

DEPARTMENT OF THE LOTTERY

Financial Audit

For the Fiscal Years Ended
June 30, 2012 and 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. Cynthia F. O'Connell served as Secretary.

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 Tina Greene, CPA, CISA. Please address inquiries regarding the information technology portions of this report to Jonathan E. Ingram, CPA, CISA, Audit Manager, by e-mail at joningram@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, 2012, and 2011, 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 2, 2012, retailers comprising one minority type totaled 65 percent of the total number of minority retailers. A similar finding has been included in prior reports.

MARKETING AND RESEARCH SUPPORT FUNDS

Finding No. 3: The Lottery's Terminal ticket and Scratch-Off ticket gaming service vendors are each contractually required to make periodic deposits into marketing and research support funds (funds) maintained by the vendors. In Auditor General report No. 2007-093, we recommended that the Lottery amend the applicable provisions of each contract to include language that specifically addressed the ownership of each fund; that based on these clarifications, the Lottery reconsider the appropriateness of the budgetary and financial reporting treatments utilized for the funds; and that the Lottery more closely monitor compliance with its established purchase authorization and payment procedures. Our audit disclosed that while the Lottery had taken steps to address most of these recommendations, the Lottery had not included complete information relating to these funds in Lottery budgetary and financial reports.

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. 2012-083.

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, 2012, and 2011, 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, 2012, and 2011, 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 audits.

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

As discussed in Note 1, the financial statements of the Lottery are intended to present the financial position, the changes in financial position, and cash flows of only that portion of the business-type activities and major funds of the State that is attributable to the transactions of the Lottery. They do not purport to, and do not, present fairly the operations of the State of Florida as of June 30, 2012, and 2011, 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, 2012, and 2011, 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 financial audits and attestation engagements in *Government Auditing Standards*, we have also issued a report on our examination of the Lottery's internal control over financial reporting, 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***. As noted by that report, dated January 22, 2013, we have examined, 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*, the Lottery's internal control over financial reporting as of June 30, 2012, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and expressed an unqualified opinion. 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 22, 2013

MANAGEMENT'S DISCUSSION AND ANALYSIS

YEARS ENDED JUNE 30, 2012, AND JUNE 30, 2011

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, 2012, and 2011. 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 Terminal (formerly referred to as On-line) products. The Lottery has been successful in sustaining ticket sales in excess of \$2 billion for the twenty-third consecutive fiscal year, with the past two fiscal years exceeding \$4 billion. During the same twenty-three year period the transfer to the Educational Enhancement Trust Fund (EETF) has been a minimum of \$800 million annually, with the fiscal year 2012 transfer exceeding \$1 billion for the tenth consecutive year.

For the fiscal year ended June 30, 2012:

- Transfers to the EETF increased to approximately \$1.32 billion compared to \$1.19 billion in the prior fiscal year.
- The Lottery's ticket sales increased by 11.01% over the prior fiscal year from approximately \$4.01 billion to \$4.45 billion.
- Approximately 57.69% of total sales were provided by the Scratch-Off product line. This shift in product mix from the higher profit margin Terminal product to the lower profit margin Scratch-Off product directly impacted the amount transferred the EETF.
- Prize expense increased \$305.90 million, which represented a 12.43% increase during fiscal year 2012. 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 62.16% 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 2012 expenses for these items increased 9.62% over the prior fiscal year 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 decrease of

\$1.15 million. Administrative operating expenses for fiscal years 2012 and 2011 were \$70.30 million and \$71.45 million, respectively.

- Nonoperating income increased \$47.62 million over the prior fiscal year. Unrealized appreciation on investments accounted for \$38.56 million of the increase due to higher market values of investments of similar securities and a reduction in holdings in fiscal year 2012 compared to fiscal year 2011.
- EETF transfers from unclaimed prize money decreased \$8.4 million over the prior fiscal year. Unclaimed prize money generated by Scratch-Off games decreased significantly compared to fiscal year 2011 due to the Lottery closing 29 games during fiscal year 2012 compared to 43 games during fiscal year 2011. Unclaimed prize money generated by Terminal games increased \$2.7 million over the prior fiscal year due to the Lottery receiving \$4.01 million from the Multi-State Lottery Association (MUSL) for Florida's prorated share of an unclaimed Powerball® jackpot.

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 each fiscal year to the EETF. 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 restricted for future prize payouts or promotions, and the MUSL deposit amounts. 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 2012, 2011, and 2010.

Table 1
Condensed Statement of Net Assets
As of June 30, 2012, 2011, and 2010
(In Thousands)

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Assets			
Current Assets	\$ 165,785	\$ 189,859	\$ 176,765
Restricted Assets	1,291,004	1,511,185	1,745,058
Capital Assets, Net of Depreciation	<u>1,356</u>	<u>1,248</u>	<u>1,421</u>
Total Assets	<u><u>1,458,145</u></u>	<u><u>1,702,292</u></u>	<u><u>1,923,244</u></u>
Liabilities			
Current Liabilities	158,871	184,155	171,126
Current Liabilities Payable from Restricted Assets	735,382	882,439	1,018,424
Noncurrent Liabilities	<u>427,291</u>	<u>513,728</u>	<u>599,586</u>
Total Liabilities	<u><u>1,321,544</u></u>	<u><u>1,580,322</u></u>	<u><u>1,789,136</u></u>
Net Assets			
Net Investment in Capital Assets	1,356	1,248	1,421
Restricted Net Assets	<u>135,245</u>	<u>120,722</u>	<u>132,687</u>
Total Net Assets	<u><u>\$ 136,601</u></u>	<u><u>\$ 121,970</u></u>	<u><u>\$ 134,108</u></u>

Assets

Total assets at the end of fiscal year 2012 decreased \$244.15 million from \$1.70 billion at June 30, 2011, to \$1.46 billion at June 30, 2012. At the end of fiscal year 2011, total assets were \$220.95 million less than the \$1.92 billion at the end of fiscal year 2010.

- Current assets decreased from \$189.86 million in 2011 to \$165.79 million in 2012, representing a decrease of \$24.07 million. This net decrease was primarily due to a decrease of \$39.65 million in cash and cash equivalents mostly on deposit with the State Treasurer and an increase of \$16.04 million in accounts receivable. The increase in accounts receivable for fiscal year 2012 resulted from two additional days in the billing cycle to retailers when compared to the prior year.
- Restricted assets decreased \$220.18 million from \$1.51 billion in 2011 to \$1.29 billion in 2012. 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 \$156.14 million in payouts of annuities and \$12.74 million in purchases of new investments in fiscal year 2012 in comparison to fiscal year 2011, which had annuity payouts of \$178.57 million, and purchases of new investments of \$25.25 million. In addition to the downward trend in the investment portfolio, there was a decrease in the fair value of the grand prize investments. The amount of invested collateral from the lending of those securities also continued to decline. The Lottery held \$603.81 million in invested collateral at June 30, 2012, \$709.87 million at June 30, 2011, and \$749.14 million at June 30, 2010.

Liabilities

Total liabilities at June 30, 2012, were \$1.32 billion, which was approximately \$258.78 million lower than the total liabilities of \$1.58 billion at June 30, 2011. The total liabilities at June 30, 2011, were \$208.81 million lower than the June 30, 2010, amount of \$1.79 billion.

- Current liabilities decreased from \$184.16 million at June 30, 2011, to \$158.87 million at June 30, 2012. This decrease can be attributed to the decrease in the amount due to the EETF at June 30, 2012.
- As expected, current liabilities from restricted assets decreased \$147.06 million from \$882.44 million at June 30, 2011, to \$735.38 million at June 30, 2012. 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 \$127.37 million and the current portion of grand prizes payable decreased by \$19.74 million. At June 30, 2011, the current liability balance of \$882.44 million was \$135.99 million less than the balance of \$1.02 billion at June 30, 2010.
- 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 \$87.22 million from fiscal year-end 2011 to 2012 and decreased \$86.28 million from fiscal year-end 2010 to 2011.

Net Assets and Changes in Net Assets

Net assets increased \$14.63 million from June 30, 2011, to June 30, 2012. Net assets at June 30, 2012, 2011, and 2010 were \$136.60 million, \$121.97 million, and \$134.11 million, respectively. The increase was predominately due to the \$23.78 million increase in restricted net assets for undistributed appreciation on restricted investments.

The Lottery joined MUSL three years ago in order to participate in the Powerball® with Power Play® 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 Power Play game. The Lottery's deposits in reserve funds with MUSL totaled \$19.99 million and \$15.93 million as of June 30, 2012, and June 30, 2011, 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 year ended June 30, 2012, and the prior fiscal years ended June 30, 2011, and June 30, 2010, 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, 2012, 2011, and 2010
(In Thousands)

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Operating Revenues			
Ticket Sales	\$ 4,449,896	\$ 4,008,716	\$ 3,900,499
Bad Debt Expense	(1,360)	(1,212)	(1,075)
Terminal & Retailer Fees and Miscellaneous	<u>7,658</u>	<u>7,436</u>	<u>7,599</u>
Total Operating Revenues	<u>4,456,194</u>	<u>4,014,940</u>	<u>3,907,023</u>
Operating Expenses			
Prizes	2,766,119	2,460,219	2,346,162
Retailer Commissions	247,690	223,390	216,207
Vendor Commissions	66,528	63,260	58,286
Other Expenses	<u>70,304</u>	<u>71,449</u>	<u>71,519</u>
Total Operating Expenses	<u>3,150,641</u>	<u>2,818,318</u>	<u>2,692,174</u>
Income from Operations	<u>1,305,553</u>	<u>1,196,622</u>	<u>1,214,849</u>
Nonoperating Revenue, Net of Expenses	<u>30,682</u>	<u>(16,942)</u>	<u>43,874</u>
Income Before Operating Transfers	1,336,235	1,179,680	1,258,723
Transfers to EETF from Revenue and Reserves	(1,286,001)	(1,147,793)	(1,203,024)
Transfers to EETF from Unclaimed Prizes	<u>(35,603)</u>	<u>(44,025)</u>	<u>(43,770)</u>
Total Transfers to EETF	<u>(1,321,604)</u>	<u>(1,191,818)</u>	<u>(1,246,794)</u>
Change in Net Assets	14,631	(12,138)	11,929
Net Assets, Beginning of Year	<u>121,970</u>	<u>134,108</u>	<u>122,179</u>
Net Assets, End of Year	<u>\$ 136,601</u>	<u>\$ 121,970</u>	<u>\$ 134,108</u>

Sales

For the fiscal year ended June 30, 2012, ticket sales increased by \$441.18 million over the prior fiscal year, which experienced an increase of \$108.22 million. The Terminal game sales increased 5.60% from the prior fiscal year. To offset the impact of the slow economic recovery on sales, the Lottery continued to utilize proven techniques and created new promotions and product offerings for players.

- The FLORIDA LOTTO™ with XTRA® overall sales increased 1.86% over prior fiscal year while XTRA sales increased by 16.19%. This increase can be attributed to marketing efforts that focused on brand awareness. During football season there was a FAN-TASTIC promotion for FLORIDA LOTTO with XTRA that gave qualifying players a chance to win college-specific gear from one of eight partnered college teams around Florida. The FLORIDA LOTTO with XTRA also had a jackpot that rolled over 28 times producing a \$50 million winner on December 24, 2011.

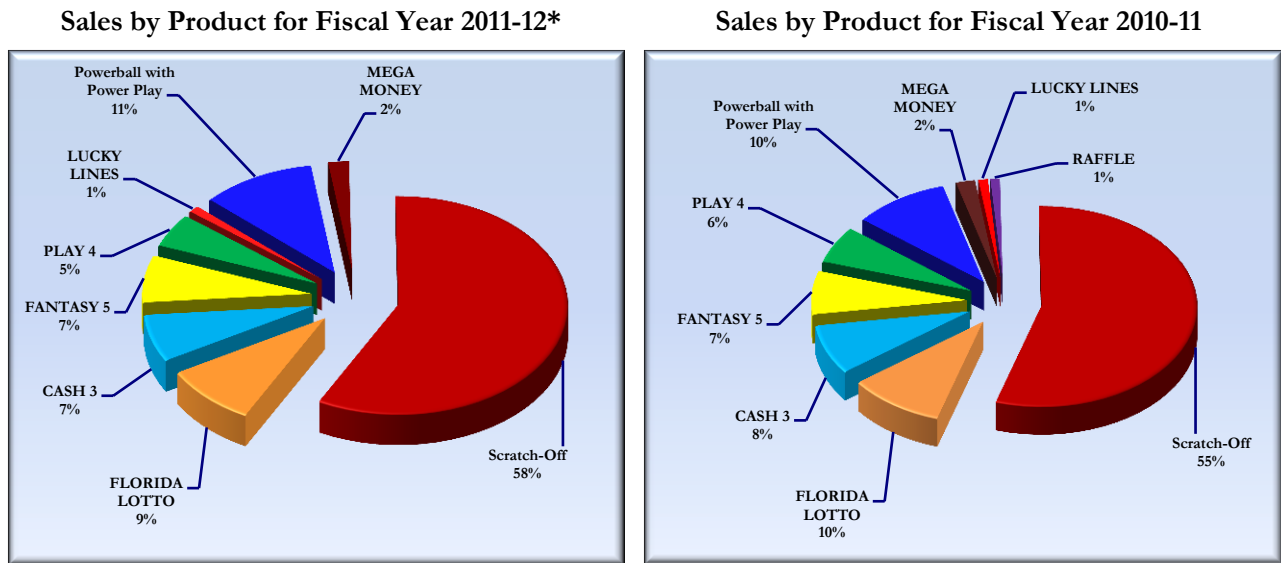
- Powerball with Power Play sales increased 28.18% over the prior fiscal year. Four times during the year the jackpot rolled to \$200 million or more. On January 15, 2012, the multi-state Powerball game was enhanced to the “Bigger, Better Powerball” game. Characteristics of the enhanced game included an increased ticket cost per play, which allowed a higher starting jackpot of \$40 million as compared to the prior \$20 million starting jackpot. The game also gave more players a chance to become a millionaire with better chances of winning.

Sales of Scratch-Off tickets increased from \$2.23 billion, or 55.52% of total ticket sales in fiscal year 2011, to \$2.57 billion, or 57.69% of total sales in fiscal year 2012.

- Scratch-Off ticket sales increased 15.34% over prior fiscal year sales, with increases in each price point. The largest increases were seen in the \$2 and \$20 price points. The \$2 price point was dominated by the MONOPOLY™ ticket sales totaling \$58.8 million. The \$20 price point was led by GOLD RUSH TRIPLER, which contributed \$370.7 million in ticket sales. In February the LUCKY FOR LIFE family was launched generating \$118.4 million in sales.
- Instant Ticket Vending Machines (ITVMs), which function similarly 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 1,500 machines in use during the fiscal year. Total sales from the ITVMs accounted for \$343.63 million of the Scratch-Off sales, which reflected an increase of \$86.40 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, 2012, and 2011, was \$1.36 million and \$1.21 million, respectively.

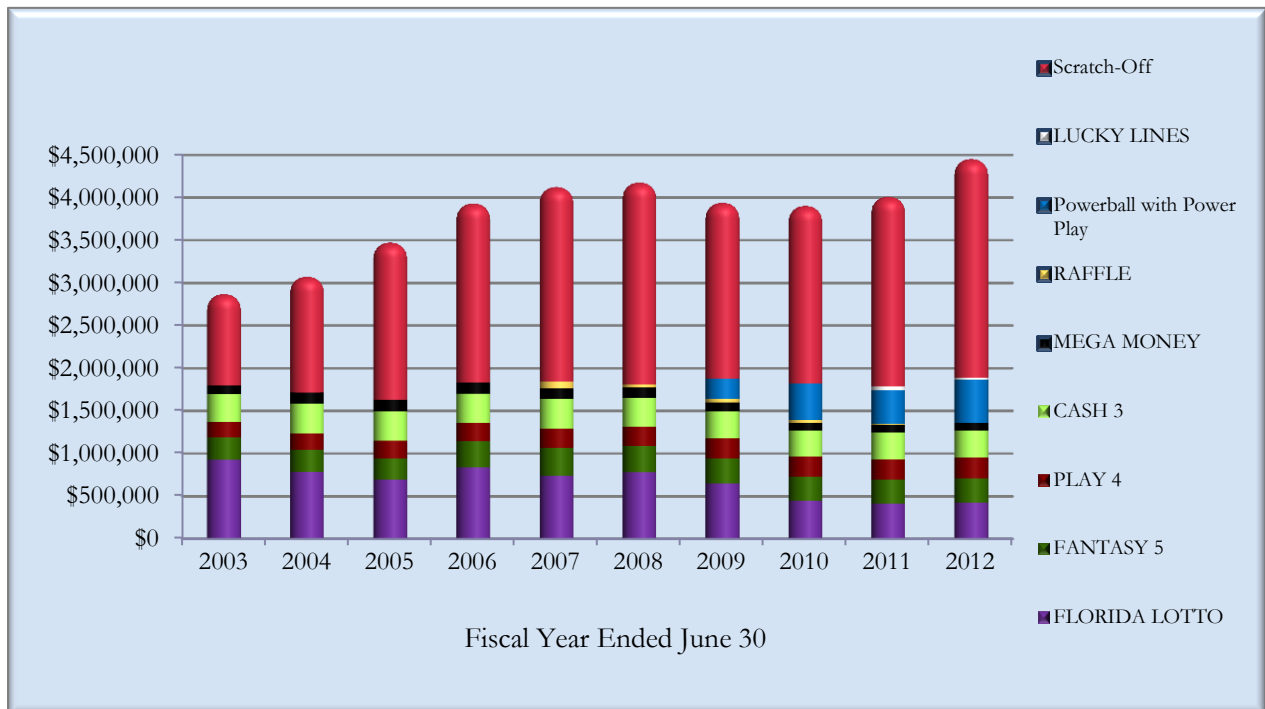
The following charts show sales by product for the various Lottery games during the fiscal years 2012 and 2011:



*Did not conduct a Raffle

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)**

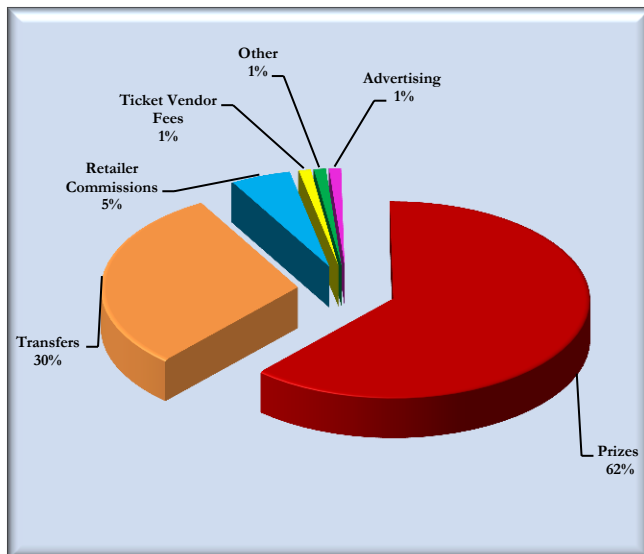
Fiscal Year Ended June 30	FLORIDA LOTTO™	FANTASY 5®	PLAY 4™	CASH 3™	MEGA MONEY™	RAFFLE™	LUCKY LINES™	Powerball® with Power Play®	Scratch- Off	Combined Sales
2003	\$ 925,474	\$ 259,999	\$ 182,716	\$ 330,001	\$ 95,930				\$ 1,073,861	\$ 2,867,981
2004	785,415	259,728	192,580	349,227	125,944				1,358,068	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
2012	419,040	290,672	244,711	314,747	92,346		17,692	503,697	2,566,991	4,449,896

Expenses

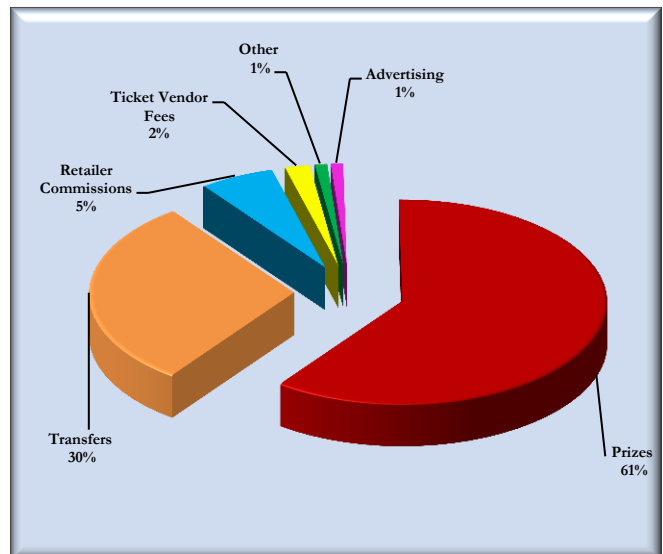
Section 24.121, Florida Statutes, stipulates that funds remaining in the Operating Trust Fund after the transfer to the EETF shall be used for the payment of administrative expenses of the Lottery. These expenses include Terminal game expenses, Scratch-Off ticket expenses, advertising, and other expenses 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 2012 and 2011 fiscal years:

**Operating Expenses and Transfers
Fiscal Year 2011-12**



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



Prizes, commissions, and gaming vendor fees are directly related to ticket sales and fluctuate accordingly. In fiscal year 2012, 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, and depreciation, decreased slightly. Fiscal year 2012 and 2011 administrative expenses were \$70.30 million and \$71.45 million, respectively.

Transfers

Since its inception the Lottery has transferred over \$24.02 billion to the EETF. The Lottery’s contribution to the EETF for the fiscal year ended June 30, 2012, \$1.32 billion, exceeded the prior fiscal year’s contribution of \$1.19 billion, and for the tenth 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 changes, tourism, and competition for discretionary consumer spending. The Lottery is challenged with Florida’s unemployment rate which remained above 8% during the fiscal year 2012, population growth that is expected to remain relatively flat over the next few years, and consumer confidence still recovering at a slow rate. In fiscal year 2012, Lottery sales totaled \$4.45 billion, setting new sales records for Scratch-Off, Terminal, and total game sales. The Lottery’s strategies have revolved around enhancing Terminal and Scratch-Off games, 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 STATEMENTS OF NET ASSETS As of June 30, 2012, and June 30, 2011 (In Thousands)

Assets	<u>June 30, 2012</u>	<u>June 30, 2011</u>
Current Assets:		
Cash and cash equivalents	\$ 124,877	\$ 164,525
Interest receivable	393	453
Accounts receivable, net	37,295	21,254
Due from other departments	4	0
Prepaid expenses	69	68
Inventories	1,143	994
Security deposits	2,004	2,565
Total Current Assets	<u>165,785</u>	<u>189,859</u>
Noncurrent Assets:		
Restricted Assets		
Cash and cash equivalents	5,289	39,774
Securities lending income receivable	655	476
Deposit with MUSL	19,995	15,926
Investments, grand prize	661,254	745,138
Investments, security lending collateral	603,811	709,871
Total Restricted Assets	<u>1,291,004</u>	<u>1,511,185</u>
Capital assets, net	1,356	1,248
Total Noncurrent Assets	<u>1,292,360</u>	<u>1,512,433</u>
Total Assets	<u>\$ 1,458,145</u>	<u>\$ 1,702,292</u>
Liabilities		
Current Liabilities:		
Accounts payable and accrued liabilities	\$ 7,992	\$ 9,566
Prizes payable	96,483	89,395
Due to Educational Enhancement Trust Fund	51,604	81,818
Deposits payable	2,007	2,567
Compensated absences payable	785	809
Total Current Liabilities	<u>158,871</u>	<u>184,155</u>
Current Liabilities Payable from Restricted Assets:		
Securities lending fees payable	98	48
Obligations under securities lending	604,556	731,926
Grand prizes payable	130,728	150,465
Total Current Liabilities Payable from Restricted Assets	<u>735,382</u>	<u>882,439</u>
Noncurrent Liabilities:		
Grand prizes payable from restricted assets	422,297	509,513
Compensated absences payable	2,798	2,743
Other long-term liabilities	2,196	1,472
Total Noncurrent Liabilities	<u>427,291</u>	<u>513,728</u>
Total Liabilities	<u>1,321,544</u>	<u>1,580,322</u>
Net Assets		
Invested in capital assets	1,356	1,248
Restricted net assets for undistributed appreciation on restricted investments	110,012	86,237
Restricted net assets for MUSL	19,995	15,926
Restricted net assets for future prizes or special prize promotions	5,238	18,559
Total Net Assets	<u>\$ 136,601</u>	<u>\$ 121,970</u>

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

DEPARTMENT OF THE LOTTERY
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
Years ended June 30, 2012, and June 30, 2011
(In Thousands)

	<u>June 30, 2012</u>	<u>June 30, 2011</u>
Operating Revenues:		
Ticket sales	\$ 4,449,896	\$ 4,008,716
Bad debt expense	(1,360)	(1,212)
Terminal fees and miscellaneous	7,465	7,237
Retailer fees	193	199
Total Operating Revenues	<u>4,456,194</u>	<u>4,014,940</u>
Operating Expenses:		
Prizes	2,766,119	2,460,219
Retailer commissions	247,690	223,390
Scratch-Off tickets	38,906	35,520
Terminal games	27,622	27,740
Advertising	33,540	33,159
Personal services	26,139	27,204
Other contractual services	8,210	8,855
Materials and supplies	1,969	1,921
Depreciation	446	310
Total Operating Expenses	<u>3,150,641</u>	<u>2,818,318</u>
Operating Income	<u>1,305,553</u>	<u>1,196,622</u>
Nonoperating Revenues (Expenses):		
Interest	5,024	4,893
Securities lending income	3,007	3,120
Securities lending fees	(824)	(1,400)
Investment management fees	(296)	(284)
Net appreciation (depreciation) in fair value of investments	60,221	21,662
Property disposition (loss)	(4)	(15)
Amortization of grand prizes payable	(36,446)	(44,918)
Total Nonoperating Revenues (Expenses), Net	<u>30,682</u>	<u>(16,942)</u>
Income Before Operating Transfers	1,336,235	1,179,680
Transfers to Educational Enhancement Trust Fund:		
Transfers from revenue and reserves	(1,286,001)	(1,147,793)
Transfers from unclaimed prizes	(35,603)	(44,025)
Total Transfers to Educational Enhancement Trust Fund	<u>(1,321,604)</u>	<u>(1,191,818)</u>
Change in Net Assets	14,631	(12,138)
Net Assets, Beginning of Year	121,970	134,108
Net Assets, End of Year	<u>\$ 136,601</u>	<u>\$ 121,970</u>

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

DEPARTMENT OF THE LOTTERY
STATEMENTS OF CASH FLOWS
Years ended June 30, 2012, and June 30, 2011
(In Thousands)

	<u>June 30, 2012</u>	<u>June 30, 2011</u>
Operating Activities:		
Ticket sales	\$ 4,432,495	\$ 4,002,723
Prizes paid to winners	(2,763,100)	(2,472,222)
Commissions paid and payments to retailers	(247,690)	(223,390)
Paid to vendors for goods and services	(112,140)	(111,404)
Paid to employees	(25,216)	(26,753)
Other operating revenue	<u>7,658</u>	<u>7,432</u>
Net Cash Provided by Operating Activities	<u>1,292,007</u>	<u>1,176,386</u>
Noncapital Financing Activities:		
Payments to Educational Enhancement Trust Fund	<u>(1,351,818)</u>	<u>(1,169,308)</u>
Net Cash Used in Noncapital Financing Activities	<u>(1,351,818)</u>	<u>(1,169,308)</u>
Capital and Related Financing Activities:		
Purchase of capital assets	<u>(558)</u>	<u>(152)</u>
Net Cash Used in Capital and Related Financing Activities	<u>(558)</u>	<u>(152)</u>
Investing Activities:		
Cash received from maturity of grand prize investments	156,135	178,569
Cash paid to grand prizewinners upon maturity of grand prize investments	(156,135)	(178,569)
Security lending	(21,200)	(64,266)
Investment income, net of fees	<u>7,436</u>	<u>5,907</u>
Net Cash Provided by Investing Activities	<u>(13,764)</u>	<u>(58,359)</u>
Net Increase (Decrease) in Cash and Cash Equivalents	(74,133)	(51,433)
Cash and Cash Equivalents, Beginning of Year	<u>204,299</u>	<u>255,732</u>
Cash and Cash Equivalents, End of Year	<u>\$ 130,166</u>	<u>\$ 204,299</u>
Reconciliation of Income from Operations to Net Cash Provided by Operating Activities:		
Income from operations	\$ 1,305,553	\$ 1,196,622
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation	446	310
Changes in assets and liabilities		
(Increase) decrease in:		
Accounts receivable	(19,514)	(12,223)
Inventories	(150)	27
Pre-paid expenses	(1)	(22)
Increase (decrease) in:		
Allowance for uncollectible accounts	(36)	732
Accounts payable and accrued liabilities	(2,135)	(4,004)
Prizes payable	7,088	(5,413)
Compensated absences payable	32	(125)
Postemployment healthcare benefits payable	<u>724</u>	<u>482</u>
Net Cash Provided by Operating Activities	<u>\$ 1,292,007</u>	<u>\$ 1,176,386</u>
Noncash Investing, Capital and Financing Activities:		
Increase/(decrease) in fair value of investments	\$ (38,722)	\$ (92,140)

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, 2012, and June 30, 2011**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, prepaid postage, and prepaid tolls.

h. Prepaid Expenses

Prepaid expenses represent warranty agreements 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 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, restricted net assets for the Restricted Prize Pool, and restricted net assets for the Multi-State Lottery Association (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 and restricted for use in 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 53ER12-6, Florida Administrative Code.

k. Revenue Recognition

Lottery games are sold to the public by contracted retailers. Revenue is recognized when Terminal game 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 Terminal 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 Terminal 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 \$61 million per occurrence for named windstorm and flood losses through February 15 2012, and \$50 million beginning February 15, 2012, 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, 2012, and June 30, 2011, was \$1,360,000 and \$1,212,000, 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 \$449,000 at June 30, 2012, and \$617,000 at June 30, 2011, were insured by either the State's collateral for public deposits in accordance with Section 280.04, Florida Statutes, or Federal depository insurance.

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 are met that protect the State's interest. 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 \$2,796,000 at June 30, 2012, and \$2,059,000 at June 30, 2011, 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 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 \$129,716,000 and \$182,482,000 at June 30, 2012, and 2011, 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 State of 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 are 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 revenue/(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 fiscal year, including purchases, maturities, and sales.

c. Investments, Security 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 security 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 \$604,556,000 of cash collateral for the lending program as of June 30, 2012, and \$731,926,000 as of June 30, 2011. At June 30, 2012, and June 30, 2011, 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, 2012, and June 30, 2011, the potential unrealized shortfall was \$406,000 and \$712,000, respectively.

Other risk factors associated with security 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, 2012, and 2011, consisted of (in thousands):

	<u>2012</u>	<u>2011</u>
Securities lending income	\$ 3,007	\$ 3,120
Less broker rebates	(748)	(1,323)
Less bank fees	(76)	(77)
Net securities lending revenue	<u>\$ 2,183</u>	<u>\$ 1,720</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 A+f as of June 30, 2012.

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

Investment Type	As of June 30, 2012						Totals
	Standard and Poor's Credit Rating						
	AAA	AA	A	CCC	A-1	NR	
Certificates of Deposit	\$ -	\$ 10,414	\$ -	\$ -	\$ -	\$ 174,853	\$ 185,267
Commercial Paper	-	-	-	-	65,481	-	65,481
Domestic Corporate Bonds & Notes	6,615	26,863	56,129	-	-	-	89,607
Domestic Non-government Asset-backed Securities	53,946	-	-	169	-	6,100	60,215
Domestic Non-government Backed CMO's	3,907	-	-	-	-	-	3,907
International Corporate Bonds & Notes	-	37,342	2,470	-	-	-	39,812
International Non-government Asset-backed Securities	25,403	-	-	-	-	-	25,403
International Non-government Backed CMO's	-	-	14,156	-	-	-	14,156
Repurchase Agreements	-	-	-	-	-	111,132	111,132
U.S. Government Securities ¹	-	-	-	-	-	8,831	8,831
Grand Total	\$ 89,871	\$ 74,619	\$ 72,755	\$ 169	\$ 65,481	\$ 300,916	\$ 603,811

¹ U.S. Treasury Obligations do not carry individual security ratings, but carried overall ratings of AA⁺ by Standard and Poor's as of June 30, 2012.

Investment Type	As of June 30, 2011						Totals	
	Standard and Poor's Credit Rating							
	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	\$ 96,143	\$ 108,572	\$ 41,702	\$ 1,842	\$ 670	\$ 114,603	\$ 346,339	\$ 709,871

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, 2012		As of June 30, 2011	
Time to Maturity	Fair Value	Time to Maturity	Fair Value
< 1 year	\$ 134,842	< 1 year	\$ 156,020
> 1 year to 3 years	195,451	> 1 year to 3 years	243,347
> 3 years to 5 years	105,302	> 3 years to 5 years	140,468
> 5 years to 10 years	87,497	> 5 years to 10 years	98,300
> 10 years to 15 years	77,072	> 10 years to 15 years	58,102
> 15 years to 20 years	47,787	> 15 years to 20 years	41,074
> 20 years to 25 years	8,985	> 20 years to 25 years	5,411
> 25 years	4,318	> 25 years	2,416
Total	\$ 661,254	Total	\$ 745,138

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:

Investment Type	June 30, 2012		June 30, 2011	
	Fair Value (Thousands)	Weighted Average Maturity (Days)	Fair Value (Thousands)	Weighted Average Maturity (Days)
Certificates of Deposit	\$ 185,267	43	\$ 232,364	55
Commercial Paper	65,481	47	114,603	53
Domestic Corporate Bonds & Notes	89,607	42	78,414	37
Domestic Non-government Asset-backed Securities	60,215	23	62,545	16
Domestic Non-government Backed CMO's	3,907	6	4,311	6
International Corporate Bonds & Notes	39,812	55	61,334	58
International Non-government Asset-backed Securities	25,403	16	11,953	16
International Non-government Backed CMO's	14,156	20	18,726	20
Repurchase Agreements	111,132	2	125,621	1
U.S. Government Securities	8,831	107	-	-
Total Fair Value	\$ 603,811		\$ 709,871	
Portfolio weighted average maturity		33		38

The effective duration of the State Treasury Investment Pool at June 30, 2012, and June 30, 2011, was approximately 2.38 years and 2.13 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.

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, 2012, and June 30, 2011, was \$603,811,000 and \$709,871,000, respectively.

At June 30, 2012, and June 30, 2011, 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 at June 30, 2012, and June 30, 2011.

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, 2012 Carrying Value	June 30, 2011 Carrying Value
Commercial Paper	\$ 65,481	\$ 114,603
Certificates of Deposit	185,267	232,364
Repurchase Agreements	111,132	125,621
U.S. Government Obligations & Federally Guaranteed Obligations	80,223	29,221
Domestic Corporate Bonds & Notes	89,607	78,414
Domestic Non-government Asset-backed Securities	60,215	62,545
International Corporate Bonds & Notes	39,812	61,334
International Non-government Asset-backed Securities	25,403	11,953
Domestic Non-government Backed CMO's	3,907	4,311
International Non-government Backed CMO's	14,156	18,726
Investments Held by Others Under Securities Lending Agreements - U.S. Obligations	589,862	715,917
Pooled Investments with State Treasury	129,717	182,482
Total Investments	\$ 1,394,782	\$ 1,637,491

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

	June 30, 2012			
	Investments	Cash at Financial Institutions	Cash at State Treasury	Total
Cash and cash equivalents	\$ 124,479	\$ 347	\$ 51	\$ 124,877
Restricted cash and cash equivalents	5,238	51	-	5,289
Investments, grand prize	661,254	-	-	661,254
Investments, security lending collateral	603,811	-	-	603,811
Total	\$ 1,394,782	\$ 398	\$ 51	\$ 1,395,231

	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, security lending collateral	709,871	-	-	709,871
Total	\$ 1,637,491	\$ 21,613	\$ 204	\$ 1,659,308

3. ACCOUNTS RECEIVABLE

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

	<u>2012</u>	<u>2011</u>
Ticket sales receivable	\$ 39,594	\$ 23,568
Other receivables	29	50
Total receivables	39,623	23,618
Less allowance for doubtful accounts	(2,328)	(2,364)
Accounts receivable, net	\$ 37,295	\$ 21,254

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-10	2010-11		Balance 30-Jun-11	2011-12		Balance 30-Jun-12
		Increase	Decrease		Increase	Decrease	
Data processing equipment	\$ 3,958	\$ 7	\$ (152)	\$ 3,813	\$ 3	\$ (123)	\$ 3,693
Office equipment and fixtures	5,851	82	(226)	5,707	249	(157)	5,799
Vehicles and other equipment	3,034	11	(63)	2,982	250	(31)	3,201
Software and other intangibles	651	52	-	703	60	-	763
	<u>13,494</u>	<u>152</u>	<u>(441)</u>	<u>13,205</u>	<u>562</u>	<u>(311)</u>	<u>13,456</u>
Less accumulated depreciation	<u>12,073</u>	<u>310</u>	<u>(426)</u>	<u>11,957</u>	<u>720</u>	<u>(577)</u>	<u>12,100</u>
Total capital assets, net	<u><u>\$ 1,421</u></u>	<u><u>\$ (158)</u></u>	<u><u>\$ (15)</u></u>	<u><u>\$ 1,248</u></u>	<u><u>\$ (158)</u></u>	<u><u>\$ 266</u></u>	<u><u>\$ 1,356</u></u>

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 2011-12. This association offers the Powerball with Power Play Terminal game and several other Terminal 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 Power Play 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, 2012, and June 30, 2011, the Lottery had deposits with MUSL of \$19,995,144, and \$15,926,144, 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>2012</u>	<u>2011</u>
FLORIDA LOTTO grand prizes (face value)	\$ 662,012	\$ 815,283
MEGA MONEY grand prizes (face value)	8,796	7,590
Win for Life grand prizes (face value)	11,930	12,294
Flamingo Fortune Game Show grand prizes (face value)	600	700
Win a Million grand prizes (face value)	300	350
Yearly Bonus grand prizes (face value)	50	100
Lucky for Life grand prizes (face value)	21,750	24,500
Set for Life grand prizes (face value)	2,100	2,280
Cash Spectacular grand prizes (face value)	550	600
Cash for Life grand prizes (face value)	210	220
Loaded for Life grand prizes (face value)	2,850	2,950
Billion Dollar Blockbuster grand prizes (face value)	8,000	8,500
Gas for Life grand prizes (face value)	186	192
2 Million Dollar Casino Action grand prizes (face value)	1,800	-
Million Dollar Holiday grand prizes (face value)	950	-
Week for Life grand prizes (face value)	13,650	-
Monopoly grand prizes (face value)	2,850	-
Less imputed interest	<u>(185,559)</u>	<u>(215,581)</u>
Net present value of grand prizes payable	<u>\$ 553,025</u>	<u>\$ 659,978</u>
Current prizes payable from restricted assets	\$ 130,728	\$ 150,465
Noncurrent prizes payable from restricted assets	<u>422,297</u>	<u>509,513</u>
Total grand prizes payable	<u>\$ 553,025</u>	<u>\$ 659,978</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>
2013	\$ 134,951
2014	112,142
2015	84,655
2016	64,750
2017	43,188
2018-2022	96,465
2023-2027	101,810
2028-2032	74,178
2033-2037	16,856
2038-2041	<u>9,589</u>
Grand prizes (face value)	738,584
Less imputed interest	<u>(185,559)</u>
Net present value of grand prizes payable	<u>\$ 553,025</u>

b. Compensated Absences Payable

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

	<u>2012</u>	<u>2011</u>
Current compensated absences	\$ 785	\$ 809
Noncurrent compensated absences	<u>2,798</u>	<u>2,743</u>
Total	<u>\$ 3,583</u>	<u>\$ 3,552</u>

c. Changes in Long-Term Liabilities

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

	2011-2012				
	Balance	Additions	Reductions	Balance	Amount
	June 30, 2011			June 30, 2012	Due Within One Year
Grand prizes payable	\$ 659,978	\$ 49,182	\$ (156,135)	\$ 553,025	\$ 130,728
Compensated absences payable	3,552	1,635	(1,604)	3,583	785
Postemployment healthcare benefits payable	1,472	724	-	2,196	-
Total long-term liabilities	\$ 665,002	\$ 51,541	\$ (157,739)	\$ 558,804	\$ 131,513

	2010-2011				
	Balance June	Additions	Reductions	Balance	Amount
	30, 2010			June 30, 2011	Due Within One Year
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

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 Terminal games 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, 2012, was \$1,321,604,000 (29.7 percent of revenues), and for the fiscal year ended June 30, 2011, the transferred amount was \$1,191,818,000 (29.7 percent 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 minus expenses rather than a percent of revenue.

The amount due to the EETF at June 30, 2012, and June 30, 2011, was as follows (in thousands):

	<u>June 30, 2012</u>	<u>June 30, 2011</u>
Terminal ticket sales	\$ 1,882,905	\$ 1,783,040
Average percent transferred	39%	38%
Transfer of Terminal ticket sales	<u>729,820</u>	<u>678,540</u>
Unclaimed Terminal ticket prizes (excluding Powerball jackpot prizes)	26,608	28,194
Percent transferred	80%	80%
Transfer of unclaimed Terminal ticket prizes	<u>21,286</u>	<u>22,555</u>
Unclaimed Powerball jackpot prizes	<u>4,007</u>	<u>-</u>
Scratch-Off ticket sales	2,566,991	2,225,676
Average percent transferred	21%	20%
Transfer of Scratch-Off ticket sales	<u>541,616</u>	<u>455,503</u>
Unclaimed Scratch-Off ticket prizes	12,888	26,837
Percent transferred	80%	80%
Transfer of unclaimed Scratch-Off ticket prizes	<u>10,310</u>	<u>21,470</u>
Nonoperating revenues (expenses), net	30,682	(16,942)
Add:		
Net (appreciation) depreciation in fair value of investments	(60,221)	(21,662)
Amortization of grand prizes payable	36,446	44,918
Total Nonoperating revenues, net	<u>6,907</u>	<u>6,314</u>
Terminal fees and miscellaneous revenue	<u>7,658</u>	<u>7,436</u>
Due for the year	<u>\$ 1,321,604</u>	<u>\$ 1,191,818</u>
Balance due, beginning of year	81,818	59,308
Paid during the year	<u>(1,351,818)</u>	<u>(1,169,308)</u>
Due to Educational Enhancement Trust Fund, June 30	<u><u>\$ 51,604</u></u>	<u><u>\$ 81,818</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) or 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, required employer and employee 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 for members initially enrolled before July 1, 2011, and at eight years for members initially enrolled on or after July 1, 2011. 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. For members initially enrolled on or after July 1, 2011, Special Risk Class members are eligible for normal retirement benefits at age 60 and vested or after 30 years of service at any age. All other members are eligible for normal retirement benefits at age 60 and vested or at any age after 35 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. Retirees with service prior to July 1, 2011, receive annual cost-of-living adjustments. Retirees with service accrued only on or after July 1, 2011, do not 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 if initially enrolled before July 1, 2011, or the average of highest eight fiscal years' salaries if initially enrolled on or after July 1, 2011).

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 and employee 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:

Class or Plan	Employee Rate	Employer Rate	Employee Rate	Employer Rate
	Fiscal Year Ended	Fiscal Year Ended	Fiscal Year Ended	Fiscal Year Ended
	June 30, 2012	June 30, 2012	June 30, 2011	June 30, 2011
Senior Management Service	3.00 percent	6.27 percent	0.00 percent	14.57 percent
Regular	3.00 percent	4.91 percent	0.00 percent	10.77 percent
Special Risk	3.00 percent	14.10 percent	0.00 percent	23.25 percent
DROP - Applicable to members from all of the above classes	0.00 percent	4.42 percent	0.00 percent	12.25 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 0.03 percent for fiscal year ended June 30, 2012 and June 30, 2011, for administrative costs of the financial education program and the Investment Plan. Required employee contributions are deducted on a pre-tax basis.

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 employer contributions for the fiscal years ended June 30, 2012, June 30, 2011, and June 30, 2010, totaled \$957,759, \$1,681,368, and \$1,506,859, respectively, which

were equal to 100 percent of the required contributions for each fiscal year. These contributions represented 5.7 percent, 10.4 percent, and 9.2 percent of covered payroll, for the fiscal years ended June 30, 2012, June 30, 2011, and June 30, 2010, 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 9.49 percent of covered payroll for July 2011 through June 2012, and 12.49 percent of covered payroll for July 2010 through June 2011. This contribution rate includes a contribution that would otherwise be paid to the Retiree Health Insurance Subsidy (HIS) Program 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, 2012, June 30, 2011, and June 30, 2010, totaled \$24,509, \$52,329, and \$71,933 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, 2012, and 2011, 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, 2012, 2011, and 2010, 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, 2012, 2011, and 2010, the Lottery contributed \$182,359, \$179,978, and \$181,236, 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 fail 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 the 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 Comprehensive Annual Financial Report of the State of Florida, 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 Employees' Health Insurance Program, a cost-sharing multiple-employer defined benefit postemployment healthcare plan administered by the State of 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's group health insurance programs and assigns the authority to establish and amend benefit provisions to the 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 Department of Financial Services.

In accordance with GASB Statement 45, the Lottery is required to record its portion of the implicit postemployment healthcare benefit liability beginning in the fiscal year ended June 30, 2008. Postemployment healthcare benefits payable at June 30, 2012, June 30, 2011, and June 30, 2010, was \$2,196,000, \$1,472,000, and \$990,000, 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, 2012, are scheduled as follows (in thousands):

Year Ending June 30	Headquarters	Districts	Total
2013	\$ 2,664	\$ 1,031	\$ 3,695
2014	2,690	599	3,289
2015	2,717	552	3,269
2016	2,744	568	3,312
2017	2,772	585	3,357
Total	\$ 13,587	\$ 3,335	\$ 16,922

Rental expense under all operating leases totaled approximately \$3,669,000 and \$3,613,000 for the fiscal years ended June 30, 2012, and 2011, respectively.

11. OTHER COMMITMENTS

The Lottery has contractual agreements under which Terminal and Scratch-Off lottery game vendors provide gaming systems, tickets, and related services. The Lottery's Terminal gaming vendor is compensated at a rate of 1.0699% of net Terminal game ticket sales. The vendor's compensation for

Terminal games for the fiscal years ended June 30, 2012, and 2011, was \$27,622,000, and \$27,740,000, respectively.

The Lottery's Scratch-Off ticket vendor is compensated at rates that range from 0.9985 percent to 2.24 percent based on ticket price points and total annual sales. Compensation under this agreement amounted to \$33,895,000 for the fiscal year ended June 30, 2012, and \$30,900,000 for the fiscal year ended June 30, 2011.

Each of the gaming vendor contracts requires the vendors to provide a fund for marketing support activities as directed by the Lottery. The vendors are required to make deposits into the designated accounts either weekly or monthly and distribute the funds as directed by the Lottery. The funds are used for market research and other expenses directly linked to product sales. Each contract requires that any funds remaining in the accounts at the end of each contract's term will be returned to the Lottery for transfer to the Educational Enhancement Trust Fund. The combined balance in the two funds as of June 30, 2012, and June 30, 2011, was \$3,134,090 and \$3,117,502, respectively.

The Lottery also has contractual agreements for game vending machines. The contracted vendor receives a monthly fee associated with each vending machine. The compensation received by the vendor for the fiscal years ended June 30, 2012, and 2011, was \$5,011,000 and \$4,620,000.

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, 2012, and have issued our report thereon dated January 22, 2013, included under the heading **INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS**. In our report, we expressed an unqualified opinion. 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, 2012, 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 and for its assertion of the effectiveness of internal control over financial reporting, included in the accompanying **MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**. Our responsibility is to express an opinion on the effectiveness of internal control over financial reporting based on our examination.

We conducted our examination 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. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our examination included obtaining an understanding of the internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of the internal control based on the assessed risk. Our examination also included performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

An entity'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.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct misstatements. Also, projections of any evaluation of effectiveness 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, 2012, based on the criteria established in *Internal Control – Integrated Framework* issued by COSO. 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.

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, the Executive Office of the Governor, 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 22, 2013

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 assessed the effectiveness of the Florida Lottery’s internal control over financial reporting as of June 30, 2012, 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, 2012, 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 F. O'Connell
Secretary

January 22, 2013



**STATE OF FLORIDA
DEPARTMENT OF THE LOTTERY
SCHEDULE OF FINDINGS
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

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 eight separate areas, seven 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 2, 2012, 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 its efforts to increase retailer participation in under-represented minority groups.

Finding No. 3: Marketing and Research Support Funds

The Lottery's Terminal ticket and Scratch-Off ticket gaming service vendors are each contractually required to make periodic deposits into marketing and research support funds (funds). The contracts require that the vendors maintain the funds; however, the Lottery is responsible for determining the ultimate distribution of the amounts in the funds. The vendor contracts include provisions stipulating that any remaining moneys in the funds will be returned to the Lottery at each contract's end.

Unobligated cash balances in the funds as of June 30 for the last seven fiscal years are summarized as follows:

Fiscal Year Ended June 30	GTECH Fund	Scientific Games Funds	Total at June 30
2006	\$119,220	\$3,754,813	\$3,874,033
2007	\$9,703	\$2,893,864	\$2,903,567
2008	\$18,602	\$1,272,298	\$1,290,900
2009	\$55,921	\$542,891	\$598,812
2010	\$72,970	\$2,047,794	\$2,120,764
2011	\$146,444	\$2,327,932	\$2,474,376
2012	\$278,971	\$2,005,970	\$2,284,941

Source: Lottery Marketing Support Fund Reports

According to fund transaction documentation provided by the Lottery, moneys were contributed to these funds as stipulated in the vendor contracts and the funds were to be used to pay for market research, promotional materials, advertising, and ticket dispensers.

In Auditor General report No. 2007-093, we recommended that the Lottery amend the applicable provisions of each contract to include language that specifically addressed the ownership of each fund; that based on these clarifications, the Lottery consider the appropriateness of the budgetary and financial reporting treatments utilized for the funds; and that the Lottery more closely monitor compliance with its established purchase authorization and payment procedures.

The Lottery executed new contracts with Scientific Games, effective October 1, 2008, and GTECH, effective March 28, 2011, with the provisions stipulating that any remaining moneys in the funds will be returned to the Lottery at each contract's end. In addition, the Lottery has increased its monitoring of compliance with the Lottery's established procedures. However, the Lottery had not included information relating to these funds in Lottery budgetary and financial reports.

In response to audit inquiry, the Lottery has added a disclosure to Note 11 of the financial statements describing the funds and their balances at June 30, 2012, and June 30, 2011.

Absent the inclusion of the transactions and balances for those funds, the Lottery's budgetary and financial reports do not provide an accounting for all financial resources available to the Lottery.

Recommendation: We recommend that the Lottery incorporate in its financial accounts and reports the transactions and balances associated with these Lottery resources.

In response to this finding, the Lottery indicated that although the Lottery can direct the vendors on how to make payments, the Lottery does not actually have access to the funds. While we agree that under the vendor contracts, the Lottery was not granted physical access to the funds, the Lottery did control the funds, as evidenced by its ability to direct disbursements of the moneys therein. The recording of the transactions and balances of these funds would enhance the accuracy and completeness of the Lottery's financial accounts and reports.

EXHIBIT A
MANAGEMENT'S RESPONSE

RICK SCOTT
Governor



CYNTHIA F. O'CONNELL
Secretary

FLORIDA LOTTERY

January 22, 2013

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 21, 2012 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, 2012. The staff has discussed your recommendations and responds as follows:

1. Recommendation: The Lottery make the necessary enhancements 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. 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 in its efforts to increase retailer participation in under-represented minority groups.

Response: As noted in the initial response, the Lottery continues its efforts to increase retailer participation in under-represented minority groups with strategic initiatives including attending minority trade shows to recruit retailers, working with Florida's 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, exploring non-traditional trade style retailer prospects, and providing access to inquire how to become a retailer through the Lottery's website.



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EXHIBIT A
MANAGEMENT'S RESPONSE (CONTINUED)

David W. Martin, CPA
Auditor General
Response to Preliminary and Tentative Findings
January 22, 2013

Despite these efforts, the level of participation from these groups has decreased slightly over the past fiscal year. A number of factors could contribute to this decline including the challenges presented by current economic conditions as well as the aggressive corporate convenience store expansion taking place in Florida, often purchasing units from struggling independent operators including minority retailers.

However, we agree with the recommendation and will continue to aggressively pursue retailer participation in under-represented minority groups.

3. Recommendation: The Lottery incorporate in its financial accounts and reports the transactions and balances associated with these (Marketing and Research Support Funds) Lottery resources.

Response: As the recommendation narrative indicates, each of the primary gaming vendors is required by contract to set aside funds to be spent, at the Lottery's direction, for the purposes of market research and product sales and promotion activities. Each vendor has incorporated this requirement into the percentage of sales payment for providing the scope of services required in the contract. While it is true that the Lottery can direct the vendors on how to make the expenditures, the Lottery does not actually have access to the funds. The percentage of sales payments are reflected in the Lottery's financial statements. The marketing fund contract requirement was carried over from prior contracts and has allowed the Lottery to reduce its appropriation requests over the years, as critical items now covered by the vendor funds are no longer included in the department's annual appropriation. It is worth noting that, without the vendor-provided marketing and research funding, the Lottery would need to seek additional appropriations of approximately \$3.7 million per year to cover the mission-critical elements. In addition, as is recognized in your narrative, any funds left unspent in the vendor's accounts will be returned to the Lottery at the end of each contract and thus transferred to the Educational Enhancement Trust Fund.

As suggested in previous audits, the Lottery has strengthened the internal controls and internal reporting around the direction and monitoring of the vendor funds, to ensure that no inappropriate procurements are being executed and that all the resources are accountable. The Lottery does keep detailed accounting records of the market research, point of sale materials, ticket display equipment and other items covered by the funds and routinely reviews the information internally.

EXHIBIT A
MANAGEMENT'S RESPONSE (CONTINUED)

David W. Martin, CPA
Auditor General
Response to Preliminary and Tentative Findings
January 22, 2013

As noted in your narrative, the marketing fund balances currently are disclosed in the financial statement note 11. With regard to budget reports, the required budget reports routinely provided by the Lottery cover appropriated expenditures. These funds are clearly not appropriated. The data is available for any interested party upon request. When ownership issues raised implicitly in audit reports in 2007, 2008 and 2009 were not included in subsequent years, the Lottery believed that those issues had been addressed to the satisfaction of the Auditor General's Office. The Lottery will seek independent guidance regarding other disclosure options within existing reports to ensure adequate information is being provided to interested parties.

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

Sincerely,



Cynthia F. O'Connell
Secretary

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