

**AUDIT REPORT  
OF THE  
NEBRASKA LOTTERY**

**JULY 1, 1999 THROUGH JUNE 30, 2000**

NEBRASKA LOTTERY

TABLE OF CONTENTS

|  | <u>Page</u> |
|--|-------------|
| <b>Background Information Section</b>  |             |
| Background   | 1           |
| Mission Statement  | 1           |
| Organizational Chart   | 2           |
| <b>Comments Section</b>  |             |
| Summary of Comments  | 3           |
| Comments and Recommendations   | 4 - 5       |
| <b>Financial Section</b>   |             |
| Independent Auditors' Report   | 6 - 7       |
| Financial Statements:  |             |
| Balance Sheet  | 8           |
| Income Statement   | 9           |
| Statement of Cash Flows  | 10          |
| Notes to Financial Statements  | 11 - 18     |
| <b>Government Auditing Standards Section</b>   |             |
| Report on Compliance and on Internal Control Over<br>Financial Reporting Based on an Audit of Financial<br>Statements Performed in Accordance with<br><u>Government Auditing Standards</u> | 19 - 20     |

# NEBRASKA LOTTERY

## BACKGROUND

The Legislature created the Lottery Division of the Nebraska Department of Revenue in 1991. Nebraska voters passed a constitutional amendment allowing the creation of a state lottery in November 1992, and the Legislature established the State Lottery in 1993. As the 37<sup>th</sup> lottery in the nation, the Nebraska Lottery began scratch ticket sales on September 11, 1993. Sales of on-line products began on July 21, 1994.

The Nebraska Lottery is responsible for contracting for scratch ticket production, on-line equipment, advertising, security, and related services. In addition, the Nebraska Lottery recruits and screens Nebraska Lottery retailers, develops Nebraska Lottery products, and collects Nebraska Lottery revenues.

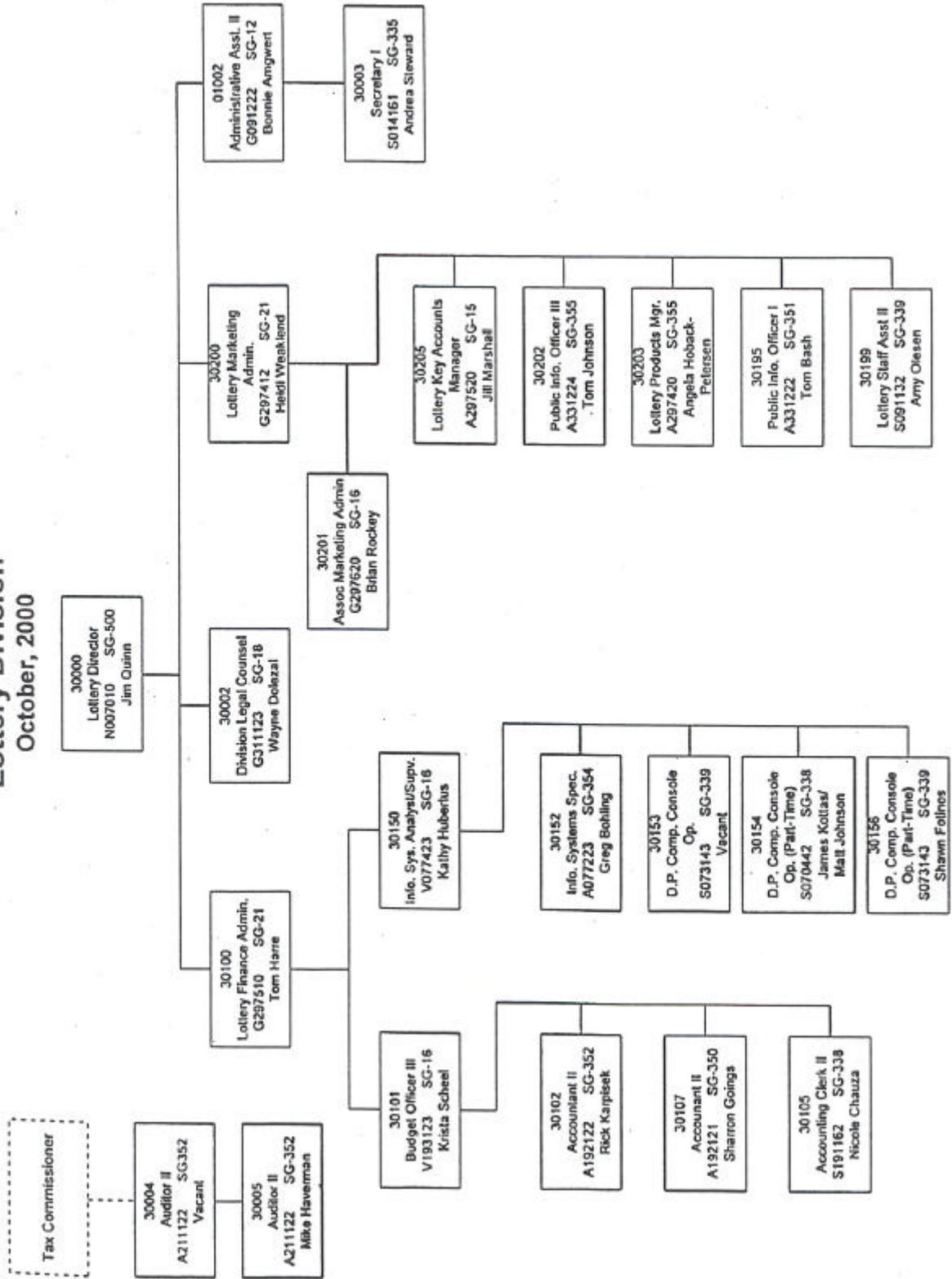
Currently, the Nebraska Lottery offers Powerball®, Pick5®, Rolldown®, and instant games. The Cash 4 Life® game was discontinued in September 2000.

Neb. Rev. Stat. Section 9-812(1) R.S. Supp., 1999 requires not less than forty percent of the dollar amount of lottery tickets sold be used for the payment of prizes. Nebraska Lottery retailers generally receive a five percent commission on their gross sales. Section 9-812(1) provides that at least twenty-five percent of Nebraska Lottery sales be divided among the following funds: (1) Education Innovation Fund (49.5%); (2) Nebraska Environmental Trust Fund (49.5%); and (3) Compulsive Gamblers Assistance Fund (1.0%).

## MISSION STATEMENT

The Nebraska Lottery's mission is to offer winning opportunities to Nebraska citizens while maximizing dollars for Nebraska educational and environmental causes.

# Lottery Division October, 2000



## NEBRASKA LOTTERY

### SUMMARY OF COMMENTS

During our audit of the Nebraska Lottery, we noted certain matters involving the internal control over financial reporting and other operational matters that are presented here. Comments and recommendations are intended to improve the internal control over financial reporting, ensure compliance, or result in operational efficiencies.

1. ***Ticket Inventory:*** There was a variance of 700 tickets, for one of ten games tested, between the number of tickets delivered and omitted according to the instant game computer system and the number of tickets delivered and omitted according to the bill of lading.
2. ***Disaster Recovery Plans:*** GTECH and Scientific Games Intl. did not perform formal testing of their Disaster Recovery Plans.

The Nebraska Lottery had a separate examination completed of the Nebraska Lottery's information systems, including their Instant and On-Line Game Vendor's information systems, by RMS McGladrey, Inc. This report was dated April 14, 2000.

More detailed information on the above items is provided hereafter. It should be noted this report is critical in nature since it contains only our comments and recommendations on the areas noted for improvement.

Draft copies of this report were furnished to the Nebraska Lottery to provide them an opportunity to review the report and to respond to the comments and recommendations included in this report. All formal responses received have been incorporated into this report. Responses have been objectively evaluated and recognized, as appropriate, in the report. Responses that indicate corrective action has been taken were not verified at this time but will be verified in the next audit.

We appreciate the cooperation and courtesy extended to our auditors during the course of the audit.

# NEBRASKA LOTTERY

## COMMENTS AND RECOMMENDATIONS

### 1. Ticket Inventory

Good internal control requires adequate accounting procedures be in place to ensure the number of tickets actually delivered and omitted agrees to the number of tickets shown as delivered and omitted on the computer system.

There were 62 instant games active during fiscal year 2000. Instant tickets are each individually numbered during the printing process. The numbers are consecutive, except some numbers are omitted. Gross tickets can be calculated by using the beginning and ending ticket numbers. Gross tickets less omitted tickets equals tickets delivered.

For one out of ten games tested, we noted there was a variance of 700 tickets between the number of tickets delivered and omitted according to the instant game computer system and the number of tickets delivered and omitted according to the original bill of lading. We also noted the bill of lading was not reconciled to the computer system to ensure the accuracy of ticket numbers loaded onto the computer system.

We recommend procedures be implemented which ensure the number of tickets actually delivered and omitted agrees to the number of tickets entered into the instant game computer system. This could be accomplished by a documented reconciliation of the number of tickets delivered and omitted according to the bill of lading to the number of tickets entered onto the computer system.

**NEBRASKA LOTTERY'S RESPONSE:** SINCE ONLY PHYSICALLY DELIVERED TICKETS CAN BE DISTRIBUTED TO RETAILERS FROM THE NEBRASKA WAREHOUSE AND SINCE ONLY COMPUTER LOADED AND SYSTEM DISTRIBUTED TICKETS CAN BE COMPUTER SYSTEM VALIDATED BY NEBRASKA LOTTERY RETAILERS, THE RECOMMENDED PROCEDURE IS NOT A SECURITY ISSUE BUT AN INVENTORY TRACKING ISSUE. DOCUMENTED RECONCILIATION OF THE NUMBER OF TICKETS DELIVERED AND OMITTED ACCORDING TO THE BILL OF LADING TO THE NUMBER OF TICKETS ENTERED ONTO THE COMPUTER SYSTEM WILL BE COMPLETED FOR ALL FUTURE GAMES.

### 2. Disaster Recovery Plans

Good internal control over information systems requires a written Disaster Recovery Plan (DRP) be maintained for essential information systems. This plan should be tested and updated on a regular basis to ensure it is adequate to facilitate recovery from a disaster.

During our audit, we noted there were three separate information systems which are critical to the Nebraska Lottery's operations. These include information systems for the Nebraska Lottery, GTECH (on-line game vendor), and Scientific Games, Intl. (instant ticket vendor). Based on our review of system documentation and DRP's, we noted the following:

# NEBRASKA LOTTERY

## COMMENTS AND RECOMMENDATIONS

### 2. Disaster Recovery Plans (Concluded)

#### GTECH

No formal testing of the GTECH DRP had been completed, and the DRP did not address testing of the plan or plan maintenance.

#### Scientific Games

No formal testing of the Scientific Games, Intl. DRP had been completed, and the DRP did not address plan maintenance.

This was a comment in a prior report.

We recommend GTECH test its disaster recovery plan, develop plan maintenance procedures, and perform plan maintenance procedures. We recommend Scientific Games Intl. test its disaster recovery plan, develop plan maintenance procedures, and perform plan maintenance procedures.

**NEBRASKA LOTTERY'S RESPONSE:** THE NEBRASKA LOTTERY HAS AWARDED THE INSTANT TICKET CONTRACT TO GTECH WITH AN EFFECTIVE DATE OF JULY 1, 2001. EMPHASIS WILL BE PLACED ON WORKING WITH GTECH TO DEVELOP, TEST AND MAINTAIN A DISASTER RECOVERY PLAN THAT COVERS BOTH INSTANT AND ON-LINE SYSTEMS.

STATE OF NEBRASKA  
Auditor of Public Accounts



**Kate Witek**  
State Auditor  
kwitek05@nol.org

P.O. Box 98917  
Suite 2303, State Capitol  
Lincoln, NE 68509  
402-471-2111, FAX 402-471-3301

NEBRASKA LOTTERY

**INDEPENDENT AUDITORS' REPORT**

We have audited the accompanying financial statements of the Nebraska Lottery as of and for the fiscal year ended June 30, 2000, as listed in the Table of Contents. These financial statements are the responsibility of the Nebraska Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards 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 audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Nebraska Lottery, a division of the Nebraska Department of Revenue, and are not intended to present fairly the financial position, results of operations and cash flows of the Nebraska Department of Revenue, in conformity with generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Nebraska Lottery as of June 30, 2000, and the results of its operations and cash flows for the year then ended in conformity with generally accepted accounting principles.

In accordance with Government Auditing Standards, we have also issued our report dated October 4, 2000 on our consideration of Nebraska Lottery's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. The report on compliance and on internal control over financial reporting is an integral part of a Government Auditing Standards audit and should be considered in conjunction with the report on the financial statements.

Handwritten signature of Timothy J. Chamber CPA in cursive script.

Manager

October 4, 2000

NEBRASKA LOTTERY  
**BALANCE SHEET**  
June 30, 2000

**ASSETS:**

**CURRENT ASSETS**

|                              |  |                |
|------------------------------|--|----------------|
| Cash and Cash Equivalents    |  | \$ 11,263,879  |
| Accounts Receivable (Note 3) |  | 3,465,197      |
| Prepaid Prizes               |  | <u>184,846</u> |

**TOTAL CURRENT ASSETS** 14,913,922

**RESTRICTED ASSETS**

|                              |  |                  |
|------------------------------|--|------------------|
| Reserves on Deposit (Note 6) |  | <u>2,796,229</u> |
|------------------------------|--|------------------|

**FIXED ASSETS**

|   |                |  |
|---|----------------|--|
| Furniture, Fixtures, and Equipment (Note 2) | 348,229        |  |
| Less: Accumulated Depreciation              | <u>256,551</u> |  |

**FIXED ASSETS, NET** 91,678

**TOTAL ASSETS** \$ 17,801,829

**LIABILITIES**

**CURRENT LIABILITIES**

|                               |  |               |
|-------------------------------|--|---------------|
| Accounts Payable              |  | \$ 411,753    |
| Vendors Payable               |  | 847,258       |
| Compensated Absences Payable  |  | 108,796       |
| Accrued Payroll Payable       |  | 44,466        |
| Withheld Taxes on Prizes Paid |  | 80,480        |
| Prizes Payable                |  | 4,674,093     |
| Due to Other Funds            |  | 3,000,511     |
| Other Accrued Liabilities     |  | <u>93,304</u> |

**TOTAL CURRENT LIABILITIES** 9,260,661

**TOTAL LIABILITIES** 9,260,661

**RETAINED EARNINGS**

|                           |                  |  |
|---------------------------|------------------|--|
| Reserve for Future Prizes | 2,796,229        |  |
| Unreserved (Note 8)       | <u>5,744,939</u> |  |

**TOTAL RETAINED EARNINGS** 8,541,168

**TOTAL LIABILITIES AND FUND EQUITY** \$ 17,801,829

The accompanying notes to the Financial Statements are an integral part of this statement.

NEBRASKA LOTTERY  
**INCOME STATEMENT**  
For the Year Ended June 30, 2000

**OPERATING REVENUE**

|                                |  |                   |
|--------------------------------|--|-------------------|
| Sales                          |  | \$ 69,582,587     |
| Less: Sales Returns            |  | <u>1,412,107</u>  |
| <b>TOTAL OPERATING REVENUE</b> |  | <b>68,170,480</b> |

**OPERATING EXPENSES**

|                                 |                  |                          |
|---------------------------------|------------------|--------------------------|
| Prize Expense                   | 36,850,024       |                          |
| Retailer Commissions            | 4,686,492        |                          |
| Contractual Services Expense    | 7,169,299        |                          |
| Marketing                       | 2,658,761        |                          |
| Lottery Operating               | <u>1,707,439</u> |                          |
| <b>TOTAL OPERATING EXPENSES</b> |                  | <b><u>53,072,015</u></b> |

**OPERATING INCOME**

15,098,465

**NON-OPERATING INCOME**

|  |                |                       |
|--|----------------|-----------------------|
| Interest Income                        | 723,841        |                       |
| Multi-State Lottery Association Income | <u>272,221</u> |                       |
| <b>TOTAL NON-OPERATING INCOME</b>      |                | <b><u>996,062</u></b> |

**NET INCOME BEFORE OPERATING TRANSFERS**

16,094,527

**TRANSFERS TO OTHER FUNDS**

(17,042,620)

**NET INCOME**

(948,093)

**RETAINED EARNINGS, BEGINNING OF YEAR**

|                        |                |                  |
|------------------------|----------------|------------------|
| As Previously Reported | 8,931,184      |                  |
| Adjustments (Note 9)   | <u>558,077</u> |                  |
| As Restated            |                | <u>9,489,261</u> |

**RETAINED EARNINGS, END OF YEAR**

\$ 8,541,168

The accompanying notes to the financial Statements are an integral part of this statement.

NEBRASKA LOTTERY  
**STATEMENT OF CASH FLOWS**  
 FOR THE YEAR ENDED JUNE 30, 2000

**OPERATING ACTIVITIES:**

|  |                 |            |
|--|-----------------|------------|
| Ticket Sales                                     | \$ 69,059,055   |            |
| Prizes Paid to Winners                           | (37,619,001)    |            |
| Commissions Paid to Retailers                    | (4,689,205)     |            |
| Paid to Contractors for Goods and Services       | (11,524,257)    |            |
| Paid to Employees                                | (1,137,795)     |            |
| Other Operating Expenses                         | (656,477)       |            |
| POWERBALL® Grand Prize Winner Receipts from MUSL | 8,810,202       |            |
| Payments to POWERBALL® Grand Prize Winners       | (8,810,202)     |            |
| Reserves on Deposit                              | 94,576          |            |
| Advances for Vendors                             | 63,033          |            |
| Prepaid Prize Expense                            | <u>(19,837)</u> |            |
| Net Cash Provided by Operating Activities        |                 | 13,570,092 |

**NON-CAPITAL FINANCING ACTIVITIES:**

|  |                  |              |
|--|------------------|--------------|
| Paid to Education Innovation Fund                | (8,854,331)      |              |
| Paid to Environmental Trust Fund                 | (6,511,925)      |              |
| Paid to Compulsive Gamblers Assistance Fund      | <u>(178,875)</u> |              |
| Net Cash Used in Noncapital Financing Activities |                  | (15,545,131) |

**CAPITAL AND RELATED FINANCING ACTIVITIES:**

|                                    |  |          |
|------------------------------------|--|----------|
| Purchase of Property and Equipment |  | (28,849) |
|------------------------------------|--|----------|

**INVESTING ACTIVITIES:**

|  |                |                |
|--|----------------|----------------|
| Interest on Cash                           | 723,840        |                |
| Multi-State Lottery Association Income     | <u>101,887</u> |                |
| Net Cash Provided by Investment Activities |                | <u>825,727</u> |

**NET INCREASE IN CASH AND CASH EQUIVALENTS**

(1,178,161)

**CASH AT BEGINNING OF YEAR**

12,442,039

**CASH AT END OF YEAR**

\$ 11,263,878

**RECONCILIATION OF INCOME FROM OPERATIONS TO NET CASH PROVIDED BY OPERATING ACTIVITIES:**

|   |  |                             |
|---|--|-----------------------------|
| Income from Operations  |  | \$ 15,098,465               |
| Adjustments to Reconcile Income from Operations to Net Cash Provided by Operating Activities: |  |                             |
| Reserves on Deposit   |  | 94,576                      |
| Prepaid Prize Expense   |  | (19,837)                    |
| Advances for Vendors  |  | 63,033                      |
| Depreciation  |  | 51,085                      |
| Changes in Assets and Liabilities:  |  |                             |
| (Increase) Decrease in:   |  |                             |
| Accounts Receivable   |  | 828,199                     |
| Advance Sales   |  | 24,575                      |
| Accounts Payable and Accrued Liabilities  |  | (2,683,976)                 |
| Prizes Payable  |  | 90,802                      |
| Compensated Absences Payable  |  | <u>23,170</u>               |
| Net Cash Provided by Operating Activities   |  | <u><u>\$ 13,570,092</u></u> |

The accompanying Notes to Financial Statements are an integral part of this statement.

# NEBRASKA LOTTERY

## NOTES TO FINANCIAL STATEMENTS

For the Fiscal Year Ended June 30, 2000

### 1. Summary of Significant Accounting Policies

#### A. Basis of Presentation

The accompanying financial statements of the Nebraska Lottery have been prepared in conformance with generally accepted accounting principles (GAAP) as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

The financial statements have been prepared primarily from data maintained by the Nebraska Lottery on computer systems provided by the instant and on-line games vendors, and from accounts maintained by the State Accounting Administrator of the Department of Administrative Services.

#### B. Reporting Entity

The Nebraska Lottery was established on February 24, 1993, by the Nebraska Legislature as a division of the Nebraska Department of Revenue which is a State agency established under and governed by the laws of the State of Nebraska. As such, the Nebraska Lottery is exempt from State and Federal income taxes. The Nebraska Lottery is to provide an instant win and a random number selection on-line lottery. The net proceeds as outlined in State Statute Section 9-812, R.S. Supp., 1999 are to be used for education, the environment, and compulsive gamblers assistance. The financial statements include only the Nebraska Lottery and are not intended to present the financial position of the Nebraska Department of Revenue or the results of operations and changes in fund balance of the Department as a whole. The Nebraska Department of Revenue is part of the primary government for the State of Nebraska.

The Nebraska Lottery has also considered all potential component units for which it is financially accountable, and other organizations which are fiscally dependent on the Nebraska Lottery, or the significance of their relationship with the Nebraska Lottery are such that exclusion would be misleading or incomplete. The Governmental Accounting Standards Board has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body and (1) the ability of the Nebraska Lottery to impose its will on that organization or (2) the potential for the organization to provide specific benefits to, or impose specific burdens on the Nebraska Lottery. No component units were identified.

# NEBRASKA LOTTERY

## NOTES TO FINANCIAL STATEMENTS

(Continued)

### 1. Summary of Significant Accounting Policies (Continued)

#### C. Basis of Accounting

Basis of accounting refers to when revenues and expenses are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of the measurements made, regardless of the measurement focus applied.

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. The Nebraska Lottery is accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operation of the Nebraska Lottery are included on the balance sheet. Fund equity (i.e., net total assets) is segregated into contributed capital and retained earnings components. The Nebraska Lottery's operating statements present increases (e.g., revenues) and decreases (e.g., expenses) in net total assets.

The Nebraska Lottery is accounted for using the accrual basis of accounting. Revenues are recognized when they are earned and expenses are recognized when they are incurred. Instant ticket revenue is recognized when tickets are sold to the retailer and on-line revenue is recognized after the drawing is completed for the respective wagers. A 5% retailer commission and prize expense are recognized at the same time. Revenues from the sale of on-line tickets for future drawings and the related agent commission and prize expense are deferred until the drawings are held.

Prize expense is recognized in the same period that ticket revenue is recognized based on the predetermined prize structure for each game. Since the instant prize winning tickets are randomly distributed throughout the tickets and since some winning tickets will be lost, destroyed or unredeemed for other reasons, there will be differences between amounts accrued and the amounts actually paid. These differences, denoted as unclaimed prizes, are recognized as a reduction of prize expense 181 days after the end of each instant game and 181 days after each draw for on-line games as prizes unclaimed for 180 days expire.

In September 1993, the Governmental Accounting Standards Board (GASB) issued Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting." This Statement is effective for financial statement periods beginning after December 15, 1993. As permitted by the Statement, the Lottery has elected not to adopt Financial Accounting Standards Board (FASB) statements and interpretations issued after November 30, 1989, unless the GASB specifically adopts such FASB statements or interpretations.

NEBRASKA LOTTERY

NOTES TO FINANCIAL STATEMENTS

(Continued)

**1. Summary of Significant Accounting Policies (Continued)**

D. Fund Accounting

The activities of the Nebraska Lottery are accounted for as an enterprise fund. Enterprise funds are used to account for governmental operations that are financed and operated in a manner similar to private business enterprises and where the governing body has decided that periodic determination of revenues earned, expenses incurred and net income is appropriate.

E. Cash

All cash is held by the Nebraska State Treasurer. These funds are held in pooled accounts and accordingly are not categorized as to credit risk as defined by Statement 3 of the Governmental Accounting Standards Board. Investment of all available cash is made by the State Investment Officer on a daily basis based on total bank balances. Interest on funds held by the State Treasurer is periodically distributed to the participating agencies. These funds are considered to be cash and cash equivalents, which are defined as investments with maturities of three months or less.

F. Budgetary Process

The state's biennial budget cycle ends on June 30 of the odd-numbered years. By September 15, prior to a biennium, the Nebraska Lottery and all other State agencies must submit their budget request for the biennium beginning the following July 1. The requests are submitted on forms that show estimated funding requirements by programs, sub-programs, and activities. The Governor's office reviews the requests, establishes priorities, and balances the budget within the estimated resources available during the upcoming biennium. The Governor's budget bill is submitted to the Legislature in January. The Legislature considers revisions to the bill and submits the revised appropriation bill to the Governor for signature. The Governor can either: a) approve the appropriation bill in its entirety, b) veto the bill, or c) line item veto certain sections of the bill. Any vetoed bill or line item can be overridden by a three-fifths majority of the Legislature.

The appropriations that are approved will generally set spending limits for a particular program. Within the program, the Legislature may provide funding from one or more budgetary fund types. Thus, the legal level of control is fund type, within program, within the agency. The central accounting system maintains this control. A separate publication titled "Annual Budgetary Report" shows the detail of this legal level of control. The publication is available from the Department of Administrative Services Accounting Division.

NEBRASKA LOTTERY

NOTES TO FINANCIAL STATEMENTS

(Continued)

**1. Summary of Significant Accounting Policies (Concluded)**

All State Budgetary expenditures for the enterprise fund type are made pursuant to the appropriations in the annual budget, as amended from time to time by budget amendments. The Tax Commissioner may allocate the appropriations between the major object of expenditure accounts except that the Legislature's approval is required to exceed the personal service limitations contained in the appropriations bill.

G. Compensated Employee Absences

All permanent employees earn sick and annual leave and are allowed to accumulate compensatory leave rather than being paid overtime. Temporary and intermittent employees are not eligible for paid leave. State employees accrue vested annual leave at a variable rate based on years of service. Generally accrued annual leave cannot exceed 35 days at the end of a calendar year. Employees accrue sick leave at a variable rate based on years of service. In general, accrued sick leave cannot exceed 180 days. Sick leave is not vested except upon death or upon reaching the retirement age of 55, at which time the State is liable for 25 percent of the employees accumulated sick leave. In accordance with GASB 16, the compensated absence liability is increased for accumulated sick leave for employees who are expected to become eligible in the future.

The Nebraska Lottery recognizes the expense and accrued liability when vacation and sick leave are expected to be paid as termination payments.

**2. Fixed Assets**

A summary of the activity in the fixed assets accounts during the period July 1, 1999 through June 30, 2000 is as follows:

|                                     |                  |
|-------------------------------------|------------------|
| Balance as of July 1, 1999          | \$ 450,221       |
| Additions Fiscal 1999/2000          | 28,849           |
| Removals Fiscal 1999/2000           | (130,841)        |
| Less Prior Accumulated Depreciation | (206,032)        |
| Less Current Depreciation           | <u>(50,519)</u>  |
| Balance June 30, 2000               | <u>\$ 91,678</u> |

NEBRASKA LOTTERY

NOTES TO FINANCIAL STATEMENTS

(Continued)

2. **Fixed Assets (Concluded)**

Fixed assets acquired or constructed for the Lottery and costing in excess of \$500 were capitalized and depreciated. Assets costing \$500 or less were expensed in the period purchased. Depreciation of equipment is provided using the straight-line method over a period of three to seven years depending on the estimated useful life of individual items.

3. **Accounts Receivable**

Retailers comprised principally of grocery stores, convenience stores and off sale liquor stores serve as the primary distribution channel for lottery sales to the general public. No one retailer accounts for a significant amount of the Lottery's sales or accounts receivable. Unless an accelerated payment plan for a specific retailer is in place, retailers must pay for instant lottery tickets either two weeks after delivery under one option or at 45 days after delivery or when pack is 75% sold whichever comes first under a second option. Retailers pay for on-line tickets each Wednesday for balances due through the previous Saturday.

|                      |                     |
|----------------------|---------------------|
| Accounts Receivable: |                     |
| Retailers(net)       | \$ 2,866,281        |
| Other                | 598,916             |
| Total                | <u>\$ 3,465,197</u> |

4. **State Employees Retirement System**

The Retirement System for State Agencies is a single-employer defined contribution plan administered by the Public Employees Retirement Board in accordance with the provisions of the State Employees Retirement Act. In the defined contribution plan, retirement benefits depend upon total contributions, age at retirement, investment earnings, and the investment options selected. Membership in the System is required of all permanent full-time employees on reaching the age of thirty and completion of twenty-four months of continuous service and voluntary participation is permitted of all full-time or part-time employees upon reaching age twenty and twelve months of service within a five year period, except any individual appointed by the Governor may elect not to become a member of the retirement system. The plan provisions are established under State Statute and may be amended through legislative action.

Employees contributed 4.33% of their compensation until such time as they have paid during any calendar year a total of \$864, after which time they contribute 4.8% of their compensation for the remainder of the calendar year. The Nebraska Lottery matches the employee's contribution at a rate of 156% of the employee's contribution. The contribution rates are established by State

NEBRASKA LOTTERY

NOTES TO FINANCIAL STATEMENTS

(Continued)

**4. State Employees Retirement System (Concluded)**

Statute and may be amended through legislative action. The employee's account is fully vested. The employer's account is vested 100% after five years of participation in the plan or at retirement.

For the Fiscal Year Ended June 30, 2000, employees contributed \$39,364 and the Nebraska Lottery contributed \$61,408.

**5. Risk Management**

The Nebraska Lottery is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; natural disasters; and health care insurance. The Lottery as part of the primary government for the State participates in the State's risk management program. The Nebraska Department of Administrative Services (DAS) Division of Risk Management is responsible for maintaining the insurance and self insurance programs for the State. The State generally self-insures for general liability and workers compensation. The State has chosen to purchase insurance for:

1. Motor vehicle liability which is insured for the first \$5 million of exposure per accident. Insurance is also purchased for medical payments, physical damage and uninsured and underinsured motorists with various limits and deductibles.
2. Health care insurance for employees selecting certain coverage options. All health care insurance was purchased.
3. Crime coverage with a limit of \$1 million for each loss with a \$10,000 retention per incident.
4. Real and personal property on a blanket basis for losses up to \$250,000,000 with a self-insured retention of \$100,000 per loss occurrence. The perils of Flood and Earthquake are covered up to \$9,000,000. Newly acquired properties are only covered up to \$1,000,000 for 60 days or until the value of the property is reported to the insurance company.

No settlements exceeded commercial insurance coverage in any of the past three fiscal years. Health care insurance is funded in the Risk Management Internal Service Fund through a combination of employee and state contributions. Workers compensation is also funded in the Risk Management Internal Service Fund through assessments on each agency based on total

# NEBRASKA LOTTERY

## NOTES TO FINANCIAL STATEMENTS

(Continued)

### 5. Risk Management (Concluded)

agency payroll and past experience. Tort claims; theft of, damage to and destruction of assets; errors and omissions; and natural disasters would be funded through the State General Fund or by individual agency assessments as directed by the Legislature, unless covered by purchased insurance. No amounts for estimated claims have been reported in the Nebraska Lottery's financial statements.

**Litigation.** The potential amount of liability involved in litigation pending against the Lottery, if any, could not be determined at this time. However, it is the Lottery's opinion that final settlement of those matters should not have an adverse effect on the Lottery's ability to administer current programs. Any judgment against the Lottery would have to be processed through the State Claims Board and be approved by the Legislature.

### 6. On-Line Games

During the fiscal year ending June 30, 2000, The Nebraska Lottery offered a variety of on-line games as described in the following table.

| <u>Game Name</u> | <u>Operated by</u> | <u>Nebraska's Share of Prize Reserves</u> |
|------------------|--------------------|---|
| POWERBALL®       | MUSL               | \$2,433,691                               |
| NEBRASKA PICK 5® | Nebraska Lottery   | n/a                                       |
| CASH 4 LIFE®     | MUSL               | \$362,538                                 |

The Nebraska Lottery is a member of the Multi-State Lottery Association (MUSL) which operates games on behalf of participating state lotteries. Each MUSL member sells on-line game tickets through its agents and makes weekly payments to MUSL in an amount equal to each game's prize structure, less amounts retained for prizes paid directly to the winners by each member lottery. MUSL maintains prize reserve funds on each game to serve as a contingency reserve to protect from unforeseen prize liabilities. The money in these reserve funds are to be used at the discretion of the MUSL Board of Directors. The prize reserve funds are refundable to MUSL members if MUSL disbands or if a member leaves MUSL. Members leaving MUSL must wait one year before receiving their remaining share of the prize reserve funds.

The Powerball grand prize can be paid either as annual installments or a lump sum cash payment, depending on the selection of the winner when claiming the prize. If the winner selects annual installments, MUSL purchases bonds which are held in trust to fund the future installments. Maturities are staggered in order to provide adequate cash flow for each installment. MUSL is responsible for paying amounts owed to the grand prize winners. The assets and related liabilities are reflected in MUSL's financial statements and, therefore, are not reflected in the Nebraska Lottery's financial statements.

NEBRASKA LOTTERY

NOTES TO FINANCIAL STATEMENTS

(Continued)

**7. Significant Compliance Requirements**

Neb. Rev. Stat. Section 9-812 R.S. Supp., 1999 requires at least twenty-five percent of the dollar amount of lottery tickets which have been sold on an annualized basis to be transferred to the beneficiary funds. Of the money remaining after the payment of prizes and operating expenses forty-nine and one-half percent shall be transferred to the Education Innovation Fund, forty-nine and one-half percent shall be transferred to the Nebraska Environmental Trust Fund, and one percent shall be transferred to the Compulsive Gamblers Assistance Fund.

The Lottery develops game structures to comply with the minimum prize provision of its enabling legislation which requires a minimum of forty percent must be paid in prizes. Prizes are redeemable for 180 days after game end or applicable on-line drawing.

The Nebraska Lottery compares the social security number of each winner that has a per wager prize in excess of \$500 against a list of social security numbers having an outstanding state tax liability or delinquent child support payments. Any delinquent payments are withheld from winnings and forwarded to the appropriate state agency. During the fiscal year the Nebraska Lottery collected \$3,911 in delinquent state taxes and \$24,709 in delinquent child support payments.

As required under its enabling legislation, transfers of \$15,545,132 have been made to other funds during the fiscal year. In addition to the above transfers, \$2,984,958 has been accrued as a current liability, Due to Other Funds, and will be included in future distributions.

Operating Transfers In/Out will not balance and Due To/From Other Funds will not balance, within the Nebraska Lottery's financial statements, as the Nebraska Lottery only represents part of the State's primary government.

**8. Retained Earnings**

The Nebraska Lottery's unreserved retained earnings represent funds not legally restricted for any specific purpose. The funds, however, may only be used to fund additional prize pay-outs, transfers to the beneficiary funds, or additional operating expenses of the Nebraska Lottery. It is management's intention to use the Retained Earnings to fund additional prize pay-outs, retailer incentives, and other game enhancements.

**9. Prior Period Adjustment**

The balance of retained earnings at June 30, 1999 has been restated from amounts previously reported in order to reflect the corrected calculation of prize expense for instant ticket games for the fiscal year ended June 30, 1999. This prior period adjustment would increase the year ending June 30, 1999 net income by \$558,077.

STATE OF NEBRASKA  
Auditor of Public Accounts



Kate Witek  
State Auditor  
kwitek05@nol.org

P.O. Box 98917  
Suite 2303, State Capitol  
Lincoln, NE 68509  
402-471-2111, FAX 402-471-3301

NEBRASKA LOTTERY  
**REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL  
REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED  
IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

We have audited the financial statements of the Nebraska Lottery as of and for the year ended June 30, 2000, and have issued our report thereon dated October 4, 2000. The report was modified to emphasize that the financial statements present only the funds of the Nebraska Lottery. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Nebraska Lottery's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, 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 that are required to be reported under Government Auditing Standards.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Nebraska Lottery's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that

misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that we have reported to the management of Nebraska Lottery in the Comments Section of this report as Comment Number 1 (Ticket Inventory) and Comment Number 2 (Disaster Recovery Plans).

This report is intended solely for the information and use of the Department, the appropriate Federal and regulatory agencies and citizens of the State of Nebraska and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink that reads "Timothy J. Chamber CPA". The signature is written in a cursive style with a large initial 'T'.

Manager

October 4, 2000