



A REPORT  
TO THE  
MONTANA  
LEGISLATURE

FINANCIAL AUDIT

# *Montana State Lottery*

*For the Fiscal Year Ended  
June 30, 2014*

FEBRUARY 2015

LEGISLATIVE AUDIT  
DIVISION

13-30B

**LEGISLATIVE AUDIT  
COMMITTEE**

**REPRESENTATIVES**

RANDY BRODEHL, CHAIR  
[Randybrodehl57@gmail.com](mailto:Randybrodehl57@gmail.com)

VIRGINIA COURT  
[vcourtforlegislature@yahoo.com](mailto:vcourtforlegislature@yahoo.com)

MIKE CUFFE  
[mcuffe@interbel.net](mailto:mcuffe@interbel.net)

DENISE HAYMAN  
[Rep.Denise.Hayman@mt.gov](mailto:Rep.Denise.Hayman@mt.gov)

RYAN OSMUNDSON  
[Ryanosmundson@gmail.com](mailto:Ryanosmundson@gmail.com)

MITCH TROPILA  
[tropila@mt.net](mailto:tropila@mt.net)

**SENATORS**

DEE BROWN  
[repdee@yahoo.com](mailto:repdee@yahoo.com)

TAYLOR BROWN  
[taylor@northernbroadcasting.com](mailto:taylor@northernbroadcasting.com)

SUE MALEK  
[senatormalek@gmail.com](mailto:senatormalek@gmail.com)

MARY McNALLY  
[McNally4MTLeg@gmail.com](mailto:McNally4MTLeg@gmail.com)

FREDRICK (ERIC) MOORE  
[mail@SenatorEricMoore.com](mailto:mail@SenatorEricMoore.com)

CYNTHIA WOLKEN  
[Sen.Cynthia.Wolken@mt.gov](mailto:Sen.Cynthia.Wolken@mt.gov)

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](mailto:ladhotline@mt.gov)

**FINANCIAL AUDITS**

Financial audits are conducted by the Legislative Audit Division to determine if the financial statements included in this report are presented fairly and the agency has complied with laws and regulations having a direct and material effect on the financial statements. 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 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 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, 2013, was issued March 28, 2014. The Single Audit Report for the two fiscal years ended June 30, 2015, will be issued by March 31, 2016. 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**

---

JESSICA CURTIS  
CHARLES RICHARDSON

PAUL J. O'LOUGHLIN  
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

February 2015

The Legislative Audit Committee  
of the Montana State Legislature:

This is our financial audit report of the Montana State Lottery (lottery) for the fiscal year ended June 30, 2014. The financial statements included on page A-3 of the report contain comparative information for the fiscal year ended June 30, 2013. This report contains no recommendations to the lottery.

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

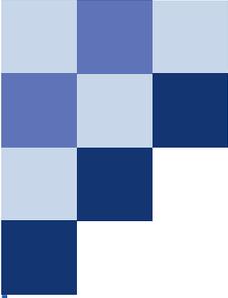
Appointed and Administrative Officials .....	ii
Report Summary .....	S-1
<b>CHAPTER I – INTRODUCTION.....</b>	<b>1</b>
Introduction .....	1
Transfer Determination .....	1
Background.....	2
Prior Audit Recommendation .....	3
<b>INDEPENDENT AUDITOR’S REPORT AND LOTTERY FINANCIAL STATEMENTS</b>	
Independent Auditor’s Report .....	A-1
Statement of Net Position June 30, 2014, and 2013 .....	A-3
Statement of Revenues, Expenses and Changes in Net Position for the Fiscal Years Ended June 30, 2014, and 2013.....	A-4
Statements of Cash Flows for the Fiscal Years Ended June 30, 2014, and 2013.....	A-5
Notes to the Financial Statements June 30, 2014, and 2013 .....	A-7
<b>LOTTERY RESPONSE</b>	
Montana State Lottery .....	B-1

## APPOINTED AND ADMINISTRATIVE OFFICIALS

			<u>Term Expires</u>
<b>Montana State Lottery Commission Members</b>	Wilbur Rehmann, Chair	Helena	1/1/2017
	Frank DiFonzo, Chief of Police	Sidney	1/1/2017
	Thomas M. Keegan, Attorney at Law	Helena	1/1/2018
	Cindy Hiner	Deer Lodge	1/1/2017
	Leo Prigge, CPA	Butte	1/1/2019
<b>Administrative Officials</b>	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](mailto:asergeant@mt.gov)



# MONTANA LEGISLATIVE AUDIT DIVISION

## FINANCIAL AUDIT

### Montana State Lottery

For the Fiscal Year Ended June 30, 2014

FEBRUARY 2015

13-30B

REPORT SUMMARY

Over the last five fiscal years, the Montana State Lottery sold approximately \$255.4 million in lottery tickets, and transferred approximately \$60 million to the state's General Fund. In fiscal year 2014, ticket sales decreased 6.53 percent from fiscal year 2013 sales levels.

### Context

The Montana State Lottery (lottery) currently offers a variety of online games, including multi-state games such as Powerball, Mega Millions, and Hot Lotto, as well as state-specific games such as Montana Cash and Montana Millionaire. The lottery also offers an assortment of scratch games, as well as EZPlay games. In fiscal year 2014, sales from these games approximated \$53.1 million and direct costs associated with the sales approximated \$36.6 million. The lottery transferred roughly \$12.2 million to the state's General Fund in fiscal year 2014.

The lottery's operations are funded by the net proceeds from ticket sales. Operating expenses were approximately \$4.7 million in fiscal year 2014. In fiscal year 2014, the lottery also received approximately \$14,000 from the Department of Administration's Risk Management and Tort Defense Division for security system upgrades.

Our audit efforts were focused primarily on the review of sales revenues and direct game costs, and the account balances associated with these

activities. We specifically reviewed: scratch and online ticket revenues; direct game costs such as scratch and online ticket prize expenses, retailer commissions, and vendor fees; the estimated prize liability related to winning tickets sold but not claimed by fiscal year-end; accounts receivables associated with ticket sales at retailer locations; and transfer activity required under state law. Additionally, we reviewed the lottery's personal service expenses, as well as the lottery's investments held by the Multi-State Lottery Association. Throughout the audit, we reviewed the lottery's control systems, and determined compliance with state laws having a direct impact on financial statement amounts.

### Results

This report contains no recommendations to the lottery.

For a complete copy of the report (13-30B) or for further information, contact the Legislative Audit Division at 406-444-3122; e-mail to [lad@mt.gov](mailto: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](mailto:ladhotline@mt.gov).



# Chapter I – Introduction

## **Introduction**

We performed a financial audit of the Montana State Lottery (lottery) for the fiscal year ended June 30, 2014. 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 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 lottery.
2. Determine whether the lottery complied with state laws having a direct impact on financial statement amounts.
3. Determine whether the lottery's financial statements present fairly the financial position, results of operations, and cash flows for the fiscal year ended June 30, 2014, with comparative financial amounts for the fiscal year ended June 30, 2013.
4. Determine the implementation status of the prior audit recommendation.

We addressed these objectives by focusing our audit efforts primarily on the review of revenues, expenses, and account balances resulting from ticket sales. We specifically reviewed: scratch and online ticket revenues; direct game costs such as scratch and online ticket prize expenses, retailer commissions, and vendor fees; the estimated prize liability related to winning tickets sold but not claimed by fiscal year-end; accounts receivables associated with ticket sales at retailer locations; cash and cash equivalents resulting primarily from the proceeds of ticket sales; and transfer activity required under state law. Additionally, we reviewed the lottery's personal service expenses, as well as the lottery's investments held by the Multi-State Lottery Association. Throughout the audit, we reviewed the lottery's control systems, and determined compliance with state laws having a direct impact on financial statement amounts.

## **Transfer Determination**

Section 23-7-402(4), MCA, requires the lottery to transfer its net revenue to the state general fund on a quarterly basis. While preparing the financial statements included in this report, the lottery, in consultation with the Department of Administration State Financial Services Division, determined there was an error in the calculation of the transfer amounts for fiscal years 2008 through 2014. The calculation for these years included the lottery's other post-employment benefit (OPEB) expenses in arriving at the net revenue to be transferred to the general fund. While recording the OPEB expense is required by generally accepted accounting principles for financial reporting

purposes, it does not represent a legal liability for the lottery, and therefore, does not result in a cash outflow.

For these reasons, the lottery and State Financial Services Division determined the annual OPEB expense should not be included in the calculation of the amount transferred to the state general fund. The financial statements included in this report reflect the change in methodology for calculating the transfer amount. The accumulated effect of this change in methodology for fiscal years 2008 to 2012 was an increase in the transfer obligation due to the general fund of \$488,054. This is presented within the Prior-Period Adjustments on the Statement of Revenues, Expenses, and Changes in Net Position on page A-4. The Transfer Obligations on the Statement of Net Position on page A-3 reflect the additional amounts due to the general fund. This change in methodology also increased the transfer to the general fund for fiscal years 2013 and 2014 by \$101,836 and \$108,929, respectively. These increases were considered in arriving at the dollar amounts presented on the financial statements for fiscal years 2013 and 2014.

As part of the audit, we reviewed the lottery and State Financial Services Division's logic for changing the transfer methodology, as well as the financial statement presentation resulting from the change in methodology. We determined the change in methodology was reasonable, and accurately presented on the financial statements contained within this report. Therefore, we make no recommendation to the lottery and our opinion on the financial statements is not modified.

This report contains no recommendations to the lottery.

## **Background**

The lottery is established in state law, and governed by a five-member Lottery Commission (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, EZPlay, 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. 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 Recommendation**

The prior audit report contained one recommendation to the lottery related to compliance with policy requirements governing the use of procurement cards. The lottery fully implemented the recommendation.



# 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, 2014, and 2013, the related Statement of Revenues, Expenses and Changes in Net Position, and the 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 audit. We conducted our audit 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 net position of the Montana State Lottery as of June 30, 2014, and 2013, 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 to the financial statements, 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, 2014, and 2013, 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.

As discussed in Note 2 to the financial statements, the financial statements for the fiscal year ended June 30, 2013, have been restated to correct misstatements in the Other Post Employment Benefits liability, the Transfer Obligation liability, and the Operating Transfers Out-General Fund. Our opinion is not modified with respect to this matter.

Respectfully submitted,

*/s/ Cindy Jorgenson*

Cindy Jorgenson, CPA  
Deputy Legislative Auditor  
Helena, MT

January 23, 2015

**MONTANA LOTTERY  
STATEMENT OF NET POSITION  
JUNE 30, 2014 AND 2013**

A-3

	2014	Restated 2013
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and Cash Equivalents	\$ 4,007,918	\$ 3,770,373
Receivables (Net)	1,699,476	1,655,004
Multi-State Reserve Fund	65,000	65,000
Inventories	390,026	446,525
Securities Lending Collateral	2,162	8,773
Prepaid Expenses	<u>13,643</u>	<u>30,672</u>
<b>TOTAL CURRENT ASSETS</b>	<b>6,178,225</b>	<b>5,976,347</b>
<b>NONCURRENT ASSETS</b>		
Computer, Furniture & Equipment	2,981,106	2,981,106
Leasehold Improvements	59,781	45,448
Accumulated Depreciation	(2,085,091)	(1,571,075)
Investments	31,964	41,698
Multi-State Reserve Fund	<u>1,448,704</u>	<u>1,670,644</u>
<b>TOTAL NONCURRENT ASSETS</b>	<b>2,436,464</b>	<b>3,167,821</b>
<b>TOTAL ASSETS</b>	<b>\$ <u>8,614,689</u></b>	<b>\$ <u>9,144,168</u></b>
<b>LIABILITIES</b>		
<b>CURRENT LIABILITIES</b>		
Accounts Payable	\$ 514,851	\$ 450,526
Estimated Prize Liability	2,377,348	2,265,134
Transfer Obligations	3,309,805	3,452,451
Liability under Security Lending	2,162	8,773
Unearned Revenue	126,321	153,680
Accrued Compensated Absences	122,710	170,894
Current Portion Long-Term Obligations	<u>72,168</u>	<u>72,168</u>
<b>TOTAL CURRENT LIABILITIES</b>	<b>6,525,365</b>	<b>6,573,626</b>
<b>NONCURRENT LIABILITIES</b>		
Multi-State Prize Liability	1,309,638	1,484,881
Accrued Compensated Absences	93,500	18,557
Long Term Obligations	54,126	126,294
Other Post Employment Benefits	<u>532,562</u>	<u>461,119</u>
<b>TOTAL NONCURRENT LIABILITIES</b>	<b>1,989,826</b>	<b>2,090,851</b>
<b>TOTAL LIABILITIES</b>	<b>8,515,191</b>	<b>8,664,477</b>
<b>NET POSITION</b>		
Net Investment in Capital Assets	829,502	1,257,017
Unrestricted	<u>(730,004)</u>	<u>(777,326)</u>
<b>TOTAL NET POSITION</b>	<b>\$ <u>99,498</u></b>	<b>\$ <u>479,691</u></b>

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

<b>MONTANA LOTTERY</b> <b>STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION</b> <b>FOR THE YEARS ENDED JUNE 30, 2014 AND 2013</b>
---

	2014	Restated 2013
<b>OPERATING REVENUES:</b>		
Scratch Ticket Revenue	\$ 16,516,113	\$ 17,279,829
On Line Ticket Revenue	36,575,152	39,522,990
License, Permits, and Misc	<u>31,347</u>	<u>18,680</u>
Total Operating Revenues	53,122,612	56,821,499
<b>DIRECT GAME COSTS:</b>		
Scratch Ticket Prize Expense	9,995,125	10,903,493
On Line Ticket Prize Expense	19,553,196	21,273,390
Retailer Commissions	3,012,490	3,367,050
Cost of Tickets Sold	945,078	977,583
Vendor fees	<u>3,128,737</u>	<u>3,347,350</u>
Total Direct Game Costs	36,634,626	39,868,866
Income Before Operating Expenses	16,487,986	16,952,633
<b>OPERATING EXPENSES:</b>		
Advertising	492,336	553,906
Advertising Production	217,218	200,395
Audit Fees	34,740	3,772
Bad Debts Expense	6,453	4,324
Communications	130,629	138,520
Contractual Services	77,631	97,722
Depreciation and Amortization	514,016	513,644
Interest	9,510	13,659
Administrative Service Fee	64,950	63,234
Multi-State Dues	44,308	117,008
Public Relations	59,171	61,422
Other Post Employment Benefits	88,325	84,396
Other Expenses	28,243	26,821
Personal Services	1,971,482	1,836,523
Repairs and Maintenance	14,999	24,459
Supplies and Materials	258,956	199,981
Travel	39,691	50,363
Utilities and Rent	<u>621,959</u>	<u>162,535</u>
Total Operating Expense	4,674,617	4,152,684
Operating Income	11,813,369	12,799,949
<b>NONOPERATING REVENUES (EXPENSES):</b>		
Interest Earnings	5,944	9,858
Security Lending Income	6	33
Security Lending Expense	<u>0</u>	<u>(11)</u>
Total Nonoperating Revenues(Expenses)	<u>5,950</u>	<u>9,880</u>
Income Before Operating Transfers	11,819,319	12,809,829
Operating Transfers Out - General Fund	<u>(12,199,512)</u>	<u>(13,185,632)</u>
CHANGE IN NET POSITION	(380,193)	(375,803)
Total Net Position, Beginning of Period	<u>479,691</u>	<u>1,242,356</u>
Prior Period Adjustments	<u>0</u>	<u>(386,862)</u>
TOTAL NET POSITION, END OF PERIOD	<u>\$ 99,498</u>	<u>\$ 479,691</u>

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

**MONTANA LOTTERY  
STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED JUNE 30, 2014 AND 2013**

	2014	Restated 2013
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Receipts for Sales & Services	\$ 53,044,328	\$ 57,024,040
Payments for Goods & Services	(9,033,283)	(9,518,630)
Payments to Employees	(1,961,605)	(1,868,102)
Payments for Prizes	(29,611,350)	(32,041,456)
Net Cash Provided by Operating Activities	<u>12,438,090</u>	<u>13,595,852</u>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>		
Transfer to Other Funds	(12,342,158)	(13,463,176)
Net Cash Used For Noncapital Financing	<u>(12,342,158)</u>	<u>(13,463,176)</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Acquisition of Fixed Assets	(14,333)	(16,500)
Principal & Interest Payment on Leases	(81,678)	(85,826)
Net Cash Used For Capital Financing	<u>(96,011)</u>	<u>(102,326)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Interest and Dividends on Investments	5,950	9,880
Received from (Paid to) MUSL Prize Reserve Fund	221,940	326,461
Sale (Purchase) of long term investments	9,734	2,115
Net Cash Provided by Investing Activities	<u>237,624</u>	<u>338,456</u>
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>237,545</b>	<b>368,806</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>	<u><b>3,770,373</b></u>	<u><b>3,401,567</b></u>
<b>CASH AND CASH EQUIVALENTS, END OF YEAR</b>	<b>\$ <u>4,007,918</u></b>	<b>\$ <u>3,770,373</u></b>
 <b>Reconciliation of Operating Income to Net Cash Provided by Operating Activities</b>		
Operating Income	\$ 11,813,369	\$ 12,799,949
<b>Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities</b>		
Depreciation	514,016	513,644
Interest Expense	9,510	13,659
<b>Change in Assets and Liabilities:</b>		
Decr (Incr) in Account Receivable	(44,472)	190,910
Decr (Incr) in Inventories	6,611	(64,197)
Decr (Incr) in Collateral securities on loan	56,499	(3,189)
Decr (Incr) in Prepaid expenses	17,029	(1,723)
Incr (Decr) in Accounts Payable	64,325	(60,589)
Incr (Decr) in Lottery Prizes Payable	(63,029)	135,427
Incr (Decr) in Liability for securities on loan	(6,611)	3,189
Incr (Decr) in Unearned Income	(27,359)	15,955
Incr (Decr) in Other Post Employment Benefits	71,443	74,257
Incr (Decr) in Compensated Absences Payable	26,759	(21,440)
Total Adjustments	<u>624,721</u>	<u>795,903</u>
Net Cash Provided by Operating Activities	<b>\$ <u>12,438,090</u></b>	<b>\$ <u>13,595,852</u></b>

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



**MONTANA LOTTERY**  
Notes to the Financial Statements  
June 30, 2014 and 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 unearned income 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.

## 2. OTHER ACCOUNTING ISSUES

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.

For the year ended June 30, 2014, the Montana Lottery implemented the provisions of GASB Statement No. 65 – “Items Previously Reported as Assets and Liabilities.” This statement essentially changes and redefines the different elements of a financial statement, specifically the Statement of Net Position. The Lottery has adopted this statement by changing the line item of “deferred revenue” to the new title of “unearned revenue” on the Statement of Net Position. This was not a restatement for Fiscal Year 2013 as this only changed the title for the same statement item without changing any amounts.

Prior Period Adjustments. Prior period adjustments reported in the accompanying financial statements relate to corrections of errors and changes in accounting policy from prior periods. The two most significant adjustments relate to Other Post Employment Benefits (OPEB). It was determined that OPEB liability was overstated by the amortization of Net OPEB Obligation and was not adjusted in the ending liability balance for each year, as it relates to the Annual Required Contribution. This actuarial calculation is now reflected in the liability as an implicit rate subsidy with the corrected ending liability balance. Also, it was determined that generally accepted accounting standards and state statutes did not intend to include the OPEB expense when determining the amount of transfer to the General Fund each year. This expense is now disregarded and added to the change in net position on the Statement of Revenues, Expenses, and Changes in Net Position. As a result of the above, the Net Position was increased by \$101,192 for the amended amortization of the Net OPEB obligation and reduced by \$488,054 for the recalculation of the transfer to the General Fund.

Reclassification and Restatement. In order to make certain prior year amounts compare to current year presentation on the Statement of Net Position, the Statement of Revenues, Expenses, and Changes in Net Position, and the Statement of Cash Flows, fiscal year 2013 items were adjusted to reflect the above Prior Period Adjustments. The restatement of fiscal year 2013 was due to the change in calculation of Other Post Employment Benefits and the calculation of the Transfer Obligations.

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, 2014 was \$333,863.

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, 2014, promotional credits resulted in a revenue reduction of approximately \$16,678 and an expense reclassification of approximately \$14,317. 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 these 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 6/30/14	Quarter Ended 6/30/13	Year To Date 6/30/14	Year To Date 6/30/13
Lotto	\$143,868	\$158,999	\$ 542,113	\$561,656
Scratch	\$153,080	\$ 80,080	\$ 666,415	\$369,562
<b>TOTALS</b>	\$296,948	\$239,079	\$1,208,528	\$931,218

### 3. 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>2014</u>	<u>2013</u>
Short-term investment pool	\$2,883,970	\$3,169,315
Cash on deposit with State Treasurer	1,113,748	590,858
Cash in revolving deposit account	10,000	10,000
Petty Cash & Cash on Hand	200	200
<b>TOTALS</b>	\$4,007,918	\$3,770,373

The bank balance of the revolving deposit account, not including outstanding deposits or checks, was \$28,063 as of June 30, 2014 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. For the year ended June 30, 2014, receivables include \$1,935,691, representing amounts due the Lottery for tickets purchased by retailers. Receivables also include \$298 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, 2014, 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, 2014. The allowance for ticket returns is \$251,075 as of June 30, 2014. The return of vendor fees related to the allowance for returns is \$14,562.

For the year ended June 30, 2013, receivables included \$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 for years ended June 30, 2014 and 2013 include scratch tickets valued at \$299,022, and \$327,072, respectively, 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. For the years ended June 30, 2014, and 2013, supplies inventories totaled \$91,004, and \$119,453, respectively. These inventories are also recorded at cost using the specific identification method.

Other Current Assets. Other current assets include the following:

	June 30,	
	2014	2013
Prepaid Expenses	\$13,643	\$30,672

The prepaid expenses for the year ended June 30, 2014 were all for prepaid commissions and vendor fees related to unearned income. The prepaid expenses for the year ended June 30, 2013 consisted of \$14,075 for booth fees for upcoming summer fairs, and \$16,597 for prepaid commissions and vendor fees related to unearned income.

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

	June 30,			June 30,
	2013	Additions	Deletions	2014
Leasehold Improvements	\$ 45,448	\$ 14,333	\$ -	\$ 59,781
Furniture & Equipment	\$ 2,981,106	\$ -	\$ -	\$ 2,981,106
Accumulated Depreciation	\$(1,571,075)	\$(514,016)	\$ -	\$(2,085,091)

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, 2014 and 2013 were \$3,309,805 and \$3,452,451, 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, 2013</u>	<u>Net Leave</u> <u>Earned/(Used)</u>	<u>Balance</u> <u>June 30, 2014</u>
\$189,451	\$26,759	\$216,210

Other Postemployment Benefits (OPEB).

*General.* The State of Montana and the Montana Lottery provide optional postemployment healthcare benefits in accordance with Montana Code Annotated, Title 2, Chapter 18, Section 704 to the following employees and dependents who elect to continue coverage and pay administratively established contributions: (1) employees and dependents who retire under applicable retirement provisions, and (2) surviving dependents of deceased employees. Medical, dental, and vision benefits are available through this plan.

*Plan Description.* The State OPEB plans are agent multiple employer plans. There are a number of State agencies who are participating employers under this plan. Each participating employer is required by GASB Statement No. 43 to disclose additional information regarding funding policy, the employer's annual OPEB cost and contributions made, the funded status and funding progress of the employer's individual plan, and actuarial methods and assumptions used.

The healthcare OPEB plans allow retirees to participate, as a group, at a rate that does not cover all of the related costs. This results in the reporting of an "implied rate" subsidy in the related financial statements and footnotes. While this liability is disclosed for financial statement purposes, it does not represent a legal liability of the State or any of its component units. Accordingly, reported contributions are not a result of direct funding to the plans or for associated liabilities, but are a

measure of the difference in retiree payments into the plans and actual medical costs associated with those individuals paid for by the plans. The healthcare OPEB plans are reported as agency funds. There are no assets or liabilities as only contributions collected and distributions made are reflected in these funds. See the funding policy that follows.

*Bases of Accounting.* OPEB is recorded on an accrual basis for all enterprise and internal service funds as well as component units. OPEB is recorded on a modified accrual basis for the governmental funds. Plan member contributions are recognized in the period in which the contributions are made. Benefits and refunds are recognized when due and payable in accordance with the terms of each plan.

*Funding Policy.* The State of Montana pays for postemployment healthcare benefits on a pay-as-you-go basis. Montana Code Annotated, Title 2, Chapter 18, Part 8 gives authority for establishing and amending the funding policy to the Department of Administration. As of June 2014, the State plan's administratively established retiree medical premiums vary between \$299 and \$1,109 per month depending on the medical plan selected, family coverage, and Medicare eligibility. Administratively established dental premiums vary between \$17.50 and \$60 and vision hardware premiums vary between \$5.76 and \$16.76 depending on the coverage selected.

*Annual Other Postemployment Benefit Cost and Contributions.* The annual required contribution (ARC), an actuarially determined rate in accordance with the parameters of GASB Statement No. 45, represents a level of funding that, if paid on an ongoing basis, is projected to cover the normal cost each year and amortize any unfunded actuarial liabilities over a period not to exceed 30 years.

The following table presents the OPEB cost for the year, the amount contributed, and changes in the OPEB plans for fiscal year 2014 and 2013:

<b>Year ended June 30.</b>	<b>2014</b>	<b>2013</b>
Annual Required Contribution/OPEB cost	\$ 84,123	\$ 80,845
Interest on net OPEB obligation	19,313	16,460
Amortization Factor	(15,111)	(12,910)
Annual OPEB cost	88,325	84,395
Retiree Claims Paid	(16,882)	(10,138)
Increase in net OPEB obligation	71,443	74,257
Net OPEB obligation – beginning of year	461,119	386,862
Net OPEB obligation – end of year	\$ 532,562	\$ 461,119

The Lottery's annual healthcare OPEB cost, the percentage of annual implicit contributions toward the OPEB cost through retiree claims paid on their behalf, and the net OPEB obligation for the fiscal years 2014 through 2012 was as follows:

<b>Fiscal Year Ended</b>	<b>Annual OPEB Cost</b>	<b>Percentage of Annual OPEB Cost Contributed</b>	<b>Net OPEB Obligation</b>
6/30/2014	\$ 88,325	19.1%	\$ 532,562
6/30/2013	\$ 84,395	10.0%	\$ 461,119
6/30/2012	\$ 79,321	12.1%	\$ 386,862

*Actuarial Methods and Assumptions.* Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Actuarially determined amounts are subject to continual revisions being actual results are compared with past expectations and new estimates are made about the future. Actuarial calculations reflect a long-term perspective.

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 years ended June 30, 2014 and 2013, retailers earned bonus commissions of \$331,350 and \$475,579, respectively. For the years ended June 30, 2014 and 2013, total commissions were \$3,012,490 and \$3,367,050, respectively.

#### **4. 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 years ended June 30, 2014 and 2013:

<b>Year ended June 30</b>	<b>2014</b>	<b>2013</b>
Administrative Service Fees	\$ 64,950	\$ 63,234
Audit Fees	34,740	3,772
Computer Fees	63,981	56,807
Insurance	12,786	12,062
Mail Processing Fees	10,898	9,530
Other Expenses	2,478	1,306
Payroll Services	7,404	7,444
Printing	555	1,347
State Accounting System Support	3,283	2,597
Supplies & Materials	117	12,027
Telecommunications	14,043	18,205
Vehicle Rental Fees	632	-
Warrant Writing Services	473	576
	<u>\$ 216,340</u>	<u>\$ 188,907</u>

## 5. 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, 2014, the prize expense of \$29,548,321 is 55.66% of net Lottery ticket revenue of \$53,091,265. For the year ended June 30, 2013, the prize expense of \$32,176,883 was 56.6% of net Lottery ticket revenue of \$56,802,819.

## 6. 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 years ended June 30, 2014 and 2013, the net revenue payable to the State General Fund totaled \$3,309,805, and \$3,452,451, respectively.

## 7. 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 \$1,513,704 and \$1,735,644 as of June 30, 2014, and 2013, 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:

### June 30, 2014

	US <u>Treasury</u>	Federal <u>Agencies</u>	<u>Total</u>
Powerball Prize Reserve Account	\$ 158,277	\$ 325,750	\$ 484,027
Powerball Set Prize Reserve Account	96,385	114,062	210,447
Powerball Unreserved Account	72,015	132,051	204,066
Wild Card Prize Reserved Account	-	141,412	141,412
Hot Lotto Set Prize Reserve Account	-	297,464	297,464
Mega Millions Prize Reserve Account	<u>57,646</u>	<u>118,642</u>	<u>176,288</u>
Total Reserves	<u>\$ 384,323</u>	<u>\$1,129,381</u>	1,513,704
Less Current Portion			<u>(65,000)</u>
<b>Non Current Reserves</b>			<b><u>\$ 1,448,704</u></b>

### June 30, 2013

	US <u>Treasury</u>	Federal <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>
<b>Non Current Reserves</b>			<b><u>\$ 1,670,644</u></b>

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 2014, the Lottery received \$1,157 in interest and had \$47,854 withdrawn for annual MUSL dues and assessments. During the 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 fee for the use of these patents.

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.

## 8. 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 \$40,000. Players select five numbers from a field of 45 and must match at least two out of five to win a prize. Matching 2 of 5 wins \$1, 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.

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 2013 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 26, 2013. On January 1, 2014, 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 31, 2014, with a drawing on New Year's Day 2015.

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.

## **9. 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.

SGI, 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.

#### 10. **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 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, 2014, 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 \$2,670,000. Total annual payments due as of June 30, 2014 are as follows:

<u>FYE</u>	
2015	2,120,000
2016	<u>550,000</u>
	<u>\$ 2,670,000</u>

#### 11. **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 \$12,128 through August 2014. 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, 2014 are as follows:

<u>FYE</u>	
2015	77,528
2016	<u>55,423</u>
Total Minimum Payments	132,951
Less: Interest	<u>( 6,657)</u>
 Present value of Minimum Payments	 <u>\$ 126,294</u>

## 12. 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 2014 the prize reserves held on behalf of the Montana Lottery are invested in the Montana Winners Trust and include an average of 13% in securities held as obligations of the U.S. Government and are not considered to have credit risk. The other 87% 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, 2014, the duration for the U.S. Government Treasury securities was a blended rate of 1.34 years.

### 13. **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.

MONTANA STATE LOTTERY

LOTTERY RESPONSE



