

DEPARTMENT OF THE LOTTERY

Financial Audit

For the Fiscal Year Ended
June 30, 2011



STATE OF FLORIDA
AUDITOR GENERAL
DAVID W. MARTIN, CPA

Secretary of the Department of the Lottery

The State of Florida, Department of the Lottery (Lottery) was established as a State agency with the enactment of the Florida Public Education Lottery Act (the Act), Chapter 24, Florida Statutes, in 1987. The head of the Lottery is the Secretary, who, pursuant to Section 20.317, Florida Statutes, is appointed by the Governor subject to the confirmation of the Senate. The following Secretaries served the Department during the period of our audit:

Cynthia F. O'Connell From February 9, 2011

Leo DiBenigno Through January 4, 2011

The Auditor General conducts audits of governmental entities to provide the Legislature, Florida's citizens, public entity management, and other stakeholders unbiased, timely, and relevant information for use in promoting government accountability and stewardship and improving government operations.

The audit team leader was Robin Ralston, CPA, and the audit was supervised by Haesun Baek, CPA. Please address inquiries regarding this report to Kathryn D. Walker, CPA, Audit Manager, by e-mail at kathrynwalker@aud.state.fl.us or by telephone at (850) 487-9085. For the information technology portion of this audit, the audit team leader was Suzanne Varick, CPA, and the supervisor was Shelly Posey, CISA. Please address inquiries regarding the information technology portions of this report to Jonathan E. Ingram, CPA, CISA, Audit Manager, by e-mail at joningham@aud.state.fl.us or by telephone at (850) 487-9330.

This report and other reports prepared by the Auditor General can be obtained on our Web site at www.myflorida.com/audgen; by telephone at (850) 487-9175; or by mail at G74 Claude Pepper Building, 111 West Madison Street, Tallahassee, Florida 32399-1450.

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EXECUTIVE SUMMARY

Summary of Report on Financial Statements

The financial statements prepared by the Department of the Lottery (Lottery) present fairly, in all material respects, the financial position of the Lottery as of June 30, 2011, and 2010, and the changes in the financial position and cash flows thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Summary of Report on Internal Control and Compliance

In our opinion, Lottery management maintained, in all material respects, effective internal control over financial reporting.

The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*; however, we noted certain additional matters as summarized below.

Additional Matters

INFORMATION TECHNOLOGY CONTROLS

Finding No. 1: During our audit, we identified the need for enhancements to the Lottery's information technology (IT) control practices. Specific details of these matters are not disclosed in this report to avoid the possibility of compromising Lottery information. However, the appropriate Lottery personnel have been notified of these issues.

MINORITY RETAILER PARTICIPATION

Finding No. 2: Section 24.113, Florida Statutes, requires that 15 percent of the Lottery's retailers shall be minority business enterprises, as defined in Section 288.703(3), Florida Statutes; however, no more than 35 percent of such retailers shall be owned by the same type of minority person, as defined by Section 288.703(4), Florida Statutes. Our audit disclosed that as of July 1, 2011, retailers comprising one minority type totaled 65 percent of the total number of minority retailers. A similar finding has been included in prior reports.

SALES-BASED EXPENSES

Finding No. 3: The Lottery's contracts with On-line and Scratch-Off game vendors provide that the Lottery pay a percentage of ticket sales to the vendors. The fees paid to these vendors are thus sales-based expenses that increase as ticket revenues increase. Our audit disclosed that in June 2011, the sales-based expenses incurred for the On-line games contract exceeded by \$419,300 the available 2010-2011 fiscal year budget of \$27,740,321. Chapter 2010-152, Laws of Florida, the General Appropriations Act, provided the approved budgeted amounts for fiscal year 2010-11, and included specific language authorizing the Lottery to submit budget amendments should actual sales exceed the projected sales used to calculate the amounts appropriated. Rather than submitting a budget amendment in accordance with the process authorized by the General Appropriations Act, the amount of the excess was charged to the 2011-12 fiscal-year's operations.

Audit Objectives and Scope

Our audit objectives were to determine whether the Lottery had:

- Presented the Lottery's basic financial statements in accordance with generally accepted accounting principles;
- Established and implemented internal control over financial reporting and compliance with requirements that could have a direct and material effect on the financial statements;
- Complied with the various provisions of laws, rules, regulations, and contracts that are material to the financial statements; and
- Taken corrective actions for findings included in our report No. 2011-080.

The scope of this audit included an examination of the Lottery's basic financial statements as of and for the fiscal years ended June 30, 2011, and 2010, and an examination of the effectiveness of the Lottery's internal control over financial reporting. With respect to internal control over financial reporting, our examination included obtaining an understanding of the internal control over financial reporting, testing and evaluating the design and operating effectiveness of the internal control, and performing such other procedures as we considered necessary in the circumstances. We also examined various transactions to determine whether they were executed, both in manner and substance, in accordance with governing provisions of laws, rules, regulations, and contracts.

Audit Methodology

The methodology used to develop the findings in this report included the examination of pertinent Lottery records in connection with the application of procedures required by auditing standards generally accepted in the United States of America, and applicable standards contained in *Government Auditing Standards* issued by the Comptroller General of the United States.



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The President of the Senate, the Speaker of the
House of Representatives, and the
Legislative Auditing Committee

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

We have audited the accompanying financial statements of the Department of the Lottery (Lottery), an enterprise fund of the State of Florida, as of and for the fiscal years ended June 30, 2011, and 2010, as listed in the table of contents. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express opinions on these financial statements based on our audit.

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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Lottery and do not purport to, and do not, present fairly the operations of the State of Florida as of June 30, 2011, and 2010, and the changes in its financial position and 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 financial position of the Lottery as of June 30, 2011, and 2010, and the changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with attestation standards established by the American Institute of Certified Public Accountants and the standards applicable to attestation engagements in *Government Auditing Standards*, we have also issued a report on

our examination of the Lottery's internal control over financial reporting, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and on our tests of the Lottery's compliance with certain provisions of laws, rules, regulations, contracts, and other matters included under the heading **INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF THE FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**. One purpose of that report is to describe the scope of our testing of internal control over financial reporting and to provide an opinion thereon. With respect to compliance, the purpose of that report is not to provide an opinion on compliance, but rather to describe the scope of our testing of compliance and the results of that testing. 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.

Accounting principles generally accepted in the United States of America require that the **MANAGEMENT'S DISCUSSION AND ANALYSIS** (pages 3 through 12) be presented to supplement the basic financial statements. Such information, although not part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Respectfully submitted,



David W. Martin, CPA
January 23, 2012

MANAGEMENT'S DISCUSSION AND ANALYSIS

YEARS ENDED JUNE 30, 2011, AND JUNE 30, 2010

The information presented in the Management's Discussion and Analysis (MD&A) introduces the Florida Lottery's (Lottery) financial statements and provides readers an analytical overview of the Lottery's financial activities and performance for the fiscal years ended June 30, 2011, and 2010. We encourage readers to consider the information presented here in conjunction with the financial statements and notes to the financial statements, which begin on page 13.

FINANCIAL HIGHLIGHTS

The Lottery has as its mission the maximization of revenues for the benefit of education in a manner consistent with the dignity of the State of Florida and the welfare of its citizens. The Lottery is considered a mature lottery and offers its players a full range of both Scratch-Off and On-line products. The Lottery has been successful in sustaining ticket sales in excess of \$2 billion for the twenty-second consecutive fiscal year, with the past eight fiscal years exceeding \$3 billion. During the same twenty-two year period the transfer to the Educational Enhancement Trust Fund (EETF) has been a minimum of \$800 million annually, with the fiscal year 2011 transfer exceeding \$1 billion for the ninth consecutive year.

For the fiscal year ended June 30, 2011:

- Transfers to the EETF decreased slightly to approximately \$1.19 billion compared to \$1.25 billion in the prior fiscal year.
- The Lottery's ticket sales increased by 2.77% over the prior fiscal year from approximately \$3.90 billion to \$4.01 billion.
- Approximately 55.5% of total sales was provided by the Scratch-Off product line. This shift in product mix from the higher profit margin On-line product to the lower profit margin Scratch-Off product directly impacts the amount transferred to the EETF.
- Prize expense increased \$114.1 million, which represents a 4.86% increase during fiscal year 2011. The Lottery has the authority to vary the prize expense in order to maximize transfers. This expense typically increases or decreases in proportion to ticket sales and represented approximately 61.37% of net ticket sales.
- The gaming vendors' fees and retailer commissions are based on sales and therefore fluctuate in direct correlation with sales revenue. Fiscal year 2011 expenses for these items increased 4.43% over the prior fiscal year expenses in conjunction with the increase in sales.
- Administrative operating expenses, which include advertising, salaries and benefits, rent, utilities and maintenance, professional fees, depreciation, and other administrative expenses, experienced a nominal

decrease. Administrative operating expenses for fiscal years 2011 and 2010 were \$71.4 million and \$71.5 million, respectively.

- Nonoperating income decreased \$60.82 million from the prior fiscal year. Unrealized appreciation on investments accounted for \$69.2 million of the decrease due to a reduction in holdings and lower market values of investments in fiscal year 2011 compared to fiscal year 2010.
- EETF transfers from unclaimed prize money increased \$255,000 over the prior fiscal year. Despite the \$1.58 million decrease in unclaimed prize money generated by On-line games, Scratch-Off games provided an additional \$1.83 million in unclaimed prize money compared to fiscal year 2010.

OVERVIEW OF THE FINANCIAL STATEMENTS

The Lottery is accounted for as an enterprise fund, reporting transactions using the accrual basis of accounting similar to the method used by business entities. This MD&A is intended to serve as an introduction to the Lottery's basic financial statements, including the notes to the financial statements. The Statement of Net Assets on page 13, the Statement of Revenues, Expenses, and Changes in Net Assets on page 14, and the Statement of Cash Flows on page 15 report the Lottery's net assets and changes therein. The notes to the financial statements provide additional information that is essential to a reader's understanding of the data provided in the financial statements.

The Lottery transfers its net profits to the EETF each fiscal year. As a result, the Lottery's net assets consist of funds invested in fixed capital assets and restricted assets. The restricted net assets consist of the investments being held by the Lottery to fund deferred prize payouts, 20 percent of unclaimed prizes designated for future prize payouts, and the Multi-State Lottery Association (MUSL) deposit amount. The financial statements do include the cumulative effect of periodic adjustments to recognize the fair value of the grand prize investments despite the fact that the Lottery purchased the investments with the intention of holding the investments until maturity in order to meet the future obligations and, therefore, would not realize any gains or losses related to these investments for distribution as net proceeds.

SUMMARY OF NET ASSETS

Table 1 presents a comparative summary of the Lottery's Statement of Net Assets for fiscal years 2011, 2010, and 2009.

Table 1
Condensed Statement of Net Assets
As of June 30, 2011, 2010, and 2009
(In Thousands)

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Assets			
Current Assets	\$ 189,859	\$ 176,765	\$ 173,395
Restricted Assets	1,511,185	1,745,058	1,926,734
Capital Assets, Net of Depreciation	<u>1,248</u>	<u>1,421</u>	<u>1,235</u>
Total Assets	<u>1,702,292</u>	<u>1,923,244</u>	<u>2,101,364</u>
Liabilities			
Current Liabilities	184,155	171,126	173,542
Current Liabilities Payable from Restricted Assets	882,439	1,018,424	1,083,453
Noncurrent Liabilities	<u>513,728</u>	<u>599,586</u>	<u>722,190</u>
Total Liabilities	<u>1,580,322</u>	<u>1,789,136</u>	<u>1,979,185</u>
Net Assets			
Net Investment in Capital Assets	1,248	1,421	1,235
Restricted Net Assets	<u>120,722</u>	<u>132,687</u>	<u>120,944</u>
Total Net Assets	<u>\$ 121,970</u>	<u>\$ 134,108</u>	<u>\$ 122,179</u>

Assets

Total assets decreased \$221 million from \$1.9 billion at June 30, 2010, to \$1.7 billion at June 30, 2011. At the end of fiscal year 2010, total assets were \$178.1 million less than the \$2.1 billion at the end of fiscal year 2009.

- Current assets increased from \$176.8 million in 2010 to \$189.9 million in 2011, representing an increase of \$13.1 million. This net increase was primarily due to an increase of \$8.2 million in cash and cash equivalents, mostly on deposit with the State Treasurer, and an increase of \$4.8 million in accounts receivable. This increase in accounts receivable was due to an additional day in the retailer billing cycle when compared to the prior year.
- Restricted assets decreased \$233.9 million from \$1.7 billion in 2010 to \$1.5 billion in 2011. This decrease was predominately due to the continued decrease in the deferred payment investment portfolio as the preference in payout options for jackpot prizewinners progressively shifted toward the cash option instead of the alternative annuity option. There were \$178.6 million in payouts of annuities and \$25.2 million in purchases of new investments in fiscal year 2011, and in fiscal year 2010, there were annuity payouts of \$201.7 million, and purchases of new investments of \$2.2 million. As a result of the downward trend in the investment portfolio, there was also a decrease of \$138.9 million in the fair value of the grand prize investments. Additionally, the amount of invested collateral from the lending of those securities declined. At June 30, 2011, the Lottery held \$709.9 million in invested collateral, \$749.1 million at June 30, 2010, and \$842.7 million at June 30, 2009.

Liabilities

Total liabilities at June 30, 2011, were \$1.6 billion, which was approximately \$208.8 million lower than the total liabilities of \$1.8 billion at June 30, 2010. The total liabilities at June 30, 2010, were \$190 million lower than the June 30, 2009 amount of \$2.0 billion.

- Current liabilities increased from \$171.1 million at June 30, 2010, to \$184.2 million at June 30, 2011. This increase can be attributed to the increase in the amount due to EETF.
- As expected, current liabilities from restricted assets decreased \$136 million from \$1.02 billion at June 30, 2010, to \$882.4 million at June 30, 2011. The amount of grand prizes payable due within one year and the obligation under securities lending, which are the two primary components of this liability class, are associated with the amounts payable to jackpot winners who have chosen the deferred payment (annuity) option. The obligation under securities lending decreased by \$113.8 million and the current portion of grand prizes payable decreased by \$22.1 million. At June 30, 2010, the current liability balance of \$1.02 billion was \$65 million less than the balance of \$1.08 billion at June 30, 2009. This decrease was also attributable to a net decrease of \$42.1 million in obligations under securities lending.
- Noncurrent liabilities principally consist of the long-term portion of grand prizes payable, which represents the amount to be paid to grand prizewinners in future years. Correlative to current grand prizes payable, the long-term grand prizes payable decreased \$86.3 million from fiscal year-end 2010 to 2011 and decreased \$123 million from fiscal year-end 2009 to 2010.

Net Assets and Changes in Net Assets

Net assets decreased \$12.1 million from June 30, 2010, to June 30, 2011. Net assets at June 30, 2011, 2010, and 2009 were \$122.0 million, \$134.1 million, and \$122.2 million, respectively. The decrease was predominately due to the decrease in restricted net assets for undistributed appreciation on restricted investments. The Lottery expects the restricted net assets for undistributed appreciation on restricted investments to continue to decline over the foreseeable future due to the fact that grand prizewinners consistently choose the cash option when they claim their prizes. The majority of grand prizewinners that are receiving annual payments will be paid off within the next five years. Refer to Note 2 – Cash and Investments in the notes to the financial statements for more details.

The Lottery joined MUSL two years ago in order to participate in the Powerball® with Powerplay® game. In accordance with MUSL's rules, the Lottery must contribute to various prize reserve funds maintained by MUSL for unforeseen prize payouts related to the Powerball with Powerplay game. The Lottery's deposits in reserve funds with MUSL totaled \$15.9 million and \$9.3 million as of June 30, 2011, and June 30, 2010, respectively. Refer to Note 6 in the notes to the financial statements for further detail.

SUMMARY OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

The most important element demonstrated with the Lottery's financial statements is the transfer to the EETF. Accordingly, the primary focus of these financial statements is determining net income available for transfer, rather than the change in net assets of the Lottery, which primarily reflects the changes in fair value of restricted investments.

Table 2 presents a condensed Summary of Revenues, Expenses, and Changes in Net Assets for the fiscal years ended June 30, 2011, 2010, and 2009, as derived from the Lottery's Statement of Revenues, Expenses, and Changes in Net Assets.

Table 2
Condensed Statement of Revenues, Expenses, and Changes in Net Assets
For the Fiscal Years Ended June 30, 2011, 2010, and 2009
(In Thousands)

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Operating Revenues			
Ticket Sales	\$ 4,008,716	\$ 3,900,499	\$ 3,938,037
Bad Debt Expense	(1,212)	(1,075)	(1,256)
On-line & Retailer Fees and Miscellaneous	7,436	7,599	7,408
Total Operating Revenues	<u>4,014,940</u>	<u>3,907,023</u>	<u>3,944,189</u>
Operating Expenses			
Prizes	2,460,219	2,346,162	2,340,372
Retailer Commissions	223,390	216,207	220,548
Vendor Commissions	63,260	58,286	59,875
Other Expenses	71,449	71,519	71,223
Total Operating Expenses	<u>2,818,318</u>	<u>2,692,174</u>	<u>2,692,018</u>
Income from Operations	<u>1,196,622</u>	<u>1,214,849</u>	<u>1,252,171</u>
Nonoperating Revenue, Net of Expenses	<u>(16,942)</u>	<u>43,874</u>	<u>(1,947)</u>
Income Before Operating Transfers	<u>1,179,680</u>	<u>1,258,723</u>	<u>1,250,224</u>
Transfers to EETF from Revenue and Reserves	(1,147,793)	(1,203,024)	(1,241,015)
Transfers to EETF from Unclaimed Prizes	(44,025)	(43,770)	(46,840)
Total Transfers to EETF	<u>(1,191,818)</u>	<u>(1,246,794)</u>	<u>(1,287,855)</u>
Change in Net Assets	(12,138)	11,929	(37,631)
Net Assets, Beginning of Year	<u>134,108</u>	<u>122,179</u>	<u>159,810</u>
Net Assets, End of Year	<u>\$ 121,970</u>	<u>\$ 134,108</u>	<u>\$ 122,179</u>

Sales

For the fiscal year ended June 30, 2011, ticket sales increased \$108.2 million, which reflects an improvement over the two prior years that experienced sales decreases due to the economic downturn. The On-line sales decreased 2.2% from the prior year. However, to offset the impact of the slowly recovering economy on sales, the Lottery not only continued to utilize proven techniques, but also created new promotions and product offerings for players.

- In August of 2010, a new play style was added to the CASH 3™ game called 1-OFF™. As a result, CASH 3 ended the year with an increase in sales of more than \$9 million over the prior year.
- A new instant-win On-line game called LUCKY LINES™ was also launched in October of 2010. The new game added more than \$45 million to sales for the fiscal year.
- Despite the decrease in sales in the FLORIDA LOTTO™ with XTRA® game that resulted from fewer consecutive rollover series and jackpots, it continues to be a strong State game. More than 1.1 million winners (6%) selected the XTRA feature and increased their non-jackpot winnings by almost \$43 million in cash prizes. In June 2011, a promotion was offered in an effort to enhance FLORIDA LOTTO with XTRA sales. The result was an increase in the play-through rate of XTRA sales.
- Sales for the multi-state Powerball game declined due to fewer rollovers and lower jackpots than in the previous year; however, since the January 2009 inception of Powerball sales in Florida, the game has brought in more than \$1 billion in additional sales to the State. Three additional Florida players were jackpot winners in fiscal year 2010-11, with winning jackpots of \$64 million in July 2010, \$60 million in October 2010, and \$184 million in February 2011.
- The Lottery has revised its strategy for the utilization of the traditional MILLIONAIRE RAFFLE™ by introducing different price points and themes. The *Firecracker* MILLIONAIRE RAFFLE, which had a July 4th theme, and the early spring LUCKY 7 RAFFLE carrying a St. Patrick's Day theme produced combined sales that exceeded \$12 million. The LUCKY 7 RAFFLE was the first \$10 raffle game offered to players.
- The Lottery continued to utilize numerous second chance drawings during the fiscal year to give non-winning players another chance to win.

Sales of Scratch-Off tickets increased from \$2.08 billion, or 53.3% of total sales in fiscal year 2010, to \$2.23 billion, or 55.5% of total sales in fiscal year 2011.

- The \$3, \$5, \$10, and \$20 price points all contributed to the increase. The largest increases were seen in the \$5 and \$20 price points. The \$250,000 Monopoly™ game dominated the \$5 price point with more than \$74 million in sales. The \$10 price point was led by Lucky \$100,000 a Year for Life with \$91 million in sales, Cash Bonanza with \$84 million in sales, and The Color of Money with approximately \$40 million in sales. There were five \$20 games that each exceeded \$100 million in sales: Billion Dollar Blockbuster, Lucky

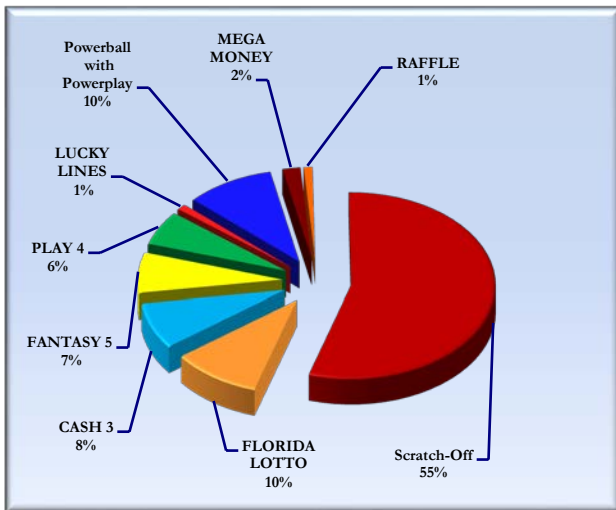
\$200,000 a Year for Life, Florida Millionaires Club, Gold Rush, and \$3 Million Monopoly™. Gold Rush contributed \$151 million and the top selling \$3 Million Monopoly game provided \$165 million in sales.

- Instant Ticket Vending Machines (ITVMs), which function similar to other vending machines, continued to have a notable impact on Scratch-Off ticket sales. They have proven successful in increasing the visibility of Scratch-Off ticket products and offering a convenience to players. There were 500 additional machines installed in the current fiscal year that added to the initial 1,000 machines deployed in the prior fiscal year. Total ITVM sales accounted for \$257 million of total Scratch-Off sales, which reflects an increase of \$118 million over the prior fiscal year.

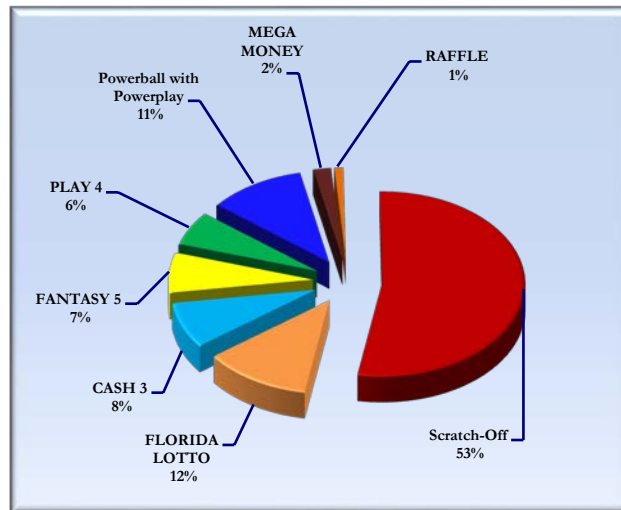
Bad debt expense is reported as a reduction in gross revenue in accordance with Governmental Accounting Standards Board requirements. The amount of bad debt expense for the fiscal years ended June 30, 2011, and 2010, was \$1,212,000 and \$1,075,000, respectively.

The following charts show sales by product for the various Lottery games during the fiscal years 2011 and 2010:

Sales by Product for Fiscal Year 2010-11

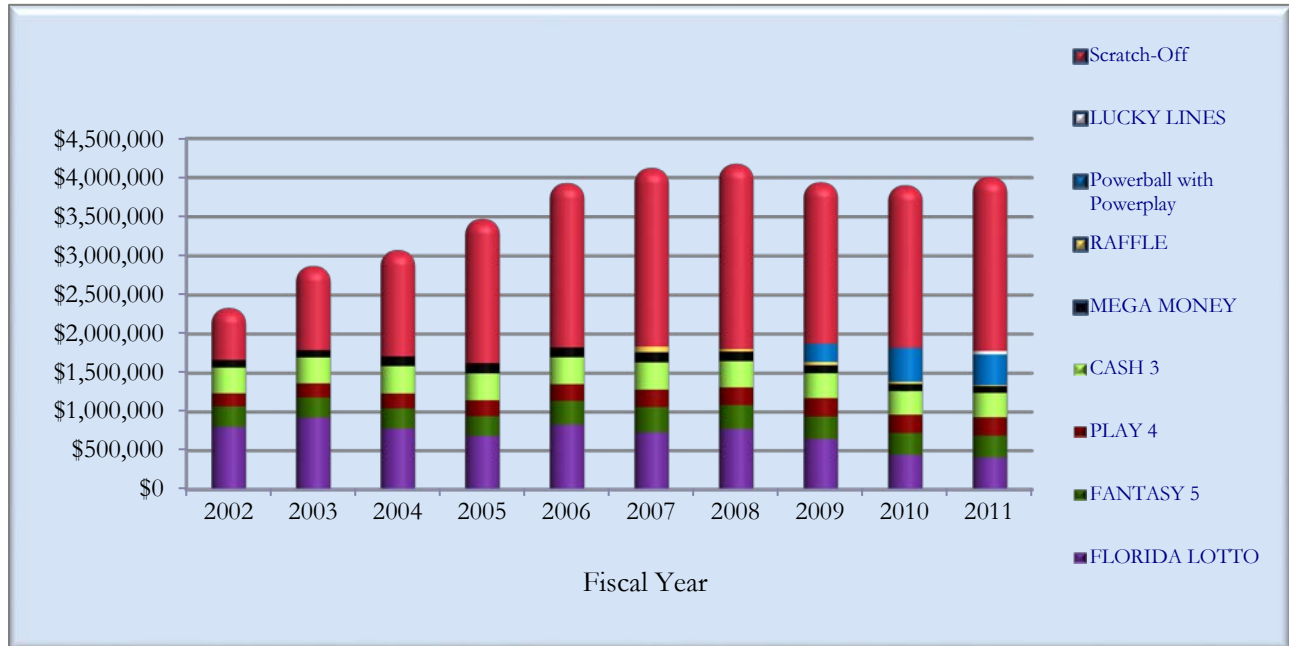


Sales by Product for Fiscal Year 2009-10



The following chart and table show sales by game for the last ten fiscal years:

**Department of the Lottery
Historical Lottery Sales by Game
(In Thousands)**



**Department of the Lottery
Historical Lottery Sales By Game
Last Ten Fiscal Years
(In Thousands)**

Fiscal Year Ended June 30	FLORIDA LOTTO™	FANTASY 5®	PLAY 4™	CASH 3™	MEGA MONEY™	RAFFLE™	LUCKY LINES™	Powerball® with Powerplay®	Scratch-Off	Combined Sales
2002	\$ 806,023	\$ 262,923	\$ 170,708	\$ 329,830	\$ 98,315				\$ 662,566	\$ 2,330,365
2003	925,474	259,999	182,716	330,001	95,930				1,073,861	2,867,981
2004	785,415	259,728	192,580	349,227	125,944				1,358,068	3,070,962
2005	689,820	252,467	206,982	345,598	131,248				1,844,619	3,470,734
2006	835,028	306,679	215,529	343,174	128,502				2,100,118	3,929,030
2007	735,585	326,241	225,285	348,694	130,142	\$ 72,549			2,283,620	4,122,116
2008	778,954	309,445	227,940	336,096	122,742	30,818			2,368,781	4,174,776
2009	650,603	287,285	238,957	320,157	102,190	41,314		\$ 233,396	2,064,135	3,938,037
2010	445,881	281,963	235,027	304,039	92,060	29,334		434,062	2,078,133	3,900,499
2011	411,389	282,777	235,692	313,270	88,971	12,603	\$ 45,369	392,969	2,225,676	4,008,716

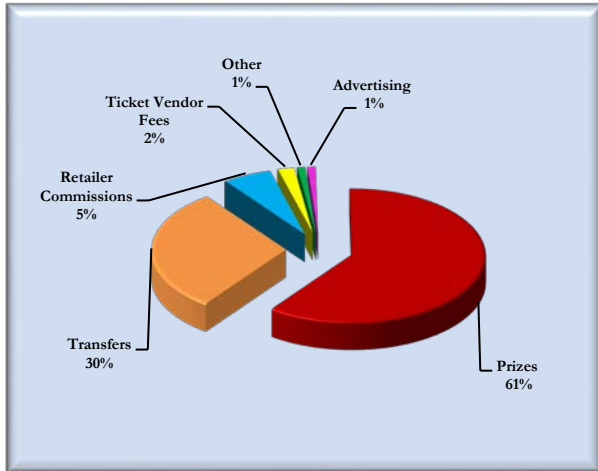
Expenses

Section 24.121, Florida Statutes, stipulates that funds remaining in the Operating Trust Fund after the transfer to the EETF shall be used for the payment of administrative expenses of the Lottery. These expenses include On-line game

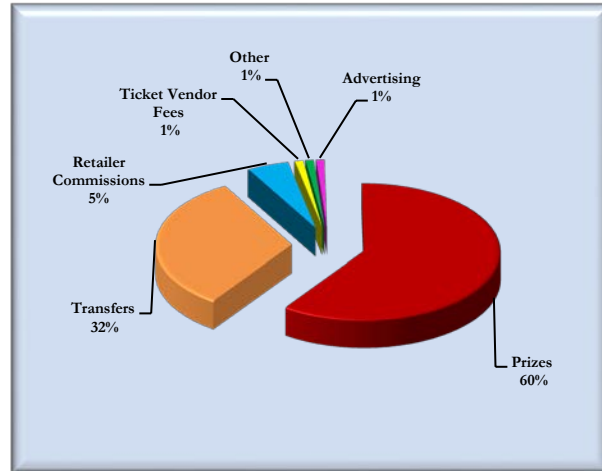
expenses, Scratch-Off ticket expenses, advertising, and other expenses required for the day-to-day operations of the Lottery.

The following charts show the major components of Lottery operating expenses and transfers as a percentage of ticket sales for the 2011 and 2010 fiscal years:

**Operating Expenses and Transfers
Fiscal Year 2010-11**



**Operating Expenses and Transfers
Fiscal Year 2009-10**



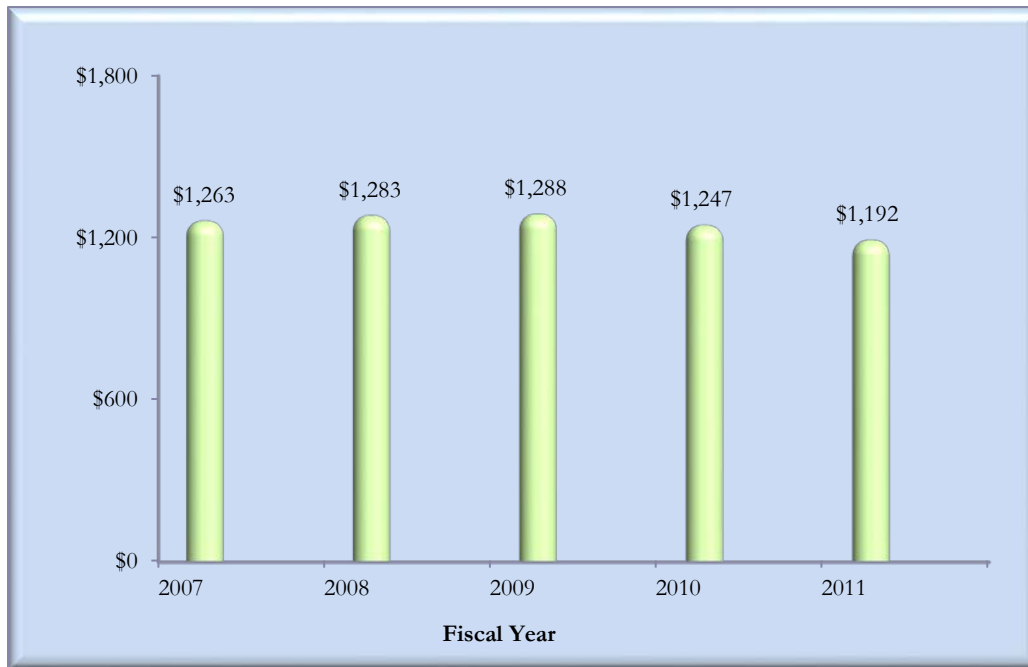
Prizes, commissions, and vendor fees directly relate to ticket sales and fluctuate accordingly. In fiscal year 2011, these expenses changed proportionally; yet, as a percentage of total expenses they remained constant. The other expenses, which consist of advertising, salary and benefits, professional fees, rent, maintenance, depreciation, and other administrative expenses, remained relatively stable. Fiscal year 2011 and 2010 administrative expenses were \$71.4 million and \$71.5 million, respectively.

Transfers

Since its inception the Lottery has transferred over \$22.7 billion to the EETF. The Lottery’s contribution to the EETF for the fiscal year ended June 30, 2011, \$1.19 billion, was slightly below the prior fiscal year contribution of \$1.25 billion; however, for the ninth consecutive year the Lottery contributed over \$1 billion. With the exception of the 2010 and 2011 fiscal years, the Lottery has shown increases in transfers since fiscal year 2001.

The following chart shows the total transfers to the EETF for the past five years:

**Department of the Lottery
Total Transfers to the EETF
(In Millions)**



ECONOMIC FACTORS AND FUTURE IMPACTS

The main economic factors affecting lottery sales are population growth, personal income growth, tourism, and competition for discretionary consumer spending. The Lottery is challenged with Florida’s unemployment rate which remained above 10% during the fiscal year 2011, population growth that is expected to remain relatively flat over the next few years, and consumer confidence still recovering at a slow rate. Ways to improve its generation of funds and increase the annual transfer to the EETF must be found. The Lottery’s strategies revolve around enhancing On-line and Scratch-Off product sales, increasing retailer penetration in the State, and refreshing the Lottery’s brand.

FINANCIAL CONTACT

The Lottery’s financial statements and this Management’s Discussion and Analysis are designed to give a general overview to the reader. If you have any questions regarding this report or require additional information, please contact the State of Florida, Department of the Lottery, Chief Financial Officer, 250 Marriott Drive, Capitol Complex, Tallahassee, Florida 32399.

BASIC FINANCIAL STATEMENTS

**DEPARTMENT OF THE LOTTERY
STATEMENT OF NET ASSETS
As of June 30, 2011, and June 30, 2010
(In Thousands)**

Assets	<u>June 30, 2011</u>	<u>June 30, 2010</u>
Current Assets:		
Cash and cash equivalents	\$164,525	\$156,313
Interest receivable	453	468
Accounts receivable, net	21,254	16,473
Prepaid expenses	68	46
Inventories	994	1,021
Security deposits	2,565	2,444
Total Current Assets	<u>189,859</u>	<u>176,765</u>
Noncurrent Assets:		
Restricted Assets		
Cash and cash equivalents	39,774	99,419
Securities lending income receivable	476	292
Deposit with MUSL	15,926	9,336
Pending investment sales	0	2,816
Investments, grand prize	745,138	884,058
Investments, securities lending collateral	709,871	749,137
Total Restricted Assets	<u>1,511,185</u>	<u>1,745,058</u>
Capital assets, net	1,248	1,421
Total Noncurrent Assets	<u>1,512,433</u>	<u>1,746,479</u>
Total Assets	<u>1,702,292</u>	<u>1,923,244</u>
Liabilities		
Current Liabilities:		
Accounts payable and accrued liabilities	9,566	13,686
Prizes payable	89,395	94,809
Due to Educational Enhancement Trust Fund	81,818	59,308
Deposits payable	2,567	2,450
Compensated absences payable	809	873
Total Current Liabilities	<u>184,155</u>	<u>171,126</u>
Current Liabilities Payable from Restricted Assets:		
Securities lending fees payable	48	143
Obligations under securities lending	731,926	845,692
Grand prizes payable	150,465	172,589
Total Current Liabilities Payable from Restricted Assets	<u>882,439</u>	<u>1,018,424</u>
Noncurrent Liabilities:		
Grand prizes payable from restricted assets	509,513	595,792
Compensated absences payable	2,743	2,804
Postemployment healthcare benefits payable	1,472	990
Total Noncurrent Liabilities	<u>513,728</u>	<u>599,586</u>
Total Liabilities	<u>1,580,322</u>	<u>1,789,136</u>
Net Assets		
Invested in capital assets	1,248	1,421
Restricted net assets for undistributed appreciation on restricted investments	86,237	109,494
Restricted net assets for MUSL	15,926	9,336
Restricted net assets for future prizes or special prize promotions	18,559	13,857
Total Net Assets	<u>\$121,970</u>	<u>\$134,108</u>

The notes to the financial statements are an integral part of this statement.

DEPARTMENT OF THE LOTTERY
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
Years ended June 30, 2011, and June 30, 2010
(In Thousands)

	<u>June 30, 2011</u>	<u>June 30, 2010</u>
Operating Revenues:		
Ticket sales	\$4,008,716	\$3,900,499
Bad debt expense	(1,212)	(1,075)
On-line fees and miscellaneous	7,237	7,373
Retailer fees	199	226
Total Operating Revenues	<u>4,014,940</u>	<u>3,907,023</u>
Operating Expenses:		
Prizes	2,460,219	2,346,162
Retailer commissions	223,390	216,207
Scratch-Off tickets	35,520	30,896
On-line games	27,740	27,390
Advertising	33,159	34,197
Personal services	27,204	27,045
Other contractual services	8,855	7,474
Materials and supplies	1,921	2,309
Depreciation	310	494
Total Operating Expenses	<u>2,818,318</u>	<u>2,692,174</u>
Operating Income	<u>1,196,622</u>	<u>1,214,849</u>
Nonoperating Revenues (Expenses):		
Interest	4,893	6,057
Securities lending income	3,120	2,909
Securities lending fees	(1,400)	(1,520)
Investment management fees	(284)	(364)
Net appreciation (depreciation) in fair value of investments	21,662	90,875
Property disposition (loss)	(15)	(4)
Amortization of grand prizes payable	(44,918)	(54,079)
Total Nonoperating Revenues (Expenses), Net	<u>(16,942)</u>	<u>43,874</u>
Income Before Operating Transfers	<u>1,179,680</u>	<u>1,258,723</u>
Transfers to Educational Enhancement Trust Fund:		
Transfers from revenue and reserves	(1,147,793)	(1,203,024)
Transfers from unclaimed prizes	(44,025)	(43,770)
Total Transfers to Educational Enhancement Trust Fund	<u>(1,191,818)</u>	<u>(1,246,794)</u>
Change in Net Assets	(12,138)	11,929
Net Assets, Beginning of Year	134,108	122,179
Net Assets, End of Year	<u>\$121,970</u>	<u>\$134,108</u>

The notes to the financial statements are an integral part of this statement.

DEPARTMENT OF THE LOTTERY
STATEMENT OF CASH FLOWS
Years ended June 30, 2011, and June 30, 2010
(In Thousands)

	June 30, 2011	June 30, 2010
Operating Activities:		
Ticket sales	\$ 4,002,723	\$ 3,926,136
Prizes paid to winners	(2,472,222)	(2,335,361)
Commissions paid and payments to retailers	(223,390)	(216,207)
Paid to vendors for goods and services	(111,404)	(97,306)
Paid to employees	(26,753)	(26,545)
Other operating revenue	7,432	7,599
Net Cash Provided by Operating Activities	1,176,386	1,258,316
Noncapital Financing Activities:		
Payments to Educational Enhancement Trust Fund	(1,169,308)	(1,271,251)
Net Cash Used in Noncapital Financing Activities	(1,169,308)	(1,271,251)
Capital and Related Financing Activities:		
Purchase of capital assets	(152)	(684)
Net Cash Used in Capital and Related Financing Activities	(152)	(684)
Investing Activities:		
Cash received from maturity of grand prize investments	178,569	201,688
Cash paid to grand prizewinners upon maturity of grand prize investments	(178,569)	(201,688)
Securities lending	(64,266)	85,466
Investment income, net of fees	5,907	7,233
Net Cash Provided by Investing Activities	(58,359)	92,699
Net Increase (Decrease) in Cash and Cash Equivalents	(51,433)	79,080
Cash and Cash Equivalents, Beginning of Year	255,732	176,652
Cash and Cash Equivalents, End of Year	\$ 204,299	\$ 255,732
Reconciliation of Income from Operations to Net Cash Provided by Operating Activities:		
Income from operations	\$ 1,196,622	\$ 1,214,849
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation	310	494
Changes in assets and liabilities		
(Increase) decrease in:		
Accounts receivable	(12,223)	20,283
Inventories	27	(178)
Prepaid expenses	(22)	(19)
Increase (decrease) in:		
Allowance for uncollectible accounts	732	166
Accounts payable and accrued liabilities	(4,004)	5,278
Prizes payable	(5,413)	17,064
Compensated absences payable	(125)	(153)
Postemployment healthcare benefits payable	482	532
Net Cash Provided by Operating Activities	\$ 1,176,386	\$ 1,258,316
Noncash Investing, Capital and Financing Activities:		
Increase(decrease) in fair value of investments	\$ (92,140)	\$ (31,456)

The notes to the financial statements are an integral part of this statement.

NOTES TO FINANCIAL STATEMENTS**DEPARTMENT OF THE LOTTERY**
Years ended June 30, 2011, and June 30, 2010**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES****a. Reporting Entity**

The State of Florida, Department of the Lottery (the Lottery) was established as a State agency with the enactment of the Florida Public Education Lottery Act (the Act) in 1987. The purpose of the Act is “to implement Section 15, Article X of the State Constitution in a manner that enables the people of the State to benefit from significant additional moneys for education and also enables the people of the State to play the best lottery games available.”

In evaluating the Lottery as a reporting entity, management has addressed all potential component units for which the Lottery may be financially accountable and, as such, be includable in the Lottery’s financial statements. The Lottery is financially accountable if it appoints a voting majority of the organization’s governing board and (1) it is able to impose its will on the organization or (2) there is a potential for the organization to provide specific financial benefit to or impose specific financial burden on the Lottery. Additionally, the primary government is required to consider other organizations for which the nature and significance of their relationship with the primary government is such that exclusion would cause the reporting entity’s financial statements to be misleading or incomplete. Management’s analysis has disclosed no component units that should be included in the Lottery’s financial statements.

b. Basis of Presentation

The Lottery is accounted for as a proprietary type enterprise fund. Enterprise funds are used to account for activities that are financed and operated in a manner similar to private business enterprises: (1) where the costs of providing goods and services to the general public on a continuing basis are to be financed through user charges; or (2) where the periodic determination of net income is considered appropriate. The Lottery is reported as an enterprise fund within the State of Florida’s Comprehensive Annual Financial Report.

c. Basis of Accounting

Basis of accounting refers to the timing of recognition of revenues and expenses in the accounts and reporting in the financial statements. The financial statements are prepared on the accrual basis of accounting in accordance with generally accepted accounting principles. Under this method, revenues are recognized when they are earned and expenses are recognized when they are incurred.

The measurement focus of proprietary fund types is on a flow of economic resources method, which emphasizes the determination of net income, financial position, and cash flows. All fund assets and liabilities, current and noncurrent, are accounted for on the Statement of Net Assets. Under Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, proprietary funds have the option to elect to apply all pronouncements of the Financial Accounting Standards Board (FASB) issued after November 30, 1989. The Lottery has elected not to apply FASB pronouncements issued after November 30, 1989, unless so directed by GASB.

The Lottery's operating revenues and expenses generally result from the sale and marketing of Lottery tickets and the payment of related prizes. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

d. Cash and Cash Equivalents

The Lottery considers all highly liquid investments with an original maturity of three months or less when purchased to be cash equivalents. This includes cash in banks, repurchase agreements with financial institutions, petty cash, balances held by the State Board of Administration (SBA), and pooled investments in the State Treasury.

e. Investments

Florida Statutes authorize the Lottery to invest in certain instruments. The Lottery reports investments at fair value. Investments that are not publicly quoted are priced by a third party through a discounted cash flow method. Details of investments are included in Note 2.

f. Allowance for Doubtful Accounts

The allowance for doubtful accounts is based on an analysis of collectability of accounts receivable, which considers the age of the accounts.

g. Inventories

Supply inventory and promotional items are valued at cost, using the first-in, first-out method. Supply inventory is comprised of game merchandise and prepaid postage.

h. Prepaid Expenses

Prepaid expenses represent warranty agreements which were paid for during the current fiscal year but will not be consumed or used up until a future period.

i. Capital Assets

Capital assets are stated at cost less accumulated depreciation. As required by Chapter 273, Florida Statutes, a capitalization threshold of \$1,000 and a useful life extending beyond one year are employed for tangible personal property. The Lottery's capitalization threshold for intangible assets is \$5,000. Depreciation on all capital assets is computed using the straight-line method over the following estimated useful lives:

Data processing equipment	3 to 5 years
Office furniture and fixtures	3 to 15 years
Vehicles and other equipment	3 to 20 years
Software	3 to 15 years

When capital assets are retired or otherwise disposed of, the costs and related accumulated depreciation are removed from the accounts and any resulting gain or loss is reflected in the Statement of Revenues, Expenses, and Changes in Net Assets, in the period of disposal. See Note 5 for more detailed information on capital assets.

j. Net Assets

Net Assets includes categories for net investments in capital assets, restricted net assets for undistributed appreciation on restricted investments, restricted net assets for future prizes or special prize promotions, and restricted net assets for MUSL. See Note 6 for more information on MUSL.

The net investments in capital assets category represents the investment in capital assets, recorded at cost less accumulated depreciation.

The restricted net assets for undistributed appreciation on restricted investments category represents the undistributed appreciation for all restricted asset accounts.

The restricted net assets for future prizes or special prize promotions category represents the portion of unclaimed prize obligations legally reverted back to the Lottery for the payment of future prize pools or special prize promotions in accordance with Section 24.115(2), Florida Statutes.

The restricted net assets for MUSL category represents the amount placed into reserve for the Florida Lottery by the MUSL Powerball Product Group in accordance with Rule 53ER09-52, Florida Administrative Code.

k. Revenue Recognition

Lottery games are sold to the public by contracted retailers. Revenue is recognized when On-line tickets are sold to players and when books of Scratch-Off tickets are settled. Certain games include tickets that entitle the holder to exchange one ticket for another (free tickets). Such tickets are deemed to be replacements and, therefore, are not included in ticket sales.

l. Commissions

Retailers receive a commission of five percent on ticket sales. The commission on ticket sales for Scratch-Off games is based upon total tickets distributed to the players (including free tickets) which, when compared to revenue, causes the percentage to be slightly higher than five percent. Additionally, retailers are paid commissions through a one percent cashing bonus on redemption of tickets (including free tickets).

m. Prizes

In accordance with the Act, variable percentages of the gross revenue from the sale of On-line and Scratch-Off lottery tickets shall be returned to the public in the form of prizes paid by the Lottery or retailers as authorized.

Prize expense for On-line games is recorded based on prizes won by the players, as revenue is recognized. Any prize that remains unclaimed at the end of a 180-day period following a draw is considered unclaimed.

Prize expense for Scratch-Off games is recorded based on the predetermined prize structure for each game, as revenue is recognized. Any prize that remains unclaimed 60 days after a Scratch-Off game is closed is considered unclaimed.

Effective July 1, 2005, 80 percent of all unclaimed prize money is deposited in the Educational Enhancement Trust Fund (EETF). The remaining 20 percent of unclaimed prize money is added to

the pool from which future prizes are to be awarded or used for special prize promotions and is reported as restricted net assets for future prizes or special prize promotions.

All prizes are recorded at the actual amount except for the annuity-funded prizes, which are paid out on a deferred basis. The actual prize expense for these types of prizes is based on the present value of an annuity using the interest yield on the investments, which were acquired to fund the annuity.

n. *Compensated Absences*

Employees earn the right to be compensated during absences for vacation, illness, and unused special compensatory leave earned for hours worked on legal holidays. Compensated absences for annual leave are recorded as a liability when the benefits are earned. Compensated absences for sick leave are calculated based on the vesting method. Within the limits established by law or rule, unused leave benefits are paid to employees upon separation from State service. The cost of vacation and calculated sick leave benefits is accrued in the period in which earned. The compensated absences amounts are based on current fiscal year-end salary rates and include employer social security and pension contributions at current rates.

o. *Self-Insurance*

The Lottery participates in the various self-insurance programs established by the State of Florida for property and casualty losses and employee health insurance. Coverage includes property, general liability, automobile liability, workers' compensation, court-awarded attorney fees, and Federal civil rights actions. The property insurance program self-insures the first \$2 million per occurrence for all perils except named windstorm and flood. The property insurance program self-insures the first \$2 million per occurrence with an annual aggregate of \$40 million for named windstorm and flood. Commercial excess insurance is purchased for losses over the self-insured retention up to \$58.75 million per occurrence for named windstorm and flood losses through February 14, 2011, and \$61 million beginning February 15, 2011, and \$200 million per occurrence for all other perils. Workers' compensation is provided to comply with the applicable law. The employee health and dental insurance program provides for payment of medical claims of employees and covered dependents.

p. *Use of Estimates*

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, restricted net assets, revenues, and expenses, and disclosures of contingent assets and liabilities. Actual results could differ from those estimates.

q. *Bad Debt Expense*

Bad debt expense is reported as a reduction in gross revenue. Bad debt expense is recognized when a Lottery retailer's uncollected revenue is past due. The amount of expense is based on an accounts receivable age analysis. The bad debt expense for the fiscal years ended June 30, 2011, and June 30, 2010, was \$1,212,000 and \$1,075,000, respectively.

2. CASH AND INVESTMENTS

a. Cash and Cash Equivalents

Cash is held in demand deposits at various financial institutions. These deposits, with a book value of approximately \$617,000 at June 30, 2011, and \$649,000 at June 30, 2010, were insured by either the State's collateral for public deposits in accordance with Section 280.04, Florida Statutes, or Federal depository insurance. Cash held in time deposits for the securities lending program with a book value of \$21,200,000 was exposed to custodial credit risk as these balances were uncollateralized and uninsured.

Chapter 280, Florida Statutes, generally requires public funds to be deposited in a Qualified Public Depository, which is a bank or savings association that is designated by the State of Florida Chief Financial Officer (State CFO) as authorized to receive deposits in the State and that meets the collateral requirements. The State CFO determines the collateral requirements and collateral pledging level for each Qualified Public Depository following guidelines outlined in Section 280.04, Florida Statutes, and Chapter 69C-2, Florida Administrative Code. Collateral pledging levels include 25, 50, 125, and 200 percent of a Qualified Public Depository's average daily deposit balance or, if needed, an amount as prescribed by the State CFO. Collateral may be held by another custodian with approval of the State CFO if conditions that protect the State's interest are met. Eligible collateral includes federal, federally-guaranteed, state and local government obligations, corporate bonds, and other securities designated allowable under conditions set by the State CFO.

Florida Statutes provide that if a loss to public depositors is not covered by deposit insurance and the proceeds from the sale of securities pledged by the defaulting depository, the difference will be provided by an assessment levied against other Qualified Public Depositories of the same type as the depository in default.

Due to the investing policy of the Lottery, book overdrafts were approximately \$2,059,000 at June 30, 2011, and \$2,269,000 at June 30, 2010, representing outstanding prize payment checks and retailer payment checks. These outstanding checks are included as a component of prizes payable and accounts payable. The Lottery has an agreement with a financial institution to honor prize payments and retailer payments, as they are presented to the bank, up to \$75 million.

Surplus cash is maintained in the State Treasury's general pool of investments. The State CFO pools funds from all state agencies. Included in the pool are primarily time deposits, U.S. Government securities, federal agency securities, commercial paper, corporate bonds and notes, and repurchase agreements. The Lottery's share of this investment pool was approximately \$182,482,000 and \$169,617,000 at June 30, 2011, and 2010, respectively. No allocation will be made as to the Lottery's share of the types of investments or their risk categories. The Lottery's share of the assets and liabilities arising from the securities lending agreements administered by the State Treasury will likewise not be carried on the Statement of Net Assets since the State Treasury operates on a pooled basis and to do so may give the misleading impression that the Lottery itself has entered into such agreements. For further information, refer to the State of Florida's Comprehensive Annual Financial Report or publications of the Florida Department of Financial Services, Office of the Chief Financial Officer.

b. Investments, Grand Prize

The grand prize investments primarily consist of U.S. Government obligations held on the Lottery's behalf by the SBA. Grand prize investments and related grand prizes payable are not presented in current assets or liabilities. They are not part of current operations but instead are restricted assets and liabilities that are held by the Lottery for grand prize winnings to be paid on a deferred basis if the cash payment option is not selected.

Grand prize investments are shown at fair value, and the related grand prizes payable is adjusted to the net present value using the yield on the investments. The difference between the fair value of the investments and the net present value of the grand prizes payable is reflected as a restriction for undistributed appreciation on investments in net assets. This represents the unrealized gains on the investments. Because these investments are held restrictively for grand prizewinners, this balance is not available for transfer to the EETF.

Interest accreted on grand prize investments during the fiscal year is reflected as an increase in the carrying value of grand prizes payable on the Statement of Net Assets, and as a nonoperating expense on the Statement of Revenues, Expenses, and Changes in Net Assets. Net appreciation(depreciation) in fair value of investments is reflected as a nonoperating revenue(expense) on the Statement of Revenues, Expenses, and Changes in Net Assets, and takes into account all changes in fair value that occurred during the year, including purchases, maturities, and sales.

c. Investments, Securities Lending Collateral

These investments consist of the fair value of investments made with cash collateral held by the SBA on the Lottery's behalf as part of a securities lending program.

The SBA, authorized by Section 215.47, Florida Statutes, participates in a securities lending program involving grand prize investments. The Lottery, through the SBA, loans various securities to borrowers for collateral with a simultaneous agreement to return collateral for the same securities in the future. Collateral received from borrowers may be cash or U.S. Government securities. The SBA is contractually limited from pledging or selling collateral except in the event of borrower default. The contract with the lending agent requires it to indemnify the SBA if the borrowers fail to return the underlying securities or fail to pay income distributions on them. No significant violations of legal or contractual provisions occurred, and no losses resulted from borrower or lending agent defaults.

The Bank of New York Mellon (Mellon) is the agent for lending U.S. Treasury securities to various authorized brokers for cash or U.S. Government securities. Initially, collateral received shall be in the form of cash at 100 percent, or other securities valued at 102 percent, of the fair value of the securities loaned as required by the lending agreement. Borrowers must be approved for lending by Mellon's credit department. Mellon monitors the fair value of collateral provided and the securities on loan on a daily basis. Additional collateral is required if the fair value of the collateral for any loan is less than 100 percent of the fair value of the securities provided for such loan. The SBA had no credit risk exposure to borrowers at fiscal year-end.

The SBA had received \$731,926,000 of cash collateral for the lending program as of June 30, 2011, and \$845,692,000 as of June 30, 2010. At June 30, 2011, and June 30, 2010, the collateral that was held for the securities lending transactions exceeded the fair value of the securities underlying the agreements (including accrued interest). The cash was invested in securities authorized by the lending agreement. Authorized securities include primarily certificates of deposit, corporate and medium term notes, asset-backed securities, and repurchase agreements. The invested cash collateral generally has a shorter maturity than the securities on loan.

A risk factor associated with this lending agreement is the potential for declines in the value of the invested holdings purchased with the cash collateral. If these investments must be liquidated, any shortfall between the value of the investments and the securities lending obligation becomes the responsibility of the Lottery. As of June 30, 2011, and June 30, 2010, the potential unrealized shortfall was \$712,000 and \$8.1 million, respectively.

Other risk factors associated with securities lending include counterparty default and failure of the custodial bank to indemnify the Lottery.

Securities lending income and expenses for the years ended June 30, 2011, and 2010, consisted of (in thousands):

	<u>2011</u>	<u>2010</u>
Securities lending income	\$ 3,120	\$ 2,909
Less broker rebates	(1,323)	(1,483)
Less bank fees	(77)	(37)
Net securities lending revenue	<u>\$ 1,720</u>	<u>\$ 1,389</u>

d. Investment Credit Risk

Lottery grand prizewinner investments have been limited to U.S. Government guaranteed securities.

The State Treasury Investment Pool's current rating by Standard and Poor's is Af as of June 30, 2011.

Listed below are the Standard and Poor's credit ratings for the lending program's invested cash collateral (in thousands):

As of June 30, 2011								
Investment Type	Standard and Poor's Credit Rating							Totals
	AAA	AA	A	BBB	B	A-1	NR	
Certificates of Deposit	\$ -	\$ 27,623	\$ 4,005	\$ -	\$ -	\$ -	\$ 200,736	\$ 232,364
Commercial Paper	-	-	-	-	-	114,603	-	114,603
Domestic Corporate Bonds & Notes	6,601	34,116	37,697	-	-	-	-	78,414
Domestic Non-government Asset-backed Securities	54,552	4,801	-	1,842	670	-	680	62,545
Domestic Non-government Backed CMO's	4,311	-	-	-	-	-	-	4,311
International Corporate Bonds & Notes	-	42,032	-	-	-	-	19,302	61,334
International Non-government Asset-backed Securities	11,953	-	-	-	-	-	-	11,953
International Non-government Backed CMO's	18,726	-	-	-	-	-	-	18,726
Repurchase Agreements	-	-	-	-	-	-	125,621	125,621
Grand Total	<u>\$ 96,143</u>	<u>\$ 108,572</u>	<u>\$ 41,702</u>	<u>\$ 1,842</u>	<u>\$ 670</u>	<u>\$ 114,603</u>	<u>\$ 346,339</u>	<u>\$ 709,871</u>

As of June 30, 2010

Investment Type	Standard and Poor's Credit Rating							Totals
	AAA	AA	A	BBB	B	A-1	NR	
Certificates of Deposit	\$ -	\$ 17,883	\$ -	\$ -	\$ -	\$ -	\$ 180,065	\$ 197,948
Commercial Paper	-	-	-	-	-	161,357	-	161,357
Domestic Corporate Bonds & Notes	-	22,867	7,705	-	-	-	-	30,572
Domestic Non-government Asset-backed Securities	218,071	-	-	3,527	1,014	-	6,701	229,313
Domestic Non-government Backed CMO's	4,392	-	-	-	-	-	-	4,392
International Corporate Bonds & Notes	-	11,911	-	-	-	-	10,970	22,881
International Non-government Asset-backed Securities	13,405	-	-	-	-	-	-	13,405
International Non-government Backed CMO's	37,930	-	-	-	-	-	-	37,930
Repurchase Agreements	-	-	-	-	-	-	51,339	51,339
Grand Total	\$ 273,798	\$ 52,661	\$ 7,705	\$ 3,527	\$ 1,014	\$ 161,357	\$ 249,075	\$ 749,137

e. Investment Interest Rate Risk

The investment policy objective is to match maturities of investments with the maturities of the lottery winner annuities. Therefore, investments are held to maturity after they are purchased thereby eliminating interest rate risk. Listed below are the Lottery's investments in U.S. Treasury Strips (in thousands):

As of June 30, 2011		As of June 30, 2010	
<u>Time to Maturity</u>	<u>Fair Value</u>	<u>Time to Maturity</u>	<u>Fair Value</u>
< 1 year	\$ 156,020	< 1 year	\$ 178,478
> 1 year to 3 years	243,347	> 1 year to 3 years	283,945
> 3 years to 5 years	140,468	> 3 years to 5 years	181,658
> 5 years to 10 years	98,300	> 5 years to 10 years	132,986
> 10 years to 15 years	58,102	> 10 years to 15 years	52,935
> 15 years to 20 years	41,074	> 15 years to 20 years	47,871
> 20 years to 25 years	5,411	> 20 years to 25 years	4,505
> 25 years	2,416	> 25 years	1,680
Total	\$ 745,138	Total	\$ 884,058

The Lottery contracts with the SBA to execute the securities lending program. The securities lending authorization agreement between Mellon and the SBA requires that the maximum weighted average portfolio maturity not exceed 90 days. The lending program invests a significant amount of its assets in floating rate securities and limits the maximum reset period for interest rate changes to six months. Next reset dates are used in the calculation of weighted average maturity. Listed below are the weighted average maturities for the lending program's invested cash collateral:

<u>Investment Type</u>	<u>June 30, 2011</u>		<u>June 30, 2010</u>	
	<u>Fair Value (Thousands)</u>	<u>Weighted Average Maturity (Days)</u>	<u>Fair Value (Thousands)</u>	<u>Weighted Average Maturity (Days)</u>
Certificates of Deposit	\$ 232,364	55	\$ 197,948	33
Commercial Paper	114,603	53	161,357	31
Domestic Corporate Bonds & Notes	78,414	37	30,572	48
Domestic Non-government Asset-backed Securities	62,545	16	229,313	16
Domestic Non-government Backed CMO's	4,311	6	4,392	6
International Corporate Bonds & Notes	61,334	58	22,881	56
International Non-government Asset-backed Securities	11,953	16	13,405	77
International Non-government Backed CMO's	18,726	20	37,930	28
Repurchase Agreements	125,621	1	51,339	1
Total Fair Value	\$ 709,871		\$ 749,137	
Portfolio Weighted Average Maturity		38		27

The effective duration of the State Treasury Investment Pool at June 30, 2011, and June 30, 2010, was approximately 2.13 years and 1.81 years, respectively.

f. Investment Concentration of Credit Risk

Since all long-term investments (other than in the securities lending program) are in U.S. Government-guaranteed securities, the Lottery has not adopted a policy regarding concentration of credit risk. The securities lending program has established investment concentration of credit risk policies that limit the aggregate exposure to any one issuer or guarantor that is not the U.S. Government or guaranteed by the U.S. Government to 10 percent of the book value of the lending program's invested cash collateral. No invested cash collateral exceeded the 10 percent limitation. However, during the fiscal year ended June 30, 2010, the securities lending program had investments in GE Floorplan (5.73 percent), Discover Card (5.14 percent), and Chase Issuance (5.09 percent) that exceeded 5 percent of invested securities lending collateral.

g. Investment Custodial Credit Risk

Custodial credit risk is defined as the risk that an entity may not recover securities held by another party. The Lottery does not have a formal policy regarding custodial credit risk. The custodian for the SBA-administered lending program is also the counterparty to the investment transactions. Therefore, the amount of investments subject to investment custodial credit risk at June 30, 2011, and June 30, 2010, was \$709,871,000 and \$749,137,000, respectively.

At June 30, 2011, and June 30, 2010, all non-lending investments held were either insured or registered and held by the Lottery or its agents in the Lottery's name and thus were not subject to custodial credit risk.

h. Foreign Currency Risk

The Lottery had no exposure to foreign currency risk as of June 30, 2011, and June 30, 2010.

i. Investment Summary

The following schedule summarizes all investments and investments loaned under securities lending agreements at June 30 (in thousands):

Investment Type	June 30, 2011 Carrying Value	June 30, 2010 Carrying Value
Commercial Paper	\$ 114,603	\$ 161,357
Certificates of Deposit	232,364	197,948
Repurchase Agreements	125,621	51,339
U.S. Government Obligations & Federally Guaranteed Obligations	29,221	55,507
Domestic Corporate Bonds & Notes	78,414	30,572
Domestic Non-government Asset-backed Securities	62,545	229,313
International Corporate Bonds & Notes	61,334	22,881
International Non-government Asset-backed Securities	11,953	13,405
Domestic Non-government Backed CMO's	4,311	4,392
International Non-government Backed CMO's	18,726	37,930
Investments Held by Others Under Securities Lending Agreements - U.S. Obligations	715,917	828,551
Pooled Investments with State Treasury	182,482	169,616
Total Investments	\$ 1,637,491	\$ 1,802,811

The following schedules reconcile cash and investments to the Statement of Net Assets at June 30 (in thousands):

	June 30, 2011			
	Investments	Cash at Financial Institutions	Cash at State Treasury	Total
Cash and cash equivalents	\$ 163,923	\$ 398	\$ 204	\$ 164,525
Restricted cash and cash equivalents	18,559	21,215	-	39,774
Investments, grand prize	745,138	-	-	745,138
Investments, securities lending collateral	709,871	-	-	709,871
Total	\$ 1,637,491	\$ 21,613	\$ 204	\$ 1,659,308

	June 30, 2010			
	Investments	Cash at	Cash at	Total
		Financial Institutions	State Treasury	
Cash and cash equivalents	\$ 155,758	\$ 310	\$ 245	\$ 156,313
Restricted cash and cash equivalents	13,858	85,561	-	99,419
Investments, grand prize	884,058	-	-	884,058
Investments, securities lending collateral	749,137	-	-	749,137
Total	\$ 1,802,811	\$ 85,871	\$ 245	\$ 1,888,927

3. ACCOUNTS RECEIVABLE

Accounts receivable as of June 30 consisted of (in thousands):

	2011	2010
Ticket sales receivable	\$ 23,568	\$ 18,080
Other receivables	50	25
Total receivables	23,618	18,105
Less allowance for doubtful accounts	(2,364)	(1,632)
Accounts receivable, net	\$ 21,254	\$ 16,473

4. SECURITY DEPOSITS AND DEPOSITS PAYABLE

The Lottery receives certificates of deposit and cashier’s checks from certain vendors and retailers in order to secure contract performance. Certificates of deposit are held in trust by the State with any interest earnings being credited to the vendor or retailer. Cashier’s checks are held as cash by the Lottery. These deposits are established to reduce the potential financial risk to the Lottery in the event of a breach of contract. The certificates appear on the Statement of Net Assets, in assets as security deposits, and in liabilities, as deposits payable. The checks appear on the Statement of Net Assets, in assets as cash, and in liabilities, as deposits payable.

5. CAPITAL ASSETS

Capital assets at June 30 consisted of (in thousands):

	Balance 30-Jun-09	2009-10		Balance 30-Jun-10	2010-11		Balance 30-Jun-11
		Increase	Decrease		Increase	Decrease	
Data processing equipment	\$ 5,391	\$ 33	\$ (1,466)	\$ 3,958	\$ 7	\$ (152)	\$ 3,813
Office equipment and fixtures	5,968	-	(117)	5,851	82	(226)	5,707
Vehicles and other equipment	3,115	-	(81)	3,034	11	(63)	2,982
Software and other intangibles	-	651	-	651	52	-	703
	14,474	684	(1,664)	13,494	152	(441)	13,205
Less accumulated depreciation	13,239	494	(1,660)	12,073	310	(426)	11,957
Total capital assets, net	\$ 1,235	\$ 190	\$ (4)	\$ 1,421	\$ (158)	\$ (15)	\$ 1,248

6. **MULTI-STATE LOTTERY ASSOCIATION**

MUSL is an unincorporated government-benefit voluntary association created for the purpose of administering joint lottery games. MUSL included 31 state lottery entities, the District of Columbia, and the Virgin Islands during fiscal year 2010-11. This association offers the Powerball with Powerplay On-line game and several other On-line games in participating states. The chief executive officer of each member lottery serves on the MUSL board of directors.

As a member of MUSL, the Lottery is required to contribute to various prize reserve funds maintained by MUSL. The prize reserve funds serve as a contingency reserve to protect MUSL from unforeseen prize payments. MUSL periodically reallocates the prize reserve funds among the states based on relative Powerball with Powerplay sales levels. All remaining funds remitted, and the related interest earnings (net of administrative costs), will be returned to the Lottery upon leaving MUSL, less any portion of unanticipated prize claims that may have been paid from the fund.

As of June 30, 2011, and June 30, 2010, the Lottery had deposits with MUSL of \$15,926,144, and \$9,336,505, respectively, representing the Lottery's deposits of reserve funds.

A copy of the MUSL financial statements may be obtained by submitting a written request to MUSL, 4400 N.W. Urbandale Drive, Urbandale, Iowa 50322.

7. **LONG-TERM LIABILITIES**

a. **Grand Prizes Payable**

Grand prizes payable at June 30 consisted of (in thousands):

	<u>2011</u>	<u>2010</u>
FLORIDA LOTTO grand prizes (face value)	\$ 815,283	\$ 962,505
MEGA MONEY grand prizes (face value)	7,590	7,754
Win for Life grand prizes (face value)	12,294	12,658
Flamingo Fortune Game Show grand prizes (face value)	700	800
Win a Million grand prizes (face value)	350	400
Yearly Bonus grand prizes (face value)	100	150
Lucky for Life grand prizes (face value)	24,500	12,950
Set for Life grand prize (face value)	2,280	2,460
Cash Spectacular grand prize (face value)	600	650
Cash for Life (face value)	220	230
Loaded for Life (face value)	2,950	3,050
Billion Dollar Blockbuster (face value)	8,500	9,000
Gas for Life (face value)	192	198
Less imputed interest	<u>(215,581)</u>	<u>(244,424)</u>
Net present value of grand prizes payable	<u>\$ 659,978</u>	<u>\$ 768,381</u>
Current prizes payable from restricted assets	\$ 150,465	\$ 172,589
Noncurrent prizes payable from restricted assets	<u>509,513</u>	<u>595,792</u>
Total grand prizes payable	<u>\$ 659,978</u>	<u>\$ 768,381</u>

The following depicts by fiscal year the value (in thousands) of the grand prize annuities to pay prizewinners:

<u>Year Ended June 30</u>	<u>Amount</u>
2012	\$ 156,135
2013	134,271
2014	111,462
2015	83,975
2016	64,070
2017-2021	118,141
2022-2026	95,673
2027-2031	88,197
2032-2036	15,170
2037-2040	8,465
Grand prizes (face value)	875,559
Less imputed interest	(215,581)
Net present value of grand prizes payable	\$ 659,978

b. Compensated Absences Payable

Compensated absences payable at June 30 consisted of (in thousands):

	<u>2011</u>	<u>2010</u>
Current compensated absences	\$ 809	\$ 873
Noncurrent compensated absences	2,743	2,804
Total	\$ 3,552	\$ 3,677

c. Changes in Long-Term Liabilities

Changes in long-term liabilities are summarized as follows (in thousands):

	<u>2010-2011</u>				
	<u>Balance June 30, 2010</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance June 30, 2011</u>	<u>Amount Due Within One Year</u>
Grand prizes payable	\$768,381	\$70,166	(\$178,569)	\$659,978	\$150,465
Compensated absences payable	3,677	1,407	(1,532)	3,552	809
Postemployment healthcare benefits payable	990	482	-	1,472	-
Total long-term liabilities	\$773,048	\$72,055	(\$180,101)	\$665,002	\$151,274
	<u>2009-2010</u>				
	<u>Balance June 30, 2009</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance June 30, 2010</u>	<u>Amount Due Within One Year</u>
Grand prizes payable	\$913,745	\$56,324	(\$201,688)	\$768,381	\$172,589
Compensated absences payable	3,831	1,799	(1,953)	3,677	873
Postemployment healthcare benefits payable	458	532	-	990	-
Total long-term liabilities	\$918,034	\$58,655	(\$203,641)	\$773,048	\$173,462

See Note 9 for additional information regarding the postemployment healthcare benefits payable.

8. DUE TO EDUCATIONAL ENHANCEMENT TRUST FUND

In accordance with the Act, effective July 1, 2005, variable percentages of the gross revenue from the sale of On-line and Scratch-Off lottery tickets as determined by the Lottery, and other earned revenue, excluding application processing fees, shall be deposited in the Educational Enhancement Trust Fund (EETF) as provided in Section 24.121, Florida Statutes, as amended. The amount transferred for the fiscal year ended June 30, 2011, was \$1,191,818,000 (29.7% of revenues), and for the fiscal year ended June 30, 2010, the transferred amount was \$1,246,794,000 (31.1% of revenues).

Because the net appreciation in fair value of investments and amortization of grand prizes payable, included in nonoperating revenues and expenses, relate to valuations of the restricted grand prize investments and grand prizes payable, they are excluded from the determination of transfers to the EETF.

Effective July 1, 2005, provisions of the Act relating to the allocation of revenues for public education were revised. The changes in the provisions were designed to maximize the transfers of moneys to the EETF. These revisions resulted in changes in the methodology used to calculate the transfer based on a business model of revenues less expenses rather than a percent of revenues.

The amount due to the EETF at June 30, 2011, and June 30, 2010, was as follows (in thousands):

	<u>June 30, 2011</u>	<u>June 30, 2010</u>
On-line ticket sales	\$ 1,783,040	\$ 1,822,365
Average percent transferred	38%	39%
Transfer of On-line ticket sales	<u>678,540</u>	<u>712,347</u>
Undaimed On-line ticket prizes	28,194	30,166
Percent transferred	80%	80%
Transfer of undaimed On-line ticket prizes	<u>22,555</u>	<u>24,133</u>
Scratch-Off ticket sales	2,225,676	2,078,134
Average percent transferred	20%	21%
Transfer of Scratch-Off ticket sales	<u>455,503</u>	<u>442,444</u>
Undaimed Scratch-Off ticket prizes	26,837	24,546
Percent transferred	80%	80%
Transfer of undaimed Scratch-Off ticket prizes	<u>21,470</u>	<u>19,637</u>
Nonoperating revenues (expenses), net	(16,942)	43,874
Add:		
Net (appreciation) depreciation in fair value of investments	(21,662)	(90,875)
Amortization of grand prizes payable	44,918	54,079
Total nonoperating revenues, net	<u>6,314</u>	<u>7,078</u>
On-line fees and miscellaneous revenue	<u>7,436</u>	<u>7,599</u>
Nonrecurring transfers, net	<u>-</u>	<u>33,556</u>
Due for the year	<u>\$ 1,191,818</u>	<u>\$ 1,246,794</u>
Balance due, beginning of year	59,308	83,765
Paid during the year	<u>(1,169,308)</u>	<u>(1,271,251)</u>
Due to Educational Enhancement Trust Fund, June 30	<u><u>\$ 81,818</u></u>	<u><u>\$ 59,308</u></u>

9. PENSIONS AND OTHER POSTEMPLOYMENT BENEFITS

a. Retirement Programs

Florida Retirement System. The Florida Retirement System (FRS) is a State-administered cost-sharing multiple-employer retirement plan that offers members an initial choice between participating in a defined benefit plan (FRS Pension Plan) and a defined contribution plan (FRS Investment Plan) and one additional choice to change plans before retirement. FRS provisions are established by Chapters 121, 122, and 238, Florida Statutes; Chapter 112, Part IV, Florida Statutes; and Florida Retirement System Rules, Chapter 60S, Florida Administrative Code; wherein eligibility, contributions, and benefits are defined and described in detail. Essentially, all employees of participating employers in regularly established positions must be enrolled as members of the FRS or other non-integrated defined contribution plans in lieu of FRS membership.

Benefits in the FRS Pension Plan vest at six years of service. Special Risk Class members are eligible for normal retirement benefits at age 55 and vested or after 25 years of service at any age. All other members are eligible for normal retirement benefits at age 62 and vested or at any age after 30 years of service. Early retirement is available but imposes a penalty for each year a member retires before his or her normal retirement age. Retirement, disability, and death benefits are provided and retirees receive annual cost-of-living adjustments. Benefits are calculated at retirement based on the age, years of service, accrual value by membership class, and average final compensation (average of highest five fiscal years' salaries).

Members of the FRS Pension Plan who reach normal retirement may participate in the Deferred Retirement Option Program (DROP), subject to provisions of Section 121.091(13), Florida Statutes. DROP participants are technically retired, deferring termination and receipt of monthly retirement benefits for up to 60 months. During the period of DROP participation, deferred monthly benefits are held in the FRS Trust Fund and accrue interest.

FRS Investment Plan benefits are established in Part II, Chapter 121, Florida Statutes, and participation is available to all FRS members in lieu of the FRS Pension Plan. Members vest after one year of creditable service for Investment Plan contributions. If an accumulated benefit obligation for service credit originally earned under the FRS Pension Plan is transferred to the FRS Investment Plan, six years of service (including the service credit represented by the transferred funds) is required to be vested for these funds and the earnings on the funds. Benefits under the FRS Investment Plan are based on the account balance at retirement composed of contributions plus investment gains less investment losses and fees. Employer contributions are a percentage of salary based on membership class (Regular class, Special Risk class, etc.). Contributions are directed to individual member accounts and the individual members allocate contributions and account balances among various approved investment choices offered under the plan.

The Florida Legislature established uniform contribution rates for participating FRS employees. FRS employers pay the same contribution rate by membership class regardless of whether the members participate in the FRS Pension Plan or FRS Investment Plan. Contribution rates as a percentage of gross salary are as follows:

<u>Class or Plan</u>	<u>Fiscal Year Ended June 30, 2011</u>	<u>Fiscal Year Ended June 30, 2010</u>
Senior Management Service	14.57 percent	13.12 percent
Regular	10.77 percent	9.85 percent
Special Risk	23.25 percent	20.92 percent
DROP - Applicable to members from all of the above classes	12.25 percent	10.91 percent

Total employer contribution rates above include 1.11 percent for the postemployment insurance subsidy in addition to the uniform retirement contribution. Also, employer rates, other than for DROP participants, include 0.05 percent for fiscal year ended June 30, 2010 and 0.03 percent for fiscal year ended June 30, 2011, for administrative costs of the financial education program and the Investment Plan.

FRS Contributions. The Lottery's liability for participation in the FRS plans defined above is limited to the payment of the required contribution at the rates and frequencies established by law on future payrolls of the Lottery. The Lottery's contributions for the fiscal years ended June 30, 2011, June 30, 2010, and June 30, 2009, totaled \$1,681,368, \$1,506,859, and \$1,437,059, respectively, which were equal to 100 percent of the required contributions for each fiscal year. These contributions represented 10.4 percent, 9.2 percent, and 8.4 percent of covered payroll, for the fiscal years ended June 30, 2011, June 30, 2010, and June 30, 2009, respectively.

Senior Management Service Optional Annuity Program. Some Lottery employees also participate in the Senior Management Service Optional Annuity Program (SMSOAP). Offered in lieu of FRS participation, the SMSOAP is a defined contribution plan that provides retirement and death benefits to the participant pursuant to Section 121.055, Florida Statutes. Participants have full and immediate vesting of all contributions paid on their behalf to the participating provider companies to invest as directed by the participants. Employees in eligible State positions may make an irrevocable election to participate in the SMSOAP in lieu of the Senior Management Service Class. Employers contributed 12.49 percent of covered payroll for the fiscal year ended June 30, 2011. This contribution rate includes a contribution that would otherwise be paid to the Retiree Health Insurance Subsidy Program (HIS) described below so the SMSOAP retiree is not eligible to receive monthly HIS benefits. A participant may contribute by salary reduction an amount not to exceed the percentage contributed by the employer. The Lottery's contributions for the fiscal years ended June 30, 2011, June 30, 2010, and June 30, 2009, totaled \$52,329, \$71,933, and \$67,941 respectively.

Retiree Health Insurance Subsidy Program. The Retiree Health Insurance Subsidy Program (HIS) was created by the Florida Legislature in 1987 to assist FRS retirees in paying health insurance costs. HIS is a non-qualified, cost-sharing multiple-employer defined benefit pension plan established under Section 112.363, Florida Statutes. For the fiscal years ended June 30, 2011, and 2010, eligible retirees or beneficiaries received a monthly HIS payment equal to the number of years of creditable service completed at the time of retirement multiplied by \$5. The payments to individual retirees or beneficiaries were at least \$30 but not more than \$150 per month. To be eligible to receive HIS, an FRS retiree must apply for the benefit, provide proof of health insurance coverage, which can include Medicare or TRICARE, and be approved.

HIS is funded by required contributions from FRS participating employers. For the fiscal years ended June 30, 2011, 2010, and 2009, the Lottery contributed 1.11 percent of payroll for all active employees covered by the FRS, pursuant to Section 112.363, Florida Statutes. For the fiscal years ended June 30, 2011, 2010, and 2009, the Lottery contributed \$179,978, \$181,236, and \$184,076, respectively, in employer contributions to HIS. HIS contributions are deposited in a separate trust fund from which HIS payments are authorized. HIS benefits are not guaranteed and are subject to legislative appropriation. If these contributions or appropriation fails to provide full subsidy benefits to all participants, the Legislature may reduce or cancel the subsidy payments.

Additional Information. Financial statements and other supplementary information for the FRS and additional disclosures for HIS are included in the State's Comprehensive Annual Financial Report, which may be obtained from the Florida Department of Financial Services. An annual report on the FRS, which includes its financial statements, required supplementary information, actuarial report, and other relevant information, is available from the Florida Department of Management Services, Division of Retirement. Further disclosures and other supplementary information for HIS are included in the State's Comprehensive Annual Financial Report, which may be obtained from the Florida Department of Financial Services.

Deferred Compensation Plan. The Lottery, through the State of Florida, offers its employees a deferred compensation plan created in accordance with Section 457 of the Internal Revenue Code. The plan (refer to Section 112.215, Florida Statutes), available to all regular payroll State employees, permits them to defer a portion of their salaries until future years. The deferred compensation is not available to employees until termination, retirement, death, or an unforeseen emergency.

All amounts of compensation deferred under the plan, all property and rights purchased with those amounts, and all income attributable to those amounts, property, or rights are held in trust for the exclusive benefit of participants and their beneficiaries as mandated by 26 U.S.C.s.457(g)(1).

The Lottery does not contribute to the plan. Participation under the plan is solely at the discretion of the employee.

The State has no liability for losses under the plan but does have the duty of due care that would be required of an ordinary and prudent investor. Pursuant to Section 112.215, Florida Statutes, the Deferred Compensation Trust Fund is created in the State Treasury.

b. Postemployment Healthcare Benefits

The Lottery participates in the State Group Health Insurance Program, a cost-sharing multiple-employer defined benefit healthcare plan administered by the Florida Department of Management Services, Division of State Group Insurance, to provide group health benefits. Section 110.123, Florida Statutes, provides that retirees may participate in the State Group Health Insurance Program and assigns the authority to establish and amend benefit provisions to the Florida Department of Management Services. Although premiums are paid by the retiree, the premium cost to the retiree is implicitly subsidized by the commingling of claims experience in a single risk pool with a single premium determination. An actuarial valuation has been performed for the plan and the Lottery's employees were included in the actuarial analysis. For more information on the plan regarding the funding policy and actuarial methods and assumptions, see the State's Comprehensive Annual Financial Report, which is available from the Florida Department of Financial Services.

In accordance with GASB Statement 45, the Lottery is required to record its portion of the implicit postemployment health benefit liability beginning in the fiscal year ended June 30, 2008. Postemployment health benefits payable at June 30, 2011, June 30, 2010, and June 30, 2009, was \$1,472,000, \$990,000, and \$458,000, respectively.

10. OPERATING LEASES

The Lottery has entered into operating leases for the rental of office and warehouse space for the headquarters and district offices as well as the rental of computer equipment. Certain leases are renewable at the option of the Lottery.

Future minimum rental payments as of June 30, 2011, are scheduled as follows (in thousands):

Year Ending June 30	Headquarters	Districts	Total
2012	\$ 2,638	\$ 1,000	\$ 3,638
2013	2,665	737	3,402
2014	2,692	399	3,091
2015	2,719	348	3,067
2016	2,745	359	3,104
Total	\$ 13,459	\$ 2,843	\$ 16,302

Rental expense under all operating leases totaled approximately \$3,613,000 and \$3,569,000 for the fiscal years ended June 30, 2011, and 2010, respectively.

11. OTHER COMMITMENTS

The Lottery has entered into contractual agreements under which On-line and Scratch-Off lottery game vendors provide gaming systems, tickets, and related services. The Lottery renewed the On-line gaming contract October 8, 2010. Effective March 28, 2011, the rate was reduced from 1.1499 percent to 1.0699 percent of net On-line ticket sales. The contractor's compensation for On-line games for the fiscal years ended June 30, 2011, and 2010, was \$27,740,000, and \$27,390,000, respectively.

The Lottery's Scratch-Off ticket vendor is compensated at rates that range from 0.9744 percent to 2.24 percent based on ticket price points and total annual sales. Compensation under this agreement amounted to \$35,520,000 for the fiscal year ended June 30, 2011, and \$30,896,000 for the fiscal year ended June 30, 2010.

12. LITIGATION

The Lottery is involved in litigation and other claims incidental to the ordinary course of its operations. In the opinion of Lottery management, based on the advice of legal counsel, the ultimate disposition of these lawsuits and claims will not have a material adverse effect on the financial position of the Lottery.



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The President of the Senate, the Speaker of the
House of Representatives, and the
Legislative Auditing Committee

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF THE FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

We have audited the financial statements of the Florida Department of the Lottery (the Lottery) as of and for the fiscal year ended June 30, 2011, and have issued our report thereon included under the heading **INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS**. 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

We have examined the effectiveness of the Lottery's internal control over financial reporting as of June 30, 2011, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Lottery's management is responsible for maintaining effective internal control over financial reporting. Our responsibility is to express an opinion on the effectiveness of internal control based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants, and the standards applicable to attestation engagements contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Our examination included obtaining an understanding of the internal control over financial reporting, testing and evaluating the design and operating effectiveness of the internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

Because of inherent limitations in any internal control, misstatements due to errors or fraud may occur and not be detected. Also, projections of any evaluation of the internal control over financial reporting to future periods are

subject to the risk that the internal control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Lottery maintained, in all material respects, effective internal control over financial reporting as of June 30, 2011, based on the criteria established by *Internal Control – Integrated Framework* issued by COSO. While we noted no matters involving internal control over financial reporting and its operation that we consider to be material weaknesses, we did note additional matters involving the internal control over financial reporting, which are discussed in the **SCHEDULE OF FINDINGS**.

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, rules, regulations, and contracts, 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*. However, we noted certain additional matters involving legal compliance, which are discussed in the **SCHEDULE OF FINDINGS**.

The Lottery's response to the findings described in the **SCHEDULE OF FINDINGS** section of this report is included as Exhibit – A. We did not audit the Lottery's response and, accordingly, we express no opinion on it.

Pursuant to Section 11.45(4), Florida Statutes, this report is a public record and its distribution is not limited. Auditing standards generally accepted in the United States of America require us to indicate that the provisions of this report relating to compliance and other matters are intended solely for the information and use of the Legislative Auditing Committee, members of the Florida Senate and the Florida House of Representatives, and applicable management and are not intended to be and should not be used by anyone other than these specified parties.

Respectfully submitted,



David W. Martin, CPA
January 23, 2012

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

RICK SCOTT
Governor



CYNTHIA F. O'CONNELL
Secretary

FLORIDA LOTTERY**Management's Report on Internal Control Over Financial Reporting**

The Florida Lottery's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with accounting principles generally accepted in the United States of America. An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

Management is responsible for establishing and maintaining effective internal control over financial reporting. Management continually assessed the effectiveness of the Florida Lottery's internal control over financial reporting through June 30, 2011, based on the framework set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control – Integrated Framework*. Based on that assessment, management concluded that, as of June 30, 2011, the Florida Lottery's internal control over financial reporting is effective based on the criteria established in *Internal Controls – Integrated Framework*.

The Florida Lottery


Cynthia O'Connell
Secretary

January 23, 2012



**STATE OF FLORIDA
DEPARTMENT OF THE LOTTERY
SCHEDULE OF FINDINGS
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

ADDITIONAL MATTERS

Finding No. 1: Information Technology Controls

Information technology (IT) controls are intended to protect the confidentiality, integrity, and availability of data and IT resources. During our audit, we identified the need for enhancements to the Lottery's IT control practices in 21 separate areas, 9 of which were repeated from the prior audit. To avoid the possibility of compromising Lottery information, specific details of these matters are not disclosed in this report. However, the appropriate Lottery personnel have been notified of these issues.

Recommendation: We recommend that the Lottery make the necessary enhancements to its IT control practices to address the issues identified.

Finding No. 2: Minority Retailer Participation

Section 24.113, Florida Statutes, requires that 15 percent of the Lottery's retailers shall be minority business enterprises, as defined in Section 288.703(3), Florida Statutes; however, no more than 35 percent of such retailers shall be owned by the same type of minority person, as defined by Section 288.703(4), Florida Statutes.

Our audit disclosed that as of July 1, 2011, retailers comprising one minority type totaled approximately 65 percent of the total number of minority retailers. A similar finding has been included in previous Auditor General reports.

The Lottery has developed an outreach program to increase retailer participation in under-represented minority groups; however, despite these efforts, the level of participation from these groups has decreased slightly over the past fiscal year.

Recommendation: We recommend that the Lottery continue to take steps to resolve this finding.

Finding No. 3: Sales-Based Expenses

The Lottery's contracts with On-line and Scratch-Off game vendors provide that the Lottery pay the vendors a percentage of ticket sales. The fees paid to these vendors are thus sales-based expenses that increase as ticket revenues increase. Amounts appropriated in the State's budget to pay the sales-based expenses are estimated using ticket sales projections determined by the Office of Economic and Demographic Research's Revenue Estimating Conference (REC). Chapter 2010-152, Laws of Florida, the General Appropriations Act, provided the approved budgeted amounts for fiscal year 2010-11, and included specific language authorizing the Lottery to submit budget amendments should actual sales exceed the projected sales used to calculate the amounts appropriated.

In February 2011, the Lottery estimated that the On-line sales-based expenses would exceed the appropriated amounts and requested a budget amendment. This budget amendment was approved resulting in an adjusted budget amount of \$27,740,321. However, in June 2011, the sales-based expenses incurred during fiscal year 2010-11 reached

a level that exceeded by \$419,300 the available appropriations for the On-line games contract, and rather than submitting an additional budget amendment, the Lottery recorded this amount as an expense of the 2011-12 fiscal year and charged this amount against the 2011-12 fiscal year's appropriation.

Recommendation: We recommend the Lottery submit appropriate budget amendments in instances where sales-based expenses are estimated to exceed appropriations.

EXHIBIT - A
MANAGEMENT'S RESPONSE

RICK SCOTT
Governor



CYNTHIA F. O'CONNELL
Secretary

FLORIDA LOTTERY

January 23, 2012

David W. Martin, CPA
Auditor General
G74 Claude Pepper Building
111 West Madison Street
Tallahassee, Florida 32399-1450

Dear Mr. Martin:

The Lottery has received your December 22, 2011 report of preliminary and tentative findings and recommendations resulting from your audit of the Lottery's financial activities for the fiscal year ended June 30, 2011. The staff has discussed your recommendations and responds as follows:

1. Recommendation: The Lottery should make necessary enhancement to its IT control practices to address the issues identified.

Response: The Lottery has made the necessary enhancements presented by this audit or is in the process of implementing the enhancements. Particular attention has been given to making control improvements to address issues raised in previous audits. The Lottery has an ongoing process to improve IT controls and will continue to reengineer where necessary to tighten controls.

2. Recommendation: The Lottery continue to take steps to resolve the Minority Retailer Participation requirement of Section 24.113, Florida Statutes.

Response: The Lottery has continued its efforts to increase retailer participation in under-represented minority groups by revising its outreach program. Strategic initiatives include attending minority business trade shows to recruit new retailers; working with the National Association of Convenience Stores and the Florida Petroleum Marketers Association to identify and recruit new retailers, including minority operators; advertising in minority business journals by featuring minority retailers currently selling Lottery products; and exploring non-traditional trade styles retailer prospects. As always, the Lottery must ensure that EETF for Lottery transfers are the foremost objective when making retailer contract and



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EXHIBIT - A
MANAGEMENT'S RESPONSE (CONTINUED)

David W. Martin, CPA
Auditor General
Response to Preliminary and Tentative Findings
January 23, 2012
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terminal placement decisions. The Lottery will continue attempts to amend s 24.113 (1) to eliminate the conflict noted in previous reports.

3. Recommendation: The Lottery submit appropriate budget amendments in instances where sales-based expenses are estimated to exceed appropriations.

Response: The Lottery acknowledges that the Fiscal Year 10-11 On-Line Games Vendor appropriation, which was approved and even amended by the legislature, was insufficient to cover the final sales amounts achieved by the department. This was a result of the final actual sales amounts being even higher than the updated forecast adopted by the Revenue Estimating Conference in February 2011. The Lottery's CFO worked with legislative budget staff to try and avoid the shortage but was not completely successful, leaving a small balance to be carried over to the next year. The department will continue to work with legislative staff to ensure that future appropriations are sufficient to cover actual sales expenditures.

I would like to thank your staff for their diligent efforts on behalf of the Lottery and look forward to receiving your final report.

Sincerely,



Cynthia F. O'Connell
Secretary

CFO/bh

cc: J. Bruce Hoffmann, Chief of Staff
Glenda Thornton, General Counsel
Cynthia B. Jackson, Chief Financial Officer
Andy Mompeller, Inspector General