



OFFICE OF AUDITOR OF STATE  
STATE OF IOWA

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David A. Vaudt, CPA  
Auditor of State

NEWS RELEASE

FOR RELEASE February 23, 2009

Contact: Andy Nielsen  
515/281-5834

Auditor of State David A. Vaudt today released an audit report on the Iowa Lottery Authority for the year ended June 30, 2008. 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, 2008 increased 6.00% from the same period one year ago.

Comparative operating data is as follows:

	Year Ended June 30, 2008	Year Ended June 30, 2007	% Increase (Decrease)
Revenues:			
Instant ticket	\$137,917,848	\$125,147,976	10.20%
Pick 3	6,373,362	6,282,529	1.45%
Pick 4	2,315,469	2,224,092	4.11%
Powerball	63,761,024	61,548,520	3.59%
Hot Lotto	11,724,416	14,453,908	(18.88%)
Raffle	1,425,460	—	100.00%
\$100,000 Cash Game	4,291,933	4,362,916	(1.63%)
Pull-tab	21,407,956	21,058,969	1.66%
Other	53,112	76,080	(30.19%)
Total operating revenue	249,270,580	235,154,990	6.00%
Prize expense	144,669,575	133,356,860	8.48%
Other expense	47,331,940	43,705,717	8.30%
Transfers to other funds	56,546,118	58,150,437	(2.76%)

An analysis of prizes awarded for the year ended June 30, 2008 is as follows:

Instant ticket prizes	= 62% of Instant ticket sales
Pick 3 prizes	= 59% of Pick 3 sales
Pick 4 prizes	= 58% of Pick 4 sales
Raffle prizes	= 84% of Raffle sales
Powerball prizes	= 48% of Powerball sales
Hot Lotto prizes	= 48% of Hot Lotto sales
\$100,000 Cash Game prizes	= 59% of \$100,000 Cash Game sales
Pull-tab prizes	= 63% of Pull-tab sales

The Iowa Lottery Authority spent \$7,307,529 on advertising and publicity for the year ended June 30, 2008, representing 2.9% 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>.

# # #

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

**JUNE 30, 2008**

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## **Iowa Lottery Authority**

### **Officials**

#### **Governor**

Honorable Chester J. Culver  
Charles J. Krogmeier  
Glen Dickinson

Governor  
Director, Department of Management  
Director, Legislative Services Agency

#### **Iowa Lottery Authority Board of Directors**

Timothy Clausen  
Mary Junge  
Elaine Baxter  
Michael Klappholz  
Thomas M. Rial  
Brad P. Schroeder

Chairperson (through April 2008)  
Vice Chairperson  
Member  
Member  
Member  
Member (beginning May 2008)

#### **Iowa Lottery Authority**

Kenneth Brickman  
Steven King

Acting Chief Executive Officer  
Vice President of Finance and Chief  
Financial Officer (retired September 2008)

**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, 2008, 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 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, 2008, 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, 2008, 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 February 10, 2009 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, 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 have applied certain 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 five years ended June 30, 2007 (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

February 10, 2009

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

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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, 2008. We encourage readers to consider this information in conjunction with the Lottery's financial statements, which follow this section.

### **FINANCIAL HIGHLIGHTS**

Strong sales of instant-scratch and Powerball tickets helped the Iowa Lottery raise more than \$56 million for state programs in fiscal year 2008, but record high fuel prices, a weakened U.S. economy and widespread storm damage and flooding dampened Lottery sales in the final months of the year. Here are some key financial highlights from fiscal year 2008:

- Lottery sales totaled \$249.2 million in fiscal year 2008, which ended June 30. That mark is the highest combined sales total for lotto, instant and pull-tab games since the Lottery's start in 1985 and a 6.0 percent increase from fiscal year 2007's lottery sales total of \$235 million.
- Sales of instant tickets, the first product introduced by the Lottery and always one of its top selling product lines, rose over 10 percent to a record \$137.9 million in fiscal year 2008. The Lottery's previous record for instant sales had been set in fiscal year 2007, when \$125.1 million in instant tickets were sold.
- Powerball sales continued at a strong rate in the Lottery's latest year, totaling \$63.8 million, a 3.6 percent increase from the prior fiscal year. However, five of the Lottery's products, including the Powerball and Hot Lotto games, saw sales decreases in June 2008 compared to the same month a year earlier. That came amidst widespread storm and flood damage and gasoline prices near \$4 per gallon.
- Lottery proceeds for state programs were over \$56.5 million for fiscal year 2008, a decrease of about 2.8 percent from the year before. This decrease primarily resulted from the following factors: 1) A large portion of lottery profits in its latest fiscal year came from instant games, which have smaller profit margins than lotto games. Lotto games accounted for a greater percentage of lottery sales in fiscal year 2007 than in fiscal year 2008, resulting in higher profits in the earlier period. 2) The Governmental Accounting Standards Board (GASB) statement number 16 requires reporting for the recently implemented Sick Leave Insurance Program (SLIP). The Lottery was informed on September 8, 2008, that GASB 16 liabilities were to be reported on the fiscal year 2008 financial statements. Including the liability for SLIP in the financial statements increased our expenses and liabilities approximately \$661,000 and decreased our net income and transfer to the state the same amount.
- Since the Lottery's inception in 1985, more than \$2.2 billion has been awarded in prizes and over \$1.1 billion 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 30.

## **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 that is 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 30 and 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 six years by game.

## **FINANCIAL ANALYSIS**

The Lottery's assets totaled \$45.1 million at the end of 2008 compared to \$49.4 million at the end of the previous year, a decrease of \$4.3 million. There are several reasons for this decrease. First, readers will see the investment in prize annuities decreased by nearly \$2.7 million. Readers will also note a corresponding decrease of over \$2.7 million for the long-term annuity prizes payable. In November 2004, the final annuity payment was issued to the Lottery's first annuity winner, Bill Watson, who had won more than \$4 million in November 1985. In addition to Bill Watson, six other annuitants received their final annuity payment in fiscal year 2005. During fiscal years 2006 through 2008, eighty-three more annuitants received their final annuity payment, including forty-one who received final payments in fiscal year 2008 alone. As annuities are paid in full during the next several years, the balance in the investment in prize annuities will continue to decrease.

Another reason for the decline in the Lottery's overall asset balance is the more than \$1.2 million decrease in net capital assets. This decrease is primarily due to the rise in the accumulated depreciation for the instant and pull-tab ticket vending machines originally purchased during fiscal year 2005.

Despite the significant decrease in the Lottery's overall asset balance, unrestricted net assets actually increased \$545,282 from fiscal year 2007 to fiscal year 2008. Unrestricted net assets represent assets used to meet the Lottery's ongoing obligations to vendors and creditors.

Net assets invested in capital assets, net of related debt, saw a significant increase as well from fiscal year 2007 to fiscal year 2008. This balance rose \$768,120, over 24 percent. The net assets invested in capital assets are net of bonds payable of \$1,500,000 (\$1,400,000 of long-term bonds payable and \$100,000 of current bonds payable). The primary reason for this increase was the Lottery's decision to purchase, rather than rent, ticket vending machines and its headquarters building and a \$2,000,000 principal payment on the bonds during fiscal year 2008.

	June 30,	
	2008	2007
<b>Net Assets:</b>		
Current assets	\$ 24,203,314	24,989,364
Prize reserve	4,022,356	3,615,320
Investment in prize annuities	11,466,178	14,139,617
Capital assets, net	5,453,019	6,684,899
<b>Total assets</b>	<b>\$ 45,144,867</b>	<b>49,429,200</b>
Current liabilities	\$ 21,685,746	25,550,075
Prize reserve	4,022,356	3,615,320
Long-term annuity prizes payable	11,466,178	14,139,617
Long-term bonds payable	1,400,000	1,500,000
Other long-term liabilities	902,806	269,809
<b>Total liabilities</b>	<b>\$ 39,477,086</b>	<b>45,074,821</b>
Net assets:		
Invested in capital assets, net of related debt	\$ 3,953,019	3,184,899
Unrestricted	1,714,762	1,169,480
<b>Total net assets</b>	<b>\$ 5,667,781</b>	<b>4,354,379</b>

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 2008 as compared to fiscal year 2007.

	Year ended June 30,	
	2008	2007
<b>Changes in Net Assets:</b>		
<b>Operating revenues:</b>		
Ticket sales	\$ 249,217,468	235,078,910
Application fees	5,150	6,325
Other	47,962	69,755
Total operating revenues	<u>249,270,580</u>	<u>235,154,990</u>
<b>Operating expenses:</b>		
Prizes	144,669,575	133,356,860
Other operating expenses	47,331,940	43,705,717
Total operating expenses	<u>192,001,515</u>	<u>177,062,577</u>
<b>Operating income</b>	<u>57,269,065</u>	<u>58,092,413</u>
<b>Non-operating revenues (expenses):</b>		
Interest income	699,922	821,922
Interest expense	(109,467)	(175,147)
Net non-operating revenues	<u>590,455</u>	<u>646,775</u>
<b>Income before transfers</b>	<u>57,859,520</u>	<u>58,739,188</u>
<b>Transfers to other funds:</b>		
State General Fund	55,296,265	56,970,554
Iowa Department of Public Health-Gambling Treatment Fund	<u>1,249,853</u>	<u>1,179,883</u>
Total transfers to other funds	<u>56,546,118</u>	<u>58,150,437</u>
<b>Changes in net assets</b>		
<b>Net assets beginning of year</b>	<u>1,313,402</u>	<u>588,751</u>
<b>Net assets end of year</b>	<u>\$ 5,667,781</u>	<u>4,354,379</u>

As noted in the financial highlights, Lottery sales for the fiscal year 2008 were up 6.0 percent, reaching a record \$249.2 million for traditional lottery products, compared to \$235.0 million for fiscal year 2007. Sales for the Lottery's Instant tickets, Powerball, Pick 3, Pick 4 and Pull-tab tickets for fiscal year 2008 all saw increases ranging from 1 percent to over 10 percent, with the largest increase in instant sales.

During fiscal year 2008, the Lottery introduced "Iowa's Million Dollar Raffle", the Lottery's first cash-raffle game. Unfortunately, weather extremes and spiking fuel prices, in particular, impacted the sales of this game. At the same time raffle sales began in April, parts of eastern Iowa began to experience flooding. This was followed by a tornado that destroyed much of Parkersburg, Iowa, and damaged other sections of northeastern Iowa as well as massive flooding that deluged much of the state and another huge tornado that destroyed property and took lives near Blencoe in western Iowa.

More than 71,000 of the raffle game's 120,000 available tickets were sold, allowing the Lottery to cover the cost of the game's prizes and clear some funds beyond that. Raffle sales, however, did not meet the Lottery's initial expectations.

Because of the overall increase in Lottery sales, the Lottery's transfers to the Gambling Treatment Fund were also up for fiscal year 2008, to \$1.25 million from \$1.2 million in fiscal year 2007. However, transfers to the State General Fund were down for fiscal year 2008 to \$55.3 from \$57.0 in the previous fiscal year. As noted in the financial highlights, the decrease resulted from several factors, including an increase in instant sales which have a higher prize payout and the addition of approximately \$661,000 in Sick Leave Insurance Program expense and liability.

The largest expense in total is prize expense, which accounts for 58.0 percent of sales. Prize expense is followed by retailer compensation expense, which accounts for nearly 6.3 percent of all sales. Retailers earned commissions on sales of all Lottery products during fiscal year 2008. In addition, the Lottery awards incentive compensation to retailers who increase their sales from a base level determined by the Lottery and bonus payments to retailers that sell jackpot-winning tickets in Powerball and Hot Lotto and tickets winning at least \$100,000 in all its lotto games.

As noted in the table on page 10, the Lottery's net assets increased \$1,313,402, over 30.0 percent, in fiscal year 2008. The first reason for the Lottery's increase in net assets is due to the change in ticket inventories. The amount of inventory increased \$581,148 due to the change from the shared risk purchasing method to the cost per thousand method. The second reason for the increase is the change in net assets invested in capital assets, net of related debt, which saw a significant increase from fiscal year 2007 to fiscal year 2008. This balance rose \$768,120, over 24 percent.

### **CAPITAL ASSETS AND DEBT ADMINISTRATION**

The Lottery's investment in capital assets as of June 30, 2008 was \$10.6 million, net of accumulated depreciation of \$5.2 million, leaving a book value of \$5.45 million. This investment in capital assets includes equipment, vehicles, land and building, with the highest percentage (53 percent of the net) invested in equipment, including instant and pull-tab ticket vending machines.

On October 4, 2004, the Lottery issued \$8.8 million in 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 eleven years.

During the fiscal year ended June 30, 2008, \$2 million of revenue bonds were retired and \$114,940 of interest expense was paid. At June 30, 2008, the remaining principal balance for these bonds was \$1.5 million.

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

The Lottery's management considered many factors when setting the 2009 fiscal year budget. Overall, the Lottery expects sales to decrease from fiscal year 2008 actual sales due to a weakened US economy. Despite the expected decrease in sales, the Lottery anticipates its fiscal year 2009 transfers to state programs will be helped by a decrease in the Lottery's bond payments for its vending machines and headquarters building. That payment will fall from \$2.0 million in fiscal year 2008 to \$100,000 in fiscal year 2009. In addition, a new law that enables the Lottery to dedicate proceeds from two instant and two pull-tab games each year to veterans' causes was passed and sales for these games will begin in fiscal year 2009. The Lottery anticipates proceeds to benefit the Veterans' Fund will be between \$2 to \$3 million.

### **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, Iowa 50312-4999.

**Iowa Lottery Authority**

**Basic Financial Statements**

**Exhibit A**

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## Iowa Lottery Authority

## Statement of Net Assets

June 30, 2008

**Assets**

## Current assets:

Cash	\$ 14,895,752
Restricted assets - cash	529,036
Prepaid expense	118,188
Interest receivable	124,062
Accounts receivable, net	3,100,442
Ticket inventories	1,333,664
Investment in prize annuities	4,102,170
Total current assets	<u>24,203,314</u>

## Noncurrent assets:

Prize reserve	4,022,356
Investment in prize annuities	11,466,178
Capital assets, net	<u>5,453,019</u>
Total noncurrent assets	<u>20,941,553</u>

**Total assets**45,144,867**Liabilities**

## Current liabilities:

On-line prizes payable	2,654,613
Annuity prizes payable	4,202,170
Accounts payable	1,391,249
Due to:	
State General Fund	11,733,115
Other state agencies	544,772
Interest payable	4,105
Bonds payable	100,000
Deferred revenue	300,063
Personal services payable	59,036
Compensated absences and OPEB	696,623
Total current liabilities	<u>21,685,746</u>

## Long-term liabilities:

Prize reserve	4,022,356
Bonds payable	1,400,000
Compensated absences and OPEB	902,806
Long-term annuity prizes payable	<u>11,466,178</u>
Total long-term liabilities	<u>17,791,340</u>

**Total liabilities**39,477,086**Net Assets**

Invested in capital assets, net of related debt	3,953,019
Unrestricted	<u>1,714,762</u>
<b>Total net assets</b>	<b>\$ 5,667,781</b>

See notes to financial statements.

Iowa Lottery Authority  
 Statement of Revenues, Expenses and Changes in Net Assets  
 Year ended June 30, 2008

## Operating revenues:

Instant ticket sales	\$ 137,917,848
Pick 3 sales	6,373,362
Pick 4 sales	2,315,469
Powerball sales	63,761,024
Raffle sales	1,425,460
Hot Lotto sales	11,724,416
\$100,000 Cash Game sales	4,291,933
Pull-tab sales	21,407,956
Application fees	5,150
Other	47,962
Total operating revenues	<u>249,270,580</u>

## Operating expenses:

## Prizes:

Instant ticket	85,907,684
Pick 3	3,763,710
Pick 4	1,352,661
Powerball	30,749,779
Raffle	1,200,000
Hot Lotto	5,668,710
\$100,000 Cash Game	2,525,366
Pull-tab	13,397,429
Promotional	104,236
Total prizes	<u>144,669,575</u>

Retailer compensation	15,650,431
Advertising/publicity	7,307,529
Vendor compensation/network expense	8,271,422
Instant and Pull-tab machine maintenance and inventory expense	2,982,131
Other operating expenses	13,120,427
Total operating expenses	<u>192,001,515</u>

## Operating income

57,269,065

## Non-operating revenues (expenses):

Interest income	699,922
Interest expense	(109,467)
Net non-operating revenues	<u>590,455</u>

## Income before transfers

57,859,520

## Transfers to other funds:

State General Fund	55,296,265
Iowa Department of Public Health – Gambling Treatment Fund	1,249,853
Total transfers to other funds	<u>56,546,118</u>

## Change in net assets

1,313,402

## Net assets beginning of year

4,354,379

## Net assets end of year

\$ 5,667,781

See notes to financial statements.

**Exhibit C**

## Iowa Lottery Authority

## Statement of Cash Flows

Year ended June 30, 2008

## Cash flows from operating activities:

Cash received from customers	\$ 248,871,307
Cash paid for prizes	(150,991,463)
Cash paid to retailers	(15,650,431)
Cash paid to suppliers for goods and services	(21,574,071)
Cash paid to employees for services	(9,086,059)
Other operating revenues	37,057

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Net cash provided by operating activities

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51,606,340

## Cash flows from non-capital financing activities:

Operating transfers	(56,553,969)
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## Cash flows from capital and related financing activities:

Principal paid on capital debt	(2,000,000)
Interest paid on capital debt	(114,940)
Acquisition of capital assets	(257,492)
Proceeds from sale of capital assets	97,526

---

Net cash used for capital and related financing activities

---

(2,274,906)

## Cash flows from investing activities:

Interest income	767,092
Annuity payments received from insurance companies	6,338,000

---

Net cash provided by investing activities

---

7,105,092

Net decrease in cash

---

(117,443)

Cash at beginning of year

---

15,542,231

Cash at end of year

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\$ 15,424,788

**Reconciliation of operating income to net cash provided by operating activities:**

Operating income	\$ 57,269,065
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Adjustments to reconcile operating income to net cash provided by operating activities:	
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Depreciation	1,407,901
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Gain on sale of capital assets	(16,055)
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Change in assets and liabilities:	
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Increase in prepaid expense	(62,706)
-----------------------------	----------

Increase in accounts receivable	(624,383)
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Increase in ticket inventories	(581,148)
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Decrease in accounts payable	(29,809)
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Decrease in prizes payable	(39,634)
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Increase in due to other state agencies	98,759
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Increase in deferred revenue	173,297
------------------------------	---------

Increase in compensated absences	734,020
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Increase in personal services payable	(384,967)
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(Decrease) in prize annuities	(6,338,000)
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Total adjustments	(5,662,725)
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Net cash provided by operating activities	\$ 51,606,340
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See notes to financial statements.

Iowa Lottery Authority

Notes to Financial Statements

June 30, 2008

**(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 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 as 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 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.

##### 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 retailers which have not settled, instant and pull-tab tickets held by the Lottery's sales representatives 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 machine maintenance and inventory expense when sold or voided. Unsold tickets are expensed upon the end or cancellation of a lottery game.

Certain instant games use the shared risk approach and carry no inventory on the financial statements. For these games, the tickets are not billed by the supplier until the tickets are sold, at which time the Iowa Lottery Authority records the related ticket expense.

##### 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 materially 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. The prize liability for Raffle is recognized after the drawing is held. Prizes for Pick 3, Pick 4, Raffle and the \$100,000 Cash Game may be claimed up to 90 days after the drawings are held. Prizes for Powerball and Hot Lotto may be claimed up to one year after the drawings are held.

#### Compensated Absences and Other Post Employment Benefits (OPEB)

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

## **(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, 2008 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 \$15,568,348 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 \$2,988,770 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 \$12,354,586 at June 30, 2008 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 Iowa Lottery Authority also had investments of \$224,992 at June 30, 2008 in pooled funds and mutual funds.

At June 30, 2008, the Iowa Lottery Authority had the following fixed income investments:

<b>Investment Type</b>	<b>Fair Value</b>
U.S. Government Treasuries, Notes and Bonds	\$ 6,654,454
U.S. Government Agencies	<u>5,700,132</u>
Total	<u>\$ 12,354,586</u>

Credit Risk. The credit risk ratings of the fixed income investments at June 30, 2008 were as follows:

	<b>Treasury</b>	<b>Agencies</b>	<b>AAA</b>	<b>Total</b>
Fixed Income	\$ 6,470,454	5,027,132	857,000	\$ 12,354,586

Interest Rate Risk. At June 30, 2008, the effective duration and composition of the fixed income investments were as follows:

<b>Investment Type</b>	<b>Fair Value</b>	<b>Effective Duration (Years)</b>
U.S. Government Treasuries, Notes and Bonds	\$ 6,654,454	3.63
U.S. Government Agencies	<u>5,700,132</u>	4.35
Total	<u>\$ 12,354,586</u>	3.96

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

Assets totaling \$15,703,848, which includes \$15,568,348 of investments and \$135,500 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 do not include an additional liability of \$35,500 to taxing authorities, of which \$18,500 is classified as due to other state agencies and \$17,000 is classified as accounts payable. The following is a schedule of future payments:

<b>Year Ending June 30,</b>	<b>Current</b>	<b>Long-term</b>	<b>Total Payments</b>
2009	\$ 4,377,000	-	4,377,000
2010	-	2,895,000	2,895,000
2011	-	2,167,000	2,167,000
2012	-	1,488,000	1,488,000
2013	-	1,488,000	1,488,000
2014-2018	-	6,258,000	6,258,000
Total future value	4,377,000	14,296,000	18,673,000
Less: unamortized discount	(274,830)	(2,829,822)	(3,104,652)
Present value of payments	<u>\$ 4,102,170</u>	<u>11,466,178</u>	<u>15,568,348</u>

#### (4) Accounts Receivable

The components of accounts receivable at June 30, 2008 are as follows:

Due from agents	\$ 5,038,724
Due from others	<u>45,069</u>
Subtotal	5,083,793
Less allowance for doubtful accounts	(1,983,351)
Accounts receivable, net	<u>\$ 3,100,442</u>

Bad debt expense of \$42,719 was charged against instant ticket sales for the year ended June 30, 2008.

#### (5) Capital Assets

Capital assets activity for the year ended June 30, 2008 is as follows:

	Balance Beginning of Year	Additions	Deletions	Balance End of Year
Capital assets not being depreciated:				
Land	\$ 392,110	-	-	392,110
Capital assets being depreciated:				
Buildings	1,986,487			1,986,487
Equipment	7,538,666	7,727	193,058	7,353,335
Vehicles	851,804	249,765	212,404	889,165
Total capital assets being depreciated	10,376,957	257,492	405,462	10,228,987
Less accumulated depreciation for:				
Buildings	105,228	51,659	-	156,887
Equipment	3,467,247	1,198,664	173,187	4,492,724
Vehicles	511,693	157,578	150,804	518,467
Total accumulated depreciation	4,084,168	1,407,901	323,991	5,168,078
Total capital assets being depreciated, net	6,292,789	(1,150,409)	81,471	5,060,909
Capital assets, net	\$ 6,684,899	(1,150,409)	81,471	5,453,019

#### (6) Revenue Bonds Payable

During fiscal year 2005, the Iowa Lottery Authority issued \$8,800,000 of revenue bonds 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 for the purchase and renovation of a building for the Iowa Lottery Authority's headquarters. The bonds mature over the next eleven years. The remaining principal balance at June 30, 2008 was \$1,500,000.

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

Year Ending June 30,	Principal	Interest	Total
2009	\$ 100,000	49,260	149,260
2010	100,000	45,976	145,976
2011	100,000	42,692	142,692
2012	100,000	39,408	139,408
2013	100,000	36,124	136,124
2014-2018	800,000	121,508	921,508
2019	200,000	6,568	206,568
Total	\$ 1,500,000	341,536	1,841,536

During the year ended June 30, 2008, \$2,000,000 of revenue bonds were retired.

## **(7) Lease Commitment**

The Iowa Lottery Authority occupies office and warehouse facilities in Cedar Rapids, Mason City, Storm Lake, Council Bluffs and Ankeny under long-term operating leases which expire by June 30, 2012.

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, 2008:

<u>Year ending June 30,</u>	<u>Amount</u>
2009	\$ 242,325
2010	242,941
2011	109,716
2012	<u>10,936</u>
Total	<u>\$ 605,918</u>

Rental expense for all operating leases totaled \$277,173 for the year ended June 30, 2008.

## **(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 3.90% of their annual salary and the Iowa Lottery Authority is required to contribute 6.05% of annual covered payroll for the years ended June 30, 2008, 2007 and 2006. Contribution requirements are established by state statute. The Iowa Lottery Authority's contributions to IPERS for the years ended June 30, 2008, 2007 and 2006 were \$390,212, \$376,951 and \$351,248, respectively, equal to the required contributions for each year.

## **(9) Compensated Absences and Other Postemployment Retirement Benefits (OPEB)**

Changes in compensated absences and other postemployment retirement benefit obligations for the year ended June 30, 2008 are summarized as follows:

	Balance June 30, 2007	Additions	Deletions	Balance June 30, 2008	Due Within One Year
Compensated absences	\$ 865,409	1,282,615	611,257	1,536,767	696,623
Net OPEB liability	-	62,662	-	62,662	-
Total	<u>\$ 865,409</u>	<u>1,345,277</u>	<u>611,257</u>	<u>1,599,429</u>	<u>696,623</u>

Sick Leave Insurance Program (SLIP) Included in the accrued compensated absences liability for the year ended June 30, 2008 is the cost of a voluntary termination benefit program entitled Sick Leave Insurance Program (SLIP). The program is an opportunity for employees who are retirement-eligible to use the value of their unused sick leave to pay the employer share of the monthly premium of the State's group health insurance plan after their retirement.

Upon retirement, employees shall first receive a cash payment for accumulated, unused sick leave converted at the employee's current regular hourly rate of pay, up to \$2,000, payable with the final payroll warrant that includes the employee's retirement date. The value of the remaining balance of the accrued sick leave will be converted based upon the original balance (before the cash payment). The remainder of the sick leave value is calculated as follows, based on the number of sick hours the employee had before the cash payment:

<b>If the sick leave balance is:</b>	<b>The conversion rate is:</b>
Zero to 750 hours	60% of the value
Over 750 hours to 1,500 hours	80% of the value
Over 1,500 hours	100% of the value

The final calculated dollar value will be credited to the employee's SLIP account. Each month, the Iowa Lottery Authority will pay 100 percent of the employer's share of the selected state group health insurance premium from the retiree's SLIP account. The retiree is responsible for any additional premiums associated with the employee/retiree share.

The Iowa Lottery Authority will continue to pay the employer's share of the health insurance premium each month until the converted value of the employee's sick leave balance is exhausted, until the employee is eligible for Medicare, the employee waives the benefit or until the employee dies, whichever comes first. The retired employees may stay with the same health insurance program as when employed or switch down at any time without underwriting. The converted value of the sick leave can only be applied to the employer's share of health insurance premium payments. It has no cash value and is not transferable to another use or to an heir. If a retired employee who has utilized this benefit returns to permanent state employment, all remaining balances in the sick leave insurance program will be forfeited.

All SLIP program benefits are financed on a pay-as-you-go basis. For the year ended June 30, 2008, five employees have retired and received benefits of \$33,768 under the SLIP program.

Other Postemployment Retirement Benefits The Iowa Lottery Authority implemented Governmental Accounting Standards Board Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, during the year ended June 30, 2008. This Statement establishes when other postemployment benefit liabilities are recorded under the accrual basis of accounting.

As a part of the State of Iowa, the Iowa Lottery Authority participates in the State of Iowa postretirement medical plan (OPEB). The OPEB Plan recognizes the implicit rate subsidy as required by GASB Statement No. 45.

The annual valuation of liabilities under the OPEB Plan is calculated using the entry age normal cost method. This method requires the calculation of an unfunded actuarial accrued liability, which was approximately \$220,000,000 for the State of Iowa as of June 30, 2008. The Iowa Lottery Authority's portion of the unfunded actuarial accrued liability is not separately determinable.

Details of the OPEB Plan are provided on a state-wide basis and are available in the State of Iowa's Comprehensive Annual Financial Report for the year ended June 30, 2008. The report may be obtained by writing to the Iowa Department of Administrative Services, Hoover State Office Building, Des Moines, Iowa 50319.

The Iowa Lottery Authority recognized a net OPEB liability of \$62,662 for other postemployment benefits, which represents the Iowa Lottery Authority's portion of the State's net OPEB obligation. The Iowa Lottery Authority's portion of the net OPEB obligation was calculated using the ratio of full time equivalent employees of the Iowa Lottery Authority compared to full time equivalent employees of the State of Iowa.

## **(10) Payment of Prizes**

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

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.

Pull-tab prize expense is comprised of actual winning tickets up to and including \$600 included in packs delivered to retailers and actual winning tickets over \$600 paid by the Lottery.

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

Raffle prize expense is comprised of winners who match the raffle numbers selected in the drawing.

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 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 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, 2008, \$104,236 in prizes were distributed through various promotional activities.

## **(11) 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, 2008, the MUSL held zero coupon bonds for the Iowa Lottery Authority to fund future installment payments aggregating \$4,082,105. The current value of those bonds totaled \$4,172,604.

## **(12) 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, 2008, the Iowa Lottery Authority has 26,052 packs at retailers which have not yet settled. The receivable and the related deferred revenue of \$3,585,908, 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	\$7,815,600
Less:	
Retailer compensation	530,604
Low-tier prize expense	<u>3,699,088</u>
Potential receivable and deferred amount	<u>\$3,585,908</u>

## **(13) 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 from 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.

## **(14) Litigation**

There are currently four lawsuits pending against, or involving, the Iowa Lottery and/or the Iowa Lottery Authority and its Chief Executive Officer, in his official capacity, seeking monetary damages arising out of the Legislature's 2006 ban of the Iowa Lottery Authority's TouchPlay Monitor Vending Machine product. There were approximately 7,000 TouchPlay monitor vending machines operating in the State at the time of the ban. Lawsuits related to this litigation are currently pending in Polk, Scott, Floyd and Webster counties. The lawsuits involve seven individual and corporate plaintiffs. The pending litigation asserts claims for money damages based on various constitutional, legal and equitable theories. A trial in the Webster County lawsuit has been set to begin on June 2, 2009. The Floyd County lawsuit is set for trial beginning on July 21, 2009. The Scott County case was dismissed on Summary Judgment. One plaintiff's claims in the Polk County case were also dismissed on Summary Judgment. The summary judgment decisions are expected to be appealed. At this time, the Iowa Lottery Authority is unable to determine what, if any, potential monetary liabilities may be incurred by the Iowa Lottery Authority as a result of these lawsuits. The Iowa Lottery Authority believes it has meritorious defenses to all of the claims asserted by the various plaintiffs and intends to vigorously defend the cases. Except as outlined above, all other TouchPlay cases and claims previously disclosed have been settled.

A lawsuit was filed in Polk County District Court against the State and various state agencies, including the Iowa Lottery Authority, alleging race discrimination in the State's hiring, retention and promotion practices. This lawsuit currently includes 23 named plaintiffs and also seeks class certification. The State believes it has meritorious defenses to the plaintiff's underlying claims as well as their request for class certification. The case is in preliminary discovery and there is currently no date set for a determination on class certification. Any estimate of any potential monetary exposure to the State would be purely speculative at this time. As with the other litigation outlined above, it is the State's intention to vigorously defend the cases and settle only those cases where the evidence and the law indicate potential liability on behalf of the State.

**Iowa Lottery Authority**

**Supplementary Information**

**Schedule 1**

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Iowa Lottery Authority

## Other Operating Expenses

Year ended June 30, 2008

Personal services	\$ 9,435,111
Travel	443,445
Supplies	107,592
Printing	17,737
Postage	4,528
Communications	126,328
Rentals	277,173
Utilities	114,292
Professional fees	144,953
Outside services and repair	218,540
Non-capitalized equipment	155,425
Data processing	37,998
Reimbursement to state agencies	500,235
Depreciation	1,407,901
Other	<hr/> 129,169
Total	<hr/> <u>\$ 13,120,427</u>

See accompanying independent auditor's report.

## Iowa Lottery Authority

## Revenues, Expenses and Changes in Net Assets

Years ended June 30, 2008 and 2007

	2008	2007	Increase (Decrease)
<b>Operating revenues:</b>			
Instant ticket sales	\$ 137,917,848	125,147,976	12,769,872
Pick 3 sales	6,373,362	6,282,529	90,833
Pick 4 sales	2,315,469	2,224,092	91,377
Powerball sales	63,761,024	61,548,520	2,212,504
Raffle sales	1,425,460	-	1,425,460
Hot Lotto sales	11,724,416	14,453,908	(2,729,492)
\$100,000 Cash Game sales	4,291,933	4,362,916	(70,983)
Pull-tab sales	21,407,956	21,058,969	348,987
Application fees	5,150	6,325	(1,175)
Other	47,962	69,755	(21,793)
<b>Total operating revenues</b>	<b>249,270,580</b>	<b>235,154,990</b>	<b>14,115,590</b>
<b>Operating expenses:</b>			
Prizes:			
Instant ticket	85,907,684	76,461,872	9,445,812
Pick 3	3,763,710	3,710,127	53,583
Pick 4	1,352,661	1,202,769	149,892
Powerball	30,749,779	29,416,275	1,333,504
Raffle	1,200,000	-	1,200,000
Hot Lotto	5,668,710	7,097,545	(1,428,835)
\$100,000 Cash Game	2,525,366	2,212,777	312,589
Pull-tab	13,397,429	13,103,358	294,071
Promotional	104,236	152,137	(47,901)
<b>Total prizes</b>	<b>144,669,575</b>	<b>133,356,860</b>	<b>11,312,715</b>
Retailer compensation	15,650,431	14,674,744	975,687
Advertising/publicity	7,307,529	6,277,829	1,029,700
Vendor compensation/network expense	8,271,422	7,765,643	505,779
Instant and Pull-tab machine			
maintenance and inventory expense	2,982,131	3,145,933	(163,802)
Other operating expenses	13,120,427	11,841,568	1,278,859
<b>Total operating expenses</b>	<b>192,001,515</b>	<b>177,062,577</b>	<b>14,938,938</b>
<b>Operating income</b>	<b>57,269,065</b>	<b>58,092,413</b>	<b>(823,348)</b>
<b>Non-operating revenues (expenses):</b>			
Interest income	699,922	821,922	(122,000)
Interest expense	(109,467)	(175,147)	65,680
<b>Net non-operating revenues</b>	<b>590,455</b>	<b>646,775</b>	<b>(56,320)</b>
Income before transfers	57,859,520	58,739,188	(879,668)
Transfers to other funds	56,546,118	58,150,437	(1,604,319)
Changes in net assets	1,313,402	588,751	724,651
Net assets beginning of year	4,354,379	3,765,628	588,751
<b>Net assets end of year</b>	<b>\$ 5,667,781</b>	<b>4,354,379</b>	<b>1,313,402</b>

See accompanying independent auditor's report.

**Iowa Lottery Authority**

## Iowa Lottery Authority

## Analysis of Net Assets

June 30, 2008

Cash on deposit with Vehicle Dispatcher	\$ 381,098
Ticket inventories	1,333,664
Capital assets, net of related debt	<u>3,953,019</u>
 Total	 <u>\$ 5,667,781</u>

See accompanying independent auditor's report.

**Schedule 4**

## Iowa Lottery Authority

Revenue by Game -  
For the Last Six Years

Games	Year ended June 30,					
	2003	2004 *	2005 *	2006 *	2007 *	2008 *
Instant ticket	\$ 80,895,147	95,258,080	103,259,272	106,562,536	125,147,976	137,917,848
Pick 3	5,726,212	6,333,801	6,200,109	6,056,037	6,282,529	6,373,362
Pick 4	-	1,662,015	2,042,499	2,066,769	2,224,092	2,315,469
Powerball	54,797,706	65,967,337	54,244,379	71,110,985	61,548,520	63,761,024
Raffle	-	-	-	-	-	1,425,460
Rolldown	-	-	-	-	-	-
Hot Lotto	5,685,215	7,717,962	10,443,903	9,634,818	14,453,908	11,724,416
Pull-tab	27,022,871	25,528,391	23,624,094	18,314,338	21,058,969	21,407,956
\$100,000 Cash Game	4,228,928	4,430,118	4,426,833	4,323,511	4,362,916	4,291,933
Freeplay Replay	324,617	77,330	-	-	-	-
Monitor vending	186,641	1,257,087	-	-	-	-
TouchPlay (net)	-	303,079	6,428,123	121,450,529	-	-
Total	\$ 178,867,337	208,535,200	210,669,212	339,519,523	235,078,910	249,217,468

\* - Beginning July 1, 2003, Lottery tickets are not subject to sales tax as they had been previously. Therefore, the entire ticket price for the years ended June 30, 2004, 2005, 2006, 2007 and 2008 are categorized as sales.

See accompanying independent auditor's report.

## Iowa Lottery Authority

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

For the Last Six Years

Games	Year ended June 30,					
	2003	2004	2005	2006	2007	2008
Instant ticket	62%	58%	59%	61%	61%	62%
Pick 3	62%	59%	58%	58%	59%	59%
Pick 4	-	54%	58%	50%	54%	58%
Powerball	50%	48%	48%	49%	48%	48%
Raffle	-	-	-	-	-	84%
Hot Lotto	55%	49%	49%	49%	49%	48%
Pull-tab	65%	62%	62%	62%	62%	63%
\$100,000 Cash Game	49%	43%	43%	47%	51%	59%
Freeplay Replay	55%	46%	-	-	-	-
Monitor vending	79%	75%	-	-	-	-

See accompanying independent auditor's report.

**Iowa Lottery Authority**



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

David A. Vaudt, CPA  
Auditor of State

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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 Board Members of the  
Iowa Lottery Authority:

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, 2008, and have issued our report thereon dated February 10, 2009. 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 as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing our opinion on the effectiveness of the Iowa Lottery Authority's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Iowa Lottery Authority's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of the control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Iowa Lottery Authority's ability to initiate, authorize, record, process or report financial data reliably in accordance with U.S. generally accepted accounting principles such that there is more than a remote likelihood a misstatement of the Iowa Lottery Authority's statements that is more than inconsequential will not be prevented or detected by the Iowa Lottery Authority's internal control. We consider the deficiencies in internal control described in the accompanying Schedule of Findings to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood a material misstatement of the financial statements will not be prevented or detected by the Iowa Lottery Authority's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, we believe none of the significant deficiencies described above are material weaknesses.

### Compliance and Other Matters

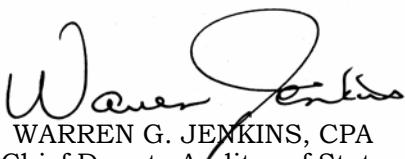
As part of obtaining reasonable assurance about whether the Iowa Lottery Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations and contracts, non-compliance with which could have a direct and material effect 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, citizens of the State of Iowa 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

February 10, 2009

Iowa Lottery Authority

Schedule of Findings

Year ended June 30, 2008

**Findings Related to the Financial Statements:**

**SIGNIFICANT DEFICIENCIES:**

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 March 21, 2008 identified deficiencies 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) Logical access to the 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) Controls regarding backups and facilities management were not fully implemented by Scientific Games International, Inc.

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

**INSTANCES OF NON-COMPLIANCE:**

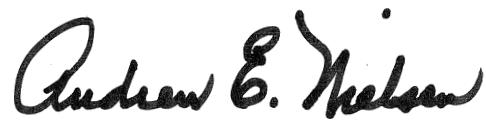
No matters were noted.

Iowa Lottery Authority

Staff

This audit was performed by:

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Steven O. Fuqua, CPA, Senior Auditor II  
Daniel L. Durbin, CPA, Staff Auditor  
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Andrew E. Nielsen, CPA  
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