

DEPARTMENT OF THE LOTTERY

Financial Audit

For the Fiscal Years Ended
June 30, 2013, and 2012



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, 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 during the audit period.

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 Jon M. Bardin, CPA, and the audit was supervised by Allen G. Weiner, 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) 412-2781. For the information technology portion of this audit, the project 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 Arthur Hart, CPA, Audit Manager, by e-mail at arthart@aud.state.fl.us or by telephone at (850) 412-2941.

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) 412-2722; 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

Our audit disclosed that the basic financial statements prepared by the Department of the Lottery (Lottery) present fairly, in all material respects, the net position of the Lottery as of June 30, 2013, and 2012, 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 issues 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 be minority business enterprises, as defined in Section 288.703(3), Florida Statutes; however, no more than 35 percent of such retailers shall be owned by the same type of minority person, as defined by Section 288.703(4), Florida Statutes. Our audit disclosed that as of July 1, 2013, retailers comprising one minority type totaled 65 percent of the total number of minority retailers. A similar finding has been included in prior 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. 2013-089.

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, 2013, and 2012, 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

Report on the 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, 2013, and 2012, and the related notes to the financial statements which collectively comprise the Lottery's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, the financial statements referred to above, present fairly, in all material respects, the respective financial position of the Lottery as of June 30, 2013, and 2012, and the respective changes in financial position and cash flows, for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

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, 2013, and 2012, 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. Our opinion is not modified with respect to this matter.

Other Matter

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the **MANAGEMENT'S DISCUSSION AND ANALYSIS** (pages 4 through 11) 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.

Other Reporting Required by Government Auditing Standards

In accordance with attestation standards established by the American Institute of Certified Public Accountants and the standards applicable to attestation engagements in *Government Auditing Standards*, we have also issued a report on our examination of the Lottery's internal control over financial reporting, 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 24, 2014, 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, 2013, 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* in considering the Lottery's internal control over financial reporting and compliance.

Respectfully submitted,



David W. Martin, CPA
January 24, 2014

MANAGEMENT'S DISCUSSION AND ANALYSIS**YEARS ENDED JUNE 30, 2013, AND JUNE 30, 2012**

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, 2013, and 2012. 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 12.

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 products. The Lottery has been successful in sustaining ticket sales in excess of \$2 billion for the twenty-fourth consecutive fiscal year, with the past three fiscal years exceeding \$4 billion. During the same twenty-four year period the transfer to the Educational Enhancement Trust Fund (EETF) has been a minimum of \$800 million annually, with the fiscal year 2013 transfer exceeding \$1 billion for the eleventh consecutive year.

For the fiscal year ended June 30, 2013:

- Transfers to the EETF increased to approximately \$1.42 billion compared to \$1.32 billion in the prior fiscal year.
- The Lottery's ticket sales increased by 12.65% over the prior fiscal year from approximately \$4.45 billion to \$5.01 billion.
- Approximately 60.41% 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 impacts the amount transferred the EETF.
- Prize expense increased \$396.77 million, which represents a 14.34% increase during fiscal year 2013. 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 63.09% 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 2013 expenses for these items increased 12.56% over the prior fiscal year expenses in conjunction with the increase in sales.
- Administrative operating expenses, which include advertising, salaries and benefits, rent, utilities and maintenance, professional fees, depreciation, and other administrative expenses, experienced an increase of \$2.35 million. Administrative operating expenses for fiscal years 2013 and 2012 were \$72.65 million and \$70.30 million, respectively.
- Nonoperating income decreased \$68.49 million over the prior fiscal year. Unrealized depreciation on investments accounted for \$73.97 million of the decrease due to lower market values of investments of similar securities and a reduction in holdings in fiscal year 2013 compared to fiscal year 2012.
- EETF transfers from unclaimed prize money increased \$15.04 million over the prior fiscal year. Unclaimed generation from Terminal games experienced a \$2.72 million decrease over last year. Scratch-Off games increased by \$17.76 million compared to the unclaimed from fiscal year 2012. This increase can be attributed

to the fact that during fiscal year 2013 the Lottery closed 61 games compared to 29 games closed during fiscal year 2012.

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 Statements of Net Position on page 12; the Statements of Revenues, Expenses, and Changes in Net Position on page 13; and the Statements of Cash Flows on page 14 report the Lottery's net position 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 position consists of funds invested in fixed capital assets and restricted assets. The restricted net position consists of the investments being held by the Lottery to fund deferred prize payouts, 20 percent of unclaimed prizes designated for future prize payouts or promotions, and the Multi-State Lottery Association (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 POSITION

Table 1 presents a comparative summary of the Lottery's Statements of Net Position for fiscal years 2013, 2012, and 2011.

Table 1
Condensed Statements of Net Position
As of June 30, 2013, 2012, and 2011
(In Thousands)

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Assets			
Current Assets	\$ 195,874	\$ 165,785	\$ 189,859
Restricted Assets	1,053,576	1,291,004	1,511,185
Capital Assets, Net of Depreciation	3,215	1,356	1,248
Total Assets	<u>1,252,665</u>	<u>1,458,145</u>	<u>1,702,292</u>
Liabilities			
Current Liabilities	190,498	158,871	184,155
Current Liabilities Payable from Restricted	607,554	735,382	882,439
Noncurrent Liabilities	349,312	427,291	513,728
Total Liabilities	<u>1,147,364</u>	<u>1,321,544</u>	<u>1,580,322</u>
Net Position			
Net Investment in Capital Assets	3,215	1,356	1,248
Restricted Net Position	102,086	135,245	120,722
Total Net Position	<u>\$ 105,301</u>	<u>\$ 136,601</u>	<u>\$ 121,970</u>

Assets

Total assets at the end of fiscal year 2013 decreased \$205.48 million from \$1.46 billion at June 30, 2012, to \$1.25 billion at June 30, 2013. At the end of fiscal year 2012, total assets were \$244.15 million less than the \$1.70 billion at the end of fiscal year 2011.

- Current assets increased from \$165.79 million in 2012 to \$195.87 million in 2013, representing an increase of \$30.09 million. This net increase was primarily due to an increase of \$21.26 million in cash and cash equivalents mostly on deposit with the State Treasurer and an increase of \$9.27 million in accounts receivable. The increase in accounts receivable for fiscal year 2013 was due to timing in the weekly sweeps at June 30, 2013.
- Restricted assets decreased \$237.42 million from \$1.29 billion in 2012 to \$1.05 billion in 2013. 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 \$134.95 million in payouts of annuities and \$9.05 million in purchases of new investments in fiscal year 2013 in comparison to fiscal year 2012, which had annuity payouts of \$156.14 million, and purchases of new investments of \$12.74 million. Coupled with the downward trend in the investment portfolio was a decrease in the fair value of the grand prize investments. The amount of invested collateral and time deposits from the lending of those securities also continues to decline. The Lottery held \$494.32 million in invested collateral and time deposits at June 30, 2013, \$603.81 million at June 30, 2012, and \$731.07 million at June 30, 2011.

Liabilities

Total liabilities at June 30, 2013, were \$1.15 billion, which was approximately \$174.18 million lower than the total liabilities of \$1.32 billion at June 30, 2012. The total liabilities at June 30, 2012, were \$258.78 million lower than the June 30, 2011, amount of \$1.58 billion.

- Current liabilities increased from \$158.87 million at June 30, 2012, to \$190.50 million at June 30, 2013. This increase can be attributed to the increase in the amount due to EETF at June 30, 2013. As expected, current liabilities payable from restricted assets decreased \$127.83 million from \$735.38 million at June 30, 2012, to \$607.55 million at June 30, 2013. The amount of grand prizes payable due within one year and the obligations 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 option. The obligations under securities lending decreased by \$109.80 million and the current portion of grand prizes payable decreased by \$17.98 million. At June 30, 2012, the current liabilities payable from restricted assets of \$735.38 million was \$147.06 million less than the balance of \$882.44 million at June 30, 2011.
- 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 \$78.86 million from fiscal year-end 2012 to 2013 and decreased \$87.22 million from fiscal year-end 2011 to 2012.

Net Position

Net position decreased \$31.30 million from June 30, 2012, to June 30, 2013. Net position at June 30, 2013, 2012, and 2011 were \$105.30 million, \$136.60 million, and \$121.97 million, respectively. The decrease in net position for the 2013 fiscal year was predominately due to the \$42.82 million decrease in the amount restricted for undistributed appreciation on restricted investments.

The Lottery joined MUSL four years ago in order to participate in the Powerball® with Power Play® game and on May 15, 2013, the Lottery began participating in Mega Millions® with Megaplier®. 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 and Mega Millions with Megaplier games. The Lottery's deposits in reserve funds with MUSL totaled \$19.04 million and \$19.99 million as of June 30, 2013, and June 30, 2012, respectively. Refer to Note 7, Multi-State Lottery Association for further detail.

SUMMARY OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION

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 position 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 Position for the fiscal year ended June 30, 2013, and the prior fiscal years ended June 30, 2012, and June 30, 2011, as derived from the Lottery's Statement of Revenues, Expenses, and Changes in Net Position.

Table 2
Condensed Statements of Revenues, Expenses, and Changes in Net Position
As of June 30, 2013, 2012, and 2011
(In Thousands)

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Operating Revenues			
Ticket Sales	\$ 5,012,996	\$ 4,449,896	\$ 4,008,716
Bad Debt Expense	(912)	(1,360)	(1,212)
Terminal & Retailer Fees and Miscellaneous	<u>7,979</u>	<u>7,658</u>	<u>7,436</u>
Total Operating Revenues	<u>5,020,063</u>	<u>4,456,194</u>	<u>4,014,940</u>
Operating Expenses			
Prizes	3,162,889	2,766,119	2,460,219
Retailer Commissions	278,493	247,690	223,390
Vendor Commissions	75,205	66,528	63,260
Other Expenses	<u>72,653</u>	<u>70,304</u>	<u>71,449</u>
Total Operating Expenses	<u>3,589,240</u>	<u>3,150,641</u>	<u>2,818,318</u>
Income from Operations	<u>1,430,823</u>	<u>1,305,553</u>	<u>1,196,622</u>
Nonoperating Revenue, Net of Expenses	<u>(37,816)</u>	<u>30,682</u>	<u>(16,942)</u>
Income Before Operating Transfers	1,393,007	1,336,235	1,179,680
Transfers to EETF from Revenue & Reserves	(1,373,668)	(1,286,001)	(1,147,793)
Transfers to EETF from Unclaimed Prizes	<u>(50,639)</u>	<u>(35,603)</u>	<u>(44,025)</u>
Total Transfers to EETF	<u>(1,424,307)</u>	<u>(1,321,604)</u>	<u>(1,191,818)</u>
Change in Net Position	(31,300)	14,631	(12,138)
Net Position, Beginning of Year	<u>136,601</u>	<u>121,970</u>	<u>134,108</u>
Net Position, End of Year	<u>\$ 105,301</u>	<u>\$ 136,601</u>	<u>\$ 121,970</u>

Sales

For the fiscal year ended June 30, 2013, ticket sales increased by \$563.10 million over the prior fiscal year, which experienced a sales increase of \$441.18 million. The Terminal game sales increased 5.39% from the prior year. To offset the impact of the slow economic recovery on sales, the Lottery not only continued to utilize proven techniques, but also created new promotions for players.

- Powerball with Power Play sales increased by 29.89% over the prior year. On two occasions the jackpot reached over \$580 million setting new records. The largest jackpot in Powerball history reached \$590 million with a single winning ticket, which was won by a Florida resident. Florida sold three Powerball jackpot winning tickets during the fiscal year ended June 30, 2013.
- Mega Millions with Megaplier was introduced into the Terminal line of games on May 15, 2013. Mega Millions contributed \$16.70 million to Terminal sales.
- A 25th Anniversary MILLIONAIRE RAFFLE™ was launched on November 9, 2012, with opportunities to win during weekly drawings or in the grand prize drawing held on December 31, 2012. The RAFFLE generated \$12.88 million in sales.
- Full Service Vending Machines (FSVMs), were distributed during fiscal year 2013. Installation began in September 2012 and was completed in November 2012. There were a total of 500 FSVMs that were installed into our top Instant Ticket Vending Machine (ITVM) locations. The FSVM allows players to purchase both Terminal and Scratch-Off tickets. Total sales for FSVMs reached \$174.40 million.

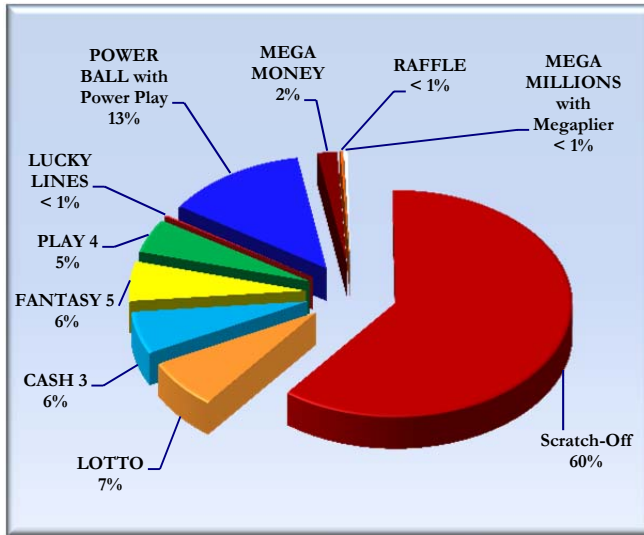
Sales of Scratch-Off tickets increased from \$2.57 billion or 57.69% of total sales in fiscal year 2012 to \$3.03 billion, or 60.41% of total sales in fiscal year 2013.

- Scratch-Off ticket sales experienced an increase of 17.98% over prior year sales with increases in most price points. The largest increases were seen in the \$5 and \$10 price points. The \$5 price point was dominated by the MONOPOLY™ ticket with sales totaling \$86.30 million. The \$10 price point was led by 50X THE CASH, which contributed \$176.21 million in ticket sales.
- In celebration of the Lottery's 25th anniversary, a \$25 price point ticket was launched on September 25, 2012. MILLIONAIRE, a namesake of the first Scratch-Off ticket sold at the Lottery, contributed \$375.25 million in sales.
- ITVMs, which function similar to other vending machines, have 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 ITVMs in use during the year. Total sales from the ITVMs accounted for \$293.58 million of the Scratch-Off sales.

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, 2013, and 2012, was \$912,000 and \$1.36 million, respectively.

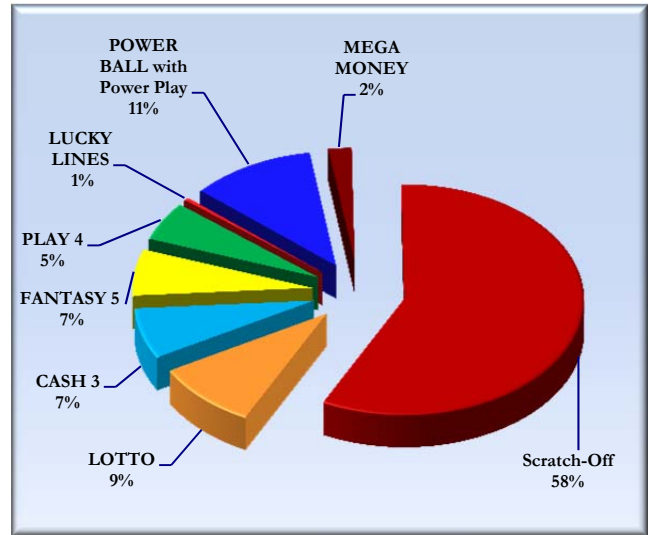
The following charts show sales by product for the various Lottery games during the fiscal years 2013 and 2012:

Sales by Product for Fiscal Year 2012-13*



*Added Mega Millions on May 15, 2013.

Sales by Product for Fiscal Year 2011-12**



**Did not conduct a Raffle.

The following chart and Table 3 show sales by game for the last ten fiscal years:

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

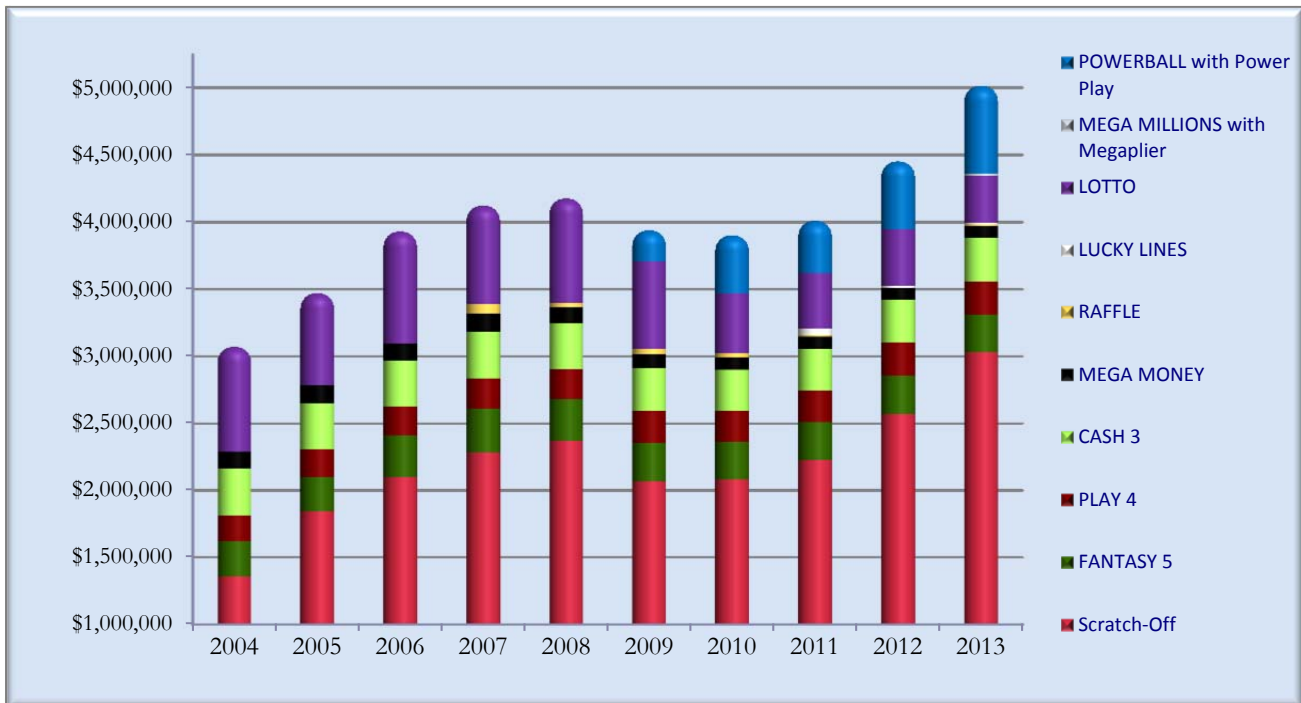


Table 3
Department of the Lottery
Historical Lottery Sales by Game
Last Ten Fiscal Years
(In Thousands)

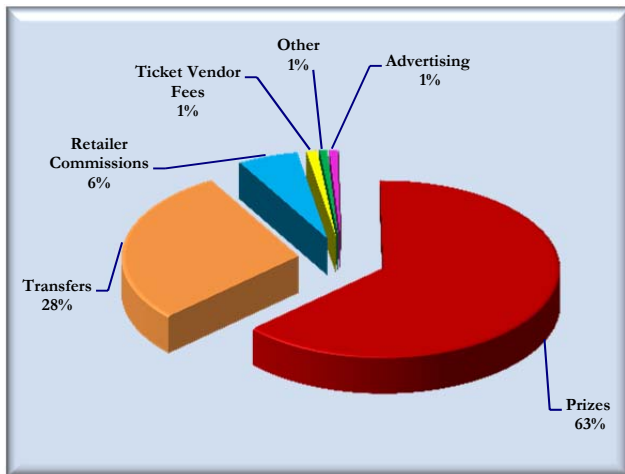
Fiscal Year Ended June 30	LOTTO™	FANTASY 5®	PLAY 4™	CASH 3™	MEGA		LUCKY LINES™	POWERBALL® with Power Play®	MEGA MILLIONS®		Scratch-Off	Combined Sales
					MONEY™	RAFFLE™			with Megaplier®	with Megaplier®		
2004	\$ 785,415	\$ 259,728	\$ 192,580	\$ 349,227	\$ 125,944						\$1,358,068	\$ 3,070,962
2005	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
2013	352,375	281,492	244,141	324,539	89,500	12,879	8,582	654,263	\$ 16,698		3,028,527	5,012,996

Expenses

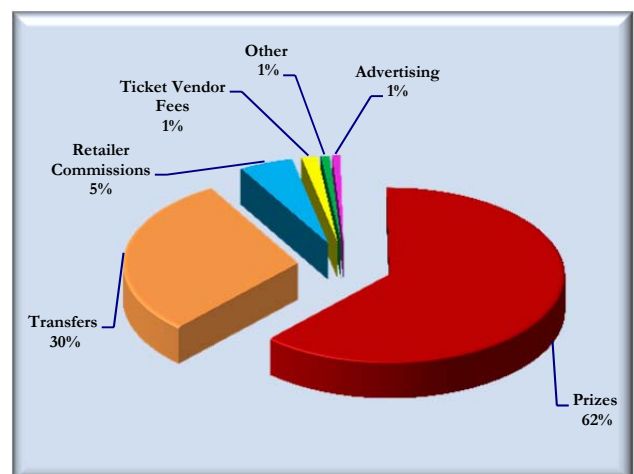
Section 24.121, Florida Statutes, stipulates that funds remaining in the Operating Trust Fund after the transfer to the EEIF shall be used for the payment of administrative expenses of the Lottery. These expenses include Terminal game expenses, Scratch-Off ticket expenses, advertising, and other expenses 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 2013 and 2012 fiscal years:

Operating Expenses and Transfers
Fiscal Year 2012-13



Operating Expenses and Transfers
Fiscal Year 2011-12



Prizes, commissions, and gaming vendor fees are directly related to ticket sales and fluctuate accordingly. In fiscal year 2013, 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, increased slightly. Fiscal year 2013 and 2012 administrative expenses were \$72.65 million and \$70.30 million, respectively.

Transfers

Since its inception the Lottery has transferred over \$25.44 billion to the EETF. The Lottery’s contribution to the EETF for the fiscal year ended June 30, 2013, \$1.42 billion, exceeded the prior fiscal year’s contribution of \$1.32 billion, and for the eleventh 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:



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 still challenged with Florida’s unemployment rate, although the rate dropped from over 8% at fiscal year-end 2012 to 7.1% at fiscal year-end 2013. Population growth is expected to remain at one percent over the next few years, and consumer confidence is still recovering at a slow rate. In fiscal year 2013, Lottery sales exceeded \$5.01 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 POSITION AS OF JUNE 30, 2013, AND JUNE 30, 2012 (IN THOUSANDS)

	June 30, 2013	June 30, 2012
Assets		
Current Assets:		
Cash and cash equivalents	\$146,137	\$124,877
Interest receivable	165	393
Accounts receivable, net	46,562	37,295
Due from other departments	1	4
Prepaid expenses	4	69
Inventories	863	1,143
Security deposits	2,142	2,004
Total Current Assets	195,874	165,785
Noncurrent Assets:		
Restricted Assets		
Cash and cash equivalents	77,063	5,289
Securities lending income receivable	373	655
Deposit with MUSL	19,037	19,995
Investments, grand prize	523,992	661,254
Investments, security lending collateral	433,111	603,811
Total Restricted Assets	1,053,576	1,291,004
Capital assets, net	3,215	1,356
Total Noncurrent Assets	1,056,791	1,292,360
Total Assets	\$1,252,665	\$1,458,145
Liabilities		
Current Liabilities:		
Accounts payable and accrued liabilities	\$7,196	\$7,992
Prizes payable	104,279	96,483
Due to Educational Enhancement Trust Fund	76,111	51,604
Deposits payable	2,143	2,007
Compensated absences payable	769	785
Total Current Liabilities	190,498	158,871
Current Liabilities Payable from Restricted Assets:		
Securities lending fees payable	46	98
Obligations under securities lending	494,757	604,556
Grand prizes payable	112,751	130,728
Total Current Liabilities Payable from Restricted Assets	607,554	735,382
Noncurrent Liabilities:		
Grand prizes payable from restricted assets	343,442	422,297
Compensated absences payable	2,908	2,798
Other long-term liabilities	2,962	2,196
Total Noncurrent Liabilities	349,312	427,291
Total Liabilities	1,147,364	1,321,544
Net Position		
Invested in capital assets	3,215	1,356
Restricted for undistributed appreciation on restricted investments	67,195	110,012
Restricted for MUSL	19,037	19,995
Restricted for future prizes or special prize promotions	15,854	5,238
Total Net Position	105,301	136,601
Total Liabilities and Net Position	\$1,252,665	\$1,458,145

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

DEPARTMENT OF THE LOTTERY
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
YEARS ENDED JUNE 30, 2013, AND JUNE 30, 2012
(IN THOUSANDS)

	<u>June 30, 2013</u>	<u>June 30, 2012</u>
Operating Revenues:		
Ticket sales	\$5,012,996	\$4,449,896
Bad debt expense	(912)	(1,360)
Terminal fees and miscellaneous	7,773	7,465
Retailer fees	206	193
Total Operating Revenues	<u>5,020,063</u>	<u>4,456,194</u>
Operating Expenses:		
Prizes	3,162,889	2,766,119
Retailer commissions	278,493	247,690
Scratch-Off tickets	44,193	38,906
Terminal games	31,012	27,622
Advertising	37,696	33,540
Personal services	25,730	26,139
Other contractual services	6,801	8,210
Materials and supplies	2,156	1,969
Depreciation	270	446
Total Operating Expenses	<u>3,589,240</u>	<u>3,150,641</u>
Operating Income	<u>1,430,823</u>	<u>1,305,553</u>
Nonoperating Revenues (Expenses):		
Interest	3,984	5,024
Securities lending income	2,543	3,007
Securities lending fees	(1,090)	(824)
Investment management fees	(376)	(296)
Net appreciation (depreciation) in fair value of investments	(13,749)	60,221
Property disposition (loss)	(60)	(4)
Amortization of grand prizes payable	(29,068)	(36,446)
Total Nonoperating Revenues (Expenses), Net	<u>(37,816)</u>	<u>30,682</u>
Income Before Operating Transfers	1,393,007	1,336,235
Transfers to Educational Enhancement Trust Fund:		
Transfers from revenue and reserves	(1,373,668)	(1,286,001)
Transfers from unclaimed prizes	(50,639)	(35,603)
Total Transfers to Educational Enhancement Trust Fund	<u>(1,424,307)</u>	<u>(1,321,604)</u>
Change in Net Position	(31,300)	14,631
Net Position, Beginning of Year	<u>136,601</u>	<u>121,970</u>
Net Position, End of Year	<u>\$105,301</u>	<u>\$136,601</u>

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

DEPARTMENT OF THE LOTTERY
STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2013, AND JUNE 30, 2012
(IN THOUSANDS)

	<u>June 30, 2013</u>	<u>June 30, 2012</u>
Operating Activities:		
Ticket sales	\$5,002,817	\$4,432,495
Prizes paid to winners	(3,154,136)	(2,763,100)
Commissions paid and payments to retailers	(278,493)	(247,690)
Paid to vendors for goods and services	(122,478)	(112,140)
Paid to employees	(24,700)	(25,216)
Other operating revenue	7,979	7,658
Net Cash Provided by Operating Activities	<u>1,430,989</u>	<u>1,292,007</u>
Noncapital Financing Activities:		
Payments to Educational Enhancement Trust Fund	(1,399,800)	(1,351,818)
Net Cash Used in Noncapital Financing Activities	<u>(1,399,800)</u>	<u>(1,351,818)</u>
Capital and Related Financing Activities:		
Purchase of capital assets	(2,189)	(558)
Net Cash Used in Capital and Related Financing Activities	<u>(2,189)</u>	<u>(558)</u>
Investing Activities:		
Cash received from maturity of grand prize investments	134,951	156,135
Cash paid to grand prizewinners upon maturity of grand prize investments	(134,951)	(156,135)
Security lending	61,209	(21,200)
Investment income, net of fees	2,825	7,436
Net Cash Provided by Investing Activities	<u>64,034</u>	<u>(13,764)</u>
Net Increase (Decrease) in Cash and Cash Equivalents	<u>93,034</u>	<u>(74,133)</u>
Cash and Cash Equivalents, Beginning of Year	130,166	204,299
Cash and Cash Equivalents, End of Year	<u>\$223,200</u>	<u>\$130,166</u>
Reconciliation of Income from Operations to Net Cash Provided by Operating		
Income from operations	\$1,430,823	\$1,305,553
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation	270	446
Changes in assets and liabilities		
(Increase) decrease in:		
Accounts receivable	(8,747)	(19,514)
Inventories	280	(150)
Pre-paid expenses	64	(1)
Increase (decrease) in:		
Allowance for uncollectible accounts	301	(36)
Accounts payable and accrued liabilities	(658)	(2,135)
Prizes payable	7,796	7,088
Compensated absences payable	93	32
Postemployment healthcare benefits payable	767	724
Net Cash Provided by Operating Activities	<u>\$1,430,989</u>	<u>\$1,292,007</u>
Noncash Investing, Capital and Financing Activities:		
Increase/(decrease) in fair value of investments	(\$99,563)	(\$38,722)

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

NOTES TO FINANCIAL STATEMENTS

**DEPARTMENT OF THE LOTTERY
YEARS ENDED JUNE 30, 2013, AND JUNE 30, 2012****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 when the recognition of revenue and expenses and the related assets and liabilities are recognized in the accounts and reported 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 Statements of Net Position.

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 3.

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 composed of game merchandise, prepaid postage and prepaid tolls.

h. Prepaid Expenses

Prepaid expenses represent warranty agreements paid for during the current year but which 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 Statements of Revenues, Expenses, and Changes in Net Position in the period of disposal. See Note 6 for more detailed information on Capital Assets.

j. Net Position

Net Position includes categories for invested in capital assets, restricted for undistributed appreciation on restricted investments, restricted for future prizes or special prize promotions, and restricted for the Multi-State Lottery Association (MUSL). See Note 7 for more information on MUSL.

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

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

The restricted 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 for MUSL category represents the amount placed into reserve for the Florida Lottery by the MUSL 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 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 or lower than five percent at any given time. 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 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 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. For named windstorm and flood, the property insurance program self-insures the first \$2 million per occurrence but with an additional annual aggregate retention of \$40 million. Commercial excess insurance is purchased for losses over the self-insured retention up to \$50 million per occurrence for named windstorm and flood losses 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 position, 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, 2013, and June 30, 2012, was \$912,000 and \$1,360,000, respectively.

2. ADOPTION OF NEW ACCOUNTING PRONOUNCEMENT

Lottery implemented Government Accounting Standards Board (GASB) Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which became effective for financial statements for periods beginning after December 15, 2011. The primary objective of GASB Statement No. 62 is to directly incorporate the applicable guidance from those FASB and AICPA pronouncements into the state and local government accounting and financial reporting standards, with the provisions modified, as appropriate, to recognize the effects of the governmental environment and the needs of governmental financial statement users without affecting the substance of the applicable guidance. There was no effect on beginning net position as a result of this change for either fiscal year.

Lottery implemented GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which became effective for financial statements for periods beginning after December 15, 2011. GASB Statement No. 63 identifies net position, rather than net assets, as the residual of all other elements presented in a statement of net position. Although Lottery did not have any deferred outflows of resources or deferred inflows of resources to report, the change in format of the financial statements was incorporated into Lottery's 2013 financial statements. Comparative prior year financial statements for 2012 have also been modified to reflect this format change. There was no effect on beginning net position as a result of this change for either fiscal year.

3. 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 \$396,000 at June 30, 2013, and \$449,000 at June 30, 2012, were insured by either the State's collateral for public deposits in accordance with Section 280.04, Florida Statutes, or Federal depository insurance. Cash held in time deposits for the security lending program with a book value of \$61,209,000 were exposed to custodial credit risk as these balances were uncollateralized and uninsured.

Chapter 280, Florida Statutes, generally requires public funds to be deposited in a Qualified Public Depository, which is a bank or savings association that is designated by the State of Florida Chief Financial Officer (State CFO) as authorized to receive deposits in the State and that meets the collateral requirements. The State CFO determines the collateral requirements and collateral pledging level for each Qualified Public Depository following guidelines outlined in Section 280.04, Florida Statutes, and Chapter 69C-2, Florida Administrative Code. Collateral pledging levels include 25, 50, 125, and 200 percent of a Qualified Public Depository's average daily deposit balance or, if needed, an amount as prescribed by the State CFO. Collateral may be held by another custodian with approval of the State CFO if conditions 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 \$2,372,000 at June 30, 2013, and \$2,796,000 at June 30, 2012, representing outstanding prize payment checks and retailer payment checks. These outstanding checks are included as a component of prizes payable and accounts payable. The Lottery has an agreement with a financial institution to honor prize payments and retailer payments, as they are presented to the bank, up to \$75 million.

Surplus cash is maintained in the State Treasury's general pool of investments. The State CFO pools funds from all State agencies. Included in the pool are primarily time deposits, U.S. Government securities, Federal agency securities, commercial paper, corporate bonds and notes, and repurchase agreements. The Lottery's share of this investment pool was approximately \$161,595,000 and \$129,716,000 at June 30, 2013, and 2012, 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 Statements of Net Position 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 restricted for undistributed appreciation on restricted investments in net position. 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 year is reflected as an increase in the carrying value of grand prizes payable on the Statements of Net Position, and as a nonoperating revenue (expense) on the Statements of Revenues, Expenses, and Changes in Net Position. Net appreciation (depreciation) in fair value of investments is reflected as a nonoperating revenue (expense) on the Statements of Revenues, Expenses, and Changes in Net Position, and takes into account all changes in fair value that occurred during the 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 year-end.

The SBA had received \$494,757,000 of cash collateral for the lending program as of June 30, 2013, and \$604,556,000 as of June 30, 2012. At June 30, 2013, and June 30, 2012, 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 investment 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, 2013, and June 30, 2012, the unrealized shortfall was \$199,000 and \$406,000, 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 year ended June 30, 2013, and 2012, consisted of (in thousands):

	<u>2013</u>	<u>2012</u>
Securities lending income	\$ 2,543	\$ 3,007
Less broker rebates	(955)	(748)
Less bank fees	(135)	(76)
Net securities lending revenue	<u>\$ 1,453</u>	<u>\$ 2,183</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, 2013.

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, 2013						Totals
	Standard and Poor's Credit Rating						
	AAA	AA	A	CCC	A-1	NR	
Certificates of Deposit	\$ -	\$ 13,105	\$ 3,606	\$ -	\$ -	\$ 83,987	\$ 100,698
Commercial Paper	-	-	-	-	81,270	-	\$ 81,270
Domestic Corporate Bonds & Notes	-	49,062	45,932	-	-	-	\$ 94,994
Domestic Non-government Asset-backed Securities	44,496	-	-	174	-	6,094	\$ 50,764
International Corporate Bonds & Notes	-	32,257	5,497	-	-	5,074	\$ 42,828
International Non-government Asset-backed Securities	7,104	-	-	-	-	9,940	\$ 17,044
International Non-government Backed CMOs	-	-	11,628	-	-	-	\$ 11,628
Repurchase Agreements	-	-	-	-	-	33,885	\$ 33,885
Grand Total	\$ 51,600	\$ 94,424	\$ 66,663	\$ 174	\$ 81,270	\$ 138,980	\$ 433,111

Investment Type	Standard and Poor's Credit Rating						Totals
	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 CMOs	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 CMOs	-	-	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.

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, 2013		As of June 30, 2012	
Time to Maturity	Fair Value	Time to Maturity	Fair Value
< 1 year	\$ 112,508	< 1 year	\$ 134,842
> 1 year to 3 years	149,135	> 1 year to 3 years	195,451
> 3 years to 5 years	65,510	> 3 years to 5 years	105,302
> 5 years to 10 years	79,059	> 5 years to 10 years	87,497
> 10 years to 15 years	69,170	> 10 years to 15 years	77,072
> 15 years to 20 years	37,240	> 15 years to 20 years	47,787
> 20 years to 25 years	7,879	> 20 years to 25 years	8,985
> 25 years	3,491	> 25 years	4,318
Total	\$ 523,992	Total	\$ 661,254

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, 2013		June 30, 2012	
	Fair Value (Thousands)	Weighted Average Maturity (Days)	Fair Value (Thousands)	Weighted Average Maturity (Days)
Certificates of Deposit	\$ 100,698	56	\$ 185,267	43
Commercial Paper	81,270	77	65,481	47
Domestic Corporate Bonds & Notes	94,994	47	89,607	42
Domestic Non-government Asset-backed Secu	50,764	16	60,215	23
Domestic Non-government Backed CMOs	-		3,907	6
International Corporate Bonds & Notes	42,828	46	39,812	55
International Non-government Asset-backed S	17,044	15	25,403	16
International Non-government Backed CMOs	11,628	22	14,156	20
Repurchase Agreements	33,885	1	111,132	2
U.S. Government Securities	-		8,831	107
Total Fair Value	\$ 433,111		\$ 603,811	
Portfolio weighted average maturity		45		33

The effective duration of the State Treasury Investment Pool at June 30, 2013, and June 30, 2012, was approximately 2.65 years and 2.38 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, 2013, and June 30, 2012, was \$433,111,000 and \$603,811,000 respectively.

At June 30, 2013, and June 30, 2012, all non-lending investments held were either insured or registered and held by the Lottery or its agents in the Lottery's name and thus were not subject to custodial credit risk.

h. Foreign Currency Risk

The Lottery had no exposure to foreign currency risk as of June 30, 2013, and June 30, 2012.

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, 2013 Carrying Value	June 30, 2012 Carrying Value
Commercial Paper	\$ 81,270	\$ 65,481
Certificates of Deposit	100,698	185,267
Repurchase Agreements	33,885	111,132
U.S. Government Obligations & Federally Guaranteed Obligations	38,871	80,223
Domestic Corporate Bonds & Notes	94,994	89,607
Domestic Non-government Asset-backed Securities	50,764	60,215
International Corporate Bonds & Notes	42,828	39,812
International Non-government Asset-backed Securities	17,044	25,403
Domestic Non-government Backed CMOs	-	3,907
International Non-government Backed CMOs	11,628	14,156
Investments Held by Others Under Securities Lending Agreements - U.S. Obligations	485,121	589,862
Pooled Investments with State Treasury	161,595	129,717
Total Investments	\$ 1,118,698	\$ 1,394,782

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

	June 30, 2013			
	Investments	Cash at Financial Institutions	Cash at State Treasury	Total
Cash and cash equivalents	\$ 145,741	\$ 361	\$ 35	\$ 146,137
Restricted cash and cash equivalents	15,854	61,209	-	77,063
Investments, grand prize	523,992	-	-	523,992
Investments, security lending collateral	433,111	-	-	433,111
Total	\$ 1,118,698	\$ 61,570	\$ 35	\$ 1,180,303

	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

4. ACCOUNTS RECEIVABLE

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

	2013	2012
Ticket sales receivable	\$ 49,138	\$ 39,594
Other receivables	52	29
Total receivables	49,190	39,623
Less allowance for doubtful accounts	(2,628)	(2,328)
Accounts receivable, net	\$ 46,562	\$ 37,295

5. 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 Position, in assets as security deposits, and in liabilities, as deposits payable. The checks appear on the Statement of Net Position, in assets as cash, and in liabilities, as deposits payable.

6. CAPITAL ASSETS

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

	Balance 30-Jun-11	2011-12		Balance 30-Jun-12	2012-13		Balance 30-Jun-13
		Increase	Decrease		Increase	Decrease	
Data processing equipment	\$ 3,813	\$ 3	\$ (123)	\$ 3,693	\$ 5	\$ (291)	\$ 3,407
Office equipment and fixtures	5,707	249	(157)	5,799	412	(372)	5,839
Vehicles and other equipment	2,982	250	(31)	3,201	413	(73)	3,541
Software and other intangibles	703	60	-	763	1,360	-	2,123
	<u>13,205</u>	<u>562</u>	<u>(311)</u>	<u>13,456</u>	<u>2,190</u>	<u>(736)</u>	<u>14,910</u>
Less accumulated depreciation	<u>11,957</u>	<u>720</u>	<u>(577)</u>	<u>12,100</u>	<u>333</u>	<u>(738)</u>	<u>11,695</u>
Total capital assets, net	<u><u>\$ 1,248</u></u>	<u><u>\$ (158)</u></u>	<u><u>\$ 266</u></u>	<u><u>\$ 1,356</u></u>	<u><u>\$ 1,857</u></u>	<u><u>\$ 2</u></u>	<u><u>\$ 3,215</u></u>

7. 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 2013. This association offers the Powerball with Power Play, Mega Millions with Megaplier 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 and Mega Millions with Megaplier 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, 2013, and June 30, 2012, the Lottery had deposits with MUSL of \$19,037,144, and \$19,995,144, 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.

8. LONG-TERM LIABILITIES**a. Grand Prizes Payable**

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

	<u>2013</u>	<u>2012</u>
FLORIDA LOTTO grand prizes (face value)	\$ 530,605	\$ 662,012
MEGA MONEY grand prizes (face value)	8,677	8,796
Win for Life grand prizes (face value)	11,566	11,930
Flamingo Fortune Game Show grand prizes (face value)	500	600
Win a Million grand prizes (face value)	250	300
Yearly Bonus grand prizes (face value)	-	50
Lucky for Life grand prizes (face value)	20,900	21,750
Set for Life grand prizes (face value)	1,920	2,100
Cash Spectacular grand prizes (face value)	500	550
Cash for Life grand prizes (face value)	200	210
Loaded for Life grand prizes (face value)	2,750	2,850
Billion Dollar Blockbuster grand prizes (face value)	8,450	8,000
Gas for Life grand prizes (face value)	180	186
2 Million Dollar Casino Action grand prizes (face value)	1,700	1,800
Million Dollar Holiday grand prizes (face value)	900	950
Week for Life grand prizes (face value)	22,724	13,650
Monopoly grand prizes (face value)	2,700	2,850
Million Wishes grand prizes (face value)	950	-
X's The Cash grand prizes (face value)	950	-
Less imputed interest	(160,229)	(185,559)
Net present value of grand prizes payable	<u>\$ 456,193</u>	<u>\$ 553,025</u>
Current prizes payable from restricted assets	\$ 112,751	\$ 130,728
Noncurrent prizes payable from restricted assets	343,442	422,297
Total grand prizes payable	<u>\$ 456,193</u>	<u>\$ 553,025</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>
2014	\$ 112,603
2015	85,116
2016	65,211
2017	43,649
2018	24,478
2019-2023	92,865
2024-2028	100,474
2029-2033	65,215
2034-2038	17,442
2039-2043	9,369
Grand prizes (face value)	616,422
Less imputed interest	(160,229)
Net present value of grand prizes payable	<u>\$ 456,193</u>

b. Compensated Absences Payable

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

	<u>2013</u>	<u>2012</u>
Current compensated absences	\$ 769	\$ 785
Noncurrent compensated absences	2,908	2,798
Total	<u>\$ 3,677</u>	<u>\$ 3,583</u>

c. Changes in Long-Term Liabilities

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

	<u>2012-2013</u>				
	<u>Balance</u>			<u>Balance</u>	<u>Amount Due</u>
	<u>June 30, 2012</u>	<u>Additions</u>	<u>Reductions</u>	<u>June 30, 2013</u>	<u>Within One</u>
					<u>Year</u>
Grand prizes payable	\$ 553,025	\$ 38,119	\$ (134,951)	\$ 456,193	\$ 112,751
Compensated absences	3,583	1,223	(1,130)	3,676	769
Postemployment healthcare benefits payable	2,196	766	-	2,962	-
Total long-term liabilities	<u>\$ 558,804</u>	<u>\$ 40,108</u>	<u>\$ (136,081)</u>	<u>\$ 462,831</u>	<u>\$ 113,520</u>

	<u>2011-2012</u>				
	<u>Balance</u>			<u>Balance</u>	<u>Amount Due</u>
	<u>June 30, 2011</u>	<u>Additions</u>	<u>Reductions</u>	<u>June 30, 2012</u>	<u>Within One</u>
					<u>Year</u>
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	<u>\$ 665,002</u>	<u>\$ 51,541</u>	<u>\$ (157,739)</u>	<u>\$ 558,804</u>	<u>\$ 131,513</u>

See Note 10 for additional information regarding the postemployment healthcare benefits payable.

9. 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 EETF as provided in Section 24.121, Florida Statutes, as amended. The amount transferred for the fiscal year ended June 30, 2013, was \$1,424,307,000 (28.4 percent of revenues), and for the fiscal year ended June 30, 2012, the transferred amount was \$1,321,604,000 (29.7 percent of revenues).

Because the net appreciation in fair value of investments and amortization of grand prizes payable, included in nonoperating revenue 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 revenue minus expenses rather than a percent of revenue.

The amount due to the EETF at June 30, 2013, and June 30, 2012, was as follows (in thousands):

	<u>June 30, 2013</u>	<u>June 30, 2012</u>
Terminal ticket sales	\$ 1,984,469	\$ 1,882,905
Average percent transferred	38%	39%
Transfer of Terminal ticket sales ¹	<u>754,846</u>	<u>729,820</u>
Unclaimed Terminal ticket prizes	28,214	26,608
Percent transferred	80%	80%
Transfer of unclaimed Terminal ticket prizes	<u>22,571</u>	<u>21,286</u>
Unclaimed Powerball jackpot prizes	-	4,007
Scratch-Off ticket sales	3,028,527	2,566,991
Average percent transferred	20%	21%
Transfer of Scratch-Off ticket sales ¹	<u>605,842</u>	<u>541,616</u>
Unclaimed Scratch-Off ticket prizes	35,084	12,888
Percent transferred	80%	80%
Transfer of unclaimed Scratch-Off ticket prizes	<u>28,068</u>	<u>10,310</u>
Nonoperating revenues (expenses), net	(37,816)	30,682
Add:		
Net (appreciation) depreciation in fair value of investments	13,749	(60,221)
Amortization of grand prizes payable	<u>29,068</u>	<u>36,446</u>
Total Nonoperating revenues, net	<u>5,001</u>	<u>6,907</u>
Terminal fees and miscellaneous revenue	<u>7,979</u>	<u>7,658</u>
Due for the year	<u>\$ 1,424,307</u>	<u>\$ 1,321,604</u>
Balance due, beginning of year	51,604	81,818
Paid during the year	<u>(1,399,800)</u>	<u>(1,351,818)</u>
Due to Educational Enhancement Trust Fund, June 30	<u><u>\$ 76,111</u></u>	<u><u>\$ 51,604</u></u>

¹Amounts do not foot due to rounding of average percent transferred.

10. 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 65 and vested or at any age after 33 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 only with service accrued 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 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 June 30, 2013	Fiscal Year Ended June 30, 2013	Fiscal Year Ended June 30, 2012	Fiscal Year Ended June 30, 2012
Senior Management Service	3.00 percent	6.30 percent	3.00 percent	6.27 percent
Regular	3.00 percent	5.18 percent	3.00 percent	4.91 percent
Special Risk	3.00 percent	14.90 percent	3.00 percent	14.10 percent
DROP - Applicable to members from all of the above classes	0.00 percent	5.51 percent	0.00 percent	4.42 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, 2013, 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, 2013, June 30, 2012, and June 30, 2011, totaled \$851,755, \$957,759, and \$1,681,368, respectively, which were equal to 100 percent of the required contributions for each fiscal year. These contributions represented 5.4 percent, 5.7 percent, and 10.4 percent of covered payroll, for the fiscal years ended June 30, 2013, June 30, 2012, and June 30, 2011, 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 6.27 percent of covered payroll for July 2012 through June 2013. 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, 2013, June 30, 2012, and June 30, 2011, totaled \$13,103, \$24,509, and \$52,329 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, 2013, and 2012, 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 years ended June 30, 2013, 2012, and 2011, 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 years ended June 30, 2013, 2012, and 2011, the Lottery contributed \$173,089, \$182,359, and \$179,978, respectively, in employer contributions to the HIS Program. 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 No. 45, the Lottery is required to record its portion of the implicit postemployment health benefit liability beginning in the fiscal year ended June 30, 2008. Postemployment health benefits payable at June 30, 2013, June 30, 2012, and June 30, 2011, was \$2,962,000, \$2,196,000, and \$1,472,000, respectively.

11. 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, 2013, are scheduled as follows (in thousands):

Year Ending June 30	Office and Warehouse Space for		Computer Equipment	Total
	Headquarters	Districts		
2014	\$ 2,690	\$ 1,022	\$ 352	\$ 4,064
2015	2,717	849	256	3,822
2016	2,744	877	-	3,621
2017	2,772	909	-	3,681
2018	2,801	936	-	3,737
2019-2023	234	3,036	-	3,270
2024-2028	-	787	-	787
2029-2032	-	633	-	633
Total	\$ 13,958	\$ 9,049	\$ 608	\$ 23,615

Rental expense under all operating leases totaled approximately \$4,072,000 and \$3,669,000 for the fiscal years ended June 30, 2013, and 2012, respectively.

12. VENDOR SUPPORT FUNDS

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. Vendor balances committed for marketing and research vary as result of timing of marketing initiatives, industry developments and changes in technology. Actual cash balances for these activities as of June 30, 2006, through June 30, 2013, range from approximately \$1,207,000 to \$3,874,000. 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 EETF. Historically, no balances have reverted to the Lottery. The contracts were last renewed for GTech and Scientific Games in March 2011 and October 2008, respectively.

Vendor support fund activities are summarized as follows (in thousands):

2012-2013 Vendor Support Funds				
	Balance			Balance
	June 30, 2012	Additions	Deletions	June 30, 2013
GTech	\$ 286	\$ 360	\$ (306)	\$ 340
Scientific Games	2,847	3,380	(4,072)	2,155
Total Vendor Support	\$ 3,133	\$ 3,740	\$ (4,378)	\$ 2,495

2011-2012 Vendor Support Funds				
	Balance			Balance
	June 30, 2011	Additions	Deletions	June 30, 2012
GTech	\$ 146	\$ 598	\$ (458)	\$ 286
Scientific Games	2,893	3,537	(3,583)	2,847
Total Vendor Support	\$ 3,039	\$ 4,135	\$ (4,041)	\$ 3,133

13. 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 and for the provision of full service vending machines for the fiscal years ended June 30, 2013, and 2012, was \$31,012,000, and \$27,622,000, 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 and the agreement for the provision of instant ticket vending machines amounted to \$44,193,000 for the fiscal year ended June 30, 2013, and \$38,906,000 for the fiscal year ended June 30, 2012.

14. 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.



DAVID W. MARTIN, CPA
AUDITOR GENERAL

AUDITOR GENERAL STATE OF FLORIDA

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111 West Madison Street
Tallahassee, Florida 32399-1450



PHONE: 850-412-2722
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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*

Report on the Financial Statements

We have audited, 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, the financial statements of the Florida Department of the Lottery (Lottery), as of and for the fiscal year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise Florida Lottery's basic financial statements, and have issued our report thereon dated January 24, 2014, included under the heading **INDEPENDENT AUDITOR'S REPORT**.

Internal Control over Financial Reporting

We have examined the effectiveness of the Lottery's internal control over financial reporting as of June 30, 2013, 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, 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 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 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, 2013, 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 from 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, which are discussed in the accompanying **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.

Purpose of the Report

The purpose of the **INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON THE AUDIT OF THE FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS** is solely to describe the scope of our testing of internal control and on compliance and the result of that testing, and to provide an opinion on the effectiveness of the Lottery's internal control. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Lottery's internal control and compliance. Accordingly, this report is not suitable for any other purpose.

Respectfully submitted,



David W. Martin, CPA

January 24, 2014

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

RICK SCOTT
Governor



CYNTHIA F. O'CONNELL
Secretary

January 24, 2014

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, 2013, 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, 2013, the Florida Lottery's internal control over financial reporting is effective based on the criteria established in *Internal Control – Integrated Framework*.

The Florida Lottery

A handwritten signature in black ink, appearing to read "Cynthia O'Connell".

Cynthia O'Connell
Secretary

**STATE OF FLORIDA
DEPARTMENT OF THE LOTTERY
SCHEDULE OF FINDINGS
FOR THE FISCAL YEAR ENDED JUNE 30, 2013**

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, five of which were also identified in the prior audit. To avoid the possibility of compromising Lottery information, specific details of these issues are not disclosed in this report. However, the appropriate Lottery personnel have been notified of these issues.

Recommendation: We recommend that Lottery management make the necessary IT control enhancements 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 be minority business enterprises, as defined in Section 288.703(3), Florida Statutes; however, no more than 35 percent of such retailers shall be owned by the same type of minority person, as defined by Section 288.703(4), Florida Statutes.

Our audit disclosed that as of July 1, 2013, 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 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.

EXHIBIT A
MANAGEMENT'S RESPONSE

RICK SCOTT
Governor



CYNTHIA F. O'CONNELL
Secretary

January 24, 2014

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

Dear Mr. Martin:

The Lottery has received your January 10, 2014 list of preliminary and tentative audit findings and recommendations resulting from your audit of the Lottery's Financial Statements for the fiscal year ended June 30, 2013. The staff has discussed your recommendations and responds as follows:

1. Recommendation: Lottery management make the necessary IT control enhancements 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.

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

EXHIBIT A
MANAGEMENT'S RESPONSE (CONTINUED)

January 24, 2014
David W. Martin
Page Two

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.

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
Ellyn Hutson, Chief Financial Officer
Tom Delacenserie, Deputy Secretary
Louisa Warren, Deputy General Counsel
Andy Mompeller, Inspector General