593</u>	<u>6,187,366</u>	<u>2,403,216</u>	N/A	<u>501,197,409</u>
Prize %	<u>68.44%</u>	<u>52.48%</u>	<u>51.08%</u>	<u>52.00%</u>	<u>52.33%</u>	<u>46.18%</u>		<u>61.92%</u>

**COLORADO LOTTERY
BUDGETARY COMPARISON
FOR THE FISCAL YEAR ENDED JUNE 30, 2010**

	Fiscal Year 2010 Original Budget	Supplementals Allocations and Internal Transfers	Fiscal Year 2010 Final Budget	Fiscal Year 2010 Actual Expenditures	Under Expended	Percent Under Expended
Personal Services	\$ 8,924,932	\$ (23,934)	\$ 8,900,998	\$ 8,099,385	\$ 801,613	9.01%
Amortization Equalization	-	139,163	139,163	131,004	8,159	5.86%
Supplemental Amort. Equal.	-	82,825	82,825	82,093	732	0.88%
Workmen's Compensation	-	47,158	47,158	47,158	-	0.00%
Health and Life	-	656,615	656,615	656,615	-	0.00%
Short Term Disability	-	10,207	10,207	10,207	-	0.00%
Operating	1,203,156	-	1,203,156	1,000,098	203,058	16.88%
DOR Postage Allocation	-	5,054	5,054	4,711	343	6.79%
Variable Vehicle	-	192,785	192,785	192,785	-	0.00%
Leased Space	-	702,351	702,351	692,427	9,924	1.41%
Grand Junction - Leased Space	-	7,019	7,019	6,996	23	0.33%
Risk Management	-	22,390	22,390	22,390	-	0.00%
Vehicle Lease Payments	-	117,305	117,305	116,063	1,242	1.06%
Travel	113,498	-	113,498	105,120	8,378	7.38%
Purch. Serv. Comp. Center	-	3,052	3,052	3,052	-	0.00%
Marketing, Communications & Sales	14,700,000	-	14,700,000	14,599,002	100,998	0.69%
Communications Services	-	2,060	2,060	2,060	-	0.00%
Payments to MNT	-	374,676	374,676	374,676	-	0.00%
Payments to Other Agencies	239,410	-	239,410	130,188	109,222	45.62%
Legal Services	-	13,640	13,640	13,640	-	0.00%
Indirect Costs	533,305	-	533,305	528,898	4,407	0.83%
Ticket Costs-Scratch	6,070,880	213,120	6,284,000	3,262,844	3,021,156	48.08%
Research	250,000	-	250,000	250,000	-	0.00%
Vendor Fees	12,677,849	(301,695)	12,376,154	9,623,664	2,752,490	22.24%
Prize Payments	392,580,940	7,683,620	400,264,560	313,919,655	86,344,905	21.57%
Retailer Compensation	48,894,160	396,440	49,290,600	38,146,774	11,143,826	22.61%
Multi-State Lottery Fund	177,433	-	177,433	103,370	74,063	41.74%
Powerball Prize Variance	12,708,000	252,000	12,960,000	7,575,512	5,384,488	41.55%
Lottery Systems Migration	3,281,051	-	3,281,051	1,345,103	1,935,948	59.00%
Rollforwards	13,920	-	13,920	13,920	-	0.00%
TOTAL	\$ 502,368,534	\$ 10,595,851	\$ 512,964,385	\$ 401,059,410	\$ 111,904,975	21.82%

FY10 Staffing (FTE) 126.0 (Appropriated) 113.5 (Actual)

**COLORADO LOTTERY
BUDGETARY COMPARISON (Continued)
FOR THE FISCAL YEAR ENDED JUNE 30, 2010**

Reconciliation of Expenses per "Statement of Revenues, Expenses and Changes in Net Assets" to Budgeted Expenditures:

Expenses Per Statement of Revenues, Expenses and Changes in Net Assets

Prize Expense	\$313,724,135
Powerball Prize Variance	(3,525,004)
Mega Millions Prize Variance	165,279
Commissions and Bonuses	38,146,775
Cost of Tickets & Vendor Fees	10,718,354
Operating Expenses	<u>28,914,141</u>
 Total Expenses per Statement of Revenues, Expenses and Changes in Net Assets	 388,143,680
 Plus: Powerball Prize Variance classified as revenue	 11,100,516
Mega Millions Prize Variance classified as revenue	30,241
Telecommunications offset classified as revenue	748,753
 Less: Non-appropriated expenses	
Depreciation	(621,027)
Accrued Annual and Sick Leave	(34,300)
Book Value of Assets Written Off	<u>(40,157)</u>
Sub-Total	399,327,706
Plus: Capitalized purchases	1,115,883
Capitalized wages	<u>615,821</u>
	 <u>\$401,059,410</u>

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

Members of the Legislative Audit Committee:

We have audited the financial statements of the major fund and remaining fund information of the Colorado Lottery (the Lottery), an enterprise fund and private purpose fund of the State of Colorado as of and for the year ended June 30, 2010, which collectively comprise the Lottery's basic financial statements and have issued our report thereon dated September 10, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Lottery's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Lottery's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Lottery's internal control over financial reporting.

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

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Lottery's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However,

providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain additional matters that we reported to management of the Lottery in the Findings and Recommendations section (Findings 1, 2 and 3) of this report.

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

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

Clifton Gunderson LLP

Greenwood Village, Colorado
September 10, 2010

Required Communications to the Legislative Audit Committee

September 10, 2010

Members of the Legislative Audit Committee:

This letter is to provide you with information about significant matters related to our audit of the financial statements of the Colorado Lottery for the year ended June 30, 2010.

The following are our observations arising from the audit that are relevant to management's responsibilities in overseeing the financial reporting process.

Auditor's Responsibilities under Generally Accepted Auditing Standards. Our audit was performed for the purpose of forming and expressing an opinion about whether the financial statements, that have been prepared by management, are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America. Our audit does not relieve management of its responsibilities.

Other Information in Documents Containing Audited Financial Statements. In connection with the Colorado Lottery's financial statements, we did not perform any procedures or corroborate other information included in the report. However, we read management's discussion and analysis of financial conditions and results of operations and considered whether the information or the manner in which it was presented was materially inconsistent with information or the manner of presentation of the financial statements. Based on our reading, we concluded that the information did not require revision.

Significant Issues Discussed with Management Prior to Retention. We discuss various matters with management prior to retention as the Colorado Lottery's auditors. These discussions occur in the normal course of our professional relationship. There were no significant issues, including the application of accounting principles and auditing standards, which were discussed with management prior to our retention as auditors.

Consultations with Other Accountants. We were informed by management that they made no consultations with other accountants on the application of generally accepted accounting principles or generally accepted auditing standards.

Qualitative Aspects of Accounting Practices.

Accounting Policies

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the Colorado Lottery are described in Note 1 to the financial statements. There were no significant accounting policies or their application which were either initially selected or changed during the year.

We noted no transactions in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.

There were no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected.

The following is management's description of the process utilized in forming an estimate for prize expense and corresponding liability.

Prize expense and corresponding liability is calculated based on the anticipated payout approved by the Lottery Commissioners. The prize expense and corresponding liability is incurred as tickets are activated by Lottery approved retailers.

Financial Statement Disclosures

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. There were no particularly sensitive financial statement disclosures.

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

Difficulties Encountered in Performing the Audit. We encountered no significant difficulties in dealing with management related to the performance of our audit.

Representations from Management. We have requested and received representations from management.

Disagreements with Management. There were no disagreements with management on financial accounting and reporting matters, auditing procedures, or other matters which would be significant to the Colorado Lottery's financial statements or our report on those financial statements.

Please contact Paul Niedermuller if you have any questions regarding the matters included in this letter.

Clifton Henderson LLP

The electronic version of this report is available on the Web site of the
Office of the State Auditor
www.state.co.us/auditor

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

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

Report Control No. 2018-10