

# OKLAHOMA LOTTERY COMMISSION

June 30, 2012

OKLAHOMA LOTTERY COMMISSION

June 30, 2012

AUDITED FINANCIAL STATEMENTS

Independent Auditors' Report .....	1
Management's Discussion and Analysis .....	3
Statements of Net Assets.....	8
Statements of Revenues, Expenses and Changes in Net Assets.....	9
Statements of Cash Flows .....	10
Notes to Financial Statements .....	11

REPORT REQUIRED BY *GOVERNMENT AUDITING STANDARDS*

Independent Auditors' Report on Compliance and Other Matters and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance With <i>Government Auditing Standards</i> .....	23
---	----

Independent Auditors' Report

The Board of Trustees  
Oklahoma Lottery Commission

We have audited the accompanying statements of net assets of the Oklahoma Lottery Commission (the "OLC"), an enterprise fund of the State of Oklahoma, as of June 30, 2012 and 2011, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the management of the OLC. 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 of material misstatement. An audit includes examining on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the OLC as of June 30, 2012 and 2011, and the changes in its net assets and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on page 3 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 14, 2012 on our consideration of the OLC's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, 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 the internal control over financial reporting and compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Cole & Reed P.C.

Oklahoma City, Oklahoma  
September 14, 2012

## **OKLAHOMA LOTTERY COMMISSION**

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

Management of the Oklahoma Lottery Commission (the "OLC") provides this Management's Discussion and Analysis of their financial performance for the readers of the OLC's financial statements. This narrative provides an overview of the OLC's financial activity for the fiscal years ended June 30, 2012 and 2011. This analysis is to be considered in conjunction with the financial statements to provide an objective analysis of the OLC's financial activities based on facts, decisions and conditions currently facing management.

### **UNDERSTANDING THE LOTTERY'S FINANCIAL STATEMENTS**

The OLC, an instrumentality of the State of Oklahoma, is accounted for as an enterprise fund that reports all assets and liabilities using the accrual basis of accounting, much like a private business entity. In accordance with accounting principles generally accepted in the United States of America, this report consists of a series of financial statements, along with explanatory notes to the financial statements. The financial statements immediately follow this Management's Discussion and Analysis and are designed to highlight the OLC's net assets and changes to those assets resulting from the OLC's operations.

The most important relationship demonstrated within the OLC's financial statements is the requirement that the OLC transfer all net proceeds, "as defined", to the State Treasurer for the Oklahoma Education Lottery Trust Fund ("OELTF"). Accordingly, a significant focus of these financial statements is determining net proceeds available for transfer to the OELTF.

The OLC is also required to transfer annually the first \$500,000 of unclaimed prize money to the Oklahoma Department of Mental Health and Substance Abuse Services ("ODMHSAS"). This is discussed further on page 5 of Management's Discussion and Analysis.

### **FINANCIAL AND ACTIVITY HIGHLIGHTS**

Revenues from lottery games totaled \$199,854,378 and \$198,153,932 respectively for the fiscal years ending June 30, 2012 and 2011. The OLC returned \$103,052,810 and \$106,600,824 to winners of lottery games; paid commissions and incentives to retailers totaling \$13,233,747 and \$13,219,310; incurred other game related expenses of \$6,081,715 and \$5,895,707; and had operating expenses of \$4,860,761 and \$6,596,129 for each of the respective fiscal years of 2012 and 2011. The OLC's net assets increased (decreased) by \$2,535,536 in fiscal year 2012 and (\$3,628,714) in fiscal year 2011. Transfers made and due to the OELTF were \$69,990,674 and \$69,396,091 respectively for fiscal years ending June 30, 2012 and 2011.

**OKLAHOMA LOTTERY COMMISSION**

**MANAGEMENT'S DISCUSSION AND ANALYSIS--Continued**

**FINANCIAL AND ACTIVITY HIGHLIGHTS--Continued**

The following table summarizes the OLC's Statement of Net Assets as of June 30:

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Current Assets	\$ 30,872,975	\$ 23,964,528	\$ 22,624,734
Noncurrent Assets			
Deposit with MUSL	5,786,011	3,921,842	3,749,310
Capital Assets, Net	<u>105,926</u>	<u>148,503</u>	<u>234,050</u>
Total Assets	<u>36,764,912</u>	<u>28,034,873</u>	<u>26,608,094</u>
Current Liabilities	28,675,720	22,485,986	17,429,577
Noncurrent Liabilities	<u>61,679</u>	<u>56,910</u>	<u>57,826</u>
Total Liabilities	<u>28,737,399</u>	<u>22,542,896</u>	<u>17,487,403</u>
Net Assets			
Invested in Capital Assets, Net	105,926	148,503	234,050
Restricted Expendable Net Assets	<u>7,921,587</u>	<u>5,343,474</u>	<u>8,886,641</u>
Total Net Assets	<u>\$ 8,027,513</u>	<u>\$ 5,491,977</u>	<u>\$ 9,120,691</u>

The following table summarizes the OLC's Statement of Revenues, Expenses and Changes in Net Assets for the years ended June 30:

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Operating Revenues			
Gaming revenues	\$ 199,854,378	\$ 198,153,932	\$ 199,747,294
Other revenues	<u>118,975</u>	<u>120,614</u>	<u>178,604</u>
Total	199,973,353	198,274,546	199,925,898
Less Prize Expense	103,052,810	106,600,824	105,092,616
Less Retailer Commissions/Incentives	13,233,747	13,219,310	13,150,714
Less Other Direct Game Costs	6,081,715	5,895,707	5,903,703
Less Operating Expenses	<u>4,860,761</u>	<u>6,596,129</u>	<u>7,994,755</u>
Total Expense	127,229,033	132,311,970	132,141,788
Nonoperating Revenue (Expense)			
Interest Income	281,890	304,801	440,113
Transfers to ODMHSAS	(500,000)	(500,000)	(500,000)
Transfers to OELTF	<u>(69,990,674)</u>	<u>(69,396,091)</u>	<u>(69,974,064)</u>
Net nonoperating revenue (expense)	<u>(70,208,784)</u>	<u>(69,591,290)</u>	<u>(70,033,951)</u>
Increase (Decrease) in Net Assets	2,535,536	(3,628,714)	(2,249,841)
Net Assets, Beginning of Year	<u>5,491,977</u>	<u>9,120,691</u>	<u>11,370,532</u>
Net Assets, End of Year	<u>\$ 8,027,513</u>	<u>\$ 5,491,977</u>	<u>\$ 9,120,691</u>

## OKLAHOMA LOTTERY COMMISSION

### MANAGEMENT'S DISCUSSION AND ANALYSIS--Continued

#### FINANCIAL AND ACTIVITY HIGHLIGHTS--Continued

Sales increased slightly from fiscal year 2011 to fiscal year 2012. Online sales during this period increased mainly due to a record jackpot for Mega Millions at the end of March 2012. The price increase of the Powerball game in the last half of the fiscal year also provided a minimal increase to online sales for the year. There was a decrease in overall Scratcher sales from fiscal year 2011 to fiscal year 2012. One of the main contributing factors was due to a slight decrease in prize payouts across various price points. Instant payouts must be closely managed to ensure OLC fulfills our mandated requirement of 35% to education. We continually review and adjust Scratcher prize payouts to meet consumer demands and our ability to pay the prizes and transfers to education. From fiscal year 2011 to fiscal year 2012, we reduced prize expense in low price point Scratcher games to meet the demand for prizes in high price point Scratchers games. This reduced our overall Scratcher prize expense by approximately \$6,000,000. Despite the decline, Scratcher sales are still up almost \$10,000,000 from fiscal year 2008 and almost \$20,000,000 from fiscal year 2009.

Sales decreased slightly from fiscal year 2010 to fiscal year 2011. Online sales during this period decreased mainly due to a decline in large Powerball jackpots. The addition of the Mega Millions game in the last half of the fiscal year provided additional online sales for the year. Scratcher product sales for fiscal year 2011 were more than in fiscal year 2010, offsetting the decline in sales for the online products. The rise in Scratcher sales was mainly due to an increase in prize payouts. We raised the Scratcher payouts approximately \$7,000,000 from fiscal year 2010 to fiscal year 2011 to increase revenues.

Net proceeds of the OLC must be transferred to the State Treasurer for the OELTF with the following exceptions: 1) the cost of property and equipment, net of depreciation and related debt, and 2) other assets which can not be transferred due to statutory or other legal restriction, including restricted cash from unclaimed prizes, deposits with MUSL and the Restricted Fidelity Fund. Unclaimed prizes, after required transfers to the Department of Mental Health and Substance Abuse Services, must be added to a pool from which future prizes are awarded or used for special prize promotions. Deposits with MUSL result from a set aside of prize expenses paid to MUSL and are available for prize reserves and promotional expenses of MUSL games. The Restricted Fidelity Fund is derived from the licensing fees of new retailers, which may be retained by the OLC up to the budgeted expenses from the fund for the next fiscal year plus \$500,000 and used to cover losses the OLC may experience due to nonfeasance, misfeasance, or malfeasance of a lottery retailer and to pay the costs of vendor, retailer and employee background investigations conducted by the OSBI and for audits conducted by the State Auditor and Inspector.

## OKLAHOMA LOTTERY COMMISSION

### MANAGEMENT'S DISCUSSION AND ANALYSIS--Continued

#### FINANCIAL AND ACTIVITY HIGHLIGHTS--Continued

For the years ended June 30, 2012 and 2011, the total transfers made or due to the OELTF related to operations were \$69,990,674 and \$69,396,091, respectively. Since inception to June 30, 2012, total transfers made or due to the OELTF were \$488,523,586. For each of the years ended June 30, 2012 and 2011, the OLC transferred \$500,000 in unclaimed prize funds to the Department of Mental Health and Substance Abuse Services for the treatment of compulsive gambling disorders and educational programs related to such disorders. From inception to June 30, 2012, total transfers to the Oklahoma Department of Mental Health and Substance Abuse Services were \$3,044,600.

The following is a condensed version of the OLC's Statement of Cash Flows for the years ended June 30:

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Cash Provided (Used) By:			
Operating Activities	\$ 73,641,204	\$ 67,706,571	\$ 65,578,691
Noncapital Financing Activities	(65,439,871)	(65,629,521)	(68,632,345)
Capital and Related			
Financing Activities	(10,246)	(15,417)	(35,727)
Investing Activities	<u>268,533</u>	<u>307,971</u>	<u>449,435</u>
Net Increase (Decrease) in Cash	8,459,620	2,369,604	(2,639,946)
Cash at Beginning of Year	<u>15,455,512</u>	<u>13,085,908</u>	<u>15,725,854</u>
Cash at End of Year	<u>\$ 23,915,132</u>	<u>\$ 15,455,512</u>	<u>\$ 13,085,908</u>

#### POTENTIAL FACTORS IMPACTING FUTURE OPERATIONS

Increasing costs always have the potential to impact future operations. The Oklahoma Lottery Commission is committed to keeping costs to a minimum in order to maximize our contribution to education in Oklahoma. United States lotteries including the OLC are in the process of developing a national lottery game. The OLC is also considering options for a regional game to increase sales and profits. OLC continues to review options for other lottery game opportunities and will continue to release new fun and entertaining Scratcher games in fiscal year 2013.



## **OKLAHOMA LOTTERY COMMISSION**

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

#### **CONTACTING THE LOTTERY'S FINANCIAL MANAGEMENT**

This financial report is designed to provide a general overview of the OLC's financial activity for all those interested in the OLC's operations. Questions concerning any of the information provided in this report, or requests for additional financial information, should be addressed to the Director of Administration, Oklahoma Lottery Commission, 405-522-7700, 3817 N. Santa Fe Oklahoma City, Oklahoma 73118.

STATEMENTS OF NET ASSETS

OKLAHOMA LOTTERY COMMISSION

ASSETS	June 30	
	2012	2011
CURRENT ASSETS		
Cash and cash equivalents	\$ 21,779,556	\$ 14,033,880
Cash - restricted	2,135,576	1,421,632
Retailer accounts receivable	6,582,415	7,401,763
Accounts receivable - Multi-State Lottery	375,428	1,107,253
TOTAL CURRENT ASSETS	<u>30,872,975</u>	<u>23,964,528</u>
CAPITAL ASSETS, net	105,926	148,503
DEPOSIT WITH MULTI-STATE LOTTERY	5,786,011	3,921,842
TOTAL NONCURRENT ASSETS	<u>5,891,937</u>	<u>4,070,345</u>
TOTAL ASSETS	<u>\$ 36,764,912</u>	<u>\$ 28,034,873</u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Due to Oklahoma Education Lottery Trust Fund	\$ 18,716,319	\$ 13,665,516
Due to Multi-State Lottery	1,327,695	1,113,907
Prizes payable	7,521,856	6,100,543
Accounts payable	705,856	1,045,081
Accrued liabilities	149,395	139,596
Deferred revenue	254,599	421,343
TOTAL CURRENT LIABILITIES	<u>28,675,720</u>	<u>22,485,986</u>
ACCRUED COMPENSATED ABSENCES, net	61,679	56,910
TOTAL LIABILITIES	<u>28,737,399</u>	<u>22,542,896</u>
NET ASSETS		
Invested in capital assets, net	105,926	148,503
Restricted net assets - expendable	7,921,587	5,343,474
TOTAL NET ASSETS	<u>8,027,513</u>	<u>5,491,977</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 36,764,912</u>	<u>\$ 28,034,873</u>

See notes to financial statements.

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

OKLAHOMA LOTTERY COMMISSION

	Years ended June 30	
	2012	2011
REVENUES		
Scratcher games	\$ 95,978,562	\$ 102,969,295
Pick 3 game	4,650,700	5,849,788
Pick 4 game	2,048,092	-
Cash 5 game	4,205,922	4,713,329
Hot Lotto game	7,407,098	9,514,730
Mega Millions game	27,328,981	20,954,777
Powerball game	58,235,023	54,152,013
TOTAL REVENUE FROM THE SALE OF LOTTERY TICKETS	<u>199,854,378</u>	<u>198,153,932</u>
Retailer application fees	112,375	112,380
Other	6,600	8,234
TOTAL REVENUES	<u>199,973,353</u>	<u>198,274,546</u>
DIRECT COSTS		
Prize expense		
Scratcher games	54,410,671	60,780,047
Pick 3 game	2,207,960	2,847,450
Pick 4 game	948,550	-
Cash 5 game	1,981,663	2,170,004
Hot Lotto game	3,575,998	4,411,148
Mega Millions game	13,445,425	10,436,364
Powerball game	26,482,543	25,955,811
TOTAL PRIZE EXPENSE	<u>103,052,810</u>	<u>106,600,824</u>
Commissions and incentives to retailers	13,233,747	13,219,310
Instant and on-line costs	6,081,715	5,895,707
TOTAL DIRECT COSTS	<u>122,368,272</u>	<u>125,715,841</u>
GROSS PROFIT	77,605,081	72,558,705
OPERATING EXPENSES		
Advertising and promotion	1,652,640	3,023,269
Salaries, wages and benefits	2,661,825	2,888,869
Contracted and professional services	122,459	158,711
Depreciation	52,823	100,964
Equipment	702	27,449
Rent expense	194,901	205,136
Office supplies	35,127	33,024
Travel	22,269	15,338
Other general and administrative	118,015	143,369
TOTAL OPERATING EXPENSES	<u>4,860,761</u>	<u>6,596,129</u>
OPERATING INCOME	72,744,320	65,962,576
NONOPERATING INCOME (EXPENSE)		
Interest income	281,890	304,801
Transfers to Oklahoma Department of Mental Health and Substance Abuse Services	(500,000)	(500,000)
Transfers to and due to Oklahoma Education Lottery Trust Fund	(69,990,674)	(69,396,091)
NET NONOPERATING INCOME (EXPENSE)	<u>(70,208,784)</u>	<u>(69,591,290)</u>
CHANGE IN NET ASSETS	2,535,536	(3,628,714)
NET ASSETS, beginning of year	<u>5,491,977</u>	<u>9,120,691</u>
NET ASSETS, end of year	<u>\$ 8,027,513</u>	<u>\$ 5,491,977</u>

See notes to financial statements.

STATEMENTS OF CASH FLOWS

OKLAHOMA LOTTERY COMMISSION

	Years ended June 30	
	2012	2011
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Cash received from retailers	\$ 188,037,612	\$ 186,141,085
Cash payments to prize winners	(101,417,709)	(106,216,462)
Cash payments to suppliers for goods and services	(8,469,732)	(9,136,032)
Cash payments to employees for services	(2,644,798)	(2,909,488)
Cash payments to fund deposit with Multi-State Lottery	(1,864,169)	(172,532)
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>73,641,204</b>	<b>67,706,571</b>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>		
Payments to Oklahoma Department of Mental Health and Substance Abuse Services	(500,000)	(500,000)
Payments to Oklahoma Education Lottery Trust Fund	(64,939,871)	(65,129,521)
<b>NET CASH USED FOR NONCAPITAL FINANCING ACTIVITIES</b>	<b>(65,439,871)</b>	<b>(65,629,521)</b>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Purchase of capital assets	(10,246)	(15,417)
<b>NET CASH USED FOR CAPITAL AND RELATED FINANCING ACTIVITIES</b>	<b>(10,246)</b>	<b>(15,417)</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Interest received	268,533	307,971
<b>NET CASH PROVIDED BY INVESTING ACTIVITIES</b>	<b>268,533</b>	<b>307,971</b>
<b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>	<b>8,459,620</b>	<b>2,369,604</b>
<b>CASH AND CASH EQUIVALENTS, beginning of year</b>	<b>15,455,512</b>	<b>13,085,908</b>
<b>CASH AND CASH EQUIVALENTS, end of year</b>	<b>\$ 23,915,132</b>	<b>\$ 15,455,512</b>
<b>OPERATING ACTIVITIES</b>		
Operating income	\$ 72,744,320	\$ 65,962,576
Adjustment to reconcile operating income to net cash provided by operating activities		
Depreciation	52,823	100,964
Bad debt expense	20,274	41,574
Changes in operating assets and liabilities		
Retailer accounts receivable	812,431	1,575,633
Accounts receivable - Multi-State Lottery	731,825	(590,567)
Deposit with Multi-State Lottery	(1,864,169)	(172,532)
Due to Multi-State Lottery	213,788	(74,568)
Accounts payable and accrued liabilities	(324,657)	305,884
Prizes payable	1,421,313	458,930
Deferred revenue	(166,744)	98,677
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>\$ 73,641,204</b>	<b>\$ 67,706,571</b>

See notes to financial statements.

## NOTES TO FINANCIAL STATEMENTS

### OKLAHOMA LOTTERY COMMISSION

June 30, 2012

#### NOTE A--REPORTING ENTITY

The Oklahoma Lottery Commission (the "OLC"), was formed by the citizens of Oklahoma upon passage of a legislative referendum authorizing the Oklahoma Education Lottery Act (the "Act"), codified as Title 3A, Section 701, et. seq., of the Oklahoma Statutes. The OLC is an enterprise fund of the State of Oklahoma (the "State") responsible for administering lotteries in accordance with the Act. The Act established a board of seven trustees appointed by the Governor to oversee operations of the OLC. The Board of Trustees exercises powers comparable to those of the governing board of an entrepreneurial organization. The OLC transfers net proceeds as defined by the Act.

#### NOTE B--SIGNIFICANT ACCOUNTING POLICIES

Method of Accounting: The OLC is accounted for as an enterprise fund. Enterprise funds are used to account for activities that are financed and operated in a manner similar to private business enterprises where the costs of providing lottery games to the general public on a continuing basis are to be financed through the sale of lottery game tickets. The Act requires that all costs of providing lottery games, including capital costs, be recovered from the sale of lottery game tickets.

The Governmental Accounting Standards Board ("GASB") is the recognized standard setting body for accounting principles generally accepted applicable to governmental proprietary activities in the United States of America. The OLC applies all applicable GASB pronouncements and all applicable Financial Accounting Standards Board ("FASB") pronouncements issued on or before November 30, 1989 when not in conflict with GASB pronouncements. In accordance with GASB Statement No. 20, the OLC has elected not to implement FASB Statements after the applicable date.

Basis of Accounting: The financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. Under this method, revenues are recognized when they are earned and expenses are recognized when they are incurred.

The primary operating revenue of the OLC is ticket sales from games. Nonoperating income consists mostly of interest income. "Operating expenses" are defined under the Act as "all costs of doing business, including but not limited to prizes, commissions, and other compensation paid to retailers, advertising and marketing costs, personnel costs, capital costs, amounts held in or paid from the fidelity revolving fund, administration and operation of the OLC and other operating costs". All expenses not meeting this definition are reported as nonoperating expenses. The only nonoperating expenses are statutory required transfers to the Oklahoma Education Lottery Trust Fund ("OELTF") and the Oklahoma Department of Mental Health and Substance Abuse Services.

NOTES TO FINANCIAL STATEMENTS--Continued

OKLAHOMA LOTTERY COMMISSION

June 30, 2012

NOTE B--SIGNIFICANT ACCOUNTING POLICIES--Continued

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 disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue Recognition: Revenue for Pick 3, Pick 4, Cash 5, Hot Lotto, Mega Millions and Powerball (collectively referred to as "on-line games") is recognized when tickets are sold to the public by contracted retailers, except for tickets sold in advance of the draw date for which deferred revenue is recorded. Revenue for scratcher games is recognized upon activation of ticket packs for sale by the retailers.

Every scratcher ticket game has a predetermined number of free tickets in its prize structure. The majority of free tickets relate to scratcher ticket games. Revenue and prize expense are shown net of free tickets.

Commissions: Retailers receive a 6% commission on total sales and 0.75% commission on prizes cashed.

Prizes: Prize expense for scratcher ticket games is recorded as an estimate at the time the related revenue is recognized based on the predetermined prize structure for each game; periodically, the prize expense is adjusted to reflect amounts actually won. Prize expense for on-line games is recorded at the time the related revenue is recognized based on the known prizes.

Unclaimed Prizes: Prizes must be claimed within 90 days after the game-end (end of sales) for scratcher games and within 180 days after the draw date for on-line games. The first \$500,000 of unclaimed prize money accruing annually must be transferred to the Oklahoma Department of Mental Health and Substance Abuse Services for the treatment of compulsive gambling disorders and educational programs related to such disorders.

In accordance with section 724 of the Act, unclaimed prizes are added to a pool from which future prizes are awarded or used for special prize promotions. Under the Act, unclaimed prizes do not constitute net lottery proceeds and are restricted funds that are not available for transfer to the OELTF. Total unclaimed prizes amounted to \$4,182,199 and \$4,612,086 for fiscal years 2012 and 2011, respectively. Unclaimed prizes are netted against prize expense in the statement of revenues, expenses and changes in net assets.

NOTES TO FINANCIAL STATEMENTS--Continued

OKLAHOMA LOTTERY COMMISSION

June 30, 2012

NOTE B--SIGNIFICANT ACCOUNTING POLICIES--Continued

Net Assets: The OLC's net assets are classified as follows:

*Invested in capital assets* - This represents the OLC's total investment in capital assets.

*Restricted net assets – expendable* - This represents cash maintained in the OLC's restricted fidelity fund, deposits with the Multi-State Lottery ("MUSL"), and balance of unclaimed prizes to be used on future prizes or special prize promotions.

Gross Proceeds: Gross proceeds, as defined by the Act, consist of all revenue derived from the sale of lottery game tickets or shares and all other monies derived from the lottery games.

Net Proceeds: Net proceeds, as defined by the Act, consist of all revenue derived from the sale of lottery game tickets or shares and all other monies derived from the lottery games, less operating expenses and prizes.

Operating Expenses: Operating expenses, as defined by the Act, in the determination of net proceeds, consist of all costs of doing business including, but not limited to, prizes, commissions, and other compensation paid to lottery retailers, advertising and marketing costs, rental fees, personnel costs, capital costs, depreciation of property and equipment and other operating costs.

Cash and Cash Equivalents: The OLC's cash and cash equivalents are considered to be cash on-hand and interest bearing demand deposits held by the Oklahoma State Treasurer.

Retailer Accounts Receivable: Retailer accounts receivable represents lottery proceeds due from retailers for on-line ticket sales and activated ticket packs for scratcher games less commissions due to retailers and prizes paid by the retailers. Lottery proceeds are collected weekly by the OLC from retailer trust accounts established in trust for benefit of the OLC.

Capital Assets, Net: Capital assets, which consist of machinery, equipment, computers and software are stated at cost less accumulated depreciation. The OLC capitalizes all property and equipment purchases of \$500 or more. Depreciation is computed using the straight-line method over the estimated useful lives of three, five and ten years. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is reflected in the results from operations in the period of disposal.

NOTES TO FINANCIAL STATEMENTS--Continued

OKLAHOMA LOTTERY COMMISSION

June 30, 2012

NOTE B--SIGNIFICANT ACCOUNTING POLICIES--Continued

Restricted Cash: In accordance with the Act, retailers contribute a fee to a fidelity fund upon acceptance as a retailer for the OLC. The fund is used to cover losses the OLC may incur due to misfeasance, nonfeasance or malfeasance of retailers and to contract for investigations, reviews or audits. At the end of any fiscal year, the OLC must transfer to the OELTF any amount in the restricted fidelity fund which exceeds the budgeted expenses from the fund for the next fiscal year plus \$500,000. At June 30, 2012 and 2011 no amounts were available for transfer as net proceeds. During fiscal years 2012 and 2011, \$28,710 and \$41,574 respectively, was used to reimburse the OLC for retailer accounts that were delinquent and in collection status. Receipts from retailers in collection status are deposited back to the fidelity fund. The fidelity fund is held in a separate account and appears in the accompanying statement of net assets as restricted funds and expendable restricted net assets.

Deposits with MUSL are included in expendable restricted net assets. These funds are in the possession of the MUSL and serve as a contingency to protect members from unforeseen prize liabilities.

Current unclaimed prizes in excess of \$500,000 and the balance from prior years are included in restricted cash. These funds are to be utilized to enhance future OLC prizes or promotions.

As of June 30, 2012 and 2011, restricted cash totaled \$2,135,576 and \$1,421,632 respectively.

Risk Management: The OLC is exposed to various risks of loss related to torts, destruction of assets due to theft or damage, errors and omissions, injuries to employees, and natural disasters. The OLC has coverage to substantially cover these risks through a self-insured pool for agencies of the State of Oklahoma. This coverage is administered by the Risk Management Division of the Department of Central Services for the State of Oklahoma.

Compensated Absences: Employees earn the right to be compensated during absences for vacation and compensatory time. Unused leave benefits are paid to employees upon separation from service. The cost of vacation and compensatory time is accrued in the period in which it is earned.

Deposit with MUSL: The OLC has contributed to a set prize reserve fund separately maintained by the MUSL (Note J) to pay certain prizes associated with Powerball, Hot Lotto and Mega Millions. With certain restrictions, the OLC's portion of this prize reserve fund is refundable upon termination of the OLC's agreement with the MUSL or upon the disbanding of the MUSL.



NOTES TO FINANCIAL STATEMENTS--Continued

OKLAHOMA LOTTERY COMMISSION

June 30, 2012

NOTE B--SIGNIFICANT ACCOUNTING POLICIES--Continued

Deposit with MUSL--Continued: As a member of the MUSL, the OLC is required to make deposits in various prize reserve funds maintained by the MUSL. These deposits are included in the 50% prize expense computed on Powerball and Hot Lotto sales, and in the 51.5% prize expense computed on Mega Millions sales. The net amount of 50% or 51.5% prize expense, less the amount required to pay non-jackpot prizes within the State, is paid to the MUSL. This payment is to cover the OLC's share of current jackpot prizes based on the OLC's percent of sales for each drawing and the OLC share of the prize reserve fund. The prize reserve fund serves as a contingency reserve to protect all the MUSL members, including the OLC, from unforeseen prize liabilities. The balances of the deposits are made up of the following:

	June 30	
	2012	2011
Set Prize Reserve Account	\$ 846,239	\$ 663,044
Prize Reserve Account	3,360,508	3,240,467
Balance of Unreserved Account	1,579,264	18,331
	<u>\$ 5,786,011</u>	<u>\$ 3,921,842</u>

Bad Debt Expense: The OLC recognizes bad debt expense when retailer account receivables are greater than 90 days old. The accounts receivable balance due to the OLC is satisfied at that time by a transfer of funds from the restricted fidelity fund. The OLC may continue its effort to collect these accounts. Any collection from a retailer balance previously charged to bad debt expense will be deposited back to the restricted fidelity fund. For the years ended June 30, 2012 and 2011, bad debt expense was \$20,274 and \$41,574, respectively.

Reclassifications: Certain amounts in the prior year's financial statements have been reclassified to conform with the current year presentation.

NOTE C--CASH AND DEPOSITS

Custodial credit risk is the risk that in the event of a bank failure, the government's deposits may not be returned to it. The OLC does not have a deposit policy for custodial credit risk. However, all of the OLC's bank deposits are held by the Oklahoma State Treasurer ("OST") and therefore, as required by Oklahoma State Statutes, all bank deposits held by the OST are insured by Federal Deposit Insurance, collateralized by securities held by the cognizant Federal Reserve Bank, or invested in U.S. government obligations and therefore are not considered to be exposed to custodial credit risk. As of June 30, 2012 and 2011, the carrying amounts of the OLC's deposits with the OST were \$23,915,132 and \$15,455,512, respectively, and the bank balances were \$23,926,286 and \$15,490,266, respectively.

NOTES TO FINANCIAL STATEMENTS--Continued

OKLAHOMA LOTTERY COMMISSION

June 30, 2012

NOTE D--CAPITAL ASSETS, NET

The following is a summary of changes in capital assets and accumulated depreciation during the fiscal year indicated:

Year Ended June 30, 2012				
	Beginning Balance	Additions	Deletions	Ending Balance
<u>Capital Assets</u>				
Machinery and equipment	\$ 752,382	\$ 10,246	\$ -	\$ 762,628
Computers and software	400,006	-	-	400,006
	<u>1,152,388</u>	<u>10,246</u>	<u>-</u>	<u>1,162,634</u>
Accumulated depreciation				
Machinery and equipment	605,100	51,961	-	657,061
Computers and software	398,785	862	-	399,647
	<u>1,003,885</u>	<u>52,823</u>	<u>-</u>	<u>1,056,708</u>
Total capital assets, net	<u>\$ 148,503</u>	<u>\$ (42,577)</u>	<u>\$ -</u>	<u>\$ 105,926</u>

Year Ended June 30, 2011				
	Beginning Balance	Additions	Deletions	Ending Balance
<u>Capital Assets</u>				
Machinery and equipment	\$ 736,965	\$ 15,417	\$ -	\$ 752,382
Computers and software	400,006	-	-	400,006
	<u>1,136,971</u>	<u>15,417</u>	<u>-</u>	<u>1,152,388</u>
Accumulated depreciation				
Machinery and equipment	505,331	99,769	-	605,100
Computers and software	397,590	1,195	-	398,785
	<u>902,921</u>	<u>100,964</u>	<u>-</u>	<u>1,003,885</u>
Total capital assets, net	<u>\$ 234,050</u>	<u>\$ (85,547)</u>	<u>\$ -</u>	<u>\$ 148,503</u>

NOTES TO FINANCIAL STATEMENTS--Continued

OKLAHOMA LOTTERY COMMISSION

June 30, 2012

NOTE E--COMPENSATED ABSENCES

Compensated absences: The current portion of accrued compensated absences is included in accrued liabilities in the accompanying statements of net assets. The following is a summary of changes in the OLC's liability for compensated absences during the period ended June 30:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Deletions</u>	<u>Ending Balance</u>	<u>Current Portion</u>
Compensated absences 2012	<u>\$ 170,730</u>	<u>\$ 124,559</u>	<u>\$ 110,252</u>	<u>\$ 185,037</u>	<u>\$ 123,358</u>
Compensated absences 2011	<u>\$ 173,477</u>	<u>\$ 130,553</u>	<u>\$ 133,300</u>	<u>\$ 170,730</u>	<u>\$ 113,820</u>

NOTE F--OPERATING LEASES

The OLC has entered into various operating leases for office space and equipment used in its daily operations. Pursuant to Oklahoma State Statutes, the OLC's operating leases are limited to terms of one year and must be renewed annually. Accordingly, the OLC has no long-term commitments under the operating leases as of June 30, 2012 or 2011. Rent expense under all operating leases was \$194,901 for the year ended June 30, 2012, and \$205,136 for the year ended June 30, 2011.

NOTE G--EDUCATION LOTTERY ACCOUNT

In accordance with the Act, all net proceeds of the OLC are transferred to the Education Lottery Account. Net proceeds consist of all revenue derived from the sale of lottery game tickets or shares and all other monies derived from the lottery games less operating expenses and prizes. Beginning in fiscal year 2009, the OLC makes transfers to the OELTF calculated at 35% of the total revenue year-to-date, less amounts previously paid. The net proceeds transfer requirement percentage for years prior to fiscal year 2009 was 30%. All remaining net income at the end of the fiscal year is also remitted to the OELTF, unless specifically exempted by statute. According to the Act, amounts transferred to the OELTF are to be appropriated by the Legislature to education programs according to the parameters established in the Act. Following is an executive summary of these statutory provisions. For the full text, see Title 3A, Section 713 of the Oklahoma Statutes available on the OLC website.

NOTES TO FINANCIAL STATEMENTS--Continued

OKLAHOMA LOTTERY COMMISSION

June 30, 2012

NOTE G--EDUCATION LOTTERY ACCOUNT--Continued

- 5% Teachers' Retirement System Dedicated Revenue Revolving Fund
- 5% School Consolidation and Assistance Fund ("SCAF"): if the SCAF equals \$5,000,000, this 5% will be allocated to public schools to purchase technology equipment to conduct on-line testing
- 45% Kindergarten through twelfth grade public education, including compensation and benefits for public school teachers and support employees; and early childhood development programs
- 45% Tuition grants, loans and scholarships to citizens of this state for attending colleges and universities located within this state, or to attend Oklahoma Department of Career and Technology Education institutions; construction of educational facilities or capital outlay projects or technology for elementary school districts, independent school districts, the Oklahoma State System of Higher Education, and career and technology education; endowed chairs for professors at institutions of higher education operated by the Oklahoma State System of Higher Education; and programs and personnel of the Oklahoma School for the Deaf and the Oklahoma School for the Blind

The following is a summary of the amounts available for transfer to the OELTF during the years ended June 30, 2012 and 2011:

	June 30	
	<u>2012</u>	<u>2011</u>
Net assets, beginning of year	\$ 5,491,977	\$ 9,120,691
Change in net assets before transfers to OELTF	<u>72,526,210</u>	<u>65,767,377</u>
Net assets available for transfer to OELTF before amounts invested in capital assets and restricted net assets	78,018,187	74,888,068
Less: Net assets invested in capital assets	(105,926)	(148,503)
Less: Restricted net assets - expendable	<u>(7,921,587)</u>	<u>(5,343,474)</u>
Transfers to and due OELTF for the year	<u>\$ 69,990,674</u>	<u>\$ 69,396,091</u>

NOTES TO FINANCIAL STATEMENTS--Continued

OKLAHOMA LOTTERY COMMISSION

June 30, 2012

NOTE H--RETIREMENT PROGRAM

The OLC contributes to the Oklahoma Public Employees Retirement System ("OPERS") cost sharing multiple-employer defined benefit plan. OPERS was established in 1964 by the Oklahoma Legislature and covers substantially all employees of the State except those covered by six other plans sponsored by the State and also covers employees of participating counties and local agencies. The plan provides that all eligible persons, except those specifically excluded, shall become members of OPERS as a condition of their employment. The supervisory authority for the management and operation of OPERS is its Board of Trustees.

OPERS offers retirement and disability benefits, cost of living adjustments on an ad-hoc basis, life insurance benefits and survivor benefits. The Plan's provisions are established under Title 74 of the Oklahoma Statutes.

The following is a recap of OPERS' mandated contribution rates for fiscal years:

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Employee contributions	3.50%	3.50%	3.50%
Additional % for members electing stepup	2.91%	2.91%	2.91%
Employer contributions	16.50%	15.50%	15.50%

For the years ended June 30, 2012, 2011 and 2010 the OLC's contributions to OPERS were \$289,515, \$295,643 and \$317,954, respectively. All employer contributions were equal to the required contribution rates for the year.

A comprehensive annual financial report containing financial statements and required supplementary information for the Oklahoma Public Employee Retirement System is issued and publicly available by writing the Oklahoma Public Employee Retirement System, Post Office Box 53007, Oklahoma City, Oklahoma 73152-3007.

NOTE I--CONTINGENCIES

The OLC is subject to litigation in the ordinary course of its operations. In the opinion of the OLC's management and its legal counsel, the outcome of such litigation will not have a material impact on the financial position or cash flows of the OLC for the years ended June 30, 2012 and 2011.

## NOTES TO FINANCIAL STATEMENTS--Continued

### OKLAHOMA LOTTERY COMMISSION

June 30, 2012

#### NOTE J--CONTRACTUAL ARRANGEMENTS

In August 2005 the OLC entered into a contract with Scientific Games International, Inc. ("SGI") to provide amongst other things, services and equipment to operate its lotteries. Due to Oklahoma Statutes, the OLC may not contract for a period longer than one year. However, the contract with SGI does contain six one-year renewal options which the OLC's Board of Trustees may renew annually. Under the terms of the contract, the OLC pays SGI a fee based on a percentage of the OLC's sales. For the years ended June 30, 2012 and 2011, the OLC paid SGI \$6,081,715 and \$5,895,707, respectively.

The OLC is a member of the MUSL which operates games on behalf of participating lotteries. MUSL currently operates the Powerball, Mega Millions and Hot Lotto games for the OLC. Under the OLC's agreement with the MUSL, the OLC must remit 50% of its Powerball ticket sales, 50% of its Hot Lotto ticket sales and 51.5% of its Mega Millions ticket sales, less the amount of all non-jackpot winning tickets sold. The OLC is responsible for paying winning tickets purchased in Oklahoma; therefore, it is able to deduct winning tickets sold from the amount due to the MUSL on its ticket sales. As of June 30, 2012 and 2011, the OLC owed the MUSL \$1,327,695 and \$1,113,907 for ticket sales and the MUSL owed the OLC \$375,428 and \$401,609 for non-jackpot winning tickets. Additionally, the MUSL owed the OLC \$705,644 related to a grand prize jackpot ticket at June 30, 2011. The OLC has recorded these items at their gross amounts in the accompanying statements of net assets.

#### NOTE K--NEW ACCOUNTING PRONOUNCEMENTS

The GASB has issued several new accounting pronouncements, which will be effective to OLC in subsequent years. A description of the new accounting pronouncements, the fiscal year in which they are effective, and OLC's consideration of the impact of these pronouncements are described below:

*Fiscal Year Ended June 30, 2013*

- *Statement No. 60, Accounting and Financial Reporting for Service Concession Arrangements* – GASB No. 60 addresses issues related to service concession arrangements (SCAs), which are a type of public-private or public-public partnership. This Statement applies only to those arrangements in which specific criteria determining whether a transferor has control over the facility are met. OLC will only be required to adopt the provisions of GASB No. 60 if it enters into an SCA, and it currently has not entered into any such arrangements.

NOTES TO FINANCIAL STATEMENTS--Continued

OKLAHOMA LOTTERY COMMISSION

June 30, 2012

NOTE K--NEW ACCOUNTING PRONOUNCEMENTS--Continued

- Statement No. 61, *The Financial Reporting Entity: Omnibus – An Amendment of GASB Statements No. 14 and No. 34.*

GASB No. 61 modifies certain requirements for inclusion of component units in the financial reporting entity and also amends the criteria for reporting component units as if they were part of the primary government (that is, blending) in certain circumstances. Earlier application is encouraged. OLC does not believe that the adoption of GASB No. 61 will have a significant impact on its financial statement presentation.

- Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements.*

GASB No. 62 is intended to enhance the usefulness of its Codification by incorporating guidance that previously could only be found in certain FASB and AICPA pronouncements. OLC does not believe that the adoption GASB No. 62 will have a significant impact on its financial position, activities or cash flows, or its financial statement presentation.

- Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position.*

GASB No. 63 provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. Previous financial reporting standards do not include guidance for reporting those financial statement elements, which are distinct from assets and liabilities. Adoption of this statement will require OLC to make changes in its financial statement presentation.

*Fiscal Year Ended June 30, 2014*

- Statement No. 65, *Items Previously Reported as Assets and Liabilities.*

GASB No. 65 establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources (expenses) or inflows of resources (revenues), certain items that were previously recognized as assets and liabilities. OLC has not quantified the effects of adoption of GASB No. 65 on its net position.

NOTES TO FINANCIAL STATEMENTS--Continued

OKLAHOMA LOTTERY COMMISSION

June 30, 2012

NOTE K--NEW ACCOUNTING PRONOUNCEMENTS--Continued

*Fiscal Year Ended June 30, 2015*

- Statement No. 68, *Accounting and Financial Reporting for Pensions, an Amendment of GASB Statement No. 27*

GASB No. 68 establishes standards for measuring and recognizing liabilities, deferred outflows of resources, deferred inflows of resources, and pension expenses. GASB No. 68 also details the recognition and disclosure requirements for employers with liabilities to a defined benefit pension plan and for employers whose employees are provided with defined contribution pensions. Defined benefit pensions are further classified by GASB No. 68 as single employer plans, agent employer plans and cost-sharing plans, and recognition and disclosure requirements are addressed for each classification. GASB No. 68 was issued in June 2012, and OLC has not yet determined the impact that implementation of GASB No. 68 will have on its net position.



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

The Board of Trustees  
Oklahoma Lottery Commission

We have audited the financial statements of the Oklahoma Lottery Commission (the "OLC"), an enterprise fund of the State of Oklahoma, as of and for the year ended June 30, 2012. We conducted our audit 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.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the OLC's financial statements are free of material misstatement, we performed tests of compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the OLC's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the OLC's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the OLC's internal control over financial reporting.

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 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.

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 deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

This report is intended solely for the information and use of the OLC's Board of Trustees and management and the State of Oklahoma and is not intended to be and should not be used by anyone other than these specified parties.

Cole & Reed P.C.

Oklahoma City, Oklahoma  
September 14, 2012