

**AUDIT REPORT
OF THE
NEBRASKA LOTTERY**

JULY 1, 1998 THROUGH JUNE 30, 1999

NEBRASKA LOTTERY

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NEBRASKA LOTTERY

BACKGROUND

The passage of LB 849 in 1991 created the Lottery Division of the Nebraska Department of Revenue. Nebraska voters passed a constitutional amendment allowing the creation of a state lottery in November 1992. As the 37th lottery in the nation, the Nebraska Lottery began scratch ticket sales on September 11, 1993. Sales of on-line products began on July 21, 1994

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

Currently, the Nebraska Lottery offers Powerball®, Pick5®, Cash 4 Life®, and instant games. The Cash 4 Life® game was started in fiscal year 1998. During fiscal year 1999, the Wild Card® game was discontinued.

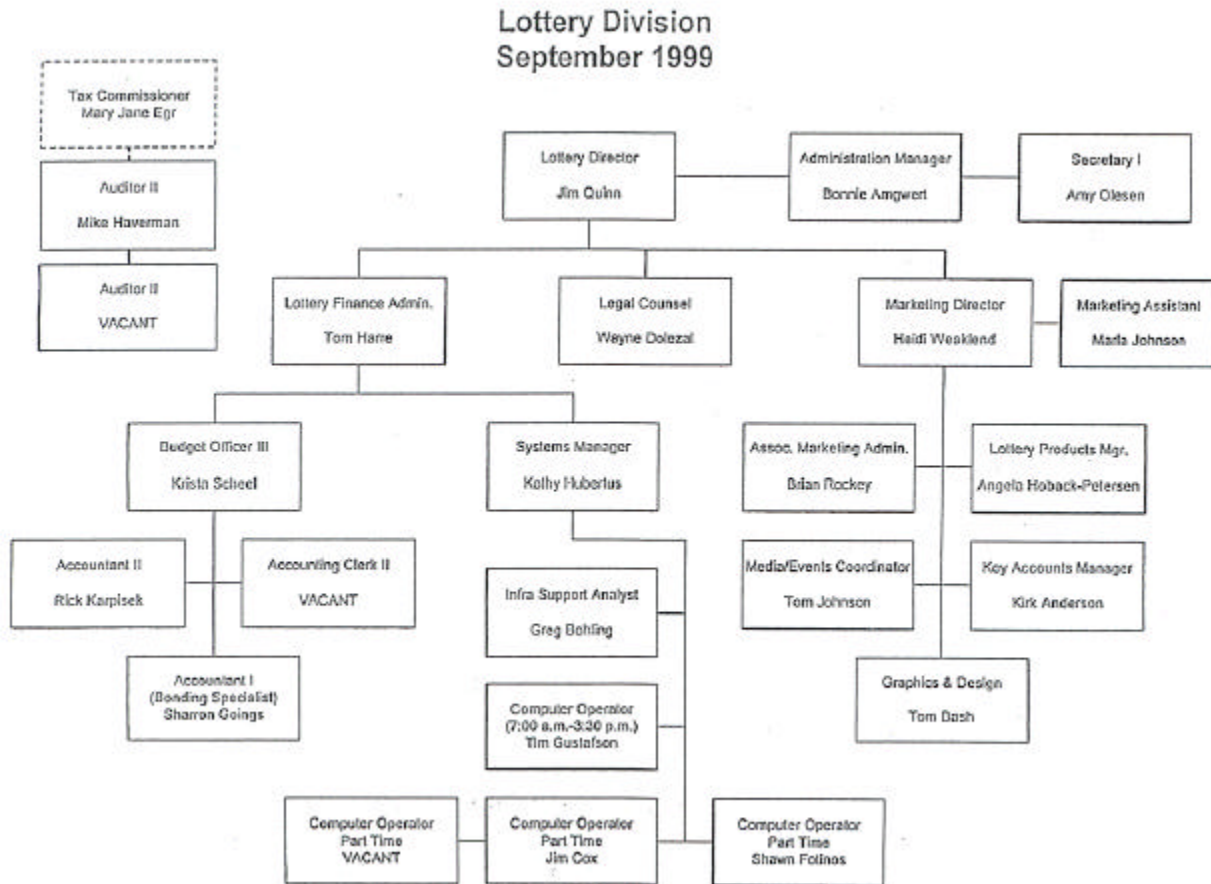
State Statute Section 9-812 R.S. Supp., 1998 requires not less than forty percent of the dollar amount of lottery tickets sold be used for the payment of prizes. Nebraska Lottery retailers generally receive a five percent commission on their gross sales. Legislation provides that twenty-five percent of Nebraska Lottery sales be divided among the following funds: (1) Education Innovation Fund (49.5%); (2) Nebraska Environmental Trust Fund (49.5%); and (3) Compulsive Gamblers Assistance Fund (1.0%).

MISSION STATEMENT

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

NEBRASKA LOTTERY

ORGANIZATIONAL CHART



NEBRASKA LOTTERY

SUMMARY OF COMMENTS

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

1. Underpaid Prizes
2. Disaster Recovery Plans

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

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

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

NEBRASKA LOTTERY

COMMENTS AND RECOMMENDATIONS

1. Underpaid Prizes

Good internal controls require adequate procedures be in place to ensure the correct amounts are paid to prize winners.

During our audit, we noted two out of forty-five prize winners tested were not paid the correct amount. The total underpayment of prizes to prize winners tested was \$15.

We recommend the Nebraska Lottery implement procedures to ensure all prizes are correctly paid. This could include a more detailed review of warrants issued or a reconciliation of prize payment warrants to tickets validated.

NEBRASKA LOTTERY'S RESPONSE: THE NEBRASKA LOTTERY'S VALIDATION SYSTEM CORRECTLY IDENTIFIED THE WINNING AMOUNT OF EACH TICKET. THE ERRORS OCCURRED WHILE COMBINING MULTIPLE WINNINGS INTO ONE PAYMENT TO THE PLAYER. PROCEDURES WERE IN PLACE TO GUARD AGAINST OVERPAYMENT AND NEW PROCEDURES WILL ALSO GUARD AGAINST UNDERPAYMENT.

2. Disaster Recovery Plans

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

During our audit, we noted there were three separate information systems which are critical to the Nebraska Lottery's operations. These include information systems for the Nebraska Lottery, GTECH, and Scientific Games, Intl. The Nebraska Lottery is testing its disaster recovery plan. Based on our review of system documentation and DRP's, we noted the following:

GTECH, the on-line game vendor:

Testing of the GTECH Disaster Recovery Plan had not been completed, and the disaster recovery plan did not address maintenance of the plan.

Scientific Games, Intl., the instant ticket vendor:

The Scientific Games, Intl. Disaster Recovery Plan did not contain provisions for testing of the plan or plan maintenance.

This was a comment in a prior audit.

NEBRASKA LOTTERY

COMMENTS AND RECOMMENDATIONS

2. **Disaster Recovery Plans** (Concluded)

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

NEBRASKA LOTTERY'S RESPONSE: THE NEBRASKA LOTTERY WILL ENCOURAGE BOTH GTECH AND SCIENTIFIC GAMES, INT. TO TEST AND MAINTAIN THEIR RESPECTIVE DISASTER RECOVERY PLANS.

STATE OF NEBRASKA
Auditor of Public Accounts



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NEBRASKA LOTTERY

INDEPENDENT AUDITORS' REPORT

We have audited the accompanying financial statements of the Nebraska Lottery as of and for the fiscal year ended June 30, 1999, as listed in the Table of Contents. These financial statements are the responsibility of the Nebraska Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Nebraska Lottery as of June 30, 1999, and the results of its operations and cash flows for the year then ended in conformity with generally accepted accounting principles.

The Year 2000 Issues supplementary information is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and do not express an opinion on it. In addition, we do not provide assurance that Nebraska Lottery is or will become year 2000 compliant, that Nebraska Lottery's year 2000 remediation efforts will be successful in whole or in part, or that parties with which Nebraska Lottery does business are or will become year 2000 compliant.

In accordance with Government Auditing Standards, we have also issued our report dated October 4, 1999 on our consideration of Nebraska Lottery's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants.

A handwritten signature in dark ink, reading "Deann Hayfman CPA". The signature is written in a cursive, flowing style. The letters "CPA" are written in a slightly more upright, blocky font at the end of the signature.

Deputy Auditor

October 4, 1999

NEBRASKA LOTTERY

BALANCE SHEET

June 30, 1999

ASSETS:**CURRENT ASSETS**

Cash and Cash Equivalents	\$	12,442,039
Accounts Receivable (Note 3)		4,186,097
Prepaid Prizes		165,009

TOTAL CURRENT ASSETS16,793,145**RESTRICTED ASSETS**

Reserves on Deposit (Note 6)		<u>2,890,805</u>
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FIXED ASSETS

Furniture, Fixtures, and Equipment (Note 2)	450,221
Less: Accumulated Depreciation	<u>336,307</u>

FIXED ASSETS, NET113,914**TOTAL ASSETS**\$ 19,797,864**LIABILITIES****CURRENT LIABILITIES**

Accounts Payable	\$	1,213,903
Vendors Payable		1,855,940
Compensated Absences Payable		96,776
Accrued Payroll Payable		33,315
Withheld Taxes on Prizes Paid		21,188
Prizes Payable		5,141,368
Due to Other Funds		1,503,022
Deferred Contract Costs		687,516
Other Accrued Liabilities		<u>313,652</u>

TOTAL CURRENT LIABILITIES10,866,680**TOTAL LIABILITIES**10,866,680**RETAINED EARNINGS:**

Reserve for Future Prizes	2,890,805
Unreserved (Note 8)	<u>6,040,379</u>

TOTAL RETAINED EARNINGS8,931,184**TOTAL LIABILITIES AND FUND EQUITY**\$ 19,797,864

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

NEBRASKA LOTTERY
INCOME STATEMENT
For the Year Ended June 30, 1999

OPERATING REVENUE:

Sales	\$ 73,770,586
Less: Sales Returns	<u>1,414,898</u>
TOTAL OPERATING REVENUE	72,355,688

OPERATING EXPENSES:

Prize Expense	38,808,897
Retailer Commissions	4,151,089
Contractual Services Expense	7,505,966
Marketing	2,964,863
Lottery Operating	<u>1,715,384</u>
TOTAL OPERATING EXPENSES	<u>55,146,199</u>

OPERATING INCOME 17,209,489

NON-OPERATING INCOME

Interest Income	742,420
Multi-State Lottery Association Income	<u>237,136</u>
TOTAL NON-OPERATING INCOME	<u>979,556</u>

NET INCOME BEFORE OPERATING TRANSFERS 18,189,045

TRANSFERS TO OTHER FUNDS (18,088,909)

NET INCOME 100,136

RETAINED EARNINGS, BEGINNING OF YEAR 8,831,048

RETAINED EARNINGS, END OF YEAR \$ 8,931,184

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

NEBRASKA LOTTERY
STATEMENT OF CASH FLOWS
 FOR THE YEAR ENDED JUNE 30, 1999

OPERATING ACTIVITIES:

Ticket Sales	\$ 71,826,280	
Prizes Paid to Winners	(37,038,258)	
Commissions Paid to Retailers	(4,148,750)	
Paid to Contractors for Goods and Services	(9,780,773)	
Paid to Employees	(1,152,616)	
Other Operating Expenses	(234,472)	
POWERBALL® Grand Prize Winner Receipts from MUSL	23,741,881	
Payments to POWERBALL® Grand Prize Winners	(23,741,881)	
Reserves on Deposit	81,970	
Advances for Vendors	(78,600)	
Prepaid Prize Expense	(8,372)	
Net Cash Provided by Operating Activities	<u>19,466,409</u>	

NON-CAPITAL FINANCING ACTIVITIES:

Paid to Education Innovation Fund	(8,702,608)	
Paid to Environmental Trust Fund	(8,702,607)	
Paid to Compulsive Gamblers Assistance Fund	(175,811)	
Net Cash Used in Noncapital Financing Activities	<u>(17,581,026)</u>	

CAPITAL AND RELATED FINANCING ACTIVITIES:

Purchase of Property and Equipment	(62,809)	
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INVESTING ACTIVITIES:

Interest on Cash	742,420	
Multi-State Lottery Association Income	106,717	
Net Cash Provided by Investment Activities	<u>849,137</u>	

NET INCREASE IN CASH AND CASH EQUIVALENTS

2,671,711

CASH AT BEGINNING OF YEAR

9,770,328

CASH AT END OF YEAR

\$ 12,442,039

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

Income from Operations	\$ 17,209,489
Adjustments to Reconcile Income from Operations to Net Cash Provided by Operating Activities:	
Reserves on Deposit	81,970
Prepaid Prize Expense	(8,372)
Advances for Vendors	(78,600)
Depreciation	52,992
Changes in Assets and Liabilities:	
(Increase) Decrease in:	
Accounts Receivable	(482,629)
Advance Sales	(21,352)
Accounts Payable and Accrued Liabilities	1,726,575
Prizes Payable	1,009,199
Compensated Absences Payable	(22,863)
Net Cash Provided by Operating Activities	<u>\$ 19,466,409</u>

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

NEBRASKA LOTTERY

NOTES TO FINANCIAL STATEMENTS

For the Fiscal Year Ended June 30, 1999

1. Summary of Significant Accounting Policies

A. Basis of Presentation

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

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

B. Reporting Entity

The Nebraska Lottery was established on February 24, 1993, by the Nebraska Legislature as a division of the Nebraska Department of Revenue which is a State agency established under and governed by the laws of the State of Nebraska. As such, the Nebraska Lottery is exempt from State and Federal income taxes. The Nebraska Lottery is to provide an instant win and a random number selection on-line lottery. The net proceeds as outlined in State Statute Section 9-812, R.S. Supp., 1998, are to be used for education, the environment and compulsive gamblers assistance. The financial statements include only the Nebraska Lottery and are not intended to present the financial position of the Nebraska Department of Revenue or the results of operations and changes in fund balance of the Department as a whole. The Nebraska Department of Revenue is part of the primary government for the State of Nebraska.

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

C. Basis of Accounting

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

NEBRASKA LOTTERY

NOTES TO FINANCIAL STATEMENTS

(Continued)

1. Summary of Significant Accounting Policies (Continued)

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

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

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

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

D. Fund Accounting

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

NEBRASKA LOTTERY

NOTES TO FINANCIAL STATEMENTS

(Continued)

1. Summary of Significant Accounting Policies (Continued)

E. Cash

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

F. Budgetary Process

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

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

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

NEBRASKA LOTTERY

NOTES TO FINANCIAL STATEMENTS

(Continued)

1. Summary of Significant Accounting Policies (Concluded)

G. Compensated Employee Absences

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

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

2. Fixed Assets

A summary of the activity in the fixed assets accounts during the period July 1, 1998 through June 30, 1999 is as follows:

Balance as of July 1, 1998	\$ 387,412
Additions Fiscal 1998/99	62,809
Less Prior Accumulated Depreciation	(283,315)
Less Current Depreciation	<u>(52,992)</u>
Balance June 30, 1999	<u>\$ 113,914</u>

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

3. Accounts Receivable

Retailers comprised principally of grocery stores, convenience stores and off sale liquor stores serve as the primary distribution channel for lottery sales to the general public. No one retailer accounts for a significant amount of the Lottery's sales or accounts receivable. Unless an accelerated payment plan for a specific retailer is in place, retailers must pay for instant lottery

NEBRASKA LOTTERY

NOTES TO FINANCIAL STATEMENTS

(Continued)

3. Accounts Receivable (Concluded)

tickets either two weeks after delivery under one option or at 45 days after delivery or when pack is 75% sold whichever comes first under a second option. Retailers pay for on-line tickets each Wednesday for balances due through the previous Saturday. Credit losses have been minimal but a reserve of \$6,113 was established as of June 30, 1999.

Accounts Receivable:

Retailers(net)	\$ 3,694,480
Other	<u>491,616</u>
Total	<u>\$ 4,186,096</u>

4. State Employees' Retirement System

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

Employees contributed 4.33% of their compensation until such time as they have paid during any calendar year a total of \$864, after which time they contribute 4.8% of their compensation for the remainder of the calendar year. The Lottery matches the employee's contribution at a rate of 156% of the employee's contribution. The contribution rates are established by State Statute and may be amended through legislative action. The employee's account is fully vested. The employer's account is vested 100% after five years of participation in the plan.

For the Fiscal Year Ended June 30, 1999, employees contributed \$36,831 and the Nebraska Lottery contributed \$57,457.

5. Risk Management

The Nebraska Lottery is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; natural disasters; and health care insurance. The Lottery as part of the primary government for the State participates

NEBRASKA LOTTERY

NOTES TO FINANCIAL STATEMENTS

(Continued)

5. **Risk Management** (Concluded)

in the State's risk management program. The Nebraska Department of Administrative Services (DAS) Division of Risk Management is responsible for maintaining the insurance and self insurance programs for the State. The State has chosen not to purchase insurance except for:

1. Motor vehicle liability which is insured for the first \$5 million of exposure per accident. Insurance is also purchased for medical payments, physical damage and uninsured and underinsured motorists with various limits and deductibles.
2. Health insurance for employees selecting certain coverage options. All health care insurance was purchased.
3. Employee dishonesty is bonded for the first \$1 million annually with a \$10,000 retention per incident.
4. Real and personal property on a blanket basis excluding the perils of Flood and Earthquake for net loss in excess of \$100,000 per loss occurrence, with a limit of \$250,000,000 per loss occurrence. Newly acquired properties are only covered up to \$1,000,000 for 30 days or until the value of the property is reported to the insurance company.

No settlements exceeded commercial insurance coverage in any of the past three fiscal years. Health care insurance is funded in the Risk Management Internal Service Fund through a combination of employee and state contributions. Workers compensation is also funded in the Risk Management Internal Service Fund through assessments on each agency based on total agency payroll and past experience. Tort claims; theft of, damage to and destruction of assets; errors and omissions; and natural disasters would be funded through the State General Fund or by individual agency assessments as directed by the legislature. No amounts for estimated claims has been reported in the Nebraska Lottery's financial statements.

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

6. **On-Line Games**

On July 21, 1994, the Nebraska Lottery began sales of on-line tickets for the POWERBALL® game. The POWERBALL® prize structure was changed as of November 1, 1997. In addition

NEBRASKA LOTTERY

NOTES TO FINANCIAL STATEMENTS

(Continued)

6. On-Line Games (Continued)

to the prize structure change, grand prizes will be paid in 25 installments unless the winner selects the cash value payment option at the time the grand prize is claimed. If the winner selects the cash value payment option, the cash value of the grand prize will be paid in one lump sum.

On February 1, 1998 the Nebraska Lottery began sales of on-line tickets for the WILD CARD® game. This game was discontinued on December 30, 1998. The WILD CARD® game was operated by the Multi-State Lottery (MUSL). The WILD CARD® Prize Reserve fund will be retained by MUSL until one year after the end of the game. As of June 30, 1999 Nebraska's share of the WILD CARD® Prize Reserve fund was \$130,711. If no obligations arise, these funds will be returned to Nebraska Lottery on December 31, 1999.

On March 30, 1998, the Nebraska Lottery began sales of on-line tickets for the CASH 4 LIFE® game. CASH 4 LIFE® grand prizes are \$1,000 a week for the life of the claimant or ten years whichever is longer.

The Nebraska Lottery is a member of the Multi-State Lottery (MUSL) which operates games on behalf of participating state lotteries. MUSL operates the POWERBALL®, and CASH 4 LIFE® games for the Nebraska Lottery. Each MUSL member sells on-line game tickets through its agents and makes weekly wire transfers to the MUSL in an amount equal to 50% of weekly sales less the amount retained for prizes paid directly to the winners by each member lottery. MUSL has placed 2% of each drawing period's POWERBALL® sales included as part of each MUSL's member's prize liability in prize reserve funds. The MUSL has placed a \$62,000,000 cap on the POWERBALL® prize reserve funds and once the prize reserve funds exceed this designated cap, the excess becomes part of the prize pool. A separate reserve is maintained by MUSL for the CASH 4 LIFE® game.

The prize reserve funds serve as a contingency reserve to protect the MUSL from unforeseen prize liabilities and the money in these reserve funds are to be used at the discretion of the MUSL Board of Directors. The prize reserve fund monies are refundable to MUSL members if the MUSL disbands or if a member leaves the MUSL. Members leaving the MUSL must wait one year before receiving their remaining share, if any, of the prize reserve funds. At June 30, 1999 the Nebraska Lottery's share of the prize reserve was \$2,890,805.

Bonds at the discounted value of grand prize annuities were purchased by MUSL to fund all future installments and are held in trust. Maturities are staggered in order to provide adequate cash flow for each installment. MUSL is responsible for paying amounts owed to the grand prize winners. The assets and related liabilities are reflected in MUSL's financial statements and therefore are not reflected in the Nebraska Lottery's financial statements.

NEBRASKA LOTTERY

NOTES TO FINANCIAL STATEMENTS

(Continued)

6. On-Line Games (Concluded)

On April 24, 1995, Nebraska Pick 5®, was started using a five of thirty (5/30) format with a prize payout structure of 51.31%. On September 14, 1997 the number of Nebraska Pick 5® draws was increased from four to six draws per week and on February 15, 1999 the game was changed to a five of thirty-five (5/35) format with a prize structure of 55%.

7. Significant Compliance Requirements

State Statute Section 9-812 R.S. Supp., 1998 requires at least twenty-five percent of the dollar amount of the lottery tickets which have been sold on an annualized basis shall be transferred to the Education Innovation Fund, the Nebraska Environmental Trust Fund, and the Compulsive Gamblers Assistance Fund. Of the money remaining after the payment of prizes and operating expenses; forty-nine and one-half percent shall be transferred to the Education Innovation Fund, forty-nine and one-half percent shall be transferred to the Nebraska Environmental Trust Fund, and one percent shall be transferred to the Compulsive Gamblers Assistance Fund.

The Lottery develops game structures to comply with the minimum prize provision of its enabling legislation which is a minimum of 40% must be paid in prizes. Prizes are redeemable for 180 days after game end or applicable on-line drawing.

The Nebraska Lottery compares the social security number of each winner that has a per wager prize in excess of \$500 against a list of social security numbers having an outstanding state tax liability or delinquent child support payments. Any delinquent payments are withheld from winnings and forwarded to the appropriate state agency. During the fiscal year the Nebraska Lottery collected \$5,759 in delinquent state taxes and \$25,188 in delinquent child support payments.

As required under its enabling legislation, transfers of \$17,581,026 had been made to other funds during the fiscal year. In addition to the above transfers, \$1,487,470 has been accrued as a current liability, Due to Other Funds, and will be included in future distributions.

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

8. Retained Earnings

The Nebraska Lottery's unreserved retained earnings represent funds not legally restricted for any specific purpose. The funds, however, may only be used to fund additional prize pay-

NEBRASKA LOTTERY

NOTES TO FINANCIAL STATEMENTS

(Continued)

8. Retained Earnings (Concluded)

outs, transfers to the other funds or additional operating expenses of the Nebraska Lottery. It is managements intention to use the Retained Earnings to fund additional prize pay-outs, retailer incentives and other game enhancements.

NEBRASKA LOTTERY

REQUIRED SUPPLEMENTARY INFORMATION

Year 2000 Issues. It is possible that computer-based financial-information and operational systems may not properly interpret and apply some dates before and following December 31, 1999 (commonly referred to as the Year 2000 problem or the Y2K problem). If an unforeseen problem does exist, the malfunction of these systems could adversely impact information processing and system operations.

Statewide systems

The State recognized this problem prior to 1995 and has been working on a resolution of the issue since that time. A formal plan was developed and has been revised and expanded, as additional information has become available. Two Statewide systems have been identified as critical to the Nebraska Lottery. They are the accounting system (commonly referred to as NAS) and the payroll system (commonly referred to as NEIS). These systems have been evaluated, repaired and tested for the ability to process transactions in the year 2000 and beyond.

Agency specific systems

The Nebraska Lottery has identified the Internal Control Systems (ICS) as critical to its operations. As of June 30, 1999, the Nebraska Lottery has committed \$0 and is in the following stages of work in process or completion to make their computer systems Year 2000 compliant:

Awareness Stage - Encompasses establishing a budget and project plan for dealing with the year 2000 issue. The Nebraska Lottery has completed this stage.

Assessment Stage - The actual process of identifying all systems (preparing and inventory) and individual components of the systems. The Nebraska Lottery has completed this stage.

Remediation Stage - The stage when changes to systems and equipment had actually been made. The Nebraska Lottery has completed this stage.

Validation/Testing Stage - The stage when changes made during the conversion process have been validated and tested. The Nebraska Lottery has completed this stage for the instant-ticket ICS system. This stage was in process as of June 30, 1999, for the online-ticket ICS system, and was completed on July 23, 1999.

NEBRASKA LOTTERY

REQUIRED SUPPLEMENTARY INFORMATION (Concluded)

Vendor specific systems

The Nebraska Lottery has identified two vendor-supplied computer systems and/or other electronic equipment as critical to its operation. These systems are the Instant-Ticket System supplied by Scientific Games, Intl.; and the Online-Ticket System supplied by Gtech, Inc. As of June 30, 1999, the two vendors reported to the Nebraska Lottery they were in the following stages of work in process or completion to make their computer systems and the electronic equipment Year 2000 compliant:

Awareness Stage - Encompasses establishing a budget and project plan for dealing with the year 2000 issue. This stage has been completed for both of the vendor-supplied computer systems.

Assessment Stage - The actual process of identifying all systems (preparing and inventory) and individual components of the systems. This stage has been completed for both of the vendor-supplied computer systems.

Remediation Stage - The stage when changes to systems and equipment are actually made. This stage has been completed for both of the vendor-supplied computer systems.

Validation/Testing Stage - The stage when changes made during the conversion process have been validated and tested. This stage was completed for the Instant-Ticket System. This stage was in process as of June 30, 1999, for the Online-Ticket System, and was completed on July 23, 1999.

It is important to note that although the completion of these stages provides a good indication of the ability of the systems to properly process transactions in the year 2000 and beyond, the completion of these stages is NOT a guarantee that system and equipment will be year 2000 compliant.

STATE OF NEBRASKA
Auditor of Public Accounts



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

We have audited the financial statements of the Nebraska Lottery as of and for the year ended June 30, 1999, and have issued our report thereon dated October 4, 1999. The report was modified to emphasize that the financial statements present only the funds of the Nebraska Lottery and an explanatory paragraph was added disclaiming an opinion on Required Supplementary Information - Year 2000 Issues. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Compliance

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

Internal Control Over Financial Reporting

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

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

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

A handwritten signature in dark ink, reading "Deann Hayfman CPA". The signature is written in a cursive, flowing style. The letters "Deann" and "Hayfman" are connected, and "CPA" is written separately to the right.

October 4, 1999

Deputy Auditor