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STATEMENT OF LOTTERY REVENUES,  
PRIZE DISBURSEMENTS AND OTHER EXPENSES

(UNAUDITED)

FOR THE FISCAL YEAR ENDED

JUNE 30, 2005

**COLORADO LOTTERY  
FINANCIAL STATEMENTS  
(UNAUDITED)**

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# STATE OF COLORADO

## DEPARTMENT OF REVENUE

Colorado State Lottery  
201 W. 8<sup>th</sup> Street, Suite 600  
Pueblo, Colorado 81003  
(719) 546-2400  
FAX (719) 546-5208



August 17, 2005

Bill Owens  
Governor

M. Michael Cooke  
Executive Director

Peggy Gordon  
Lottery Director

State Treasurer and Members of the Colorado Lottery Commission:

Pursuant to CRS 24-35-204, the Colorado Lottery is required to furnish monthly, "a complete statement of lottery revenues, prize disbursements and other expenses."

The financial performance for the fiscal year ended June 30, 2005 depicts total revenues of \$418.7 million, gross ticket sales of \$417 million, net income before proceeds distributions of \$105 million, and a net increase in net assets of \$1.3 million. Accordingly, a total of \$103.7 million in distributions will have been made by September 1, 2005 in the following manner; \$50.2 million to the Great Outdoors Colorado Fund, \$10.3 million to the Division of Parks and Outdoor Recreation, \$41.5 million to the Conservation Trust Fund, for distribution to cities and other local government agencies and \$1.7 to the State Public School Fund Contingency Reserve.

The attached financial statements for the fiscal year ended June 30, 2005 have not been audited. They have been prepared in accordance with generally accepted accounting principles, using established accounting and internal control procedures. These procedures include, but are not limited to, documentation and accounting estimates, which support the production of reliable financial statements. As with any system of accounting and internal control procedures, there are inherent limitations, and the procedures cannot be relied upon to completely eliminate the occurrence of discrepancies, error or omissions, but should reduce that risk to a relatively low tolerable level.

Respectfully submitted,

A handwritten signature in cursive script that reads "Barb Aggson".

Barb Aggson  
Controller  
Colorado Lottery

**COLORADO LOTTERY  
FINANCIAL STATEMENTS  
(UNAUDITED)**

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# Colorado Lottery

## Management's Discussion and Analysis

### Year Ended June 30, 2005

This discussion and analysis of the Lottery financial performance provides an overview of financial activities for the fiscal year ended June 30, 2005. Please read it in conjunction with the Lottery's financial statements, which begin on page 22. These financial statements reflect only activities of the Colorado Lottery, a proprietary fund of the State of Colorado.

#### ***Fiscal Year 2005 Financial Highlights***

- The Lottery's overall sales performance of \$417 million reflected a \$15.7 million increase from last year and replaced fiscal year 2002, whose sales totaled \$407 million, as the highest sales year since the Lottery's start-up in 1983. Fiscal years 2003 and 2004 sales totaled \$391.5 million and \$401 million respectively and rank as the third and fourth highest sales years ever.

Scratch sales hit a record high for the second year in a row with scratch sales totaling \$282.7 million. The second highest honors goes to fiscal year 2004, with scratch sales totaling \$260.9 million. Fiscal year 2003 scratch sales totaling \$254.3 million ranks fourth in total scratch sales with fiscal year 2002 holding the third position with scratch sales totaling \$257.2 million. An increase in marketing efforts including offering a broader range of price points, additional games and an overall upgrade to the look of our scratch tickets, contributed to this increase in scratch sales.

Lotto sales continue to decline since the introduction of Powerball in fiscal year 2002 but at a slower rate than in fiscal year 2004. Fiscal year 2005 Lotto sales of \$38.3 million reflect a decrease of \$2.5 million from the previous year sales of \$40.8 million. Fiscal year 2004 Lotto sales totaling \$40.8 million reflected a \$7.5 million decrease from the prior fiscal year 2003 sales of \$48.3 million.

Powerball sales for fiscal year 2005 also experienced a slight decrease of \$4.1 million from the prior fiscal year. Powerball sales for fiscal year 2005 totaled \$80.9 million as compared to the prior year's record breaking sales of \$85 million. Fiscal year 2003 Powerball sales totaled \$75.7 million.

Cash 5 sales for fiscal year 2005 again showed an unexpected increase. Sales increased nearly 4% to a total of \$15.1 million from \$14.5 million in fiscal year 2004. This followed a more than 9% increase in sales in fiscal year 2004 from fiscal year 2003 whose sales totaled \$13.2 million

- Proceeds distributions fell slightly, totaling \$103.7 million, as compared to \$104.1 million in fiscal year 2004 and \$104.8 million in fiscal year 2003. This included, for the fourth time, a spill-over into the State Public School Fund Contingency Reserve of \$1.7 million in fiscal year 2005. A spill-over occurs when the distribution cap for GOCO is reached in any one year. The cap for GOCO is the 1992 base year adjusted for the annual change in the cost of living increase for the Denver-Boulder area. The total amount of the spill-over over the four year period totals \$16.3 million.

# **Colorado Lottery**

## **Management's Discussion and Analysis**

### **Year Ended June 30, 2005**

- Gross profit as a percent of sales decreased by .4 percent, a reflection of the increase in the prize costs from 59% (\$236,602,960) to 59.8% (\$249,502,651) of sales. Fiscal year 2004 prize expense was slightly lower due to a greater reduction in prize expense from the absorption of unclaimed prizes. Two expiring unclaimed Lotto jackpots contributed to the higher amount of unclaimed prizes.

Gross profit as a percent of sales decreased by .2 percent between fiscal years 2003 and 2004, a reflection of the increase in the prize costs from 58% (\$227,514,771) to 59% (\$239,427,919) of sales. Fiscal year 2003 prize expense was slightly lower due to a decrease in Powerball prize expense from the absorption of an unclaimed Powerball jackpot.

#### ***Games Offered by the Colorado Lottery***

Currently, the Lottery offers two different ways to play: scratch games and online games (Powerball, Lotto and Cash 5). Scratch games consist of pre-printed tickets that may be purchased for various prices (\$1, \$2, \$3, \$5 and \$10) at any Lottery retailer. When scratched, they provide immediate knowledge if the ticket is a winner and can be cashed immediately at the retailer level if the amount of the winnings is \$599 or less.

Online games, however, require a longer playing time. Tickets are also purchased at Lottery retailers and are printed on ticket stock as the purchase is made. Each ticket contains one or more playing boards. Each board consists of a set of numbers, the combination of numbers required for play varying by game. The winning numbers for each game are posted after their respective draw nights with drawings held on every night of the week, excluding Sunday. Players must check their numbers against the numbers drawn for each respective game to determine if they have a winning ticket. The tickets may also be cashed at the retailer level if the amounts of the winnings are \$599 or less. Prizes over \$600 must be redeemed at Lottery offices.

#### ***Using this Annual Report***

This annual report consists of a series of financial statements. The statement of net assets provides information about the Lottery's assets and liabilities and reflects the Lottery's financial position as of June 30, 2005, 2004 and 2003. The statement of revenues, expenses, and changes in net assets reports the activity of selling Lottery products and the expenses related to such activity for the years ended June 30, 2005, 2004 and 2003. Finally, the statement of cash flows outlines the cash inflows and outflows related to the activity of selling Lottery products for the years ended June 30, 2005, 2004 and 2003.

**Colorado Lottery**  
**Management's Discussion and Analysis**  
**Year Ended June 30, 2005**

**Statements of Net Assets**

The statements of net assets is a financial snapshot of the Lottery at June 30, 2005, 2004 and 2003. It presents the fiscal resources of the Lottery (assets), the claims against those resources (liabilities) and the residual available for future operations (net assets). Assets and liabilities are classified by liquidity as either current or non-current. Net assets are classified by the ways in which they may be used for future operations.

**Colorado Lottery**  
**Condensed Statements of Net Assets**  
**June 30, 2005, 2004 and 2003**

	<b>2005</b>	<b>2004</b>	<b>2003</b>
<b>Assets</b>			
Current assets	\$ 49,400,246	\$ 39,951,270	\$ 47,485,313
Restricted assets	6,089,239	5,024,418	3,003,518
Capital assets	<u>861,066</u>	<u>1,029,114</u>	<u>1,427,326</u>
Total assets	<u>56,350,550</u>	<u>46,004,802</u>	<u>51,916,157</u>
<b>Liabilities</b>			
Current liabilities	52,415,997	43,576,344	48,061,451
Long-term liabilities	<u>965,078</u>	<u>782,863</u>	<u>958,754</u>
Total liabilities	<u>53,381,075</u>	<u>44,359,207</u>	<u>49,020,205</u>
<b>Net Assets</b>			
Investment in capital assets	861,066	1,029,114	1,427,326
Restricted-Licensed Agent Recovery Reserve	479,238	469,424	460,638
Unrestricted-Operating Reserve	1,700,000	0	0
Unrestricted	<u>(70,829)</u>	<u>147,057</u>	<u>1,007,988</u>
Total net assets	<u>\$ 2,969,475</u>	<u>\$ 1,645,595</u>	<u>\$ 2,895,952</u>

The Lottery's total assets at June 30, 2005 were \$56.4 million. Assets consisted primarily of cash and investments with the State Treasury of \$28.7 million, Prepaid Prize Expense with MUSL of \$3.9 million, receivables from Lottery retailers for the sale of Lottery products of \$21.5 million, and a net investment in fixed assets of \$.9 million.

Comparable figures at June 30, 2004 were \$46 million in total assets, including \$25.4 million in cash and investments with the State Treasury, Prepaid Prize Expense with MUSL of \$3.5 million, receivable from retailers of \$14.7 million, and a net investment in fixed assets of \$1 million.

**Colorado Lottery**  
**Management's Discussion and Analysis**  
**Year Ended June 30, 2005**

Comparable figures at June 30, 2003 were \$51.9 million in total assets, including \$31.5 million in cash and investments with the State Treasury, Prepaid Prize Expense with MUSL of \$2.5 million, receivable from retailers of \$15.3 million, and a net investment in fixed assets of \$1.4 million.

The \$6.8 million increase in receivables from retailers between fiscal year 2004 and fiscal year 2005 was partly the result of an undetected problem in the new on-line system, whereby billings of receivables to retailers were delayed. The error was detected in mid-July and is currently being resolved.

The Lottery's total liabilities at June 30, 2005 totaled approximately \$53 million, consisting primarily of proceeds distributions due to recipients of \$27.8 million and prize liability on all Lottery products of about \$17.1 million.

The Lottery's total liabilities at June 30, 2004 totaled \$44.4 million, which consisted primarily of proceeds distributions due of \$25.8 million and prize liability on all Lottery products of about \$14 million.

The Lottery's total liabilities at June 30, 2003 totaled \$49 million, which consisted primarily of proceeds distributions due of \$25.4 million and prize liability on all Lottery products of about \$18.6 million.

Components of the Lottery's net assets are: 1) an amount to represent the Lottery's net investment in capital assets as required by the reporting model under GASB 34, (See "Total Capital Assets" on the statements of net assets); 2) a Licensed Agent Recovery Reserve (bonding reserve) funded by retailers to cover any uncollectible receivable accounts; 3) an amount representing the funds held by the Lottery in an operating reserve as mandated by Senate Bill 204 (See "Cash and Investments-Operating Reserve" on the statements of net assets; and 4) an adjustment made by the Lottery to reflect its share of unrealized gains or losses on investments held by the State Treasurer.

The change in net assets from June 30, 2004 to June 30, 2005 consisted of a decrease in investment in capital assets from \$1 million to \$.9 million, a minor increase in the bonding reserve from \$469,424 to \$479,239, the establishment of the operating reserve of \$1.7 million, and a net decrease in unrealized gain and losses on investments of \$217,886 resulting from a net decrease in the adjustments on State Treasury investments.

Following is a schedule of net assets:

	<u>2005</u>	<u>2004</u>	<u>Change</u>
Investment in capital assets	\$ 861,066	\$ 1,029,114	\$ (168,048)
Bonding reserve	479,238	469,424	9,814
Operating reserve	1,700,000	0	1,700,000
Unrealized gain(loss) on investments	<u>(70,829)</u>	<u>147,057</u>	<u>(217,886)</u>
Total net assets	<u>\$ 2,969,475</u>	<u>\$ 1,645,595</u>	<u>\$ 1,323,880</u>



**Colorado Lottery**  
**Management's Discussion and Analysis**  
**Year Ended June 30, 2005**

The change in net assets from June 30, 2003 to June 30, 2004 consisted of a decrease in investment in capital assets from \$1.4 million to \$1 million, a minor increase in the bonding reserve from \$460,638 to \$469,424, and a net decrease in unrealized gains and losses on investments of \$860,931 resulting from a net decrease in the adjustments on State Treasury investments.

Following is a schedule of net assets:

	<u>2004</u>	<u>2003</u>	<u>Change</u>
Investment in capital assets	\$ 1,029,114	\$ 1,427,326	\$ (398,212)
Bonding reserve	469,424	460,638	8,786
Unrealized gain on investments	<u>147,057</u>	<u>1,007,988</u>	<u>860,931</u>
Total net assets	<u>\$ 1,645,595</u>	<u>\$ 2,895,952</u>	<u>\$ (1,250,357)</u>

**Colorado Lottery**  
**Management's Discussion and Analysis**  
**Year Ended June 30, 2005**

***Statements of Revenues, Expenses and Changes in Net Assets***

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

**Condensed Statements of Revenues, Expenses and  
Changes In Net Assets  
For the Fiscal Years Ended June 30, 2005, 2004 and 2003**

	<u>2005</u>	<u>2004</u>	<u>2003</u>
<b>Operating Revenues</b>	\$ 416,966,782	\$ 401,250,971	\$ 391,473,640
<b>Direct Operating Expenses</b>	<u>291,083,679</u>	<u>276,512,227</u>	<u>266,444,993</u>
<b>Gross Profit on Sale of Tickets</b>	<u>125,883,103</u>	<u>124,738,744</u>	<u>125,028,647</u>
<b>Other Operating Expenses</b>			
Marketing and communications	8,559,774	8,643,422	9,093,013
Wages and benefits	7,941,537	7,881,363	8,055,900
Other operating expenses	<u>6,022,481</u>	<u>5,550,032</u>	<u>5,142,879</u>
Total operating expenses	<u>22,523,792</u>	<u>22,074,817</u>	<u>22,291,792</u>
<b>Operating Income</b>	<u>103,359,311</u>	<u>102,663,927</u>	<u>102,736,855</u>
<b>Nonoperating Revenues (Expenses)</b>			
Other revenue	953,328	156,990	303,134
Investment income	747,176	184	1,958,747
Proceeds distributions	<u>(103,735,935)</u>	<u>(104,071,458)</u>	<u>(104,779,061)</u>
Total nonoperating revenue (expenses)	<u>(102,035,431)</u>	<u>(103,914,284)</u>	<u>(102,517,180)</u>
<b>Increase (Decrease) in Net Assets</b>	1,323,880	(1,250,357)	219,675
<b>Net Assets, Beginning of Year</b>	<u>1,645,595</u>	<u>2,895,952</u>	<u>2,676,277</u>
<b>Net Assets, End of Year</b>	<u>\$ 2,969,475</u>	<u>\$ 1,645,595</u>	<u>\$ 2,895,952</u>

**Colorado Lottery**  
**Management's Discussion and Analysis**  
**Year Ended June 30, 2005**

**Sales Activities**

Revenues from the sale of Lottery products for the fiscal year ended June 30, 2005 were the highest in the Lottery's 23-year history. As shown in the financial statements, overall sales increased by 3.9% from the prior year, from \$401.3 million in fiscal year ended June 30, 2004 to \$417 million in the current year and increased by 2.2% over the second highest sales year of \$408 million in fiscal year 2002. The increase in scratch sales from \$260.9 million to \$282.7 million represented a larger percentage increase of 8.4%. Powerball finished its third full year of sales with a slight decrease of 4.8% in sales from the prior year, a result of fewer large Powerball jackpots. Lotto sales suffered another off year statistically, resulting in a 6.1% reduction in sales. This was the third consecutive year that Lotto experienced a large percentage reduction in sales. In fiscal year 2004, Lotto sales reflected a 15.5% decrease from fiscal year 2003.

The following tables compare Lottery product sales between fiscal years. All sales are presented in millions of dollars:

<b>Product Sales</b>	<b>2005</b>	<b>2004</b>	<b>Difference</b>	<b>Percentage</b>
Scratch	\$ 282.7	\$ 260.9	\$ 21.8	8.4%
Powerball	80.9	85.0	(4.1)	(4.8)
Lotto	38.3	40.8	(2.5)	(6.1)
Cash 5	<u>15.1</u>	<u>14.5</u>	<u>.6</u>	<u>4.1</u>
Total	\$ <u>417.0</u>	\$ <u>401.2</u>	\$ <u>(15.8)</u>	<u>(3.9)%</u>

\*Certain amounts may not foot due to rounding.

<b>Product Sales</b>	<b>2004</b>	<b>2003</b>	<b>Difference</b>	<b>Percentage</b>
Scratch	\$ 260.9	\$ 254.3	\$ 6.6	2.6%
Powerball	85.0	75.7	9.3	12.3
Lotto	40.8	48.3	(7.5)	(15.5)
Cash 5	<u>14.5</u>	<u>13.2</u>	<u>1.3</u>	<u>9.8</u>
Total	\$ <u>401.2</u>	\$ <u>391.5</u>	\$ <u>9.7</u>	<u>(2.5)%</u>

\*Certain amounts may not foot due to rounding.

**Colorado Lottery**  
**Management's Discussion and Analysis**  
**Year Ended June 30, 2005**

***Total Revenues***

Nonoperating revenues for the year ended June 30, 2005 totaled \$1.7 million as compared with \$.2 million for the year ended June 30, 2004 and \$2.3 million for the year ended June 30, 2003. Two major factors contributed to the increase from fiscal year 2004 to fiscal year 2005. First, investment income for fiscal year 2004 included a net loss of \$860,931 to record the Lottery's share of unrealized gains and losses as compared to a net loss of only \$217,886 in the current fiscal year. Second other income in fiscal year 2005 included reimbursements from the on-line vendor of approximately \$855,000. Two major factors contributed to the decrease from fiscal year 2003 to fiscal year 2004. First, investment income for fiscal year 2004 included a net loss of \$860,931 to record the Lottery's share of unrealized gains and losses on investments as mandated by GASB 31. In contrast, a \$398,543 net gain from the Lottery's share of unrealized gains and losses was included in investment income for fiscal year 2003. Second, interest received from the treasury and other sources was down by nearly \$700,000 due to lower interest rates in a sluggish economy. In addition, C.R.S. 24-36-114 required that, for fiscal year 2004, 15% of the Lottery's Treasury interest be sent to the General Fund.

Total revenues were \$418.7 million and \$401.4 million for the years ended June 30, 2005 and 2004, respectively. As mentioned elsewhere, the two major contributors to the increase of approximately \$17.2 million were an increase in Lottery sales of \$15.7 million and an increase in nonoperating revenues of \$1.5 million.

Total revenues for the year ended June 30, 2003 were \$393.7 million. The major contributing factor of the increase in total revenues from fiscal year 2003 to fiscal year 2004 of \$7.7 million, was an increase in ticket sales of \$9.8 million. This was offset by a decrease in nonoperating revenues of \$2.1 million.

**Colorado Lottery**  
**Management's Discussion and Analysis**  
**Year Ended June 30, 2005**

**Major Expenses**

Approximately \$291.1 million of the Lottery's total expenses of \$313.6 for the fiscal year ended June 30, 2005 were incurred in direct support of Lottery games. This included prize expense, retailer compensation, money spent to purchase scratch tickets and compensation to the vendor who maintains and supports the online gaming system.

In comparison, \$276.5 million of the Lottery's total expenses of \$298.6 million for the fiscal year ended June 30, 2004, were game-related expenses.

In comparison, \$266.4 million of the Lottery's total expenses of \$288.7 million for the fiscal year ended June 30, 2003, were game-related expenses.

Following are tables comparing the game-related expenses between fiscal years. All expenses are presented in millions of dollars.

<b>Game-Related Expenses</b>	<b>2005</b>	<b>2004</b>	<b>Difference</b>	<b>Percentage</b>
Prize expense/Powerball prize variance	\$ 249.5	\$ 236.6	\$ 12.9	5.4%
Retailer compensation				
Commissions	27.8	26.6	1.2	4.5
Bonuses	3.9	3.6	.3	8.3
Ticket costs	3.2	3.0	.2	6.7
Vendor fees	<u>6.7</u>	<u>6.7</u>	<u>.0</u>	<u>.0</u>
Total	\$ <u>291.1</u>	\$ <u>276.5</u>	\$ <u>14.6</u>	<u>5.3%</u>

<b>Game-Related Expenses</b>	<b>2004</b>	<b>2003</b>	<b>Difference</b>	<b>Percentage</b>
Prize expense/Powerball prize variance	\$ 236.6	\$ 226.9	\$ 9.7	4.3%
Retailer compensation				
Commissions	26.6	26.0	.6	2.3
Bonuses	3.6	3.5	.1	2.9
Ticket costs	3.0	3.2	(0.2)	(6.3)
Vendor fees	<u>6.7</u>	<u>6.8</u>	<u>(0.1)</u>	<u>(1.5)</u>
Total	\$ <u>276.5</u>	\$ <u>266.4</u>	\$ <u>10.1</u>	<u>3.8%</u>

The increase in the game-related expenses, including prize expense, commission expense and bonus expense, is reflective of the increase in product sales. See the product sales schedule above. In addition, the prize expense percentage was further increased in fiscal year 2005 over the prize expense percentage in fiscal year 2004, as the prize expense percentage in fiscal year 2004 had been reduced by the expiration of two unclaimed Lotto jackpots. Also, the prize expense

# **Colorado Lottery**

## **Management's Discussion and Analysis**

### **Year Ended June 30, 2005**

percentage was further increased in fiscal year 2004 over the prize expense percentage in fiscal year 2003, as the prize expense percentage in fiscal year 2003 included the absorption of an unclaimed Powerball jackpot.

Of the \$22.5 million in fiscal year 2005 expenses that were non game-related, nearly \$8.6 million was for promotions and institutional and product advertising and \$7.8 million was for compensation to Lottery employees.

In comparison, of the fiscal year 2004 non game-related expenses of \$22.1 million, more than \$8.6 million was for promotions and institutional and product advertising, and \$8.1 million was for compensation to Lottery employees.

In comparison, of the fiscal year 2003 nongame-related expenses of \$22.3 million, just under \$9.1 million was for promotions and institutional and product advertising, and \$8.0 million was for compensation to Lottery employees.

#### ***Distributions to Proceeds Recipients***

The Lottery's efforts generated proceeds distributions of \$103.7 million in the current fiscal year, the fourth highest year ever. Of these total proceeds, nearly \$50.2 million was allocated to the Great Outdoors Colorado Trust Fund, \$41.5 million to the Conservation Trust Fund, and \$10.3 million to the Division of Parks and Outdoor Recreation per the distribution formula stated in Colorado Revised Statutes (C.R.S.) 24-35-210. The maximum distribution to Great Outdoors Colorado of \$50.2 million, pursuant to C.R.S. 33-60-104(1)(c) and 33-60-104(2), was reached, thus creating a spill-over into the State Public School Fund Contingency Reserve of \$1.7 million, pursuant to C.R.S. 22-54-117 (1.6) (a).

The Lottery's proceeds distributions for the prior year was the third highest year on record, totaling \$104.1 million. Approximately \$49.7 million was distributed to Great Outdoors Colorado, \$41.6 million to the Conservation Trust Fund, \$10.4 million to the Division of Parks and Outdoor Recreation and a spill-over into the State's Public School Fund Contingency Reserve of nearly \$2.4 million.

The Lottery's proceeds distributions for the fiscal year 2003 was the second highest year on record, totaling \$104.8 million. Approximately \$48.9 million was distributed to Great Outdoors Colorado, \$41.9 million to the Conservation Trust Fund, \$10.4 million to the Division of Parks and Outdoor Recreation and a spill-over into the State's Public School Fund Contingency Reserve of nearly \$3.6 million.

#### ***Budgetary Highlights***

The Lottery's budget is determined by a variety of methods. The majority of the budget is set by the annual appropriations bill (called the Long Bill), which determines budgets for every agency within the State. The Long Bill and department level allocations are approved shortly before the start of each fiscal year. Agencies may also request a supplemental appropriation during the fiscal year to cover unexpected expenses (or a negative supplemental for less than expected expenses), as well as year-end transfers of spending authority, if needed. In the third quarter of fiscal year 2005, the Legislature approved supplemental appropriation adjustments for the Lottery. Supplemental appropriations were approved in communication services, telecommunications, Multi-use Network

# **Colorado Lottery**

## **Management's Discussion and Analysis**

### **Year Ended June 30, 2005**

Task Force payments, workmen's compensation, Grand Junction lease space, vendor fees and the Computer Migration lines, offset by reductions in the vehicle lease payments, personal services, operating expenses, payments to the computer center, risk management, travel expenses, marketing and communications, and ticket costs. The final method of funding is special legislation. There was no special legislation affecting the Lottery's budget in fiscal year 2005.

The approved Lottery budget at the beginning of fiscal year 2005 was \$354 million. Department level allocations approved at the beginning of the fiscal year increased the budget by \$0.8 million. Supplemental appropriations and adjustments made in the third quarter decreased the budget by \$0.2 million to an amended total of \$354.6 million. Total expenditures and roll-forwards for fiscal year 2005 came to \$317 million, resulting in excess appropriations (or savings) of more than \$37.6 million.

#### ***Economic Factors and Next Year's Budget***

The Lottery considered several factors when setting the revenue estimates and the fiscal year 2005 budget. Online sales (Powerball, Lotto and Cash 5) are expected to decrease slightly overall as sales for Online games naturally decrease over the life cycle of each game.

Scratch sales for fiscal year 2005 were up approximately \$7.7 million from projections, finishing at \$282.7 million as the best Scratch sales ever. Therefore, the Lottery is projecting that fiscal year 2006 sales will be comparable or slightly higher than fiscal year 2005.

Fiscal year 2006 revenue estimates total \$410.5 million, an \$6.5 million decrease from fiscal year 2005 actual sales due primarily to a projected decrease in Powerball sales as the game matures. Powerball sales are projected to be \$74 million for fiscal year 2006 compared to actual Powerball sales of \$80.9 million for fiscal year 2005. Lotto and Cash5 projections for fiscal year 2006 are near 2005 actuals.

The Lottery does not expect major changes in costs in fiscal year 2006 other than normal increases in costs.

#### ***Contacting the Lottery's Financial Management***

This management discussion and analysis report is designed to provide Colorado citizens, Colorado government officials, our players, retailers and other interested parties with a general overview of the Lottery's financial activity for fiscal year 2004 and to demonstrate the Lottery's accountability for the money generated from the sale of Lottery products. If you have questions about this report or need additional information, contact Barbara Aggson, the Colorado Lottery's Controller, 212 W. 3<sup>rd</sup> Street, Suite 210, Pueblo, CO 81003.

COLORADO LOTTERY  
FINANCIAL HIGHLIGHTS  
\$ IN MILLIONS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2005 AND 2004

The table included below and the graphs included on page 2 present certain summarized operating results of the Colorado Lottery for the fiscal year ended June 30, 2005 and 2004, and should be read in conjunction with the financial statements presented herein. The graphs included on page 2 are presented for the purpose of demonstrating the Colorado Lottery's compliance with certain statutes that pertain to its operations.

	For the fiscal year ended June 30,			
	2005		2004	
	Total	Actual Percent	Total	Actual Percent
<b>INCOME</b>				
Gross Ticket Sales	\$416.97		\$401.25	
Nonoperating revenue	1.70		0.16	
<b>TOTAL INCOME</b>	<b>418.67</b>		<b>401.41</b>	
<b>LESS:</b>				
PRIZES	\$249.50	59.8% (1)	\$236.60	59.0% (1)
RETAILER COMMISSIONS AND BONUSES	\$31.68	7.6% (1)	\$30.26	7.5% (1)
<b>ADMINISTRATIVE COSTS</b>				
Ticket Costs and Vendor Fees	9.91		9.65	
Other Operating Expenses	22.52		22.08	
<b>TOTAL ADMINISTRATIVE COSTS (Note 3)</b>	<b>32.43</b>	<b>7.7% (2)</b>	<b>31.73</b>	<b>7.9% (2)</b>
<b>NET INCOME BEFORE DISTRIBUTIONS</b>	<b>105.06</b>		<b>102.82</b>	
<b>NET CHANGE IN NET ASSETS</b>	<b>1.32</b>		<b>-1.25</b>	
<b>PROCEEDS DISTRIBUTION</b>	<b>\$103.74</b>	<b>24.8% (2)</b>	<b>\$104.07</b>	<b>25.9% (2)</b>

Note 1: Percent of gross ticket sales.

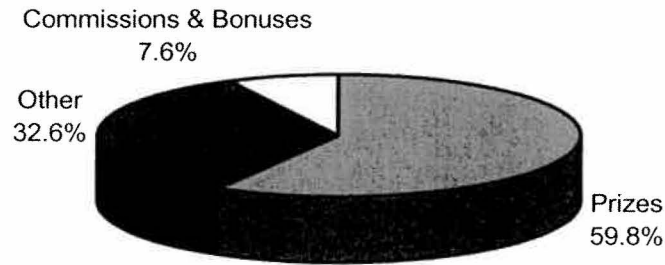
Note 2: Percent of total income.

Note 3: Total operating expenses per the statement of revenues, expenses and changes in fund net assets includes unappropriated expenses such as depreciation and accrued annual and sick leave. The actual administrative costs percentage would be slightly lower if they were removed from the calculation.



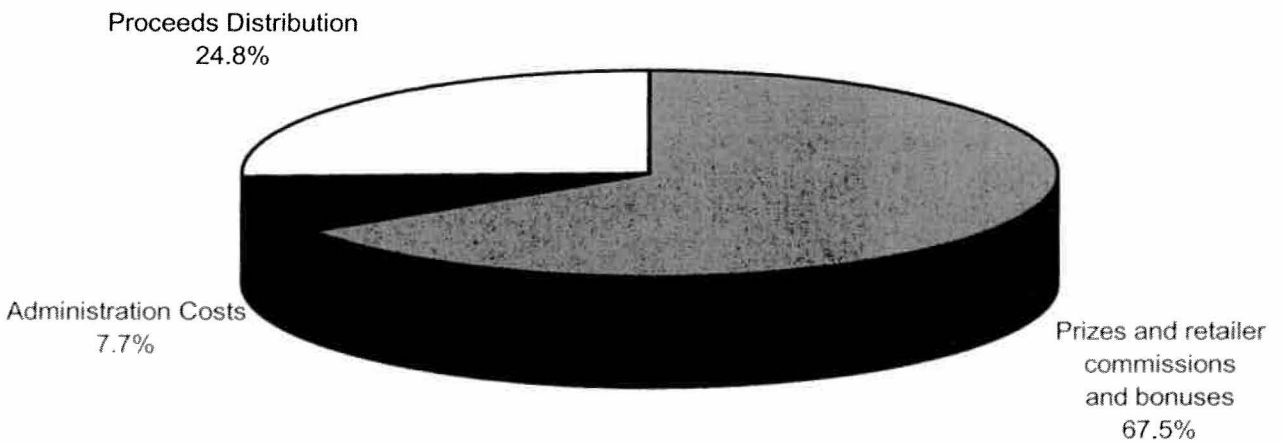
COLORADO LOTTERY  
SUPPLEMENT OF FINANCIAL HIGHLIGHTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2005

**PERCENT OF GROSS TICKET SALES**



To depict compliance with the 50% prize payment statute and the commission/bonus rules.

**PERCENT OF TOTAL INCOME**



To depict status of administrative expenditures to date.

COLORADO LOTTERY  
STATEMENT OF NET ASSETS  
JUNE 30, 2005 AND 2004  
(UNAUDITED)

ASSETS	2005	2004
Current Assets:		
Cash and Investments	\$ 26,580,839	\$ 23,920,655
Accounts Receivable, net of the allowance for doubtful accounts of \$79,044 in 2005 and \$70,846 in 2004	21,543,586	14,671,184
Game Prizes Inventory, at Cost	22,560	120,323
Consignment Inventory, at Cost	170,900	157,705
Warehouse Inventory, at Cost	1,039,705	1,043,264
Prepaid Expenses	42,656	38,139
Total Current Assets	49,400,246	39,951,270
Reserve and Restricted Assets:		
Cash and Investments-Operating Reserve	1,700,000	1,029,114
Cash and Investments-Licensed Agent Recovery Reserve Receipts	479,238	469,424
Prepaid Prize Expense with MUSL	3,910,000	3,525,880
Total Reserve and Restricted Assets	6,089,238	5,024,418
Capital Assets:		
Equipment	3,883,759	4,455,227
Leasehold Improvements	14,053	327,287
Less Accumulated Depreciation and Amortization	(3,036,746)	(3,753,400)
Total Capital Assets	861,066	1,029,114
TOTAL ASSETS	56,350,550	46,004,802
LIABILITIES		
Current Liabilities:		
Accounts Payable	5,460,542	1,987,161
Prize Liability	17,067,680	13,975,136
Payable to MUSL	142,962	129,377
Wages and Benefits	694,337	725,844
Accrued Annual and Sick Leave	12,030	78,211
Retailer Bonus Liability	1,104,390	576,370
Funds Available for Distribution	27,779,840	25,805,521
Deferred Revenue	154,216	298,723
Total Current Liabilities	52,415,997	43,576,343
Long-Term Liabilities:		
Accrued Annual and Sick Leave	835,856	653,670
Expired Warrants Liability	129,222	129,193
Total Long-Term Liabilities	965,078	782,863
TOTAL LIABILITIES	53,381,075	44,359,206
NET ASSETS		
Investment in Capital Assets	861,066	1,029,114
Restricted-Licensed Agent Recovery Reserve	479,238	469,424
Unrestricted-Operating Reserve	1,700,000	0
Unrestricted-Other	(70,829)	147,057
TOTAL NET ASSETS	\$ 2,969,475	\$ 1,645,595

The accompanying notes are an integral part of these financial statements.

COLORADO LOTTERY  
STATEMENTS OF REVENUES, EXPENSES AND  
CHANGES IN FUND NET ASSETS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2005 AND 2004  
(UNAUDITED)

	2005	2004
OPERATING REVENUES		
Gross Ticket Sales	\$ 416,966,782	\$ 401,250,971
DIRECT OPERATING EXPENSES		
Prize Expense	248,809,641	238,427,919
Powerball Prize Variance	693,010	(1,824,959)
Retailer Commissions and Bonuses	31,674,967	30,255,251
Cost of Tickets and Vendor Fees	9,906,061	9,654,016
	125,883,103	124,738,744
GROSS PROFIT ON SALE OF TICKETS		
OTHER OPERATING EXPENSES		
Marketing and Communications	8,559,774	8,643,422
Administration Fees Paid to MUSL	117,286	134,839
Wages and Benefits	7,820,332	8,129,740
Professional Services	956,988	559,685
State Agencies Services	215,969	405,910
Department of Revenue Services	309,814	330,926
Travel	80,795	111,983
Equipment	1,231,910	99,455
Depreciation	193,227	489,609
Accrued Annual and Sick Leave	121,205	(248,377)
Space Rental	766,063	746,806
Rents for Equipment	252,285	690,126
Motorpool Leasing	250,302	276,191
Materials and Supplies	121,720	141,202
Telephone	161,262	190,334
On-Line Telecommunications	567,189	725,728
Data Processing Supplies and Services	31,427	55,413
Equipment Maintenance	284,248	280,227
Postage	40,593	73,219
Printing	20,243	34,796
Other	421,160	203,583
Total Other Operating Expenses	22,523,792	22,074,817
OPERATING INCOME	103,359,311	102,663,927
NONOPERATING REVENUES (EXPENSES)		
Other Revenue	953,327	156,990
Investment Income	747,176	184
Funds Distributed for Current Year	(75,956,095)	(78,265,937)
Funds Available for Distribution for Current Year	(27,779,840)	(25,805,521)
Total Nonoperating Revenues (Expenses)	(102,035,432)	(103,914,284)
NET INCOME (LOSS)	\$ 1,323,879	\$ (1,250,357)
NET ASSETS, BEGINNING OF YEAR	1,645,595	2,895,952
Net Change in Net Assets	1,323,879	(1,250,357)
NET ASSETS, END OF PERIOD	\$ 2,969,474	\$ 1,645,595

The accompanying notes are an integral part of these financial statements.

COLORADO LOTTERY  
STATEMENTS OF CASH FLOWS  
FOR THE FISCAL YEARS ENDED JUNE 30, 2005 & 2004  
(UNAUDITED)

	2005	2004
Cash flows from operating activities:		
Cash received from retailers	\$ 411,122,036	\$ 400,528,775
Cash paid in prizes	(246,822,873)	(242,453,240)
Cash paid in retailer commissions	(27,804,768)	(26,620,204)
Cash payments to suppliers	(21,274,511)	(22,597,775)
Cash payments to employees for services	(7,735,836)	(7,990,304)
Cash received from Lotto subscription sales	0	463,239
Cash paid in retailer bonus	(3,351,226)	(3,640,176)
Cash received (used) - other	389,626	29,380
	104,522,448	97,719,695
Cash flows from non-capital financing activities:		
Distribution of net proceeds	(101,761,616)	(103,678,870)
	(101,761,616)	(103,678,870)
Cash flows from capital and related financing activities:		
Sale of capital assets	7,500	0
Acquisition of capital assets	(174,624)	(112,513)
	(167,124)	(112,513)
Cash flows from investing activities:		
Investment income received	965,062	861,115
Unrealized gains (losses) on investments	(217,886)	(860,931)
	747,176	184
Net increase (decrease) in cash and investments	3,340,884	(6,071,504)
Cash and investments, Beginning of Year (including \$464,096 and \$411,629, respectively, in restricted accounts)	25,419,193	31,490,697
Cash and investments, End of Year, (including \$460,638 and \$464,096, respectively, in restricted accounts)	\$ 28,760,077	\$ 25,419,193
 <i>Reconciliation of operating income to net cash provided by operating activities:</i>		
<i>Operating income</i>	<i>\$ 103,359,311</i>	<i>\$ 102,663,927</i>
<i>Adjustments to reconcile operating income to net cash provided by operating activities</i>		
<i>Depreciation</i>	<i>193,227</i>	<i>489,609</i>
<i>Loss on disposition of equipment</i>	<i>141,944</i>	<i>21,117</i>
<i>Other revenue</i>	<i>953,327</i>	<i>156,990</i>
<i>Increase in Prepaid Prize Expense with MUSL</i>	<i>(384,120)</i>	<i>(983,000)</i>
<i>Change in:</i>		
<i>Accounts Receivable</i>	<i>(6,872,402)</i>	<i>590,495</i>
<i>Ticket Inventory</i>	<i>(9,636)</i>	<i>(152,237)</i>
<i>Other Assets</i>	<i>93,246</i>	<i>(13,619)</i>
<i>Liabilities(excluding funds available for distribution)</i>	<i>7,047,551</i>	<i>(5,053,587)</i>
	<i>\$ 104,522,448</i>	<i>\$ 97,719,695</i>

The accompanying notes are an integral part of these financial statements.

**Colorado Lottery**  
**Notes to Financial Statements**  
**June 30, 2005 and 2004**

**Note 1: Nature of Operations and Summary of Significant Accounting Policies**

***Nature of Operations***

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

The financial statements reflect only activities of the Lottery, an enterprise fund of the State of Colorado, for the fiscal years ended June 30, 2005 and 2004. The Lottery is an agency of the State of Colorado. The financial statements are intended to present the financial position and results of operations and cash flows of only that portion of the State of Colorado that is attributable to the transactions of the Lottery in accordance with accounting principles generally accepted in the United States of America.

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

***Use of Estimates***

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues, expenses, gains, losses and other changes in net assets during the reporting period. Actual results could differ from those estimates.

***Fund Accounting***

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

# Colorado Lottery

## Notes to Financial Statements

### June 30, 2005 and 2004

#### ***Enterprise Fund***

The Lottery accounts for its operations as an enterprise fund. The intent of the State of Colorado Legislature is that the Lottery's cost (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges. As permitted by Governmental Accounting Standards Board Statement No. 20, *Accounting and Financial Reporting Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Lottery has elected to apply only those applicable Financial Accounting Standards Board Statements and interpretations issued prior to November 30, 1989.

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

#### ***Basis of Accounting***

Basis of accounting refers to when revenues, expenditures or expenses are recognized in the accounts and reported in the financial statements. The Lottery counts for funds using the accrual basis of accounting. Revenues from scratch ticket sales are recognized at the point of ticket pack activation. Revenues from Lotto, Powerball, Cash 5 and subscription ticket sales are recognized using the specific performance method whereby sales are recognized at the point that the play becomes active for the next drawing. Expenses are recognized when they are incurred.

#### ***Budget***

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

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

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

**Colorado Lottery**  
**Notes to Financial Statements**  
**June 30, 2005 and 2004**

***Accounts Receivable and Allowance for Doubtful Accounts***

Accounts receivable consist of amounts due from retailers for activated ticket packets. Accounts receivable are stated at the amount billed to retailers. Accounts receivable are ordinarily due seven days after the issuance of the invoice and are electronically transferred from the retailers accounts into the Lottery's account.

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

The Lottery uses the specific identification method to determine expected uncollectibles. Under the provisions of Section 24-35-219, C.R.S., licensed agent recovery reserve receipts are collected from the retailers to cover uncollectible accounts. The accounts receivable and the licensed agent recovery reserve are shown net of estimated uncollectible receivables of \$79,044 and \$70,846 as of June 30, 2005 and 2004, respectively.

***Game Prizes Inventory***

Game Prizes Inventory represents merchandise prizes connected to certain scratch games that, as of the statements of net assets date, have not been claimed.

***Consignment Inventory***

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

***Warehouse Inventory***

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

***Supplies Inventory***

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

# Colorado Lottery

## Notes to Financial Statements

### June 30, 2005 and 2004

#### ***Prepaid Prize Expense***

As part of the Lottery's agreement with MUSL, for the Powerball game, a certain percentage of sales must be paid to MUSL for set prize and grand prize reserves.

#### ***Fixed Assets***

Equipment and leasehold improvements are stated at cost. Beginning September 1, 1996, equipment may be capitalized if the cost exceeds \$5,000 and has a useful life of more than one year, however, a state agency may select a minimum acquisition cost or useful life which is less than the stated criteria for capitalization. Accordingly, the Lottery capitalized equipment with a cost of \$1,000 or more that has a useful life of more than one year. In addition, the Lottery capitalized all personal computers, regardless of their cost. Beginning January 1, 2004, the Lottery changed its policy and capitalizes equipment only if the cost exceeds \$5,000 and has a useful life of more than one year. Lottery did not make the change for July 1 — December 31, 2004. Depreciation for equipment is computed on the straight-line method over estimated useful lives ranging from three to ten years. Leasehold improvements are depreciated over the shorter of the lease term or the estimated useful lives of the improvements. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts, and resulting gains or losses are recognized in current operations.

The Lottery made the decision in May of 2003 to remove the Player Express Terminals (PES) from all retailers by the end of January 31, 2004. In accordance with accounting standards generally accepted in the United States of America, the monthly depreciation on these PES terminals was adjusted (accelerated) to insure that they were fully depreciated by the end of their useful life on January 31, 2004. The accelerated depreciation increased the regular monthly depreciation on these PES terminals from \$30,000 per month to \$52,061 per month for the affected months – May 2003 through January 2004. For fiscal year 2004 an additional \$154,427 of depreciation related to the PES terminals has been recorded and presented on the Lottery's financial statements.

#### ***Accrued Wages and Benefits***

During the fiscal year ending June 30, 2005 and 2004, the state changed the pay date for the month of June for most state employees, deferring the date from June 30 to July 1. For the Lottery, this created a liability for accrued wages at June 30, 2005 and 2004 of \$694,337 and \$725,844, respectively.

#### ***Prize Liability and Prize Expense***

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



# Colorado Lottery

## Notes to Financial Statements

### June 30, 2005 and 2004

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

Payments of scratch prize amounts of \$150 or less may be done at the Lottery or at the retail outlet; payment of scratch prize amounts of \$151 to \$599 may be done at the retailer level at the option of the retailer or at the Lottery. Scratch prizes of \$600 or more are paid by the Lottery. Retailers are given credit for prize payments they make on a daily basis. Prizes may be claimed up to 180 days after game-end. After the final claim date, any unclaimed scratch prizes will result in a decrease to prize expense and any prizes claimed in excess of the liability accrued will result in an increase to prize expense. Net unclaimed scratch prizes resulted in a decrease to prize expense of \$3,706,845 for the fiscal year ended June 30, 2005 and \$4,867,069 for the fiscal year ended June 30, 2004. During the fiscal year ended June 30, 2005, there were a total of 36 games ended, as compared with 33 games ended through fiscal year ended June 30, 2004.

Payments of cumulative online prize amounts of \$150 or less on a single ticket may be done at the Lottery or at the retail outlet; payment of cumulative prize amounts of \$151 to \$599 on a single ticket may be done at the retailer level at the option of the retailer or at the Lottery. Payment of cumulative prize amounts of \$600 or more on a single ticket must be done at the Lottery. Retailers are given credit for prize payments they make on a daily basis. Online prizes may be claimed up to 180 days after the date of the drawing. After the final claim date, unclaimed online prizes will result in a decrease to prize expense so long as the aggregate prize expense of all games exceeds or equals the statutory 50% of sales. In the event that the expiration of an unclaimed prize would result in the aggregate prize expense of all games to fall below the statutory 50% level, the unclaimed prize amount would remain in prize expense and be paid out to players as a guaranteed additional prize. Unclaimed online prizes resulted in a decrease to prize expense of \$5,694,443 for the fiscal year ended June 30, 2005 and \$10,313,756 for the fiscal year ended June 30, 2004.

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

#### **Retailer Bonus Liability**

Under provisions 5.10 and 10.10 of the Colorado Lottery Commission Rules and Regulations effective as of July 1, 1997:

*"...the Director may provide such additional compensation to licensees as is deemed appropriate by the Director to further the sale of lottery tickets, so long as such additional compensation is made equally available to all licensees and does not exceed a total of One and Thirteen Hundredths Percent (1.13%) for scratch, Seven Tenths Percent (.7%) for Lotto, Sixty-five Hundredths Percent (.65%) for Powerball, and Ninety-six Hundredths Percent (.96%) for Cash 5."*

# **Colorado Lottery**

## **Notes to Financial Statements**

### **June 30, 2005 and 2004**

A portion of the additional compensation shall be used to pay each licensee, as a bonus, an amount (cashing bonus) equal to one percent (1%) of each prize paid by the licensee up to and including \$599.99.

At the Director's discretion, the residual resulting after paying the cashing bonuses may be used to provide additional compensation to licensees and/or to decrease the bonus expense by reverting the excess amount.

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

#### ***Licensed Agent Recovery Reserve***

Under the provisions of Section 24-35-219, C.R.S., a Licensed Agent Recovery Reserve was established on January 1, 1988 to maintain surety bond receipts collected from Lottery retailers. Billing rates are established by the Lottery Commission and are reviewed on an annual basis. Retailers have the option to obtain private surety bond coverage at a rate of \$2,000 surety coverage per outlet at their discretion. In 2005 and 2004, the Lottery has reserved \$479,238 and \$469,424, respectively.

#### ***Lottery Fund Net Assets***

In accordance with Section 24-35-210 (4.1) (a), C.R.S., the Lottery Commission shall reserve "sufficient monies, as of the end of the fiscal year, to ensure the operation of the Lottery for the ensuing year." The Lottery Commission approved a reserve of \$1 million of the net assets for fiscal year 1989. This remained in effect until the implementation of GASB 34 which required a net asset balance sufficient to cover the net value of an agency's capital assets. Accordingly, at the June 2002 Commission meeting, the Lottery Commission approved a balance in net assets "equal to net value of the Lottery's capital assets". This remained in effect until April 2005 when the Lottery set up a separate operating reserve independent of the net capital asset reserve in the amount of \$1.7 million. The amount held in this operating reserve will be reviewed annually and adjusted accordingly. Effective July 1, 2004, under Senate Bill 04-204, this reserve is required to be held in cash and investments. This reserve is reported as restricted cash on the statements of net assets.

#### ***Equipment Expense***

Included in "The Statement of Revenues, Expenses, and Changes in Fund Net Assets" is an account titled equipment. This account reports the book value of assets which are disposed of during the year, fixed asset purchases made during the year which are not capitalized. (See Fixed Asset Footnote, page 20), software purchases and other miscellaneous equipment transactions. The balance in this account for fiscal year 2005 was substantially larger than the balance in this account for fiscal year 2004 for the following reasons: 1) the Lottery paid Scientific Games International (SGI) \$647,975 for a one time usage fee on equipment used to support the new on-line system. 2) the Lottery paid SGI \$40,000 for the ICS system software and maintenance. 3) the Lottery disposed of assets with a book value of \$149,445 facilitated by the move of the Pueblo

**Colorado Lottery**  
**Notes to Financial Statements**  
**June 30, 2005 and 2004**

office, and 4) the Lottery purchased \$219,000 worth of software in preparation for the migration from the Wang system.

***Compensated Leave***

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

	<u>June 30, 2005</u>	<u>June 30, 2004</u>	<u>Increase</u>
Annual leave	\$ 696,620	\$ 593,570	\$ 103,050
Sick leave	<u>146,684</u>	<u>135,078</u>	<u>11,606</u>
Total annual and sick leave	843,304	728,648	114,656
Compensatory time	<u>4,582</u>	<u>3,233</u>	<u>1,349</u>
Total compensated leave	<u>\$ 847,886</u>	<u>\$ 731,881</u>	<u>\$ 116,005</u>

***Expired Warrants Liability***

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

***Deferred Revenue***

The Lottery offers two methods of purchasing online tickets for future draws. One method is that tickets are purchased through the terminal, referred to as Advance Play, which allows the player to purchase online tickets good for up to 13 weeks. The second method is restricted to Lotto tickets only and is purchased through the mail via a preprinted form, referred to as subscription, which allows the player to purchase Lotto tickets good for up to 104 draws. Subscription plays were suspended indefinitely with the last subscription plays being recognized as of September 26, 2004. The revenues generated from both methods are recognized as the draws occur. Revenues for future draws are classified as a liability.

**Colorado Lottery**  
**Notes to Financial Statements**  
**June 30, 2005 and 2004**

A detail of deferred revenue at June 30, 2005 and 2004, is as follows:

	<b>2005</b>	<b>2004</b>
Subscription	\$ 0	\$ 114,843
Advance Play – Lotto	66,749	97,477
Advance Play – Powerball	55,795	56,042
Advance Play – Powerplay	14,979	13,283
Advance Play – Cash 5	16,693	17,078
Total deferred revenue	\$ 154,216	\$ 298,723

***Promotional Activity***

The Lottery engages in two types of promotional activities in an attempt to enhance sales and to increase the player base. Specific promotional coupons and Lottery Bucks coupons are distributed to players through special promotions and can be redeemed at any retailer for a lottery product. During the fiscal years ended June 30, 2005 and 2004, 640 and 16,285 coupons were redeemed, respectively. Scratch tickets for specific games are given away as a more direct approach to introduce players to lottery games. During the fiscal years ended June 30, 2005 and 2004, \$43,624 and \$70,168 worth of free scratch tickets were given away, respectively. Scratch tickets and coupons are valued at cost. For the fiscal years ended June 30, 2005 and 2004, \$29,334 and \$80,591, respectively, in promotional ticket expense was recorded as Marketing and Communications expense in the statements of revenues, expenses and changes in fund net assets for coupons redeemed and scratch tickets given away.

**Colorado Lottery**  
**Notes to Financial Statements**  
**June 30, 2005 and 2004**

**Note 2: Cash and Investments**

**Cash**

Cash includes petty cash, change funds, an imprest fund, two depository accounts and cash on deposit with the State Treasurer. A detail of cash at June 30, 2005 and 2004 is as follows:

	<b>2005</b>	<b>2004</b>
Petty cash	\$ 800	\$ 800
Change funds	70,000	70,300
Imprest fund	706,000	350,000
Depository accounts	30,000	30,000
Cash on deposit with State Treasurer	<u>25,774,039</u>	<u>23,469,555</u>
Total unrestricted cash and investments	<u>26,580,839</u>	<u>23,920,655</u>
Restricted cash and investments – Licensed Agent Recovery Reserve Receipts on deposit with State Treasurer	479,238	469,424
Operating Reserve on deposit with State Treasurer	<u>1,700,000</u>	<u>1,029,114</u>
Total restricted cash and investments	<u>2,179,238</u>	<u>1,498,538</u>
Total cash and investments	<u>\$ 27,760,077</u>	<u>\$ 25,419,193</u>

**Cash on Deposit with State Treasurer**

Under the provisions of Section 24-35-210 (6), C.R.S., the State Treasurer shall invest the monies of the Lottery in excess of operating and prize payment expenses and all authorized transfers. Interest or any other return on investments is paid to the Lottery Fund account on a monthly basis. Actual interest payments are determined by the State Treasurer. The actual allocated interest rate for fiscal years 2005 and 2004 was 3.18% and 3.17%, respectively.

In addition, the State Treasurer pools these deposits and invests them in securities approved by Section 24-75-601.1, C.R.S. The Lottery reports its share of the Treasurer's unrealized gains and losses based on its participation in the State Treasurer's pool only at fiscal year-end. Effective July 1, 1997, with the Lottery's initial adoption of Governmental Accounting Standards Board Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, all of the Treasurer's investments, which include the net Licensed Agent Recovery Reserve Receipts, are reported at fair value, which is determined based on quoted market prices. The State Treasurer does not invest any of the pool resources in any external investment pool, and there is no assignment of income related to participation in the pool. Additional information on the Treasurer's pool may be obtained in the State of Colorado's Comprehensive Annual Financial Report.

**Colorado Lottery**  
**Notes to Financial Statements**  
**June 30, 2005 and 2004**

***Insured and Collateralized Deposits***

The Lottery has one imprest and two depository accounts with banking institutions. The depository account is used for the purpose of depositing daily collections throughout the state and transferring the collections to the State Treasurer in a timely manner.

The Public Deposit Protection Act requires financial institutions to collateralize any uninsured public deposits. At June 30, 2005, the Lottery had cash with a carrying value of \$780,000 and a bank balance of \$741,744 on deposit with banking institutions. Of the bank balance, \$100,000 is insured by federal insurance (FDIC); the amount not insured is covered by collateral held in the pledging institution's trust department in the State's name.

***Statements of Cash Flows***

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

***Categorization of Deposits and Investments***

The Lottery's total bank balances are classified in the following three categories of credit risk:

Category 1 – Insured or collateralized with securities held by the Lottery or by its agent in the Lottery's name

Category 2 – Collateralized with securities held by the pledging financial institution's trust department or agent in the Lottery's name

Category 3 – Uncollateralized, including any bank balance that is collateralized with securities held by the pledging financial institution, or by its trust department or agent but not in the Lottery's name

Additionally, the Lottery classifies its investments in the following three categories of credit risk:

Category 1 – Insured or registered, or securities held by the Lottery or its agent in the Lottery's name

Category 2 – Uninsured and unregistered, with securities held by the counterparty's trust department or agent in the Lottery's name

Category 3 – Uninsured and unregistered, with securities held by the counterparty; or by its trust department or agent but not in the Lottery's name, including the portion of the carrying amount of any repurchase agreement that exceeds the market value of the underlying securities, if any

**Colorado Lottery**  
**Notes to Financial Statements**  
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The cash deposits bank balance of \$741,744 is categorized as follows as of June 30, 2005:

Category 1	\$	100,000
Category 2	\$	641,744

For Cash on Deposit with State Treasurer, the State Treasurer's investments as of June 30, 2005 are Category 1 investments and its cash deposits are principally Category 2 deposits.

**Note 3: Schedule of Changes in Fixed Assets**

Capital assets being depreciated:

	<u>June 30, 2004</u>	<u>Increases</u>	<u>Decreases</u>	<u>June 30, 2005</u>
Equipment	\$ 4,455,227	\$ 174,624	\$ (746,092)	\$ 3,883,759
Leasehold improvements	<u>327,287</u>	<u>—</u>	<u>(313,234)</u>	<u>14,053</u>
Total capital assets being depreciated	<u>4,782,514</u>	<u>174,624</u>	<u>(1,059,326)</u>	<u>3,897,812</u>
Less accumulated depreciation for equipment	(3,516,924)	(178,664)	671,489	(3,024,099)
Leasehold improvements	<u>(236,476)</u>	<u>(14,563)</u>	<u>238,392</u>	<u>(12,647)</u>
Total accumulated depreciation	<u>(3,753,400)</u>	<u>(193,227)</u>	<u>909,881</u>	<u>(3,036,746)</u>
Total capital assets, being depreciated, net	<u>\$ 1,029,114</u>	<u>\$ (18,603)</u>	<u>\$ (149,445)</u>	<u>\$ 861,066</u>

	<u>June 30, 2003</u>	<u>Increases</u>	<u>Decreases</u>	<u>June 30, 2004</u>
Equipment	\$ 5,559,322	\$ 112,513	\$ (1,216,608)	\$ 4,455,227
Leasehold improvements	<u>330,936</u>	<u>—</u>	<u>(3,649)</u>	<u>327,287</u>
Total capital assets being depreciated	<u>5,890,258</u>	<u>112,513</u>	<u>(1,220,257)</u>	<u>4,782,514</u>
Less accumulated depreciation for equipment	(4,237,420)	(475,046)	1,195,542	(3,516,924)
Leasehold improvements	<u>(225,512)</u>	<u>(14,563)</u>	<u>3,599</u>	<u>(236,476)</u>
Total accumulated depreciation	<u>(4,462,932)</u>	<u>(489,609)</u>	<u>1,199,141</u>	<u>(3,753,400)</u>
Total capital assets, being depreciated, net	<u>\$ 1,427,326</u>	<u>\$ (377,096)</u>	<u>\$ (21,116)</u>	<u>\$ 1,029,114</u>

**Colorado Lottery**  
**Notes to Financial Statements**  
**June 30, 2005 and 2004**

**Note 4: Operating Leases**

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

***Pueblo***

*Office* – The Lottery occupied office space in the Wells Fargo Bank Building in Pueblo. The lease agreement with 200 South Broadway Limited Partnership began on July 1, 1995 and expired on June 30, 2005. The Lottery entered into an agreement with Midtown RLLLP on April 19, 2005. The lease agreement began on June 27, 2005 and expires on June 30, 2015. The lease contains an option to renew for two additional five year terms commencing on July 1, 2015. There are no other provisions for extension or renewal.

*Warehouse* – The Lottery leases primary warehouse space from Santa Fe 250 LLC. The Lottery entered into a lease extension agreement, which began September 1, 2002 and expires June 30, 2007. There is no provision for renewal.

*Interlott* – The Lottery entered into a rental agreement with International Lottery, Inc., subsequently purchased by G-Tech, to rent Scratch Ticket Vending Machines (STVMs). The agreement covered the period from July 1, 2000 through June 30, 2002. The Lottery had the option to exercise two twelve-month extensions. On June 3, 2002, the Lottery entered into a contract with Interlott to exercise both 12-month extensions plus an additional four-month extension which expired on October 31, 2004. There are no other provisions for extension or renewal.

***Denver***

*Office* – The Lottery occupies office and warehouse space in the Galleria Towers Building in Denver. The lease agreement, which began on October 30, 1990, was amended on May 14, 1999 and extended the ending date for the lease from June 30, 1999 to June 30, 2006. There is no provision for renewal.

*Warehouse* – The Lottery entered into a lease agreement with Yukon Denver Valley, Inc. to occupy warehouse space. The lease agreement began on September 1, 1999 and expired on August 31, 2004. The Lottery exercised its option to extend the lease through August 31, 2009 on June 11, 2004.



**Colorado Lottery**  
**Notes to Financial Statements**  
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**Fort Collins**

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

**Grand Junction**

The Lottery occupies space in the Grand Junction State Services Building and is responsible for reimbursing the Capital Complex Division for lease payments.

**Colorado Springs**

The Lottery occupies warehouse space in a building located at 2818 Janitell Road in Colorado Springs, Colorado. The lease agreement, which began on August 1, 2003, expires on June 30, 2006. The Lottery has the option to exercise two 12-month extensions under the new lease, extending the lease through June 30, 2008. There are no other provisions for renewal.

Operating lease expense incurred for the fiscal years ended June 30, 2005 and 2004 and future minimum lease payments for fiscal years ending June 30, 2006 through 2010 are as follows:

<u>LOCATION</u>	<u>FUTURE MINIMUM LEASE PAYMENTS</u>							<u>LATER YEARS</u>
	<u>2004</u>	<u>2005</u>	<u>FY 2006</u>	<u>FY 2007</u>	<u>FY 2008</u>	<u>FY 2009</u>	<u>FY 2010</u>	
Pueblo Office	\$ 275,900	\$293,553	\$218,013	\$218,013	\$ 218,013	\$218,013	\$218,013	\$1,192,201
Pueblo Warehouse	85,885	96,218	91,052	78,623	0	0	0	0
Interlot/Gtech	652,389	217,404	0	0	0	0	0	0
CoSprgs Warehouse	11,728	12,040	12,466	0	0	0	0	0
Denver	203,354	209,833	215,316	0	0	0	0	0
	107,039	102,937	95,652	98,553	101,473	104,486	17,499	0
Fort Collins	36,720	34,298	0	0	0	0	0	0
Grand Junction	<u>4,557</u>	<u>6,637</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
	<u>\$ 1,377,572</u>	<u>\$ 972,920</u>	<u>\$ 632,499</u>	<u>\$395,189</u>	<u>\$ 319,486</u>	<u>\$322,499</u>	<u>\$235,512</u>	<u>\$1,192,201</u>

**Colorado Lottery**  
**Notes to Financial Statements**  
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**Note 5: Other Revenue**

A schedule of other revenue for the fiscal years ended June 30, 2005 and 2004 follows:

	<u>2005</u>	<u>2004</u>
License fees	\$ 50,824	\$ 61,047
Fines and penalties	855,630	24,600
Assignment fees	4,219	7,012
Net Licensed Agent Recovery Reserve Receipts	9,814	8,786
Reimbursement excess budget/production cost of game show from MUSL	21,943	9,808
Other	<u>10,898</u>	<u>45,737</u>
Total	<u>\$ 953,328</u>	<u>\$ 156,990</u>

**Note 6: Distribution of Net Proceeds**

In accordance with Section 33-60-104, C.R.S., distributions of net proceeds shall be made on a quarterly basis. The State Treasurer shall distribute net lottery proceeds as follows: forty percent (40%) to the Conservation Trust Fund, ten percent (10%) to the Division of Parks and Outdoor Recreation and all the remaining net lottery proceeds in trust to the State Board of the Great Outdoors Colorado Trust Fund up to the statutory limit. Under Section 33-60-104(2), C.R.S., the limit is \$35 million as adjusted annually based on the consumer price index. Any excess over the limit shall be transferred to the State Public School Fund as a contingency reserve set forth in Section 22-54-117(1.6)(a), C.R.S.

Income available for distribution at June 30:

	<u>2005</u>	<u>2004</u>
Income before distributions	\$ 105,059,815	\$ 102,821,101
Change in licensed agent recovery reserve	(9,814)	(8,786)
Change in fair market value of investments	217,886	860,931
Change in Operating Reserve	(1,700,000)	0
Other changes in net assets	<u>168,048</u>	<u>398,212</u>
Income available for distribution	103,735,935	104,071,458
Less distributions prior to year-end	<u>(75,956,095)</u>	<u>(78,265,937)</u>
Income available for distribution	<u>\$ 27,779,840</u>	<u>\$ 25,805,521</u>

**Colorado Lottery**  
**Notes to Financial Statements**  
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	<b>Accrued at June 30, 2004</b>	<b>Proceeds Distributions Expenses</b>	<b>Distributions Paid</b>	<b>Accrued at June 30, 2005</b>
Great Outdoors Colorado	\$ 10,506,324	\$ 50,176,516	\$ (48,484,373)	\$ 12,198,467
State Public School Fund	2,396,438	1,691,454	(2,396,438)	1,691,454
Conservation Trust Fund	10,322,209	41,494,373	(40,704,647)	11,111,935
Division of Parks and Outdoor Recreation	<u>2,580,550</u>	<u>10,373,592</u>	<u>(10,176,158)</u>	<u>2,777,984</u>
	<u>\$ 25,805,521</u>	<u>\$ 103,735,935</u>	<u>\$(101,761,616)</u>	<u>\$ 27,779,840</u>

	<b>Accrued at June 30, 2003</b>	<b>Proceeds Distributions Expenses</b>	<b>Distributions Paid</b>	<b>Accrued at June 30, 2004</b>
Great Outdoors Colorado	\$ 9,016,090	\$ 49,639,294	\$ (48,149,060)	\$ 10,506,324
State Public School Fund	3,690,377	2,396,438	(3,690,377)	2,396,438
Conservation Trust Fund	10,165,173	41,628,583	(41,471,547)	10,322,209
Division of Parks and Outdoor Recreation	<u>2,541,293</u>	<u>10,407,143</u>	<u>(10,367,886)</u>	<u>2,580,550</u>
	<u>\$ 25,412,933</u>	<u>\$ 104,071,458</u>	<u>\$(103,678,870)</u>	<u>\$ 25,805,521</u>

**Note 7: Pension Plan**

***Plan Description***

Virtually all Lottery employees participate in a defined benefit pension plan. The plan's purpose is to provide income to members and their families at retirement or in case of death or disability. The plan is a cost-sharing multiple-employer plan administered by the Public Employees' Retirement Association (PERA). PERA was established by state statute in 1931. Responsibility for the organization and administration of the plan is placed with the Board of Trustees of PERA. Changes to the plan require legislation by the General Assembly. The state plan and other divisions' plans are included in PERA's financial statements which may be obtained by writing PERA at 1300 Logan Street, Denver, Colorado 80203, by calling PERA at 303 832-9550 or 800 729-PERA (7372) or by visiting [www.copera.org](http://www.copera.org).

# **Colorado Lottery**

## **Notes to Financial Statements**

### **June 30, 2005 and 2004**

Plan members vest after five years of service and are eligible for retirement benefits at age 50 with 30 years of service, age 60 with 20 years of service or at age 65 with 5 years of service. Members are also eligible for retirement benefits, without a reduction for early retirement, if they are at least 55 and have a minimum of 5 years of service credit and their age plus years of service equals 80 or more. State troopers and judges comprise a small percentage of plan members but have higher contribution rates and state troopers are eligible for retirement benefits at different ages and years of service. Monthly benefits are calculated as a percentage of highest average salary (HAS). HAS is one-twelfth of the average of the highest salaries on which contributions were paid, associated with three periods of 12 consecutive months of service credit.

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

#### ***Funding Policy***

Most employees contribute 8% (10% for state troopers) of their salary, as defined in CRS 24-51-101(42), to an individual account in the plan.

During fiscal year 2005, the state contributed 10.15% (12.85% for state troopers and 13.66% for the judicial branch) of the employee's salary. Effective July 1, 2004, 1.02% of the total contribution was allocated to the Health Care Trust Fund.

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

The Lottery's contributions to the three programs described above for the fiscal years ended June 30, 2005, 2004 and 2003 were \$622,597, \$656,365 and \$659,854, respectively. These contributions met the contribution requirement for each year.

**Colorado Lottery**  
**Notes to Financial Statements**  
**June 30, 2005 and 2004**

**Note 8: Voluntary Tax-deferred Retirement Plans**

PERA offers a voluntary 401K plan entirely separate from the defined benefit pension plan. The state offers a 457 deferred compensation plan and certain agencies and institutions of the state offer a 403b or 401(a) plans. Members who contribute to any of these plans also receive the state match, when available.

In January 2001, the MatchMaker Program established a state match for PERA member's voluntary contributions to tax-deferred retirement plans. The PERA Board sets the level of the match annually based on the actuarial funding of the defined benefit pension plan. The match is only available when the actuarial value of the defined benefit pension plan assets is 110 percent of actuarially accrued plan liabilities. This condition was not met during fiscal year 2005.

The Lottery's contribution to the Program described above for the fiscal year ended June 30, 2004 was \$77,307. No contribution was made to this program in fiscal year 2005.

**Note 9: Post Retirement Health Care and Life Insurance Benefits**

PERACare, formerly known as the PERA Health Care Program (the Program), began covering benefit recipients and qualified dependents on July 1, 1986. This benefit was developed after legislation in 1985 established the Program and the Health Care Trust Fund. Under this program, PERA subsidizes a portion of the monthly premium for health care coverage. The benefit recipient pays any remaining amount of that premium through an automatic deduction from the monthly retirement benefit. During the fiscal year ended June 30, 2005, the premium subsidy was \$115.00 for those with 20 years of service credit (\$230.00 for members under age 65 and not eligible for Medicare), and it was reduced by 5% for each year of service fewer than 20.

The Health Care Trust Fund is maintained by an employer's contribution as discussed above in Note 7.

Monthly premium costs for participants depend on the health care plan selected, the number of persons being covered, Medicare eligibility and the number of years of service credit. PERA contracts with a major medical indemnity carrier to administer claims for self-insured medical and prescription benefit plans and with several health maintenance organizations providing services within Colorado. As of December 31, 2004, there were 39,668 enrollees, including spouses and dependents, from all contributors to the plan.

***Life Insurance Program***

PERA provides its members access to two group life insurance plans offered by Prudential Insurance Company and Anthem Life (formerly known as Rocky Mountain Life Insurance Company). Members may join one or both plans, and they may continue coverage into retirement. Premiums are collected monthly by payroll deduction or other means.

**Colorado Lottery**  
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**June 30, 2005 and 2004**

**Note 10: Contingencies and Commitments**

Prize Annuities – The Lottery purchases annuity contracts in the name of individual jackpot prize winners. Although the annuity contracts are in the name of the individual winners, the Lottery retains title to the annuity contracts. The Lottery remains liable for the payment of the guaranteed minimum prizes in the event the insurance companies issuing the annuity contracts default. The following guaranteed minimum prize payments for which annuity contracts have been purchased are due in varying amounts through September 10, 2028.

Specified prize payments	\$ 544,588,288
Lifetime prize payments	<u>44,115,000</u>
 Total guaranteed minimum prize payments	 <u>\$ 588,703,288</u>

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

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

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

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

<b>Liability</b>	<b>Limits of Liability</b>
General and automobile	Each person \$150,000 Each occurrence \$600,000

***Medical and Disability Benefits***

The Group Benefit Plans Fund is a Pension and Other Employee Benefits Fund established for the purpose of risk financing employee and state-official medical claims. The fund includes several medical plan options ranging from provider of choice to managed care. Before January 1, 2000, the state offered a variety of medical plans; some of the plans were fully insured while others were self-insured using Anthem Blue Cross Blue Shield as the plan administrator. After January 1, 2000, self-insured plans were no longer offered, and the state and its employees paid premiums for insurance purchased to cover medical claims. Through fiscal year 2001-2002, the Group Benefit Plans Fund continued to cover claims originating before January 1, 2000. The state's contribution to the premium is fixed in statute; state employees pay the difference between the statutory contribution and the premium set by the insurer.

A new chapter for employee benefits began on July 1, 2005. The State returned to self-funding through a relationship with a new vendor, Great-West Healthcare, and an existing vendor, Delta Dental. The State also moved the benefits cycle to the fiscal year to better align with the State's budgetary process. The new plan year will be from July 1 through June 30. Payment of premiums is still a shared expense between the state, who's contribution is set by statute, and the employee.

Before January 1, 1999, the Group Benefit Plans Fund provided an employer-paid short-term disability plan for all employees. On January 1, 1999, PERA began covering short-term disability claims for state employees eligible under its retirement plan. The Group Benefit Plans Fund continues to provide short-term disability coverage for employees not yet qualified for the retirement plan and secondary benefits for employees also covered under the PERA short-term disability plan. The Group Benefit Plans program provides an employee with 60 percent of their pay beginning after 30 days of disability or the exhaustion of the employee's sick leave balance, whichever is later. This benefit expires six months after the beginning of the disability. Although fully insured, the Group Benefit Plans disability program includes a risk-sharing feature that provides experience rating refunds and a termination premium that is calculated as earned premium less the aggregate of incurred claims, claim reserve, retention charge and refunds paid previously over the term of the contract. Refunds, when applicable, are paid annually while deficits are carried forward.

Furniture and Equipment – The State of Colorado carries a \$15,000 deductible replacement policy on all state owned furniture and equipment. For each loss incurred, the Lottery is responsible for the first \$1,000 of the deductible and the State of Colorado is responsible for the next \$14,000. Any loss in excess of \$15,000 is covered by the insurance carrier up to replacement cost.

# Colorado Lottery

## Notes to Financial Statements

### June 30, 2005 and 2004

Gaming Operations Commitments – The Lottery has entered into long-term contracts with certain significant vendors related to providing scratch tickets and online data processing services in support of the Lottery's gaming operations. The online data processing contract expired October 31, 2004. The total amount to be paid on the online data contract was not to exceed \$51,800,000 over the period of the contract. The Lottery entered into a new online data processing contract with a new vendor on May 13, 2003. The initial contract period began on June 1, 2003 and will expire on October 31, 2012, per the contract amendment dated January 26, 2005. These contracts overlapped in order for the new vendor to set up the new system. Renewal options include one additional two-year period and two additional periods of ninety days for conversion and turnover purposes. The total cost of the initial contract period is not to exceed \$70,616,975. The scratch ticket contracts expired on June 30, 2004 with one annual renewal available on each contract. The renewal options were exercised extending the contracts through June 30, 2005. On May 16, 2005 the Lottery received approval to extend both of the scratch ticket contracts for a six month period ending December 31, 2005 to complete the RFP process and execute new contracts. The total cost of the extended contract period is \$1,950,000. Ticket rates are based upon ticket volume, physical size and design. The total costs of the contracts for the initial contract period plus the extension period shall not exceed \$15,745,184 and \$6,950,000 for the respective contracts.

The Lottery was approved as a member of the MUSL on February 26, 2001 and thus entered into an agreement with MUSL on June 6, 2001 to become a member and participate in Powerball games. As a member, the Lottery agrees to abide by the terms of the Multi-State Agreement dated September 16, 1987 and to any amendments to that agreement duly made by the board. The Lottery will remain a member indefinitely. Pursuant to this agreement, the Lottery will make payments to MUSL for administrative fees, weekly prize expenses, promotional purchases, miscellaneous reimbursements and assessments and contributions to the prize reserves. The total amount to be contributed by the Lottery to the prize reserves as of June 30, 2005 is \$3,910,000 and is based on a percentage of sales. The total amount of the prize reserves funded as of June 30, 2005 was \$3,910,000 shown as prepaid prize expense – MUSL on the statements of net assets.

Other Major Vendor Commitments – The Lottery entered into a long-term contract with an advertising agency to provide advertising services to promote the Lottery's products. The contract provided for expiration on June 30, 2002 with an option to renew up to three additional years through June 30, 2005. The total cost of the initial contract period was not to exceed \$16,320,000. On May 15, 2002, the Lottery exercised its option to renew the contract for a period of two years, extending it until June 30, 2004. The maximum was not to exceed \$8,500,000 in fiscal year 2003 and not to exceed \$17,000,000 for the extended contract period. On June 10, 2004, the Lottery entered into a new long-term contract with the same agency. The contract period began on July 1, 2004 and expires on June 30, 2006 with an option to renew up to three additional one year periods through June 30, 2009. The total cost of the initial contract period is not to exceed \$9,000,000 for each year.

Litigation – In fiscal year 2001, a plaintiff has filed a class action suit claiming that the Lottery breached its contract with players by continuing to sell instant tickets in games in which the top prize had already been claimed. Although litigation continues, it is the opinion of Lottery's management that the ultimate outcome of this matter will not have a material impact on the Lottery's financial statements.



**Colorado Lottery**  
**Notes to Financial Statements**  
**June 30, 2005 and 2004**

**Note 11: Tax, Spending and Debt Limitations**

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

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

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

**Note 12: Related Party Transactions**

The Lottery, as an agency of the State of Colorado, paid fees to other agencies of the state for auditing, legal and other services and vehicle and office rent. The Lottery also pays fees to the Department of Revenue for indirect costs. Interagency charges were \$836,683 and \$985,613 for the fiscal years ended June 30, 2005 and 2004, respectively.

## **Supplementary Information**

**Colorado Lottery**  
**Schedule of Revenue and Costs for Scratch and Online Games**  
**for the Fiscal Year Ended June 30, 2005**  
**(With Comparative Totals for the Fiscal Year Ended June 30, 2004)**

	Games in Progress				Fiscal Year 2005	Fiscal Year 2004
	Scratch	Lotto	Powerball	Cash 5	Total	Scratch and Online
Gross ticket sales	\$ 282,735,729	\$ 38,266,117	\$ 80,912,668	\$ 15,052,268	\$ 416,966,782	\$ 401,250,97
Prize expense	(184,675,937)	(19,194,938)	(36,659,174)	(8,279,592)	(248,809,641)	(238,427,91
Powerball prize variance	<u>—</u>	<u>—</u>	(693,010)	<u>—</u>	(693,010)	<u>1,824.95</u>
Net revenue after prizes	<u>98,059,792</u>	<u>19,071,179</u>	<u>43,560,484</u>	<u>6,772,676</u>	<u>167,464,131</u>	<u>164,648.01</u>
Commissions, bonuses, ticket costs and vendor fees						
Retailer commission	(19,759,638)	(2,287,161)	(4,854,855)	(903,114)	(27,804,768)	(26,620.20
Retailer bonus	(2,949,619)	(248,721)	(530,834)	(141,025)	(3,870,199)	(3,635.04
Cost of tickets sold	(3,174,878)	—	—	—	(3,174,878)	(2,987.13
In-lane vendor fees	—	—	—	—	—	(34.07
Online vendor fees	<u>(1,640,725)</u>	<u>(1,532,276)</u>	<u>(2,950,689)</u>	<u>(607,493)</u>	<u>(6,731,183)</u>	<u>(6,632.80</u>
Total	<u>(27,524,860)</u>	<u>(4,068,158)</u>	<u>(8,336,378)</u>	<u>(1,651,632)</u>	<u>(41,581,028)</u>	<u>(39,909.26</u>
Gross profit on sale of tickets	<u>\$ 70,534,932</u>	<u>\$ 15,003,021</u>	<u>\$ 35,224,106</u>	<u>\$ 5,121,044</u>	<u>\$ 125,883,103</u>	<u>\$ 124,738.74</u>
Average daily ticket sales	<u>\$ 774,618</u>	<u>\$ 104,839</u>	<u>\$ 221,679</u>	<u>\$ 41,239</u>	<u>\$ 1,142,375</u>	<u>\$ 1,096.31</u>

**Colorado Lottery**  
**Schedule of Percent of Prize Expense to Gross Ticket Sales**  
**for the Fiscal Year Ended June 30, 2005**

	<u>Games in Progress</u>				<u>Powerball Prize Variance</u>	<u>Coupons/Free Plays</u>	<u>Fiscal Year 2005 Total</u>
	<u>Scratch</u>	<u>Lotto</u>	<u>Powerball</u>	<u>Cash 5</u>			
Prize expense	\$ 184,676,321	\$ 19,194,938	\$ 36,659,174	\$ 8,279,592	\$ 693,010	\$ (384)	\$ 249,502,651
Ticket sales before coupons	<u>282,736,163</u>	<u>38,266,176</u>	<u>80,912,792</u>	<u>15,052,291</u>	<u>—</u>	<u>(640)</u>	<u>416,966,782</u>
Prize %	<u>65.32%</u>	<u>50.16%</u>	<u>45.31%</u>	<u>55.01%</u>		<u>60.00%</u>	<u>59.84%</u>

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

**Colorado Lottery**  
**Budgetary Comparison**  
**for the Fiscal Year Ended June 30, 2005**

	Fiscal Year 2005 Original Budget	Supplementals Pots Allocations and Internal Transfers	Fiscal Year 2005 Final Budget	Fiscal Year 2005 Actual Expenditures	Under Expended	Percent Under Expended
Personal services	\$ 7,983,034	\$ 80,070	\$ 8,063,104	\$ 7,456,970	\$ 606,134	7.52%
Operating	1,594,794	(62,748)	1,532,046	1,525,623	6,423	0.42
Vehicle lease payments	163,666	(37,880)	125,786	124,131	1,655	1.32
Purch. Serve. Comp. Cen.	8,898	(4,010)	4,888	4,864	24	0.49
Communications Services	—	1,560	1,560	1,560	0	0.00
Telecommunications	132,471	84,338	216,809	176,203	40,606	18.73
MNT payments	—	218,440	218,440	218,440	0	0.00
Payments to other agencies	340,488	—	340,488	193,028	147,460	43.31
Legal services	40,944	—	40,944	22,941	18,003	43.97
Worker's compensation	—	98,540	98,540	98,540	0	0.00
Unemployment benefits	—	1,967	1,967	—	1,967	100.00
Health and life	—	302,095	302,095	286,305	15,790	5.23
Short-term disability	—	10,759	10,759	9,215	1,544	14.35
Leased space	797,239	—	797,239	787,492	9,747	1.22
Grand Junction – leased space	4,557	2,080	6,637	6,637	0	0.00
Risk management	—	18,686	18,686	18,686	0	0.00
Travel expenses	119,941	(6,443)	113,498	80,543	32,955	29.04
Marketing and communications	9,097,225	(453,805)	8,643,420	8,559,774	83,646	0.97
Indirect costs	309,814	—	309,814	309,814	0	0.00
Ticket costs	3,991,040	(286,990)	3,704,050	3,174,873	529,177	14.29
Vendor fees	7,886,689	318,840	8,205,529	7,641,575	563,954	6.87
Prizes	280,095,384	—	280,095,384	248,809,641	31,285,743	11.17
Powerball prize variance	4,610,000	—	4,610,000	4,389,286	220,714	4.79
Retailer compensation	35,566,840	—	35,566,840	31,674,971	3,891,869	10.94
Computer migration	1,088,931	365,000	1,453,931	1,278,363	175,568	12.08
Multi-State Lottery fees	<u>177,433</u>	<u>—</u>	<u>177,433</u>	<u>172,519</u>	<u>4,914</u>	<u>2.77</u>
<b>Total</b>	<b><u>\$354,009,388</u></b>	<b><u>\$ 650,499</u></b>	<b><u>\$354,659,887</u></b>	<b><u>\$ 317,021,994</u></b>	<b><u>\$ 37,637,893</u></b>	<b><u>10.61%</u></b>

Fiscal year 2005 staffing  
(FTE) 126.00 (Appropriated) 116.2 (Actual)

\*Certain amounts may not tie due to rounding.

**Colorado Lottery**  
**Budgetary Comparison (continued)**  
**for the Fiscal Year Ended June 30, 2005**

Reconciliation of expenses per "statements of revenues, expenses and changes in fund net assets" to budgeted expenditures:

<b>Operating Expenses Per Statement of Revenues, Expenses and Changes in Fund Net Assets</b>	
Prize expense	\$ 248,809,641
Powerball prize variance	693,010
Commissions and bonuses	31,674,967
Cost of tickets and vendor fees	9,906,061
Other operating expenses	<u>22,523,792</u>
Total operating expenses per statement of revenues, expenses and changes in fund net assets	313,607,471
Plus Powerball variance classified as revenue	3,696,276
Less: non-appropriated expenses	
Depreciation	(193,227)
Accrued annual and sick leave	(121,205)
Book value of assets written-off	<u>(141,945)</u>
	<u>316,847,370</u>
Plus capitalized fixed assets	<u>174,624</u>
	<u>\$ 317,021,994</u>