

**AUDIT REPORT
OF THE
NEBRASKA LOTTERY**

JULY 1, 2002 THROUGH JUNE 30, 2003

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NEBRASKA LOTTERY

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NEBRASKA LOTTERY

BACKGROUND

The Legislature created the Lottery Division of the Nebraska Department of Revenue in 1991. Nebraska voters passed a constitutional amendment allowing the creation of a State lottery in November 1992, and the Legislature established the State lottery in 1993. As the 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.

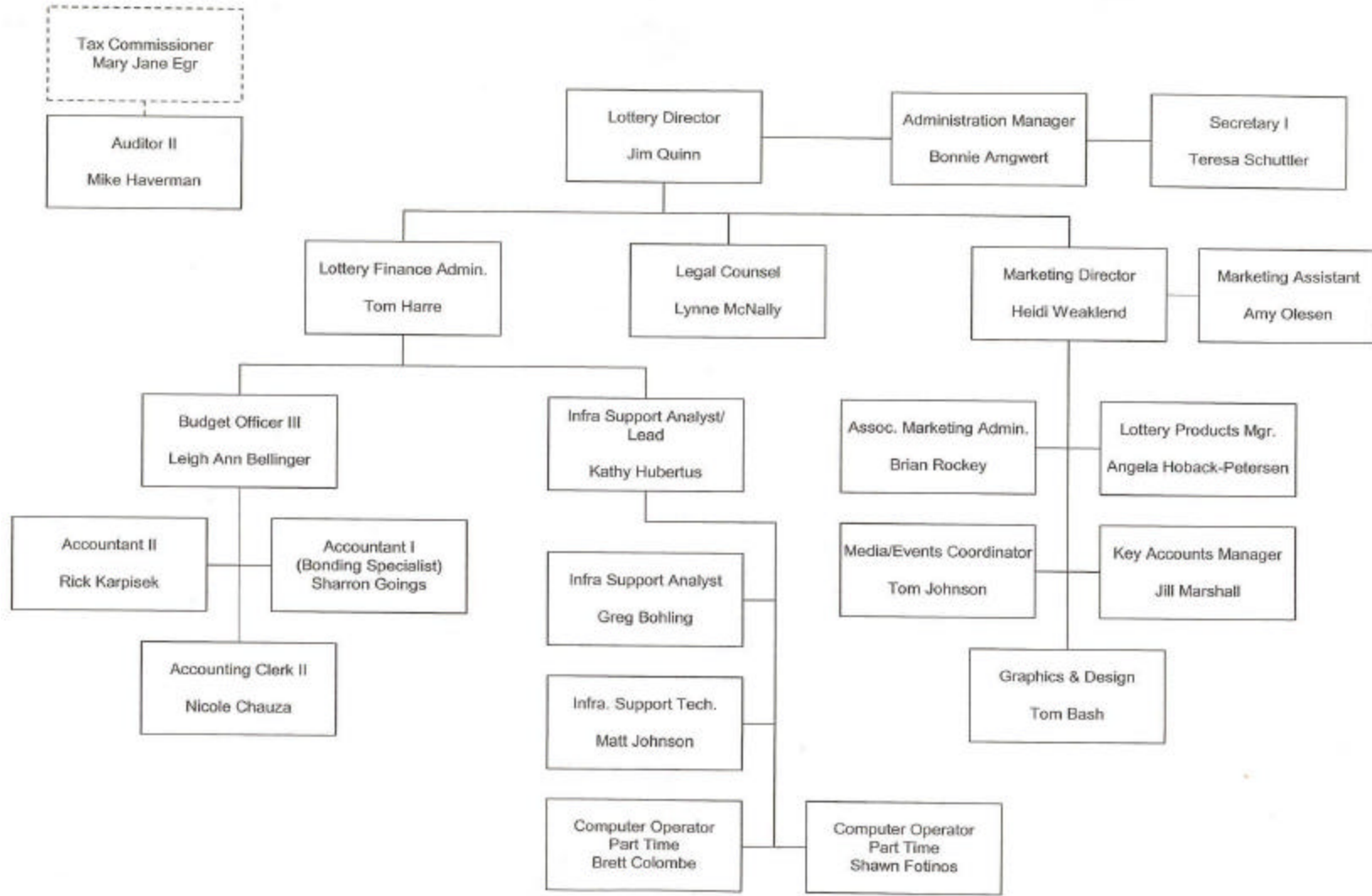
Currently, the Nebraska Lottery offers Powerball®, Pick5®, 2by2®, and instant games. The Rolldown® game was discontinued in April 2002.

Neb. Rev. Stat. Section 9-812(1) R.S.Supp., 2002 requires not less than forty percent of the dollar amount of lottery tickets sold be used for the payment of prizes. Nebraska Lottery retailers generally receive a five percent commission on their gross sales. Section 9-812(1) provides that at least twenty-five percent of Nebraska Lottery sales be divided as follows: (1) the first \$500,000 to the Compulsive Gamblers Assistance Fund, and thereafter (2) 49.5% to the Education Innovation Fund, (3) 49.5% to the Nebraska Environmental Trust Fund, and (4) 1.0% to the Compulsive Gamblers Assistance Fund.

MISSION STATEMENT

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

NEBRASKA LOTTERY
ORGANIZATIONAL CHART



NEBRASKA LOTTERY

EXIT CONFERENCE

An exit conference was held October 6, 2003 with the Nebraska Lottery to discuss the results of our examination. Those in attendance for the Nebraska Lottery were:

NAME	TITLE
James E. Quinn	Lottery Director
Tom Harre	Lottery Finance Administrator
Leigh Ann Bellinger	Budget Officer III
Mike Haverman	Auditor II

NEBRASKA LOTTERY

COMMENT AND RECOMMENDATION

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

Travel Expense Reimbursements

We tested ten travel expense reimbursements for a total of \$6,406. The Nebraska Lottery had \$52,183 in travel disbursements for the fiscal year. We noted the following related to meal and miscellaneous reimbursements.

The Nebraska Accounting System Manual, Concept 5, Travel Expense Policies, Section 6(a) states, "When an employee leaves for overnight travel at or before 06:30, breakfast may be reimbursed." Nebraska Department of Revenue Policy No. 200 followed by the Nebraska Lottery provides the framework for all travel expenditures of Lottery employees. The Revenue policy states, "When an employee leaves for travel on or before 6:30 a.m., breakfast expenses shall be reimbursed." Good internal control requires procedures to ensure daily meal costs reimbursed to employees are allowable and are within the Federal per diem guidelines for meal costs. Good accounting practices require that a reasonable amount be reimbursed for each meal. Nebraska Department of Revenue Travel Policy and Procedures effective October 22, 2001, Section II, Out-of-State Guidelines, page 12 states, "When an employee's travel status is less than a full day, the daily Federal meal guideline total can be broken down to 23 percent - breakfast, 27 percent - lunch, and 50 percent - evening dinner." The Nebraska Department of Administrative Services (DAS) - Accounting Division uses the Federal per diem rates as a reasonable guideline for meals and lodging. The United States General Service Administration's Federal per diem rate for Nebraska for meals was \$30. Neb. Rev. Stat. Section 81-1174 R.R.S. 1999 states, "When reimbursement is requested for mileage by automobile . . . the points between which such travel occurred, the times of arrival and departure, and the necessity and purpose of such travel shall be shown on such request." The Nebraska Lottery's travel policy, per memo dated October 23, 2002, states, "The Lottery will continue to reimburse for reasonable meal and lodging expense based on the Department of Revenue policy as long as 'proof of purchase' documentation is included . . . 'Proof of Purchase' is used instead of 'receipts' to allow for the use of credit card and restaurant billing stubs versus a detailed listing of meal items purchased."

During our review of meal and miscellaneous reimbursements, we noted the following:

- One employee was reimbursed for a breakfast meal that was not allowable because he started at 8:00 A.M. as indicated on the expense reimbursement document. He would have had to start on or before 6:30 A.M. to be able to claim reimbursement for a breakfast meal. For the same day the employee also exceeded the maximum Federal per diem amount for meals of \$30 by a total of \$8.76 when traveling to Grand Island, Nebraska.

NEBRASKA LOTTERY

COMMENT AND RECOMMENDATION

(Continued)

Travel Expense Reimbursements (Concluded)

- One employee did not include the stop time for travel on the expense reimbursement document. In addition, the employee was reimbursed for six meals and one exam book, but did not provide original proof of purchase. The employee also was reimbursed an unreasonable amount for two evening meals on two separate days totaling \$28.75 and \$33.46, respectively. The Federal per diem for San Diego, CA. was \$46 per day for meals. The Department of Revenue's policy regarding the percentage allocation of the Federal meal guideline to individual meals officially applies to when an employee's travel status is less than a full day. However, the percentage allocation of the Federal meal guideline to each meal is a reasonable basis to determine the reasonableness of reimbursements for individual meals.

Without an adequate review to ensure meal and miscellaneous costs reimbursed to employees are reasonable and within the DAS policy, the Department of Revenue policy, the Nebraska Lottery policy, and Federal per diem guidelines, there is an increased risk the Nebraska Lottery will pay unreasonable and unsubstantiated meal and miscellaneous expenses.

We recommend the Nebraska Lottery evaluate its policies and procedures regarding travel to ensure reimbursements for meals are allowable and reasonable and the daily Federal per diem amounts are not exceeded. We further recommend all travel reimbursements be reviewed to ensure meals and miscellaneous items reimbursed are supported by adequate documentation and the expense reimbursement document contains all pertinent information regarding the details of the travel such as the times of arrival and departure.

Nebraska Lottery's Response: The Lottery believes that Travel Expense Reimbursements have been justified and reasonable. The Lottery will continue to review all reimbursement requests for the inclusion of adequate documentation for third party review.

It should be noted this report is critical in nature since it contains only our comment and recommendation on the area noted for improvement.

Draft copies of this report were furnished to the Nebraska Lottery to provide them an opportunity to review the report and to respond to the comment and recommendation included in this report. The formal response received has been incorporated into this report. The response has been objectively evaluated and recognized, as appropriate, in the report. A response that indicates corrective action has been taken was not verified at this time but will be verified in the next audit.

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

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NEBRASKA LOTTERY

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INDEPENDENT AUDITORS' REPORT

Don Dunlap, CPA
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We have audited the accompanying financial statements of the business-type activities of the Nebraska Lottery, as of and for the year ended June 30, 2003, which collectively comprise the Nebraska Lottery's basic financial statements as listed in the Table of Contents. These financial statements are the responsibility of the Nebraska Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

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As discussed in Note 1, the financial statements of the Nebraska Lottery, a division of the Nebraska Department of Revenue, are intended to present the financial position, changes in financial position, and cash flows of only that portion of the business-type activities of the State of Nebraska that is attributable to the transactions of the Nebraska Lottery. They do not purport to, and do not, present fairly the financial position of the State of Nebraska as of June 30, 2003, and the changes in its financial position, and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Robert Hotz, JD
Legal Counsel
robhotz@mail.state.ne.us

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of the Nebraska Lottery, as of June 30, 2003, and the respective changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 6, 2003, on our consideration of the Nebraska Lottery's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Nebraska Lottery's basic financial statements. The schedules are presented for purposes of additional analysis and are not a required part of the basic financial statements. The schedules have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

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

Assistant Deputy Auditor

October 6, 2003

NEBRASKA LOTTERY
STATEMENT OF NET ASSETS
 JUNE 30, 2003

ASSETS:

CURRENT ASSETS

Cash and Cash Equivalents		\$ 6,878,514
Accounts Receivable, Net of Allowance (Note 3)		4,561,221
Prepaid Prizes		166,013
Prepaid Contract Cost - Instant		176,720
Reserves on Deposit (Note 6)		752,899
TOTAL CURRENT ASSETS		12,535,367

NONCURRENT ASSETS

Reserves on Deposit (Note 6)		1,716,588
Furniture, Fixtures, and Equipment (Note 2)	410,022	
Less: Accumulated Depreciation	326,576	
Capital Assets, Net		83,446

TOTAL NONCURRENT ASSETS		1,800,034
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TOTAL ASSETS		14,335,401
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LIABILITIES:

CURRENT LIABILITIES

Accounts Payable		672,033
Vendors Payable		901,280
Compensated Absences Payable		148,657
Accrued Payroll Payable		51,348
Withheld Taxes on Prizes Paid		17,909
Prize Payable		3,119,281
Due to Other Funds		1,064,775
Other Accrued Liabilities		114,464

TOTAL CURRENT LIABILITIES		6,089,747
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TOTAL LIABILITIES		6,089,747
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NET ASSETS

Invested in Capital Assets	83,446	
Restricted for Future Prizes	2,469,487	
Unrestricted (Note 8)	5,692,721	
TOTAL NET ASSETS		\$ 8,245,654

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

NEBRASKA LOTTERY
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
 FOR THE YEAR ENDED JUNE 30, 2003

OPERATING REVENUE:

Sales		\$ 82,228,810
Less: Sales Returns		<u>1,310,003</u>
TOTAL OPERATING REVENUE		80,918,807

OPERATING EXPENSES:

Prize Expense	42,984,053	
Retailer Commissions	4,676,188	
Contractual Services Expense	8,581,560	
Marketing	3,367,538	
Lottery Operating	<u>1,846,447</u>	
TOTAL OPERATING EXPENSES		<u>61,455,786</u>

OPERATING INCOME 19,463,021

NON-OPERATING REVENUE

Interest Income	403,543	
Multi-State Lottery Association Income	<u>102,335</u>	
TOTAL NON-OPERATING REVENUE		<u>505,878</u>

INCOME BEFORE OPERATING TRANSFERS 19,968,899

TRANSFERS TO OTHER FUNDS (20,229,702)

CHANGE IN NET ASSETS (260,803)

TOTAL NET ASSETS, BEGINNING OF YEAR 8,506,457

TOTAL NET ASSETS, END OF YEAR \$ 8,245,654

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, 2003

CASH FLOWS FROM OPERATING ACTIVITIES:

Ticket Sales	\$	80,135,098	
Prizes Paid to Winners		(42,657,453)	
Commissions Paid to Retailers		(4,682,641)	
Paid to Contractors for Goods and Services		(11,559,431)	
Paid to Employees		(1,287,755)	
Other Operating Expenses		(498,424)	
POWERBALL® Grand Prize Winner Receipts from MUSL		5,030,000	
Payments to POWERBALL® Grand Prize Winners		(5,030,000)	
Reserves on Deposit		(11,419)	
Advances for Vendors		8,607	
Prepaid Prize Expense		21,528	
		21,528	
Net Cash Provided by Operating Activities			\$ 19,468,110

CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES:

Paid to Education Innovation Fund		(9,701,339)	
Paid to Environmental Trust Fund		(9,701,339)	
Paid to Compulsive Gamblers Assistance Fund		(695,986)	
		(695,986)	
Net Cash Used in Non-capital Financing Activities			(20,098,664)

CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:

Purchase of Property and Equipment			(44,702)
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CASH FLOWS FROM INVESTING ACTIVITIES:

Interest on Cash		403,543	
Multi-State Lottery Association Income		79,804	
		79,804	
Net Cash Provided by Investment Activities			483,347

NET DECREASE IN CASH AND CASH EQUIVALENTS (191,909)

CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR 7,070,423

CASH AND CASH EQUIVALENTS AT END OF YEAR \$ 6,878,514

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

Operating Income			\$ 19,463,021
Adjustments to Reconcile Income from Operations to Net Cash Provided by Operating Activities:			
Reserves on Deposit			(11,419)
Prepaid Prize Expense			21,528
Advances for Vendors			8,608
Depreciation			70,294
Changes in Assets and Liabilities:			
(Increase) Decrease in:			
Accounts Receivable (Net)			(918,276)
Advance Sales			58,078
Accounts Payable and Accrued Liabilities			826,506
Prizes Payable			(58,062)
Compensated Absences Payable			7,832
			7,832
Net Cash Provided by Operating Activities			\$ 19,468,110

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

NEBRASKA LOTTERY

NOTES TO THE FINANCIAL STATEMENTS

For the Fiscal Year Ended June 30, 2003

1. Summary of Significant Accounting Policies

A. Basis of Presentation

The accompanying financial statements of the Nebraska Lottery have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to governmental units. As the Nebraska Lottery is a business-type activity, the financial statements are in the format of fund financial statements as required by Governmental Accounting Standards Board (GASB) Statement Number 34. GASB is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

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

B. Reporting Entity

The Nebraska Lottery was established on February 24, 1993, by the Nebraska Legislature as a division of the Nebraska Department of Revenue, which is a State agency established under and governed by the laws of the State of Nebraska. As such, the Nebraska Lottery is exempt from State and Federal income taxes. The financial statements include all funds of the Nebraska Lottery. The Nebraska Lottery is to provide an instant win and a random number selection on-line lottery. The net proceeds as outlined in Neb. Rev. Stat. Section 9-812 R.S.Supp., 2002, 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 balances of the Department as a whole. The Nebraska Department of Revenue is part of the primary government for the State of Nebraska's reporting entity.

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

NEBRASKA LOTTERY

NOTES TO THE FINANCIAL STATEMENTS

(Continued)

1. Summary of Significant Accounting Policies (Continued)

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

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

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

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

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

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

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

NEBRASKA LOTTERY

NOTES TO THE FINANCIAL STATEMENTS

(Continued)

1. Summary of Significant Accounting Policies (Continued)

D. Fund Accounting

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

E. Cash

All cash is held by the Nebraska State Treasurer. These funds are held in pooled accounts and accordingly are not categorized as to credit risk as defined by GASB Statement No. 3. Investment of all available cash is made by the State Investment Officer on a daily basis, based on total bank balances. 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 requests for the biennium beginning the following July 1. The requests are submitted on forms that show estimated funding requirements by programs, sub-programs, and activities. The Executive Branch reviews the requests, establishes priorities, and balances the budget within the estimated resources available during the upcoming biennium.

The Governor's budget bill is submitted to the Legislature in January. The Legislature considers revisions to the bill and presents the appropriation bill to the Governor for signature. The Governor may: a) approve the appropriations bill in its entirety, b) veto the bill, or c) line item veto certain sections of the bill. Any vetoed bill or line item can be overridden by a three-fifths vote of the Legislature.

The approved appropriations will generally set spending limits for a particular program. Within the program, the Legislature may provide funding from one to five budgetary fund types. Thus, the control is by fund type, within a program, within an agency. The central accounting system maintains this control. A separate publication titled "Annual Budgetary Report" shows the detail of this 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, which may be amended by the Legislature, upon approval by the Governor. The Tax Commissioner may reallocate the appropriations between the major objects 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 THE FINANCIAL STATEMENTS

(Continued)

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

G. **Compensated Employee Absences**

All permanent employees working for the Nebraska Lottery earn sick and annual leave and are allowed to accumulate compensatory leave rather than being paid overtime. Temporary and intermittent employees are not eligible for paid leave. Nebraska Lottery employees accrue vested annual leave at a variable rate based on years of service. Generally, accrued annual leave cannot exceed 35 days at the end of a calendar year. Employees accrue sick leave at a variable rate based on years of service. In general, accrued sick leave cannot exceed 180 days. There is no maximum limit on the accumulation of sick days for employees under certain labor contracts. 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. Employees under certain labor contracts can only be paid a maximum of 50 days. The liability has been calculated using the vesting method, in which leave amounts, for both employees who are currently eligible to receive termination payments and other employees who are expected to become eligible in the future to receive such payments upon termination, are included.

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

H. **Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at fiscal year end and revenues and expenditures during the reporting period. Actual results could differ from those estimates.

2. **Capital Assets**

A summary of the activity in the capital assets accounts during the period July 1, 2002 through June 30, 2003 is as follows:

Balance July 1, 2002	\$	443,905
Additions Fiscal 2002/2003		44,702
Removals Fiscal 2002/2003		(78,584)
Less Prior Accumulated Depreciation		(256,283)
Less Current Depreciation		<u>(70,294)</u>
Balance June 30, 2003	\$	<u>83,446</u>

NEBRASKA LOTTERY

NOTES TO THE FINANCIAL STATEMENTS

(Continued)

2. Capital Assets (Concluded)

Capital assets acquired or constructed for the Nebraska Lottery and costing in excess of \$1,500 were capitalized and depreciated. Assets costing \$1,500 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 Nebraska Lottery's sales or accounts receivable. Retailers must pay for instant lottery tickets 45 days after activation or when pack is 70% sold whichever comes first. Retailers pay for on-line tickets each Wednesday for balances due through the previous Saturday.

Accounts Receivable:	
Retailers (net)	\$ 4,078,085
Other	483,136
Total	<u>\$ 4,561,221</u>

4. State Employees' Retirement System (Plan)

The Plan 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 and may be amended by legislative action. Membership in the Plan is mandatory for all permanent full-time employees after completion of twelve continuous months of service. Full time employee is defined as an employee who is employed to work one-half or more of the regularly scheduled hours during each pay period. Voluntary participation is permitted for all permanent full-time or permanent part-time employees upon reaching age twenty and completion of twelve months of permanent service within a five-year period. Any individual appointed by the Governor may elect not to become a member of the Plan.

Employees contribute 4.33% of their monthly compensation until such time as they have paid during any calendar year a total of eight hundred sixty-four dollars, after which time they pay a sum equal to 4.8% of their monthly compensation for the remainder of such calendar year. The Nebraska Lottery matches the employee's contribution at a rate of 156%.

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

For the fiscal year ended June 30, 2003, employees contributed \$45,555 and the Nebraska Lottery contributed \$71,066.

NEBRASKA LOTTERY

NOTES TO THE FINANCIAL STATEMENTS

(Continued)

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; and natural disasters. The Nebraska Lottery as part of the primary government for the State participates in the State's risk management program. The Nebraska Department of Administrative Services (DAS) Division of Risk Management is responsible for maintaining the insurance and self-insurance programs for the State. The State generally self-insures for general liability and workers compensation. The State has chosen to purchase insurance for:

- A. Motor vehicle liability, which is insured for the first \$5 million of exposure per accident, except for accidents involving vehicular pursuit which have a \$1,000,000 self-insured retention per accident. Insurance is also purchased for medical payments, physical damage, and uninsured and underinsured motorists with various limits and deductibles. State agencies have the option to purchase coverage for physical damage to vehicles.
- B. Health care and life insurance for eligible employees.
- C. Crime coverage, with a limit of \$1 million for each loss, with a \$25,000 self-insured retention per incident.
- D. Real and personal property on a blanket basis for losses up to \$100,000,000 with a self-insured retention of \$200,000 per loss occurrence. Newly acquired properties are only covered up to \$1,000,000 for 60 days or until the value of the property is reported to the insurance company. The perils of flood and earthquake are covered up to \$10,000,000. Acts of terrorism are covered up to \$2,500,000 aggregate per year. State agencies have the option to purchase building contents and inland marine coverage.

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

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

NEBRASKA LOTTERY

NOTES TO THE FINANCIAL STATEMENTS

(Continued)

6. On-Line Games

During the fiscal year ending June 30, 2003, the Nebraska Lottery offered a variety of on-line games as described in the following table.

Game Name	Operated by	Nebraska's Share of Prize Reserves
POWERBALL®	MUSL	\$ 2,433,691
NEBRASKA PICK 5®	Nebraska Lottery	n/a
2by2 ®	MUSL	35,796
		\$ 2,469,487

The amount of Reserve on Deposit shown as a current asset is a portion of the Powerball® prize reserve. The Multi-State Lottery Association (MUSL) reallocated the reserve shares of the states participating in the Powerball® game. The Nebraska Lottery has contributed more than their share to the prize reserve and the current portion is expected to be refunded within the year. The remainder of the Nebraska Lottery's share of prize reserves is shown as a noncurrent asset.

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

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

NEBRASKA LOTTERY

NOTES TO THE FINANCIAL STATEMENTS

(Continued)

7. Significant Compliance Requirements

Neb. Rev. Stat. Section 9-812 R.S.Supp., 2002 requires at least twenty-five percent of the dollar amount of the lottery tickets, which have been sold, on an annualized basis to be transferred to the beneficiary funds. Of the money remaining after the payment of prizes and operating expenses; the first five hundred thousand dollars shall be transferred to the Compulsive Gamblers Assistance Fund. Thereafter, 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.

Of the funds transferred to the Education Innovation Fund, for fiscal years 2002 and 2003, the Education Innovation Fund shall be allocated up to one million five hundred thousand dollars per fiscal year for distance education network completion grants. The remaining funds, after operating expenses for the Excellence in Education Council are deducted, shall be transferred by the Nebraska Department of Education to the State's general fund.

2002 Special Session LB 1, Section 8, passed during the August 2002 Special Session, requires the State Treasurer to transfer a portion of the funds received by the Nebraska Environmental Trust Fund to the Nebraska Department of Natural Resources Interstate Water Rights Cash Fund and to the Low-Level Radioactive Waste Cash Fund.

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

The Nebraska Lottery compares the social security number of each winner that has a per wager prize in excess of \$500 against a list of social security numbers having an outstanding State tax liability or delinquent child support payments. Any delinquent payments are withheld from winnings and forwarded to the appropriate State agency. During the fiscal year the Nebraska Lottery collected \$2,599 in delinquent State taxes and \$8,970 in delinquent child support payments.

As required under its enabling legislation, transfers of \$20,098,664 had been made to other funds during the fiscal year. In addition to the above transfers, \$1,040,214 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.

NEBRASKA LOTTERY

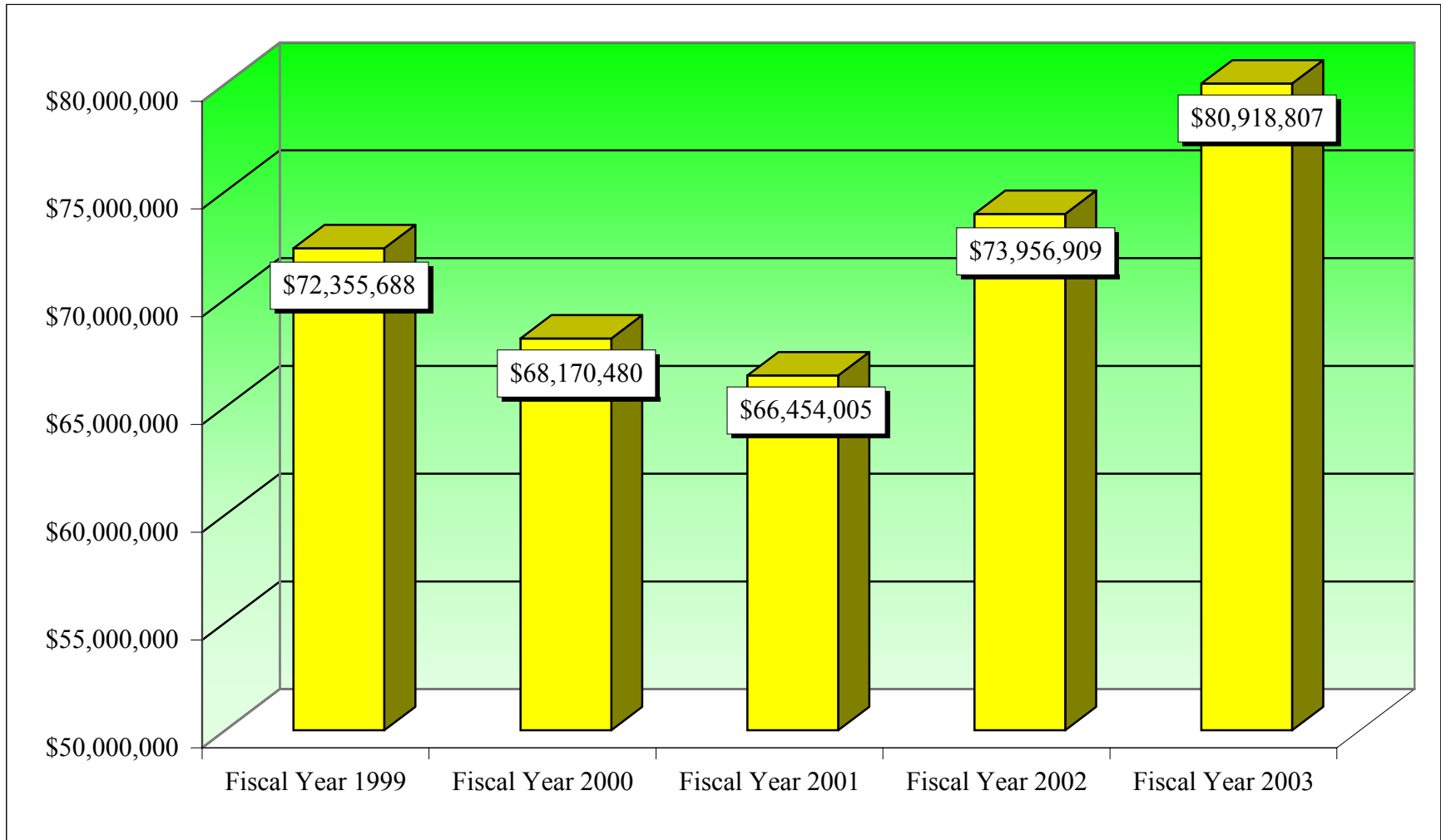
NOTES TO THE FINANCIAL STATEMENTS

(Continued)

8. Net Assets

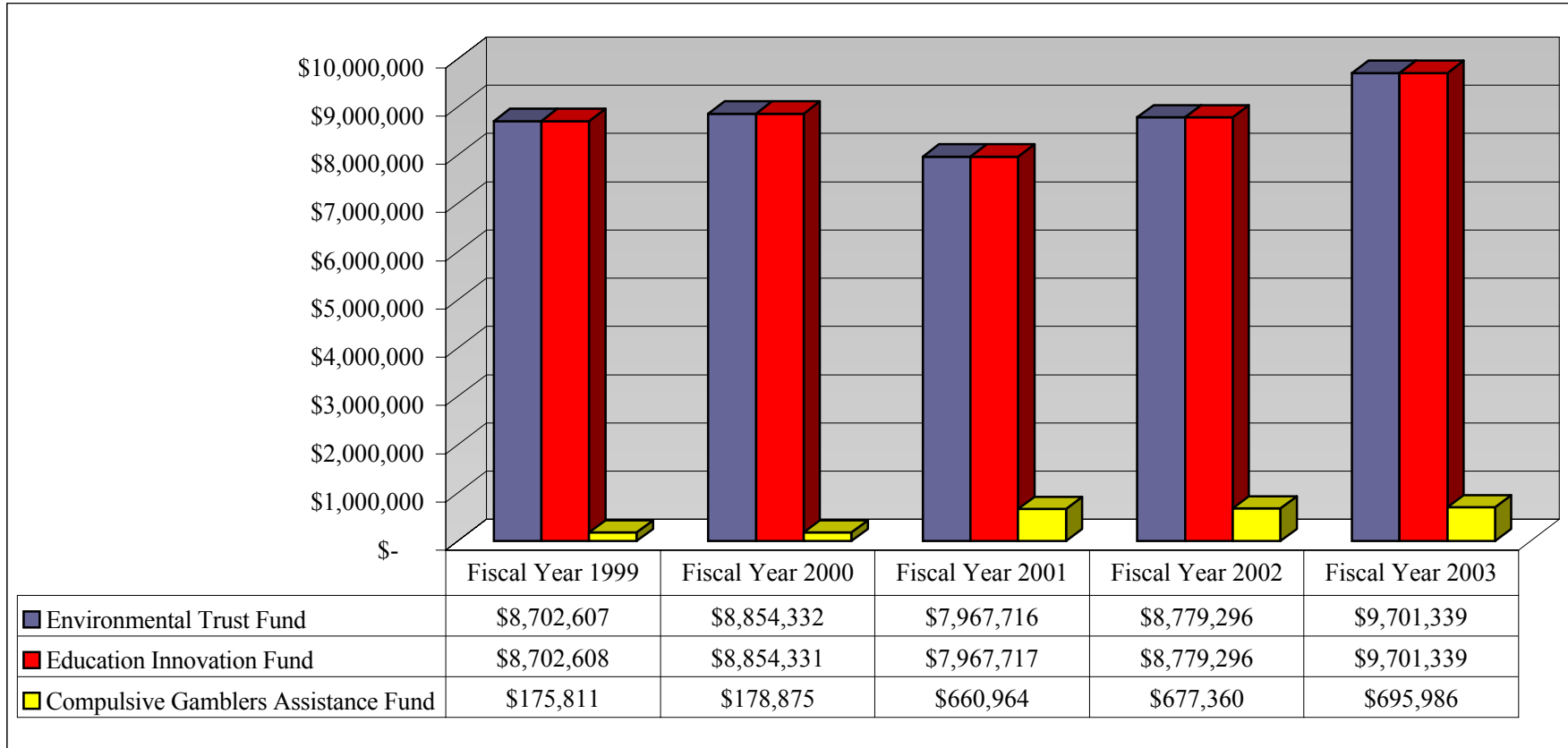
The Nebraska Lottery's unrestricted net assets represent funds not legally restricted for any specific purpose. The funds, however, may only be used to fund additional prize pay-outs, transfers to the beneficiary funds or additional operating expenses of the Nebraska Lottery. It is management's intention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

NEBRASKA LOTTERY
LOTTERY TICKET SALES
For the Fiscal Years 1999 through 2003



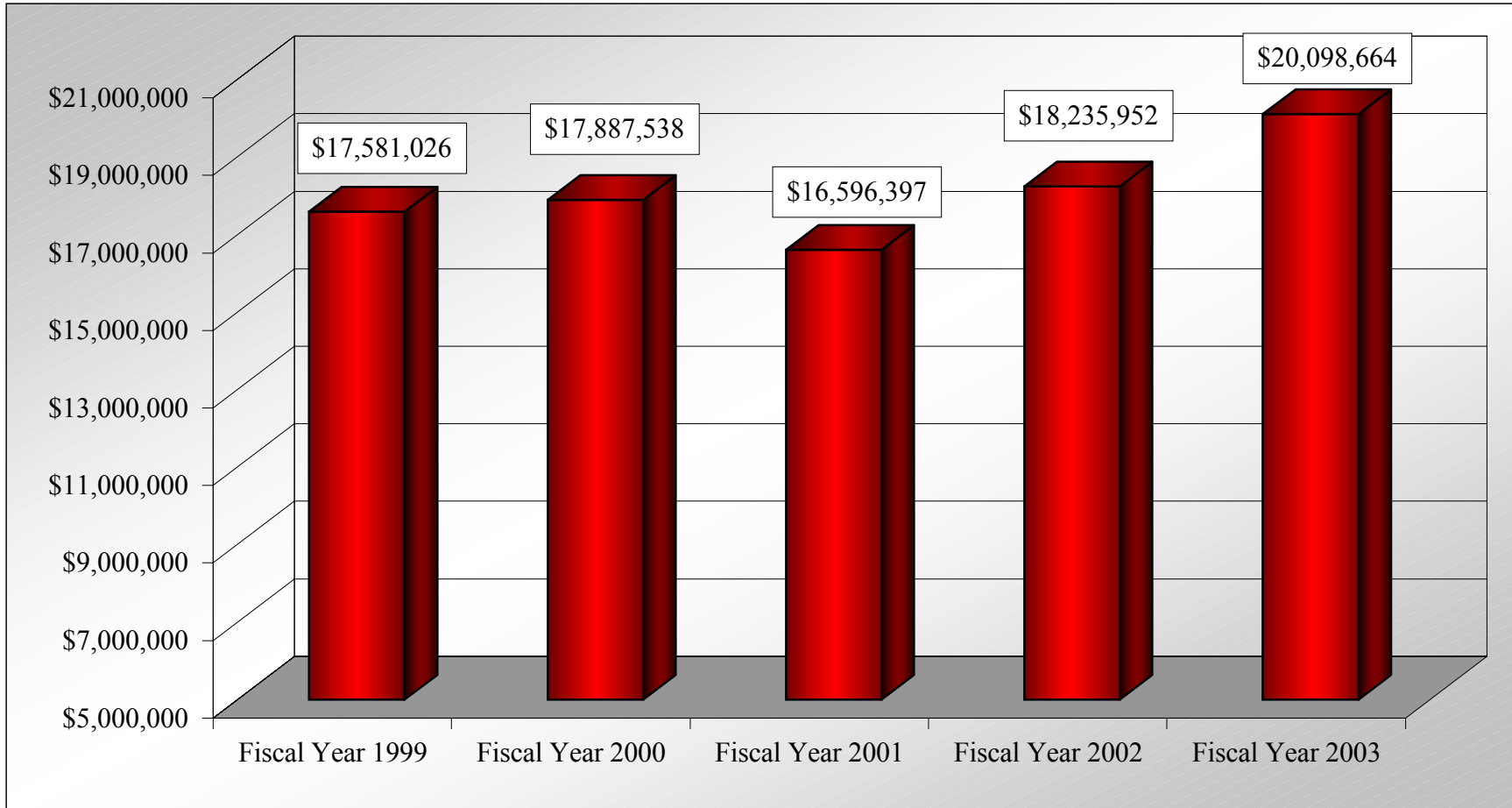
Note: These sales are shown on an accrual basis.

**NEBRASKA LOTTERY
OPERATING TRANSFERS**
For the Fiscal Years 1999 through 2003



Note: Effective July 13, 2000, the first \$500,000 was transferred to the Compulsive Gambler Assistance Fund. Thereafter, of the money remaining after the payment of prizes and operating expenses and the initial transfer to the Compulsive Gamblers Assistance Fund, 49.5% shall be transferred to the Nebraska Environmental Trust Fund, 49.5% shall be transferred to the Education Innovation Fund, and 1% shall be transferred to the Compulsive Gamblers Assistance Fund. These transfers are shown on a cash basis except for an adjustment of \$2,342,407 to the Environmental Trust Fund transfers. Fiscal Year 2001 was decreased and Fiscal Year 2000 was increased to better reflect the transfer in the year it relates to.

NEBRASKA LOTTERY
TOTAL OPERATING TRANSFERS
For the Fiscal Years 1999 through 2003



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

NEBRASKA LOTTERY
SCHEDULE OF CUMULATIVE OPERATING TRANSFERS

State Fiscal Year	Transfer Amount
1994	\$ 10,931,811
1995	19,308,170
1996	20,486,304
1997	23,363,387
1998	18,740,463
1999	17,581,026
2000	17,887,538
2001	16,596,397
2002	18,235,953
2003	20,098,664
Total Cumulative Transfers	\$ 183,229,713

Note: Total Cumulative Transfers includes transfers to the Solid Waste Landfill Closure Fund, the Environmental Trust Fund, the Education Innovation Fund, and the Compulsive Gamblers Assistance Fund. These transfers are shown on a cash basis except for an adjustment of \$2,342,407 increasing the Fiscal Year 2000 transfer amount and decreasing the Fiscal Year 2001 transfer amount to better reflect the transfer in the year it relates to.

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NEBRASKA LOTTERY

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

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We have audited the financial statements of the Nebraska Lottery as of and for the year ended June 30, 2003, and have issued our report thereon dated October 6, 2003. The report was modified to emphasize the financial statements present only the funds of the Nebraska Lottery. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

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

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 another matter involving the internal control over financial reporting that we have reported to management of Nebraska Lottery in the Comments Section of this report as Travel Expense Reimbursements.

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

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

Assistant Deputy Auditor

October 6, 2003