

DEPARTMENT OF THE LOTTERY

Financial Audit

For the Fiscal Year Ended
June 30, 2009



Secretary of the Department of the 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. For the information technology portion of this audit, the audit team leader was Suzanne Varick, CPA, and the supervisor was 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 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.

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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, 2009, and 2008, 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 information technology control practices. Specific details of these matters are not disclosed in this report to avoid the possibility of compromising Lottery information. However, the appropriate Lottery personnel have again been notified of these issues. While the Lottery had made progress in resolving many of the findings disclosed in connection with the prior audit, some issues previously reported had not yet been fully addressed.

ELECTRONIC FUNDS TRANSFER OF ANNUAL PRIZE PAYMENTS

Finding No. 2: The Lottery pays the prizewinners of various games through a deferred payment (annuity) option rather than a single lump-sum payment. Our audit disclosed that controls over related electronic funds transfer payments could be further improved.

MONTHLY REPORTS

Finding No. 3: In accordance with Section 24.105(4), Florida Statutes, the Lottery issues monthly reports to the Governor, the State of Florida Chief Financial Officer, the President of the Senate, and the Speaker of the House of Representatives. These reports disclose details of the total lottery revenues, prize disbursements, and other expenses of the Lottery during the preceding month and present fiscal year-to-date cumulative totals. Our review disclosed errors in the reported monthly totals and a lack of procedures for a final proofing of the reports to check for mathematical accuracy prior to sending them to the designated entities.

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 August 24, 2009, retailers comprising one minority type totaled 64 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 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 our report No. 2009-101.

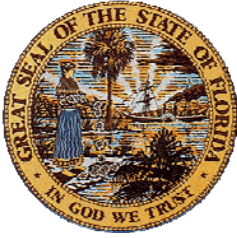
The scope of this audit included an examination of the Lottery's basic financial statements as of and for the fiscal years ended June 30, 2009, and 2008, and an examination of the effectiveness of the Lottery's internal control over financial reporting. With respect to internal control over financial 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.

Related Reports

In Report No. 09-14, the Office of Program Policy Analysis and Government Accountability (OPPAGA) made recommendations to enhance the Department of the Lottery's earning capability and improve operational efficiencies. The report also tracks the Lottery's implementation of revenue enhancement initiatives and prior OPPAGA recommendations. OPPAGA plans to issue its annual Department of the Lottery report, including an examination of alternative field support service delivery models and a report examining the return on investment of the Lottery's advertising expenditures, in January 2010.



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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, 2009, and 2008. 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, 2009, and 2008, 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, 2009, and 2008, 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 attestation standards established by the American Institute of Certified Public Accountants and the standards applicable to attestation engagements in *Government Auditing Standards*, we have also issued a report on

our examination of the Lottery's internal control over financial reporting, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and on our tests of the Lottery's 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 12) 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
January 26, 2010

MANAGEMENT'S DISCUSSION AND ANALYSIS**YEARS ENDED JUNE 30, 2009, AND JUNE 30, 2008**

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, 2009, and 2008. 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 13.

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 of Florida 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 the twentieth consecutive fiscal year and has transferred a minimum of \$800 million annually to the Educational Enhancement Trust Fund (EETF) during this same period, with the fiscal year 2009 transfer exceeding \$1 billion for the seventh consecutive year.

For the fiscal year ended June 30, 2009:

- Transfers to the EETF increased slightly at approximately \$1.29 billion compared to the prior fiscal year.
- Florida Lottery's ticket sales decreased 5.7% over the prior fiscal year from approximately \$4.17 billion to \$3.94 billion.
- Prize expense decreased \$135.7 million (5.5%) during fiscal year 2009. The Lottery has the authority to vary the prize expense in order to maximize transfers. This expense typically increases or decreases in direct proportion to ticket sales and represented approximately 59.5% of net ticket sales.
- The gaming vendors' fees and retailer commissions are based on sales and therefore fluctuate in direct correlation with sales revenue. Fiscal year 2009 expenses for these items decreased over the prior year expenses by 11.5%. The additional decrease is due to a new contract effective October 1, 2008, for Scratch-Off ticket expense, which applies variable percentages to sales of tickets with different price points. Under the new contract, Scratch-Off ticket expense during fiscal year 2009 averaged 1.29% of sales plus any required royalty fees.
- Administrative operating expenses, which includes advertising, salaries and benefits, rent, utilities and maintenance, professional fees, depreciation, and other administrative expenses, decreased slightly by 1.9%. Administrative operating expenses for fiscal years 2009 and 2008 were \$71.2 million and \$72.6 million, respectively.
- Nonoperating income decreased \$36.1 million over the prior fiscal year. Net interest earned decreased approximately \$5.5 million due to lower interest rates in fiscal year 2009 compared to fiscal year 2008.

Unrealized appreciation on investments decreased \$30.7 million due to lower market values of investments of similar securities and a reduction in holdings in fiscal year 2009 compared to fiscal year 2008.

- EETF transfers of unclaimed prize money decreased \$20 million over the prior fiscal year due primarily to the reduction of unclaimed prize money generated by Scratch-Off games. On-line games generated \$3.3 million more of unclaimed prize money over fiscal year 2008.
- On January 4, 2009, the Lottery joined the Multi-State Lottery Association (MUSL) in order to sell the multi-state On-line game POWERBALL® with Power Play®. MUSL is a nonprofit government benefit association owned and operated by its member lotteries. During the 2008-09 fiscal year, MUSL included 30 state lottery entities, the District of Columbia, and the Virgin Islands. The chief executive officer of each member lottery serves on the MUSL board of directors.

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 13, the Statement of Revenues, Expenses, and Changes in Net Assets on page 14, and the Statement of Cash Flows on page 15 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 20 percent for unclaimed prizes designated for future prizes, the MUSL deposit amount, 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 the 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, 2009, and the prior fiscal years ended June 30, 2008, and 2007, as derived from the Statement of Net Assets.

Table 1
Condensed Statement of Net Assets
As of June 30, 2009, 2008, and 2007
(In Thousands)

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Assets			
Current Assets	\$ 173,395	\$ 188,200	\$ 223,108
Restricted Assets	1,926,734	2,306,205	2,553,972
Capital Assets, Net of Depreciation	<u>1,235</u>	<u>1,279</u>	<u>1,908</u>
Total Assets	<u><u>2,101,364</u></u>	<u><u>2,495,684</u></u>	<u><u>2,778,988</u></u>
Liabilities			
Current Liabilities	173,542	187,526	218,842
Current Liabilities Payable from Restricted Assets	1,083,453	1,310,654	1,488,254
Noncurrent Liabilities	<u>722,190</u>	<u>837,694</u>	<u>979,115</u>
Total Liabilities	<u><u>1,979,185</u></u>	<u><u>2,335,874</u></u>	<u><u>2,686,211</u></u>
Net Assets			
Net Investment in Capital Assets	1,235	1,279	1,908
Restricted Net Assets	<u>120,944</u>	<u>158,531</u>	<u>90,869</u>
Total Net Assets	<u><u>\$ 122,179</u></u>	<u><u>\$ 159,810</u></u>	<u><u>\$ 92,777</u></u>

Assets

Total assets at the end of fiscal year 2009 decreased by \$394 million from \$2.5 billion at June 30, 2008, to \$2.1 billion at June 30, 2009. At the end of fiscal year 2008, total assets were \$283 million less than the \$2.8 billion at the end of fiscal year 2007.

- Current assets decreased from \$188.2 million in 2008 to \$173.4 million in 2009, representing a decrease of \$14.8 million. This net decrease was primarily due to a decrease of \$17 million in cash and cash equivalents and an increase of \$3.1 million in accounts receivable. Accounts receivable for fiscal year 2009 included an additional day in the weekly billing cycle to retailers over fiscal year 2008.
- Restricted assets decreased \$379.5 million from \$2.3 billion in 2008 to \$1.9 billion in 2009. This decrease was 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 decreased \$131.4 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 \$220.0 million and purchases of \$22.1 million in new investments. In fiscal year 2008, payouts of annuities were \$246.3 million, and purchases of new investments consisted of \$3.4

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 the prior years. At June 30, 2009, the Lottery held \$842.7 million in collateral versus \$1.1 billion at June 30, 2008, and \$1.2 billion at June 30, 2007.

Liabilities

Total liabilities at June 30, 2009, were \$2.0 billion, which was \$357 million lower than the total liabilities of \$2.3 billion at June 30, 2008. The total liabilities at June 30, 2008, were \$350 million lower than the June 30, 2007, amount of \$2.7 billion.

- Current liabilities decreased from \$187.5 million on June 30, 2008, to \$173.5 million on June 30, 2009. The decrease of \$14 million was due to a combination of factors. Decreases in current liabilities were caused by a decrease of \$29.1 million in the amount due to EETF at year-end and decreases in accounts payable and security deposits payable of \$4.2 million combined. However, these decreases were offset by an increase in prizes payable of \$19.3 million. The RAFFLE game had a prizes payable on June 30, 2009, of \$7.4 million and only \$60 thousand on June 30, 2008, and the new On-line game (POWERBALL with Power Play) had a prizes payable at June 30, 2009 of \$12.4 million.
- Current liabilities from restricted assets decreased \$227.2 million from \$1.31 billion at June 30, 2008, to \$1.08 billion at June 30, 2009. This decrease can be primarily attributed to a net decrease in obligations under security lending of \$207.6 million. The June 30, 2008, balance of \$1.31 billion was \$177.6 million less than the June 30, 2007, balance of \$1.49 billion. Again, this decrease can be primarily attributed to a net decrease in obligations under security lending of \$152.6 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, as expected, experienced a decrease of \$115.8 million from year-end 2008 to 2009 and a decrease of \$142 million from year-end 2007 to 2008.

Net Assets and Changes in Net Assets

Net assets decreased by \$37.6 million from June 30, 2008, to June 30, 2009. Net assets at June 30, 2009, 2008, and 2007 were \$122.2 million, \$159.8 million, and \$92.8 million, respectively. The fiscal year 2009 decrease was primarily due to decreases in restricted net assets for future prizes and promotions of \$10.7 million, in the restricted net assets for restricted prize pool relative to the LOTTO PLUS game of \$12.0 million, and in restricted net assets for undistributed appreciation on restricted investments of \$17.9 million. The Lottery expects the restricted net assets for undistributed appreciation on restricted investments to continue to decline over the foreseeable future due to the fact that grand prizewinners consistently choose the cash option when they claim their prizes. The majority of grand prizewinners that are receiving annual payments will be paid off within the next five years. Please see Note 2 – Cash and Investments in the Notes to the Financial Statements for more details.

The Lottery began selling the POWERBALL with Power Play On-line game on January 4, 2009. In accordance with MUSL's game rules for POWERBALL with Power Play, the Lottery must contribute to various prize reserves funds

maintained by MUSL for unforeseen prize payouts. As of June 30, 2009, the Lottery had deposits with MUSL of \$3.1 million, representing the Lottery's deposits of reserve funds.

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 primarily reflects the changes in fair value of restricted investments.

Table 2 presents a condensed Summary of Revenues, Expenses, and Changes in Net Assets for the current fiscal year ended June 30, 2009, and the prior fiscal years ended June 30, 2008, and June 30, 2007, as derived from the Lottery's Statement of Revenues, Expenses, and Changes in Net Assets.

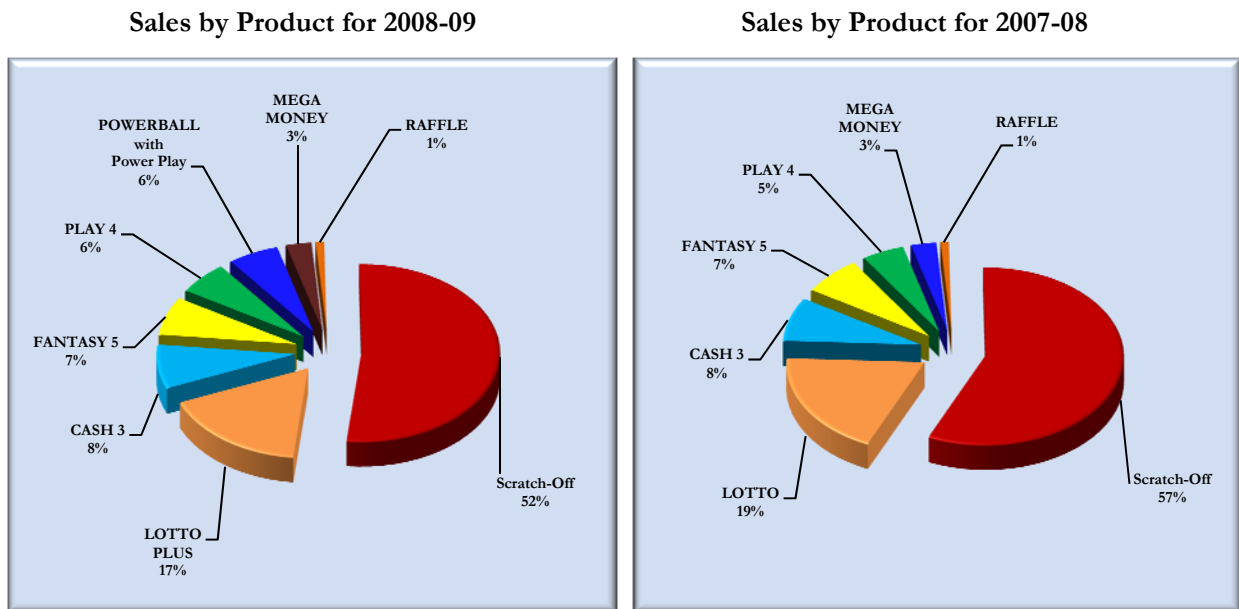
Table 2
Condensed Statement of Revenues, Expenses, and Changes in Net Assets
As of June 30, 2009, 2008, and 2007
(In Thousands)

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Operating Revenues			
Ticket Sales	\$ 3,938,037	\$ 4,174,776	\$ 4,122,116
Bad Debt Expense	(1,256)	(674)	(1,085)
On-line & Retailer Fees and Miscellaneous	7,408	7,724	7,438
Total Operating Revenues	<u>3,944,189</u>	<u>4,181,826</u>	<u>4,128,469</u>
Operating Expenses			
Prizes	2,340,372	2,476,032	2,484,519
Retailer Commissions	220,548	235,651	234,291
Vendor Commissions	59,875	81,300	78,090
Other Expenses	71,223	72,587	72,134
Total Operating Expenses	<u>2,692,018</u>	<u>2,865,570</u>	<u>2,869,034</u>
Income from Operations	<u>1,252,171</u>	<u>1,316,256</u>	<u>1,259,435</u>
Nonoperating Revenue, Net of Expenses	<u>(1,947)</u>	<u>34,191</u>	<u>(3,102)</u>
Income Before Operating Transfers	<u>1,250,224</u>	<u>1,350,447</u>	<u>1,256,333</u>
Transfers to EETF from Revenue	(1,241,015)	(1,216,839)	(1,224,524)
Transfers to EETF from Undaimed Prizes	(46,840)	(66,575)	(38,748)
Total Transfers to EETF	<u>(1,287,855)</u>	<u>(1,283,414)</u>	<u>(1,263,272)</u>
Change in Net Assets	(37,631)	67,033	(6,939)
Net Assets, Beginning of Year	<u>159,810</u>	<u>92,777</u>	<u>99,716</u>
Net Assets, End of Year	<u>\$ 122,179</u>	<u>\$ 159,810</u>	<u>\$ 92,777</u>

Sales

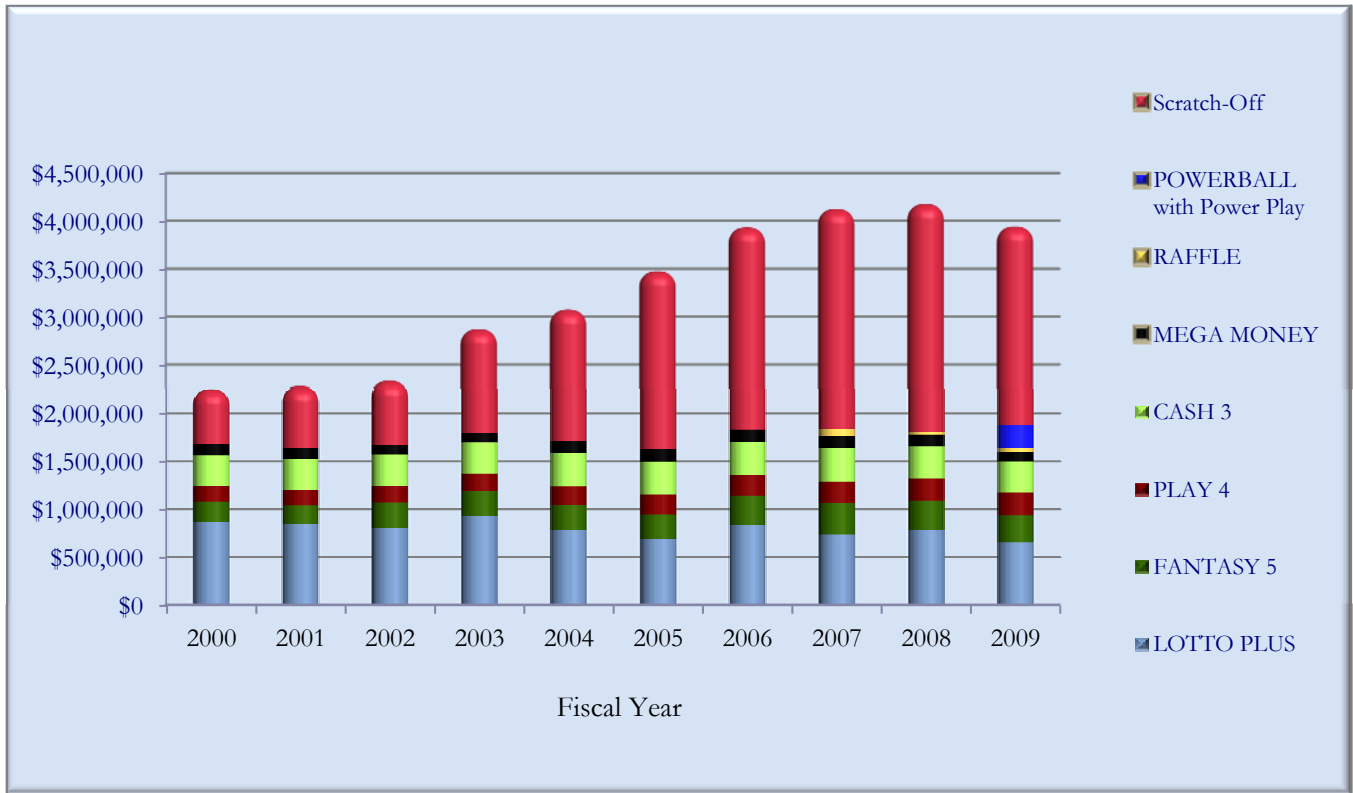
For the fiscal year ended June 30, 2009, overall ticket sales decreased \$236.7 million mirroring the downturn in the economy. Sales for On-line products increased with the new POWERBALL with Power Play game, accounting for \$233.4 million of ticket sales and compensating for the decreases in all games except for PLAY 4 and MILLIONAIRE RAFFLE, which increased \$11.0 million and \$10.5 million, respectively. Sales of Scratch-Off tickets decreased \$304.6 million from \$2.4 billion for the fiscal year ending June 30, 2008, to \$2.1 billion at June 30, 2009, and were 56.7% and 52.4% of combined sales in each of the two years, respectively. The \$5, \$10, and \$20 price point tickets accounted for approximately \$291 million of this decrease. Bad debt expense was reclassified from an operating expense to a reduction in gross revenue. The amount of bad debt expense for the fiscal years ended June 30, 2009, and June 30, 2008, was \$1,256,000 and \$674,000, respectively.

The following charts show sales by product for the various Lottery games during the June 30, 2009, and 2008, fiscal years:



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

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



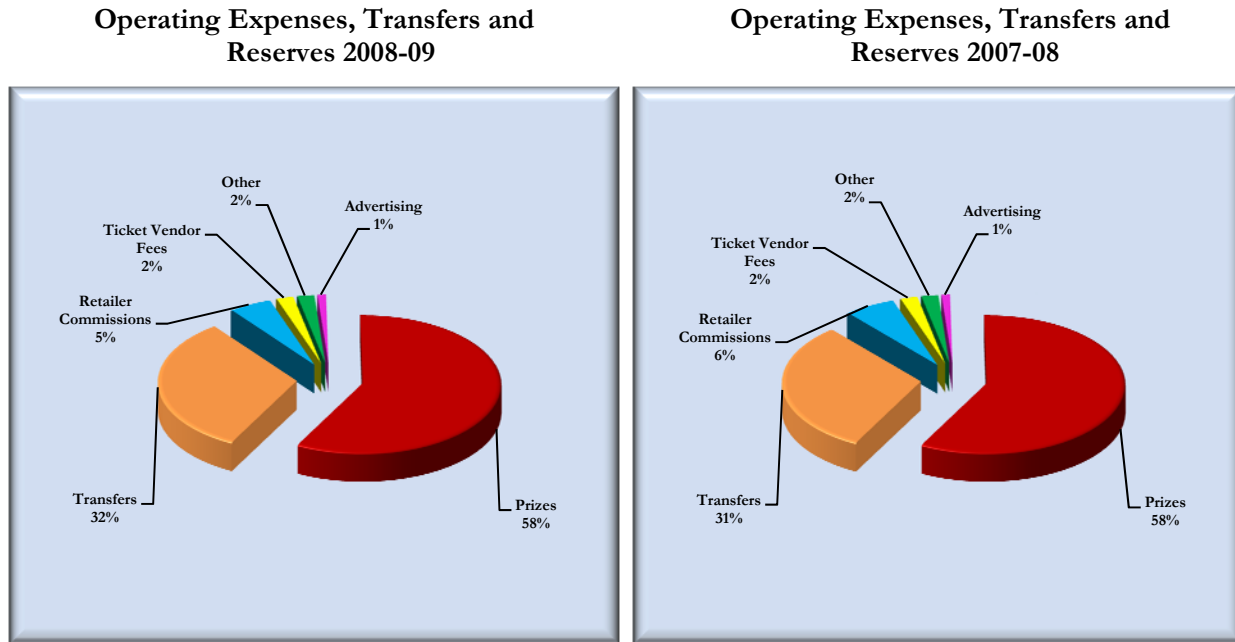
**Department of the Lottery
Historical Lottery Sales By Game
Last Ten Fiscal Years
(In Thousands)**

Fiscal Year Ended June 30	LOTTO PLUS™	FANTASY 5™	PLAY 4™	CASH 3™	MEGA MONEY™	MILLIONAIRE RAFFLE™	POWERBALL® with Power Play®	Scratch-Off	Combined Sales
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
2009	650,603	287,285	238,957	320,157	102,190	41,314	\$ 233,396	2,064,135	3,938,037

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 Lottery. 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 charts show the major components of Lottery operating expenses and transfers as a percentage of ticket sales for the June 30, 2009, and 2008, fiscal years:



Prizes, commissions and vendor fees directly relate to sales and fluctuate accordingly. In fiscal year 2009, these expenses changed 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, and depreciation, have remained relatively stable. Fiscal year 2009 and 2008 administrative expenses were \$71.2 million and \$72.6 million, respectively.

Transfers

The Lottery’s contribution to the EETF for the fiscal year ended June 30, 2009, \$1.29 billion, was the highest since the Florida Lottery began making transfers in 1988. Fiscal year 2009 was the seventh straight year in which the Lottery’s contribution to EETF was over \$1 billion. Total transfers to the EETF increased by \$4.4 million from the prior fiscal year despite a \$236.7 million decrease in ticket sales. This increase was possible due to the fact that the Lottery was able to liquidate some required reserves during the fiscal year and overall prize expense was less than previous years. When adjusted for inflation, the Lottery’s transfer amount for fiscal year 2009 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 22-year period.

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



ECONOMIC FACTORS AND FUTURE IMPACTS

The main economic factors affecting lottery sales are population growth, personal income growth, tourism, and competition for discretionary consumer spending. The Lottery must continue to find ways to maintain the annual transfer to EETF of over \$1 billion. The Lottery's strategies revolve around enhancing On-line and Scratch-Off 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 and Scratch-Off product segments.** This functional strategy will be accomplished through product extensions, redesign of existing On-line games, On-line promotions, Scratch-Off games, etc.

Chapter 24.121, Florida Statutes, authorizes the Lottery to utilize variable prize payout for both On-line games and Scratch-Off games. The Lottery began utilizing higher prize payouts for On-line games in fiscal year 2005 and did not expect the same rate of return for the On-line games; however, the Department has experienced a positive return from applying the variable prize payout strategy. During fiscal year 2008-09, the Lottery utilized the higher payout authority for LOTTO PLUS and three raffle games. Individually these efforts helped to offset the negative effects of a downturn in the economy.

- **Improve market penetration through expansion of Lottery retailer network.** The Lottery has set internal goals for continuing to grow the number of retailers so that Florida's per capita level of retailers is comparable to other successful states. The Department conducted four retailer recruitment seminars across

the state as well as continuing efforts with individual communications. As of the end of fiscal year 2009, the retailer base is holding steady at just over 13,250 retailers.

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.

BASIC FINANCIAL STATEMENTS

DEPARTMENT OF THE LOTTERY STATEMENT OF NET ASSETS

As of June 30, 2009, and June 30, 2008
(In Thousands)

Assets	<u>June 30, 2009</u>	<u>June 30, 2008</u>
Current Assets:		
Cash and cash equivalents	\$126,062	\$143,031
Interest receivable	549	728
Accounts receivable, net	43,185	40,072
Prepaid expenses	27	0
Inventories	843	844
Security deposits	2,729	3,525
Total Current Assets	173,395	188,200
Noncurrent Assets:		
Restricted Assets		
Cash and cash equivalents	50,590	74,348
Securities lending income receivable	631	2,338
Deposit with MUSL	3,073	0
Investments, grand prize	1,029,759	1,161,202
Investments, other	842,681	1,068,317
Total Restricted Assets	1,926,734	2,306,205
Capital assets, net	1,235	1,279
Total Noncurrent Assets	1,927,969	2,307,484
Total Assets	2,101,364	2,495,684
Liabilities		
Current Liabilities:		
Accounts payable and accrued liabilities	8,407	11,792
Prizes payable	77,745	58,478
Due to Educational Enhancement Trust Fund	83,765	112,879
Deposits payable	2,736	3,525
Compensated absences payable	889	852
Total Current Liabilities	173,542	187,526
Current Liabilities Payable from Restricted Assets:		
Pending purchases payable	0	1,022
Securities lending fees payable	749	2,005
Obligations under securities lending	887,749	1,095,328
Grand prizes payable	194,955	212,299
Total Current Liabilities Payable from Restricted Assets	1,083,453	1,310,654
Noncurrent Liabilities:		
Grand prizes payable from restricted assets	718,790	834,545
Compensated absences payable	2,942	2,897
Postemployment healthcare benefits payable	458	252
Total Noncurrent Liabilities	722,190	837,694
Total Liabilities	1,979,185	2,335,874
Net Assets		
Invested in capital assets	1,235	1,279
Restricted net assets for undistributed appreciation on restricted investments	67,281	85,206
Restricted net assets for Restricted Prize Pool	32,661	44,662
Restricted net assets for MUSL	3,073	0
Restricted net assets for future prizes or special prize promotions	17,929	28,663
Total Net Assets	\$122,179	\$159,810

See accompanying notes to the financial statements.

DEPARTMENT OF THE LOTTERY
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
Years ended June 30, 2009, and June 30, 2008
(In Thousands)

	<u>June 30, 2009</u>	<u>June 30, 2008</u>
Operating Revenues:		
Ticket sales	\$3,938,037	\$4,174,776
Bad debt expense	(1,256)	(674)
On-line fees and miscellaneous	7,198	7,482
Retailer fees	210	242
Total Operating Revenues	<u>3,944,189</u>	<u>4,181,826</u>
Operating Expenses:		
Prizes	2,340,372	2,476,032
Retailer commissions	220,548	235,651
Scratch-Off tickets	31,893	55,135
On-line games	27,982	26,165
Advertising	34,353	34,706
Personal services	26,857	27,240
Other contractual services	7,082	8,546
Materials and supplies	2,247	1,400
Depreciation	684	695
Total Operating Expenses	<u>2,692,018</u>	<u>2,865,570</u>
Operating Income	<u>1,252,171</u>	<u>1,316,256</u>
Nonoperating Revenues (Expenses):		
Interest	7,133	13,465
Securities lending income	18,183	53,189
Securities lending fees	(8,980)	(44,888)
Investment management fees	(327)	(290)
Net appreciation (depreciation) in fair value of investments	46,832	89,149
Property disposition (loss)	(31)	(51)
Amortization of grand prizes payable	(64,757)	(76,383)
Total Nonoperating Revenues (Expenses), Net	<u>(1,947)</u>	<u>34,191</u>
Income Before Operating Transfers	1,250,224	1,350,447
Transfers to Educational Enhancement Trust Fund:		
Transfers from revenue	(1,241,015)	(1,216,839)
Transfers from undaimed prizes	(46,840)	(66,575)
Total Transfers to Educational Enhancement Trust Fund	<u>(1,287,855)</u>	<u>(1,283,414)</u>
Change in Net Assets	(37,631)	67,033
Net Assets, Beginning of Year	159,810	92,777
Net Assets, End of Year	<u>\$122,179</u>	<u>\$159,810</u>

See accompanying notes to the financial statements.

DEPARTMENT OF THE LOTTERY
STATEMENT OF CASH FLOWS
Years ended June 30, 2009, and June 30, 2008
(In Thousands)

	<u>June 30, 2009</u>	<u>June 30, 2008</u>
Operating Activities:		
Ticket sales	\$ 3,933,668	\$ 4,168,731
Prizes paid to winners	(2,326,709)	(2,503,131)
Commissions paid and payments to retailers	(220,548)	(235,651)
Paid to vendors for goods and services	(107,442)	(125,904)
Paid to employees	(26,090)	(27,130)
Other operating revenue	7,408	7,723
Net Cash Provided by Operating Activities	1,260,287	1,284,638
Noncapital Financing Activities:		
Payments to Educational Enhancement Trust Fund	(1,316,969)	(1,287,968)
Net Cash Used in Noncapital Financing Activities	(1,316,969)	(1,287,968)
Capital and Related Financing Activities:		
Purchase of capital assets	(671)	(116)
Net Cash Used in Capital and Related Financing Activities	(671)	(116)
Investing Activities:		
Cash received from maturity of grand prize investments	219,980	246,337
Cash paid to grand prizewinners upon maturity of grand prize investments	(219,980)	(246,337)
Investment income, net of fees	16,626	19,365
Net Cash Provided by Investing Activities	16,626	19,365
Net Increase (Decrease) in Cash and Cash Equivalents	(40,727)	15,919
Cash and Cash Equivalents, Beginning of Year	217,379	201,460
Cash and Cash Equivalents, End of Year	\$ 176,652	\$ 217,379
Reconciliation of Income from Operations to Net Cash Provided by Operating Activities:		
Income from operations	\$ 1,252,171	\$ 1,316,256
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation	684	695
Changes in assets and liabilities		
(Increase) decrease in:		
Accounts receivable	(5,180)	(5,054)
Inventories	1	123
Pre-paid expenses	(27)	0
Increase (decrease) in:		
Allowance for uncollectible accounts	(1,006)	(317)
Accounts payable and accrued liabilities	(3,379)	(76)
Prizes payable	16,735	(27,098)
Compensated absences payable	82	(143)
Postemployment healthcare benefits payable	206	252
Net Cash Provided by Operating Activities	\$ 1,260,287	\$ 1,284,638
Noncash Investing, Capital and Financing Activities:		
Increase/(decrease) in fair value of investments	\$ (91,099)	\$ (64,268)

See accompanying notes to financial statements.

NOTES TO THE FINANCIAL STATEMENTS**DEPARTMENT OF THE LOTTERY**

Years ended June 30, 2009, and June 30, 2008

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 is 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. Prepaid expenses

Prepaid expenses represent warranty agreements paid for during the current year but which will not be consumed or used up until a future period.

i. 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. See Note 5 for more detailed information on Capital Assets.

j. 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, restricted net assets for the Restricted Prize Pool, and restricted net assets for Multi-State Lottery Association (MUSL). See Note 6 for more information on MUSL.

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, which was replaced by Rule 53ER08-88, Florida Administrative Code.

The restricted net assets for MUSL category represents the amount placed into reserve for the Florida Lottery by the MUSL Powerball Product Group in accordance with Rule 53ER08-84, Florida Administrative Code.

k. 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.

l. 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).

m. 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 fifty 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, 80 percent of all unclaimed prize money is deposited in the Educational Enhancement Trust Fund (EETF). The remaining 20 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. As any unclaimed prize money is remitted to EETF, it reduces overall prize expense. The Lottery also maintains reserves for

Lotto Plus and POWERBALL with Power Play. If any of these reserves are transferred to EETF, it reduces prize expense.

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.

n. *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.

o. *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.

p. *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.

q. *Bad Debt Expense*

Bad debt expense was reclassified from an operating expense to a reduction in gross revenue for the fiscal years ended June 30, 2009, and June 30, 2008. Bad debt expense is recognized when a Lottery retailer's uncollected revenue is past due. The amount of expense is based on an accounts receivable age analysis. The bad debt expense for the fiscal years ended June 30, 2009, and June 30, 2008, was \$1,256,000 and \$674,000, respectively.

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 \$893,000 at June 30, 2009, and \$1,168,000 at June 30, 2008, 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 Qualified Public Depository, which is a bank or savings association that is designated by the State of Florida Chief Financial Officer (State CFO) as authorized to receive deposits in the State and that meets the collateral requirements. The State CFO determines the collateral requirements and collateral pledging level for each Qualified Public Depository following guidelines outlined in Section 280.04, Florida Statutes, and Chapter 69C-2, Florida Administrative Code. Collateral pledging levels include 25, 50, 125, and 200 percent of a Qualified Public Depository's average daily deposit balance or, if needed, an amount as prescribed by the State CFO. Collateral may be held by another custodian with approval of the State CFO if conditions are met that protect the State's interest. Eligible collateral includes federal, federally-guaranteed, state and local government obligations, corporate bonds, and other securities designated allowable under conditions set by the State CFO.

Statutes provide that if a loss to public depositors 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 \$2,117,000 at June 30, 2009, and \$2,769,000 at June 30, 2008, 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 State CFO 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 \$175,759,000 and \$216,211,000 at June 30, 2009, and 2008, 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 securities lending agreements administered by the State Treasury 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 State of Florida Department of Financial Services, 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 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 prizewinners, 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, and sales.

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.

Mellon Bank is the agent for 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 \$887,749,000 of cash collateral for the lending program as of June 30, 2009, and \$1,095,328,000 as of June 30, 2008. At June 30, 2009, 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.

A risk factor associated with this lending agreement is the potential for shortfalls in 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, 2009, and June 30, 2008, the potential unrealized shortfall was \$45 million and \$27 million, respectively. Other risk factors include counterparty default and failure of the custodial bank to indemnify the Lottery.

Securities lending income and expenses for the years ended June 30, 2009, and 2008, consisted of (in thousands):

	<u>2009</u>	<u>2008</u>
Securities lending income	\$ 18,183	\$ 53,189
Less broker rebates	(7,835)	(43,106)
Less bank fees	(1,145)	(1,782)
Net securities lending revenue	<u>\$ 9,203</u>	<u>\$ 8,301</u>

d. Investment Credit Risk

Lottery grand prizewinner investments have been limited to U.S. Government guaranteed securities.

The State Treasury Investment Pool's current rating by Standard and Poor's is A+f.

Listed below are the Standard and Poor's credit ratings for the lending program's invested cash collateral (in thousands):

As of June 30, 2009								
Investment Type	Standard and Poor's Credit Rating							Totals
	AAA	AA	A	BBB	BB	CCC	NR	
Certificates of Deposit	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Domestic Corporate Bonds & Notes	-	9,953	195,387	12,416	-	-	4,921	222,677
Domestic Non-government Asset-backed Securities	317,625	-	-	4,196	1,494	2,114	14,357	339,786
Domestic Non-government Backed CMO's	3,913	-	-	-	-	-	-	3,913
International Corporate Bonds & Notes	19,942	-	-	-	-	-	-	19,942
International Non-government Asset-backed Securities	12,150	-	-	-	-	-	-	12,150
International Non-government Backed CMO's	72,225	-	-	-	-	-	-	72,225
Repurchase Agreements	-	-	-	-	-	-	171,988	171,988
Grand Total	<u>\$ 425,855</u>	<u>\$ 9,953</u>	<u>\$ 195,387</u>	<u>\$ 16,612</u>	<u>\$ 1,494</u>	<u>\$ 2,114</u>	<u>\$ 191,266</u>	<u>\$ 842,681</u>

As of June 30, 2008						
Investment Type	Standard & Poor's Credit Rating					Totals
	AAA	AA	A	BB	NR	
Certificates of Deposit	\$ -	\$ -	\$ -	\$ -	\$ 7,966	\$ 7,966
Domestic Corporate Bonds & Notes	9,956	199,833	290,646	-	-	500,435
Domestic Non-government Asset-backed Securities	373,148	-	-	5,527	14,833	393,508
International Corporate Bonds & Notes	19,947	-	-	-	-	19,947
International Non-government Asset-backed Securities	30,285	-	-	-	-	30,285
International Non-government Backed CMO's	108,462	-	-	-	-	108,462
Repurchase Agreements	-	-	-	-	7,714	7,714
Grand Total	<u>\$ 541,798</u>	<u>\$ 199,833</u>	<u>\$ 290,646</u>	<u>\$ 5,527</u>	<u>\$ 30,513</u>	<u>\$ 1,068,317</u>

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 (in thousands):

As of June 30, 2009		As of June 30, 2008	
Time to Maturity	Fair Value	Time to Maturity	Fair Value
< 1 year	\$ 201,477	< 1 year	\$ 217,587
> 1 year to 3 years	325,664	> 1 year to 3 years	358,555
> 3 years to 5 years	221,593	> 3 years to 5 years	251,279
> 5 years to 10 years	178,920	> 5 years to 10 years	239,954
> 10 years to 15 years	47,805	> 10 years to 15 years	40,310
> 15 years to 20 years	37,026	> 15 years to 20 years	34,796
> 20 years to 25 years	15,410	> 20 years to 25 years	17,771
> 25 years	1,864	> 25 years	950
Total	\$ 1,029,759	Total	\$ 1,161,202

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 six 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):

Investment Type	June 30, 2009	
	Fair Value (Thousands)	Weighted Average Maturity (Days)
Domestic Corporate Bonds & Notes	\$ 222,677	42
Domestic Non-government Asset-backed Securities	339,786	19
Domestic Non-government Backed CMO's	3,913	7
International Corporate Bonds & Notes	19,942	15
International Non-government Asset-backed Securities	12,150	77
International Non-government Backed CMO's	72,225	32
Repurchase Agreements	171,988	1
Total Fair Value	\$ 842,681	
Portfolio weighted average maturity		23

The effective duration of the State Treasury Investment Pool at June 30, 2009, and June 30, 2008, was approximately 1.84 years and 3.31 years, respectively.

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 of credit 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, the amount of investments subject to investment custodial credit risk at June 30, 2009, and June 30, 2008, was \$842,681,000 and \$1,068,317,000, respectively.

At June 30, 2009, and June 30, 2008, 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 had no exposure to foreign currency risk as of June 30, 2009, and June 30, 2008.

i. Investment Summary

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

Investment Type	June 30, 2009 Carrying Value	June 30, 2008 Carrying Value
Certificates of Deposit	\$ -	\$ 7,966
Repurchase Agreements	171,988	7,714
U.S. Government Obligations & Federally Guaranteed Obligations	152,569	79,413
Domestic Corporate Bonds & Notes	222,677	500,435
Domestic Non-government Asset-backed Securities	339,786	393,508
International Corporate Bonds & Notes	19,942	19,947
International Non-government Asset-backed Securities	12,150	30,285
Domestic Non-government Backed CMO's	3,913	-
International Non-government Backed CMO's	72,225	108,462
Investments Held by Others Under Securities Lending Agreements - U.S. Obligations	877,190	1,081,789
Pooled Investments with State Treasury	175,759	216,211
Total Investments	\$ 2,048,199	\$ 2,445,730

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

	June 30, 2009			
		Cash at Financial	Cash at State	
	Investments	Institutions	Treasury	Total
Cash and cash equivalents	\$ 125,169	\$ 807	\$ 86	\$ 126,062
Restricted cash and cash equivalents	50,590	-	-	50,590
Investments, grand prize	1,029,759	-	-	1,029,759
Investments, other	842,681	-	-	842,681
Total	\$ 2,048,199	\$ 807	\$ 86	\$ 2,049,092

	June 30, 2008			
		Cash at Financial	Cash at State	
	Investments	Institutions	Treasury	Total
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

3. ACCOUNTS RECEIVABLE

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

	2009	2008
Ticket sales receivable	\$ 44,533	\$ 42,477
Other receivables	118	67
Total receivables	44,651	42,544
Less allowance for doubtful accounts	(1,466)	(2,472)
Accounts receivable, net	\$ 43,185	\$ 40,072

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. Certificates of deposit are held in trust by the State with any interest earnings being credited to the vendor or retailer. Cashier’s checks are held as cash by the Lottery. These deposits are established to reduce the potential financial risk to the Lottery in the event of a breach of contract. The certificates appear on the Statement of Net Assets, in assets as security deposits, and in liabilities, as deposits payable. The checks appear on the Statement of Net Assets, in assets as cash, and in liabilities, as deposits payable.

5. CAPITAL ASSETS

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

	Balance 30-Jun-07	2007-08		Balance 30-Jun-08	2008-09		Balance 30-Jun-09
		Increase	Decrease		Increase	Decrease	
Data processing equipment	\$ 9,394	\$ -	\$ (158)	\$ 9,236	\$ 317	\$ (4,162)	\$ 5,391
Office equipment and fixtures	5,960	8	-	5,968	-	-	5,968
Vehicles and other equipment	3,172	110	(226)	3,056	367	(308)	3,115
	18,526	118	(384)	18,260	684	(4,470)	14,474
Less accumulated depreciation	16,618	695	(332)	16,981	684	(4,426)	13,239
Total capital assets, net	\$ 1,908	\$ (577)	\$ (52)	\$ 1,279	\$ -	\$ (44)	\$ 1,235

6. MULTI-STATE LOTTERY ASSOCIATION

MUSL is an unincorporated government-benefit voluntary association created for the purpose of administering joint lottery games. MUSL included 30 state lottery entities, the District of Columbia, and the Virgin Islands during fiscal year 2008-09. This association offers the POWERBALL with Power Play On-line game and several other On-line games in participating states. The chief executive officer of each member lottery serves on the MUSL board of directors.

During the fiscal year, the Lottery joined the MUSL POWERBALL with Power Play On-line game on January 4, 2009. As a member of MUSL, the Lottery is required to contribute to various prize reserve funds maintained by MUSL. The prize reserve funds serve as a contingency reserve to protect MUSL from unforeseen prize payments. MUSL periodically reallocates the prize reserve funds among the states based on relative POWERBALL with Power Play sales levels. All remaining funds remitted, and the related interest earnings (net of administrative costs), will be returned to the Lottery upon leaving MUSL, less any portion of unanticipated prize claims that may have been paid from the fund.

As of June 30, 2009, the Lottery had deposits with MUSL of \$3,073,441, representing the Lottery's deposits of reserve funds.

A copy of the MUSL financial statements may be obtained by submitting a written request to MUSL, 4400 N.W. Urbandale Drive, Urbandale, Iowa 50322.

7. LONG-TERM LIABILITIES

a. Grand Prizes Payable

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

	<u>2009</u>	<u>2008</u>
LOTTO grand prizes (face value)	\$ 1,159,485	\$ 1,351,603
Mega Money grand prizes (face value)	8,081	7,660
Win for Life grand prizes (face value)	13,022	13,386
Flamingo Fortune Game Show grand prizes (face value)	900	1,000
Monthly Grand game prizes (face value)	12	36
Win a Million grand prizes (face value)	450	500
Yearly Bonus grand prizes (face value)	200	250
Lucky for Life grand prizes (face value)	11,900	12,300
Set for Life grand prize (face value)	2,640	2,820
Cash Spectacular grand prize (face value)	700	750
Cash for Life	240	250
Loaded for Life	3,150	3,250
Billion Dollar Blockbuster	9,500	-
Gas for Life	204	-
Less imputed interest	<u>(296,739)</u>	<u>(346,961)</u>
Net present value of grand prizes payable	<u>\$ 913,745</u>	<u>\$ 1,046,844</u>
Current prizes payable from restricted assets	\$ 194,955	\$ 212,299
Noncurrent prizes payable from restricted assets	<u>718,790</u>	<u>834,545</u>
Total grand prizes payable	<u>\$ 913,745</u>	<u>\$ 1,046,844</u>

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

<u>Year Ended June 30</u>	<u>Amount</u>
2010	\$ 201,688
2011	178,428
2012	154,477
2013	132,613
2014	109,804
2015-2019	223,032
2020-2024	83,000
2025-2029	81,725
2030-2034	39,557
2035-2039	<u>6,160</u>
Grand prizes (face value)	1,210,484
Less imputed interest	<u>(296,739)</u>
Net present value of grand prizes payable	<u>\$ 913,745</u>

b. Compensated Absences Payable

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

	<u>2009</u>	<u>2008</u>
Current compensated absences	\$ 889	\$ 852
Noncurrent compensated absences	<u>2,942</u>	<u>2,897</u>
Total	<u>\$ 3,831</u>	<u>\$ 3,749</u>

c. Changes in Long-Term Liabilities

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

	2008-2009				
	Balance	Additions	Reductions	Balance	Amount Due
	July 1, 2008			June 30, 2009	Within One Year
Grand prizes payable	\$1,046,844	\$86,881	(\$219,980)	\$913,745	\$194,955
Compensated absences payable	3,749	1,775	(1,693)	3,831	889
Postemployment healthcare benefits payable	252	206	-	458	-
Total long-term liabilities	\$1,050,845	\$88,862	(\$221,673)	\$918,034	\$195,844

	2007-2008				
	Balance	Additions	Reductions	Balance	Amount Due
	July 1, 2007			June 30, 2008	Within One Year
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	\$1,217,311	\$81,819	(\$248,285)	\$1,050,845	\$213,151

See Note 9 for additional information regarding the postemployment healthcare benefits payable.

8. 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, 2009, was \$1,287,855,000 (32.6 percent of revenues), and for the fiscal year ended June 30, 2008, the transferred amount was \$1,283,414,000 (30.7 percent of revenues).

Because the net appreciation in fair value of investments and amortization of grand prizes payable, included in nonoperating 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.

The amount due to EETF at June 30, 2009, and June 30, 2008, was as follows (in thousands):

	<u>June 30, 2009</u>	<u>June 30, 2008</u>
On-line ticket sales	\$ 1,873,902	\$ 1,805,996
Average percent transferred	41%	37%
Transfer of On-line ticket sales	<u>767,245</u>	<u>675,547</u>
Unclaimed On-line ticket prizes	36,816	33,514
Percent transferred	80%	80%
Transfer of unclaimed On-line ticket prizes	<u>29,453</u>	<u>26,811</u>
Scratch-Off ticket sales	2,064,135	2,368,781
Average percent transferred	22%	22%
Transfer of Scratch-Off ticket sales	<u>450,384</u>	<u>512,143</u>
Unclaimed Scratch-Off ticket prizes	21,734	49,705
Percent transferred	80%	80%
Transfer of unclaimed Scratch-Off ticket prizes	<u>17,387</u>	<u>39,764</u>
Nonoperating revenues (expenses), net	(1,947)	34,191
Add:		
Net (appreciation) depreciation in fair value of investments	(46,832)	(89,149)
Amortization of grand prizes payable	<u>64,757</u>	<u>76,383</u>
Total Nonoperating revenues, net	<u>15,978</u>	<u>21,425</u>
On-line fees and miscellaneous revenue	<u>7,408</u>	<u>7,724</u>
Due for the year	<u>\$ 1,287,855</u>	<u>\$ 1,283,414</u>
Balance due, beginning of year	112,879	117,433
Paid during the year	<u>(1,316,969)</u>	<u>(1,287,968)</u>
Due to Educational Enhancement Trust Fund, June 30	<u>\$ 83,765</u>	<u>\$ 112,879</u>

9. 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 six 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

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:

<u>Class or Plan</u>	<u>Fiscal Year</u>	<u>Fiscal Year</u>
	<u>Ended</u>	<u>Ended</u>
	<u>June 30, 2009</u>	<u>June 30, 2008</u>
Senior Management	13.12 percent	13.12 percent
Regular Employees	9.85 percent	9.85 percent
Special Risk	20.92 percent	20.92 percent
DROP - Applicable to members from all of the above classes	10.91 percent	10.91 percent

Employer rates include 1.11 percent for the postemployment insurance subsidy. Also, employer rates, other than for DROP participants, include 0.05 percent for administrative costs of the Public Employee 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, 2009, June 30, 2008, and June 30, 2007, totaled \$1,505,000, \$1,575,000, and \$1,605,000, respectively, which were equal to 100 percent of the required contributions for each fiscal year. These contributions represented 8.4 percent, 8.7 percent, and 9.0 percent of covered payroll, for the fiscal years ended June 30, 2009, June 30, 2008, and June 30, 2007, 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, 2009, 2008, and 2007, totaled \$320,295, \$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 2008 through June 2009. 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 under Section 112.363, Florida Statutes. For the fiscal years ended June 30, 2009, and 2008, 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, 2009, 2008, and 2007, the Lottery contributed 1.11 percent of payroll for all active employees covered by the FRS, pursuant to Section 112.363, Florida Statutes. For the years ending June 30, 2009, 2008, and 2007, the Lottery contributed \$184,076, \$185,528, and \$180,607, respectively, in employer contributions to the HIS Program. HIS contributions are 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.

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 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 postemployment health benefit liability beginning in the fiscal year ended June 30, 2008.

Postemployment health benefits payable at June 30, 2009, and June 30, 2008, was \$458,000 and \$252,000, respectively.

10. 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, 2009, are scheduled as follows (in thousands):

Year Ending June 30	Headquarters	Districts	Total
2010	\$ 2,587	\$ 949	\$ 3,536
2011	2,612	885	3,497
2012	2,639	889	3,528
2013	2,666	630	3,296
2014	2,693	274	2,967
Total	\$ 13,197	\$ 3,627	\$ 16,824

Rental expense under all operating leases totaled approximately \$2,959,000 and \$3,412,000 for the fiscal years ended June 30, 2009, and 2008, respectively.

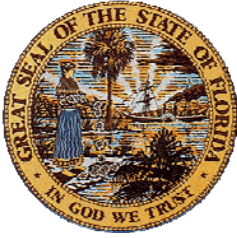
11. OTHER COMMITMENTS

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's On-line gaming system 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, 2009, and 2008, was \$27,982,000, and \$26,165,000, respectively.

The Lottery entered into a new contract for Scratch-Off game tickets and related services on October 1, 2008. The rates under the new contract range from 0.9744 percent to 2.24 percent based on ticket price points and total annual sales. The rate in effect for July 1, 2008, through September 30, 2008, was 2.25 percent based on net sales. Compensation under these agreements amounted to \$31,893,000 for the fiscal year ended June 30, 2009, and \$55,135,000 for the fiscal year ended June 30, 2008.

12. 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.



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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, 2009, 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 Lottery's internal control over financial reporting as of June 30, 2009, 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, and for its assertion of the effectiveness of internal control over financial reporting, included in the accompanying **MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**. Our responsibility is to express an opinion on the Lottery's internal control over financial reporting 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. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our examination included obtaining an understanding of the internal control over

financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of the internal control based on the assessed risk. Our examination also included performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with accounting principles generally accepted in the United States of America. An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls 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, 2009, based on the criteria established by *Internal Control – Integrated Framework* issued by COSO.

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 – A. 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
January 26, 2010

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

CHARLIE CRIST
Governor



LEO DIBENIGNO
Secretary

FLORIDA LOTTERYManagement's Report on Internal Control Over Financial Reporting

The Florida Lottery's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with accounting principles generally accepted in the United States of America. An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

Management is responsible for establishing and maintaining effective internal control over financial reporting. Management assessed the effectiveness of the Florida Lottery's internal control over financial reporting as of June 30, 2009, based on the framework set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control – Integrated Framework*. Based on that assessment, management concluded that, as of June 30, 2009, the Florida Lottery's internal control over financial reporting is effective based on the criteria established in *Internal Controls – Integrated Framework*.

The Florida Lottery

A handwritten signature in blue ink, appearing to read "Leo DiBenigno".

Leo DiBenigno
Secretary

January 26, 2010



**STATE OF FLORIDA
DEPARTMENT OF THE LOTTERY
SCHEDULE OF FINDINGS
FOR THE FISCAL YEAR ENDED JUNE 30, 2009**

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. To avoid the possibility of compromising Lottery information, specific details of these findings are not disclosed in this report. However, the appropriate Lottery personnel have been notified of these issues. While the Lottery had made progress in resolving many of the findings disclosed in connection with the prior audit, some issues previously reported had not yet been fully addressed.

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

Finding No. 2: Electronic Funds Transfer of Annual Prize Payments

The Lottery pays the prizewinners of various games through a deferred payment plan (annuity) option rather than a single lump-sum payment. The Lottery annually pays approximately \$220 million to its 795 annuity recipients, approximately 716 of whom receive their payments through an electronic funds transfer. In Auditor General Report No. 2009-101, we concluded that controls over related electronic funds transfer payments could be improved. Our review of claims processing procedures used by the Lottery during fiscal year 2008-2009 disclosed that although the Lottery had made some improvements in controls over electronic funds transfers to annuity recipients, these controls could be further 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 again been notified of this issue.

Recommendation: We recommend that the Lottery make the necessary enhancements to its controls over electronic funds transfer payment of annuities.

Finding No. 3: Monthly Reports

In accordance with Section 24.105(4), Florida Statutes, the Lottery issues monthly reports to the Governor, the State of Florida Chief Financial Officer (State CFO), the President of the Senate, and the Speaker of the House of Representatives. These reports disclose details of the total Lottery revenues, prize disbursements, and other expenses of the Lottery during the preceding month and present fiscal year-to-date cumulative totals.

A review of the 12 monthly reports submitted for the 2008-09 fiscal year disclosed 13 instances where amounts shown for the reported month were incorrect on 5 of the reports. Examples of errors included the following:

- In the November 2008 report, the month's prize disbursement amounts for Mega Money and Scratch-Off tickets were reported with October's monthly totals rather than the November amounts. As a result, Mega Money prize disbursements were overstated by \$85,000 and Scratch-Off ticket prize disbursements were overstated by approximately \$3.7 million.
- In the June 2009 report, due to a formula error, the combined total for June's prize disbursements was overstated by approximately \$2.5 million.
- In the Transfers Due to Education table in the April and May 2009 reports, a formatting error resulted in each month's On-line expense total being rounded to millions and appearing as \$90,000 and \$96,000, respectively. On-line expense for April and May 2009 should have been shown as approximately \$90 million and approximately \$96.3 million, respectively. The calculation of the total available for transfer was correct.

Our audit disclosed that there were no procedures in place for a final proofing of the reports to check for mathematical accuracy prior to sending them to the oversight bodies. Lottery personnel indicated that these reports were produced through a manual process that depended largely on spreadsheets to calculate monthly activity. They also indicated that this manual process, along with staffing issues, led to the undetected report errors.

Reports such as these are relied upon by oversight entities such as the Governor, the State CFO, and the Legislature in order to monitor Lottery operations. When the amounts reported are in error, the conclusions drawn in reliance on these reports may also be prone to error.

Recommendation: We recommend that the Lottery establish and follow a procedure for the performance of a final review of these reports prior to sending them to the Governor, the State CFO, and the Legislature.

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 August 24, 2009, retailers comprising one minority type totaled 64 percent of the total number of minority retailers. A similar finding has been included in previous audit reports.

The Lottery has developed an outreach program to increase retailer participation in under-represented minority groups; however, despite these efforts, the level of participation from these groups has decreased slightly over the past fiscal year.

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

EXHIBIT - A
MANAGEMENT'S RESPONSE

CHARLIE CRIST
Governor



LEO DIBENIGNO
Secretary

FLORIDA LOTTERY

January 26, 2010

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 January 13, 2010 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, 2009. 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 make the necessary enhancements to its controls over annuity electronic funds transfer payments.

Response: The Lottery will update all written procedures and related documents to ensure the new security enhancements are consistently utilized.

3. Recommendation: The Lottery should establish and follow a procedure for the performance of a final review of the monthly reports prior to sending them to the Governor, the State CFO, and the Legislature.



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EXHIBIT - A
MANAGEMENT'S RESPONSE (Continued)

David W. Martin, CPA
Auditor General
Response to Preliminary and Tentative Findings
January 26, 2010
Page 2 of 2

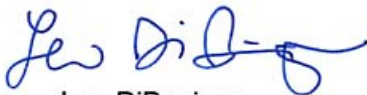
Response: The Lottery takes its financial reporting requirements very seriously to ensure all data is timely and accurate. The department will enhance its review processes as well as evaluate additional alternatives to ensure accuracy of monthly and year to date data.

4. Recommendation: 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

cc: Dennis Harmon, Deputy Secretary
Ken Hart, General Counsel
Marcy Jackson, Chief Financial Officer
Andy Mompeller, Inspector General