



COLORADO LOTTERY

FINANCIAL AND COMPLIANCE AUDIT
June 30, 2014 and 2013

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Members of the Legislative Audit Committee:

We have completed the financial statement audit of the Colorado Lottery as of and for the year ended June 30, 2014. Our audit was conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

We were engaged to conduct our audit pursuant to Section 24-35-211, C.R.S., which requires the State Auditor to audit the Lottery Fund. The reports we have issued as a result of this engagement are set forth in the table of contents which follows.

Eide Bailly LLP

Greenwood Village, Colorado
October 7, 2014

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**COLORADO LOTTERY
REPORT SUMMARY
Years Ended June 30, 2014 and 2013**

Purposes and Scope of Audit

Authority, Purpose and Scope

The Office of the State Auditor, State of Colorado, engaged Eide Bailly ,LLP to conduct the financial audit of the Colorado Lottery for the Fiscal Year ended June 30, 2014. The audit of the Colorado Lottery (the Lottery) was performed under authority of Section 24-35-211, C.R.S., which requires the State Auditor to conduct an annual audit of the Lottery. The purpose of the audit was to express opinions on the financial statements of the Lottery for the year ended June 30, 2014.

Eide Bailly LLP conducted the audit in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards* issued by the Comptroller General of the United States of America.

The purposes and scope of this audit were:

- To express opinions on the financial statements of the Lottery as of and for the year ended June 30, 2014, including a review of the related systems of internal controls as required by auditing standards generally accepted in the United States of America.
- To review the Lottery's compliance with rules and regulations governing the expenditure of State funds for the year ended June 30, 2014.
- To evaluate progress in implementing the prior audit recommendations.

Summary of Major Audit Comments

Audit Findings and Financial Statement Audit Report Section

There were no new recommendations as a result of the current year audit.

**COLORADO LOTTERY
REPORT SUMMARY
Years Ended June 30, 2014 and 2013**

Audit Opinions and Reports

The independent auditor's reports included herein, state that the financial statements of the Lottery are fairly stated, in all material respects, in accordance with accounting principles generally accepted in the United States of America, and that no material weaknesses in internal controls were discovered during the course of the audit.

Auditor's Communication to Legislative Audit Committee

The auditor's communication to the Legislative Audit Committee describes the auditor's responsibility under auditing standards generally accepted in the United States of America and significant management judgments and estimates. This communication is located on page 63.

Summary of Progress in Implementing the Prior Year Audit Recommendations

As of our Fiscal Year 2014 audit, we determined the 2013 prior year recommendation was fully implemented and the 2011 prior year recommendation was partially implemented. The Disposition of Prior Year Audit Recommendations begins on page 4.

**COLORADO LOTTERY
BACKGROUND
Years Ended June 30, 2014 and 2013**

In 1980, Colorado voters passed a referendum that added Article XVIII, Section 2(1) to the Colorado Constitution, allowing the establishment of a state-supervised lottery. Senate Bill 82- 119 created the Lottery as a division within the Department of Revenue. The Lottery began operations on July 1, 1982 and sold its first lottery ticket on January 24, 1983.

During Fiscal Year 2014, the Lottery employed 120 employees in its headquarters in Pueblo and branch offices in Denver, Fort Collins and Grand Junction.

The Lottery games are governed by rules and regulations established by a Commission of five members appointed by the Governor and approved by the Senate. 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.

Colorado Revised Statutes (C.R.S.) Section 24-35-210(9), requires that no less than 50% 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 within the Department of Local Affairs, the Division of Parks and Wildlife within the Department of Natural Resources, and the Great Outdoors Colorado Trust Fund (GOCO). The amount distributed to GOCO is limited by a constitutional cap.

Prior to 2002, amounts exceeding the GOCO cap (the spillover) were distributed to the State General Fund. For Fiscal Years 2002 through 2007, the spillover funds were distributed to the State Public School Fund Contingency Reserve. For Fiscal Year 2008, the spillover funds were transferred to the Lottery Proceeds Contingency Reserve Fund. For Fiscal Years 2009 through 2014, the spillover funds were required to be transferred to the Public School Capital Construction Assistance Fund.

**COLORADO LOTTERY
DISPOSITION OF PRIOR YEAR AUDIT RECOMMENDATION
Year Ended June 30, 2014**

<u>Number</u>	<u>Recommendation</u>	<u>Disposition</u>
2013-1	<p>The Lottery should ensure that:</p> <p>a) Personnel monitor and perform a review of the report used to create the annuity contingent liability footnote and agree all annuities issued during the current year to that information being included in the detailed internal system report.</p> <p>b) Individuals responsible for performing a supervisory review of the financial statements should review the analysis performed and either agree with the analysis or request further investigation based on knowledge of current year events. If adjustments are required to be made to the report as a result of the reviews performed, such adjustments should be communicated timely to the IT department.</p>	<p>Implemented</p>
2011-1	<p>The Colorado Lottery should ensure it is maximizing the amount of lottery revenue available to beneficiaries by reevaluating its current games structure, payout percentages, and operating expenses.</p>	<p>Partially implemented - Since Fiscal Year 2011 and through Fiscal Year 2014, the Lottery has continued to evaluate operating expenses, make game changes and develop strategic goals, which will allow the maximization of lottery revenue available to beneficiaries. The results of these evaluations and changes have provided an increase in the revenue available to beneficiaries as a percentage of total sales since the date of the finding (from 21.8% in Fiscal Year 2011, 22.6% in fiscal year 2012, 23.9% in Fiscal Year 2013, to 23.8% in Fiscal Year 2014). The Lottery is continuing its evaluation of game structure, payout percentages and operating expenses.</p>



Independent Auditor's Report

Members of the Legislative Audit Committee
State of Colorado, Department of Revenue, Division of Lottery
Denver, Colorado

Report on the Financial Statements

We have audited the accompanying basic financial statements of the major fund and remaining fund information of the Colorado Lottery, an enterprise fund and private purpose fund of the State of Colorado, as of and for the years ended June 30, 2014 and 2013, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the major fund and remaining fund information of the Colorado Lottery as of June 30, 2014 and 2013, and the respective changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Relationship with the State of Colorado

As discussed in Note 1 – Nature of Operations and Summary of Significant Accounting Policies, the financial statements of the Colorado Lottery are intended to present the financial position and cash flows for only that portion of the financial reporting entity, the State of Colorado, which is attributable to the transactions of the Colorado Lottery. They do not purport to, and do not, present fairly the financial position of the State of Colorado as of June 30, 2014 and 2013, and the changes in its financial position, or, where applicable, its cash flows, for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 8 through 23 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Supplemental Information

Our audit was conducted for the purpose of forming opinions on the basic financial statements. The Schedule of Revenue and Costs for Scratch and Jackpot Games, Schedule of Percent of Prize Expense to Gross Ticket Sales and Budgetary Comparison are presented for purposes of additional analysis and are not a required part of the basic financial statements. The Schedule of Revenue and Costs for Scratch and Jackpot Games, Schedule of Percent of Prize Expense to Gross Ticket Sales and Budgetary Comparison is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated October 7, 2014 on our consideration of the Colorado Lottery's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Colorado Lottery's internal control over financial reporting and compliance.

A handwritten signature in cursive script that reads "Eric Sully LLP".

Greenwood Village, Colorado
October 7, 2014

Colorado Lottery

Management's Discussion and Analysis

Years Ended June 30, 2014 and 2013

This discussion and analysis of the Colorado Lottery's financial performance provides an overview of financial activities for the fiscal years ended June 30, 2014 and 2013. Please read it in conjunction with the Lottery's financial statements, which begin on page 24. These financial statements reflect only activities of the Colorado Lottery, a proprietary fund of the State of Colorado.

Financial Highlights

- The Lottery's current fiscal year's overall sales performance came in at \$545.0 million, making Fiscal Year 2014 the third highest sales year in the Lottery's history. Last fiscal year's sales of \$566.3 million remained the highest sales with Fiscal Year 2012 with sales of \$545.3 million remaining in the second spot. Overall sales for Fiscal Year 2014 reflected a nearly \$21.3 million decrease from Fiscal Year 2013. On the other hand, Fiscal Year 2013 reflected a \$21.0 million increase from Fiscal Year 2012 sales. The decrease in sales in Fiscal Year 2014 was chiefly due to the overall decrease in jackpot games sales of \$14.7 million combined with a decrease of over \$6.5 million in scratch sales. The increase in sales in Fiscal Year 2013 was due to the overall increase in jackpot games sales of nearly \$16.7 million from \$181.0 million to \$197.7 million combined with an increase of \$4.3 million in scratch sales.

The \$14.7 million decrease in jackpot games sales in Fiscal Year 2014 from the previous fiscal year consisted of a \$32.2 million or a 27.6 percent drop in Powerball sales, attributed to the lack of any record breaking jackpots as seen in the previous year. The highest Powerball jackpot in Fiscal Year 2014 was \$448.4 million compared to two jackpots of nearly \$600 million reached in Fiscal Year 2013. An increase in Mega Millions sales of nearly \$13.6 million and an overall increase in sales of \$3.9 million for the Lottery's in-state jackpot games (Lotto, Cash 5 and Pick 3) partially offset the decline in Powerball sales. The Mega Millions jump in sales was due to an increase in the average jackpot hit from \$62.3 million in Fiscal Year 2013 to \$211.4 million in Fiscal Year 2014.

The nearly \$16.7 million increase in jackpot games sales in Fiscal Year 2013 over the previous fiscal year consisted of a \$34.9 million or a 42.6 percent increase in Powerball sales, attributed to the two highest jackpots in Powerball history occurring in Fiscal Year 2013; a \$2.0 million increase in the Holiday Raffle game; a \$1.9 million increase in the new Pick 3 game, introduced on April 28, 2013; and a \$1.8 million increase in the Cash 5 game. These increases were offset by a drop in Mega Millions sales of \$13.9 million, the elimination of the MatchPlay game in Fiscal Year 2013 resulting in a \$9.3 million drop in sales, and a slight decrease of \$.7 million in Lotto sales.

- Funds distributed or available for distribution from 2014 sales were \$130.1 million, the second highest proceeds amount in Lottery history. Fiscal Year 2014 distributions included a spill-over of funds to the Public School Capital Construction Assistance Fund of over \$4.7 million. This occurs when the Great Outdoors Colorado (GOCO) proceeds cap, \$60.3 million in Fiscal Year 2014, is reached. The cap for GOCO is the 1992 base year amount of \$35 million as adjusted for the annual change in the cost of living increase for the Denver-Boulder area. The funds distributed or available for distribution from 2013 sales of \$135.6 million, with a spill-over totaling \$8.6 million, remained the highest in the Lottery's history. Since

Colorado Lottery

Management's Discussion and Analysis

Years Ended June 30, 2014 and 2013

starting in fiscal year 2009, the spill-over going to the Public School Capital Construction Assistance Fund has totaled \$69.3 million.

- Gross profit as a percent of sales for fiscal year 2014 continued to climb with a slight increase of 0.2 percent from fiscal year 2013. This was mainly the result of the over 0.1 percent and nearly 0.1 percent decreases in prize expense and retailer bonus expense, respectively, as a percentage of sales. Other costs directly tied to the sale of Lottery products, including commissions, vendor fees and ticket costs, as a percentage of sales remained steady. Gross profit as a percent of sales for fiscal year 2013 increased by over 1.1 percent from fiscal year 2012, a reflection of the 1.0 percent decrease in prize expense combined with the nearly 0.2 percent decrease in retailer bonuses. All other costs directly tied to the sale of Lottery products as a percentage of sales remained steady or declined slightly.

Total prize expense as a percentage of sales for all Lottery products decreased from 61.8 percent in fiscal year 2013 to 61.7 percent in fiscal year 2014. This was due to a decrease from 69.3 to 68.3 percent for scratch games, partially offset by an increase from 47.9 to 48.7 percent for jackpot games in fiscal years 2013 and 2014, respectively. The decrease in scratch game prize expense as a percentage of sales was mainly due to the Lottery's efforts to increase distribution to its proceeds partners by lowering prize percentages by game. The increase in jackpot games overall prize expense percentage was due to a \$2 million drop in unclaimed prizes in fiscal year 2014. Unclaimed prizes ultimately reduce the prize expense percentages for all products. Total prize expense as a percentage of sales for all Lottery products decreased from 62.8 to 61.8 percent in fiscal years 2012 and 2013, respectively, with a slight increase from 69.2 to 69.3 percent for scratch games and a 50.1 to 47.9 percent drop for jackpot games. The overall decrease in prize expense as a percentage of sales in fiscal year 2013 was mainly due to a shift from scratch to jackpot games which have lower prize expense percentages, an increase of \$1.5 million in unclaimed Jackpot game prizes, and, in part, to the Lottery's efforts to increase distributions to its proceeds partners by lowering prize percentages by game.

Retailer bonuses as a percentage of sales decreased from 0.8 percent for fiscal year 2013 to 0.7 percent for fiscal year 2014 while retailer commissions as a percentage of sales remained virtually unchanged. Bonuses as a percentage of sales decreased from 1.0 to 0.8 percent for fiscal years 2012 and 2013 respectively while commissions as a percentage of sales also remained virtually unchanged. Combined commissions and bonuses as a percentage of sales in fiscal year 2014 were 7.4 percent down from 7.5 percent in fiscal year 2013. A similar drop from the previous fiscal year was seen in fiscal year 2013, with combined commissions and bonuses as a percentage of sales decreasing to 7.5 percent from 7.6 percent in fiscal year 2013 and fiscal year 2012, respectively. The drop in the bonus percentage was due to changes in the retailer incentive bonus plans for both fiscal years 2014 and 2013, a plan that switched the emphasis to and paid bonuses only on jackpot game sales with the fiscal year 2014 plan paid on an annual basis versus a quarterly basis in fiscal year 2013. Cost of tickets sold and vendor fees as a percentage of sales remained at 2.0 percent as a percentage of sales for both fiscal years 2014 and 2013. Vendor fees totaled \$8,258,562, \$8,575,816, and \$8,204,497 for fiscal years ended June 30, 2012,

Colorado Lottery

Management's Discussion and Analysis

Years Ended June 30, 2014 and 2013

2013 and 2014, respectively, corresponding directly with the increase or decrease in sales seen over the last three fiscal years.

Games Offered by the Colorado Lottery

Currently, the Lottery offers two different ways to play: scratch games and jackpot games which include Powerball, Lotto, Cash 5, Mega Millions, and Pick 3, the newest jackpot game with a full year of sales in fiscal year 2014 with introduction to the Lottery market in late April 2013. Scratch games consist of pre-printed tickets that may be purchased for various prices (\$1, \$2, \$3, \$5, \$10 and \$20) at any Lottery retailer. When scratched, they provide immediate knowledge if the ticket is a winner and can be cashed immediately at the retailer level if the amount of the winnings is \$599 or less. Prizes over \$599 must be redeemed at the Lottery offices.

Jackpot games, on the other hand, require a longer playing time. Tickets are also purchased at the Lottery retailers and are printed on ticket stock as the purchase is made. Each ticket contains one or possibly more playing boards for one draw or up to thirteen weeks of draws. Each board consists of a set of numbers, the combination of numbers required for play varying by game. The winning numbers for each game are posted after their respective draw nights with drawings held on every night of the week. Players must check their numbers against the numbers drawn for each respective game to determine if they have a winning ticket. The tickets may also be cashed at the retailer level if the amounts of the winnings are \$599 or less. Prizes over \$599 must be redeemed at the Lottery offices.

Using this Annual Report

This annual report consists of a series of financial statements. The statements of net position provide information about the Lottery's assets and liabilities and reflect the Lottery's financial position as of June 30, 2014 and 2013. The statements of revenues, expenses and changes in fund net position report the activity of selling the Lottery products and the expenses related to such activity for the years ended June 30, 2014 and 2013. Finally, the statements of cash flows outline the cash inflows and outflows related to the activity of selling the Lottery products for the years ended June 30, 2014 and 2013.

Statements of Net Position

The statements of net position present a financial snapshot of the Lottery at June 30, 2014 and 2013. It presents the fiscal resources of the Lottery (assets), the claims against those resources (liabilities) and the residual available for future operations (net position). Assets and liabilities are classified by liquidity as either current or noncurrent. Net position is classified by the ways in which these assets may be used for future operations.

Colorado Lottery
Management's Discussion and Analysis
Years Ended June 30, 2014 and 2013

Condensed Statements of Net Position
June 30, 2014, 2013 and 2012

	2014	2013	2012
Assets			
Current assets	\$ 57,706,896	\$ 64,107,946	\$ 52,923,837
Restricted assets	6,736,352	6,630,364	6,645,053
Capital assets	<u>957,567</u>	<u>1,900,322</u>	<u>2,831,868</u>
Total assets	\$ <u>65,400,815</u>	\$ <u>72,638,632</u>	\$ <u>62,400,758</u>
Liabilities			
Current liabilities	\$ 61,723,207	\$ 68,056,857	\$ 56,555,518
Long-term liabilities	<u>760,275</u>	<u>919,090</u>	<u>897,366</u>
Total liabilities	\$ <u>62,483,482</u>	\$ <u>68,975,947</u>	\$ <u>57,452,884</u>
Net Position			
Net Investment in capital assets	\$ 957,567	\$ 1,900,322	\$ 2,831,868
Restricted – Licensed Agent			
Recovery Reserve	383,534	388,870	351,031
Restricted – Operating Reserve	1,400,000	1,300,000	1,300,000
Unrestricted	<u>176,232</u>	<u>73,493</u>	<u>464,975</u>
Total net position	\$ <u>2,917,333</u>	\$ <u>3,662,685</u>	\$ <u>4,947,874</u>

The Lottery's total assets at June 30, 2014 were \$65.4 million. Assets consisted primarily of cash and investments of \$39.1 million, including restricted balances of \$1.8 million, receivables from Lottery retailers for the sales of Lottery products of \$18.9 million, Prepaid Prize Expense with Multi-State Lottery Association (MUSL) of over \$4.9 million, scratch ticket inventory of \$1.3 million and a net investment in fixed assets of \$1.0 million.

Comparable figures at June 30, 2013 were \$72.6 million in total assets, principally including cash and investments of \$44.3 million, including restricted balances of \$1.7 million, receivables from retailers of \$20.3 million, Prepaid Prize Expense with MUSL of \$4.9 million, scratch ticket inventory of \$1.2 million, and a net investment in fixed assets of \$1.9 million.

Comparable figures at June 30, 2012 were \$62.4 million in total assets, principally including cash and investments of \$34.0 million, including restricted balances of \$1.7 million, receivables from retailers of \$19.5 million, Prepaid Prize Expense with MUSL of \$5.0 million, and a net investment in fixed assets of \$2.8 million.

The Lottery's total assets decreased by \$7.2 million from fiscal year 2013 to fiscal year 2014. This decrease was primarily caused by the \$5.2 million decrease in cash and investments, the \$1.4 decrease in receivables from retailers, and the \$0.9 million decrease in capital assets. The \$5.2 million decrease in cash and investments was primarily due to the drop in funds available for distribution for the fourth

Colorado Lottery

Management's Discussion and Analysis

Years Ended June 30, 2014 and 2013

quarter from \$37.3 million at fiscal year-end 2013 to \$30.5 million at June 30, 2014 due to the high sales seen in May 2013. The \$1.4 million decrease in receivables from retailers was primarily due to a drop in the value of scratch tickets activated by retailers but not yet billed from fiscal year-end 2013 to 2014. The \$0.9 million decrease in capital assets was due to the continued full-year depreciation of the back office system reflected in accumulated depreciation. The Lottery's total assets increased by \$10.2 million from fiscal year 2012 to fiscal year 2013. This increase was chiefly due to the increases of \$10.3 million in cash and investments and \$0.8 million in accounts receivables due from retailers offset by the \$0.9 million decrease in capital assets. The increase in cash and investments was the result of a large increase in May's sales due to the record-breaking \$590 million Powerball jackpot seen in that month and the resulting undistributed proceeds amount. The \$0.8 million increase in accounts receivable is a timing difference when amounts become due and the \$0.9 million decrease in capital assets was due to normal depreciation.

The Lottery's total liabilities at June 30, 2014 totaled \$62.5 million, which consisted primarily of prize liability on all Lottery products of \$25.8 million, proceeds distributions due of \$30.5 million, Lottery vendor payments due of \$2.6 million and retailer bonus payments due of \$1.5 million.

The Lottery's liabilities at June 30, 2013 totaled approximately \$69.0 million, which consisted primarily of prize liability on all the Lottery products of about \$25.4 million, proceeds distribution due to recipients of \$37.3 million, \$2.3 million due to Lottery vendors and \$1.4 million due to MUSL.

The Lottery's total liabilities at June 30, 2012 totaled approximately \$57.5 million, which consisted primarily of prize liability on all the Lottery products of about \$22.6 million, proceeds distributions due to recipients of \$29.0 million, \$2.0 million due to Lottery vendors and \$1.2 million due to MUSL.

The Lottery's total liabilities decreased from Fiscal Year 2013 to Fiscal Year 2014 by nearly \$6.5 million. The decrease was chiefly due to the \$6.8 million decrease in the proceeds distribution due to recipients and the \$1.0 million decrease in the amount payable to MUSL offset by the \$0.9 million increase in the retailer bonus liability and the \$0.4 million increase in prize liability. The \$6.8 million decrease in the proceeds distribution due to recipients was due to the more profitable fourth quarter experienced in Fiscal Year 2013 compared to the same quarter in Fiscal Year 2014. The change of \$1.0 million in the amount payable to MUSL is due to the amount of Powerball and Mega Millions sales net of actual Colorado winners in the final draws of the fiscal year compared to the previous year. These amounts can and do vary year to year. The increase in retailer bonus liability of \$0.9 million was due to the change from a quarterly-paid bonus in Fiscal Year 2013 to an annual-paid bonus in Fiscal Year 2014. The \$0.4 million increase in prize liability was mainly due to an increase in the scratch and lotto prize liabilities offset by a decrease in Powerball liability.

The Lottery's total liabilities increased from Fiscal Year 2012 to Fiscal Year 2013 by \$11.5 million. The increase was primarily the result of an \$8.3 million increase in proceeds distributions due to recipients, a nearly \$2.8 million increase in prize liability and a \$0.3 million slight increase in the amount due to vendors. The \$8.3 million increase in proceeds distributions due to recipients was the result of the May 2013 record-breaking

Colorado Lottery

Management's Discussion and Analysis

Years Ended June 30, 2014 and 2013

Powerball jackpot. The nearly \$2.8 million increase in prize liability was primarily due to the climbing \$5.5 million Lotto jackpot at June 30, 2013 and, in part, to unclaimed Powerball prizes tied to May's large jackpot. The \$0.3 million increase in the amount due to vendors is due to the timing of payments from one year to the next.

Components of the Lottery's net position are: 1) an amount to represent the Lottery's net investment in capital assets as required by the reporting model under GASB 34, (see "Total Capital Assets" on the statements of net position); 2) a Licensed Agent Recovery Reserve (bonding reserve) funded by retailers to cover any uncollectible receivable accounts; 3) an amount representing the funds held by the Lottery in an operating reserve to ensure the operation of the Lottery for the ensuing year in accordance with Section 24-35-210 (4.1)(a), C.R.S. (see "Cash and Investments – Operating Reserve") on the statements of net position; and 4) remaining unrestricted net assets, which represents an adjustment made by the Lottery to reflect its share of unrealized gains or losses on investments held by the State Treasurer.

The change in net position from June 30, 2013 to June 30, 2014 consisted of a decrease in investment in capital assets of \$942,755 due to the depreciation expense in Fiscal Year 2014, a decrease in the bonding reserve from \$388,870 to \$383,534, an increase in the operating reserve from \$1.3 million to \$1.4 million and a net increase in unrealized gain and losses on investments of \$102,739 resulting from a net increase in the adjustments on State Treasury investments.

Following is a schedule of net position for Fiscal Years 2014 and 2013:

	2014	2013	Change
Investment in capital assets	\$ 957,567	\$ 1,900,322	\$ (942,755)
Bonding reserve	383,534	388,870	(5,336)
Operating reserve	1,400,000	1,300,000	100,000
Unrestricted -unrealized gain (loss) on investments	<u>176,232</u>	<u>73,493</u>	<u>102,739</u>
Total net position	\$ <u>2,917,333</u>	\$ <u>3,662,685</u>	\$ <u>(745,352)</u>

The change in net position from June 30, 2012 to June 30, 2013 consisted of a slight increase in the bonding reserve of \$37,839 offset by a decrease in investment in capital assets from \$2,831,868 to \$1,900,322 due to the write off of obsolete property combined with the normal depreciation expense for Fiscal Year 2013 and a net decrease in unrealized gain and losses on investments of \$391,482 held by the State Treasury.

Following is a schedule of net position for Fiscal Years 2013 and 2012:

	2013	2012	Change
Investment in capital assets	\$ 1,900,322	\$ 2,831,868	\$ (931,546)
Bonding reserve	388,870	351,031	37,839
Operating reserve	1,300,000	1,300,000	-
Unrestricted -unrealized gain (loss) on investments	<u>73,493</u>	<u>464,975</u>	<u>(391,482)</u>
Total net position	\$ <u>3,662,685</u>	\$ <u>4,947,874</u>	\$ <u>(1,285,189)</u>

Percentages may not calculate and amounts may not add up due to rounding.

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Statements of Revenues, Expenses and Changes in Net Position

The statements of revenues, expenses and changes in net position present the financial activity of the Lottery over the fiscal year. The focus is on operating revenues and expenses that have a significant effect on the distributions paid to the proceeds recipients.

**Condensed Statements of Revenues, Expenses and
Changes in Net Position**
For the Fiscal Years Ended June 30, 2014, 2013, and 2012

	<u>2014</u>	<u>2013</u>	<u>2012</u>
Operating Revenues	\$545,030,260	\$566,286,598	\$545,303,548
Direct Operating Expenses	<u>387,530,205</u>	<u>403,656,257</u>	<u>395,329,218</u>
Gross Profit on Sale of Tickets	<u>157,500,055</u>	<u>162,630,341</u>	<u>149,974,330</u>
Other Operating Expenses			
Marketing and communications	13,629,282	13,627,884	13,388,426
Wages and benefits	9,256,494	9,187,414	8,980,570
Other operating expenses	<u>6,182,913</u>	<u>5,835,169</u>	<u>6,153,342</u>
Total Other Operating Expenses	<u>29,068,689</u>	<u>28,650,467</u>	<u>28,522,338</u>
Other Operating Revenue	<u>382,539</u>	<u>289,398</u>	<u>201,559</u>
Total Operating Income	<u>128,813,905</u>	<u>134,269,272</u>	<u>121,653,551</u>
Nonoperating Revenues (Expenses)			
Investment income	554,251	77,300	343,764
Proceeds distributions	<u>(130,113,508)</u>	<u>(135,631,761)</u>	<u>(123,249,476)</u>
Total nonoperating expenses	(129,559,257)	(135,554,461)	(122,905,712)
Change in Net Position	(745,352)	(1,285,189)	(1,252,161)
Net Position, Beginning of Year	<u>3,662,685</u>	<u>4,947,874</u>	<u>6,200,035</u>
Net Position, End of Year	\$ <u>2,917,333</u>	\$ <u>3,662,685</u>	\$ <u>4,947,874</u>

Percentages may not calculate and amounts may not add up due to rounding.

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Sales Activities

Revenues from the sales of Lottery products for the fiscal year ended June 30, 2014 were the third highest in the Lottery's thirty plus year history, although down from the previous fiscal year. Fiscal Year 2014 sales of \$545.0 million represented a decrease of 3.8 percent or \$21.3 million from Fiscal Year 2013 sales of \$566.3 million. Overall sales for Fiscal Year 2013 increased by 3.8 percent or \$21.0 million from Fiscal Year 2012 sales of \$545.3 resulting in the highest sales figure in Lottery history. Fiscal Year 2014 scratch sales of \$362.0 million represented a nearly \$6.6 million or a 1.3 percent decrease compared to the prior fiscal year scratch sales of \$368.6 million. Fiscal Year 2014 scratch sales began strong, higher than the previous year's sales. December holiday scratch sales, however, were down \$0.8 million from the previous year, possibly due to the shorter Christmas 2013 shopping season between Thanksgiving and Christmas Day. Continuing the downward trend into the third quarter of Fiscal Year 2014, scratch sales saw an unprecedented drop of 6.0 percent or \$5.8 million from Fiscal Year 2013 third quarter.

Fiscal Year 2013 scratch sales of \$368.6 represented a \$4.3 million increase or 1.2 percent over the prior year scratch sales of \$364.2 million. The increase can be attributed to Lottery players shifting from the lower priced tickets of \$1, \$2, and \$3 to the higher priced tickets of \$5, \$10 and \$20 which have better odds of winning. The smaller percentage increase in scratch sales in Fiscal Year 2013 compared to recent prior years may be tied to the higher Powerball jackpots and resulting shift to jackpot sales seen in the year.

Total jackpot game sales in Fiscal Year 2014 of \$183.0 million represented a decrease of \$14.7 million or 7.4 percent from Fiscal Year 2013. Total jackpot game sales in Fiscal Year 2013 of \$197.7 represented an increase of \$16.6 million or 9.2 percent over fiscal 2012 sales of \$181.1 million. As mentioned above in the *Financial Highlights* section, the decrease in jackpot games sales in Fiscal Year 2014 was primarily due to the \$32.2 million decrease in Powerball sales tied to the lack of relatively high jackpots compared to the previous year's record breaking ones. Players also appear to be suffering from "jackpot fatigue", a term describing the phenomenon where players do not buy tickets until the game offers bigger and bigger jackpots. For example, a jackpot of \$427.2 million won in February 2014 generated \$15.1 million dollars in Powerball sales during the sixteen draw run; a similar run of sixteen draws in Fiscal Year 2013 generated a jackpot of \$587.5 million and \$28.8 million in sales. The decline in Powerball sales was partially offset by an increase of \$13.6 million or 2.7% increase in Mega Millions sales. Starting in October 2013, the Mega Millions game experienced a change to its matrix in an effort to grow jackpots faster and to higher amounts. Results were mixed in Fiscal Year 2014 seeing three Mega Millions jackpots of near or over \$400 million, two prior to the change and one after. This compared to the highest jackpot of \$190 million in Fiscal Year 2013. The decrease in jackpot game sales was also offset by a combined increase in in-state jackpot games (Lotto, Cash 5, and Pick 3) sales of \$3.9 million.

The increase in jackpot game sales in Fiscal Year 2013 was primarily due to the \$34.9 million or 42.6 percent increase in Powerball sales tied to overall increase in jackpot amounts in the year and the full year sales of the \$2 ticket from the \$1 which changed in January 2012. Fiscal Year 2013 saw the two highest Powerball jackpots to date, both over \$500 million, two jackpots over \$300 million and two additional jackpots over \$200 million. In addition, Cash 5 sales showed a 9.0 percent or \$1.8 million increase. With the

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reintroduction of a holiday Raffle game and the start of the new Pick 3 game, Fiscal Year 2013 jackpot game sales increased by \$2.0 million and \$1.9 million, respectively in "new" sales over the previous fiscal year. These sales were offset by a \$13.9 million or 37.5 percent decrease in Mega Millions sales, a slight 2.1 percent drop of \$0.7 million in Lotto sales and a \$9.2 million loss in MatchPlay sales due to the ending of the game at the end of Fiscal Year 2012. Unlike in the previous record-breaking year, the highest Mega Millions jackpot reached in Fiscal Year 2013 was \$190 million, as earlier mentioned, with only one other jackpot over \$100 million, causing the sharp drop in sales.

The following tables compare Lottery product sales between fiscal years.

Product Sales	2014	2013	Difference	Change
Scratch	\$362,045,443	\$368,583,078	(\$6,537,635)	(1.8)%
Powerball	84,518,786	116,726,233	(32,207,447)	(27.6)
Lotto	33,809,181	32,561,865	1,247,316	3.8
Mega Millions	36,799,903	23,217,230	13,582,673	58.5
Cash 5	19,173,636	21,279,304	(2,105,668)	(9.9)
Raffle	0	1,969,010	(1,969,010)	(100.0)
Pick 3	8,683,311	1,949,878	6,733,434	345.3
Total	<u>\$545,030,260</u>	<u>\$566,286,598</u>	<u>(\$21,256,338)</u>	<u>(3.8)%</u>

Product Sales	2013	2012	Difference	Change
Scratch	\$368,583,078	\$364,244,843	\$4,338,235	1.2%
Powerball	116,726,233	81,865,488	34,860,745	42.6
Lotto	32,561,865	33,276,914	(715,049)	(2.1)
Mega Millions	23,217,230	37,122,665	(13,905,435)	(37.5)
Cash 5	21,279,304	19,520,456	1,758,848	9.0
MatchPlay	0	9,273,182	(9,273,182)	(100.0)
Raffle	1,969,010	0	1,969,010	N/A
Pick 3	1,949,878	0	1,949,878	N/A
Total	<u>\$566,286,598</u>	<u>\$545,303,548</u>	<u>\$20,983,050</u>	<u>3.8%</u>

Other Operating Revenues

Other operating revenues for the years ended June 30, 2014 and June 30, 2013 totaled \$0.4 million and \$0.3 million, respectively. Other operating revenues for the year ended June 30, 2013 and June 30, 2012 totaled \$0.3 million and \$0.2 million, respectively. The major reason for the \$0.1 million increases in each year to the next was due to the increase in liquidated damages charged to Scientific Games for non-performance of the jackpot gaming vendor contract.

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Nonoperating Revenues

Nonoperating revenues for the years ended June 30, 2014 and June 30, 2013 totaled \$0.6 million and \$80 thousand, respectively. The major reason for the increase was due to the increase to the GASB 31 adjustment recording the Lottery's share of the unrealized gains and losses on investments held by the treasury decreasing from a net loss of \$391,482 in Fiscal Year 2013 to a net \$102,739 gain in Fiscal Year 2014. In addition, continued decline in interest rates, offset by an increase in the average cash balances held on which interest was paid, resulted in a \$23,765 decrease in nonoperating revenues.

Nonoperating revenues for the years ended June 30, 2013 and June 30, 2012 totaled \$80 thousand and \$0.3 million, respectively. The major reason for the decrease was due to the GASB 31 adjustment recording the Lottery's share of the unrealized gains and losses on investments held by the Treasury increasing from a net loss of \$149,612 in Fiscal Year 2012 to a net loss of \$391,482 in Fiscal Year 2013. In addition, continued decline in interest rates paid on investments in Fiscal Year 2013 played a role (\$24,594 decrease) in the decline of nonoperating revenues.

Total Revenues

Total revenues were \$546.0 million and \$566.7 million for the years ended June 30, 2014 and 2013, respectively. The major contributing factor to the decrease in total revenues of nearly \$20.7 million was the overall 3.8 percent decrease in Lottery product sales totaling \$21.3 million offset by the approximately \$0.5 million increase of nonoperating revenues and the \$0.1 million increase in other operating revenues outlined in the previous section.

Total revenues were \$566.7 million and \$545.8 million for the years ended June 30, 2013 and 2012, respectively. The major contributing factor to the increase in total revenues of approximately \$20.9 million was primarily due to the 9.2 percent increase in total jackpot game sales and the 1.2 percent increase in scratch game sales totaling \$21.0 million in the current fiscal year. In addition, other operating revenue increased by \$0.1 million. These increases were offset by the approximate \$0.2 million reduction of nonoperating revenues mentioned above.

Major Expenses

Approximately \$387.5 million of the Lottery's total expenses of \$416.6 million for the fiscal year ended June 30, 2014 were incurred in direct support of the Lottery games. These expenses include prize expense, retailer compensation, money spent to purchase scratch tickets and compensation to the vendor who maintains and supports the jackpot gaming system. Of the \$387.5 million spent in Fiscal Year 2014 for the direct support of the Lottery games, \$336.5 million or 86.8% was for prize expense associated with those games.

In comparison, approximately \$403.7 million of the Lottery's total expenses of \$432.3 million for the fiscal year ended June 30, 2013 were game-related expenses. Of the \$403.7 million spent in Fiscal Year 2013 for direct support of the Lottery games, \$350.3 million or 86.8% was for prize expense associated with those games.

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In comparison, \$395.3 million of the Lottery's total expenses of \$423.9 million for the fiscal year ended June 30, 2012 were game-related expenses. Of the \$395.3 million spent in Fiscal Year 2012 for direct support of the Lottery games, \$342.3 million or 86.7% was spent for prize expense associated with those games.

Total prize expense in Fiscal Year 2014 decreased \$13.7 million from Fiscal Year 2013. Generally, a decrease would be expected with an associated decrease in product sales as was seen in Fiscal Year 2014. As a percentage of sales, however, overall prize expense went down from 61.9 percent in Fiscal Year 2013 to 61.7 percent in Fiscal Year 2014. The decrease in the prize percentage is equivalent to a \$0.6 million reduction in prize expense.

Total prize expense in Fiscal Year 2013 increased \$7.6 million over Fiscal Year 2012. In Fiscal Year 2013, based on the \$21.0 million increase in sales and the Fiscal Year 2012 prize expense percentage, a \$13.2 million increase in prize expense would have been expected. As a percentage of sales, however, prize expense actually went down from 62.8 percent in Fiscal Year 2012 to 61.9 percent in Fiscal Year 2013. The decrease in the prize percentage is equivalent to a \$5.6 million reduction in prize expense. The reduction in the prize expense percentage of sales was due to several factors and was in part the direct result of changes implemented by Lottery management to decrease prize expense.

Scratch prize expense as a percentage of sales decreased by 1.0 percent in Fiscal Year 2014 from Fiscal Year 2013. Starting in Fiscal Year 2012, Lottery management issued a directive to change the prize structure of some of our scratch games and introduce scratch games with lower overall prize payouts, in order to increase the distributions to our proceeds recipients. This process has been a slow one due to the amount of time it takes for the development, approval and ultimate launch of a scratch game out in the market. The decrease in scratch prize expense seen in Fiscal Year 2014 was a direct result of the continuation of this directive. A \$0.7 million drop in unclaimed scratch tickets in Fiscal Year 2014 (the write off of which lowers prize expense), however, negated some of the decrease in the scratch prize expense as a percentage of sales.

Scratch prize expense as a percentage of sales increased by only 0.1 percent in Fiscal Year 2013 over the previous year. The desired results of the above mentioned directive became more evident in Fiscal Year 2013 compared to Fiscal Year 2012. In Fiscal Year 2013, the increase to scratch prize expense would have been even higher if the efforts toward meeting the above stated goal had not been taken. The shift in sales from the lower price point games (the \$1, \$2 and \$3 games) to the higher price point games (the \$5, \$10 and \$20 games) continued into Fiscal Year 2013 from Fiscal Year 2012. The higher priced tickets carry a higher prize expense percentage causing the overall scratch prize expense to increase and negating some of the progress made by lowering the prize expense percentages. The \$0.9 million drop in unclaimed scratch tickets in Fiscal Year 2013 (the write off of which lowers prize expense) also accounted for some of the increase in the prize expense as a percentage of sales.

Overall jackpot game prize expense as a percentage of sales increased from 47.9 percent in Fiscal Year 2013 to 48.7 percent in Fiscal Year 2014. The main reason for the increase was due to the \$2.0 million decrease in the write off of unclaimed jackpot tickets in Fiscal Year 2014. Due to the lack of higher jackpots in the Powerball game in Fiscal Year 2014 and the associated increase in write offs when these occur, Powerball accounted for \$1.9

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million of this drop. On the other hand, jackpot game prize expense as a percentage of sales decreased by an overall 2.2 percent in Fiscal Year 2013 compared to Fiscal Year 2012. This resulted in a \$4.3 million reduction in jackpot game prize expense from what was expected with the \$16.6 million increase in sales. The main reason for this reduction was the shift in sales to the more profitable Powerball game due to the higher jackpots seen in Fiscal Year 2013. The elimination of the MatchPlay game with a 63.9 percent prize expense late Fiscal Year 2012 and the ultimate introduction of the new Pick 3 replacement game with an expectant prize payout of 50.3 percent also helped lower the jackpot game prize expense in Fiscal Year 2013

As a percentage of sales, the Lottery saw a slight decrease in the overall other game-related expenses in Fiscal Year 2014 from Fiscal Year 2013, namely with a decrease in the retailer bonus expense category. Total other game-related expenses were under 9.4 percent of sales in Fiscal Year 2014 compared to over 9.4 percent in Fiscal Year 2013. The Lottery also saw a decrease in all other game-related expenses in Fiscal Year 2013 from Fiscal Year 2012, including retailer commissions, retailer bonuses, ticket costs and vendor fees; especially in the retailer bonus expense category. Total other game-related expenses were 9.4 percent of sales in Fiscal Year 2013 compared to 9.7 percent in Fiscal Year 2012.

Following are tables comparing the game-related expenses between Fiscal Years 2014 and 2013.

Game-Related Expenses	2014	% of Sales	2013	% of Sales	Difference	Change in % of Sales
Prize Expense						
Scratch	\$247,349,989	68.3%	\$255,573,498	69.3%	\$(8,223,509)	(1.0)%
Powerball	40,130,951	47.5	54,336,854	46.6	(14,205,903)	0.9
Lotto	16,846,382	49.8	16,289,162	50.0	557,220	(0.2)
Mega Millions	17,627,121	47.9	10,722,656	46.2	6,904,465	1.7
Cash 5	10,398,485	54.2	11,554,225	54.3	(1,155,740)	(0.1)
MatchPlay	-	N/A	(128,894)	N/A	128,894	N/A
Raffle	(40,120)	N/A	1,000,000	50.8	(1,040,120)	N/A
Pick 3	<u>4,198,685</u>	48.3	<u>912,954</u>	46.8	<u>3,285,731</u>	1.5
Total Prize expense	\$336,511,493	61.7%	\$350,260,455	61.9%	\$(13,748,962)	(0.2)%
Retailer compensation						
Commissions	36,249,056	6.6%	37,596,118	6.6%	(1,347,062)	(0.0)
Bonuses	3,963,926	0.7	4,617,752	0.8	(653,826)	(0.1)
Ticket costs	2,601,233	0.5	2,606,116	0.5	(4,883)	0.0
Vendor fees	<u>8,204,497</u>	1.5	<u>8,575,816</u>	1.5	<u>(371,319)</u>	0.0
Total	<u>\$387,530,205</u>	71.1%	<u>\$403,656,257</u>	71.3%	<u>\$(16,126,052)</u>	(0.2)%

Percentages may not calculate and amounts may not add up due to rounding.

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Following are tables comparing the game-related expenses between Fiscal Years 2013 and 2012.

Game-Related Expenses	2013	% of Sales	2012	% of Sales	Difference	Change in % of Sales
Prize Expense						
Scratch	\$255,573,498	69.3%	\$251,968,935	69.2%	\$ 3,604,563	0.1%
Powerball	54,336,854	46.6	38,347,359	46.8	15,989,495	(0.2)
Lotto	16,289,162	50.0	17,878,569	53.7	(1,589,407)	(3.7)
Mega Millions	10,722,656	46.2	18,183,635	49.0	(7,460,979)	(2.8)
Cash 5	11,554,225	54.3	10,536,969	54.0	1,017,256	0.3
MatchPlay	(128,894)	N/A	5,929,284	63.9	(6,058,178)	N/A
Raffle	1,000,000	50.8	(204,500)	N/A	1,204,500	N/A
Pick 3	<u>912,954</u>	46.8	<u>--</u>	N/A	<u>912,954</u>	N/A
Total Prize expense	\$350,260,455	61.9%	\$342,640,251	62.8%	\$7,620,204	(0.9)%
Retailer compensation						
Commissions	37,596,118	6.6%	36,305,943	6.7%	1,237,663	(0.1)
Bonuses	4,617,752	0.8	5,334,999	1.0	199,650	(0.2)
Ticket costs	2,606,116	0.5	2,789,463	0.5	(37,048)	0.0
Vendor fees	<u>8,575,816</u>	1.5	<u>8,258,562</u>	1.5	<u>238,806</u>	0.0
Total	<u>\$403,656,257</u>	71.3%	<u>\$395,329,218</u>	72.5%	<u>\$18,013,652</u>	(1.2)%

Non game-related expenses totaled \$29.1 million in Fiscal Year 2014 compared to \$28.6 million in Fiscal Year 2013, a 1.5 percent or \$418,222 increase. Of the \$29.1 million expenses that were non game-related in Fiscal Year 2014, more than \$13.6 million, virtually the same as the previous year, was for promotions and institutional and product advertising. Approximately \$9.4 million, a \$0.2 million increase over Fiscal Year 2013, was for compensation to the Lottery employees. The increase in employee compensation in Fiscal Year 2014 was mainly the result of over \$0.4 million and \$0.1 million increases in base building and non-base building pay effective July 1, 2013 and benefit contribution increases effective both July 1, 2013 and January 1, 2014, offset by a \$0.3 million decrease in employee sales bonus pay. Over \$1.7 million was paid to other state agencies, chiefly for pass-through expenses including fleet and computer expenses. Depreciation expense and delivery expense for scratch games both made up \$1.0 million of non game-related expenses. In addition, the equipment expense of \$0.5 million primarily consisted of the purchase of 100 new retailer gaming terminals due to the aging of the current terminals out in the field.

Non game-related expenses totaled \$28.6 million in Fiscal Year 2013 compared to \$28.5 million in Fiscal Year 2012, a slight increase of 0.5 percent or \$128,129. Of the \$28.6 million expenses in Fiscal Year 2013, more than \$13.6 million, a \$0.2 million increase from the previous fiscal year, was for promotions and institutional and product advertising, especially for the new Pick 3 jackpot game. About \$9.2 million, also a \$0.2 million increase over Fiscal Year 2012, was for compensation to the Lottery employees. The increase in employee compensation was mainly the result of an increase to employer PERA and health benefit contributions for Lottery employees. Depreciation expense made up \$1.0 million of the non game-related expenses with a slight decrease from the

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prior year, while scratch delivery expense made up \$0.9 million of the expenses, a decrease of \$54,544 despite the increase in scratch sales seen in Fiscal Year 2013. As the result of a lawsuit with a party suing for the use of the Powerball "multiplier" feature, a decision was made by the MUSL, which the Lottery is a member, to purchase the intellectual property for this feature. Colorado's share of the purchase was approximately \$0.4 million which falls in the "Other" category of the non game-related expenses. On the other hand, with the final payment for the development and implementation of back office system being made in Fiscal Year 2012, cost savings of approximately \$0.6 million were realized in Fiscal Year 2013 in the professional services, equipment and equipment maintenance categories. This savings along with several smaller cuts in other expenses helped maintain the ten percent cut to the marketing and operating budgets put into place in Fiscal Year 2012.

Distributions to the Proceeds Recipients

The Lottery's continued efforts in Fiscal Year 2014 to increase proceeds as a percentage of revenue generated funds available for distributions of \$130.1 million, the second largest distribution amount in Lottery history despite the drop in sales, especially in jackpot game category which has the highest gross profit margin. As a percentage of total revenue, the Lottery returned 23.8 percent in Fiscal Year 2014, a slight drop from the 23.9 percent in Fiscal Year 2013. Of these total proceeds, \$60.3 million was allocated to the Great Outdoors Colorado Trust Fund, nearly \$52.1 million to the Conservation Trust Fund and \$13.0 million to the Division of Parks and Outdoor Recreation per the distribution formula stated in Colorado Revised Statutes (C.R.S.) 24-35-210. The maximum distribution to Great Outdoors Colorado of \$60.3 million, pursuant to C.R.S. 33-60-104(1)(c) and 33-60-104(2), was reached, thus creating a spill-over into the Public School Capital Construction Assistance Fund of over \$4.7 million pursuant to C.R.S. 22-43.7-104 (2)(b)(III).

The Lottery's proceeds distribution for Fiscal Year 2013 totaled \$135.6 million, an increase of \$12.4 million or 10.0 percent over Fiscal Year 2012. The \$135.6 million became the highest distribution amount of any fiscal year in the Lottery's history. This represented an increase of proceeds as a percentage of revenue from 22.6 percent to 23.9 percent for Fiscal Year 2012 and 2013, respectively. Of these total proceeds, \$59.2 million was allocated to the Great Outdoors Colorado Trust Fund, \$54.3 million to the Conservation Trust Fund and \$13.6 million to the Division of Parks and Outdoor Recreation. The spill-over into the Public School Capital Construction Assistance Fund was over \$8.6 million, a nearly 90 percent increase over the \$4.1 million allocated in fiscal 2012.

The Lottery's proceeds distributions for Fiscal Year 2012 totaled \$123.3 million. Approximately \$57.1 million was distributed to Great Outdoors Colorado, \$49.3 million to the Conservation Trust Fund, \$12.3 million to the Division of Parks and Outdoor Recreation and a spill-over into the Public School Capital Construction Assistance Fund of \$4.5 million.

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Capital Assets

The Lottery's investment in net capital assets at June 30, 2014, 2013 and 2012 amounted to \$1.0 million, \$1.9 million and \$2.8 million, respectively. The investment in capital assets as of June 30, 2014, 2013 and 2012 included computer equipment, servers, back office computer system, drawing equipment, modular furniture, cameras, recorders and leasehold improvements net of accumulated depreciation. Equipment asset value decreased by \$24,594 and \$132,523 from Fiscal Year 2013 to Fiscal Year 2014 and from Fiscal Year 2012 to Fiscal Year 2013, respectively. The decrease in equipment from Fiscal Year 2013 to Fiscal Year 2014 was all due to the write off of obsolete computer equipment and from 2012 to Fiscal Year 2013 was mainly due to the write off of obsolete computer and marketing production equipment. Capital assets are shown on the Statement of Net Position at the cost on the day of acquisition. Analysis of changes in capital assets is as follows:

Capital Assets as of June 30, 2013, 2012 and 2011

	2014	2013	2012
Capital Assets			
Equipment	\$ 5,922,293	\$ 5,946,887	\$ 6,079,410
Leasehold Improvements	64,711	64,711	64,711
Less: Accumulated Depreciation	<u>(5,029,437)</u>	<u>(4,111,276)</u>	<u>(3,312,253)</u>
Net capital assets	<u>\$ 957,567</u>	<u>\$ 1,900,322</u>	<u>\$ 2,831,868</u>

Budgetary Highlights

The Lottery's budget is determined by a variety of methods. The majority of the budget is set by the annual appropriations bill (the Long Bill), which determines budgets for every agency within the State. Many of the appropriation lines in the Long Bill are at the department level, and the department has the discretion to allocate them among each agency within the department. The Long Bill and department level allocations are approved shortly before the start of each fiscal year. Agencies may also request a supplemental appropriation during the fiscal year to cover unexpected expenses (or a negative supplemental for less than expected expenses), as well as year-end transfers of spending authority, if needed. Department level re-allocations were approved in employee benefits, variable vehicle, legal services and vehicle lease payments. The final method of funding is special legislation. There was no special legislation affecting the Lottery's budget in Fiscal Year 2014.

The approved Lottery budget at the beginning of Fiscal Year 2014 was \$525.1 million. Department level reallocations approved throughout the fiscal year increased the budget by \$70,340 to an amended total of \$525.2 million. Total expenditures and roll-forwards for Fiscal Year 2014 on a budget basis came to \$416.5 million, resulting in excess appropriations (or savings) of nearly \$108.7 million.

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Economic Outlook

The Lottery plans to concentrate on investing in new infrastructure and enhancing marketing activities in Fiscal Year 2015. The Lottery expects sales to remain relatively constant with Fiscal Year 2015 sales projected at \$546.0 million, up slightly over the \$545.0 million in Fiscal Year 2014. The projected distribution for Fiscal Year 2015 is \$128.3 million, slightly lower than the \$130.1 million in Fiscal Year 2014.

The Lottery plans to convert its central computer system from the current vendor to a new vendor in the second quarter of Fiscal Year 2015. This will entail building and testing a new central system, setting up a new communications network for the retailer network, changing out counter terminals as well as ticket vending machines. It is expected that these changes will enhance sales in the long term, as the new vending machines will also sell jackpot game tickets as opposed to the current Scratch-only machines. Also, aging equipment has made it more difficult to service the current retailer network and the new machines will rectify this issue.

The Lottery plans to complete research for jackpot games in two different areas--portfolio optimization and Lotto game market research. The results of these two research objectives will be available during the first quarter of Fiscal Year 2015 and will allow the Lottery to integrate identified changes to the jackpot games category during the third and fourth quarters of Fiscal Year 2015 after the central system conversion is completed. The Lottery plans to help launch changes to the games with additional advertising campaigns to make customers aware of the changes.

Contacting the Lottery's Financial Management

This management discussion and analysis report is designed to provide Colorado citizens, Colorado government officials, our players, retailers and other interested parties with a general overview of the Lottery's financial activity for Fiscal Year 2014 and to demonstrate the Lottery's accountability for the money generated from the sale of the Lottery products. If you have questions about this report or need additional information, contact John Caligaris, the Colorado Lottery's Controller, 225 North Main Street, Pueblo, CO 81003.

**COLORADO LOTTERY
STATEMENTS OF NET POSITION
June 30, 2014 and 2013**

	2014	2013
ASSETS		
Current Assets:		
Cash and Investments	\$ 37,344,039	\$ 42,624,838
Accounts Receivable, net of the allowance for doubtful accounts of \$156,458 in 2014 and \$129,441 in 2013	18,923,528	20,260,613
Consignment Inventory, at Cost	96,822	107,001
Warehouse Inventory, at Cost	1,158,843	1,064,149
Prepaid Expenses	183,664	51,345
Total Current Assets	57,706,896	64,107,946
Reserve and Restricted Assets:		
Cash and Investments-Operating Reserve	1,400,000	1,300,000
Cash and Investments-Licensed Agent Recovery Reserve Receipts	383,534	388,870
Prepaid Prize Expense with MUSL	4,952,818	4,941,494
Total Reserve and Restricted Assets	6,736,352	6,630,364
Capital Assets:		
Equipment	5,922,293	5,946,887
Leasehold Improvements	64,711	64,711
Less Accumulated Depreciation and Amortization	(5,029,437)	(4,111,276)
Total Capital Assets	957,567	1,900,322
 TOTAL ASSETS	 \$ 65,400,815	 \$ 72,638,632

**COLORADO LOTTERY
STATEMENTS OF NET POSITION
(Continued)
June 30, 2014 and 2013**

	2014	2013
LIABILITIES		
Current Liabilities:		
Accounts Payable	\$ 2,551,217	\$ 2,349,687
Prize Liability	25,829,136	25,389,816
Payable to MUSL	520,686	1,439,549
Accrued Annual and Sick Leave	9,305	-
Wages and Benefits	770,834	872,731
Retailer Bonus Liability	1,533,522	706,712
Funds Available for Distribution	30,508,507	37,298,362
Total Current Liabilities	61,723,207	68,056,857
Long-Term Liabilities:		
Accrued Annual and Sick Leave	699,550	858,365
Expired Warrants Liability	60,725	60,725
Total Long-Term Liabilities	760,275	919,090
TOTAL LIABILITIES	62,483,482	68,975,947
NET POSITION		
Net Investment in Capital Assets	957,567	1,900,322
Restricted-Licensed Agent Recovery Reserve	383,534	388,870
Restricted-Operating Reserve	1,400,000	1,300,000
Unrestricted-Other	176,232	73,493
TOTAL NET POSITION	\$ 2,917,333	\$ 3,662,685

See Notes to Financial Statements

**COLORADO LOTTERY
STATEMENTS OF REVENUES, EXPENSES AND
CHANGES IN FUND NET POSITION
FOR THE YEARS ENDED June 30, 2014 and 2013**

	2014	2013
OPERATING REVENUES		
Gross Ticket Sales	\$ 545,030,260	\$ 566,286,598
DIRECT OPERATING EXPENSES		
Prize Expense	336,511,493	350,260,455
Retailer Commissions and Bonuses	40,212,982	42,213,870
Cost of Tickets and Vendor Fees	10,805,730	11,181,932
Total direct operating expenses	387,530,205	403,656,257
GROSS PROFIT ON SALE OF TICKETS	157,500,055	162,630,341
OTHER OPERATING EXPENSES		
Marketing and Communications	13,629,282	13,627,884
Administration Fees Paid to MUSL	85,228	148,940
Wages and Benefits	9,256,494	9,187,414
Professional Services	178,471	139,806
State Agencies Services	267,553	158,648
Department of Revenue Services	486,936	586,212
Travel	51,803	70,001
Equipment (including loss on disposition of equipment of \$826 and \$3,411, respectively)	521,428	59,522
Depreciation	960,109	977,298
Space Rental	754,269	728,305
Rents for Equipment	25,557	31,788
Motor pool Leasing	368,640	364,798
Materials and Supplies	100,755	92,032
Telephone	233,137	185,898
On-Line Telecommunications	431,334	415,230
Data Processing Supplies and Services	329,666	53,805
Equipment Maintenance	272,636	286,600
Printing	21,526	23,927
Delivery Expense	961,938	927,943
Other	131,927	584,416
Total Other Operating Expenses	29,068,689	28,650,467
OTHER OPERATING REVENUE	382,539	289,398

COLORADO LOTTERY
STATEMENTS OF REVENUES, EXPENSES AND
CHANGES IN FUND NET POSITION
(Continued)
FOR THE YEARS ENDED June 30, 2014 and 2013

	<u>2014</u>	<u>2013</u>
TOTAL OPERATING INCOME	<u>128,813,905</u>	<u>134,269,272</u>
NONOPERATING REVENUES (EXPENSES)		
Investment Income	554,251	77,300
Funds Distributed for Current Year	(99,605,001)	(98,333,399)
Funds Available for Distribution for Current Year	<u>(30,508,507)</u>	<u>(37,298,362)</u>
Total Nonoperating Revenues (Expenses)	<u>(129,559,257)</u>	<u>(135,554,461)</u>
NET INCOME(LOSS)	<u>\$ (745,352)</u>	<u>\$ (1,285,189)</u>
NET POSITION, BEGINNING OF YEAR	\$3,662,685	\$4,947,874
Net Change in Net Position	<u>(745,352)</u>	<u>(1,285,189)</u>
NET POSITION, END OF PERIOD	<u>\$ 2,917,333</u>	<u>\$ 3,662,685</u>

See Notes to Financial Statements

COLORADO LOTTERY
STATEMENTS OF CASH FLOWS
FOR THE FISCAL YEARS ENDED June 30, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Cash Flows from Operating Activities		
Cash received from retailers	\$ 547,217,929	\$ 564,973,271
Cash paid in prizes	(336,622,967)	(348,231,797)
Cash paid in retailer commissions	(36,249,056)	(37,596,118)
Cash payments to suppliers	(30,518,493)	(27,664,040)
Cash payments to employees for services	(9,507,901)	(9,135,030)
Cash paid in retailer bonus	<u>(3,138,356)</u>	<u>(4,726,192)</u>
Net cash provided by operating activities	<u>131,181,156</u>	<u>137,620,094</u>
Cash Flows from Noncapital Financing Activities		
Distribution of net proceeds	<u>(136,903,363)</u>	<u>(127,317,475)</u>
Net cash used by noncapital financing activities	<u>(136,903,363)</u>	<u>(127,317,475)</u>
Cash Flows from Capital and Related Financing Activities		
Acquisition of capital assets	<u>(18,179)</u>	<u>(49,163)</u>
Net cash used by capital and related financing activities	<u>(18,179)</u>	<u>(49,163)</u>
Cash Flows from Investing Activities		
Interest received	451,512	468,782
Change in fair market value of investments	<u>102,739</u>	<u>(391,482)</u>
Net cash provided by investing activities	<u>554,251</u>	<u>77,300</u>
Increase (Decrease) in Cash and Investments	(5,186,135)	10,330,756
Cash and Investments, Beginning of Year (including \$1,688,870 and \$1,651,031, respectively, in restricted accounts)	<u>44,313,708</u>	<u>33,982,952</u>
Cash and Investments, End of Period, (including \$1,783,534 and \$1,688,870, respectively, in restricted accounts)	<u>\$ 39,127,573</u>	<u>\$ 44,313,708</u>

COLORADO LOTTERY
STATEMENTS OF CASH FLOWS (Continued)
FOR THE FISCAL YEARS ENDED JUNE 30, 2014 and 2013

	2014	2013
Reconciliation of Operating Income to Net Cash		
Provided by Operating Activities		
Operating income	\$ 128,813,905	\$ 134,269,272
Adjustments of reconcile operating income to net cash provided by operating activities		
Depreciation	960,109	977,298
Loss (gain) on disposition of equipment	825	3,411
Change in:		
Accounts Receivable	1,337,085	(768,727)
Ticket Inventory	(84,515)	(143,682)
Prepaid Expenses	(132,319)	21,217
Prepaid Prize Expense with MUSL	(11,324)	52,528
Liabilities (excluding funds available for distribution)	297,390	3,208,777
	<u>\$ 131,181,156</u>	<u>\$ 137,620,094</u>
Statement of Net Position Classification		
Cash and investments	\$ 37,344,039	\$ 42,624,838
Cash and investments- Licensed Agent Recovery Reserve	383,534	388,870
Cash and investments- Operating Reserve	1,400,000	1,300,000
Cash and Investments, End of Period	<u>\$ 39,127,573</u>	<u>\$ 44,313,708</u>

See Notes to Financial Statements

**COLORADO LOTTERY
POWERBALL ANNUITY WINNERS TRUST FUND
STATEMENTS OF FIDUCIARY NET POSITION
June 30, 2014 and 2013**

	<u>2014</u>	<u>2013</u>
ASSETS		
Current Assets		
Investments	<u>\$ 11,675,761</u>	<u>\$ 11,567,677</u>
Total Assets	<u>11,675,761</u>	<u>11,567,677</u>
NET POSITION		
Held in Trust for Powerball winner	<u>11,675,761</u>	<u>11,567,677</u>
Total Net Position	<u>\$ 11,675,761</u>	<u>\$ 11,567,677</u>

See Notes to Financial Statements

**COLORADO LOTTERY
POWERBALL ANNUITY WINNERS TRUST FUND
STATEMENTS OF CHANGES IN FIDUCIARY NET POSITION
June 30, 2014 and 2013**

	2014	2013
Additions		
Investment income (loss)	\$ 559,084	\$ (673,266)
Deductions		
Prize payment	451,000	434,000
Change in Net Position	108,084	(1,107,266)
Net Position of Assets Held in Trust for Powerball Winner		
Beginning of Year	<u>11,567,677</u>	<u>12,674,943</u>
End of Year	<u>\$ 11,675,761</u>	<u>\$ 11,567,677</u>

See Notes to Financial Statements

**COLORADO LOTTERY NOTES TO
FINANCIAL STATEMENTS
June 30, 2014 and 2013**

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

The Colorado Lottery (the Lottery) began operations April 30, 1982 under the provisions of Section 24-35-202, C.R.S. The Lottery operates under a commission and provides operation and service of lottery games as authorized by the statute. The Lottery's revenues are predominantly earned from the sale of lottery products, including scratch games and jackpot games including Lotto, Powerball, Cash 5, Mega Millions and Pick 3.

The financial statements reflect activities of the Lottery, an enterprise fund of the State of Colorado and activities of the Lottery's Powerball Annuity Winners Trust Fund, a private trust fund of the State of Colorado, for the Fiscal Years ended June 30, 2014 and 2013. The Lottery is an agency 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 Lottery and the Lottery's Powerball Annuity Winners Trust Fund in accordance with accounting principles generally accepted in the United States of America.

The accounting policies of the Lottery conform to accounting principles generally accepted in the United States of America as applicable to governments. The following is a summary of the more significant policies.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues, expenses, gains, losses and other changes in net position during the reporting period. Actual results could differ from those estimates.

Reclassifications

Certain reclassifications of amounts previously reported have been made to the accompanying financial statements to maintain consistency between periods presented. The Lottery eliminated separately presenting prize variance for Powerball and Mega Millions from total prize expense in the statements of revenues, expenses, and changes in fund net position. The reclassifications had no impact on net income or previously reported net position.

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, net position, revenues and expenditures.

**COLORADO LOTTERY NOTES TO
FINANCIAL STATEMENTS
June 30, 2014 and 2013**

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Enterprise Fund

The Lottery accounts for its operations as an enterprise fund. The intent of the State of Colorado Legislature is that the Lottery's 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. The Lottery defines operating revenues as those earned as a direct result of the fund's principal ongoing operations, i.e., the sale of lottery products. Operating expenses include expenses incurred in earning those revenues such as prize payments, the cost of tickets, vendor fees, retailer commissions and bonuses, administrative expenses and depreciation on capital assets. All revenues and expenses not meeting these definitions are reported as non-operating revenues and expenses.

With the implementation of GASB Statement No. 62 *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* effective for financial statements for periods beginning after December 15, 2011, Statement No. 20 was superseded thereby eliminating the election to apply post-November 30, 1989 FASB Statements and Interpretations. The implementation of GASB Statement No. 62 had no effect on the Lottery's financial statement presentation.

Effective July 1, 2012 for Fiscal Year 2013, the Lottery implemented the provisions of GASB Statement No. 63, "Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position". GASB Statement No. 63 provides guidance for reporting deferred outflows and deferred inflows of resources as introduced and defined in GASB Concepts Statement No. 4 "Elements of Financial Statements" (Concepts Statement No. 4). Concepts Statement No. 4 defines a deferred outflow of resources as a consumption of net assets that is applicable to a future reporting period. A deferred inflow of resources is defined as an acquisition of net assets applicable to a future reporting period. The only impact on the Lottery's financial statements has been to replace the term "net assets" with "net position".

Private Trust Fund

The Lottery accounts for Powerball Annuity Prizes in a private trust fund. The prizes are considered awarded when claimed by the winner. The Lottery is placed in a fiduciary situation, while the Multi-State Lottery Association (MUSL) manages the prize funds for the winner. Governmental accounting mandates that a separate Statement of Net Position and Statement of Changes in Net Position be prepared for such fund. Those statements are included herein.

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 Lottery accounts for funds using the accrual basis of accounting. Revenues from scratch ticket sales are recognized at the point of ticket pack activation. Revenues from Lotto, Powerball, Cash 5, Mega Millions, and Pick 3 ticket sales are recognized when the tickets are sold. Prize expense for scratch tickets is recognized at the point of ticket activation. Prize expense for Lotto, Powerball, Cash 5, Mega Millions, and

**COLORADO LOTTERY NOTES TO
FINANCIAL STATEMENTS
June 30, 2014 and 2013**

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Pick 3 is recognized when tickets are sold. Other operating expenses are recognized when they are incurred. Revenues (additions) are recognized in the Powerball Annuity Winners Trust Fund based on the Fair Market Value of the original investment as of June 30, 2014 and 2013. Expenses (deductions) are recognized when payments are remitted to the winner(s).

Budget

By October 24th of each year, the Department of Revenue Executive Director submits to the Governor's 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 law 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 State Controller and the Office of State Planning and Budgeting and the Legislature.

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable consist of amounts due from retailers for activated scratch ticket packs and uncollected jackpot game sales. Billable accounts receivable consist of amounts due from retailers for settled scratch ticket packs and uncollected jackpot game sales. Billable accounts receivable are invoiced weekly and are electronically transferred from the retailers' accounts into the Lottery's account one week following the invoice date.

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, and 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/or can be reasonably estimated.

The Lottery uses the specific identification method to determine expected uncollectibles. Under the provisions of Section 24-35-219, C.R.S., 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 \$156,458 and \$129,441 as of June 30, 2014 and 2013, respectively.

Consignment Inventory

Inventory on consignment represents non-activated ticket inventory in the possession of retailers who act as agents of the Lottery. The retailer cannot sell a pack of tickets until the

**COLORADO LOTTERY NOTES TO
FINANCIAL STATEMENTS
June 30, 2014 and 2013**

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

pack is activated by the retailer, which enables the winning tickets to be cashed. The activation is therefore the point at which the transfer of ownership is recognized. Since the Lottery still owns non-activated tickets, the tickets are included in the inventory and reported on the statements of net position. Consignment inventory is stated at cost using the specific identification method.

Warehouse Inventory

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

Supplies Inventory

The State of Colorado's threshold for recording supplies inventories is \$100,000 per location. The supplies inventory of the Lottery consistently falls below the \$100,000 threshold per location. Accordingly, no supplies inventory appears on the statements of net position.

Prepaid Prize Expense

As part of the Lottery's agreement with MUSL, for both the Powerball and Mega Millions games, at times, a certain percentage of sales must be paid to MUSL to build the set prize and grand prize reserves. No payments were required for Powerball reserves in Fiscal Years 2013 and 2014. To bring the Mega Millions reserve up to the reserve requirement, 1.5 percent of Mega Million sales and approximately 3.1 percent of Megaplier sales in Fiscal Year 2012 and until March 29, 2013 in Fiscal Year 2013 were paid to MUSL. From March 30 to October 18, 2013 these rates were reduced to 1.0 percent and 1.6 percent, respectively. From October 19, 2013 to March 28, 2014, the 1.0 percent of Mega Million sales continued to be paid to MUSL with the 1.6 percent of Megaplier sales eliminated. A total of \$264,492 and \$389,518 were paid to MUSL for the Mega Millions reserve in Fiscal Years 2014 and 2013, respectively. Effective April 1, 2014, MUSL rebalanced both the Powerball and Mega Millions reserves and new reserve ceilings were determined for each member state. With the addition of Texas as a new MUSL member in the current fiscal year, the ceilings for most members were below their current reserve balances. This resulted in a refund of \$167,585 of Powerball reserves and \$37,890 of the Mega Million reserve to the Colorado Lottery and the discontinuance of the 1.0 percent of Mega Millions sales required reserve payment for the remainder of the fiscal year, which caused a decrease in prepaid prize expense.

Capital Assets

Capital assets, which include internal use computer software, equipment, vehicles, and leasehold improvements, are stated at cost. The Lottery adopted the state policy of capitalizing equipment only if the cost exceeds \$5,000 and has a useful life of more than one year. Depreciation for equipment and internal use computer software is computed on the straight-line method over estimated useful lives ranging from three to ten years. Depreciation for vehicles is computed on the straight-line method over the estimated useful lives of five years. Leasehold improvements are depreciated over the greater of five years or the term of the lease. When

**COLORADO LOTTERY NOTES TO
FINANCIAL STATEMENTS
June 30, 2014 and 2013**

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

Accrued Wages and Benefits

During each fiscal year, the state shifts the pay date for the month of June for employees paid on a monthly basis, deferring the date from the last working day of June to the first working day of July. For the Lottery, along with other minor payroll accruals, this created a liability for accrued wages and benefits at June 30, 2014 and 2013 of \$770,834 and \$872,731, respectively.

Prize Liability and Prize Expense

Under the provisions of Section 24-35-210 (9), C.R.S., the Lottery must pay no less than fifty percent (50%) of total ticket sales as prizes. In the aggregate, the Lottery continues to meet this requirement. 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 10).

All scratch, jackpot game and special drawing prizes are accounted for using the accrual basis of accounting. Scratch prize liability and expense are recognized at the point of ticket pack activation. The liability and expense for jackpot game prizes are recognized at the point of retail sale and are adjusted as the jackpot game draws occur and actual prize liability is determined. The liability for special drawing prizes is accrued on the first day of sales. Prize liability for all games is reduced as prizes are paid to winners. The net prize liability at June 30, 2014 and 2013 was \$25,829,136 and \$25,389,816, respectively.

Payments of scratch prize amounts of \$150 or less may be made at the Lottery or at the retail outlet; payment of scratch prize amounts of \$151 to \$599 may be made at the retailer level at the option of the retailer or at the Lottery. Scratch prizes of \$600 or more are paid by the Lottery. Retailers are given credit for prize payments they make on a daily basis. Prizes may be claimed up to 180 days after game-end. After the final claim date, any unclaimed scratch prizes accrued as a liability 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 \$5,530,434 for the fiscal year ended June 30, 2014 and \$6,262,268 for the fiscal year ended June 30, 2013.

Payments of cumulative jackpot game prize amounts of \$150 or less on a single ticket may be made at the Lottery or at the retail outlet; payment of cumulative prize amounts of \$151 to \$599 on a single ticket may be made 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 made at the Lottery. Retailers are given credit for prize payments they make on a daily basis. Jackpot game prizes may be claimed up to 180 days after the date of the drawing. After the final claim date, unclaimed jackpot game prizes will result in a decrease to prize expense so long as the aggregate prize expense of all games exceeds or equals the statutory 50% of sales. In the event that the expiration of an unclaimed prize would result in the aggregate prize expense of

**COLORADO LOTTERY NOTES TO
FINANCIAL STATEMENTS
June 30, 2014 and 2013**

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

all games to fall below the statutory 50% level, the unclaimed prize amount would remain in prize expense and be paid out to players as a guaranteed additional prize. Unclaimed jackpot game prizes resulted in a decrease to prize expense of \$3,765,363 including \$102,336 representing Colorado's share of an unclaimed Powerball jackpot prize in the state of Georgia for the fiscal year ended June 30, 2014 and \$5,753,658 for the fiscal year ended June 30, 2013.

Retailer Bonus Liability

Under provisions 5.17, 10.13 and 14.19 of the Colorado Lottery Commission Rules and Regulations:

“Each licensee shall be entitled to receive a cashing bonus of one percent (1%) of each prize paid by the licensee up to and including \$599.99.” In addition, *“a marketing performance bonus up to five-tenths of one percent (0.5%) of total product sales may be earned by licensees that meet the criteria set forth by the Lottery Director or their designee. In the event there is a residual from the accrual of the one percent (1%) cashing bonus and/or the five-tenths (0.5%) marketing bonus....the Director may provide additional compensation to licensees... or may revert the excess amount thereby decreasing the bonus expense.”*

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 in fiscal years 2014 and 2013 resulted in a reduction of bonus expense.

The marketing performance bonus is accrued monthly and paid to retailers in accordance with the criteria as set out in the fiscal year marketing performance plan as approved by the Director. Any excess marketing performance bonus accrued in fiscal years 2014 and 2013 resulted in a reduction of bonus expense.

Licensed Agent Recovery Reserve

Under the provisions of Section 24-35-219, C.R.S., a Licensed Agent Recovery Reserve was established on January 1, 1988 to maintain surety bond receipts collected from Lottery retailers. Billing rates are established by the Executive Director of the Department of Revenue 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. As of June 30, 2014 and June 30, 2013, the Lottery had reserved \$383,534 and \$388,870, respectively. The Lottery utilizes restricted net assets before using unrestricted net assets.

Lottery Fund Net Position

In accordance with Section 24-35-210 (4.1)(a), C.R.S., the Lottery is required to reserve “sufficient monies, as of the end of the fiscal year, to ensure the operation of the Lottery for the ensuing fiscal year.” The moneys reserved by the lottery shall be held in cash and investments.

**COLORADO LOTTERY NOTES TO
FINANCIAL STATEMENTS
June 30, 2014 and 2013**

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

In June 2002 the Lottery Commission approved a balance in net assets “equal to the net value of the Lottery’s capital assets”. As of June 30, 2014 and June 30, 2013, the Lottery had reserved \$957,567 and \$1,900,322, respectively.

In April 2005, the Lottery set up a separate operating reserve independent of the net capital asset reserve in the amount of \$1.7 million. The amount held in this operating reserve is reviewed annually and adjusted accordingly. The annual reviews were completed in October 2013 and October 2012. The reserve was increased to \$1.4 million in Fiscal Year 2014 from \$1.3 million in Fiscal Year 2013, in accordance with the reviews.

Equipment Expense

Included in “The Statement of Revenues, Expenses, and Changes in Fund Net Position” is an account titled equipment. This account reports the gain or loss on disposed assets, fixed asset purchases under the capitalization threshold, software purchases under the capitalization threshold, and other miscellaneous equipment transactions that do not qualify for capitalization.

Compensated Leave

All permanent employees of the 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 absences for which employees are vested is as follows:

	<u>June 30, 2013</u>	<u>Increases</u>	<u>Decreases</u>	<u>June 30, 2014</u>
Annual leave	\$ 723,364	\$ 520,051	\$ (648,382)	\$ 595,033
Sick leave	<u>133,918</u>	<u>41,669</u>	<u>(62,583)</u>	<u>113,004</u>
Total annual and sick leave	857,282	561,720	(710,965)	708,037
Compensatory time	<u>1,083</u>	<u>3,785</u>	<u>(4,050)</u>	<u>818</u>
Total compensated leave	<u>\$ 858,365</u>	<u>\$ 565,505</u>	<u>\$ (715,015)</u>	<u>\$ 708,855</u>
	<u>June 30, 2012</u>	<u>Increases</u>	<u>Decreases</u>	<u>June 30, 2013</u>
Annual leave	\$ 706,468	\$ 643,418	\$ (626,522)	\$723,364
Sick leave	<u>129,591</u>	<u>45,926</u>	<u>(41,599)</u>	<u>133,918</u>
Total annual and sick leave	836,059	689,344	(668,121)	857,282
Compensatory time	<u>397</u>	<u>5,225</u>	<u>(4,539)</u>	<u>1,083</u>
Total compensated leave	<u>\$ 836,456</u>	<u>\$ 694,569</u>	<u>\$ (672,660)</u>	<u>\$ 858,365</u>

**COLORADO LOTTERY NOTES TO
FINANCIAL STATEMENTS
June 30, 2014 and 2013**

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The short-term portion of the above accrued annual and sick leave at June 30, 2014 and June 30, 2013 is \$9,305 and \$0, respectively. This represents the amount to be paid out to known current employees planning to retire and cash in their leave balances within the next twelve months.

Expired Warrants Liability

Expired warrants liability represents the expiration of aged uncashed warrants and imprest checks which expired on or before June 30, 2003. In accordance with Section 15-12-914 (2), C.R.S., recipients are entitled to claim payment up to 21 years after original date of issue. Pursuant to Section 24-35-212 (2), C.R.S., the amount of these uncashed warrants shall remain in the Lottery fund. Pursuant to the Unclaimed Property Act, Section 38-13-113, C.R.S., the funds to cover the liability for any uncashed warrants, which expire after June 30, 2003 are transferred to the Unclaimed Property Fund. The Lottery must request reimbursement from the Unclaimed Property Fund for any warrants presented for payment that expired after June 30, 2003. No request for reimbursement was made for fiscal years ending June 30, 2013 and June 30, 2014 from the Unclaimed Property Fund.

Promotional Activity

The Lottery engages in three types of promotional activities in an attempt to enhance sales, to increase player awareness and to increase the player base: special promotions and drawings, direct giveaways, and buy x-get y. Specific promotional coupons/tickets are distributed/awarded to players through special promotions and drawings and can be redeemed/claimed at any lottery office for a specified lottery product. Specific promotional coupons/tickets with a total face value of \$5,531 and \$5,146 were redeemed in fiscal years ended June 30, 2014 and June 30, 2013, respectively.

Scratch and jackpot game tickets for specific games are given away as a more direct approach to introduce players to lottery games. During the fiscal years ended June 30, 2014 and 2013, scratch tickets with a total face value of \$154,020 and \$221,379, respectively, were given away. During the fiscal year ended June 30, 2013, jackpot games tickets (specifically Pick 3) with a total face value of \$3,525 were given away at kickoff events for the new game. No new games were introduced in Fiscal Year 2014.

A new type of promotion tied directly to the jackpot gaming system was introduced in Fiscal Year 2013. Through these promotions, players are given the opportunity to receive a “free” jackpot ticket when a qualifying purchase is made, for instance buy five Lotto tickets receive a free Pick 3 ticket. During the fiscal year ended June 30, 2014, jackpot games tickets with a total face value of \$165,153 were given away through this method. During the fiscal year ended June 30, 2013, jackpot games tickets with a total face value of \$361,829 were given away. Scratch and jackpot game tickets and coupon promotions are valued at cost. For the fiscal years ended June 30, 2014 and 2013, \$186,520 and \$352,702, respectively, were recorded as costs related to free tickets and coupons. These costs were included in Marketing and Communications expense in the statements of revenues, expenses and changes in fund net position for coupons redeemed and scratch and jackpot game tickets given away.

**COLORADO LOTTERY NOTES TO
FINANCIAL STATEMENTS
June 30, 2014 and 2013**

NOTE 2 – CASH AND INVESTMENTS

Cash

Cash includes petty cash funds, change funds, an imprest account, a depository account and cash on deposit with the State Treasurer. A detail of cash at June 30, 2014 and 2013 is as follows:

	<u>2014</u>	<u>2013</u>
Petty cash	\$ 1,100	\$ 800
Change funds	72,000	71,000
Imprest account	200,000	170,000
Depository accounts	30,000	45,000
Cash on deposit with State Treasurer	<u>37,040,939</u>	<u>42,338,038</u>
 Total unrestricted cash and investments	 <u>37,344,039</u>	 <u>42,624,838</u>
 Restricted cash and investments – Licensed Agent Recovery Reserve Receipts on deposit with State Treasurer	 383,534	 388,870
Operating Reserve on deposit with State Treasurer	<u>1,400,000</u>	<u>1,300,000</u>
 Total restricted cash and investments	 <u>1,783,534</u>	 <u>1,688,870</u>
Total cash and investments	<u>\$ 39,127,573</u>	<u>\$ 44,313,708</u>

Cash on Deposit with State Treasurer

Under the provisions of Section 24-35-210 (6), C.R.S., the State Treasurer shall invest the monies of the 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 account on a monthly basis. Actual interest payments are determined by the State Treasurer. The actual allocated interest rate for Fiscal Years 2014 and 2013 was 0.96% and 1.07%, respectively.

In addition, the State Treasurer pools these deposits and invests them in securities approved by Section 24-75-601.1; C.R.S. Moneys deposited in the Treasury are invested until the cash is needed. As of June 30, 2014, the Lottery had cash on deposit with the State Treasurer of \$38,824,473, which represented approximately 0.5 percent of the total \$7,455.0 million fair value of deposits in the State Treasurer's Pool (Pool).

The 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 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, and there is no assignment of income related to participation in the

**COLORADO LOTTERY NOTES TO
FINANCIAL STATEMENTS
June 30, 2014 and 2013**

NOTE 2 – CASH AND INVESTMENTS (CONTINUED)

Pool. Additional information on the Treasurer's Pool may be obtained in the State of Colorado's Comprehensive Annual Financial Report.

Deposits

Custodial credit risk is the risk that in the event of a bank failure, a government's deposits may not be returned to it. The Lottery's deposit policy for custodial credit risk requires compliance with the provisions of state law. State law requires collateralization of all deposits with federal depository insurance; bonds and other obligations of the U.S. Treasury, U.S. agencies or instrumentalities or the State of Colorado; bonds of any city, county, school district or special road district of the State of Colorado; bonds of any state; or a surety bond having an aggregate value at least equal to the amount of the deposits.

The Lottery accounts are held in Public Deposit Protection Act (PDPA) qualified institutions, thus balances held in the Lottery's accounts in excess of \$250,000 per institution are secured through PDPA with guaranteed securities.

Investments

A Private Purpose Trust was established in Fiscal Year 2008 to record the Lottery's investments, held by MUSL, for the benefit of Colorado's Powerball annuity prize winners (Colorado Winners Trust). An investment policy followed by MUSL governs the purchase of these investments.

The policy states that a brokerage firm wishing to submit a bid for the sale of securities to MUSL must first be qualified by 1) providing information to MUSL which substantiates compliance with minimum standards and guidelines as set forth by MUSL and 2) by entering into an agreement with MUSL. In addition, MUSL will purchase from qualifying brokers only securities which are backed by the full faith and credit of the United States Government or its agencies. The approved securities are Certificates on Government Receipts, Certificates Accrual Treasury Securities, Coupon Treasury Receipts, Easy Growth Treasury Receipts, Government & Agency Term Obligation Receipts, Government Loan Trust, Class 1-Z, Government Trust Certificates, JOB Certificates, Principal Treasury Receipts, Resolution Funding Corporation Strips, Stripped Government Receipts, Treasury Investment Growth Receipts, Treasury Bond Receipts, United States Agency for International Development bonds, United States Treasury Coupon Under Book Entry, United States Treasury Bills, United States Treasury Securities Stripped, Physical Coupon Treasury Strips, Zero Coupon Treasury Obligations, Government Loan Trusts, and AID Bonds.

Custodial Credit Risk – Investments

Custodial credit risk for investments is the risk that in the event of the failure of the counterparty (e.g. broker-dealer) to a transaction, the Lottery will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The Lottery's securities are held by the counterparty in the Lottery's name and therefore, custodial risk is minimal.

**COLORADO LOTTERY NOTES TO
FINANCIAL STATEMENTS
June 30, 2014 and 2013**

NOTE 2 – CASH AND INVESTMENTS (CONTINUED)

Interest Rate Risk – Investments

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value is to changes in market interest rates. MUSL manages its exposure to interest rate risk by purchasing only securities which are either explicitly or implicitly guaranteed by the United States Government and by holding these investments to maturity.

Investment Type	2014		2013	
	Fair Value	Weighted Average Maturity (in years)	Fair Value	Weighted Average Maturity (in years)
U. S. Treasury Investments	\$ 3,561,739	18.71	\$ 3,328,347	19.69
Federal Judiciary Government Trust Certificates	1,819,709	7.26	1,757,404	8.25
U.S. Aid Bonds	221,541	2.26	217,229	3.26
Resolution Funding Corp Strips	3,216,477	5.27	3,582,033	5.45
	<u>2,856,295</u>	11.55	<u>2,682,664</u>	12.42
	<u>\$ 11,675,761</u>		<u>\$ 11,567,677</u>	

Credit Risk – Investments

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. The U.S. Aid Bonds carry a AAA rating under the Moody's rating system. The Resolution Funding Corporation Strips, Federal Judiciary and Government Trust Certificates are not rated (NR).

Concentration of Credit Risk – Investments

Investment in any one issuer (other than U.S. Treasury securities, other investments explicitly guaranteed by the U. S. government, mutual funds, and external investment pools) that represent 5% or more of the total investment as of June 30, 2014 are the Resolution Funding Corporation Strips and the Federal Judiciary Bonds, which represent 24.5% and 15.6%, respectively, of the total investments. Such securities representing 5% or more of the total investment as of June 30, 2013 were the Resolution Funding Corporation Strips and the Federal Judiciary Bonds, which represented 23.2% and 15.2%, respectively, of the total investments.

Statements of Cash Flows

The statements of cash flows is prepared under the direct method then adjusted for prize payments and commission and bonus payments to retailers, which are netted from cash received from retailers and applied against accounts receivable balances. For cash flow

**COLORADO LOTTERY NOTES TO
FINANCIAL STATEMENTS
June 30, 2014 and 2013**

NOTE 2 – CASH AND INVESTMENTS (CONTINUED)

purposes, cash and investments include restricted cash and investments held by the State Treasurer in its cash and investment pool.

NOTE 3 – SCHEDULE OF CHANGES IN CAPITAL ASSETS

	<u>June 30, 2013</u>	<u>Increases</u>	<u>Decreases</u>	<u>June 30, 2014</u>
Capital assets being depreciated:				
Equipment and software	\$ 5,946,887	\$ 18,179	\$ (42,773)	\$ 5,922,293
Leasehold improvements	<u>64,711</u>	<u>-</u>	<u>-</u>	<u>64,711</u>
Total historical costs	<u>6,011,598</u>	<u>18,179</u>	<u>(42,773)</u>	<u>5,987,004</u>
Less accumulated depreciation for equipment	<u>(4,085,392)</u>	<u>(947,167)</u>	<u>41,948</u>	<u>(4,990,611)</u>
Less accumulated depreciation for leasehold improvements	<u>(25,884)</u>	<u>(12,942)</u>	<u>-</u>	<u>(38,826)</u>
Total accumulated depreciation	<u>(4,111,276)</u>	<u>(960,109)</u>	<u>41,948</u>	<u>(5,029,437)</u>
Total capital assets, being depreciated, net	<u>\$ 1,900,322</u>	<u>\$ (941,930)</u>	<u>\$ (825)</u>	<u>\$ 957,567</u>
	<u>June 30, 2012</u>	<u>Increases</u>	<u>Decreases</u>	<u>June 30, 2013</u>
Capital assets being depreciated:				
Equipment and software	\$ 6,079,410	\$ 49,163	\$ (181,686)	\$ 5,946,887
Leasehold improvements	<u>64,711</u>	<u>-</u>	<u>-</u>	<u>64,711</u>
Total historical costs	<u>6,144,121</u>	<u>49,163</u>	<u>(181,686)</u>	<u>6,011,598</u>
Less accumulated depreciation for equipment	<u>(3,299,311)</u>	<u>(964,356)</u>	<u>178,275</u>	<u>(4,085,392)</u>
Less accumulated depreciation for leasehold improvements	<u>(12,942)</u>	<u>(12,942)</u>	<u>-</u>	<u>(25,884)</u>
Total accumulated depreciation	<u>(3,312,253)</u>	<u>(977,298)</u>	<u>178,275</u>	<u>(4,111,276)</u>
Total capital assets, being depreciated, net	<u>\$ 2,831,868</u>	<u>\$ (928,135)</u>	<u>\$ (3,411)</u>	<u>\$ 1,900,322</u>

**COLORADO LOTTERY NOTES TO
FINANCIAL STATEMENTS
June 30, 2014 and 2013**

NOTE 4 – OPERATING LEASES

The Lottery occupies office and warehouse space in Pueblo, Denver, Grand Junction and Fort Collins and up until July 31, 2012 in Colorado Springs. Rental payments are contingent upon the continuing availability of funds. Specific lease information follows:

Pueblo

Office – The Lottery entered into an agreement with Midtown RLLLP on April 19, 2005 and the lease agreement began on June 27, 2005. The original lease was superseded July 31, 2012 when a new lease agreement was executed. A lease amendment was signed on April 9, 2013 to provide the Lottery with funds to offset the costs of equipment and cabling, moving/relocation, and security equipment connected with acquiring the first and mezzanine floors of the building. The new lease expires on June 30, 2022. The lease contains an option to renew for two additional five-year terms commencing on July 1, 2022. There are no other provisions for extension or renewal.

Warehouse – The Lottery leases primary warehouse space from Santa Fe 250 LLC. The Lottery entered into a lease agreement, which began July 1, 2011 and expires June 30, 2016. A lease amendment was signed August 8, 2012 to reduce monthly rent payments on the warehouse loft space. The lease contains an option to renew for one additional five-year term commencing on July 1, 2016. The lease also contains a holdover clause where the Lottery will become a month-to-month tenant if the Lottery fails to vacate the premises upon expiration or sooner termination of this lease. The rent to be paid by the Lottery during such continued occupancy shall be the same being paid by the Lottery as of the date of expiration or sooner termination. Landlord and the Lottery each hereby agree to give the other party at least thirty days written notice prior to termination of any holdover tenancy.

Denver

Office – The Lottery occupies office space in the Galleria Towers Building in Denver. The Lottery entered into a lease agreement, which began July 1, 2009 and expires June 30, 2019. The lease contains an option to renew the lease for two (2) consecutive additional periods of five years each. The lease also contains a holdover provision, whereby if the Lottery fails to vacate the premises upon the expiration or sooner termination of the lease, the Lottery will continue making the same monthly rent payment in effect pursuant to the lease agreement as of the date of expiration or sooner termination of the lease. Galleria Acquisitions, Inc. and the Lottery both agree to give each other thirty (30) days written notice prior to the termination of a holdover tenancy period.

Warehouse – On December 11, 2009, the Lottery entered into a lease agreement with Valley Business Corp., Inc. beginning on December 11, 2009 and expiring on June 30, 2015. The lease contains an option to renew the lease for two (2) consecutive additional periods of five years each. The lease also contains a holdover provision, whereby if the Lottery fails to vacate the premises upon the expiration or sooner termination of the lease, the Lottery will continue making the same monthly rent payment in effect pursuant to the lease agreement as of the date of expiration or sooner termination of the lease. Valley Business Corp. Inc. and the Lottery both agree to give each other thirty (30) days written notice prior to the termination of a holdover tenancy period.

**COLORADO LOTTERY NOTES TO
FINANCIAL STATEMENTS
June 30, 2014 and 2013**

NOTE 4 – OPERATING LEASES (CONTINUED)

Fort Collins

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

Grand Junction

The Lottery occupies space in the Grand Junction State Services Building and is responsible for reimbursing the Capitol Complex Division of the Colorado Department of Personnel and Administration for lease payments.

Colorado Springs

The Lottery occupied space leased by the Department of Revenue and was responsible for reimbursing the Department of Revenue for lease payments up until July 31, 2012 when the space was vacated by the Lottery.

Operating lease expense incurred for the fiscal years ended June 30, 2014 and 2013 and future minimum lease payments for fiscal years ending June 30, 2015 through 2019 and later years are as follows:

<u>LOCATION</u>	<u>FUTURE MINIMUM LEASE PAYMENTS</u>							<u>LATER YEARS</u>
	<u>FY 2013</u>	<u>FY 2014</u>	<u>FY 2015</u>	<u>FY 2016</u>	<u>FY 2017</u>	<u>FY 2018</u>	<u>FY 2019</u>	
Pueblo Office	\$ 242,456	\$ 256,575	\$ 257,799	\$ 265,433	\$ 273,238	\$ 353,206	\$ 363,685	\$1,157,566
Pueblo Warehouse	161,918	163,510	156,220	156,220	-	-	-	-
Denver	194,519	197,246	199,646	205,627	211,608	217,589	223,570	-
Denver Warehouse	95,986	101,496	87,811	-	-	-	-	-
Fort Collins Office	24,918	25,989	-	-	-	-	-	-
Grand Jct Office	5,434	7,661	-	-	-	-	-	-
CoSprgs Warehouse	529	-	-	-	-	-	-	-
Parking	<u>2,545</u>	<u>1,790</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
	<u>\$ 728,305</u>	<u>\$ 754,267</u>	<u>\$ 701,476</u>	<u>\$ 627,280</u>	<u>\$ 484,846</u>	<u>\$ 570,795</u>	<u>\$ 587,255</u>	<u>\$1,157,566</u>

**COLORADO LOTTERY NOTES TO
FINANCIAL STATEMENTS
June 30, 2014 and 2013**

NOTE 5 – OTHER REVENUE

A schedule of other revenue for the fiscal years ended June 30, 2014 and 2013 follows:

	<u>2014</u>	<u>2013</u>
License fees	\$ 66,255	\$ 65,436
Fines and penalties	267,916	171,192
Assignment fees	2,700	1,500
Net licensed agent recovery reserve receipts	(5,336)	37,839
Other	<u>51,004</u>	<u>13,431</u>
Total	<u>\$ 382,539</u>	<u>\$ 289,398</u>

NOTE 6 – DISTRIBUTION OF NET PROCEEDS

In accordance with Section 33-60-104, C.R.S., distributions of net proceeds shall be made on a quarterly basis. 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 Wildlife and all the remaining net lottery proceeds in trust to the State Board of the Great Outdoors Colorado Trust Fund up to the statutory limit. Under Section 33-60-104(2), C.R.S., the limit is \$35 million as adjusted annually based on the consumer price index. Any excess over the limit shall be transferred to the State Public School Fund. In Fiscal Year 2008 these proceeds were transferred to the Lottery Proceeds Contingency Reserve Fund as set forth in section 22-54-117(1.6)(a), C.R.S. Starting in Fiscal Year 2009 these proceeds were transferred to the Public School Capital Construction Assistance Fund as set forth in Section 22-43.7-104(2)(b)(III), C.R.S.

Income available for distribution at June 30:

	<u>2014</u>	<u>2013</u>
Operating income	\$128,813,905	\$134,269,272
Plus: Investment income	<u>554,251</u>	<u>77,300</u>
Income before distributions	129,368,156	134,346,572
Change in licensed agent recovery reserve	5,336	(37,839)
Change in fair market value of investments	(102,739)	391,482
Change in operating reserve	(100,000)	-
Other changes in investment in capital assets	<u>942,755</u>	<u>931,546</u>
Income available for distribution	130,113,508	135,631,761
Less distributions prior to year-end	<u>(99,605,001)</u>	<u>(98,333,399)</u>
Income available for distribution	<u>\$ 30,508,507</u>	<u>\$ 37,298,362</u>

**COLORADO LOTTERY NOTES TO
FINANCIAL STATEMENTS
June 30, 2014 and 2013**

NOTE 6—DISTRIBUTION OF NET PROCEEDS (CONTINUED)

	Accrued at June 30, 2013	Proceeds Distributions Expenses	Distributions Paid	Accrued at June 30, 2014
Great Outdoors Colorado Public School Capital Construction Assistance Fund	\$ 10,005,058	\$ 60,321,412	\$ (59,807,559)	\$ 10,518,911
Conservation Trust Fund	8,644,124	4,735,342	(8,644,124)	4,735,342
Division of Parks and Outdoor Recreation	14,919,344	52,045,403	(54,761,344)	12,203,403
	<u>3,729,836</u>	<u>13,011,351</u>	<u>(13,690,336)</u>	<u>3,050,851</u>
	<u>\$ 37,298,362</u>	<u>\$130,113,508</u>	<u>\$(136,903,363)</u>	<u>\$ 30,508,507</u>
	Accrued at June 30, 2012	Proceeds Distributions Expenses	Distributions Paid	Accrued at June 30, 2013
Great Outdoors Colorado Public School Capital Construction Assistance Fund	\$ 9,932,879	\$ 59,171,757	\$ (59,099,578)	\$ 10,005,058
Conservation Trust Fund	4,559,159	8,644,124	(4,559,159)	8,644,124
Division of Parks and Outdoor Recreation	11,593,630	54,252,704	(50,926,990)	14,919,344
	<u>2,898,408</u>	<u>13,563,176</u>	<u>(12,731,748)</u>	<u>3,729,836</u>
	<u>\$ 28,984,076</u>	<u>\$135,631,761</u>	<u>\$(127,317,475)</u>	<u>\$ 37,298,362</u>

NOTE 7 – PENSION PLANS

Plan Description

Most of the 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 an actuarial assessment and 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 PO Box 5800, Denver, Colorado 80217, by calling PERA at 1-800-759-PERA (7372), or by visiting <http://www.copera.org>.

Non-higher education employees hired by the State after January 1, 2006 are allowed 60 days to elect to participate in a defined contribution retirement plan administered by the State Deferred Compensation Committee rather than becoming a member of PERA. If that election is not made, the employee becomes a member of PERA, and the member is allowed

**COLORADO LOTTERY NOTES TO
FINANCIAL STATEMENTS
June 30, 2014 and 2013**

NOTE 7 – PENSION PLANS (CONTINUED)

60 days from commencing employment to elect to participate in a defined contribution retirement plan administered by PERA rather than the defined benefit plan.

Prior to legislation passed during the 2006 session, higher education employees may have participated in social security, PERA's defined benefit plan, or the institution's optional retirement plan. Currently, higher education employees, except for community college employees, are required to participate in their institution's optional plan, if available, unless they are active or inactive members of PERA with at least one year of service credit. In that case they may elect either PERA or their institution's optional plan. Community college employees hired after January 1, 2010, are required to become members of PERA and must elect either PERA's defined benefit or defined contribution plan within 60 days, unless they had been a PERA member within the prior twelve months. In that case, they are required to remain in the PERA plan in which they participated previously.

PERA members electing the defined contribution plan are allowed an irrevocable election between the second and fifth year to use their defined contribution account to purchase service credit and be covered under the defined benefit retirement plan. However, making this election subjects the member to the rules in effect for those hired on or after January 1, 2007, as discussed below. Employer contributions to defined contribution plan is the same as the contributions to the PERA defined benefit plan.

Defined benefit plan members (except state troopers) vest after five years of service and are eligible for full retirement based on their original hire date as follows:

- Hired before July 1, 2005 – age 50 with 30 years of service, age 60 with 20 years of service, or age 65 with 5 years of service.
- Hired between July 1, 2005 and December 31, 2006 – any age with 35 years of service, age 55 with 30 years of service, age 60 with 20 years of service, or age 65 with any years of service.
- Hired between January 1, 2007 and December 31, 2010 – any age with 35 years of service, age 55 with 30 years of service, age 60 with 25 years of service, or age 65 with 5 years of service. For members with less than five years of service credit as of January 1, 2011 age and service requirements increase to those required for members hired between January 1, 2007 and December 31, 2010.
- Hired between January 1, 2011 and December 31, 2016 – any age with 35 years of service, age 58 with 30 years of service, or age 65 with 5 years of service.
- Hired on or after January 1, 2017 – any age with 35 years of service, age 60 with 30 years of service, or age 65 with 5 years of service.

Members are also eligible for retirement benefits without a reduction for early retirement based on their original hire date as follows:

**COLORADO LOTTERY NOTES TO
FINANCIAL STATEMENTS
June 30, 2014 and 2013**

NOTE 7 – PENSION PLANS (CONTINUED)

- Hired before January 1, 2007 – age 55 with a minimum of 5 years of service credit and age plus years of service equals 80 or more.
- Hired between January 1, 2007 and December 31, 2006 – age 55 with a minimum of 5 years of service credit and age plus years of service equals 85 or more. Age plus years of service requirements increase to 85 for members with less than five years of service credit as of January 1, 2011.
- Hired between January 1, 2011 and December 31, 2016 – age 58 and age plus years of service equals 88 or more.
- Hired on or after January 1, 2017 – age 60 and age plus years of service equals 90.

State troopers and judges comprise a small percentage of plan members but have higher contribution rates, and state troopers are eligible for retirement benefits at different ages and years of service.

Members automatically receive the higher of the defined retirement benefit or money purchase benefit at retirement. Defined benefits are calculated as 2.5 percent times the number of years of service times the highest average salary (HAS). For retirements before January 1, 2009, HAS is calculated as 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 and limited to a 15 percent increase between periods. For retirements after January 1, 2009, or persons hired on or after January 1, 2007, more restrictive limits are placed on salary increases between periods used in calculating HAS.

Retiree benefits are increased annually in July after one year of retirement based on the member's original hire date as follows:

- Hired before July 1, 2007 – the lesser of 2 percent or the average of the monthly Consumer Price Index increase.
- Hired on or after January 1, 2007 – the lesser of 2 percent or the actual increase in the national Consumer Price Index, limited to a 10 percent reduction in a reserve established for cost of living increases related strictly to those hired on or after January 1, 2007. (The reserve is funded by 1 percentage point of salaries contributed by employers for employees hired on or after January 1, 2007.)
- The upper limits on benefits increase by one-quarter percentage point each year when the funded ratio of PERA equals or exceeds 103 percent and declines by one-quarter percentage point when the funded ratio drops below 90 percent after having exceeded 103 percent. The funded ratio increase does not apply for three years when a negative return on investment occurs.

**COLORADO LOTTERY NOTES TO
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NOTE 7 – PENSION PLANS (CONTINUED)

Members who are 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 a member dies before retirement, their eligible

children under the age of 18 (23 if a full time student) or their spouse may be entitled to a single payment or monthly benefit payments. If there is no eligible child or spouse, then financially dependent parents, beneficiaries, or the member's estate, may be entitled to a survivor's benefit.

Funding Policy

The contribution requirements of plan members and their employers are established, and may be amended, by the General Assembly. Salary subject to PERA contribution is 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.

Most employees contribute 8.0 percent (10.0 percent for state troopers) of their salary, as defined in CRS 24-51-101(42), to an individual account in the plan. Effective July 1, 2012, the temporary contribution rate increase of 2.5 percent for members in the State and Judicial Divisions to replace the 2.5 percent reduction in employer contributions effective for Fiscal Years 2010-11 and 2011-12 expired.

From July 1, 2013, to December 31, 2013, the State contributed 16.55 percent (19.25 percent for state troopers and 17.36 percent for the Judicial Branch) of the employee's salary. From January 1, 2014, through June 30, 2014, the state contributed 17.45 percent (20.15 percent for state troopers and 17.36 percent for the Judicial Branch). During all of Fiscal Year 2013-14, 1.02 percent of the employees' total salary was allocated to the Health Care Trust Fund.

Per Colorado Revised Statutes, an amortization period of 30 years is deemed actuarially sound. At December 31, 2013, the division of PERA in which the State participates has a funded ratio of 57.5 percent and a 60 year amortization period based on current contribution rates. The funded ratio on the market value of assets is slightly higher at 61.0 percent.

In the 2004 and 2010 legislative sessions, the General Assembly authorized an Amortization Equalization Disbursement (AED) to address a pension-funding shortfall. The AED requires PERA employers to pay an additional 0.5 percent of salary for calendar years 2006 and 2007, with subsequent year increases of 0.4 percent of salary through 2017, to a maximum of 5 percent (except for the Judicial Division whose AED contribution was frozen at the 2010 level).

In the 2006 and 2010 legislative sessions, the General Assembly authorized a Supplemental Amortization Equalization Disbursement (SAED) that requires PERA employers to pay an additional one half percentage point of total salaries, for calendar years 2008 through 2017, to a maximum of 5 percent (except for the Judicial Division whose SAED contribution was frozen at the 2010 level). The SAED will be deducted from the amount otherwise available to increase State employees' salaries.

**COLORADO LOTTERY NOTES TO
FINANCIAL STATEMENTS
June 30, 2014 and 2013**

NOTE 7 – PENSION PLANS (CONTINUED)

At a 103 percent funding ratio, both the AED and the SAED will be reduced by one-half percentage point, and for subsequent declines to below 90 percent funded both the AED and SAED will be increased by one-half percentage point. For the Judicial Division, if the funding ratio reaches 90 percent and subsequently declines, the AED and SAED will be increased by one-half percentage point.

Historically members have been allowed to purchase service credit at reduced rates. However, legislation passed in the 2006 session required, that future agreements to purchase service credit be sufficient to fund the related actuarial liability.

The Lottery's contributions to the PERA defined benefit plan and/or the defined contribution plan for the fiscal years ending June 30, 2014, 2013, and 2012 were \$1,070,065, \$958,457, and \$745,721, respectively. These contributions met the contribution requirement for each year.

NOTE 8 – OTHER RETIREMENT PLANS

Defined Contribution Plan

The PERA Defined Contribution Retirement Plan was established January 1, 2006, as an alternative to the defined benefit plan. All employees, with the exception of certain higher education employees, have the option of participating in the plan. At July 1, 2009, the State's administrative functions for the defined contribution plan were transferred to PERA. New member contributions to the plan vest from 50 percent to 100 percent evenly over 5 years. Participants in the plan are required to contribute 8 percent (10 percent for state troopers) of their salary. The temporary contribution rate increase to 10.5 percent (12.5 percent for State Troopers) effective in Fiscal Years 2010-11 and 2011-12 expired on July 1, 2012. At December 31, 2013, the plan had 4,719 participants.

Deferred Compensation Plan

The PERA Deferred Compensation Plan (457) was established July 1, 2009, as a continuation of the State's deferred compensation plan which was established for the state and local government employees in 1981. At July 1, 2009, the State's administrative functions for the 457 plan were transferred to PERA, where all costs of administration and funding are borne by the plan participants. In calendar year 2013, participants were allowed to make contribution of up to 100 percent of their annual gross salary (reduced by their 8 percent PERA contribution) to a maximum of \$17,500. The reduction for the 8 percent PERA contribution reflects the expiration of the temporary contribution rate increase to 10.5 percent effective in Fiscal Years 2010-11 and 2011-12. Participants who are age 50 and older, and contributing the maximum amount allowable, were allowed to make an additional \$5,500 contribution in 2013, for total contributions of \$23,000. Contributions and earnings are tax deferred. At December 31, 2013, the plan had 17,462 participants.

**COLORADO LOTTERY NOTES TO
FINANCIAL STATEMENTS
June 30, 2014 and 2013**

NOTE 8 – OTHER RETIREMENT PLANS (CONTINUED)

Voluntary Tax-Deferred Retirement Plans

PERA offers a voluntary 401k plan entirely separate from the defined benefit pension plan. The State offers a 457 deferred compensation plan and certain agencies and institutions of the State offer 403(b) or 401(a) plans.

NOTE 9 – OTHER POSTEMPLOYMENT BENEFITS AND LIFE INSURANCE

Health Care Plan

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; the program was converted to a trust fund in 1999. The plan is a cost-sharing multiple-employer plan under which PERA subsidizes a portion of the monthly premium for health care coverage. The benefits and employer contributions are established in statute and may be amended by the General Assembly. PERA includes the Health Care Trust Fund in its Comprehensive Annual Financial Report, which may be obtained by writing PERA at PO Box 5800, Denver, Colorado 80217, by calling PERA at 1-800-759-PERA (7372), or by visiting <http://www.copera.org>.

After the PERA subsidy, the benefit recipient pays the balance of the premium through an automatic deduction from the monthly retirement benefit. Monthly premium costs for participants depend on the health care plan selected, the PERA subsidy amount, Medicare eligibility, and the number of persons covered. Effective July 1, 2000, the maximum monthly subsidy is \$230 per month for benefit recipients who are under 65 years of age and who are not entitled to Medicare and \$115 per month for benefit recipients who are 65 years of age or older or who are under 65 years of age and entitled to Medicare. The maximum subsidy is based on the recipient having 20 years of service credit, and is subject to reduction by 5 percent for each year less than 20 years.

Employees are not required to contribute to the Health Care Trust Fund, which is maintained by employer's contributions as discussed above in Note 7. Beginning July 1, 2004, state agencies/institutions are required to contribute 1.02 percent of gross covered wages to the Health Care Trust Fund. The Lottery contributed \$68,312, \$64,806, and \$65,105 as required by statute in Fiscal Years 2013-14, 2012-13, and 2011-12, respectively. In each year, the amount contributed was 100 percent of the required contribution.

The Health Care Trust Fund offers two general types of plans: fully-insured plans offered through health care organizations and self-insured plans administered for PERA by third party vendors. As of December 31, 2013, there were 53,041 enrolled participants, including spouses and dependents, from all contributors to the plan. At December 31, 2013, the Health Care Trust Fund had an unfunded actuarial accrued liability of \$1.26 billion, a funded ratio of 18.8 percent, and a 30-year amortization period.

**COLORADO LOTTERY NOTES TO
FINANCIAL STATEMENTS
June 30, 2014 and 2013**

NOTE 10 – 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. The Lottery remains liable for the payment of the guaranteed prizes in the event the insurance companies issuing the annuity contracts default. The following estimated prize payments for which annuity contracts have been purchased are due in varying amounts and are estimated to continue through June 5, 2061 based on updated life expectancy tables.

Specified prize payments	\$227,244,850
Lifetime prize payments	<u>32,232,000</u>
Total guaranteed prize payments	<u>\$259,476,850</u>

Prize Commitment – The Lottery also acts as a transfer agent for the single Powerball Jackpot Winner on October 10, 2007. These funds are held in trust at the MUSL in securities deemed appropriate by the Grand Prize Trust Agreement. The future value of this prize was \$17,183,000 as of June 30, 2014.

Self-insurance – The State of Colorado currently self-insures its agencies, officials and employees for the risks of losses to which they are exposed. These include general liability, motor vehicle liability, and workers' compensation. The Lottery participates in the Risk Management Fund. State agency premiums are based on an assessment of risk exposure and historical experience. The State Risk Management Fund is a Special Purpose General Fund used for claims adjustment, investigation, defense and authorization for the settlement and payment of claims or judgments against the state. The State insures its property through private carriers and is self-insured against general liability risks for both its officials for both its officials and employees. It is also self-funded for employee healthcare plans; however, the risk resides with the employees.

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 injuries. The state utilizes the services of BroadspireServices, Inc. to administer its plan. The state reimburses BroadspireServices, Inc. for the current cost of claims paid and related administrative expenses.

Risk management 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.

**COLORADO LOTTERY NOTES TO
FINANCIAL STATEMENTS
June 30, 2014 and 2013**

NOTE 10 – CONTINGENCIES AND COMMITMENTS (CONTINUED)

The limits of liability for which the state accepts responsibility pursuant to Section 24-10-114(1), C.R.S., are as follows:

Liability	Limits of Liability
General and automobile	Each person \$350,000 Each occurrence \$990,000

Before January 1, 1999, the Group Benefit Plans Fund provided an employer-paid short-term disability plan for all employees. On January 1, 1999, PERA began covering short-term disability claims for state employees eligible under its retirement plan. The Group Benefit Plans Fund continues to provide short-term disability coverage for employees not yet qualified for the retirement plan and secondary benefits for employees also covered under the PERA short-term disability plan.

The Group Benefit Plans short-term disability program provides an employee with 60 percent of their pay beginning after 30 days of disability or exhausting their sick leave balance, whichever is later. This benefit expires six months after the beginning of the disability. Although fully insured, the Group Benefit Plans disability program includes a risk-sharing feature that provides experience rating refunds calculated as earned premium less the aggregate of incurred claims, claim reserve, retention charge and refunds paid previously over the term of the contract. Refunds, when applicable, are paid annually.

Furniture and Equipment – The State of Colorado carries a \$5,000 deductible replacement policy on all state owned furniture and equipment per Colorado Revised Statutes 24-30-1510.5(3)(a)(IV). For each loss incurred, the Lottery is responsible for the first \$5,000 of the deductible. Any loss in excess of \$5,000 is covered by the insurance carrier up to replacement cost.

Gaming Operations Commitments – The Lottery entered into long-term contracts with certain significant vendors related to providing jackpot data processing services and scratch tickets in support of the Lottery’s gaming operations. The jackpot data processing contract expired on October 31, 2012 per the contract amendment dated January 26, 2005, however, The Lottery has exercised the sole two-year renewal option period extending the contract through October 31, 2014. There are also available renewal options for two additional periods of ninety days for conversion and turnover purposes. Per Option Letter #14, the amended total cost of this contract is not to exceed \$90,971,175. Payments for the jackpot data processing contract were \$9,122,111 and \$9,474,512 for the fiscal years ended June 30, 2014 and 2013, respectively.

The Lottery entered into three contracts with scratch ticket vendors, one starting on February 28, 2011, one on March 14, 2011 and the other starting on April 1 2011. All three contracts expire on June 30, 2014. The Lottery has exercised the option to extend for three additional periods of 12 months on all three contracts beyond the expiration date beginning July 1, 2014 and ending on June 30, 2017.

**COLORADO LOTTERY NOTES TO
FINANCIAL STATEMENTS
June 30, 2014 and 2013**

NOTE 10 – CONTINGENCIES AND COMMITMENTS (CONTINUED)

There are no other provisions for extension or renewal. The total costs of the three extended contracts are not to exceed a total of \$11,100,000. Payments under the initial contracts were \$2,579,503 and \$2,743,261 for the fiscal years ended June 30, 2014 and 2013, respectively.

The Lottery was approved as a member of the MUSL on February 26, 2001 and thus entered into an agreement with MUSL on June 6, 2001 to become a member and participate in Powerball games. As a member, the Lottery agrees to abide by the terms of the Multi-State Agreement dated September 16, 1987 and to any amendments to that agreement duly made by the board. The Lottery will remain a member indefinitely. Pursuant to this agreement, the Lottery will make payments to MUSL for administrative fees, weekly prize expenses, promotional purchases, miscellaneous reimbursements and assessments and contributions to

the prize reserves. On November 15, 2012, the MUSL Powerball Group unanimously agreed to accept the recommendations of the Finance & Audit Committee and the Executive Committee and set the Prize Reserve Account (PRA) cap to \$80 million reduced from the previous \$100 million cap. The total amount contributed by the Lottery to the Powerball prize reserves as of June 30, 2014 is \$3,685,288 and is based on a percentage of sales. This amount is shown as prepaid prize expense – MUSL on the statements of net position. MUSL reserves the right to hold funds which do not exceed 110% of the required balance. If the actual balance in the reserves should exceed 110% of the required balance, MUSL will refund any funds in excess of the 110% threshold. As of June 30, 2014 the excess funds held by MUSL over Colorado's required reserves is \$335,026, the maximum allowable excess amount, over the required reserves balance of \$3,350,262.

In 2009, the Powerball and Mega Millions governing bodies entered discussions regarding cross-selling the Powerball and Mega Millions games, whereby each state currently selling Mega Millions tickets would also sell Powerball tickets and those states currently selling Powerball tickets would also sell Mega Million tickets. On March 10, 2010, the Lottery commission voted to allow the Colorado Lottery to participate in the cross-selling of the Mega Millions game. The rule became effective as of April 30, 2010 and the first day of ticket sales was May 16, 2010. The Multi-State Lottery Association (MUSL) agreed to undertake the administrative functions associated with the Mega Millions game for the states currently participating in their Powerball game. MUSL immediately began collecting a percentage of sales to fund the newly formed Mega Millions prize reserve fund. On March 22, 2013, the MUSL Mega Millions Game Group set the maximum prize reserve fund at \$45 million. The Colorado Lottery's balance in the reserve as of June 30, 2014 is \$1,252,996. For the Mega Millions reserve, MUSL also reserves the right to hold funds not to exceed 110% of the required balance. As of June 30, 2014 the excess funds held by MUSL over Colorado's required Mega Millions reserve is \$113,909, the maximum allowable excess amount, over the required reserves balance of \$1,139,087.

In addition, MUSL may deposit and hold any Unreserved Account Funds in trust for the benefit of member lotteries. These funds will not be comingled with any other funds held in trust and can be used only for authorized uses of the unreserved funds. The Colorado Lottery's balance in the unreserved fund held by MUSL as of June 30, 2014 is \$14,534.

**COLORADO LOTTERY NOTES TO
FINANCIAL STATEMENTS
June 30, 2014 and 2013**

NOTE 10 – CONTINGENCIES AND COMMITMENTS (CONTINUED)

Other Major Vendor Commitments –The Lottery entered into a long-term contract with an advertising agency to provide advertising services to promote the Lottery's products. The contract period began on July 1, 2012 and expires on June 30, 2015. The Lottery has the option to renew the contract for two (2) additional twelve-month periods. The total cost of the initial contract period, including amendments, is not to exceed \$44,850,000. Payments under this contract were \$12,730,316 and \$12,573,518 for the fiscal years ended June 30, 2014 and 2013, respectively.

Litigation – Currently, there is no reportable outstanding litigation.

NOTE 11 – 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 Section 24-77-102 (17) (b) (IX), C.R.S., that the net proceeds from the 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.

NOTE 12 – RELATED PARTY TRANSACTIONS

The 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 Lottery also pays fees to the Department of Revenue for indirect costs. Interagency charges were \$1,750,971 and \$1,176,931 for the fiscal years ended June 30, 2014 and 2013, respectively.

NOTE 13 – SUBSEQUENT EVENT

The contract between the Lottery and GTECH, the new vendor selected to provide the communication network and jackpot data processing services in support of the Lottery's gaming operations, has been signed and services will be implemented in November 2014.

SUPPLEMENTARY INFORMATION

COLORADO LOTTERY
SCHEDULE OF REVENUE AND COSTS FOR SCRATCH AND JACKPOT GAMES
FOR THE FISCAL YEAR ENDED JUNE 30, 2014
(With Comparative Totals for the Fiscal Year Ended June 30, 2013)

	Jackpot Games						FY 2014	FY 2013	
	Scratch	Lotto	Powerball	Cash 5	Mega Millions	Raffle III	Pick 3	Total	Scratch and Jackpot Games
TICKET SALES	\$ 362,045,443	\$ 33,809,181	\$ 84,518,786	\$ 19,173,636	\$ 36,799,903	-	\$ 8,683,311	\$ 545,030,260	\$ 566,286,598
PRIZE EXPENSE	(247,349,989)	(16,846,382)	(40,130,951)	(10,398,485)	(17,627,121)	40,120	(4,198,685)	(336,511,493)	(350,260,455)
NET REVENUE AFTER PRIZES	<u>114,695,454</u>	<u>16,962,799</u>	<u>44,387,835</u>	<u>8,775,151</u>	<u>19,172,782</u>	<u>40,120</u>	<u>4,484,626</u>	<u>208,518,767</u>	<u>216,026,143</u>
COMMISSIONS, BONUSES, TICKET COSTS & VENDOR FEES (Note 1)									
Retailer Commission	(25,293,729)	(2,023,853)	(5,061,363)	(1,147,212)	(2,203,110)	-	(519,789)	(36,249,056)	(37,596,118)
Retailer Bonus	(3,158,137)	(159,839)	(297,216)	(149,799)	(138,309)	282	(60,908)	(3,963,926)	(4,617,752)
Cost of Tickets Sold	(2,601,233)	N/A	N/A	N/A	N/A	N/A	N/A	(2,601,233)	(2,606,116)
Telecomm Reimbursements	527,334	49,245	123,105	27,927	53,601	-	12,648	793,860	777,745
On-Line Vendor Fees	(5,976,291)	(557,861)	(1,394,592)	(316,365)	(609,450)	-	(143,798)	(8,998,357)	(9,353,561)
TOTAL	<u>(36,502,056)</u>	<u>(2,692,308)</u>	<u>(6,630,066)</u>	<u>(1,585,449)</u>	<u>(2,897,268)</u>	<u>282</u>	<u>(711,847)</u>	<u>(51,018,712)</u>	<u>(53,395,802)</u>
GROSS PROFIT ON SALE OF TICKETS	<u>\$ 78,193,398</u>	<u>\$ 14,270,491</u>	<u>\$ 37,757,769</u>	<u>\$ 7,189,702</u>	<u>\$ 16,275,514</u>	<u>\$ 40,402</u>	<u>\$ 3,772,779</u>	<u>\$ 157,500,055</u>	<u>\$ 162,630,341</u>
AVERAGE DAILY TICKET SALES	<u>\$ 991,905</u>	<u>\$ 92,628</u>	<u>\$ 231,558</u>	<u>\$ 52,531</u>	<u>\$ 100,822</u>	<u>\$ -</u>	<u>\$ 23,790</u>	<u>\$ 1,493,234</u>	<u>\$ 1,551,470</u>

Note 1: 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, 2014

	Scratch	Jackpot Games					FY 2014		FY 2013
		Lotto	Powerball	Cash 5	Mega Millions	Raffle	Pick 3	Total	Total
Prize Expense	\$247,349,989	\$16,846,382	\$40,130,951	\$10,398,485	\$17,627,121	(\$40,120)	\$4,198,685	\$336,511,493	\$350,260,455
(/)/Ticket Sales	<u>\$362,045,443</u>	<u>\$33,809,181</u>	<u>\$84,518,786</u>	<u>\$19,173,636</u>	<u>\$36,799,903</u>	<u>\$ -</u>	<u>\$8,683,311</u>	<u>\$545,030,260</u>	<u>\$566,286,598</u>
Prize %	68.32%	49.83%	47.48%	54.23%	47.90%	N/A	48.35%	61.74%	61.85%

**COLORADO LOTTERY
BUDGETARY COMPARISON
FOR THE FISCAL YEAR ENDED JUNE 30, 2014**

	Fiscal Year 2014 Original Budget	Supplementals Allocations & Internal Transfers	Fiscal Year 2014 Final Budget	Fiscal Year 2014 Actual Expenditures	Under Expended	Percent Under Expended
Personal Services	\$ 9,096,469	\$ -	\$ 9,096,469	\$ 8,100,062	\$ 996,407	10.95%
Amortization Equalization	258,375	(10,474)	247,901	245,489	2,412	0.97%
Supplemental Amort. Equal.	233,224	(8,025)	225,199	221,624	3,575	1.59%
Workmen's Compensation	77,428	-	77,428	77,428	-	0.00%
Health and Life	903,179	18,661	921,840	921,840	-	0.00%
Short Term Disability	13,634	(456)	13,178	13,178	-	0.00%
Operating	1,203,156	-	1,203,156	833,528	369,628	30.72%
Variable Vehicle	207,185	(700)	206,485	200,721	5,764	N/A
Leased Space	758,805	-	758,805	744,818	13,987	1.84%
Grand Junction - Leased Space	7,661	-	7,661	7,661	-	0.00%
Risk Management	27,049	-	27,049	27,049	-	0.00%
Vehicle Lease Payments	160,731	13,300	174,031	167,641	6,390	3.67%
Travel	113,498	-	113,498	51,803	61,695	54.36%
Purch. Serv. Comp. Center	276,527	-	276,527	276,527	-	0.00%
Marketing, Communications & Sales	14,700,000	-	14,700,000	13,439,653	1,260,347	8.57%
Communications Services	3,029	-	3,029	3,029	-	0.00%
Payments to MNT	282,286	-	282,286	282,286	-	0.00%
Payments to Other Agencies	239,410	-	239,410	134,175	105,235	43.96%
Legal Services	31,058	58,034	89,092	75,031	14,061	15.78%
Indirect Costs	500,260	-	500,260	486,936	13,324	2.66%
Ticket Costs-Scratch	6,578,000	-	6,578,000	3,609,710	2,968,290	45.12%
Research	250,000	-	250,000	189,629	60,371	24.15%
Vendor Fees	12,571,504	-	12,571,504	9,595,025	2,976,479	23.68%
Prize Payments	424,104,016	-	424,104,016	336,511,493	87,592,523	20.65%
Retailer Compensation	52,241,350	-	52,241,350	40,212,982	12,028,368	23.02%
Multi-State Lottery Fund	177,433	-	177,433	85,228	92,205	51.97%
COFRS Modernization	35,657	-	35,657	35,657	-	0.00%
OIT Security	13,167	-	13,167	13,167	-	0.00%
MNT & AD OIT	45,180	-	45,180	45,180	-	0.00%
TOTAL	\$ 525,109,271	\$ 70,340	\$ 525,179,611	\$ 416,608,550	\$ 108,571,061	20.67%

FY 2014 Staffing – FTE - (Note 1) 117.0 (Appropriated) 120.0 (Actual)

Reconciliation of Expenses per Statement of Revenues, Expenses and Changes in Fund Net Position to Budgeted Expenditures:

Expenses Per Statement of Revenues, Expenses and Changes in Net Position

Prize Expense	\$ 336,511,493
Commissions and Bonuses	40,212,982
Cost of Tickets & Vendor Fees	10,805,730
Operating Expenses	<u>29,068,689</u>
Total Expenses per Statement of Revenues, Expenses and Changes in Net Position	416,598,894
Plus: Telecommunications offset classified as revenue	793,860
Less: Non-appropriated expenses	
Depreciation	(960,109)
Accrued Annual and Sick Leave	158,551
Book Value of Assets Written Off	<u>(825)</u>
Sub-Total	416,590,371
Plus: Capitalized purchases	<u>18,179</u>
	<u>\$ 416,608,550</u>

Note 1 - The Governor's budget office has informed departments that the appropriated FTE can be exceeded by 10% for FY 2014.



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

To the Members of the Legislative Audit Committee
State of Colorado, Department of Revenue, Division of the Lottery
Denver, Colorado

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of the major fund and remaining fund information of the Colorado Lottery, an enterprise fund and private purpose fund of the State of Colorado as of and for the years ended June 30, 2014 and 2013, and the related notes to the financial statements, which collectively comprise Colorado Lottery's basic financial statements and have issued our report thereon dated October 7, 2014.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Colorado Lottery's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Colorado Lottery's internal control. Accordingly, we do not express an opinion on the effectiveness of the Colorado Lottery's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not yet been identified.

Compliance and Other Matters

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

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

A handwritten signature in black ink that reads "Eide Sully LLP". The signature is written in a cursive, flowing style.

Greenwood Village, Colorado
October 7, 2014



October 7, 2014

To the Members of the Legislative Audit Committee
State of Colorado, Department of Revenue, Division of the Lottery
Denver, Colorado

We have audited the basic financial statements of the major fund and remaining fund information of the Colorado Lottery, an enterprise fund and private purpose fund of the State of Colorado, as of and for the years ended June 30, 2014 and 2013, and the related notes to the financial statements. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards and *Government Auditing Standards*, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our engagement letter to you dated April 23, 2014. Professional standards also require that we communicate to you the following information related to our audit.

Significant Audit Issues

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the Colorado Lottery are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during 2014. We noted no transactions entered into by the Colorado Lottery during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the Colorado Lottery's financial statements were:

Management's estimate of the prize expense and the corresponding liability is calculated based on the anticipated payout approved by the Lottery Commissioners. The prize expense and corresponding liability is incurred as tickets are activated by Lottery approved retailers. We evaluated the key factors and assumptions used to develop the prize expense and corresponding liability in determining that it is reasonable in relation to the financial statements taken as a whole.

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosures affecting the financial statements were:

The disclosure of Cash and Investments in Note 2; Distribution of Net Proceeds in Note 6; Pension Plans in Note 7; Contingencies and Commitments in Note 10, Tax, Spending and Debt Limitations in Note 11; Related Party Transactions in Note 12 and Subsequent Event in Note 13.

The financial statement disclosures are neutral, consistent, and clear.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. There were no material adjustments or uncorrected misstatements in Fiscal 2014.

Disagreements with Management

For purposes of this letter, a disagreement with management is a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated October 7, 2014.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the Colorado Lottery's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Colorado Lottery's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Other Matters

We were engaged to report on the Schedule of Revenue and Costs for Scratch and Jackpot Games, Schedule of Percent of Prize Expense to Gross Ticket Sales, and Budgetary Comparison for the year ended June 30, 2014. With respect to the supplementary information accompanying the financial statements, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation

to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

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

Very truly yours,

Eide Bailly LLP

Greenwood Village, Colorado