

COMPLIANCE AUDIT, FINANCIAL
STATEMENTS AND REPORT OF
INDEPENDENT CERTIFIED PUBLIC
ACCOUNTANTS

COLORADO LOTTERY

JUNE 30, 1999 AND 1998

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COLORADO LOTTERY FINANCIAL STATEMENTS

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COLORADO LOTTERY
FINANCIAL HIGHLIGHTS
\$ IN MILLIONS
AS OF JUNE 30, 1999

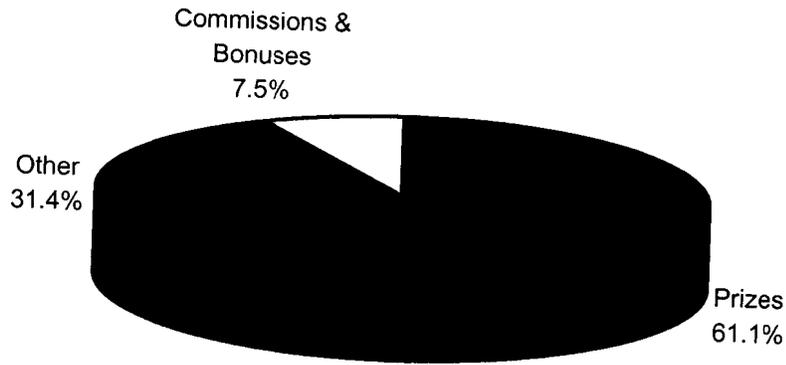
	Total	Actual Percent	Budgeted Percent
INCOME			
Gross Ticket Sales	\$368.40		
Other Income	2.07		
TOTAL INCOME	370.47		
LESS:			
PRIZES	\$224.94	61.1% (1)	60.0%
RETAILER COMMISSIONS AND BONUS	\$27.79	7.5% (1)	7.6%
ADMINISTRATIVE COSTS			
Ticket Costs	10.76		
Operating Expenses	22.48		
TOTAL ADMINISTRATIVE COSTS	33.24	9.0% (2)	9.1%
NET INCOME BEFORE OPERATING TRANSFERS	\$84.50	22.8% (2)	23.5%

Note 1: Percent of gross ticket sales.

Note 2: Percent of total income.

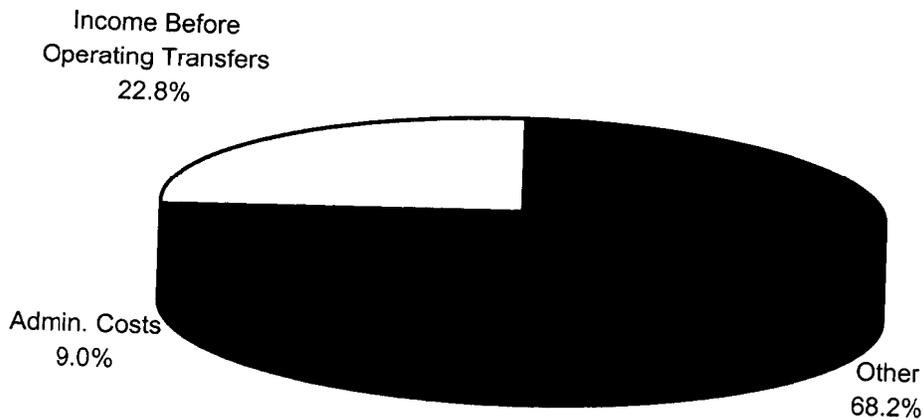
COLORADO LOTTERY
SUPPLEMENT TO FINANCIAL HIGHLIGHTS
AS OF JUNE 30, 1999

PERCENT OF GROSS TICKET SALES



To depict compliance with the 50% prize payment statute and the commission/bonus rules.

PERCENT OF TOTAL INCOME



To depict status of administrative expenditures to date.

REPORT SUMMARY
COLORADO LOTTERY
FINANCIAL AND COMPLIANCE AUDIT
FISCAL YEAR ENDED JUNE 30, 1999

Authority, Purpose and Scope

The audit of the Colorado Lottery was done under authority of Section 24-35-211, C.R.S., which requires an annual audit of the Lottery Fund. The purpose of the audit was to express an opinion on the financial statements of the Colorado Lottery for the year ended June 30, 1999.

We conducted our audit in accordance with generally accepted auditing standards. We obtained our information by reviewing documents, interviewing staff, analyzing data, and performing other audit procedures as we deemed necessary. Audit work was performed from May through September 1999.

Financial Audit Opinion

We have issued an unqualified opinion dated August 27, 1999, on the Colorado Lottery's June 30, 1999, financial statements.

Current Year
Findings and Recommendations

There are no current year findings and recommendations.

Summary of Progress in Implementing
Prior Year Recommendations

There were no prior year recommendations.

Required Communications

The following specific matters are required to be discussed with the Audit Committee in accordance with Statement on Auditing Standard No. 61, *Communication with Audit Committees*. The matters discussed herein are those that we have noted as of August 27, 1999, and we have not updated our procedures regarding these matters since that date to the current date. Accordingly, we advise you of the following with respect to the Colorado Lottery (Lottery) for the year ended June 30, 1999:

Auditors' Responsibility Under Generally Accepted Auditing Standards and *Government Auditing Standards*

- Our audit was conducted in accordance with generally accepted auditing standards and *Government Auditing Standards* and was designed to provide reasonable, rather than absolute, assurance that financial statements are free of material misstatement.
- Our responsibility is to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. As such, our audit of Lottery's financial statements is not designed to determine Lottery's readiness for the year 2000. Further, we have no responsibility with regard to Lottery's efforts to make its systems, or any other systems, such as those of vendors, service providers, or any other third parties year 2000 ready, or to provide assurance on whether Lottery has addressed or will be able to address all affected systems on a timely basis.

Disagreements with Management

For purposes of these required communications, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter which could be significant to the Lottery's financial statements or the audit report. We are pleased to report that no such disagreements arose during the course of our audit.

Our Responsibility for Other Information in Documents Containing Audited Financial Statements

Pursuant to professional standards, the auditors' responsibility for other information in documents containing the Lottery's audited financial statements does not extend beyond the financial information identified in the audit report, and the auditor is not required to perform procedures to corroborate such other information. However, in accordance with such standards, we are required to read the information in such documents and consider whether such information, or the manner of its presentation, is materially inconsistent with its presentation in the financial statements. Our responsibility also includes calling to management's attention any information which we believe is a material misstatement of fact.

DESCRIPTION OF THE COLORADO LOTTERY AND THE LOTTERY COMMISSION

The Colorado Lottery was created as a Division within the Department of Revenue with the passage of Senate Bill 119 on April 30, 1982. The Lottery began operations on July 1, 1982 and sold its first lottery ticket on January 24, 1983.

During Fiscal Year 1999, the Lottery employed 125 FTE in its headquarters in Pueblo and branch offices in Denver, Fort Collins and Grand Junction.

The Lottery is governed by a Commission of five members appointed by the Governor. By statute, Lottery Commission members must include an attorney, a certified public accountant and a law enforcement officer. Members may serve up to two 4-year terms. The Commission's responsibilities are stated in Section 24-35-208, C.R.S., and include:

Promulgation of rules and regulations to govern Lottery operations.

Carrying on a continuous study and investigation of the Lottery to determine the need for changes in statutes, rules or regulations or in the administration and operation of the Lottery.

The Lottery's enabling legislation requires that no less than 50 percent of the total revenue from sales of lottery tickets be for prizes. The legislation also provides guidelines for distribution of net proceeds to beneficiary agencies. "Net lottery proceeds" (that is, proceeds after the payment of prizes and lottery expenses and a reserve for future operations) are to be distributed to the Conservation Trust Fund, the State Division of Parks and Outdoor Recreation, Capital Construction for the State, and Great Outdoors Colorado Trust Fund. The final distribution to Capital Construction for the State was made during the year ended June 30, 1999.

On May 29, 1999, sales of the Perfecto on-line game were terminated. Elimination of Perfecto did not alter the distribution method used by the Lottery in allocating earnings.

Report of Independent Certified Public Accountants

Members of The Legislative Audit Committee

We have audited the accompanying balance sheets of the Colorado Lottery (Lottery) as of June 30, 1999 and 1998, and the related statements of revenues, expenses and changes in retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with 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 that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Colorado Lottery, an enterprise fund of the State of Colorado. The financial statements are intended to present the financial position and the results of operations and cash flows of only that portion of the State of Colorado that is attributable to the transactions of the Colorado Lottery in conformity with generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Colorado Lottery as of June 30, 1999 and 1998, and the results of its operations and its cash flows for the years then ended, in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 27, 1999, on our consideration of the Lottery's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations and contracts.

Colorado Springs, Colorado
August 27, 1999

STATE OF MICHIGAN
JUNE 30, 1999 AND 1998

ASSETS	1999	1998
Current Assets:		
Cash and Investments	\$ 19,947,231	\$ 26,331,051
Accounts Receivable	12,891,231	15,211,073
Consignment Inventory, at Cost	212,328	207,322
Warehouse Inventory, at Cost	1,428,702	1,186,963
Prepaid Expenses	18,908	33,027
Total Current Assets	34,498,400	42,969,436
Restricted Assets:		
Cash and Investments-Conservation Trust Fund	0	2,149,336
Cash and Investments-Licensed Agent Recovery Reserve Receipts	310,593	239,986
Total Restricted Assets	310,593	2,389,322
Fixed Assets:		
Equipment	5,411,782	5,150,527
Leasehold Improvements	254,508	254,508
Less Accumulated Depreciation and Amortization	(3,543,508)	(3,219,687)
Total Fixed Assets	2,122,782	2,185,348
TOTAL ASSETS	\$ 36,931,775	\$ 47,544,106
LIABILITIES & RETAINED EARNINGS		
Liabilities:		
Accounts Payable	\$ 2,701,711	\$ 5,658,505
Wages & Benefits	13,360	146,382
Funds Available for Distribution	17,500,481	17,961,508
Funds Held for Conservation Trust Fund	0	2,132,639
Prize Liability	13,594,311	18,288,384
Retailer Bonus Liability	512,661	650,651
Deferred Revenue	465,141	450,817
Accrued Annual and Sick Leave	751,623	686,637
Expired Warrants Liability	110,370	106,586
Total Liabilities	35,649,658	46,082,109
Retained Earnings:		
Unreserved	1,000,000	1,000,000
Reserved		
Unrealized Gain (Loss) on Investments	(28,476)	222,011
Licensed Agent Recovery Reserve	310,593	239,986
Total Retained Earnings	1,282,117	1,461,997
TOTAL LIABILITIES & RETAINED EARNINGS	\$ 36,931,775	\$ 47,544,106

The accompanying notes are an integral part of these financial statements.

COLORADO LOTTERY
STATEMENTS OF REVENUES, EXPENSES AND
CHANGES IN RETAINED EARNINGS
FOR THE FISCAL YEARS ENDED JUNE 30, 1999 AND 1998

	1999	1998
GROSS TICKET SALES	\$ 368,404,165	\$ 374,282,243
PRIZE EXPENSE	(224,940,615)	(220,420,715)
COMMISSIONS, BONUS, AND TICKET COSTS		
Retailer Commission and Bonus	(27,787,798)	(25,386,484)
Cost of Tickets & Vendor Fees	(10,764,251)	(10,720,372)
GROSS PROFIT ON SALE OF TICKETS	104,911,501	117,754,672
OPERATING EXPENSES		
Marketing and Communications	10,056,698	9,860,542
Wages and Benefits	6,834,326	6,699,453
Professional Services	316,531	197,718
State Agencies Services	154,845	177,528
Department of Revenue Services	304,811	313,534
Travel	135,808	112,994
Equipment	100,717	307,208
Depreciation	446,087	459,998
Accrued Annual and Sick Leave	64,575	30,831
Space Rental	426,156	406,683
Rents for Equipment	1,060,342	905,909
Motorpool Leasing	284,739	304,277
Materials and Supplies	253,044	120,503
Telephone	151,887	142,896
On-Line Telecommunications	1,204,768	1,215,107
Data Processing Supplies and Services	55,387	59,395
Equipment Maintenance	315,015	286,235
Postage	89,818	64,558
Printing	92,664	152,720
Other	134,519	108,040
TOTAL OPERATING EXPENSES	22,482,737	21,926,129
OPERATING INCOME	82,428,764	95,828,543
Other Revenue	405,508	267,608
Interest Income	1,669,947	1,692,113
INCOME BEFORE OPERATING TRANSFERS	84,504,219	97,788,264
LESS OPERATING TRANSFERS OUT:		
Funds Distributed for Current Year	(67,183,618)	(79,613,886)
Funds Available for Distribution for Current Year	(17,500,481)	(17,961,508)
NET INCOME (LOSS)	(179,880)	212,870
RETAINED EARNINGS, BEGINNING OF YEAR	1,461,997	1,249,127
Net Income (Loss)	(179,880)	212,870
RETAINED EARNINGS, END OF YEAR	\$ 1,282,117	\$ 1,461,997

The accompanying notes are an integral part of these financial statements.

COLORADO LOTTERY
STATEMENTS OF CASH FLOWS
FOR THE FISCAL YEARS ENDED JUNE 30, 1999 & 1998

	1999	1998
Cash flows from operating activities:		
Cash received from retailers	\$ 174,565,513	\$ 184,953,171
Cash paid in prizes	(65,751,950)	(56,662,191)
Cash payments to suppliers	(23,356,400)	(24,245,925)
Cash payments to employees for services	(6,856,748)	(6,589,388)
Cash received from lotto subscription sales	817,761	806,030
Cash paid in retailer bonus	(1,888,755)	(1,664,659)
Cash received - other	35,805	21,306
	77,565,226	96,618,344
Cash flows from non-capital financing activities:		
Distribution of net proceeds	(85,145,126)	(96,210,973)
Decrease in funds held for Conservation Trust Fund	(2,132,639)	(1,604,040)
	(87,277,765)	(97,815,013)
Cash flows from capital and related financing activities:		
Acquisition of capital assets	(401,511)	(842,938)
Cash flows from investing activities:		
Interest received	1,901,988	1,557,290
Net decrease in cash and investments	(8,212,062)	(482,317)
Cash and investments, Beginning of Year (including \$2,372,625 and \$3,898,618, respectively, in restricted accounts)	28,720,373	28,980,679
Unrealized gains (losses) on investments	(250,487)	222,011
Cash and investments, End of Year, (including \$310,593 and \$2,372,625, respectively, in restricted accounts)	\$ 20,257,824	\$ 28,720,373
<i>Reconciliation of operating income to net cash provided by operating activities:</i>		
<i>Operating income</i>	\$ 82,428,764	95,828,543
<i>Adjustments to reconcile operating income to net cash</i>		
<i>Depreciation</i>	446,087	459,998
<i>Loss on disposition of equipment</i>	36,436	128,275
<i>Other revenue</i>	405,508	267,608
<i>Change in:</i>		
<i>Accounts Receivable</i>	2,319,842	(514,097)
<i>Ticket Inventory</i>	(246,745)	(93,377)
<i>Other Assets</i>	14,119	(5,511)
<i>Liabilities</i>	(7,838,785)	546,905
<i>Net cash provided by operating activities</i>	\$ 77,565,226	\$ 96,618,344

The accompanying notes are an integral part of these financial statements.

**COLORADO LOTTERY
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 1999 AND 1998**

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

The Colorado Lottery was incorporated April 30, 1982, under the provision of C.R.S. 24-35-202. The Colorado Lottery operates under a Commission and provides operation and service of lottery games as authorized by the statute. The Lottery's revenues are predominately earned from the sale of lottery products including scratch, lotto, perfecto (through May 29, 1999) and cash 5.

The financial statements reflect activities of the Colorado Lottery, a proprietary fund of the State of Colorado, plus funds held for the Conservation Trust Fund, a non-expendable trust fund of the State of Colorado, for the fiscal years ended June 30, 1999 and 1998. All intra-agency transactions have been eliminated for reporting purposes. The Colorado Lottery is an agency of the State of Colorado. The financial statements present only the Colorado Lottery, an enterprise fund of the State of Colorado. The financial statements are intended to present the financial position and results of operations and cash flows of only that portion of the State of Colorado that is attributable to the transactions of the Colorado Lottery in accordance with generally accepted accounting principles.

The accounting policies of the Colorado Lottery conform to generally accepted accounting principles as applicable to governments. The following is a summary of the more significant policies:

A. Fund Accounting

Government resources are allocated to and accounted for in separate sub-entities, called funds, based upon the purposes for which the resources are to be spent and the means by which spending activities are controlled. A fund is a fiscal and accounting entity with a self-balancing set of accounts that comprise its assets, liabilities, fund equity, revenues, and expenditures.

B. Enterprise Fund

The Colorado Lottery accounts for its operations as an enterprise fund. The intent of the State of Colorado Legislature is that the cost (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges. As permitted by Governmental Accounting Standards Board Statement No. 20, the Colorado Lottery has elected to apply only those applicable Financial Accounting Standards Board Statements and interpretations issued prior to November 30, 1989.

C. Basis of Accounting

Basis of accounting refers to when revenues, expenditures or expenses are recognized in the accounts and reported in the financial statements.

The Colorado Lottery accounts for funds using the accrual basis of accounting. Revenues from scratch ticket sales are recognized at the point of pack activation. Revenues from lotto ticket, perfecto ticket, cash 5 ticket, and subscription sales are recognized using the specific performance method whereby sales are recognized at the point that the play becomes active for the next drawing. Expenses are recognized when they are incurred.

D. Budget

By October 24th of each year, the Department Director submits to the Office of State Planning and Budgeting a proposed legislative budget for the fiscal year commencing the following July 1. The legislative budget includes proposed expenditures and the means of financing them.

Public hearings are conducted by the Joint Budget Committee to obtain clarification and taxpayer comments. Prior to June 30, the budget is legally enacted through passage of a statute referred to as the Long Bill.

During the fiscal year, the approved legislative budget may be modified due to roll-forward authorization, supplemental budget approval, or line item transfer authorization. All modifications must be approved by the Legislature, the State Controller, and the Office of State Planning and Budgeting.

E. Allowance for Doubtful Accounts

Allowance for Doubtful Accounts represents a provision for receivables that will probably not be collected in the future. Consideration of the economic climate, credit-worthiness of individual account debtors, bankruptcy of debtor, discontinuance of debtor's business, failure of repeated attempts to collect, and barring of collection by statute of limitations are factors used in considering when an account becomes uncollectible. The accrual of a loss contingency is required when a loss is probable and can be reasonably estimated.

The Colorado Lottery uses the specific identification method to determine expected uncollectibles. Under the provision of C.R.S. 24-35-219, licensed agent recovery reserve receipts are collected from the retailers to cover uncollectible accounts. The accounts receivable and the licensed agent recovery reserve are shown net of estimated uncollectible receivables of \$93,831 and \$94,191 as of June 30, 1999 and June 30, 1998, respectively.

F. Consignment Inventory

Inventory on consignment represents non-activated ticket inventory in the possession of retailers who act as agents of the Colorado Lottery. The Lottery retains title to these tickets since retailers have the right to return non-activated tickets; therefore, the tickets are included in the inventory and reported on the balance sheet. Consignment inventory is stated at cost using the specific identification method.

G. Warehouse Inventory

Warehouse inventory represents unsold tickets in possession of the Lottery and is stated at cost using the specific identification method.

H. Supplies Inventory

The State of Colorado's threshold for recording supplies inventories is \$35,000 per location. The supplies inventory of the Colorado Lottery consistently falls below the \$35,000 threshold per location. Accordingly, no supplies inventory appears on the balance sheet.

I. Fixed Assets

Equipment and leasehold improvements are stated at cost. Beginning September 1, 1996, equipment may be capitalized if the cost exceeds \$5,000 and has a useful life of more than one year, however, a state agency may select a minimum acquisition cost or useful life which is less than the stated criteria for capitalization. Accordingly, the Lottery capitalizes equipment with a cost of \$1,000 or more that has a useful life of more than one year. Depreciation for equipment is computed on the straight-line method over estimated useful lives ranging from three to eight years. Leasehold improvements are depreciated over the shorter of the lease term or the estimated useful lives of the improvements. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts, and resulting gains or losses are recognized in current operations.

J. Prize Liability and Prize Expense

Under the provision of C.R.S. 24-35-210, the Colorado Lottery must pay no less than fifty percent (50%) of total ticket sales as prizes. In the aggregate, all games to date are planned to pay 50% or more of total ticket sales in prizes. Additional prize expense and corresponding liability may be incurred as a result of market fluctuations in the cost of annuities used to pay lotto jackpots (see note 8).

All scratch, on-line, and special drawing prizes are accounted for using the accrual basis of accounting. The liability for scratch prizes and on-line prizes is recognized at the point of retail sale. The liability for special drawing prizes is accrued on the first day of sales.

The Colorado Lottery enables all retailers to pay scratch prizes on barcoded games of less than \$600 by validating them through the on-line terminal. Payment of scratch prizes of \$600 or more must be done by the Lottery. Prizes may be claimed up to 180 days after game-end. After the final claim date, any unclaimed scratch prizes will result in a decrease to prize expense and any prizes claimed in excess of the liability accrued will result in an increase to prize expense. Net unclaimed scratch prizes resulted in a decrease to prize expense of \$4,138,169 for the fiscal year ended June 30, 1999 and \$2,607,494 for the fiscal year ended June 30, 1998.

Payments of cumulative on-line prize amounts of \$150 or less on a single ticket may be done at the Lottery or at the retail outlet; payment of cumulative prize amounts of \$151 to \$600 on a single ticket may be done at the retailer level at the option of the retailer, or at the Lottery. Payment of cumulative prize amounts of \$600 or more on a single ticket must be done at the Lottery. Retailers are given credit for prize payments they make on a daily basis. On-line prizes may be claimed up to 180 days after the date of the drawing. After the final claim date, unclaimed on-line prizes will result in a decrease to prize expense so long as the aggregate prize expense exceeds or equals the statutory fifty percent of sales per the Fiscal Year 1998 interpretation of the payout rule. Unclaimed on-line prizes resulted in a decrease to prize expense of \$5,121,282 for the fiscal year ended June 30, 1999 and \$6,920,272 for the fiscal year ended June 30, 1998.

K. Retailer Bonus Liability

Under provision 5.10 and 10.10 of the Colorado Lottery Commission Rules and Regulations effective as of July 1, 1997:

". .the Director may provide such additional compensation to licensees as is deemed appropriate by the Director to further the sale of lottery tickets, so long as such additional compensation is made equally available to all licensees and does not exceed a total of One and Thirteen Hundredths Percent (1.13%) for scratch, Seven Tenths Percent (.7%) for lotto, Ninety-six Hundredths Percent (.96%) for Cash 5, Ninety-six Hundredths Percent (.96%) for Hot Dice, Eighty-four Hundredths Percent (.84%) for Football Fortune, Eighteen Hundredths Percent (.18%) for Holiday Bucks, and Forty-four Hundredths Percent (.44%) for Tic Tac Dough."

A portion of the additional compensation shall be used to pay each licensee, as a bonus, an amount (Cashing Bonus) equal to One Percent (1%) of each prize paid by the licensee up to and including \$599.99.

At the Director's discretion, the residual resulting after paying the cashing bonuses may be used to provide additional compensation to licensees and/or to decrease the bonus expense by reverting the excess amount.

The cashing bonus is accrued as tickets are sold and paid as winning tickets are redeemed. Any cashing bonuses unclaimed at the end of the claim period result in a reduction of bonus expense.

L. Licensed Agent Recovery Reserve

Under the provision C.R.S. 24-35-219, a licensed agent recovery reserve was established on July 1, 1988 to maintain surety bond receipts collected from Colorado Lottery retailers. Billing rates are established by the Lottery Commission and are reviewed on an annual basis. Retailers have the option to obtain private surety bond coverage at a rate of \$2,000 surety coverage per outlet at their discretion.

M. Compensated Leave

All permanent employees of the Colorado Lottery may accrue annual and sick leave based on length of service subject to certain limitations on the amount that will be paid on termination. In addition, employees who are classified as non-exempt from overtime pay have accumulated overtime which must be taken as compensatory time or paid. The estimated cost of compensated absence for which employees are vested is as follows:

	<u>June 30, 1999</u>	<u>June 30, 1998</u>	<u>Increase</u>
Annual Leave	\$557,926	\$502,349	\$ 55,577
Sick Leave	<u>190,971</u>	<u>181,973</u>	<u>8,998</u>
Total Annual & Sick Leave	748,897	684,322	64,575
Compensatory Time	<u>2,726</u>	<u>2,315</u>	<u>411</u>
Total Compensated Leave	<u>\$751,623</u>	<u>\$686,637</u>	<u>\$64,986</u>

N. Expired Warrants Liability

Expired Warrants Liability represents the expiration of aged uncashed warrants and imprest checks over one (1) year old. In accordance with C.R.S. 15-12-914, recipients are entitled to claim payment up to 21 years after original date of issue.

O. Pension Plan

a. Plan Description

Virtually all of the Colorado Lottery's employees participate in a defined benefit pension plan. The plan's purpose is to provide income to members and their families at retirement or in case of death or disability. The plan is a cost sharing multiple employer plan administered by the Public Employees' Retirement Association (PERA). PERA was established by state statute in 1931. Responsibility for the organization and administration of the plan is placed with the Board of Trustees of PERA. Changes to the plan require legislation by the General Assembly. The state plan and other divisions' plans are included in PERA's financial statements which may be obtained by writing PERA at 1300 Logan Street, Denver, Colorado 80203.

Plan members vest after five years of service and most are eligible for retirement benefits at age 50 with 30 years of service, age 60 with 20 years of service, or at age 65 with 5 years of service. State troopers and judges comprise a small percentage of plan members but have higher contribution rates and are eligible for retirement benefits at different ages and years of service. Monthly benefits are calculated as a percentage of highest average salary (HAS). HAS is one-twelfth of the average of the highest salaries on which contributions were paid, associated with three periods of 12 consecutive months of service credit.

Members disabled, who have five or more years of service credit, six months of which has been earned since the most recent period of membership, may receive retirement benefits if determined to be permanently disabled. If members die before retirement, their spouses or their eligible children under the age of 18 (23 if a full time student) are entitled to monthly benefit payments. If there is no eligible spouse, financially dependent parents will receive a survivor's benefit.

b. Funding Policy

Most employees contribute 8 percent (11.5 percent for state troopers) of their annual gross covered wages to an individual account in the plan. The State contributes 10.6 percent (12.3 percent for state troopers) of the employee's gross covered wages. The annual gross covered wages subject to PERA is the gross earnings less any reduction in pay to offset employer contributions to the state sponsored IRC 125 plan established under Section 125 of the Internal Revenue Code. The contribution requirements of plan members and their employers are established, and may be amended, by the General Assembly.

The Colorado Lottery's contributions to PERA for the fiscal years ending June 30, 1999, 1998 and 1997 were \$623,831, \$601,917 and \$555,578 respectively. These contributions were equal to the required contributions for each year.

P. Post Retirement Health Care and Life Insurance Benefits

Health Care Program

The PERA Health Care Program began covering benefit recipients and qualified dependents on July 1, 1986. This benefit was developed after legislation in 1985 established the Program and the Health Care Fund. Under this program, PERA subsidizes a portion of the monthly premium for health care coverage. The benefit recipient pays any remaining amount of that premium through an automatic deduction from the monthly retirement benefit. During 1998, the subsidy was \$115.00 for those with 20 years of service credit and reduced by \$5.75 for each year under 20.

The Health Care Fund is maintained by an employer's contribution of 0.8 percent of covered salary. During the fiscal years ending June 30, 1999 and 1998, the Colorado Lottery paid \$44,070 and \$42,000, respectively, into this Fund.

Monthly premium costs for participants depend on the health care plan selected, the number of persons being covered, Medicare eligibility and the number of years of service credit a retiree has. PERA contracts with a major medical indemnity carrier to administer claims for self-insured plans, and with health maintenance organizations providing services within Colorado. During 1998 there were approximately 37,400 participants, including spouses and dependents from all contributors to the plan.

Life Insurance Program

PERA provides its members access to two group life insurance plans offered by Prudential and Rocky Mountain Life. Members may join one or both plans and they may continue coverage into retirement. Premiums are paid monthly by payroll deduction.

Q. Deferred Revenue

The Lottery offers two methods of purchasing on-line tickets for future draws. One is purchased through the terminal, referred to as Advance Play, and allows the player to purchase on-line tickets good for up to 10 draws. The second method is restricted to lotto tickets only and is purchased through the mail via a pre-printed form, referred to as subscription, and allows the player to purchase lotto tickets good for up to 104 draws. The revenues generated from both methods are recognized as the draws occur. Revenues for future draws are classified as a liability.

A detail of Deferred Revenue at June 30, 1999 and 1998, is as follows:

	<u>1999</u>	<u>1998</u>
Subscription	\$285,895	\$269,827
Advance play-Lotto	160,749	155,811
Advance play-Perfecto	0	2,510
Advance play-Cash 5	<u>18,497</u>	<u>22,669</u>
Total Deferred Revenue	<u>\$465,141</u>	<u>\$450,817</u>

R. Promotional Activity

The Lottery engages in two types of promotional activities in an attempt to enhance sales and to increase the player base. Specific promotional coupons and Lottery Bucks coupons are distributed to players through special promotions and can be redeemed at any retailer for a lottery product. During the years ended June 30, 1999 and 1998, 1,048,045 and 839,799 coupons were redeemed, respectively. Scratch tickets for specific games are given away as a more direct approach to introduce players to lottery games. During the years ended June 30, 1999 and 1998, 416,134 and 208,653 scratch tickets were given away, respectively. Scratch tickets and coupons are valued at cost. For the years ended June 30, 1999 and 1998, approximately \$900,000 and \$700,000, respectively, in promotional ticket expense was recorded relating to coupons redeemed and scratch tickets given away.

2. CASH AND INVESTMENTS

A. Cash

Cash includes petty cash, change funds, imprest fund, depository account, and cash on deposit with the State Treasurer. A detail of cash at June 30, 1999 and 1998, is as follows:

	<u>1999</u>	<u>1998</u>
Petty Cash	\$ 1,550	\$ 1,550
Change Funds	90,025	80,025
Imprest Fund	350,000	350,000
Depository Account	15,000	26,227
Cash on Deposit with State Treasurer	<u>19,490,656</u>	<u>25,873,249</u>
TOTAL UNRESTRICTED CASH	<u>19,947,231</u>	<u>26,331,051</u>
Cash Restricted - Conservation Trust Fund	0	2,149,336
Cash Restricted - Licensed Agent Recovery Reserve Receipts	<u>310,593</u>	<u>239,986</u>
TOTAL RESTRICTED CASH	<u>310,593</u>	<u>2,389,322</u>
TOTAL CASH	<u>\$20,257,824</u>	<u>\$28,720,373</u>

B. Cash on Deposit with State Treasurer

Under the provisions of C.R.S. 24-35-210, the State Treasurer shall invest the moneys of the Colorado Lottery in excess of operating and prize payment expenses and all authorized transfers. Interest or any other return on investments is paid to the Lottery Fund and the Conservation Trust Fund Sub-Account on a monthly basis. Actual interest payments are determined by the State Treasurer. The average annual yield on the average daily cash balance during Fiscal Year 1998-99 was approximately 5.95 percent. The current yield is approximately 5.73 percent.

In addition, the State Treasurer pools these deposits and invests them in securities approved by C.R.S. 24-75-601.1. The Colorado Lottery reports its share of the Treasurer's unrealized gains and losses based on its participation in the State Treasurer's pool only at fiscal year end. Effective July 1, 1997, with the Lottery's initial adoption of Governmental Accounting Standards Board Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, all of the Treasurer's investments, which include the restricted cash and investments held for the Conservation Trust Fund and the net Licensed Agent Recovery Reserve Receipts, are reported at fair value, which is determined based on quoted market prices. The State Treasurer does not invest any of the pool resources in any external investment pool. Additional information on the Treasurer's pool may be obtained in the State of Colorado's Comprehensive Annual Financial Report.

C. Insured and Collateralized Deposits

The Colorado Lottery has one imprest and one depository account with banking institutions. The depository account is used for the purpose of depositing daily collections throughout the state and transferring the collections to the State Treasurer in a timely manner.

The Public Deposit Protection Act requires financial institutions to collateralize any uninsured public deposits. At June 30, 1999, the Colorado Lottery had cash with a carrying value of \$365,000, and a bank balance of \$259,176 on deposit with banking institutions. Of the bank balance, \$100,000 is insured by federal insurance (FDIC); the amount not insured is covered by collateral held in the pledging institution's trust department in the state's name.

D. Statement of Cash Flows

The statement of cash flows is prepared under the direct method. Cash received from retailers is net of certain adjustments applied against accounts receivable balances, consisting primarily of prizes paid directly by retailers to the prize winner. For cash flow purposes, cash and investments include restricted cash and investments held by the State Treasurer in its cash and investments pool.

3. SCHEDULE OF CHANGES IN FIXED ASSETS

	<u>June 30, 1998</u>	<u>Additions</u>	<u>Deletions</u>	<u>June 30, 1999</u>
Equipment	\$ 5,150,527	\$401,511	\$140,256	\$ 5,411,782
Leasehold Improvements	254,508	0	0	254,508
TOTAL	<u>\$ 5,405,035</u>	<u>\$401,511</u>	<u>\$140,256</u>	<u>\$ 5,666,290</u>
	<u>June 30, 1997</u>	<u>Additions</u>	<u>Deletions</u>	<u>June 30, 1998</u>
Equipment	\$ 4,858,662	\$831,376	\$539,511	\$ 5,150,527
Leasehold Improvements	282,816	11,562	39,870	254,508
TOTAL	<u>\$ 5,141,478</u>	<u>\$842,938</u>	<u>\$579,381</u>	<u>\$ 5,405,035</u>

4. OPERATING LEASES

The Colorado Lottery occupies office and warehouse space in Pueblo, Denver, Colorado Springs, Grand Junction, and Fort Collins. Rental payments are contingent upon the continuing availability of funds. Specific lease information follows:

Pueblo

Office - The Colorado Lottery occupies office space in the Norwest Bank Building in Pueblo. The lease agreement with 200 South Broadway Limited Partnership began on July 1, 1995 and expires on June 30, 2005. There is no provision for renewal.

Warehouse -The Colorado Lottery leases primary warehouse space from the City of Pueblo. The Lottery entered into a lease extension agreement which began July 1, 1997 and expires on June 30, 2002. There is no provision for renewal. The Lottery leases additional warehouse space from Musso & Cardinale. The Lottery entered into a lease extension agreement which began July 1, 1997 and expires on June 30, 2002. There is no provision for renewal.

Interlott - The Colorado Lottery entered into a rental agreement with International Lottery, Inc. to rent Scratch Ticket Vending Machines (STVMs). The agreement covers the period from July 1, 1997 through June 30, 2000 which includes the exercise of two twelve month extensions. There are no other provisions for extension or renewal.

Denver

The Colorado Lottery occupies office and warehouse space in the Galleria Towers Building in Denver. The lease agreement which began on October 30, 1990, was amended on May 14, 1999 and extended the ending date for the lease from June 30, 1999 to June 30, 2006. There is no provision for renewal.

Fort Collins

The Colorado Lottery occupies space leased by the Department of Revenue and is responsible for reimbursing the Department of Revenue for lease payments.

Grand Junction

The Colorado Lottery occupies space in the Grand Junction State Services Building and is responsible for reimbursing the Capital Complex Division for lease payments.

Colorado Springs

The Colorado Lottery occupies warehouse space in a building located at 2818 Janitell Rd. in Colorado Springs, Colorado. The lease agreement, which began on April 22, 1999, expires on June 30, 2003. There is no provision for renewal.

Operating lease expense incurred for the fiscal years ended June 30, 1999 and 1998 and future minimum lease payments are as follows:

<u>Location</u>	<u>Expense</u>		<u>Future Minimum Lease Payments</u>					<u>LATER YEARS</u>
	<u>1998</u>	<u>1999</u>	<u>FY 2000</u>	<u>FY 2001</u>	<u>FY 2002</u>	<u>FY 2003</u>	<u>FY 2004</u>	
Pueblo Office	\$ 205,820	\$ 220,891	\$ 226,978	\$238,318	\$250,336	\$262,692	\$275,900	\$289,773
Pueblo Warehouse	32,637	32,637	32,637	32,637	32,637	0	0	0
Interlott	874,718	1,031,065	1,034,000	0	0	0	0	0
Co Sprgs W/House	0	1,923	12,065	12,612	13,196	13,812	0	0
Denver	147,172	147,152	179,430	185,411	191,392	197,373	203,354	424,651
Fort Collins	13,074	14,749	0	0	0	0	0	0
Grand Junction	<u>4,768</u>	<u>4,444</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
	<u>\$1,278,189</u>	<u>\$1,452,861</u>	<u>\$1,485,110</u>	<u>\$468,978</u>	<u>\$487,561</u>	<u>\$473,877</u>	<u>\$479,254</u>	<u>\$714,424</u>

5. OTHER REVENUE

A schedule of other revenue for the fiscal years ended June 30, 1999 and 1998 follows:

	<u>1999</u>	<u>1998</u>
License Fees	\$ 46,691	\$ 45,570
Fines & Penalties	242,600	14,450
Assignment Fees	20,453	19,336
Net licensed agent recovery reserve receipts	70,606	78,047
Ended Game Revenue	18,038	0
Other	<u>7,120</u>	<u>110,205</u>
Total	<u>\$405,508</u>	<u>\$267,608</u>

6. LOTTERY FUND RETAINED EARNINGS

In accordance with C.R.S. 24-35-210(g), (l), the Lottery Commission shall, reserve ".sufficient moneys to ensure the operation of the Lottery for the ensuing year." Under the provision, the Lottery Commission approved a reserve of \$1 million of retained earnings for Fiscal Year 1989 and has not changed it since then.

7. DISTRIBUTION OF NET PROCEEDS

Under the provision of C.R.S. 24-35-210, as amended effective September 1, 1998, beginning with the first quarter of fiscal year 1998-99, distributions shall be made on a quarterly basis in accordance with the provisions of section 33-60-104, C.R.S. with the distribution of net lottery proceeds for the first quarter occurring on December 1 of such fiscal year, distribution of net lottery proceeds for the second quarter occurring on March 1 of such fiscal year, distribution of net lottery proceeds for the third quarter occurring on June 1 of such fiscal year, and distribution of net lottery proceeds for the fourth quarter occurring on September 1 following the close of such fiscal year. Because of this change in distribution frequency, at June 30, 1999 it is no longer necessary for the Lottery to utilize a segregated cash fund for distributions to the Conservation Trust Fund. For the first quarter of Fiscal Year 1999 and for each quarter thereafter, the state treasurer shall distribute net lottery proceeds as follows: forty percent (40%) to the Conservation Trust Fund, ten percent (10%) to the Division of Parks and Outdoor Recreation and all the remaining net lottery proceeds in trust to the trust fund board to be split between the Great Outdoors Colorado Trust Fund, the final payment for the Capital Construction Fund and any excess to the General Fund as set forth in 33-60-104 (1) (c) and 33-60-104 (2).

Income Available for Distribution at June 30:

	<u>1999</u>	<u>1998</u>
Income Before Operating Transfers	\$84,504,219	\$97,788,264
Less: Increase in licensed agent recovery reserve	(70,607)	(78,047)
Unrealized gains on investments		(134,823)
Plus: Unrealized losses on investments	<u>250,487</u>	
Income Available for Distribution	\$84,684,099	\$97,575,394
Less: Prior Distributions	<u>(67,183,618)</u>	<u>(79,613,886)</u>
Income Available for Distribution June 30, 1999 & 1998	<u>\$17,500,481</u>	<u>\$17,961,508</u>

The following is a schedule of funds available for distribution at fiscal year end, the operating transfers out by fund by fiscal year, and distributions paid by fund by fiscal year:

	Accrued at June 30, 1998	Operating Transfers Out	Distributions Paid	Accrued at June 30, 1999
Capital Construction	\$ 7,504,477	\$11,091,795	\$(18,596,272)	\$ -
Great Outdoors Funds	1,476,277	31,231,743	(23,957,778)	8,750,242
Conservation Trust Fund	7,184,603	33,895,855	(34,080,266)	7,000,192
Division of Parks & Outdoor Recreation	<u>1,796,151</u>	<u>8,464,706</u>	<u>(8,510,810)</u>	<u>1,750,047</u>
	<u>\$17,961,508</u>	<u>\$84,684,099</u>	<u>\$(85,145,126)</u>	<u>\$17,500,481</u>

	Accrued at June 30, 1997	Operating Transfers Out	Distributions Paid	Accrued at June 30, 1998
Capital Construction	\$ 4,463,269	\$30,054,762	\$(27,013,554)	\$ 7,504,477
Great Outdoors Funds	3,835,274	22,944,509	(25,303,506)	1,476,277
Conservation Trust Fund	6,638,835	35,689,889	(35,144,121)	7,184,603
Division of Parks & Outdoor Recreation	<u>1,659,709</u>	<u>8,886,234</u>	<u>(8,749,792)</u>	<u>1,796,151</u>
	<u>\$16,597,087</u>	<u>\$97,575,394</u>	<u>\$(96,210,973)</u>	<u>\$17,961,508</u>

8. CONTINGENCIES AND COMMITMENTS

Prize Annuities - The Lottery purchases annuity contracts in the name of individual jackpot prize winners. Although the annuity contracts are in the name of the individual winners, the Lottery retains title to the annuity contracts. Colorado Lottery remains liable for the payment of the guaranteed minimum prizes in the event the insurance companies issuing the annuity contracts default. The following guaranteed minimum prize payments for which annuity contracts have been purchased are due in varying amounts through June 8, 2023.

Specified Prize Payments	\$655,975,679
Lifetime prize payments	<u>52,960,000</u>
Total guaranteed minimum prize payments	<u>\$708,935,679</u>

Self Insurance - The State of Colorado currently self-insures its agencies, officials and employees for the risks of losses to which they are exposed. That includes general liability, motor vehicle liability, worker's compensation and medical claims. The State Risk Management Fund is a restricted General Fund used for claims adjustment, investigation, defense and authorization for the settlement and payment of claims or judgements against the State except for employee medical claims. The State Employees and Officials Insurance Fund is an Internal Service Fund established for the purpose of risk financing employees' and officials' medical claims. Property claims are not self-insured, rather the State has purchased insurance.

Colorado employers are liable for occupational injuries and diseases of their employees. Benefits are prescribed by the Worker's Compensation Act of Colorado for medical expenses and loss of wages resulting from job-related disabilities. The State utilizes the services of Pinnacol Assurance (formerly Colorado Compensation Insurance Authority), a related party, to administer its plan. The State reimburses Pinnacol Assurance for the current cost of claims paid and related administrative expenses.

The Colorado Lottery participates in the Risk Management Fund. State agency premiums are based on an assessment of risk exposure and historical experience. Liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported. Because actual claims liabilities depend on such complex factors as inflation, changes in legal doctrines and damage awards, the process used in computing claims liability does not necessarily result in an exact amount. Claims liabilities are reevaluated periodically to take into consideration recently settled claims, the frequency of claims and other economic and social factors.

The limits of liability for which the State accepts responsibility pursuant to the Colorado Governmental Immunity Act, section 24-10-101 are as follows:

<u>Liability</u>	<u>Limits of Liability</u>
General & Automobile	Each person \$150,000 Each occurrence \$600,000

During Fiscal Years 1998 (most recent information available), 1997 and 1996, medical claims against the State Employees and Officials Insurance Fund exceeded the premiums collected. This resulted in decreases in the medical reserve fund equity of approximately \$3.8 million, \$6.5 million and \$2.1 million, respectively. The fund includes several medical plan options ranging from provider of choice to managed care.

The fund also provides an employer paid short-term disability plan. This program provides an employee with 60 percent of their pay beginning after 30 days of disability or the exhaustion of the employee's sick leave balance, whichever is later. This benefit expires six months after the beginning of the disability.

There were no significant reductions or changes in insurance coverage from the prior year. With the exception of the short-term disability program of the State Employees and Officials Insurance Fund, settlements did not exceed insurance coverage in any of the past three fiscal years.

Furniture and Equipment - The State of Colorado carries a \$15,000 deductible replacement policy on all state owned furniture and equipment. For each loss incurred, the Colorado Lottery is responsible for the first \$1,000 of the deductible and the State of Colorado is responsible for the next \$14,000 of the deductible. Any loss in excess of \$15,000 is covered by the insurance carrier up to replacement cost.

Gaming Operations Commitments - The Lottery has entered into long term contracts with certain significant vendors related to providing scratch tickets and on-line data processing services in support of Lottery's gaming operations. The on-line data processing contract expires October 31, 2000, with two possible extensions, each for two year periods. Thus the initial contract and all possible extensions will expire no later than October 31, 2004. The instant ticket contract expired June 30, 1996 with four annual renewals available. The Lottery exercised its options to renew the contract through June 30, 2000. Ticket rates are based upon ticket volume, physical size and design.

9. TAX, SPENDING AND DEBT LIMITATIONS

In November 1992, the Colorado voters passed Section 20, Article X of the Colorado Constitution, commonly known as the Taxpayer's Bill of Rights (TABOR). TABOR contains revenue, spending, tax and debt limitations that apply to the State of Colorado and all local governments. In the same general election, Article XXVII was passed creating the State Board of the Great Outdoors Colorado Trust Fund. The simultaneous passage of these two constitutional amendments raised questions as to whether there are irreconcilable conflicts between the two amendments.

The General Assembly determined in C.R.S. 24-77-102(17)(6)(ix), that the net proceeds from the Colorado Lottery are excluded from the scope of "state fiscal year spending" for purposes of TABOR. The Colorado Supreme Court, in response to an interrogatory from the General Assembly approved that determination.

TABOR is complex and subject to further legislative and judicial interpretation. The Lottery believes it is in compliance with both of these constitutional amendments.

10. RELATED-PARTY TRANSACTIONS

The Colorado Lottery, as an agency of the State of Colorado, paid fees to other agencies of the State for auditing, legal and other services and vehicle and office rent. The Colorado Lottery also pays fees to the Department of Revenue for indirect costs. Interagency charges were \$761,918 and \$810,213 for the fiscal years ending June 30, 1999 and June 30, 1998, respectively.

11. APPROPRIATIONS

The details of appropriations legislated by the Colorado General Assembly (the Long Bill) and related expenditures by the Colorado Lottery for the year ended June 30, 1999 are as follows:

<u>FTE: 124.648</u>	<u>Long Bill/ Roll Forward Augmenting Revenue</u>	<u>Supplemental Appropriations, Potted Funds, & Adjustments</u>	<u>Total Appropriations/ Augmenting Revenue</u>	<u>Expenditures</u>	<u>Roll- Forward</u>	<u>Excess Appropriations</u>
Fixed Costs	\$ 10,057,407	\$ 352,960	\$ 10,410,367	\$ 10,070,236	\$ 0	\$ 340,131
Health and Life	0	252,405	252,405	249,048	0	3,357
Short Term Disability	0	12,555	12,555	11,768	0	787
Risk Management	0	13,735	13,735	13,735	0	0
Workmen's Compensation	0	55,920	55,920	55,920	0	0
Unemployment Insurance	0	1,823	1,823	0	0	1,823
Travel	139,111	0	139,111	135,807	0	3,304
Leased Space	446,293	0	446,293	431,313	0	14,980
Leased Space-Grand Junction	5,546	(693)	4,853	4,444	0	409
Indirect Costs	304,811	0	304,811	304,811	0	0
Marketing, Communications, & Sales	9,160,532	0	9,160,532	9,159,600	0	932
Ticket Costs-Scratch	4,109,525	218,052	4,327,577	3,944,449	0	383,128
Roll Forward-Capital Const. #461	13,761	0	13,761	13,761	0	0
Roll Forward-Starlite Purchase	139,000	0	139,000	139,000	0	0
Capital Outlay	24,411	0	24,411	24,000	0	411
Retailer Compensation	27,362,700	1,489,932	28,852,632	27,955,733	0	896,899
Prize Payments	215,000,000	26,354,411	241,354,411	225,548,482	0	15,805,929
Vendor Fees	8,632,560	(496,699)	8,135,861	7,664,857	97,500	373,504
TOTAL	<u>\$ 275,395,657</u>	<u>\$ 28,254,401</u>	<u>\$ 303,650,058</u>	<u>\$ 285,726,964</u>	<u>\$ 97,500</u>	<u>\$ 17,825,594</u>

Note: Amount expended does not equal total expenses reported in the accompanying Statement of Revenues, Expenses and Changes in Retained Earnings because of Capital Outlay adjustments and other expenses which are not appropriated including Depreciation and Accrued Annual and Sick Leave. Marketing, Communications and Sales expenditures do not include amounts related to the promotional use of coupons and scratch tickets.

Report of Independent Certified Public Accountants
on Compliance and on Internal Control Over
Financial Reporting Based on an Audit of
Financial Statements Performed in Accordance
with Government Auditing Standards

Members of The Legislative Audit Committee

We have audited the financial statements of the Colorado Lottery (Lottery) as of and for the year ended June 30, 1999, and have issued our report thereon dated August 27, 1999. We conducted our audit in accordance with 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.

Compliance

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

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Lottery'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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. 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. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the State of Colorado Legislative Audit Committee, the Lottery Commission and the Lottery's management and is not intended to be and should not be used by anyone other than these specified parties.

Colorado Springs, Colorado
August 27, 1999

Report of Independent Certified Public
Accountants on Supplementary Information

Members of The Legislative Audit Committee

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole of the Colorado Lottery (Lottery) for the years ended June 30, 1999 and 1998, which are presented in the preceding section of this report. The supplementary information presented hereinafter is not a required part of the basic financial statements. The supplementary schedules presented on the following page have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

The year 2000 supplementary information included as miscellaneous information 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 supplementary information. However, we did not audit the information and do not express an opinion on it. In addition, we do not provide assurance that the Lottery is or will become year 2000 compliant, that the Lottery's year 2000 remediation efforts will be successful in whole or in part, or that parties with which the Lottery does business are or will become year 2000 compliant.

Colorado Springs, Colorado
August 27, 1999

COLORADO LOTTERY
SCHEDULE OF REVENUE AND COSTS FOR SCRATCH AND ON-LINE GAMES
FOR THE FISCAL YEAR ENDED JUNE 30, 1999

	Games in Progress				FY 98-99	FY 97-98
	Scratch	Lotto	Cash 5	Perfecto	Total	Scratch and On-Line
GROSS TICKET SALES (Note 1)	\$233,937,322	\$119,716,980	\$12,068,634	\$2,681,229	\$368,404,165	\$374,282,243
PRIZE EXPENSE	<u>(150,747,067)</u>	<u>(66,155,675)</u>	<u>(6,431,223)</u>	<u>(1,606,650)</u>	<u>(224,940,615)</u>	<u>(\$220,420,715)</u>
NET REVENUE AFTER PRIZES	<u>83,190,255</u>	<u>53,561,305</u>	<u>5,637,411</u>	<u>1,074,579</u>	<u>143,463,550</u>	<u>153,861,528</u>
COMMISSIONS, BONUS, TICKET COSTS & VENDOR FEES (Note 2)						
Retailer Commission	(16,294,003)	(7,178,903)	(724,529)	(160,877)	(24,358,312)	(22,782,018)
Retailer Bonus	(2,518,360)	(775,892)	(111,982)	(23,252)	(3,429,486)	(2,604,466)
Cost of Tickets Sold	(3,944,446)	N/A	N/A	N/A	(3,944,446)	(3,943,011)
In-Lane Vendor Fees	(18,081)	(9,290)	(932)	(199)	(28,502)	0
On-Line Vendor Fees	<u>(1,101,148)</u>	<u>(5,010,434)</u>	<u>(562,888)</u>	<u>(116,833)</u>	<u>(6,791,303)</u>	<u>(6,777,361)</u>
TOTAL	<u>(23,876,038)</u>	<u>(12,974,519)</u>	<u>(1,400,331)</u>	<u>(301,161)</u>	<u>(38,552,049)</u>	<u>(36,106,856)</u>
GROSS PROFIT ON SALE OF TICKETS	<u>\$59,314,217</u>	<u>\$40,586,786</u>	<u>\$4,237,080</u>	<u>\$773,418</u>	<u>\$104,911,501</u>	<u>\$117,754,672</u>
AVERAGE DAILY TICKET SALES	<u>\$640,924</u>	<u>\$327,992</u>	<u>\$33,065</u>	<u>\$7,346</u>	<u>\$1,009,326</u>	<u>\$1,025,431</u>

Note 1: Gross ticket sales excludes coupons

Note 2: Administrative costs of Lottery operations, including wages, advertising and other expenses are not shown.

COLORADO LOTTERY
SCHEDULE OF PERCENT OF PRIZE EXPENSE TO GROSS TICKET SALES
FOR THE FISCAL YEAR ENDED JUNE 30, 1999

	Games in Progress				Coupons	FY 98-99
	Scratch	Lotto	Cash 5	Perfecto	Total	Total
Prize Expense	\$151,354,934	\$66,155,675	\$6,431,223	\$1,606,650	(\$607,867)	\$224,940,615
(/) Ticket Sales including coupons	<u>234,320,349</u>	<u>120,368,415</u>	<u>12,079,649</u>	<u>2,683,797</u>	<u>(1,048,045)</u>	<u>368,404,165</u>
Prize %	<u>64.59%</u>	<u>54.96%</u>	<u>53.24%</u>	<u>59.86%</u>	<u>58.00%</u>	<u>61.06%</u>

COLORADO LOTTERY
Y2K COMPLIANCE DISCLOSURE
FOR FISCAL YEAR ENDED JUNE 30, 1999
(UNAUDITED)

The year 2000 issue arises because most computer software programs allocate two digits to the year date field on the assumption that the first two digits will be 19. Without reprogramming, such programs may interpret the year 2000 as the year 1900. In addition, some programs may be unable to recognize the year 2000 as a leap year.

The year 2000 issue may affect electronic equipment containing computer chips that have date recognition features – such as, environmental systems, elevators, and vehicles – as well as computer software programs. In addition, the year 2000 issue affects not only computer applications and equipment under the Colorado Lottery's direct control but also the systems of other entities with which the Colorado Lottery transacts business. Some of the Colorado Lottery's systems and equipment affected by the year 2000 issue are critical to the continued and uninterrupted operations of the Colorado Lottery.

Because of the unprecedented nature of the year 2000 issue, its effects and the success of the related remediation efforts will not be fully determinable until the year 2000 and thereafter. Management cannot guarantee that the Colorado Lottery is or will be year 2000 ready, that the Colorado Lottery's remediation efforts will be successful in whole or in part, or that parties with whom the Colorado Lottery does business will be year 2000 ready.

In early 1997, the Colorado General Assembly directed the Office of State Planning and Budgeting (OSPB) and the Commission on Information Management (IMC) to assess and report on the cost of year 2000 readiness preparations. The IMC developed a process for assessing and monitoring year 2000 project progress. It has asked state agencies that are not higher education institutions to report on completion of stages for each critical system. Higher education institutions report similar information directly to the Joint Budget Committee of the Legislature.

At any given time, work on the year 2000 issue with respect to each system deemed critical falls predominantly in one of the following stages:

- . *Awareness stage* – Establishing a budget and project plan for dealing with the year 2000 issue.
- . *Assessment stage* – Identifying the systems and components for which year 2000 work is needed.
- . *Remediation stage* – Making changes to systems and equipment.
- . *Validation/Testing Stage* – Validating and testing changes that were made during the remediation stage.

Y2K Compliance Disclosure - Continued

Completion of any or all of the stages does not mean the Colorado Lottery's systems are or will be year 2000 ready or compliant.

The Colorado Lottery identified four (4) systems in its inventory, and all were deemed critical. The year 2000 work on these critical systems was 100% complete as of June 30, 1999.

The Colorado Lottery does business with many external entities that may have year 2000 problems. The Colorado Lottery makes no representation that these external entities are or will be year 2000 ready or compliant.

Additional information as to the year 2000 issue related to nonhigher-education state agencies can be obtained from the Year 2000 Project Office web site at <http://www.state.co.us/Y2K>.

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General Support Services
Executive Director (1)
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