



A REPORT
TO THE
MONTANA
LEGISLATURE

FINANCIAL-COMPLIANCE AUDIT

Montana State Lottery

*For the Fiscal Year Ended
June 30, 2013*

JANUARY 2014

LEGISLATIVE AUDIT
DIVISION

13-30A

**LEGISLATIVE AUDIT
COMMITTEE**

REPRESENTATIVES

RANDY BRODEHL, CHAIR
Randybrodehl57@gmail.com

VIRGINIA COURT
Vjchd52@yahoo.com

MIKE CUFFE
mike@mcuffe.com

MARY McNALLY
mcnallyhd49@gmail.com

RYAN OSMUNDSON
Ryanosmundson@gmail.com

J.P. POMNICHOWSKI
pomnicho@montanadsl.net

SENATORS

DEE BROWN
repdee@yahoo.com

TAYLOR BROWN
taylor@northernbroadcasting.com

GREG JERGESON, VICE CHAIR
jergeson4senator@yahoo.com

SUE MALEK
senatormalek@gmail.com

FREDRICK (ERIC) MOORE
mail@SenatorEricMoore.com

MITCH TROPILA
tropila@mt.net

MEMBERS SERVE UNTIL A
MEMBER'S LEGISLATIVE TERM
OF OFFICE ENDS OR UNTIL A
SUCCESSOR IS APPOINTED,
WHICHEVER OCCURS FIRST.

§5-13-202(2), MCA

FRAUD HOTLINE
(STATEWIDE)
1-800-222-4446
(IN HELENA)
444-4446
ladhotline@mt.gov

FINANCIAL-COMPLIANCE AUDITS

Financial-compliance audits are conducted by the Legislative Audit Division to determine whether an agency's financial operations are properly conducted, the financial reports are presented fairly, and the agency has complied with applicable laws and regulations. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States Government Accountability Office. Financial-compliance audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) licenses.

Government Auditing Standards, the Single Audit Act Amendments of 1996 and OMB Circular A-133 require the auditor to issue certain financial, internal control, and compliance reports. This individual agency audit report is not intended to comply with these reporting requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 2011, was issued March 29, 2012. The Single Audit Report for the two fiscal years ended June 30, 2013, will be issued by March 31, 2014. Copies of the Single Audit Report can be obtained by contacting:

Single Audit Coordinator
Office of Budget and Program Planning
Room 277, State Capitol
P.O. Box 200802
Helena, MT 59620-0802

Legislative Audit Division
Room 160, State Capitol
P.O. Box 201705
Helena, MT 59620-1705

AUDIT STAFF

JEFF CLARKE
PAUL J. O'LOUGHLIN

BRENDA KEDISH
KAREN E. SIMPSON

Reports can be found in electronic format at:
<http://leg.mt.gov/audit>

LEGISLATIVE AUDIT DIVISION

Tori Hunthausen, Legislative Auditor
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors
Cindy Jorgenson
Angus Maciver

January 2014

The Legislative Audit Committee
of the Montana State Legislature:

This is our financial-compliance audit report of the Montana State Lottery (Lottery) for the fiscal year ended June 30, 2013. The financial statements included on page A-3 of the report contain comparative information for the fiscal year ended June 30, 2012. We issued an unmodified opinion on the financial statements, which means the reader can rely on the information presented. This report contains one recommendation to the Lottery related to compliance with policy requirements governing the use of procurement cards.

The Lottery's response to the audit is included on B-1 of the audit report. We thank the Director and her staff for their assistance and cooperation throughout the audit.

Respectfully submitted,

/s/ Tori Hunthausen

Tori Hunthausen, CPA
Legislative Auditor

TABLE OF CONTENTS

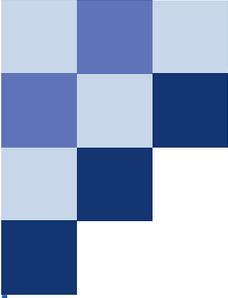
Appointed and Administrative Officials	ii
Report Summary	S-1
CHAPTER I – INTRODUCTION.....	1
Introduction	1
Background.....	1
Prior Audit Recommendations.....	2
CHAPTER II – FINDINGS AND RECOMMENDATIONS.....	3
Procurement Cards	3
INDEPENDENT AUDITOR’S REPORT AND LOTTERY FINANCIAL STATEMENTS	
Independent Auditor’s Report	A-1
Statement of Net Position as of June 30, 2013, and 2012.....	A-3
Statement of Revenues, Expenses, and Changes in Net Position for the Years Ended June 30, 2013, and 2012	A-4
Statements of Cash Flows for the Years Ended June 30, 2013, and 2012.....	A-5
Notes to the Financial Statements.....	A-6
LOTTERY RESPONSE	
Montana State Lottery	B-1

APPOINTED AND ADMINISTRATIVE OFFICIALS

			<u>Term Expires</u>
Montana State Lottery Commission Members	Wilbur Rehmann, Chair	Helena	1/1/2017
	Frank DiFonzo, Sidney Chief of Police	Sidney	1/1/2017
	Thomas M. Keegan, Attorney at Law	Helena	1/1/2014
	Cindy Hiner	Deer Lodge	1/1/2014
	Leo Prigge, CPA	Butte	1/1/2015
Administrative Officials	Angela Wong, Montana State Lottery Director		
	John Tarr, Montana State Lottery Director of Security		
	Armond Sergeant, Financial Services Director		

For additional information concerning the Montana State Lottery, contact:

Armond Sergeant, Financial Services Director
 2525 N. Montana Ave.
 Helena, MT 59601
 (406) 444-5813
 e-mail: asergeant@mt.gov



MONTANA LEGISLATIVE AUDIT DIVISION

FINANCIAL-COMPLIANCE AUDIT

Montana State Lottery

For the Fiscal Year Ended June 30, 2013

JANUARY 2014

13-30A

REPORT SUMMARY

In fiscal year 2013, the Montana State Lottery recorded approximately \$56.80 million in lottery ticket sales revenue, and transferred approximately \$13.08 million to the state's General Fund.

Context

The Montana State Lottery (Lottery) currently offers for sale a variety of lotto games, such as Powerball; scratch ticket games; EZ Play games; and the Montana Millionaire game. State law dictates that a minimum of 45 percent of the money paid to the Lottery for tickets or chances be paid out as prize money. In fiscal years 2013 and 2012, respectively, prize expense was 56.6 and 54.4 percent of ticket sales revenue.

State law also requires the Lottery to transfer the net proceeds of its operations to the state's General Fund. In fiscal year 2013, the Lottery sold approximately \$56.80 million in lottery tickets and transferred \$13.08 million to the state's General Fund. By comparison, in fiscal year 2012, the Lottery sold approximately \$52.60 million in lottery tickets and transferred \$13.06 million to the state's General Fund. As these numbers indicate, the fiscal year 2013 transfer, as a percentage of ticket sales, is less than that for fiscal year 2012. This is due in part to the Lottery receiving back unclaimed jackpot prizes of approximately \$625 thousand in fiscal year 2012. When the unclaimed jackpot prizes were returned in fiscal year 2012, they increased the amount transferred to the general fund. Additionally, the Lottery

incurred approximately \$112 thousand in additional operating expenses in fiscal year 2013.

Results

This audit report includes one recommendation to the Lottery concerning compliance with state policy requirements governing the use of procurement cards. We reviewed 16 monthly procurement card statements from fiscal year 2013, and identified noncompliance in 12 of the 16 statements.

Recommendation Concurrence	
Concur	1
Partially Concur	0
Do Not Concur	0
Source: Agency audit response included in final report.	

For a complete copy of the report (13-30A) or for further information, contact the Legislative Audit Division at 406-444-3122; e-mail to lad@mt.gov; or check the web site at <http://leg.mt.gov/audit>
Report Fraud, Waste, and Abuse to the Legislative Auditor's FRAUD HOTLINE
Call toll-free 1-800-222-4446, or e-mail ladhotline@mt.gov.

Chapter I – Introduction

Introduction

We performed a financial-compliance audit of the Montana State Lottery (Lottery) for the fiscal year ended June 30, 2013. The audit was performed to comply with §23-7-410, MCA, which requires the Legislative Auditor to conduct, or have conducted, an annual audit of the Montana State Lottery. The objectives of the audit were to:

1. Obtain an understanding of the Montana State Lottery's control systems to the extent necessary to support our audit of the financial statements and, if appropriate, make recommendations for improvements in management and internal controls for the Montana State Lottery.
2. Determine whether the Montana State Lottery complied with selected state laws and regulations.
3. Determine whether the Montana State Lottery's financial statements present fairly the financial position, results of operations, and cash flows for the fiscal year ended June 30, 2013, with comparative financial amounts for the fiscal year ended June 30, 2012.

This report contains one recommendation to the Lottery, related to compliance with policy requirements governing the use of procurement cards.

Background

The Lottery is established in state law, and governed by a five-member Lottery Commission. Members of the Commission are appointed by the governor to serve four-year staggered terms. The director of the Lottery is also appointed by the governor. The Commission is responsible for overseeing Lottery operations and maximizing the net revenue earned by the Lottery and paid to the state. Additionally, the Commission is responsible for setting the price of tickets and the number and size of prizes awarded for Montana-specific lottery games.

The Lottery is a member of the Multi-State Lottery Association (MUSL), a nonprofit, government-benefit association. It is owned and operated by member lotteries, and each state member lottery sits on the MUSL Board of Directors. Rules and regulations for all member state lotteries are developed by the MUSL Board. The Lottery is required to comply with these regulations as a condition of offering MUSL games such as Powerball.

Current games offered by the Lottery include scratch tickets, Powerball, Mega Millions, Montana Cash, Wild Card, Hot Lotto, 10 Spot, EZ Play, Fantasy Football, Fantasy Racing, and Montana Millionaire. State law requires a minimum of 45 percent of money paid for tickets and chances on lottery games be used for prizes.

The Lottery's operations are accounted for in an enterprise fund, which means that its operations are financed and operated similar to a private business enterprise where the intent is to finance or recover all costs primarily through user charges. The Lottery receives no state funding. State law requires the Lottery to transfer the net revenues from its operations to the state's General Fund.

The Lottery is allocated to the Department of Administration for administrative purposes. The financial activity of the Lottery is also included in the Department of Administration's financial schedules.

Prior Audit Recommendations

The prior audit report contained no recommendations to the Lottery.

Chapter II – Findings and Recommendations

Procurement Cards

The Lottery did not comply with policy requirements governing the procurement card program.

Procurement cards are state owned credit cards issued to employees for the purpose of purchasing state supplies, services, and travel-related expenses. The Montana State Lottery (Lottery) participates in the state's procurement card program, issuing cards to employees on a business-need basis. Use of procurement cards is governed by state policy.

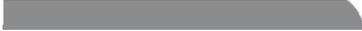
Employees issued procurement cards are sent monthly statements outlining the transactions charged to their cards. Policy requires employees obtain receipts for all transactions charged to their procurement cards, attach the receipts to each month's statement, verify the transactions charged to their cards, and sign and date their monthly statements. Policy further requires the employee's supervisor review and approve all transactions on the monthly statement and sign the statement before forwarding to the agency's accounting office.

We reviewed 16 monthly statements from 11 Lottery employees with procurement cards and identified the following instances of noncompliance with state policy requirements:

- ◆ Three statements did not have supporting receipts for all charges made on the card for the month.
- ◆ Five statements were not signed and dated by the employee.
- ◆ Ten statements were not signed and dated by the employee's supervisor.

The total dollar amount of charges made without supporting receipts was approximately \$1,000. We reviewed these charges for reasonableness, and did not take exception to any.

Lottery management indicated not all staff were aware of these requirements in policy. Policy requirements are in place to ensure charges made to procurement cards are supported and are reasonable for the agency's operations. By not following these established procedures, the Lottery is at an increased risk of improper charges being made on state owned procurement cards. To reduce the risk of improper charges, the Lottery should educate its employees on the policy requirements.



RECOMMENDATION #1

We recommend Montana State Lottery comply with state policy by educating employees on requirements governing the procurement card program.



Independent Auditor's Report and Lottery Financial Statements

LEGISLATIVE AUDIT DIVISION

Tori Hunthausen, Legislative Auditor
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors
Cindy Jorgenson
Angus Maciver

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

Introduction

We have audited the accompanying Statement of Net Position of the Montana State Lottery as of June 30, 2013, and 2012, the related Statement of Revenues, Expenses and Changes in Net Position and Statement of Cash Flows for each of the fiscal years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this responsibility includes designing, implementing, and maintaining internal controls relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the Montana State Lottery's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Montana State Lottery's internal control, and accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Montana State Lottery as of June 30, 2013, and 2012, and the changes in net position and cash flows for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1, the financial statements present only the enterprise fund of the Montana State Lottery and do not purport to, and do not, present fairly the financial position of the State of Montana, as of June 30, 2013, and 2012, the changes in its financial position, or its cash flows for each of the two fiscal years then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Respectfully submitted,

/s/ Cindy Jorgenson

Cindy Jorgenson, CPA
Deputy Legislative Auditor
Helena, MT

November 22, 2013

**MONTANA LOTTERY
STATEMENT OF NET POSITION
JUNE 30, 2013 AND 2012**

A-3

	2013	2012
ASSETS:		
CURRENT ASSETS		
Cash and Cash Equivalents	\$ 3,770,373	\$ 3,401,567
Receivables (Net)	1,655,004	1,845,914
Multi-State Reserve Fund	65,000	65,000
Inventories	446,525	382,328
Securities Lending Collateral	8,773	5,584
Prepaid Expenses	<u>30,672</u>	<u>28,949</u>
TOTAL CURRENT ASSETS	5,976,347	5,729,342
NONCURRENT ASSETS		
Computer, Furniture & Equipment	2,981,106	2,899,606
Leasehold Improvements	45,448	45,448
Equipment - Work in Process	0	65,000
Accumulated Depreciation	(1,571,075)	(1,057,431)
Investments	41,698	43,813
Multi-State Reserve Fund	<u>1,670,644</u>	<u>1,997,105</u>
TOTAL NONCURRENT ASSETS	3,167,821	3,993,541
TOTAL ASSETS	\$ <u>9,144,168</u>	\$ <u>9,722,883</u>
LIABILITIES:		
CURRENT LIABILITIES		
Accounts Payable	\$ 450,526	\$ 511,115
Estimated Prize Liability	2,265,134	2,071,903
Transfer Obligations	2,862,561	3,241,941
Liability under Security Lending	8,773	5,584
Deferred Revenue	153,680	137,725
Accrued Compensated Absences	170,894	120,213
Current Portion Long-Term Obligations	<u>72,168</u>	<u>72,168</u>
TOTAL CURRENT LIABILITIES	5,983,736	6,160,649
NONCURRENT LIABILITIES		
Multi-State Prize Liability	1,484,881	1,542,685
Accrued Compensated Absences	18,557	90,678
Long Term Obligations	126,294	198,461
Other Post Employment Benefits	<u>589,890</u>	<u>488,054</u>
TOTAL NONCURRENT LIABILITIES	2,219,622	2,319,878
TOTAL LIABILITIES	8,203,358	8,480,527
NET POSITION		
Net Investment in Capital Assets	1,257,017	1,681,994
Unrestricted	<u>(316,207)</u>	<u>(439,638)</u>
TOTAL NET POSITION	\$ <u>940,810</u>	\$ <u>1,242,356</u>

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

MONTANA LOTTERY
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
FOR THE YEARS ENDED JUNE 30, 2013 AND 2012

	2013	2012
OPERATING REVENUES:		
Scratch Ticket Revenue	\$ 17,279,829	\$ 16,527,196
On Line Ticket Revenue	39,522,990	36,074,640
License, Permits, and Misc	<u>18,680</u>	<u>15,464</u>
Total Operating Revenues	56,821,499	52,617,300
DIRECT GAME COSTS:		
Scratch Ticket Prize Expense	10,903,493	10,307,079
On Line Ticket Prize Expense	21,273,390	18,307,863
Retailer Commissions	3,367,050	3,146,282
Cost of Tickets Sold	977,583	885,876
Vendor fees	<u>3,347,350</u>	<u>3,086,206</u>
Total Direct Game Costs	39,868,866	35,733,306
Income Before Operating Expenses	16,952,633	16,883,994
OPERATING EXPENSES:		
Advertising	553,906	610,303
Advertising Production	200,395	155,662
Audit Fees	3,772	55,610
Bad Debts Expense	4,324	4,318
Communications	138,520	130,969
Contractual Services	97,722	91,719
Depreciation and Amortization	513,644	458,598
Interest	13,659	17,809
Administrative Service Fee	63,234	63,348
Multi-State Dues	117,008	49,657
Public Relations	61,422	36,017
Other Post Employment Benefits	101,836	89,199
Other Expenses	26,821	27,743
Personal Services	1,846,662	1,809,740
Repairs and Maintenance	24,459	29,215
Supplies and Materials	199,981	235,208
Travel	50,363	41,806
Utilities and Rent	<u>162,535</u>	<u>161,776</u>
Total Operating Expense	4,180,263	4,068,697
Operating Income	12,772,370	12,815,297
NONOPERATING REVENUES (EXPENSES):		
Interest Earnings	9,858	10,358
Security Lending Income	33	1,037
Security Lending Expense	(11)	(204)
Gain/Loss on Sale of Assets	<u>0</u>	<u>(5,303)</u>
Total Nonoperating Revenues(Expenses)	<u>9,880</u>	<u>5,888</u>
Income Before Operating Transfers	12,782,250	12,821,185
Operating Transfers Out - General Fund	<u>(13,083,796)</u>	<u>(13,060,672)</u>
CHANGE IN NET POSITION	(301,546)	(239,487)
Total Net Position, Beginning of Period	<u>1,242,356</u>	<u>1,481,843</u>
TOTAL NET POSITION, END OF PERIOD	<u>\$ 940,810</u>	<u>\$ 1,242,356</u>

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

**MONTANA LOTTERY
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2013 AND 2012**

	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts for Sales & Services	\$ 57,024,040	\$ 52,598,794
Payments for Goods & Services	(9,518,630)	(8,677,957)
Payments to Employees	(1,868,102)	(1,798,018)
Payments for Prizes	(32,041,456)	(28,257,652)
Net Cash Provided by Operating Activities	<u>13,595,852</u>	<u>13,865,167</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Transfer to Other Funds	(13,463,176)	(12,711,503)
Net Cash Used For Noncapital Financing	<u>(13,463,176)</u>	<u>(12,711,503)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisition of Fixed Assets	(16,500)	(19,500)
Proceeds from Sale of Fixed Assets	0	8,485
Principal & Interest Payment on Leases	(85,826)	(89,977)
Net Cash Used For Capital Financing	<u>(102,326)</u>	<u>(100,992)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest and Dividends on Investments	9,880	11,191
Received from (Paid to) MUSL Prize Reserve Fund	326,461	(373,535)
Sale (Purchase) of long term investments	2,115	(6,599)
Net Cash Provided by (Used for) Investing Activities	<u>338,456</u>	<u>(368,943)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	368,806	683,729
CASH AND CASH EQUIVALENTS, JULY 1	<u>3,401,567</u>	<u>2,717,838</u>
CASH AND CASH EQUIVALENTS, JUNE 30	\$ <u>3,770,373</u>	\$ <u>3,401,567</u>
 Reconciliation of Operating Income to Net Cash Provided by Operating Activities		
Operating Income	\$ 12,772,370	\$ 12,815,297
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities		
Depreciation	513,644	458,598
Interest Expense	13,659	17,809
Change in Assets and Liabilities:		
Decr (Incr) in Account Receivable	190,910	(20,651)
Decr (Incr) in Inventories	(64,197)	23,584
Decr (Incr) in Collateral securities on loan	(3,189)	(14,703)
Decr (Incr) in Prepaid expenses	(1,723)	(1,774)
Incr (Decr) in Accounts Payable	(60,589)	142,399
Incr (Decr) in Lottery Prizes Payable	135,427	357,290
Incr (Decr) in Liability for securities on loan	3,189	(23,584)
Incr (Decr) in Deferred Revenue	15,955	6,463
Incr (Decr) in Other Post Employment Benefits	101,836	92,717
Incr (Decr) in Compensated Absences Payable	(21,440)	11,722
Total Adjustments	<u>823,482</u>	<u>1,049,870</u>
Net Cash Provided by Operating Activities	\$ <u>13,595,852</u>	\$ <u>13,865,167</u>

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

MONTANA LOTTERY
Notes to the Financial Statements
June 30, 2013

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity.

The Montana Lottery, established under the provisions of Section 23-7-101, Montana Code Annotated (MCA), was approved by the Montana electorate through Legislative Referendum No. 100 on November 4, 1986.

Montana's first lottery tickets went on sale June 24, 1987.

The Montana Lottery is operated 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 types and forms of lottery games, set the ticket price, number and size of prizes, conduct lottery drawings, enter into agreements to offer lottery games in conjunction with other lottery states and countries, and prepare financial reports. The Montana Lottery is attached to the Montana Department of Administration for administrative purposes.

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

Basis of Presentation. The Montana Lottery reports its financial activity in accordance with generally accepted accounting principles (GAAP) as prescribed in pronouncements of the Governmental Accounting Standards Board (GASB).

Enterprise Fund. The Montana Lottery is classified as an Enterprise Fund of the Proprietary Fund Type. Enterprise Funds account for operations: a) financed and operated 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 b) where the Legislature has decided that periodic determination of revenue earned, expenses incurred, or net income is appropriate.

Basis of Accounting. The Montana Lottery's financial statements are prepared using the accrual basis of accounting. Revenues are recognized in the accounting period in which they are earned and become measurable; expenses are recognized in the period incurred, if measurable.

Property and equipment. Property and equipment are recorded at cost. Donated property 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 property and equipment, the cost and related accumulated depreciation or amortization are removed from the accounts. Gain or loss on disposal is reflected in non-operating revenues and expenses. Depreciation and amortization are calculated on a straight-line basis over estimated useful lives of three to ten years. The Lottery conforms to the State of Montana capitalization threshold for capitalizing property and equipment as well as buildings and building/land improvements. The threshold for capitalizing property and equipment is \$5,000 and the threshold for capitalizing buildings/land improvements is \$25,000.

Revenue Recognition. Lottery scratch ticket sales are recorded as revenue based on the time the retailer activates the pack of tickets for sale. In accordance with an established policy, retailers may return unsold tickets to the Lottery for credit. Sales are decreased by an allowance for estimated ticket returns.

Ticket sales for lotto games Powerball, Wild Card, Montana Cash, Hot Lotto, Montana Millionaire, Mega Millions, and 10 Spot are recorded as revenue based on drawings. Tickets sold in advance for future drawings are recorded as deferred revenue until such time as the tickets become valid for the most current drawing.

Ticket sales for Fantasy Sports games are based upon MCA 23-4-302 and an interagency agreement between the Lottery and the Board of Horse Racing. The Lottery is only a facilitator of these games and charges an administrative fee for this service. The actual sales of these games are not reflected on the Lottery's financial statements as they are not income to the Lottery.

Classification of Revenues. The Lottery has classified its revenues as either operating or non-operating according to the following criteria:

Operating revenues – include activities that have characteristics of exchange transactions, including (1) ticket sales, net of returns, and (2) retailer license fees and administrative fees in relation to selling lottery tickets.

Non-Operating revenues – include activities that have the characteristics of non-exchange transactions, such as gifts and other revenue sources that are defined as non-operating revenues by GASB No. 9, "Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting," and GASB No. 34, "Basic Financial Statements and Management Discussion and Analysis for State and Local Governments." Types of revenue sources that fall into this classification are investment income, and gain or loss on disposition of assets.

New Accounting Guidance Implemented. For the year ended June 30, 2013, the Montana Lottery implemented the provisions of GASB Statement No. 63 – “Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position.” The objective of this statement is to standardize the presentation of deferred outflows of resources, deferred inflows of resources, and their effects on a government’s net position. For the Lottery, this entailed changing the titles of the financial statements. Also changed were the presentation of the net position section, and the overall accounting formula of the Statement of Net Position. GASB 63 changes the terminology of the different types of net position, which the Lottery has adopted, without any change to the financial information from Fiscal Year 2012.

Free Tickets. Some Montana Lottery scratch games award free tickets as prizes. Net lottery ticket revenue does not include the value of free tickets given away and free plays won. The face value of these free ticket prizes distributed for the year ended June 30, 2013 was \$481,163.

Promotional Credits. The Lottery issues promotional credits to retailers to be used to distribute free tickets to players. The tickets are distributed as part of a promotion run by the retailer, e.g., “Ask for the Sale” or second chance drawings. The Lottery also directly distributes scratch tickets for promotional purposes at trade shows, for media give-aways, and during new game introductions. The tickets distributed as a result of promotional credits are reflected as a reduction in revenue. The related prize expense and ticket cost for all promotions are reclassified as an advertising expense. For the year ended June 30, 2013 promotional credits resulted in a revenue reduction of approximately \$21,296 and an expense reclassification of approximately \$15,154.

Prizes. Expenses for scratch prizes are recorded based on the predetermined prize structure for each game. Expenses for lotto prizes are recorded based on the predetermined prize structure for each individual game. No prize expense is recorded for free tickets distributed.

Unclaimed Prizes. Prizes for the lotto games must be claimed within six months after the appropriate draw date. Prizes for scratch games must be claimed within six months of the announced end of each game. The unclaimed prize amounts for the Montana Lottery lotto games 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 amount of unclaimed prizes for all Montana Lottery games is represented in the table below.

	Quarter Ended 6/30/13	Quarter Ended 6/30/12	Year To Date 6/30/13	Year To Date 6/30/12
Lotto	\$158,999	\$124,768	\$561,656	\$484,389
Scratch	\$ 80,080	\$260,931	\$369,562	\$454,014
TOTALS	\$239,079	\$385,699	\$931,218	\$938,403

2. SUMMARY OF ACCOUNTS

Cash and Cash Equivalents. Cash and cash equivalents consist of interest-bearing deposits with the Montana Board of Investments short-term investment pool; cash on deposit in a revolving account with a non-state financial institution; 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.

Cash and cash equivalents consist of the following:

	June 30,	
	<u>2013</u>	<u>2012</u>
Short-term investment pool	\$3,169,315	\$2,658,107
Cash on deposit with State Treasurer	590,858	723,045
Cash in revolving deposit account	10,000	20,215
Petty Cash & Cash on Hand	200	200
TOTALS	\$3,770,373	\$3,401,567

The bank balance of the revolving deposit account, not including outstanding deposits or checks, was \$23,481 as of June 30, 2013 and was covered by federal depository insurance. The carrying amount reported in the balance sheet for cash and cash equivalents approximates the fair market value.

Receivables. Receivables include \$1,928,974, representing amounts due the Lottery for tickets purchased by retailers. Receivables also include \$426 for interest income due from the Montana Board of Investments short-term investment pool. An allowance for ticket returns is included in the receivables amount. This allowance represents a reduction in receivables as of June 30, 2013, for estimated ticket returns. This is an estimate based on returns received to date, as well as an estimate of tickets unsold by retailers for games that have a public sale end date prior to July 1, 2013. The allowance for ticket returns is \$291,291 as of June 30, 2013. The return of vendor fees related to the allowance for returns is \$16,895.

Inventories. Inventories consist of merchandise and supplies inventories. Merchandise inventory includes scratch tickets valued at \$327,072 that are stored in the warehouse, at retailers prior to being activated by the retailer, and with the marketing representatives. These ticket inventories are recorded at cost using the specific identification method and maintained on a perpetual inventory system. Tickets are charged to cost of tickets sold upon activation or after game end.

Supplies inventories include ticket dispensers, premiums and point-of-sale materials. At year end, supplies inventories totaled \$119,453. These inventories are also recorded at cost using the specific identification method.

Other Current Assets. Other current assets include the following:

	June 30,	
	<u>2013</u>	<u>2012</u>
Prepaid Expenses	<u>\$30,672</u>	<u>\$28,949</u>

The prepaid expense amount consists of \$14,075 for booth fees for upcoming summer fairs, and \$16,597 for prepaid commissions and vendor fees related to deferred revenue.

Property and Equipment. A summary of property and equipment for the Lottery is as follows:

	June 30,				June 30,
	<u>2012</u>	Additions	Deletions		<u>2013</u>
Leasehold Improvements	\$ 45,448	\$ -	\$ -		\$ 45,448
Furniture & Equipment	\$ 2,899,606	\$ 81,500	\$ -		\$ 2,981,106
Accumulated Depreciation	\$(1,057,431)	\$(513,644)	\$ -		\$(1,571,075)

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.

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 SB83 by the 1995 Legislature and signed into law by Governor Racicot in April 1995. The transfer obligations outstanding at June 30, 2013 and 2012 were \$2,862,561 and \$3,241,941, respectively.

Compensated Absences. State employees earn vacation leave ranging from 15 to 24 days per year depending on the individual’s years of service. Vacation leave may be accumulated not to exceed two times the maximum number of days earned annually. With no limit on accumulation, sick leave is earned at 12 days per year. Upon retirement or termination, an employee is paid 100% for unused vacation and 25% for unused sick leave. The Lottery’s liability for compensated absences is detailed below.

<u>Balance</u> <u>June 30, 2012</u>	<u>Net Leave</u> <u>Earned/(Used)</u>	<u>Balance</u> <u>June 30, 2013</u>
\$210,891	\$(21,440)	\$189,451

OPEB (Other Post Employment Benefits) Implicit Rate Subsidy LT. Effective for Fiscal Year End 08, 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 Governmental Accounting Standards Board (GASB). The allocation is made based on the fiscal year’s benefits expense and the number of full time employees for an agency.

The Lottery’s OPEB obligations for 2013 and 2012 are as follows:

<u>Year ended June 30,</u>	<u>2013</u>	<u>2012</u>
Annual Required Contribution	\$ 101,836	\$ 92,717
Adjustment to annual required contributions	-	-
Annual OPEB cost	\$ 101,836	\$ 92,717
Contributions made	-	-
Increase to net OPEB obligation	\$ 101,836	\$ 92,717
Net OPEB obligation – beginning of year	<u>\$ 488,054</u>	<u>\$ 395,337</u>
Net OPEB obligation – end of year	<u>\$ 589,890</u>	<u>\$ 488,054</u>

Commissions. Section 23-7-301(10), MCA, provides retailers a commission on scratch and lotto tickets or chances sold. The Lottery Commission established this commission at 5% of the face value of scratch tickets activated by the retailers and the face value of lotto tickets sold. Section 23-4-302 (5)(b)(i), MCA, establishes a 3.99% commission for the face value of Fantasy Sports tickets sold. In addition retailers can earn bonus commissions on tickets sold based on incremental sales of scratch tickets. For the quarter and twelve months ended June 30, 2013 retailers earned bonus commissions of \$84,018 and \$475,579, respectively. For the quarter and twelve months ended June 30, 2013 total commissions were \$785,915 and \$3,367,050, respectively.

3. PAYMENTS TO OTHER STATE AGENCIES

The Lottery receives a variety of services, supplies, and materials from other state agencies. These services and materials are detailed below for the fiscal year ended June 30, 2013:

Insurance	\$ 12,062
Warrant Writing Services	576
Payroll Services	7,444
Audit Fees	3,772
Computer Fees	56,807
Printing	1,347
State Accounting System Support	2,597
Supplies & Materials	12,027
Mail Processing Fees	9,530
Telecommunications	18,205
Administrative Service Fees	63,234
Other	<u>1,306</u>
TOTAL	\$ <u>188,907</u>

4. PRIZES

Paid Prizes. Section 23-7-402, MCA states, "A minimum of 45% of the money paid for tickets or chances must be paid as prize money." Prize expense is recorded based on the predetermined prize structure percentage for each game less unclaimed prizes. For the year ended June 30, 2013, the prize expense of \$32,176,883 is 56.6% of net Lottery ticket revenue of \$56,802,819. For the year ended June 30, 2012, the prize expense of \$28,614,942 was 54.4% of net Lottery ticket revenue of \$52,601,836.

5. TRANSFER TO STATE GENERAL FUND

Section 23-7-402(3), MCA, states “That part of all gross revenue not used for payment of prizes, commissions, and operating expenses, together with the interest earned on the gross revenue while the gross revenue is in the enterprise fund, is net revenue. Net revenue must be transferred quarterly from the enterprise fund established by 23-7-401 to the State General Fund.” For the year ended June 30, 2013, the net revenue payable to the State General Fund totaled \$2,862,561.

6. MULTI-STATE LOTTERY

In November 1989 the Montana State 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. Powerball, Wild Card, Hot Lotto, and Mega Millions are the games jointly operated by the members, in which Montana presently participates. Each lottery participating in MUSL is represented on the Board of Directors.

The Multi-State Lottery Reserve Fund with a balance of \$1,735,644 and \$2,062,105 as of June 30, 2013, and 2012, respectively, is comprised of several reserve accounts, which are maintained by the Multi-State Lottery Association (MUSL). A portion of the Powerball Unreserved Account is classified as a current asset which represents an amount expected to be converted into cash and collected from MUSL within the next fiscal year. The balance of these reserve accounts and investment category is as follows:

	<u>June 30, 2013</u>		
	US	Federal	
	<u>Treasury</u>	<u>Agencies</u>	<u>Total</u>
Powerball Prize Reserve Account	\$ 325,136	\$ 196,836	\$ 521,972
Powerball Set Prize Reserve Account	117,585	116,554	234,139
Powerball Unreserved Account	57,425	193,338	250,763
Wild Card Prize Reserved Account	73,698	118,074	191,772
Hot Lotto Set Prize Reserve Account	97,829	265,309	363,138
Mega Millions Prize Reserve Account	<u>108,297</u>	<u>65,563</u>	<u>173,860</u>
Total Reserves	<u>\$ 779,970</u>	<u>\$ 955,674</u>	1,735,644
Less Current Portion			<u>(65,000)</u>
Non Current Reserves			\$ <u>1,670,644</u>

June 30, 2012

	US <u>Treasury</u>	Federal <u>Agencies</u>	<u>Total</u>
Powerball Prize Reserve Account	\$ 433,871	\$ 212,058	\$ 645,929
Powerball Set Prize Reserve Account	105,003	102,226	207,229
Powerball Unreserved Account	243,972	275,448	519,420
Wild Card Prize Reserved Account	145,102	73,854	218,956
Hot Lotto Set Prize Reserve Account	211,485	143,355	354,840
Mega Millions Prize Reserve Account	<u>58,641</u>	<u>57,090</u>	<u>115,731</u>
Total Reserves	<u>\$1,198,074</u>	<u>\$ 864,031</u>	2,062,105
Less Current Portion			<u>(65,000)</u>
Non Current Reserves			\$ <u>1,997,105</u>

The Powerball Prize Reserve Account is to be used only in the event of an unanticipated prize claim. It is an insurance fund intended to protect the member lotteries against the liability that could result from a system failure at one of the member lotteries. All money paid to this fund would be returned to the Lottery one year after the Lottery leaves the Powerball game, assuming that no unanticipated prize claims have been paid.

The Powerball Set Prize Reserve Account is used to fund prize payments for current drawings. Since the Powerball game has fixed prizes, it is often necessary to draw from this reserve to fund payment of prizes at the fixed amount. This account would be returned to the Lottery upon withdrawal from the Powerball game.

The Lottery contributes to these reserve funds through the 50% set aside for prizes. In addition the Lottery was required to contribute for its portion of the reserve funds accumulated since the start of the Powerball game. Payments made to this fund are considered a portion of prize expense associated with the game.

The Powerball Unreserved Account is a separate account used by a participating Lottery to have MUSL hold funds due to the Lottery. Balances in this account are created when any MUSL jackpot expires and goes unclaimed. Each Lottery is then refunded its pro rata share of the jackpot based on sales during the accumulation of that specific jackpot. This money is then invested in U.S. Treasury securities until withdrawn. Interest earned on the Lottery's share of the fund is added to the Unreserved Account on a quarterly basis. The amount in the Unreserved Account has limited uses and are set and approved by the Board with the stipulation that requests to use the funds are accompanied by certification from the requesting Board Member that the payment is made in conformance with state or jurisdiction law and is related to a MUSL activity.

During fiscal year ended 2013, the Lottery received \$1,303 in interest and had \$117,008 withdrawn for annual MUSL dues and assessments. Also, during the

fiscal year ending 2013, MUSL purchased patents relating to Power Play and Megaplier (add-ons to Powerball and Mega Millions) and began charging all member lotteries a license for the use of the patents. During the fiscal year ended 2012, the Lottery received two refunds for unclaimed jackpots; one for \$185,854 for an unclaimed Powerball jackpot, and another for \$439,281 for an unclaimed Hot Lotto jackpot. The Lottery also received \$870 in interest and had \$49,657 withdrawn for annual MUSL dues.

The Wild Card Reserve Account is to be used in the event of an unanticipated prize claim on the Wild Card game. This account is also administered by MUSL and would be returned to the Lottery one year after the Wild Card Product Group of Idaho, Montana, South Dakota, and North Dakota is disbanded. The Lottery contributes to this account through the 57% set aside for prizes. Payments made to this fund are considered a portion of prize expense related to the Wild Card game.

The Hot Lotto Set Prize Reserve Account is administered by MUSL and is to be used only in the event of unanticipated prize claims. Like other MUSL games the reserve amount would be returned to the Lottery one year after withdrawal from the Hot Lotto game. The Lottery contributes to the reserve through the 50% set aside for prizes. Payments made to the reserve are considered a portion of the prize expense related to the game.

The Mega Millions Prize Reserve Account is to be used only in the event of an unanticipated prize claim. It is an insurance fund intended to protect the member lotteries against the liability that could result from a system failure at one of the member lotteries. All money paid to this fund would be returned to the Lottery one year after the Lottery leaves the Mega Millions game, assuming that no unanticipated prize claims have been paid. The Lottery contributes to the reserve through the 51% set aside for prizes for Mega Millions plays and 50% for Megaplier plays. Payments made to the reserve are considered a portion of the prize expense related to the game.

7. GAMES

Currently, Montana Lottery games are scratch ticket games and six lotto games referred to as Powerball, Montana Cash, Wild Card, Hot Lotto, Mega Millions, and 10 Spot. The lottery also offers EZPLAY®, a line of instant terminal-issued games with pre-determined odds, and Montana Millionaire, a limited-edition lottery game. The lottery is facilitating Fantasy Sports games on behalf of the Board of Horse Racing. Currently the lottery is selling Montana Sports Action Fantasy Football and Fantasy Racing games.

Scratch ticket games provide players the opportunity to win instantly by scratching the latex covering to reveal a prize. The lottery sells tickets for \$1, \$2, \$3, \$5, \$10, and \$20. Top prizes range from \$500 to \$250,000.

The Powerball game allows players a chance to win a minimum parimutuel jackpot of \$40 million. A player must match all six numbers to win the jackpot. Players also win prizes ranging from \$4 to \$1 million for matching fewer than all six numbers. Drawings are held twice weekly on Wednesday and Saturday nights. Powerball is offered in 45 lottery jurisdictions including Montana. For any drawing, if no ticket matches 6 out of 6 numbers, the jackpot rolls over to the next drawing, creating a progressive jackpot. In March 2001, the Lottery added Power Play to the Powerball game. For an additional \$1 per play, Power Play doubles the Match 5 prize from \$1 million to \$2 million and increases other prizes as well.

The Montana Cash game allows players the chance to win a minimum parimutuel jackpot of \$20,000. Players select five numbers from a field of 37 and must match at least three out of five to win a prize. Matching 3 of 5 wins \$5, and 4 of 5 wins \$200. The drawings are conducted twice weekly on Wednesday and Saturday nights. If no ticket matches all five numbers, the jackpot rolls over to the next drawing to create a progressive jackpot.

Wild Card is played in four lottery jurisdictions and allows players the chance to win a parimutuel jackpot with a guaranteed minimum of \$200,000. In January 2013, the game was improved by increasing the minimum jackpot from \$100,000 and increasing other prizes as well. Players select five numbers from a field of 33 plus one of 16 face cards (the Wild Card) and must match all five numbers and the Wild Card to win the jackpot. Players win prizes from \$1 to \$6,000 for matching fewer than all five numbers and/or the Wild Card. Drawings are held twice weekly on Wednesday and Saturday nights. If no ticket matches all five numbers and the Wild Card, the jackpot rolls over to the next drawing to create a progressive jackpot.

Hot Lotto allows players in the 16 participating lotteries a chance to win an all-cash parimutuel jackpot with a guaranteed minimum of \$1 million, plus tax withholdings paid. This change was implemented in May 2013. Each time the jackpot is not won, it grows, thus creating a progressive jackpot. Players choose five numbers from one to 47, and one Hot Ball number from 1 to 19. To win the parimutuel jackpot, a player must match all six numbers drawn. Players can also win prizes from \$2 to \$30,000 by matching fewer than all six numbers. If a player chooses, for an additional bet amount, to add Sizzler to their ticket, any prize except the jackpot is multiplied by three. Drawings are held twice weekly on Wednesday and Saturday nights.

Mega Millions is a multi-state game that allows players to win a minimum parimutuel jackpot starting at \$12 million. If no one wins the jackpot, the jackpot continues to grow. Mega Millions went on sale March 1, 2010, in Montana. To win the jackpot, players must match all six numbers drawn; other prizes range from \$2 to \$250,000. For an additional \$1 per play, Mega Millions has a Megaplier option which multiplies non-jackpot prizes by two, three, or four. Drawings are held each Tuesday and Friday night. This game will be improved with the drawing starting October 22, 2013.

10 Spot, which went on sale February 1, 2010, is a Montana-only, twice-daily game. Players select 10 numbers from one through 80. The lottery draws 20 numbers, and players win by matching 10, nine, eight, seven, six, five, or none of the numbers drawn. Prizes range from \$2 to \$25,000.

The EZPLAY® games are offered on self-serve terminals in taverns and casinos that are licensed to sell Montana Lottery products. Introduced in November 2011, they are a suite of games with a pre-determined prize structure like a scratch game. Players can tell instantly if they have won a prize. The tickets sell for \$1, \$2, \$3, and \$5.

Montana Millionaire is a seasonal raffle-type game offering a \$1 million top prize. The first offering went on sale October 1, 2007. The lottery has sold the game every winter since. Tickets are sold sequentially, and the 2012 game offered 130,000 tickets, which sell for \$20 each. Early bird drawings for \$10,000 were offered on Thanksgiving weekend and the second week of December to stimulate early sales. There were also 200 \$50 instant winners and 500 \$500 instant winners. Available tickets for the game sold out prior to the expected end of the game, selling out on December 29, 2012. On January 1, 2013, one \$1 million prize was awarded, along with two \$100,000 prizes and three \$10,000 prizes. Montana Millionaire is scheduled to sell from November 1 through December 3, 2013, with a drawing on New Year's Day 2014.

The Montana Lottery offers a product line called Montana Sports Action on behalf of the Montana Board of Horse Racing. The product line began in August 2008 with a game called Fantasy Football. To play the game, players choose five offensive players and a defensive unit from the official roster of professional football players and teams. The players can also select a bet amount (\$5, \$10, \$20, \$50, or \$100) which determines the shares of the prize pool players are eligible to win should their team have one of the three highest point totals for the week. Tickets are sold weekly through the professional playoffs, excluding the championship game. A second game called Fantasy Racing was introduced in February 2009 and follows the NASCAR® Sprint Cup Series. Teams are created by selecting a driver from the top nine ranked drivers for the week, three drivers ranked from 10 through 34, and one driver ranked 35 or above. The sixth element in a player's Fantasy Racing team is the number of yellow-flag cautions the player believes might occur in that week's race. Like Fantasy Football, players may also choose to purchase a higher-cost ticket to increase the share of the prize pool in the event their team has one of the three highest point totals for that race.

8. COMMITMENTS - GAMING SUPPLIER CONTRACTS

Scratch Tickets. On June 27, 2008 the Montana Lottery Commission approved the award of a five-year contract with Scientific Games International (SGI) for the provision of scratch tickets. The contract is for five years with the option for two

additional one-year renewals. The contract contains specifications regarding ticket design, printing, game ownership, inspection, and prize structure.

SGL, as the vendor, provided a performance bond covering the contract term and an errors and omissions policy covering an ultimate net loss of \$3,000,000. The Lottery may terminate this contract by providing proper notification to Scientific Games.

On-line Services. On October 11, 2005, the Lottery signed a seven-year contract with Intralot, Inc. of Duluth, GA to provide an on-line gaming system and the associated services beginning March 31, 2006. The contract requires Intralot to provide new terminals to all retailers with the associated software and communications. Payment under the contract is based on 5.8% of net weekly Lottery sales of lotto and scratch games. On August 18, 2008 an addendum was signed to provide services for the Fantasy Sports games at 3% of net weekly Lottery sales up to \$2,999,999 of Montana Sports Action games. The contract currently has a termination date of March 30, 2016.

9. LOTTO*AMERICA/POWERBALL/TRI-WEST JACKPOT PRIZES

Jackpot prizes awarded in the Lotto*America/POWERBALL and TRI-WEST LOTTO games are funded through the purchase of U.S. Treasury Zero-Coupon Bonds purchased in the name of the Montana Lottery by MUSL. MUSL will cash the bonds each year as they mature and will wire the funds to the Lottery for payment to winners on the Anniversary date of the win.

On July 6, 1994 the Montana Lottery awarded its first Tri-West Lotto jackpot prize totaling \$700,565. The first annual payment of \$35,000 was made on July 26, 1994.

On July 22, 1995 the Montana Lottery awarded its first Powerball jackpot prize totaling \$31,401,655.99. The first payment of \$1,571,655.99 was made on August 8, 1995. On April 5, 1997 the Lottery awarded a second Powerball jackpot prize totaling \$11,000,000. The first annual payment of \$550,000 was awarded on April 18, 1997.

As of June 30, 2013, the combined total of future prize payments funded through the purchase of U.S. Treasury Zero-Coupon Bonds for Powerball and Tri-West Lotto winners is \$4,825,000. Total annual payments due as of June 30, 2013 are as follows:

<u>FYE</u>	
2014	2,155,000
2015	2,120,000
2016	<u>550,000</u>
	<u>\$ 4,825,000</u>

10. LEASES/INSTALLMENT PURCHASES PAYABLE

Rent. The Montana Lottery leases its office, administrative and warehouse facilities under a lease agreement that is effective September 2007 through August 2017. The monthly lease payment is \$11,775 through August 2013. The base rate will increase 3% annually.

Capital Lease. The Lottery has contracted with its vendor to lease equipment for the remaining life of its contract with them. Obligations under this capital lease/ installment purchase at June 30, 2013 are as follows:

<u>FYE</u>	
2014	81,677
2015	77,528
2016	<u>55,423</u>
Total Minimum Payments	214,628
Less: Interest	<u>(16,166)</u>
Present value of Minimum Payments	<u>\$ 198,462</u>

11. INVESTMENT RISK DISCLOSURES

Effective June 30, 2005, the State of Montana implemented the provisions of Governmental Accounting 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.

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."

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). STIP is an external 2a-7 like pool.

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

securities have credit risk as measured by major credit rating services, however, the pool is not rated. The Lottery does not have a policy regarding credit risk

Per MUSL, for 2013 the prize reserves held on behalf of the Montana Lottery are invested in the Montana Winners Trust and include an average of 50% in securities held as obligations of the U.S. Government and are not considered to have credit risk. The other 50% of the prize reserves are invested in Federal Agencies and have an AAA credit quality rating. The Lottery does not have any authority or a policy regarding the investment portfolios.

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. Custodial credit risk does not apply to STIP because it is a 2a-7 like pool.

The MUSL prize reserves are held in the Montana Winners Trust using policies set forth by the MUSL board regarding policies for the type of securities, as well as the custody, trading and the use of proceeds of the securities. The Lottery does not have any authority or a policy regarding the investment portfolios.

Concentration of credit is the risk of loss attributed to the magnitude of a government's investment in a single issuer. Because STIP is a pooled investment, this risk does not apply. Because the MUSL reserves are also a pooled investment, this risk does not apply to them either.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Interest rate risk does not apply to STIP because it is a 2a-7 like pool. The Lottery does not have any authority or a policy regarding the investment portfolios.

The MUSL prize reserves are invested through the Montana Winners Trust in the Morgan Stanley Government Portfolio Funds with daily liquidity and therefore have no interest rate risk. The MUSL board's investment policy limits the individual security and the portfolio's maturity. As of June 30, 2013, the duration for the U.S. Government Treasury securities was a blended rate of .90 years.

12. EMPLOYEE RETIREMENT PLAN

All Lottery employees hired are, initially, members of the Public Employees Retirement System – Defined Benefit Retirement Plan (PERS-DBRP). PERS-DBRP is a defined benefit cost sharing, multiple-employer public retirement system established on July 1, 1945 and governed by Title 19, chapters 2 & 3 of the Montana Code Annotated. This plan provides retirement, disability and death benefits to substantially all public employees and their beneficiaries not covered by another public plan.

New hires have a 12 month window during which they may choose to transfer to the Public Employees Retirement System – Defined Contribution Retirement Plan (PERS-DCRP) or remain in the current PERS-DBRP. Members may not be members of both plans. The choice is irrevocable. Members of the DCRP direct their contributions and a portion of their employer’s contributions among the offered investment options. The remaining portion of their employer’s contributions is used to reduce the Plan Choice Rate unfunded actuarial liability, to fund the long-term disability benefits to participants of the DCRP, and to fund an employee education program.

13. SUBSEQUENT EVENTS

On September 5, 2013, the Montana Lottery entered into a contract amendment with its operating system vendor to lease 150 MP machines. These machines are self service terminals that allow players to purchase on-line tickets and/or play instant predetermined games at the terminal itself. The lease is for two and a half years and ends in March of 2016. The total obligation to the vendor for this lease is \$1,230,372 and is being paid on a monthly basis.

MONTANA STATE
LOTTERY

LOTTERY RESPONSE



2525 N. Montana, Helena, MT 59601 • P: 406-444-5825 • F: 406-444-5830

RECEIVED

JAN 13 2014

LEGISLATIVE AUDIT DIV.

January 13, 2014

Ms. Tori Hunthausen, Legislative Auditor
Legislative Audit Division
Room 135, State Capitol
Helena, MT 59620

Dear Ms. Hunthausen;

I would like to thank the Legislative Audit staff for their assistance and work performed on the Montana Lottery Financial-Compliance Audit for the fiscal year ending June 30, 2013. We appreciate the services your staff provide in reviewing the Lottery's procedures, internal controls, accounting practices, and the accuracy of the financial statements. We feel this audit was productive and instrumental in continually improving the financial reporting for the agency. There was one recommendation made in the audit in regard to procurement cards; the following is the Lottery's response and action plan:

Recommendation 1:

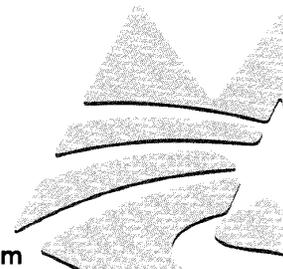
We recommend the Montana State Lottery comply with state policy by educating employees on requirements governing the procurement card program.

The Lottery concurs with this finding and has implemented a review of procurement card policy and established guidelines with all staff.

I am available to answer questions or provide further information that you or the Legislative Audit Committee may require.

Sincerely,

Angela Wong
Lottery Director



**Montana Lottery Financial-Compliance Audit
 Management Action Plan
 For Fiscal Year Ending June 30, 2011**

Audit Recommendation #	Lottery Response	Corrective Action Plan	Responsible Area	Target Date
<p>Procurement Cards Recommendation #1</p> <p>The Lottery did not comply with policy requirements governing the procurement card program.</p>	<p>Concur</p>	<p>Policy and procedures were reviewed, updated, presented and explained to all staff within agency.</p>	<p>MT Lottery All Departments</p>	<p>Jun - 13</p>