

Audited Financial Statements

**OKLAHOMA LOTTERY
COMMISSION**

June 30, 2013 and 2012

OKLAHOMA LOTTERY COMMISSION

June 30, 2013 and 2012

AUDITED FINANCIAL STATEMENTS

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REPORT REQUIRED BY *GOVERNMENT AUDITING STANDARDS*

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Independent Auditors' Report

To the Board of Trustees
Oklahoma Lottery Commission
Oklahoma City, Oklahoma

Report on the Financial Statements

We have audited the accompanying statements of net position of the Oklahoma Lottery Commission (the "OLC"), an enterprise fund of the State of Oklahoma, as of June 30, 2013, and 2012, and the related statements of revenues, expenses, and changes in net position and cash flows for the 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 includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of 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 control relevant to the entity'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 entity's internal control. 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 evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Oklahoma Lottery Commission as of June 30, 2013, and 2012, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matter

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued a report dated September 11, 2013, 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 and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the OLC's internal control over financial reporting and compliance.

Cole & Reed P.C.

Oklahoma City, Oklahoma
September 11, 2013

MANAGEMENT'S DISCUSSION AND ANALYSIS

OKLAHOMA LOTTERY COMMISSION

June 30, 2013

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, 2013, and 2012. 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 position and changes to its net position 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 \$200,208,874 and \$199,854,378 respectively for the fiscal years ending June 30, 2013, and 2012. The OLC returned \$104,463,424 and \$103,052,810 to winners of lottery games; paid commissions and incentives to retailers totaling \$13,114,765 and \$13,233,747; incurred other game related expenses of \$5,948,626 and \$6,081,715; and had operating expenses of \$4,615,135 and \$4,860,761 for each of the respective fiscal years of 2013 and 2012. The OLC's net position increased by \$1,917,159 in fiscal year 2013 and \$2,535,536 in fiscal year 2012. Transfers made and due to the OELTF were \$70,113,527 and \$69,990,674 respectively for fiscal years ending June 30, 2013, and 2012.

MANAGEMENT'S DISCUSSION AND ANALYSIS--Continued

OKLAHOMA LOTTERY COMMISSION

June 30, 2013

FINANCIAL AND ACTIVITY HIGHLIGHTS--Continued

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

| | <u>2013</u> | <u>2012</u> | <u>2011</u> |
|------------------------------------|----------------------|----------------------|----------------------|
| CURRENT ASSETS | \$ 30,815,345 | \$ 30,872,975 | \$ 23,964,528 |
| NONCURRENT ASSETS | | | |
| Deposit with MUSL | 5,599,779 | 5,786,011 | 3,921,842 |
| Capital assets, net | 85,122 | 105,926 | 148,503 |
| TOTAL ASSETS | <u>\$ 36,500,246</u> | <u>\$ 36,764,912</u> | <u>\$ 28,034,873</u> |
| CURRENT LIABILITIES | \$ 26,493,129 | \$ 28,675,720 | \$ 22,485,986 |
| NONCURRENT LIABILITIES | 62,445 | 61,679 | 56,910 |
| TOTAL LIABILITIES | <u>\$ 26,555,574</u> | <u>\$ 28,737,399</u> | <u>\$ 22,542,896</u> |
| NET POSITION | | | |
| Invested in capital assets, net | \$ 85,122 | \$ 105,926 | \$ 148,503 |
| Restricted expendable net position | 9,859,550 | 7,921,587 | 5,343,474 |
| TOTAL NET POSITION | <u>\$ 9,944,672</u> | <u>\$ 8,027,513</u> | <u>\$ 5,491,977</u> |

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

| | <u>2013</u> | <u>2012</u> | <u>2011</u> |
|---------------------------------------|---------------------|---------------------|---------------------|
| OPERATING REVENUES | | | |
| Gaming revenues | \$ 200,208,874 | \$ 199,854,378 | \$ 198,153,932 |
| Other revenues | 115,485 | 118,975 | 120,614 |
| TOTAL OPERATING REVENUES | 200,324,359 | 199,973,353 | 198,274,546 |
| Less: Prize expense | 104,463,424 | 103,052,810 | 106,600,824 |
| Less: Retailer commissions/incentives | 13,114,765 | 13,233,747 | 13,219,310 |
| Less: Other direct game costs | 5,948,626 | 6,081,715 | 5,895,707 |
| Less: Operating expenses | 4,615,135 | 4,860,761 | 6,596,129 |
| TOTAL EXPENSE | <u>128,141,950</u> | <u>127,229,033</u> | <u>132,311,970</u> |
| NONOPERATING REVENUE (EXPENSE) | | | |
| Interest income | 348,277 | 281,890 | 304,801 |
| Transfers to ODMHSAS | (500,000) | (500,000) | (500,000) |
| Transfers to OELTF | (70,113,527) | (69,990,674) | (69,396,091) |
| NET NONOPERATING REVENUE (EXPENSE) | <u>(70,265,250)</u> | <u>(70,208,784)</u> | <u>(69,591,290)</u> |
| INCREASE (DECREASE) IN NET POSITION | 1,917,159 | 2,535,536 | (3,628,714) |
| NET POSITION, BEGINNING OF YEAR | <u>8,027,513</u> | <u>5,491,977</u> | <u>9,120,691</u> |
| NET POSITION, END OF YEAR | <u>\$ 9,944,672</u> | <u>\$ 8,027,513</u> | <u>\$ 5,491,977</u> |

MANAGEMENT'S DISCUSSION AND ANALYSIS--Continued

OKLAHOMA LOTTERY COMMISSION

June 30, 2013

FINANCIAL AND ACTIVITY HIGHLIGHTS--Continued

Sales increased slightly from fiscal year 2012 to fiscal year 2013. Online sales during this period increased mostly because Powerball had four jackpots in fiscal year 2013 that were over \$300 million. There was a decrease in overall Scratcher sales from fiscal year 2012 to fiscal year 2013. The OLC slightly reduced prize payouts in fiscal year 2013 to adjust to fluctuations in costs and to meet the minimum mandated profit of 35%.

Sales increased slightly from fiscal year 2011 to fiscal year 2012. Online sales during this period increased mainly due to a record jackpot for Mega Millions at the end of March 2012. The price increase of the Powerball game in the last half of the fiscal year also provided a minimal increase to online sales for the year. There was a decrease in overall Scratcher sales from fiscal year 2011 to fiscal year 2012. One of the main contributing factors was due to a slight decrease in prize payouts across various price points. Instant payouts must be closely managed to ensure OLC fulfills our mandated requirement of 35% to education. We continually review and adjust Scratcher prize payouts to meet consumer demands and our ability to pay the prizes and transfers to education.

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 cannot 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, 2013, and 2012, the total transfers made or due to the OELTF related to operations were \$70,113,527 and \$69,990,674, respectively. Since inception to June 30, 2013, total transfers made or due to the OELTF were \$558,637,113. For each of the years ended June 30, 2013, and 2012, 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, 2013, total transfers to the Oklahoma Department of Mental Health and Substance Abuse Services were \$3,544,600.

MANAGEMENT'S DISCUSSION AND ANALYSIS--Continued

OKLAHOMA LOTTERY COMMISSION

June 30, 2013

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>2013</u> | <u>2012</u> | <u>2011</u> |
|--|----------------------|----------------------|----------------------|
| CASH PROVIDED (USED) BY: | | | |
| Operating activities | \$ 71,378,287 | \$ 73,641,204 | \$ 67,706,571 |
| Noncapital financing activities | (70,435,881) | (65,439,871) | (65,629,521) |
| Capital and related financing activities | (17,013) | (10,246) | (15,417) |
| Investing activities | <u>353,209</u> | <u>268,533</u> | <u>307,971</u> |
| NET INCREASE IN CASH | 1,278,602 | 8,459,620 | 2,369,604 |
| CASH AT BEGINNING OF YEAR | <u>23,915,132</u> | <u>15,455,512</u> | <u>13,085,908</u> |
| CASH AT END OF YEAR | <u>\$ 25,193,734</u> | <u>\$ 23,915,132</u> | <u>\$ 15,455,512</u> |

POTENTIAL FACTORS IMPACTING FUTURE OPERATIONS

Future operations always have the potential to be impacted by economic factors and rising costs. The Oklahoma Lottery Commission strives to maximize the contribution to education while maintaining new and entertaining games that engage players. In order to meet these goals, the OLC strives to keep costs low and introduce new games regularly. The OLC is always looking for opportunities to participate in new regional and multi state games. The OLC is also trying to develop new local games to stay up-to-date with player demands.

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 Executive Director, Oklahoma Lottery Commission, 405-522-7700, 3817 N. Santa Fe Oklahoma City, Oklahoma 73118.

STATEMENTS OF NET POSITION

OKLAHOMA LOTTERY COMMISSION

| | Years ended June 30, | |
|--|-------------------------|----------------------|
| | 2013 | 2012 |
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash and cash equivalents | \$ 20,933,963 | \$ 21,779,556 |
| Cash - restricted | 4,259,771 | 2,135,576 |
| Retailer accounts receivable | 5,190,812 | 6,582,415 |
| Accounts receivable - Multi-State Lottery | 430,799 | 375,428 |
| TOTAL CURRENT ASSETS | <u>30,815,345</u> | <u>30,872,975</u> |
| CAPITAL ASSETS, net | 85,122 | 105,926 |
| DEPOSIT WITH MULTI-STATE LOTTERY | 5,599,779 | 5,786,011 |
| TOTAL NONCURRENT ASSETS | <u>5,684,901</u> | <u>5,891,937</u> |
| TOTAL ASSETS | <u>\$ 36,500,246</u> | <u>\$ 36,764,912</u> |
| LIABILITIES AND NET POSITION | | |
| CURRENT LIABILITIES | | |
| Due to Oklahoma Education Lottery Trust Fund | \$ 18,893,965 | \$ 18,716,319 |
| Due to Multi-State Lottery | 1,495,627 | 1,327,695 |
| Prizes payable | 4,666,257 | 7,521,856 |
| Accounts payable | 913,848 | 705,856 |
| Accrued liabilities | 224,662 | 149,395 |
| Deferred revenue | 298,770 | 254,599 |
| TOTAL CURRENT LIABILITIES | <u>26,493,129</u> | <u>28,675,720</u> |
| ACCRUED COMPENSATED ABSENCES, net | 62,445 | 61,679 |
| TOTAL LIABILITIES | <u>26,555,574</u> | <u>28,737,399</u> |
| NET POSITION | | |
| Net position, investment in capital assets | 85,122 | 105,926 |
| Restricted net position - expendable | 9,859,550 | 7,921,587 |
| TOTAL NET POSITION | <u>9,944,672</u> | <u>8,027,513</u> |
| TOTAL LIABILITIES AND NET POSITION | <u>\$ 36,500,246</u> | <u>\$ 36,764,912</u> |

See notes to financial statements.

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION

OKLAHOMA LOTTERY COMMISSION

| | Years ended June 30, | |
|---|-------------------------|---------------------|
| | 2013 | 2012 |
| REVENUES | | |
| Scratcher games | \$ 89,393,668 | \$ 95,978,562 |
| Pick 3 game | 4,331,388 | 4,650,700 |
| Pick 4 game | 1,859,943 | 2,048,092 |
| Cash 5 game | 4,161,703 | 4,205,922 |
| Hot Lotto game | 8,306,635 | 7,407,098 |
| Mega Millions game | 16,108,965 | 27,328,981 |
| Powerball game | 76,046,572 | 58,235,023 |
| TOTAL REVENUE FROM THE SALE OF LOTTERY TICKETS | <u>200,208,874</u> | <u>199,854,378</u> |
| Retailer application fees | 108,637 | 112,375 |
| Other | 6,848 | 6,600 |
| TOTAL REVENUES | <u>200,324,359</u> | <u>199,973,353</u> |
| DIRECT COSTS | | |
| Prize expense | | |
| Scratcher games | 50,727,284 | 54,410,671 |
| Pick 3 game | 2,222,700 | 2,207,960 |
| Pick 4 game | 1,212,400 | 948,550 |
| Cash 5 game | 1,995,343 | 1,981,663 |
| Hot Lotto game | 3,942,229 | 3,575,998 |
| Mega Millions game | 7,218,111 | 13,445,425 |
| Powerball game | 37,145,357 | 26,482,543 |
| TOTAL PRIZE EXPENSE | <u>104,463,424</u> | <u>103,052,810</u> |
| Commissions and incentives to retailers | 13,114,765 | 13,233,747 |
| Instant and on-line costs | 5,948,626 | 6,081,715 |
| TOTAL DIRECT COSTS | <u>123,526,815</u> | <u>122,368,272</u> |
| GROSS PROFIT | 76,797,544 | 77,605,081 |
| OPERATING EXPENSES | | |
| Advertising and promotion | 1,623,715 | 1,652,640 |
| Salaries, wages, and benefits | 2,419,342 | 2,661,825 |
| Contracted and professional services | 162,144 | 122,459 |
| Depreciation | 37,817 | 52,823 |
| Equipment | 17,291 | 702 |
| Rent expense | 199,791 | 194,901 |
| Office supplies | 34,872 | 35,127 |
| Travel | 17,102 | 22,269 |
| Other general and administrative | 103,061 | 118,015 |
| TOTAL OPERATING EXPENSES | <u>4,615,135</u> | <u>4,860,761</u> |
| OPERATING INCOME | 72,182,409 | 72,744,320 |
| NONOPERATING INCOME (EXPENSE) | | |
| Interest income | 348,277 | 281,890 |
| 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 | (70,113,527) | (69,990,674) |
| NET NONOPERATING INCOME (EXPENSE) | <u>(70,265,250)</u> | <u>(70,208,784)</u> |
| CHANGE IN NET POSITION | 1,917,159 | 2,535,536 |
| NET POSITION, beginning of year | <u>8,027,513</u> | <u>5,491,977</u> |
| NET POSITION, end of year | <u>\$ 9,944,672</u> | <u>\$ 8,027,513</u> |

See notes to financial statements.

STATEMENTS OF CASH FLOWS

OKLAHOMA LOTTERY COMMISSION

| | Years ended June 30, | |
|--|-------------------------|----------------------|
| | 2013 | 2012 |
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Cash received from retailers | \$ 188,488,786 | \$ 188,037,612 |
| Cash payments to prize winners | (107,151,091) | (101,417,709) |
| Cash payments to suppliers for goods and services | (7,802,331) | (8,469,732) |
| Cash payments to employees for services | (2,343,309) | (2,644,798) |
| Cash payments to fund deposit with Multi-State Lottery | 186,232 | (1,864,169) |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | <u>71,378,287</u> | <u>73,641,204</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 | (69,935,881) | (64,939,871) |
| NET CASH USED FOR NONCAPITAL FINANCING ACTIVITIES | <u>(70,435,881)</u> | <u>(65,439,871)</u> |
| CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES | | |
| Purchase of capital assets | (17,013) | (10,246) |
| NET CASH USED FOR CAPITAL AND RELATED FINANCING ACTIVITIES | <u>(17,013)</u> | <u>(10,246)</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Interest received | 353,209 | 268,533 |
| NET CASH PROVIDED BY INVESTING ACTIVITIES | <u>353,209</u> | <u>268,533</u> |
| NET CHANGE IN CASH AND CASH EQUIVALENTS | 1,278,602 | 8,459,620 |
| CASH AND CASH EQUIVALENTS, beginning of year | <u>23,915,132</u> | <u>15,455,512</u> |
| CASH AND CASH EQUIVALENTS, end of year | <u>\$ 25,193,734</u> | <u>\$ 23,915,132</u> |
| OPERATING ACTIVITIES | | |
| Operating income | \$ 72,182,409 | \$ 72,744,320 |
| Adjustment to reconcile operating income to net cash provided by operating activities | | |
| Depreciation | 37,817 | 52,823 |
| Bad debt expense | 8,169 | 20,274 |
| Changes in operating assets and liabilities | | |
| Retailer accounts receivable | 1,378,502 | 812,431 |
| Accounts receivable - Multi-State Lottery | (55,371) | 731,825 |
| Deposit with Multi-State Lottery | 186,232 | (1,864,169) |
| Due to Multi-State Lottery | 167,932 | 213,788 |
| Accounts payable and accrued liabilities | 284,025 | (324,657) |
| Prizes payable | (2,855,599) | 1,421,313 |
| Deferred revenue | 44,171 | (166,744) |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | <u>\$ 71,378,287</u> | <u>\$ 73,641,204</u> |

See notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

OKLAHOMA LOTTERY COMMISSION

June 30, 2013

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 an enterprise fund 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.

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, 2013

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, Pick 4, 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 \$4,858,318 and \$4,182,199 for fiscal years 2013 and 2012, respectively. Unclaimed prizes are netted against prize expense in the statement of revenues, expenses, and changes in net position.

NOTES TO FINANCIAL STATEMENTS--Continued

OKLAHOMA LOTTERY COMMISSION

June 30, 2013

NOTE B--SIGNIFICANT ACCOUNTING POLICIES--Continued

Deferred Inflows of Resources: Deferred inflows are the acquisition of net position by the OLC that are applicable to a future reporting period. At June 30, 2013, and 2012, the OLC had no deferred inflows of resources.

Deferred Outflows of Resources: Deferred outflows are the consumption of net position by the OLC that are applicable to a future reporting period. At June 30, 2013, and 2012, the OLC had no deferred outflows of resources.

Net Position: The OLC's net position is classified as follows:

Net position, invested in capital assets - This represents the OLC's total investment in capital assets.

Restricted net position - 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.

NOTES TO FINANCIAL STATEMENTS--Continued

OKLAHOMA LOTTERY COMMISSION

June 30, 2013

NOTE B--SIGNIFICANT ACCOUNTING POLICIES--Continued

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 following estimated useful lives of: machinery and equipment - five to ten years; computers and software - three to five 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.

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, 2013, and 2012 no amounts were available for transfer as net proceeds. During fiscal years 2013 and 2012, \$140,375 and \$28,710, respectively, was used to reimburse the OLC for retailer accounts that were delinquent and in collection status and for the retailer application fees. 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 position as restricted funds and expendable restricted net position.

Deposits with MUSL are included in expendable restricted net position. 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, 2013, and 2012, restricted cash totaled \$4,259,771 and \$2,135,576, 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.

NOTES TO FINANCIAL STATEMENTS--Continued

OKLAHOMA LOTTERY COMMISSION

June 30, 2013

NOTE B--SIGNIFICANT ACCOUNTING POLICIES--Continued

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.

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:

| | June 30 | |
|-------------------------------|---------------------|---------------------|
| | 2013 | 2012 |
| Set Prize Reserve Account | \$ 827,626 | \$ 846,239 |
| Prize Reserve Account | 3,128,601 | 3,360,508 |
| Balance of Unreserved Account | 1,643,542 | 1,579,264 |
| | <u>\$ 5,599,769</u> | <u>\$ 5,786,011</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, 2013, and 2012, bad debt expense was \$8,169 and \$20,274, respectively.

Changes in Accounting Principles: The OLC adopted Government Accounting Standards Board ("GASB") Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements* ("GASB No. 60"), in 2013. GASB No. 60 addresses issues related to service concession arrangements ("SCAs"), which are a type of public-private or public-public partnership. GASB No. 60 applies only to those arrangements in which specific criteria determining whether a transferor has control over the facility are met. Management has determined that the OLC has not entered into any such arrangements; therefore, the adoption of GASB No. 60 did not have an impact on the OLC's financial position, activities or cash flows, or its financial statement presentation.

NOTES TO FINANCIAL STATEMENTS--Continued

OKLAHOMA LOTTERY COMMISSION

June 30, 2013

NOTE B--SIGNIFICANT ACCOUNTING POLICIES--Continued

Changes in Accounting Principles--Continued: The OLC adopted GASB Statement No. 61, *The Financial Reporting Entity: Omnibus - An Amendment of GASB Statements No. 14 and No. 34* ("GASB No. 61"), during 2013. GASB No. 61 modifies certain requirements for inclusion of component units in the financial reporting entity and also amends the criteria for reporting component units as if they were part of the primary government (that is, blending) in certain circumstances. The adoption of GASB No. 61 did not have a significant impact on the OLC's financial position, activities or cash flows, or its financial statement presentation.

The OLC adopted GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* ("GASB No. 62"), during 2013. GASB No. 62 is intended to enhance the usefulness of its Codification by incorporating guidance that previously could only be found in certain FASB and AICPA pronouncements. The adoption of GASB No. 62 did not have a significant impact on the OLC's financial position, activities or cash flows, or its financial statement presentation.

The OLC adopted GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position* ("GASB No. 63"), during 2013. GASB No. 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. Adoption of GASB No. 63 resulted in changes to the OLC's financial statement presentation, but such changes were not significant.

The OLC elected to early adopt Statement No. 65, *Items Previously Reported as Assets and Liabilities* ("GASB No. 65"). GASB No. 65 establishes accounting and financial reporting standards that reclassify as deferred outflows of resources or deferred inflows of resources certain items that were previously reported as assets and liabilities and recognizes as outflows of resources (expenses) or inflows of resources (revenues) certain items that were previously recognized as assets and liabilities. The adoption of GASB No. 65 did not have a significant impact on the OLC's financial position, activities or cash flows, or its financial statement presentation.

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

NOTES TO FINANCIAL STATEMENTS--Continued

OKLAHOMA LOTTERY COMMISSION

June 30, 2013

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, 2013, and 2012, the carrying amounts of the OLC's deposits with the OST were \$25,193,734 and \$23,915,132, respectively, and the bank balances were \$25,229,635 and \$23,926,286, respectively.

The OLC's deposits with the State Treasurer are invested in OK INVEST. For financial reporting purposes, deposits with the State Treasurer that are invested in OK INVEST are classified as cash equivalents. At June 30, the distribution of deposits in OK INVEST is as follows:

| OK INVEST Portfolio | 2013 | | 2012 | |
|-----------------------------------|----------------------|----------------------|----------------------|----------------------|
| | Cost | Market Value | Cost | Market Value |
| U.S. Agency securities | \$ 9,917,720 | \$ 9,875,790 | \$ 8,459,156 | \$ 8,484,020 |
| Money market mutual funds | 2,367,558 | 2,367,558 | 3,275,037 | 3,275,037 |
| Certificates of deposit | 644,529 | 644,529 | 772,805 | 772,805 |
| Mortgage-backed agency securities | 10,841,682 | 10,894,907 | 10,560,695 | 11,220,294 |
| Municipal bonds | 425,052 | 470,503 | 429,163 | 489,625 |
| Foreign bonds | 199,290 | 199,174 | 120,402 | 120,402 |
| Commercial paper | 530,303 | 530,303 | - | - |
| U.S. Treasury Obligations | 303,501 | 371,550 | 309,028 | 385,533 |
| | <u>\$ 25,229,635</u> | <u>\$ 25,354,314</u> | <u>\$ 23,926,286</u> | <u>\$ 24,747,716</u> |

NOTES TO FINANCIAL STATEMENTS--Continued

OKLAHOMA LOTTERY COMMISSION

June 30, 2013

NOTE C--CASH AND DEPOSITS--Continued

Agencies and funds that are considered to be part of the State's reporting entity in the State's Comprehensive Annual Financial Report are allowed to participate in OK INVEST. Oklahoma statutes and the State Treasurer establish the primary objectives and guidelines governing the investment of funds in OK INVEST. Safety, liquidity, and return on investment are the objectives that establish the framework for the day to day OK INVEST management with an emphasis on safety of the capital and the probable income to be derived and meeting the State and its funds' and agencies' daily cash flow requirements. Guidelines in the Investment Policy address credit quality requirements, diversification percentages and the types and maturities of allowable investments. The specifics regarding these policies can be found on the State Treasurer's website at <http://www.ok.gov/treasurer>. The State Treasurer, at his discretion, may further limit or restrict such investments on a day to day basis. OK INVEST includes a substantial investment in securities with an overnight maturity as well as in U.S. government securities with a maturity of up to three years. OK INVEST maintains an overall weighted average maturity of less than 270 days.

Participants in OK INVEST maintain interest in its underlying investments and, accordingly, may be exposed to certain risks. As stated in the State Treasurer information statement, the main risks are interest rate risk, credit/default risk, liquidity risk, and U.S. government securities risk. Interest rate risk is the risk that during periods of rising interest rates, the yield and market value of the securities will tend to be lower than prevailing market rates; in periods of falling interest rates, the yield will tend to be higher. Credit/default risk is the risk that an issuer or guarantor of a security, or a bank or other financial institution that has entered into a repurchase agreement, may default on its payment obligations. Liquidity risk is the risk that OK INVEST will be unable to pay redemption proceeds within the stated time period because of unusual market conditions, an unusually high volume of redemption requests, or other reasons. U.S. Government securities risk is the risk that the U.S. government will not provide financial support to U.S. government agencies, instrumentalities, or sponsored enterprises if it is not obligated to do so by law. Various investment restrictions and limitations are enumerated in the State Treasurer's Investment Policy to mitigate those risks; however, any interest in OK INVEST is not insured or guaranteed by the State, the FDIC, or any other government agency.

NOTES TO FINANCIAL STATEMENTS--Continued

OKLAHOMA LOTTERY COMMISSION

June 30, 2013

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, 2013 | | | |
|---------------------------|--------------------------|--------------------|-------------|-------------------|
| | Beginning Balance | Additions | Deletions | Ending Balance |
| <u>Capital Assets</u> | | | | |
| Machinery and equipment | \$ 762,628 | \$ 15,841 | \$ - | \$ 778,469 |
| Computers and software | 400,006 | 1,172 | - | 401,178 |
| | <u>1,162,634</u> | <u>17,013</u> | <u>-</u> | <u>1,179,647</u> |
| Accumulated depreciation | | | | |
| Machinery and equipment | 657,061 | 37,425 | - | 694,486 |
| Computers and software | 399,647 | 392 | - | 400,039 |
| | <u>1,056,708</u> | <u>37,817</u> | <u>-</u> | <u>1,094,525</u> |
| Total capital assets, net | <u>\$ 105,926</u> | <u>\$ (20,804)</u> | <u>\$ -</u> | <u>\$ 85,122</u> |

| | Year Ended June 30, 2012 | | | |
|---------------------------|--------------------------|--------------------|-------------|-------------------|
| | Beginning Balance | Additions | Deletions | Ending Balance |
| <u>Capital Assets</u> | | | | |
| Machinery and equipment | \$ 752,382 | \$ 10,246 | \$ - | \$ 762,628 |
| Computers and software | 400,006 | - | - | 400,006 |
| | <u>1,152,388</u> | <u>10,246</u> | <u>-</u> | <u>1,162,634</u> |
| Accumulated depreciation | | | | |
| Machinery and equipment | 605,100 | 51,961 | - | 657,061 |
| Computers and software | 398,785 | 862 | - | 399,647 |
| | <u>1,003,885</u> | <u>52,823</u> | <u>-</u> | <u>1,056,708</u> |
| Total capital assets, net | <u>\$ 148,503</u> | <u>\$ (42,577)</u> | <u>\$ -</u> | <u>\$ 105,926</u> |

NOTES TO FINANCIAL STATEMENTS--Continued

OKLAHOMA LOTTERY COMMISSION

June 30, 2013

NOTE E--COMPENSATED ABSENCES

Compensated absences: The current portion of accrued compensated absences is included in accrued liabilities in the accompanying statements of net position. The following is a summary of changes in the OLC's liability for compensated absences during the year ended June 30:

| | <u>Beginning Balance</u> | <u>Additions</u> | <u>Deletions</u> | <u>Ending Balance</u> | <u>Current Portion</u> |
|---------------------------|------------------------------|-------------------|-------------------|---------------------------|----------------------------|
| Compensated absences 2013 | <u>\$ 185,037</u> | <u>\$ 111,582</u> | <u>\$ 109,284</u> | <u>\$ 187,335</u> | <u>\$ 124,890</u> |
| Compensated absences 2012 | <u>\$ 170,730</u> | <u>\$ 124,559</u> | <u>\$ 110,252</u> | <u>\$ 185,037</u> | <u>\$ 123,358</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, 2013, or 2012. Rent expense under all operating leases was \$199,791 for the year ended June 30, 2013, and \$194,901 for the year ended June 30, 2012.

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.

- 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

NOTES TO FINANCIAL STATEMENTS--Continued

OKLAHOMA LOTTERY COMMISSION

June 30, 2013

NOTE G--EDUCATION LOTTERY ACCOUNT--Continued

- 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, 2013, and 2012:

| | June 30 | |
|--|----------------------|----------------------|
| | 2013 | 2012 |
| Net position, beginning of year | \$ 8,027,513 | \$ 5,491,977 |
| Change in net position before transfers to OELTF | <u>72,030,686</u> | <u>72,526,210</u> |
| Net position available for transfer to OELTF before amounts invested in capital assets and restricted net position | 80,058,199 | 78,018,187 |
| Less: Net position invested in capital assets | (85,122) | (105,926) |
| Less: Restricted net position - expendable | <u>(9,859,550)</u> | <u>(7,921,587)</u> |
| Transfers to and due OELTF for the year | <u>\$ 70,113,527</u> | <u>\$ 69,990,674</u> |

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.

NOTES TO FINANCIAL STATEMENTS--Continued

OKLAHOMA LOTTERY COMMISSION

June 30, 2013

NOTE H--RETIREMENT PROGRAM--Continued

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>2013</u> | <u>2012</u> | <u>2011</u> |
|--|-------------|-------------|-------------|
| Employee contributions | 3.50% | 3.50% | 3.50% |
| Additional % for members electing stepup | 2.91% | 2.91% | 2.91% |
| Employer contributions | 16.50% | 16.50% | 15.50% |

For the years ended June 30, 2013, 2012, and 2011, the OLC's contributions to OPERS were \$260,035, \$289,515, and \$295,643, 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, 2013, and 2012.

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 seven 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, 2013, and 2012, the OLC paid SGI \$5,948,626 and \$6,081,715, respectively.

NOTES TO FINANCIAL STATEMENTS--Continued

OKLAHOMA LOTTERY COMMISSION

June 30, 2013

NOTE J--CONTRACTUAL ARRANGEMENTS--Continued

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, 2013, and 2012, the OLC owed the MUSL \$1,495,627 and \$1,327,695 for ticket sales, and the MUSL owed the OLC \$430,799 and \$375,428 for non-jackpot winning tickets. The OLC has recorded these items at their gross amounts in the accompanying statements of net position.

NOTE K--NEW ACCOUNTING PRONOUNCEMENTS

The GASB has issued several new accounting pronouncements which will be effective to OLC in subsequent years. A description of the new accounting pronouncements, the fiscal year in which they are effective, and OLC's consideration of the impact of these pronouncements are described below:

Fiscal Year Ended June 30, 2014

- *Statement No. 66, Technical Corrections - 2012; an Amendment of GASB Statements No. 10 and No. 62.*
GASB No. 66 amends GASB Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, by removing the provision that limits fund-based reporting of a state and local government's risk financing activities to the general fund and the internal service fund type. The OLC does not expect GASB No. 66 to have a significant impact on its financial statements.
- *Statement No. 70, Accounting and Financial Reporting for Nonexchange Financial Guarantees*
GASB No. 70 requires a government that extends a nonexchange financial guarantee to recognize a liability when qualitative factors and historical data, if any, indicate that it is more likely than not that the government will be required to make a payment on the guarantee. GASB No. 70 also provides additional guidance for intra-entity nonexchange financial guarantees involving blended component units and specifies information required to be disclosed by governments that extend and/or receive nonexchange financial guarantees. GASB No. 70 was issued in April 2013, and OLC has not yet determined the impact that implementation of GASB No. 70 will have on its net position.

NOTES TO FINANCIAL STATEMENTS--Continued

OKLAHOMA LOTTERY COMMISSION

June 30, 2013

NOTE K--NEW ACCOUNTING PRONOUNCEMENTS--Continued

Fiscal Year Ended June 30, 2015

- *Statement No. 68, Accounting and Financial Reporting for Pensions, an Amendment of GASB Statement No. 27*

GASB No. 68 establishes standards for measuring and recognizing liabilities, deferred outflows of resources, deferred inflows of resources, and pension expenses. GASB No. 68 also details the recognition and disclosure requirements for employers with liabilities to a defined benefit pension plan and for employers whose employees are provided with defined contribution pensions. Defined benefit pensions are further classified by GASB No. 68 as single employer plans, agent employer plans, and cost-sharing plans, and recognition and disclosure requirements are addressed for each classification. GASB No. 68 was issued in June 2012, and OLC has not yet determined the impact that implementation of GASB No. 68 will have on its net position.

- *Statement No. 69, Government Combinations and Disposals of Government Operations*

GASB No. 69 establishes guidance for 1) determining whether a specific government combination is a government merger, a government acquisition, or a transfer of operations; 2) using carrying values to measure the assets, deferred outflows of resources, liabilities, and deferred inflows of resources combined in a government merger or transfer of operations; 3) measuring acquired assets, deferred outflows of resources, liabilities, and deferred inflows of resources based upon their acquisition values in a government acquisition; and 4) reporting the disposal of government operations that have been transferred or sold. GASB No. 69 was issued in January 2013, and OLC has not yet determined the impact that implementation of GASB No. 69 will have on its net position.

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

The Board of Trustees
Oklahoma Lottery Commission
Oklahoma City, Oklahoma

We have audited, in accordance with the 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, the financial statements of the Oklahoma Lottery Commission (the "OLC") as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the OLC's basic financial statements, and have issued our report thereon dated September 11, 2013.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the OLC's internal control over financial reporting ("internal control") to determine the audit procedures that are appropriate in the circumstances 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. Accordingly, we do not express an opinion on the effectiveness of the OLC's internal control.

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 a 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. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

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

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Cole & Reed P.C.

Oklahoma City, Oklahoma
September 11, 2013