

**AUDIT REPORT  
OF THE  
NEBRASKA LOTTERY**

**JULY 1, 2003 THROUGH JUNE 30, 2004**

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**Issued on October 15, 2004**

# NEBRASKA LOTTERY

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## **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®, 2by2®, and instant games.

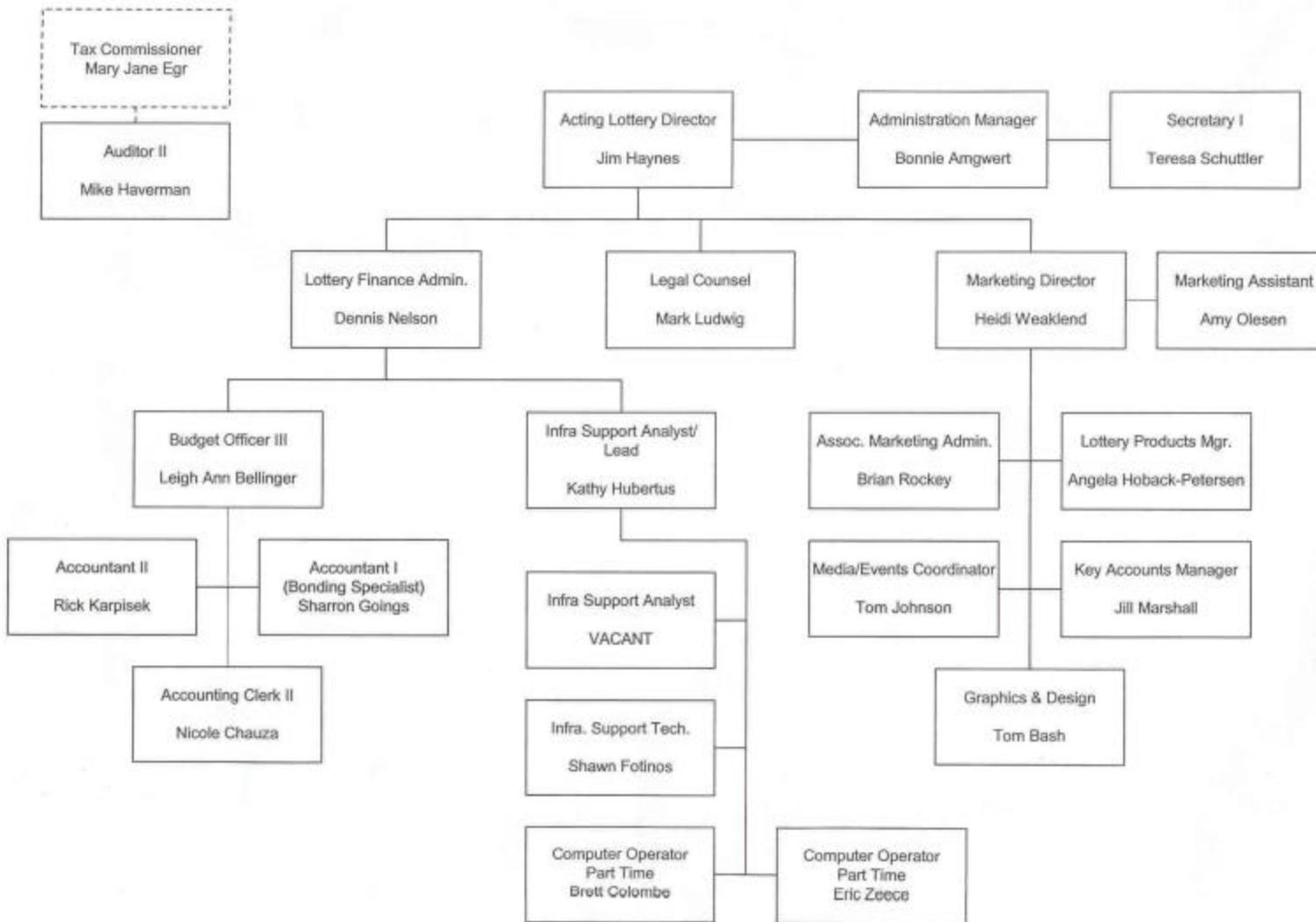
Neb. Rev. Stat. Section 9-812 R.S.Supp., 2003 requires until October 1, 2003, at least twenty-five percent and beginning October 1, 2003, and until January 1, 2008, a portion of the dollar amount of the lottery tickets, which have been sold, on an annualized basis to be transferred to the beneficiary funds, except that the dollar amount transferred shall not be less than the dollar amount transferred to the funds in fiscal year 2003. Of the money remaining after the payment of prizes and operating expenses; the first five hundred thousand dollars shall be transferred to the Compulsive Gamblers Assistance Fund. Thereafter, twenty-four and three-fourths percent shall be transferred to the Education Innovation Fund, twenty-four and three-fourths percent shall be transferred to the Nebraska Scholarship Fund, forty-nine and one-half percent shall be transferred to the Nebraska Environment Trust Fund, and one percent shall be transferred to the Compulsive Gamblers Assistance Fund.

### **MISSION STATEMENT**

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

# NEBRASKA LOTTERY

## ORGANIZATIONAL CHART



**NEBRASKA LOTTERY**

**EXIT CONFERENCE**

An exit conference was held September 30, 2004 with the Nebraska Lottery to discuss the results of our examination. Those in attendance for the Nebraska Lottery were:

<b>NAME</b>	<b>TITLE</b>
James M. Haynes	Acting Lottery Director
Dennis Nelson	Finance Administrator

## 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 which are presented here. Comments and recommendations are intended to improve the internal control over financial reporting, ensure compliance, or result in operational efficiencies.

1. ***Nebraska Information System and Accounting Procedures:*** Significant concerns or areas where improvement to the Nebraska Information System (NIS) and related accounting procedures were needed to ensure NIS integrity and operational efficiency.
2. ***Premium Items Inventory:*** During our review we noted the Nebraska Lottery did not have comprehensive policies and procedures to ensure inventory for premium items was adequately accounted for and safeguarded. Nebraska Lottery spent a total of \$338,077 for premium items for the fiscal year ended June 30, 2004.
3. ***Travel Expense – Lodging:*** Our review noted lodging for one of seven applicable documents contained lodging that was unreasonable based on DAS Travel Expense Policy and five employees exceeded the maximum Federal per diem amount for lodging of \$63 per day by \$16 each when traveling to Omaha, Nebraska.

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. Where no response has been included, the Nebraska Lottery declined to respond. 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. Nebraska Information System and Accounting Procedures**

Good internal control requires a plan of organization, procedures, and records designed to safeguard assets and provide reliable financial records. Without adequate training, written procedures, and controls, there is a risk that employees may unintentionally corrupt critical data and that errors could occur and go undetected.

During the fiscal year ended June 30, 2003, the State of Nebraska implemented significant components of a new information system called the Nebraska Information System (NIS). Three major components were the Payroll, Fixed Asset, and Financial components, which went live during the fiscal year ended June 30, 2003. During the fiscal year ended June 30, 2004 the Procurement and Employee Self-Service components were partially implemented. NIS affects all Nebraska State agencies.

A consultant hired by the Auditor of Public Accounts (APA) with expertise in studying large computer systems performed a study of NIS processes and controls prior to June 30, 2003. The APA also performed a preliminary examination of internal controls as of June 30, 2003 at all State agencies in July and August of 2003. In addition, while performing examination procedures the APA obtained a further understanding of NIS.

From these studies and examinations, the APA has identified concerns and areas where improvement to NIS is needed. During the fiscal year ended June 30, 2004, the Department of Administrative Services (DAS) Accounting Division addressed some areas of concern previously reported. However, the following are the more significant concerns or areas where improvement is still needed to ensure NIS integrity and operational efficiency:

- a. The reconciliation between the State Treasurer's actual bank statements and records, the Nebraska Accounting System (NAS-the previous accounting system before NIS), NIS accounting records, and the related disposition of reconciling items was not completed for November 2002 through December 2003 in a timely manner. Subsequent to December 2003, the DAS Accounting Division performed some reconciliation procedures. As of July 2004, the June 30, 2003 reconciliation indicates an unknown variance between the bank records and the accounting records of \$3,654,783, with the bank being short compared to the accounting records.

During the fiscal year ended June 30, 2004, DAS Accounting Division began performing a daily reconciliation of activity recorded on NIS compared to the activity recorded in the bank on a limited test basis. For those days tested, the activity recorded on NIS can be reconciled to the activity in the bank. The monthly reconciliations for the months of July 2003 through February 2004 for the fiscal year ended June 30, 2004 have been performed and indicate fluctuations in the variance amounts. The latest monthly reconciliation performed, February 2004, indicates an

## NEBRASKA LOTTERY

### **COMMENTS AND RECOMMENDATIONS**

(Continued)

#### **1. Nebraska Information System and Accounting Procedures (Continued)**

unknown variance between the bank records and the accounting records of \$5,112,201, with the bank being short compared to the accounting records. This variance was provided to us by DAS Accounting Division and its accuracy has not been verified by the APA.

Although some reconciliation procedures have been performed (daily reconciliation of activity going through NIS to the activity recorded through the bank), the monthly reconciliation for the months March 2004 through June 2004 are still in the preliminary stages and are not complete as of July 2004. Complete and timely reconciliation procedures between bank records and accounting records provide control over cash and accurate financial information. The reconciliation procedures should be completed timely and on at least a monthly basis to ensure all financial information is correct in NIS.

- b. During the early implementation months of NIS, DAS Accounting Division did not have a comprehensive written NIS policy and procedures manual available for users. During the fiscal year ended June 30, 2004, DAS Accounting Division made progress in this area and significant policies and procedures can be found by users on the DAS Accounting Division website. However, the APA, after reviewing the old accounting procedures manual, did note some procedures still being performed under those policies that have not been incorporated as NIS policies. We recommend DAS Accounting Division continue to update their NIS policies and procedures to include all policies and procedures in place to help ensure consistent and accurate accounting of the State's financial transactions.
- c. During the early implementation of NIS it was determined the NIS Payroll application was not allocating salaries and benefits appropriately to salaried employees who incur hours that are distributed across multiple business units. This would apply to many State agencies' funds, programs, and grants. During the fiscal year ended June 30, 2004, agencies developed "work around" solutions to this problem, however, there has been no system change to resolve this problem. The "work around" solutions can be very time consuming. We recommend DAS Accounting Division consider obtaining a system change to allocate salaries and benefits appropriately for salaried employees who incur hours that are distributed across multiple business units.
- d. During the first year of NIS implementation an outside consultant noted a detailed analysis had not been performed to determine whether users received adequate training to enable them to appropriately perform their job functions. The APA is not aware of any detailed analysis of user training conducted by the DAS Accounting Division during the fiscal year ended June 30, 2004, but does acknowledge a significant training effort by the DAS Accounting Division during this period. We recommend the DAS Accounting Division continue their training efforts as well as identifying user training needs.

NEBRASKA LOTTERY

**COMMENTS AND RECOMMENDATIONS**

(Continued)

**1. Nebraska Information System and Accounting Procedures (Continued)**

- e. Since the implementation of NIS, DAS Accounting Division has not updated their records retention and disposition schedule with the Records Management Division of the Secretary of State (Secretary of State). The records retention schedule on file with the Secretary of State covers the records under the old accounting system and was last updated in 1986.

Neb. Rev. Stat. Section 84-1207 R.R.S. 1999 states the head of any State agency shall make, and submit to the administrator, (administrator means the State Records Administrator) schedules proposing the length of time each record series warrants retention for administrative, legal, historical or fiscal purposes, after it has been made in or received by the agency, and lists of records in the custody or under the control of the agency which are not needed in the transaction of current business, and do not possess sufficient administrative, legal, historical or fiscal value to warrant their further retention.

Since many of the records (and their titles) are significantly different under NIS than they were under the old accounting system we do not believe the DAS Accounting Division is in compliance with the above statute with the current retention schedule on file with the Secretary of State. In addition, for legal purposes and for good business practices we believe a comprehensive DAS Accounting Division records retention schedule is imperative. We recommend the DAS Accounting Division work with the Secretary of State to develop a comprehensive records retention schedule for all records they maintain.

- f. The payroll component is not designed to promote an effective segregation of duties. We recommend the DAS Accounting Division consider implementing the compensating control as identified in the k. section of this comment.
- g. During the first year of NIS implementation an outside consultant noted access to sensitive General Accounting functions had been provided to individuals who may not require such access as a part of their job responsibilities. Based on our inquiries, DAS Accounting Division management noted, "All critical function access rights have been secured down to the appropriate high level matrix codes." We could not verify the accuracy of this statement as requested information and documentation has not been provided to us.
- h. During the first year of NIS implementation an outside consultant noted the State had not documented or formalized comprehensive information security procedures for NIS. Based on our inquiries, DAS Accounting Division management noted, "The NIS CNC's and the NIS Security team have developed a comprehensive security policy." We could not verify the accuracy of this statement as requested information and documentation has not been provided to us.

## NEBRASKA LOTTERY

### **COMMENTS AND RECOMMENDATIONS**

(Continued)

#### **1. Nebraska Information System and Accounting Procedures (Continued)**

- i. During the first year of NIS implementation an outside consultant noted the State had not implemented a formal, comprehensive business continuity or disaster recovery plan that comprehends both NIS and its supporting infrastructure. Based on our inquiries, DAS Accounting Division management noted, "We have now contracted with an outside vendor for business continuity planning." Documentation provided to us by DAS management indicates the State has a disaster recovery plan, however, it is not complete and the business continuity plan is in the draft stage but has not yet been tested. We recommend the State continue to implement formal, comprehensive business continuity and disaster recovery plans.
- j. The APA reviewed certain data in the NIS address book in July 2004. We noted the following related vendor information:
  1. Duplicate Name and Address – Our review noted a total of 4,435 duplicate records. However, all have different address book numbers.
  2. Duplicate Bank Information – 4,118 vendors had duplicate bank information.
  3. Vendors with no Federal Tax Identification Number (FTIN) in NIS and Vendors with an FTIN of 000000000 – 3,789 vendors either had no FTIN or an FTIN with all zeros. The vendors with zeros as their FTIN were all PW (welfare) vendor types. Out of the 3,789 records 3,408 had no FTIN at all.

When duplicate records are in the NIS address book database there is a greater risk of duplicate payments being made and not being detected and queries of the database for vendor information may not be complete because the queries may not include all vendor information. In addition, when the database does not include FTIN numbers for all vendors there is a greater risk of payments to a fictitious vendor. DAS Accounting Division should correct the database for duplicate records and ensure all vendors included in the database have an FTIN.

- k. DAS Accounting Division payroll procedures require each State agency to certify its payroll for each pay period to ensure payroll is processed accurately and completely. This certification is to be in writing, either through an email or letter to the DAS Accounting Administrator. In our review of the final payroll notification and certification procedures processed in July 2003 and May of 2004 and discussion with DAS Accounting Division personnel, the certification procedures were not always performed. Our review also noted that the DAS Accounting Division did not have a policy on the information that should be included in the written certification. We noted during our testing, when there was a certification, there was no consistency in the information provided by State agencies.

## NEBRASKA LOTTERY

### **COMMENTS AND RECOMMENDATIONS**

(Continued)

#### **1. Nebraska Information System and Accounting Procedures (Concluded)**

DAS Accounting Division should establish a policy on detailing the information to be included in the certification, should ensure all State agencies consistently follow this policy, and ensure all payroll expenditures are certified.

The issues identified above are the responsibility of the DAS Accounting Division and NIS Functional Team as they relate directly to NIS; however, they directly affect all Nebraska State agencies' financial information and must be disclosed in this report. The results of the consultant's study of NIS were communicated in a separate report to DAS, who is responsible for NIS. Letters to each State agency communicated the results of the APA's preliminary examination of internal controls at the State agency level. Additional concerns identified by the APA were communicated to the appropriate State officials.

#### **2. Premium Items Inventory**

The Nebraska Lottery, for the purpose of promoting sales of Lottery games, has an annual budget of 1% of sales for promotion expense. The fiscal year ended June 30, 2004 budget for promotions was \$920,000, and \$350,000 was budgeted for premium items. As of October 2003, the Nebraska Lottery had 168 different premium items in stock. Premium items purchased by the Nebraska Lottery, for example, consist of pens, t-shirts, caps, golf balls, mugs, beach towels, sports bags, tool kits, etc. and vary in cost of a few cents to approximately \$20.00 per item. A total of \$338,077 was spent on premium items for the fiscal year ended June 30, 2004.

Good internal controls require procedures to adequately account for inventory items and have an inventory system that can be relied upon for accuracy.

Our review of the premium items inventory noted the following:

- Nebraska Lottery maintains their premium inventory on a system called POS. During our review we noted the Nebraska Lottery did not have comprehensive policies and procedures to ensure inventory for premium items was adequately accounted for and safeguarded.
- A physical count was taken once during the year. The physical count noted, of the 168 items that were in inventory, 38 items were overstated and 40 items were understated. There was no accurate accountability to reconcile the actual physical inventory amount with the POS inventory amount. No investigation of the differences or approval of the adjustments were made.
- Adjustments were only made to the POS inventory system if the amounts were significant, and according to Nebraska Lottery management this was due to the complexity of the system.

## NEBRASKA LOTTERY

### **COMMENTS AND RECOMMENDATIONS**

(Continued)

#### **2. Premium Items Inventory (Concluded)**

When appropriate internal controls are not maintained over inventory items, there is a greater risk of loss or theft of items.

We recommend the Nebraska Lottery evaluate its policies and procedures regarding premium items to ensure the accuracy of the inventory amount. We further recommend procedures be put in place to guarantee premium items are properly accounted for and distributed.

*Nebraska Lottery's Response: The Nebraska Lottery will continue to evaluate its policies and procedures regarding premium items. The Lottery will also review the current inventory system being used for premium items and will work in conjunction with GTECH to make changes to the system, if appropriate and obtainable.*

#### **3. Travel Expense - Lodging**

In order for lodging to be eligible the Department of Administrative Services (DAS) Nebraska Accounting Manual, Travel Policies states, “The absence must be of such duration that you cannot reasonably leave and return to that location before and after each day’s work . . . a person generally must be more than 60 miles from his or her workplace . . . .” The Nebraska Department of Revenue Policy No. 200 effective October 23, 2003, Section IV, Lodging, page 9 states, “Government rates or the lowest rates available are requested.” The current Federal Per Diem rate for Omaha, Nebraska is \$63 (excluding taxes).

We tested 13 travel expense documents for a total of \$20,805. The Nebraska Lottery had \$76,068 in total travel disbursements for the fiscal year ended June 30, 2004. Of the 13 travel documents tested, seven related directly to lodging expenses. We noted the following related to lodging expenses:

- Lodging for one of seven applicable documents contained lodging that was unreasonable based on DAS Travel Expense Policies. Five individuals stayed overnight in Omaha for the purpose of providing training the following morning. The distance from Lincoln to Omaha is less than 60 miles and could have been driven before and after the day’s work. Per discussion with Nebraska Lottery employees, training began at 9:30 am and the approximate set up time was one hour.
- In addition, for the same document, the five employees also exceeded the maximum Federal per diem amount for lodging of \$63 per day by \$16 each when traveling to Omaha, Nebraska.

NEBRASKA LOTTERY

**COMMENTS AND RECOMMENDATIONS**

(Continued)

**3. Travel Expense – Lodging (Concluded)**

The above travel expenses were not in compliance with DAS and the Department of Revenue policies.

We recommend the Nebraska Lottery follow the State of Nebraska  
DAS and the Department of Revenue travel policies.

*Nebraska Lottery's Response: The Nebraska Lottery believes the lodging expenses noted were justified due to the work involved with providing training to our retailers. The Lottery will continue to review travel needs and expenditures to insure compliance with DAS and Department of Revenue policies.*

# STATE OF NEBRASKA

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### NEBRASKA LOTTERY

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### INDEPENDENT AUDITORS' REPORT

We have audited the accompanying financial statements of the business-type activities of the Nebraska Lottery, as of and for the year ended June 30, 2004, which collectively comprise the Nebraska Lottery's basic financial statements 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 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 our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements of the Nebraska Lottery, a division of the Nebraska Department of Revenue, are intended to present the financial position and changes in financial position of only that portion of the business-type activities of the State that is attributable to the transactions of the Nebraska Lottery. They do not purport to, and do not, present fairly the financial position of the business-type activities of the State of Nebraska as of June 30, 2004, and its changes in financial position for the year 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 business-type activities of the Nebraska Lottery, as of June 30, 2004, and the respective changes in financial position thereof for the year 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 30, 2004, on our consideration of the Nebraska Lottery's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Nebraska Lottery's basic financial statements. The schedules and Management's Discussion and Analysis are presented for purposes of additional analysis and are not a required part of the basic financial statements. The schedules have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole. The Management's Discussion and Analysis has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on it.



September 30, 2004

Assistant Deputy Auditor

## NEBRASKA LOTTERY

### **MANAGEMENT'S DISCUSSION AND ANALYSIS**

This section of the Nebraska Lottery's annual audit presents management's discussion and analysis of the financial performance of the Nebraska Lottery for the fiscal period ended June 30, 2004. This discussion should be read in conjunction with the accompanying financial statements and related notes. The financial statements, notes, and this discussion are the responsibility of the Nebraska Lottery's management.

#### **OVERVIEW OF THE FINANCIAL STATEMENTS**

The Nebraska Legislature established the Nebraska Lottery on February 24, 1993. The Nebraska Lottery is to provide instant win games and on-line random number selection games. The Nebraska Lottery is a division of the Nebraska Department of Revenue and as such, the financial summaries presented here and the related comments are for Nebraska Lottery activities only and do not include the Department of Revenue's activities or statements.

The Nebraska Lottery accounts for its financial transactions 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. The Nebraska Lottery uses the accrual basis of accounting. The annual report includes three financial reports.

1) Statement of Net Assets

This report will show the assets, liabilities, and net assets ("equity") of the Nebraska Lottery as of June 30, 2004. This report is basically the balance sheet for a private business.

2) Statement of Revenues, Expenses, and Changes in Net Assets

This report will show the revenue, expenses, transfers to other funds, and changes in net assets for the year. This report would be similar to an income statement for a private business.

3) Statement of Cash Flows

This report is an analysis of the sources of cash flows into and out of the Nebraska Lottery via external transactions as well as internal transactions.

#### **DISCUSSION OF NET ASSETS**

While reviewing the Summary of Net Assets, it must be compared to the prior year's Net Assets to see the changes in the various classifications. One of the largest asset increases was in the cash balance. The cash balance increased by over \$1 million. Most of this is due to the reallocation of the Nebraska Lottery's reserves that are with the Multi-state Lottery Association (MUSL). This reallocation was done in the prior fiscal year and the refundable portion was classified by the Nebraska Lottery as a current asset. Accordingly, the amount no longer required to be in the reserve was refunded to the Nebraska Lottery (approximately \$795,000) during this year. Also, the Nebraska Lottery requested a partial refund from the unreserved deposit account held by MUSL. This refund was \$200,000.

# NEBRASKA LOTTERY

## MANAGEMENT'S DISCUSSION AND ANALYSIS

(Continued)

As discussed earlier, these transactions increased cash position but in effect lowered other asset accounts such as Current Reserves on Deposits and Accounts Receivable (See Table A).

The other change that appears to be material when comparing this year's financial statements to last year's financial statements is the Accounts Receivable. When reviewing this change, it has been determined to be a timing situation regarding 1) the activation/settlement of scratch tickets sent to retailers, 2) the number of days from the last EFT sweep to the end of the year, and 3) the size of the Powerball® jackpot at June 30, 2003 in comparison to June 30, 2004 (at June 30, 2003, the Powerball® jackpot was \$160 million while the June 30, 2004 Powerball® jackpot was at the set minimum of \$10 million). The large difference in the size of those two jackpots would have a material effect on the sales and related amounts due (higher sales at June 30, 2003 means higher accounts receivable at that same date).

The \$200,000 refund discussed in the cash explanation above also accounts for a portion of the Accounts Receivable change.

**Table A**  
Summary of Net Assets

	FY 2004	FY 2003	Change
<b>CURRENT ASSETS</b>			
Cash and Cash Equivalents	\$ 8,014.088	\$ 6,878.514	\$ 1,135.574
Accounts Receivable	3,207.464	4,561.221	(1,353.757)
Prepaid Prizes and Costs	413.900	342.733	71.167
Reserves on Deposit	-	752.899	(752.899)
<b>RESTRICTED ASSETS</b>			
Reserves on Deposit	1,712.039	1,716.588	(4.549)
<b>FIXED ASSETS</b>			
Furniture, Fixtures, Equipment (Net)	40,631	83,446	(42,815)
<b>TOTAL ASSETS</b>	<u>\$ 13,388,122</u>	<u>\$ 14,335,401</u>	<u>\$ (947,279)</u>
<b>CURRENT LIABILITIES</b>			
Accounts Payable	\$ 1,232.598	\$ 1,573.313	\$ (340.715)
Accrued Payroll Payable	185.667	200.005	(14.338)
Prizes Payable	3,602.222	3,119.281	482.941
Other Liabilities and Payables	<u>915,553</u>	<u>1,197,148</u>	<u>(281,595)</u>
<b>TOTAL LIABILITIES</b>	<u>\$ 5,936,040</u>	<u>\$ 6,089,747</u>	<u>\$ (153,707)</u>
<b>NET ASSETS</b>			
Invested in Capital Assets	\$ 40.631	\$ 83.446	\$ (42.815)
Reserved for Future Prizes	1,712.039	2,469.487	(757.448)
Unreserved Assets	<u>5,699,412</u>	<u>5,692,721</u>	<u>6,691</u>
<b>TOTAL NET ASSETS</b>	<u>\$ 7,452,082</u>	<u>\$ 8,245,654</u>	<u>\$ (793,572)</u>

## NEBRASKA LOTTERY

### **MANAGEMENT'S DISCUSSION AND ANALYSIS**

(Continued)

#### **DISCUSSION OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS**

During this year, the Nebraska Lottery experienced higher than expected sales. Overall, revenues increased by about \$11.6 million. This increase is attributed to about an equal split between instant ticket sales (increased \$5.8 million) and on-line ticket sales (increased \$5.8 million). Without knowing the true intentions of players, Nebraska Lottery believes the instant ticket sales increased due to higher prize payouts (See 1. below) and on-line ticket sales increased due to the number of large Powerball® jackpots (greater than \$100 million) that occurred during the year.

Due to the increased sales, the related prize expense, commission expense, and contractual services expense (payments to Gtech, the instant and on-line provider) increased as well. This can be seen in the Statement of Revenues, Expenses, and Changes in Net Assets (See Table B). Two other factors increased the prize expense and the commission expense.

1. Effective October 1, 2003, the Legislature enacted a statute modification that changed the computation method used to transfer monies to the beneficiary funds. Previously, 25% of gross sales were transferred. Now, the amount transferred is at the discretion of the Nebraska Lottery. The only caveat is that the amount transferred during the year must be at least as much as was transferred for the fiscal year ended June 30, 2003. That amount was \$20,229,702. This provision (called the Hold Harmless clause which will be in effect until January 1, 2008) allows the Nebraska Lottery to increase prize payouts, mainly on instant games.
2. Effective January 1, 2004, the Nebraska Lottery offered additional incentives to the retailers that sell instant tickets. If the retailer agreed, via a contract extension, to follow certain criteria regarding marketing objectives, then that retailer would be allowed an additional 1% commission on the amount of instant tickets purchased for sale.

Table B  
Statement of Revenues, Expenses, and Changes in Net Assets

	FY 2004	FY 2003	Change
<b>REVENUES</b>			
Sales	\$ 94,078,583	\$ 82,228,810	\$ 11,849,773
Sales Returns	(1,469,940)	(1,310,003)	(159,937)
<b>OPERATING REVENUE</b>	<u>92,608,643</u>	<u>80,918,807</u>	<u>\$ 11,689,836</u>
Interest Income	400,646	403,543	(2,897)
Multi-State Lottery Assoc. Income	51,997	102,335	(50,338)
<b>NON-OPERATING REVENUE</b>	<u>452,643</u>	<u>505,878</u>	<u>(53,235)</u>
<b>TOTAL REVENUES</b>	<u>93,061,286</u>	<u>81,424,685</u>	<u>11,636,601</u>

NEBRASKA LOTTERY

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

(Continued)

**EXPENSES**

Prize Expense	52,607,966	42,984,053	9,623,913
Retailer Commissions	5,632,373	4,676,188	956,185
Contractual Services Expense	9,753,242	8,581,560	1,171,682
Marketing Expense	3,400,374	3,367,538	32,836
Lottery Operating Expense	1,870,417	1,846,447	23,970
<b>TOTAL EXPENSES</b>	<b><u>73,264,372</u></b>	<b><u>61,455,786</u></b>	<b><u>11,808,586</u></b>
<b>NET INCOME BEFORE TRANSFERS</b>	<b>19,796,914</b>	<b>19,968,899</b>	<b>(171,985)</b>
<b>TRANSFERS TO OTHER FUNDS</b>	<b><u>(20,590,486)</u></b>	<b><u>(20,229,702)</u></b>	<b><u>(360,784)</u></b>
<b>CHANGE IN NET ASSETS</b>	<b>\$ <u>(793,572)</u></b>	<b>\$ <u>(260,803)</u></b>	<b>\$ <u>(532,769)</u></b>

**OTHER ITEMS OF NOTE**

Effective July 1, 2003, there was another beneficiary fund that the Nebraska Lottery began to include in transfers. In the prior fiscal year, the Nebraska Lottery transferred funds to the Education Innovation Fund, the Environmental Trust Fund, and the Compulsive Gamblers Fund. The new fund is the Nebraska Scholarship Fund. It receives 24.75% of the transfers and the Education Innovation Fund percentage was reduced to 24.75%. The percentages and amounts for the other two funds did not change. Overall, this did not have an effect on the financial statements as the additional transfer made to the “new” fund simply reduced the amount transferred to an “old” fund.

**CONTACTING LOTTERY MANAGEMENT**

This financial report is required as part of GASB 34 and is prepared to provide the readers such as the Legislature, the public, and other interested parties with an overview of the financial results of the Nebraska Lottery's activities. If you have any questions about this report, please contact the Nebraska Lottery at PO Box 98901, Lincoln, NE 68509-8901.

**NEBRASKA LOTTERY**  
**STATEMENT OF NET ASSETS**  
JUNE 30, 2004

**ASSETS:**

**CURRENT ASSETS**

Cash and Cash Equivalents	\$ 8,014,088
Accounts Receivable, Net of Allowance (Note 4)	3,207,464
Prepaid Prizes	240,291
Prepaid Contract Cost-Instant	173,609
<b>TOTAL CURRENT ASSETS</b>	<u>11,635,452</u>

**NONCURRENT ASSETS**

Reserves on Deposit (Note 6)	1,712,039
Furniture, Fixtures, and Equipment (Note 5)	417,965
Less: Accumulated Depreciation	<u>377,334</u>
Capital Assets, Net	40,631
<b>TOTAL NONCURRENT ASSETS</b>	<u>1,752,670</u>
<b>TOTAL ASSETS</b>	<u><u>\$ 13,388,122</u></u>

**LIABILITIES:**

**CURRENT LIABILITIES**

Accounts Payable	\$ 377,763
Vendors Payable	854,835
Compensated Absences Payable	125,461
Accrued Payroll Payable	60,206
Withheld Taxes on Prizes Paid	21,686
Prize Payable	3,602,222
Due to Other Funds	842,270
Other Accrued Liabilities	<u>51,597</u>
<b>TOTAL CURRENT LIABILITIES</b>	<u>5,936,040</u>
<b>TOTAL LIABILITIES</b>	<u><u>\$ 5,936,040</u></u>

**NET ASSETS**

Invested in Capital Assets	\$ 40,631
Restricted for Future Prizes	1,712,039
Unrestricted (Note 8)	<u>5,699,412</u>
<b>TOTAL NET ASSETS</b>	<u><u>\$ 7,452,082</u></u>

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

**NEBRASKA LOTTERY**  
**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS**  
**FOR THE YEAR ENDED JUNE 30, 2004**

**OPERATING REVENUE:**

Sales	\$ 94,078,583
Less: Sales Returns	1,469,940
<b>TOTAL OPERATING REVENUE</b>	<b>92,608,643</b>

**OPERATING EXPENSES:**

Prize Expense	52,607,966
Retailer Commissions	5,632,373
Contractual Services Expense	9,753,242
Marketing	3,400,374
Lottery Operating	<u>1,870,417</u>
<b>TOTAL OPERATING EXPENSES</b>	<b><u>73,264,372</u></b>

<b>OPERATING INCOME</b>	<b>19,344,271</b>
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**NON-OPERATING REVENUE**

Interest Income	400,293
Multi-State Lottery Association Income	51,997
Other Income	<u>353</u>
<b>TOTAL NON-OPERATING REVENUE</b>	<b><u>452,643</u></b>

<b>INCOME BEFORE OPERATING TRANSFERS</b>	<b>19,796,914</b>
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<b>TRANSFERS TO OTHER FUNDS</b>	<b><u>(20,590,486)</u></b>
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<b>CHANGE IN NET ASSETS</b>	<b>(793,572)</b>
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<b>TOTAL NET ASSETS, BEGINNING OF YEAR</b>	<b><u>8,245,654</u></b>
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<b>TOTAL NET ASSETS, END OF YEAR</b>	<b><u>\$ 7,452,082</u></b>
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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, 2004**

**CASH FLOWS FROM OPERATING ACTIVITIES:**

Ticket Sales	\$ 93,585,104
Prizes Paid to Winners	(52,413,039)
Commissions Paid to Retailers	(5,625,168)
Paid to Contractors for Goods and Services	(13,196,950)
Paid to Employees	(1,396,149)
Other Operating Expenses	(371,351)
POWERBALL® Grand Prize Winner Receipts from MUSL	5,030,000
Payments to POWERBALL® Grand Prize Winners	(5,030,000)
Reserves on Deposit	757,449
Advances for Vendors	(39,268)
Prepaid Prize Expense	(72,787)
Net Cash Provided by Operating Activities	21,227,841

**CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES:**

Paid to Education Innovation Fund	(5,283,669)
Paid to Nebraska Scholarship Fund	(4,768,764)
Paid to Environmental Trust Fund	(10,052,433)
Paid to Compulsive Gamblers Assistance Fund	(703,079)
Net Cash Used in Non-Capital Financing Activities	(20,807,945)

**CASH FLOWS FROM CAPITAL AND RELATED  
FINANCING ACTIVITIES:**

Purchase of Property and Equipment	(7,943)
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**CASH FLOWS FROM INVESTING ACTIVITIES:**

Interest on Cash	400,646
Multi-State Lottery Association Income	322,975
Net Cash Provided by Investment Activities	723,621

**NET INCREASE IN CASH AND CASH EQUIVALENTS**

<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</b>	6,878,514
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>	\$ 8,014,088

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

Income from Operations	\$ 19,344,271
Adjustments to Reconcile Income from Operations to Net Cash Provided by Operating Activities:	
Reserves on Deposit	757,449
Prepaid Prize Expense	(72,787)
Advances for Vendors	(39,268)
Depreciation	50,757
Changes in Assets and Liabilities: (Increase) Decrease in:	
Accounts Receivable (Net)	1,120,555
Advance Sales	(62,866)
Accounts Payable and Accrued Liabilities	(338,873)
Prizes Payable	482,941
Compensated Absences Payable	(14,338)
Net Cash Provided by Operating Activities	\$ 21,227,841

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

# NEBRASKA LOTTERY

## NOTES TO THE FINANCIAL STATEMENTS

For the Fiscal Year Ended June 30, 2004

### 1. Summary of Significant Accounting Policies

#### A. Basis of Presentation

The accompanying basic financial statements of the Nebraska Lottery have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to governmental units. As the Nebraska Lottery is a business-type activity, the financial statements are in the format of fund financial statements as required by Governmental Accounting Standards Board (GASB) Statement Number 34. 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 vendor 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 financial statements include all funds of the Nebraska Lottery. The Nebraska Lottery is to provide an instant win and a random number selection on-line lottery. The net proceeds as outlined in Neb. Rev. Stat. Section 9-812 R.S.Supp., 2003, are to be transferred to the Education Innovation Fund, the Nebraska Scholarship Fund, the Nebraska Environmental Trust Fund, and the Compulsive Gamblers Assistance Fund. 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 balances of the Department as a whole. The Nebraska Department of Revenue is part of the primary government for the State of Nebraska's reporting entity.

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 is such that exclusion would be misleading or incomplete. The Governmental Accounting Standards Board (GASB) 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 financial benefits to, or impose specific financial burdens on the Nebraska Lottery.

## NEBRASKA LOTTERY

### **NOTES TO THE FINANCIAL STATEMENTS**

(Continued)

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

These financial statements present the Nebraska Lottery. No component units were identified.

#### **C. Basis of Accounting, Measurement Focus**

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus and 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 Nebraska Lottery financial statements were reported using the economic resources measurement focus and the accrual basis of accounting. With the economic resources measurement focus, all assets and all liabilities associated with the operations are included on the Statement of Net Assets. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Fund equity (i.e., net total assets) is segregated into restricted and unrestricted net assets. The Nebraska Lottery's operating statements present increases (e.g., revenues) and decreases (e.g., expenses) in net total assets.

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% or 6% 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.

Revenues generated from the sale of lottery tickets are reported as operating revenues. Transactions which are capital financing, non-capital financing, or investing related are reported as non-operating revenues. All expenses related to operating the Nebraska Lottery are reported as operating expenses. All other expenses are reported as non-operating expenses.

Prize expense is recognized in the same period 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.

## NEBRASKA LOTTERY

### **NOTES TO THE FINANCIAL STATEMENTS**

(Continued)

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

In September 1993, 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 Nebraska Lottery has elected not to adopt Financial Accounting Standards Board (FASB) statements and interpretations issued after November 30, 1989, unless GASB specifically adopts such FASB statements or interpretations.

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 assets is appropriate.

#### **D. Cash**

Cash primarily represents the cash balance of a fund as reflected on the Nebraska Information System. These funds are held in pooled accounts and accordingly are not categorized as to credit risk as defined by GASB Statement No. 3. Investment of all available cash is made by the State Investment Officer, on a daily basis, based on total bank balances. Investment income is distributed based on the average daily book cash balance of funds designated for investment. 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. Also included in the cash amount is Petty Cash and Deposits with Vendors.

#### **E. 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 requests 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 Executive Branch 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 presents the appropriations bill to the Governor for signature. The Governor may: a) approve the appropriations 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 vote of the Legislature.

## NEBRASKA LOTTERY

### **NOTES TO THE FINANCIAL STATEMENTS**

(Continued)

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

The approved appropriations will generally set spending limits for a particular program within the agency. Within the agency or program, the Legislature may provide funding from one to five budgetary fund types. Thus, the control is by fund type, within a program, within an agency. Appropriations are usually made for each year of the biennium, with unexpended balances being reappropriated at the end of the first year of the biennium. For most appropriations, balances lapse at the end of the biennium.

All State budgetary expenditures for the enterprise fund type are made pursuant to the appropriations, which may be amended by the Legislature, upon approval by the Governor. State agencies may reallocate the appropriations between major objects of expenditure accounts, except that the Legislature's approval is required to exceed the personal service limitations contained in the appropriations bill.

#### **F. Allowance for Uncollectible Amounts**

Estimated allowances for uncollectible amounts are determined based upon past collection experience and current economic conditions.

#### **G. Capital Assets**

Capital assets include equipment which is valued at cost where historical records are available and at estimated historical cost where no historical records exist. Donated Capital assets are valued at their estimated fair market value on the date received. Generally, equipment which has a cost in excess of \$1,500 at the date of acquisition and has an expected useful life of three to seven years is capitalized.

The cost of normal maintenance and repairs that do not add to the value of the asset or extend asset life is not capitalized.

#### **H. Compensated Absences**

All permanent employees working for the Nebraska Lottery 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. The liability has been calculated using the vesting method, in which leave amounts, for both employees who are currently eligible to receive termination payments and other employees who are expected to become eligible in the future to receive such payments upon termination, are included.

## NEBRASKA LOTTERY

### **NOTES TO THE FINANCIAL STATEMENTS**

(Continued)

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

Nebraska Lottery 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. There is no maximum limit on the accumulation of sick leave days for employees under certain labor contracts. Sick leave is not vested except upon death or upon reaching the retirement eligibility age of 55, at which time the State is liable for 25 percent of the employee's accumulated sick leave. Employees under certain labor contracts can only be paid a maximum of 50 days.

The Nebraska Lottery financial statements recognize the expense and accrued liability when vacation and compensatory leave is earned or when sick leave is expected to be paid as termination payments.

#### **I. 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 at fiscal-year-end and revenues and expenditures during the reporting period. Actual results could differ from those estimates.

#### **2. Contingencies and Commitments**

**Risk Management.** The Nebraska Lottery is exposed to various risks of loss related to torts, theft of, damage to, or destruction of assets, errors or omissions, injuries to employees, and natural disasters. The Nebraska 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 with the exception of the health and life insurance programs which are maintained by the DAS Personnel Division. The State generally self-insures for general liability and workers' compensation. The State has chosen to purchase insurance for:

- A. Motor vehicle liability, which is insured for the first \$5 million of exposure per accident with a self-insured retention of \$300,000 per accident, except for accidents involving vehicular pursuit which have a \$1,000,000 self-insured retention per accident. Insurance is also purchased for medical payments, physical damage, and uninsured and underinsured motorists with various limits and deductibles. State agencies have the option to purchase coverage for physical damage to vehicles.

## NEBRASKA LOTTERY

### **NOTES TO THE FINANCIAL STATEMENTS**

(Continued)

#### **2. Contingencies and Commitments (Concluded)**

- B. Health care and life insurance for eligible employees.
- C. Crime coverage, with a limit of \$1 million for each loss, and a \$25,000 self-insured retention per incident.
- D. Real and personal property on a blanket basis for losses up to \$100,000,000, with a self-insured retention of \$200,000 per loss occurrence. Newly acquired properties are covered up to \$1,000,000 for 60 days or until the value of the property is reported to the insurance company. The perils of flood and earthquake are covered up to \$10,000,000. Acts of terrorism are covered up to \$2,500,000 aggregate per year. State agencies have the option to purchase building contents and inland marine coverage.

No settlements exceeded commercial insurance coverage in any of the past three fiscal years. Health care insurance is funded in the Compensation Insurance Trust Fund through a combination of employee and State contributions. Workers' compensation is funded in the Workers' Compensation Internal Service Fund through assessments on each agency based on total agency payroll and past experience. Tort claims, theft of, damage to, or destruction of assets, errors or 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 Nebraska Lottery, if any, could not be determined at this time. However, it is the Nebraska Lottery's opinion that final settlement of those matters should not have an adverse effect on the Nebraska Lottery's ability to administer current programs. Any judgment against the Nebraska Lottery would have to be processed through the State Claims Board and be approved by the Legislature.

#### **3. State Employees Retirement Plan (Plan)**

The single-employer plan became effective by statute on January 1, 1964. Prior to January 1, 2003, the plan consisted of a defined contribution plan that covered State employees. Effective January 1, 2003, a cash balance benefit was added to the State Employees Retirement Act. The cash balance benefit is a type of defined benefit plan. Each member employed and participating in the retirement system prior to January 1, 2003, elected to either continue participation in the defined contribution benefit or begin participation in the cash balance benefit. The defined contribution benefit is closed to new entrants. All new members of the Plan on and after January 1, 2003, become members of the cash balance benefit. The benefits and funding policy of the Plan is established and can only be amended by the Nebraska Legislature.

## NEBRASKA LOTTERY

### **NOTES TO THE FINANCIAL STATEMENTS**

(Continued)

#### **3. State Employees Retirement Plan (Plan) (Concluded)**

All permanent full-time employees who have 12 continuous months of service are required to begin participation in the retirement system. All permanent full-time or permanent part-time employees who have 12 months of service within a five-year period, and who have attained the age of 20, may exercise the option to begin participation in the retirement system.

**Contribution.** Each member contributes 4.33% of his or her monthly compensation until \$864 has been contributed and 4.8% of pay for the rest of the calendar year. The Nebraska Lottery matches the member's contribution at a rate of 156%. The employee's and employer's contributions are kept in separate accounts.

The employee's account is fully vested. The employer's account is vested 100% after a total of three years of participation in the system, including the twelve-month eligibility period or credit for participation in another governmental plan prior to actual contribution to the Plan.

**Defined Contribution Benefit.** Upon attainment of age 55, regardless of service, the retirement allowance shall be equal to the sum of the employee and employer account. Members have several forms of payment available, including withdrawals, deferrals, annuities, or a combination of these.

**Cash Balance Benefit.** Upon attainment of age 55, regardless of service, the retirement allowance shall be equal to the accumulated employee and employer cash balance accounts, including interest credits, annuitized for payment in the normal form. The normal form of payment is a single life annuity with five year certain, payable monthly. Members will have the option to convert their member cash balance account to a monthly annuity with built in cost-of-living adjustments of 2.5% annually. Also available are additional forms of payment allowed under the Plan which are actuarially equivalent to the normal form, including the option of lump-sum or partial lump-sum.

For the fiscal year ended June 30, 2004, employees contributed \$49,421 and the Nebraska Lottery contributed \$77,096. A separate plan report is issued and can be obtained from the Nebraska Public Employees Retirement System. This report contains full pension-related disclosures.

#### **4. Receivables**

Retailers comprised principally of grocery store, 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 Nebraska Lottery's sales or accounts receivable. Retailers must pay for instant lottery tickets 45 days after activation or when pack is 70% sold

# NEBRASKA LOTTERY

## **NOTES TO THE FINANCIAL STATEMENTS**

(Continued)

### **4. Receivables (Concluded)**

whichever comes first. Retailers pay for on-line tickets each Wednesday for balances due through the previous Saturday. The retailers account receivable is net of allowance for uncollectible in the amount of \$19,213.

#### Accounts Receivable:

Retailers (net)	\$ 2,957,530
Other	<u>249,934</u>
Total	<u><u>\$ 3,207,464</u></u>

### **5. Capital Assets**

Capital asset activity for the year ended June 30, 2004, was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Total Capital Assets	\$ 410,022	\$ 7,943	\$ -	\$ 417,965
Total Accumulated Depreciation	<u>326,576</u>	<u>50,758</u>	<u>-</u>	<u>377,334</u>
Total Capital Assets, Net	<u><u>\$ 83,446</u></u>	<u><u>\$ (42,815)</u></u>	<u><u>\$ -</u></u>	<u><u>\$ 40,631</u></u>

### **6. On-Line Games**

During the fiscal year ended June 30, 2004, the Nebraska Lottery offered a variety of on-line games as described in the following table.

Game Name	Operated by	Nebraska's Share of Prize Reserves
POWERBALL®	MUSL	\$ 1,639,000
NEBRASKA PICK 5®	Nebraska Lottery	n/a
2by2®	MUSL	73,039
		<u><u>\$ 1,712,039</u></u>

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.

## NEBRASKA LOTTERY

### **NOTES TO THE FINANCIAL STATEMENTS**

(Continued)

#### **6. On-Line Games (Concluded)**

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.

#### **7. Significant Compliance Requirements**

Neb. Rev. Stat. 9-812 R.S.Supp., 2003 requires until October 1, 2003, at least twenty-five percent and beginning October 1, 2003, and until January 1, 2008, a portion of the dollar amount of the lottery tickets, which have been sold, on an annualized basis to be transferred to the beneficiary funds, except that the dollar amount transferred shall not be less than the dollar amount transferred to the funds in fiscal year 2003. Of the money remaining after the payment of prizes and operating expenses; the first five hundred thousand dollars shall be transferred to the Compulsive Gamblers Assistance Fund. Thereafter, twenty-four and three-fourths percent shall be transferred to the Education Innovation Fund, twenty-four and three-fourths percent shall be transferred to the Nebraska Scholarship 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.

Of the funds transferred to the Education Innovation Fund, for fiscal years 2004 and 2005, shall be allocated to the General Fund after operating expenses for the Excellence in Education Council are deducted.

The Nebraska 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 \$843 in delinquent State taxes and \$5,044 in delinquent child support payments.

NEBRASKA LOTTERY

**NOTES TO THE FINANCIAL STATEMENTS**

(Continued)

**7. Significant Compliance Requirements (Concluded)**

As required under its enabling legislation, transfers of \$20,807,945 had been made to other funds during the fiscal year. In addition to the above transfers, \$822,755 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.

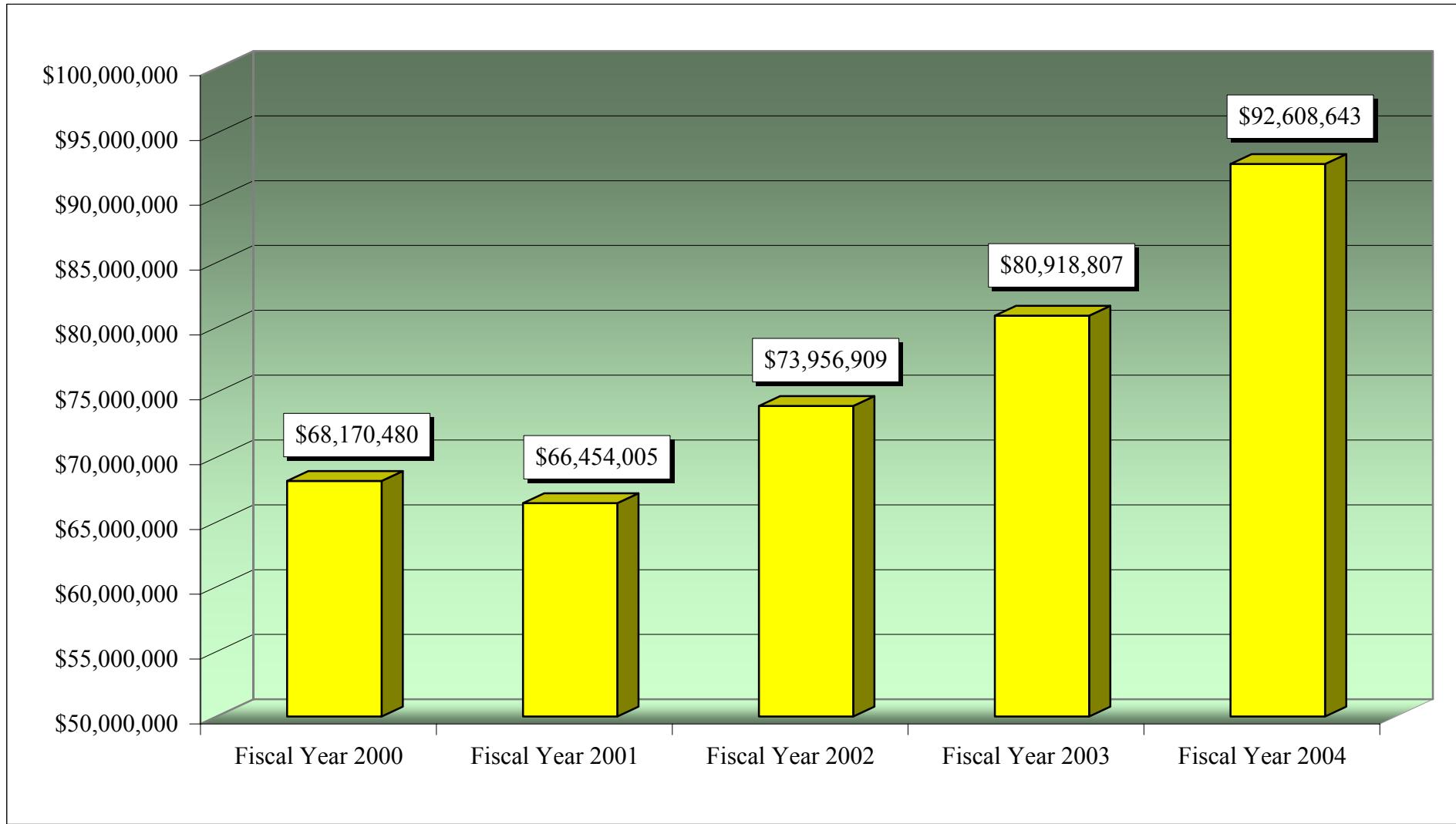
**8. Net Assets**

The Nebraska Lottery's unrestricted net assets 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 unrestricted net assets to fund additional prize pay-outs, retailer incentives, and other game enhancements.

**9. Subsequent Event**

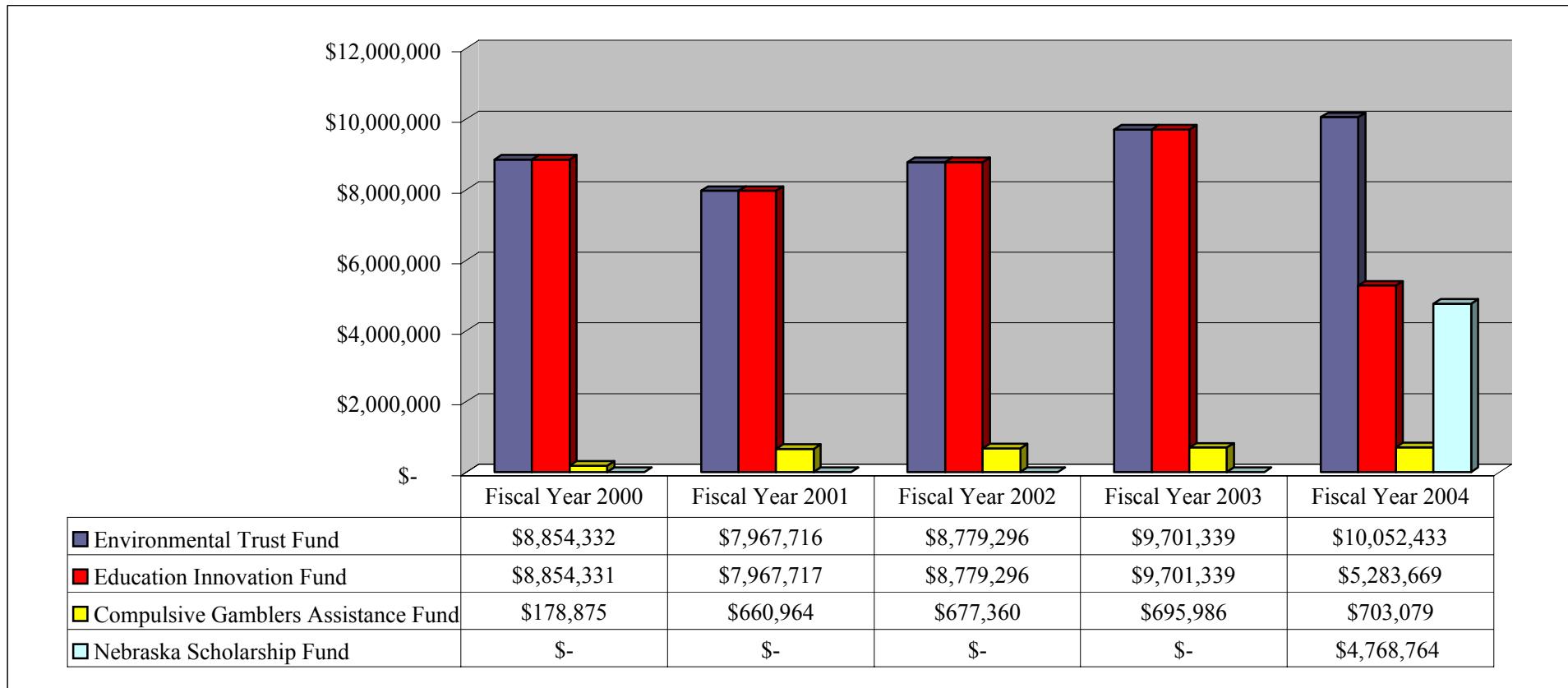
The State Treasurer transferred five million dollars from the State Lottery Operation Trust Fund to the General Fund on July 15, 2004, as required by the 2004 Neb. Laws LB 1091, Section 1.

NEBRASKA LOTTERY  
**LOTTERY TICKET SALES**  
For the Fiscal Years 2000 through 2004



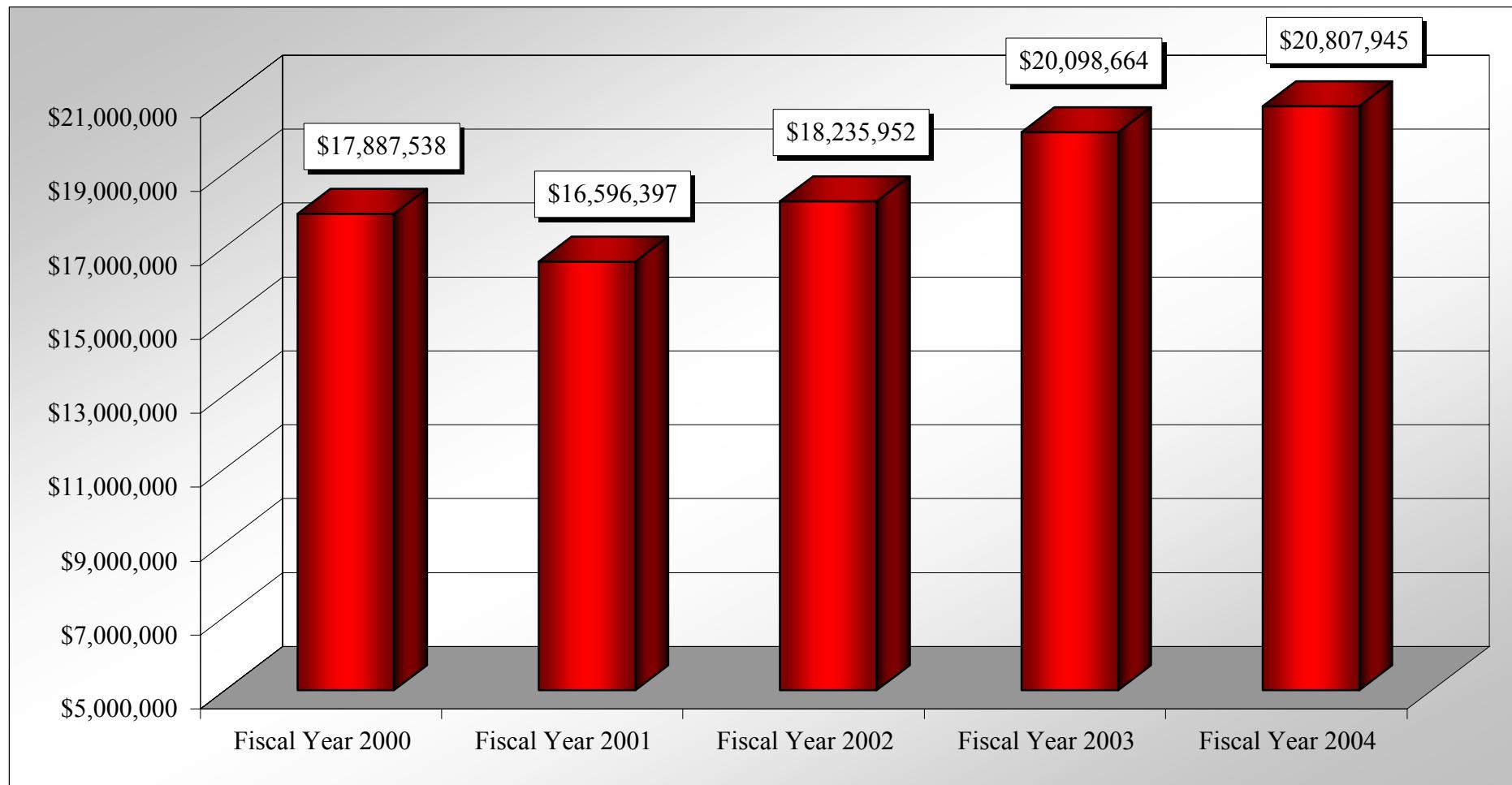
**Note:** These sales are shown on an accrual basis.

**NEBRASKA LOTTERY  
OPERATING TRANSFERS**  
For the Fiscal Years 2000 through 2004



**Note:** Neb. Rev. Stat. Section 9-812 R.S.Supp., 2003 requires until October 1, 2003, at least twenty-five percent and beginning October 1, 2003, and until January 1, 2008, a portion of the dollar amount of the lottery tickets, which have been sold, on an annualized basis to be transferred to the beneficiary funds, except that the dollar amount transferred shall not be less than the dollar amount transferred to the funds in fiscal year 2003. Of the money remaining after the payment of prizes and operating expenses; the first five hundred thousand dollars shall be transferred to the Compulsive Gamblers Assistance Fund. Thereafter, twenty-four and three-fourths percent shall be transferred to the Education Innovation Fund, twenty-four and three-fourths percent shall be transferred to the Nebraska Scholarship 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.

NEBRASKA LOTTERY  
**TOTAL OPERATING TRANSFERS**  
For the Fiscal Years 2000 through 2004



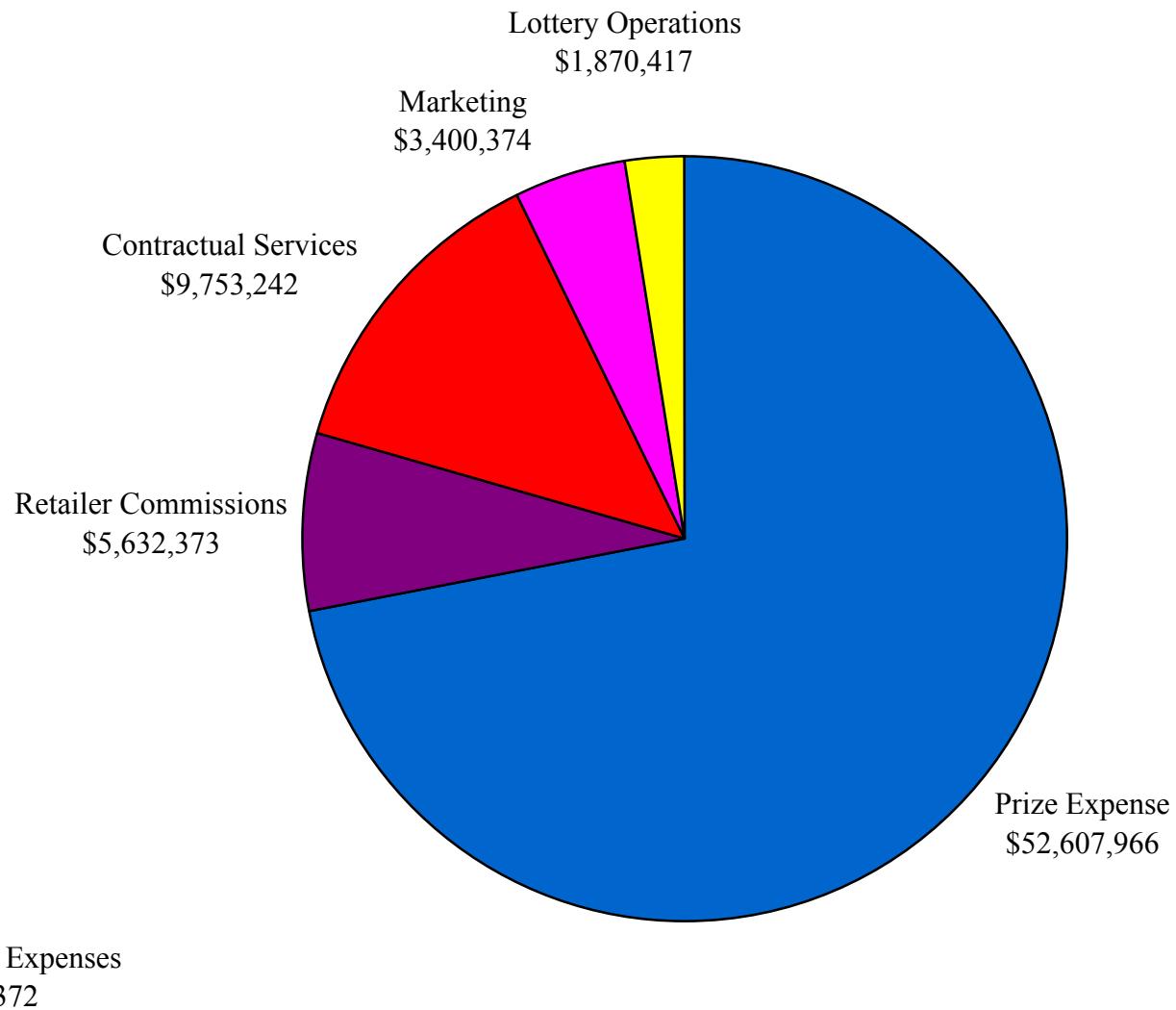
**Note:** The Total Operating Transfers include transfers to the Environmental Trust Fund, the Education Innovation Fund, Nebraska Scholarship Fund (starting in fiscal year 2004), and the Compulsive Gamblers Assistance Fund. These transfers are shown on a cash basis except for an adjustment of \$2,342,407 increasing the Fiscal Year 2000 transfer amount and decreasing the Fiscal Year 2001 transfer amount to better reflect the transfer in the year it relates to.

**NEBRASKA LOTTERY**  
**SCHEDULE OF CUMULATIVE OPERATING TRANSFERS**

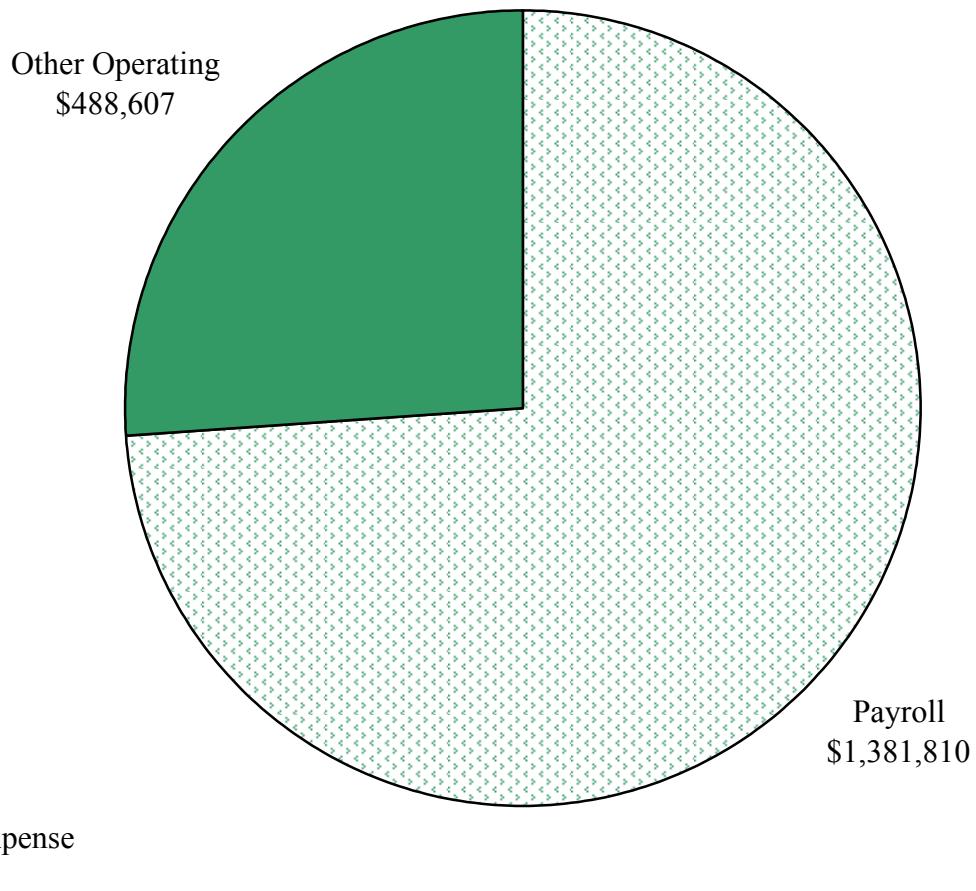
State Fiscal Year	Transfer Amount
1994	\$ 10,931,811
1995	19,308,170
1996	20,486,304
1997	23,363,387
1998	18,740,463
1999	17,581,026
2000	17,887,538
2001	16,596,397
2002	18,235,953
2003	20,098,664
2004	20,807,945
Total Cumulative Transfers	<u>\$ 204,037,658</u>

**Note:** Total Cumulative Transfers includes transfers to the Solid Waste Landfill Closure Fund (no longer transferred beginning fiscal year 1999), the Environmental Trust Fund, the Education Innovation Fund, the Nebraska Scholarship Fund (starting in fiscal year 2004), and the Compulsive Gamblers Assistance Fund. These transfers are shown on a cash basis except for an adjustment of \$2,342,407 increasing the Fiscal Year 2000 transfer amount and decreasing the Fiscal Year 2001 transfer amount to better reflect the transfer in the year it relates to.

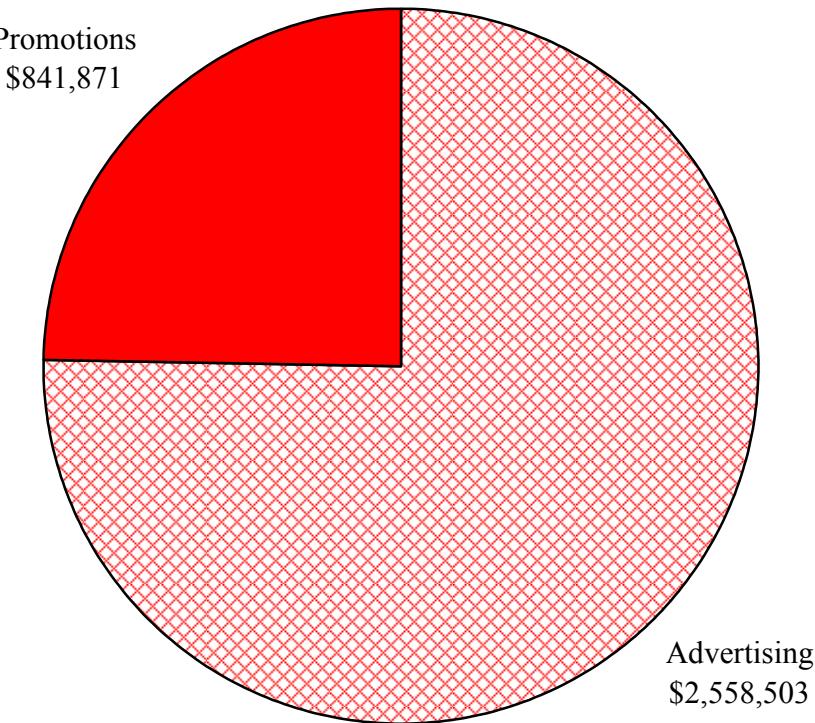
NEBRASKA LOTTERY  
**TOTAL OPERATING EXPENSES**  
For the Fiscal Year Ended June 30, 2004



NEBRASKA LOTTERY  
**LOTTERY OPERATIONS EXPENSE**  
For the Fiscal Year Ended June 30, 2004

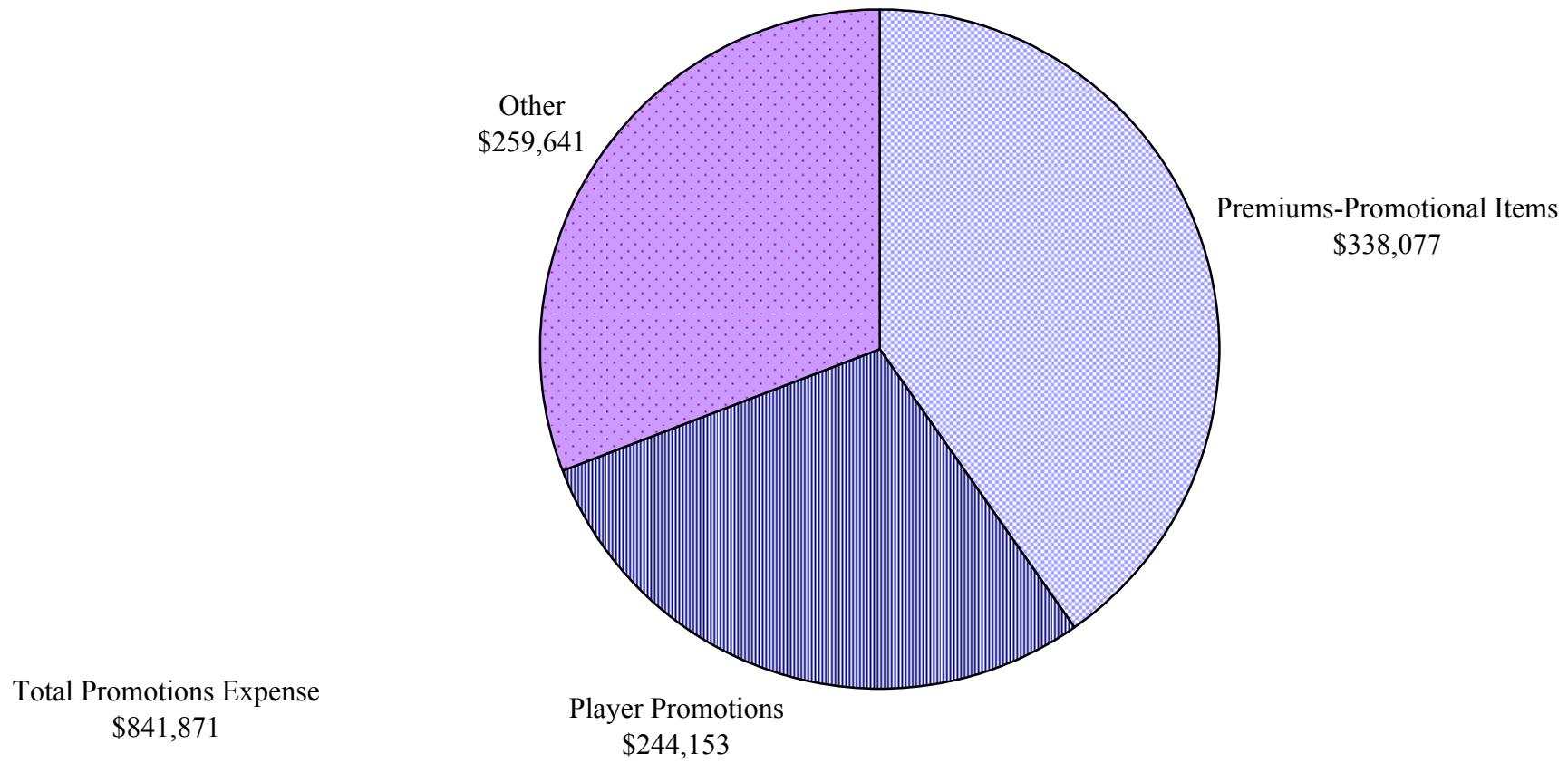


NEBRASKA LOTTERY  
**MARKETING EXPENSE**  
For the Fiscal Year Ended June 30, 2004



Total Marketing Expense  
\$3,400,374

NEBRASKA LOTTERY  
PROMOTIONS EXPENSE  
For the Fiscal Year Ended June 30, 2004



**Other consists of:** Ad agency fee, promotional events, data maintenance, media promotions, printing, player magazines, promotional support, retailer ticket talk, sports sponsorships, trade shows, and web support.

**Premiums - Promotional Items consist of:** T-shirts, caps, golf balls, mugs, sports bags, tool kits, beach towels, blankets, and other miscellaneous items with the Nebraska Lottery logo used for advertising purposes.

# STATE OF NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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## 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*

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We have audited the financial statements of the Nebraska Lottery as of and for the year ended June 30, 2004, and have issued our report thereon dated September 30, 2004. The report was modified to emphasize the financial statements present only the funds of the Nebraska Lottery. 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.

### 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*. We noted a certain immaterial instance of noncompliance that we have reported to management of the Nebraska Lottery in the Comments Section of this report as Comment Number 3 (Travel Expense - Lodging).

### 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.

However, we noted a certain matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Nebraska Lottery's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. A reportable condition is described in the Comments Section of the report as Comment Number 1 (Nebraska Information System and Accounting Procedures).

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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe the reportable condition described above is not a material weakness. We also noted other matters involving internal control over financial reporting that we have reported to management of the Nebraska Lottery in the Comments Section of the report as Comment Number 2 (Premium Items Inventory) and Comment Number 3 (Travel Expense - Lodging).

This report is intended solely for the information and use of the Nebraska Lottery, 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. However, this report is a matter of public record and its distribution is not limited.



September 30, 2004

Assistant Deputy Auditor