

DEPARTMENT OF THE LOTTERY

Financial Audit

For the Fiscal Year Ended
June 30, 2008



Secretary of the Department of Lottery

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), Chapter 24, Florida Statutes, in 1987. The head of the Department is the Secretary, who, pursuant to Section 20.317, Florida Statutes, is appointed by the Governor subject to the confirmation of the Senate. Mr. Leo DiBenigno served as Secretary during the audit period.

The Auditor General conducts audits of governmental entities to provide the Legislature, Florida's citizens, public entity management, and other stakeholders unbiased, timely, and relevant information for use in promoting government accountability and stewardship and improving government operations.

The audit team leader was Robin Ralston, CPA, and the audit was supervised by Ben H. Cox, CPA. Please address inquiries regarding this report to Kathryn D. Walker, CPA, Audit Manager, by e-mail at kathrynwalker@aud.state.fl.us or by telephone at (850) 487-9085. The information technology portion of this audit was conducted by Sarah B. Hall, CISA, and supervised by Shelly Posey, CISA. Please address inquiries regarding the information technology resources portion of this report to Jonathan E. Ingram, CPA, CISA, Audit Manager, by e-mail at joningram@aud.state.fl.us or by telephone at (850) 487-9330.

This report and other audit reports prepared by the Auditor General can be obtained on our Web site at www.myflorida.com/audgen; by telephone at (850) 487-9024; or by mail at G74 Claude Pepper Building, 111 West Madison Street, Tallahassee, Florida 32399-1450.

DEPARTMENT OF LOTTERY
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EXECUTIVE SUMMARY

Summary of 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, 2008, and 2007, and the changes in the financial position and cash flows thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Summary of Report on Internal Control and Compliance

In our opinion, Lottery management maintained, in all material respects, effective internal control over financial reporting.

The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards; however, we noted certain additional matters as summarized below.

Additional Matters

INFORMATION TECHNOLOGY CONTROLS

Finding No. 1: During our audit, we identified the need for enhancements to the Lottery's IT control practices, many of which were recurring issues disclosed in prior audits of the Department. 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 again been notified of these issues.

MARKETING AND RESEARCH SUPPORT FUNDS

Finding No. 2: The Lottery's On-line ticket and Scratch-Off ticket gaming service vendors are contractually required to periodically make deposits into marketing and research support funds (fund). In our prior reports, we recommended that the Lottery amend applicable provisions of each contract to include language that specifically addressed the ownership of each fund. The Lottery executed a new contract with its Scratch-Off vendor effective October 1, 2008, that includes provisions stipulating that any remaining moneys in the fund will be returned to the Lottery and establishing the Lottery's right to hold back final payment to the vendor if the moneys are not returned. The Lottery had chosen not to pursue contract renegotiations with its On-line vendor, but intends to utilize all available moneys prior to the contract's end.

ELECTRONIC FUNDS TRANSFER OF ANNUAL PRIZE PAYMENTS

Finding No. 3: The Lottery pays the prizewinners of various games through a deferred payment (annuity) option rather than a single lump sum payment. Our review disclosed that controls over related electronic funds transfer payments could be improved.

MINORITY RETAILER PARTICIPATION

Finding No. 4: 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(2), 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(3), Florida Statutes. Our audit disclosed that as of November 3, 2008, retailers comprising one minority type totaled 63 percent of the total number of minority retailers. A similar finding was included in prior reports.

Audit Objectives and Scope

Our audit objectives were to determine whether the Department of the Lottery (Lottery) had:

- Presented the Lottery's basic financial statements in accordance with generally accepted accounting principles;
- Established and implemented effective internal control over financial reporting and compliance with requirements that could have a direct and material effect on the financial statements;
- Complied with the various provisions of laws, rules, regulations, and contracts that are material to the financial statements; and
- Taken corrective actions for findings included in report No. 2008-069.

The scope of this audit included an examination of the Lottery's basic financial statements of and for the fiscal years ended June 30, 2008, and 2007, and an examination of the effectiveness of the Lottery's internal control over financial reporting. With respect to internal control over financial reporting, 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 also examined various transactions to determine whether they were executed, both in manner and substance, in accordance with governing provisions of laws, rules, regulations, contracts, and grant agreements.

Audit Methodology

The methodology used to develop the findings in this report included the examination of pertinent Lottery records in connection with the application of procedures required by auditing standards generally accepted in the United States of America, and applicable standards contained in *Government Auditing Standards* issued by the Comptroller General of the United States.



David W. Martin, CPA
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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 fiscal years ended June 30, 2008, and 2007. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express opinions 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 audit provides 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, 2008, and 2007, 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, 2008, and 2007, and the changes in financial position and cash flows 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 a report on our examination of the effectiveness of the Lottery's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, rules, regulations, contracts, and other matters included under the heading **INDEPENDENT**

AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF THE FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*. 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. 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.

The **MANAGEMENT'S DISCUSSION AND ANALYSIS** (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,



David W. Martin, CPA
December 23, 2008

MANAGEMENT'S DISCUSSION AND ANALYSIS

YEARS ENDED JUNE 30, 2008, AND JUNE 30, 2007

As management of the Florida Lottery, we offer readers of the Florida Lottery's financial statements this overview and analysis of the Lottery's financial results and position for the fiscal years ended June 30, 2008, and 2007. We encourage readers to consider the information presented here in conjunction with the financial statements and notes to the financial statements, which begin on page 12.

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 ticket sales in excess of \$2 billion for nineteen 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 2008 transfer exceeding \$1 billion for the sixth consecutive year.

For the fiscal year ended June 30, 2008:

- Transfers to the EETF increased from approximately \$1.26 billion to approximately \$1.28 billion or 1.6%, over the prior fiscal year.
- Florida Lottery's ticket sales increased 1.2 % over the prior fiscal year from approximately \$4.12 billion to \$4.17 billion.
- Prize expense decreased \$8.5 million (0.3%) during fiscal year 2008. The Lottery has the authority to vary the prize expense in order to maximize transfers. This expense represented approximately 59.3% of net ticket sales.
- The gaming vendors' fees and retailer commissions are based on sales and therefore fluctuate in parallel with sales revenue. Fiscal year 2008 expenses for these items increased over the prior year expenses by 1.5%.
- Administrative operating expenses, which includes advertising, salaries and benefits, rent, utilities and maintenance, professional fees, depreciation and other administrative expenses, experienced a minor increase. Administrative operating expenses for fiscal years 2008 and 2007 were \$73.3 million and \$73.2 million, respectively.

OVERVIEW OF THE FINANCIAL STATEMENTS

The Lottery is accounted for as an enterprise fund, reporting transactions using the accrual basis of accounting similar to a business entity. 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 Statement 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. The restricted assets consist of the twenty percent for unclaimed prizes designated for future prizes, a reserve fund established to pay set prize amounts, and 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, 2008, and the prior fiscal years ended June 30, 2007, and 2006, as derived from the Statement of Net Assets.

Table 1
Condensed Statement of Net Assets
As of June 30, 2008, 2007, and 2006
(In Thousands)

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Assets			
Current Assets	\$ 188,200	\$ 223,108	\$ 178,017
Restricted Assets	2,306,205	2,553,972	2,879,757
Capital Assets, Net of Depreciation	1,279	1,908	1,244
Total Assets	<u>2,495,684</u>	<u>2,778,988</u>	<u>3,059,018</u>
Liabilities			
Current Liabilities	187,526	218,842	175,955
Current Liabilities Payable from Restricted Assets	1,310,654	1,488,254	1,665,130
Noncurrent Liabilities	837,694	979,115	1,118,217
Total Liabilities	<u>2,355,874</u>	<u>2,686,211</u>	<u>2,959,302</u>
Net Assets			
Net Investment in Capital Assets	1,279	1,908	1,244
Restricted Net Assets	158,531	90,869	98,472
Total Net Assets	<u>\$ 159,810</u>	<u>\$ 92,777</u>	<u>\$ 99,716</u>

Assets

Total assets at the end of fiscal year 2008 decreased by \$283 million from \$2.8 billion at June 30, 2007, to \$2.5 billion at June 30, 2008. At the end of fiscal year 2007, total assets were \$280 million less than the \$3.1 billion at the end of fiscal year 2006.

- Current assets decreased from \$223.1 million in 2007 to \$188.2 million in 2008, representing a decrease of \$34.9 million. This decrease is primarily due to a decrease of \$40.0 million in cash and cash equivalents and a \$5.2 million increase in retailer accounts receivable due to the timing of billing and collections from our retailers at year-end cutoff. In fiscal year 2007, current assets had increased \$45.1 million from \$178.0 million at June 30, 2006. That increase was primarily due to the increase of \$36.5 million in cash and cash equivalents and a \$10.1 million increase in retailer accounts receivable due to the timing of billing and collections from our retailers at year-end cutoff.
- Restricted assets decreased \$247.8 million from \$2.5 billion in 2007 to \$2.3 billion in 2008. This decrease is mostly attributable to the continuing decrease in the size of the deferred payment investment portfolio. The net appreciation in fair value of the grand prize investments increased \$116.2 million. However, the size of the total portfolio continues to decrease 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 \$246.3 million and purchases of only \$3.4 million in new investments. In fiscal year 2007, payouts of annuities were \$246.5 million and purchases of new investments consisted of \$19.5 million. 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 in the prior year. At June 30, 2008, the Lottery held \$1.1 billion in collateral verses \$1.2 billion at June 30, 2007, and \$1.4 billion at June 30, 2006.

Liabilities

Total liabilities at June 30, 2008, were \$2.3 billion, which is \$350 million lower than the total liabilities of \$2.7 billion at June 30, 2007. The total liabilities at June 30, 2007, were \$273 million lower than the June 30, 2006, amount of \$2.9 billion.

- Current liabilities decreased from \$218.8 million on June 30, 2007, to \$187.5 million on June 30, 2008. The decrease of \$31.3 million is largely due to a decrease in the year-end payable to EETF of \$4.6 million and a decrease in prizes payable of \$27.1 million. The decrease in prizes payable resulted primarily from a Raffle game with prizes payable on June 30, 2007, of \$16.5 million and none on June 30, 2008, as well as a reduction in prizes payable for Scratch-Off games of \$16.3 million. The June 30, 2007, current liabilities of \$218.8 million were higher than the June 30, 2006, amounts of \$175.9 million. The primary reasons for the \$42.8 million increase was the increase in transfers to EETF of \$23.5 million and the increase in prizes payable of \$17.6 million.
- Current liabilities from restricted assets decreased \$177.6 million from \$1.49 billion at June 30, 2007, to \$1.31 billion at June 30, 2008. This decrease can be primarily attributed to a net decrease in obligations under security lending of \$152.6 million. The June 30, 2007, current liabilities from restricted assets balance of \$1.49 billion was \$176.8 million less than the June 30, 2006, balance of \$1.66 billion. Again, this decrease can be primarily attributed to a net decrease in obligations under security lending of \$177.2 million. Noncurrent liabilities principally consist of grand prizes payable, which represents the amount to be paid to

grand prizewinners over future years. Grand prizes payable experienced a decrease of \$141 million from year-end 2007 to 2008 and a decrease of \$139 million from year-end 2006 to 2007.

Net Assets and Changes in Net Assets

Net assets increased by \$67.0 million from June 30, 2007, to June 30, 2008. Net assets at June 30, 2008, 2007, and 2006 were \$159.8 million, \$92.8 million, and \$99.7 million, respectively. The fiscal year 2008 increase is primarily due to increases in restricted net assets for future prizes and promotions of \$10.2 million and in restricted net assets for undistributed appreciation on restricted investments of \$12.8 million, as well as the newly established reserve for the new Lotto Plus game of \$44.7 million.

SUMMARY OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

The most important element 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 changes in fair value of restricted investments and restricted reserves.

Table 2 presents a condensed Summary of Revenues, Expenses and Changes in Net Assets for the current fiscal year ended June 30, 2008, and the prior fiscal years ended June 30, 2007, and June 30, 2006, as derived from the Lottery's Statement of Revenues, Expenses and Changes in Net Assets.

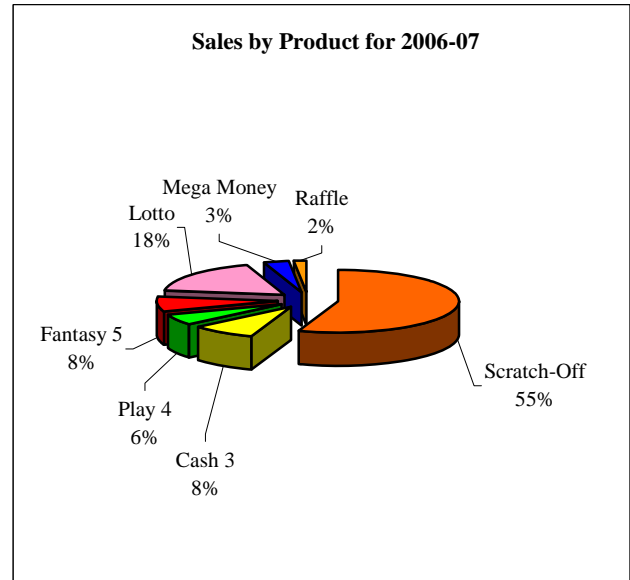
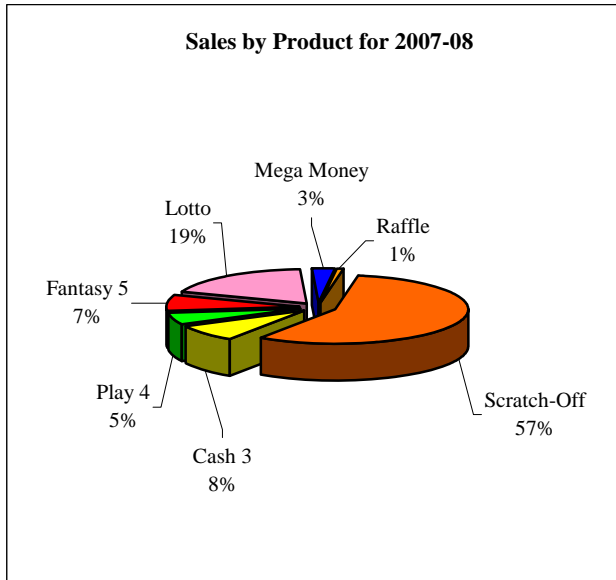
Table 2
Condensed Statement of Revenues, Expenses and Changes in Net Assets
As of June 30, 2008, 2007, and 2006
(In Thousands)

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Operating Revenues			
Ticket Sales	\$4,174,776	\$4,122,116	\$3,929,030
On-Line & Retailer Fees and Miscellaneous	7,724	7,438	7,291
Total Operating Revenues	<u>4,182,500</u>	<u>4,129,554</u>	<u>3,936,321</u>
Operating Expenses			
Prizes	2,476,032	2,484,519	2,340,859
Retailer Commissions	235,651	234,291	224,570
Vendor Commissions	81,300	78,090	75,047
Other Expenses	73,261	73,219	71,994
Total Operating Expenses	<u>2,866,244</u>	<u>2,870,119</u>	<u>2,712,470</u>
Income from Operations	<u>1,316,256</u>	<u>1,259,435</u>	<u>1,223,851</u>
Nonoperating Revenue, net of expenses	<u>34,191</u>	<u>(3,102)</u>	<u>(105,001)</u>
Income Before Operating Transfers	<u>1,350,447</u>	<u>1,256,333</u>	<u>1,118,850</u>
Transfers to EETF from Revenue	(1,216,839)	(1,224,524)	(1,182,763)
Transfers to EETF from Unclaimed Prizes	(66,575)	(38,748)	(41,888)
Total Transfers to EETF	<u>(1,283,414)</u>	<u>(1,263,272)</u>	<u>(1,224,651)</u>
Change in Net Assets	67,033	(6,939)	(105,801)
Net Assets, Beginning of Year	<u>92,777</u>	<u>99,716</u>	<u>205,517</u>
Net Assets, End of Year	<u>\$ 159,810</u>	<u>\$ 92,777</u>	<u>\$ 99,716</u>

Sales

For the fiscal year ended June 30, 2008, overall ticket sales increased \$52.7 million due primarily to growth in the Scratch-Off market. Sales for On-line products decreased. The \$4.17 billion sales figure represents the highest sales in the history of the Florida Lottery. Fiscal year 2007-08 is the second year in which the Lottery has surpassed its \$4 billion sales goal, although the sale of lottery tickets has been affected by the downturn in the economy.

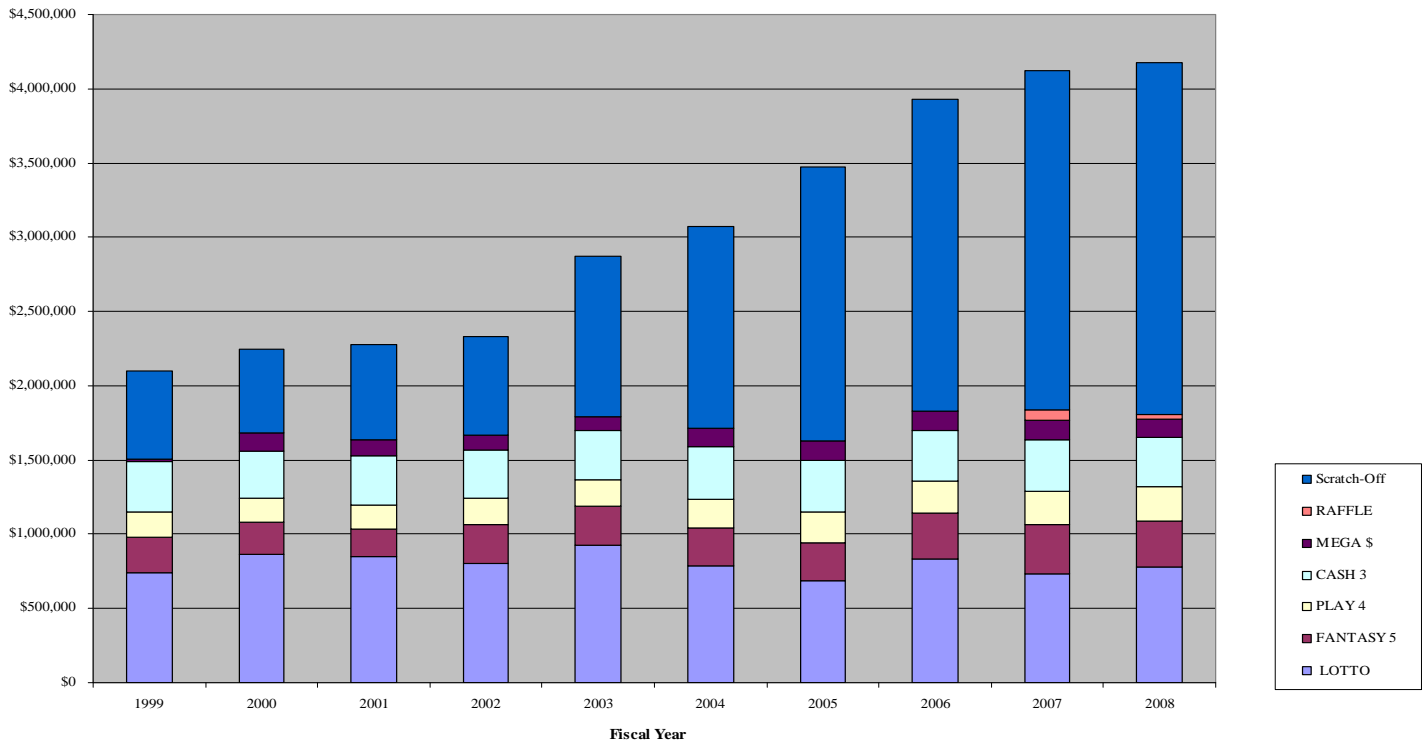
The following chart shows sales by product for the various Lottery games during the June 30, 2008, and 2007 fiscal years:



Sales of Scratch-Off tickets for the fiscal years ending June 30, 2008, and 2007, were \$2.37 billion or 57% and \$2.28 billion or 55% of combined sales in each of the two years. The continuing increase in Scratch-Off sales is attributed to the introduction of higher price point Scratch-Off games introduced over the last three years, record sales of holiday-themed games, utilization of central-themed games across price points 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:

Department of the Lottery
 Historical Lottery Sales by Game
 (In Thousands)



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

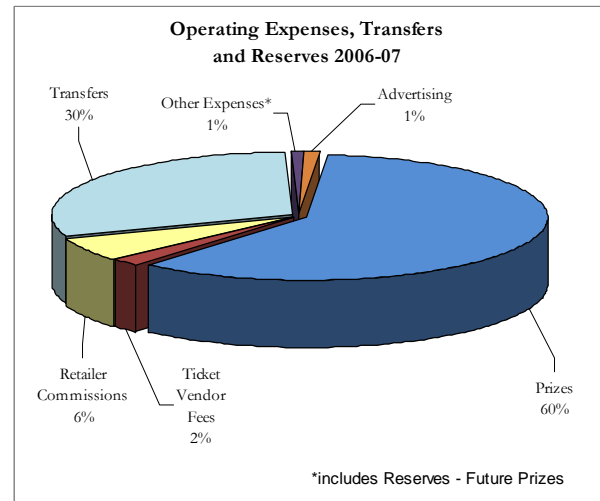
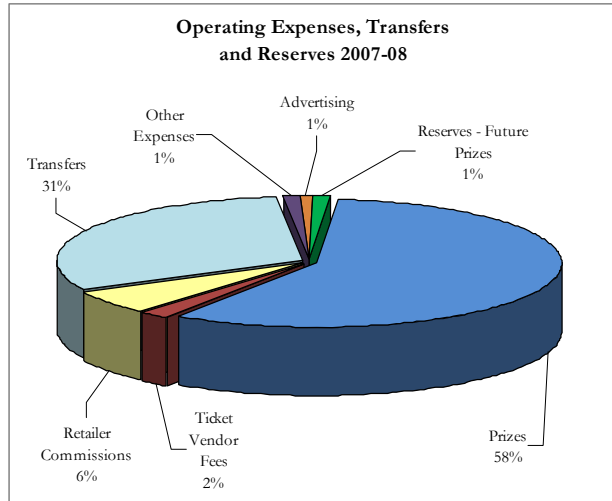
Fiscal Year Ended June 30	FLORIDA LOTTO™	FANTASY 5®	PLAY 4™	CASH 3™	MEGA MONEY™	MILLIONAIRE RAFFLE™	Scratch-Off Tickets	Combined Sales
1999	\$737,687	\$241,799	\$169,415	\$339,273	\$ 14,861		\$593,691	\$2,096,726
2000	864,983	216,303	158,620	318,972	121,266		568,352	2,248,496
2001	845,433	191,614	163,157	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
2007	735,585	326,241	225,285	348,694	130,142	72,549	2,283,620	4,122,116
2008	778,954	309,445	227,940	336,096	122,742	30,818	2,368,781	4,174,776

As shown, Scratch-Off ticket sales have continued to increase dramatically (74.42%) over the past five years while On-line ticket sales have increased only 5.44%. The Lottery has been able to “ride the coattails” of its Scratch-Off ticket boom, and is focusing efforts on cultivating and ensuring its continuance. However, at the beginning of fiscal year 2008, game sales began showing declines when compared to prior years. The rapid rise in gasoline prices and the resulting drop in available funds for discretionary spending in products like lottery tickets seem to be the key factors for the declines; however, other economic conditions, most notably the dramatic decline in the housing market, the credit crisis, and the increase in grocery prices, are also likely contributors.

Expenses

Section 24.121, Florida Statutes, stipulates that funds remaining in the Operating Trust Fund after the transfer to EETF shall be used for the payment of administrative expenses of the Department. These expenses include 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, 2008, and 2007 fiscal years:



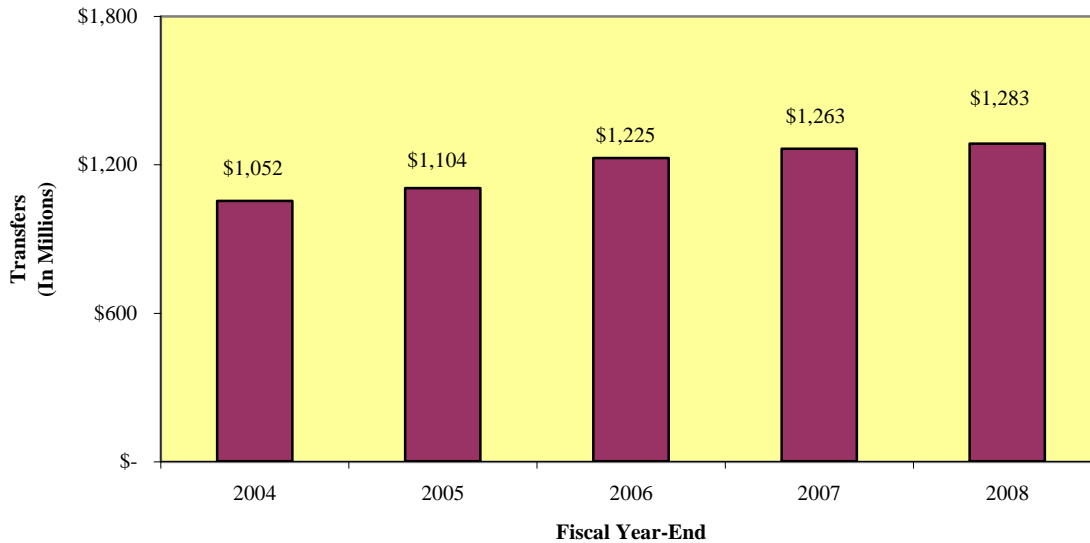
Prizes, commissions, and vendor fees directly relate to sales and fluctuate accordingly. In fiscal year 2008, these expenses increased proportionally, yet as a percentage of total expenses they remained constant. The other expenses, which consist of advertising, salary and benefits, professional fees, rent, maintenance, bad debt, and depreciation, have remained relatively stable. Fiscal year 2008 and 2007 administrative expenses were \$73.3 million and \$73.2 million, respectively.

Transfers

The Lottery’s contribution to the EETF for the fiscal year ended June 30, 2008, \$1.28 billion, was the highest since the Florida Lottery began making transfers in 1988. Fiscal year 2008 is the sixth straight year in which the Lottery’s contribution to EETF has been over \$1 billion. Total transfers to the EETF increased by \$20.1 million from the prior fiscal year. When adjusted for inflation, the Lottery’s transfer amount for fiscal year 2008 was lower than the prior year adjusted-for-inflation transfer amount. However, overall the Lottery’s transfer rates have increased slightly over the rate of inflation during the 20-year period.

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

Transfers to Educational Enhancement Trust Fund



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 currently being explored by management:

- **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 24.121, Florida Statutes, authorizes the Lottery to utilize variable prize payouts for both On-line games and Scratch-Off games. The Lottery began utilizing higher prize payouts for On-line games in fiscal year 2005. Although the Department did not expect the same rate of return for the On-line games, it has experienced a positive return from applying the variable prize payout strategy. During fiscal year 2007-08, the Lottery utilized the higher payout authority to launch the new Lotto Plus feature, an EZ Match promotion, one complete raffle, and started a second Raffle game. Individually these efforts resulted in increased sales and transfers to EETF and overall helped to offset the negative effects of a downturn in the economy.

- **Improve market penetration through expansion of Lottery retailer network.** As a result of the 2005 On-line vendor contract, approximately 2,000 retailers that were only selling Scratch-Off tickets now sell all On-line products as well. As of the end of fiscal year 2008, the retailer base had grown to approximately

13,400 retailers. The Department has set internal goals for continuing to grow the number of retailers over the next two and a half years by another 5%.

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.

EXHIBIT A
DEPARTMENT OF THE LOTTERY

STATEMENT OF NET ASSETS

As of June 30, 2008, and June 30, 2007
(In Thousands)

Assets	<u>June 30, 2008</u>	<u>June 30, 2007</u>
Current Assets:		
Cash and cash equivalents	\$143,031	\$183,031
Interest receivable	728	1,312
Accounts receivable, net	40,072	34,700
Inventories	844	967
Security deposits	<u>3,525</u>	<u>3,098</u>
Total Current Assets	<u>188,200</u>	<u>223,108</u>
Restricted Assets:		
Cash and cash equivalents	74,348	18,429
Securities lending income receivable	2,338	3,343
Investments, grand prize	1,161,202	1,287,954
Investments, other	<u>1,068,317</u>	<u>1,244,246</u>
Total Restricted Assets	<u>2,306,205</u>	<u>2,553,972</u>
Capital assets, net	<u>1,279</u>	<u>1,908</u>
Total Assets	<u>2,495,684</u>	<u>2,778,988</u>
Liabilities		
Current Liabilities:		
Accounts payable and accrued liabilities	11,792	11,868
Prizes payable	58,478	85,576
Due to Educational Enhancement Trust Fund	112,879	117,433
Deposits payable	3,525	3,098
Compensated absences payable	<u>852</u>	<u>867</u>
Total Current Liabilities	<u>187,526</u>	<u>218,842</u>
Current Liabilities Payable from Restricted Assets:		
Pending purchases payable	1,022	0
Securities lending fees payable	2,005	2,994
Obligations under securities lending	1,095,328	1,247,931
Grand prizes payable	<u>212,299</u>	<u>237,329</u>
Total Current Liabilities Payable from Restricted Assets	<u>1,310,654</u>	<u>1,488,254</u>
Noncurrent Liabilities:		
Grand prizes payable	834,545	976,090
Compensated absences payable	2,897	3,025
Postemployment healthcare benefits payable	<u>252</u>	<u>0</u>
Total Noncurrent Liabilities	<u>837,694</u>	<u>979,115</u>
Total Liabilities	<u>2,335,874</u>	<u>2,686,211</u>
Net Assets		
Invested in capital assets	1,279	1,908
Restricted net assets for undistributed appreciation on restricted investments	85,206	72,440
Restricted net assets for Restricted Prize Pool	44,662	0
Restricted net assets for future prizes or special prize promotions	<u>28,663</u>	<u>18,429</u>
Total Net Assets	<u>\$159,810</u>	<u>\$92,777</u>

See accompanying notes to financial statements.

EXHIBIT B
DEPARTMENT OF THE LOTTERY

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

Years ended June 30, 2008, and June 30, 2007
(In Thousands)

	<u>June 30, 2008</u>	<u>June 30, 2007</u>
Operating Revenues:		
Ticket sales	\$4,174,776	\$4,122,116
On-line fees and miscellaneous	7,482	7,196
Retailer fees	242	242
Total Operating Revenues	<u>4,182,500</u>	<u>4,129,554</u>
Operating Expenses:		
Prizes	2,476,032	2,484,519
Retailer commissions	235,651	234,291
Scratch-Off tickets	55,135	53,298
On-line games	26,165	24,792
Advertising	34,706	34,575
Personal services	27,240	26,147
Other contractual services	8,546	7,615
Materials and supplies	1,400	3,071
Bad debts	674	1,085
Depreciation	695	726
Total Operating Expenses	<u>2,866,244</u>	<u>2,870,119</u>
Operating Income	<u>1,316,256</u>	<u>1,259,435</u>
Nonoperating Revenues (Expenses):		
Interest	13,465	10,138
Securities lending income	53,189	74,549
Securities lending fees	(44,888)	(71,374)
Investment management fees	(290)	(297)
Net appreciation (depreciation) in fair value of investments	89,149	71,930
Property disposition (loss)	(51)	(97)
Amortization of grand prizes payable	(76,383)	(87,951)
Total Nonoperating Revenues (Expenses), Net	<u>34,191</u>	<u>(3,102)</u>
Income Before Operating Transfers	<u>1,350,447</u>	<u>1,256,333</u>
Transfers to Educational Enhancement Trust Fund:		
Transfers from revenue	(1,216,839)	(1,224,524)
Transfers from unclaimed prizes	(66,575)	(38,748)
Total Transfers to Educational Enhancement Trust Fund	<u>(1,283,414)</u>	<u>(1,263,272)</u>
Change in Net Assets	<u>67,033</u>	<u>(6,939)</u>
Net Assets, Beginning of Year	92,777	99,716
Net Assets, End of Year	<u>\$159,810</u>	<u>\$92,777</u>

See accompanying notes to financial statements.

EXHIBIT C
DEPARTMENT OF THE LOTTERY

STATEMENT OF CASH FLOWS

Years ended June 30, 2008, and June 30, 2007
(In Thousands)

	<u>June 30, 2008</u>	<u>June 30, 2007</u>
Operating Activities:		
Ticket sales	\$ 4,168,731	\$ 4,110,980
Prizes paid to winners	(2,503,131)	(2,466,776)
Commissions paid and payments to retailers	(235,651)	(234,291)
Paid to vendors for goods and services	(125,904)	(121,703)
Paid to employees	(27,130)	(26,125)
Other operating revenue	7,723	7,439
Net Cash Provided by Operating Activities	<u>1,284,638</u>	<u>1,269,524</u>
Noncapital Financing Activities:		
Payments to Educational Enhancement Trust Fund	(1,287,968)	(1,239,762)
Net Cash Used in Noncapital Financing Activities	<u>(1,287,968)</u>	<u>(1,239,762)</u>
Capital and Related Financing Activities:		
Purchase of capital assets	(116)	(1,488)
Net Cash Used in Capital and Related Financing Activities	<u>(116)</u>	<u>(1,488)</u>
Investing Activities:		
Cash received from maturity of grand prize investments	246,337	246,500
Cash paid to grand prizewinners upon maturity of grand prize investments	(246,337)	(246,500)
Investment income, net of fees	19,365	15,422
Net Cash Provided by Investing Activities	<u>19,365</u>	<u>15,422</u>
Net Increase in Cash and Cash Equivalents	15,919	43,696
Cash and Cash Equivalents, Beginning of Year	201,460	157,764
Cash and Cash Equivalents, End of Year	<u>\$ 217,379</u>	<u>\$ 201,460</u>
Reconciliation of Income from Operations to Net Cash Provided by Operating Activities:		
Income from operations	\$ 1,316,256	\$ 1,259,435
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation	695	726
Changes in assets and liabilities		
(Increase) decrease in:		
Accounts receivable	(5,371)	(10,051)
Inventories	123	470
Increase (decrease) in:		
Accounts payable and accrued liabilities	(76)	1,178
Prizes payable	(27,098)	17,744
Compensated absences payable	(143)	22
Postemployment healthcare benefits payable	252	0
Net Cash Provided by Operating Activities	<u>\$ 1,284,638</u>	<u>\$ 1,269,524</u>
Noncash Investing, Capital and Financing Activities:		
Increase/(decrease) in fair value of investments	\$ (64,268)	\$ (75,543)

See accompanying notes to financial statements.

EXHIBIT D
DEPARTMENT OF THE LOTTERY

NOTES TO FINANCIAL STATEMENTS

Years ended June 30, 2008, and June 30, 2007

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 resources 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 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. Investments that are not publicly quoted are priced by a third party through a discounted cash flow method. 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 game merchandise 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, restricted net assets for future prizes or special prize promotions, and restricted net assets for the Restricted Prize Pool.

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 represents 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.

The restricted net assets for Restricted Prize Pool category represents the prize expense reserved to support payments to winners of the Florida Lotto \$2 and \$3 jackpots in accordance with Rule 53ER08-12, Florida Administrative Code.

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 that 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 percent 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.

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 game 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 for all perils except named windstorm and flood. Property losses in excess of \$2 million are commercially insured up to \$200 million per loss event excluding named windstorm or flooding events. Named windstorm and flood losses have a \$2 million deductible per occurrence, with a \$40 million annual aggregate deductible with commercial insurance coverage up to \$50 million per occurrence. Workers' compensation is provided to comply with the applicable law. The employee health and dental 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, restricted net assets, 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 \$1,168,000 at June 30, 2008, and \$3,269,000 at June 30, 2007, 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 that 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, corporate bonds, and other securities designated allowable under conditions set by the Chief Financial Officer.

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 \$2,769,000 at June 30, 2008, and \$4,415,000 at June 30, 2007, 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 \$216,211,000 and \$198,120,000 at June 30, 2008, and 2007, 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 statement 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 borrowers 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. The contract with the lending agent requires it 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.

In March 2008, Mellon Bank replaced Dresdner Bank as the agent in lending U.S. Treasury securities to various authorized brokers for cash or U.S. Government securities. Initially, collateral received shall be in the form of cash at 100 percent, or other securities valued at 102 percent, of the fair value

of the securities loaned as required by the lending agreement. Borrowers must be approved for lending by Mellon Bank's credit department. Mellon 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 \$1,095,328,000 of cash collateral for the lending program as of June 30, 2008, and \$1,247,931,000 as of June 30, 2007. At June 30, 2008, 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 securities authorized by the lending agreement. Authorized securities include primarily certificates of deposit, corporate and medium term notes, asset-backed securities, and repurchase agreements. The invested cash collateral generally has a shorter maturity than the securities on loan.

Securities lending activity for the years ended June 30, 2008, and 2007, consisted of (in thousands):

	2008	2007
Securities lending income	\$ 53,189	\$ 74,549
Less broker rebates	(43,106)	(70,582)
Less bank fees	(1,782)	(792)
Net securities lending revenue	\$ 8,301	\$ 3,175

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 Treasury Investment Pool's current rating by Standard and Poors is AA-f. Listed below are the Standard & Poors credit ratings for the lending program's invested cash collateral (in thousands):

Investment Type	Standard & Poors Credit Rating					Totals
	AAA	AA	A	BB	NR	
Certificates of Deposits	\$ -	\$ -	\$ -	\$ -	\$ 7,966	\$ 7,966
Domestic Corporate Bonds & Notes	9,956	199,833	290,646	-	-	500,435
Domestic Asset-backed Securities	373,148	-	-	5,527	14,833	393,508
International Corporate Bonds & Notes	19,947	-	-	-	-	19,947
International Asset-backed Securities	30,285	-	-	-	-	30,285
International Backed CMO's	108,462	-	-	-	-	108,462
Repurchase Agreements	-	-	-	-	7,714	7,714
Grand Total	\$ 541,798	\$ 199,833	\$ 290,646	\$ 5,527	\$ 30,513	\$ 1,068,317

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, 2008 (in thousands):

<u>Time to Maturity</u>	<u>Fair Value</u>
< 1 year	\$ 217,587
> 1 year to 3 years	358,555
> 3 years to 5 years	251,279
> 5 years to 10 years	239,954
> 10 years to 15 years	40,310
> 15 years to 20 years	34,796
> 20 years to 25 years	17,771
> 25 years	950
Total	<u><u>\$ 1,161,202</u></u>

The Lottery contracts with the SBA to execute the securities lending program. The securities lending authorization agreement between Mellon Bank and the SBA requires that the maximum weighted average portfolio maturity not exceed 90 days. The lending program 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. Listed below are the weighted average maturities for the lending program's invested cash collateral (in thousands):

<u>Investment Type</u>	<u>Fair Value</u> (Thousands)	<u>Weighted</u> <u>Average</u> <u>Maturity</u> (Days)
Certificates of Deposits	\$ 7,966	0.01
Domestic Corporate Bonds & Notes	500,435	19.63
Domestic Asset-backed Securities	393,508	6.73
International Corporate Bonds & Notes	19,947	0.28
International Asset-backed Securities	30,285	1.18
International Backed CMO's	108,462	4.23
Repurchase Agreements	7,714	0.01
Total	<u><u>\$ 1,068,317</u></u>	<u><u>32.07</u></u>

A risk factor associated with this lending agreement is the value of the invested cash collateral. If the invested cash collateral is required to be liquidated, any shortfall between the value of the invested cash collateral and the securities lending obligation becomes the responsibility of the Lottery. As of June 30, 2008, the potential unrealized shortfall is \$27 million. Other risk factors include counterparty default and failure of the custodial bank to indemnify the Lottery.

The effective duration of the Treasury Investment Pool is approximately 3.31 years at June 30, 2008.

f. Investment Concentration of Credit Risk

Since all long-term investments (other than in the securities lending program) are in U.S. Government guaranteed securities, the Lottery has not adopted a policy regarding concentration of credit risk. The securities lending program has established investment concentration risk policies that limit the aggregate exposure to any one issuer or guarantor that is not the U.S. Government or guaranteed by the U.S. Government to 10 percent of the book value of the lending program's invested cash collateral. No invested cash collateral exceeded the 10 percent limitation.

g. Investment Custodial Credit Risk

Custodial credit risk is defined as the risk that an entity may not recover securities held by another party. The Lottery does not have a formal policy regarding custodial credit risk. The custodian for the SBA-administered lending program is also the counterparty to the investment transactions. Therefore, \$1,068,317,000 of investments were subject to investment custodial risk at June 30, 2008.

At June 30, 2008, and June 30, 2007, all non-lending investments held were either insured or registered and held by the Lottery or its agents in the Lottery's name and thus were not subject to custodial credit risk.

h. Foreign Currency Risk

The Lottery has no exposure to foreign currency risk as of June 30, 2008, and June 30, 2007.

i. Investment Summary

The following schedule summarizes all investments and investments loaned under security lending agreements at June 30 (in thousands):

Investment Type	June 30, 2008 Carrying Value	June 30, 2007 Carrying Value
Certificates of Deposit	\$ 7,966	\$ -
Repurchase Agreements	7,714	-
U.S. Government Obligations and Federally Guaranteed Obligations	79,413	56,452
Domestic Corporate Bonds and Notes	500,435	-
Domestic Non-Governmental Asset-backed Securities	393,508	-
International Corporate Bonds and Notes	19,947	-
International Non-Governmental Asset-backed Securities	30,285	-
International Non-Governmental CMO's	108,462	-
Investments Held by Others Under Securities Lending Agreements - U.S. Obligations	1,081,789	1,231,502
Pooled Investments with State Treasurer	216,211	198,120
Money Market and Mutual Funds	-	1,244,246
Total Investments	\$ 2,445,730	\$ 2,730,320

The following schedule reconciles cash and investments to the Statement of Net Assets at June 30 (in thousands):

	June 30, 2008				
	Investments	Cash at Financial		Cash at State Treasury	Total
		Institutions			
Cash and cash equivalents	\$ 141,863	\$ 687	\$ 481	\$ 143,031	
Restricted cash and cash equivalents	74,348	-	-	74,348	
Investments, grand prize	1,161,202	-	-	1,161,202	
Investments, other	1,068,317	-	-	1,068,317	
Total	\$ 2,445,730	\$ 687	\$ 481	\$ 2,446,898	

	June 30, 2007			
	Investments	Cash at Financial Institutions	Cash at State Treasury	Total
Cash and cash equivalents	\$ 179,691	\$ 3,269	\$ 71	\$ 183,031
Restricted cash and cash equivalents	18,429	-	-	18,429
Investments, grand prize	1,287,954	-	-	1,287,954
Investments, other	1,244,246	-	-	1,244,246
Total	\$ 2,730,320	\$ 3,269	\$ 71	\$ 2,733,660

3. ACCOUNTS RECEIVABLE

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

	2008	2007
Ticket sales receivable	\$ 42,477	\$ 37,237
Other receivables	67	253
Total receivables	42,544	37,490
Less allowance for doubtful accounts	(2,472)	(2,790)
Accounts receivable, net	\$ 40,072	\$ 34,700

4. SECURITY DEPOSITS AND DEPOSITS PAYABLE

The Lottery receives certificates of deposit and cashier’s 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 30-Jun-06	2006-07		Balance 30-Jun-07	2007-08		Balance 30-Jun-08
		Increase	Decrease		Increase	Decrease	
Data processing equipment	\$ 8,532	\$ 1,283	\$ (421)	\$ 9,394	\$ -	\$ (158)	\$ 9,236
Office equipment and fixtures	6,563	5	(608)	5,960	8	-	5,968
Vehicles and other equipment	3,297	200	(325)	3,172	110	(226)	3,056
	18,392	1,488	(1,354)	18,526	118	(384)	18,260
Less: accumulated depreciation	17,148	726	(1,256)	16,618	695	(332)	16,981
Total capital assets, net	\$ 1,244	\$ 762	\$ (98)	\$ 1,908	\$ (577)	\$ (52)	\$ 1,279

6. LONG-TERM LIABILITIES

a. Grand Prizes Payable

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

	2008	2007
Lotto grand prizes (face value)	\$ 1,351,603	\$ 1,596,403
Mega Money grand prizes (face value)	7,660	5,594
Win for Life grand prizes (face value)	13,386	13,750
Big 10 grand prizes (face value)	-	10
Flamingo Fortune Game Show grand prizes (face value)	1,000	1,100
Monthly Grand game prizes (face value)	36	60
Win a Million grand prizes (face value)	500	550
Yearly Bonus grand prizes (face value)	250	300
Lucky for Life grand prizes (face value)	12,300	12,700
Set for Life grand prize (face value)	2,820	3,000
Cash Spectacular grand prize (face value)	750	800
Cash for Life	250	-
Loaded for Life	3,250	-
Less imputed interest	(346,961)	(420,848)
Net present value of grand prizes payable	<u>\$ 1,046,844</u>	<u>\$ 1,213,419</u>
Current prizes payable from restricted assets	\$ 212,299	\$ 237,329
Noncurrent prizes payable	834,545	976,090
Total grand prizes payable	<u><u>\$ 1,046,844</u></u>	<u><u>\$ 1,213,419</u></u>

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

Year Ended June 30	Amount
2009	\$ 219,980
2010	200,237
2011	176,977
2012	153,026
2013	131,162
2014-2018	309,807
2019-2023	71,615
2024-2028	79,224
2029-2033	48,495
2034-2037	3,282
Grand prizes (face value)	<u>1,393,805</u>
Less imputed interest	<u>(346,961)</u>
Net present value of grand prizes payable	<u><u>\$ 1,046,844</u></u>

b. Compensated Absences Payable

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

	<u>2008</u>	<u>2007</u>
Current compensated absences	\$ 852	\$ 867
Noncurrent compensated absences	<u>2,897</u>	<u>3,025</u>
Total	<u>\$ 3,749</u>	<u>\$ 3,892</u>

c. Changes in Long-Term Liabilities

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

	Balance			Balance	Amount
	<u>July 1, 2007</u>	<u>Additions</u>	<u>Reductions</u>	<u>June 30, 2008</u>	<u>Due Within</u>
					<u>One Year</u>
Grand prizes payable	\$1,213,419	\$79,762	(\$246,337)	\$1,046,844	\$212,299
Compensated absences payable	3,892	1,805	(1,948)	3,749	852
Postemployment healthcare benefits payable	-	252	-	252	-
Total long-term liabilities	<u>\$1,217,311</u>	<u>\$81,819</u>	<u>(\$248,285)</u>	<u>\$1,050,845</u>	<u>\$213,151</u>

See Note 8 for additional information regarding the postemployment healthcare benefits payable.

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, 2008, was \$1,283,414,000, (30.7 percent of revenues) and for the fiscal year ended June 30, 2007, the transferred amount was \$1,263,272,000, (30.6 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.

Effective July 1, 2005, provisions of the Act relating to the allocation of revenues for public education were revised. 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.

During fiscal year 2008, the Lottery established a restricted prize reserve to support prize payments to winners of the Florida Lotto \$2 and \$3 jackpots. This change directly impacted the On-line transfer rate and was the primary reason for the rate reduction.

The amount due to EETF at June 30, 2008, and June 30, 2007, was as follows (in thousands):

	<u>June 30, 2008</u>	<u>June 30, 2007</u>
On-line ticket sales	\$ 1,805,996	\$ 1,838,496
Average percent transferred	37%	39%
Transfer of On-line ticket sales	<u>675,547</u>	<u>717,013</u>
Unclaimed On-line ticket prizes	33,514	32,969
Percent transferred	80%	80%
Transfer of unclaimed On-line ticket prizes	<u>26,811</u>	<u>26,375</u>
Scratch-Off ticket sales	2,368,781	2,283,620
Average percent transferred	22%	21%
Transfer of Scratch-Off ticket sales	<u>512,143</u>	<u>487,396</u>
Unclaimed Scratch-Off ticket prizes	49,705	15,466
Percent transferred	80%	80%
Transfer of Scratch-Off ticket prizes	<u>39,764</u>	<u>12,373</u>
Nonoperating (revenues) expenses, net	34,191	(3,102)
Add:		
Net (appreciation) depreciation in fair value of investments	(89,149)	(71,930)
Amortization of grand prizes payable	76,383	87,951
Total Nonoperating revenue, net	<u>21,425</u>	<u>12,919</u>
On-line fees and miscellaneous revenue	<u>7,724</u>	<u>7,196</u>
Due for the year	<u>\$ 1,283,414</u>	<u>\$ 1,263,272</u>
Balance due, beginning of year	117,433	93,923
Paid during the year	<u>(1,287,968)</u>	<u>(1,239,762)</u>
Due to Educational Enhancement Trust Fund, June 30	<u>\$ 112,879</u>	<u>\$ 117,433</u>

8. PENSIONS AND OTHER POSTEMPLOYMENT BENEFITS

a. Retirement Programs

Florida Retirement System. The Florida Retirement System (FRS) is primarily a State-administered, cost-sharing, multiple-employer, defined benefit retirement plan (Plan). FRS provisions are established by Chapters 121 and 122, Florida Statutes; Chapter 112, Part IV, Florida Statutes; Chapter 238, Florida Statutes; and Florida Retirement System Rules, Chapter 60S, Florida Administrative Code; wherein eligibility, contributions, and benefits are defined and described in detail. Essentially, all regular employees of participating employers are eligible to enroll as members of the FRS.

Benefits in the Plan vest at 6 years of service. All members are eligible for normal retirement benefits at age 62 or at any age after 30 years of service, which may include up to 4 years of credit for military service. The Plan also includes an early retirement provision, but imposes a penalty for each year a member retires before his or her normal retirement date. The Plan provides retirement, disability, and death benefits, and annual cost-of-living adjustments.

A Deferred Retirement Option Program (DROP), subject to provisions of Section 121.091, Florida Statutes, permits employees eligible for normal retirement under the Plan to defer receipt of monthly benefit payments while continuing employment with an FRS employer. An employee may participate in the DROP for a period not to exceed 60 months after electing to participate. During

the period of DROP participation, deferred monthly benefits are held in the FRS Trust Fund and accrue interest.

The State of Florida establishes contribution rates for participating employers. Contribution rates as a percentage of gross salary were as follows:

Class or Plan	Fiscal Year Ended June 30, 2008	Fiscal Year Ended June 30, 2007
Senior Management	13.12 percent	13.12 percent
Regular Employees	9.85 percent	9.85 percent
Special Risk	20.92 percent	20.92 percent
Deferred Retirement Option Program (DROP) - Applicable to members from all of the above classes	10.91 percent	10.91 percent

Employer rates include 1.11 percent for the post-employment insurance subsidy. Also, employer rates, other than for DROP participants, include 0.05 percent for administrative costs of the Public Employees Optional Retirement Program.

The Lottery’s liability for participation is limited to the payment of the required contribution at the rates and frequencies established by law on future payrolls of the Lottery. The Lottery’s contributions for the fiscal years ended June 30, 2006, June 30, 2007, and June 30, 2008, totaled \$1,283,000, \$1,605,000, and \$1,575,000, respectively, which were equal to 100 percent of the required contributions for each fiscal year. These contributions represented 7.4 percent, 9.0 percent, and 8.7 percent of covered payroll, for the years ended June 30, 2006, June 30, 2007, and June 30, 2008, respectively.

Section 121.4501, Florida Statutes, provides for a Public Employee Optional Retirement Program (PEORP). The PEORP is a defined contribution plan alternative available to all FRS members in lieu of the FRS defined benefit plan. Lottery employees already participating in DROP are not eligible to participate in this program. 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, 2008, and 2007, totaled \$281,510 and \$218,759, respectively.

Financial statements and other supplementary information of the FRS are included in the State’s Comprehensive Annual Financial Report, which is available from the Florida Department of Financial Services. An annual report on the FRS, which includes its financial statements, required supplementary information, actuarial report, and other relevant information, is available from the Florida Department of Management Services, Division of Retirement.

Senior Management Service Optional Annuity Program. Some Lottery employees also participate in the Senior Management Service Optional Annuity Program (SMSOAP). The SMSOAP is a defined contribution plan that provides retirement and death benefits to the participant pursuant to Section 121.055, Florida Statutes. Participants have full and immediate vesting of all contributions paid on their behalf to the participating provider companies to invest as directed by the participants. 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 2007 through June 2008. This contribution rate includes a contribution that would otherwise be paid to the Retiree Health Insurance Subsidy (HIS) Program described below so the SMSOAP retiree is not eligible to

receive monthly HIS benefits. A participant may contribute by salary reduction an amount not to exceed the percentage contributed by the employer.

Retiree Health Insurance Subsidy (HIS). The Retiree Health Insurance Subsidy (HIS) was created by the Florida Legislature in 1987 to assist FRS retirees in paying health insurance costs. The HIS is a cost-sharing multiple-employer defined benefit pension plan established in Section 112.363, Florida Statutes. For the fiscal years ended June 30, 2008, and 2007, eligible retirees or beneficiaries received a monthly HIS 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. To be eligible to receive the HIS, an FRS retiree must apply for the benefit, provide proof of health insurance coverage, which can include Medicare or TRICARE, and be approved.

The HIS is funded by required contributions from FRS participating employers. For the years ended June 30, 2008, and 2007, the Lottery contributed 1.11 percent of payroll for all active employees covered by the FRS. For the year ending June 30, 2008, the Lottery contributed \$185,528 in employer contributions to the HIS Program. This contribution 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.

The State of Florida's implementation of GASB Statement No. 43, Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans, resulted in a reevaluation of the HIS classification as a "postemployment benefit other than a pension" and its reclassification as a "pension benefit." The accounting and financial reporting for the HIS is now governed by GASB Statements No. 25 and 27, Accounting for Pensions by State and Local Government Employers, which was implemented for the fiscal year ending June 30, 2007, the transition year. Further disclosures and other supplementary information for the HIS are included in the Comprehensive Annual Financial Report of the State of Florida which may be obtained from the Florida Department of Financial Services.

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 of an ordinary and prudent investor. Pursuant to Section 112.215, Florida Statutes, the Deferred Compensation Trust Fund is created in the State Treasury.

b. Postemployment Healthcare Benefits

The Lottery participates in the State Employees' Health Insurance Program, a cost-sharing multiple-employer defined benefit postemployment healthcare plan administered by the State of Florida, Department of Management Services, Division of State Group Insurance, to provide group health benefits. Section 110.123, Florida Statutes, provides that retirees may participate in the State's group health insurance programs and assigns the authority to establish and amend benefit provisions to the Department of Management Services. Although premiums are paid by the retiree, the premium cost to the retiree is implicitly subsidized by the commingling of claims

experience in a single risk pool with a single premium determination. An actuarial valuation has been performed for the plan and the Lottery’s employees were included in the actuarial analysis. For more information on the plan regarding the funding policy and actuarial methods and assumptions, see the State’s Comprehensive Annual Financial Report, which is available from the Department of Financial Services.

In accordance with GASB Statement 45, the Lottery is required to record its portion of the implicit post employment health benefit liability beginning in the fiscal year ended June 30, 2008. Post employment health benefits payable at June 30, 2008, was \$252,000.

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, 2008, are scheduled as follows (in thousands):

Year Ending June 30	Headquarters	Districts	Total
2009	\$ 2,562	\$ 946	\$ 3,508
2010	2,587	906	3,493
2011	2,612	803	3,415
2012	2,639	691	3,330
2013	2,666	354	3,020
Total	\$ 13,066	\$ 3,700	\$ 16,766

Rental expense under all operating leases totaled approximately \$3,412,000 and \$3,323,000 for the years ended June 30, 2008, and 2007, respectively.

10. OTHER COMMITMENTS

The Lottery has entered into contractual agreements under which On-line and Scratch-Off lottery game vendors provide gaming systems, 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. The contractor’s compensation for On-line games for the fiscal years ended June 30, 2008, and 2007, was \$26,165,000, and \$24,792,000, respectively.

The Lottery is entering into a new contract for Scratch-Off game tickets and related services to take effect on October 1, 2008. The rates under the new contract will range from 0.9744 percent to 2.385 percent based on ticket price point and total annual sales. The current rate is 2.25 percent in effect since October 2006. Compensation under this agreement amounted to \$55,135,000 for the fiscal year ended June 30, 2008, and \$53,298,000 for the fiscal year ended June 30, 2007.

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.



David W. Martin, CPA
AUDITOR GENERAL

AUDITOR GENERAL STATE OF FLORIDA

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111 West Madison Street
Tallahassee, Florida 32399-1450



850/488-5534
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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 INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF THE FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

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, 2008, and have issued our report thereon included under the heading **INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS**. 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.

Internal Control Over Financial Reporting

We have examined the effectiveness of the Lottery's internal control over financial reporting as of June 30, 2008, 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, 2008, 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 additional matters involving the internal control over financial reporting, which are discussed in the **SCHEDULE OF FINDINGS**.

Compliance and Other Matters

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

The Lottery's response to the findings described in the **SCHEDULE OF FINDINGS** section of this report is included as Exhibit E. We did not audit the Lottery's response and, accordingly, we express no opinion on it.

Pursuant to Section 11.45(4), Florida Statutes, this report is a public record and its distribution is not limited. Auditing standards generally accepted in the United States of America require us to indicate that the provisions of this report relating to compliance and other matters are intended solely for the information and use of the Legislative Auditing Committee, members of the Florida Senate and the Florida House of Representatives, and applicable management, and are not intended to be and should not be used by anyone other than these specified parties.

Respectfully submitted,



David W. Martin, CPA
December 23, 2008

**STATE OF FLORIDA
DEPARTMENT OF THE LOTTERY
SCHEDULE OF FINDINGS
FOR THE FISCAL YEAR ENDED JUNE 30, 2008**

ADDITIONAL MATTERS

Finding No. 1: Information Technology Controls

Information technology (IT) controls are intended to protect the confidentiality, integrity, and availability of data and IT resources. During our audit, we identified the need for enhancements to the Lottery's IT control practices in fourteen separate areas, thirteen of which included issues that were repeated from the prior audit. 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 again been notified of these issues.

Recommendation: We again recommend that the Lottery make the necessary enhancements to its IT control practices to address the issues identified.

Finding No. 2: Marketing and Research Support Funds

The Lottery's On-line ticket and Scratch-Off ticket gaming service vendors are contractually required to periodically set aside amounts 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. Cash balances for the funds held by the Scratch-Off and the On-line vendors at June 30, 2008, were \$1,272,298 and \$18,602, respectively.

In previous Auditor General reports, we recommended that the Lottery continue its renegotiation efforts with its Scratch-Off vendor to amend its existing contract to include language that addressed the ownership of the marketing and research support fund. We also recommended that, in lieu of renegotiating with the On-line vendor to amend its existing contract, the Lottery continue to closely monitor the balance in the fund, with the intention and expectation of effectively utilizing all of the available moneys prior to the contract's end.

The Lottery executed a new contract with its Scratch-Off vendor effective October 1, 2008, that includes provisions stipulating that any remaining moneys in the fund will be returned to the Lottery and establishing the Lottery's right to hold back final payment to the vendor if the moneys are not returned.

The Lottery has continued to monitor the marketing and research fund balance held by its On-line vendor. The Lottery's intention remains to fully expend all moneys in the fund. Lottery personnel indicated that the issue of ownership would be considered for the next On-line vendor contract. The current contract expires in March 2011.

Recommendation: We recommend that, in lieu of renegotiating with the On-line vendor to amend its existing contract, the Lottery continue to closely monitor the marketing and research support fund balance with the intention and expectation of effectively utilizing all of the available moneys prior to the contract's end.

Finding No. 3: Electronic Funds Transfer of Annual Prize Payments

The Lottery pays the prizewinners of various games through a deferred payment plan (annuity) rather than a single lump sum payment. The Lottery annually pays approximately \$246 million to its 846 annuity recipients, approximately 740 of whom receive their payments through an electronic funds transfer. Our review disclosed that controls over related electronic funds transfer payments could be improved. Specific details of this matter are not disclosed in this report to avoid the possibility of compromising Lottery information. However, the appropriate Lottery personnel have been notified of this issue.

Recommendation: We recommend that the Lottery make the necessary enhancements to its controls over annuity electronic funds transfer payments.

Finding No. 4: 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(2), 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(3), Florida Statutes.

Our audit disclosed that as of November 3, 2008, retailers comprising one minority type totaled 63 percent of the total number of minority retailers. A similar finding has been included in previous Auditor General reports.

The Lottery has developed an outreach program to increase retailer participation in under-represented minority groups and participation has increased slightly.

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

MANAGEMENT'S RESPONSE

Management's response is included as Exhibit E.

EXHIBIT E
MANAGEMENT'S RESPONSE

CHARLIE CRIST
Governor



LEO DIBENIGNO
Secretary

FLORIDA LOTTERY

January 23, 2009

Mr. David W. Martin, CPA
Auditor General
G74 Claude Pepper Building
111 West Madison Street
Tallahassee, Florida 32399-1450

Dear Mr. Martin:

The Lottery has received your December 23, 2008 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, 2008. The staff has discussed your recommendations and responds as follows:

1. Recommendation: The Lottery should make necessary enhancement to its IT control practices to address the issues identified.

Response: The Lottery has an ongoing process to improve technology controls for information technology. The enhancements presented by this audit have been considered and either have been or are in the process of implementation.

2. Recommendation: The Lottery should continue to closely monitor the marketing and research support fund balance with the intention and expectation of effectively utilizing all of the available moneys prior to the contract's end.

Response: The Lottery has and will continue to monitor the marketing and research support fund balance and fully expects to utilize all available moneys prior to contract's end.

3. Recommendation: The Lottery should make the necessary enhancements to its controls over annuity electronic funds transfer payments.

Response: The Lottery has plans to further strengthen existing controls over all annuity electronic funds transfer payments.



EXHIBIT E
MANAGEMENT'S RESPONSE (CONTINUED)

David W. Martin, CPA
Auditor General
Response to Preliminary and Tentative Findings
January 23, 2009
Page 2 of 2

4. Recommendation: That the Lottery continue to take steps to resolve the Minority Retailer Participation requirement of Section 24.113, Florida Statutes.

Response: As recommended the Lottery has and will continue 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 styles for Lottery retailer prospects. 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

LD/AM/jl

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