



**OFFICE OF AUDITOR OF STATE  
STATE OF IOWA**

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**NEWS RELEASE**

FOR RELEASE November 27, 2002

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Auditor of State Richard Johnson today released an audit report on the Lottery Division, Iowa Department of Revenue and Finance for the year ended June 30, 2002. The Lottery Division oversees the marketing of lottery games and performs the administrative duties necessary to maximize the amount of money available for transfer to the State General Fund. Total operating revenue for the year ended June 30, 2002 increased 4.2% over the same period one year ago.

Comparative operating data is as follows:

	Year Ended June 30, 2002	Year Ended June 30, 2001	% Increase (Decrease)
<b>Revenues:</b>			
Instant ticket	\$ 76,754,614	80,164,456	(4.25%)
Pick 3	4,717,393	3,802,826	24.05%
Powerball	57,966,865	49,626,328	16.81%
Hot Lotto	1,277,648	-	100.00%
Rolldown	1,139,610	2,109,976	(45.99%)
\$100,000 Cash Game	4,138,619	4,081,822	1.39%
Freeplay Replay	350,049	636,538	(45.01%)
Pull-tab	26,324,246	25,722,808	2.34%
Cash 4 Life	-	481,238	(100.00%)
Contract settlement	2,750,000	-	100.00%
Other	65,577	1,750,819	(96.25%)
Total revenue	175,484,621	168,376,811	4.22%
Prize expense	99,996,233	96,712,105	3.40%
Other expense	37,858,825	36,840,608	2.76%
Transfers to other funds	39,528,425	35,933,474	10.00%

An analysis of prizes awarded for the year ended June 30, 2002 is as follows:

Instant ticket prizes expense	=	61% of Instant ticket sales
Pick 3 prizes expense	=	61% of Pick 3 sales
Powerball prizes expense	=	51% of Powerball sales
Rolldown prizes expense	=	45% of Rolldown sales
Pull-tab prizes expense	=	65% of Pull-tab sales
Hot Lotto prizes expense	=	53% of Hot Lotto sales
\$100,000 Cash Game prizes expense	=	49% of \$100,000 Cash Game sales
Freeplay Replay prizes expense	=	55% of Freeplay Replay sales

The Lottery Division spent \$6,232,056 on advertising, publicity and promotional prizes for the year ended June 30, 2002, representing 3.6% of revenue. Iowa laws allow the Division to spend up to 4% of revenue for the marketing of lottery games.

A copy of the audit report is available for review in the office of the Auditor of State and the Lottery Division of the Iowa Department of Revenue and Finance.

# # #



**LOTTERY DIVISION  
IOWA DEPARTMENT OF REVENUE AND FINANCE**

**INDEPENDENT AUDITOR'S REPORTS  
FINANCIAL STATEMENTS AND  
SUPPLEMENTAL INFORMATION**

**JUNE 30, 2002**



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**Lottery Division  
Iowa Department of Revenue and Finance**

**Officials**

Name

Title

**State**

Honorable Thomas J. Vilsack  
Cynthia P. Eisenhauer  
Dennis C. Prouty

Governor  
Director, Department of Management  
Director, Legislative Fiscal Bureau

**Iowa Lottery Board**

Mary B. Junge  
Timothy Clausen  
William C. Brosnahan  
Elaine Baxter  
Michael McCoy

Chairperson  
Vice Chairperson  
Member  
Member  
Member

**Department of Revenue and Finance**

Gerald D. Bair

Director

**Lottery Division**

Dr. Edward Stanek  
Steven King

Commissioner  
Vice President of Finance, Chief Financial Officer

**Lottery Division**  
**Iowa Department of Revenue and Finance**



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Chief Deputy Auditor of State

Independent Auditor's Report

To the Members of the Iowa  
Lottery Board:

We have audited the accompanying basic financial statements, listed as exhibits in the table of contents of this report, of the Lottery Division of the Iowa Department of Revenue and Finance, as of and for the year ended June 30, 2002. These basic financial statements are the responsibility of the Lottery Division's management. Our responsibility is to express an opinion on these basic financial statements based on our audit.

We conducted our audit in accordance with U.S. generally accepted auditing standards, Chapter 11 of the Code of Iowa, and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards and provisions require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements of the Lottery Division of the Iowa Department of Revenue and Finance are intended to present the financial position, and the changes in financial position and cash flows of only that portion of the financial reporting entity of the State of Iowa that is attributable to the transactions of the Lottery Division. They do not purport to, and do not, present fairly the financial position of the State of Iowa as of June 30, 2002, and the changes in its financial position and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the Lottery Division of the Iowa Department of Revenue and Finance at June 30, 2002, and the changes in financial position and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

As described in Note 12 to the financial statements, during the year ended June 30, 2002, the Lottery Division of the Iowa Department of Revenue and Finance adopted Governmental Accounting Standards Board Statement Number 34, Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments. The Lottery Division of the Iowa Department of Revenue and Finance also changed the capital asset capitalization threshold as described in Note 12.

In accordance with Government Auditing Standards, we have also issued our report dated October 11, 2002 on our consideration of the Lottery Division's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations and contracts. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

Management's Discussion and Analysis is not a required part of the basic financial statements, but is supplementary information the Governmental Accounting Standards Board requires. We applied limited procedures, consisting principally of inquiries of management regarding methods of measurement and presentation of the supplementary information. We did not audit the information and express no opinion thereon.

Our audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. We previously audited, in accordance with the standards referred to in the second paragraph of this report, the financial statements for the four years ended June 30, 2001 (none of which are presented herein) and expressed unqualified opinions on those financial statements. The supplemental information included in Schedules 1 through 6 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in our audit of the aforementioned basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

RICHARD D. JOHNSON, CPA  
Auditor of State

WARREN G. JENKINS, CPA  
Chief Deputy Auditor of State

October 11, 2002

## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

Management of the Iowa Lottery provides this Management's Discussion and Analysis of the Iowa Lottery's annual financial statements. This narrative overview and analysis of the financial activities of the Iowa Lottery is for the fiscal year ended June 30, 2002. We encourage readers to consider this information in conjunction with the Iowa Lottery's financial statements, which follow this section.

### **FINANCIAL HIGHLIGHTS**

The Lottery continues to provide strong, stable proceeds for the state of Iowa and has met or exceeded its profit projections for at least the last three years. Here are some key financial highlights from fiscal year 2002:

- Lottery sales were up approximately 3.6%, at \$173 million, for fiscal year 2002. In August of 2001, the Powerball jackpot rose to its second highest level in history, \$295 million. In fact, this jackpot level resulted in the Iowa Lottery's highest sales week ever. Over \$11.6 million in sales were generated for the week ending August 25, 2001.
- In July of 2001, the Iowa Lottery began using a new computer system to distribute lotto tickets statewide. The new equipment comes under a lottery contract that began July 1, 2001 with Scientific Games International Inc. of Alpharetta, Georgia. The Iowa Lottery Board approved this contract in September 2000 between the Iowa Lottery and Autotote Lottery Corp. of Newark, Delaware, which proposed operating the Iowa Lottery's computer system for at least seven years for a projected cost of \$49.25 million. Autotote later merged with Scientific Games International, Inc.
- Since the Lottery's inception in 1985, more than \$1.55 billion has been awarded in prizes and nearly \$780 million has been raised for state programs.

### **USING THIS ANNUAL REPORT**

This discussion and analysis are intended to serve as an introduction to the Iowa Lottery's basic financial statements. The Iowa Lottery's basic financial statements consist of a series of financial statements. The Statement of Net Assets and the Statement of Revenues, Expenses and Changes in Net Assets (on pages 12 and 13) provide information about the activities of the Iowa Lottery as a whole and present a longer-term view of the Iowa Lottery's finances. These basic financial statements also include the notes to the financial statements that explain some of the information in the statements and provide more detail. Supplemental information is also in schedule form and begins on page 26.

### **REPORTING THE IOWA LOTTERY AS A WHOLE**

The Statement of Net Assets and the Statement of Revenues, Expenses and Changes in Net Assets:

One of the most important questions asked about the Iowa Lottery's finances is "Is the Lottery as a whole better off or worse off as a result of the year's activities?" The Statement of Net Assets and the Statement of Revenues, Expenses and Changes in Net Assets report information about the Iowa Lottery as a whole and about its activities in a way that helps answer this question. These statements include all assets and liabilities using the accrual basis of accounting, which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid. The Lottery's financial statements include these two statements:

The Statement of Net Assets presents all of the Iowa Lottery's assets and liabilities, with the difference between the two reported as "net assets". Per the Code of Iowa, all Lottery revenue remaining after expenses must be transferred on a monthly basis to the state General Fund. However, the Lottery may retain an amount sufficient to cover anticipated administrative expenses for a period of twenty-one days. Unrestricted net assets are calculated as the sum of cash on deposit with the state vehicle dispatcher, ticket inventory and the net book value of capital assets.

The Statement of Revenues, Expenses and Changes in Net Assets presents information showing how the Iowa Lottery's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the event or change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will not result in cash flows until future fiscal periods. Both Lottery ticket sales and related proceeds transfers to the state serve as useful indicators of the Iowa Lottery's future ability to provide a steady, reliable stream of revenue to the state. As noted in the financial highlights above, the Lottery has met or exceeded its profit projections for at least the last three years.

Notes to the Financial Statements:

The notes provide additional information that is essential to a full understanding of the data provided in the basic financial statements. The notes to the financial statements can be found beginning on page 16.

Supplemental Information:

The supplemental information begins on page 26 and provides detailed information about other operating expenses by object. Schedules 2 and 3 show revenues and expenses by individual Lottery games. Schedule 4 provides an analysis of net assets. In addition, other financial data in this section compares revenues and prize payouts over the past five years by game.

**GOVERNMENTAL FINANCIAL ANALYSIS**

The Lottery's assets totaled \$71.9 million at the end of 2002 compared to \$76.5 million at the end of the previous year. Unrestricted net assets represent assets used to meet the Lottery's ongoing obligations to vendors and creditors. Unrestricted net assets increased by \$209,501 from fiscal year 2001 to fiscal year 2002. This change is primarily due to the increase in value of ticket inventory at the end of fiscal year 2002 as compared to fiscal year 2001.

	June 30,	
	2002	2001 (Restated)
<b>Net Assets:</b>		
Current assets	\$ 20,835,756	\$ 20,704,506
Prize reserve	5,570,033	5,566,250
Investment in prize annuities	45,015,622	49,750,250
Capital assets, net	483,307	521,561
<b>Total assets</b>	<b>\$ 71,904,718</b>	<b>\$ 76,542,567</b>
Current liabilities	\$ 18,820,433	19,121,604
Prize reserve fund	5,570,033	5,566,250
Long-term annuity prizes payable	45,015,622	49,750,250
Other long-term liabilities	184,666	-
<b>Total liabilities</b>	<b>\$ 69,590,754</b>	<b>74,438,104</b>
Net assets:		
Invested in capital assets	\$ 483,307	521,561
Unrestricted	1,830,657	1,582,902
<b>Total net assets</b>	<b>\$ 2,313,964</b>	<b>2,104,463</b>

As noted previously, two more useful indicators of the Iowa Lottery's ongoing ability to maximize revenues to the state include Lottery ticket sales and proceeds transfers over time. The next schedule helps to highlight that activity for fiscal year 2002 compared to fiscal year 2001.

	Year ended June 30,	
	2002	2001
<b>Changes in Net Assets:</b>		
<b>Operating revenues:</b>		
Ticket sales	\$ 172,669,044	166,625,992
Application fees	21,350	20,575
Other	2,794,227	1,730,244
<b>Total operating revenues</b>	<b>175,484,621</b>	<b>168,376,811</b>
<b>Operating expenses:</b>		
Prizes	99,996,233	96,712,105
Other operating expenses	37,858,825	36,840,608
<b>Total operating expenses</b>	<b>137,855,058</b>	<b>133,552,713</b>
<b>Operating income</b>	<b>37,629,563</b>	<b>34,824,098</b>
<b>Non-operating revenues:</b>		
Interest income	926,194	887,377
Principal demutualization proceeds	1,182,169	-
<b>Total non-operating revenues</b>	<b>2,108,363</b>	<b>887,377</b>
<b>Income before transfers</b>	<b>39,737,926</b>	<b>35,711,475</b>
<b>Transfers to other funds:</b>		
State General Fund	38,995,651	35,430,858
Iowa Department of Public Health- Gambling Treatment Fund	532,774	502,616
<b>Change in net assets</b>	<b>209,501</b>	<b>(221,999)</b>
<b>Net assets beginning of year, as restated</b>	<b>2,104,463</b>	<b>2,326,462</b>
<b>Net assets end of year</b>	<b>\$ 2,313,964</b>	<b>2,104,463</b>

As noted above, the Iowa Lottery's net assets increased by \$209,501 or 10.0%. Proceeds transfers of \$39.0 million were made to the State General Fund and transfers totaling \$.5 million were made to the Gambling Treatment Fund.

Lottery sales for fiscal year 2002 were up about 3.6 percent, at \$173 million, compared to \$167 million for fiscal year 2001. Scratch tickets were the Lottery's leading seller during fiscal year 2002, with nearly \$76.8 million in sales. Powerball was the next most popular game category with sales of more than \$57.9 million, an increase of nearly 17 percent from fiscal year 2001.

Other revenues jumped to \$2.8 million due primarily to a \$2.75 million contract settlement of liquidated damages from Scientific Games International, Inc. Non-operating revenue also increased due to \$1.18 million of proceeds from the Principal Financial Group, which was the result of their change to a stock company from a mutual insurer.

The largest expense in total is prize expense, which accounts for 72.5% of all expenses. Prize expense is followed by retailer compensation expense, which accounts for 8.5% of all expenses. Retailers earn 5% commission on pull-tab sales, 5.5%-7% for instant sales and 5.5% for online sales. In addition, the Lottery awards incentive compensation to retailers who increase their sales from a base level determined by the Lottery.

### **CAPITAL ASSETS**

The Iowa Lottery's investment in capital assets for its business-type activities at June 30, 2002 was \$2.4 million, net of accumulated depreciation of \$1.9 million, leaving a net book value of \$.5 million. This investment in capital assets includes both equipment and vehicles, with the majority (76%) invested in vehicles. The Lottery's district sales representatives are the primary users of these vehicles. The sales representatives use the vehicles to deliver lottery tickets to retailer locations.

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

The Iowa Lottery's management considered many factors when setting the 2003 fiscal year budget. Management anticipates most product sales to remain steady through fiscal year 2003, although the Lottery expects to see a slight decrease in Powerball sales due to the near record jackpot level achieved during the fiscal year 2002. This forecast, coupled with the decrease in other operating and non-operating revenue of approximately \$3.93 million due to the Principal demutualization and collection of liquidated damages in fiscal year 2002, should result in an overall decrease in lottery sales and proceeds to the state for fiscal year 2003.

### **CONTACTING THE IOWA LOTTERY'S FINANCIAL MANAGEMENT**

This financial report is designed to present users with a general overview of the Lottery's finances and to demonstrate the Lottery's accountability for the funds generated. If you have questions about the report or need additional financial information, please contact the Finance Department, Iowa Lottery Headquarters, 2015 Grand Avenue, Des Moines, IA 50312-4999.

## **Financial Statements**

**Exhibit A**

Lottery Division  
Iowa Department of Revenue and Finance

Statement of Net Assets

June 30, 2002

<b>Assets</b>	
Current assets:	
Cash (note 2)	\$ 7,733,162
Restricted assets - cash	483,329
Prepaid expense	25,384
Interest receivable	47,548
Accounts receivable, net (note 7)	1,659,160
Ticket inventories	1,533,223
Investment in prize annuities (note 3)	9,353,950
Total current assets	<u>20,835,756</u>
Noncurrent assets:	
Prize reserve	5,570,033
Investment in prize annuities (note 3)	45,015,622
Capital assets, net (note 4)	483,307
Total noncurrent assets	<u>51,068,962</u>
<b>Total assets</b>	<u>71,904,718</u>
<b>Liabilities</b>	
Current liabilities:	
On-line prizes payable	3,410,935
Instant prizes payable	149,693
Annuity prizes payable (note 3)	9,524,450
Sales tax payable	301,481
Accounts payable	1,658,560
Due to:	
State General Fund	2,905,589
Other state agencies	153,010
Deferred revenue	140,433
Personal services payable	163,196
Compensated absences	413,086
Total current liabilities	<u>18,820,433</u>
Long-term liabilities:	
Prize reserve fund	5,570,033
Personal services payable	38,556
Compensated absences	146,110
Long-term annuity prizes payable (note 3)	45,015,622
Total long-term liabilities	<u>50,770,321</u>
Total liabilities	<u>69,590,754</u>
<b>Net Assets</b>	
Invested in capital assets	483,307
Unrestricted	1,830,657
<b>Total net assets</b>	<u>\$ 2,313,964</u>

See notes to financial statements.

Lottery Division  
Iowa Department of Revenue and Finance

Statement of Revenues, Expenses and Changes in Net Assets

Year ended June 30, 2002

Operating revenues:	
Instant ticket sales	\$ 76,754,614
Pick 3 sales	4,717,393
Powerball sales	57,966,865
Hot Lotto sales	1,277,648
Rolldown sales	1,139,610
Freeplay Replay sales	350,049
\$100,000 Cash Game sales	4,138,619
Pull-tab sales	26,324,246
Application fees	21,350
Contract settlement	2,750,000
Other	44,227
Total operating revenues	<u>175,484,621</u>
Operating expenses:	
Prizes:	
Instant ticket	46,985,002
Pick 3	2,873,174
Powerball	29,365,955
Hot Lotto	671,364
Rolldown	516,502
Freeplay Replay	192,433
\$100,000 Cash Game	2,043,731
Pull-tab	17,198,504
Promotional	149,568
Total prizes	<u>99,996,233</u>
Retailer compensation	11,679,659
Advertising/publicity	6,082,488
Vendor compensation/network expense	6,578,945
Instant and Pull-tab rental and inventory expense	4,856,817
Other operating expenses	8,660,916
Total operating expenses	<u>137,855,058</u>
Operating income	37,629,563
Non-operating revenues:	
Interest income	926,194
Principal demutualization proceeds	1,182,169
Total non-operating revenues	<u>2,108,363</u>
Income before transfers	39,737,926
Transfers to other funds:	
State General Fund	38,995,651
Iowa Department of Public Health - Gambling Treatment Fund	532,774
Change in net assets	209,501
Net assets beginning of year, as restated (note 12)	<u>2,104,463</u>
Net assets end of year	<u>\$ 2,313,964</u>

See notes to financial statements.

**Exhibit C**

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Lottery Division  
Iowa Department of Revenue and Finance

Statement of Cash Flows

Year ended June 30, 2002

Cash flows from operating activities:	
Cash received from customers	\$ 172,578,814
Cash payments for prizes	(109,871,981)
Cash payments to retailers	(11,679,659)
Cash payments to suppliers for goods and services	(19,396,888)
Cash payments to employees for services	(5,990,046)
Other operating revenue	2,791,977
	<u>28,432,217</u>
Net cash provided by operating activities	
	<u>28,432,217</u>
Cash flows from non-capital financing activities:	
Operating transfers	(40,525,450)
	<u>(40,525,450)</u>
Cash flows from capital and related financing activities:	
Acquisition of capital assets	(330,383)
Proceeds from sale of equipment	68,600
	<u>(261,783)</u>
Net cash used for capital and related financing activities	
	<u>(261,783)</u>
Cash flows from investing activities:	
Interest income	939,653
Annuity payments received from insurance companies	9,901,114
Principal demutualization proceeds	1,182,169
	<u>12,022,936</u>
Net cash provided by investing activities	
	<u>12,022,936</u>
Net decrease in cash	(332,080)
Cash at beginning of year	8,548,571
	<u>8,548,571</u>
Cash at end of year	<u>\$ 8,216,491</u>

Lottery Division  
Iowa Department of Revenue and Finance

Statement of Cash Flows

Year ended June 30, 2002

Reconciliation of operating income to net cash provided by operating activities:	
Operating income	<u>\$ 37,629,563</u>
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation	327,955
Gain on sale of property and equipment	(23,600)
Compensated absences	4,292
Provision for doubtful accounts	11,830
Change in assets and liabilities:	
Decrease in current investment in prize annuity	31,784
Decrease in prepaid expenses	97,714
Increase in accounts receivable	(293,870)
Increase in inventories	(324,247)
Increase in accounts payable	673,265
Decrease in prizes payable	(14,325)
Increase in sales tax payable	21,390
Decrease in due to other state agencies	(4,619)
Increase in deferred revenue	140,433
Increase in personal services payable	47,550
Increase in current annuities payable	8,216
Decrease in prize annuities	<u>(9,901,114)</u>
Total adjustments	<u>(9,197,346)</u>
Net cash provided by operating activities	<u><u>\$ 28,432,217</u></u>

See notes to financial statements.

Lottery Division  
Iowa Department of Revenue and Finance

Notes to Financial Statements

June 30, 2002

**(1) Summary of Significant Accounting Policies**

The Lottery Division of the Iowa Department of Revenue and Finance has the responsibility to produce the maximum amount of net revenues for the state in a manner which maintains the dignity of the state and the general welfare of the people. The Lottery Division oversees the marketing of lottery games and performs the administrative procedures necessary to ensure the most efficient and effective operation possible.

The head of the Lottery Division is a Commissioner appointed by the Governor. The Governor also appoints the Iowa Lottery Board, consisting of five members.

The Board and Commissioner have joint responsibility for entering into major contracts, procuring the printing of instant and pull-tab tickets and for the purchase or lease of equipment or services essential to the operation of a lottery game.

The Board must promulgate rules regarding the following:

- (a) Types, prize structure and price of lottery games.
- (b) Retailer licensing requirements, fees, incentives, locations and compensation.
- (c) Method of selecting winning tickets or shares, manner of prize payment, method of ticket validation, preliminary drawings and jackpot events, ticket printing and purchasing.

The organizational structure of the Lottery Division consists of five sections: Security, Finance, Operations, Marketing, and Sales.

The financial statements of the Lottery Division have been prepared in conformity with U.S. generally accepted accounting principles as applied to governmental units. The more significant of the Division's accounting policies are described below.

**A. Reporting Entity**

For financial reporting purposes, the Lottery Division has included all funds. The Lottery Division has also considered all potential component units for which it is financially accountable, and other organizations for which the nature and significance of their relationship with the Lottery Division are such that exclusion would cause the Lottery Division's financial statements to be misleading or incomplete. The Governmental Accounting Standards Board has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body, and (1) the ability of the Lottery Division to impose its will on that organization or (2) the potential for the organization to provide specific benefits to or impose specific financial burdens on the Lottery Division. The Lottery Division has no component units which meet the Governmental Accounting Standards Board criteria.

**B. Fund Accounting**

The Lottery Division is reported for accounting purposes as an Enterprise Fund. The operations of the fund are accounted for with self-balancing accounts which comprise its assets, liabilities, net assets, revenues and expenses. Enterprise Funds are used to account for operations (a) that are financed and operated in a manner similar to private business enterprises--where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred and/or net income is appropriate for capital maintenance, public policy, management control, accountability or other purposes.

**C. Measurement Focus**

Enterprise Funds are accounted for on a cost of services or "capital maintenance" measurement focus. This means that all assets and liabilities, whether current or non-current, associated with their activity are included on their balance sheets. Their reported fund equity, net total assets, is reported as net assets. Enterprise Fund operating statements present increases (revenues) and decreases (expenses) in net total assets.

In reporting the financial activity of its Enterprise Fund, the Lottery Division applies all applicable GASB pronouncements as well as the following pronouncements issued on or before November 30, 1989, unless these pronouncements conflict with or contradict GASB pronouncements: Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedure.

**D. Basis of Accounting**

Basis of accounting refers to when revenues and expenses are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of the measurements made, regardless of the measurement focus applied.

The Enterprise Fund is accounted for using the accrual basis of accounting. Revenues are recognized when they are earned and expenses are recognized when they are incurred.

The Lottery Division distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. All revenues and expense not meeting this definition are reported as nonoperating revenues and expenses.

**E. Budgets and Budgetary Accounting**

Budgetary control is exercised over the Lottery Division through the annual budgetary process prescribed in Chapter 8 of the Iowa Code.

**F. Revenue Recognition**

Sales of instant, pull-tab and on-line tickets are made to the public through licensed retail sales agents. Instant ticket sales are recognized when the retailer settles a pack of tickets. Revenues for pull-tab games are recognized upon the sale of tickets to the retail sales agents. Revenues for on-line games are recognized after the drawings are held. Deferred revenue represents on-line tickets sold for future prize drawings.

G. Assets, Liabilities and Net Assets

The following accounting policies are followed in preparing the basic financial statements:

Cash, Pooled Investments, and Cash Equivalents

Generally, all cash is held on deposit with the Treasurer of State and is invested by that office. Interest on funds held by the State Treasurer is credited to the Lottery Division as received.

The Division also earned interest on the prize reserve account maintained by the Multi-State Lottery Association (MUSL).

Restricted Assets - Cash

The Lottery Division makes monthly contributions to the State Vehicle Dispatcher. Such contributions are restricted for the purpose of purchasing replacement vehicles. Also, included are annuity payments received by the Lottery during the fiscal year, which are not owed to jackpot winners until the next fiscal year.

Investments

Investments are reported at fair value. Insurance annuities are valued on the basis of future installment payments, and are discounted using established annuity contract interest rates.

Ticket Inventories

Inventories consist of instant tickets held by sales agents and instant and pull-tab tickets stored in the main or regional warehouses for games in progress or new games. Inventories are carried at cost using the specific identification method. Tickets are charged to instant and pull-tab rental and inventory expense when sold or voided. Unsold tickets are expensed upon the end or cancellation of a lottery game.

Prize Reserve

The Lottery Division makes weekly payments to the Multi-State Lottery Association. Such payments are for the purpose of funding the jackpot prize and funding an errors and omissions reserve.

Capital Assets

Capital assets which include vehicles and equipment are defined by the Division as assets with an initial individual cost of more than \$5,000 and an estimated useful life in excess of two years. Such assets are recorded at historical cost.

The costs of normal maintenance and repairs that do not add to the value of the asset or material extend asset lives are not capitalized.

Depreciation is computed using the straight-line method over the following estimated useful lives:

<u>Asset</u>	<u>Years</u>
Equipment	5-10
Vehicles	2-4

### Prize Liability

The prize liabilities for the \$100,000 Cash Game, and the Pick 3 Game are determined by actual matches and are recognized daily after the drawings are held. The prize liabilities for the Powerball, Hot Lotto, and Freeplay Replay Game are determined and recognized twice a week, after the jackpot drawings are held. The prize liability for the Rolldown Game is determined and recognized three times a week, after the jackpot drawings are held. Prizes for Pick 3, Freeplay Replay, and the \$100,000 Cash Game may be claimed up to 90 days after the jackpot drawing is held. Prizes for Powerball, Rolldown, and Hot Lotto may be claimed up to one year after the drawings are held.

### Compensated Absences

Employees accumulate a limited amount of earned but unused vacation and sick leave for subsequent use or for payment upon termination, death, or retirement. The liabilities recorded for compensated absences are based on current rates of pay.

#### **(2) Deposits**

The Lottery Division's deposits throughout the period and at June 30, 2002 were entirely covered by federal depository insurance, or by the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. This chapter provides for additional assessments against the depositories to insure that there will be no loss of public funds.

#### **(3) Investment in Prize Annuities and Annuity Prizes Payable**

The Lottery Division held investments for the purpose of paying installment prizes. The Lottery Division may invest in financial instruments carrying the full faith and credit of the U.S. government or insurance annuities purchased from companies with an A.M. Best A+ rating and a stated surplus of at least \$100,000,000 in accordance with Chapter 99E.9 of the Code of Iowa.

The Treasurer of State is responsible for investing the Lottery Division's funds, except for insurance annuities. The Lottery Division's investments in U.S. government securities with a fair value of \$19,975,837 at year end are all insured and registered investments held by the State of Iowa or held by the State of Iowa's agent in the name of the State.

The Lottery Division is responsible for investing in insurance annuities. The Lottery Division had investments in insurance annuities with a fair value of \$34,393,735, that are not subject to credit risk categorization.

Assets totaling \$54,555,467, which includes \$185,895 of restricted assets, are held by the Lottery Division for the purpose of paying installment prizes which have already been won but will not be fully paid until 2018. Annuity liabilities to fund jackpot winners are valued at an amount equal to the carrying values of the respective assets held to fund the annuity obligations. Annuity prizes payable does not include an additional liability of \$15,395 to taxing authorities, which is classified as due to other state agencies. The following is a schedule of future payments:

Year Ending June 30,	Current	Long-term	Total Payments
2003	\$ 9,903,114	-	9,903,114
2004	-	9,901,114	9,901,114
2005	-	9,901,114	9,901,114
2006	-	9,355,574	9,355,574
2007	-	8,152,083	8,152,083
2008-2018	-	25,013,000	25,013,000
Total future value	9,903,114	62,322,885	72,225,999
Less: unamortized discount	(378,664)	(17,307,263)	(17,685,927)
Present value of payments	<u>\$ 9,524,450</u>	<u>45,015,622</u>	<u>54,540,072</u>

**(4) Capital Assets**

Capital assets activity for the year ended June 30, 2002 is as follows:

	Balance Beginning of Year, as restated (note 12)	Additions	Deletions	Balance End of Year
Equipment	\$ 1,768,848	8,041	402,017	1,374,872
Vehicles	1,005,357	326,660	274,174	1,057,843
Total capital assets	<u>2,774,205</u>	<u>334,701</u>	<u>676,191</u>	<u>2,432,715</u>
Less accumulated depreciation:				
Equipment	(1,645,859)	59,886	402,017	(1,303,728)
Vehicles	(606,785)	268,069	229,174	(645,680)
Total accumulated depreciation	<u>(2,252,644)</u>	<u>327,955</u>	<u>631,191</u>	<u>(1,949,408)</u>
Capital assets, net	<u>\$ 521,561</u>	<u>6,746</u>	<u>45,000</u>	<u>483,307</u>

**(5) Pension and Retirement Benefits**

The Lottery Division contributes to the Iowa Public Employees Retirement System (IPERS) which is a cost-sharing multiple-employer defined benefit pension plan administered by the State of Iowa. IPERS provides retirement and death benefits which are established by state statute to plan members and beneficiaries. IPERS issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained by writing to IPERS, P.O. Box 9117, Des Moines, Iowa, 50306-9117.

Plan members are required to contribute 3.70% of their annual salary and the Lottery Division is required to contribute 5.75% of annual payroll. Contribution requirements are established by state statute. The Lottery Division's contribution to IPERS for the years ended June 30, 2002, 2001, and 2000 were \$271,028, \$257,606, and \$248,373 respectively, equal to the required contributions for each year.

**(6) Lease Commitment and Subsequent Event**

The Lottery Division occupies office and warehouse facilities in Des Moines, Cedar Rapids, Mason City, Storm Lake, Council Bluffs and Ankeny under long-term operating leases which expire by June 30, 2006. In addition, the Lottery Division rents pull tab ticket machines under long-term operating leases which expire by September 30, 2002 and instant ticket machines which expire by December 31, 2004. The lease for the pull tab ticket machines was extended for two years by the Lottery on October 4, 2002.

The following is a schedule, by year, of future minimum rental payments required under operating leases which have initial or remaining non-cancelable lease terms in excess of one year as of June 30, 2002:

<u>Year ending June 30:</u>	
2002	\$ 1,180,667
2003	1,180,667
2004	829,980
2005	<u>144,928</u>
Total	<u>\$ 3,336,242</u>

Rental expense for all operating leases totaled \$2,744,726 for the year ended June 30, 2002.

**(7) Accounts Receivable**

The components of accounts receivable at June 30, 2002 are as follows:

Due from agents	\$ 1,652,965
Due from others	<u>48,405</u>
Subtotal	1,701,370
Less allowance for doubtful accounts	<u>(42,210)</u>
Accounts receivable, net	<u>\$ 1,659,160</u>

**(8) Payment of Prizes**

Instant ticket prize expense is comprised of actual winning tickets validated for payment by any retailer or Lottery headquarters.

The Powerball prize expense is comprised of two different prize structures. One prize structure is winners who match 3, 4, or 5 of 5 numbers, or none, 1, 2, 3, or 4 of 5 numbers plus match the Powerball number. The second prize structure involves a jackpot which increases from drawing to drawing until the jackpot is won. The jackpot is won when 5 of 5 numbers are matched, plus the Powerball number.

All pull-tab prizes are paid by the retailer who sold the ticket. Therefore, substantially all of the pull-tab prize expense shown on the financial statements has been disbursed to the prize winner.

The \$100,000 Cash Game prize expense is comprised of winners who match 2, 3, 4, or 5 of 5 numbers.

The Hot Lotto prize expense is comprised of two different prize structures. One prize structure is winners who match 3, 4, or 5 of 5 numbers, or none, 1, 2, 3, 4, of 5 numbers plus match the Hot Ball number. The second prize structure involves a jackpot which increases from drawing to drawing until the jackpot is won. The jackpot is won when 5 of 5 numbers are matched, plus the Hot Ball number.

The Pick 3 prize expense is comprised of winners who match 3 of 3 numbers. A player may win from \$50 to \$3,000 depending on the play type selected and the play amount. Play types are Straight, Box, or Straight/Box and require the player to match all numbers in the exact order as drawn, match all three numbers in any order, or match either exact and/or any order, respectively.

The Freeplay Replay prize expense is comprised of winners who match 0, 4, 5, or 6 of 6 numbers. The top prize is \$15,000 per year for 15 years.

The Rolldown prize expense is comprised of winners who match 2, 3, 4, or 5 of 5 numbers. The jackpot is paid out each drawing. If no player matches 5 of 5 numbers, the "prize pool" is divided between the match 2, 3, and 4 winners on a pari-mutuel basis. Players may also win for matching 2, 3, or 4 numbers when a jackpot is paid out.

During the year ended June 30, 2002, \$149,568 in prizes were distributed through various promotional activities.

**(9) Lotto America/Powerball**

U.S. Treasury zero coupon bonds are purchased by the Multi-State Lottery Association (MUSL) to provide payments corresponding to the Iowa Lottery Board's obligation to Lotto America/Powerball prize winners. The MUSL holds these bonds and will cash the bonds when due and wire the money to the Lottery Division's account on or before the anniversary date of the jackpot.

At June 30, 2002, the MUSL held zero coupon bonds for the Lottery Division, to fund future installment payments aggregating \$17,956,437. The current value of those bonds totaled \$15,519,781.

**(10) Instant Ticket Packs**

The Lottery Division issues instant ticket packs to retailers on an ongoing basis. The District Sales Representative must activate the pack on the system before the pack may be sold to the public. The retailer may not be billed for these packs until a pack is activated and settled on the system. A pack may be settled in one of three ways: 1) 70% of the low-tier tickets in the pack have been validated; 2) 45 days have elapsed from the date the pack was activated; 3) or the pack has been settled at delivery or settled manually through the terminal. As of June 30, 2002, the Lottery Division has 15,127 packs at retailers for which the Lottery has not yet received payment. The receivable and the related deferred revenue of \$1,872,020, calculated as shown below, have not been included in the Lottery Division's financial statements since the sales associated with these packs have not been recognized.

Unsettled packs	\$ 4,538,100
Less:	
Retailer compensation	301,791
Low-tier prize expense	<u>2,364,289</u>
Receivable and deferred amount	<u>\$ 1,872,020</u>

**(11) Risk Management**

State employee benefits for health, dental, long-term disability and life insurance coverage are insured through commercial insurers. There were no significant reductions in insurance coverage for the prior year and settlements have not exceeded coverage for the past three fiscal years.

The State of Iowa self-insures on behalf of its agencies for losses related to workers' compensation, its motor vehicle fleet, property damage and torts. A contingent fund exists under Section 29C.20 of the Code of Iowa to provide compensation for loss or damage to state property (casualty losses).

Upon advice of legal counsel, the Lottery Division has purchased commercial insurance for certain risks.

**(12) Accounting Change**

Governmental Accounting Standards Board (GASB) Statement Number 34, Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments was implemented during fiscal year 2002. The statement creates new basic financial statements for reporting on the Division's financial activities.

Except for the restatement explained below, the beginning net asset amount for the Lottery Division is the fund equity of the Enterprise Fund at the end of the prior year.

For reporting purposes, the State of Iowa implemented a new capitalization policy, which the Division has complied with. This results in a restatement of the beginning balances for capital assets and accumulated depreciation.

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<b>Financial Statements</b>			
Net assets at June 30, 2001	\$	2,151,078	
GASB 34 adjustment for capital assets		(46,615)	
Net assets, as restated July 1, 2001	\$	2,104,463	

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<b>Capital Assets</b>	Balance Beginning of Year	Adjustment	Restated Balances
Equipment	\$ 2,160,438	(391,590)	1,768,848
Vehicles	1,005,357	-	1,005,357
Total	3,165,795	(391,590)	2,774,205
Less accumulated depreciation:			
Equipment	(1,990,834)	344,975	(1,645,859)
Vehicles	(606,785)	-	(606,785)
Total	(2,597,619)	344,975	(2,252,644)
Capital assets, net	\$ 568,176	(46,615)	521,561

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**Lottery Division**  
**Iowa Department of Revenue and Finance**

## **Supplemental Information**

**Schedule 1**

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Lottery Division  
Iowa Department of Revenue and Finance

## Other Operating Expenses

Six months and year ended June 30, 2002

	<u>Six Months Ended</u> <u>June 30, 2002</u>	<u>Year Ended</u> <u>June 30, 2002</u>
Personal services	\$ 3,048,152	6,041,888
Travel	132,204	299,009
Supplies	10,718	114,232
Printing	31,306	68,584
Communications	83,281	156,499
Rentals	280,628	565,287
Utilities	32,085	60,958
Professional fees	29,196	51,626
Outside services and repair	39,503	91,790
Non-capitalized equipment	127,823	215,801
Data processing	3,196	6,529
Reimbursement to state agencies	200,014	386,033
Multi-State administrative expense	124,410	203,335
Depreciation	184,641	327,955
Other	25,247	71,390
	<hr/>	<hr/>
Total	\$ 4,352,404	8,660,916

See accompanying independent auditor's report.

Lottery Division  
Iowa Department of Revenue and Finance  
Revenues, Expenses and Changes in Net Assets  
Years ended June 30, 2002 and 2001

	Year Ended		Increase (Decrease)
	June 30, 2002	June 30, 2001	
<b>Operating revenues:</b>			
Instant ticket sales	\$ 76,754,614	80,164,456	(3,409,842)
Pick 3 sales	4,717,393	3,802,826	914,567
Powerball sales	57,966,865	49,626,328	8,340,537
Hot Lotto sales	1,277,648	-	1,277,648
Rolldown sales	1,139,610	2,109,976	(970,366)
Freeplay Replay sales	350,049	636,538	(286,489)
\$100,000 Cash Game sales	4,138,619	4,081,822	56,797
Cash 4 Life sales	-	481,238	(481,238)
Pull-tab sales	26,324,246	25,722,808	601,438
Application fees	21,350	20,575	775
Contract settlement	2,750,000	-	2,750,000
Other	44,227	1,730,244	(1,686,017)
Total operating revenues	175,484,621	168,376,811	7,107,810
<b>Operating expenses:</b>			
<b>Prizes:</b>			
Instant ticket	46,985,002	48,929,667	(1,944,665)
Pick 3	2,873,174	2,265,935	607,239
Powerball	29,365,955	24,977,085	4,388,870
Hot Lotto	671,364	-	671,364
Rolldown	516,502	1,108,006	(591,504)
Freeplay Replay	192,433	336,901	(144,468)
\$100,000 Cash Game	2,043,731	2,014,110	29,621
Cash 4 Life	-	155,653	(155,653)
Pull-tab	17,198,504	16,805,566	392,938
Promotional	149,568	119,182	30,386
Total prizes	99,996,233	96,712,105	3,284,128
Retailer compensation	11,679,659	10,977,987	701,672
Advertising/publicity	6,082,488	6,025,220	57,268
Vendor compensation/network expense	6,578,945	6,097,095	481,850
Instant and Pull-tab rental and inventory expense	4,856,817	5,040,893	(184,076)
Other operating expenses	8,660,916	8,699,413	(38,497)
Total operating expenses	137,855,058	133,552,713	4,302,345
Operating income	37,629,563	34,824,098	2,805,465
<b>Non-operating revenues:</b>			
Interest income	926,194	887,377	38,817
Principal demutualization proceeds	1,182,169	-	1,182,169
Total non-operating revenues	2,108,363	887,377	1,220,986
Income before transfers	39,737,926	35,711,475	4,026,451
Transfers to other funds	39,528,425	35,933,474	3,594,951
Change in net assets	209,501	(221,999)	431,500
Net assets beginning of year, as restated	2,104,463	2,326,462	(221,999)
Net assets end of year	\$ 2,313,964	2,104,463	209,501

See accompanying independent auditor's report.

**Schedule 3**

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Lottery Division  
Iowa Department of Revenue and Finance  
Revenues, Expenses and Changes in Net Assets  
Six months ended June 30, 2002

Operating revenues:	
Instant ticket sales	\$ 39,616,421
Pick 3 sales	2,523,236
Powerball sales	23,779,676
Hot Lotto sales	1,277,648
Rolldown Sales	368,100
Freeplay Replay sales	164,306
\$100,000 Cash Game sales	2,052,298
Pull-tab sales	13,782,002
Application fees	14,000
Contract settlement	2,750,000
Other	26,523
Total operating revenues	<u>86,354,210</u>
Operating expenses:	
Prizes:	
Instant ticket	23,727,947
Pick 3	1,569,546
Powerball	11,872,562
Hot Lotto	671,364
Rolldown	157,524
Freeplay Replay	90,857
\$100,000 Cash Game	1,016,836
Pull-tab	9,003,028
Promotional	72,215
Total prizes	<u>48,181,879</u>
Retailer compensation	5,643,814
Advertising/publicity	2,792,960
Vendor compensation/network expense	3,867,736
Instant and Pull-tab rental and inventory expense	2,327,131
Other operating expenses	4,352,404
Total operating expenses	<u>67,165,924</u>
Operating income	19,188,286
Non-operating revenues:	
Interest income	<u>385,772</u>
Income before transfers	19,574,058
Transfers to other funds	<u>19,418,323</u>
Change in net assets	155,735
Net assets beginning of period, as restated (note 12)	<u>2,158,229</u>
Net assets end of period	<u>\$ 2,313,964</u>

See accompanying independent auditor's report.

Lottery Division  
Iowa Department of Revenue and Finance

Analysis of Net Assets

June 30, 2002

Assets:

Restricted assets - cash on deposit with Vehicle Dispatcher	\$ 297,434
Ticket inventories	1,533,223
Capital assets - net	<u>483,307</u>
	<u>\$ 2,313,964</u>

See accompanying independent auditor's report.

**Schedule 5**

Lottery Division  
Iowa Department of Revenue and Finance

Revenue by Game -  
For the Last Five Years

Games	Year ended June 30				
	1998	1999	2000	2001	2002
Instant	\$ 86,303,333	86,675,749	85,958,684	80,164,456	76,754,614
Pick 3	-	3,597,008	3,881,002	3,802,826	4,717,393
Lotto America/Powerball	35,579,748	49,295,596	45,715,822	49,626,328	57,966,865
Rolldown	-	-	-	2,109,976	1,139,610
Hot Lotto	-	-	-	-	1,277,648
Pull-tab	25,690,165	27,231,788	25,921,140	25,722,808	26,324,246
Daily Millions/Cash 4 Life	5,799,350	3,963,258	3,172,828	481,238	-
\$100,000 Cash Game	4,762,181	4,542,717	4,665,929	4,081,822	4,138,619
Freeplay Replay	-	-	395,969	636,538	350,049
Supercash	7,458,064	-	-	-	-
Total	\$ 165,592,841	175,306,116	169,711,374	166,625,992	172,669,044

See accompanying independent auditor's report.

Lottery Division  
Iowa Department of Revenue and Finance

Analysis of Prize Payout  
On-Line, Instant, and Pull Tab Games

For the Last Five Years

Games	Year ended June 30,				
	1998	1999	2000	2001	2002
Instant	61%	61%	61%	61%	61%
Pick 3	-	61%	62%	60%	61%
Lotto America/Powerball	48%	52%	51%	51%	51%
Rolldown	-	-	-	54%	45%
Hot Lotto	-	-	-	-	53%
Pull-tab	66%	66%	65%	65%	65%
Daily Millions/Cash 4 Life	50%	49%	51%	32%	-
\$100,000 Cash Game	49%	49%	48%	49%	49%
Freeplay Replay	-	-	68%	60%	55%
Supercash	49%	-	-	-	-

See accompanying independent auditor's report.

**Lottery Division**  
**Iowa Department of Revenue and Finance**



**OFFICE OF AUDITOR OF STATE  
STATE OF IOWA**

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Chief Deputy Auditor of State

**Independent Auditor's Report on Compliance  
and on Internal Control over Financial Reporting**

To the Members of the Iowa  
Lottery Board:

We have audited the financial statements of the Lottery Division of the Iowa Department of Revenue and Finance as of and for the year ended June 30, 2002, and have issued our report thereon dated October 11, 2002. We conducted our audit in accordance with U.S. generally accepted auditing standards, Chapter 11 of the Code of Iowa and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

**Compliance**

As part of obtaining reasonable assurance about whether the Lottery Division's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts non-compliance 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 non-compliance that are required to be reported under Government Auditing Standards.

**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered Lottery Division's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted a matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Lottery Division's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. The reportable condition is described in the accompanying Schedule of Findings.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we do not believe that the reportable condition described in the accompanying Schedule of Findings is a material weakness.

This report, a public record by law, is intended solely for the information and use of the officials and employees of the Lottery Division, Lottery Board Members and other parties to whom the Division may report. This report is not intended to be and should not be used by anyone other than these specified parties.

We would like to acknowledge the many courtesies and assistance extended to us by personnel of the Lottery Division during the course of our audit. Should you have any questions concerning any of the above matters, we shall be pleased to discuss them with you at your convenience.

RICHARD D. JOHNSON, CPA  
Auditor of State

WARREN G. JENKINS, CPA  
Chief Deputy Auditor of State

October 11, 2002

Lottery Division  
Iowa Department of Revenue and Finance

Schedule of Findings

Year ended June 30, 2002

**Findings Related to Financial Statements:**

**REPORTABLE CONDITION:**

The Office of Auditor of State employed a public accounting firm to study and evaluate certain Lottery data processing controls in effect at Scientific Games International, Inc. The public accounting firm's report dated December 5, 2001 identified conditions where, in their opinion, control objectives had not been achieved, as follows:

- (A) Certain information protection policies and procedures were not fully implemented for the Scientific Games system.
- (B) Physical access to the facility and computing equipment was not restricted to limit personnel to the minimum level of access required to perform their assigned responsibilities.
- (C) System security logging and reporting functions were not fully enabled.
- (D) Certain backup files are not taken off-site. A disaster recovery plan has been established, however, a test of the recovery plan has not been conducted.

The Lottery Division and Scientific Games International, Inc. subsequently addressed or implemented changes to correct the conditions noted. The Office of Auditor of State received a follow-up report from the public accounting firm dated September 13, 2002 which indicated that some of the conditions had been satisfactorily addressed and progress made for others. The remaining items will be reviewed with the next report.

Lottery Division  
Iowa Department of Revenue and Finance

Staff

This audit was performed by:

Pamela J. Bormann, CPA, Manager  
Gina L. Cunningham, CPA, Senior Auditor  
Daniel L. Durbin, Staff Auditor  
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Andrew E. Nielsen, CPA  
Deputy Auditor of State