



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

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NEWS RELEASE

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FOR RELEASE January 2, 2004 515/281-5834

Auditor of State David A. Vautd today released an audit report on the Lottery Division, Iowa Department of Revenue and Finance for the year ended June 30, 2003. 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. Sales revenue and total operating revenue for the year ended June 30, 2003 increased 3.6% and 2.6%, respectively, over the same period one year ago.

Comparative operating data is as follows:

	Year Ended June 30, 2003	Year Ended June 30, 2002	% Increase (Decrease)
<b>Revenues:</b>			
Instant ticket	\$ 80,895,147	76,754,614	5.39%
Pick 3	5,726,212	4,717,393	21.39%
Powerball	54,797,706	57,966,865	(5.47%)
Hot Lotto	5,685,215	1,277,648	344.98%
Monitor vending machine	186,641	-	100.00%
Rolldown	-	1,139,610	(100.00%)
Freeplay Replay	324,617	350,049	(7.27%)
\$100,000 Cash Game	4,228,928	4,138,619	2.18%
Pull-tab	27,022,871	26,324,246	2.65%
Total sales	178,867,337	172,669,044	3.59%
Other	1,192,096	2,815,577	(57.66%)
Total operating revenues	180,059,433	175,484,621	2.61%
Prize expense	104,199,159	99,996,233	4.20%
Other expense	38,042,562	37,858,825	.49%
Transfers to other funds	39,008,480	39,528,425	(1.32%)

An analysis of prizes awarded for the year ended June 30, 2003 is as follows:

Instant ticket prizes	= 62% of Instant ticket sales
Pick 3 prizes	= 62% of Pick 3 sales
Powerball prizes	= 50% of Powerball sales
Monitor vending machine	= 79% of Monitor Vending Ticket sales
Pull-tab prizes	= 65% of Pull-tab sales
Hot Lotto prizes	= 54% of Hot Lotto sales
\$100,000 Cash Game prizes	= 49% of \$100,000 Cash Game sales
Freeplay Replay prizes	= 55% of Freeplay Replay sales

The Lottery Division spent \$6,022,415 on advertising, publicity and promotional prizes for the year ended June 30, 2003, representing 3.3% 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 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  
SCHEDULE OF FINDINGS**

**JUNE 30, 2003**

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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 Services Agency

**Iowa Lottery Board**

Timothy Clausen  
Michael McCoy  
Elaine Baxter  
William Brosnahan  
Mary Junge

Chairperson  
Vice Chairperson  
Member  
Member  
Member

**Department of Revenue and Finance**

Michael D. Ralston

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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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, 2003. These financial statements are the responsibility of the Lottery Division's management. Our responsibility is to express an opinion on these 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, 2003, 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 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, 2003, 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 accordance with Government Auditing Standards, we have also issued our report dated October 24, 2003 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 required the Governmental Accounting Standards Board. We applied limited procedures, consisting principally of inquiries of management regarding methods of measurement and presentation of the required 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 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, 2002 (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.



DAVID A. VAUDT, CPA  
Auditor of State



WARREN G. JENKINS, CPA  
Chief Deputy Auditor of State

October 24, 2003



## **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, 2003. 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 2003:

- Lottery sales have increased for a second straight year led by a sales upswing in the Lottery's core product, instant-scratch tickets. Overall, sales were up about 3.6%, at \$179 million, for fiscal year 2003.
- Despite the fact that fiscal year 2002 lottery revenues to the state were helped by nearly \$4 million in one-time income as compared to one-time income of approximately \$1.2 million for fiscal year 2003, the Lottery was able to make up most of the difference and maintain its revenue to the state. The Lottery raised almost \$48 million, including sales tax of almost \$9 million, for state programs, nearly unchanged from the previous year.
- Since the Lottery's inception in 1985, more than \$1.6 billion has been awarded in prizes and nearly \$828 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, the Statement of Revenues, Expenses and Changes in Net Assets and the Statement of Cash Flows (on pages 12 through 14) 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 24.

### **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 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. For fiscal year 2003, House File (HF) 2627 directed the Lottery to deduct \$500,000 from this calculation resulting in an additional one-time transfer to the State General Fund.

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.

The Statement of Cash Flows:

The statement of cash flows reports cash receipts, cash payments and net changes in cash and cash equivalents resulting from four defined types of activities. It provides answers to such questions as where did cash come from, what was cash used for and what was the change in cash and cash equivalents during the fiscal year.

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 15.

Supplemental Information:

The supplemental information begins on page 24 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 over the past five years by game.

#### **GOVERNMENTAL FINANCIAL ANALYSIS**

The Lottery's assets totaled \$68.3 million at the end of 2003 compared to \$71.9 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 decreased by \$334,529 from fiscal year 2002 to fiscal year 2003. This change is due, in large part, to the additional amount required to be transferred to the State General Fund in accordance with HF 2627 for fiscal year 2003.

	June 30,	
	2003	2002
<b>Net Assets:</b>		
Current assets	\$ 22,229,905	20,835,756
Prize reserve	5,355,730	5,570,033
Investment in prize annuities	40,420,493	45,015,622
Capital assets, net	280,497	483,307
<b>Total assets</b>	<b>\$ 68,286,625</b>	<b>71,904,718</b>
Current liabilities	\$ 20,430,624	18,820,433
Prize reserve fund	5,355,730	5,570,033
Long-term annuity prizes payable	40,420,493	45,015,622
Other long-term liabilities	303,153	184,666
<b>Total liabilities</b>	<b>\$ 66,510,000</b>	<b>69,590,754</b>
Net assets:		
Invested in capital assets	\$ 280,497	483,307
Unrestricted	1,496,128	1,830,657
<b>Total net assets</b>	<b>\$ 1,776,625</b>	<b>2,313,964</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 2003 compared to fiscal year 2002.

	Year ended June 30,	
	2003	2002
<b>Changes in Net Assets:</b>		
<b>Operating revenues:</b>		
Ticket sales	\$ 178,867,337	172,669,044
Application fees	16,825	21,350
Other	1,175,271	2,794,227
Total operating revenues	<u>180,059,433</u>	<u>175,484,621</u>
<b>Operating expenses:</b>		
Prizes	104,199,159	99,996,233
Other operating expenses	38,042,562	37,858,825
Total operating expenses	<u>142,241,721</u>	<u>137,855,058</u>
<b>Operating income</b>	<u>37,817,712</u>	<u>37,629,563</u>
<b>Non-operating revenues:</b>		
Interest income	653,429	926,194
Principal demutualization proceeds	-	1,182,169
Total non-operating revenues	<u>653,429</u>	<u>2,108,363</u>
<b>Income before transfers</b>	<u>38,471,141</u>	<u>39,737,926</u>
<b>Transfers to other funds:</b>		
State General Fund	38,466,350	38,995,651
Iowa Department of Public Health- Gambling Treatment Fund	542,130	532,774
Total transfers to other funds	<u>39,008,480</u>	<u>39,528,425</u>
<b>Changes in net assets</b>	(537,339)	209,501
<b>Net assets beginning of year</b>	<u>2,313,964</u>	<u>2,104,463</u>
<b>Net assets end of year</b>	<u>\$ 1,776,625</u>	<u>2,313,964</u>

As noted above, the Iowa Lottery's net assets decreased by \$537,339, or 23.2%. Transfers of \$38.5 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 2003 were up about 3.6 percent, at \$179 million, compared to \$173 million for fiscal year 2002. Scratch tickets were the Lottery's leading seller during fiscal year 2003, with nearly \$81 million in sales. Sales of the Lottery's Pick 3 game had the largest increase, jumping more than 21 percent for fiscal year 2003 to almost \$6 million.

Other operating revenues decreased significantly by over \$1.5 million. In fiscal year 2002, the Iowa Lottery received a one-time \$2.75 million contract settlement of liquidated damages from Scientific Games International, Inc. During fiscal year 2003, one-time operating revenues only brought in about \$1.2 million, which resulted from a Powerball jackpot that went unclaimed in Indiana. Non-operating revenue also decreased from fiscal year 2002 due to \$1.18 million of proceeds from the Principal Financial Group that was received in 2002. These proceeds were the result of the Principal Financial Group's change to a stock company from a mutual insurer.

The largest expense in total is prize expense, which accounts for 73.3% of all expenses. Prize expense is followed by retailer compensation expense, which accounts for 8.3% 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, 2003 was \$2.2 million, net of accumulated depreciation of \$1.9 million, leaving a net book value of \$.3 million. This investment in capital assets includes both equipment and vehicles, with the majority (80%) 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 2004 fiscal year budget. One of the most significant factors impacting fiscal year 2004 revenues is Senate File 453, new legislation that was passed after the original budget had been approved by the Legislature. This bill, signed into law at the end of May 2003, replaces the Iowa Lottery Division of the Department of Revenue and Finance as of July 1, 2003 with the new Iowa Lottery Authority. Under the legislation, Iowa will become the eighth U.S. Lottery structured on a corporate business model. Because the Iowa Lottery will have greater flexibility and speed in implementing day-to-day business decisions, management expects products to be brought to market more quickly and efficiently and is, therefore, forecasting an overall increase in lottery sales and proceeds to the state for fiscal year 2004.

### **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, 2003

<b>Assets</b>	
Current assets:	
Cash (note 2)	\$ 7,256,362
Restricted assets - cash	635,379
Prepaid expense	45,846
Interest receivable	36,083
Accounts receivable, net (note 7)	3,371,381
Ticket inventories	1,530,904
Investment in prize annuities (note 3)	9,353,950
Total current assets	<u>22,229,905</u>
Noncurrent assets:	
Prize reserve	5,355,730
Investment in prize annuities (note 3)	40,420,493
Capital assets, net (note 4)	280,497
Total noncurrent assets	<u>46,056,720</u>
<b>Total assets</b>	<u>68,286,625</u>
<b>Liabilities</b>	
Current liabilities:	
On-line prizes payable	5,052,211
Instant prizes payable	48,413
Annuity prizes payable (note 3)	9,484,450
Sales tax payable	407,803
Accounts payable	1,707,606
Due to:	
State General Fund	2,500,666
Other state agencies	162,502
Deferred revenue	432,143
Personal services payable	210,040
Compensated absences	424,790
Total current liabilities	<u>20,430,624</u>
Long-term liabilities:	
Prize reserve	5,355,730
Personal services payable	27,540
Compensated absences	275,613
Long-term annuity prizes payable (note 3)	40,420,493
Total long-term liabilities	<u>46,079,376</u>
<b>Total liabilities</b>	<u>66,510,000</u>
<b>Net Assets</b>	
Invested in capital assets	280,497
Unrestricted	1,496,128
<b>Total net assets</b>	<u>\$ 1,776,625</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, 2003

Operating revenues:	
Instant ticket sales	\$ 80,895,147
Pick 3 sales	5,726,212
Powerball sales	54,797,706
Hot Lotto sales	5,685,215
Monitor vending machine sales	186,641
Freeplay Replay sales	324,617
\$100,000 Cash Game sales	4,228,928
Pull-tab sales	27,022,871
Application fees	16,825
Unclaimed Powerball jackpot	1,155,767
Other	19,504
Total operating revenues	<u>180,059,433</u>
Operating expenses:	
Prizes:	
Instant ticket	49,816,015
Pick 3	3,566,507
Powerball	27,403,942
Hot Lotto	3,067,550
Monitor vending machine	147,328
Freeplay Replay	178,769
\$100,000 Cash Game	2,080,865
Pull-tab	17,655,043
Promotional	283,140
Total prizes	<u>104,199,159</u>
Retailer compensation	11,763,229
Advertising/publicity	5,739,275
Vendor compensation/network expense	6,781,087
Instant and Pull-tab rental and inventory expense	4,803,090
Other operating expenses	8,955,881
Total operating expenses	<u>142,241,721</u>
Operating income	37,817,712
Non-operating revenues:	
Interest income	<u>653,429</u>
Income before transfers	<u>38,471,141</u>
Transfers to other funds:	
State General Fund	38,466,350
Iowa Department of Public Health – Gambling Treatment Fund	542,130
Total transfers to other funds	<u>39,008,480</u>
Change in net assets	(537,339)
Net assets beginning of year	<u>2,313,964</u>
Net assets end of year	<u>\$ 1,776,625</u>

See notes to financial statements.

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

## Statement of Cash Flows

Year ended June 30, 2003

Cash flows from operating activities:	
Cash received from customers	\$ 177,566,430
Cash payments for prizes	(112,543,321)
Cash payments to retailers	(11,763,229)
Cash payments to suppliers for goods and services	(19,618,706)
Cash payments to employees for services	(6,262,008)
Other operating revenues	<u>1,186,096</u>
Net cash provided by operating activities	<u>28,565,262</u>
Cash flows from non-capital financing activities:	
Operating transfers	<u>(39,405,414)</u>
Cash flows from capital and related financing activities:	
Acquisition of capital assets	(27,214)
Proceeds from sale of equipment	<u>14,608</u>
Net cash used for capital and related financing activities	<u>(12,606)</u>
Cash flows from investing activities:	
Interest income	664,894
Annuity payments received from insurance companies	<u>9,863,114</u>
Net cash provided by investing activities	<u>10,528,008</u>
Net decrease in cash	(324,750)
Cash at beginning of year	<u>8,216,491</u>
Cash at end of year	<u>\$ 7,891,741</u>
Reconciliation of operating income to net cash provided by operating activities:	
Operating income	<u>\$ 37,817,712</u>
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation	213,250
Gain on sale of capital assets	(2,608)
Change in assets and liabilities:	
(Increase) in prepaid expenses	(20,462)
(Increase) in accounts receivable	(1,712,221)
Decrease in inventories	2,319
Increase in accounts payable	53,820
Increase in prizes payable	1,539,996
Increase in sales tax payable	106,322
Increase in due to other state agencies	1,503
Increase in deferred revenue	291,710
Increase in compensated absences	141,207
Increase in personal services payable	35,828
(Decrease) in current annuities payable	(40,000)
(Decrease) in prize annuities	<u>(9,863,114)</u>
Total adjustments	<u>(9,252,450)</u>
Net cash provided by operating activities	<u>\$ 28,565,262</u>

See notes to financial statements.



Lottery Division  
Iowa Department of Revenue and Finance

Notes to Financial Statements

June 30, 2003

**(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 statements of net assets. 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 earned and expenses are recognized when 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 an Enterprise 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. 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 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, 2003 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 \$20,425,010 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 \$ 29,349,433 that are not subject to credit risk categorization.

Assets totaling \$49,944,598, which includes \$170,155 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 \$39,655 to taxing authorities, of which \$21,295 is classified as due to other state agencies and \$18,360 is classified as accounts payable. The following is a schedule of future payments:

Year Ending June 30,	Current	Long-term	Total Payments
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	-	6,340,000	6,340,000
2009-2013	-	12,415,000	12,415,000
2014-2018	-	6,258,000	6,258,000
Total future value	9,901,114	52,421,771	62,322,885
Less: unamortized discount	(416,664)	(12,001,278)	(12,417,942)
Present value of payments	<u>\$ 9,484,450</u>	<u>40,420,493</u>	<u>49,904,943</u>

#### (4) Capital Assets

Capital assets activity for the year ended June 30, 2003 is as follows:

	Balance Beginning of Year	Additions	Deletions	Balance End of Year
Equipment	\$ 1,374,872	6,933	148,776	1,233,029
Vehicles	1,057,843	15,507	74,176	999,174
Total capital assets	<u>2,432,715</u>	<u>22,440</u>	<u>222,952</u>	<u>2,232,203</u>
Less accumulated depreciation:				
Equipment	(1,303,728)	23,693	148,776	(1,178,645)
Vehicles	(645,680)	189,557	62,176	(773,061)
Total accumulated depreciation	<u>(1,949,408)</u>	<u>213,250</u>	<u>210,952</u>	<u>(1,951,706)</u>
Capital assets, net	<u>\$ 483,307</u>	<u>(190,810)</u>	<u>12,000</u>	<u>280,497</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 contributions to IPERS for the years ended June 30, 2003, 2002, and 2001 were \$283,343, \$271,028, and \$257,606, respectively, equal to the required contributions for each year.

#### (6) Lease Commitment

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 October 4, 2004, and instant ticket machines, which expire by December 31, 2004.

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, 2003:

<u>Year ending June 30,</u>	<u>Amount</u>
2004	\$ 2,568,336
2005	1,225,958
2006	<u>145,768</u>
Total	<u>\$ 3,940,061</u>

Rental expense for all operating leases totaled \$2,630,055 for the year ended June 30, 2003.

**(7) Accounts Receivable**

The components of accounts receivable at June 30, 2003 are as follows:

Due from agents	\$ 3,346,107
Due from others	<u>74,916</u>
Subtotal	3,421,023
Less allowance for doubtful accounts	<u>(49,642)</u>
Accounts receivable, net	<u>\$ 3,371,381</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 and monitor vending machine prizes are paid by the retailer who sold the ticket. Therefore, substantially all of the pull-tab and monitor vending machine 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.

During the year ended June 30, 2003, \$283,140 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, 2003, the MUSL held zero coupon bonds for the Lottery Division to fund future installment payments aggregating \$14,251,036. The current value of those bonds totaled \$12,720,659.

**(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 four 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) the pack has been settled at delivery or settled manually through the terminal; 4) or 21 days have elapsed from the date the pack was activated regardless of validations. As of June 30, 2003, the Lottery Division has 20,274 packs at retailers for which the Lottery has not yet received payment. The receivable and the related deferred revenue of \$2,453,635, 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	\$ 6,082,200
Less:	
Retailer compensation	408,114
Low-tier prize expense	<u>3,220,451</u>
Receivable and deferred amount	<u>\$ 2,453,635</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) Subsequent Event**

On July 1, 2003, the Iowa Lottery Authority was established by 2003 Iowa Acts, Senate File 453, Division XVIII, to operate the Iowa Lottery. As a result of this change, the Iowa Lottery will no longer be a division of the Iowa Department of Revenue and Finance. Instead, the Lottery Authority Board will administer the Lottery. The Lottery is directed and supervised by the chief executive officer of the Lottery, and the Lottery Authority Board has rule-making authority for the Lottery.

**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, 2003

	<u>Six Months Ended</u> <u>June 30, 2003</u>	<u>Year Ended</u> <u>June 30, 2003</u>
Personal services	\$ 3,261,067	6,439,043
Travel	151,417	315,371
Supplies	15,951	104,718
Printing	50,277	76,704
Communications	65,702	132,075
Rentals	288,382	589,006
Utilities	41,660	66,670
Professional fees	27,911	93,901
Outside services and repair	27,253	58,799
Non-capitalized equipment	70,267	168,410
Data processing	5,487	10,886
Reimbursement to state agencies	202,059	391,896
Multi-State administrative expense	118,739	233,326
Depreciation	93,306	213,250
Other	27,546	61,826
	<hr/>	<hr/>
Total	\$ 4,447,024	8,955,881

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, 2003 and 2002

	2003	2002	Increase (Decrease)
Operating revenues:			
Instant ticket sales	\$ 80,895,147	76,754,614	4,140,533
Pick 3 sales	5,726,212	4,717,393	1,008,819
Powerball sales	54,797,706	57,966,865	(3,169,159)
Hot Lotto sales	5,685,215	1,277,648	4,407,567
Monitor vending machine sales	186,641	-	186,641
Rolldown sales	-	1,139,610	(1,139,610)
Freeplay Replay sales	324,617	350,049	(25,432)
\$100,000 Cash Game sales	4,228,928	4,138,619	90,309
Pull-tab sales	27,022,871	26,324,246	698,625
Application fees	16,825	21,350	(4,525)
Contract settlement	-	2,750,000	(2,750,000)
Unclaimed Powerball jackpot	1,155,767	-	1,155,767
Other	19,504	44,227	(24,723)
Total operating revenues	<u>180,059,433</u>	<u>175,484,621</u>	<u>4,574,812</u>
Operating expenses:			
Prizes:			
Instant ticket	49,816,015	46,985,002	2,831,013
Pick 3	3,566,507	2,873,174	693,333
Powerball	27,403,942	29,365,955	(1,962,013)
Hot Lotto	3,067,550	671,364	2,396,186
Monitor vending machine	147,328	-	147,328
Rolldown	-	516,502	(516,502)
Freeplay Replay	178,769	192,433	(13,664)
\$100,000 Cash Game	2,080,865	2,043,731	37,134
Pull-tab	17,655,043	17,198,504	456,539
Promotional	283,140	149,568	133,572
Total prizes	<u>104,199,159</u>	<u>99,996,233</u>	<u>4,202,926</u>
Retailer compensation	11,763,229	11,679,659	83,570
Advertising/publicity	5,739,275	6,082,488	(343,213)
Vendor compensation/network expense	6,781,087	6,578,945	202,142
Instant and Pull-tab rental and inventory expense	4,803,090	4,856,817	(53,727)
Other operating expenses	8,955,881	8,660,916	294,965
Total operating expenses	<u>142,241,721</u>	<u>137,855,058</u>	<u>4,386,663</u>
Operating income	<u>37,817,712</u>	<u>37,629,563</u>	<u>188,149</u>
Non-operating revenues:			
Interest income	653,429	926,194	(272,765)
Principal demutualization proceeds	-	1,182,169	(1,182,169)
Total non-operating revenues	<u>653,429</u>	<u>2,108,363</u>	<u>(1,454,934)</u>
Income before transfers	38,471,141	39,737,926	(1,266,785)
Transfers to other funds	39,008,480	39,528,425	(519,945)
Changes in net assets	(537,339)	209,501	(746,840)
Net assets beginning of year	<u>2,313,964</u>	<u>2,104,463</u>	<u>209,501</u>
Net assets end of year	<u>\$ 1,776,625</u>	<u>2,313,964</u>	<u>(537,339)</u>

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, 2003

Operating revenues:	
Instant ticket sales	\$ 42,849,169
Pick 3 sales	3,016,640
Powerball sales	23,707,610
Hot Lotto sales	3,057,563
Monitor vending machine sales	186,641
Freeplay Replay sales	165,495
\$100,000 Cash Game sales	2,145,393
Pull-tab sales	13,670,118
Application fees	5,700
Unclaimed powerball jackpot	1,155,767
Other	2,106
Total operating revenues	<u>89,962,202</u>
Operating expenses:	
Prizes:	
Instant ticket	26,031,767
Pick 3	1,879,732
Powerball	12,013,099
Hot Lotto	1,622,637
Monitor vending machine	147,328
Freeplay Replay	91,089
\$100,000 Cash Game	1,049,493
Pull-tab	8,930,244
Promotional	79,474
Total prizes	<u>51,844,863</u>
Retailer compensation	5,796,180
Advertising/publicity	3,131,287
Vendor compensation/network expense	3,727,224
Instant and Pull-tab rental and inventory expense	2,468,335
Other operating expenses	4,447,024
Total operating expenses	<u>71,414,913</u>
Operating income	18,547,289
Non-operating revenues:	
Interest income	<u>254,159</u>
Income before transfers	18,801,448
Transfers to other funds	<u>18,933,971</u>
Change in net assets	(132,523)
Net assets beginning of period	<u>1,909,148</u>
Net assets end of period	<u>\$ 1,776,625</u>

See accompanying independent auditor's report.

Lottery Division  
Iowa Department of Revenue and Finance

Analysis of Net Assets

June 30, 2003

Assets:

Restricted assets - cash on deposit with Vehicle Dispatcher	\$ 465,224
Ticket inventories	1,530,904
Capital assets, net	280,497
Less additional transfer in accordance with House File 2627	<u>(500,000)</u>
	<u>\$ 1,776,625</u>

See accompanying independent auditor's report.

**Schedule 5**Lottery Division  
Iowa Department of Revenue and FinanceRevenue by Game -  
For the Last Five Years

Games	Year ended June 30,				
	1999	2000	2001	2002	2003
Instant ticket	\$ 86,675,749	85,958,684	80,164,456	76,754,614	80,895,147
Pick 3	3,597,008	3,881,002	3,802,826	4,717,393	5,726,212
Lotto America/Powerball	49,295,596	45,715,822	49,626,328	57,966,865	54,797,706
Rolldown	-	-	2,109,976	1,139,610	-
Hot Lotto	-	-	-	1,277,648	5,685,215
Pull-tab	27,231,788	25,921,140	25,722,808	26,324,246	27,022,871
Daily Millions/Cash 4 Life	3,963,258	3,172,828	481,238	-	-
\$100,000 Cash Game	4,542,717	4,665,929	4,081,822	4,138,619	4,228,928
Freeplay Replay	-	395,969	636,538	350,049	324,617
Monitor vending machine	-	-	-	-	186,641
Total	<u>\$ 175,306,116</u>	<u>169,711,374</u>	<u>166,625,992</u>	<u>172,669,044</u>	<u>178,867,337</u>

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,				
	1999	2000	2001	2002	2003
Instant ticket	61%	61%	61%	61%	62%
Pick 3	61%	62%	60%	61%	62%
Lotto America/Powerball	52%	51%	51%	51%	50%
Rolldown	-	-	54%	45%	-
Hot Lotto	-	-	-	53%	55%
Pull-tab	66%	65%	65%	65%	65%
Daily Millions/Cash 4 Life	49%	51%	32%	-	-
\$100,000 Cash Game	49%	48%	49%	49%	49%
Freeplay Replay	-	68%	60%	55%	55%
Monitor vending machine	-	-	-	-	79%

See accompanying independent auditor's report.

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





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

David A. Vaudt, CPA  
Auditor of State

State Capitol Building  
Des Moines, Iowa 50319-0004

Telephone (515) 281-5834 Facsimile (515) 242-6134

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, 2003, and have issued our report thereon dated October 24, 2003. 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 the 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.



DAVID A. VAUDT, CPA  
Auditor of State



WARREN G. JENKINS, CPA  
Chief Deputy Auditor of State

October 24, 2003

Lottery Division  
Iowa Department of Revenue and Finance

Schedule of Findings

Year ended June 30, 2003

**Findings Related to the Financial Statements:**

**INSTANCES OF NON-COMPLIANCE:**

No matters were noted.

**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 February 21, 2003 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 according to the scheduled intervals.
- (E) Certain logs and checklists were not always complete.

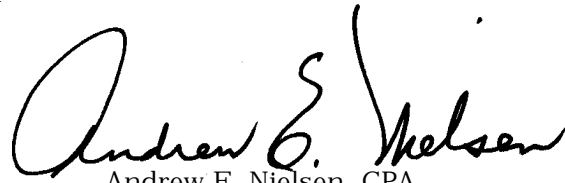
The Lottery Division and Scientific Games International, Inc. subsequently addressed or implemented changes to correct the conditions noted. The Office of Auditor of State received a follow-up report from the public accounting firm dated October 3, 2003 which indicated that some of the conditions had 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  
Kelly V. Rea, CPA, Staff Auditor  
Daniel L. Durbin, Staff Auditor  
Sarah D. McFadden, CPA, Staff Auditor  
Michael J. Gentry, Jr., CPA, Assistant Auditor  
Heather L. Templeton, Assistant Auditor

A handwritten signature in black ink that reads "Andrew E. Nielsen". The signature is written in a cursive style with a large initial "A" and "N".

Andrew E. Nielsen, CPA  
Deputy Auditor of State