

OKLAHOMA LOTTERY COMMISSION

June 30, 2011

OKLAHOMA LOTTERY COMMISSION

June 30, 2011

AUDITED FINANCIAL STATEMENTS

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REPORT REQUIRED BY *GOVERNMENT AUDITING STANDARDS*

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Independent Auditors' Report

The Board of Trustees
Oklahoma Lottery Commission

We have audited the accompanying statements of net assets of the Oklahoma Lottery Commission (the "OLC"), a component unit of the State of Oklahoma, as of June 30, 2011 and 2010, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the management of the OLC. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the OLC as of June 30, 2011 and 2010, and the changes in its net assets and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Management's Discussion and Analysis is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 8, 2011 on our consideration of the OLC's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance, and the results of that testing, and not to provide an opinion on the internal control over financial reporting and compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Cole & Reed P.C.

Oklahoma City, Oklahoma
September 8, 2011

OKLAHOMA LOTTERY COMMISSION

MANAGEMENT'S DISCUSSION AND ANALYSIS

Management of the Oklahoma Lottery Commission (the "OLC") provides this Management's Discussion and Analysis of their financial performance for the readers of the OLC's financial statements. This narrative provides an overview of the OLC's financial activity for the fiscal years ended June 30, 2011 and 2010. This analysis is to be considered in conjunction with the financial statements to provide an objective analysis of the OLC's financial activities based on facts, decisions and conditions currently facing management.

UNDERSTANDING THE LOTTERY'S FINANCIAL STATEMENTS

The OLC, an instrumentality of the State of Oklahoma, is accounted for as an enterprise fund that reports all assets and liabilities using the accrual basis of accounting, much like a private business entity. In accordance with accounting principles generally accepted in the United States of America, this report consists of a series of financial statements, along with explanatory notes to the financial statements. The financial statements immediately follow this Management's Discussion and Analysis and are designed to highlight the OLC's net assets and changes to those assets resulting from the OLC's operations.

The most important relationship demonstrated within the OLC's financial statements is the requirement that the OLC transfer all net proceeds, "as defined", to the State Treasurer for the Oklahoma Education Lottery Trust Fund ("OELTF"). Accordingly, a significant focus of these financial statements is determining net proceeds available for transfer to the OELTF.

The OLC is also required to transfer annually the first \$500,000 of unclaimed prize money to the Oklahoma Department of Mental Health and Substance Abuse Services ("ODMHSAS"). This is discussed further on page 5 of Management's Discussion and Analysis.

FINANCIAL AND ACTIVITY HIGHLIGHTS

Revenues from lottery games totaled \$198,153,932 and \$199,747,294 respectively for the fiscal years ending June 30, 2011 and 2010. The OLC returned \$106,600,824 and \$105,092,616 to winners of lottery games; paid commissions and incentives to retailers totaling \$13,219,310 and \$13,150,714; incurred other game related expenses of \$5,895,707 and \$5,903,703; and had operating expenses of \$6,596,129 and \$7,994,755 for each of the respective fiscal years of 2011 and 2010. The OLC's net assets decreased by \$3,628,714 in fiscal year 2011 and \$2,249,841 in fiscal year 2010. Transfers made and due to the OELTF were \$69,396,091 and \$69,974,064 respectively for fiscal years ending June 30, 2011 and 2010.

OKLAHOMA LOTTERY COMMISSION

MANAGEMENT'S DISCUSSION AND ANALYSIS--Continued

FINANCIAL AND ACTIVITY HIGHLIGHTS--Continued

The following table summarizes the OLC's Statement of Net Assets as of June 30:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Current Assets	\$ 23,964,528	\$ 22,624,734	\$ 24,723,406
Noncurrent Assets			
Deposit with MUSL	3,921,842	3,749,310	3,465,906
Capital Assets, Net	<u>148,503</u>	<u>234,050</u>	<u>398,509</u>
Total Assets	<u>28,034,873</u>	<u>26,608,094</u>	<u>28,587,821</u>
Current Liabilities	22,485,986	17,429,577	17,154,697
Noncurrent Liabilities	<u>56,910</u>	<u>57,826</u>	<u>62,592</u>
Total Liabilities	<u>22,542,896</u>	<u>17,487,403</u>	<u>17,217,289</u>
Net Assets			
Invested in Capital Assets, Net	148,503	234,050	398,509
Restricted Expendable Net Assets	<u>5,343,474</u>	<u>8,886,641</u>	<u>10,972,023</u>
Total Net Assets	<u>\$ 5,491,977</u>	<u>\$ 9,120,691</u>	<u>\$ 11,370,532</u>

The following table summarizes the OLC's Statement of Revenues, Expenses and Changes in Net Assets for the years ended June 30:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Operating Revenues			
Gaming revenues	\$ 198,153,932	\$ 199,747,294	\$ 193,164,684
Other revenues	<u>120,614</u>	<u>178,604</u>	<u>161,359</u>
Total	198,274,546	199,925,898	193,326,043
Less Prize Expense	106,600,824	105,092,616	95,922,950
Less Retailer Commissions/Incentives	13,219,310	13,150,714	12,753,727
Less Other Direct Game Costs	5,895,707	5,903,703	5,675,014
Less Operating Expenses	<u>6,596,129</u>	<u>7,994,755</u>	<u>8,109,261</u>
Total Expense	132,311,970	132,141,788	122,460,952
Nonoperating Revenue (Expense)			
Interest Income	304,801	440,113	592,790
Transfers to ODMHSAS	(500,000)	(500,000)	(500,000)
Transfers to OELTF	<u>(69,396,091)</u>	<u>(69,974,064)</u>	<u>(69,226,501)</u>
Net nonoperating revenue (expense)	<u>(69,591,290)</u>	<u>(70,033,951)</u>	<u>(69,133,711)</u>
Increase (Decrease) in Net Assets	(3,628,714)	(2,249,841)	1,731,380
Net Assets, Beginning of Year	<u>9,120,691</u>	<u>11,370,532</u>	<u>9,639,152</u>
Net Assets, End of Year	<u>\$ 5,491,977</u>	<u>\$ 9,120,691</u>	<u>\$ 11,370,532</u>

OKLAHOMA LOTTERY COMMISSION

MANAGEMENT'S DISCUSSION AND ANALYSIS--Continued

FINANCIAL AND ACTIVITY HIGHLIGHTS--Continued

Sales increased from fiscal year 2009 to fiscal year 2010. Online sales during this period decreased mainly due to a decline in larger Powerball jackpots. The addition of the Mega Millions game in the last half of the fiscal year provided additional online sales for the year. There was an increase in the income from Scratch products which offset the decrease in online sales. Sales from fiscal year 2010 to fiscal year 2011 were slightly down. The Mega Millions game had its first full year of sales in fiscal year 2011, which helped offset some of the loss from the other multi-state jackpot game sales. Scratch product sales for fiscal year 2011 were more than in fiscal year 2010, offsetting the decline in sales for the online products.

Net proceeds of the OLC must be transferred to the State Treasurer for the OELTF with the following exceptions: 1) the cost of property and equipment, net of depreciation and related debt, and 2) other assets which can not be transferred due to statutory or other legal restriction, including restricted cash from unclaimed prizes, deposits with MUSL and the Restricted Fidelity Fund. Unclaimed prizes, after required transfers to the Department of Mental Health and Substance Abuse Services, must be added to a pool from which future prizes are awarded or used for special prize promotions. Deposits with MUSL result from a set aside of prize expenses paid to MUSL and are available for prize reserves and promotional expenses of MUSL games. The Restricted Fidelity Fund is derived from the licensing fees of new retailers, which may be retained by the OLC up to the budgeted expenses from the fund for the next fiscal year plus \$500,000 and used to cover losses the OLC may experience due to nonfeasance, misfeasance, or malfeasance of a lottery retailer and to pay the costs of vendor, retailer and employee background investigations conducted by the OSBI and for audits conducted by the State Auditor and Inspector.

For the years ended June 30, 2011 and 2010, the total transfers made or due to the OELTF related to operations were \$69,396,091 and \$69,974,064, respectively. Since inception to June 30, 2011, total transfers made or due to the OELTF were \$418,532,912. For each of the years ended June 30, 2011 and 2010, the OLC transferred \$500,000 in unclaimed prize funds to the Department of Mental Health and Substance Abuse Services for the treatment of compulsive gambling disorders and educational programs related to such disorders. From inception to June 30, 2011, total transfers to the Oklahoma Department of Mental Health and Substance Abuse Services were \$2,544,600.

OKLAHOMA LOTTERY COMMISSION

MANAGEMENT'S DISCUSSION AND ANALYSIS--Continued

FINANCIAL AND ACTIVITY HIGHLIGHTS--Continued

The following is a condensed version of the OLC's Statement of Cash Flows for the years ended June 30:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Cash Provided (Used) By:			
Operating Activities	\$ 67,706,571	\$ 65,578,691	\$ 67,346,826
Noncapital Financing Activities	(65,629,521)	(68,632,345)	(78,893,647)
Capital and Related			
Financing Activities	(15,417)	(35,727)	(30,261)
Investing Activities	<u>307,971</u>	<u>449,435</u>	<u>638,104</u>
Net Increase (Decrease) in Cash	2,369,604	(2,639,946)	(10,938,978)
Cash at Beginning of Year	<u>13,085,908</u>	<u>15,725,854</u>	<u>26,664,832</u>
Cash at End of Year	<u>\$ 15,455,512</u>	<u>\$ 13,085,908</u>	<u>\$ 15,725,854</u>

POTENTIAL FACTORS IMPACTING FUTURE OPERATIONS

On July 5, 2011, the Oklahoma Lottery introduced a new online game, Pick 4. This new game expanded the product offering for our players and in return will increase our contribution to education. United States lotteries including the OLC are in the process of developing a national lottery game. The OLC is also considering options for a regional game to increase sales and profits. OLC continues to review options for other lottery game opportunities and will continue to release new fun and entertaining Scratcher games in fiscal year 2012.

CONTACTING THE LOTTERY'S FINANCIAL MANAGEMENT

This financial report is designed to provide a general overview of the OLC's financial activity for all those interested in the OLC's operations. Questions concerning any of the information provided in this report, or requests for additional financial information, should be addressed to the Director of Administration, Oklahoma Lottery Commission, 405-522-7700, 3817 N. Santa Fe Oklahoma City, Oklahoma 73118.

STATEMENTS OF NET ASSETS

OKLAHOMA LOTTERY COMMISSION

ASSETS	June 30	
	<u>2011</u>	<u>2010</u>
CURRENT ASSETS		
Cash and cash equivalents	\$ 14,033,880	\$ 7,948,577
Cash - restricted	1,421,632	5,137,331
Retailer accounts receivable	7,401,763	9,022,140
Accounts receivable - Multi-State Lottery	<u>1,107,253</u>	<u>516,686</u>
TOTAL CURRENT ASSETS	23,964,528	22,624,734
 CAPITAL ASSETS, net	 148,503	 234,050
 DEPOSIT WITH MULTI-STATE LOTTERY	 <u>3,921,842</u>	 <u>3,749,310</u>
TOTAL NONCURRENT ASSETS	<u>4,070,345</u>	<u>3,983,360</u>
TOTAL ASSETS	<u>\$ 28,034,873</u>	<u>\$ 26,608,094</u>
 LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Due to Oklahoma Education Lottery Trust Fund	\$ 13,665,516	\$ 9,398,946
Due to Multi-State Lottery	1,113,907	1,188,475
Prizes payable	6,100,543	5,641,613
Accounts payable	1,045,081	718,578
Accrued liabilities	139,596	159,299
Deferred revenue	<u>421,343</u>	<u>322,666</u>
TOTAL CURRENT LIABILITIES	22,485,986	17,429,577
 ACCRUED COMPENSATED ABSENCES, net	 <u>56,910</u>	 <u>57,826</u>
TOTAL LIABILITIES	22,542,896	17,487,403
 NET ASSETS		
Invested in capital assets, net	148,503	234,050
Restricted net assets - expendable	<u>5,343,474</u>	<u>8,886,641</u>
TOTAL NET ASSETS	<u>5,491,977</u>	<u>9,120,691</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 28,034,873</u>	<u>\$ 26,608,094</u>

See notes to financial statements.

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

OKLAHOMA LOTTERY COMMISSION

	Years ended June 30	
	2011	2010
REVENUES		
Scratcher games	\$ 102,969,295	\$ 88,966,304
Pick 3 game	5,849,788	6,279,596
Cash 5 game	4,713,329	5,445,698
Hot Lotto game	9,514,730	12,467,350
Mega Millions game	20,954,777	6,938,995
Powerball game	54,152,013	79,649,351
TOTAL REVENUE FROM THE SALE OF LOTTERY TICKETS	<u>198,153,932</u>	<u>199,747,294</u>
Retailer application fees	112,380	115,585
Other	8,234	63,019
TOTAL REVENUES	<u>198,274,546</u>	<u>199,925,898</u>
DIRECT COSTS		
Prize expense		
Scratcher games	60,780,047	53,159,059
Pick 3 game	2,847,450	2,980,480
Cash 5 game	2,170,004	2,706,052
Hot Lotto game	4,411,148	5,894,100
Mega Millions game	10,436,364	3,621,713
Powerball game	25,955,811	36,731,212
TOTAL PRIZE EXPENSE	<u>106,600,824</u>	<u>105,092,616</u>
Commissions and incentives to retailers	13,219,310	13,150,714
Instant and on-line costs	5,895,707	5,903,703
TOTAL DIRECT COSTS	<u>125,715,841</u>	<u>124,147,033</u>
GROSS PROFIT	72,558,705	75,778,865
OPERATING EXPENSES		
Advertising	2,493,063	3,406,740
Promotion	530,206	549,825
Salaries, wages and benefits	2,888,869	3,091,050
Contracted and professional services	158,711	238,146
Depreciation	100,964	200,186
Equipment	27,449	23,096
Rent expense	205,136	229,973
Office supplies	33,024	62,328
Travel	15,338	27,284
Other general and administrative	143,369	166,127
TOTAL OPERATING EXPENSES	<u>6,596,129</u>	<u>7,994,755</u>
OPERATING INCOME	65,962,576	67,784,110
NONOPERATING INCOME (EXPENSE)		
Interest income	304,801	440,113
Transfers to Oklahoma Department of Mental Health and Substance Abuse Services	(500,000)	(500,000)
Transfers to and due to Oklahoma Education Lottery Trust Fund	<u>(69,396,091)</u>	<u>(69,974,064)</u>
NET NONOPERATING INCOME (EXPENSE)	<u>(69,591,290)</u>	<u>(70,033,951)</u>
CHANGE IN NET ASSETS	(3,628,714)	(2,249,841)
NET ASSETS, beginning of year	<u>9,120,691</u>	<u>11,370,532</u>
NET ASSETS, end of year	<u>\$ 5,491,977</u>	<u>\$ 9,120,691</u>

See notes to financial statements.

STATEMENTS OF CASH FLOWS

OKLAHOMA LOTTERY COMMISSION

	Years ended June 30	
	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from retailers	\$ 186,141,085	\$ 185,481,464
Cash payments to prize winners	(106,216,462)	(105,789,408)
Cash payments to suppliers for goods and services	(9,136,032)	(10,701,660)
Cash payments to employees for services	(2,909,488)	(3,128,301)
Cash payments to fund deposit with Multi-State Lottery	(172,532)	(283,404)
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>67,706,571</u>	<u>65,578,691</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Payments to Oklahoma Department of Mental Health and Substance Abuse Services	(500,000)	(500,000)
Payments to Oklahoma Education Lottery Trust Fund	(65,129,521)	(68,132,345)
NET CASH USED FOR NONCAPITAL FINANCING ACTIVITIES	<u>(65,629,521)</u>	<u>(68,632,345)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Purchase of capital assets	(15,417)	(35,727)
NET CASH USED FOR CAPITAL AND RELATED FINANCING ACTIVITIES	<u>(15,417)</u>	<u>(35,727)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest received	307,971	449,435
NET CASH PROVIDED BY INVESTING ACTIVITIES	<u>307,971</u>	<u>449,435</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	2,369,604	(2,639,946)
CASH AND CASH EQUIVALENTS, beginning of year	<u>13,085,908</u>	<u>15,725,854</u>
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 15,455,512</u>	<u>\$ 13,085,908</u>
OPERATING ACTIVITIES		
Operating income	\$ 65,962,576	\$ 67,784,110
Adjustment to reconcile operating income to net cash provided by operating activities		
Depreciation	100,964	200,186
Bad debt expense	41,574	30,714
Changes in operating assets and liabilities		
Retailer accounts receivable	1,575,633	(1,028,222)
Accounts receivable - Multi-State Lottery	(590,567)	446,915
Deposit with Multi-State Lottery	(172,532)	(283,404)
Due to Multi-State Lottery	(74,568)	(572,228)
Accounts payable and accrued liabilities	305,884	(165,708)
Prizes payable	458,930	(525,258)
Deferred revenue	98,677	(308,414)
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>\$ 67,706,571</u>	<u>\$ 65,578,691</u>

See notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

OKLAHOMA LOTTERY COMMISSION

June 30, 2011

NOTE A--REPORTING ENTITY

The Oklahoma Lottery Commission (the "OLC"), was formed by the citizens of Oklahoma upon passage of a legislative referendum authorizing the Oklahoma Education Lottery Act (the "Act"), codified as Title 3A, Section 701, et. seq., of the Oklahoma Statutes. The OLC is a component unit of the State of Oklahoma (the "State") responsible for administering lotteries in accordance with the Act. The Act established a board of seven trustees appointed by the Governor to oversee operations of the OLC. The Board of Trustees exercises powers comparable to those of the governing board of an entrepreneurial organization. The OLC transfers net proceeds as defined by the Act. Therefore, the OLC is reported as a discretely presented component unit in the State of Oklahoma's Comprehensive Annual Financial Report ("CAFR").

NOTE B--SIGNIFICANT ACCOUNTING POLICIES

Method of Accounting: The OLC is accounted for as an enterprise fund. Enterprise funds are used to account for activities that are financed and operated in a manner similar to private business enterprises where the costs of providing lottery games to the general public on a continuing basis are to be financed through the sale of lottery game tickets. The Act requires that all costs of providing lottery games, including capital costs, be recovered from the sale of lottery game tickets.

The Governmental Accounting Standards Board ("GASB") is the recognized standard setting body for accounting principles generally accepted applicable to governmental proprietary activities in the United States of America. The OLC applies all applicable GASB pronouncements and all applicable Financial Accounting Standards Board ("FASB") pronouncements issued on or before November 30, 1989 when not in conflict with GASB pronouncements. In accordance with GASB Statement No. 20, the OLC has elected not to implement FASB Statements after the applicable date.

Basis of Accounting: The financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. Under this method, revenues are recognized when they are earned and expenses are recognized when they are incurred.

The primary operating revenue of the OLC is ticket sales from games. Nonoperating income consists mostly of interest income. "Operating expenses" are defined under the Act as "all costs of doing business, including but not limited to prizes, commissions, and other compensation paid to retailers, advertising and marketing costs, personnel costs, capital costs, amounts held in or paid from the fidelity revolving fund, administration and operation of the OLC and other operating costs". All expenses not meeting this definition are reported as nonoperating expenses. The only nonoperating expenses are statutory required transfers to the Oklahoma Education Lottery Trust Fund ("OELTF") and the Oklahoma Department of Mental Health and Substance Abuse Services.

NOTES TO FINANCIAL STATEMENTS--Continued

OKLAHOMA LOTTERY COMMISSION

June 30, 2011

NOTE B--SIGNIFICANT ACCOUNTING POLICIES--Continued

Use of Estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue Recognition: Revenue for Pick 3, Cash 5, Hot Lotto, Mega Millions and Powerball (collectively referred to as "on-line games") is recognized when tickets are sold to the public by contracted retailers, except for tickets sold in advance of the draw date for which deferred revenue is recorded. Revenue for scratcher games is recognized upon activation of ticket packs for sale by the retailers.

Every scratcher ticket game has a predetermined number of free tickets in its prize structure. The majority of free tickets relate to scratcher ticket games. Revenue and prize expense are shown net of free tickets.

Commissions: Retailers receive a 6% commission on total sales and 0.75% commission on prizes cashed.

Prizes: Prize expense for scratcher ticket games is recorded as an estimate at the time the related revenue is recognized based on the predetermined prize structure for each game; periodically, the prize expense is adjusted to reflect amounts actually won. Prize expense for on-line games is recorded at the time the related revenue is recognized based on the known prizes.

Unclaimed Prizes: Prizes must be claimed within 90 days after the game-end (end of sales) for scratcher games and within 180 days after the draw date for on-line games. The first \$500,000 of unclaimed prize money accruing annually must be transferred to the Oklahoma Department of Mental Health and Substance Abuse Services for the treatment of compulsive gambling disorders and educational programs related to such disorders.

In accordance with section 724 of the Act, unclaimed prizes are added to a pool from which future prizes are awarded or used for special prize promotions. Under the Act, unclaimed prizes do not constitute net lottery proceeds and are restricted funds that are not available for transfer to the OELTF. Total unclaimed prizes amounted to \$4,612,086 and \$6,065,325 for fiscal years 2011 and 2010, respectively. Unclaimed prizes are netted against prize expense in the statement of revenues, expenses and changes in net assets.

NOTES TO FINANCIAL STATEMENTS--Continued

OKLAHOMA LOTTERY COMMISSION

June 30, 2011

NOTE B--SIGNIFICANT ACCOUNTING POLICIES--Continued

Net Assets: The OLC's net assets are classified as follows:

Invested in capital assets - This represent's the OLC's total investment in capital assets.

Restricted net assets – expendable - This represents cash maintained in the OLC's restricted fidelity fund, deposits with the Multi-State Lottery ("MUSL"), and balance of unclaimed prizes to be used on future prizes or special prize promotions.

Gross Proceeds: Gross proceeds, as defined by the Act, consist of all revenue derived from the sale of lottery game tickets or shares and all other monies derived from the lottery games.

Net Proceeds: Net proceeds, as defined by the Act, consist of all revenue derived from the sale of lottery game tickets or shares and all other monies derived from the lottery games, less operating expenses and prizes.

Operating Expenses: Operating expenses, as defined by the Act, in the determination of net proceeds, consist of all costs of doing business including, but not limited to, prizes, commissions, and other compensation paid to lottery retailers, advertising and marketing costs, rental fees, personnel costs, capital costs, depreciation of property and equipment and other operating costs.

Cash and Cash Equivalents: The OLC's cash and cash equivalents are considered to be cash on-hand and interest bearing demand deposits held by the Oklahoma State Treasurer.

Retailer Accounts Receivable: Retailer accounts receivable represents lottery proceeds due from retailers for on-line ticket sales and activated ticket packs for scratcher games less commissions due to retailers and prizes paid by the retailers. Lottery proceeds are collected weekly by the OLC from retailer trust accounts established in trust for benefit of the OLC.

Capital Assets, Net: Capital assets, which consist of machinery, equipment, computers and software are stated at cost less accumulated depreciation. The OLC capitalizes all property and equipment purchases of \$500 or more. Depreciation is computed using the straight-line method over the estimated useful lives of three, five and ten years. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is reflected in the results from operations in the period of disposal.

NOTES TO FINANCIAL STATEMENTS--Continued

OKLAHOMA LOTTERY COMMISSION

June 30, 2011

NOTE B--SIGNIFICANT ACCOUNTING POLICIES--Continued

Restricted Cash: In accordance with the Act, retailers contribute a fee to a fidelity fund upon acceptance as a retailer for the OLC. The fund is used to cover losses the OLC may incur due to misfeasance, nonfeasance or malfeasance of retailers and to contract for investigations, reviews or audits. At the end of any fiscal year, the OLC must transfer to the OELTF any amount in the restricted fidelity fund which exceeds the budgeted expenses from the fund for the next fiscal year plus \$500,000. At June 30, 2011 and 2010 no amounts were available for transfer as net proceeds. During fiscal years 2011 and 2010, \$41,574 and \$30,714 respectively, was used to reimburse the OLC for retailer accounts that were delinquent and in collection status. Receipts from retailers in collection status are deposited back to the fidelity fund. The fidelity fund is held in a separate account and appears in the accompanying statement of net assets as restricted funds and expendable restricted net assets.

Deposits with MUSL are included in expendable restricted net assets. These funds are in the possession of the MUSL and serve as a contingency to protect members from unforeseen prize liabilities.

Current unclaimed prizes in excess of \$500,000 and the balance from prior years are included in restricted cash. These funds are to be utilized to enhance future OLC prizes or promotions.

As of June 30, 2011 and 2010, restricted cash totaled \$1,421,632 and \$5,137,331 respectively.

Risk Management: The OLC is exposed to various risks of loss related to torts, destruction of assets due to theft or damage, errors and omissions, injuries to employees, and natural disasters. The OLC has coverage to substantially cover these risks through a self-insured pool for agencies of the State of Oklahoma. This coverage is administered by the Risk Management Division of the Department of Central Services for the State of Oklahoma.

Compensated Absences: Employees earn the right to be compensated during absences for vacation and compensatory time. Unused leave benefits are paid to employees upon separation from service. The cost of vacation and compensatory time is accrued in the period in which it is earned.

Deposit with MUSL: The OLC has contributed to a set prize reserve fund separately maintained by the MUSL (Note J) to pay certain prizes associated with Powerball, Hot Lotto and Mega Millions. With certain restrictions, the OLC's portion of this prize reserve fund is refundable upon termination of the OLC's agreement with the MUSL or upon the disbanding of the MUSL.

NOTES TO FINANCIAL STATEMENTS--Continued

OKLAHOMA LOTTERY COMMISSION

June 30, 2011

NOTE B--SIGNIFICANT ACCOUNTING POLICIES--Continued

Deposit with MUSL--Continued: As a member of the MUSL, the OLC is required to make deposits in various prize reserve funds maintained by the MUSL. These deposits are included in the 50% prize expense computed on Powerball and Hot Lotto sales, and in the 51.5% prize expense computed on Mega Millions sales. The net amount of 50% or 51.5% prize expense, less the amount required to pay non-jackpot prizes within the State, is paid to the MUSL. This payment is to cover the OLC's share of current jackpot prizes based on the OLC's percent of sales for each drawing and the OLC share of the prize reserve fund. The prize reserve fund serves as a contingency reserve to protect all the MUSL members, including the OLC, from unforeseen prize liabilities. The balances of the deposits are made up of the following:

	<u>June 30, 2011</u>	<u>June 30, 2010</u>
Set Prize Reserve Account	\$ 663,044	\$ 867,753
Prize Reserve Account	3,240,467	2,878,099
Balance of Unreserved Account	<u>18,331</u>	<u>3,458</u>
	<u>\$ 3,921,842</u>	<u>\$ 3,749,310</u>

Bad Debt Expense: The OLC recognizes bad debt expense when retailer account receivables are greater than 90 days old. The accounts receivable balance due to the OLC is satisfied at that time by a transfer of funds from the restricted fidelity fund. The OLC may continue its effort to collect these accounts. Any collection from a retailer balance previously charged to bad debt expense will be deposited back to the restricted fidelity fund. For the years ended June 30, 2011 and 2010, bad debt expense was \$41,574 and \$30,714, respectively.

Reclassifications: Certain amounts in the prior year's financial statements have been reclassified to conform with the current year presentation.

NOTE C--CASH AND DEPOSITS

Custodial credit risk is the risk that in the event of a bank failure, the government's deposits may not be returned to it. The OLC does not have a deposit policy for custodial credit risk. However, all of the OLC's bank deposits are held by the Oklahoma State Treasurer ("OST") and therefore, as required by Oklahoma State Statutes, all bank deposits held by the OST are insured by Federal Deposit Insurance, collateralized by securities held by the cognizant Federal Reserve Bank, or invested in U.S. government obligations and therefore are not considered to be exposed to custodial credit risk. As of June 30, 2011 and 2010, the carrying amounts of the OLC's deposits with the OST were \$15,455,512 and \$13,085,908, respectively, and the bank balances were \$15,490,266 and \$13,101,320, respectively.

NOTES TO FINANCIAL STATEMENTS--Continued

OKLAHOMA LOTTERY COMMISSION

June 30, 2011

NOTE D--CAPITAL ASSETS, NET

The following is a summary of changes in capital assets and accumulated depreciation during the fiscal year indicated:

	Year Ended June 30, 2011			
	Beginning Balance	Additions	Deletions	Ending Balance
<u>Capital Assets</u>				
Machinery and equipment	\$ 736,965	\$ 15,417	\$ -	\$ 752,382
Computers and software	400,006	-	-	400,006
	<u>1,136,971</u>	<u>15,417</u>	<u>-</u>	<u>1,152,388</u>
Accumulated depreciation				
Machinery and equipment	505,331	99,769	-	605,100
Computers and software	397,590	1,195	-	398,785
	<u>902,921</u>	<u>100,964</u>	<u>-</u>	<u>1,003,885</u>
Total capital assets, net	<u>\$ 234,050</u>	<u>\$ (85,547)</u>	<u>\$ -</u>	<u>\$ 148,503</u>

	Year Ended June 30, 2010			
	Beginning Balance	Additions	Deletions	Ending Balance
<u>Capital Assets</u>				
Machinery and equipment	\$ 703,536	\$ 33,429	\$ -	\$ 736,965
Computers and software	397,708	2,298	-	400,006
	<u>1,101,244</u>	<u>35,727</u>	<u>-</u>	<u>1,136,971</u>
Accumulated depreciation				
Machinery and equipment	378,772	126,559	-	505,331
Computers and software	323,963	73,627	-	397,590
	<u>702,735</u>	<u>200,186</u>	<u>-</u>	<u>902,921</u>
Total capital assets, net	<u>\$ 398,509</u>	<u>\$ (164,459)</u>	<u>\$ -</u>	<u>\$ 234,050</u>

NOTES TO FINANCIAL STATEMENTS--Continued

OKLAHOMA LOTTERY COMMISSION

June 30, 2011

NOTE E--COMPENSATED ABSENCES

Compensated absences: The following is a summary of changes in the OLC's liability for compensated absences during the period ended June 30:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Deletions</u>	<u>Ending Balance</u>	<u>Current Portion</u>
Compensated absences 2011	<u>\$ 173,477</u>	<u>\$ 130,553</u>	<u>\$ 133,300</u>	<u>\$ 170,730</u>	<u>\$ 113,820</u>
Compensated absences 2010	<u>\$ 187,401</u>	<u>\$ 132,309</u>	<u>\$ 146,233</u>	<u>\$ 173,477</u>	<u>\$ 115,651</u>

NOTE F--OPERATING LEASES

The OLC has entered into various operating leases for office space and equipment used in its daily operations. Pursuant to Oklahoma State Statutes, the OLC's operating leases are limited to terms of one year and must be renewed annually. Accordingly, the OLC has no long-term commitments under the operating leases as of June 30, 2011 or 2010. Rent expense under all operating leases was \$205,136 for the year ended June 30, 2011, and \$229,973 for the year ended June 30, 2010.

NOTE G--EDUCATION LOTTERY ACCOUNT

In accordance with the Act, all net proceeds of the OLC are transferred to the Education Lottery Account. Net proceeds consist of all revenue derived from the sale of lottery game tickets or shares and all other monies derived from the lottery games less operating expenses and prizes. Beginning in fiscal year 2009, the OLC makes transfers to the OELTF calculated at 35% of the total revenue year-to-date, less amounts previously paid. The net proceeds transfer requirement percentage for years prior to fiscal year 2009 was 30%. All remaining net income at the end of the fiscal year is also remitted to the OELTF, unless specifically exempted by statute. According to the Act, amounts transferred to the OELTF are to be appropriated by the Legislature to education programs according to the parameters established in the Act. Following is an executive summary of these statutory provisions. For the full text, see Title 3A, Section 713 of the Oklahoma Statutes available on the OLC website.

NOTES TO FINANCIAL STATEMENTS--Continued

OKLAHOMA LOTTERY COMMISSION

June 30, 2011

NOTE G--EDUCATION LOTTERY ACCOUNT--Continued

- 5% Teachers' Retirement System Dedicated Revenue Revolving Fund
- 5% School Consolidation and Assistance Fund ("SCAF"): if the SCAF equals \$5,000,000, this 5% will be allocated to public schools to purchase technology equipment to conduct on-line testing
- 45% Kindergarten through twelfth grade public education, including compensation and benefits for public school teachers and support employees; and early childhood development programs
- 45% Tuition grants, loans and scholarships to citizens of this state for attending colleges and universities located within this state, or to attend Oklahoma Department of Career and Technology Education institutions; construction of educational facilities or capital outlay projects or technology for elementary school districts, independent school districts, the Oklahoma State System of Higher Education, and career and technology education; endowed chairs for professors at institutions of higher education operated by the Oklahoma State System of Higher Education; and programs and personnel of the Oklahoma School for the Deaf and the Oklahoma School for the Blind

The following is a summary of the amounts available for transfer to the OELTF during the years ended June 30, 2011 and 2010:

	June 30	
	<u>2011</u>	<u>2010</u>
Net assets, beginning of year	\$ 9,120,691	\$ 11,370,532
Change in net assets before transfers to OELTF	<u>65,767,377</u>	<u>67,724,223</u>
Net assets available for transfer to OELTF		
before amounts invested in capital assets		
and restricted net assets	74,888,068	79,094,755
Less: Net assets invested in capital assets	(148,503)	(234,050)
Less: Restricted net assets - expendable	<u>(5,343,474)</u>	<u>(8,886,641)</u>
Transfers to and due OELTF for the year	<u>\$ 69,396,091</u>	<u>\$ 69,974,064</u>

NOTES TO FINANCIAL STATEMENTS--Continued

OKLAHOMA LOTTERY COMMISSION

June 30, 2011

NOTE H--RETIREMENT PROGRAM

The OLC contributes to the Oklahoma Public Employees Retirement System ("OPERS") cost sharing multiple-employer defined benefit plan. OPERS was established in 1964 by the Oklahoma Legislature and covers substantially all employees of the State except those covered by six other plans sponsored by the State and also covers employees of participating counties and local agencies. The plan provides that all eligible persons, except those specifically excluded, shall become members of OPERS as a condition of their employment. The supervisory authority for the management and operation of OPERS is its Board of Trustees.

OPERS offers retirement and disability benefits, cost of living adjustments on an ad-hoc basis, life insurance benefits and survivor benefits. The Plan's provisions are established under Title 74 of the Oklahoma Statutes.

The following is a recap of OPERS' mandated contribution rates for fiscal years:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Employee contributions	3.50%	3.50%	3.50%
Additional % for members electing stepup	2.91%	2.91%	2.91%
Employer contributions	15.50%	15.50%	14.50%

For the years ended June 30, 2011, 2010 and 2009 the OLC's contributions to OPERS were \$295,643, \$317,954 and \$295,497, respectively. All employer contributions were equal to the required contribution rates for the year.

A comprehensive annual financial report containing financial statements and required supplementary information for the Oklahoma Public Employee Retirement System is issued and publicly available by writing the Oklahoma Public Employee Retirement System, Post Office Box 53007, Oklahoma City, Oklahoma 73152-3007.

NOTE I--CONTINGENCIES

The OLC is subject to litigation in the ordinary course of its operations. In the opinion of the OLC's management and its legal counsel, the outcome of such litigation will not have a material impact on the financial position or cash flows of the OLC for the years ended June 30, 2011 and 2010.

NOTES TO FINANCIAL STATEMENTS--Continued

OKLAHOMA LOTTERY COMMISSION

June 30, 2011

NOTE J--CONTRACTUAL ARRANGEMENTS

In August 2005 the OLC entered into a contract with Scientific Games International, Inc. ("SGI") to provide amongst other things, services and equipment to operate its lotteries. Due to Oklahoma Statutes, the OLC may not contract for a period longer than one year. However, the contract with SGI does contain six one-year renewal options which the OLC's Board of Trustees may renew annually. Under the terms of the contract, the OLC pays SGI a fee based on a percentage of the OLC's sales. For the years ended June 30, 2011 and 2010, the OLC paid SGI \$5,895,707 and \$5,903,703, respectively.

The OLC is a member of the MUSL which operates games on behalf of participating lotteries. MUSL currently operates the Powerball, Mega Millions and Hot Lotto games for the OLC. Under the OLC's agreement with the MUSL, the OLC must remit 50% of its Powerball ticket sales, 50% of its Hot Lotto ticket sales and 51.5% of its Mega Millions ticket sales, less the amount of all non-jackpot winning tickets sold. The OLC is responsible for paying winning tickets purchased in Oklahoma; therefore, it is able to deduct winning tickets sold from the amount due to the MUSL on its ticket sales. As of June 30, 2011 and 2010, the OLC owed the MUSL \$1,113,907 and \$1,188,475 for ticket sales and the MUSL owed the OLC \$401,609 and \$516,686 for non-jackpot winning tickets. Additionally, the MUSL owed the OLC \$705,644 related to a grand prize jackpot ticket at June 30, 2011. The OLC has recorded these items at their gross amounts in the accompanying statements of net assets.

NOTE K--RECENTLY ISSUED PRONOUNCEMENTS

During December 2010, the GASB issued Statement No. 62, Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements ("Statement 62"). The requirements of Statement 62 are effective for periods beginning after December 15, 2011. Statement 62 is intended to enhance the usefulness of its Codification by incorporating guidance that previously could only be found in certain Financial Accounting Standards Board ("FASB") and American Institute of Certified Public Accountants ("AICPA") pronouncements. Statement 62 is not expected to have a significant impact on the OLC's financial statements.

NOTES TO FINANCIAL STATEMENTS--Continued

OKLAHOMA LOTTERY COMMISSION

June 30, 2011

NOTE K--RECENTLY ISSUED PRONOUNCEMENTS--Continued

During June 2011, the GASB issued Statement No. 63, Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position ("Statement 63"). The requirements of Statement 63 are effective for periods beginning after December 15, 2011. Statement 63 provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. Previous financial reporting standards do not include guidance for reporting those financial statement elements, which are distinct from assets and liabilities. Management is currently evaluating the impact Statement 63 will have on the OLC's financial statements.

Independent Auditors' Report on Compliance and Other Matters and on Internal Control
Over Financial Reporting Based on an Audit of Financial Statements
Performed in Accordance with *Government Auditing Standards*

The Board of Trustees
Oklahoma Lottery Commission

We have audited the financial statements of the Oklahoma Lottery Commission (the "OLC"), a component unit of the State of Oklahoma, as of and for the year ended June 30, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States of America.

Compliance and Other Matters

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

Internal Control over Financial Reporting

In planning and performing our audit, we considered the OLC's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the OLC's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the OLC's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

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

This report is intended solely for the information and use of the OLC's Board of Trustees and management and the State of Oklahoma and is not intended to be and should not be used by anyone other than these specified parties.

Cole & Reed P.C.

Oklahoma City, Oklahoma
September 8, 2011