



OFFICE OF AUDITOR OF STATE
STATE OF IOWA

David A. Vaudt, CPA
Auditor of State

State Capitol Building
Des Moines, Iowa 50319-0004

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

NEWS RELEASE

FOR RELEASE January 21, 2005

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, 2004. 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, 2004 increased 16.58% over the same period one year ago.

Comparative operating data is as follows:

	Year Ended June 30, 2004	Year Ended June 30, 2003	% Increase (Decrease)
Revenues:			
Instant ticket	\$ 95,258,080	80,895,147	17.75%
Pick 3	6,333,801	5,726,212	10.61%
Pick 4	1,662,015	-	
Powerball	65,967,337	54,797,706	20.38%
Hot Lotto	7,717,962	5,685,215	37.75%
Monitor vending machine	1,257,087	186,641	573.53%
Touch play machine (net)	303,079	-	
Freeplay Replay	77,330	324,617	(76.18%)
\$100,000 Cash Game	4,430,118	4,228,928	4.76%
Pull-tab	25,528,391	27,022,871	(5.53%)
Other	<u>1,370,252</u>	<u>1,192,096</u>	<u>14.94%</u>
Total operating revenue	209,905,452	180,059,433	16.58%
Prize expense	114,456,963	104,199,159	9.84%
Other expense	40,606,995	38,042,562	6.74%
Transfers to other funds	55,791,763	39,008,480	43.02%

An analysis of prizes awarded for the year ended June 30, 2004 is as follows:

Instant ticket prizes	= 58% of Instant ticket sales
Pick 3 prizes	= 59% of Pick 3 sales
Pick 4 prizes	= 54% of Pick 4 sales
Powerball prizes	= 48% of Powerball sales
Hot Lotto prizes	= 49% of Hot Lotto sales
Monitor vending machine prizes	= 75% of Monitor vending machine sales
Touch play machine prizes	= 63% of Touch play machine sales
Freeplay Replay prizes	= 46% of Freeplay Replay 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 \$6,115,714 on advertising and publicity for the year ended June 30, 2004, representing 2.9% of revenue. Iowa laws allow 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 in the Office of Auditor of State and the Iowa Lottery Authority.

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**IOWA LOTTERY AUTHORITY
(Previously Known as the Lottery Division
of the Department of Revenue and Finance)**

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

JUNE 30, 2004

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Iowa Lottery Authority

Officials

Name

Title

State

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

Governor
Director, Department of Management
Director, Legislative Services Agency

Iowa Lottery Authority Board of Directors

Michael McCoy
Mary Junge
Elaine Baxter
William Brosnahan
Timothy Clausen

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, 2004, 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, Chapter 11 of the Code of Iowa and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards and provisions require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe 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, 2004, 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, 2004, 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 November 9, 2004 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. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

Management's Discussion and Analysis 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, consisting principally of inquiries of management regarding methods of measurement and presentation of the required supplementary information. We did not audit the information and express no opinion thereon.

Our audit was performed for the purpose of forming an opinion on the financial statements 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, 2003 (which are not presented herein) and expressed unqualified opinions on those financial statements. The 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 aforementioned basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.


DAVID A. VAUDT, CPA
Auditor of State


WARREN G. JENKINS, CPA
Chief Deputy Auditor of State

November 9, 2004

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, 2004. We encourage readers to consider this information in conjunction with the Lottery's financial statements, which follow this section.

FINANCIAL HIGHLIGHTS

Fiscal year 2004 marked the first year of operations for the Iowa Lottery Authority, which was created with the passage of legislation that reinvented the Lottery as a public enterprise based on a business model. With this legislation, the Lottery was given greater flexibility in its day-to-day operating decisions, with the goal of producing greater profits to the state. As demonstrated by the 2004 financial results, the Lottery more than succeeded in achieving that goal, surpassing the proceeds target of \$54.8 million that was established in the legislation. From a financial reporting standpoint, one of the biggest changes from the legislation eliminated the practice of classifying a portion of Lottery revenues as sales tax. All revenues are now classified as operating revenues. For comparison purposes between fiscal years, a column that includes sales tax receipts for fiscal year 2003 was included in the table on page 10. Here are some key financial highlights from fiscal year 2004:

- Lottery proceeds for state programs rose more than 16 percent to \$55.8 million in its latest fiscal year, an increase of \$7.8 million over the previous year's results of \$48.0 million. This increase followed profits that held steady in fiscal year 2003 and had increased 9 percent in fiscal year 2002.
- Lottery sales increased for a third straight year. For fiscal year 2004, sales totaled more than \$208.5 million. Overall, sales were up 11 percent in fiscal year 2004 after a 3.6 percent increase in fiscal year 2003 and a 3.6 percent increase in fiscal year 2002.
- The Lottery, in partnership with amusement operators from across the state, also began statewide introduction of Touch Play machines in the last two months of the fiscal year following a successful market test of the technology, which added video and sound to the traditional vending machine. By the end of June, about 200 Touch Play machines had been installed at businesses around the state. For the year, the machines produced more than \$1.5 million in sales, \$1.2 million in monitor vending machine test revenues and \$.3 million in net Touch Play machine revenues.
- Since the Lottery's inception in 1985, more than \$1.77 billion has been awarded in prizes and more than \$883 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 13 through 15) 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. Supplemental information is in schedule form and begins on page 26.

REPORTING THE IOWA LOTTERY AS A WHOLE

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

One of the most important questions asked about the 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 inventory and the net book value of capital assets. During the 2002 Legislative Session, House File (HF) 2627 was passed requiring the Lottery to reduce retained earnings by \$500,000. This was a one-time increased transfer to the General Fund for fiscal year 2003. During the 2003 Legislative Session, HF 655 continued the reduction to retained earnings for fiscal year 2004 only.

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 Lottery has exceeded its profit projections for at least the last three years.

The Statement of Cash Flows:

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

Notes to 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 16.

Supplementary Information

The supplementary information begins on page 26 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 five years by game.

FINANCIAL ANALYSIS

The Lottery's assets totaled \$67.4 million at the end of 2004 compared to \$68.3 million at the end of the previous year. Unrestricted net assets represent assets used to meet the Lottery's ongoing obligations to vendors and creditors. Unrestricted net assets decreased by \$393,097 from fiscal year 2003 to fiscal year 2004. This change is due, in large part, to the reduction in ticket inventories from 2003 to 2004, which were \$1,530,904 and \$1,101,422 respectively.

	June 30,	
	2004	2003
Net Assets:		
Current assets	\$ 30,456,887	\$ 22,229,905
Prize reserve	4,234,782	5,355,730
Investment in prize annuities	32,380,859	40,420,493
Capital assets, net	291,168	280,497
Total assets	\$ 67,363,696	\$ 68,286,625
Current liabilities	29,084,429	20,430,624
Prize reserve	4,234,782	5,355,730
Long-term annuity prizes payable	32,380,859	40,420,493
Other long-term liabilities	269,427	303,153
Total liabilities	\$ 65,969,497	\$ 66,510,000
Net assets:		
Invested in capital assets	291,168	280,497
Unrestricted	1,103,031	1,496,128
Total net assets	\$ 1,394,199	\$ 1,776,625

As noted previously, 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 2004 as compared to fiscal year 2003. For comparison purposes between fiscal years, a column that includes sales tax receipts for fiscal year 2003 was included in the table.

	Year ended June 30,		
	2004	2003	2003 With Sales Tax
Changes in Net Assets:			
Operating revenues:			
Ticket sales	\$ 208,535,200	178,867,337	178,867,337
Sales tax	-	-	8,962,231
Total ticket sales and sales tax	208,535,200	178,867,337	187,829,568
Application fees	18,450	16,825	16,825
Other	1,351,802	1,175,271	1,175,271
Total operating revenues	209,905,452	180,059,433	189,021,664
Operating expenses:			
Prizes	114,456,963	104,199,159	104,199,159
Other operating expenses	40,606,995	38,042,562	38,042,562
Total operating expenses	155,063,958	142,241,721	142,241,721
Operating income	54,841,494	37,817,712	46,779,943
Non-operating revenues:			
Interest income	567,843	653,429	653,429
Income before transfers	55,409,337	38,471,141	47,433,372
Transfers to other funds:			
State General Fund	55,160,347	38,466,350	38,466,350
Sales tax (also transferred to State General Fund)	-	-	8,962,231
Iowa Department of Public Health- Gambling Treatment Fund	631,416	542,130	542,130
Total transfers to other funds	55,791,763	39,008,480	47,970,711
Changes in net assets	(382,426)	(537,339)	(537,339)
Net assets beginning of year	1,776,625	2,313,964	2,313,964
Net assets end of year	\$ 1,394,199	1,776,625	1,776,625

Sales for fiscal year 2004 were up 11 percent, at \$208.5 million, compared to \$187.8 million (includes 5% sales tax) for fiscal year 2003. Instant-scratch tickets, the Lottery's traditional sales leader, claimed that spot again in FY 2004, with sales increasing by more than 12 percent to \$95.3 million. Powerball sales for the year were up more than 14 percent to \$66.0 million while sales of Hot Lotto increased more than 29 percent to \$7.7 million. Sales in the Lottery's Pick 3 lotto game jumped more than 5 percent for the year to about \$6.3 million and the introduction of the Pick 4 game brought in more than \$1.6 million in sales.

We noted in the previous paragraph that Lottery sales figures for fiscal year 2003 included 5 percent sales tax. There is no corresponding figure for fiscal year 2004 because a portion of Lottery revenues are no longer classified as sales tax in Iowa. That difference was just a part of the changes brought on by the 2003 legislation that created the Iowa Lottery Authority.

With the new legislation, the Lottery continues to come under legislative review but is no longer subject to expense appropriations from the Legislature. Instead, the Iowa Lottery Authority Board of Directors has been given more oversight responsibility and approves or alters the Lottery's budget. The change is designed to depoliticize the financial process and allow the people closest to that process to make best business-practice decisions.

As mentioned above, the new law also eliminated the process of classifying some Lottery proceeds as sales tax revenue. The change is revenue-neutral to the state budget, as all Lottery proceeds are now classified as State General Fund revenues. But for the Lottery, the change eliminates the unnecessary and often confusing process of separating its revenues into two income streams to the state, only to have both deposited into the state General Fund.

In addition to an increase in sales, the Statement of Revenues, Expenses and Changes in Net Assets shows that other operating revenues increased by approximately 15%. In fiscal year 2004, the Lottery received a one-time MUSL prize reserve adjustment totaling \$497,966 and a 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 2003, one-time operating revenues brought in about \$1.16 million, which resulted from a Powerball jackpot that went unclaimed in Indiana.

The largest expense in total is prize expense, which accounts for 54.9% of all sales. Prize expense is followed by retailer compensation expense, which accounts for 6.4% of all sales. Retailers earn 5% commission on pull-tab sales, 5.5%-7% for instant sales and 5.5% for online sales. Touch Play 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 9, the Lottery's net assets decreased by \$382,426, or 21.5%. The primary reason for this decrease was the reduction in ticket inventories as of the end of year. Proceeds transfers of \$55.2 million were made to the State General Fund and transfers totaling \$631,416 were made to the Gambling Treatment Fund.

CAPITAL ASSETS

The Lottery's investment in capital assets at June 30, 2004 was \$2.2 million, net of accumulated depreciation of \$1.9 million, leaving a book value of \$291,168. This investment in capital assets includes both equipment and vehicles, with the majority (84% of the net) invested in vehicles. The Lottery's district sales representatives are the primary users of these vehicles. The sales representatives use the vehicles for the delivery of Lottery tickets and point-of-purchase marketing and informational materials to retailer locations.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The Lottery's management considered many factors when setting the 2005 fiscal year budget. Because of the uncertainty involving new gaming licenses that may potentially be issued by the Iowa Racing and Gaming Commission for casinos in the state, the Lottery's projection of profits for fiscal year 2005 is not as aggressive as the increase projected over the last fiscal year. The projection is driven by the timetable of the Iowa Racing and Gaming Commission, which is expected to make a decision by the end of the year on granting new licenses. Despite this uncertainty, the Lottery does forecast an overall increase in Lottery sales and proceeds to the state for fiscal year 2005. The Lottery expects the increase to be fueled by the introduction of the new product line, Touch Play, the addition of a new corporate partner, Casey's, 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 Authority Headquarters, 2015 Grand Avenue, Des Moines, IA 50312-4999.

Basic Financial Statements

Iowa Lottery Authority

Statement of Net Assets

June 30, 2004

Assets	
Current assets:	
Cash	\$ 16,040,362
Restricted assets - cash	663,504
Prepaid expense	108,630
Interest receivable	65,681
Accounts receivable, net	3,123,338
Ticket inventories	1,101,422
Investment in prize annuities	9,353,950
Total current assets	<u>30,456,887</u>
Noncurrent assets:	
Prize reserve	4,234,782
Investment in prize annuities	32,380,859
Capital assets, net	291,168
Total noncurrent assets	<u>36,906,809</u>
Total assets	<u>67,363,696</u>
Liabilities	
Current liabilities:	
On-line prizes payable	3,283,969
Instant prizes payable	172,957
Annuity prizes payable	9,488,450
Sales tax payable	163
Accounts payable	1,197,775
Due to:	
State General Fund	13,730,316
Other state agencies	332,543
Deferred revenue	125,679
Personal services payable	281,364
Compensated absences	471,213
Total current liabilities	<u>29,084,429</u>
Long-term liabilities:	
Prize reserve	4,234,782
Personal services payable	16,525
Compensated absences	252,902
Long-term annuity prizes payable	32,380,859
Total long-term liabilities	<u>36,885,068</u>
Total liabilities	<u>65,969,497</u>
Net Assets	
Invested in capital assets	291,168
Unrestricted	1,103,031
Total net assets	<u>\$ 1,394,199</u>

See notes to financial statements.

Exhibit B

Iowa Lottery Authority
Statement of Revenues, Expenses and Changes in Net Assets
Year ended June 30, 2004

Operating revenues:	
Instant ticket sales	\$ 95,258,080
Pick 3 sales	6,333,801
Pick 4 sales	1,662,015
Powerball sales	65,967,337
Hot Lotto sales	7,717,962
Monitor vending machine sales	1,257,087
Touch Play machines (net receipts)	303,079
Freeplay Replay sales	77,330
\$100,000 Cash Game sales	4,430,118
Pull-tab sales	25,528,391
Application fees	18,450
Prize reserve refunds	1,338,053
Other	13,749
Total operating revenues	<u>209,905,452</u>
Operating expenses:	
Prizes:	
Instant ticket	55,231,505
Pick 3	3,723,158
Pick 4	899,662
Powerball	31,756,964
Hot Lotto	3,761,399
Monitor vending machine	945,638
Freeplay Replay	35,897
\$100,000 Cash Game	1,907,647
Pull-tab	15,884,332
Promotional	310,761
Total prizes	<u>114,456,963</u>
Retailer compensation	13,303,839
Advertising/publicity	6,115,714
Vendor compensation/network expense	6,549,862
Instant and Pull-tab rental and inventory expense	4,948,894
Other operating expenses	9,688,686
Total operating expenses	<u>155,063,958</u>
Operating income	54,841,494
Non-operating revenues:	
Interest income	<u>567,843</u>
Income before transfers	<u>55,409,337</u>
Transfers to other funds:	
State General Fund	55,160,347
Iowa Department of Public Health – Gambling Treatment Fund	631,416
Total transfers to other funds	<u>55,791,763</u>
Change in net assets	(382,426)
Net assets beginning of year	<u>1,776,625</u>
Net assets end of year	<u>\$ 1,394,199</u>

See notes to financial statements.

Iowa Lottery Authority
Statement of Cash Flows
Year ended June 30, 2004

Cash flows from operating activities:	
Cash received from customers	\$ 208,085,943
Cash paid for prizes	(125,998,668)
Cash paid to retailers	(13,303,839)
Cash paid to suppliers for goods and services	(19,950,971)
Cash paid to employees for services	(7,248,032)
Other operating revenues	1,364,151
	<u>42,948,584</u>
Net cash provided by operating activities	<u>42,948,584</u>
Cash flows from non-capital financing activities:	
Operating transfers	(44,454,931)
	<u>(44,454,931)</u>
Cash flows from capital and related financing activities:	
Acquisition of capital assets	(147,987)
Proceeds from sale of capital assets	27,100
	<u>(120,887)</u>
Net cash used for capital and related financing activities	<u>(120,887)</u>
Cash flows from investing activities:	
Interest income	538,245
Annuity payments received from insurance companies	9,901,114
	<u>10,439,359</u>
Net cash provided by investing activities	<u>10,439,359</u>
Net increase in cash	8,812,125
Cash at beginning of year	7,891,741
	<u>16,703,866</u>
Cash at end of year	<u>\$ 16,703,866</u>
Reconciliation of operating income to net cash provided by operating activities:	
Operating income	\$ 54,841,494
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation	116,317
Gain on sale of capital assets	(6,101)
Change in assets and liabilities:	
(Increase) in prepaid expense	(62,784)
Decrease in accounts receivable	248,043
Decrease in ticket inventories	429,482
(Decrease) in accounts payable	(509,831)
(Decrease) in prizes payable	(1,643,698)
(Decrease) in sales tax payable	(407,640)
Increase in due to other state agencies	62,859
(Decrease) in deferred revenue	(306,464)
Increase in compensated absences	23,712
Increase in personal services payable	60,309
Increase in current annuities payable	4,000
(Decrease) in prize annuities	(9,901,114)
	<u>(11,892,910)</u>
Total adjustments	<u>(11,892,910)</u>
Net cash provided by operating activities	<u>\$ 42,948,584</u>

See notes to financial statements.

Iowa Lottery Authority

Notes to Financial Statements

June 30, 2004

(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

Through June 30, 2004, budgetary control was exercised over the Iowa Lottery Authority through the annual budgetary process prescribed in Chapter 8 of the Iowa Code. Effective July 1, 2004, the authority for establishing the budget of the Iowa Lottery Authority is prescribed in Chapter 99G of the Code of Iowa.

F. Revenue Recognition

Sales of instant, pull-tab, on-line, monitor vending machine and touch play machine 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. Monitor vending machine and touch play machine sales are recognized upon the sale of the ticket to the player. Touch play machine 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 Lottery during the fiscal year which are not owed to jackpot winners until the next fiscal year.

Investments

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

Ticket Inventories

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

Prize Reserve

The 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 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. 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>
Equipment	5-10
Vehicles	2-4

Prize Liability

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 the Powerball, Hot Lotto and Freeplay Replay Game are determined and recognized twice a week after the jackpot drawings are held. Prizes for Pick 3, Pick 4, Freeplay Replay and the \$100,000 Cash Game may be claimed up to 90 days after the jackpot drawing is held. Prizes for Powerball and Hot Lotto may be claimed up to one year after the drawings are held.

Compensated Absences

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

(2) Deposits

The Iowa Lottery Authority's deposits throughout the period and at June 30, 2004 were entirely covered by federal depository insurance or by the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. This chapter provides for additional assessments against the depositories to insure there will be no loss of public funds.

(3) Investment in Prize Annuities and Annuity Prizes Payable

The Iowa Lottery Authority held investments 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 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 \$17,857,043 at year end are all insured and registered investments held by the State of Iowa or held by the State of Iowa's agent in the name of the State.

The Iowa Lottery Authority is responsible for investing in insurance annuities. The Iowa Lottery Authority had investments in insurance annuities with a fair value of \$23,877,766 that are not subject to credit risk categorization.

Assets totaling \$41,896,704, which includes \$161,895 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
2005	\$ 9,901,114	-	9,901,114
2006	-	9,355,574	9,355,574
2007	-	8,152,083	8,152,083
2008	-	6,340,000	6,340,000
2009	-	4,377,000	4,377,000
2010-2014	-	9,528,000	9,528,000
2015-2018	-	4,768,000	4,768,000
Total future value	9,901,114	42,520,657	52,421,771
Less: unamortized discount	(412,664)	(10,139,798)	(10,552,462)
Present value of payments	<u>\$ 9,488,450</u>	<u>32,380,859</u>	<u>41,869,309</u>

(4) Capital Assets

Capital assets activity for the year ended June 30, 2004 is as follows:

	Balance Beginning of Year	Additions	Deletions	Balance End of Year
Equipment	\$ 1,233,029	12,530	59,920	1,185,639
Vehicles	999,174	135,457	121,750	1,012,881
Total capital assets	<u>2,232,203</u>	<u>147,987</u>	<u>181,670</u>	<u>2,198,520</u>
Less accumulated depreciation:				
Equipment	(1,178,645)	21,107	59,919	(1,139,833)
Vehicles	(773,061)	95,210	100,752	(767,519)
Total accumulated depreciation	<u>(1,951,706)</u>	<u>116,317</u>	<u>160,671</u>	<u>(1,907,352)</u>
Capital assets, net	<u>\$ 280,497</u>	<u>31,670</u>	<u>20,999</u>	<u>291,168</u>

(5) 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, 2004, 2003 and 2002. Contribution requirements are established by state statute. The Iowa Lottery Authority's contributions to IPERS for the years ended June 30, 2004, 2003 and 2002 were \$327,398, \$283,343 and \$271,028, respectively, equal to the required contributions for each year.

(6) 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, 2006. In addition, the Iowa Lottery Authority rents pull tab and instant ticket machines under long-term operating leases which expire by December 31, 2004.

The following is a schedule, by year, of future minimum rental payments required under operating leases which have initial or remaining non-cancelable lease terms in excess of one year as of June 30, 2004:

<u>Year ending June 30,</u>	<u>Amount</u>
2005	\$ 1,548,224
2006	<u>146,944</u>
Total	<u>\$ 1,695,168</u>

Rental expense for all operating leases totaled \$2,610,251 for the year ended June 30, 2004.

(7) Accounts Receivable

The components of accounts receivable at June 30, 2004 are as follows:

Due from agents	\$ 3,113,595
Due from others	<u>66,876</u>
Subtotal	3,180,471
Less allowance for doubtful accounts	<u>(57,133)</u>
Accounts receivable, net	<u>\$ 3,123,338</u>

Bad debt expense of \$16,804 for the year ended June 30, 2004 was charged against instant ticket sales.

(8) Payment of Prizes

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

The Powerball prize expense is comprised of two different prize structures. One prize structure is winners who match 3, 4 or 5 of 5 numbers or none, 1, 2, 3 or 4 of 5 numbers plus 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, monitor vending machine and touch play machine prizes are paid by the retailer who sold the ticket. Therefore, substantially all of the pull-tab and monitor vending machine prize expense shown on the financial statements has been disbursed to the prize winner. Touch Play machine sale revenues are recorded net of prize expense in the financial statements.

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 \$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 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.

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

During the year ended June 30, 2004, \$310,761 in prizes were distributed through various promotional activities.

(9) Lotto America/Powerball

U.S. Treasury zero coupon bonds are purchased by the Multi-State Lottery Association (MUSL) to provide payments corresponding to the Iowa Lottery 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, 2004, the MUSL held zero coupon bonds for the Iowa Lottery Authority to fund future installment payments aggregating \$12,338,448. The current value of those bonds totaled \$11,597,242.

(10) 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, 2004, the Iowa Lottery Authority has 20,960 packs at retailers which have not yet settled. The receivable and the related deferred revenue of \$2,814,480, 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	\$ 6,288,000
Less:	
Retailer compensation	419,307
Low-tier prize expense	<u>3,054,213</u>
Receivable and deferred amount	<u>\$ 2,814,480</u>

(11) Risk Management

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

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

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

(12) Subsequent Events

In October 2004, the Iowa Lottery Authority issued \$8,800,000 of Lottery Revenue Bonds for the purchase, financing and installation of approximately 300 instant ticket vending machines and 1,000 pull-tab vending machines. The proceeds will also be used to purchase, finance and renovate real property for use as the Authority's Headquarters. The Iowa Lottery Authority has entered into purchase agreements for the instant and pull-tab vending machines and a building to serve as Headquarters.

Iowa Lottery Authority

Supplementary Information

Schedule 1

Iowa Lottery Authority

Other Operating Expenses

For the year ended June 30, 2004

Personal services	\$ 7,332,053
Travel	321,020
Supplies	106,211
Printing	42,445
Postage	12,499
Communications	126,972
Rentals	602,692
Utilities	67,885
Professional fees	82,458
Outside services and repair	65,940
Non-capitalized equipment	133,976
Data processing	10,322
Reimbursement to state agencies	353,296
Multi-State administrative expense	230,810
Depreciation	116,317
Insurance	73,897
Other	<u>9,893</u>
Total	<u><u>\$ 9,688,686</u></u>

See accompanying independent auditor's report.

Iowa Lottery Authority
Revenues, Expenses and Changes in Net Assets
Years ended June 30, 2004 and 2003

	2004	2003	Increase (Decrease)
Operating revenues:			
Instant ticket sales	\$ 95,258,080	80,895,147	14,362,933
Pick 3 sales	6,333,801	5,726,212	607,589
Pick 4 sales	1,662,015	-	1,662,015
Powerball sales	65,967,337	54,797,706	11,169,631
Hot Lotto sales	7,717,962	5,685,215	2,032,747
Monitor vending machine sales	1,257,087	186,641	1,070,446
Touch Play machines (net receipts)	303,079	-	303,079
Freeplay Replay sales	77,330	324,617	(247,287)
\$100,000 Cash Game sales	4,430,118	4,228,928	201,190
Pull-tab sales	25,528,391	27,022,871	(1,494,480)
Application fees	18,450	16,825	1,625
Prize reserve refunds	1,338,053	-	1,338,053
Unclaimed Powerball jackpot	-	1,155,767	(1,155,767)
Other	13,749	19,504	(5,755)
Total operating revenues	<u>209,905,452</u>	<u>180,059,433</u>	<u>29,846,019</u>
Operating expenses:			
Prizes:			
Instant ticket	55,231,505	49,816,015	5,415,490
Pick 3	3,723,158	3,566,507	156,651
Pick 4	899,662	-	899,662
Powerball	31,756,964	27,403,942	4,353,022
Hot Lotto	3,761,399	3,067,550	693,849
Monitor vending machine	945,638	147,328	798,310
Freeplay Replay	35,897	178,769	(142,872)
\$100,000 Cash Game	1,907,647	2,080,865	(173,218)
Pull-tab	15,884,332	17,655,043	(1,770,711)
Promotional	310,761	283,140	27,621
Total prizes	<u>114,456,963</u>	<u>104,199,159</u>	<u>10,257,804</u>
Retailer compensation	13,303,839	11,763,229	1,540,610
Advertising/publicity	6,115,714	5,739,275	376,439
Vendor compensation/network expense	6,549,862	6,781,087	(231,225)
Instant and Pull-tab rental and inventory expense	4,948,894	4,803,090	145,804
Other operating expenses	9,688,686	8,955,881	732,805
Total operating expenses	<u>155,063,958</u>	<u>142,241,721</u>	<u>12,822,237</u>
Operating income	54,841,494	37,817,712	17,023,782
Non-operating revenues:			
Interest income	567,843	653,429	(85,586)
Income before transfers	55,409,337	38,471,141	16,938,196
Transfers to other funds	55,791,763	39,008,480	16,783,283
Changes in net assets	(382,426)	(537,339)	154,913
Net assets beginning of year	1,776,625	2,313,964	(537,339)
Net assets end of year	<u>\$ 1,394,199</u>	<u>1,776,625</u>	<u>(382,426)</u>

See accompanying independent auditor's report.

Schedule 3

Iowa Lottery Authority

Analysis of Net Assets

June 30, 2004

Assets:

Restricted assets - cash on deposit with Vehicle Dispatcher	\$ 501,609
Ticket inventories	1,101,422
Capital assets, net	291,168
Less additional transfer in accordance with House File 655	<u>(500,000)</u>
	<u>\$ 1,394,199</u>

See accompanying independent auditor's report.

Iowa Lottery Authority

Revenue by Game -
For the Last Five Years

Games	Year ended June 30,				
	2000	2001	2002	2003	2004 *
Instant ticket	\$ 85,958,684	80,164,456	76,754,614	80,895,147	95,258,080
Pick 3	3,881,002	3,802,826	4,717,393	5,726,212	6,333,801
Pick 4	-	-	-	-	1,662,015
Lotto America/Powerball	45,715,822	49,626,328	57,966,865	54,797,706	65,967,337
Rolldown	-	2,109,976	1,139,610	-	-
Hot Lotto	-	-	1,277,648	5,685,215	7,717,962
Pull-tab	25,921,140	25,722,808	26,324,246	27,022,871	25,528,391
Daily Millions/Cash 4 Life	3,172,828	481,238	-	-	-
\$100,000 Cash Game	4,665,929	4,081,822	4,138,619	4,228,928	4,430,118
Freeplay Replay	395,969	636,538	350,049	324,617	77,330
Monitor vending machine	-	-	-	186,641	1,257,087
Touch Play machine (net receipts)	-	-	-	-	303,079
Total	\$ 169,711,374	166,625,992	172,669,044	178,867,337	208,535,200

* - 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 year ended June 30, 2004 is 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,				
	2000	2001	2002	2003	2004
Instant ticket	61%	61%	61%	62%	58%
Pick 3	62%	60%	61%	62%	59%
Pick 4	-	-	-	-	54%
Lotto America/Powerball	51%	51%	51%	50%	48%
Rolldown	-	54%	45%	-	-
Hot Lotto	-	-	53%	55%	49%
Pull-tab	65%	65%	65%	65%	62%
Daily Millions/Cash 4 Life	51%	32%	-	-	-
\$100,000 Cash Game	48%	49%	49%	49%	43%
Freeplay Replay	68%	60%	55%	55%	46%
Monitor vending machine	-	-	-	79%	75%
Touch Play machine	-	-	-	-	63%

See accompanying independent auditor's report.



OFFICE OF AUDITOR OF STATE
STATE OF IOWA

David A. Vaudt, CPA
Auditor of State

State Capitol Building
Des Moines, Iowa 50319-0004

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

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

To the Members of the Iowa
Lottery Board:

We have audited the financial statements of the Iowa Lottery Authority, a component unit of the State of Iowa, as of and for the year ended June 30, 2004, and have issued our report thereon dated November 9, 2004. We conducted our audit in accordance with U.S. generally accepted auditing standards, Chapter 11 of the Code of Iowa and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the 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 that are required to be reported under Government Auditing Standards.

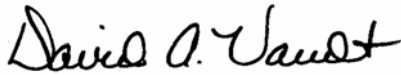
Internal Control Over Financial Reporting

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.

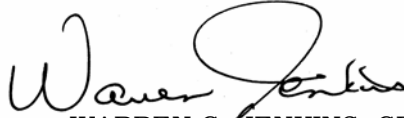
A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected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

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

November 9, 2004

Iowa Lottery Authority

Schedule of Findings

Year ended June 30, 2004

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. 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 January 23, 2004 identified conditions where, in their opinion, control objectives had not been achieved, as follows:

- (A) Certain information protection policies and procedures were not fully implemented for the Scientific Games system.
- (B) Physical access to the facility and computing equipment was not restricted to limit personnel to the minimum level of access required to perform their assigned responsibilities.
- (C) System security logging and reporting functions were not fully enabled.
- (D) Certain backup files are not taken off-site according to the scheduled intervals.
- (E) Certain logs and checklists were not always complete.

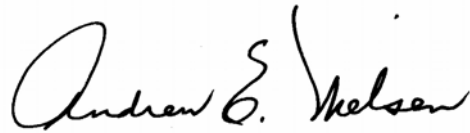
The Iowa Lottery Authority and Scientific Games International, Inc. is in the process of addressing or implementing changes to correct the conditions noted. These items will be reviewed during the next evaluation of the Lottery data processing controls in effect at Scientific Games International, Inc.

Iowa Lottery Authority

Staff

This audit was performed by:

Pamela J. Bormann, CPA, Manager
Lesley R. Geary, CPA, Senior Auditor II
Kip M. Druecker, Staff Auditor
Daniel L. Durbin, CPA, Staff Auditor
Sarah D. McFadden, CPA, Staff Auditor
Heather L. Templeton, Staff Auditor
Michael J. Gentry, Jr., CPA, Assistant Auditor
Corinne M. Johnson, Assistant Auditor
Donald N. Miksch, Assistant Auditor
Brandon J. Yuska, Assistant Auditor

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

Andrew E. Nielsen, CPA
Deputy Auditor of State