COLORADO LOTTERY

FINANCIAL AND COMPLIANCE AUDIT

June 30, 2012 and 2011

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Members of the Legislative Audit Committee:

We have completed the financial statement audit of the Colorado Lottery as of and for the year ended June 30, 2012. Our audit was conducted 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.

We were engaged to conduct our audit pursuant to Section 24-35-211, C.R.S., which requires the State Auditor to audit the Lottery Fund. The reports we have issued as a result of this engagement are set forth in the table of contents which follows.

CliftonLarsonAllen LLP

Greenwood Village, Colorado
September 24, 2012

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Purposes and Scope of Audit

Authority, Purpose and Scope

The Office of the State Auditor, State of Colorado, engaged CliftonLarsonAllen, LLP to conduct the financial audit of the Colorado Lottery for the Fiscal Year ended June 30, 2012. The audit of the Colorado Lottery (the Lottery) was performed under authority of Section 24-35-211, C.R.S., which requires the State Auditor to conduct an annual audit of the Lottery. The purpose of the audit was to express opinions on the financial statements of the Lottery for the year ended June 30, 2012.

CliftonLarsonAllen, LLP conducted the audit in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards* issued by the Comptroller General of the United States of America.

The purposes and scope of this audit were:

- To express opinions on the financial statements of the Lottery as of and for the year ended June 30, 2012, including a review of the related systems of internal controls as required by auditing standards generally accepted in the United States of America.
- To review the Lottery's compliance with rules and regulations governing the expenditure of State funds for the year ended June 30, 2012.
- To evaluate progress in implementing the prior audit recommendations.

Summary of Major Audit Comments

Audit Findings and Financial Statement Audit Report Section

The auditor's findings and recommendations section contains the following recommendation:

- The Colorado Lottery should ensure that the game prize payout percentage for its on-line game, "Lotto," is managed in accordance with the game rules, as approved by the Lottery Commission, by a) analyzing the projected prize payout percentage and updating the game rules, if appropriate, and b) establishing a policy to perform a similar analysis on a periodic basis, as well as when any significant change is made to the game that may effect the prize payout percentage.

The recommendation and the response from the Lottery can also be found in the recommendation locator.

COLORADO LOTTERY
REPORT SUMMARY
Years Ended June 30, 2012 and 2011

Audit Opinions and Reports

The independent auditor's reports, included herein, state that the financial statements of the Lottery are fairly stated, in all material respects, in accordance with accounting principles generally accepted in the United States of America, and that no material weaknesses in internal controls were discovered during the course of the audit.

Auditor's Communication to Legislative Audit Committee

The auditor's communication to the Legislative Audit Committee describes the auditor's responsibility under auditing standards generally accepted in the United States of America and significant management judgments and estimates. It also notes that there were no proposed audit adjustments for the year ending June 30, 2012. This communication is located on page 63.

Summary of Progress in Implementing the Prior Year Audit Recommendation

The audit report for the year ended June 30, 2011, contained one recommendation. As of our Fiscal Year 2012 audit, we determined that this recommendation was partially implemented. The Disposition of Prior Year Audit Recommendations begins on page 7.

COLORADO LOTTERY
RECOMMENDATION LOCATOR
Years Ended June 30, 2012 and 2011
Fiscal Year 2012 Recommendation

Recommendation Number	Page Number	Recommendation Summary	Response	Implementation Date
1	6	The Colorado Lottery should ensure that the game prize payout percentage for its on-line game, “Lotto,” is managed in accordance with the game rules, as approved by the Lottery Commission, by a) analyzing the projected prize payout percentage and updating the game rules, if appropriate, and b) establishing a policy to perform a similar analysis on a periodic basis, as well as when any significant change is made to the game that may effect the prize payout percentage.	Agree	June 30, 2013

COLORADO LOTTERY
BACKGROUND
Years Ended June 30, 2012 and 2011

In 1980, Colorado voters passed a referendum that added Article XVIII, Section 2(1) to the Colorado Constitution, allowing the establishment of a state-supervised lottery. Senate Bill 82-119 created the Lottery as a division within the Department of Revenue. The Lottery began operations on July 1, 1982 and sold its first lottery ticket on January 24, 1983.

During Fiscal Year 2012, the Lottery employed 117 employees in its headquarters in Pueblo and branch offices in Denver, Fort Collins and Grand Junction.

The Lottery games are governed by rules and regulations established by a Commission of five members appointed by the Governor and approved by the Senate. By statute, Lottery Commission members must include an attorney, a certified public accountant and a law enforcement officer. Members may serve up to two 4-year terms.

Colorado Revised Statutes (C.R.S.) Section 24-35-210(9), requires that no less than 50% of the total revenue from sales of lottery tickets be for prizes. The legislation also provides guidelines for distribution of net proceeds to beneficiary agencies. "Net lottery proceeds" (that is, proceeds after the payment of prizes and lottery expenses and a reserve for future operations) are to be distributed to the Conservation Trust Fund, the Division of Parks and Wildlife, and the Great Outdoors Colorado Trust Fund (GOCO). The amount distributed to GOCO is limited by a constitutional cap. Prior to 2002, amounts exceeding the GOCO cap (the spillover) were distributed to the State General Fund. For Fiscal Years 2002 through 2007, the spillover funds were distributed to the State Public School Fund Contingency Reserve. For Fiscal Year 2008, the spillover funds were transferred to the Lottery Proceeds Contingency Reserve Fund. For Fiscal Years 2009 through 2012, the spillover funds were required to be transferred to the Public School Capital Construction Assistance Fund.

Background

Colorado Revised Statutes (C.R.S.) Section 24-35-210(9), requires that no less than 50% of the total revenue from sales of lottery tickets for all games offered by the Colorado Lottery be used for prizes. However, individual on-line games have game rules that are approved by the Lottery Commission and govern that game's play. The game rules include a projected prize payout, which may be slightly higher than the minimum rate established by Colorado Statutes. The projected prize payout percentage will vary from the actual prize payment percentage each year due to unclaimed prizes, changes in interest rates, the number of jackpots won, the number of jackpot winners that choose to receive an annuity versus cash payout, and the rate at which the jackpot is increased based on weekly ticket sales. The game rules are available to the public via the Colorado Lottery's website, and serve as the definitive source of information related to the game.

What was the purpose of the audit work?

The purpose of the audit work was to ensure that all games at the Colorado Lottery are being managed in accordance with Colorado Revised Statutes, the State Constitution and individual game rules, as approved by the Lottery Commission.

What audit work was performed and how were results measured?

As part of our procedures over all of Lottery's games, we evaluated the actual game prize payout percentage for the Colorado Lottery on-line game, "Lotto," based on the current year sales, game rules, jackpots won, and prizes awarded. Rule 10.A, as last approved by the Lottery Commission in July 2010, relates to the Lotto and includes a projected prize payout ratio of 57.5% of sales. As noted above, the actual prize payout percentage in a given year will vary depending on several factors, some of which are under the direct control of the Colorado Lottery and some which are not. Factors that are not under the Colorado Lottery's control include current year sales, unclaimed prizes, the number of jackpots won, interest rates affecting the cost of annuities, and the number of jackpot winners that choose to receive an annuity versus cash payout. The primary factor under the direct control of the Lottery is the rate at which the jackpot increases based on weekly ticket sales. For example, during 2012, we noted the Colorado Lottery decreased the rate at which the Lotto jackpot increases, by approximately 3%, which has a direct effect on the total prize payout for Lotto. Similar decreases, as well as increases, have been made in previous years.

What problem did the audit work identify?

The Lotto's projected prize payout of 57.5% does not appear to reflect the actual payout, based on the current circumstances and factors that impact overall payout. For 2012, the actual prize payout percentage was 53.73%. As it relates to 2012 Lotto ticket sales, the difference between 57.5% and 53.73% represents approximately $1,256,000 of additional prize expense. As noted above, the actual payout in a given year is not expected to match the projected payout. However, as noted above, the Colorado Lottery has changed the rate at which the jackpot increases several times in recent years, which has had a direct effect on the total prize payout. However, the projected prize payout has not been updated for over ten years. During the most recent ten year period, the actual prize payout percentage has ranged from 50.13% (2009) to 59.69% (2006), with an average of 53.0%.

Why did the problem occur?

The Colorado Lottery originally established a projected prize payout of 57.5% for Lotto with the assistance of an actuary during the 1990's. No analysis has been performed since that time to re-evaluate the accuracy of the estimate. Given the history of the game, related experience factors, and certain changes that the Colorado Lottery has made over the years, this estimate requires periodic review to ensure current conditions are reflected.

Why does this problem matter?

Lotto game rules are available to the public via the Colorado Lottery's website. Colorado Lottery customers may review these rules for information on game play, odds, and projected prize payouts. Decisions affecting the customer's choice to play certain games could be affected by this information. Presenting outdated information to the public related to the Lotto game may be misleading or inaccurate.

(Classification of Finding: Not classified – not an internal control issue)

Recommendation No. 1:

The Colorado Lottery should ensure that the game prize payout percentage for its on-line game, "Lotto," is managed in accordance with individual game rules, as approved by the Lottery Commission, by:

a. Performing an analysis to determine the accuracy of the projected prize payout percentage for the on-line game Lotto and updating game rules, if appropriate, to reflect the revised estimate. Such analysis may be performed by Colorado Lottery staff, or with the assistance of an actuary. The analysis should consider recent trends in ticket sales, jackpot winners, the rate at which annuities are selected, interest rates, and the rate at which sales are used to increase the Lotto jackpot.

b. Establishing a policy to perform a similar analysis as described in part a. on a periodic basis, such as every three years, as well as when any significant change is made to the game that may affect the prize payout percentage.

Colorado Lottery Response:

Response: Agree. The Lottery will present to the Commission an evaluation of the current Lotto rule, which will include an analysis of the prize payout percentage. If appropriate, the Lottery will recommend changes to update the Lotto rule based on the evaluation and seek the Commission's approval for any recommended changes. In addition, the Lottery will implement a policy to perform similar analyses on a periodic basis and when any significant change is made to the game (including significant changes to uncontrollable factors affecting the game) that may affect the prize payout percentage.

Implementation Date: June 30, 2013.

COLORADO LOTTERY
DISPOSITION OF PRIOR YEAR AUDIT RECOMMENDATION
Year Ended June 30, 2012

Fiscal Year 2011 Recommendation

Number	Recommendation	Disposition
1	The Colorado Lottery should ensure it is maximizing the amount of lottery revenue available to beneficiaries by reevaluating its current games structure, payout percentages, and operating expenses.	Partially implemented. During fiscal year 2012 the Colorado Lottery evaluated operating expenses and made certain game changes, which resulted in an increase in the revenue available to beneficiaries as a percentage of total sales (from 21.8% in fiscal year 2011 to 22.6% in fiscal year 2012). As indicated in their response to the fiscal year 2011 recommendation, the Lottery changed its Powerball game to enhance sales, evaluated its game mix and marketing strategies to maximize jackpot game profits, and evaluated and changed prize payouts on Scratch games. However, certain of management's changes cannot be realized until fiscal year 2013 and beyond. Accordingly, the comment is considered partially implemented and requires ongoing monitoring.

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Independent Auditor's Report

Members of the Legislative Audit Committee:

We have audited the accompanying financial statements of the major fund and remaining fund information of the Colorado Lottery, an enterprise fund and private purpose fund of the State of Colorado, as of and for the years ended June 30, 2012 and 2011, which collectively comprise the Colorado Lottery's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Colorado Lottery's management. Our responsibility is to express opinions on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the 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 opinions.

As discussed in Note 1 – Nature of Operations and Summary of Significant Accounting Policies, the financial statements of the Colorado Lottery are intended to present the financial position and the changes in financial position and, where applicable, cash flows for only that portion of the financial reporting entity, the State of Colorado, that is attributable to the transactions of the Colorado Lottery. They do not purport to, and do not, present fairly the financial position of the State of Colorado as of June 30, 2012 and 2011, and the changes in its financial position, or, where applicable, its cash flows, for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the major fund and remaining fund information of the Colorado Lottery as of June 30, 2012 and 2011, and the respective changes in financial position and cash flows, where applicable, thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 24, 2012 on our consideration of the Colorado Lottery's internal control over financial reporting and on 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* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 10 through 25 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. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming opinions on the financial statements that collectively comprise the Colorado Lottery's basic financial statements. The revenue and expense schedules and budgetary comparison information listed in the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic financial statements as a whole.

CliftonLarsonAllen LLP

Greenwood Village, Colorado
September 24, 2012

This discussion and analysis of the Colorado Lottery's financial performance provides an overview of financial activities for the fiscal years ended June 30, 2012 and 2011. Please read it in conjunction with the Lottery's financial statements, which begin on page 26. These financial statements reflect only activities of the Colorado Lottery, a proprietary fund of the State of Colorado.

Financial Highlights

- For the second year in a row, the Lottery's current fiscal year's overall sales performance became the highest sales year in Lottery history coming in at $545.3 million. Last year's $518.9 million moved to the second highest sales year in Lottery history, with the third highest sales year achieved in fiscal year 2008 with sales of $505.8 million. Overall sales for fiscal year 2012 reflected a $26.4 million increase from fiscal year 2011. In turn, fiscal year 2011 reflected a $17.7 million increase from fiscal year 2010 sales of $501.2 million. The overall increase in sales in 2012 was mainly the result of increased scratch sales of $19.3 million from $344.9 million in fiscal year 2011 to $364.2 million in fiscal year 2012, in addition to an overall increase of $7.1 million in online products. The overall increase in sales in 2011 was mainly the result of increased scratch sales of $16.8 million from $328.1 million in 2010 to the $344.9 million in fiscal year 2011 with a slight increase of $0.9 million in online products.

  The increase in online sales in fiscal year 2012 was chiefly due to the $12.0 million increase in Mega Millions sales tied to the historic jackpot run in March 2012 to a $656 million annuitized jackpot, the largest in American lottery history, and a $11.8 million increase in Powerball sales over the previous year due to the change to a $2 ticket from a $1 ticket in January 2012. Cash 5 sales increased slightly by $0.4 million over the previous year. These sales increases were offset by the $6.0 million and $2.1 million decreases in Lotto and MatchPlay sales, respectively, and the absence of a Raffle game in 2012 compared to the $9.0 million in Raffle sales in 2011.

  Fiscal year 2011 showed an increase in sales from fiscal year 2010 in both Mega Millions and MatchPlay, mainly due to a full year of sales for both products compared to partial year sales in fiscal year 2010 when the games were introduced. Sales for these two games increased from $8.6 million in fiscal year 2010 to $36.5 million in fiscal year 2011. Online sales in fiscal year 2011 also included an additional $9.0 million with the introduction of a new online Raffle game. Fiscal year 2011 saw a decrease in sales from fiscal year 2010 for each of the Lottery's other three existing online products due to a larger variety of games to choose from in fiscal year 2011. Powerball, Lotto and Cash 5 sales decreased by a total of $36.0 million from $164.5 million in fiscal year 2010 to $128.5 million in fiscal year 2011.

- Funds distributed or available for distribution from 2012 sales increased by $9.9 million up from $113.4 million in fiscal year 2011 to nearly $123.3 million in fiscal year 2012. The $123.3 million for fiscal year 2012 represents the second highest year of distributions in the Lottery's history behind the $125.6 million distributed in fiscal year 2006. Fiscal year 2012 included a spill-over of funds in excess of the Great Outdoors Colorado (GOCO) cap. A spill-over occurs when the distribution cap for GOCO is reached in any one year. The cap for GOCO is the 1992 base year amount of $35 million as adjusted for the annual change in the cost of living increase for the Denver-

Boulder area. Currently, the spill-over, by statute, is distributed to the Public School Capital Construction Assistance Fund. The spill-over totaled $4.6 million and $0.7 million for fiscal years 2012 and 2011, respectively. A spill-over occurs when the distribution cap for GOCO is reached in any one year. The cap for GOCO is the 1992 base year amount of $35 million as adjusted for the annual change in the cost of living increase for the Denver-Boulder area. Over the most recent eleven-year period, the spill-over has totaled $55.9 million.

- Gross profit as a percent of sales for fiscal year 2012 increased by 0.2 percent from fiscal year 2011, a reflection of the nearly 0.2 percent decrease in prize expense as a percentage of sales, while the other costs directly tied to the sale of Lottery products as a percentage of sales remained steady. These include commissions, bonuses, vendor fees and ticket costs. Gross profit as a percent of sales for fiscal year 2011 decreased by 1.0 percent from fiscal year 2010, a reflection of the 1.1 percent increase in prize expense as a percentage of sales. The overall prize expense as a percentage of sales decreased from 63.0 to 62.8 percent for the fiscal years ended June 30, 2011 and 2012, respectively. Prize expense for scratch products increased from 68.8 percent to 69.2 percent, while prize expense for online products decreased from 51.4 percent to 50.1 percent. The decrease in prize expense included an increase in unclaimed prizes of $0.5 million from fiscal year 2011 to fiscal year 2012. The overall prize expense as a percentage of sales increased from 61.9 to 63.0 percent for the fiscal years ended June 30, 2010 and 2011, respectively. Prize expense for scratch products increased from 68.4 percent to 68.8 percent, while prize expense for online products increased from 49.6 percent to 51.4 percent. The increase in prize expense was offset by an increase in unclaimed prizes of $2.5 million from fiscal year 2010 to fiscal year 2011. Commissions and bonuses as a percentage of sales were consistently 7.6 percent for the fiscal years ended June 30, 2010, 2011 and 2012. Cost of tickets sold and vendor fees as a percentage of sales dropped to 2.0 percent for fiscal year 2012 down from the 2.1 percent for fiscal years ended 2010 and 2011. Vendor fees totaled $7,653,391, $7,892,197, and $8,258,562 for fiscal years ended June 30, 2010, 2011 and 2012, respectively, reflecting an increase only due to the increase in sales seen over the last three fiscal years.

Games Offered by the Colorado Lottery

The Lottery offers two different ways to play: scratch games and online games -- Powerball, Lotto, Cash 5, MatchPlay (sales ending on June 29, 2012), Mega Millions, and two Raffle games (offered in fiscal year 2011 but not offered in fiscal year 2012). Scratch games consist of pre-printed tickets that may be purchased for various prices ($1, $2, $3, $5, $10 and $20) at any Lottery retailer. When scratched, they provide immediate knowledge if the ticket is a winner and can be cashed immediately at the retailer level if the amount of the winnings is $599 or less. Prizes over $599 must be redeemed at the Lottery offices. Online games, on the other hand, require a longer playing time. Tickets are also purchased at the Lottery retailers and are printed on ticket stock as the purchase is made. Each ticket contains one or possibly more playing boards for one draw or up to thirteen weeks of draws. Each board consists of a set of numbers, the combination of numbers required for play varying by game. For the Raffle games, which were introduced in fiscal year 2011 and not offered in fiscal year 2012, a pre-determined number of tickets were numbered and issued sequentially upon each sale until the maximum number of tickets was sold out or the last day of sales was reached, whichever came first. The winning numbers for each game were posted after their respective draw nights with drawings held on every night of the week. Players had to check their numbers against the numbers drawn for each respective game to determine if they had a winning ticket. The tickets could also be cashed at the retailer level if the amounts of the winnings were $599 or less. Prizes over $599 had to be redeemed at the Lottery offices.

Using this Annual Report

This annual report consists of a series of financial statements. The statements of net assets provide information about the Lottery's assets and liabilities and reflect the Lottery's financial position as of June 30, 2012 and 2011. The statements of revenues, expenses and changes in net assets report the activity of selling the Lottery products and the expenses related to such activity for the years ended June 30, 2012 and 2011. Finally, the statements of cash flows outline the cash inflows and outflows related to the activity of selling the Lottery products for the years ended June 30, 2012 and 2011.

Statements of Net Assets

The statements of net assets present a financial snapshot of the Lottery at June 30, 2012 and 2011. They present the fiscal resources of the Lottery (assets), the claims against those resources (liabilities) and the residual available for future operations (net assets). Assets and liabilities are classified by liquidity as either current or noncurrent. Net assets are classified by the ways in which they may be used for future operations.

Condensed Statements of Net Assets
June 30, 2012, 2011 and 2010

	2012	2011	2010
Assets			
Current assets	$ 52,923,837	$ 57,902,172	$ 61,950,762
Restricted assets	6,645,053	6,232,920	5,499,120
Capital assets	2,831,868	3,782,655	3,830,221
Total assets	$ 62,400,758	$ 67,917,747	$ 71,280,103
Liabilities			
Current liabilities	$ 56,555,518	$ 60,841,890	$ 63,991,689
Long-term liabilities	897,366	875,822	1,026,906
Total liabilities	$ 57,452,884	$ 61,717,712	$ 65,018,595

Net Assets			
Investment in capital assets	$ 2,831,868	$ 3,782,655	$ 3,830,221
Restricted – Licensed agent recovery reserve	351,031	402,793	370,801
Restricted – Operating reserve	1,300,000	1,400,000	1,200,000
Unrestricted	464,975	614,587	860,486
Total net assets	$ 4,947,874	$ 6,200,035	$ 6,261,508

The Lottery's total assets at June 30, 2012 were $62.4 million. Assets consisted primarily of cash and investments with the State Treasury of $34.0 million, including restricted balances of $1.7 million, Prepaid Prize Expense with Multi-State Lottery (MUSL) of $5.0 million, receivables from Lottery retailers for the sale of Lottery products of $19.5 million and a net investment in fixed assets of $2.8 million.

Comparable figures at June 30, 2011 were $67.9 million in total assets, principally including cash and investments with the State Treasury of $39.2 million, Prepaid Prize Expense with MUSL of $4.4 million, receivables from retailers of $19.2 million and a net investment in fixed assets of $3.8 million.

Comparable figures at June 30, 2010 were $71.3 million in total assets, principally including $42.4 million in cash and investments with the State Treasury, $3.9 million Prepaid Prize Expense with MUSL, $19.8 million receivable from retailers and $3.8 million net investment in fixed assets.

The Lottery's total assets decreased by $5.5 million from fiscal year 2011 to fiscal year 2012. This decrease was primarily caused by the $5.2 million decrease in cash and investments and the $1.0 million decrease in capital assets, offset by the $0.6 million increase in prepaid prize expense with MUSL. The $5.2 million decrease in cash and investments was primarily due to the $119.9 million used to pay net proceeds in fiscal year 2012 compared to the $114.5 million in cash provided from the Lottery's operating activities. The $1.0 million decrease in capital assets was due to the first full-year depreciation of the new back office system reflected in accumulated depreciation. The prepaid prize expense with MUSL increased by $0.6 million due to an increase to the Mega Millions prize reserve funded from a portion of the prize percentage of sales approved by and due to MUSL for each draw. MUSL has currently not set a limit on the Mega Millions prize reserve. The Lottery's total assets decreased by $3.4 million from fiscal year 2010 to fiscal year 2011. This decrease was primarily caused by the $3.2 million decrease in cash and investments and the $0.6 million decrease in receivables from Lottery retailers, offset by the $0.5 million increase in prepaid prize expense with MUSL. The $3.2 million decrease in cash and investments was primarily the result of a corresponding decrease of $3.1 million in current liabilities. The $0.6 million decrease in receivables from Lottery retailers was due to the timing of the billing week-ending date and the fiscal year-end date. The prepaid prize expense with MUSL increased by $0.5 million due to an increase to the Mega Millions prize reserve.

The Lottery's total liabilities at June 30, 2012 totaled approximately $57.5 million, which consisted primarily of prize liability on all the Lottery products of about $22.6 million and proceeds distributions due to recipients of $29.0 million.

The Lottery's total liabilities at June 30, 2011 totaled $61.7 million, which consisted primarily of prize liability on all the Lottery products of $32.0 million and proceeds distributions due of $25.6 million.

The Lottery's total liabilities at June 30, 2010 totaled approximately $65.0 million, consisting primarily of prize liability on all the Lottery products of about $29.7 million and proceeds distributions due to recipients of $30.3 million.

The Lottery's total liabilities decreased from fiscal year 2011 to fiscal year 2012 by $4.3 million. The decrease was chiefly due to the $9.4 million decrease in prize liability offset by the $3.4 million increase in the proceeds distribution due to recipients, the $1.0 million increase in the amount payable to MUSL and the $0.8 million increase in accounts payable. The decrease in prize liability was primarily due to the $21.2 million scratch liability, the $2.8 million Raffle prize liability, and the $5.7 million Lotto liability recorded at the end of fiscal year 2011 compared to the $18.8 million scratch, $0 Raffle, $1.2 million Lotto prize liabilities recorded at the end of fiscal year 2012. Due to the timing of the introduction of new scratch games and the timing of online draws and outstanding prizes to be claimed, the prize liability amount can vary greatly at any one point in time. The $3.4 million increase in the proceeds distribution due to recipients was due to the more profitable fourth quarter experienced in fiscal year 2012 compared to the same quarter in fiscal year 2011.

The Lottery's total liabilities decreased from fiscal year 2010 to fiscal year 2011 by $3.3 million. The decrease was primarily the result of a $4.6 million decrease in proceeds distributions due to recipients and a $0.8 million decrease in the amount due to vendors, offset by a $2.4 million increase in the in prize liability on Lottery products. The $4.6 million decrease in proceeds distributions due to recipients was the result of increases in prize and operating expenses incurred in the fourth quarter of 2011 compared to the same quarter in 2010, resulting in a lower net profit in 2011. The increase in prize liability of $2.4 million was due to the June 30, 2012 draw of the Raffle game where prizes could not be claimed until after July 1, 2011.

Components of the Lottery's net assets are: 1) an amount to represent the Lottery's net investment in capital assets as required by the reporting model under GASB 34, (see "Total Capital Assets" on the statements of net assets); 2) a Licensed Agent Recovery Reserve (bonding reserve) funded by retailers to cover any uncollectible receivable accounts; 3) an amount representing the funds held by the Lottery in an operating reserve to ensure the operation of the Lottery for the ensuing year in accordance with Section 24-35-210 (4.1)(a), C.R.S. (see "Cash and Investments – Operating Reserve") on the statements of net assets; and 4) remaining unrestricted net assets, which represents an adjustment made by the Lottery to reflect its share of unrealized gains or losses on investments held by the State Treasurer.

The change in net assets from June 30, 2011 to June 30, 2012 consisted of a decrease in investment in capital assets of $950,787 due to the increase in depreciation expense in fiscal year 2012, a decrease in the bonding reserve from $402,793 to $351,031, a decrease in the operating reserve from $1.4 million to $1.3 million and a net decrease in unrealized gain and losses on investments of $149,612 resulting from a net decrease in the adjustments on State Treasury investments.

Following is a schedule of net assets for fiscal years 2012 and 2011:

	2012	2011	Change
Investment in capital assets	$ 2,831,868	$ 3,782,655	$ (950,787)
Bonding reserve	351,031	402,793	(51,762)
Operating reserve	1,300,000	1,400,000	(100,000)
Unrestrictied - unrealized gain (loss) on investments	464,975	614,587	(149,612)
Total net assets	$ 4,947,874	$ 6,200,035	$ (1,252,161)

The change in net assets from June 30, 2010 to June 30, 2011 consisted of a slight decrease in investment in capital assets of $47,566, a small increase in the bonding reserve from $370,801 to $402,793, an increase in the operating reserve from $1.2 million to $1.4 million and a net decrease in unrealized gain and losses on investments of $245,899 resulting from a net decrease in the adjustments on State Treasury investments. Following is a schedule of net assets for fiscal years 2011 and 2010:

	2011	2010	Change
Investment in capital assets	$ 3,782,655	$ 3,830,221	$ (47,566)
Bonding reserve	402,793	370,801	31,992
Operating reserve	1,400,000	1,200,000	200,000
Unrestricted - unrealized gain (loss) on investments	614,587	860,486	(245,899)
Total net assets	$ 6,200,035	$ 6,261,508	$ (61,473)

Statements of Revenues, Expenses and Changes in Net Assets

The statements of revenues, expenses and changes in net assets present the financial activity of the Lottery over the fiscal year. The focus is on operating revenues and expenses that have a significant effect on the distributions paid to the proceeds recipients.

Condensed Statements of Revenues, Expenses and Changes in Net Assets
For the Fiscal Years Ended June 30, 2012, 2011 and 2010

	2012	2011	2010
Operating Revenues	$ 545,303,548	$ 518,920,841	$ 501,197,409
Direct Operating Expenses	395,329,218	377,243,191	359,229,539
Gross Profit on Sale of Tickets	149,974,330	141,677,650	141,967,870
Other Operating Expenses			
Marketing and communications	13,388,426	14,823,254	14,849,003
Wages and benefits	8,950,454	8,636,669	8,139,527
Other operating expenses	6,183,458	5,663,233	5,925,611
Total other operating expenses	28,522,338	29,123,156	28,914,141
Operating Income	121,451,992	112,554,494	113,053,729
Nonoperating Revenues (Expenses)			
Other revenue	201,559	184,871	177,641
Investment income	343,764	560,155	1,317,086
Proceeds distributions	(123,249,476)	(113,360,993)	(112,941,567)
Total nonoperating expenses	(122,704,153)	(112,615,967)	(111,446,840)
Increase (Decrease) in Net Assets	(1,252,161)	(61,473)	1,606,889
Net Assets, Beginning of Year	6,200,035	6,261,508	4,654,619
Net Assets, End of Year	$ 4,947,874	$ 6,200,035	$ 6,261,508

Sales Activities

Revenues from the sales of Lottery products for the fiscal year ended June 30, 2012 were the highest in the Lottery's 30-year history. As shown in the financial statements, overall sales increased by 5.1 percent or $26.4 million from fiscal year 2011 sales of $518.9 million to $545.3 in fiscal year 2012. Fiscal year 2011 sales of $518.9 million, another record breaking year, represented an increase of 3.5 percent or $17.7 million from fiscal year 2010 sales of $501.2 million. Fiscal year 2012 scratch sales of $364.2 million represented a $19.3 million or a 5.6 percent increase over the prior fiscal year scratch sales of $344.9 million. As in the prior fiscal year, the sales of scratch tickets continued its upward trend in fiscal year 2012. The number of individual scratch tickets sold increased by 1.5 percent over the previous fiscal year, from 98.5 million tickets to 100.0 million tickets, with the average ticket price also continuing to move upward from $3.50 in fiscal year 2011 to $3.64 in fiscal year 2012.

Fiscal year 2011 scratch sales of $344.9 million represented a $16.8 million increase or 5.1 percent over the prior year scratch sales of $328.1 million. The increase in scratch sales may be attributed to several factors: 1) the number of individual scratch tickets sold increased by 1.3 percent from 97.3 million tickets to 98.5 million tickets over the previous year with the average ticket price also increasing from $3.37 in fiscal year 2010 to $3.50 in fiscal year 2011; 2) implementation of a full courier system in September 2011, resulted in better availability of scratch tickets to the players because not only did the Lottery have initial new game orders being delivered via courier (UPS), but also started having replenishments being delivered via courier based on previous sales history, or predictive ordering (replenishments were previously being delivered by Lottery sales representatives typically on a semi-weekly basis); and 3) the perceived improvement of the economy in Colorado with increased spending on Lottery products.

Total online game sales in fiscal year 2012 of $181.1 million represented an increase of $7.1 million or 4.1 percent over fiscal year 2011 online sales of $174.0 million. Total online game sales remained virtually the same in fiscal year 2011 from fiscal year 2010. A slight sales increase from $173.1 million in fiscal year 2010 sales to $174.0 million in fiscal year 2011 represented an increase of $0.9 million or 0.5 percent. As mentioned above in the *Financial Highlights* section, the increase in online sales in fiscal year 2012 was chiefly due to the $12.0 million increase in Mega Millions sales tied to the historic jackpot run in March 2012 and to the $11.8 million increase in Powerball sales over the previous year due to the change to a $2 ticket from a $1 ticket in January 2012. Cash 5 sales showed a slight increase of $0.4 million or 1.9 percent in fiscal year 2012 over the previous fiscal year. These sales increases were offset by a $9.0 million decrease in Raffle sales due to management's decision to hold off offering the next Raffle game until the fall of fiscal year 2013; by a $6.0 million decrease in Lotto sales due to a decline in the average size of the Lotto jackpots experienced in fiscal year 2012 (the average Lotto jackpot claimed in fiscal year 2011 was $5.8 million compared to $3.7 million in fiscal year 2012); and by a $2.1 million or 18.8 percent decrease in MatchPlay sales.

With Mega Millions and MatchPlay available for sale the entire 2011 fiscal year and with the introduction of the new $20 Raffle game in September 2011, online players appeared to shift their dollars to the newer games from the existing ones in fiscal year 2011. These three newer products contributed to a $36.9 million increase in online sales from $8.6 million in fiscal year 2010 to $45.5 million in fiscal year 2011. These sales gains were virtually offset, however, by a decrease in Powerball sales in fiscal year 2011 of $31.5 million from fiscal year 2010 in addition to a decrease of $2.4 million and 2.1 million in Lotto and Cash 5 sales, respectively.

The following tables compare Lottery product sales between fiscal years.

Product Sales	**2012**	**2011**	**Difference**	**Change**
Scratch	$364,244,843	$344,945,609	$ 19,299,234	5.6%
Powerball	81,865,488	70,046,464	11,819,024	16.9
Lotto	33,276,914	39,257,377	(5,980,463)	(15.2)
Mega Millions	37,122,665	25,126,942	11,995,723	47.7
Cash 5	19,520,456	19,153,751	366,705	1.9
MatchPlay	9,273,182	11,418,378	(2,145,196)	(18.8)
Raffle	---	8,972,320	(8,972,320)	(100.0)
Total	$545,303,548	$518,920,841	$ 26,382,707	5.1%

Product Sales	**2011**	**2010**	**Difference**	**Change**
Scratch	$344,945,609	$ 328,108,741	$ 16,836,868	5.1%
Powerball	70,046,464	101,568,085	(31,521,621)	(31.0)
Lotto	39,257,377	41,620,408	(2,363,031)	(5.7)
Mega Millions	25,126,942	2,403,216	22,723,726	945.6
Cash 5	19,153,751	21,309,593	(2,155,842)	(10.1)
MatchPlay	11,418,378	6,187,366	5,231,012	84.5
Raffle	8,972,320	---	8,972,320	---
Total	$518,920,841	$501,197,409	$ 17,723,432	3.5%

Nonoperating Revenues

Nonoperating revenues for the years ended June 30, 2012 and June 30, 2011 totaled $0.5 million and $0.7 million, respectively. The major reason for the decrease was due to the continuing drop in interest rates in fiscal year 2012. The amount of interest received for Lottery investments held by the state treasury decreased approximately $311,000 from fiscal year 2011 to fiscal year 2012, the result of a drop in the average interest rate of 1.95 percent in fiscal year 2011 to 1.36 percent in fiscal year 2012. This decrease was offset by an increase to the GASB 31 adjustment recording the Lottery's share of the unrealized gains and losses on investments held by the treasury decreasing from a $245,899 loss in fiscal year 2011 to a $149,612 loss in fiscal year 2012.

Nonoperating revenues for the years ended June 30, 2011 and June 30, 2010 totaled $0.7 million and $1.5 million, respectively. The major reason for the decrease was due to the GASB 31 adjustment recording the Lottery's share of the unrealized gains and losses on investments held by the Treasury decreasing from a $454,339 gain in fiscal year 2010 to a $245,899 loss in fiscal year 2011. Also contributing to the lower nonoperating revenues in fiscal year 2011 was a one-time increase of $47,867 in revenue recorded in fiscal year 2010, reflecting the Lottery's election to recognize revenues from advance play sales immediately upon purchase rather than over the life of the respective draws. In addition, continued decline in interest rates paid on investments in fiscal year 2011 played a role in the decline of nonoperating revenues. The amount of interest received from the treasury decreased approximately $34,000 from fiscal year 2010 to fiscal year 2011, the result of a drop in the average interest rate of 2.30 percent in fiscal year 2010 to 1.95 percent in fiscal year 2011. The interest received from the Multi-State Lottery Association (MUSL) also decreased in fiscal year 2011. The total received was approximately $46,000 compared with $69,000 in fiscal year 2010. Finally the revenue received from MUSL representing Powerball royalties decreased by approximately $21,000 from the prior fiscal year to the current.

Total Revenues

Total revenues were $545.8 million and $519.7 million for the years ended June 30, 2012 and 2011, respectively. As mentioned elsewhere, the major contributing factor to the increase in total revenues of nearly $26.2 million was the overall 5.1 percent increase in Lottery product sales totaling $26.4 million offset by the approximately $0.2 million reduction of nonoperating revenues outlined in the previous section.

Total revenues were $519.7 million and $502.7 million for the years ended June 30, 2011 and 2010, respectively. As mentioned elsewhere, the major contributing factor to the increase in total revenues of approximately $17.0 million was the 5.1 percent increase in scratch sales and the modest 0.5 percent in total online sales totaling $17.7 million in the current fiscal year. This increase was offset by the approximately $0.7 million reduction of nonoperating revenues mentioned above.

Major Expenses

Approximately $395.3 million of the Lottery's total expenses of the nearly $423.9 million for the fiscal year ended June 30, 2012 were incurred in direct support of the Lottery games. These expenses include prize expense, retailer compensation, money spent to purchase scratch tickets and compensation to the vendor who maintains and supports the on-line gaming system. Of the $395.3 million spent in fiscal year 2012 for direct support of the Lottery games, $342.6 million or 86.6% was for prize expense associated with those games.

In comparison, $377.2 million of the Lottery's total expenses of $406.4 million for the fiscal year ended June 30, 2011 were game-related expenses. Of the $377.2 million spent in fiscal year 2011 for direct support of the Lottery games, $326.7 million or 86.6% was spent for prize expense associated with those games.

In comparison, $359.2 million of the Lottery's total expenses of $388.1 million for the fiscal year ended June 30, 2010 were game-related expenses. Of the $359.2 million spent in fiscal year 2010 for direct support of the Lottery games, $310.4 million or 86.4% was spent for prize expense associated with those games.

Prize expense in fiscal year 2012 increased $15.9 million over fiscal year 2011. Generally, prize expense will increase or decrease in conjunction with the increase or decrease in product sales. In fiscal year 2012, based on the $26.4 million increase in sales, a $16.6 million increase in prize expense would have been expected. The net $0.7 million reduction in prize expense was due to several factors and was in part the direct result of changes implemented by Lottery management to decrease prize expense.

Scratch prize expense as a percentage of sales increased by 0.4 percent in fiscal year 2012 compared to fiscal year 2011. Despite the directive of the Lottery management to change the prize structure of some of our scratch games and introduce scratch games with lower overall prize payouts, the process is a slow one due to the amount of time it takes for the development, approval and ultimate launch of a scratch game out in the market. However, the increase to scratch prize expense would have been even higher if the initial efforts toward meeting this goal had not been made in fiscal year 2012. In addition, the shift in sales from the lower price point games (especially from the $1 game) to the higher price point games (especially to the $5 and $20 games) continued in fiscal year 2012. The higher priced tickets carry a higher prize expense percentage causing the overall scratch prize expense increase from 68.8 percent in fiscal year 2011 to 69.2 percent in fiscal year 2012 or an additional $1.3 million in prize expense over and above the expected increase due to higher sales. In addition, fiscal year 2012 scratch sales accounted for 66.8 percent of total sales and the remaining 33.2 percent were online sales. In comparison, scratch accounted for 65.5 percent and online for the remaining 34.5 percent in fiscal year 2011. This shift to the less profitable scratch products resulted in an increase of $0.3 million to the overall prize expense.

Online prize expense as a percentage of sales, on the other hand, decreased by an overall 1.3 percent in fiscal year 2012 compared to fiscal year 2011. This resulted in a $2.3 million reduction in online prize expense from what was expected with the $7.1 million increase in sales. The main reason for this reduction was the shift in sales to the more profitable mega jackpot games Powerball and Mega Millions from the other online games offered. These shifts are generally tied to the size of the jackpots and are out of the control of the Lottery. In the effort to lower controllable aspects of prize expense, however, the Lottery changed the formula to compute how fast the Lotto jackpot grows by draw. This change, put into effect in January 2012, not only saved the Lottery $0.5 million in prize expense but also limited the increase in the Lotto prize expense percentage. The 0.8 percent increase in prize expense as a percent of sales would have been a 2.5 percent increase if the change had not been made. Additionally, the Lottery management made the decision to end the MatchPlay online game at the end of fiscal year 2012 due to its declining sales and its 63.9 prize expense percentage, the highest of all online games.

The increase in the other game-related expenses in fiscal year 2012 from fiscal year 2011, including retailer commission expense, ticket costs and vendor fees was reflective of the increase in product sales with only slight increases and decreases in the individual expenses as a percentage of sales. Total other game-related expenses were 9.7% of sales for both fiscal years.

Following are tables comparing the game-related expenses between fiscal years 2012 and 2011.

Game-Related Expenses	**2012**	**% of Sales**	**2011**	**% of Sales**	**Difference**	**Change in % of Sales**
Prize Expense including Powerball and Mega Millions prize variances						
Scratch	$ 251,968,935	69.2%	$ 237,372,938	68.8%	$ 14,595,997	0.4%
Powerball	38,347,359	46.8	32,694,312	46.7	5,653,047	0.1
Lotto	17,878,569	53.7	20,768,717	52.9	(2,890,148)	0.8
Mega Millions	18,183,635	49.0	12,754,477	50.8	5,429,158	(1.8)
Cash 5	10,536,969	54.0	10,483,126	54.7	53,843	(0.7)
MatchPlay	5,929,284	63.9	6,967,421	61.0	(1,038,137)	2.9
Raffle	(204,500)	N/A	5,698,000	63.5	(5,902,500)	N/A
Total prize expense	342,640,251	62.8%	326,738,991	63.0%	15,901,260	(0.2)%
Retailer compensation						
Commissions	36,305,943	6.7%	34,531,189	6.6%	1,774,754	0.1
Bonuses	5,334,999	1.0	5,052,899	1.0	282,100	0.0
Ticket costs	2,789,463	0.5	3,027,915	0.6	(238,452)	(0.1)
Vendor fees	8,258,562	1.5	7,892,197	1.5	366,365	0.0
Total	$ 395,329,218	72.5%	$ 377,243,191	72.7%	$ 18,086,027	(0.2)%

Prize expense in fiscal year 2011 increased $16.4 million over fiscal year 2010. In fiscal year 2011, $11.0 million of the $16.4 million was a reflection of the increase in sales of $17.7 million. The remaining $5.4 million increase was due to other factors. Three reasons were identified for this increase.

First, the Lottery saw a shift in product sales mix in fiscal year 2011 accounting for $3.8 million of the $5.4 million increase in prize expense. The shift in product sales mix can be broken down into three components. 1) In fiscal year 2010 scratch sales accounted for 65.5 percent of total sales and the remaining 34.5 percent were online sales. In fiscal year 2011 scratch sales increased by 1.0 percent to 66.5 percent of total sales with a corresponding decrease to the online sales percentage to 33.5 percent. With a higher prize expense compared to online products, the shift to scratch resulted in a $1.1 million increase in prize expense in fiscal year 2011 compared to fiscal year 2010. 2) The scratch game prize expense increase of 0.4 percent in fiscal year 2011 compared to fiscal year 2010 was the result of a shift in sales from the lower price point games ($1 and $2 games) to the higher price point games ($3, $5, $10 and $20). The higher priced tickets carry a higher prize expense percentage causing the overall scratch prize expense increase from 68.4 percent in fiscal year 2010 to 68.8 percent in fiscal years 2011. This shift accounted for $1.3 million of the increase in prize expense. 3) The Lottery also saw a product mix change within the online group itself, with a large shift from the more profitable Powerball game to less profitable newer games accounting for a $1.4 million increase in prize expense.

Next, $1.1 million of the $5.4 million increase in prize expense was attributable to the fact that sales for the second Raffle game fell short of management's expectations. With the first Raffle game selling out, a second game with added bonus features to encourage sales was offered to Lottery players. Unfortunately, the second Raffle game was not as well received by the players, which resulted in lower sales and a higher prize expense as a percentage of sales due to the fixed prize payout feature of the game.

Finally, online games are designed to return a certain percentage of prizes based on sales over the long run. In the short run, this amount can be higher or lower due to the luck of the draw. In fiscal year 2011, total prizes won by online players including jackpot prizes were higher than in fiscal year 2010 resulting in an increase in prize expense of $0.5 million.

The increase in the other game-related expenses from fiscal year 2011 from fiscal year 2010 was reflective of the increase in product sales with virtually no overall change in these expenses as a percentage of sales.

Following are tables comparing the game-related expenses between fiscal years 2011 and 2010.

Game-Related Expenses	2011	% of Sales	2010	% of Sales	Difference	Change in % of Sales
Prize Expense including Powerball and Mega Millions prize variances						
Scratch	$237,372,938	68.8%	$ 224,567,596	68.4%	$ 12,805,342	0.4%
Powerball	32,694,312	46.7	48,358,921	47.6	(15,664,609)	(0.9)
Lotto	20,768,717	52.9	21,843,486	52.5	(1,074,769)	0.4
Mega Millions	12,754,477	50.8	1,275,005	53.1	11,479,472	(2.3)
Cash 5	10,483,126	54.7	11,081,335	52.0	(598,209)	2.7
MatchPlay	6,967,421	61.0	3,238,067	52.3	3,729,354	8.7
Raffle	5,698,000	63.5	---	--	5,698,000	N/A
Total prize expense	326,738,991	63.0%	310,364,410	61.9%	16,374,581	1.1%
Retailer compensation						
Commissions	34,531,189	6.6%	33,293,526	6.6%	1,237,663	0.0
Bonuses	5,052,899	1.0	4,853,249	1.0	199,650	0.0
Ticket costs	3,027,915	0.6	3,064,963	0.6	(37,048)	0.0
Vendor fees	7,892,197	1.5	7,653,391	1.5	238,806	0.0
Total	$377,243,191	72.7%	$ 359,229,539	71.6%	$ 18,013,652	1.1%

Of the $28.5 million expenses that were non game-related in fiscal year 2012, more than $13.4 million, a nearly ten percent drop from the previous year, was for promotions and institutional and product advertising. Approximately $8.9 million, a $0.3 million increase over fiscal year 2011, was for compensation to the Lottery employees. The increase in employee compensation was the result of fewer position vacancies in fiscal year 2012 compared to fiscal year 2011. Depreciation expense made up $1.0 million of non game-related expenses with the first full-year of depreciation of the back office computer system. The increase in equipment maintenance from $365,000 in fiscal year 2011 to $617,000 was chiefly due to the accrued $240,000 payment of the final software license fee tied to the new back office. (See *Other Major Vendor Commitments* in the Notes to Financial Statements section.) Overall, with the goal to increase proceeds as a percentage of revenues in fiscal year 2012, the Lottery implemented a ten percent cut to the marketing and operating budgets which resulted in over $1.4 million in savings over the previous fiscal year.

Of the $29.1 million expenses that were non game-related in fiscal year 2011, more than $14.8 million, a slight drop from the previous year, was for promotions and institutional and product advertising. About $8.6 million, a $0.5 million increase over fiscal year 2010, was for compensation to the Lottery employees. The increase in employee compensation was the result of hiring several employees to fill vacant positions and the discontinuation of the capitalization of salaries and benefits associated with the completion of the back office computer system project. This increase in compensation was offset by a $0.2 million decrease in accrued annual and sick leave due to Lottery retirements. Delivery expense increased by $0.7 million due to the implementation of the full-courier scratch ticket delivery system in fiscal year 2011. Depreciation expense increased by $0.6 million due to the start of depreciating Phase I of the back office computer system project in fiscal year 2011.

In comparison, of the $28.9 million in fiscal year 2010 expenses that were non game-related, more than $14.9 million was for promotions and institutional and product advertising and about $8.1 million was for compensation to the Lottery employees.

Distributions to the Proceeds Recipients

The Lottery's efforts in fiscal year 2012 to increase proceeds as a percentage of revenue over the previous fiscal year generated funds available for distributions of $123.2 million in the current fiscal year. This represented an increase of proceeds as a percentage of revenue from 21.8 percent to 22.6 percent. Of these total proceeds, $57.1 million was allocated to the Great Outdoors Colorado Trust Fund, $49.3 million to the Conservation Trust Fund and $12.3 million to the Division of Parks and Wildlife per the distribution formula stated in Colorado Revised Statutes (C.R.S.) 24-35-210. The maximum distribution to Great Outdoors Colorado of $57.1 million, pursuant to C.R.S. 33-60-104(1)(c) and 33-60-104(2), was reached, thus creating a spill-over into the Public School Capital Construction Assistance Fund of over $4.5 million pursuant to C.R.S. 22-43.7-104 (2)(b)(III).

The Lottery's proceeds distributions for fiscal year 2011 totaled $113.4 million, or 21.8 percent of revenue. Approximately $56.0 million was distributed to Great Outdoors Colorado, $45.3 million to the Conservation Trust Fund, $11.3 million to the Division of Parks and Wildlife and a spill-over into the Public School Capital Construction Assistance Fund of $662,230.

The Lottery's proceeds distributions for fiscal year 2010 totaled $112.9 million, or 22.5 percent of revenue. Approximately $56.4 million was distributed to Great Outdoors Colorado, $45.2 million to the Conservation Trust Fund, $11.3 million to the Division of Parks and Wildlife and a spill-over into the Public School Capital Construction Assistance Fund of $88,550.

Capital Assets

The Lottery's investment in capital assets at June 30, 2012, 2011 and 2010 amounted to $2.8 million, $3.8 million and $3.8 million, respectively. The investment in capital assets as of June 30, 2012 and June 30, 2011 included computer equipment, servers, back office computer system, drawing equipment, modular furniture, cameras, recorders and leasehold improvements. The decrease in equipment from fiscal year 2011 to fiscal year 2012 was mainly due to the write off of obsolete computer and marketing production equipment. The investment in capital assets as of June 30, 2010 included the capitalization of salaries and other costs related to the development of a new back office system. Capital assets are shown on the Statement of Net Assets at the cost on the day of acquisition. Analysis of changes in capital assets is as follows:

Capital Assets as of
June 30, 2012, 2011 and 2010

	2012	2011	2010
Capital Assets			
Equipment	$ 6,079,410	$ 6,378,722	$ 6,724,664
Leasehold improvements	64,711	64,711	---
Less: Accumulated depreciation	(3,312,253)	(2,660,778)	(2,894,443)
Net capital assets	$ 2,831,868	$ 3,782,655	$ 3,830,221

Budgetary Highlights

The Lottery's budget is determined by a variety of methods. The majority of the budget is set by the annual appropriations bill (the Long Bill), which determines budgets for every agency within the State. The Long Bill and department level allocations are approved shortly before the start of each fiscal year. Agencies may also request a supplemental appropriation during the fiscal year to cover unexpected expenses (or a negative supplemental for less than expected expenses), as well as year-end transfers of spending authority, if needed. Department level re-allocations were approved in health-dental-life allocation, amortization equalization disbursement, legal services and leased space, offset by reductions in appropriations for supplemental amortization equalization disbursement, indirect costs, variable vehicle payments and vehicle lease payments. The final method of funding is special legislation. There was no special legislation affecting the Lottery's budget in fiscal year 2012.

The approved Lottery budget at the beginning of fiscal year 2012 was $525.0 million. Department level allocations approved throughout the fiscal year decreased the budget by $570.9 million to an amended total of $524.4 million. Total expenditures and roll-forwards for fiscal year 2012 on a budget basis came to $437.6 million, resulting in excess appropriations (or savings) of more than $86.8 million.

Economic Outlook

- The Lottery plans to launch a $5 Raffle game in October 2012 which will be played through the end of the calendar year. Raffle's limited ticket availability and purchase timeframe fits in well with the Lottery players' sales behavior during the holiday season and the advertisement of the game can be incorporated into the holiday marketing during that period. The Lottery's previous Raffle game held during the holiday season of 2010 was very successful and sold out three days prior to the scheduled drawing.

- In addition, the Lottery plans to launch an additional jackpot game in the Pick 3 genre in the third quarter of the fiscal year. The game is a standard industry game currently offered in thirty-seven states. Research to identify several games appropriate for Colorado was conducted in fiscal year 2012 and the Pick 3 game was chosen for two reasons. First, the Lottery was looking for a long-term, sustainable game and second, the game has proven to be successful in other jurisdictions.

- In fiscal year 2013 the Lottery plans to reallocate marketing resources toward the jackpot games in the current product mix with the highest rate of return. The reallocation is projected to ensure the availability of marketing resources to successfully support the combined Scratch/Raffle holiday campaign and to launch the Pick 3 game later in the year.

- Recommendations have been made to management to revamp the current Lotto game in late fiscal year 2013 or in early fiscal year 2014. Changes will likely include the addition of a multiplier feature where players can possibly multiply their prize with the purchase of the multiplier option for an additional dollar or a change to the current 6 of 42 game matrix in order to stimulate the Lotto's jackpot growth.

Contacting the Lottery's Financial Management

This management discussion and analysis report is designed to provide Colorado citizens, Colorado government officials, our players, retailers and other interested parties with a general overview of the Lottery's financial activity for fiscal year 2012 and to demonstrate the Lottery's accountability for the money generated from the sale of the Lottery products. If you have questions about this report or need additional information, contact John Caligaris, the Colorado Lottery's Controller, 212 W. 3rd Street, Suite 210, Pueblo, CO 81003.

COLORADO LOTTERY
STATEMENTS OF NET ASSETS
June 30, 2012 and 2011

	2012	2011
Current Assets		
Cash and investments	$ 32,331,921	$ 37,353,939
Accounts receivable, net of the allowance for doubtful accounts of $227,135 in 2012 and $169,428 in 2011	19,491,886	19,236,806
Consignment inventory, at cost	119,406	132,308
Warehouse inventory, at cost	908,062	1,100,188
Prepaid expenses	72,562	78,931
Total current assets	52,923,837	57,902,172
Reserve and Restricted Assets		
Cash and investments - Operating reserve	1,300,000	1,400,000
Cash and investments - Licensed agent recovery reserve receipts	351,031	402,793
Prepaid prize expense with MUSL	4,994,022	4,430,127
Total reserve and restricted assets	6,645,053	6,232,920
Capital Assets		
Equipment	6,079,410	6,378,722
Leasehold Improvements	64,711	64,711
Less accumulated depreciation and amortization	(3,312,253)	(2,660,778)
Total capital assets	2,831,868	3,782,655
Total assets	62,400,758	67,917,747

	2012	2011
Current Liabilities		
Accounts payable	2,025,621	1,252,207
Prize liability	22,647,331	32,042,529
Payable to MUSL	1,244,205	255,935
Wages and benefits	842,256	843,900
Accrued annual and sick leave	-	24,835
Retailer bonus liability	812,029	809,699
Funds available for distribution	28,984,076	25,612,785
Total current liabilities	56,555,518	60,841,890
Long-Term Liabilities		
Accrued annual and sick leave	836,456	807,224
Expired warrants liability	60,910	68,598
Total long-term liabilities	897,366	875,822
Total liabilities	57,452,884	61,717,712
Net Assets		
Investment in capital assets	2,831,868	3,782,655
Restricted - Licensed agent recovery reserve	351,031	402,793
Restricted -Operating reserve	1,300,000	1,400,000
Unrestricted - Other	464,975	614,587
Total net assets	$ 4,947,874	$ 6,200,035

See notes to financial statements.

COLORADO LOTTERY
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
Years Ended June 30, 2012 and 2011

	2012	2011
Operating Revenues		
Gross ticket sales	$ 545,303,548	$ 518,920,841
Direct Operating Expenses		
Prize expense	347,536,804	326,624,241
Powerball prize variance	(5,672,459)	792,467
Megamillions prize variance	775,906	(677,717)
Retailer commissions and bonuses	41,640,942	39,584,088
Cost of tickets and vendor fees	11,048,025	10,920,112
Total direct operating expenses	395,329,218	377,243,191
Gross profit on sale of tickets	149,974,330	141,677,650
Other Operating Expenses		
Marketing and communications	13,388,426	14,823,254
Administration fees paid to MUSL	137,472	116,175
Wages and benefits	8,950,454	8,636,669
Professional services	409,244	614,802
State agencies services	128,181	129,813
Department of Revenue services	495,367	528,542
Travel	110,638	146,229
Equipment (including loss on disposition of equipment of $34,093 and $110,479, respectively)	205,608	198,071
Depreciation	1,048,886	795,467
Accrued annual and sick leave	30,116	(144,923)
Space rental	733,444	704,995
Rents for equipment	33,009	32,046
Motorpool leasing	387,512	352,785
Materials and supplies	137,755	152,417
Telephone	156,179	143,733
Online telecommunications	353,216	372,579
Data processing supplies and services	33,077	32,899
Equipment maintenance	617,332	365,071
Postage	54,789	65,786
Printing	13,066	6,097
Delivery expense	982,487	963,827
Other	116,080	86,822
Total other operating expenses	28,522,338	29,123,156

COLORADO LOTTERY
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
(Continued)
Years Ended June 30, 2012 and 2011

	2012	2011
Operating Income	121,451,992	112,554,494
Nonoperating Revenues (Expenses)		
Other revenue	201,559	184,871
Investment income	343,764	560,155
Funds distributed for current year	(94,265,400)	(87,748,208)
Funds available for distribution for current year	(28,984,076)	(25,612,785)
Total nonoperating revenues (expenses)	(122,704,153)	(112,615,967)
Net Loss	$ (1,252,161)	$ (61,473)
Net Assets, Beginning of Year	$ 6,200,035	$ 6,261,508
Net Change in Net Assets	(1,252,161)	(61,473)
Net Assets, End of Year	$ 4,947,874	$ 6,200,035

See Notes to Financial Statements.

COLORADO LOTTERY
STATEMENTS OF CASH FLOWS
Years Ended June 30, 2012 and 2011

	2012	2011
Operating Activities		
Cash received from retailers	$ 544,804,882	$ 518,382,515
Cash paid in prizes	(352,131,817)	(323,877,300)
Cash paid in retailer commissions	(36,305,943)	(34,531,189)
Cash payments to suppliers	(27,563,803)	(31,051,756)
Cash payments to employees for services	(8,977,817)	(8,544,805)
Cash paid in retailer bonus	(5,332,669)	(5,267,198)
Net cash provided by operating activities	114,492,833	115,110,267
Noncapital Financing Activities		
Distribution of net proceeds	(119,878,185)	(118,002,493)
Net cash used in noncapital financing activities	(119,878,185)	(118,002,493)
Capital and Related Financing Activities		
Acquisition of capital assets	(132,792)	(941,236)
Proceeds from the sale of capital assets	600	-
Net cash used in capital and related financing activities	(132,192)	(941,236)
Investing Activities		
Interest received	493,376	806,054
Net cash provided by investing activities	493,376	806,054
Decrease in Cash and Investments	(5,024,168)	(3,027,408)
Change in Fair Market Value of Investments	(149,612)	(245,899)
Cash and Investments, Beginning of Year (including $1,802,793 and $1,570,801, respectively, in restricted accounts)	39,156,732	42,430,039
Cash and investments, End of Year, (including $1,651,031 and $1,802,793, respectively, in restricted accounts)	$ 33,982,952	$ 39,156,732

COLORADO LOTTERY
STATEMENTS OF CASH FLOWS (Continued)
Years Ended June 30, 2012 and 2011

	2012	2011
Reconciliation of Operating Income to Net Cash Provided by Operating Activities		
Operating income	$ 121,451,992	$ 112,554,494
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	1,048,886	795,467
Disposition of equipment	34,093	112,279
Other revenue	201,559	184,871
Increase in prepaid prize expense with MUSL	(563,895)	(501,808)
Change in:		
Accounts receivable	(255,080)	530,048
Ticket inventory	205,028	37,583
Other assets	6,369	(24,340)
Liabilities (excluding funds available for distribution)	(7,636,119)	1,421,673
Net cash provided by operating activities	$ 114,492,833	$ 115,110,267
Statement of Net Assets Classification		
Cash and investments	$ 32,331,921	$ 37,353,939
Cash and investments - Licensed agent recovery reserve	351,031	402,793
Cash and investments - Operating reserve	1,300,000	1,400,000
Cash and investments, End of Year	$ 33,982,952	$ 39,156,732

See Notes to Financial Statements.

COLORADO LOTTERY
POWERBALL ANNUITY WINNERS TRUST FUND
STATEMENTS OF FIDUCIARY NET ASSETS
June 30, 2012 and 2011

	2012	2011
ASSETS		
Current Assets		
Investments	$ 12,674,943	$ 10,288,210
Total Assets	$ 12,674,943	$ 10,288,210
NET ASSETS		
Held in trust for Powerball winner	$ 12,674,943	$ 10,288,210
Total Net Assets	$ 12,674,943	$ 10,288,210

See Notes to Financial Statements.

COLORADO LOTTERY
POWERBALL ANNUITY WINNERS TRUST FUND
STATEMENTS OF CHANGES IN FIDUCIARY NET ASSETS
Years Ended June 30, 2012 and 2011

	2012	2011
Additions		
Investment income	$ 2,803,733	$ 10,129
Total additions	2,803,733	10,129
Deductions		
Prize payment	417,000	401,000
Change in Net Assets	2,386,733	(390,871)
Net Assets Held in Trust for Powerball Winner		
Beginning of Year	10,288,210	10,679,081
End of Year	$ 12,674,943	$ 10,288,210

See Notes to Financial Statements.

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

The Colorado Lottery (the Lottery) began operations April 30, 1982 under the provisions of Section 24-35-202, C.R.S. The Lottery operates under a commission and provides operation and service of lottery games as authorized by the statute. The Lottery's revenues are predominantly earned from the sale of lottery products, including scratch, Lotto, Powerball, Cash 5, Mega Millions and MatchPlay. MatchPlay ended on June 29, 2012.

The financial statements reflect activities of the Lottery, an enterprise fund of the State of Colorado, and activities of the Lottery's Powerball Annuity Winners Trust Fund, a private trust fund of the State of Colorado, for the fiscal years ended June 30, 2012 and 2011. The Lottery is an agency of the State of Colorado. The financial statements are intended to present the financial position and results of operations and cash flows of only that portion of the State of Colorado that is attributable to the transactions of the Lottery and the Lottery's Powerball Annuity Winners Trust Fund in accordance with accounting principles generally accepted in the United States of America.

The accounting policies of the Lottery conform to accounting principles generally accepted in the United States of America as applicable to governments. The following is a summary of the more significant policies.

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 disclosure of contingent assets and liabilities at the date of the financial statements a42
nd the reported amounts of revenues, expenses, gains, losses and other changes in net assets during the reporting period. Actual results could differ from those estimates.

Fund Accounting

Government resources are allocated to, and accounted for, in separate sub-entities called funds, based upon the purposes for which the resources are to be spent and the means by which spending activities are controlled. A fund is a fiscal and accounting entity with a self-balancing set of accounts that comprise its assets, liabilities, net assets, revenues and expenditures.

Enterprise Fund

The Lottery accounts for its operations as an enterprise fund. The intent of the State of Colorado Legislature is that the Lottery's cost (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges. As permitted by Governmental Accounting Standards Board (GASB)

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Statement No. 20, *Accounting and Financial Reporting Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Lottery had elected to apply only those applicable Financial Accounting Standards Board Statements and interpretations issued prior to November 30, 1989.

The Lottery defines operating revenues as those earned as a direct result of the fund's principal ongoing operations, i.e., the sale of lottery products. Operating expenses include expenses incurred in earning those revenues such as the cost of tickets, vendor fees, retailer commissions and bonuses, administrative expenses and depreciation on capital assets. All revenues and expenses not meeting these definitions are reported as non-operating revenues and expenses.

Private Trust Fund

The Lottery accounts for Powerball Annuity Prizes in a private trust fund. The prizes are considered awarded when claimed by the winner. The Lottery is placed in a fiduciary situation, whereby it manages the prize funds for the winner. Governmental accounting mandates that a separate Statement of Net Assets and Statement of Changes in Net Assets be prepared for such fund. Those statements are included herein.

Basis of Accounting

Basis of accounting refers to when revenues, expenditures or expenses are recognized in the accounts and reported in the financial statements. The Lottery accounts for funds using the accrual basis of accounting. Revenues from scratch ticket sales are recognized at the point of ticket pack activation. Revenues from Lotto, Powerball, Cash 5, MatchPlay, and Mega Millions ticket sales are recognized when the tickets are sold. Expenses are recognized when they are incurred.

Revenues (additions) are recognized in the Powerball Annuity Winners Trust Fund based on the Fair Market Value of the original investment as of June 30, 2012 and 2011. Expenses (deductions) are recognized when payments are remitted to the winner(s).

Budget

By October 24th of each year, the Department of Revenue Executive Director submits to the Office of State Planning and Budgeting a proposed legislative budget for the fiscal year commencing the following July 1. The legislative budget includes proposed expenditures and the means of financing them.

Public hearings are conducted by the Joint Budget Committee to obtain clarification and taxpayer comments. Prior to June 30, the budget is legally enacted through passage of a law referred to as the Long Bill.

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

During the fiscal year, the approved legislative budget may be modified due to roll-forward authorization, supplemental budget approval or line item transfer authorization. All modifications must be approved by the State Controller and the Office of State Planning and/or Budgeting and the Legislature.

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable consist of amounts due from retailers for activated scratch ticket packs and uncollected on-line sales. Billable accounts receivable consist of amounts due from retailers for settled scratch ticket packs and uncollected on-line sales. Billable accounts receivable are invoiced weekly and are electronically transferred from the retailer's accounts into the Lottery's account one week following the invoice date.

Allowance for doubtful accounts represents a provision for receivables that will probably not be collected in the future. Consideration of the economic climate, credit-worthiness of individual account debtors, bankruptcy of debtor, discontinuance of debtor's business, and failure of repeated attempts to collect and barring of collection by statute of limitations are factors used in considering when an account becomes uncollectible. The accrual of a loss contingency is required when a loss is probable and/or can be reasonably estimated.

The Lottery uses the specific identification method to determine expected uncollectibles. Under the provisions of Section 24-35-219, C.R.S., licensed agent recovery reserve receipts are collected from the retailers to cover uncollectible accounts. The accounts receivable and the licensed agent recovery reserve receipts are shown net of estimated uncollectible receivables of $227,135 and $169,428 as of June 30, 2012 and 2011, respectively.

Consignment Inventory

Inventory on consignment represents non-activated ticket inventory in the possession of retailers who act as agents of the Lottery. The Lottery retains title to these tickets since retailers have the right to return non-activated tickets; therefore, the tickets are included in the inventory and reported on the statements of net assets. Consignment inventory is stated at cost using the specific identification method.

Warehouse Inventory

Warehouse inventory represents unsold tickets in possession of the Lottery and is stated at cost, using the specific identification method.

Supplies Inventory

The State of Colorado's threshold for recording supplies inventories is $100,000 per location. The supplies inventory of the Lottery consistently falls below the $100,000 threshold per location. Accordingly, no supplies inventory appears on the statements of net assets.

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Prepaid Prize Expense

As part of the Lottery's agreement with Multi-State Lottery Association (MUSL), for both the Powerball and Mega Millions games, a certain percentage of sales must be paid to MUSL for set prize and grand prize reserves.

Capital Assets

Capital assets, which include internal use computer software, equipment, and leasehold improvements, are stated at cost. The Lottery adopted the state policy of capitalizing equipment only if the cost exceeds $5,000 and has a useful life of more than one year. Depreciation for equipment and internal use computer software is computed on the straight-line method over estimated useful lives ranging from three to ten years. Leasehold improvements are depreciated over the shorter of the lease term or the estimated useful lives of the improvements. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts, and resulting gains or losses are recognized in current operations.

Accrued Wages and Benefits

During each fiscal year, the state changes the pay date for the month of June for all state employees, deferring the date from the last working day of June to the first working day of July. For the Lottery, this created a liability for accrued wages and benefits at June 30, 2012 and 2011 of $842,256 and $843,900, respectively.

Prize Liability and Prize Expense

Under the provisions of Section 24-35-210 (9), C.R.S., the Lottery must pay no less than fifty percent (50%) of total ticket sales as prizes. In the aggregate, all games to date are planned to pay 50% or more of total ticket sales in prizes. Additional prize expense and corresponding liability may be incurred as a result of market fluctuations in the cost of annuities used to pay Lotto jackpots (see Note 10).

All scratch, online and special drawing prizes are accounted for using the accrual basis of accounting. The liability for scratch prizes and online prizes is recognized at the point of retail sale. The liability for special drawing prizes is accrued on the first day of sales.

Payments of scratch prize amounts of $150 or less may be made at the Lottery or at the retail outlet; payment of scratch prize amounts of $151 to $599 may be made at the retailer level at the option of the retailer or at the Lottery. Scratch prizes of $600 or more are paid by the Lottery. Retailers are given credit for prize payments they make on a daily basis. Prizes may be claimed up to 180 days after game-end. After the final claim date, any unclaimed scratch prizes will result in a decrease to prize expense and any prizes claimed in excess of the liability accrued will result in an increase to prize expense. Net unclaimed scratch prizes resulted in a decrease to prize expense of $7,160,199 for the fiscal year ended June 30, 2012 and $7,277,648 for the fiscal year ended June 30, 2011.

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Payments of cumulative online prize amounts of $150 or less on a single ticket may be made at the Lottery or at the retail outlet; payment of cumulative prize amounts of $151 to $599 on a single ticket may be made at the retailer level at the option of the retailer or at the Lottery. Payment of cumulative prize amounts of $600 or more on a single ticket must be made at the Lottery. Retailers are given credit for prize payments they make on a daily basis. Online prizes may be claimed up to 180 days after the date of the drawing. After the final claim date, unclaimed online prizes will result in a decrease to prize expense so long as the aggregate prize expense of all games exceeds or equals the statutory 50% of sales. In the event that the expiration of an unclaimed prize would result in the aggregate prize expense of all games to fall below the statutory 50% level, the unclaimed prize amount would remain in prize expense and be paid out to players as a guaranteed additional prize. Unclaimed online prizes resulted in a decrease to prize expense of $4,229,621 for the fiscal year ended June 30, 2012 and $3,573,284 for the fiscal year ended June 30, 2011.

Powerball Prize Variance expense (revenue) represents a portion of the Powerball 50% prize expense accrual (as mandated by game rule) that is transferred to or received from MUSL. Powerball Prize Variance expense occurs when Colorado's liability, which consists of the low-tier prizes won by Colorado players plus Colorado's contribution to the jackpot, is less than the 50% accrual. If Colorado's Powerball liability, at the end of any interim reporting period, exceeds the 50% accrual, revenue is recognized. In the event that Colorado's total Powerball liability in any week should exceed the 50% accrual, MUSL will reimburse the excess to the Lottery.

Mega Millions Prize Variance expense (revenue) represents a portion of the Mega Millions prize expense accrual (51% through November 30, 2010 and 52.5% from December 1, 2010 to June 30, 2011) and the Megaplier prize expense accrual (50% to November 30, 2010 and 52.5% from December 1, 2010 to June 30, 2011), as mandated by game rule, that is transferred to or received from MUSL as with the Powerball Prize Variance as described above. Effective July 1, 2011 the prize expense accrual for both MegaMillions and Megaplier was 51.5%.

Retailer Bonus Liability

Under provisions 5.17, 10.13 and 14.19 of the Colorado Lottery Commission Rules and Regulations:

"Each licensee shall be entitled to receive a cashing bonus of one percent (1%) of each prize paid by the licensee up to and including $599.99." In addition*, "a marketing performance bonus up to five-tenths of one percent (0.5%) of total product sales may be earned by licensees that meet the criteria set forth by the Lottery Director or their designee. In the event there is a residual from the accrual of the one percent (1%) cashing bonus and/or the five-tenths (0.5%) marketing bonus...the Director may provide additional compensation to licensees… or may revert the excess amount thereby decreasing the bonus expense."*

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The cashing bonus is accrued as tickets are sold and paid as winning tickets are redeemed. Any cashing bonuses unclaimed at the end of the claim period in fiscal years 2012 and 2011 resulted in a reduction of bonus expense.

The marketing performance bonus is accrued monthly and paid to retailers in accordance with the criteria as set out in the fiscal year marketing performance plan as approved by the Director. Any excess marketing performance bonus accrued but not paid in fiscal years 2012 and 2011 resulted in a reduction of bonus expense.

Licensed Agent Recovery Reserve

Under the provisions of Section 24-35-219, C.R.S., a licensed agent recovery reserve was established on January 1, 1988 to maintain surety bond receipts collected from Lottery retailers. Billing rates are established by the Executive Director of the Department of Revenue and are reviewed on an annual basis. Retailers have the option to obtain private surety bond coverage at a rate of $2,000 surety coverage per outlet at their discretion. As of June 30, 2012 and June 30, 2011, the Lottery has reserved $351,031 and $402,793, respectively. The Lottery utilizes restricted net assets before using unrestricted net assets.

Lottery Fund Net Assets

In accordance with Section 24-35-210 (4.1)(a), C.R.S., the Lottery Commission shall reserve “sufficient monies, as of the end of the fiscal year, to ensure the operation of the Lottery for the ensuing year.” The Lottery Commission approved a reserve of $1 million of the net assets for fiscal year 1989. This remained in effect until the implementation of GASB 34, which required a net asset balance sufficient to cover the net value of an agency’s capital assets. Accordingly, at the June 2002 Commission meeting, the Lottery Commission approved a balance in net assets “equal to net value of the Lottery’s capital assets.” Effective July 1, 2004, under Senate Bill 04-204, this reserve is required to be held in cash and investments. In April 2005, the Lottery set up a separate operating reserve independent of the net capital asset reserve in the amount of $1.7 million. The amount held in this operating reserve is reviewed annually and adjusted accordingly. The annual reviews were completed in October 2010 and October 2011. The reserve was increased to $1.4 million in fiscal year 2011 and decreased to $1.3 million in fiscal year 2012, in accordance with the reviews.

Equipment Expense

Included in “The Statement of Revenues, Expenses, and Changes in Fund Net Assets” is an account titled equipment. This account reports the book value of assets, which are disposed of during the year, fixed asset purchases under the capitalization threshold, software purchases under the capitalization threshold, and other miscellaneous equipment transactions that do not qualify for capitalization.

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Compensated Leave

All permanent employees of the Lottery may accrue annual and sick leave based on length of service subject to certain limitations on the amount that will be paid on termination. In addition, employees who are classified as non-exempt from overtime pay have accumulated overtime which must be taken as compensatory time or paid. The estimated cost of compensated absences for which employees are vested is as follows:

	June 30, 2011	Increases	Decreases	June 30, 2012
Annual leave	$ 700,703	$ 613,143	$ (607,378)	$ 706,468
Sick leave	130,075	45,075	(45,559)	129,591
Total annual and sick leave	830,778	658,218	(652,937)	836,059
Compensatory time	1,281	2,434	(3,318)	397
Total compensated leave	$ 832,059	$ 660,652	$ (656,255)	$ 836,456

	June 30, 2010	Increases	Decreases	June 30, 2011
Annual leave	$ 823,566	$ 552,164	$ (675,027)	$ 700,703
Sick leave	150,647	43,389	(63,961)	130,075
Total annual and sick leave	974,213	595,553	(738,988)	830,778
Compensatory time	1,585	4,470	(4,774)	1,281
Total compensated leave	$ 975,798	$ 600,023	$ (743,762)	$ 832,059

The short-term portion of the above accrued annual and sick leave at June 30, 2012 is $0 and for June 30, 2011 is $24,835.

Expired Warrants Liability

Expired warrants liability represents the expiration of aged uncashed warrants and imprest checks over one (1) year old which expired on or before June 30, 2003. In accordance with Section 15-12-914 (2), C.R.S., recipients are entitled to claim payment up to 21 years after original date of issue. Pursuant to Section 24-35-212 (2), C.R.S., the amount of these uncashed warrants shall remain in the Lottery fund. Pursuant to the Unclaimed Property Act, Section 38-13-113, C.R.S., the funds to cover the liability for any uncashed warrants, which expire after June 30, 2003 are transferred to the Unclaimed Property Fund. The Lottery must request reimbursement from the Unclaimed Property Fund for any warrants presented for payment that expired after June 30, 2003.

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

A request for $209 was made and reimbursement is pending for fiscal year ending June 30, 2012 from the Unclaimed Property Fund and a request for $308 was made and received for fiscal year 2011.

Promotional Activity

The Lottery engages in two types of promotional activities in an attempt to enhance sales and to increase the player base. Specific promotional coupons/tickets are distributed to players through special promotions and can be redeemed/claimed at any lottery office for a specified lottery product. Specific promotional coupons/tickets with a total face value of $1,280 and $6,020 were redeemed in fiscal years ended June 30, 2012 and June 30, 2011, respectively. A new type of promotional coupon was introduced in 2010. These coupons are in the form of a scratch ticket and can be redeemed at any retailer location for a specified online product. Scratch ticket promotional coupons with a total face value of $0 were redeemed in fiscal year ended June 30, 2012 and $22,566 in fiscal year ended June 30, 2011. Scratch tickets for specific games are given away as a more direct approach to introduce players to lottery games. During the fiscal years ended June 30, 2012 and 2011, scratch tickets with a total face value of $275,957 and $219,020, respectively, were given away. Scratch ticket and coupon promotions are valued at cost. For the fiscal years ended June 30, 2012 and 2011, $178,031 and $159,119, respectively, were recorded as costs related to free tickets and coupons. These costs were included in Marketing and Communications expense in the statements of revenues, expenses and changes in net assets for coupons redeemed and scratch tickets given away.

NOTE 2 – CASH AND INVESTMENTS

Cash

Cash includes petty cash, change funds, an imprest fund, two depository accounts and cash on deposit with the State Treasurer. A detail of cash at June 30, 2012 and 2011 is as follows:

	2012	2011
Petty cash	$ 800	$ 800
Change funds	71,000	71,000
Imprest fund	188,000	157,000
Depository accounts	45,000	30,000
Cash on deposit with State Treasurer	32,027,121	37,095,139
Total unrestricted cash and investments	32,331,921	37,353,939
Restricted cash and investments – Licensed agent recovery reserve receipts on deposit with State Treasurer	351,031	402,793
Operating reserve on deposit with State Treasurer	1,300,000	1,400,000
Total restricted cash and investments	1,651,031	1,802,793
Total cash and investments	$ 33,982,952	$ 39,156,732

NOTE 2 – CASH AND INVESTMENTS (CONTINUED)

Cash on Deposit with State Treasurer

Under the provisions of Section 24-35-210 (6), C.R.S., the State Treasurer shall invest the monies of the Lottery in excess of operating and prize payment expenses and all authorized transfers. Interest or any other return on investments is paid to the Lottery Fund account on a monthly basis. Actual interest payments are determined by the State Treasurer. The actual allocated interest rate for fiscal years 2012 and 2011 was 1.36% and 1.95%, respectively.

In addition, the State Treasurer pools these deposits and invests them in securities approved by Section 24-75-601.1, C.R.S. The Lottery reports its share of the Treasurer's unrealized gains and losses based on its participation in the State Treasurer's pool only at fiscal year-end.

Effective July 1, 1997, with the Lottery's initial adoption of Governmental Accounting Standards Board Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, all of the Treasurer's investments, which include the net licensed agent recovery reserve receipts, are reported at fair value, which is determined based on quoted market prices. The State Treasurer does not invest any of the pool resources in any external investment pool, and there is no assignment of income related to participation in the pool. Additional information on the Treasurer's pool may be obtained in the State of Colorado's Comprehensive Annual Financial Report.

Deposits

Custodial credit risk is the risk that in the event of a bank failure, a government's deposits may not be returned to it. The Lottery's deposit policy for custodial credit risk requires compliance with the provisions of state law.

State law requires collateralization of all deposits with federal depository insurance; bonds and other obligations of the U.S. Treasury, U.S. agencies or instrumentalities or the State of Colorado; bonds of any city, county, school district or special road district of the State of Colorado; bonds of any state; or a surety bond having an aggregate value at least equal to the amount of the deposits.

The Lottery accounts are held in Public Deposit Protection Act (PDPA) qualified institutions, thus balances held in the Lottery's accounts in excess of $250,000 per institution are secured through PDPA with guaranteed securities.

Investments

A Private Purpose Trust was established in fiscal year 2008 to record the Lottery's investments, held by MUSL, for the benefit of Colorado's Powerball annuity prize winners (Colorado Winners Trust). An investment policy followed by MUSL governs the purchase of these investments. The policy states that a brokerage firm wishing to submit a bid for the sale of securities to MUSL must first be qualified by 1) providing information to MUSL which substantiates compliance with minimum standards and guidelines as set forth by MUSL and 2) by entering into an agreement with MUSL. In addition, MUSL will purchase from qualifying brokers only securities which

NOTE 2 – CASH AND INVESTMENTS (CONTINUED)

are backed by the full faith and credit of the United States Government or its agencies. The approved securities are Certificates on Government Receipts, Certificates Accrual Treasury Securities, Coupon Treasury Receipts, Easy Growth Treasury Receipts, Government & Agency Term Obligation Receipts, Government Loan Trust, Class 1-Z, Government Trust Certificates, JOB Certificates, Principal Treasury Receipts, Resolution Funding Corporation Strips, Stripped Government Receipts, Treasury Investment Growth Receipts, Treasury Bond Receipts, United States Agency for International Development bonds, United States Treasury Coupon Under Book Entry, United States Treasury Bills, United States Treasury Securities Stripped, Physical Coupon Treasury Strips, Zero Coupon Treasury Obligations, Government Loan Trusts, and AID Bonds.

Custodial Credit Risk – Investments

Custodial credit risk for investments is the risk that in the event of the failure of the counterparty (e.g. broker-dealer) to a transaction, the Lottery will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The Lottery's securities are held by the counterparty in the Lottery's name and therefore, custodial risk is minimal.

Interest Rate Risk – Investments

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value is to changes in market interest rates. MUSL manages its exposure to interest rate risk by purchasing only securities which are either explicitly or implicitly guaranteed by the United States Government and by holding these investments to maturity.

	2012		2011	
Investment Type	Fair Value	Weighted Average Maturity (in years)	Fair Value	Weighted Average Maturity (in years)
U. S. Treasury Investments	$ 3,855,402	20.17	$ 2,708,649	19.53
Federal Judiciary	1,803,841	9.27	1,714,793	8.67
Government Trust Certificates	214,785	4.26	196,390	5.26
U.S. Aid Bonds	3,941,407	6.01	3,500,856	6.62
Resolution Funding Corp Strips	2,859,508	13.62	2,167,522	14.02
	$ 12,674,943		$ 10,288,210	

NOTE 2 – CASH AND INVESTMENTS (CONTINUED)

Credit Risk – Investments

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. The U.S. Aid Bonds carry a AAA rating under the Moody's rating system. The Resolution Funding Corporation Strips, Federal Judiciary and Government Trust Certificates are not rated (NR).

Concentration of Credit Risk – Investments

Investment in any one issuer (other than U.S. Treasury securities, other investments explicitly guaranteed by the U. S. government, mutual funds, and external investment pools) that represent 5% or more of the total investment as of June 30, 2012 are the Resolution Funding Corporation Strips and the Federal Judiciary Bonds, which represent 22.6% and 14.2%, respectively, of the total investments. Such securities representing 5% or more of the total investment as of June 30, 2011 were the Resolution Funding Corporation Strips and the Federal Judiciary Bonds, which represented 21.1% and 16.7%, respectively, of the total investments.

Statements of Cash Flows

The statements of cash flows is prepared under the direct method then adjusted for prize payments and commission and bonus payments to retailers, which are netted from cash received from retailers and applied against accounts receivable balances. For cash flow purposes, cash and investments include restricted cash and investments held by the State Treasurer in its cash and investment pool.

NOTE 3 – SCHEDULE OF CHANGES IN CAPITAL ASSETS

	June 30, 2011	Increases	Decreases	June 30, 2012
Capital assets being depreciated:				
Equipment and software	$ 6,378,722	$ 132,792	$ (432,104)	$ 6,079,410
Leasehold improvements	64,711	-	-	64,711
Total historical costs	6,443,433	132,792	(432,104)	6,144,121
Less accumulated depreciation for equipment	(2,660,778)	(1,048,886)	397,411	(3,312,253)
Less accumulated depreciation for leasehold improvements	-	-	-	-
Total accumulated depreciation	(2,660,778)	(1,048,886)	397,411	(3,312,253)
Total capital assets, being depreciated, net	$ 3,782,655	$ (916,094)	$ (34,693)	$ 2,831,868

NOTE 3 – SCHEDULE OF CHANGES IN CAPITAL ASSETS (CONTINUED)

	June 30, 2010	Increases	Decreases	June 30, 2011
Capital assets being depreciated:				
Equipment and software	$ 6,724,664	$ 795,469	$ (1,141,411)	$ 6,378,722
	-	64,711	-	64,711
Total historical costs	6,724,664	860,180	(1,141,411)	6,443,433
Less accumulated depreciation for equipment	(2,894,443)	(795,467)	1,029,132	(2,660,778)
	-	-	-	-
Total accumulated depreciation	(2,894,443)	(795,467)	1,029,132	(2,660,778)
Total capital assets, being depreciated, net	$ 3,830,221	$ 64,713	$ (112,279)	$ 3,782,655

NOTE 4 – OPERATING LEASES

The Lottery occupies office and warehouse space in Pueblo, Denver, Grand Junction and Fort Collins and up until July 31, 2012 in Colorado Springs. Rental payments are contingent upon the continuing availability of funds. Specific lease information follows:

Pueblo

Office – The Lottery entered into an agreement with Midtown RLLLP on April 19, 2005 and the lease agreement began on June 27, 2005. The original lease was superseded July 31, 2012 when a new lease agreement was executed. The new lease expires on June 30, 2022. The lease contains an option to renew for two additional five-year terms commencing on July 1, 2023. There are no other provisions for extension or renewal.

Warehouse – The Lottery leases primary warehouse space from Santa Fe 250 LLC. The Lottery entered into a new lease agreement, which began July 1, 2011 and expires June 30, 2016. The lease contains an option to renew for one additional five-year term commencing on July 1, 2016. The lease also contains a holdover clause where the Lottery will become a month-to-month tenant if the Lottery fails to vacate the premises upon expiration or sooner termination of this lease. The rent to be paid by the Lottery during such continued occupancy shall be the same being paid by the Lottery as of the date of expiration or sooner termination. Landlord and the Lottery each hereby agree to give the other party at least thirty days written notice prior to termination of any holdover tenancy.

NOTE 4 – OPERATING LEASES (CONTINUED)

Denver

Office – The Lottery occupies office space in the Galleria Towers Building in Denver. The Lottery entered into a lease agreement, which began July 1, 2009 and expires June 30, 2019. The lease contains an option to renew the lease for two (2) consecutive additional periods of five years each. The lease also contains a holdover provision, whereby if the Lottery fails to vacate the premises upon the expiration or sooner termination of the lease, the Lottery will continue making the same monthly rent payment in effect pursuant to the lease agreement as of the date of expiration or sooner termination of the lease. Galleria Acquisitions, Inc. and the Lottery both agree to give each other thirty (30) days written notice prior to the termination of a holdover tenancy period.

Warehouse – On December 11, 2009, the Lottery entered a lease agreement with Valley Business Corp., Inc. beginning on December 11, 2009 and expiring on June 30, 2015. The lease contains an option to renew the lease for two (2) consecutive additional periods of five years each. The lease also contains a holdover provision, whereby if the Lottery fails to vacate the premises upon the expiration or sooner termination of the lease, the Lottery will continue making the same monthly rent payment in effect pursuant to the lease agreement as of the date of expiration or sooner termination of the lease. Valley Business Corp. Inc. and the Lottery both agree to give each other thirty (30) days written notice prior to the termination of a holdover tenancy period.

Fort Collins

The Lottery occupies space leased by the Department of Revenue and is responsible for reimbursing the Department of Revenue for lease payments.

Grand Junction

The Lottery occupies space in the Grand Junction State Services Building and is responsible for reimbursing the Capitol Complex Division of the Colorado Department of Personnel and Administration for lease payments.

Colorado Springs

The Lottery occupied space leased by the Department of Revenue and was responsible for reimbursing the Department of Revenue for lease payments up until July 31, 2012 when the space was vacated by the Lottery.

Operating lease expense incurred for the fiscal years ended June 30, 2012 and 2011 and future minimum lease payments for fiscal years ending June 30, 2013 through 2017 and later years are as follows:

NOTE 4 – OPERATING LEASES (CONTINUED)

LOCATION	FUTURE MINIMUM LEASE PAYMENTS							
	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	LATER YEARS
Pueblo Office	$ 236,326	$ 242,943	$ 238,872	$ 244,480	$ 252,115	$ 259,749	$ 267,554	$1,846,071
Pueblo Warehouse	148,523	168,679	176,139	176,139	176,139	176,139	-	-
CoSprgs Warehouse	9,688	6,181	-	-	-	-	-	-
Denver	171,222	189,630	187,684	193,665	199,646	205,627	211,608	441,159
Denver Warehouse	90,983	92,921	82,533	85,004	87,811	-	-	-
Fort Collins	39,329	24,411	-	-	-	-	-	-
Grand Junction	7,200	6,899	-	-	-	-	-	-
	$ 703,271	$ 731,664	$ 685,228	$ 699,288	$ 715,711	$ 641,515	$ 479,162	$2,287,230

NOTE 5 – OTHER REVENUE

A schedule of other revenue for the fiscal years ended June 30, 2012 and 2011 follows:

	2012	2011
License fees	$ 65,205	$ 59,577
Fines and penalties	69,188	61,400
Assignment fees	1,500	2,430
Net licensed agent recovery reserve receipts	(51,762)	31,992
Royalty income	-	3,395
Other	117,428	26,077
Total	$ 201,559	$ 184,871

NOTE 6 – DISTRIBUTION OF NET PROCEEDS

In accordance with Section 33-60-104, C.R.S., distributions of net proceeds shall be made on a quarterly basis. The State Treasurer shall distribute net lottery proceeds as follows: forty percent (40%) to the Conservation Trust Fund, ten percent (10%) to the Division of Parks and Wildlife and all the remaining net lottery proceeds in trust to the State Board of the Great Outdoors Colorado Trust Fund up to the statutory limit. Under Section 33-60-104(2), C.R.S., the limit is $35 million as adjusted annually based on the consumer price index. Any excess over the limit shall be transferred to the Public School Capital Construction Assistance Fund as set forth in section 22-43.7-104(2)(b)(III), C.R.S.

NOTE 6 – DISTRIBUTION OF NET PROCEEDS (CONTINUED)

Income available for distribution at June 30:

	2012	2011
Operating income	$121,451,992	$112,554,494
Plus: Other revenue	201,559	184,871
Investment income	343,764	560,155
Income before distributions	121,997,315	113,299,520
Change in licensed agent recovery reserve	51,762	(31,992)
Change in fair market value of investments	149,612	245,899
Change in operating reserve	100,000	(200,000)
Other changes in investment in capital assets	950,787	47,566
Income available for distribution	123,249,476	113,360,993
Less distributions prior to year-end	(94,265,400)	(87,748,208)
Income available for distribution	$ 28,984,076	$ 25,612,785

	Accrued at June 30, 2011	Proceeds Distributions Expenses	Distributions Paid	Accrued at June 30, 2012
Great Outdoors Colorado	$12,144,162	$ 57,065,579	$ (59,276,862)	$ 9,932,879
Public School Capital Construction Assistance Fund	662,230	4,559,159	(662,230)	4,559,159
Conservation Trust Fund	10,245,114	49,299,790	(47,951,274)	11,593,630
Division of Parks and Wildlife	2,561,279	12,324,948	(11,987,819)	2,898,408
	$25,612,785	$123,249,476	$(119,878,185)	$ 28,984,076

	Accrued at June 30, 2010	Proceeds Distributions Expenses	Distributions Paid	Accrued at June 30, 2011
Great Outdoors Colorado	$15,038,589	$ 56,018,266	$ (58,912,693)	$ 12,144,162
Public School Capital Construction Assistance Fund	88,550	662,230	(88,550)	662,230
Conservation Trust Fund	12,101,715	45,344,397	(47,200,998)	10,245,114
Division of Parks and Wildlife	3,025,431	11,336,100	(11,800,252)	2,561,279
	$30,254,285	$113,360,993	$(118,002,493)	$ 25,612,785

NOTE 7 – PENSION PLANS

Plan Description

Most of the Lottery's employees participate in a defined benefit pension plan. The plan's purpose is to provide income to members and their families at retirement or in case of death or disability. The plan is a cost sharing multiple employer plan administered by the Public Employees' Retirement Association (PERA). PERA was established by state statute in 1931. Responsibility for the organization and administration of the plan is placed with the Board of Trustees of PERA. Changes to the plan require an actuarial assessment and legislation by the General Assembly. The state plan and other divisions' plans are included in PERA's financial statements, which may be obtained by writing PERA at PO Box 5800, Denver, Colorado 80217, by calling PERA at 1-800-759-PERA (7372), or by visiting http://www.copera.org.

Non-higher education employees hired by the State after January 1, 2006 are allowed 60 days to elect to participate in a defined contribution retirement plan administered by the State Deferred Compensation Committee rather than becoming a member of PERA. If that election is not made, the employee becomes a member of PERA, and the member is allowed 60 days from commencing employment to elect to participate in a defined contribution retirement plan administered by PERA rather than the defined benefit plan.

Prior to legislation passed during the 2006 session, higher education employees may have participated in social security, PERA's defined benefit plan, or the institution's optional retirement plan. Currently, higher education employees, except for community college employees, are required to participate in their institution's optional plan, if available, unless they are active or inactive members of PERA with at least one year of service credit. In that case they may elect either PERA or their institution's optional plan. Community college employees hired after January 1, 2010, are required to become members of PERA and must elect either PERA's defined benefit or defined contribution plan within 60 days, unless they had been a PERA member within the prior twelve months. In that case, they are required to remain in the PERA plan in which they participated previously.

PERA members electing the defined contribution plan are allowed an irrevocable election between the second and fifth year to use their defined contribution account to purchase service credit and be covered under the defined benefit retirement plan. However, making this election subjects the member to the rules in effect for those hired on or after January 1, 2007, as discussed below. Employer contributions to defined contribution plan is the same as the contributions to the PERA defined benefit plan.

Defined benefit plan members (except state troopers) vest after five years of service and are eligible for full retirement based on their original hire date as follows:

- Hired before July 1, 2005 – age 50 with 30 years of service, age 60 with 20 years of service, or age 65 with 5 years of service.

- Hired between July 1, 2005 and December 31, 2006 – any age with 35 years of service, age 55 with 30 years of service, age 60 with 20 years of service, or age 65 with 5 years of service.

NOTE 7 – PENSION PLANS (CONTINUED)

- Hired between January 1, 2007 and December 31, 2010 – any age with 35 years of service, age 55 with 30 years of service, age 60 with 25 years of service, or age 65 with 5 years of service. For members with less than five years of service credit as of January 1, 2011 age and service requirements increase to those required for members hired between January 1, 2007 and December 31, 2010.

- Hired between January 1, 2011 and December 31, 2016 – any age with 35 years of service, age 58 with 30 years of service, or age 65 with 5 years of service.

- Hired on or after January 1, 2017 – any age with 35 years of service, age 58 with 30 years of service, or age 65 with 5 years of service.

Members are also eligible for retirement benefits without a reduction for early retirement based on their original hire date as follows:

- Hired before January 1, 2007 – age 55 with a minimum of 5 years and age plus years of service equals 80 or more.

- Hired on or after January 1, 2007 – age 55 with a minimum of 5 years of service credit and age plus years of service equals 85 or more.

- Hired between January 1, 2011 and December 31, 2016 – age 58 and age plus years of service equals 88 or more.

- Hired on or after January 1, 2017 – age 60 and age plus years of service equals 90.

State troopers and judges comprise a small percentage of plan members but have higher contribution rates, and state troopers are eligible for retirement benefits at different ages and years of service.

Members automatically receive the higher of the defined retirement benefit or money purchase benefit at retirement. Defined benefits are calculated as 2.5 percent times the number of years of service times the highest average salary (HAS). For retirements before January 1, 2009, HAS is calculated as one-twelfth of the average of the highest salaries on which contributions were paid, associated with three periods of 12 consecutive months of service credit and limited to a 15 percent increase between periods. For retirements after January 1, 2009, or persons hired on or after January 1, 2007, more restrictive limits are placed on salary increases between periods used in calculating HAS.

Retiree benefits are increased annually in July after one year of retirement based on the member's original hire date as follows:

- Hired before July 1, 2007 – the lesser of 2 percent or the average of the monthly Consumer Price Index increases.

NOTE 7 – PENSION PLANS (CONTINUED)

- Hired on or after January 1, 2007 – the lesser of 2 percent or the actual increase in the national Consumer Price Index, limited to a 10 percent reduction in a reserve established for cost of living increases related strictly to those hired on or after January 1, 2007. (The reserve is funded by 1 percentage point of salaries contributed by employers for employees hired on or after January 1, 2007.)

- The upper limits on benefits increase by one-quarter percentage point each year when the funded ratio of PERA equals or exceeds 103 percent and declines by one-quarter percentage point when the funded ratio drops below 90 percent after having exceeded 103 percent. The funded ratio increase does not apply for three years when a negative return on investment occurs.

Members who are disabled, who have five or more years of service credit, six months of which has been earned since the most recent period of membership, may receive retirement benefits if determined to be permanently disabled. If a member dies before retirement, their eligible children under the age of 18 (23 if a full time student) or their spouse may be entitled to a single payment or monthly benefit payments. If there is no eligible child or spouse, then financially dependent parents, beneficiaries, or the member’s estate, may be entitled to a survivor’s benefit.

Funding Policy

The contribution requirements of plan members and their employers are established, and may be amended, by the General Assembly. Salary subject to PERA contribution is gross earnings less any reduction in pay to offset employer contributions to the state sponsored IRC 125 plan established under Section 125 of the Internal Revenue Code.

Most employees contribute 8.0 percent (10.0 percent for state troopers) of their salary, as defined in CRS 24-51-101(42), to an individual account in the plan. Effective July 1, 2011, Senate Bill 11-076 extended the requirement for members in the State and Judicial Divisions to pay 2.5 percent additional member contributions through June 30, 2012. Employer contributions for members in these two divisions will be reduced by 2.5 percent.

From July 1, 2011, to December 31, 2011, the State contributed 12.25 percent (14.95 percent for state troopers and 14.86 percent for the Judicial Branch) of the employee’s salary. From January 1, 2012, through June 30, 2012, the state contributed 13.15 percent (15.85 percent for state troopers and 14.86 percent for the Judicial Branch). During all of Fiscal Year 2011-12, 1.02 percent of the employees’ total salary was allocated to the Health Care Trust Fund.

Per Colorado Revised Statutes, an amortization period of 30 years is deemed actuarially sound. At December 31, 2011, the division of PERA in which the State participates has a funded ratio of 57.7 percent and a 56 year amortization period based on current contribution rates. The funded ratio on the market value of assets is slightly lower at 57.6 percent.

In the 2004 and 2010 legislative sessions, the General Assembly authorized an Amortization Equalization Disbursement (AED) to address a pension-funding shortfall. The AED requires PERA employers to pay an additional .5 percent of salary for calendar years 2006 and 2007, with subsequent year increases of .4 percent of salary through 2017, to a maximum of 5 percent (except for the Judicial Division whose AED contribution was frozen at the 2010 level).

NOTE 7 – PENSION PLANS (CONTINUED)

In the 2006 and 2010 legislative sessions, the General Assembly authorized a Supplemental Amortization Equalization Disbursement (SAED) that requires PERA employers to pay an additional one half percentage point of total salaries, for calendar years 2008 through 2017, to a maximum of 5 percent (except for the Judicial Division whose SAED contribution was frozen at the 2010 level). The SAED will be deducted from the amount otherwise available to increase State employees' salaries.

At a 103 percent funding ratio, both the AED and the SAED will be reduced by one-half percentage point, and for subsequent declines to below 90 percent funded both the AED and SAED will be increased by one-half percentage point. For the Judicial Division, if the funding ratio reaches 90 percent and subsequently declines, the AED and SAED will be increased by one-half percentage point.

Historically members have been allowed to purchase service credit at reduced rates. However, legislation passed in the 2006 session required, that future agreements to purchase service credit be sufficient to fund the related actuarial liability.

The Lottery's contributions to the PERA defined benefit plan and/or the defined contribution plan for the fiscal years ending June 30, 2012, 2011, and 2010 were $745,721, $677,156, and $730,534, respectively. These contributions met the contribution requirement for each year.

NOTE 8 – OTHER RETIREMENT PLANS

Defined Contribution Plan

The PERA Defined Contribution Retirement Plan was established January 1, 2006, as an alternative to the defined benefit plan. All employees, with the exception of certain higher education employees, have the option of participating in the plan. At July 1, 2009, the State's administrative functions for the defined contribution plan were transferred to PERA. New member contributions to the plan vest from 50 percent to 100 percent evenly over 5 years. Participants in the plan are required to contribute 8 percent (10 percent for state troopers) of their salary. For Fiscal Years 2009-10 and 2010-11 the legislature temporarily increased the required contribution rate to 10.5 percent (12.5 percent for State Troopers). At December 31, 2011, the plan had 4,029 participants.

Deferred Compensation Plan

The PERA Deferred Compensation Plan (457) was established July 1, 2009, as a continuation of the State's deferred compensation plan which was established for state and local government employees in 1981. At July 1, 2009, the State's administrative functions for the 457 plan were transferred to PERA, where all costs of administration and funding are borne by the plan participants. In calendar year 2010, participants were allowed to make contributions of up to 100 percent of their annual gross salary (reduced by their 8 percent PERA contribution with a temporarily increase to 10.5 percent for Fiscal Years 2010-11 and 2011-12) to a maximum of $16,500. Participants who are age 50 and older, and contributing the maximum amount allowable, were allowed to make an additional $5,500 contribution in 2010, for total contributions of $22,000. Contributions and earnings are tax deferred. At December 31, 2011, the plan had 17,821 participants.

NOTE 9 – OTHER POSTEMPLOYMENT BENEFITS AND LIFE INSURANCE

Health Care Plan

The PERA Health Care Program began covering benefit recipients and qualified dependents on July 1, 1986. This benefit was developed after legislation in 1985 established the Program and the Health Care Fund; the program was converted to a trust fund in 1999. The plan is a cost-sharing multiple-employer plan under which PERA subsidizes a portion of the monthly premium for health care coverage. The benefits and employer contributions are established in statute and may be amended by the General Assembly. PERA includes the Health Care Trust Fund in its Comprehensive Annual Financial Report, which may be obtained by writing PERA at PO Box 5800, Denver, Colorado 80217, by calling PERA at 1-800-759-PERA (7372), or by visiting http://www.copera.org.

After the PERA subsidy, the benefit recipient pays the balance of the premium through an automatic deduction from the monthly retirement benefit. Monthly premium costs for participants depend on the health care plan selected, the PERA subsidy amount, Medicare eligibility, and the number of persons covered. Effective July 1, 2000, the maximum monthly subsidy is $230 per month for benefit recipients who are under 65 years of age and who are not entitled to Medicare and $115 per month for benefit recipients who are 65 years of age or older or who are under 65 years of age and entitled to Medicare. The maximum subsidy is based on the recipient having 20 years of service credit, and is subject to reduction by 5 percent for each year less than 20 years.

Employees are not required to contribute to the Health Care Trust Fund, which is maintained by employer's contributions as discussed above in Note 7. Beginning July 1, 2004, state agencies/institutions are required to contribute 1.02 percent of gross covered wages to the Health Care Trust Fund. The Lottery contributed $65,105, $63,995, and $60,171 as required by statute in Fiscal Years 2011-12, 2010-11, and 2009-10, respectively. In each year, the amount contributed was 100 percent of the required contribution.

The Health Care Trust Fund offers two general types of plans: fully-insured plans offered through health care organizations and self-insured plans administered for PERA by third party vendors. As of December 31, 2011, there were 50,217 enrolled participants, including spouses and dependents, from all contributors to the plan. At December 31, 2011, the Health Care Trust Fund had an unfunded actuarial accrued liability of $1.43 billion, a funded ratio of 16.5 percent, and a 49-year amortization period.

NOTE 10 – CONTINGENCIES AND COMMITMENTS

Prize Annuities – The Lottery purchases annuity contracts in the name of individual jackpot prize winners. Although the annuity contracts are in the name of the individual winners, the Lottery retains title to the annuity contracts. The Lottery remains liable for the payment of the guaranteed minimum prizes in the event the insurance companies issuing the annuity contracts default. The following guaranteed minimum prize payments for which annuity contracts have been purchased are due in varying amounts through October 25, 2035.

NOTE 10 – CONTINGENCIES AND COMMITMENTS (CONTINUED)

Specified prize payments	$306,778,105
Lifetime prize payments	34,559,000
Total guaranteed minimum prize payments	$341,337,105

Prize Commitment – The Lottery also acts as a transfer agent for the single Powerball Jackpot Winner on October 10, 2007. These funds are held in trust at the MUSL in securities deemed appropriate by the Grand Prize Trust Agreement. The future value of this prize was $18,068,000 as of June 30, 2012.

Self-insurance – The State of Colorado currently self-insures its agencies, officials and employees for the risks of losses to which they are exposed. That includes general liability, motor vehicle liability, workers' compensation and medical claims. The State Risk Management Fund is a restricted General Fund used for claims adjustment, investigation, defense and authorization for the settlement and payment of claims or judgments against the state except for employee medical claims. The State Employees and Officials Insurance Fund is an Internal Service Fund established for the purpose of risk, financing employees' and officials' medical claims. Property claims are not self-insured; rather, the state has purchased insurance.

Colorado employers are liable for occupational injuries and diseases of their employees. Benefits are prescribed by the Worker's Compensation Act of Colorado for medical expenses and loss of wages resulting from job-related disabilities. The state utilizes the services of BroadspireServices, Inc., a related party, to administer its plan. The state reimburses BroadspireServices, Inc. for the current cost of claims paid and related administrative expenses.

The Lottery participates in the Risk Management Fund. State agency premiums are based on an assessment of risk exposure and historical experience. Liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported. Because actual claims liabilities depend on such complex factors as inflation, changes in legal doctrines and damage awards, the process used in computing claims liability does not necessarily result in an exact amount. Claims liabilities are reevaluated periodically to take into consideration recently settled claims, the frequency of claims and other economic and social factors.

The limits of liability for which the state accepts responsibility pursuant to Section 24-10-114(1), C.R.S., are as follows:

Liability	Limits of Liability
General and automobile	Each person $150,000 Each occurrence $600,000

Before January 1, 1999, the Group Benefit Plans Fund provided an employer-paid short-term disability plan for all employees. On January 1, 1999, PERA began covering short-term disability claims for state employees eligible under its retirement plan. The Group Benefit Plans Fund continues to provide short-term disability coverage for employees not yet qualified for the retirement plan and secondary benefits for employees also covered under the PERA short-term disability plan.

NOTE 10 – CONTINGENCIES AND COMMITMENTS (CONTINUED)

The Group Benefit Plans short-term disability program provides an employee with 60 percent of their pay beginning after 30 days of disability or exhausting their sick leave balance, whichever is later. This benefit expires six months after the beginning of the disability. Although fully insured, the Group Benefit Plans disability program includes a risk-sharing feature that provides experience rating refunds calculated as earned premium less the aggregate of incurred claims, claim reserve, retention charge and refunds paid previously over the term of the contract. Refunds, when applicable, are paid annually.

Furniture and Equipment – The State of Colorado carries a $5,000 deductible replacement policy on all state owned furniture and equipment per Colorado Revised Statutes 24-30-1510.5(3)(a)(IV). For each loss incurred, the Lottery is responsible for the first $5,000 of the deductible. Any loss in excess of $5,000 is covered by the insurance carrier up to replacement cost.

Gaming Operations Commitments – The Lottery entered into long-term contracts with certain significant vendors related to providing scratch tickets and online data processing services in support of the Lottery's gaming operations. The online data processing contract expires on October 31, 2012 per the contract amendment dated January 26, 2005. The Lottery has exercised the sole two-year renewal option period extending the contract through October 31, 2014. There are also available renewal options for two additional periods of ninety days for conversion and turnover purposes. Per Amendment 7, the amended total cost of the initial contract period is not to exceed $90,460,975.

The Lottery entered into three contracts with scratch vendors, one starting on February 28, and the other two starting on March 1, 2011. All three contracts expire on June 30, 2014. The Lottery may require continued performance for three additional periods of 12 months on all three contracts beyond the expiration date. In addition, in the event that a contract with a successor contractor cannot be signed prior to the expiration or termination date of this contract, the State reserved the right to extend these contracts for a maximum of one hundred eighty (180) days or until a new contract is executed, whichever occurs first. There are no other provisions for extension or renewal. The total costs of the contracts for the initial contract period are not to exceed a total of $12,100,000.

The Lottery was approved as a member of the MUSL on February 26, 2001 and thus entered into an agreement with MUSL on June 6, 2001 to become a member and participate in Powerball games. As a member, the Lottery agrees to abide by the terms of the Multi-State Agreement dated September 16, 1987 and to any amendments to that agreement duly made by the board. The Lottery will remain a member indefinitely. Pursuant to this agreement, the Lottery will make payments to MUSL for administrative fees, weekly prize expenses, promotional purchases, miscellaneous reimbursements and assessments and contributions to the prize reserves. Both the total amount to be contributed and the amount funded by the Lottery to the Powerball prize reserves as of June 30, 2012 is $4,353,475 and is based on a percentage of sales. This amount is shown as prepaid prize expense – MUSL on the statements of net assets. MUSL reserves the right to hold funds which do not exceed 110% of the required balance. If the actual balance in the reserves should exceed 110% of the required balance, MUSL will refund any funds in excess of the 110% threshold.

NOTE 10 – CONTINGENCIES AND COMMITMENTS (CONTINUED)

In 2009, the Powerball and Mega Millions governing bodies entered discussions regarding cross-selling the Powerball and Mega Millions games, whereby each state currently selling Mega Millions tickets would also sell Powerball tickets and those states currently selling Powerball tickets would also sell Mega Million tickets. On March 10, 2010, the Lottery commission voted to allow the Colorado Lottery to participate in the cross-selling of the Mega Millions game. The rule became effective as of April 30, 2010 and the first day of ticket sales was May 16, 2010. MUSL agreed to undertake the administrative functions associated with the Mega Millions game for the states currently participating in their Powerball game. MUSL immediately began collecting a percentage of sales to fund the newly formed Mega Millions prize reserve fund. No cap on the reserve had been set as of June 30, 2012. The Colorado Lottery's balance in the reserve as of June 30, 2012 is $640,547.

Other Major Vendor Commitments – The Lottery entered into a long-term contract with an advertising agency to provide advertising services to promote the Lottery's products. The contract period began on September 1, 2007, and expired on June 30, 2010. The Lottery has the option to renew the contract for two (2) additional twelve-month periods. On June 11, 2010, the Lottery exercised its first option to renew the contract for one (1) additional twelve-month period starting on July 1, 2010, and expiring on June 30, 2011, for a total cost of $14,950,000 for fiscal year 2011. On June 20, 2011, the Lottery exercised its second option to renew the contract for one (1) additional twelve-month period starting on July 1, 2011, and expiring on June 30, 2012 for a total cost of $14,950,000 for the fiscal year 2012. The total cost of the initial contract period including previous amendments plus the two twelve-month extensions is not to exceed $63,850,000. The Lottery entered into a new long-term contract with an advertising agency to provide advertising services to promote the Lottery's products. The contract period began on July 1, 2012, and expires on June 30, 2015. The Lottery has the option to renew the contract for two (2) additional twelve-month periods. The total cost of the initial contract period amendments is not to exceed $44,850,000.

On November 3, 2008, the Lottery entered into a three year contract with a consulting firm contracted to develop and implement a new back office system including the maintenance and functionality of the Lottery's scratch product. The Lottery chose not to exercise any of the renewal options to continue the contract past November 2, 2011. The Lottery is currently finalizing negotiations with the consulting firm noted above regarding the payment of a final software license fee. A draft agreement calling for a final payment of $240,000 is currently being reviewed by legal counsel for both parties and is expected to be executed within the ensuing fiscal year. The Lottery has accrued the anticipated final payment of $240,000 as an expense in FY 2012.

Litigation – Currently, there is no reportable outstanding litigation

NOTE 11 – TAX, SPENDING AND DEBT LIMITATIONS

In November 1992, the Colorado voters passed Section 20, Article X of the Colorado Constitution, commonly known as the Taxpayer's Bill of Rights (TABOR). TABOR contains revenue, spending, tax and debt limitations that apply to the State of Colorado and all local governments. In the same general election, Article XXVII was passed creating the State Board of the Great Outdoors Colorado Trust Fund. The simultaneous passage of these two constitutional amendments raised questions as to whether there are irreconcilable conflicts between the two amendments.

The General Assembly determined in Section 24-77-102 (17) (b) (IX), C.R.S., that the net proceeds from the Lottery are excluded from the scope of "state fiscal year spending" for purposes of TABOR. The Colorado Supreme Court, in response to an interrogatory from the General Assembly, approved that determination.

TABOR is complex and subject to further legislative and judicial interpretation. The Lottery believes it is in compliance with both of these constitutional amendments.

NOTE 12 – RELATED PARTY TRANSACTIONS

The Lottery, as an agency of the State of Colorado, paid fees to other agencies of the state for auditing, legal and other services and vehicle and office rent. The Lottery also pays fees to the Department of Revenue for indirect costs. Interagency charges were $1,039,170 and $1,049,437 for the fiscal years ended June 30, 2012 and 2011, respectively.

NOTE 13 – UPCOMING STANDARD CHANGES

The GASB issued Statement No. 68 *Accounting and Financial Reporting for Pensions* (Statement No. 68), which revises and establishes new financial reporting requirements for most governments that provide their employees with pension benefits. The Lottery provides certain of its employees with pension benefits through the state's multiple employer cost-sharing Public Employees' Retirement Association (PERA) defined benefit retirement program.

Statement No. 68 requires cost-sharing employers participating in the PERA program, such as the Lottery, to record their proportionate share, as defined in Statement No. 68, of PERA's unfunded pension liability. The Lottery has no legal obligation to fund this shortfall nor does it have any ability to affect funding, benefit, or annual required contribution decisions made by PERA. The requirement of Statement No. 68 to record a portion of PERA's unfunded liability will negatively impact the Lottery's future unrestricted net assets. Statement No. 68 is effective for fiscal year 2015. At this time, management is unable to estimate the magnitude of this impact. Information regarding PERA's current funding status can be found in their Comprehensive Annual Financial Report.

SUPPLEMENTARY INFORMATION

COLORADO LOTTERY
SCHEDULE OF REVENUE AND COSTS FOR SCRATCH AND ON-LINE GAMES
FOR THE FISCAL YEAR ENDED JUNE 30, 2012
(With Comparative Totals for the Fiscal Year Ended June 30, 2011)

		On-line Games						FY 12	FY 11
	Scratch	Lotto	Powerball	Cash 5	Matchplay	Mega Millions	Raffle II	Total	Scratch and On-Line
TICKET SALES	$ 364,244,843	$ 33,276,914	$ 81,865,488	$ 19,520,456	$ 9,273,182	$ 37,122,665	$ -	$ 545,303,548	$ 518,920,841
PRIZE EXPENSE	(251,968,935)	(17,878,569)	(44,019,818)	(10,536,969)	(5,929,284)	(17,407,729)	204,500	(347,536,804)	(326,624,241)
MULTI-STATE PRIZE VARIANCES	N/A	N/A	5,672,459	N/A	N/A	(775,906)	N/A	4,896,553	(114,750)
NET REVENUE AFTER PRIZES	112,275,908	15,398,345	43,518,129	8,983,487	3,343,898	18,939,030	204,500	202,663,297	192,181,850
COMMISSIONS, BONUSES, TICKET COSTS & VENDOR FEES (Note 1)									
Retailer Commission	(25,460,000)	(1,993,193)	(4,904,904)	(1,169,269)	(554,821)	(2,223,756)	-	(36,305,943)	(34,531,189)
Retailer Bonus	(4,119,691)	(216,858)	(503,929)	(181,689)	(85,127)	(228,130)	425	(5,334,999)	(5,052,899)
Cost of Tickets Sold	(2,789,463)	N/A	N/A	N/A	N/A	N/A	N/A	(2,789,463)	(3,027,915)
Telecomm Reimbursements	516,272	47,166	116,034	27,668	13,144	52,618	-	772,902	761,170
On-Line Vendor Fees	(6,038,533)	(551,550)	(1,352,920)	(323,803)	(153,889)	(610,769)	-	(9,031,464)	(8,653,367)
TOTAL	(37,891,415)	(2,714,435)	(6,645,719)	(1,647,093)	(780,693)	(3,010,037)	425	(52,688,967)	(50,504,200)
GROSS PROFIT ON SALE OF TICKETS	$ 74,384,493	$ 12,683,910	$ 36,872,410	$ 7,336,394	$ 2,563,205	$ 15,928,993	$ 204,925	$ 149,974,330	$ 141,677,650
AVERAGE DAILY TICKET SALES	$ 995,204	$ 90,921	$ 223,676	$ 53,335	$ 25,337	$ 101,428	$ -	$ 1,489,900	$ 1,421,701

Note 1: Administrative costs of Lottery operations, including wages, advertising and other expenses are not shown.

COLORADO LOTTERY
SCHEDULE OF PERCENT OF PRIZE EXPENSE TO GROSS TICKET SALES
FOR THE FISCAL YEAR ENDED JUNE 30, 2012

		On-line Games						FY 12	FY 11
	Scratch	Lotto	Powerball	Cash 5	Matchplay	Mega Millions	Raffle	Total	Total
Prize Expense *	$ 251,968,935	$ 17,878,569	$ 38,347,359	$ 10,536,969	$ 5,929,284	$ 18,183,635	$ (204,500)	$ 342,640,251	$ 326,738,991
(/)Ticket Sales	364,244,843	33,276,914	81,865,488	19,520,456	9,273,182	37,122,665	-	545,303,548	518,920,841
Prize %	69.18%	53.73%	46.84%	53.98%	63.94%	48.98%	N/A	62.83%	62.97%

*Net of Multi-State Prize Variances

COLORADO LOTTERY
BUDGETARY COMPARISON
FOR THE FISCAL YEAR ENDED JUNE 30, 2012

	Fiscal Year 2012 Original Budget	Supplementals Allocations & Internal Transfers	Fiscal Year 2012 Final Budget	Fiscal Year 2012 Actual Expenditures	Under Expended	Percent Under Expended
Personal Services	$ 8,961,156	$ (168,142)	$ 8,793,014	$ 8,062,627	$ 730,387	8.31%
Amortization Equalization	191,348	9,000	200,348	182,795	17,553	8.76%
Supplemental Amort. Equal.	153,762	(3,200)	150,562	146,895	3,667	2.44%
Workmen's Compensation	62,670	-	62,670	62,670	-	0.00%
Health and Life	671,016	28,800	699,816	699,816	-	0.00%
Short Term Disability	12,096	-	12,096	11,949	147	1.22%
Operating	1,203,156	-	1,203,156	1,013,624	189,532	15.75%
DOR Postage	-	-	-	-	-	N/A
Variable Vehicle	192,785	(10,000)	182,785	182,785	-	0.00%
Leased Space	718,145	21,000	739,145	726,545	12,600	1.70%
Grand Junction - Leased Space	6,907	-	6,907	6,899	8	0.12%
Risk Management	25,231	-	25,231	25,231	-	0.00%
Vehicle Lease Payments	138,708	(4,373)	134,335	132,441	1,894	1.41%
Travel	113,498	-	113,498	110,638	2,860	2.52%
Purch. Serv. Comp. Center	2,193	-	2,193	-	2,193	100.00%
Marketing, Communications & Sales	14,700,000	-	14,700,000	13,282,526	1,417,474	9.64%
Communications Services	2,306	-	2,306	2,306	-	0.00%
Payments to MNT	210,811	-	210,811	210,811	-	0.00%
Payments to Other Agencies	239,410	-	239,410	107,348	132,062	55.16%
Legal Services	16,081	4,752	20,833	20,832	1	0.00%
Indirect Costs	503,032	(7,165)	495,867	495,367	500	0.10%
Ticket Costs-Scratch	6,578,000	-	6,578,000	3,834,164	2,743,836	41.71%
Research	250,000	-	250,000	105,900	144,100	57.64%
Vendor Fees	12,571,504	-	12,571,504	9,228,154	3,343,350	26.59%
Prize Payments	424,104,016	-	424,104,016	356,679,293	67,424,723	15.90%
Retailer Compensation	52,241,350	-	52,241,350	41,640,942	10,600,408	20.29%
Multi-State Lottery Fund	177,433	-	177,433	137,472	39,961	22.52%
Lottery Systems Migration	1,014,752	(441,590)	573,162	573,162	-	0.00%
Rollforwards	-	-	-	-	-	N/A
TOTAL	$ 525,061,366	$ (570,918)	$ 524,490,448	$ 437,683,192	$ 86,807,256	16.55%

FY12 Staffing (FTE) 117.0 (Appropriated) 117.5 (Actual)

Reconciliation of Expenses per "Statement of Revenues, Expenses and Changes in Net Assets" to Budgeted Expenditures:

Expenses Per Statement of Revenues, Expenses and Changes in Net Assets	
Prize Expense	347,536,804
Powerball Prize Variance	(5,672,459)
Mega Millions Prize Variance	775,906
Commissions and Bonuses	41,640,942
Cost of Tickets & Vendor Fees	11,048,025
Operating Expenses	28,522,338
Total Expenses per Statement of Revenues, Expenses and Changes in Net Assets	423,851,556
Plus: Powerball Prize Variance classified as revenue	12,366,532
Mega Millions Prize Variance classified as revenue	1,672,507
Telecommunications offset classified as revenue	772,900
Less: Non-appropriated expenses	
Depreciation	(1,048,886)
Accrued Annual and Sick Leave	(30,116)
Loss on disposition of equipment	(34,093)
Sub-Total	437,550,400
Plus: Capitalized purchases	132,792
	437,683,192

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

Members of the Legislative Audit Committee:

We have audited the financial statements of the major fund and remaining fund information of the Colorado Lottery (the Lottery), an enterprise fund and private purpose fund of the State of Colorado as of and for the year ended June 30, 2012, which collectively comprise the Lottery's basic financial statements and have issued our report thereon dated September 24, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

Management of the Lottery is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Lottery's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Lottery'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.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Lottery's financial statements are free of 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*.

We noted a certain matter that we reported to management of the Lottery described as Recommendation Number 1 in the Auditor's Finding and Recommendation section of the report.

This report is intended solely for the information and use of management, the State of Colorado Legislative Audit Committee, others within the entity, and the Lottery Commission, and is not intended to be and should not be used by anyone other than these specified parties.

CliftonLarsonAllen LLP

Greenwood Village, Colorado
September 24, 2012

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www.cliftonlarsonallen.com

Independent Auditor's
Required Communications to the Legislative Audit Committee

September 24, 2012

Members of the Legislative Audit Committee:

This letter is to provide you with information about significant matters related to our audit of the financial statements of the Colorado Lottery for the year ended June 30, 2012. It is intended solely for the members of the Legislative Audit Committee and should not be used by anyone other than this specified party.

The following are our observations arising from the audit that are relevant to your responsibilities in overseeing the financial reporting process.

Auditor's Responsibilities under Generally Accepted Auditing Standards. Our audit was performed for the purpose of forming and expressing opinions about whether the financial statements, that have been prepared by management with your oversight, are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America. Our audit does not relieve you or management of your responsibilities.

Other Information in Documents Containing Audited Financial Statements. With respect to the supplementary information accompanying the financial statements, we made certain inquiries of management and evaluated the form, content and methods of preparing the information to determine that the information complies with U.S. generally accepted accounting principles, the method of preparing it has not changed from the prior period and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

In connection with the Colorado Lottery's audit, we did not perform any procedures or corroborate other information included in the financial statements. However, we read management's discussion and analysis of financial conditions and results of operations and considered whether the information or the manner in which it was presented was materially inconsistent with information or the manner of presentation of the financial statements. Based on our reading, we concluded that the information did not require revision.

Significant Issues Discussed with Management Prior to Retention. We discuss various matters with management prior to retention as the Colorado Lottery's auditors. These discussions occur in the normal course of our professional relationship. There were no significant issues, including the application of accounting principles and auditing standards, which were discussed with management prior to our retention as auditors.

Consultations with Other Accountants. We were informed by management that they made no consultations with other accountants on the application of generally accepted accounting principles or generally accepted auditing standards.

Qualitative Aspects of Accounting Practices.

Accounting Policies
Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the Colorado Lottery are described in Note 1 to the financial statements. There were no significant accounting policies or their application which were either initially selected or changed during the year.

We noted no transactions in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.

There were no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

Accounting Estimates
Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected.

The following is management's description of the process utilized in forming an estimate for prize expense and corresponding liability.

Prize expense and corresponding liability is calculated based on the anticipated payout approved by the Lottery Commissioners. The prize expense and corresponding liability is incurred as tickets are activated by Lottery approved retailers.

We evaluated the key factors and assumptions used to develop the prize expense and corresponding liability in determining that it is reasonable in relation to the financial statements taken as a whole.

Financial Statement Disclosures
Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. There were no particularly sensitive financial statement disclosures.

Difficulties Encountered in Performing the Audit. We encountered no significant difficulties in dealing with management related to the performance of our audit.

Corrected Misstatements. There were no misstatements detected as a result of audit procedures and corrected by management that were material, either individually or in the aggregate, to the financial statements taken as a whole.

Representations from Management. We have requested and received representations from management.

Disagreements with Management. There were no disagreements with management on financial accounting and reporting matters, auditing procedures, or other matters which would be significant to the Colorado Lottery's financial statements or our report on those financial statements.

Please contact Paul Niedermuller if you have any questions regarding the matters included in this letter.

CliftonLarsonAllen LLP

The electronic version of this report is available on the Web site of the
Office of the State Auditor
www.state.co.us/auditor

A bound report may be obtained by calling the
Office of the State Auditor
303 869-2800

Please refer to the Report Control Number below when requesting this report.

Report Control No. 2114-12