



OFFICE OF AUDITOR OF STATE
STATE OF IOWA

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NEWS RELEASE

FOR RELEASE January 9, 2006

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Auditor of State David A. Vaudt today released an audit report on the Iowa Lottery Authority for the year ended June 30, 2005. The Iowa Lottery Authority 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, 2005 increased less than 1% over the same period one year ago.

Comparative operating data is as follows:

	Year Ended June 30, 2005	Year Ended June 30, 2004	% Increase (Decrease)
Revenues:			
Instant ticket	\$103,259,272	95,258,080	8.40%
Pick 3	6,200,109	6,333,801	(2.11%)
Pick 4	2,042,499	1,662,015	22.89%
Powerball	54,244,379	65,967,337	(17.77%)
Hot Lotto	10,443,903	7,717,962	35.32%
Monitor vending	-	1,257,087	(100.00%)
TouchPlay (net)	6,428,123	303,079	2,020.94%
Freeplay Replay	-	77,330	(100.00%)
\$100,000 Cash Game	4,426,833	4,430,118	(0.07%)
Pull-tab	23,624,094	25,528,391	(7.46%)
Other	337,031	1,370,252	(75.40%)
Total operating revenue	211,006,243	209,905,452	0.52%
Prize expense	113,455,673	114,456,063	(0.87%)
Other expense	45,914,605	40,606,995	13.07%
Transfers to other funds	51,094,109	55,791,763	(8.42%)

An analysis of prizes awarded for the year ended June 30, 2005 is as follows:

Instant ticket prizes = 59% of Instant ticket sales
Pick 3 prizes = 58% of Pick 3 sales
Pick 4 prizes = 58% of Pick 4 sales
Powerball prizes = 48% of Powerball sales
Hot Lotto prizes = 49% of Hot Lotto sales
\$100,000 Cash Game prizes = 43% of \$100,000 Cash Game sales
Pull-tab prizes = 62% of Pull-tab sales

The Iowa Lottery Authority spent \$5,911,199 on advertising and publicity for the year ended June 30, 2005, representing 2.8% of revenue. Iowa law allows the Iowa Lottery Authority to spend up to 4% of revenue for the marketing of lottery games.

A copy of the audit report is available for review at the Iowa Lottery Authority, in the Office of Auditor of State and on the Auditor of State's web site at <http://auditor.iowa.gov/reports/reports.htm>.

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IOWA LOTTERY AUTHORITY
INDEPENDENT AUDITOR'S REPORTS
BASIC FINANCIAL STATEMENTS AND
SUPPLEMENTARY INFORMATION
SCHEDULE OF FINDINGS

JUNE 30, 2005

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Iowa Lottery Authority

Officials

Name

Title

State

Honorable Thomas J. Vilsack
Michael L. Tramontina
Dennis C. Prouty

Governor
Director, Department of Management
Director, Legislative Services Agency

Iowa Lottery Authority Board of Directors

Mary Junge
Elaine Baxter
William Brosnahan
Timothy Clausen
Michael McCoy

Chairperson
Vice-Chairperson
Member
Member
Member

Iowa Lottery Authority

Dr. Edward Stanek
Steven King

Chief Executive Officer
Vice President of Finance, Chief Financial Officer

Iowa Lottery Authority



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Independent Auditor's Report

To the Board Members of the Iowa
Lottery Authority:

We have audited the accompanying financial statements of the Iowa Lottery Authority, a component unit of the State of Iowa, as of and for the year ended June 30, 2005, which collectively comprise the Iowa Lottery Authority's basic financial statements listed in the table of contents. These financial statements are the responsibility of the Iowa Lottery Authority'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 and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audit provides a reasonable basis for our opinion.

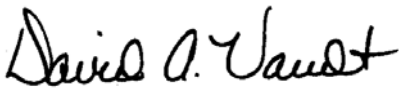
As discussed in Note 1, the financial statements of the Iowa Lottery Authority are intended to present the financial position, and the changes in financial position and cash flows, of only that portion of the financial reporting entity of the State of Iowa that is attributable to the transactions of the Iowa Lottery Authority. They do not purport to, and do not, present fairly the financial position of the State of Iowa as of June 30, 2005, 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 Iowa Lottery Authority at June 30, 2005, 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.

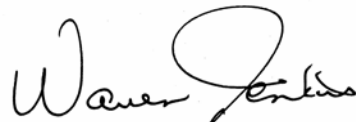
In accordance with Government Auditing Standards, we have also issued our report dated December 7, 2005 on our consideration of the Iowa Lottery Authority's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations and contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

Management's Discussion and Analysis on pages 7 through 11 is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board. We applied limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. We did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Iowa Lottery Authority's basic financial statements. 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, 2004 (which are not presented herein) and expressed unqualified opinions on those financial statements. Other supplementary information included in Schedules 1 through 5 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 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

December 7, 2005

MANAGEMENT'S DISCUSSION AND ANALYSIS

Management of the Iowa Lottery Authority (Lottery) provides this Management's Discussion and Analysis of the Lottery's annual financial statements. This narrative overview and analysis of the financial activities of the Lottery is for the fiscal year ended June 30, 2005. We encourage readers to consider this information in conjunction with the Lottery's financial statements, which follow this section.

FINANCIAL HIGHLIGHTS

The Iowa Lottery achieved record sales in its latest fiscal year and raised more than \$51 million for state programs. Here are some key financial highlights from fiscal year 2005:

- Lottery sales increased for a fourth straight year. For fiscal year 2005, Lottery sales totaled more than \$210.6 million, which marked the highest sales total for the Lottery in its 20-year history. Overall, sales were up 1 percent in fiscal year 2005 after an 11 percent increase in fiscal year 2004 and a 3.6 percent increase in fiscal year 2003.
- The Lottery welcomed the addition of 350 Iowa Casey's General Stores to its retailer base in fiscal year 2005. Installation of equipment in Casey's General Stores began in mid-September of 2004 and by late January, those installations were completed. Although the additions meant a one-time expenditure of about \$2 million by the Lottery for satellite communications equipment, ticket-vending equipment and point-of-sale material for those locations during 2005, the long-term benefits to the state will more than offset the cost in years to come.
- The Lottery, in partnership with amusement operators from across the state, continued its statewide deployment of TouchPlay machines throughout fiscal year 2005 in efforts to meet customer demand. By the end of June, the machines produced more than \$6.4 million in net TouchPlay revenues.
- Lottery proceeds for state programs were more than \$51 million, a decrease of about 8 percent from the previous year. The main factors that affected the Lottery's 2005 profits included: the cost of equipping Casey's General Stores locations in Iowa to sell lottery products, a reduction in other revenue of more than \$1 million resulting from one-time adjustments in fiscal year 2004 for a MUSL prize reserve, a Freeplay Replay prize reserve and a decrease in Powerball sales, which are expected to rebound in the upcoming fiscal year.
- Since the Lottery's inception in 1985, more than \$1.88 billion has been awarded in prizes and nearly \$935 million has been raised for state programs.

USING THIS ANNUAL REPORT

This discussion and analysis are intended to serve as an introduction to the Lottery's basic financial statements. The 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 14 through 16) provide information about the activities of the Lottery as a whole and present a longer-term view of the Lottery's finances. These basic financial statements also include the notes to financial statements that explain some of the information in the statements and provide more detail. Supplementary information is in schedule form and begins on page 28.

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 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 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 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 quarterly 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 inventories and the net book value of capital assets, less related bonds payable.

The Statement of Revenues, Expenses and Changes in Net Assets presents information showing how the 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 ticket sales and related proceeds transfers to the state serve as useful indicators of the Lottery's future ability to provide a steady, reliable stream of revenue to the state.

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 Financial Statements:

The notes provide additional information essential to a full understanding of the data provided in the basic financial statements. The notes to financial statements can be found beginning on page 17.

Supplementary Information:

The supplementary information begins on page 28. Schedule 1 provides detailed information about other operating expenses by object. Schedule 2 shows revenues and expenses by individual Lottery games. Schedule 3 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.

FINANCIAL ANALYSIS

The Lottery's assets totaled \$69.7 million at the end of 2005 compared to \$67.4 million at the end of the previous year. Unrestricted net assets increased by \$301,540 from fiscal year 2004 to fiscal year 2005. Unrestricted net assets represent assets used to meet the Lottery's ongoing obligations to vendors and creditors.

In addition to these increases, net assets invested in capital assets rose by \$638,550, an increase of over 200 percent. The net assets invested in capital assets are net of bonds payable of \$7,500,000 (\$5,500,000 of long-term bonds payable and \$2,000,000 of current bonds payable). The primary reason for this increase was the Lottery's purchase, rather than rental, of ticket vending machines and a headquarters building.

Net Assets:	June 30,	
	2005	2004
Current assets	\$ 31,008,729	30,456,887
Prize reserve	4,243,090	4,234,782
Investment in prize annuities	25,992,771	32,380,859
Capital assets, net	8,429,718	291,168
Total assets	\$ 69,674,308	67,363,696
Current liabilities	\$ 31,366,031	29,084,429
Prize reserve	4,243,090	4,234,782
Long-term annuity prizes payable	25,992,771	32,380,859
Long-term bonds payable	5,500,000	-
Other long-term liabilities	238,127	269,427
Total liabilities	\$ 67,340,019	65,969,497
Net assets:		
Invested in capital assets, net of related debt	\$ 929,718	291,168
Unrestricted	1,404,571	1,103,031
Total net assets	\$ 2,334,289	1,394,199

Two more useful indicators of the 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 2005 as compared to fiscal year 2004.

	Year ended June 30,	
	2005	2004
Changes in Net Assets:		
Operating revenues:		
Ticket sales	\$ 210,669,212	208,535,200
Application fees	61,225	18,450
Other	275,806	1,351,802
Total operating revenues	211,006,243	209,905,452
Operating expenses:		
Prizes	113,455,673	114,456,963
Other operating expenses	45,914,605	40,606,995
Total operating expenses	159,370,278	155,063,958
Operating income	51,635,965	54,841,494
Non-operating revenues (expenses):		
Interest income	608,980	567,843
Interest expense	(210,746)	-
Net non-operating revenues	398,234	567,843
Income before transfers	52,034,199	55,409,337
Transfers to other funds:		
State General Fund	50,036,035	55,160,347
Iowa Department of Public Health- Gambling Treatment Fund	1,058,074	631,416
Total transfers to other funds	51,094,109	55,791,763
Changes in net assets	940,090	(382,426)
Net assets beginning of year	1,394,199	1,776,625
Net assets end of year	\$ 2,334,289	1,394,199

Lottery sales for fiscal year 2005 were up 1 percent, at \$210.7 million, compared to \$208.5 million for fiscal year 2004. TouchPlay revenue grew to \$6,428,123 in fiscal year 2005. Instant-scratch tickets, the Lottery's traditional sales leader, claimed that spot again in fiscal year 2005, with sales increasing by more than 8 percent to \$103.3 million. In addition, sales of Hot Lotto rose more than 35 percent to \$10.4 million while sales of the Pick 4 game increased by over 22 percent to bring in more than \$2.0 million in sales for fiscal year 2005. Powerball sales for the year, however, were down more than 17 percent to \$54.2 million. Also declining were pull-tab sales, which fell \$1.9 million from \$25.5 million in fiscal year 2004 to \$23.6 million in fiscal year 2005. The main factors involved in the pull-tab sales drop are: the spread of illegal Ad-Tab games in Iowa and the prevalence of amusement devices in retail locations that also sell Iowa Lottery tickets. Although overall sales achieved record levels, the decrease in Powerball sales, which has a higher profit margin than most other lottery products, combined with the cost of equipping the Casey's General Stores and decline in pull-tab sales, resulted in an overall decrease in profits transferred for fiscal year 2005.

The Statement of Revenues, Expenses and Changes in Net Assets also shows other operating revenues decreased by approximately 80%. In fiscal year 2004, the Lottery received a one-time MUSL prize reserve adjustment totaling \$497,966 and one-time revenue of \$840,087 remaining from the Freeplay Replay prize reserve funds. The last drawing for Freeplay Replay took place on September 20, 2003. During fiscal year 2005, one-time operating revenues only brought in a little over \$275 thousand.

The largest expense in total is prize expense, which accounts for 53.9% of all sales. Prize expense is followed by retailer compensation expense, which accounts for 8.2% of all sales. Retailers earn commissions on sales of all Lottery products with the exception of TouchPlay. TouchPlay amusement operators earn commissions based on the net sales (gross sales less prizes). In addition, the Lottery awards incentive compensation to retailers who increase their sales from a base level determined by the Lottery.

As noted in the table on page 10, the Lottery's net assets increased by \$940,090, or 67.4%, which resulted primarily from the expiration of the additional transfer of \$500,000 mandated by the Legislature for fiscal year 2004. The other reason for the Lottery's increase in net assets is the net capital assets in excess of the bonds payable balance resulting from the purchase of ticket vending machines and a headquarters building.

Proceeds transfers of over \$50.0 million were made to the State General Fund and transfers totaling nearly \$1.1 million were made to the Gambling Treatment Fund.

CAPITAL ASSETS AND DEBT ADMINISTRATION

The Lottery's investment in capital assets at June 30, 2005 was \$10.7 million, net of accumulated depreciation of \$2.3 million, leaving a book value of \$8.4 million. This investment in capital assets includes equipment, vehicles, land and building, with the majority (75% of the net) invested in instant and pull-tab ticket vending machines.

On October 4, 2004, the Lottery issued \$8.8 million of revenue bonds. The Lottery used the proceeds from these bonds for the purchase, financing and installation of instant and pull-tab ticket vending machines. In addition, the proceeds were used for the purchase and renovation of a building for the Lottery's headquarters in Des Moines, IA. The interest rate on these revenue bonds is 3.284% per annum and the bonds mature over the next fourteen years.

During the year ended June 30, 2005, \$1.3 million of revenue bonds were retired and \$190,224 of interest expense was paid. As of June 30, 2005, the remaining principal balance for these bonds was \$7.5 million.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The Lottery's management considered many factors when setting the 2006 fiscal year budget and has forecasted an overall increase in Lottery sales and proceeds to the state for fiscal year 2006. The Lottery expects the increase to be fueled by the continued introduction of the new product line, TouchPlay, recent changes announced in Powerball that will take affect in August 2005, and the reduction in expenses resulting from the purchase, rather than rental, of a headquarters building and ticket vending machines.

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, 2323 Grand Avenue, Des Moines, IA 50312-4999.

Iowa Lottery Authority

Basic Financial Statements

Exhibit A

Iowa Lottery Authority
Statement of Net Assets
June 30, 2005

Assets	
Current assets:	
Cash	\$ 15,601,324
Restricted assets - cash	1,309,152
Prepaid expense	84,274
Interest receivable	124,844
Accounts receivable, net	3,949,309
Ticket inventories	1,096,220
Investment in prize annuities	8,843,606
Total current assets	<u>31,008,729</u>
Noncurrent assets:	
Prize reserve	4,243,090
Investment in prize annuities	25,992,771
Capital assets, net	8,429,718
Total noncurrent assets	<u>38,665,579</u>
Total assets	<u>69,674,308</u>
Liabilities	
Current liabilities:	
On-line prizes payable	2,813,265
TouchPlay prizes payable	25,527
Annuity prizes payable	8,974,106
Sales tax payable	125
Accounts payable	1,494,973
Due to:	
State General Fund	14,470,768
Other state agencies	435,194
Interest payable	20,522
Bonds payable	2,000,000
Deferred revenue	202,125
Personal services payable	361,832
Compensated absences	567,594
Total current liabilities	<u>31,366,031</u>
Long-term liabilities:	
Prize reserve	4,243,090
Bonds payable	5,500,000
Personal services payable	5,146
Compensated absences	232,981
Long-term annuity prizes payable	25,992,771
Total long-term liabilities	<u>35,973,988</u>
Total liabilities	<u>67,340,019</u>
Net Assets	
Invested in capital assets, net of related debt	929,718
Unrestricted	1,404,571
Total net assets	<u>\$ 2,334,289</u>

See notes to financial statements.

Iowa Lottery Authority
 Statement of Revenues, Expenses and Changes in Net Assets
 Year ended June 30, 2005

Operating revenues:	
Instant ticket sales	\$ 103,259,272
Pick 3 sales	6,200,109
Pick 4 sales	2,042,499
Powerball sales	54,244,379
Hot Lotto sales	10,443,903
TouchPlay sales (net)	6,428,123
\$100,000 Cash Game sales	4,426,833
Pull-tab sales	23,624,094
Application fees	61,225
Other	275,806
Total operating revenues	<u>211,006,243</u>
Operating expenses:	
Prizes:	
Instant ticket	60,759,895
Pick 3	3,596,814
Pick 4	1,179,953
Powerball	25,878,086
Hot Lotto	5,111,857
\$100,000 Cash Game	1,897,416
Pull-tab	14,699,032
Promotional	332,620
Total prizes	<u>113,455,673</u>
Retailer compensation	17,341,859
Advertising/publicity	5,911,199
Vendor compensation/network expense	7,859,205
Instant and Pull-tab rental and inventory expense	3,914,178
Other operating expenses	10,888,164
Total operating expenses	<u>159,370,278</u>
Operating income	51,635,965
Non-operating revenues (expenses):	
Interest income	608,980
Interest expense	(210,746)
Net non-operating revenues	<u>398,234</u>
Income before transfers	<u>52,034,199</u>
Transfers to other funds:	
State General Fund	50,036,035
Iowa Department of Public Health – Gambling Treatment Fund	1,058,074
Total transfers to other funds	<u>51,094,109</u>
Change in net assets	940,090
Net assets beginning of year	<u>1,394,199</u>
Net assets end of year	<u>\$ 2,334,289</u>

See notes to financial statements.

Exhibit C

Iowa Lottery Authority
Statement of Cash Flows
Year ended June 30, 2005

Cash flows from operating activities:	
Cash received from customers	\$ 209,932,842
Cash paid for prizes	(123,945,273)
Cash paid to retailers	(17,341,859)
Cash paid to suppliers for goods and services	(20,190,370)
Cash paid to employees for services	(7,370,861)
Other operating revenues	318,035
	<u>41,402,514</u>
Net cash provided by operating activities	41,402,514
Cash flows from non-capital financing activities:	
Operating transfers	<u>(50,211,567)</u>
Cash flows from capital and related financing activities:	
Proceeds from capital debt	8,800,000
Principal paid on capital debt	(1,300,000)
Interest paid on capital debt	(190,224)
Acquisition of capital assets	(8,810,241)
Proceeds from sale of capital assets	65,197
	<u>(1,435,268)</u>
Net cash used for capital and related financing activities	(1,435,268)
Cash flows from investing activities:	
Interest income	549,817
Annuity payments received from insurance companies	9,901,114
	<u>10,450,931</u>
Net cash provided by investing activities	10,450,931
Net increase in cash	206,610
Cash at beginning of year	<u>16,703,866</u>
Cash at end of year	<u>\$ 16,910,476</u>
Reconciliation of operating income to net cash provided by operating activities:	
Operating income	<u>\$ 51,635,965</u>
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation	625,491
Gain on sale of capital assets	(18,996)
Change in assets and liabilities:	
Decrease in prepaid expense	24,356
(Increase) in accounts receivable	(825,971)
Decrease in ticket inventories	5,202
Increase in accounts payable	297,198
(Decrease) in prizes payable	(618,134)
(Decrease) in sales tax payable	(38)
(Decrease) in due to other state agencies	(39,440)
Increase in deferred revenue	76,446
Increase in compensated absences	76,460
Increase in personal services payable	69,089
(Decrease) in current annuities payable	(4,000)
(Decrease) in prize annuities	(9,901,114)
	<u>(10,233,451)</u>
Total adjustments	(10,233,451)
Net cash provided by operating activities	<u>\$ 41,402,514</u>

See notes to financial statements.

Iowa Lottery Authority

Notes to Financial Statements

June 30, 2005

(1) Summary of Significant Accounting Policies

The Iowa Lottery Authority was created by the 2003 Iowa Legislature as the successor to the Lottery Division of the Iowa Department of Revenue and Finance.

The Iowa Lottery Authority, a component unit of the State of Iowa, is a public instrumentality of the State of Iowa with comprehensive and extensive powers to operate a state lottery. The Iowa Lottery Authority has the responsibility to operate and manage lottery games in a manner to provide continuing entertainment to the public, maximize revenues and transfer the net proceeds to the General Fund of the State of Iowa and ensure the lottery is operated with integrity and dignity and free from political influence. The Iowa Lottery Authority 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 Iowa Lottery Authority is a Chief Executive Officer appointed by the Governor. The Governor also appoints the Iowa Lottery Authority Board, consisting of five members.

The Board and Chief Executive Officer 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 Iowa Lottery Authority consists of five sections: Security, Finance, Operations, Marketing and Sales.

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

A. Reporting Entity

For financial reporting purposes, the Iowa Lottery Authority has included all funds. The Iowa Lottery Authority 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 Iowa Lottery Authority are such that exclusion would cause the Iowa Lottery Authority'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 Iowa Lottery Authority 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 Iowa Lottery Authority. The Iowa Lottery Authority has no component units which meet the Governmental Accounting Standards Board criteria.

B. Fund Accounting

The Iowa Lottery Authority 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 report activities for which fees are charged to external users for goods or services.

C. Measurement Focus

Enterprise Funds are accounted for on a cost of services or "capital maintenance" measurement focus. This means all assets and liabilities, whether current or non-current, associated with their activity are included on the statement of net assets, with the difference 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 Iowa Lottery Authority 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 Iowa Lottery Authority distinguishes operating revenues and expenses from non-operating 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 expenses not meeting this definition are reported as non-operating revenues and expenses.

E. Budgets and Budgetary Accounting

Budgetary control is exercised over the Iowa Lottery Authority by the Board and Chief Executive Officer through the budgetary process prescribed in Chapter 99G of the Iowa Code.

F. Revenue Recognition

Sales of instant, pull-tab, on-line, and TouchPlay 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. TouchPlay sales are recognized upon the sale of the ticket to the player. TouchPlay sales are recorded net of prize expense.

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 Iowa Lottery Authority as received.

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

Restricted Assets - Cash

The Iowa Lottery Authority 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 Iowa Lottery Authority during the fiscal year which are not owed to jackpot winners until the next fiscal year. In addition, unused proceeds from the bond issuance are restricted for specific purposes, including servicing the debt as it comes due.

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 Iowa Lottery Authority 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 buildings, vehicles and equipment, are defined by the Iowa Lottery Authority as assets with an initial individual cost of more than \$5,000 and an estimated useful life in excess of two years and assets purchased through special financing arrangements. Such assets are recorded at historical cost.

The costs of normal maintenance and repair 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>
Buildings	39
Equipment	5-10
Vehicles	2-4

Prize Liabilities

The prize liabilities for the \$100,000 Cash Game, the Pick 3 Game and the Pick 4 Game are determined by actual matches and are recognized daily after the drawings are held. The prize liabilities for Powerball and Hot Lotto are determined and recognized twice a week after the jackpot drawings are held. Prizes for Pick 3, Pick 4, 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. The prize liability for TouchPlay represents funds the Lottery collects and pays in excess of \$600.

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 and Investments

The Iowa Lottery Authority's deposits with the office of the Treasurer of State throughout the period and at June 30, 2005 were entirely covered by federal depository insurance or by the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa.

The Iowa Lottery Authority held investments totaling \$34,836,377 for the purpose of paying installment prizes. The Iowa Lottery Authority 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 99G.9 of the Code of Iowa.

The Iowa Lottery Authority is responsible for investing in insurance annuities. The Iowa Lottery Authority had investments in insurance annuities with a fair value of \$17,953,542 that are not subject to credit risk categorization.

The Treasurer of State is responsible for investing the Iowa Lottery Authority's funds, except for insurance annuities. The Iowa Lottery Authority's investments in U.S.

government securities with a fair value of \$16,882,835 at June 30, 2005 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.

At June 30, 2005, the Iowa Lottery Authority had the following fixed income investments:

Investment Type	Fair Value
U.S. Government Treasuries, Notes and Bonds	\$ 9,983,483
U.S. Government Agencies	6,899,352
Total	<u>\$ 16,882,835</u>

Credit Risk. The credit risk ratings of the fixed income investments at June 30, 2005 were as follows:

	Treasury	Agencies	AAA	Total
Fixed Income	\$ 9,764,640	6,899,352	218,843	16,882,835

Interest Rate Risk. At June 30, 2005, the effective duration and composition of the fixed income investments were as follows:

Investment Type	Fair Value	Effective Duration
U.S. Government Treasuries, Notes and Bonds	\$ 9,983,483	4.52
U.S. Government Agencies	6,899,352	5.62
Total	<u>\$ 16,882,835</u>	<u>4.97</u>

(3) Investment in Prize Annuities and Annuity Prizes Payable

Assets totaling \$34,994,272, which includes \$34,836,377 of investments and \$157,895 of restricted assets, are held by the Iowa Lottery Authority 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 \$27,395 to taxing authorities, of which \$17,395 is classified as due to other state agencies and \$10,000 is classified as accounts payable. The following is a schedule of future payments:

Year Ending June 30,	Current	Long-term	Total Payments
2006	\$ 9,355,574	-	9,355,574
2007	-	8,152,083	8,152,083
2008	-	6,340,000	6,340,000
2009	-	4,377,000	4,377,000
2010	-	2,895,000	2,895,000
2011-2015	-	8,119,000	8,119,000
2016-2018	-	3,282,000	3,282,000
Total future value	9,355,574	33,165,083	42,520,657
Less: unamortized discount	(381,468)	(7,172,312)	(7,553,780)
Present value of payments	<u>\$ 8,974,106</u>	<u>25,992,771</u>	<u>34,966,877</u>

(4) Accounts Receivable

The components of accounts receivable at June 30, 2005 are as follows:

Due from agents	\$ 3,936,593
Due from others	<u>52,683</u>
Subtotal	3,989,276
Less allowance for doubtful accounts	<u>(39,967)</u>
Accounts receivable, net	<u>\$ 3,949,309</u>

Bad debt expense of \$13,193 for the year ended June 30, 2005 was charged against instant ticket sales.

(5) Capital Assets

Capital assets activity for the year ended June 30, 2005 is as follows:

	Balance Beginning of Year	Additions	Deletions	Balance End of Year
Capital assets not being depreciated:				
Land	\$ -	392,110	-	392,110
Construction in progress	-	175,881	-	175,881
	-	<u>567,991</u>	-	<u>567,991</u>
Capital assets being depreciated:				
Buildings	-	953,035	-	953,035
Equipment	1,185,639	6,875,386	-	8,061,025
Vehicles	1,012,881	413,829	251,651	1,175,059
Total capital assets being depreciated	<u>2,198,520</u>	<u>8,242,250</u>	<u>251,651</u>	<u>10,189,119</u>
Less accumulated depreciation for:				
Buildings	-	14,255	-	14,255
Equipment	1,139,833	493,908	-	1,633,741
Vehicles	767,519	117,328	205,451	679,396
Total accumulated depreciation	<u>1,907,352</u>	<u>625,491</u>	<u>205,451</u>	<u>2,327,392</u>
Total capital assets being depreciated, net	<u>291,168</u>	<u>7,616,759</u>	<u>46,200</u>	<u>7,861,727</u>
Capital assets, net	<u>\$ 291,168</u>	<u>8,184,750</u>	<u>46,200</u>	<u>8,429,718</u>

(6) Revenue Bonds Payable

The Iowa Lottery Authority issued \$8,800,000 of revenue bonds on October 4, 2004 with an interest rate of 3.284% per annum. The proceeds were used for the purchase, financing and installation of instant ticket and pull-tab vending machines and also for the purchase and renovation of a building for the Iowa Lottery Authority's headquarters. The bonds mature over the next fourteen years. The remaining principal balance at June 30, 2005 was \$7,500,000.

The following is a schedule by year of the future minimum payments required:

Year Ending June 30,	Principal	Interest	Total
2006	\$ 2,000,000	246,263	2,246,263
2007	2,000,000	180,592	2,180,592
2008	2,000,000	114,923	2,114,923
2009	100,000	49,252	149,252
2010	100,000	45,969	145,969
2011-2015	500,000	180,593	680,593
2016-2019	800,000	65,670	865,670
Total	\$ 7,500,000	883,262	8,383,262

During the year ended June 30, 2005, \$1,300,000 of revenue bonds were retired.

(7) Lease Commitment

The Iowa Lottery Authority 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, 2010. In addition, the Iowa Lottery Authority rented pull-tab and instant ticket machines under long-term operating leases which expired December 31, 2004.

The following is a schedule, by year, of the 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, 2005:

Year ending June 30,	Amount
2006	\$ 131,400
2007	73,800
2008	73,800
2009	79,950
2010	79,950
Total	\$ 438,900

Rental expense for all operating leases totaled \$1,527,912 for the year ended June 30, 2005.

(8) Pension and Retirement Benefits

The Iowa Lottery Authority 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 Iowa Lottery Authority is required to contribute 5.75% of annual covered payroll for the years ended June 30, 2005, 2004 and 2003. Contribution requirements are established by state statute. The Iowa Lottery Authority's contributions to IPERS for the years ended June 30, 2005, 2004 and 2003 were \$329,050, \$327,398 and \$283,343, respectively, equal to the required contributions for each year.

(9) 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 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.

TouchPlay sale revenues are recorded net of prize expense in the financial statements. TouchPlay prizes less than or equal to \$600 are paid by the retailer and prizes greater than \$600 are paid by the Iowa Lottery Authority.

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 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 either 2 or 3 of 3 numbers. A player may win from \$30 to \$3,000 depending on the play type selected and the play amount. Play types are Straight, Box, Straight/Box, Front Pair or Back Pair and require the player to match all numbers in the exact order as drawn, match all three numbers in any order, match either exact and/or any order, first two numbers or last two numbers in exact order, respectively.

The Pick 4 prize expense is comprised of winners who match either 2 or 4 of 4 numbers. A player may win from \$30 to \$30,000 depending on the play type selected and the play amount. Play types are Straight, Box, Straight/Box, Front Pair or Back Pair and require the player to match all numbers in the exact order as drawn, match all four numbers in any order, match either exact and/or any order, first two numbers or last two numbers in exact order, respectively.

During the year ended June 30, 2005, \$332,620 in prizes were distributed through various promotional activities.

(10) 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 Authority'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 Iowa Lottery Authority's account on or before the anniversary date of the jackpot.

At June 30, 2005, the MUSL held zero coupon bonds for the Iowa Lottery Authority to fund future installment payments aggregating \$10,108,506. The current value of those bonds totaled \$9,593,554.

(11) Instant Ticket Packs

The Iowa Lottery Authority 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, or 4) 21 days have elapsed from the date the pack was activated regardless of validations. As of June 30, 2005, the Iowa Lottery Authority has 23,718 packs at retailers which have not yet settled. The receivable and the related deferred revenue of \$3,453,183, calculated as shown below, have not been included in the Iowa Lottery Authority's financial statements since the sales associated with these packs have not been recognized.

Unsettled packs	\$ 7,115,400
Less:	
Retailer compensation	477,423
Low-tier prize expense	<u>3,184,794</u>
Potential receivable and deferred amount	<u>\$ 3,453,183</u>

(12) 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 Iowa Lottery Authority has purchased commercial insurance for certain risks.

Iowa Lottery Authority

Supplementary Information

Schedule 1

Iowa Lottery Authority
Other Operating Expenses
For the year ended June 30, 2005

Personal services	\$ 7,516,410
Travel	389,080
Supplies	103,143
Printing	24,621
Postage	30,781
Communications	130,550
Rentals	624,527
Utilities	84,421
Professional fees	161,862
Outside services and repair	287,010
Non-capitalized equipment	280,412
Data processing	18,256
Reimbursement to state agencies	364,998
Multi-State administrative expense	118,272
Depreciation	625,491
Insurance	88,605
Other	<u>39,725</u>
Total	<u><u>\$ 10,888,164</u></u>

See accompanying independent auditor's report.

Iowa Lottery Authority
Revenues, Expenses and Changes in Net Assets
Years ended June 30, 2005 and 2004

	2005	2004	Increase (Decrease)
Operating revenues:			
Instant ticket sales	\$ 103,259,272	95,258,080	8,001,192
Pick 3 sales	6,200,109	6,333,801	(133,692)
Pick 4 sales	2,042,499	1,662,015	380,484
Powerball sales	54,244,379	65,967,337	(11,722,958)
Hot Lotto sales	10,443,903	7,717,962	2,725,941
Monitor vending sales	-	1,257,087	(1,257,087)
TouchPlay (net)	6,428,123	303,079	6,125,044
Freeplay Replay sales	-	77,330	(77,330)
\$100,000 Cash Game sales	4,426,833	4,430,118	(3,285)
Pull-tab sales	23,624,094	25,528,391	(1,904,297)
Application fees	61,225	18,450	42,775
Prize reserve refunds	-	1,338,053	(1,338,053)
Other	275,806	13,749	262,057
Total operating revenues	<u>211,006,243</u>	<u>209,905,452</u>	<u>1,100,791</u>
Operating expenses:			
Prizes:			
Instant ticket	60,759,895	55,231,505	5,528,390
Pick 3	3,596,814	3,723,158	(126,344)
Pick 4	1,179,953	899,662	280,291
Powerball	25,878,086	31,756,964	(5,878,878)
Hot Lotto	5,111,857	3,761,399	1,350,458
Monitor vending	-	945,638	(945,638)
Freeplay Replay	-	35,897	(35,897)
\$100,000 Cash Game	1,897,416	1,907,647	(10,231)
Pull-tab	14,699,032	15,884,332	(1,185,300)
Promotional	332,620	310,761	21,859
Total prizes	<u>113,455,673</u>	<u>114,456,963</u>	<u>(1,001,290)</u>
Retailer compensation	17,341,859	13,303,839	4,038,020
Advertising/publicity	5,911,199	6,115,714	(204,515)
Vendor compensation/network expense	7,859,205	6,549,862	1,309,343
Instant and Pull-tab rental and inventory expense	3,914,178	4,948,894	(1,034,716)
Other operating expenses	10,888,164	9,688,686	1,199,478
Total operating expenses	<u>159,370,278</u>	<u>155,063,958</u>	<u>4,306,320</u>
Operating income	<u>51,635,965</u>	<u>54,841,494</u>	<u>(3,205,529)</u>
Non-operating revenues (expenses):			
Interest income	608,980	567,843	41,137
Interest expense	(210,746)	-	(210,746)
Net non-operating revenues	<u>398,234</u>	<u>567,843</u>	<u>(169,609)</u>
Income before transfers	52,034,199	55,409,337	(3,416,275)
Transfers to other funds	51,094,109	55,791,763	(4,697,654)
Changes in net assets	940,090	(382,426)	1,281,379
Net assets beginning of year	1,394,199	1,776,625	(382,426)
Net assets end of year	<u>\$ 2,334,289</u>	<u>1,394,199</u>	<u>898,953</u>

See accompanying independent auditor's report.

Schedule 3

Iowa Lottery Authority

Analysis of Net Assets

June 30, 2005

Cash on deposit with Vehicle Dispatcher	\$ 308,351
Ticket inventories	1,096,220
Capital assets, net of related debt	<u>929,718</u>
Total	<u>\$ 2,334,289</u>

See accompanying independent auditor's report.

Iowa Lottery Authority

Revenue by Game -
For the Last Five Years

Games	Year ended June 30,				
	2001	2002	2003	2004 *	2005 *
Instant ticket	\$ 80,164,456	76,754,614	80,895,147	95,258,080	103,259,272
Pick 3	3,802,826	4,717,393	5,726,212	6,333,801	6,200,109
Pick 4	-	-	-	1,662,015	2,042,499
Lotto America/Powerball	49,626,328	57,966,865	54,797,706	65,967,337	54,244,379
Rolldown	2,109,976	1,139,610	-	-	-
Hot Lotto	-	1,277,648	5,685,215	7,717,962	10,443,903
Pull-tab	25,722,808	26,324,246	27,022,871	25,528,391	23,624,094
Daily Millions/Cash 4 Life	481,238	-	-	-	-
\$100,000 Cash Game	4,081,822	4,138,619	4,228,928	4,430,118	4,426,833
Freeplay Replay	636,538	350,049	324,617	77,330	-
Monitor vending	-	-	186,641	1,257,087	-
TouchPlay (net)	-	-	-	303,079	6,428,123
Total	\$ 166,625,992	172,669,044	178,867,337	208,535,200	210,669,212

* - Beginning July 1, 2003, Lottery tickets are no longer subject to sales tax as they had been previously. Therefore, the entire ticket price for the years ended June 30, 2004 and June 30, 2005 are categorized as sales.

See accompanying independent auditor's report.

Schedule 5

Iowa Lottery Authority
Analysis of Prize Payout
On-Line, Instant, and Pull Tab Games
For the Last Five Years

Games	Year ended June 30,				
	2001	2002	2003	2004	2005
Instant ticket	61%	61%	62%	58%	59%
Pick 3	60%	61%	62%	59%	58%
Pick 4	-	-	-	54%	58%
Lotto America/Powerball	51%	51%	50%	48%	48%
Rolldown	54%	45%	-	-	-
Hot Lotto	-	53%	55%	49%	49%
Pull-tab	65%	65%	65%	62%	62%
Daily Millions/Cash 4 Life	32%	-	-	-	-
\$100,000 Cash Game	49%	49%	49%	43%	43%
Freeplay Replay	60%	55%	55%	46%	-
Monitor vending	-	-	79%	75%	-

See accompanying independent auditor's report.



OFFICE OF AUDITOR OF STATE
STATE OF IOWA

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Independent Auditor's Report on
Internal Control over Financial Reporting and on Compliance and Other Matters
Based on an Audit of Financial Statements Performed in Accordance
with Government Auditing Standards

To the Members of the Iowa
Lottery Board:

We have audited the financial statements of the Iowa Lottery Authority, a component unit of the State of Iowa, as of and for the year ended June 30, 2005, and have issued our report thereon dated December 7, 2005. Our report expressed an unqualified opinion on the financial statements. We conducted our audit in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Iowa Lottery Authority'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 Iowa Lottery Authority'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.

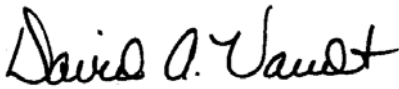
A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being 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 the reportable condition described in the accompanying Schedule of Findings is a material weakness.

Compliance and Other Matters

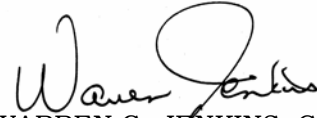
As part of obtaining reasonable assurance about whether the Iowa Lottery Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, non-compliance with which could have a direct and material effect 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 or other matters that are required to be reported under Government Auditing Standards.

This report, a public record by law, is intended solely for the information and use of the Board Members, other officials and employees of the Iowa Lottery Authority and other parties to whom the Iowa Lottery Authority 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 Iowa Lottery Authority 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

December 7, 2005

Iowa Lottery Authority

Schedule of Findings

Year ended June 30, 2005

Findings Related to the Financial Statements:

INSTANCES OF NON-COMPLIANCE:

No matters were noted.

REPORTABLE CONDITION:

Scientific Games International, Inc. provides on-line and instant lottery game processing, sales and support to the Iowa Lottery Authority. 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 11, 2005 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 logs and checklists were not always complete.

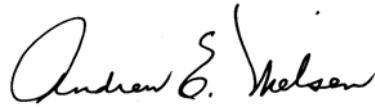
The Iowa Lottery Authority and Scientific Games International, Inc. is in the process of addressing or implementing changes to correct the conditions noted. These items will be reviewed during the next evaluation of the Lottery data processing controls in effect at Scientific Games International, Inc.

Iowa Lottery Authority

Staff

This audit was performed by:

Ronald D. Swanson, CPA, Manager
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Karen L. Brustkern, CPA, Senior Auditor
Daniel L. Durbin, CPA, Staff Auditor
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Cheryl R. Moya, CPA, Assistant Auditor
Andrew J. Muff, Assistant Auditor
Brandon J. Yuska, Assistant Auditor
Andrew J. Harrigan, Auditor Intern

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