

**AUDIT REPORT  
OF THE  
NEBRASKA LOTTERY**

**JULY 1, 2006 THROUGH JUNE 30, 2007**

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**Issued on October 12, 2007**

# 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®, Pick3®, 2by2®, and instant games.

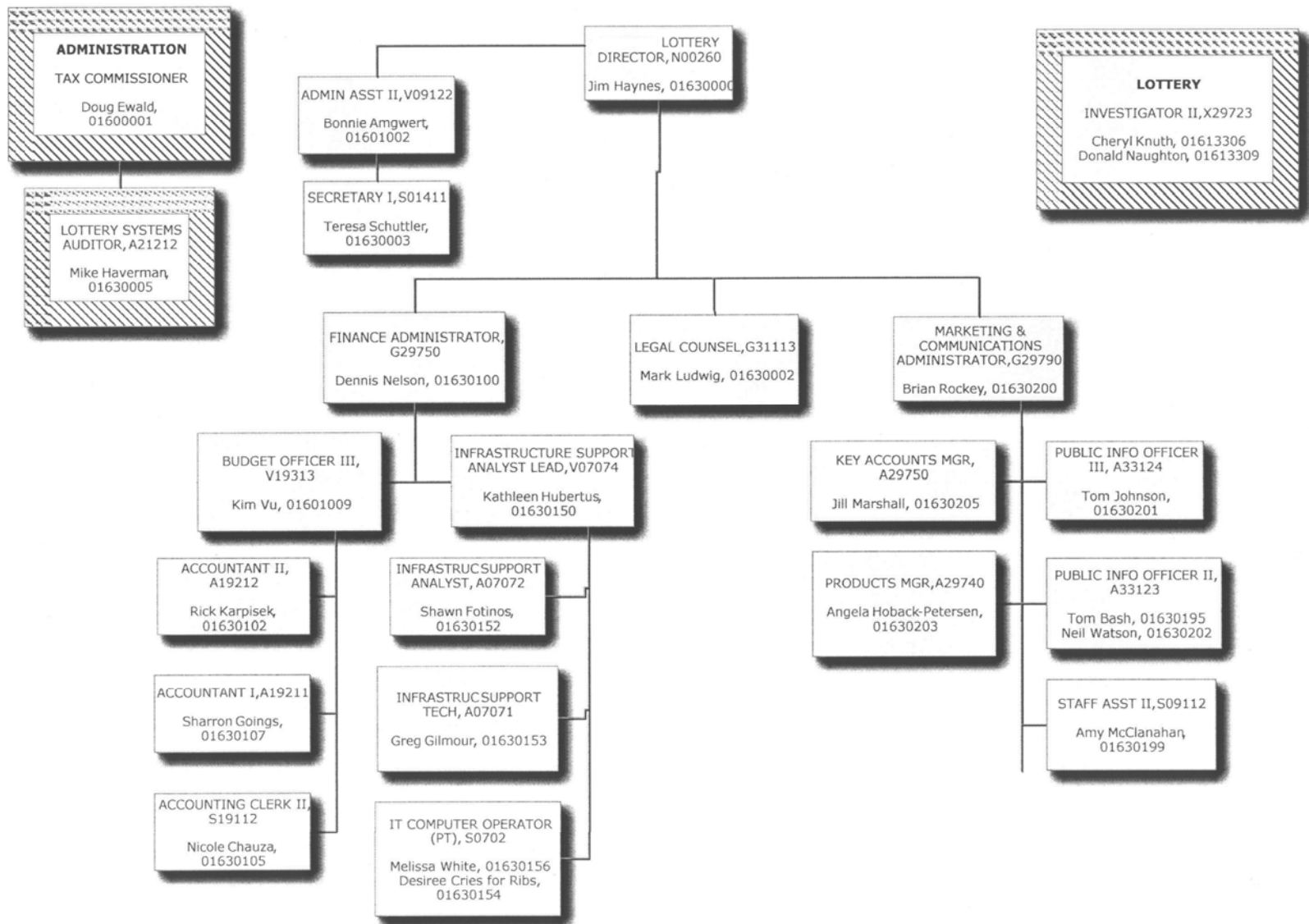
The Nebraska Constitution establishes the basic requirements for the transfer of lottery ticket sales to certain beneficiary funds. The portion designated for the education beneficiary can be amended by the Legislature. Neb. Rev. Stat. Section 9-812 as amended identifies the specific requirements and they are as follows: Beginning October 1, 2003, and until July 1, 2009, a portion of the dollar amount of the lottery tickets, which have been sold on an annualized basis shall 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. Neb. Rev. Stat. Section 9-812 as amended further requires the following: 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. Of the money remaining after the payment of prizes, operating expenses, and transfer to the Compulsive Gamblers Assistance Fund; nineteen 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-four and one-half percent shall be transferred to the Nebraska Environmental Trust Fund, ten percent shall be transferred to the State Fair Support and Improvement Cash Fund, and one percent shall be transferred to the Compulsive Gamblers Assistance Fund.

## MISSION STATEMENT

The mission of the Nebraska Lottery is to generate proceeds for good causes as determined by the voters and the Legislature, while providing quality entertainment options to Nebraskans.

# NEBRASKA LOTTERY

## ORGANIZATIONAL CHART



NEBRASKA LOTTERY

**EXIT CONFERENCE**

An exit conference was held October 1, 2007, with the Nebraska Lottery to discuss the results of our audit. Those in attendance for the Nebraska Lottery were:

<b>NAME</b>	<b>TITLE</b>
Doug Ewald	State Tax Commissioner
James Haynes	Lottery Director
Mark Ludwig	Lottery Legal Counsel
Dennis Nelson	Finance Director
Kim Vu	Budget Officer III
Kathleen Hubertus	Technology Manager
Mike Haverman	Internal Auditor

# NEBRASKA LOTTERY

## COMMENT AND RECOMMENDATION

During our audit of the Nebraska Lottery, we noted a certain matter involving the internal control over financial reporting and other operational matters which is presented here. The comment and recommendation is intended to improve the internal control over financial reporting, ensure compliance, or result in operational efficiencies.

### **Information Systems Internal Control Review**

Good internal control requires general and application controls of computer systems supporting financial data to be in place and working effectively. When control deficiencies are identified, management should appropriately assess risk and determine how the deficiency will be dealt with in a timely manner to reduce the risk of financial data being misstated due to error or fraudulent acts.

In 2006 the Nebraska Lottery had an outside specialist perform a review of the information systems for the on-line vendor, instant ticket vendor, and the Nebraska Lottery Internal Control System (ICS). The scope of the information systems review included information system processing policies, procedures, and practices for identified control areas for Nebraska Lottery operations. The areas reviewed included IT governance, network administration, internal network and system security, computer operations, application controls, physical security, and environmental controls review. The outside specialist noted deficiencies related to each system. Some deficiencies noted still exist. During our audit, we performed additional procedures and noted additional information technology control issues related to Nebraska Lottery systems.

When control issues related to information systems exist and corrective action plans for areas of concern are not put in place in a timely manner, there is an increased risk for the misuse or loss of financial data.

We recommend the Nebraska Lottery develop a detailed corrective action plan to address each control deficiency identified, including formal documentation of the following.

- Determination of the risk for each deficiency.
- Identification of other current procedures that may reduce the risk of each deficiency, and document how these current procedures reduce that risk.
- Corrective measures to be taken to further reduce the risk.
- Agreement and approval by the Nebraska Lottery and vendor management of the final plan.

NEBRASKA LOTTERY

**COMMENT AND RECOMMENDATION**

(Continued)

**Information Systems Internal Control Review** (Concluded)

*Nebraska Lottery's Response: The 2006 information systems review performed by the outside specialist yielded several issues in regards to the Nebraska Lottery's system as well as our on-line vendor's system and our instant vendor's system. The respective systems were changed to address some of the issues, but as noted in the audit comment, several of the issues still exist.*

*Nebraska Lottery staff will confer with both vendors and if possible, develop corrective action plans for the outstanding items. If changes are not possible, the risks for each item will be evaluated. Overall, this follow-up process will be better documented in the future.*

It should be noted this report is critical in nature since it contains only our comment and recommendation on the area 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 comment and recommendation included in this report. The formal response received has been incorporated into this report. The response has been objectively evaluated and recognized, as appropriate, in the report. A response that indicates corrective action has been taken was 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 AUDITOR OF PUBLIC ACCOUNTS

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## NEBRASKA LOTTERY

### INDEPENDENT AUDITORS' REPORT

State Tax Commissioner  
Nebraska Department of Revenue, Lottery Division

We have audited the accompanying financial statements of the business-type activities of the Nebraska Lottery as of and for the fiscal year ended June 30, 2007, 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, 2007, 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, 2007, 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 October 10, 2007, 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 other matters. 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.

Management's Discussion and Analysis is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

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 statistical information schedules are presented for purposes of additional analysis and are not a required part of the basic financial statements. The statistical information schedules have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

October 10, 2007

  
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, 2007. 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 began selling instant (scratch) tickets on September 11, 1993, and began selling on-line (lotto) tickets on July 21, 1994. 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 the 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. In the annual report issued by the Nebraska Lottery, we include 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, 2007. 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 or a profit-loss statement for a private business.
- 3) **Statement of Cash Flows**  
This report is an analysis of the sources of cash flows into the Nebraska Lottery and out of the Nebraska Lottery.

#### **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 (see Table A below). The largest asset increase was in the Cash and Cash Equivalents. The cash balance increased by nearly one million dollars. The increase is the result of additional sales for which prizes have not yet been paid. This can be seen in the increased Prizes Payable as it increased by more than \$600,000. The sales revenues increased by more than \$1.3 million and some of the related prizes that have not yet been claimed are the reason for the increase in Cash and Prizes Payable.

NEBRASKA LOTTERY

MANAGEMENT'S DISCUSSION AND ANALYSIS

(Continued)

The Accounts Payable increased this fiscal year by about a half-million dollars. Most of that increase, about \$425,000 is due to what the Nebraska Lottery owes the Multi-State Lottery Association (MUSL). MUSL operates Powerball® and other lotto games on behalf of member states. The amount owed to MUSL for our portion of the prizes is offset by what we must payout to the players. The amount owed increased as we had more \$200,000 Powerball® winners and more 2by2® grand prize winners in the final three weeks of last year than the final three weeks of this year.

Table A  
Summary of Net Assets

	<u>FY 2007</u>	<u>FY 2006</u>	<u>Change</u>
<b>CURRENT ASSETS</b>			
Cash and Cash Equivalents	\$ 9,059,287	\$ 8,067,339	\$ 991,948
Accounts Receivable	4,556,004	4,426,474	129,530
Prepaid Prizes and Costs	339,472	353,153	(13,681)
<b>TOTAL CURRENT ASSETS</b>	<u>13,954,763</u>	<u>12,846,966</u>	<u>1,107,797</u>
<b>NONCURRENT ASSETS</b>			
Reserves on Deposit	1,599,482	1,733,682	(134,200)
Furniture, Fixtures, Equipment (Net)	23,722	36,753	(13,031)
<b>TOTAL NONCURRENT ASSETS</b>	<u>1,623,204</u>	<u>1,770,435</u>	<u>(147,231)</u>
<b>TOTAL ASSETS</b>	<u>\$15,577,967</u>	<u>\$14,617,401</u>	<u>\$ 960,566</u>
<b>CURRENT LIABILITIES</b>			
Accounts Payable	\$ 1,549,772	\$ 1,067,766	\$ 482,006
Compensated Absences and Accrued Payroll Payable	100,767	222,069	(121,302)
Prizes Payable	6,070,515	5,483,253	587,262
Other Liabilities and Payables	115,380	191,479	(76,099)
<b>TOTAL CURRENT LIABILITIES</b>	<u>7,836,434</u>	<u>6,964,567</u>	<u>871,867</u>
<b>NONCURRENT LIABILITIES</b>			
Compensated Absences	168,704	-	168,704
<b>TOTAL NONCURRENT LIABILITIES</b>	<u>168,704</u>	<u>-</u>	<u>168,704</u>
<b>TOTAL LIABILITIES</b>	<u>\$ 8,005,138</u>	<u>\$ 6,964,567</u>	<u>\$ 1,040,571</u>
<b>NET ASSETS</b>			
Invested in Capital Assets	\$ 23,722	\$ 36,753	\$ (13,031)
Restricted for Future Prizes	1,599,482	1,733,682	(134,200)
Unrestricted Assets	5,949,625	5,882,399	67,226
<b>TOTAL NET ASSETS</b>	<u>\$ 7,572,829</u>	<u>\$ 7,652,834</u>	<u>\$ (80,005)</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 sales. Overall, revenues increased by about \$1.4 million (see Table B below). This overall increase is attributed to instant ticket sales (increased \$2.7 million). Sales of on-line tickets decreased during the year (decreased \$1.3 million). The decrease in on-line ticket sales was due to the size of the Powerball® jackpots. Last year, there were six large Powerball® jackpots (greater than \$100 million) but for this year, there were only five large jackpots. Also, last year we had two jackpots greater than \$300 million (including the record-setting jackpot that was won here in Nebraska) whereas this year had none. The increase in instant ticket sales was due to the introduction of the first \$20 scratch ticket in Nebraska. Sales for the \$20 ticket were greater than \$4 million.

On the expense side, the Prize Expense went up more than \$1.8 million. This is due to the increased sales and the shift of the sales makeup. Instant tickets have an overall higher prize structure than on-line tickets. The combination of higher instant ticket sales (higher prize expense) with the lower on-line ticket sales (lower prize expense) increased the overall prize expense.

Our Marketing Expense increased slightly this year due to LB 1039 (2006). This statute change directs the Nebraska Lottery to spend 5% of its marketing monies to support gambling awareness messages.

The Contractual Services Expense (payments to our instant ticket contractor, our on-line ticket contractor, and our security contractor) increased during the year. Again, this is due to the increased sales that we experienced and the makeup of the sales. The percentage paid to the on-line contractor is 2.39% of sales while the instant contractor is paid 8.6639% of sales. Also, as the sales increase, so does the Retailer Commission that we pay our retailers to sell our products.

The Transfers to Other Funds increased by more than \$1.6 million. As the Nebraska Lottery was able to increase sales and profits, it allowed for more money to be transferred to the beneficiary funds.

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

<b>REVENUES</b>	<u>FY 2007</u>	<u>FY 2006</u>	<u>Change</u>
Sales	\$ 117,153,155	\$ 115,010,414	\$ 2,142,741
Sales Returns	(2,664,267)	(1,902,073)	(762,194)
<b>OPERATING REVENUE</b>	<u>114,488,888</u>	<u>113,108,341</u>	<u>1,380,547</u>
Interest Income	574,373	520,583	53,790
Multi-State Lottery Assoc. Income	17,393	126,770	(109,377)
<b>NON-OPERATING REVENUE</b>	<u>591,766</u>	<u>647,353</u>	<u>(55,587)</u>
<b>TOTAL REVENUES</b>	<u>\$ 115,080,654</u>	<u>\$ 113,755,694</u>	<u>\$ 1,324,960</u>

NEBRASKA LOTTERY

MANAGEMENT'S DISCUSSION AND ANALYSIS  
(Continued)

Table B - (Concluded)  
Statement of Revenues, Expenses, and Changes in Net Assets

	FY 2007	FY 2006	Change
<b>EXPENSES</b>			
Prize Expense	\$ 65,397,832	\$ 63,722,319	\$ 1,675,513
Retailer Commissions	7,176,601	7,083,259	93,342
Contractual Services Expense	7,030,562	6,759,801	270,761
Marketing Expense	4,333,421	4,105,622	227,799
Lottery Operating Expense	1,956,024	1,769,838	186,186
<b>TOTAL EXPENSES</b>	<u>\$ 85,894,440</u>	<u>\$ 83,440,839</u>	<u>\$ 2,453,601</u>
<b>NET INCOME BEFORE TRANSFERS</b>	\$ 29,186,214	\$ 30,314,855	\$ (1,128,641)
<b>TRANSFERS TO OTHER FUNDS</b>	<u>29,266,219</u>	<u>27,601,895</u>	<u>1,664,324</u>
<b>CHANGE IN NET ASSETS</b>	<u>\$ (80,005)</u>	<u>\$ 2,712,960</u>	<u>\$ (2,792,965)</u>

**OTHER ITEMS OF NOTE**

During this fiscal year, the Nebraska Lottery underwent a performance audit conducted by the Performance Audit Section of the Legislative Audit and Research Office. The audit focused on the Nebraska Lottery's implementation of the provisions contained in LB 1039. The audit report is available at [www.nebraskalegislature.gov](http://www.nebraskalegislature.gov).

The Nebraska Lottery has merged with the Charitable Gaming division of the Nebraska Department of Revenue. This consolidation was effective as of July 1, 2007. This combined business unit (still a section/division of Revenue) shares resources but accounts for funds separately and operates under the direction of Jim Haynes, Lottery Director. Also, the Nebraska Lottery/Charitable Gaming unit has moved from the Nebraska State Office Building to 1800 'O' Street, Suite 101, in Lincoln, Nebraska.

The increased sales noted this fiscal year may not be sustainable. The unpredictability of the Powerball® jackpots and external forces that affect player purchases (fuel prices, international tensions, other entertainment options, etc.) could have a drastic effect on future sales.

NEBRASKA LOTTERY

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

(Continued)

**CONTACTING LOTTERY MANAGEMENT**

This financial report is required as part of Governmental Accounting Standards Board (GASB) Statement 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**  
AS OF JUNE 30, 2007

**ASSETS**

**CURRENT ASSETS:**

Cash and Cash Equivalents	\$ 9,059,287
Accounts Receivable, Net of Allowance (Note 4)	4,556,004
Prepaid Prizes	120,400
Prepaid Contract Costs - Instant	219,072

<b>TOTAL CURRENT ASSETS</b>	<b>13,954,763</b>
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**NONCURRENT ASSETS:**

Reserves on Deposit (Note 6)	1,599,482
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Capital Assets:

Furniture, Fixtures, and Equipment (Note 5)	407,901
Less: Accumulated Depreciation	(384,179)

Total Capital Assets, Net	23,722
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<b>TOTAL NONCURRENT ASSETS</b>	<b>1,623,204</b>
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<b>TOTAL ASSETS</b>	<b>\$ 15,577,967</b>
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**LIABILITIES**

**CURRENT LIABILITIES:**

Accounts Payable	\$ 557,869
Vendors Payable	991,903
Compensated Absences Payable (Note 7)	12,698
Accrued Payroll Payable	88,069
Withheld Taxes on Prizes Paid	17,300
Prize Payable	6,070,515
Due to Other Funds	25,549
Other Accrued Liabilities	72,531

<b>TOTAL CURRENT LIABILITIES</b>	<b>7,836,434</b>
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**NONCURRENT LIABILITIES:**

Compensated Absences Payable (Note 7)	168,704
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<b>TOTAL NONCURRENT LIABILITIES</b>	<b>168,704</b>
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<b>TOTAL LIABILITIES</b>	<b>8,005,138</b>
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**NET ASSETS**

Invested in Capital Assets	23,722
Restricted for Future Prizes (Note 6)	1,599,482
Unrestricted (Note 10)	5,949,625

<b>TOTAL NET ASSETS</b>	<b>7,572,829</b>
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<b>TOTAL LIABILITIES AND FUND EQUITY</b>	<b>\$ 15,577,967</b>
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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 YEAR ENDED JUNE 30, 2007

<b>OPERATING REVENUE:</b>	
Sales	\$ 117,153,155
Less: Sales Returns	2,664,267
<b>TOTAL OPERATING REVENUE</b>	<u>114,488,888</u>
 <b>OPERATING EXPENSES:</b>	
Prize Expense	65,397,832
Retailer Commissions	7,176,601
Contractual Services Expense	7,030,562
Marketing	4,333,421
Lottery Operating	1,956,024
<b>TOTAL OPERATING EXPENSES</b>	<u>85,894,440</u>
 <b>OPERATING INCOME</b>	 <u>28,594,448</u>
 <b>NONOPERATING REVENUES:</b>	
Interest Income	574,373
Multi-State Lottery Association Income	17,393
<b>TOTAL NONOPERATING REVENUES</b>	<u>591,766</u>
 <b>INCOME BEFORE TRANSFERS</b>	 29,186,214
 <b>TRANSFERS TO OTHER FUNDS</b> (Note 9)	 <u>(29,266,219)</u>
 <b>CHANGE IN NET ASSETS</b>	 (80,005)
 <b>TOTAL NET ASSETS, BEGINNING OF YEAR</b>	 <u>7,652,834</u>
 <b>TOTAL NET ASSETS, END OF YEAR</b>	 <u><u>\$ 7,572,829</u></u>

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, 2007

<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>	
Ticket Sales	\$ 114,132,369
Prizes Paid to Winners	(64,219,707)
Commissions Paid to Retailers	(7,170,320)
Paid to Contractors for Goods and Services	(11,280,199)
Paid to Employees	(1,364,998)
Other Operating Expenses	(439,378)
POWERBALL® Grand Prize Winner Receipts from MUSL	5,030,000
Payments to POWERBALL® Grand Prize Winners	(5,030,000)
Net Cash Provided by Operating Activities	<u>29,657,767</u>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:</b>	
Paid to Education Innovation Fund	(5,681,329)
Paid to Nebraska Scholarship Fund	(7,119,639)
Paid to State Fair Improvement Fund	(2,876,621)
Paid to Environmental Trust Fund	(12,800,967)
Paid to Compulsive Gamblers Assistance Fund	(787,663)
Net Cash Used in NonCapital Financing Activities	<u>(29,266,219)</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:</b>	
Purchase of Property and Equipment	<u>(1,571)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>	
Interest on Cash	574,373
Multi-State Lottery Association Income	27,598
Net Cash Provided by Investing Activities	<u>601,971</u>
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	991,948
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</b>	<u>8,067,339</u>
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>	<u>\$ 9,059,287</u>
<b>RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:</b>	
Operating Income	<u>\$ 28,594,448</u>
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities:	
Depreciation Expense	14,602
Changes in Assets (Increase) Decrease in:	
Reserves on Deposit	134,200
Prepaid Prizes	(13,729)
Accounts Receivable (Net)	(139,735)
Prepaid Contract Costs - Instant	27,410
Changes in Liabilities Increase (Decrease) in:	
Other Accrued Liabilities	(56,464)
Accounts Payable and Due to Other Funds	503,936
Prize Payable	587,262
Compensated Absences and Accrued Payroll Payable	47,402
Withheld Taxes on Prizes Paid	(21,850)
Vendors Payable	(19,715)
Total Adjustments	<u>1,063,319</u>
Net Cash Provided by Operating Activities	<u>\$ 29,657,767</u>

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, 2007

### 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 as applied to governmental units. As the Nebraska Lottery is a business-type activity, the financial statements presented are the financial statements required by Governmental Accounting Standards Board (GASB) Statement Number 34 for an enterprise fund. 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 game vendors and from accounts maintained by the State Accounting Administrator of the Nebraska Department of Administrative Services (DAS).

#### 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., 2006, are to be transferred to the Education Innovation Fund, the Nebraska Scholarship Fund, the Nebraska Environmental Trust Fund, and the Compulsive Gamblers Assistance Fund. As of January 1, 2005, Neb. Const. art. III, Section 24, Amendment 4, required an additional transfer to the State Fair Support and Improvement Cash Fund, a fund of the State Fair Board. 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. GASB has set forth criteria to be considered in determining financial accountability. These criteria include appointing a

# NEBRASKA LOTTERY

## NOTES TO THE FINANCIAL STATEMENTS

(Continued)

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

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.

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

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

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. Because the instant prize winning tickets are randomly distributed throughout the tickets and because some winning tickets will be

# NEBRASKA LOTTERY

## NOTES TO THE FINANCIAL STATEMENTS

(Continued)

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

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 close of each instant game and 181 days after each draw for on-line games as prizes unclaimed for 180 days expire. Total unclaimed prizes for the fiscal year ended June 30, 2007, was \$1,628,550.

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 and Cash Equivalents**

In addition to bank accounts and petty cash, this classification includes all short-term investments such as certificates of deposit, repurchase agreements, and U.S. treasury bills. These short-term investments may have original maturities (remaining time to maturity at acquisition) greater than three months; however, cash is available and is considered cash and cash equivalents for reporting purposes. These investments are stated at cost, which at June 30, 2007, approximates market. Banks pledge collateral, as required by law, to guarantee State funds held in time and demand deposits.

Cash and cash equivalents are under the control of the State Treasurer or other administrative bodies as determined by law. Investments of all available cash is made by the State Investment Officer on a daily basis, based on total bank balances. These funds are held in the State of Nebraska Operating Investment Pool (OIP), and internal investment pool. Interest earned on these investments is allocated to funds based on their percentage of the investment pool. Additional information on the deposits and investments portfolio including investment policies, risks, and types of investments can be found in the State of Nebraska's Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2007.

# NEBRASKA LOTTERY

## NOTES TO THE FINANCIAL STATEMENTS

(Continued)

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

#### **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.

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. Increases in total appropriations must also be approved by the Legislature as a deficit appropriations bill. Revenues are not budgeted.

#### **F. Receivables and Related Allowance for Uncollectible Amounts**

Receivables are reported net of estimated allowances for uncollectible amounts and are estimated 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.

# NEBRASKA LOTTERY

## NOTES TO THE FINANCIAL STATEMENTS

(Continued)

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

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.

Equipment is depreciated using the straight line method over the estimated useful lives of three to seven years.

#### **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 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 60 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.

NEBRASKA LOTTERY

NOTES TO THE FINANCIAL STATEMENTS

(Continued)

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 of 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.
- B. Health care and life insurance for eligible employees.
- C. Crime coverage, with a limit of \$21 million for each loss, and a \$25,000 self-insured retention per incident was in effect from July 1, 2006 through October 18, 2006. Starting October 19, 2006 the limit for each loss was increased to \$31 million.
- D. Real and personal property on a blanket basis for losses up to \$250,000,000, with a self-insured retention of \$200,000 per loss occurrence. Newly acquired properties are covered up to \$5,000,000 for 120 days or until the value of the property is reported to the insurance company. The perils of flood, earthquake, and acts of terrorism have various coverages, sublimits, and self insurance. Details of these coverages are available from the Department of Administrative Services Risk Management Division. 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 Insurance Trust Funds 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

NEBRASKA LOTTERY

NOTES TO THE FINANCIAL STATEMENTS

(Continued)

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

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 option or begin participation in the cash balance benefit. The defined contribution option is closed to new entrants. All new members of the Plan on and after January 1, 2003, become members of the cash balance benefit. Additionally, on or after November 1, 2007, but before January 1, 2008 members who are employed and participating in the retirement system may either elect to continue participation in the defined contribution option or elect to participate in the cash balance benefit. Members who elect to participate in the cash balance benefit during this timeframe shall commence participation in the cash balance benefit on January 1, 2008. The benefits and funding policy of the Plan is established and can only be amended by the Nebraska Legislature.

Prior to January 1, 2007, all permanent full-time employees who had 12 continuous months of service were required to begin participation in the retirement system. All permanent full-time or permanent part-time employees who had 12 months of service within a five-year period, and who had attained the age of 20, could exercise the option to begin participation in the retirement system. As of January 1, 2007, all permanent full-time employees are required to begin participation in the retirement system upon employment; and all permanent part-time employees, who have attained the age of twenty years, may exercise the option to begin participation in the retirement system.



## NEBRASKA LOTTERY

### NOTES TO THE FINANCIAL STATEMENTS

(Continued)

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

**Contribution.** Prior to January 1, 2007, each member contributed 4.33% of his or her monthly compensation until \$864 had been contributed and 4.8% of his or her monthly compensation for the remainder of the calendar year. As of January 1, 2007, each member contributes 4.8% of his or her monthly compensation.

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 credit for participation in another Nebraska governmental plan prior to actual contribution to the Plan.

**Defined Contribution Option.** 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 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, 2007, employees contributed \$48,296 and the Nebraska Lottery contributed \$75,341. 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 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 Nebraska Lottery's sales or accounts receivable. Retailers must pay for instant lottery tickets 45 days after activation or when the pack is 70% validated whichever comes first. Retailers pay for on-line tickets each Wednesday for balances due through the previous Saturday. The retailers accounts receivable is net of allowance for uncollectible in the amount of \$34,296.

NEBRASKA LOTTERY

**NOTES TO THE FINANCIAL STATEMENTS**

(Continued)

**4. Receivables** (Concluded)

Accounts Receivable:		
Retailers (net)	\$	4,398,083
Other		157,921
Total	\$	4,556,004

**5. Capital Assets**

Capital asset activity for the fiscal year ended June 30, 2007, was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Total Capital Assets	\$ 419,570	\$ 1,571	\$ 13,240	\$ 407,901
Total Accumulated Depreciation	382,817	14,602	13,240	384,179
Total Capital Assets, Net	\$ 36,753	\$ (13,031)	\$ 0	\$ 23,722

**6. On-Line Games**

During the fiscal year ended June 30, 2007, 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	\$ 1,471,800
NEBRASKA PICK 5®	Nebraska Lottery	n/a
NEBRASKA PICK 3®	Nebraska Lottery	n/a
2by2®	MUSL	127,682
		\$ 1,599,482

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. Noncurrent Liabilities**

Changes in noncurrent liabilities for the year ended June 30, 2007, are as follows:

	Beginning Balance	Increases	Decreases	Ending Balance	Amounts Due Within One Year
Compensated Absences	\$ 152,846	\$ 50,556	\$ 22,000	\$ 181,402	\$ 12,698

**8. Lease Commitments**

The minimum annual office lease payments for operating leases as of June 30, 2007, are as follows:

Year	Amount
2008	\$ 49,753
2009	49,753
2010	49,753
2011	49,754
2012	49,754
2013-2017	265,219
Total	\$ 513,986

**9. Significant Compliance Requirements**

The Nebraska Constitution establishes the basic requirements for the transfer of lottery ticket sales to certain beneficiary funds. The portion designated for the education beneficiary can be amended by the Legislature. Neb. Rev. Stat. Section 9-812 as amended identifies the specific requirement and they are as follows: Beginning October 1, 2003, and until July 1, 2009, a portion of the dollar amount of the lottery tickets, which have been sold on an annualized basis shall be transferred to the beneficiary funds, except that the dollar amount transferred shall not be less than the

## NEBRASKA LOTTERY

### NOTES TO THE FINANCIAL STATEMENTS

(Continued)

#### 9. **Significant Compliance Requirements** (Concluded)

dollar amount transferred to the funds in fiscal year 2003. Neb. Rev. Stat. Section 9-812 as amended further requires the following: 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. Of the money remaining after the payment of prizes, operating expenses, and transfer to the Compulsive Gamblers Assistance Fund; nineteen 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-four and one-half percent shall be transferred to the Nebraska Environmental Trust Fund, ten percent shall be transferred to the State Fair Support and Improvement Cash Fund, and one percent shall be transferred to the Compulsive Gamblers Assistance Fund.

As required under its enabling legislation, transfers of \$29,266,219 were made to other funds during the fiscal year.

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 \$7,006 in delinquent State taxes and \$13,676 in delinquent child support payments.

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.

#### 10. **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.

NEBRASKA LOTTERY

NOTES TO THE FINANCIAL STATEMENTS

(Continued)

**11. Reconciliation of Bank Records to the Nebraska Information System**

Through their bank reconciliation procedures, DAS State Accounting Division (State Accounting) has identified a large unknown statewide variance between the State Treasurer's bank statements and the State's balances in the general ledger. This unknown variance indicates the bank records are short as compared to the accounting records. Some adjustments to the accounting records may be needed and may affect the fund balances of the Nebraska Lottery. At this time, it has not been determined how or when adjustments to the accounting records might be made. State Accounting is unable to determine the affect of such adjustment, if any, on the Nebraska Lottery's balances; however, State Accounting believes it will not have a material impact on the Nebraska Lottery's operations.



# NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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

State Tax Commissioner  
Nebraska Department of Revenue, Lottery Division

We have audited the financial statements of the Nebraska Lottery as of and for the year ended June 30, 2007, and have issued our report thereon dated October 10, 2007. 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.

### Internal Control Over Financial Reporting

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

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Nebraska Lottery's internal control.

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

#### Compliance and Other Matters


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

We noted a certain additional item that we reported to management of the Nebraska Lottery in the Comment Section of this report as Information Systems Internal Control Review.

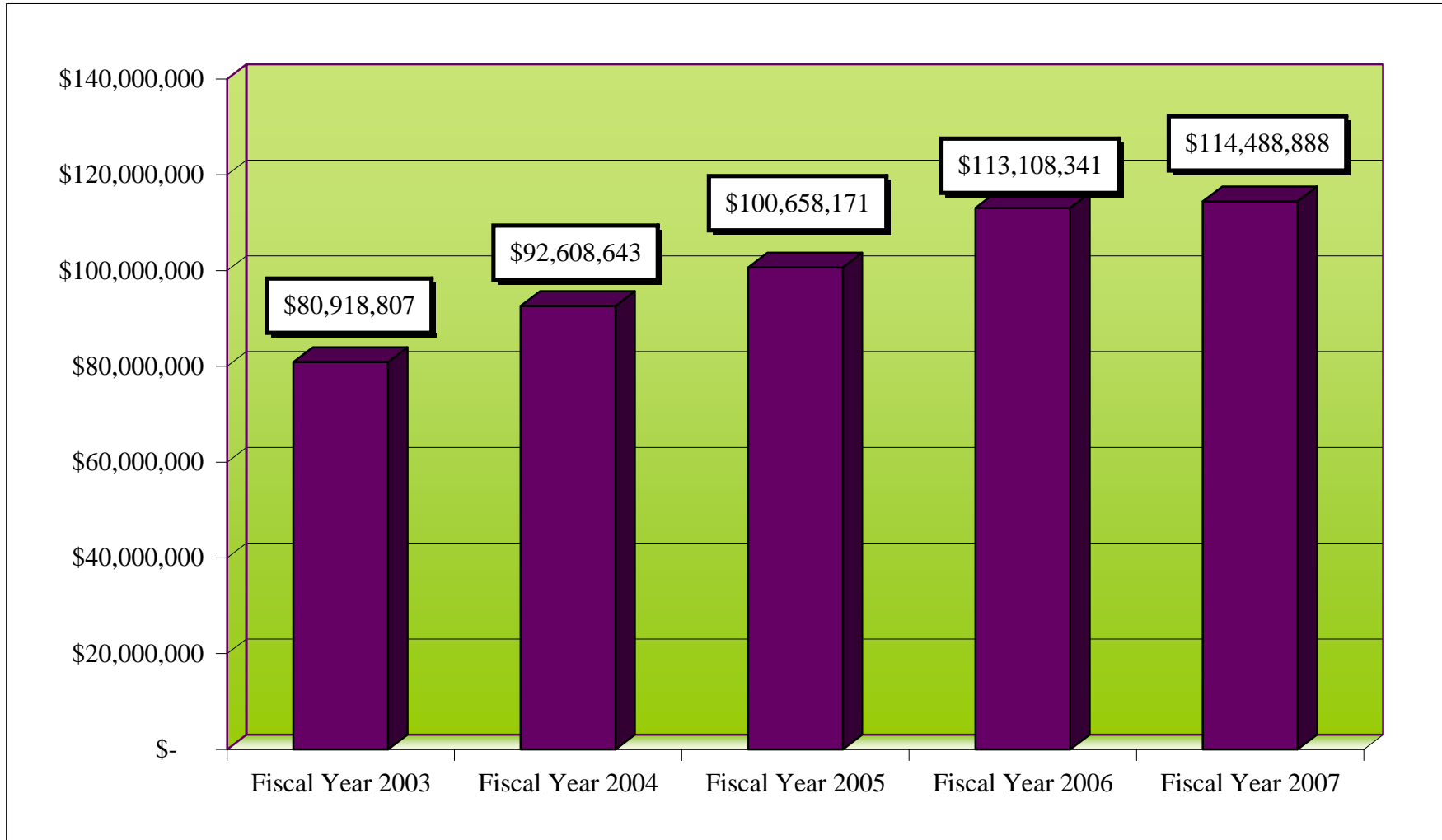
Nebraska Lottery's written response to the finding identified in our audit is described in the Comment Section of the report. We did not audit Nebraska Lottery's response and, accordingly, we express no opinion on it. Where no response is indicated, the Nebraska Lottery declined to respond.

This report is intended solely for the information and use of management, others within the Nebraska Lottery, and the appropriate Federal and regulatory agencies. However, this report is a matter of public record and its distribution is not limited.

October 10, 2007

  
Assistant Deputy Auditor

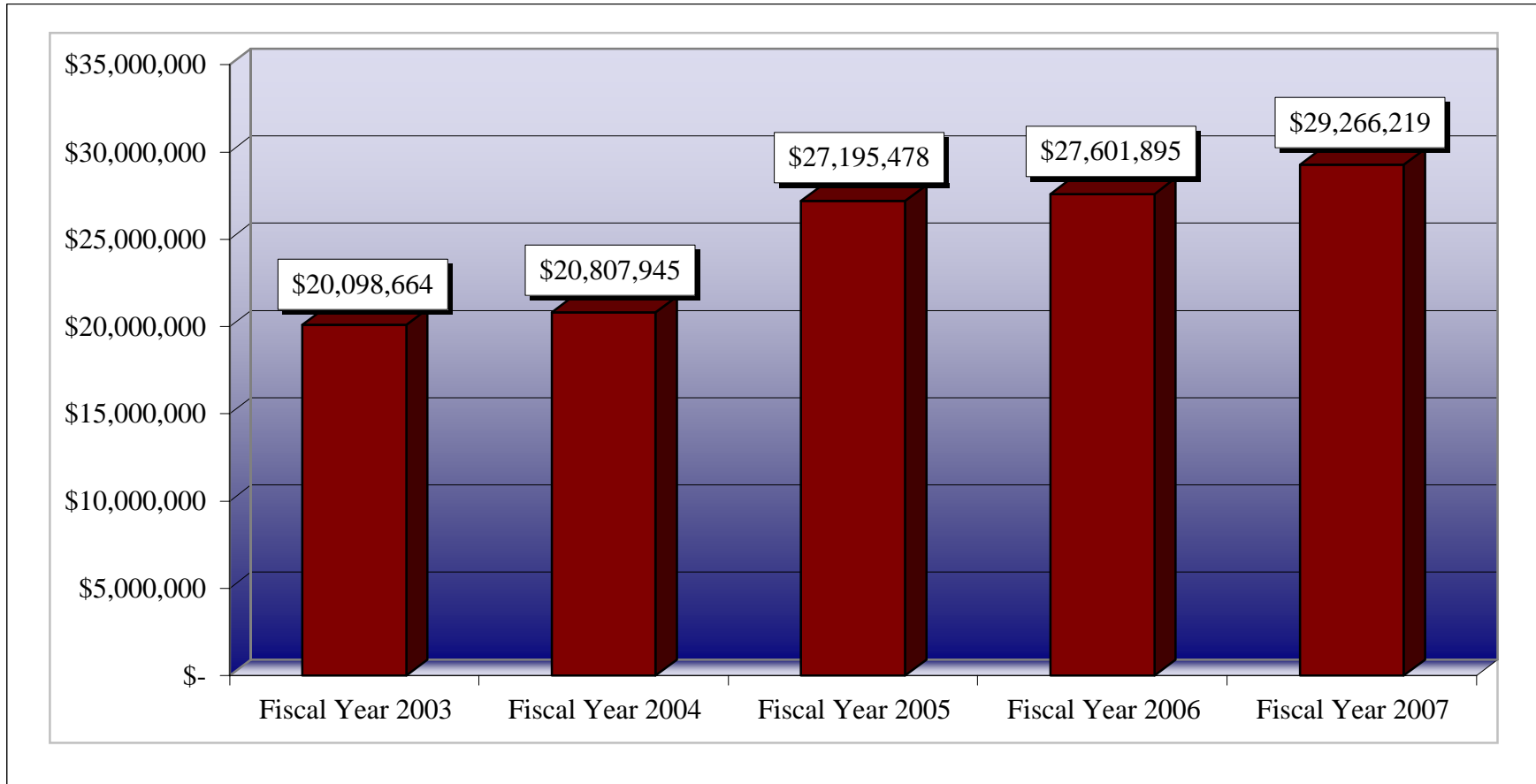
**NEBRASKA LOTTERY**  
**LOTTERY TICKET SALES**  
For the Fiscal Years 2003 through 2007



Note: These sales are shown on an accrual basis.



**NEBRASKA LOTTERY**  
**TOTAL OPERATING TRANSFERS**  
For the Fiscal Years 2003 through 2007



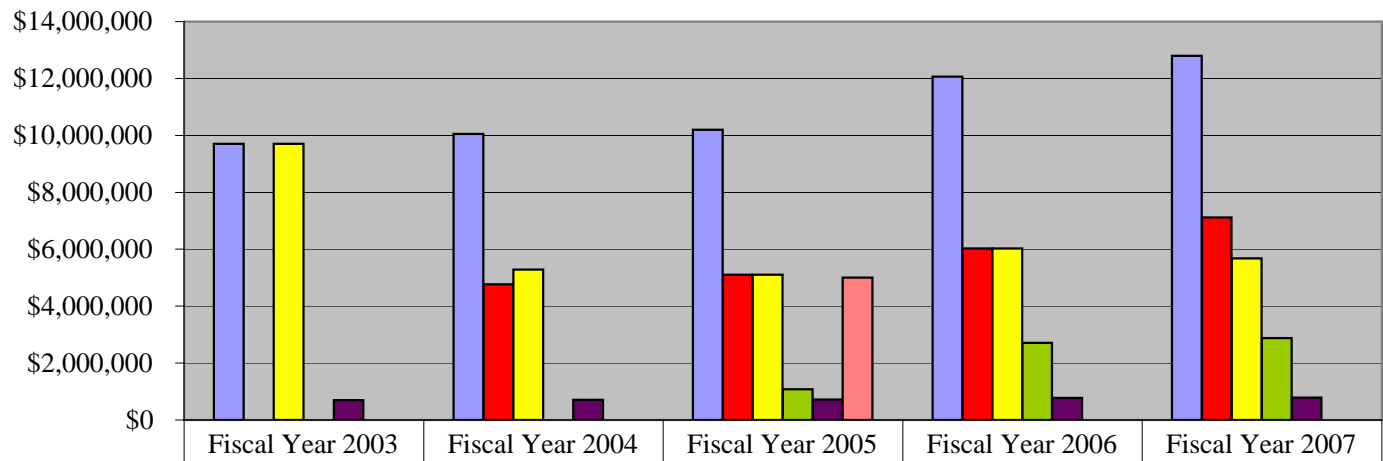
Note: The Total Operating Transfers include transfers to the Environmental Trust Fund, the Education Innovation Fund, the Nebraska Scholarship Fund (as of October 1, 2003), the Compulsive Gamblers Assistance Fund, and the State Fair Support and Improvement Cash Fund (as of January 1, 2005). The fiscal year 2005 Operating Transfers amount includes an additional \$5,000,000 transfer made from the State Lottery Operation Trust Fund to the General Fund in July 2004, as required by Neb. Rev. Stat. Section 9-812 R.S.Supp., 2004. These transfers are shown on a cash basis.

**NEBRASKA LOTTERY  
SCHEDULE OF CUMULATIVE OPERATING TRANSFERS**

<u>State Fiscal Year</u>	<u>Transfer Amount</u>
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	18,235,952
2003	20,098,664
2004	20,807,945
2005	27,195,478
2006	27,601,895
2007	29,266,219
Total Cumulative Transfers	<u>\$ 288,101,249</u>

Note: Total Cumulative Transfers includes transfers to the Solid Waste Landfill Closure Fund (final allocation made in July 1997), the Environmental Trust Fund, the Education Innovation Fund, the Nebraska Scholarship Fund (beginning October 1, 2003), the Compulsive Gamblers Assistance Fund, and the State Fair Support and Improvement Cash Fund (beginning January 1, 2005). 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. The Fiscal Year 2005 transfer amount includes a \$5,000,000 transfer from the State Lottery Operation Trust Fund to the General Fund in July 2004, as required by Neb. Rev. Stat. Section 9-812 R.S.Supp., 2004.

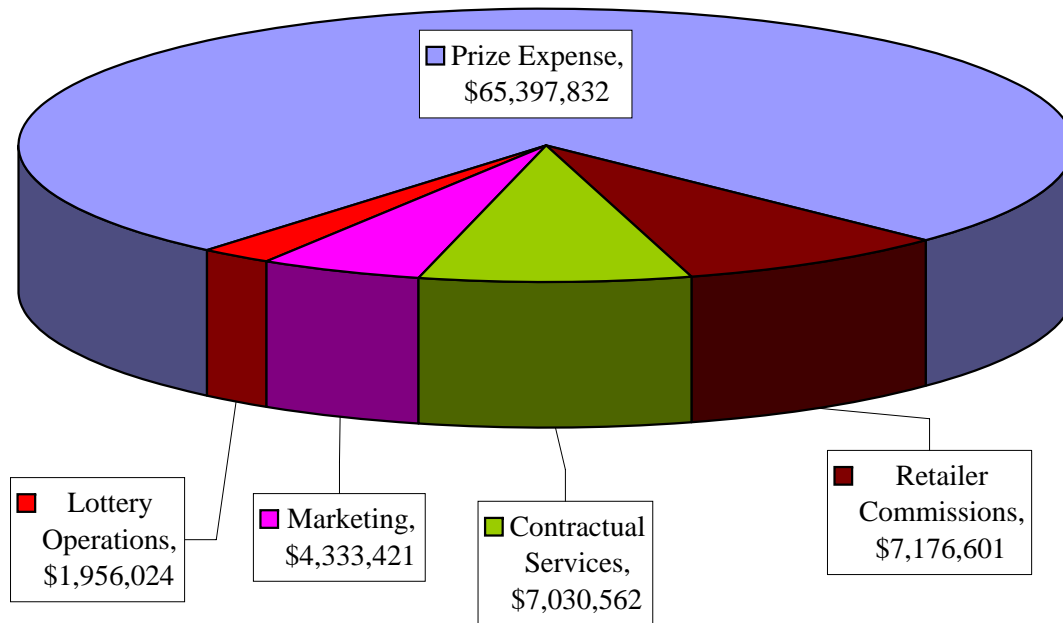
**NEBRASKA LOTTERY  
OPERATING TRANSFERS**  
For the Fiscal Years 2003 through 2007



Environmental Trust Fund	\$9,701,339	\$10,052,433	\$10,201,368	\$12,060,343	\$12,800,967
Nebraska Scholarship Fund	\$0	\$4,768,764	\$5,100,683	\$6,030,172	\$7,119,639
Education Innovation Fund	\$9,701,339	\$5,283,669	\$5,100,683	\$6,030,172	\$5,681,329
State Fair Support and Improvement Cash Fund	\$0	\$0	\$1,075,788	\$2,710,190	\$2,876,621
Compulsive Gamblers Assistance Fund	\$695,986	\$703,079	\$716,956	\$771,018	\$787,663
General Fund	\$0	\$0	\$5,000,000	\$0	\$0

**Note:** The Nebraska Constitution establishes the basic requirements for the transfer of lottery ticket sales to certain beneficiary funds. The portion designated for the education beneficiary can be amended by the Legislature. Neb. Rev. Stat. Section 9-812 as amended identifies the specific requirement and they are as follows: Beginning October 1, 2003, and until July 1, 2009, a portion of the dollar amount of the lottery tickets, which have been sold on an annualized basis shall 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. Neb. Rev. Stat. Section 9-812 as amended further requires the following: 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. Of the money remaining after the payment of prizes, operating expenses, and transfer to the Compulsive Gamblers Assistance Fund; nineteen 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-four and one-half percent shall be transferred to the Nebraska Environmental Trust Fund, ten percent shall be transferred to the State Fair Support and Improvement Cash Fund, and one percent shall be transferred to the Compulsive Gamblers Assistance Fund. Please note that changes were made for the fiscal year 2007 distributions and these percentages did not apply to every fiscal year listed above. In addition to the above transfers, a transfer of \$5,000,000 was made by the State Treasurer from the State Lottery Operation Trust Fund to the General Fund on July 15, 2004, as required by Neb. Rev. Stat. Section 9-812 R.S.Supp., 2004.

**NEBRASKA LOTTERY  
OPERATING EXPENSES**  
For the Fiscal Year Ended June 30, 2007



Total Operating Expenses \$85,894,440

**Breakdown of Expenses**

**Prize Expense:**

Instant Prize Expense	\$39,469,213
On-Line Prize Expense	\$27,557,169
Unclaimed Prizes	<u>(\$1,628,550)</u>
<b>Total</b>	<b>\$65,397,832</b>

**Retailer Commissions:**

Instant Commissions	\$4,117,191
On-line Commissions	\$2,911,912
Misc. Retailer Expense	<u>\$147,498</u>
<b>Total</b>	<b>\$7,176,601</b>

**Contractual Services:**

Gtech	\$5,173,183
Intralot	\$1,311,029
Other Contractors	<u>\$546,350</u>
<b>Total</b>	<b>\$7,030,562</b>

**Marketing Expense:**

Advertising Expense	\$3,063,017
Promotions Expense	<u>\$1,270,404</u>
<b>Total</b>	<b>\$4,333,421</b>

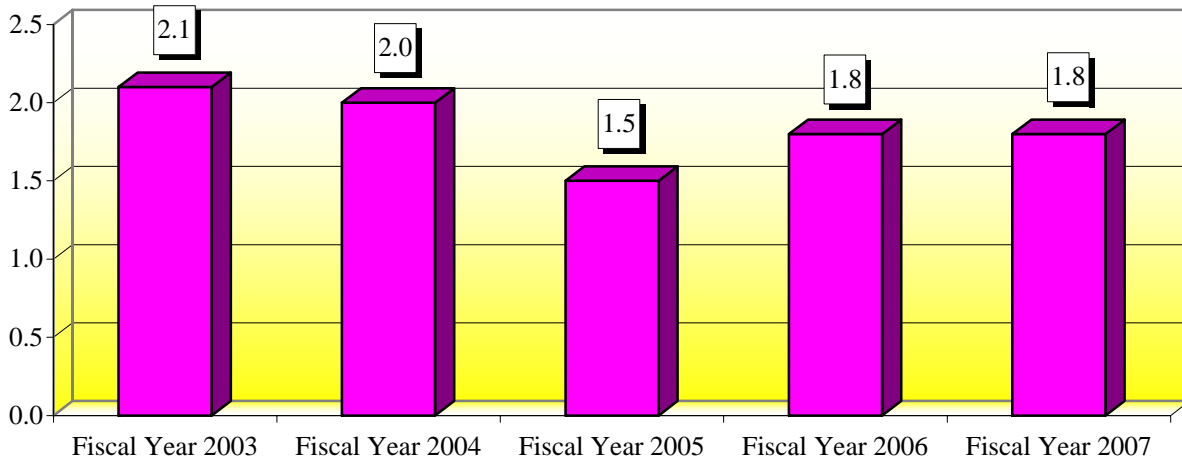
**Lottery Operations:**

Payroll Expense	\$1,412,400
Other Operating Expense	<u>\$543,624</u>
<b>Total</b>	<b>\$1,956,024</b>

# NEBRASKA LOTTERY

## CURRENT RATIO

For the Fiscal Years 2003 through 2007

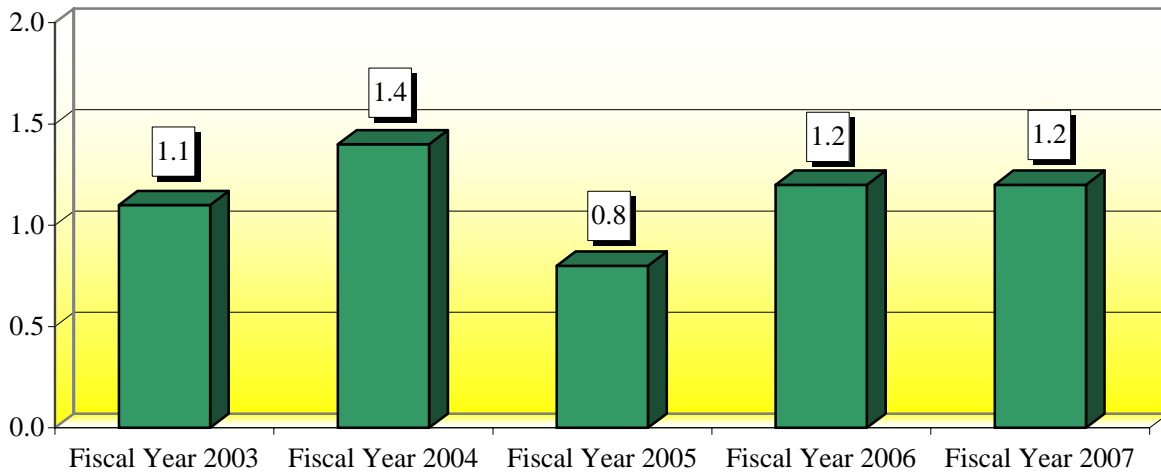


	Fiscal Year 2003	Fiscal Year 2004	Fiscal Year 2005	Fiscal Year 2006	Fiscal Year 2007
Current Assets	\$12,535,367	\$11,635,452	\$9,401,348	\$12,846,966	\$13,954,763
Current Liabilities	\$6,089,747	\$5,936,040	\$6,249,164	\$6,964,567	\$7,836,434

**Note:** The Current Ratio is an assessment of the Nebraska Lottery's current assets in excess of current liabilities.

## QUICK RATIO

For the Fiscal Years 2003 through 2007



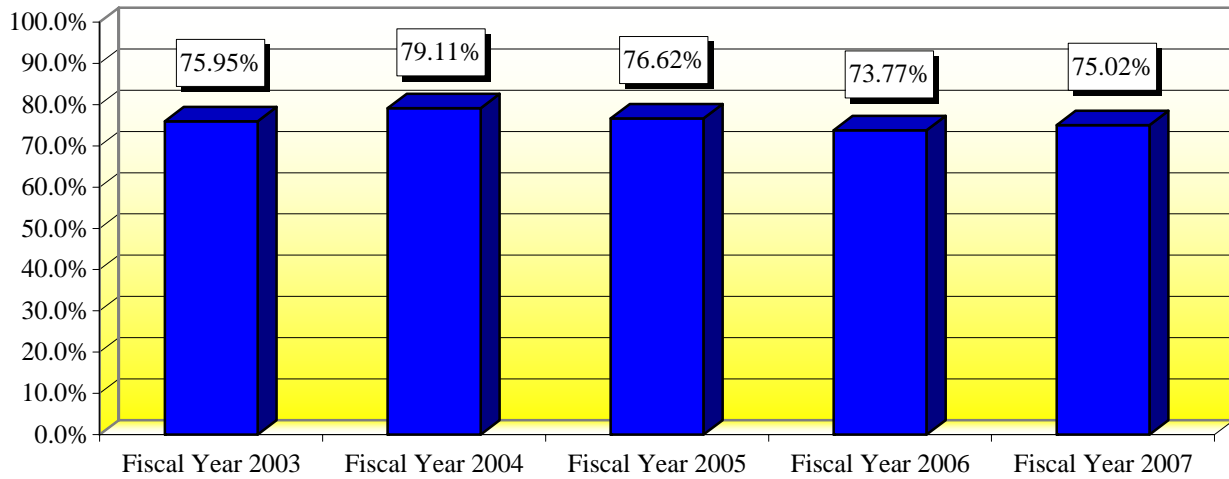
	Fiscal Year 2003	Fiscal Year 2004	Fiscal Year 2005	Fiscal Year 2006	Fiscal Year 2007
Cash & Cash Equivalents	\$6,878,514	\$8,014,088	\$5,267,568	\$8,067,339	\$9,059,287
Current Liabilities	\$6,089,747	\$5,936,040	\$6,249,164	\$6,964,567	\$7,836,434

**Note:** The Quick Ratio is an assessment of the Nebraska Lottery's cash in excess of current liabilities.

## NEBRASKA LOTTERY

### PERCENTAGE OF OPERATING EXPENSES TO REVENUES

For the Fiscal Year 2003 through 2007

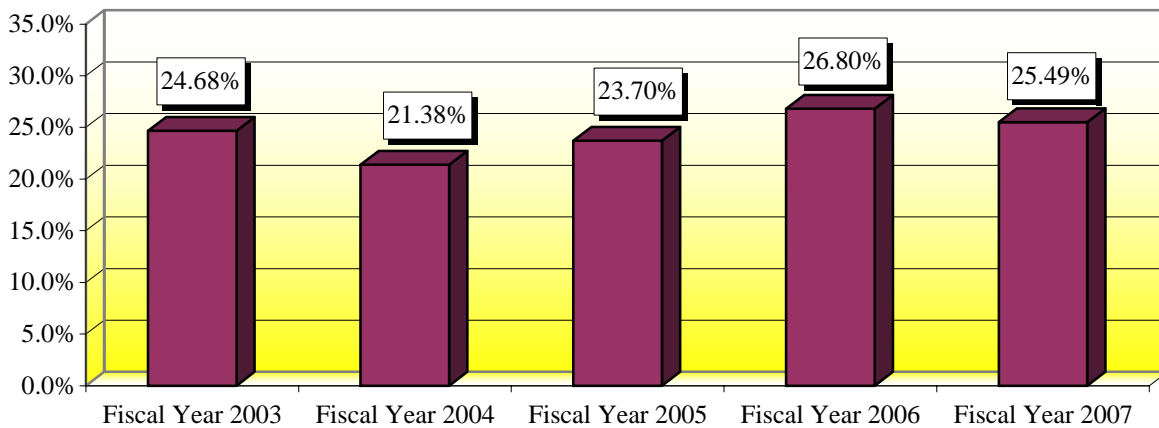


	Fiscal Year 2003	Fiscal Year 2004	Fiscal Year 2005	Fiscal Year 2006	2007
Total Operating Expense	\$61,455,786	\$73,264,372	\$77,127,721	\$83,440,839	\$85,894,440
Total Operating Revenue	\$80,918,807	\$92,608,643	\$100,658,171	\$113,108,341	\$114,488,888

**Note:** The graph represents the percentage of operating expenses to revenues.

### NET INCOME BEFORE TRANSFERS COMPARED TO OPERATING REVENUE

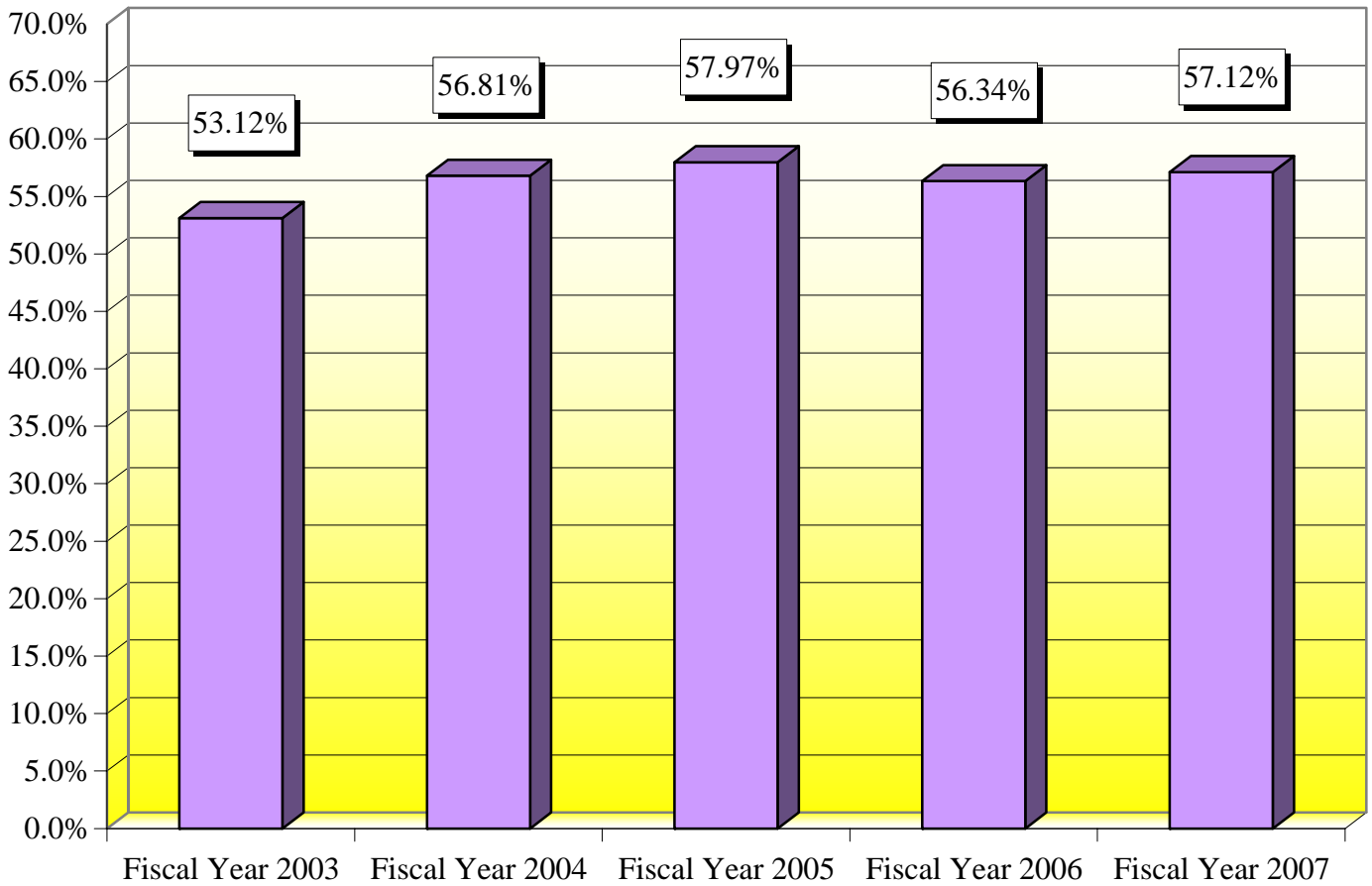
For the Fiscal Years 2003 through 2007



	Fiscal Year 2003	Fiscal Year 2004	Fiscal Year 2005	Fiscal Year 2006	Fiscal Year 2007
Net Income Before Transfers	\$19,968,899	\$19,796,914	\$23,860,515	\$30,314,855	\$29,186,214
Total Operating Revenue	\$80,918,807	\$92,608,643	\$100,658,171	\$113,108,341	\$114,488,888

**Note:** The graph represents the percentage of net income before operating transfers compared to total operating revenue.

**NEBRASKA LOTTERY**  
**PRIZE PERCENTAGE OF SALES PAID OUT**  
For the Fiscal Years 2003 through 2007



	Fiscal Year 2003	Fiscal Year 2004	Fiscal Year 2005	Fiscal Year 2006	Fiscal Year 2007
Prize Expense	\$42,984,053	\$52,607,966	\$58,352,134	\$63,722,319	\$65,397,832
Total Operating Revenue	\$80,918,807	\$92,608,643	\$100,658,171	\$113,108,341	\$114,488,888

**Note:** The graph represents the percentage of net sales paid out in prizes.