



AUDITOR GENERAL
WILLIAM O. MONROE



FINANCIAL AUDIT OF THE
STATE OF FLORIDA
DEPARTMENT OF THE LOTTERY
For the Fiscal Year Ended
June 30, 2006

AUDITOR GENERAL

The Auditor General provides independent, unbiased, timely, and relevant information to the Legislature, entity management, and the citizens of the State of Florida which can be used to improve the operations and accountability of public entities.

**STATE OF FLORIDA
DEPARTMENT OF THE LOTTERY**

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EXECUTIVE SUMMARY

Report on Financial Statements

The financial statements prepared by the Department of the Lottery present fairly, in all material respects, the financial position of the Lottery as of June 30, 2006, and the changes in operations and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Report on Internal Control and on Compliance and Other Matters

In our opinion, Lottery management maintained, in all material respects, effective internal control over financial reporting. Also, for those items tested, the Lottery generally complied with significant provisions of laws, administrative rules, regulations, contracts, and other guidelines.

Other Observations and Findings**Information Technology (IT) Controls**

During our audit, we identified the need for enhancements to the Lottery's IT control practices. Specific details of these matters are not disclosed in this report to avoid the possibility of compromising Lottery information. However, the appropriate Lottery personnel have been notified of these issues.

Payments made to Advertising Agencies

Invoices received from Lottery advertising agencies sometimes included requests for reimbursement of subcontracted media vendor services (media air-time charges for Lottery advertisements). Our audit disclosed that for these types of charges, the Lottery generally reimbursed the amounts invoiced based only on the receipt of a signed certification from an advertising agency representative declaring that the invoice accurately reflected advertising services received and documented in subcontractor invoices. To provide assurance that the Lottery pays for only goods and services actually received, the Lottery should have in place procedures to either test the agency's verification of media air-time charges or to obtain its own verification that Lottery advertisements were broadcast on the dates and at the times reflected by the charges.

Marketing and Research Support Funds

The Lottery's On-line ticket and Scratch-Off ticket gaming service vendors are each contractually required to periodically make deposits into marketing and research support funds maintained by the vendors. Due to the lack of contract terms addressing ownership of the moneys, the extent of the Lottery's rights to claim the moneys in the event of contract termination was not clear. Also, the lack of clarity made impracticable a reasonable determination as to how the existence and use of the funds should be reflected in the budgets and financial reports of the Lottery. Also, our audit tests of ten disbursements disclosed that for eight of the ten related invoices, Lottery records did not contain documentation of either of the two required Lottery manager approvals.

Minority Retailer Participation

Section 24.113, Florida Statutes, requires that 15 percent of the Lottery's retailers shall be minority business enterprises, as defined in Section 288.703, Florida Statutes; however, no more than 35 percent of such retailers shall be owned by the same type of minority person, as defined by Section 288.703, Florida Statutes. Our audit disclosed that as of October 9, 2006, retailers comprising one minority type totaled 64 percent of the total number of minority retailers. A similar finding was included in Auditor General Report Numbers 2006-098 and 2005-089.

Management Response

In a letter dated January 19, 2007, the Secretary provided responses to our findings. This letter is included in its entirety at the end of this report.

Related Reports

In its Report No. 06-04, the Office of Program Policy Analysis and Government Accountability (OPPAGA) provided recommendations to enhance the earning capability of the Lottery and improve the efficiency of Lottery operations. The report also tracks the Lottery's implementation of revenue enhancement initiatives and prior OPPAGA recommendations. OPPAGA plans to issue a follow-up report in February 2007.

This audit was conducted by Robin Ralston, CPA*, and supervised by Frank Belt, CPA*. Please address inquiries regarding this report to Kathryn D. Walker, CPA*, Audit Manager, via e-mail at kathrynwalker@aud.state.fl.us or by telephone at (850) 487-9085. The information technology resources portion of this audit was conducted by Stephanie J. Hogg, CISA, and supervised by Nancy Reeder, CPA*, CISA. Please address inquiries regarding the information technology resources portion of this report to Jonathan E. Ingram, CPA*, CISA, Audit Manager, via email at joningram@aud.state.fl.us or by telephone at (850) 487-9330.

This report, as well as other audit reports prepared by the Auditor General, can be obtained on our Web site (<http://www.state.fl.us/audgen>); by telephone at (850) 487-9024; or by mail at G74 Claude Pepper Building, 111 West Madison Street, Tallahassee, Florida 32399-1450.

*Regulated by State of Florida.



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The President of the Senate, the Speaker of the
House of Representatives, and the
Legislative Auditing Committee

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

We have audited the accompanying financial statements of the Department of the Lottery (the Lottery), an enterprise fund of the State of Florida, as of and for the years ended June 30, 2006, and 2005. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

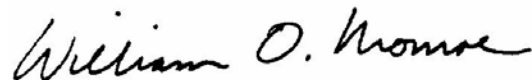
As discussed in Note 1, the financial statements present only the Lottery and do not purport to, and do not, present fairly the operations of the State of Florida as of June 30, 2006, and 2005, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Lottery as of June 30, 2006, and 2005, and the results of operations and cash flows thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 22, 2006, on our examination of the effectiveness of the Lottery's internal control over financial reporting and on our tests of the Lottery's compliance with certain provisions of laws, regulations, contracts, and other matters. One purpose of that report is to describe the scope of our testing of internal control over financial reporting and to provide an opinion thereon. With respect to compliance, the purpose of that report is not to provide an opinion on compliance, but rather to describe the scope of our testing of compliance and the results of that testing. The 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.

The accompanying management's discussion and analysis, presented on pages 3 through 11, is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Respectfully submitted,

A handwritten signature in black ink that reads "William O. Monroe". The signature is written in a cursive style with a large, prominent initial "W".

William O. Monroe, CPA
December 22, 2006

**STATE OF FLORIDA
DEPARTMENT OF THE LOTTERY**

MANAGEMENT'S DISCUSSION AND ANALYSIS

YEARS ENDED JUNE 30, 2006, AND JUNE 30, 2005

This discussion of the Florida Lottery's financial statements is meant to provide an overview and analysis of the Lottery's financial results and position for the fiscal years ended June 30, 2006, and 2005. Please read it in conjunction with the financial statements and notes to the financial statements.

FINANCIAL HIGHLIGHTS

The Florida Lottery has as its mission the maximization of revenues for the benefit of education in a manner consistent with the dignity of the state and the welfare of its citizens. The Florida Lottery is considered a mature lottery with a full complement of both Scratch-Off and On-line products. The Department has maintained lottery sales in excess of \$2 billion for seventeen consecutive fiscal years and has transferred a minimum of \$800 million annually to the Educational Enhancement Trust Fund (EETF) during this same period, with the fiscal year 2006 transfer exceeding \$1 billion for the fourth consecutive year.

For the fiscal year ended June 30, 2006:

- Transfers to the EETF increased from approximately \$1,103,633,000 to approximately \$1,224,651,000, or 11.1%, over the prior fiscal year.
- Florida Lottery's ticket sales increased 13.2% over the prior fiscal year from approximately \$3,470,734,000 to \$3,929,030,000.
- Florida Lottery's total operating revenue increased by \$459,812,000 (or 13.23%), and shows minor growth in revenue sources other than ticket sales.
- Non-operating revenues, net of expenses, decreased \$118,597,000 million or approximately 872% in 2006 as compared to 2005. This change is mostly attributable to the change in fair value of the grand prize investments held by the Lottery for funding of future grand prize payments.
- The gaming vendors' fees and retailer commissions are based on sales and therefore fluctuate in direct correlation with sales revenue. Fiscal year 2006 expenses for these items increased over the prior year expenses by 11.24%.
- Administrative operating expenses, which includes salaries and benefits, rent, utilities and maintenance, professional fees, depreciation and other administrative expenses, increased slightly by 1.34%. Administrative operating expenses for fiscal years 2006 and 2005 were \$71.9 million and \$71.0 million respectively.

OVERVIEW OF THE FINANCIAL STATEMENTS

The Lottery 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: (1) where the costs of providing goods and services to the general public on a continuing basis are to be financed through user charges; or (2) where the periodic determination of net income is considered appropriate. The Lottery utilizes the accrual basis of accounting as do most business entities. This discussion and analysis is intended to serve as an introduction to

the Lottery's basic financial statements, along with the notes to the financial statements. The Statement of Net Assets on page 12, the Statement of Revenues, Expenses and Changes in Net Assets on page 13, and the Statements of Cash Flows on page 14 report the Lottery's net assets and changes therein. The notes to the financial statements provide additional information that is essential to a reader's understanding of the data provided in the financial statements.

The Lottery transfers its net profits each fiscal year to the EETF. As a result, the Lottery's net assets consist of funds invested in fixed capital assets and restricted assets, which consist of the investments being held by the Lottery to fund deferred prize payouts. The investments do include the cumulative effect of periodic adjustments to recognize the fair value of the grand prize investments despite the fact that Lottery purchased the investments with the intention of holding the investments until maturity in order to meet the future obligations and therefore, would not realize any gains or losses related to these investments for distribution as net proceeds.

SUMMARY OF NET ASSETS

Table 1 presents the Lottery's condensed Statement of Net Assets as of the current fiscal year ended June 30, 2006, and the prior fiscal years ended June 30, 2005, and 2004, as derived from the Statement of Net Assets.

Table 1
Condensed Statement of Net Assets
As of June 30, 2006, 2005, and 2004
(In Thousands)

	2006	2005	2004
Assets			
Current Assets	\$ 178,017	\$ 262,160	\$ 198,377
Restricted Assets	2,879,757	3,383,529	3,543,204
Capital Assets, Net of Depreciation	1,244	1,481	2,316
Total Assets	3,059,018	3,647,170	3,743,897
Liabilities			
Current Liabilities	175,955	258,090	195,130
Current Liabilities Payable from Restricted Assets	1,665,130	1,949,327	1,980,899
Noncurrent Liabilities	1,118,217	1,234,236	1,364,182
Total Liabilities	2,959,302	3,441,653	3,540,211
Net Assets			
Net Investment in Capital Assets	1,244	1,481	2,316
Restricted Net Assets	98,472	204,036	201,370
Total Net Assets	\$ 99,716	\$ 205,517	\$ 203,686

Current Year Impacts to the Statement of Net Assets

For the fiscal year ended June 30, 2006:

- Total assets decreased by \$ 588,152,000. This is mostly attributable to the decreases in size of the investment portfolio. The fair value of the individual investments decreased \$17,545,000. In addition the size of the total portfolio decreased due to a consistent pattern of jackpot prizewinners selecting the cash option when they have the option of selecting either an annuity or cash. This pattern resulted in a payout of annuities for the current fiscal year of \$244,516,000 and purchases of only \$31,816,000 in new investments. As a result of the diminishing size of the investment portfolio, the value of the collateral

from the lending of those securities was also less than the prior year. At June 30, 2006, the Lottery held \$1.4 billion in collateral verses \$1.7 billion at June 30, 2005.

- Total liabilities decreased by \$482,351,000. This can be primarily attributed to a net decrease in obligation under security lending of \$ 241,930,000 and a decrease of \$114,671,000 in grand prize deferred payments to winners. In addition, there was a decrease in the year-end liability to EETF of \$69,304,000. This reduction was due to the transferring of more funds during the course of the year rather than making a large transfer at year-end.
- Net assets decreased by \$105,801,000 due to the decrease in both total liabilities and total assets as described above.

For the fiscal year ended June 30, 2005:

- Total assets decreased by \$96,727,000. This is mostly attributable to the decreases in size of the investment portfolio. The market value of the individual investments increased \$110,029,000 but the size of the total portfolio decreased due to a consistent pattern of jackpot prizewinners that when they have the option of selecting either an annuity or cash have been selecting the cash option. This pattern resulted in a payout of annuities for the current fiscal year of \$244,124,000 and only purchased \$7,103,000 in new investments.
- Total liabilities decreased by \$98,558,000. This can primarily be attributed to net decreases in obligation under security lending of \$72,605,000 and a decrease of \$130,229,000 in grand prize deferred payments to winners. However, these decreases were offset by an increase in the current liabilities of \$62,960,000 primarily the increase in the year-end transfer to EETF.
- Net assets increased by \$1,831,000 primarily due to the decrease in the total liability owed to grand prizewinners netted against the financial statement elements.

SUMMARY OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

The most important relationship demonstrated with the Lottery's financial statements is the transfer of net income to the EETF. Accordingly, the primary focus of these financial statements is determining net income available for transfer, rather than the change in net assets of the Lottery, which reflects the decrease in fair value of restricted investments.

Table 2 presents a condensed Summary of Revenues, Expenses and Changes in Net Assets for the current fiscal year ended June 30, 2006, and the prior fiscal years ended June 30, 2005, and June 30, 2004 as derived from the Lottery's Statement of Revenues, Expenses and Changes in Net Assets.

Table 2
Condensed Statement of Revenues, Expenses and Changes in Net Assets
As of June 30, 2006, 2005 and 2004
(In Thousands)

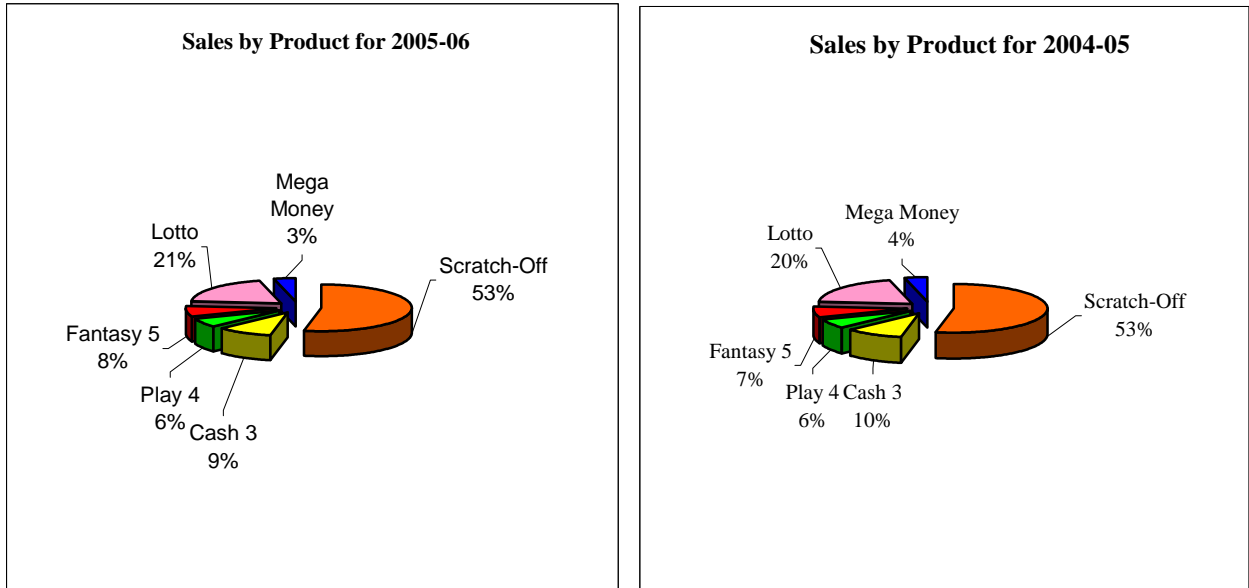
	<u>2006</u>	<u>2005</u>	<u>2004</u>
Operating Revenues			
Ticket Sales	\$3,929,030	\$3,470,734	\$3,070,962
On-Line Fees and Miscellaneous	7,047	5,519	4,950
Retailer Fees	244	256	196
Total Operating Revenues	<u>3,936,321</u>	<u>3,476,509</u>	<u>3,076,108</u>
Operating Expenses			
Prizes	2,340,859	2,044,246	1,724,488
Retailer Commissions	224,570	197,781	174,389
Vendor Commissions	75,047	71,572	65,544
Other Expenses	71,994	71,042	70,548
Total Operating Expenses	<u>2,712,470</u>	<u>2,384,641</u>	<u>2,034,969</u>
Income from Operations	<u>1,223,851</u>	<u>1,091,868</u>	<u>1,041,139</u>
Nonoperating Revenue (Expense)			
Interest and Securities Lending Income, Net of Fees	10,597	10,964	10,307
Net Appreciation in Fair Value of Investments	(17,545)	110,029	(33,038)
Property Disposal Loss	(23)	(45)	(81)
Amortization of Grand Prizes Payable	(98,030)	(107,352)	(116,046)
Total Nonoperating Revenue (Expenses), Net	<u>(105,001)</u>	<u>13,596</u>	<u>(138,858)</u>
Income Before Operating Transfers	<u>1,118,850</u>	<u>1,105,464</u>	<u>902,281</u>
Transfers to Educational Enhancement Trust Fund			
Transfers from Revenue	(1,182,763)	(1,103,633)	(1,051,658)
Transfers from Unclaimed Prizes	(41,888)	0	0
Total Transfers to Educational Enhancement Trust Fund	<u>(1,224,651)</u>	<u>(1,103,633)</u>	<u>(1,051,658)</u>
Change in Net Assets	(105,801)	1,831	(149,377)
Net Assets, Beginning of Year	<u>205,517</u>	<u>203,686</u>	<u>353,063</u>
Net Assets, End of Year	<u>\$ 99,716</u>	<u>\$ 205,517</u>	<u>\$ 203,686</u>

Current Year Impacts/Analysis of the Statement of Revenues and Expenses and Changes in Net Assets

Revenue

For the fiscal year ended June 30, 2006, ticket sales increased another \$458,296,000 due to growth in both the Scratch-Off and On-line markets. The \$3,929,030,000 sales figure represents the highest sales in the history of the Florida Lottery. Fiscal year 2005-06 is also the third year in which the Lottery reached the \$3 billion sales mark.

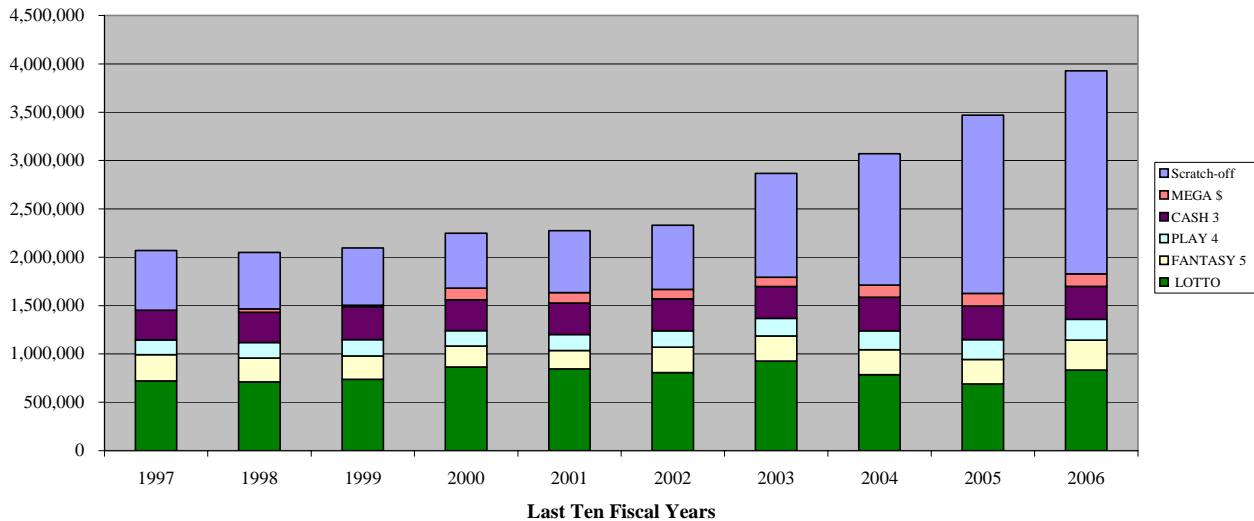
The following chart shows sales by product for the various Lottery games during the June 30, 2006, and 2005 fiscal years:



Sales of Scratch-Off tickets for the fiscal years ending June 30, 2006, and 2005 were \$2,100,118,000 and \$1,844,619,000, or 53% of combined sales in each of the two years. The increase in Scratch-Off sales is largely attributable to the introduction of a second \$20 price point Scratch-Off game introduced in January 2006, record sales of holiday-themed games and, more generally, the effects of the variable prize payouts, implemented in September 2002.

The following chart and table shows sales by game for the last ten fiscal years:

Historical Lottery Sales by Game - (In Thousands)



Department of the Lottery
Historical Lottery Sales By Game
Last Ten Fiscal Years
(In Thousands)

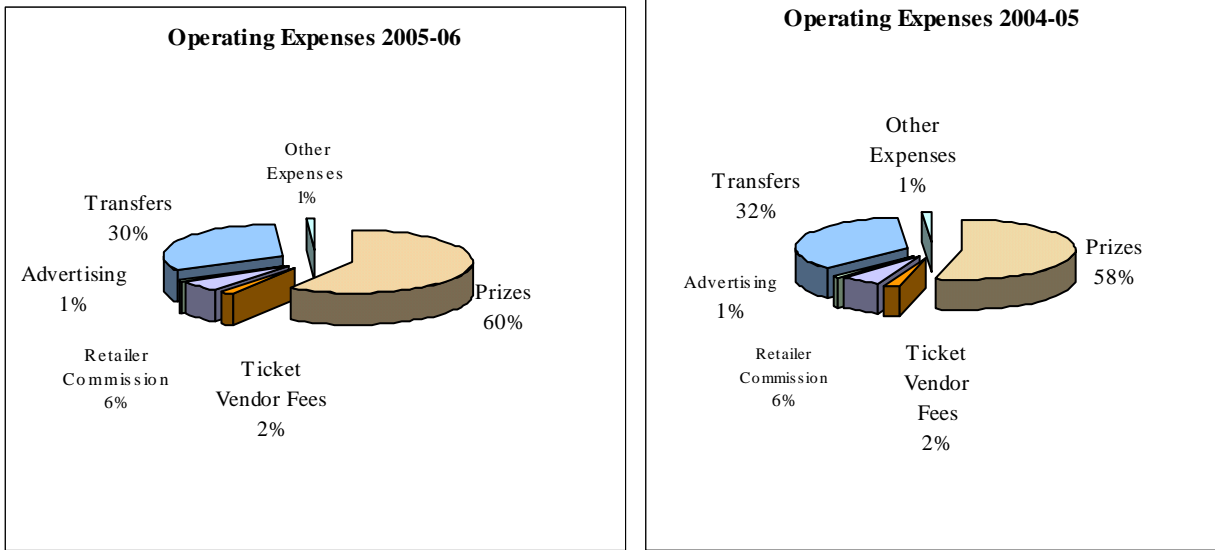
Fiscal Year Ended June 30	FLORIDA LOTTO TM	FANTASY 5 [®]	PLAY 4 TM	CASH 3 TM	MEGA \$ MONEY TM	Scratch-Off Tickets	Combined Sales
1997	\$721,070	\$272,289	\$151,094	\$309,376	\$ -	\$ 616,229	\$2,070,058
1998	711,326	245,725	159,649	313,930	35,968	583,439	2,050,037
1999	737,687	241,799	169,415	339,273	14,861	593,691	2,096,726
2000	864,983	216,303	158,620	318,972	121,266	568,352	2,248,496
2001	845,433	191,614	163,157	326,471	108,842	639,209	2,274,726
2002	806,023	262,923	170,708	329,830	98,315	662,566	2,330,365
2003	925,474	259,999	182,716	330,001	95,930	1,073,861	2,867,981
2004	785,415	259,728	192,580	349,227	125,944	1,358,068	3,070,962
2005	689,820	252,467	206,982	345,598	131,248	1,844,619	3,470,734
2006	835,028	306,679	215,529	343,174	128,502	2,100,118	3,929,030

Sales as a whole have been increasing due to the active management of various game structures, aggressive marketing of both product lines and implementation of variable prize payouts strategies.

Expenses

Section 24.121, Florida Statutes, stipulates that after the payment of prizes and transfers to EETF, the remaining funds are to be used for operating and administrative expenses. These expenses include retailer commissions, On-line game expenses, Scratch-Off ticket expenses, Advertising and other expenses required for the day-to-day operations of the Lottery.

The following chart shows the major components of Lottery operating expenses and transfers as a percentage of ticket sales for the June 30, 2006, and 2005 fiscal years:

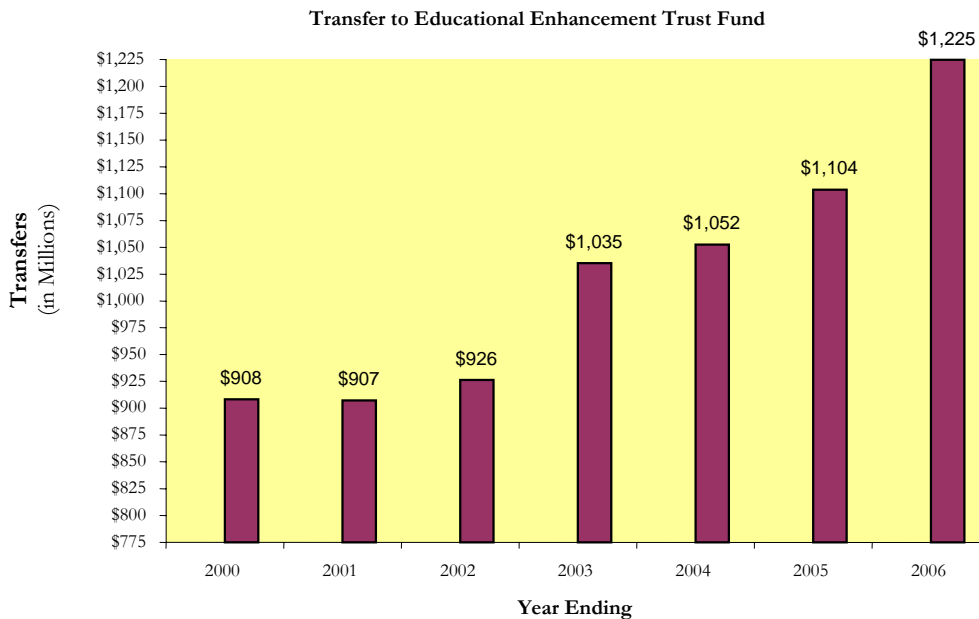


Prizes, commissions and vendor fees all directly relate to sales. As expected, as sales have increased so have these expenses. The other expenses which consist of advertising, salary and benefits, professional fees, rent, maintenance, bad debt, and depreciation have remained relatively stable.

Transfers

The Lottery’s contribution to the EETF for the fiscal year ended June 30, 2006 (\$1,224,651,000) was the highest since the Florida Lottery began making transfers in 1988. Fiscal year 2005-06 is the fourth straight year in which the Lottery’s contribution to EETF has been over \$1 billion. Total transfers to the EETF increased by \$121,018,000 from the prior fiscal year. When adjusted for inflation, the Lottery’s transfer amount for fiscal year 2005-06, was 8% higher than the prior year adjusted-for-inflation transfer amount. However, overall the Lottery’s transfer rates have increased slightly over the rate of inflation over the 19-year period.

The following chart shows the total transfers to the EETF for the past seven fiscal years:



ECONOMIC FACTORS AND FUTURE IMPACTS

The main economic factors affecting lottery sales are population growth, personal income growth, tourism, and competition for discretionary consumer spending. The Lottery must continue to find ways to maintain the annual transfer to EETF of over \$1 billion. The Lottery’s strategies revolve around enhancing On-line product sales and increasing retailer penetration in the state. The following are some of the functional strategies discussed in the 2004 Strategic Plan:

- Increase the focus of research and product development for the On-line product segment:**
 This functional strategy will be accomplished through product extensions, redesign of existing On-line games, On-line promotions, etc.

Chapter 2005-84, Laws of Florida, authorized the Lottery to implement a variable prize payout for On-line games similar to the program approved for Scratch-Off games in 2002. It has been the experience of the Department and lotteries of other states that a program that increases the prize payout percentages of Scratch-Off games leads to higher sales and greater net profits. This strategy has resulted in an increase of 217% in Scratch-Off ticket sales since fiscal year 2002, and an increase of \$197 million in the annual transfer to the EETF from sales of Scratch-Off tickets during the same period. The Department does not expect the same rate of return for the On-line games but does expect to see a positive return from applying the variable prize payout strategy. During fiscal year 2005-06, the Department utilized one promotion and one product add-on feature to begin implementing the higher prize payout strategy for its On-line games. The holiday promotion resulted in a \$17.7 million sales increase and a net EETF contribution of \$4.7 million. EZmatch, the

add on feature for Fantasy 5, increased FY 05-06 sales by 44.1 million which resulted in \$13 million in additional EETF transfers.

- **Improve market penetration through expansion of Lottery retailer network.** As a result of a new Lottery vendor contract, which went into effect on January 31, 2005, approximately 2,000 retailers that were only selling Scratch-Off tickets now sell all On-line products as well. Given that fact, and other enhancements provided by the new system, ticket sales are expected to increase. The Department has set internal goals for continuing to grow the number of retailers over the next five years by 25 percent.

The positive impacts of the above factors will be partially offset by the negative impacts of hurricane related activities. Four major hurricanes hit Florida during 2004 and another major hurricane hit Florida in October 2005. Management estimates that the storms resulted in a reduction of approximately \$40 million in Lottery sales in 2004-2005, with a corresponding drop in the EETF of about \$12 million. The 2005 hurricane decreased sales by approximately \$22 million and decreased EETF transfers by \$7.5 million.

FINANCIAL CONTACT

The Florida Lottery's Financial Statements and this Management's Discussion and Analysis are designed to give a general overview to all interested parties. If you have any questions regarding this report or require additional information, please contact the State of Florida, Department of the Lottery, Chief Financial Officer, 250 Marriott Drive, Capitol Complex, Tallahassee, Florida 32399.

**STATE OF FLORIDA
DEPARTMENT OF THE LOTTERY**

Statement of Net Assets

As of June 30, 2006, and June 30, 2005
(In Thousands)

Assets	<u>June 30, 2006</u>	<u>June 30, 2005</u>
Current Assets:		
Cash and cash equivalents	\$146,578	\$211,245
Interest receivable	2,800	1,489
Accounts receivable, net	24,650	46,179
Inventories	1,437	1,006
Security deposits	2,552	2,241
Total Current Assets	<u>178,017</u>	<u>262,160</u>
Restricted Assets:		
Investments with State Treasurer	11,187	0
Securities lending income receivable	1,856	4,564
Investments, grand prize	1,438,466	1,669,744
Investments, other	1,428,248	1,709,221
Total restricted assets	<u>2,879,757</u>	<u>3,383,529</u>
Capital assets, net	1,244	1,481
Total Assets	<u>3,059,018</u>	<u>3,647,170</u>
 Liabilities		
Current Liabilities:		
Accounts payable and accrued liabilities	10,690	11,766
Prizes payable	67,903	80,057
Due to Educational Enhancement Trust Fund	93,923	163,227
Deposits payable	2,552	2,241
Compensated absences payable	887	799
Total Current Liabilities	<u>175,955</u>	<u>258,090</u>
Current Liabilities Payable from Restricted Assets:		
Pending purchases payable	1,181	42,188
Securities lending fees payable	1,528	4,216
Obligations under securities lending	1,425,162	1,667,092
Grand prizes payable	237,259	235,831
Total Current Liabilities Payable from Restricted Assets	<u>1,665,130</u>	<u>1,949,327</u>
Noncurrent Liabilities:		
Grand prizes payable	1,115,234	1,231,333
Compensated absences payable	2,983	2,903
Total Noncurrent Liabilities	<u>1,118,217</u>	<u>1,234,236</u>
Total Liabilities	<u>2,959,302</u>	<u>3,441,653</u>
 Net Assets		
Invested in capital assets	1,244	1,481
Restricted net assets for undistributed appreciation on restricted investments	88,462	204,036
Restricted net assets for future prizes or special prize promotions	10,010	0
Total Net Assets	<u>\$99,716</u>	<u>\$205,517</u>

See accompanying notes to financial statements.

**STATE OF FLORIDA
DEPARTMENT OF THE LOTTERY**

Statement of Revenues, Expenses and Changes in Net Assets

Years ended June 30, 2006, and June 30, 2005
(In Thousands)

	<u>June 30, 2006</u>	<u>June 30, 2005</u>
Operating Revenues:		
Ticket sales	\$3,929,030	\$3,470,734
On-line fees and miscellaneous	7,047	5,519
Retailer fees	244	256
Total Operating Revenues	<u>3,936,321</u>	<u>3,476,509</u>
Operating Expenses:		
Prizes	2,340,859	2,044,246
Retailer commissions	224,570	197,781
Scratch-Off tickets	48,792	43,282
On-line games	26,255	28,290
Advertising	34,194	34,027
Personal services	25,207	24,177
Other contractual services	8,360	7,880
Materials and supplies	3,409	3,660
Bad debts	219	293
Depreciation	605	1,005
Total Operating Expenses	<u>2,712,470</u>	<u>2,384,641</u>
Operating Income	<u>1,223,851</u>	<u>1,091,868</u>
Nonoperating Revenues (Expenses):		
Interest	6,898	6,543
Securities lending income	68,122	42,003
Securities lending fees	(64,335)	(37,582)
Investment management fees	(88)	0
Net appreciation (depreciation) in fair value of investments	(17,545)	110,029
Property disposition (loss)	(23)	(45)
Amortization of grand prizes payable	(98,030)	(107,352)
Total Nonoperating Revenues (Expenses), Net	<u>(105,001)</u>	<u>13,596</u>
Income Before Operating Transfers	1,118,850	1,105,464
Transfers to Educational Enhancement Trust Fund		
Transfers from revenue	(1,182,763)	(1,103,633)
Transfers from unclaimed prizes	(41,888)	0
Total Transfers to Educational Enhancement Trust Fund	<u>(1,224,651)</u>	<u>(1,103,633)</u>
Change in Net Assets	(105,801)	1,831
Net Assets, Beginning of Year	205,517	203,686
Net Assets, End of Year	<u>\$99,716</u>	<u>\$205,517</u>

See accompanying notes to financial statements.

**STATE OF FLORIDA
DEPARTMENT OF THE LOTTERY**

Statement of Cash Flows

Years ended June 30, 2006, and June 30, 2005
(In Thousands)

	<u>June 30, 2006</u>	<u>June 30, 2005</u>
Operating Activities:		
Ticket sales	\$3,950,339	\$3,466,215
Prizes paid to winners	(2,351,585)	(2,024,299)
Commissions paid and payments to retailers	(224,570)	(197,781)
Paid to vendors for goods and services	(122,517)	(114,489)
Paid to employees	(25,039)	(23,693)
Other operating revenue	<u>7,291</u>	<u>5,775</u>
Net Cash Provided by Operating Activities	<u>1,233,919</u>	<u>1,111,728</u>
Noncapital Financing Activities:		
Payments to Educational Enhancement Trust Fund	<u>(1,293,955)</u>	<u>(1,062,883)</u>
Net Cash Used in Noncapital Financing Activities	<u>(1,293,955)</u>	<u>(1,062,883)</u>
Capital and Related Financing Activities:		
Purchase of capital assets	<u>(391)</u>	<u>(218)</u>
Net Cash Used in Capital and Related Financing Activities	<u>(391)</u>	<u>(218)</u>
Investing Activities:		
Cash received from maturity of grand prize investments	244,516	244,124
Cash paid to grand prize winners upon maturity of grand prize investments	(244,516)	(244,124)
Investment income, net of fees	<u>6,946</u>	<u>10,817</u>
Net Cash Provided by Investing Activities	<u>6,946</u>	<u>10,817</u>
Net Increase in Cash and Cash Equivalents	<u>(53,481)</u>	<u>59,444</u>
Cash and Cash Equivalents, Beginning of Year	<u>211,245</u>	<u>151,801</u>
Cash and Cash Equivalents, End of Year	<u>\$157,764</u>	<u>\$211,245</u>
Reconciliation of Income from Operations to Net Cash Provided by Operating Activities:		
Income from operations	\$1,223,851	\$1,091,868
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation	605	1,005
Changes in assets and liabilities		
(Increase) decrease in:		
Accounts receivable	21,528	(4,227)
Inventories	(431)	(13)
Increase (decrease) in:		
Accounts payable and accrued liabilities	(1,075)	2,738
Prizes payable	(10,726)	19,948
Compensated absences payable	<u>167</u>	<u>409</u>
Net Cash Provided by Operating Activities	<u>\$1,233,919</u>	<u>\$1,111,728</u>
Noncash Investing, Capital and Financing Activities:		
Increase/(decrease) in fair value of investments	(\$157,508)	(\$22,008)

See accompanying notes to financial statements.

**STATE OF FLORIDA
DEPARTMENT OF THE LOTTERY**

Notes to Financial Statements

Years ended June 30, 2006, and June 30, 2005

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. Reporting Entity

The State of Florida, Department of the Lottery (the Lottery) was established as a State agency with the enactment of the Florida Public Education Lottery Act (the Act) in 1987. The purpose of the Act is “to implement Section 15, Article X of the State Constitution in a manner that enables the people of the State to benefit from significant additional moneys for education and also enables the people of the State to play the best lottery games available.”

In evaluating the Lottery as a reporting entity, management has addressed all potential component units for which the Lottery may be financially accountable and, as such, be includable in the Lottery’s financial statements. The Lottery is financially accountable if it appoints a voting majority of the organization’s governing board and (1) it is able to impose its will on the organization or (2) there is a potential for the organization to provide specific financial benefit to or impose specific financial burden on the Lottery. Additionally, the primary government is required to consider other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity’s financial statements to be misleading or incomplete. Management’s analysis has disclosed no component units that should be included in the Lottery’s financial statements.

b. Basis of Presentation

The Lottery is accounted for as a proprietary type enterprise fund. Enterprise funds are used to account for activities that are financed and operated in a manner similar to private business enterprises: (1) where the costs of providing goods and services to the general public on a continuing basis are to be financed through user charges; or (2) where the periodic determination of net income is considered appropriate. The Lottery is reported as an enterprise fund within the State of Florida’s Comprehensive Annual Financial Report.

c. Basis of Accounting

Basis of accounting refers to the timing of recognition of revenue and expenses in the accounts and reporting in the financial statements. The financial statements are prepared on the accrual basis of accounting in accordance with generally accepted accounting principles. Under this method, revenues are recognized when they are earned and expenses are recognized when they are incurred.

The measurement focus of proprietary fund types is on a flow of economic resource method, which emphasizes the determination of net income, financial position, and cash flows. All fund assets and liabilities, current and noncurrent, are accounted for on the Statement of Net Assets. Under Governmental Accounting Standards Board (GASB) Statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting, proprietary funds have the option to elect to apply all pronouncements of the Financial Accounting Standards Board (FASB) issued after November 30, 1989. The Lottery has elected not to apply Financial Accounting Standards Board (FASB) pronouncements issued after

November 30, 1989. As also provided by GASB, the Lottery has elected not to adopt any FASB statements issued after November 30, 1989, unless so directed by GASB.

The Lottery’s operating revenues and expenses generally result from the sale and marketing of Lottery tickets and the payment of related prizes. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

d. Cash and Cash Equivalents

The Lottery considers all highly liquid investments with an original maturity of three months or less when purchased, to be cash equivalents. This includes cash in banks, repurchase agreements with financial institutions, petty cash, balances held by the State Board of Administration (SBA), and pooled investments in the State Treasury.

e. Investments

Florida Statutes authorize the Lottery to invest in certain instruments. The Lottery reports investments at fair value. Details of investments are included in Note 2.

f. Allowance for Doubtful Accounts

The allowance for doubtful accounts is based on an analysis of collectibility of accounts receivable which considers the age of the accounts.

g. Inventories

Supply inventory and promotional items are valued at cost, using the first-in, first-out method. Supply inventory is comprised of office materials, game merchandise, supplies, and prepaid postage.

h. Capital Assets

Capital assets are stated at cost less accumulated depreciation. As required by Chapter 273, Florida Statutes, a capitalization threshold of \$1,000 and useful life extending beyond one year is employed. Depreciation on capital assets is computed using the straight-line method over the following estimated useful lives:

Data processing equipment	3 to 5 years
Office furniture and fixtures	3 to 15 years
Vehicles and other equipment	3 to 20 years

When capital assets are retired or otherwise disposed of, the costs and related accumulated depreciation are removed from the accounts and any resulting gain or loss is reflected in the Statement of Revenues, Expenses and Changes in Net Assets, in the period of disposal.

i. Net Assets

Net Assets includes categories for net investments in capital assets, restricted net assets for undistributed appreciation on restricted investments, and restricted net assets for future prizes or special prize promotions.

The net investments in capital assets category represents the investment in capital assets, recorded at cost less accumulated depreciation.

The restricted net assets for undistributed appreciation on restricted investments category represents the undistributed appreciation for all restricted asset accounts.

The restricted net assets for future prizes or special prize promotions category represent the portion of unclaimed prize obligations legally reverted back to the Lottery for the payment of future prize pools or special prize promotions in accordance with Section 24.115(2), Florida Statutes.

j. Revenue Recognition

Lottery games are sold to the public by contracted retailers. Revenue is recognized when On-line tickets are sold to players and when books of Scratch-Off tickets are settled. Certain games include tickets which entitle the holder to exchange one ticket for another (free tickets). Such tickets are deemed to be replacements and, therefore, are not included in ticket sales.

k. Commissions

Retailers receive a commission of five percent on ticket sales. The commission on ticket sales for Scratch-Off games is based upon total tickets distributed to the players (including free tickets) which, when compared to revenue, causes the percentage to be slightly higher than five percent. Additionally, retailers are paid commissions through a one percent cashing bonus on redemption of tickets (including free tickets).

l. Prizes

In accordance with the Act variable percentages of the gross revenue from the sale of On-line and Scratch-Off Lottery tickets shall be returned to the public in the form of prizes paid by the Lottery or retailers as authorized. Prior to July 1, 2006, the Act authorized, as nearly as practicable, at least 50% of ticket sales must be returned to the public in the form of prizes.

Prize expense for On-line games is recorded based on prizes won by the players, as revenue is recognized. Any prize that remains unclaimed at the end of a 180 day period following a draw is considered unclaimed. Prior to June 30, 2004, unclaimed prizes for On-line games included a prior estimate made at the time of the draw adjusted to actual unclaimed prizes, plus a future estimate of On-line prizes that will not be claimed within 180 days after the drawing. As of July 1, 2004, the Lottery discontinued the practice of estimating the future unclaimed On-line prizes.

Prize expense for Scratch-Off games is recorded based on the predetermined prize structure for each game, as revenue is recognized. Any prize that remains unclaimed 60 days after a Scratch-Off games is closed is considered unclaimed.

As of July 1, 2005, eighty percent of all unclaimed prize money is deposited in the Educational Enhancement Trust Fund (EETF). The remaining twenty percent of unclaimed prize money is added to the pool from which future prizes are to be awarded or used for special prize promotions and is reported as Restricted net assets for future prizes or special prize promotions.

All prizes are recorded at the actual amount except for the annuity-funded prizes, which are paid out on a deferred basis. The actual prize expense for these types of prizes is based on the present value of an annuity using the interest yield on the investments, which were acquired to fund the annuity.

m. Compensated Absences

Employees earn the right to be compensated during absences for vacation, illness, and unused special compensatory leave earned for hours worked on legal holidays. Compensated absences for

annual leave are recorded as a liability when the benefits are earned. Compensated absences for sick leave are calculated based on the vesting method. Within the limits established by law or rule, unused leave benefits are paid to employees upon separation from State service. The cost of vacation and calculated sick leave benefits is accrued in the period in which earned. The compensated absences amounts are based on current year-end salary rates and include employer social security and pension contributions at current rates.

n. Self-Insurance

The Lottery participates in the various self-insurance programs established by the State of Florida for property and casualty losses and employee health insurance. Coverages include property, general liability, automobile liability, workers' compensation, court-awarded attorney fees, and federal civil rights actions. Property is self-insured for actual cash value to an aggregate of \$2 million per loss event. Property losses in excess of \$2 million are commercially insured up to \$100 million per loss event. Workers' compensation is provided to comply with the applicable law. The employee health insurance program provides for payment of medical claims of employees and covered dependents.

o. Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, and expenses and disclosures of contingent assets and liabilities. Actual results could differ from those estimates.

2. CASH AND INVESTMENTS

a. Cash and Cash Equivalents

Cash is held in demand deposits at various financial institutions. These deposits, with a book value of approximately \$386,000 at June 30, 2006, and \$300,000 at June 30, 2005, were insured by either the State's collateral for public deposits in accordance with Section 280.04, Florida Statutes, or Federal depository insurance.

Chapter 280, Florida Statutes, generally requires public funds to be deposited in a bank or savings association that is designated by the Chief Financial Officer as authorized to receive deposits in the State and that meets the collateral requirements. Collateral in the amount of the greater of the average daily balance of public deposits multiplied by the depository's minimum collateral pledging level, established by the Chief Financial Officer, or 25 percent of the average monthly balance of public deposits or 125 percent of the average daily balance of public deposits greater than capital, is required to be deposited with the Chief Financial Officer as security for public deposits. Collateral may be held by another custodian with approval of the Chief Financial Officer if conditions are met which protect the State's interest. The amount of collateral may be increased to 125 percent of the average daily balance of public deposits if specified conditions exist. Eligible collateral includes federal, federally-guaranteed, state and local government obligations, and corporate bonds.

Statutes provide that if a loss to public depositories is not covered by deposit insurance and the proceeds from the sale of securities pledged by the defaulting depository, the difference will be provided by an assessment levied against other qualified public depositories of the same type as the depository in default.

Due to the investing policy of the Lottery, book overdrafts were approximately \$2,184,000 at June 30, 2006, and \$1,763,000 at June 30, 2005, representing outstanding prize payment checks and retailer payment checks. These outstanding checks are included as a component of prizes payable

and accounts payable. The Lottery has an agreement with a financial institution to honor prize payments and retailer payments, as they are presented to the bank, up to \$75 million.

Surplus cash is maintained in the State Treasury's general pool of investments. The Chief Financial Officer pools funds from all departments. Included in the pool are primarily time deposits, U.S. Government securities, federal agency securities, bankers' acceptances, commercial paper, corporate bonds and notes, repurchase agreements and reverse repurchase agreements. The Lottery's share of this investment pool was approximately \$157,140,000 and \$210,046,000 at June 30, 2006, and 2005, respectively. No allocation will be made as to the Lottery's share of the types of investments or their risk categories. The Lottery's share of the assets and liabilities arising from the security lending agreements will likewise not be carried on the statement of net assets since the State Treasury operates on a pooled basis and to do so may give the misleading impression that the Lottery itself has entered into such agreements. For further information refer to the State of Florida's Comprehensive Annual Financial Report or publications of the Office of the Chief Financial Officer.

b. Investments, Grand Prize

The grand prize investments primarily consist of U.S. Government obligations held on the Lottery's behalf by the State Board of Administration (SBA). Grand prize investments and related grand prizes payable are not presented in current assets or liabilities. They are not part of current operations but instead are restricted assets and liabilities that are held by the Lottery for grand prize winnings to be paid on a deferred basis if the cash payment option is not selected.

Grand prize investments are shown at fair value, and the related grand prizes payable are adjusted to the net present value using the yield on the investments. The difference between the fair value of the investments and the net present value of the grand prizes payable is reflected as a restriction for undistributed appreciation on investments in net assets. This represents the unrealized gains on the investments. Because these investments are held restrictively for grand prize winners, this balance is not available for transfer to the EETF.

Interest accreted on grand prize investments during the year is reflected as an increase in the carrying value of grand prizes payable on the statement of net assets, and as a nonoperating expense on the statements of revenues, expenses and changes in net assets. Net appreciation in fair value of investments is reflected as a nonoperating revenue on the statement of revenues, expenses and changes in net assets, and takes into account all changes in fair value that occurred during the year, including purchases, maturities, sales, and interest on maturities.

c. Investments, Other

These investments consist of the fair value of investments made with cash collateral held by the SBA on the Lottery's behalf as part of a securities lending program.

The SBA, authorized by Section 215.47, Florida Statutes, participates in a securities lending program involving grand prize investments. The Lottery, through the SBA, loans various securities to a borrower for collateral with a simultaneous agreement to return collateral for the same securities in the future. Collateral received from borrowers may be cash or U.S. Government securities. The SBA is contractually limited from pledging or selling collateral except in the event of borrower default. Contracts with lending agents require them to indemnify the SBA if the borrowers fail to return the underlying securities or fail to pay income distributions on them. No significant violations of legal or contractual provisions occurred, and no losses resulted from borrower or lending agent defaults.

Dresdner Bank is the agent in lending U.S. Treasury securities to various authorized brokers for cash or U.S. Government securities. Collateral in the form of cash at 100 percent, or other

securities at 102 percent, of the fair value of the securities loaned is required by the lending agreement. Borrowers must be approved for lending by Dresdner Bank’s credit department. Dresdner Bank monitors the fair value of collateral provided and the securities on loan on a daily basis. Additional collateral is required if the fair value of the collateral for any loan is less than 100 percent of the fair value of the securities provided for such loan. The SBA had no credit risk exposure to borrowers at year-end.

The SBA received \$1,425,162,000 of cash collateral for the lending program as of June 30, 2006, and \$1,667,092,000 as of June 30, 2005. At June 30, 2006, the collateral that was held for the securities lending transactions exceeded the fair value of the securities underlying the agreements (including accrued interest). The cash was invested in Dresdner Bank’s short-term collateral investment pool.

Securities lending activity for the year ended June 30, 2006, and 2005, consisted of (in thousands):

	2006	2005
Securities lending income	\$ 68,122	\$ 42,003
Less broker rebates	(63,390)	(36,478)
Less bank fees	(945)	(1,104)
Net securities lending revenue	\$ 3,787	\$ 4,421

d. Investment Credit Risk

Lottery grand prize winner investments have been limited to U.S. Government guaranteed securities in order to comply with Section 24.120(2), Florida Statutes. The security lending short-term collateral investment pool is not rated. The Treasury Investment Pool’s current rating by Standard and Poors is AA-f.

e. Investment Interest Rate Risk

The investment policy objective is to match maturities of investments with the maturities of the lottery winner annuities. Therefore, investments are held to maturity after they are purchased thereby eliminating interest rate risk. Listed below are the Lottery’s investments in U.S. Treasury Strips at June 30, 2006:

Time to Maturity	Fair Value
< 1 year	\$ 240,537,000
> 1 year to 3 years	420,009,000
> 3 years to 5 years	307,626,000
> 5 years to 10 years	370,183,000
> 10 years to 15 years	51,147,000
> 15 years to 20 years	31,640,000
> 20 years	17,324,000
Total	\$ 1,438,466,000

The Lottery participates in a securities lending program at the State Board of Administration.

- 1) The contract between Dresdner Bank and the SBA requires that the maximum weighted average portfolio maturity not exceed 60 days. The pool invests a significant amount of its assets in floating rate securities and limits the maximum reset period for interest rate changes to 6 months. Next reset dates are used in the calculation of weighted average maturity. The weighted average maturity of the short-term investment pool at June 30, 2006 was 27 days.

- 2) The effective duration of the Treasury Investment Pool is 2.72 years at June 30, 2006.

f. Investment Concentration of Credit Risk

Since all long-term investments are in U.S. Government guaranteed securities, the Lottery has not adopted a policy regarding concentration of credit risk.

g. Investment Custodial Credit Risk

Custodial credit risk is defined as the risk that an entity may not recover securities held by another party. At June 30, 2006, all investments held were either insured or registered and held by the Lottery or its agents in the Lottery's name; therefore, the Lottery does not have a formal policy regarding custodial credit risk.

h. Foreign Currency Risk

The Lottery has no exposure to foreign currency risk as of June 30, 2006.

i. Investment Summary

The following schedule summarizes all investments and investments loaned under security lending agreements (in thousands):

	<u>Carrying Value</u>
U.S. Government Obligations	\$ 40,596
Investments Held by Others Under Security Lending Agreements - U.S. Obligations	1,397,870
Pooled Investments with State Treasury	157,140
Money Market and Mutual Funds	<u>1,428,248</u>
Total Investments	<u>\$ 3,023,854</u>

The following schedule reconciles cash and investments to the statement of net assets (in thousands):

	<u>Investments</u>	<u>Cash at Financial Institutions</u>	<u>Cash at State Treasury</u>	<u>Total</u>
Cash and cash equivalents	\$ 145,953	\$ 386	\$ 239	\$ 146,578
Restricted cash and cash equivalents	11,187			11,187
Investments, grand prize	1,438,466			1,438,466
Investments, other	1,428,248			1,428,248
Total	<u>\$ 3,023,854</u>	<u>\$ 386</u>	<u>\$ 239</u>	<u>\$ 3,024,479</u>

3. ACCOUNTS RECEIVABLE

The Ticket sales receivable balance for fiscal year 2004-05 included an estimated amount totaling \$28,245,301 for unrecorded Scratch-Off ticket sales prior to fiscal year-end. The practice of including an estimated receivable amount for unrecorded Scratch-Off ticket sales was discontinued beginning with fiscal year 2005-06.

Accounts receivable as of June 30 consisted of (in thousands):

	2006	2005
Ticket sales receivable	<u>\$ 26,361</u>	<u>\$ 47,295</u>
Other receivables	<u>18</u>	<u>394</u>
Total receivables	<u>26,379</u>	<u>47,689</u>
Less allowance for doubtful accounts	<u>(1,729)</u>	<u>(1,510)</u>
Accounts receivable, net	<u><u>\$ 24,650</u></u>	<u><u>\$ 46,179</u></u>

4. SECURITY DEPOSITS AND DEPOSITS PAYABLE

The Lottery receives certificates of deposit and cashier checks from certain vendors and retailers in order to secure contract performance. These instruments are held in trust by the State with any interest earnings being credited to the vendor or retailer. These deposits are established to reduce the potential financial risk to the Lottery in the event of a breach of contract. These certificates and checks appear on the Statement of Net Assets, in assets as security deposits, and in liabilities, as deposits payable.

5. CAPITAL ASSETS

Capital assets at June 30 consisted of (in thousands):

	Balance June 30, 2004	2004-05		Balance June 30, 2005	2005-06		Balance June 30, 2006
		Increase	Decrease		Increase	Decrease	
Data processing equipment	\$8,690	\$80	\$(243)	\$8,527	\$102	\$(97)	\$8,532
Office equipment and fixtures	6,617	14	(35)	6,596	42	(75)	6,563
Vehicles and other equipment	<u>3,322</u>	<u>134</u>	<u>(299)</u>	<u>3,157</u>	<u>247</u>	<u>(107)</u>	<u>3,297</u>
	18,629	228	(577)	18,280	391	(279)	18,392
Less: accumulated depreciation	<u>16,313</u>	<u>1,005</u>	<u>(519)</u>	<u>16,799</u>	<u>605</u>	<u>(256)</u>	<u>17,148</u>
Total capital assets, net	<u><u>\$2,316</u></u>	<u><u>\$(777)</u></u>	<u><u>\$(58)</u></u>	<u><u>\$1,481</u></u>	<u><u>\$(214)</u></u>	<u><u>\$(23)</u></u>	<u><u>\$1,244</u></u>

6. LONG-TERM LIABILITIES

a. Grand Prizes Payable

Grand prizes payable at June 30 consisted of (in thousands):

	2006	2005
Lotto grand prizes (face value)	\$ 1,813,250	\$ 2,011,120
Mega Money grand prizes (face value)	3,963	247
Win for Life grand prizes (face value)	14,114	14,478
Big 10 grand prizes (face value)	100	190
Flamingo Fortune Game Show grand prizes (face value)	1,200	1,300
Monthly Grand game prizes (face value)	84	-
Win a Million grand prizes (face value)	600	650
Yearly Dividend grand prizes (face value)	-	24
Yearly Bonus grand prizes (face value)	350	400
Lucky for Life grand prizes (face value)	6,400	-
Set for Life grand prize (face value)	3,180	2,160
Cash Spectacular grand prize (face value)	850	900
Less imputed interest	(491,598)	(564,305)
Net present value of grand prizes payable	<u>\$ 1,352,493</u>	<u>\$ 1,467,164</u>
Current Prizes Payable from restricted assets	\$ 237,259	\$ 235,831
Noncurrent Prizes Payable	1,115,234	1,231,333
Total Grand Prizes Payable	<u>\$ 1,352,493</u>	<u>\$ 1,467,164</u>

The following depicts by fiscal year the value (in thousands) of the grand prize annuities to pay prize winners:

Year Ended June 30	Amount
2007	\$ 246,500
2008	245,063
2009	218,471
2010	198,728
2011	175,468
2012-2016	526,823
2017-2021	95,051
2022-2026	72,583
2027-2031	65,404
Grand prizes (face value)	1,844,091
Less imputed interest	(491,598)
Net present value of grand prizes payable	<u>\$ 1,352,493</u>

b. Compensated Absences Payable

Compensated absences payable at June 30 consisted of (in thousands):

	2006	2005
Current Compensated Absences	\$ 887	\$ 799
Noncurrent Compensated Absences	2,983	2,903
Total	<u>\$ 3,870</u>	<u>\$ 3,702</u>

c. Changes in Long-Term Liabilities

Changes in long-term liabilities are summarized as follows (in thousands):

	Balance July 1, 2005	Additions	Reductions	Balance June 30, 2006	Amount due within one year
Grand prizes payable	\$1,467,164	\$129,845	(\$244,516)	\$1,352,493	\$237,259
Compensated absences payable	3,702	466	(298)	3,870	887
Total long-term liabilities	<u>\$1,470,866</u>	<u>\$130,311</u>	<u>(\$244,814)</u>	<u>\$1,356,363</u>	<u>\$238,146</u>

7. DUE TO EDUCATIONAL ENHANCEMENT TRUST FUND

In accordance with the Act, effective July 1, 2005, variable percentages of the gross revenue from the sale of On-line and Scratch-Off lottery tickets as determined by the Lottery, and other earned revenue, excluding application processing fees, shall be deposited in the Educational Enhancement Trust Fund (EETF) as provided in Section 24.121, Florida Statutes, as amended. Previously, the Act required at least 39 percent of On-line and miscellaneous revenue, net of retailer fees, be transferred to the EETF for the benefit of public education. Effective July 1, 2002, the Department was authorized, pursuant to Section 24.121(1), Florida Statutes, to increase the percentage of Scratch-Off game revenues returned as prizes and transfer a variable percentage to the EETF. The Lottery implemented this strategy in September 2002. The amount transferred for the fiscal year ended June 30, 2006, was \$1,244,651,000, (31.2% percent of revenues) and for the fiscal year ended June 30, 2005, the transferred amount was \$1,103,633,000 (31.7 percent of revenues).

Because the net appreciation in fair value of investments and amortization of grand prizes payable, included in non-operating revenue and expenses, relate to valuations of the restricted grand prize investments and grand prizes payable, they are excluded from the determination of transfers to the EETF.

The amount due to EETF at June 30, 2005, was as follows (in thousands):

	June 30, 2005
Operating revenues less Scratch-Off ticket sales	\$ 1,631,890
Nonoperating revenue, net	13,596
Less: Retailer fees	(256)
Net appreciation in fair value of investments	(110,029)
Amortization of grand prizes payable	107,352
Net revenue less Scratch-Off ticket sales	<u>1,642,553</u>
Total revenue subject to transfer at 39%	1,642,553
	39%
Statutorily required transfer	<u>640,614</u>
Scratch-Off ticket sales	1,844,619
Transfer percentage for Scratch-Off ticket sales	21.031%
Direct transfer from Scratch-Off ticket sales	<u>387,944</u>
Additional transfer appropriated	60,000
Supplemental balance transferred	<u>15,075</u>
Due for the year	<u>\$ 1,103,633</u>
Balance due beginning of the year	122,477
Paid during the year	<u>(1,062,883)</u>
Due to Educational Enhancement Trust Fund, June 30, 2005	<u>\$ 163,227</u>

Effective July 1, 2005, the Act revised the provisions relating to the allocation of revenues for public education. The changes in the provisions were designed to maximize the transfers of moneys to the EETF. These revisions resulted in changes in the methodology used to calculate the transfer based on a business model of revenue minus expenses rather than a percent of revenue.

The amount due to EETF at June 30, 2006, was as follows (in thousands):

	June 30, 2006
On-line ticket sales	\$ 1,828,912
Average percent transferred	39%
Transfer of On-line ticket sales	<u>716,541</u>
Unclaimed On-line ticket prizes	41,963
Percent transferred	80%
Transfer of unclaimed On-line ticket prizes	<u>33,570</u>
Scratch-Off ticket sales	2,100,118
Average percent transferred	21%
Transfer of Scratch-Off ticket sales	<u>448,601</u>
Unclaimed Scratch-Off ticket prizes	10,397
Percent transferred	80%
Transfer of Scratch-Off ticket prizes	<u>8,318</u>
Nonoperating expenses, net	(105,001)
Add:	
Net depreciation in fair value of investments	17,545
Amortization of grand prizes payable	<u>98,030</u>
Total Nonoperating revenue, net	<u>10,574</u>
On-line fees and miscellaneous revenue	<u>7,047</u>
Due for the year	<u>\$ 1,224,651</u>
Balance due, beginning of year	163,227
Paid during the year	<u>(1,293,955)</u>
Due to Educational Enhancement Trust Fund, June 30, 2006	<u>\$ 93,923</u>

8. EMPLOYEE BENEFITS

a. Defined Benefit Plan

Plan Description – The Lottery participates in the Florida Retirement System (FRS), a cost-sharing multiple-employer public employee defined benefit retirement system administered by the State of Florida, Department of Management Services, Division of Retirement, to provide retirement and survivor benefits to participating public employees. Chapter 121, Florida Statutes, establishes the authority for participant eligibility, contribution requirements, vesting eligibility and benefit provisions. The FRS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by contacting the State of Florida, Department of Management Services, Division of Retirement.

Funding Policy - The Lottery is required to pay all contributions for participating full-time and part-time employees. The contribution rates were as follows:

	Fiscal Year Ended <u>June 30, 2006</u>	Fiscal Year Ended <u>June 30, 2005</u>
Senior Management	10.45 percent	9.37 percent
Regular Employees	7.83 percent	7.39 percent
Special Risk	18.53 percent	18.53 percent

The Lottery’s contributions to the FRS amounted to approximately \$1,283,000 and \$1,166,000 for the years ended June 30, 2006, and 2005, respectively. These contributions represented 7.4 percent and 7.14 percent of covered payroll, for the years ended June 30, 2006, and 2005, respectively. The Lottery contributed 100 percent of the required contributions for the years ended June 30, 2006, and 2005.

b. Senior Management Service Optional Annuity Program (SMSOAP)

Section 121.055, Florida Statutes, created the SMSOAP as an optional retirement program for State members of the Senior Management Service Class. The SMSOAP is a defined contribution plan that provides full and immediate vesting of all contributions paid on behalf of the participants to the participating provider companies to invest as directed to provide retirement and death benefits. Employees in eligible State positions may make an irrevocable election to participate in the SMSOAP in lieu of the Senior Management Service Class. Employers contributed 12.49 percent of covered payroll for July 2005 through June 2006. A participant may contribute by salary reduction an amount not to exceed the percentage contributed by the employer.

c. Defined Contributions Plan

Effective July 1, 2002, the Public Employee Optional Retirement Program (PEORP) was implemented as a defined contribution plan alternative available to all FRS members in lieu of the defined benefit plan. Employer contributions are defined by law, but the ultimate benefit depends in part on the performance of investment funds. The PEORP is funded by employer contributions that are based on salary and membership class (Regular Class, Special Risk Class, etc.). Contributions are directed to individual member accounts, and the individual members allocate contributions and account balances among various approved investment choices. Required employer contributions made to PEORP for the fiscal years ended June 30, 2006, and 2005, totaled \$144,947 and \$89,947, respectively.

d. Other Postemployment Benefits

In 1987, the Florida Legislature established through Section 112.363, Florida Statutes, the Retiree Health Insurance Subsidy (“HIS”) to assist retirees of all State-administered retirement systems in paying health insurance costs. For the fiscal year ended June 30, 2004, eligible retirees or beneficiaries received a monthly retiree health insurance subsidy payment equal to the number of years of creditable service completed at the time of retirement multiplied by \$5. The payments to individual retirees or beneficiaries were at least \$30 but not more than \$150 per month, pursuant to Section 112.363, Florida Statutes. To be eligible to receive the HIS, a retiree under any State-administered retirement system must provide proof of health insurance coverage, which can include Medicare.

HIS is funded by required contributions from FRS participating employers. For the years ended June 30, 2006, and 2005, the Lottery contributed 1.11 percent of payroll for all active employees covered by the FRS. This contribution was added to the amount submitted for retirement contributions and was deposited in a separate trust fund from which HIS payments are authorized. If these contributions fail to provide full subsidy benefits to all participants, the subsidy payments may be reduced or canceled.

In addition to the HIS, Section 110.123, Florida Statutes, provides that retirees may participate in the State's group health insurance programs. Premiums are paid by the retiree.

e. Deferred Compensation Plan

The Lottery, through the State of Florida, offers its employees a deferred compensation plan created in accordance with Section 457 of the Internal Revenue Code. The plan (refer to Section 112.215, Florida Statutes), available to all regular payroll State employees, permits them to defer a portion of their salaries until future years. The deferred compensation is not available to employees until termination, retirement, death or an unforeseen emergency.

All amounts of compensation deferred under the plan, all property and rights purchased with those amounts, and all income attributable to those amounts, property, or rights are (notwithstanding the mandates of 26 U.S.C.s.457(b)(6), all of assets specified in subparagraph 1) held in trust for the exclusive benefit of participants and their beneficiaries as mandated by 26 U.S.C.s.457(g)(1).

The Lottery does not contribute to the plan. Participation under the plan is solely at the discretion of the employee.

The State has no liability for losses under the plan but does have the duty of due care that would be required to an ordinary and prudent investor. Pursuant to Section 112.215, Florida Statutes, the Deferred Compensation Trust Fund is created in the State Treasury.

9. OPERATING LEASES

The Lottery has entered into operating leases for the rental of office and warehouse space for the headquarters and district offices as well as the rental of computer equipment. Certain leases are renewable at the option of the Lottery.

Future minimum rental payments as of June 30, 2006, are scheduled as follows (in thousands):

Year Ending			
June 30	Headquarters	Districts	Total
2007	\$ 2,491	\$ 796	\$ 3,287
2008	2,516	471	2,987
2009	2,615	260	2,875
2010	210	217	427
2011	0	106	106
	<u>\$ 7,832</u>	<u>\$ 1,850</u>	<u>\$ 9,682</u>

Rental expense under all operating leases totaled approximately \$3,274,000 and \$3,214,000 for the years ended June 30, 2006, and 2005, respectively.

10. OTHER COMMITMENTS

The Lottery has entered into contractual agreements to provide On-line and Scratch-Off lottery game tickets and related services. The Lottery entered into a new contract for an On-line gaming

system, which took effect on January 31, 2005. The new contractor is compensated at a rate of 1.1499 percent of sales. Prior to January 31, 2005, the base compensation for the On-line games contract was 1.85 percent of sales, with additional compensation of 1.11 percent of the amount of On-line sales in excess of \$1,580,480,000. However, there was a cap which limited the potential combined compensation rate to 2.08 percent of sales. The contractor's compensation for On-line games for the fiscal years ended June 30, 2006, and 2005, was \$26,255,000, and \$28,290,000, respectively.

For Scratch-Off lottery game tickets and related services, the contractor was compensated at the rate of 2.4375 percent of net Scratch-Off ticket sales, with the rate declining to 2.3 percent effective January 1, 2003, and to 2.25 percent effective October 1, 2006, subject to the payment provisions of the agreement. Compensation under this agreement amounted to \$48,792,000 for the fiscal year ended June 30, 2006, and \$43,282,000 for the fiscal year ended June 30, 2005.

11. LITIGATION

The Lottery is involved in litigation and other claims incidental to the ordinary course of its operations. In the opinion of Lottery management, based on the advice of legal counsel, the ultimate disposition of these lawsuits and claims will not have a material adverse effect on the financial position of the Lottery.



AUDITOR GENERAL STATE OF FLORIDA

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111 West Madison Street
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WILLIAM O. MONROE, CPA
AUDITOR GENERAL



850/488-5534/SC 278-5534
Fax: 488-6975/SC 278-6975

The President of the Senate, the Speaker of the
House of Representatives, and the
Legislative Auditing Committee

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS

We have audited the financial statements of the Florida Department of the Lottery (the Lottery) as of and for the fiscal year ended June 30, 2006, and have issued our report thereon dated December 22, 2006. We conducted our audit of the financial statements 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. Our report on our examination of the Lottery's internal control over financial reporting and on our tests of compliance and other matters follows.

Internal Control Over Financial Reporting

We have examined the effectiveness of the Lottery's internal control over financial reporting as of June 30, 2006, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Lottery's management is responsible for maintaining effective internal control over financial reporting. Our responsibility is to express an opinion on the effectiveness of internal control based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants, and the standards applicable to attestation engagements contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Our examination included obtaining an understanding of the internal control over financial reporting, testing and evaluating the design and operating effectiveness of the internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

Because of inherent limitations in any internal control, misstatements due to errors or fraud may occur and not be detected. Also, projections of any evaluation of the internal control over financial reporting to future periods are

subject to the risk that the internal control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

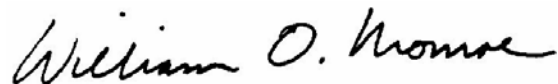
In our opinion, the Lottery maintained, in all material respects, effective internal control over financial reporting as of June 30, 2006, based on the criteria established by *Internal Control – Integrated Framework* issued by COSO. While we noted no matters involving internal control over financial reporting and its operation that we consider to be material weaknesses, we did note other matters involving the internal control over financial reporting, which we have reported to management of the Lottery in a separate letter dated December 22, 2006.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Lottery's basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, rules, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. However, we noted certain other matters involving legal compliance, which we have reported to management of the Lottery in the above-referenced letter dated December 22, 2006.

This report is intended for the information of the Legislative Auditing Committee, members of the Florida Senate and the Florida House of Representatives, and applicable management. Copies of this report are available pursuant to Section 11.45(4), Florida Statutes, and its distribution is not limited.

Respectfully submitted,



William O. Monroe, CPA
December 22, 2006



WILLIAM O. MONROE, CPA
AUDITOR GENERAL

AUDITOR GENERAL STATE OF FLORIDA

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OTHER OBSERVATIONS AND FINDINGS

The President of the Senate, the Speaker of the House of Representatives, and the Legislative Auditing Committee

We have audited the financial statements of the Florida Department of the Lottery (the Lottery) as of and for the fiscal year ended June 30, 2006, and have issued our report thereon dated December 22, 2006. We have also issued our Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters dated December 22, 2006. Disclosures in these reports should be considered in conjunction with this management letter.

We conducted our examination in accordance with auditing standards generally accepted in the United States of America and applicable *Government Auditing Standards*.

The purpose of this management letter is to disclose:

- Matters relating to internal controls that were not considered to be reportable conditions, but which were also not considered clearly inconsequential.
- Illegal acts (violations of statute) inconsequential to the Lottery's financial statements, but requiring resolution by Lottery management.

Information Technology Controls

Information technology (IT) controls are intended to protect the integrity, confidentiality, and availability of information systems data and resources. During our audit, we identified the need for enhancements to the Lottery's IT control practices. To avoid the possibility of compromising Lottery information, specific details of these matters are not disclosed in this report. However, the appropriate Lottery personnel have been notified of these issues.

Recommendation:

The Lottery should make the recommended enhancements to its information technology controls.

Payments Made to Advertising Agencies

Invoices received from Lottery advertising agencies sometimes included requests for reimbursement of subcontracted media vendor services (media air-time charges for Lottery advertisements). Our audit disclosed that for these types of charges, the Lottery generally reimbursed the amounts invoiced based only on the receipt of a signed certification from an advertising agency representative declaring that the invoice accurately reflected advertising services received and documented in subcontractor invoices. The certification also stated that to the best of the agency's knowledge, the advertisements ran according to the subcontractor's invoice.

To provide assurance that the Lottery pays for only goods and services actually received, the Lottery should have in place procedures to either test the agency's verification of media air-time charges or to obtain its own verification that Lottery advertisements were broadcast on the dates and at the times reflected by the charges. The Lottery has represented that limited resources have precluded the implementation of procedures to verify the accuracy of the media air-time charges. However, the Lottery has also indicated that its Inspector General's Office plans to audit the invoicing processes of the agencies, including those relating to media air-time charges.

Recommendation: We recommend that the Lottery proceed with its plans to have the Inspector General's Office perform an audit of the invoicing processes of its advertising agencies. We also recommend that the Lottery adopt a policy establishing periodic evaluations of the effectiveness of advertising agency processes designed to ensure the accuracy of invoiced media air-time charges.

Marketing and Research Support Funds

The Lottery's On-line ticket and Scratch-Off ticket gaming service vendors are each contractually required to periodically make deposits into marketing and research support funds (fund). The contracts require that the vendors maintain the funds; however, the Lottery is responsible for determining the ultimate distribution of the amounts in the funds. Reports from the gaming service contractors provided the following summary information for the funds for the fiscal year ending June 30, 2006:

	Scratch-Off Gaming Services Contractor Fund	On-Line Gaming Services Contractor Fund	Total
Balance, July 1, 2005	\$2,967,439	\$100,000	\$3,067,439
Deposits*	1,777,835	240,000	2,017,835
Payments	(990,461)	(220,780)	(1,211,241)
Balance, June 30, 2006	<u>\$3,754,813</u>	<u>\$119,220</u>	<u>\$3,874,033</u>

* The Scratch-Off gaming services contract requires a monthly variable deposit amount based on a percentage of net instant sales for market research and a \$20,000 per week deposit for marketing support. The On-line gaming services contract requires a \$20,000 per month deposit for marketing support.

Our audit disclosed the following:

- The contracts were silent concerning the legal ownership of the funds. Due to the lack of contract terms addressing ownership of the moneys, the extent of the Lottery’s rights to claim the moneys in the event of contract termination was not clear. Also, the lack of clarity made impracticable a reasonable determination as to how the existence and use of the funds should be reflected in the budgets and financial reports of the Lottery. The existence and use of the funds is not currently addressed in the Lottery’s budget and financial reports.
- The Lottery’s written procedures require that all invoices be approved by two specified members of Lottery’s management prior to authorizing a gaming service contractor to pay an invoice. Our audit tests of ten disbursements disclosed that for eight of the ten related invoices, Lottery records did not contain documentation of either of the two required Lottery manager approvals. In these eight instances, the items purchased consisted of, for example, promotional point of sale dispensers and holiday stickers, with invoice amounts ranging from \$8,244 to \$107,411. Absent the required approvals, Lottery records do not demonstrate the extent to which the goods and services purchased were authorized, received by the Lottery, and approved for payment.

Recommendation: We recommend the Lottery amend the applicable provisions of each contract to include language that specifically addresses the ownership of each fund. Based on these clarifications, the Lottery should also reconsider the appropriateness of the budgetary and financial reporting treatments utilized for the funds. We also recommend that the Lottery more closely monitor compliance with its established purchase authorization and payment procedures.

Follow-up to Management Response: *In response to this finding, the Secretary indicated that because there has never been any contemplation that unexpended funds would remain at the end of either contract term, it was not germane to address ownership of funds. While the Lottery may not have contemplated the existence of unexpended funds, a balance of approximately \$3.8 million has accrued as of June 30, 2006. As noted in our finding, the contract does not currently address ownership of these moneys, and related deposits, payments, and balances are not addressed in the Lottery’s budget and financial reports.*

Minority Retailer Participation

Section 24.113, Florida Statutes, requires that 15 percent of the Lottery’s retailers shall be minority business enterprises, as defined in Section 288.703, Florida Statutes; however, no more than 35 percent of such retailers shall be owned by the same type of minority person, as defined by Section 288.703, Florida Statutes. Our audit

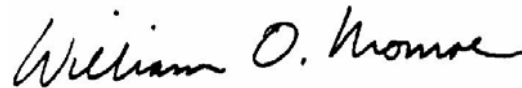
disclosed that as of October 9, 2006, retailers comprising one minority type totaled 64 percent of the total number of minority retailers. A similar finding was included in Auditor General Report Numbers 2006-098 and 2005-089.

Recommendation: We recommend that the Lottery continue to take steps to resolve this finding.

Management Response

As required by law, our preliminary and tentative findings were provided to the Department's Secretary. In a letter dated January 19, 2007, the Secretary provided responses to our findings. The letter is included in its entirety at the end of this report.

Respectfully submitted,



William O. Monroe, CPA
December 22, 2006

APPENDIX A
MANAGEMENT RESPONSE

CHARLIE CRIST
Governor



LEO DIBENIGNO
Secretary

FLORIDA LOTTERY

January 19, 2007

William O. Monroe, CPA
Auditor General
G74 Claude Pepper Building
111 West Madison Street
Tallahassee, Florida 32399-1450

Dear Mr. Monroe:

The Lottery has received your December 22, 2006 report of preliminary and tentative findings and recommendations resulting from your audit of the Lottery's financial activities for the fiscal year ended June 30, 2006. The staff has discussed your recommendations and responds as follows:

- 1 Recommendation: The Lottery should make the recommended enhancements to its information technology controls.

Response: The Lottery has an ongoing process to improve technology controls for information technology. Potential enhancements presented by this audit will be considered and implemented as soon as practical.

2. Recommendation: The Lottery should proceed with its plans to have the Inspector General's Office perform an audit of the invoicing processes of its advertising agencies. In addition, the Lottery should adopt a policy establishing periodic evaluation of the effectiveness of advertising agency processes designed to ensure the accuracy of invoiced media air-time charges.

Response: The Lottery has an ongoing process to improve controls over financial transactions. The Lottery is currently in the process of performing a review of many of the General Accounting Policies and Procedures. These documents will be enhanced to include suggestions presented by this audit and will be considered for implementation as soon as practical.



APPENDIX A
MANAGEMENT RESPONSE (CONTINUED)

William O. Monroe, CPA
Auditor General
Response to Preliminary and Tentative Findings
January 19, 2007
Page 2 of 3

3. Recommendation: The Lottery should amend the applicable provisions of each contract (gaming vendors) to include language that specifically

addresses the ownership of each fund (marketing and research funds). Based on these clarifications, the Lottery should also reconsider the appropriateness of the budgetary and financial reporting treatments utilized for the funds. The Lottery should also more closely monitor compliance with its established purchase authorization and payment procedures for these funds.

Response: The Lottery has never viewed the marketing and research funding in terms of “ownership” of the funds. We believe this is an unnecessary, if not incorrect, analysis.

Under both contracts, the vendors are required to make the specified funding available for use as provided in the contracts, i.e., for marketing and research support as directed by the Lottery. Funding accumulates on a weekly (scratch-off) or monthly (on-line) basis throughout the term of the respective contracts. The scratch-off contract expressly states the intention of the parties that every reasonable effort will be made to spend the funding on a timely basis for the maximum benefit to sales performance, that is, that the money will not be allowed to accumulate indefinitely but will be used during the term of the contract to increase ticket sales. Although not expressly stated in the on-line contract, a similar objective and intent—to use the funds to maximize ticket sales during the contract term—could reasonably be inferred.

Because there has never been any contemplation that unexpended funds would remain at the end of either contract term, it was not germane to address ownership of the funds. Instead, the contracts give the Lottery a legally enforceable right to require both vendors to provide specified funding for marketing support purposes and the right to direct how the money will be spent. Neither vendor has ever failed to perform in this regard but, if such a failure occurred, enforcement would be addressed by the Lottery as a breach of contract issue, not as an “ownership” issue.

The Lottery’s financial reporting unit has an ongoing process to monitor compliance with financial policies and procedures. The Lottery’s CFO is currently in the process of performing a review of many of the General Accounting policies and procedures, including the compliance-monitoring tools. These tools will be enhanced to include suggestions presented by this audit.

4. Recommendation: That the Lottery continue to take steps to resolve the Minority Retailer Participation finding included in the Auditor General Report No. 2004-061, 2005-089 and 2006-098.

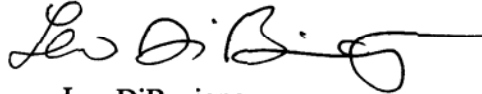
APPENDIX A
MANAGEMENT RESPONSE (CONTINUED)

William O. Monroe, CPA
Auditor General
Response to Preliminary and Tentative Findings
January 19, 2007
Page 3 of 3

Response: As recommended the Lottery has continued to address the Minority Retailer Participation criteria established in s.24.113 using a variety of approaches. In addition to attempts to amend s. 24.113(1) to eliminate the conflict created by including both a floor and a ceiling, the Lottery has implemented strategic initiatives to seek out and recruit under-represented minorities. The strategic initiatives include identifying and partnering with minority oriented business associations, conducting retailer recruitment seminars, advertising for new retailers in community newspapers and magazines and exploring non-traditional trade style for Lottery retailer prospects. As a result of these efforts the Lottery added 78 additional retailers from under-represented minority sectors during the fiscal year. As always, the Lottery must ensure that EETF transfers are the foremost objective when making retailer contract and terminal placement decisions.

I would like to thank your staff for their diligent efforts on behalf of the Lottery and look forward to receiving your final report.

Sincerely,



Leo DiBenigno
Secretary

cc: Dennis Harmon, Deputy Secretary
Ken Hart, General Counsel
Marcy Jackson, Chief Financial Officer
Andy Mompeller, Inspector General
Eli Nortelus, Director of Legislative Affairs