

FINANCIAL STATEMENTS AND  
INDEPENDENT AUDITOR'S REPORT

**Montana State Lottery**

*June 30, 2009 and 2008*

**GALUSHA  
HIGGINS &  
GALUSHA**

A PROFESSIONAL CORPORATION OF  
CERTIFIED PUBLIC ACCOUNTANTS

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# Montana State Lottery

June 30, 2009 and 2008

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# LEGISLATIVE AUDIT DIVISION

Tori Hunthausen, Legislative Auditor  
Monica Huyg, Legal Counsel



Deputy Legislative Auditors:  
James Gillett  
Angie Grove

December 2009

The Legislative Audit Committee  
of the Montana State Legislature:

Enclosed is the report on the financial audit of the Montana Lottery for the fiscal year ended June 30, 2009.

The audit was conducted by Galusha, Higgins, & Galusha, PC, under a contract between the firm and our office. There are no recommendations in this report.

Respectfully submitted,

*/s/ Tori Hunthausen*

Tori Hunthausen, CPA  
Legislative Auditor

09C-01

**Montana State Lottery**  
COMMISSION MEMBERS AND ADMINISTRATIVE OFFICIALS  
*June 30, 2009*

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**COMMISSION MEMBERS**

Robert Crippen, Chairperson

Wilbur Rehmann

Craig Anderson

Tom Keegan

Elizabeth O'Halloran

**RESIDENCE**

Butte

Helena

Glendive

Helena

Missoula

**ADMINISTRATIVE OFFICIALS**

George Parisot, Montana State Lottery Director

John Tarr, Montana State Lottery Director of Security

**Montana State Lottery**  
INTRODUCTION AND BACKGROUND  
*June 30, 2009*

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**INTRODUCTION**

The purpose of our contract with the State of Montana and Montana State Lottery was to conduct a financial-compliance audit of the Montana State Lottery's financial statements and issue an opinion on such. The scope of our services is defined in our contract with the Office of the Legislative Auditor, dated June 18, 2009, and as supplemented by certain requirements included in the bidder information.

As a result of our audit, we have also issued a report on compliance and on internal control structure over financial reporting based on our audit of the financial statements performed in accordance with *Government Auditing Standards*.

**BACKGROUND**

The Montana State Lottery was created in November 1986 by a referendum vote of the people of Montana. The "Montana State Lottery Act of 1985" appears as Chapter 669 of the Montana Session Laws and Title 23, Chapter 7, of the Montana Code Annotated. The general purpose is to allow lottery games in which players purchase from the State, through the administration of the Montana State Lottery, a chance to win a prize. Disposition of revenue is a minimum of 45 percent for prizes and a maximum of 10 percent for commission to sales agents. The Montana State Lottery is required to transfer its net revenue to the Montana State General Fund.



## INDEPENDENT AUDITOR'S REPORT

To the Commissioners  
Montana State Lottery  
Helena, Montana

We have audited the accompanying financial statements of the Montana State Lottery (the Lottery), an enterprise fund of the State of Montana, as of and for the years ended June 30, 2009 and 2008, as listed in the table of contents. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

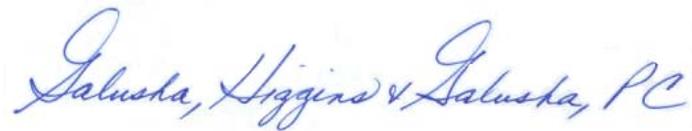
As discussed in Note A, the financial statements present only the Lottery and are not intended to present the financial position of the State of Montana and the results of its operations and cash flows of its proprietary fund types in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Lottery, an enterprise fund of the State of Montana, as of June 30, 2009 and 2008, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated December 8, 2009 on our consideration of the Lottery's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

To the Commissioners  
Montana State Lottery

The Management's Discussion and Analysis on pages 6 through 9 are not a required part of the basic financial statements but are supplementary information required by the 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 supplementary information. However, we did not audit the information and express no opinion on it.

A handwritten signature in blue ink that reads "Galusha, Higgins & Galusha, PC". The signature is written in a cursive, flowing style.

GALUSHA, HIGGINS AND GALUSHA, PC  
Certified Public Accountants and Advisors

Helena, Montana  
December 8, 2009

## MANAGEMENT'S DISCUSSION AND ANALYSIS

The following *Management Discussion and Analysis* of the Montana State Lottery's (Lottery) activities and financial performance provides the reader with an introduction to and overview of the financial statements for the fiscal years ended June 30, 2009 and 2008. We encourage readers to consider this information in conjunction with the financial statements, which directly follow.

### FISCAL YEAR 2009 HIGHLIGHTS

The Montana Lottery completed another successful fiscal year, with overall sales slightly ahead of fiscal year 2008, at \$43.8 million. This figure marks a new record for the fourth year in a row.

Lottery scratch game sales were 3% higher than fiscal year 2008, spurred by increased introductions of games, and the strong player and retailer support of licensed products like Yahtzee®, PBR® and Monopoly®, and periodic second-chance drawings associated with some scratch games.

Hot Lotto sales saw a significant increase of more than 23%, primarily due to higher-than-average jackpots and an advertising focus on the value of the Sizzler option. Powerball, Montana Cash, Montana Millionaire and Wild Card sales remained relatively steady. While many lotteries nationwide experienced sales declines, the Montana Lottery was able to stabilize sales by adding more than 150 new retail locations because of a partnership with the Montana Board of Horse Racing to offer fantasy sports in bars and casinos. Traditional lottery product sales in these new retail locations converted to nearly \$2 million in additional revenue.

Expenses for advertising, personal services, repairs and maintenance and contracted services increased. The benefit of fiscal year 2009 expenditures will be realized in fiscal year 2010, since most expenditures in these areas became investments for future ad campaigns. The transfer to the General Fund was \$10.1 million in fiscal year 2009, or 23.1% of total revenue.

### OVERVIEW OF THE FINANCIAL STATEMENTS

The Lottery is classified as a special-purpose government fund engaged only in business-type activities. Accordingly, the Lottery operates in much the same manner as commercial enterprises using the full accrual method of accounting in accordance with accounting principles generally accepted in the United States of America. The basic financial statements consist of two components:

1. Three Fund Financial Statements: a *Statement of Net Assets*, a *Statement of Revenues, Expenses, and Changes in Fund Net Assets*, and a *Statement of Cash Flows*; and
2. Notes to the Financial Statements.

The *Statement of Net Assets* provides information about the nature and amounts included in both short-term and long-term assets and liabilities at the end of the year. Long-term fixed assets are capitalized and depreciated over their useful lives. Because the Lottery is required to transfer all "profits," or the excess of assets over liabilities, to the State's General Fund, its "net assets" will always be zero.

The *Statement of Revenues, Expenses, and Changes in Fund Net Assets* includes all of the current years' revenues and expenses. Revenues are recognized when earned and become measurable, not when they are received. Expenses are recognized when incurred, not when paid. This statement measures the success of the Lottery's operations over the past two years and details the total amount transferred to the General Fund.

Continued

## MANAGEMENT'S DISCUSSION AND ANALYSIS

### OVERVIEW OF THE FINANCIAL STATEMENTS, continued

The final statement is the *Statement of Cash Flows*. The primary purpose is to provide information about the cash receipts and payments during the reporting period. The statement also reports changes in cash resulting from operations, investing and financial activities, and provides answers to questions such as where cash came from and what cash was used for.

### NET ASSETS

The table below presents a summary of the Lottery's *Statement of Fund Net Assets*.

Condensed Statement of Net Assets as of June 30				
	2009	2008	Dollar Change	Percentage Change
			\$(100,015	
Current Assets	\$4,524,671	\$4,624,686	)	-2.2%
Capital Assets net of depreciation	234,436	227,090	7,346	3.2%
Other Assets	1,903,057	1,765,916	137,141	7.8%
<b>Total Assets</b>	<b>\$6,662,164</b>	<b>\$6,617,692</b>	<b>\$ 44,472</b>	<b>0.7%</b>
			\$	
Current Liabilities	\$5,194,036	\$5,286,692	(92,656)	-1.75%
Long-Term Liabilities	1,468,128	1,331,000	137,128	10.3%
<b>Total Liabilities</b>	<b>\$6,662,164</b>	<b>\$6,617,692</b>	<b>\$ 44,472</b>	<b>0.7%</b>
Invested in Capital Assets, Net of Related Debt	\$ 234,436	\$ 227,090	\$ 7,346	3.2%
Unrestricted Net Assets	(234,436)	(227,090)	(7,346)	3.2%
<b>TOTAL NET ASSETS</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>0.0%</b>

The change in Current Assets is mainly due to an increase in Cash and Cash Equivalents, a decrease in Inventories, and an increase in Prepaid Expenses. Cash and Cash Equivalents are \$156,334 higher as a result of an increase in Short Term Investments. The decrease in inventory of \$604,585 is due to a decrease in scratch game inventories as a result of games closing and the timing between ordering and receiving new games. The increase of \$371,000 in Prepaid Expenses is due primarily to the prepaid expense of \$392,200 for the purchase of 11 trucks for prizes for our scratch game that began in the spring of 2009. Other Assets increased by \$137,141 which is due to an increase in the Multi-State Reserve fund.

The decrease in Current Liabilities is due to a combination of increases and decreases. The major decrease of \$506,356 is in Prize Liability which is a timing difference between the winning of prizes and the payment of prizes. The major increase is in the Transfer Obligation for the fourth quarter of 2009 which was higher than that of fourth quarter 2008 by \$253,332. The increase in Long-Term Liabilities is mainly a result of an increase in MUSL (Multi-State Lottery Association) prize liability and an increase in the liability for OPEB,

Continued

## MANAGEMENT'S DISCUSSION AND ANALYSIS

### NET ASSETS, continued

Other Post Employment Benefits. MUSL prize liability is amounts held in reserve accounts for multi-state games, and it increased by \$60,954. The OPEB liability increased by \$111,819 and is a result of the requirements of GASB 45 and recording of the "implied rate subsidy". This requires the State of Montana to book substantial liabilities for the state's requirement to allow retired employees to remain in the medical insurance plan after retirement. This results in an implicit rate subsidy since retirees pay the same amount as active employees. "Actuaries Northwest" prepared the report for the State of Montana to calculate the Annual Required Contribution according to GASB. The 2009 allocation was made based on benefits expense and the number of FTE for the agency.

The category, *Invested in Capital Assets, Net of Related Debt*, consists of capital assets less accumulated depreciation, amortization and the outstanding balance on the debt related to the purchase of these assets, if any. Since the Lottery is required to transfer the total results of operations to the General Fund, the Net Assets should always be \$ - 0 - and the Unrestricted category is just a balancing figure. This figure can be used to measure asset liquidity and demonstrates where and if the Lottery's funds are obligated.

### OPERATIONS AND CHANGES IN NET ASSETS

The table below presents a summary of the Lottery's Operations for the last two years.

Condensed Statements of Revenues, Expenses, & Changes in Fund Net Assets  
For the Years Ended June 30

	2009	2008	Dollar Change	Percentage Change
Total Operating Revenues	\$43,852,041	\$43,827,111	\$ 24,930	0.1%
Total Direct Game Costs	29,486,257	29,330,405	155,852	0.5%
<b>Income Before Operating Expenses</b>	<b>\$14,365,784</b>	<b>\$ 14,496,706</b>	<b>\$(130,922)</b>	<b>-0.9%</b>
Total Operating Expense	4,182,511	3,545,581	636,930	17.9%
<b>Operating Net Income</b>	<b>\$10,183,273</b>	<b>\$ 10,951,125</b>	<b>\$(767,852)</b>	<b>-7.0%</b>
Total Non-operating Revenues(Expenses)	(56,965)	77,438	(134,403)	-173.6%
<b>Income Before Transfers</b>	<b>\$10,126,308</b>	<b>\$ 11,028,563</b>	<b>\$(902,255)</b>	<b>-8.3%</b>
Transfer to General Fund	10,126,308	11,028,563	(902,255)	-8.2%
<b>CHANGE IN NET ASSETS</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>0.0%</b>

Hot Lotto revenue increased by 23.5% and Scratch and Wild Card revenues showed slight increases. Sports Action sales increased by 100% since it was the first year of this game. Power Ball revenue decreased by 4.1% with Montana Cash and Montana Millionaire also showing slight decreases.

Total Operating Expenses increased 17.9%. The majority of the individual expense categories increased, with the largest increases occurring in Advertising and Advertising Production. This was a result of start up costs with a new Advertising Agency, expanding our advertising into new venues including social networks, and starting the Montana Sports Action games Fantasy Football and Fantasy Auto Racing.

Continued

## MANAGEMENT'S DISCUSSION AND ANALYSIS

### OPERATIONS AND CHANGES IN NET ASSETS, continued

The income from Non-Operating activities decreased from the previous year. This was a result of the decrease in interest earnings.

The revenues in excess of expenses for the fiscal year resulted in the Lottery transferring \$10.1 million to the General Fund.

### CAPITAL ASSETS AND DEBT ADMINISTRATION

The Lottery follows the State's policy of capitalizing long-term assets with an historical value of \$5,000 or more. In FY2009, the Lottery's capital assets were divided into two categories: 1) vehicles used by staff, and 2) office and computer equipment.

Capital assets are depreciated using the straight-line method over the appropriate estimated useful life, ranging from three to seven years.

In FY 2009, the Lottery purchased a trailer for use at events where Lottery products are sold, a copier and two company vehicles.

The Lottery currently has no debt-related commitments.

### LOOKING AHEAD

The Lottery's goal is to maximize revenue for the State's programs while maintaining the public trust in lottery gaming. This requires offering games that Lottery players want to play, providing convenient locations for the purchase of tickets, and controlling operating expenses.

The Lottery estimates that 45 new scratch games will be introduced in fiscal year 2010. We plan to continue building scratch sales through innovative game themes, offering games with built-in name recognition (licensed property games), and higher price points. In January 2010, the Lottery will offer its first \$20 scratch game.

The Lottery will continue to look for opportunities to meet the expectations of our players for new and interesting games. We will again offer the *Montana Millionaire* game. A twice-daily draw game will be introduced in February. This game, called 10 Spot, is expected to generate \$2 million yearly in sales. Additionally, the Montana Lottery will join in a multi-state venture to offer Mega Millions to Montana Lottery players. This game will be managed by the Multi-State Lottery Association and offers drawings on Tuesdays and Fridays.

### CONTACTING THE LOTTERY'S FINANCIAL MANAGEMENT

This financial report is designed to provide a general overview of the Lottery's finances for all of Montana's citizens, taxpayers, players and creditors, and to report on the Lottery's accountability for its funds. Questions concerning any of the information provided in this report or requests for additional information should be addressed to: Montana Lottery, 2525 N. Montana Avenue, Helena, MT 59601.

Concluded

**Montana State Lottery**  
**STATEMENTS OF FUND NET ASSETS**

*June 30,*

	2009	2008
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 1,845,899	\$ 1,689,565
Accounts receivable, net of allowance	1,344,939	1,412,247
Due from other funds	1,015	590
Inventory	795,040	1,399,625
Collateral securities on loan	109,844	65,762
Prepaid expenses	427,934	56,897
Total current assets	4,524,671	4,624,686
<b>FURNITURE AND EQUIPMENT</b>		
Furniture and equipment	545,289	540,093
Accumulated depreciation	(310,853)	(313,003)
Total furniture and equipment	234,436	227,090
<b>OTHER ASSETS</b>		
MUSL Prize Reserve fund	1,763,784	1,626,036
Investments	139,273	139,880
Total other assets	1,903,057	1,765,916
<b>TOTAL ASSETS</b>	<b>\$ 6,662,164</b>	<b>\$ 6,617,692</b>
<b>LIABILITIES AND FUND NET ASSETS</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable	\$ 655,690	\$ 612,088
Estimated prize liability	1,524,464	2,030,820
Liability for securities on loan	109,844	65,762
Transfer obligations to general fund	2,536,330	2,282,998
Due to other funds	-	24,512
Deferred revenue	252,863	190,851
Current portion of accrued compensated absences	114,845	79,661
Total current liabilities	5,194,036	5,286,692
<b>LONG-TERM LIABILITIES</b>		
MUSL prize liability	1,155,717	1,094,763
Long-term portion of accrued compensated absences	96,223	131,868
OPEB liability	216,188	104,369
Total long-term liabilities	1,468,128	1,331,000
<b>TOTAL LIABILITIES</b>	<b>6,662,164</b>	<b>6,617,692</b>
<b>COMMITMENTS AND CONTINGENCIES</b>		
	-	-
<b>FUND NET ASSETS</b>		
Invested in capital assets, net of related debt	234,436	227,090
Unrestricted fund net assets	(234,436)	(227,090)
<b>TOTAL FUND NET ASSETS</b>	-	-
<b>TOTAL LIABILITIES AND FUND NET ASSETS</b>	<b>\$ 6,662,164</b>	<b>\$ 6,617,692</b>

The accompanying notes are an integral part of these financial statements.

**Montana State Lottery**  
**STATEMENTS OF REVENUES, EXPENSES AND**  
**CHANGES IN FUND NET ASSETS**  
*for the years ended June 30,*

	<b>2009</b>	<b>2008</b>
<b>OPERATING REVENUES</b>		
Scratch ticket games	\$ 13,231,442	\$ 12,837,664
Terminal ticket games	30,595,437	30,983,930
Miscellaneous	25,162	5,517
Total operating revenues	43,852,041	43,827,111
 <b>DIRECT GAME COSTS</b>		
Scratch ticket prize expense	7,953,974	7,764,464
Terminal ticket prize expense	15,126,369	15,073,993
Retailer commission	2,517,344	2,564,201
Gaming vendor fees	2,701,988	2,804,090
Cost of tickets sold	1,186,582	1,123,657
Total direct game costs	29,486,257	29,330,405
Income before operating expenses	14,365,784	14,496,706
 <b>OPERATING EXPENSES</b>		
Advertising	852,736	635,240
Advertising production	217,682	93,328
Communications	106,603	89,047
Audit fees	47,029	52,177
Contractual services	217,827	133,929
Depreciation and amortization	44,969	43,206
Interest expense	-	4,327
Management fees	50,987	50,449
MUSL operating fees	30,143	32,175
Other	44,944	57,743
Public relations	49,128	59,399
Personal services	1,830,625	1,736,905
Repairs and maintenance	104,421	43,154
Supplies and materials	351,151	306,249
Utilities and rent	157,887	140,416
Travel	76,379	67,837
Total operating expenses	4,182,511	3,545,581
<b>OPERATING NET INCOME</b>	<b>10,183,273</b>	<b>10,951,125</b>

Continued

The accompanying notes are an integral part of these financial statements.

**Montana State Lottery**  
**STATEMENTS OF REVENUES, EXPENSES AND**  
**CHANGES IN FUND NET ASSETS**  
*for the years ended June 30,*

	<b>2009</b>	2008
NON-OPERATING REVENUES (EXPENSES)		
Interest income	\$ 55,714	\$ 181,987
Securities on loan income	5,274	4,486
Securities on loan expense	(1,773)	(3,511)
Loss on disposal of furniture and equipment	(4,361)	(1,155)
OPEB expenses	(111,819)	(104,369)
Total non-operating net (loss) income	(56,965)	77,438
INCOME BEFORE TRANSFERS	<b>10,126,308</b>	11,028,563
TRANSFERS OUT		
General fund	<b>10,126,308</b>	11,028,563
Total transfers out	<b>10,126,308</b>	11,028,563
Fund net assets, beginning of year	-	-
Fund net assets, end of year	\$ -	\$ -

Concluded

The accompanying notes are an integral part of these financial statements.

**Montana State Lottery**  
**STATEMENTS OF CASH FLOWS**  
*for the years ended June 30,*

	2009	2008
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Cash received from sales	\$ 43,980,936	\$ 43,881,901
Cash paid to suppliers for goods and services	(8,460,193)	(7,990,495)
Cash paid to employees	(1,831,086)	(1,599,957)
Cash paid for prizes	(23,525,745)	(22,611,058)
Net cash from operating activities	<b>10,163,912</b>	11,680,391
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Interest and dividend income	59,215	85,739
Cash paid to MUSL Prize Reserve Fund	(137,749)	(116,068)
(Purchase) sale of long term investments (reclassification of STIP)	607	(139,880)
Net cash from investing activities	<b>(77,927)</b>	(170,209)
<b>CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES</b>		
Transfers out:		
General fund	(9,872,976)	(11,599,078)
Net cash from non-capital financing activities	<b>(9,872,976)</b>	(11,599,078)
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Purchase of fixed assets	(60,675)	(61,696)
Proceeds from sale of fixed assets	4,000	1,101
Net cash from capital and related financing activities	<b>(56,675)</b>	(60,595)
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>156,334</b>	(149,491)
Cash and cash equivalents, beginning of year	<b>1,689,565</b>	1,839,056
Cash and cash equivalents, end of year	<b>\$ 1,845,899</b>	\$ 1,689,565
<b>RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES</b>		
Operating income	\$ 10,183,273	\$ 10,951,125
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	44,969	43,206
Changes in assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	67,308	(30,493)
Due from other funds	(425)	269
Inventory	604,585	214,750
Collateral securities on loan	(44,082)	(65,762)
Prepaid expenses	(371,037)	(48,529)
Increase (decrease) in:		
Accounts payable	43,602	1,489
Lottery prizes payable	(445,402)	419,228
Liability for securities on loan	44,082	65,762
Deferred revenue	62,012	83,783
Due to other funds	(24,512)	15,372
Compensated absences payable	(461)	30,191
Net cash from operating activities	<b>\$ 10,163,912</b>	\$ 11,680,391

The accompanying notes are an integral part of these financial statements.

**Montana State Lottery**  
NOTES TO THE FINANCIAL STATEMENTS  
*June 30, 2009 and 2008*

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**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Organization - The Montana State Lottery (hereafter referred to as the Lottery) was created in November 1986 by a referendum vote of the people of Montana.

Section 23-7-101, Montana Code Annotated (MCA) establishes the provision of the code under which the Lottery operates. The Lottery is overseen by a five-member commission consisting of Montana residents appointed by the Governor. The Commission, by law, has the power to operate a state lottery, determine the type and forms of lottery games, set ticket prices, determine the number and size of prizes, conduct lottery drawings, enter into agreements to offer lottery games with other states, and prepare financial reports. The Lottery is attached to the Department of Administration for administrative purposes.

Disposition of revenue is a minimum of 45 percent for prizes and a maximum of 10 percent for commission to sales agents. The remaining revenues, less expenses, are transferred to the Montana State General Fund.

Reporting Entity - The Lottery is included in the State of Montana's financial statements as an enterprise fund. In accordance with governmental accounting and financial reporting standards, there are no component units to be included within the Lottery's financial statements as a reporting agency.

Basis of Accounting - The Lottery utilizes the accrual basis of accounting and is classified as an enterprise fund of the governmental proprietary fund type. Enterprise funds account for operations similar to private business enterprises where the intent of the Legislature is that costs are to be financed or recovered primarily through user charges, or where the Legislature has decided that periodic determination of revenue earned, expenses incurred or net income is appropriate.

Revenue Recognition - Sales of scratch lottery tickets are made to licensed retailers who market the tickets to the public on a commission basis. Revenue is recognized when tickets are activated by retailers. Tickets activated, but not sold by retailers, may be returned for credit. Sales are reduced for estimated ticket returns.

Sales of terminal issued tickets, Powerball, Wild Card, Hot Lotto, Qwik Tix, Montana Cash, and Montana Millionaire, are made through licensed retailers who market the tickets on a commission basis using computerized terminals. Revenue is recognized on drawing dates for Powerball, Wild Card, Hot Lotto, Montana Cash, and Montana Millionaire. Tickets sold in advance of future drawing dates are recorded as deferred revenue until the ticket becomes valid for a drawing. Qwik Tix revenue is recognized at the time of the sale by the retailer through the terminal.

Cash and Cash Equivalents - Cash and cash equivalents consist of interest-bearing deposits with the Montana Board of Investments short-term investments pool, cash deposited with banks and cash on deposit with the Montana State Treasurer that is part of the State's pooled cash and is not separately identifiable as to specific types of securities. These funds are highly liquid and may be drawn on daily.

Continued

**Montana State Lottery**  
NOTES TO THE FINANCIAL STATEMENTS  
*June 30, 2009 and 2008*

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**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**, continued

Allowance for Uncollectible Accounts - The Lottery uses the allowance method to account for uncollectible receivables. The allowance is based on management's estimate of possible bad debts.

Advertising Costs - Advertising costs are expensed as incurred.

Allowance for Returned Tickets - The Lottery's policy is to accept any unplayed scratch ticket from a retailer for credit without regard to when the ticket or pack of tickets was activated. Therefore, an allowance to recognize the possibility of returns is calculated at the end of each fiscal year.

Inventory - Inventory consists of tickets and supplies. Ticket inventory includes scratch lottery tickets that are carried at cost using the specific identification method. Tickets are charged to cost of sales when activated. Unsold tickets are charged to cost of sales upon the end or cancellation of the related game. Supply inventory is carried at cost and expensed as used.

Prizes - Prize expense is recognized based on a predetermined prize structure for each scratch ticket and terminal game. Free tickets, when used as part of a game's prize structure, are recorded as a reduction in revenue and not as prize expense.

Unclaimed Prizes - Prizes for Powerball, Wild Card, Hot Lotto, Montana Cash, and Montana Millionaire must be claimed within six months after the appropriate draw date. Prizes for Qwik Tix must be claimed within six months of the sales date. Prizes for scratch games must be claimed within six months of the announced end of each game. The unclaimed prize amounts are taken as a reduction in the Lottery Prizes Payable liability and the Prize Expense and are transferred to the State of Montana General Fund as a portion of the quarterly transfer. The combined amounts of unclaimed prizes for terminal games were \$732,122 and \$588,115 and for the scratch games were \$635,838 and \$469,497 for the fiscal years ended June 30, 2009 and 2008, respectively.

Furniture and equipment - Furniture and equipment are recorded at cost. Donated furniture and equipment are recorded at their estimated fair market value at the date of donation. Ordinary maintenance and repairs are charged to operations as incurred; major renewals and betterments are capitalized. Upon disposition or retirement of furniture and equipment, the cost and related accumulated depreciation or amortization are removed from the accounts. Gain or loss on disposal is reflected in nonoperating revenues and expenses. Depreciation and amortization are calculated on a straight-line basis over estimated useful lives of three to seven years. The Lottery conforms to the State of Montana capitalization threshold for recording furniture and equipment as well as buildings and building/land improvements. The threshold for capitalizing furniture and equipment is \$5,000 and the threshold for capitalizing buildings and building/land improvements is \$25,000.

Use of Estimates - The preparation of financial statements in conformity with Generally Accepted Accounting Principles (GAAP) requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Continued

**Montana State Lottery**  
 NOTES TO THE FINANCIAL STATEMENTS  
 June 30, 2009 and 2008

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**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**, continued

Compensated Absences - State employees earn vacation leave ranging from fifteen to twenty-four days per year based on years of service. Vacation leave may be accumulated to a total not to exceed twice the maximum number of days earned annually. Sick leave accumulates at a rate of twelve days per year with no maximum accumulation. Upon retirement or termination, an employee is paid for 100 percent of unused vacation leave and 25 percent of unused sick leave.

Subsequent Events - Management has performed an analysis of the activities and transactions subsequent to June 30, 2009 to determine the need for any adjustments to and/or disclosures within the audited financial statements for the year ended June 30, 2009. Management has performed this analysis through December 8, 2009.

**NOTE B - CASH AND CASH EQUIVALENTS**

Cash and cash equivalents consist of the following:

	<b>June 30,</b>	
	<b>2009</b>	2008
Short-term investment pool	<b>\$ 1,534,754</b>	\$1,358,596
Cash on deposit with State Treasurer	<b>300,925</b>	320,819
Cash in revolving deposit account	<b>10,000</b>	10,000
Petty cash	<b>220</b>	150
	<b>\$ 1,845,899</b>	\$1,689,565

The Lottery participates in the Montana Board of Investments Short Term Investment Pool (STIP). STIP balances are highly liquid investments with maturities of 397 days or less. \$139,273 of STIP was reclassified to Investments to reflect investments in Structure Investment Vehicles that were no longer liquid. The bank balance of the revolving deposit account was \$20,327 and \$32,673 at June 30, 2009 and 2008, respectively, and was covered by federal depository insurance up to \$250,000. The carrying amounts reported in the Statements of Fund Net Assets for cash and cash equivalents approximate the fair market value.

**NOTE C - INVESTMENT RISK DISCLOSURES**

Effective June 30, 2005, the State of Montana implemented the provisions of Governmental Account Standards Board (GASB) Statement No. 40, *Deposit and Investment Risk Disclosures*. The Lottery participates in two investment pools: the Multi-State Lottery Association (MUSL) reserve accounts and the State of Montana's Short Term Investment Pool (STIP). There are four types of risk that must be disclosed. These risks are defined below followed by their applicability to each of the investment pools.

Continued

**Montana State Lottery**  
NOTES TO THE FINANCIAL STATEMENTS  
*June 30, 2009 and 2008*

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**NOTE C - INVESTMENT RISK DISCLOSURES**, continued

**Credit risk** is defined as the risk that an issuer to an investment will not fulfill its obligation, i.e., not make timely principal and interest payments.

**Custodial credit risk** is the risk that the Lottery would not be able to recover the value of the investment or collateral securities that are in the possession of an outside party in the event of the failure of that party.

**Concentration of credit** is the risk of loss attributed to the magnitude of a government's investment in a single issuer.

**Interest rate risk** is the risk that changes in interest rates will adversely affect the fair value of an investment.

Multi-State Lottery Association

The MUSL investment policy for prize reserve and unreserved funds states that permitted investments "include direct obligations of the United States government, perfected repurchase agreements, and obligations issued or guaranteed as to payment of principal and interest by agencies or instrumentalities of the United States government, and mutual funds of approved investments". Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk nor concentration of credit risk per GASB Statement No. 40.

Short-term Investment Pool

All short-term funds are held in the State's Short Term Investment Pool (STIP) administered by the Board of Investments (BOI). A summarized description of their disclosure follows and full details may be obtained by contacting the Montana Board of Investments, 2401 Colonial Drive, P.O. Box 200126, Helena, MT 59620-0126.

For STIP securities, BOI's policy specifies that STIP securities have ratings provided by Standard and Poors, Moody's, or Fitch. Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and do not require disclosure of credit quality per GASB Statement No. 40.

Continued

**Montana State Lottery**  
 NOTES TO THE FINANCIAL STATEMENTS  
 June 30, 2009 and 2008

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**NOTE C - INVESTMENT RISK DISCLOSURES**, continued

Per the BOI, all STIP securities are registered in the nominee name for the Montana Board of Investments and held in the possession of the Board's custodial bank. The STIP Investment Policy Statement addresses concentration of credit risk by investment category. The STIP had concentration of credit risk exposure to the Federal Home Loan Bank of 10.04%, Federal National Mortgage Association (Fannie Mae) of 8.67 % and the Federal Home Loan Mortgage Corp. (Freddie Mac) of 8.69% as of June 30, 2009. For the year ended June 30, 2008 the STIP had concentration of credit risk exposure to the Federal Home Loan Bank of 6.89%, Federal National Mortgage Association (Fannie Mae) of 7.55 % and the Federal Home Loan Mortgage Corp. (Freddie Mac) of 5.71%. Per GASB Statement No. 40, interest rate disclosures are not required for STIP since STIP is a 2a-7-like pool.

Under the provisions of state statutes, the BOI has, by a Securities Lending Authorization Agreement, authorized the custodial bank, State Street Bank, to lend BOI's securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. During the period the securities are on loan, BOI receives a fee and the custodial bank must initially receive collateral equal to 102% of the fair value of the securities on loan and must maintain collateral equal to not less than 102% of the fair value of the loaned security. BOI retains all rights of ownership during the loan period. At year-end, the BOI had no credit risk exposure.

**NOTE D - ACCOUNTS RECEIVABLE**

Accounts receivable consists of the following:

	<b>June 30,</b>	
	<b>2009</b>	<b>2008</b>
Interest receivable	\$ 1,961	\$ 7,639
Accounts receivable	1,665,218	1,650,158
Allowance for returned tickets	(322,240)	(245,550)
	<b>\$ 1,344,939</b>	<b>\$1,412,247</b>

**NOTE E - INVENTORY**

Inventory consists of the following:

	<b>June 30,</b>	
	<b>2009</b>	<b>2008</b>
Scratch tickets	\$ 671,924	\$1,265,494
Supplies	123,116	134,131
	<b>\$ 795,040</b>	<b>\$1,399,625</b>

Continued

**Montana State Lottery**  
 NOTES TO THE FINANCIAL STATEMENTS  
 June 30, 2009 and 2008

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**NOTE F - FURNITURE AND EQUIPMENT**

A summary of furniture and equipment for the Lottery is as follows:

	June 30, 2008	Additions	Deletions	June 30, 2009
Furniture, fixtures and equipment	\$ 540,093	\$ 60,675	\$ (55,479)	\$ 545,289
Accumulated depreciation	(313,003)	(44,969)	47,119	(310,853)
	<u>\$ 227,090</u>	<u>\$ 15,706</u>	<u>\$ (8,360)</u>	<u>\$ 234,436</u>

**NOTE G - INVESTMENTS**

Investments of \$139,273 and \$139,880, respectively, have been recorded at June 30, 2009 and 2008 as a result of a reclassification of STIP. The STIP balances include investments in Structure Investment Vehicles that are no longer liquid. As a result these investments have been reclassified from cash and cash equivalents to investments.

**NOTE H - MULTI-STATE LOTTERY ASSOCIATION (MUSL)**

Joint Venture Association - In November 1989, the Lottery joined the Multi-State Lottery Association (MUSL). MUSL was created in September 1987 to operate a multi-state lottery game for the benefit of party lotteries. The Powerball game, Wild Card game and Hot Lotto game are presently the only games operated jointly by the members in which the Lottery participates. Each lottery participating in MUSL is represented on the Board of Directors.

Prize Reserve Fund Receivable/Payable - As a member of the MUSL, the Lottery is required to contribute to various prize reserve funds maintained by MUSL. The contributions are to be used to fund unanticipated prize claims. All funds remitted and the related interest earnings will be returned to the Lottery upon leaving the association, less any portion of unanticipated prize claims, which was paid from the fund.

The Lottery contributes to the reserve fund through the set-aside for prizes. Payments made to the reserve fund are considered a portion of the prize expense associated with each game.

During 1990, the MUSL Board created the unreserved accounts to record interest earned on the various prize reserve funds when the prize reserve fund balance is not below the predetermined ceiling amount. The amounts in the unreserved accounts may be used at the Board's discretion.

Continued

**Montana State Lottery**  
NOTES TO THE FINANCIAL STATEMENTS  
*June 30, 2009 and 2008*

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**NOTE H - MULTI-STATE LOTTERY ASSOCIATION**, continued

The long-term receivable balance of \$1,763,784 and \$1,626,036 at June 30, 2009 and 2008, respectively, represents the Lottery's share of the MUSL prize reserve fund that had a balance of \$131,621,432 and \$127,328,390 for 2009 and 2008, respectively. The long-term liability balance of \$1,155,717 and \$1,094,763 at June 30, 2009 and 2008, respectively, represents the Lottery's share of the total estimated prize liability.

Lotto\*America Prizes and Investments - Prizes awarded to Lotto\*America grand prize winners are paid in twenty annual installments funded by investments in United States Treasury zero coupon bonds. Bonds purchased on behalf of Montana source winners are held in trust by MUSL with the Montana State Lottery as beneficiary. As the bonds mature, the proceeds are forwarded to the Lottery and distributed to the grand prize winners on the anniversary date of each win.

At June 30, 2009 and 2008, MUSL held United States Government zero coupon bonds in trust for the Lottery winners with respective par values of \$18,709,949 and \$22,355,852 and respective market values of \$17,634,165 and \$22,008,985.

The Lottery has eight Lotto\*America/Powerball/Tri-West winners. The combined total future prize payments owed is \$18,709,000 and \$24,052,000, at June 30, 2009 and 2008, respectively. The present value of future prize payments approximates the current market value of the bonds held in trust for the Lottery winners.

Total annual payments due as of June 30, 2009 are:

2010	\$ 4,971,000
2011	4,603,000
2012	2,155,000
2013	2,155,000
2014	2,155,000
Thereafter	2,670,000
	<u>\$18,709,000</u>

Continued

**Montana State Lottery**  
NOTES TO THE FINANCIAL STATEMENTS  
*June 30, 2009 and 2008*

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**NOTE H - MULTI-STATE LOTTERY ASSOCIATION**, continued

Multi-State Lottery Association Financial Position - Information related to the Multi-State Lottery Association's audited financial statements is as follows:

	<b>June 30,</b>	
	<b>2009</b>	2008
Total assets	<b>\$ 816,489,735</b>	\$ 899,702,496
Total liabilities	<b>\$ 815,695,384</b>	\$ 899,427,315
Total net assets	<b>794,351</b>	275,181
Total liabilities and net assets, unrestricted	<b>\$ 816,489,735</b>	\$ 899,702,496
Total revenues	<b>\$ 4,818,549</b>	\$ 11,167,862
Total expenses	<b>3,620,598</b>	4,125,761
Distributions to party lotteries	<b>678,781</b>	6,964,312
Increase in unrestricted net assets	<b>\$ 519,170</b>	\$ 77,789

**NOTE I - ESTIMATED PRIZE LIABILITY**

The estimated prize liability represents the Lottery's estimate of prizes payable related to games in process at year-end based on the predetermined prize structure of each outstanding game.

**NOTE J - OBLIGATION TO TRANSFER FUNDS**

The Lottery is required to transfer its net revenue to the Montana State General Fund. This change was enacted through the passage of SB 83 by the 1995 Legislature and signed into law by Governor Racicot in April 1995. Transfer obligations outstanding at June 30, 2009 and 2008 were \$2,536,330 and \$2,282,998, respectively.

**NOTE K - LEASES**

The Lottery leases its office, administrative and warehouse facilities under a non-cancelable lease agreement that is effective September 2007 through August 2017. Rent expense under operating leases charged to operations was \$135,400 and \$116,979 for the years ended June 30, 2009 and 2008, respectively.

Continued

**Montana State Lottery**  
NOTES TO THE FINANCIAL STATEMENTS  
*June 30, 2009 and 2008*

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**NOTE K - LEASES**, continued

The future minimum lease payments under operating leases that have remaining terms in excess of one year as follows:

2010	\$ 128,685
2011	132,546
2012	136,522
2013	140,618
2014	144,837
Thereafter	487,612
	<u>\$1,170,820</u>

**NOTE L - EMPLOYEE BENEFIT PLANS**

Pension Plan - The Lottery participates in the Public Employees Retirement System (PERS). PERS is a statewide mandatory cost-sharing multiple employer retirement plan which covers all employees. The plan is established under State law and is administered by the State of Montana. The plan provides disability and death benefits to plan members and beneficiaries as well as a choice of a defined benefit or a defined contribution retirement plan.

The plan issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained from the following address: Public Employees Retirement System, Montana Public Employees Retirement Administration, P.O. Box 200131, 100 N. Park, Suite 220, Helena, MT 59620-0131, (406) 444-3154.

The contribution rate for the plan is required and determined by State law. In fiscal years 2009 and 2008 the employer contribution rate, expressed as a percentage of covered payroll, was 7.035% and the employee rate was 6.9%. The amounts contributed to the plan by the employer during the years ended June 30, 2009 and 2008, were \$95,742 and \$89,150, respectively, and were equal to the required contributions for each year.

Deferred Compensation Plan - The Lottery's full-time regular employees are eligible to participate in the State of Montana's deferred compensation plan. The plan is administered by Benefits Corporation on behalf of Great West Life Insurance Company through a contract with the State of Montana. The amount of compensation deferred is not available to employees until termination, retirement, death, or unforeseen emergency. All amounts are deferred under the plan created under Internal Revenue Code Section 457 and Title 19, chapter 50, Montana Code Annotated (MCA). Assets of the deferred compensation plan are required to be held in trusts, custodial accounts or insurance company contracts for the exclusive benefit of participants and their beneficiaries.

Continued

**Montana State Lottery**  
NOTES TO THE FINANCIAL STATEMENTS  
*June 30, 2009 and 2008*

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**NOTE M - RELATED PARTY TRANSACTIONS**

During the ordinary course of business, other State agencies provide certain services and supplies to the Lottery. During 2009 and 2008, total payments to other State agencies were approximately \$230,289 and \$213,743, respectively.

**NOTE N - COMMITMENTS, CONTINGENCIES AND SUBSEQUENT EVENT**

Scratch Tickets - The Lottery has an agreement with Scientific Games, Inc. to print scratch game tickets. The contract expires August 8, 2013. The Lottery incurs approximately \$850,000 to \$900,000 per year under this contract.

Terminal Vendor - The Lottery is contracted with Intralot, Inc to provide for the operation of the gaming system through March 30, 2016. The contract price is 5.8% of each \$1 ticket sold, which is an estimated total contract price of approximately \$17 million over the seven-year contract. The contract price includes the cost of equipment.

Advertising - The Lottery signed a contract with Citrus, Inc. to provide advertising services for \$11,805 per month through July 31, 2011.

**NOTE O - RISK MANAGEMENT/PUBLIC ENTITY RISK POOL**

The Lottery contributes to the Group Employee Comprehensive Medical and Dental Plan and the Property and Casualty Insurance plans of the State of Montana. Details of these plans can be found in the State of Montana Comprehensive Annual Financial Report available through the Department of Administration's website at [www.mt.gov/doa/afsd/cafr/cafr.asp](http://www.mt.gov/doa/afsd/cafr/cafr.asp).

**NOTE P - OPEB (OTHER POST EMPLOYMENT BENEFITS)**

Effective for the year ended June 30, 2008, Governmental Accounting Standards Board (GASB) Statement 45 and the reporting requirements for the "implied rate subsidy" required the State of Montana to book substantial liabilities. The liability is a result of the state's requirement to allow retired employees to remain in the health insurance plan after retirement. This results in an implicit rate subsidy since retirees pay the same amount as active employees. "Actuaries Northwest" prepared the report for the State of Montana to calculate the Annual Required Contribution under the GASB. The allocation was then made based on 2009 and 2008 benefits expense and the number of full time employees for an agency. The amounts calculated for the years ended June 30, 2009 and 2008 for the Lottery are \$216,188 and \$104,369, respectively. Additional information will be available in the State's Comprehensive Annual Financial Report (<http://accounting.mt.gov/cafr/carf.asp>).

Concluded



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

Board of Directors  
Montana State Lottery  
Lottery  
Helena, Montana

We have audited the financial statements of Montana State Lottery, as of and for the year ended June 30, 2009, and have issued our report thereon dated December 8, 2009. 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

In planning and performing our audit, we considered Montana State Lottery internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

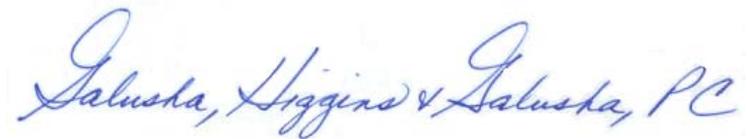
Board of Directors  
Montana State Lottery

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

### Compliance

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

This report is intended solely for the information and use of the audit committee, management, and others within the Montana State Lottery, and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in blue ink that reads "Galusha, Higgins & Galusha, PC". The signature is written in a cursive, flowing style.

GALUSHA, HIGGINS AND GALUSHA, PC  
Certified Public Accountants and Advisors

Helena, Montana  
December 8, 2009

OTHER ENCLOSURES

**Montana State Lottery**

*June 30, 2009 and 2008*



910 N. Last Chance Gulch, Helena, MT 59601  
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A Professional Corporation of  
Certified Public Accountants and Advisors

www.ghg-cpa.com

December 8, 2009

File: 41.9262  
6/30/09

Montana State Lottery Commission  
Helena, Montana

This letter is intended to inform the Montana State Lottery Commission about significant matters related to the conduct of the annual audit so it can appropriately discharge its oversight responsibility and that we comply with our professional responsibilities to the Montana State Lottery Commission.

The following summarizes various matters which must be communicated to you under auditing standards generally accepted in the United States of America and *Government Auditing Standards*.

**The Auditor's Responsibility Under Auditing Standards Generally Accepted in the United States of America**

Our audit of the financial statements of the Montana State Lottery (the Lottery) for the year ended June 30, 2009 was conducted in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error, fraudulent financial reporting or misappropriation of assets. 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. Accordingly, the audit was designed to obtain reasonable, rather than absolute, assurance about the financial statements. We believe that our audit accomplished that objective.

In accordance with *Government Auditing Standards*, we have also performed tests of controls over internal control over financial reporting and tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements that contribute to the evidence supporting our opinion on the financial statements. However, they do not provide a basis for opining on the Lottery's internal control over financial reporting or on compliance and other matters.

**Management Judgments and Accounting Estimates**

Accounting estimates are an integral part of the preparation of financial statements and are based upon management's current judgment. The process used by management encompasses their knowledge and experience about past and current events and certain assumptions about future events. Management has informed us they used all the relevant facts available to them at the time to make the best judgments about accounting estimates and we considered this information in the scope of our audit. Estimates significant to the financial statements include the allowance for returned tickets of \$322,240. The Commission may wish to monitor throughout the year the process used to compute and record these accounting estimates.

**Planned Scope and Timing of the Audit**

We conducted our audit consistent with the planned scope and timing previously communicated to you.

**Audit Adjustments**

There were no audit adjustments made to the original trial balance presented to us to begin our audit.

**Uncorrected Misstatements**

We accumulated no uncorrected misstatements (passed adjustments).

**Accounting Policies and Alternative Treatments**

Management and the Commission have the ultimate responsibility for the appropriateness of the accounting policies used by the Montana State Lottery. The Lottery did not adopt any significant new accounting policies nor have there been any changes in existing significant accounting policies during the current period which should be brought to your attention for approval.

We did not identify any significant or unusual transactions or significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.

**Disagreements with Management**

We encountered no disagreements with management over the application of significant accounting principles, the basis for management's judgments on any significant matters, the scope of the audit or significant disclosures to be included in the financial statements.

**Consultation with Other Accountants**

We are not aware of any consultations management had with other accountants about accounting or auditing matters.

**Major Issues Discussed with Management Prior to Retention**

No major issues were discussed with management prior to our retention to perform the aforementioned audit.

**Difficulties Encountered in Performing the Audit**

We did not encounter any difficulties in dealing with management relating to the performance of the audit.

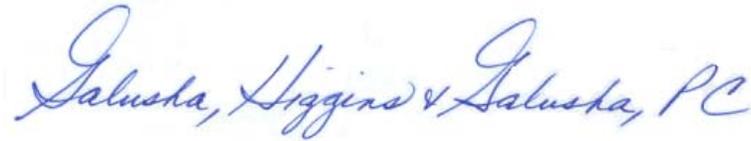
**Closing**

We will be pleased to respond to any questions you have about the foregoing. We appreciate the opportunity to continue to be of service to the Montana State Lottery.

\* \* \* \* \*

This report is intended solely for the information and use of the Commission Members, Directors and management and is not intended to be and should not be used by anyone other than the specified parties.

Very truly yours,

A handwritten signature in blue ink that reads "Galusha, Higgins & Galusha, PC". The signature is written in a cursive, flowing style.

GALUSHA, HIGGINS AND GALUSHA, PC  
Certified Public Accountants and Advisors