

# ***Georgia Lottery Corporation***

*Management's Discussion and Analysis for the  
Years Ended June 30, 2012 and 2011, Financial  
Statements as of and for the Years Ended June 30,  
2012 and 2011, and Independent Auditor's Report*

# GEORGIA LOTTERY CORPORATION

## TABLE OF CONTENTS

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	<b>Page</b>
INDEPENDENT AUDITOR'S REPORT	1
MANAGEMENT'S DISCUSSION AND ANALYSIS	2-12
FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2012 AND 2011:	
Statements of Net Assets	13
Statements of Revenues, Expenses, and Changes in Net Assets	14
Statements of Cash Flows	15 and 16
Notes to Financial Statements	17-29

## INDEPENDENT AUDITOR'S REPORT

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**The Board of Directors  
of the Georgia Lottery Corporation:**

We have audited the accompanying basic financial statements of the **Georgia Lottery Corporation**, a component unit of the State of Georgia (the "GLC"), as of and for the years ended June 30, 2012 and 2011, as listed in the table of contents. These financial statements are the responsibility of the GLC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to previously present fairly, in all material respects, the financial position of the Georgia Lottery Corporation as of June 30, 2012 and 2011, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Accounting principles generally accepted in the United State of America require that the management's discussion and analysis on pages 2 through 12 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Atlanta, Georgia  
October 17, 2012



## Management's Discussion and Analysis

As management of the Georgia Lottery Corporation (the "GLC"), we offer readers of the GLC's financial statements this narrative overview and analysis of the financial activities for the fiscal years ended June 30, 2012 and June 30, 2011. We encourage readers to consider the information presented here in conjunction with the financial statements, which begin on page 13.

### *Financial Highlights*

The GLC had a record year of sales and profits in fiscal year 2012. Gross ticket sales were \$3.835 billion in fiscal year 2012. For the 2011 fiscal year, gross ticket sales were \$3.598 billion. For fiscal year 2012, the net proceeds paid to the Lottery for Education Account were \$901.3 million. The net proceeds paid to the Lottery for Education represent an increase of \$55.2 million as compared to the prior year. For fiscal year 2011, net proceeds paid were \$846.1 million, which represented a decrease of \$37.8 million over fiscal year 2010. Other significant financial highlights include the following:

- For fiscal year 2012, gross tickets sales increased by \$236.8 million, a 6.6% increase as compared to 2011. For fiscal year 2011, gross tickets sales decreased by \$47.5 million, a 1.3% decrease as compared to 2010.
- Prizes expense increased \$169.0 million during fiscal year 2012 and decreased \$8.3 million in fiscal year 2011. This expense usually increases or decreases in direct proportion to ticket sales and represented approximately 60% of gross ticket sales in fiscal years 2012 and 59% in 2011. Prize expense represented approximately 58% of gross ticket sales in 2010.
- Direct gaming expenses, which include retailer commissions, contractor fees, advertising, and retailer merchandising and marketing increased \$.2 million in fiscal year 2012. These expenses also fluctuate in proportion to ticket sales and represented approximately 8.9% of gross ticket sales in 2012 and 9.4% in 2011. For fiscal year 2011, direct gaming expenses decreased \$6.9 million below 2010. These expenses represented approximately 9.4% of gross ticket sales in 2010.
- Operating expenses remained at less than 1% of gross ticket sales for fiscal years 2012 and 2011. Fiscal year 2012 operating expenses decreased \$.4 million below 2011 expenses, resulting primarily from decreases of \$.9 million in sales employee commissions, \$.5 million in professional fees, \$.3 million in depreciation expense, and \$.2 million in bad debt expense, partially offset by a \$1.3 million increase in personnel costs, and \$.2 million in computer expense. Fiscal year 2011 operating expenses increased \$.7 million over the previous fiscal year. Operating expenses remained at less than 1% of gross ticket sales for fiscal years 2011 and 2010.
- Nonoperating expenses, net of revenues, increased \$24.3 million in 2012 as compared to 2011. This increase is attributable to the increase in payments to/due to Lottery for Education Account over the prior fiscal year, offset by the change in the fair value of grand prize investments held by the GLC for funding future grand prize payments, and a slight decrease in interest revenue. Nonoperating expenses, net of revenues, decreased \$20.6 million in 2011 as compared to 2010. This decrease is attributable to the decrease in payments to/due to Lottery for Education Account over the prior fiscal year, partially offset by the change in the fair value of grand prize investments held by the GLC for funding future grand prize payments, and a slight decrease in interest revenue.

## ***Overview of the Financial Statements***

The GLC is accounted for as an enterprise fund, reporting transactions using the accrual basis of accounting similar to a business entity. This discussion and analysis is intended to serve as an introduction to the GLC's basic financial statements, along with the notes to the financial statements. The statements of net assets on page 13, the statements of revenues, expenses, and changes in net assets on page 14, and the statements of cash flows on pages 15 and 16 report the GLC's net assets and changes therein. The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the financial statements. The notes to the financial statements begin on page 17 of this report.

The GLC pays its net proceeds each fiscal year to the General Fund of the state treasury for credit to the Lottery for Education Account. As a result, the GLC's net assets consist of funds invested in capital assets and unrestricted net assets. Unrestricted net assets normally result from the inclusion of capital costs in the determination of net proceeds (as required by the Georgia Lottery for Education Act) and the cumulative effect of periodic adjustments to recognize the fair value of grand prize investments which are held to fund grand prizes payable. The GLC expects to hold these investments to maturity to meet our future grand prize winner obligations and, therefore, will not realize any gains or losses related to the current value of these investments for distribution as net proceeds. The reader of these financial statements should review the assets and liabilities in the statements of net assets and the operating revenues and expenses and the payment to and due to Lottery for Education Account in the statements of revenues, expenses, and changes in net assets to assess the GLC's financial position as of June 30, 2012 and 2011, and the results of its operations for the years then ended.

## ***Financial Analysis***

### **Assets**

At the end of fiscal year 2012, total assets were \$648.3 million compared to \$647.1 million at the end of fiscal year 2011, representing an increase of \$1.2 million. Total assets at the end of fiscal year 2011 were \$647.1 million compared to \$613.7 million at the end of fiscal year 2010, representing an increase of \$33.4 million.

Current assets decreased from \$354.8 million in 2011 to \$353.3 million in 2012, representing a decrease of \$1.5 million. This decrease is primarily due to a \$36.2 million decrease in retailer accounts receivable, and a \$1.4 million decrease in prepaid and other assets, offset by a \$36.1 million increase in cash and cash equivalents. The decrease in retailer accounts receivable was due to the timing of the accounting week for billing and collections from our retailers at year-end. Current assets increased from \$302.0 million in 2010 to \$354.8 million in 2011, representing an increase of \$52.8 million. This increase was primarily due to a \$57.7 million increase in retailer accounts receivable, comprised of an \$18.6 million increase in funds due to the timing of the accounting week for billing and collections from our retailers at year-end cutoff and a \$39.8 million increase in the receivable due from the Virginia Lottery for a Georgia jackpot winner in the June 29, 2011 Powerball draw, and a \$1.3 million increase in prepaids and other assets. These increases were partially offset by a \$6.1 million decrease in cash and cash equivalents.

In fiscal year 2012, noncurrent assets increased from \$292.2 million in 2011 to \$295.0 million in 2012, representing an increase of \$2.8 million. This increase is due to grand prize investments increasing from \$287.9 million in 2011 to \$290.9 million in 2012, an increase of \$3.0 million. The increase resulted from net purchases of \$2.8 million, payments to grand prize winners totaling \$35.8 million, interest earned on current-year maturities of \$12.1 million, and a \$23.9 million increase in the fair value of the investments. Capital assets decreased from \$4.4 million in 2011 to \$4.1 million in 2012. The decrease resulted from capital asset purchases of \$1.6 million less depreciation expense of \$1.9 million.

Noncurrent assets decreased from \$311.6 million in 2010 to \$292.2 million in 2011, representing a decrease of \$19.4 million. This decrease was due to grand prize investments decreasing from \$306.6 million in 2010 to \$287.9 million in 2011, a decrease of \$18.7 million. The decrease resulted from net purchases of \$10.5 million, payments to grand prize winners totaling \$35.3 million, interest earned on current-year maturities of \$13.0 million, and a \$7.0 million decrease in the fair value of the investments. Capital assets decreased from \$5.0 million in 2010 to \$4.4 million in 2011. The decrease resulted from capital asset purchases of \$1.5 million less depreciation expense of \$2.1 million.

## **Liabilities**

Total liabilities at the end of fiscal year 2012 were \$606.9 million compared to \$629.5 million at the end of fiscal year 2011, representing a decrease of \$22.6 million. Total liabilities at the end of fiscal year 2011 were \$629.5 million compared to \$589.1 million at the end of fiscal year 2010, representing an increase of \$40.4 million.

Current liabilities decreased from \$354.4 million in 2011 to \$352.3 million in 2012, a decrease of \$2.1 million. The decrease is due to a \$10.5 million decrease in prizes payable, offset by a \$5.6 million increase in the funds due to the Lottery for Education Account, a \$2.3 million increase in accounts payable and accrued liabilities, and \$.5 million increase in the retailer escrow liability. The decrease in prizes payable was primarily due to a \$41.0 million decrease in the prizes payable clearing account primarily resulting from the previous fiscal year Powerball jackpot winner in Georgia, a \$6.4 million decrease in the deferred prize expense liability for several online games (*Cash 3, Cash 4, Decades of Dollars, Keno!, Mega Millions, and Powerball*), and a \$.9 million decrease in the *Win For Life* annuity prize liability clearing account. These decreases were offset by a \$34.2 million increase in prizes payable for prizes won and due to winners not yet claimed, and increases of \$2.9 million in expired *Mega Millions* prizes and \$.9 million in expired *Powerball* prizes of \$.9 million over the prior year. The increase in funds due to the Lottery for Education Account resulted from higher fourth quarter sales in fiscal year 2012 versus 2011. The increase in accounts payable and accrued liabilities was primarily due to higher year-end accrued payments of \$1.8 million owed to other vendors at June 30, 2012 as compared to June 30, 2011.

Current liabilities increased from \$302.8 million in 2010 to \$354.4 million in 2011, an increase of \$51.6 million. The increase is due to a \$70.5 million increase in prizes payable, a \$.8 million increase in the retailer escrow liability, partially offset by a \$4.6 million decrease in accounts payable and accrued liabilities and a \$15.1 million decrease in the funds due to the Lottery for Education Account. The increase in prizes payable was due to a \$40.8 million increase in the prizes payable clearing account primarily resulting from a jackpot winner in Georgia for the June 29, 2011 Powerball draw, a \$26.8 million increase in the deferred prize expense liability for several online games (*Cash 3, Cash 4, Decades of Dollars, Keno!, Mega Millions, and Powerball*), a \$.9 million increase in prizes payable for prizes won and due to winners not yet claimed over the prior year, a \$.9 million increase in the *Win For Life* annuity prize liability clearing account, and an increase in deferred sales of \$.5 million as of June 30, 2011. The decrease in funds due to the Lottery for Education Account resulted from lower fourth quarter sales in fiscal year 2011 versus 2010. The decrease in accounts payable and accrued liabilities was primarily due to lower year-end accrued payments of \$2.3 million for sales and non-sales employee commissions, \$.9 million for advertising, and a \$1.5 million decrease in amounts owed to other vendors at June 30, 2011 as compared to June 30, 2010.

Noncurrent liabilities decreased \$20.5 million from \$275.1 million in 2011 to \$254.6 million in 2012. Noncurrent liabilities principally consist of grand prizes payable, which represent the amount to be paid to grand prize winners over future years. In fiscal year 2012, grand prizes payable decreased \$20.6 million below 2011, from \$271.4 million to \$250.8 million. The decrease was primarily attributable to two factors. Grand prize payables of \$23.7 million (winner payments net of interest earned on current-year

maturities) became due and payable in fiscal year 2012 as an annual payment obligation to our grand prize winners, thus reducing the long-term liabilities. The GLC increased its grand prizes payable by \$2.8 million as the result of new annual payment obligations for grand prize winners for the online *Win For Life*. The GLC has purchased or will purchase U.S. Treasury securities to fund these future payment obligations.

Noncurrent liabilities decreased \$11.2 million from \$286.3 million in 2010 to \$275.1 million in 2011. Noncurrent liabilities principally consist of grand prizes payable, which represent the amount to be paid to grand prize winners over future years. In fiscal year 2011, grand prizes payable decreased \$11.7 million below 2010, from \$283.1 million to \$271.4 million. The decrease was primarily attributable to two factors. Grand prize payables of \$22.2 million (winner payments net of interest earned on current-year maturities) became due and payable in fiscal year 2011 as an annual payment obligation to our grand prize winners, thus reducing the long-term liabilities. The GLC increased its grand prizes payable by \$10.5 million as the result of new annual payment obligations for grand prize winners for several instant games: *Extreme Green*, *Maximum Green*, *Big Payout*, *Millionaire Celebration*, and *Win for Life*. The GLC has purchased or will purchase U.S. Treasury securities to fund these future payment obligations.

### **Net Assets and Changes in Net Assets**

Net assets increased \$23.9 million in 2012 from \$17.6 million in fiscal year 2011, to an end of year balance of \$41.5 million. This increase resulted from a \$23.9 million unrealized change in the fair market value of grand prize investments held by the GLC for the funding of future grand prize payments. Accounting principles generally accepted in the United States of America require the GLC to record its grand prize investments at fair value, and the change in the fair value is recorded as nonoperating revenue (expense) annually. The GLC classifies the decreases and increases in fair value as unrealized, due to the investments generally being held to maturity to fund future prize obligations.

Net assets decreased \$7.0 million in 2011 from \$24.6 million in fiscal year 2010, to an end of year balance of \$17.6 million. This decrease resulted from a \$7.0 million unrealized change in the fair market value of grand prize investments held by the GLC for the funding of future grand prize payments.

### **Sales**

Total lottery ticket sales for fiscal year 2012 were \$3.835 billion, as compared to \$3.598 billion in 2011. This represents an increase of \$236.8 million, with instant games showing an increase of \$161.2 million while online games increased by \$75.6 million. The instant sales increase was primarily attributable to the \$20 instant games. A record \$656 million *Mega Millions* jackpot, a change to a \$2 price point for *Powerball* tickets, along with the continued growth of *Keno!* drove the increase in online sales. Average weekly gross ticket sales for fiscal year 2012 were \$73.7 million versus \$69.2 million in 2011.

Gross instant ticket sales increased \$161.2 million during fiscal year 2012, from \$2.424 billion in 2011 to \$2.585 billion in 2012. The GLC's administration of a sound marketing strategy, continuous development and introduction of new instant ticket games, and effective management of the instant product mix led to the 6.7% increase in ticket sales for 2012 versus 2011. Management will continue its efforts to provide players with new and exciting instant and online games. Gross instant ticket sales increased \$10.3 million during fiscal year 2011, from \$2.413 billion in 2010 to \$2.424 billion in 2011.

The GLC's four holiday-themed instant games, offered from late October 2011 through early 2012 and based on our popular Jumbo Bucks line of core instant games, demonstrated strong player appeal and contributed approximately \$138 million in ticket sales. The games include \$1 *Junior Jingle Bucks*, \$2 *Jingle Bucks*, \$5 *Giant Jingle Bucks*, and \$10 *Jingle Jumbo Bucks*.

Instant tickets at the \$1, \$2, and \$3 price points generated approximately \$210 million, \$444 million, and \$197 million in sales, respectively, in fiscal year 2012. Some of our most successful instant games at the

lower price points, other than holiday games, included \$1 *Junior Jumbo Bucks*, \$1 *Lucky 7's*, \$1 *5X The Money*, \$2 *Jumbo Bucks Classic*, \$2 *10X The Money*, \$2 *Cashword IV*, \$3 *Jumbo Bucks Bingo*, \$3 *Cherry, Orange, Lemon Doubler Cashword*, and \$3 *Cash Jubilee 2012*.

Ticket sales at the \$5 price point totaled over \$563 million in fiscal year 2012. New instant games introduced during 2012 at the \$5 price point included *Golden Age*, *Cash Crop*, *Atlanta Falcons In The House*, *Jeep Outdoor Adventure*, *Black Pearls*, *\$400,000 Grant*, "\$", *Cadillac Riches*, *Georgia Hold 'Em*, *Cash Deluxe*, and a holiday-themed game, *Giant Jingle Bucks*. Collectively, these new \$5 instant games produced over \$277 million in ticket sales. The two top selling \$5 instant games in fiscal year 2012 were *Giant Jumbo Bucks* and *20X The Money*, which contributed \$87 million and \$69 million in revenue, respectively.

Instant games at the \$10 price point provided approximately \$671 million in revenue, the largest contribution to overall instant ticket sales. The GLC offered players nine different games at this price point in fiscal year 2012 including *\$150,000,000 Slots of Luck*, *Jumbo Jumbo Bucks*, *50X The Money*, *Extreme Green*, *Georgia Millions*, *Georgia Lottery Black*, *Millionaire Celebration*, *\$100 Million Cash Blast*, and a holiday-themed game, *Jingle Jumbo Bucks*.

Sales of the \$20 price point category continued as a significant part of the overall sales and product mix in fiscal year 2012 by contributing \$489 million in ticket revenue, a \$135 million increase from fiscal year 2011. During fiscal year 2012, the GLC had several \$20 instant games on sale, including *Millionaire Jumbo Bucks*, *\$7 Million Jackpot*, *Maximum Green*, *\$3,000,000 Taxes Paid*, *Super Millions*, and *\$100 Million Lucky Fortunes*.

Instant tickets at the \$1, \$2, and \$3 price points generated approximately \$236 million, \$482 million, and \$182 million in sales, respectively in fiscal year 2011. Some of our most successful new instant games at the lower price points included, \$1 *Lucky 7's*, \$1 *5X The Money*, and \$1 *\$15,000 Football Fever*, \$2 *10X The Money*, \$2 *Georgia Lottery Limited*, \$2 *Cashword III*, \$2 *Lotteria*, \$1 *Lucky 7's*, \$3 *Instant Keno!*, and \$3 2011 *Cash Celebration*.

Ticket sales at the \$5 price point totaled over \$530 million in fiscal year 2011. New instant games introduced during 2011 at the \$5 price point included *Atlanta Falcons \$500,000 Score*, *Sapphires & Gold*, *King & Queens*, *Royal Riches*, *Cool Cash*, *Lotta Bucks*, *King's Ransom*, *Power 7's*, and a holiday-themed game, *Holiday Gift*. Collectively, these new \$5 instant games produced over \$232 million in ticket sales. The two top selling \$5 instant games in fiscal year 2011 were *Giant Jumbo Bucks* and *20X The Money*, which contributed \$99 million and \$77 million in revenue, respectively.

Instant games at the \$10 price point provided approximately \$630 million in revenue, the largest contribution to overall instant ticket sales. The GLC offered players nine different games at this price point included *\$150,000,000 Slots of Luck*, *Jumbo Jumbo Bucks*, *Super Luck 7's*, *Extreme Green*, *Red Hot Millions*, *Georgia Lottery Black*, *Millionaire Celebration*, *\$100 Million Cash Blast*, and a holiday-themed game, *Jingle Jumbo Bucks*.

Sales of the \$20 price point category continued as part of the overall sales and product mix by contributing \$363 million in ticket revenue. During fiscal year 2011, the GLC had several \$20 instant games on sale, *Millionaire Jumbo Bucks*, *World Class Millions*, *Maximum Green*, *\$3,000,000 Taxes Paid*, and *Super Millions*.

The GLC's four holiday-themed instant games in fiscal year 2011, offered from late October 2010 through early 2011, demonstrated strong player appeal and contributed approximately \$134 million in ticket sales. The games include \$1 *Season's Greeting*, \$2 *Betty Boop Holiday Surprise*, \$5 *Holiday Gifts*, and \$10 *Jingle Jumbo Bucks*.



For fiscal year 2012, online game sales were \$1.250 billion, an increase of \$75.6 million, approximately 6.4% above the 2011 online sales of \$1.174 billion. For fiscal year 2011, online game sales decreased by \$57.7 million or 4.7%, from 1.232 billion in 2010 to \$1.174 billion.

*Cash 3* sales increased slightly by \$1.3 million to \$468.8 million in 2012 compared to \$467.6 million in 2011. *Cash 3* is a twice-daily drawing game whereby the player chooses a three-digit number and wins a specified fixed amount if his or her numbers are selected in the draw. The aggregate prize amount per draw varies based on the number of winners. The actual prize payout experienced was approximately 52% for fiscal year 2012 and 46% for fiscal year 2011. Historically, as the prize amount won for this game increases above or decreases below the industry average of 50% of sales, a corresponding increase or decrease in sales will occur.

*Cash 3* sales decreased \$20.7 million to \$467.6 million in 2011 compared to \$488.3 million in 2010. The actual prize payout experienced was approximately 46% for fiscal year 2011 and 50% for fiscal year 2010. The decrease in prize payouts in 2011 as compared to 2010 resulted in a decline in *Cash 3* sales.

In fiscal year 2012, *Mega Millions* sales increased \$11.1 million or approximately 7.5% to \$159.0 million compared to \$147.9 million in 2011. *Mega Millions* produced five jackpots over \$100 million in 2012, including a record \$656 million jackpot in March 2012 that helped drive *Mega Millions* sales in Georgia to the 7.5% increase realized in 2012. Other jackpots over \$100 million included \$107 million in July 2011, \$114 million in October 2011, \$208 million in December 2011, and a jackpot of \$119 million in May 2012. *Mega Millions* is a multi-state lottery game operated with eleven other states—California, Illinois, Maryland, Massachusetts, Michigan, New Jersey, New York, Ohio, Texas, Virginia, and Washington. Through an agreement with the Mega Millions consortium and the Multi-State Lottery Association (MUSL), MUSL members are allowed to cross-sell tickets for the *Mega Millions* game. Drawings are held twice weekly on Tuesday and Friday.

*Mega Millions* sales decreased \$55.1 million or approximately 27% to \$147.9 million in fiscal year 2011 compared to \$203.0 million in 2010. *Mega Millions* produced four jackpots over \$100 million in 2011. There were jackpots of \$380 million in January 2011, \$319 million in March 2011, \$141 million in October 2010, and a jackpot of \$135 million in August 2010. *Mega Millions* sales are jackpot driven and, as a whole, jackpot rollovers did not reach the higher levels in 2011 which were achieved in 2010. In November 2010, the GLC added the *Megaplier* feature to *Mega Millions*. *Megaplier* is an add-on feature that increases players' non-jackpot prizes for an additional \$1 per play. Depending on the *Megaplier* number selected during the draw, players have the opportunity to multiply their winnings by two, three, or four times. Winning *Mega Millions* with *Megaplier* tickets matching 5 of 5 numbers automatically win \$1 million, regardless of which *Megaplier* is drawn.

*Powerball* sales increased \$33.1 million to \$111.0 million in 2012 compared to \$77.9 million in 2011. The increase is primarily attributable to a change in the ticket price point from \$1 to \$2 in January 2012 that drove the overall sales increase. *Powerball* is a multi-state lottery online game operated by the Multi-State Lottery Association (MUSL). Through a cross-sell agreement between MUSL and participating *Mega Millions* states, the GLC began selling tickets for the *Powerball* online game during fiscal year 2010, on January 30, 2010. Drawings are held twice weekly on Wednesday and Saturday. Five winning numbers are drawn from a set of 59 white balls and one number is drawn from a second set of 39 red balls. Additionally, players can choose the *PowerPlay* option to increase their non-jackpot prizes for an additional \$1 per play, per draw. Non-jackpot prizes are multiplied two to five times, depending on the *PowerPlay* multiplier for that drawing. Players can win \$1 million dollars automatically with *PowerPlay* when they match all 5 white balls regardless of the multiplier number.

*Powerball* sales increased \$35.4 million to \$77.9 million in 2011 compared to \$42.5 million in 2010. The increase is attributable to *Powerball* sales being offered for the entire fiscal year in 2011 versus approximately five months during fiscal year 2010.

In fiscal year 2012, *Cash 4* sales increased \$4.2 million, from \$191.5 million in 2011 to \$195.7 million in 2011. *Cash 4* is a twice-daily drawing game whereby the player chooses a four-digit number and wins a specified fixed amount if his or her numbers are selected in the draw. The aggregate prize amount per draw varies based on the number of winners. Actual prize payouts in fiscal years 2012 and 2011 were approximately 41% and 44%, respectively. Historically, as the prize amount won for this game increases above or decreases below the industry average of 50% of sales, a corresponding increase or decrease in sales will occur. However, lower than expected actual *Cash 4* prize payouts in fiscal year 2012 produced an increase in sales. The increase may have been attributable to strong instant ticket sales and multiple *Mega Millions* jackpots exceeding \$100 million driving additional sales for this game.

In fiscal year 2011, *Cash 4* sales decreased \$28.4 million, from \$219.9 million in 2010 to \$191.5 million in 2011. Actual prize payouts in fiscal years 2011 and 2010 were approximately 44% and 52%, respectively. Historically, as the prize amount won for this game increases above or decreases below the industry average of 50% of sales, a corresponding increase or decrease in sales will occur. Consequently, lower than expected actual prize payouts in fiscal year 2011 resulted in a decline in *Cash 4* sales.

*Win For Life* sales decreased by \$2.6 million to \$8.8 million in 2012, compared to 2011 sales of \$11.4 million. *Win For Life* is a multi-state fixed prize online game operated in conjunction with the Virginia Lottery. Drawings are held twice weekly on Wednesday and Saturday. Six winning numbers followed by one “free ball” number are drawn from a single set of 42 balls. By matching the six winning numbers, players win the top prize of \$1,000 a week for life payable in quarterly payments of \$13,000. Players matching five of the six winning numbers plus the “free ball” number win the second tier prize of \$1,000 a week for one year. Matching the “free ball” number also increases other lower level prize amounts.

*Win For Life* sales were \$11.4 million in 2011, a decrease of \$6.0 million compared to 2010 sales of \$17.4 million. Kentucky discontinued its participation in the *Win For Life* game as of January 29, 2011, leaving Georgia and Virginia as the remaining lotteries selling this game.

*Decades of Dollars* sales increased by \$9.7 million to \$20.0 million in fiscal year 2012, compared to \$10.3 million in fiscal year 2011. The increase is attributable to the game being on sale for the entire fiscal year in 2012, as opposed to five months (February 2011 to June 2011) in fiscal year 2011. *Decades of Dollars* is a multi-state fixed prize online game operated in conjunction with lotteries in Arkansas, Kentucky, and Virginia. Drawings are held twice weekly on Monday and Thursday. Six winning numbers are drawn from a single set of 47 balls. By matching the six winning numbers, players win the top prize and may select at the time of prize claim to receive the prize as \$250,000 each year for 30 years, payable annually or the one-time cash option amount of \$4,000,000. Players matching five of the six winning numbers win the second tier prize of \$10,000 payable in one payment. By matching 2, 3, or 4 winning numbers, players can win lower tier prizes, ranging from \$2 to \$100.

*Decades of Dollars* was launched on January 30, 2011. For fiscal year 2011, *Decades of Dollars* sales were \$10.3 million.

*Fantasy 5* sales decreased \$2.4 million in fiscal year 2012 to \$94.9 million from \$97.3 million in 2011. Additionally, *eZmatch* sales declined \$1.4 million in fiscal year 2012 to \$6.6 million from \$8.0 in fiscal year 2011. The sales decrease in *Fantasy 5* for fiscal year was not as substantial as the prior year. Increased player traffic at retailer locations during the high *Powerball* and *Mega Millions* jackpots, and add-on sales from players purchasing instant games may have lessened the impact of lower *Fantasy 5* sales in 2012.

*Fantasy 5* sales decreased \$15.2 million in 2011 to \$97.3 million from \$112.6 million in 2010. In fiscal year 2011, players had the opportunity to participate in the *Fantasy 5* Fridays promotion, held March 4 through June 24. On Fridays during the promotional period, players received one free one-play quik pik ticket for each *Fantasy 5* ticket purchased. Another *Fantasy 5* promotion was conducted for the entire

month of May 2011. For this promotion, the *Fantasy 5* minimum daily jackpot started at \$100,000. During fiscal year 2010, a new feature, *eZmatch* was added to the *Fantasy 5* game. Players can choose the *eZmatch* option, for an additional \$1 per play, for a chance to win an instant cash prize. By matching their *Fantasy 5* numbers to any of the *eZmatch* numbers, players can win up to 5 times on each ticket with instant cash prizes from \$4 to \$500. *eZmatch* ticket sales were \$8.0 million in fiscal year 2011 and \$19.1 million in fiscal year 2010, a decrease of \$11.1 million.

*Georgia FIVE* sales declined \$7.4 million, from \$18.0 million in fiscal year 2011 to \$10.6 million in fiscal year 2012. *Georgia FIVE* is a fixed prize online game where players pick their own five numbers, in a single PLAY area - one from each vertical column of 0 to 9 or have their numbers randomly selected through the terminal by requesting a Quik Pik lottery ticket. Players win by matching their numbers to the winning number(s) drawn in the exact order and position in a single play. By matching all five of your numbers in exact order to the winning numbers, players win the top prize of \$10,000. Other opportunities to win prizes are available by matching one or more numbers in a specific order and position sequence/order, with prizes ranging from \$1 to \$225.

*Georgia FIVE* was launched in August 2010. For fiscal year 2011, *Georgia FIVE* sales totaled \$18.0 million.

*Keno!* sales increased \$30.0 million to \$174.3 million in fiscal year 2012, compared to \$144.3 million in fiscal year 2011. In fiscal year 2012, higher *Keno!* sales were driven by sound marketing plans, which included continuing *Keno! Bonus Hours* promotions and the *Keno! To Go Initiative*, launched in late fiscal year 2011. *Keno! To Go* allows players to purchase a ticket and then watch the drawings on their computer or smartphone.

Sales for *Keno!* were \$144.3 million and \$127.4 million in fiscal years 2011 and 2010, respectively. This represented a \$16.9 million increase in sales during 2011 versus 2010. Higher *Keno!* sales were attributable to the execution of the GLC's marketing plan and promotional activities conducted to support the game, including *Keno! Bonus Hours*, and providing *Keno! To Go*. During fiscal year 2011, the number of retailers offering *Keno!* increased. The *Keno!* product was made available for purchase from any retailer selling other GLC online games.

### **Other Operating Revenue**

Other operating revenue includes online fees and other miscellaneous revenue. Other operating revenue was \$4.4 million in fiscal year 2012 versus \$4.6 million in 2011, a decrease of \$.2 million. This was mainly due to a decrease in service fees from retailers. Other operating revenue was \$4.6 million in fiscal year 2011 versus \$5.0 million in 2010, a decrease of \$.4 million. The decrease was primarily due to receipt of a \$.6 million one-time operating revenue recognized in fiscal year 2010.

### **Prize Expense**

Gross prize expense for instant games increased to \$1.679 billion in fiscal year 2012 from \$1.552 billion in 2011, an increase of \$127.7 million (approximately 8.2%), resulting from significantly higher instant sales and brisk sales of the \$20 price point games which offer higher prize payouts. Gross prize expense for instant games was \$1.552 billion in fiscal year 2011 versus \$1.538 billion in 2010, an increase of \$13.2 million (approximately .9%). Instant games prize expense is managed through the number of tickets printed for each game and value of prizes at each price point, as determined prior to ticket production. Prize expense is recognized based on an established prize structure and related percentage of sales for each game introduced and is recognized when products are made available for sale to the public. The increase in instant game prize expense is a result of the increase in sales of the higher price point games as a percentage of total instant sales. The increase in the prize expense for higher price point games, which offer a larger prize payout than lower price point games, is negligible as a component of gross instant ticket sales. In addition, the increase in instant game prize expense for fiscal year 2012 was

impacted by \$2.5 million reduction in unclaimed prizes available to apply towards the overall instant game prize.

Instant game prize expense is reduced by applying unclaimed prizes recognized during the fiscal year. For fiscal year 2012, prize expense, net of unclaimed prizes for instant games, totaled \$1.648 billion as compared to \$1.518 billion in 2011, and \$1.498 billion in 2010. Gross instant prize expense was reduced by \$31.3 million, \$33.8 million, and \$40.2 million, by using unclaimed prizes in 2012, 2011, and 2010, respectively.

Prize expense for online games generally increases or decreases each year in direct proportion to ticket sales of the related game. For pari-mutuel online games (*Mega Millions* jackpot prize, *Powerball* jackpot prize, and *Fantasy 5*), actual prize expense is recognized as a percentage of ticket sales. For nonpari-mutuel games with fixed prize payouts (*Cash 3*, *Cash 4*, *Decades of Dollars*, *Georgia FIVE*, *Mega Millions* secondary tier prizes, *Powerball* secondary tier prizes, *eZmatch*, *Win For Life*, and *Keno!*), actual prize expense is impacted by the number and prize value of winning tickets. To recognize prize expense on a consistent basis for these games, the GLC recognizes prize expense based on the greater of actual prizes paid or the estimated payout experience over the life of the game or based on industry averages. The GLC has established prize liability limits, per draw, for non pari-mutuel games.

Total online prize expense increased \$38.7 million in 2012 to \$641.7 million compared to \$603.0 million in 2011, in direct proportion to game sales. For fiscal year 2011, total online prize expense decreased \$27.9 million to \$603.0 million compared to \$630.9 million in 2010. The net increase/decrease is comprised of the following increases and decreases by game as follows:

- Prize expense for *Cash 3* decreased \$4.1 million in fiscal year 2012 as compared to 2011. The recognized expense percentage was adjusted from 50% in 2011 to 49% in 2012 in conjunction with an analysis of actual prize payouts since liability caps were implemented. Prize expense for *Cash 3* decreased \$11.6 million in fiscal year 2011 as compared to 2010.
- Prize expense for *Mega Millions* increased \$5.5 million in 2012 versus 2011. Prize expense for *Mega Millions* decreased \$27.5 million in 2011 versus 2010.
- Prize expense for *Powerball* increased \$16.5 million in fiscal year 2012 as compared to 2011. For fiscal year 2011, prize expense for *Powerball* increased \$17.7 million as compared to 2010.
- Prize expense for *Cash 4* increased \$0.6 million in 2012 over 2011. The recognized expense percentage was adjusted from 49.5% in 2011 to 48.75% in 2012 in conjunction with an analysis of actual prize payouts since liability caps were implemented. Prize expense for *Cash 4* decreased \$14.6 million over 2010.
- Prize expense for *Fantasy 5* increased \$1.2 million in 2012 versus 2011. Prize expense for *Fantasy 5* decreased \$8.3 million in 2011 versus 2010. *eZmatch* prize expense decreased \$1.0 million in fiscal year 2012 as compared to 2011. *eZmatch* prize expense decreased \$7.2 million in fiscal year 2011 as compared to 2010.
- Prize expense for *Georgia FIVE* decreased \$3.9 million in 2012 to \$5.7 million. Prize expense for *Georgia FIVE* was \$9.7 million in fiscal year 2011. *Georgia FIVE* was not conducted in fiscal year 2010.
- Prize expense for *Keno!* increased \$19.3 million in 2012 as compared to 2011. Prize expense for *Keno!* increased \$10.9 million in 2011 versus 2010.
- Prize expense for *Win For Life* decreased \$1.3 million in fiscal year 2012 as compared to 2011. Prize expense for *Win For Life* decreased \$2.0 million in fiscal year 2011 below 2010.

- Prize expense for *Decades of Dollars* increased \$5.8 million to \$12.0 million in fiscal year 2012. Prize expense for *Decades of Dollars* was \$6.2 million in fiscal year 2011. *Decades of Dollars* was not conducted in fiscal years 2010.
- The *Sit and Win Games* were not conducted in fiscal years 2012 or 2011. Prize expense for the *Sit and Win Games* was \$1.2 million in fiscal year 2010.

## **Direct Gaming and Operating Expenses**

Direct gaming expenses usually change in proportion with changes in ticket sales. For fiscal year 2012, increased ticket sales resulted in a corresponding increase in contractor (vendor) fees, and a slight increase in retailer merchandising and marketing, largely offset by a decrease in retailer commissions as compared to 2011. For fiscal year 2011, the decrease in direct gaming expense primarily resulted from a significant change in how the GLC compensates its retailers as compared to 2010.

Retailer commissions for fiscal year 2012 were \$228.7 million compared to \$230.9 million in 2011, and \$239.3 million in 2010. This represents a \$2.2 million decrease in fiscal year 2012 versus 2011, and \$8.4 million decrease in 2011 as compared to 2010. For fiscal year 2012, the GLC paid its retailers a set 6% commission percentage for selling lottery tickets. During the previous fiscal year in March 2011, due to legislative changes with the passing of House Bill 326, the GLC began compensating its retailers at a set commission percentage of 6% for selling tickets. Cashing bonuses for validating and paying winning prizes up to \$600 and winning ticket jackpot incentives on certain online games were discontinued.

Contractor (vendor), fees represent payments made to our two major suppliers of the gaming products, systems, and services, and three other suppliers of instant ticket printing and property licensing. The payments made to our two major suppliers are determined based on a percentage of sales formula. During fiscal year 2009, GLC extended its major vendor contracts for Online Gaming Systems and Services and Instant Ticket Printing and Associated Services until September 2013. The contract extension will provide lower vendor fees resulting from the reduction in the charges for services provided to the GLC. Payments made to the other suppliers are based on contract terms. In fiscal year 2012, contractor (vendor) fees were \$70.9 million as compared to \$68.2 million in 2011, representing an increase of \$2.7 million. The increase was primarily attributable to increased ticket sales in fiscal year 2012, partially offset by the savings generated from a rate reduction for services by the GLC's primary provider of instant ticket printing and merchandising during the last six months of fiscal year 2012. In fiscal year 2011, contractor (vendor) fees were \$68.2 million as compared to \$67.7 million in 2010, representing a slight increase of \$.5 million. The increase was primarily attributable to the inclusion of expenses for web site development and enhancements being included in vendor fees.

Advertising expense decreased \$.6 million to \$20.6 million in 2012 from \$21.1 million in 2011. The GLC's advertising agency, BBDO, provided point-of-sale items, and media production for various lottery games and marketing initiatives during fiscal year 2012. Advertising services provided were media production for the Atlanta Falcons Waffle House Halftime Event, the *Powerball* Hawks Halftime Event, the All Access Music Reunion, the Three Stooges Movie Premier, and various media advertising for instant games, and development of related point-of-sale merchandise. In fiscal year 2011, advertising expense decreased \$4.1 million to \$21.1 million from \$25.2 million in 2010. The decrease was partially due to the reallocation of \$4.1 million in funds to retailer merchandising and marketing from advertising.

Fiscal year 2012, retailer merchandising and marketing expenses increased \$.3 million from \$18.9 million in 2011 to \$19.2 million in 2012. Retailer merchandising and marketing expenses increased \$5.1 million from \$13.8 million in 2010 to \$18.9 million in 2011. This increase primarily resulted from the reallocation of funds from advertising to new game development expenses associated with marketing

campaigns supporting new lottery games and features, special promotions for retailer partnerships, various second chance drawings, and media production expenses to increase player awareness.

Operating expenses decreased \$.4 million to \$33.9 million in 2012 from \$34.3 million in 2011. The \$.4 million decrease in operating expenses resulted from a decrease of \$.5 million in professional fees and \$.3 million in depreciation expense, partially offset by an increase of \$.5 million in personnel costs. Operating expenses increased \$.7 million to \$34.3 million from \$33.7 million in 2011 as compared to 2010. The \$.7 million increase in operating expenses resulted from increases of \$.7 million in personnel costs, \$.2 million in depreciation expense, \$.2 million in repairs and maintenance, and \$.2 million in professional fees, partially offset by decreases of \$.6 million in sales employee commissions, and \$.2 million in rent expense.

### **Nonoperating Revenues (Net of Expenses)**

Nonoperating revenues, net of expenses, consist primarily of payments to/due to Lottery for Education Account, interest revenue, and the change in the fair value of grand prize investments held by the GLC for funding of future grand prize payments. The increases or decreases in the fair value of grand prize investments are the result of current period market fluctuations. For fiscal year 2012, nonoperating revenues, net of expenses, increased \$24.3 million from \$852.9 million in 2011 to \$877.3 million in 2012. The increase in nonoperating revenues, net of expenses is attributable to a \$55.2 million increase in payments to/due to Lottery for Education Account, partially offset by a \$30.9 million change in the fair value of grand prize investments held by the GLC for funding of future grand prize payments.

For fiscal year 2011, nonoperating revenues, net of expenses, decreased \$20.6 million from \$873.5 million in 2010 to \$852.9 million in 2011. The decrease in nonoperating revenues, net of expenses is attributable to a \$37.8 million decrease in payments to/due to Lottery for Education Account, partially offset by a \$17.0 million change in the fair value of grand prize investments held by the GLC for funding of future grand prize payments, and a \$.1 million decrease in interest revenue.

### **Significant Factors Impacting Next Year**

A prolonged, weakened economy may adversely impact future lottery sales in the year ahead. Management will continue to monitor the marketplace, as well as industry trends, on a continual basis in order to identify both opportunities and risks for our business.

Currently, the GLC is developing and executing long-term initiatives which will take considerable time to generate appreciable returns. During fiscal year 2013, the GLC plans to expand the available product offerings to attract new lottery players and align with the trends of a cashless society.

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

This financial report is designed to provide the state of Georgia, the public, and other interested parties with an overview of the financial results of the GLC's activities and to show the GLC's accountability for conducting business in a fiscally responsible manner. If you have questions about this report or require additional financial information, contact the GLC's Corporate Affairs Division at the Georgia Lottery.

# GEORGIA LOTTERY CORPORATION

(A Component Unit of the State of Georgia)

## STATEMENTS OF NET ASSETS AS OF JUNE 30, 2012 AND 2011

	<u>2012</u>	<u>2011</u>
<b>ASSETS</b>		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 199,809,000	\$ 164,132,000
Restricted fidelity fund cash	17,000	15,000
Restricted retailers' escrow fund cash	6,675,000	6,205,000
Retailer accounts receivable—net	143,596,000	179,835,000
Prepaid expenses and other assets	<u>3,225,000</u>	<u>4,655,000</u>
Total current assets	<u>353,322,000</u>	<u>354,842,000</u>
NONCURRENT ASSETS:		
Grand prize investments	290,914,000	287,888,000
Capital assets - net	<u>4,113,000</u>	<u>4,359,000</u>
Total noncurrent assets	<u>295,027,000</u>	<u>292,247,000</u>
TOTAL ASSETS	<u>\$ 648,349,000</u>	<u>\$ 647,089,000</u>
<b>LIABILITIES AND NET ASSETS</b>		
CURRENT LIABILITIES:		
Due to Lottery for Education Account	\$ 216,929,000	\$ 211,347,000
Prizes payable	116,163,000	126,643,000
Accounts payable and accrued liabilities	12,498,000	10,215,000
Restricted fidelity fund	17,000	15,000
Restricted retailers' escrow fund	<u>6,675,000</u>	<u>6,205,000</u>
Total current liabilities	<u>352,282,000</u>	<u>354,425,000</u>
NONCURRENT LIABILITIES:		
Grand prizes payable	250,774,000	271,366,000
Noncurrent portion of other long-term liabilities	<u>3,808,000</u>	<u>3,694,000</u>
Total noncurrent liabilities	<u>254,582,000</u>	<u>275,060,000</u>
Total liabilities	<u>606,864,000</u>	<u>629,485,000</u>
NET ASSETS:		
Invested in capital assets	4,113,000	4,359,000
Unrestricted	<u>37,372,000</u>	<u>13,245,000</u>
Total net assets	<u>41,485,000</u>	<u>17,604,000</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 648,349,000</u>	<u>\$ 647,089,000</u>

See Notes to financial statements.

# GEORGIA LOTTERY CORPORATION

(A Component Unit of the State of Georgia)

## STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS FOR THE YEARS ENDED JUNE 30, 2012 AND 2011

	<u>2012</u>	<u>2011</u>
OPERATING REVENUES:		
Ticket sales	\$ 3,834,675,000	\$ 3,597,922,000
Less tickets provided as prizes	<u>(274,783,000)</u>	<u>(262,316,000)</u>
Net ticket sales	3,559,892,000	3,335,606,000
Online fees	4,342,000	4,529,000
Other	<u>81,000</u>	<u>89,000</u>
Net operating revenues	<u>3,564,315,000</u>	<u>3,340,224,000</u>
OPERATING EXPENSES:		
Prizes	2,289,811,000	2,120,835,000
Retailer commissions and bonuses	228,713,000	230,929,000
Contractor fees	70,942,000	68,202,000
Advertising	20,563,000	21,130,000
Salaries and benefits	24,153,000	23,670,000
Retailer merchandising and marketing	19,164,000	18,874,000
Rent, utilities, and maintenance	5,011,000	5,073,000
Depreciation	1,873,000	2,141,000
Professional fees	901,000	1,427,000
Other	<u>2,024,000</u>	<u>2,012,000</u>
Total operating expenses	<u>2,663,155,000</u>	<u>2,494,293,000</u>
Operating income	<u>901,160,000</u>	<u>845,931,000</u>
NONOPERATING REVENUES (EXPENSES):		
Payments to and due to Lottery for Education Account	(901,328,000)	(846,106,000)
Interest revenue	168,000	176,000
Net increase (decrease) in fair value of grand prize investments	<u>23,881,000</u>	<u>(7,009,000)</u>
Total nonoperating revenues (expenses)	<u>(877,279,000)</u>	<u>(852,939,000)</u>
Change in net assets	23,881,000	(7,008,000)
NET ASSETS — Beginning of year	<u>17,604,000</u>	<u>24,612,000</u>
NET ASSETS — End of year	<u>\$ 41,485,000</u>	<u>\$ 17,604,000</u>

See Notes to financial statements.



# GEORGIA LOTTERY CORPORATION

(A Component Unit of the State of Georgia)

## STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED JUNE 30, 2012 AND 2011

	<u>2012</u>	<u>2011</u>
OPERATING ACTIVITIES:		
Cash received from customers	\$ 3,596,132,000	\$ 3,277,936,000
Other operational cash received	4,423,000	4,617,000
Cash paid to prize winners	(2,332,754,000)	(2,074,995,000)
Cash paid to retailers	(228,713,000)	(230,929,000)
Cash paid to contractors and employees	(130,876,000)	(126,956,000)
Other operating payments	(7,572,000)	(17,923,000)
Net cash provided by operating activities	<u>900,640,000</u>	<u>831,750,000</u>
NONCAPITAL FINANCING ACTIVITIES:		
Payments to Lottery for Education Account	(895,746,000)	(861,202,000)
Payments to Department of Human Resources	(200,000)	(200,000)
Net cash used in noncapital financing activities	<u>(895,946,000)</u>	<u>(861,402,000)</u>
CAPITAL AND RELATED FINANCING ACTIVITIES:		
Purchases of property and equipment	(1,637,000)	(1,510,000)
Proceeds from disposals of property and equipment	-	84,000
Net cash used in capital and related financing activities	<u>(1,637,000)</u>	<u>(1,426,000)</u>
INVESTING ACTIVITIES:		
Interest received	168,000	176,000
Purchases of grand prize investments	(2,829,000)	(10,492,000)
Maturities of grand prize investments	35,753,000	35,253,000
Net cash provided by investing activities	<u>33,092,000</u>	<u>24,937,000</u>
NET INCREASE (DECREASE) IN CASH, CASH EQUIVALENTS, AND RESTRICTED CASH	36,149,000	(6,141,000)
CASH, CASH EQUIVALENTS, AND RESTRICTED CASH—Beginning of year	<u>170,352,000</u>	<u>176,493,000</u>
CASH, CASH EQUIVALENTS, AND RESTRICTED CASH—End of year	<u>\$ 206,501,000</u>	<u>\$ 170,352,000</u>

Continued

See Notes to financial statements.

# GEORGIA LOTTERY CORPORATION

(A Component Unit of the State of Georgia)

## STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED JUNE 30, 2012 AND 2011

	<u>2012</u>	<u>2011</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating income	\$ 901,160,000	\$ 845,931,000
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	1,873,000	2,141,000
Provision for doubtful retailer accounts	536,000	732,000
Gains (Losses) on disposals of property and equipment	10,000	(85,000)
Changes in assets and liabilities:		
Retailer accounts receivable	35,703,000	(58,402,000)
Prepaid expenses and other assets	1,431,000	(1,270,000)
Accounts payable and accrued liabilities	2,204,000	(4,429,000)
Prizes payable	(10,280,000)	70,679,000
Grand prizes payable	(32,663,000)	(24,731,000)
Restricted fidelity fund	2,000	3,000
Restricted Retailer Escrow	470,000	804,000
Other liabilities	194,000	377,000
Net cash provided by operating activities	<u>\$ 900,640,000</u>	<u>\$ 831,750,000</u>
SCHEDULE OF NONCASH INVESTING, CAPITAL, AND RELATED FINANCING ACTIVITIES:		
Increase (decrease) in fair value of investments	\$ 23,881,000	\$ (7,009,000)
Accretion of grand prizes payable	12,069,000	13,023,000
Total noncash investing, capital, and related financing activities	<u>\$ 35,950,000</u>	<u>\$ 6,014,000</u>

See Notes to financial statements.

# GEORGIA LOTTERY CORPORATION

## NOTES TO THE FINANCIAL STATEMENTS

AS OF AND FOR THE YEARS ENDED JUNE 30, 2012 AND 2011

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### 1. REPORTING ENTITY

The Georgia Lottery Corporation (the “GLC”) was established as an instrumentality of the state with the enactment of the Georgia Lottery for Education Act (the “Act”) on November 2, 1992. The GLC is responsible for the provision of lotteries on behalf of the State of Georgia in accordance with the Act and is a component unit of the State of Georgia.

The GLC’s ticket sales include instant ticket sales and online ticket sales for *Cash 3, Cash 4, Georgia FIVE, Fantasy 5, eZmatch, Keno!, Mega Millions, Powerball, Win for Life, and Decades of Dollars.*

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

***Basis of Presentation***—The GLC is accounted for as an enterprise fund. Enterprise funds are used to account for activities that are financed and operated in a manner similar to private business enterprises: (1) where the costs of providing goods and services to the general public on a continuing basis are to be financed through user charges or (2) where the periodic determination of net income is considered appropriate.

***Basis of Accounting***—The financial statements are reported using the economic resources measurement focus and the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America (“generally accepted accounting principles”). Under this method, revenues are recognized when earned and expenses are recognized and recorded when a liability is incurred, regardless of the timing of cash flows. In accordance with Statement of Governmental Accounting Standards (“SGAS”) No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the GLC is required to follow all applicable Governmental Accounting Standards Board (“GASB”) pronouncements, and has elected not to follow any pronouncements of the Financial Accounting Standards Board subsequent to November 30, 1989.

***Use of Estimates***—The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

***Revenue Recognition***—Lottery games are sold to the public by contracted retailers. Revenue is recognized for online games when tickets are sold to players and the related draw has occurred. Revenue is recognized for instant games when the product is made available for sale to the public, which is based on ticket activations by the retailers. Certain games include free tickets, which entitle the holder to exchange one ticket for another of equal value. The selling price of free tickets reduces ticket revenue when the prize is claimed by a player.

**Revenue and Expenses**—Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues generally result from providing services in connection with a proprietary fund’s principal ongoing operations. The principal operating revenues of the Georgia Lottery Corporation’s enterprise fund are primarily revenues from ticket sales and online fees. “Operating expenses” are defined under the Act as “all costs of doing business, including, but not limited to, prizes, commissions, and other compensation paid to retailers, advertising and marketing costs, personnel costs, capital costs, depreciation of property and equipment, funds for compulsive gambling education and treatment, amounts held in or paid from a fidelity fund, and other operating costs.” All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses. The principal nonoperating revenues and expenses of the Georgia Lottery Corporation’s enterprise fund are primarily interest income revenue, payments to and due to the Lottery for Education Account (an expense), and the net increase (revenue) or decrease (expense) in the fair value of grand prize investments.

**Commissions and Bonuses**— During fiscal year 2012, retailers received a sales commission of 6% on all games. In the previous fiscal year on March 15, 2011, Georgia House Bill 326 was enacted into law, which effectively eliminated all cashing bonuses and retailer incentive payments, and provided for sales commissions at a rate of 6% for all games. For most of fiscal year 2011, retailers received a commission of 5% on ticket sales, except for *Cash 3* sales, on which retailers received a commission of 7%. Retailers also received a 2% cashing bonus on all ticket validations at their location. In addition, retailers received bonuses for selling winning jackpot tickets for *Win For Life*, *Fantasy 5*, *Mega Millions*, and *Powerball*. Four instant ticket games were introduced during 2011 with a retailer sales commission of 10%, but due to the current law there were no 10% commission games introduced in 2012.

**Contractor Fees**—The GLC has contracted with three vendors for the majority of the gaming systems and supplies.

The GLC entered into a seven-year vendor contract effective September 7, 2003, with GTECH Corporation (“GTECH”) for the operation of the gaming network that consists of over 9,200 retailer ticket terminals and associated software. On November 12, 2008, the GLC amended and extended this contract until September 11, 2013. Under the amended contract, GTECH receives a fee of 1.15% of net ticket revenue.

The GLC entered into a seven-year vendor contract effective September 7, 2003, with Scientific Games, Inc. for the printing and distribution of instant game tickets. On November 12, 2008, the GLC amended and extended this contract until September 10, 2013. Under the amended contract, Scientific Games, Inc. received a fee of 1.2875% of net instant game tickets distributed to retailers through December 31, 2008. After that date, the fee lowered to 1.1781% through December 31, 2009. From January 1, 2010 through June 30, 2010, the rate was 1.15%, and the rate for fiscal year 2011 was 1.10%. This rate continued through December 31, 2011. On June 15, 2011, the GLC amended and extended this contract until September 10, 2018. Under the amended contract, Scientific Games, Inc. will receive a fee of .99% of net instant game tickets distributed to retailers beginning January 1, 2012 until the end of the contract.

The GLC entered into a vendor contract effective January 27, 2006, with Pollard Banknote Limited Partnership (“Pollard”) for the printing of various instant game tickets for which the vendor has exclusive rights. Pollard receives a fee based on the quantity of instant tickets printed. The original contract ended June 30, 2011, but was extended three additional years until June 30, 2014, unless terminated upon a sixty-day written notice by either the Pollard or the GLC. Pollard printed four instant ticket games during fiscal year 2012, which were *\$2 Cashword IV*, *\$2 Cashword V*, *\$3 Cherry, Orange, Lemon Doubler Cashword*, and *\$5 Cadillac Riches*. Pollard printed four instant ticket games during

fiscal year 2011, which were \$2 *All Access*, \$2 *Cashword III*, \$3 *Cherry, Orange, Lemon Doubler Cashword*, and \$3 *Bingo Bingo*.

**Prizes**—In accordance with the Act, as nearly as practical, at least 45% of ticket sales must be returned to the public in the form of prizes. Prize expense for instant games is recognized based on the predetermined prize structure for each game. Generally, prize expense for *Cash 3*, *Cash 4*, *Georgia FIVE*, *Mega Millions*, *Powerball*, *eZmatch*, *Keno!*, *Decades of Dollars*, and the *Win For Life* online game is recognized based on the estimated payout experience over the life of the games or the industry averages. Prize expense for *Fantasy 5* is recorded on a pari-mutuel basis according to the game structure based on a percentage of revenue recognized.

*Mega Millions*, *Win For Life*, and the *Decades of Dollars* online games are multi-state lottery games operated by member lotteries. The *Mega Millions*, *Win For Life*, and the *Decades of Dollars* prizes are shared based on contributions to the prize pools by the member lotteries. Grand prize investments for jackpot winners who purchased tickets in Georgia are held by the GLC.

The *Powerball* grand prize is a shared prize from contributions to the prize pool by all member lotteries of the Multi-State Lottery Association (“MUSL”) and certain Mega Millions states including Georgia which sell *Powerball* tickets without being a member of MUSL. All *Powerball* grand prizes won by players who purchased tickets in Georgia are funded by investments purchased by MUSL. The investments are held by MUSL in trust for the GLC and are paid in 20 annual installments. Investments of \$3,558,000 and \$4,697,000 included in the GLC’s grand prize investments in the statements of net assets at June 30, 2012 and 2011, respectively, were held by MUSL in trust. The GLC withdrew from MUSL on August 31, 1996. During fiscal year 2010, the GLC along with the other participating Mega Millions states entered into an agreement with the Multi-State Lottery Association (MUSL) to authorizing the cross-sell of tickets for the *Powerball* game. Ticket sales under the cross-sell agreement began on January 31, 2010, and the first *Powerball* drawing including participating Mega Millions states was held on February 1, 2010.

**Unclaimed Prizes**—Prizes must be claimed no later than 90 days after game-end for instant games and within 180 days after the draw date for online games. An estimate of the unclaimed prizes is based upon the historical experience rate as a percentage of ticket sales. In accordance with the Act, \$200,000 of unclaimed prizes must be transferred to the Department of Human Resources for the treatment of compulsive gambling and related educational programs. Transfers for this purpose for each fiscal year have been \$200,000. The remainder of unclaimed prizes is used to fund future prizes or special prize promotions, as defined by the statute.

**Net Assets**—Net assets represent cumulative revenues less expenses in excess of net proceeds transferred to the Lottery for Education Account, as defined under the Act (see Note 7). Net assets include funds invested in capital assets and unrestricted net assets. Unrestricted net assets normally result from the inclusion of capital costs in the determination of net proceeds as required by the Act and the cumulative effect of periodic adjustments to recognize the fair value of grand prize investments held to fund grand prizes payable. Grand prize investments are purchased to finance future payments to *Win For Life*, *Mega Millions*, *Powerball*, *Decades of Dollars*, and certain instant game grand prize winners. Any increases or decreases in the fair value of these investments are determined to be unrealized and will not affect (i) the future ability to hold these investments or (ii) the amount of funds available for distribution to the Lottery for Education Account. Unrealized gains and losses on grand prize investments at June 30, 2012 and 2011, were \$41,485,000 and \$17,604,000, respectively, resulting in a net change of \$23,881,000 in the fair value of grand prize investments.

**Cash and Cash Equivalents**—The GLC considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. This includes cash in banks, petty cash, and balances on account in Georgia Fund 1.

**Retailer Accounts Receivable**—Retailer accounts receivable represents lottery proceeds due from retailers for net ticket sales less commissions and prizes paid by the retailers. Lottery proceeds are collected weekly from retailer bank accounts held in trust for the GLC. An allowance for doubtful accounts is established based on management’s estimate of retailer receivables that will not be collected. At June 30, 2012 and 2011, the allowance for uncollectible retailer receivables was \$2,747,000 and \$2,980,000, respectively.

**Capital Assets**—Capital assets are stated at cost less accumulated depreciation. Depreciation on capital assets is computed using the straight-line method over the estimated useful lives of three to ten years. Leasehold improvements are amortized over their expected useful lives or the lease term, whichever is shorter. When assets are retired or otherwise disposed of, the costs and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is reflected in the results from operations in the period of disposal.

**Fidelity Fund**—In accordance with the Act, retailers contribute a fee to a fidelity fund upon acceptance as a GLC retailer. The GLC is reimbursed from available funds for any losses incurred as a result of the misfeasance or malfeasance of GLC retailers. At the end of each year, any amount in the fund in excess of \$500,000 is treated as net proceeds from the GLC subject to transfer to the Lottery for Education Account. There were no fidelity funds available for transfer as net proceeds for the years ended June 30, 2012 and 2011. The fidelity fund proceeds are held in a separate account and are presented in the statements of net assets as restricted fidelity fund cash and in liabilities as restricted fidelity funds.

**Retailer Escrow Fund**—Retailers pledge cash deposits to an escrow funds management service offered by a commercial bank selected by the GLC. This is one of the acceptable forms of Financial Security Deposits from Retailers pursuant to Section 19 of the Georgia Lottery for Education Act, Chapter 2 of the GLC Policies entitled ‘Retailer Rules and Regulations,’ and Chapter 8.2 of the GLC Policies entitled ‘Retailer Credit and Financial Security Policy,’ and appropriate Executive Orders. The GLC is reimbursed from available funds for any losses incurred as a result of the misfeasance or malfeasance of GLC retailers. The retailers’ escrow funds are not subject to transfer to the Lottery for Education Account. The retailer escrow fund proceeds are held in a separate account and are presented in the statements of net assets as restricted retailer escrow fund cash and in liabilities as restricted retailer escrow funds.

**Compensated Absences**—Employees earn the right to be compensated during absences for vacation and illness. Unused leave benefits are paid to employees upon separation from service. The cost of vacation and vested sick leave benefits is accrued in the period in which it was earned. In March 2005, the GLC adopted a new policy concerning payments of accrued sick leave upon termination. Sick leave accrued by employees prior to March 1, 2005, and not used prior to termination is paid at a 50% rate upon termination. No payments will be made for sick leave accrued after March 1, 2005, and not used by the employee before termination.

**Budget**—Georgia Statute requires the GLC to submit to the Office of Planning and Budget (“OPB”) and the State Auditor, annually by June 30, a proposed operating budget for the next fiscal year. Additionally, the GLC is required to submit to the OPB annually, on September 1, a proposed operating budget for the GLC and an estimate of net proceeds for the succeeding fiscal year. The GLC complied with these requirements in 2012 and 2011.

### 3. CASH, CASH EQUIVALENTS, AND GRAND PRIZE INVESTMENTS

During the year ended June 30, 2005, the GLC adopted the provisions of SGAS No. 40, *Deposit and Investment Risk Disclosures*, which amends SGAS No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*, which recognizes that deposits and investments of state and local governments are exposed to risks that have the potential to result in losses. This statement establishes and modifies disclosure requirements related to investment and deposit risks; accordingly, the GLC's note disclosures on cash, cash equivalents, and investments are in conformity with the provisions of SGAS No. 40. Following "exception-based reporting," the GLC is not required to disclose risks that do not apply to it.

**Cash**—Cash is held in demand deposits at various financial institutions. The majority of the GLC's daily operating cash is held in a master operating account with Bank of America. Other miscellaneous cash accounts for accounts payable, prizes payable, retailer return items, district offices, promotions, payroll, and petty cash are held in accounts with Bank of America, except for the Columbus district office account which is held with SunTrust Bank. At June 30, 2012, the GLC's Master Operating Account had a book balance of \$6,058,000 and a bank balance of \$6,057,000. At June 30, 2012, the other miscellaneous accounts had a bank balance of \$437,000 and net book balance of (\$1,238,000) which was primarily due to outstanding checks for the accounts payable and prize check zero balance cash accounts. These accounts are funded through automatic transfers from the master operating cash account as checks are presented for payment by the payee. At June 30, 2011, the GLC's Master Operating Account had a book balance of \$6,423,000 and a bank balance of \$6,411,000. At June 30, 2011, the other miscellaneous accounts had a bank balance of \$411,000 and net book balance of (\$1,880,000) which was primarily due to outstanding checks for the accounts payable and prize check zero balance cash accounts. The net carrying value and bank balance of all GLC cash accounts as of June 30, 2012 were \$4,820,000 and \$6,494,000 respectively. The net carrying value and bank balance of all GLC cash accounts as of June 30, 2011 were \$4,543,000 and \$6,822,000 respectively. These deposits were entirely insured by FDIC insurance or collateralized by investment securities held by the GLC's agent in the GLC's name.

**Cash Equivalents**—Cash equivalents represent surplus cash invested in Georgia Fund 1 administered by the State of Georgia's Office of the State Treasurer. The voluntary fund is a short-term investment vehicle that is available for use by state entities and local governments. Georgia Fund 1 invests its assets in U.S. Treasury bills, U.S. Treasury notes, securities issued by federal agencies and instrumentalities, banker's acceptances, and repurchase agreements.

The Georgia Fund 1 is an external investment pool that is not registered with the Securities and Exchange Commission (SEC), but does operate in a manner consistent with the SEC's Rule 2a7 of the Investment Company Act of 1940. The Office of the State Treasurer manages Georgia Fund 1 in accordance with policies and procedures established by state law and the State Depository Board, the oversight Board for the Office of the State Treasurer. This investment is valued at the pool's share price, \$1.00 per share. The Georgia Fund 1 is an AAAM rated investment pool by Standard & Poor's, and the portfolio's weighted average maturity is forty-eight (48) days at June 30, 2012. Under SGAS No. 40, since these funds represent an externally managed pool it is not exposed to custodial credit risk, and therefore, no custodial credit risk disclosures are required. The GLC's investment in Georgia Fund 1 was approximately \$194,989,000 and \$159,589,000 at June 30, 2012 and 2011, respectively. Interest earned on the GLC's investments was approximately \$168,000 and \$176,000 for the years ended June 30, 2012 and 2011, respectively.

**Other Deposits**—Cash maintained in the Retailer Escrow Fund bank account had a bank and book balance of \$6,829,000 and \$6,675,000, respectively, as of June 30, 2012. Cash maintained in the Fidelity

Fund bank account has a bank and book balance of \$56,000 and \$17,000, respectively, as of June 30, 2012. Cash maintained in the Retailer Escrow Fund bank account had a bank and book balance of \$6,352,000 and \$6,205,000, respectively, as of June 30, 2011. Cash maintained in the Fidelity Fund bank account has a bank and book balance of \$24,000 and \$15,000, respectively, as of June 30, 2011. The Retailer Escrow Fund and Fidelity Fund accounts were maintained with Bank of America, and Carver State Bank, respectively, and both accounts were entirely insured by FDIC insurance or collateralized by investment securities held by the GLC's agent in the GLC's name.

**Grand Prize Investments**—All grand prize investments represent funds held to pay grand prize winners who are entitled to multiyear payments. Grand prize investments are recorded at their fair values, based on quoted market prices. Increases or decreases in the fair value of these investments are recorded as nonoperating revenue (expense).

Grand prize investments at June 30, 2012 and 2011, consist of the following:

	<b>Fair Value</b>	
	<b>2012</b>	<b>2011</b>
U.S. Treasury securities	\$ 287,356,000	\$ 283,191,000
Government agencies	<u>3,558,000</u>	<u>4,697,000</u>
	<u>\$ 290,914,000</u>	<u>\$ 287,888,000</u>

Grand prize investments are not presented as current assets, as they are not part of the GLC's current operations.

Changes in grand prize investments for the years ended June 30, 2012 and 2011, consisted of the following:

Purchases	10,492,000
Payments to grand prize winners	(35,253,000)
Investments sold	-
Interest earned on current-year maturities	13,023,000
Change in fair value	<u>(7,009,000)</u>
Fair value—June 30, 2011	<u>\$ 287,888,000</u>
Purchases	2,829,000
Payments to grand prize winners	(35,753,000)
Investments sold	-
Interest earned on current-year maturities	12,069,000
Change in fair value	<u>23,881,000</u>
Fair value—June 30, 2012	<u>\$ 290,914,000</u>

**Custodial credit risk for Deposits**—Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. State statutes require



all deposits and investments (other than federal or state government instruments) to be collateralized by depository insurance, obligations of the U.S. government, or bonds of public authorities, counties, or municipalities. As of June 30, 2012, all deposits are considered insured.

**Investments**—The GLC’s investments consist of U.S. Treasury Strips (principal and interest) that are held to maturity to fund grand prize winners for several online games, including *Lotto Georgia*, *The Big Game*, *Mega Millions*, *Lotto South*, and *Win For Life*, and various Instant Games with annuity prizes such as *Georgia’s \$500 Million Club*. In addition, MUSL (Multistate Lottery Association) holds U.S. government agency securities on behalf of the GLC that are held to maturity to fund Georgia’s two Powerball grand prize winners. At June 30, 2012, the GLC’s investment balances consisted of:

<u>Investment Type</u>	<u>Fair Value</u>	<u>Maturity</u>
U.S Treasury Strips	\$287,356,000	Weighted average maturity of 6.9 years
U.S Government Agencies	<u>3,558,000</u>	Weighted average maturity of 1.3 years
Total	<u>\$290,914,000</u>	

U.S Treasury Strips held by the GLC are AAA-rated and current holdings mature quarterly beginning August 2012 through August 2039. U.S. government agency securities held for the GLC by MUSL are AAA-rated with maturities each year in September and May through the year 2015.

**Interest Rate Risk**—The GLC’s deposits in the master operating account with Bank of America are subject to fluctuations in short-term interest rates. The GLC purchases investments to fund future prize payments at fixed amounts for grand prize winner obligations, as detailed in Note 5, Grand Prizes Payable. Periodic market fluctuations affect the fair value of grand prize investments. The GLC expects to hold grand prize investments to maturity to meet future grand prize payments and, therefore, will not realize any gains or losses related to the changes in the market. The only exposure that the GLC has in regards to interest rate sensitivity is for the GLC’s master operating account, since there is no investment related impact on the GLC resulting from the effect of interest rate changes on grand prize investments.

**Credit Risk**—State laws limit the investment sources available to the GLC to United States Treasury securities, federal agency securities, state of Georgia securities, repurchase or reverse repurchase agreements, bank certificates of deposits, Georgia Fund 1, life insurance annuity contracts, and investments that would be permissible for the legal reserves of domestic life insurance companies under the laws of the state of Georgia.

**Custodial Credit Risk**—For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the GLC will not be able to recover the value of its investments in the possession of an outside party. The GLC’s investments in U.S. Treasury Strips include strips with a fair value of \$31,708,000 that were purchased from Bank of America and are also held by Bank of America in a safekeeping account on the behalf of the GLC.

#### 4. CAPITAL ASSETS

Capital assets at June 30, 2012 and 2011 consisted of the following:

	Balance at June 30, 2011	Increases	Decreases	Balance at June 30, 2012
Capital assets:				
Furniture and fixtures	\$ 2,751,000	\$ 53,000	\$ (26,000)	\$ 2,778,000
Computer and communications equipment	11,370,000	732,000	(464,000)	11,638,000
Vehicles	2,740,000	398,000	(14,000)	3,124,000
Leasehold improvements	3,356,000	60,000	-	3,416,000
Software	3,147,000	12,000	-	3,159,000
Other assets	1,503,000	206,000	-	1,709,000
Gaming Equipment	<u>69,000</u>	<u>176,000</u>	<u>-</u>	<u>245,000</u>
Total capital assets at historical cost	24,936,000	1,637,000	(504,000)	26,069,000
Less accumulated depreciation	<u>(20,577,000)</u>	<u>(1,873,000)</u>	<u>494,000</u>	<u>(21,956,000)</u>
Capital assets—net	<u>\$ 4,359,000</u>	<u>\$ (236,000)</u>	<u>\$ (10,000)</u>	<u>\$ 4,113,000</u>

	Balance at June 30, 2010	Increases	Decreases	Balance at June 30, 2011
Capital assets:				
Furniture and fixtures	\$ 2,703,000	\$ 48,000	\$ -	\$ 2,751,000
Computer and communications equipment	10,714,000	683,000	(27,000)	11,370,000
Vehicles	2,597,000	566,000	(423,000)	2,740,000
Leasehold improvements	3,291,000	65,000	-	3,356,000
Software	3,068,000	79,000	-	3,147,000
Other assets	1,503,000	-	-	1,503,000
Gaming Equipment	<u>-</u>	<u>69,000</u>	<u>-</u>	<u>69,000</u>
Total capital assets at historical cost	23,876,000	1,510,000	(450,000)	24,936,000
Less accumulated depreciation	<u>(18,882,000)</u>	<u>(2,141,000)</u>	<u>446,000</u>	<u>(20,577,000)</u>
Capital assets—net	<u>\$ 4,994,000</u>	<u>\$ (631,000)</u>	<u>\$ (4,000)</u>	<u>\$ 4,359,000</u>

#### 5. GRAND PRIZES PAYABLE

Grand prizes payable is recorded at the net present value of the U.S. Treasury securities purchased for each jackpot winner. Grand prizes payable was accreted by approximately \$12,069,000 and \$13,023,000

for the years ended June 30, 2012 and 2011, respectively. Grand prizes payable are not presented as current liabilities, as they are not part of the GLC's current operations.

Future payments of grand prizes payable at June 30, 2012, are scheduled as follows:

2013	\$ 41,162,000
2014	29,750,000
2015	26,715,000
2016	22,717,000
2017	19,216,000
2018-2022	76,050,000
2023-2027	66,490,000
2028-2032	28,518,000
2033-2037	18,155,000
2038-2042	<u>7,508,000</u>
	336,281,000
Less imputed interest	<u>(85,507,000)</u>
Net present value of grand prizes payable	<u>\$ 250,774,000</u>

The Omnibus Consolidated and Emergency Supplemental Appropriations Act, 1999 (the "Omnibus Act") was enacted into federal law on October 21, 1998. Included in this Omnibus Act is a Special Rule for Cash Options for Receipt of Qualified Prizes ("Special Rule"). Pursuant to the Special Rule, the GLC may extend to recipients of "qualified prizes" the opportunity, within a certain period after the drawing, to select a lump-sum payment equivalent to the cash value of an annuitized prize. Qualified prizes, as defined in the Omnibus Act, include multiple-year payments of a minimum of ten years.

Claimants of qualified prizes, as defined in the GLC Rules and Regulations, on or after the date of enactment of the Omnibus Act, can make an irrevocable election to receive a lump-sum cash payment equivalent of the annuitized prize within 60 days of the claim date. Grand prizes payable at June 30, 2012, consist of no qualified prizes under this provision of the Special Rule.

## **6. OPERATING LEASES**

The GLC has entered into operating leases for the rental of office space for its headquarters and district offices. Certain operating leases contain provisions for scheduled rental increases and are renewable at the option of the GLC.

Future minimum rental payments on noncancellable leases with original terms of one year or more are scheduled as follows:

<b>Year Ending June 30,</b>	<b>Operating Leases</b>
2013	\$ 2,158,000
2014	2,236,000
2015	2,236,000
2016	2,026,000
2017	2,026,000
2018–2023	<u>12,804,000</u>
	23,486,000
Less sublease revenues	<u>(384,000)</u>
Total	<u>\$ 23,102,000</u>

Rental expense under all operating leases totaled approximately \$2,690,000 and \$2,707,000 for the years ended June 30, 2012 and 2011, respectively.

#### **7. DUE TO LOTTERY FOR EDUCATION ACCOUNT**

In accordance with the Act, all net proceeds of the GLC are due to the Lottery for Education Account within the state of Georgia Treasury. Net proceeds is defined under the Act as “all revenue derived from the sale of lottery tickets or shares and all other monies derived from the GLC less operating expenses.” Any unrealized gain or loss resulting from changes in fair value of grand prize investments does not represent funds received from GLC operations and is excluded from determination of “net proceeds.”

“Operating expenses” are defined under the Act as “all costs of doing business, including, but not limited to, prizes, commissions, and other compensation paid to retailers, advertising and marketing costs, personnel costs, capital costs, depreciation of property and equipment, funds for compulsive gambling education and treatment, amounts held in or paid from a fidelity fund, and other operating costs.”

Net proceeds and operating expenses for the years ended June 30, 2012 and 2011, are summarized as follows:

	<u>2012</u>	<u>2011</u>
Operating revenues:		
Ticket sales	\$ 3,834,675,000	\$ 3,597,922,000
Less tickets provided as prizes	<u>(274,783,000)</u>	<u>(262,316,000)</u>
Net ticket sales	3,559,892,000	3,335,606,000
Online fees and other revenues	4,423,000	4,617,000
Interest revenue and other	<u>168,000</u>	<u>176,000</u>
GLC proceeds	<u>3,564,483,000</u>	<u>3,340,399,000</u>
Operating expenses—as defined:		
Gaming	2,629,192,000	2,459,968,000
Operating	33,963,000	34,325,000
Other	<u>1,837,000</u>	<u>1,710,000</u>
Total operating expenses—as defined	<u>2,664,992,000</u>	<u>2,496,003,000</u>
Net proceeds before distribution of unrestricted net assets	<u>899,491,000</u>	<u>844,396,000</u>
Other:		
Funds resulting from current year capital purchases	1,637,000	1,510,000
Funds resulting from previous years' capital purchases	-	-
Funds for current year compulsive gambling education and treatment	200,000	200,000
Funds for previous years' compulsive gambling education and treatment	<u>-</u>	<u>-</u>
Total other	<u>1,837,000</u>	<u>1,710,000</u>
Net proceeds subject to transfer	<u>\$ 901,328,000</u>	<u>\$ 846,106,000</u>
Amount due to Lottery for Education Account for year	\$ 901,328,000	\$ 846,106,000
Amount paid during year	<u>(684,399,000)</u>	<u>(634,759,000)</u>
Amount due to Lottery for Education Account—		
End of year	<u>\$ 216,929,000</u>	<u>\$ 211,347,000</u>

## 8. EMPLOYEE BENEFITS

**401(k) Defined Contribution Plan**—Effective July 1, 1998, House Bill 441 was enacted into law, allowing the Georgia Lottery Corporation to participate in the Deferred Compensation Plan offered by the state of Georgia for public employees pursuant to Section 401(k) of the Internal Revenue Code.

There were 279 GLC employees participating in the 401(k) plan at June 30, 2012. For the years ended June 30, 2012 and 2011, GLC contributed \$1,013,000 and \$1,107,000, respectively, to the plan. Contributions by plan participants during fiscal years ended June 30, 2012 and 2011 were \$626,000 and \$617,000, respectively.

**457 Deferred Compensation Plan**—Beginning in December 1994, the GLC offered its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all full-time employees at their option, permits participants to defer a portion of their salary until future years. The deferred compensation is not available to participants until termination, retirement, death, or unforeseeable emergency.

Section 1448 of the Small Business Job Protection Act of 1996 added Subsection (g) to Section 457 of the Internal Revenue Service Code to provide that all assets and income under a Section 457(b) plan that are maintained by a state or local government employer must be held in trust for the exclusive benefit of plan participants and their beneficiaries. Nationwide Retirement Solutions is the custodian of the plan's assets. As of June 30, 2012 and 2011, the fair value of the plan's assets was \$2,483,000 and \$2,347,000, respectively. Contributions by participants during the years ended June 30, 2012 and 2011, were \$172,000 and \$178,000, respectively.

**Compensated Absences**—At June 30, 2012 and 2011, the balance for compensated absences was \$2,839,000 and \$2,830,000, respectively. The year-end balances are comprised of earned and unused vacation and sick leave hours. At separation, employees are compensated for all earned vacation and any remaining sick leave hours accrued prior to March 1, 2005. Increases to the compensated absences balance represent vacation and sick leave hours earned by employees and decreases represent their usage of leave.

In fiscal year 2012, the GLC offered its employees an opportunity to sell back accrued vacation time. Of the 220 eligible employees, 125 participated in the program resulting in the buyback of 9,502 vacation hours, totaling approximately \$279,000. This cost was included in the decreases to the compensated absences balance for fiscal year 2012. In fiscal year 2011, increases to the compensated absences balance also included approximately \$201,000 in additional amounts for salary-related payments associated with the payment of compensated absences (the GLC's employer share of social security and Medicare taxes). In fiscal year 2011, the GLC offered its employees an opportunity to sell back accrued vacation time. Of the 225 eligible employees, 130 participated in the program resulting in the buyback of 10,012 vacation hours, totaling approximately \$298,000. This cost was included in the decreases to the compensated absences balance for fiscal year 2011.

During the year ended June 30, 2012, employees earned and used leave totaling \$1,250,000 and \$1,241,000 respectively. During the year ended June 30, 2011, employees earned and used leave totaling \$1,396,000 and \$1,281,000, respectively. The current portion of the compensated absence liability, expected to be due within one year of the statement date, June 30, 2012, is estimated using historical trends. At June 30, 2012 and 2011, the estimated current portion of the compensated absences liability was \$245,000 and \$154,000, respectively.

## **9. CONTINGENCIES**

The GLC is subject to litigation in the ordinary course of its business. In the opinion of management and legal counsel, the outcome of such litigation will not have a material impact on the financial position or cash flows of the GLC.

## **10. RISK MANAGEMENT**

The GLC is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; and injuries to employees. The GLC obtains umbrella insurance coverage for property, liability, vehicle fleet, workers' compensation, and unemployment compensation through the State of Georgia's Department of Administrative

Services (“DOAS”). The GLC purchased additional commercial insurance for certain company-owned vehicles. DOAS, as a component of the State of Georgia, utilizes self-insurance programs established by individual agreement, statute or administrative action to provide property insurance covering fire and extended coverage and automobile insurance and to pay losses that might occur from such causes; liability insurance for employees against personal liability for damages arising out of performance of their duties; survivors’ benefits for eligible members of the Employees’ Retirement System; consolidating processing of unemployment compensation claims against state agencies and the payment of sums due to the Department of Labor; and workers’ compensation statutes of the State of Georgia. These self-insurance funds are accounted for as internal service funds of the State of Georgia where assets are set aside for claim settlements. The majority of the risk management programs are funded by assessments charged to participating organizations. A limited amount of commercial insurance is purchased by the self-insurance funds applicable to property, employee and automobile liability, fidelity, and certain other risks to limit the exposure to catastrophic losses. Otherwise, the risk management programs service all claims against the state for injuries and property damage.

Financial information relative to self-insurance funds is presented in the financial reports of the Department of Administrative Services and the Employees’ Retirement System for the years ended June 30, 2012 and 2011.

Annually, the GLC negotiates and currently contracts with CIGNA for its employee health insurance coverage and Guardian Life for dental and vision coverage. Unum is the provider for short-term disability, long-term disability, and term life insurance coverage. The GLC’s health, dental, and vision insurance plans are funded by contributions from plan participants and by GLC employer contributions.

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