

---

Secretary of State

An Enterprise Fund of the  
State of Oregon

**OREGON STATE LOTTERY**

**For the Year Ended June 30, 2004**



**Audits Division**

---



---

# Secretary of State

An Enterprise Fund of the  
State of Oregon

## **OREGON STATE LOTTERY**

**For the Year Ended June 30, 2004**



**Audits Division**

---





---

*Auditing for a Better Oregon*

The Honorable Ted Kulongoski  
Governor of Oregon  
254 State Capitol  
Salem, Oregon 97310-4047

Kerry Tymchuck, Chairman  
Oregon State Lottery Commission  
500 Airport Road SE  
Salem, OR 97301

This report presents the results of our annual audit of the Oregon State Lottery (Lottery).

As required by auditing standards, we performed the audit to obtain reasonable assurance about whether the financial statements and accompanying notes have been presented fairly by management. Our Independent Auditor's Report and the financial statements for the fiscal year ended June 30, 2004, are included in the Financial Section of this report. We concluded that the financial statements are fairly presented in accordance with accounting principles generally accepted in the United States of America.

Auditing standards also require us to review the Lottery's internal control and compliance with applicable laws and regulations. Our report on the results of those reviews is included in the Other Reports section of this report. We noted no instances of noncompliance that are required to be reported under *Government Auditing Standards*. Similarly, we did not note any material weaknesses in internal control over financial reporting. However, we did note other matters involving internal control over financial reporting, which we reported to Lottery management in a separate letter.

We appreciated the cooperation and assistance of the Lottery's management and staff during the course of our audit.

OREGON AUDITS DIVISION

Cathy Pollino  
State Auditor

October 29, 2004



# T A B L E O F C O N T E N T S

	<u>Page</u>
FINANCIAL SECTION	
Independent Auditor's Report .....	3
Basic Financial Statements	
Balance Sheet – June 30, 2004.....	5
Statement of Revenues, Expenses and Changes in Fund Net Assets – For the Fiscal Year Ended June 30, 2004 .....	6
Statement of Cash Flows – For the Fiscal Year Ended June 30, 2004 .....	7
Notes to the Financial Statements .....	9
SUPPLEMENTARY INFORMATION	
Budgetary Basis Income Statement .....	26
OTHER REPORTS	
Report on Internal Control Over Financial Reporting and on Compliance and Other Matters.....	31



## **FINANCIAL SECTION**





---

*Auditing for a Better Oregon*

The Honorable Ted Kulongoski  
Governor of Oregon  
254 State Capitol  
Salem, Oregon 97310-4047

Kerry Tymchuck, Chairman  
Oregon State Lottery Commission  
500 Airport Road SE  
Salem, OR 97301

## **INDEPENDENT AUDITOR'S REPORT**

We have audited the accompanying basic financial statements of the Oregon State Lottery (Lottery), as of and for the year ended June 30, 2004, as listed in the table of contents. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

As discussed in Note 1, the basic financial statements of the Oregon State Lottery are intended to present the financial position, and the changes in financial position and cash flows that is attributable to the transactions of the Lottery. They do not purport to, and do not, present fairly the financial position of the state of Oregon as of June 30, 2004, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Oregon State Lottery, as of June 30, 2004, and the changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 29, 2004 on our consideration of the Lottery's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit. That report is separately presented in the Other Reports section as listed in the table of contents.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Lottery's basic financial statements. The Budgetary Basis Income Statement is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on it.

OREGON AUDITS DIVISION

A handwritten signature in black ink, appearing to read "Bill Bradbury", written in a cursive style.

Bill Bradbury  
Secretary of State

October 29, 2004

STATE OF OREGON  
**OREGON STATE LOTTERY**  
BALANCE SHEET  
JUNE 30, 2004

**Assets**

Current Assets

Cash and Cash Equivalents	\$170,341,990
Investments for Prize Payments at Fair Value	13,051,207
Securities Lending Cash Collateral	122,956,562
Accounts Receivable – Net of Allowance for Doubtful Accounts of \$227,571	18,406,384
Ticket Inventory	2,698,044
Prepaid Expenses	978,614

Total Current Assets \$328,432,801

Non-Current Assets

Cash and Cash Equivalents – Restricted by Multi-State Lottery	\$2,336,371
Investments for Prize Payments at Fair Value	108,344,391
Capital Assets:	
Equipment	55,549,119
Vehicles	3,585,788
Building and Improvements	10,978,601
Leasehold Improvements	71,436
Leased Assets	593,934
Computer Software	1,391,758
Less Accumulated Depreciation and Amortization	(38,975,716)

Total Non-Current Assets \$143,875,682

**Total Assets** \$472,308,483

**Liabilities and Net Assets**

Current Liabilities

Accounts Payable	\$8,095,378
Compensated Absences	1,612,834
Deposit Liability	1,470,370
Prize Liability	29,173,919
Obligations Under Securities Lending	122,956,562
Due to Economic Development Fund	115,655,029

Total Current Liabilities \$278,964,092

Non-Current Liabilities

Deferred Prize Liability	\$108,344,391
--------------------------	---------------

Total Non-Current Liabilities \$108,344,391

**Total Liabilities** \$387,308,483

Net Assets

Invested in Capital Assets \$33,194,920

Unrestricted Net Assets 51,805,080

**Total Net Assets** \$85,000,000

**Total Liabilities and Net Assets** \$472,308,483

*The accompanying notes are an integral part of the financial statements.*

STATE OF OREGON  
**OREGON STATE LOTTERY**  
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2004

**Operating Revenues**

Scratch-It Instant Tickets (Net of Returns)	\$132,731,374
Breakopen Instant Tickets	2,630,176
On-Line – Megabucks	46,473,330
On-Line – Powerball (MUSL)	45,974,759
On-Line – Sports Action	10,063,790
On-Line – Keno	116,478,125
On-Line – Pick 4	1,381,483
On-Line – Win For Life	5,475,972
On-Line – Scoreboard	1,087,911
Video Lottery (Net Receipts)	530,966,187
Provision for Bad Debts	(133,563)
<b>Total Operating Revenues</b>	<b>\$893,129,544</b>

**Operating Expenses**

Prizes	\$232,122,621
Retailer Commissions	200,968,893
Game Vendor Charges	11,816,144
Tickets	4,459,738
Advertising	6,481,679
Public Information	3,124,828
Sales Support	1,332,869
Salaries and Wages	24,700,179
Research	435,827
Services and Supplies	11,400,672
Depreciation and Amortization	4,419,544
<b>Total Operating Expenses</b>	<b>\$501,262,994</b>

**Operating Income**

\$391,866,550

**Nonoperating Revenues (Expenses)**

Interest	\$ 1,874,521
Investment Income	(1,908,981)
Other Income	414,687
Investment Expenses – Securities Lending	(837,276)
<b>Total Nonoperating Revenues (Expenses)</b>	<b>\$ (457,049)</b>

**Income Before Transfers**

\$391,409,501

Transfers To the Economic Development Fund	(380,579,755)
--	---------------

**Change in Net Assets**

\$ 10,829,746

**Net Assets – July 1, 2003** 75,000,000

Prior Period Adjustment (829,746)

**Restated Net Assets – July 1, 2003** 74,170,254

**Net Assets – June 30, 2004** **\$ 85,000,000**

*The accompanying notes are an integral part of the financial statements.*

STATE OF OREGON  
**OREGON STATE LOTTERY**  
STATEMENT OF CASH FLOWS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2004

<b><u>Cash Flows from Operating Activities:</u></b>	
Receipts from Customers	\$ 901,160,464
Payments to Employees for Services	(24,838,863)
Payments to Suppliers	(236,227,258)
Payments to Prize Winners	(230,322,514)
Other Receipts (Payments)	653,446
<b>Net Cash Provided (Used) in Operating Activities</b>	<b><u>\$ 410,425,275</u></b>
<b><u>Cash Flows from Noncapital Financing Activities:</u></b>	
Transfers to Economic Development Fund	<u>\$(364,719,912)</u>
<b>Net Cash Provided (Used) in Noncapital Financing Activities</b>	<b><u>\$(364,719,912)</u></b>
<b><u>Cash Flows from Capital and Related Financing Activities:</u></b>	
Acquisition of Capital Assets	\$ (11,912,465)
Payments on Capital Leases	(44,585)
Proceeds from Disposition of Capital Assets	123,650
<b>Net Cash Provided (Used) in Capital and Related Financing Activities</b>	<b><u>\$ (11,833,400)</u></b>
<b><u>Cash Flows from Investing Activities:</u></b>	
Purchases of Investments	\$ (9,952,793)
Proceeds from Sales and Maturities of Investments	12,416,000
Interest on Investments and Cash Balances	1,874,521
Interest Income from Securities Lending	837,276
Interest Expense from Securities Lending	(837,276)
<b>Net Cash Provided (Used) in Investing Activities</b>	<b><u>\$ 4,337,728</u></b>
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	<b>\$ 38,209,691</b>
<b>Cash and Cash Equivalents – Beginning – Restated</b>	<b><u>\$ 134,468,670</u></b>
<b>Cash and Cash Equivalents – Ending</b>	<b><u><u>\$ 172,678,361</u></u></b>
<b><u>Reconciliation of operating income to net cash provided (used) by operating activities:</u></b>	
Operating Income (Loss)	\$ 391,866,550
<b><u>Adjustments to reconcile operating income to net cash provided (used) by operating activities</u></b>	
Other Income	\$ 414,687
Investment Income Paid as Prizes	(2,746,257)
Depreciation and Amortization	4,419,544
(Gain)/Loss on Exchange of Capital Assets	(32,117)
Net Changes in Assets and Liabilities:	
(Increase) / Decrease in Accounts Receivable	8,301,797
(Increase) / Decrease in Ticket Inventory	(544,142)
(Increase) / Decrease in Prepaid Expenses	(425,773)
Increase / (Decrease) in Accounts Payable	2,918,251
Increase / (Decrease) in Compensated Absences Liability	(138,685)
Increase / (Decrease) in Deposit Liability	1,372,867
Increase / (Decrease) in Prize Liability	5,018,553
<b>Total Adjustments</b>	<b><u>\$ 18,558,725</u></b>
<b>Net Cash Provided (Used) by Operating Activities</b>	<b><u>\$ 410,425,275</u></b>
<b><u>Noncash Investing and Capital and Related Financing Activities</u></b>	
Net Change in Fair Value of Investments	<u>\$ (2,746,257)</u>
<b>Total Noncash Investing and Capital and Related Financing Activities</b>	<b><u><u>\$ (2,746,257)</u></u></b>

*The accompanying notes are an integral part of the financial statement.*



**State of Oregon  
Oregon State Lottery  
Notes to the Financial Statements  
June 30, 2004**

The accompanying financial statements of the Oregon State Lottery have been prepared in conformity with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB), the Financial Accounting Standards Board (FASB), and the American Institute of Certified Public Accountants (AICPA).

**I. Summary of Significant Accounting Policies**

**A. Reporting Entity**

The Oregon State Lottery Commission (commission) was created as an agency of the State of Oregon by enactment of Article XV, Section 4 (3), of the Oregon Constitution, an initiative measure approved by the voters of the State of Oregon at the November 1984 general election. The Commission established the Oregon State Lottery (the "Lottery"). The Lottery commenced operations in January 1985. The Lottery is part of the State of Oregon reporting entity.

**B. Measurement Focus, Basis of Accounting, and Financial Statement Presentation**

The Lottery uses an enterprise fund, the Lottery Operations Fund, with a self-balancing set of accounts to record its assets, liabilities, net assets, revenues, and expenses. Enterprise fund operations are accounted for in a manner similar to private business enterprises where the costs of providing goods and services to the general public, on a continuing basis, are intended to be financed or recovered primarily through user charges.

In accordance with GASB Statement NO. 20, the Oregon State Lottery does not apply FASB pronouncements issued after November 30, 1989, unless GASB amends its pronouncements to specifically adopt FASB pronouncements issued after that date.

Lottery financial statements are reported using the economic resources measurement focus and accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Revenues and expenses are categorized as operating, or non-operating. Operating revenues and expenses are those that are the result of selling Lottery games to the public.

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2004**

**1. Sales Revenue Recognition**

Revenues for on-line games (Megabucks, Powerball, Keno, Win for Life, Sports Action, Scoreboard and Pick 4) are recognized when shares are sold to the public.

Revenues for Breakopen instant tickets are recognized when tickets are delivered to retailers.

Revenues for instant scratch ticket games are recognized when retailers activate ticket packs for sale to the public.

Revenues for video lottery games are recognized when sales to the public occur, and are reported net of prizes awarded. Detailed information is in note III(H).

**2. Prize Expense Recognition**

Instant ticket prize expense, for prizes under \$26, is recorded when revenue is recognized and is based on game structure. Instant ticket prize expense for larger prizes is recognized when the prize is claimed.

Prize expense for on-line games is recognized as drawings are held, based on the shares sold and the estimated or known cost of the prize payouts. Prize expense for games with long-term annual payouts is adjusted when wins occur and the actual cost of the investments needed to fund the future prize payments is known. Any increase in the fair value of the investments is recognized as revenue and prize expense in the year it is earned.

Video prize expense is recognized as game play completes and prizes are known. Detailed information is in note III(H).

**3. Assets**

Assets and liabilities are classified as current and non-current. Current assets are available, or will become available within the next year to pay operating expenses and liabilities of the Lottery. Current liabilities are due within one year. Non-current assets are not easily liquidated or are restricted for purposes other than payment of normal operations and liabilities. Non-current liability amounts are due in periods following the upcoming year.

**a. Cash and Cash Equivalents**

Cash and cash equivalents include cash on hand, cash and investments held by the State Treasury in the Oregon Short-Term Fund and cash held by the Lottery's Fiscal Agent. Deposits are carried at cost. Beginning with this fiscal year, cash and cash equivalents also includes test cash held by Lottery employees who use it for testing equipment. The beginning cash and cash

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2004**

equivalent amount shown on the cash flow statement reflects this change by showing \$10,966 more than the ending cash equivalent amount shown on the 2003 cash flow statement.

**b. Investments**

Investments at year-end included investments held by the State Treasurer to fund certain Megabucks, Keno, Win for Life and Win for Life Scratch-it Instant Ticket prizes and investments held by the Lottery's fiscal agent to fund Multi-State Lottery (MUSL) prizewinners. Investments are reported at market or fair value.

**c. Securities Lending**

Securities lending amounts are reported at the fair value of the cash collateral received. The security lending liability is reported at the cash amount received as collateral.

**d. Accounts Receivable**

Throughout fiscal year 2004 most retailers who sell Lottery products were required to remit weekly proceeds (Sunday through Saturday), less commissions, on the second following Wednesday. Beginning with the collections for business week ending July 3, 2004 all retailers, except corporate accounts, will be depositing their net proceeds on the Wednesday immediately following the end of the business week.

Accounts Receivable is reported net of an allowance for those accounts estimated not to be collectible. The allowance amount reported is approximately equal to the amount of receivables over 90 days old.

**e. Inventories**

Ticket inventory consists primarily of instant scratch tickets held in the Lottery warehouse. A small amount of inventory is held at retail establishments. The inventory is valued at cost and residual inventory is expensed upon the completion of a game. Inventories are valued using the specific identification method.

**f. Restricted Assets**

Cash held by the Multi-State Lottery (MUSL) is reported as restricted. This cash is available for prize payments and operations of MUSL, and is not available for use in general Lottery operations or for payments of Lottery liabilities.

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2004**

**g. Capital Assets**

Property and equipment are recorded at historical cost. Capitalization occurs for all items with a minimum useful life of more than one year and a cost in excess of \$5,000. The straight-line method of depreciation is used. The estimated life of the major classes of property and equipment currently being depreciated ranges from three through 40 years.

**4. Liabilities**

**a. Prize Liability**

Prize liability is recorded when the prize expense is recognized. Prize payments due within one year of the financial statement date are considered current liabilities and payments due later than the upcoming year are considered long-term. Unclaimed prizes (known prizes not claimed after one year) are removed from Prize Liability and paid to the Economic Development Fund.

**b. Compensated Absences**

Vacation pay is vested when earned and is recorded as an expense when incurred. Employees earn annual leave of 10 to 17.34 hours per month, depending upon length of service. All Lottery employees can accumulate a maximum of 350 hours per employee.

Sick leave is earned at the rate of 8 hours per month, with no maximum limit. Sick leave may be taken only in the event of illness and is not convertible to pay upon termination. No liability is reported for the accumulated sick leave.

Only vacation leave and some compensatory time meet the criteria to qualify for compensated absences accrual. The criteria are:

1. The employee's right to receive compensations is based on services already rendered;
2. Rights are vested and accumulate;
3. Payment of the compensation is probable; and
4. The amount can be reasonably estimated.

The compensated absences liability is calculated based upon salary rates in effect as of June 30, 2004, and includes applicable tax and retirement costs. The total liability for the Lottery as of June 30, 2004 was \$1,612,834.

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2004**

**5. Net Assets**

All Lottery net assets are restricted to uses allowed in Article XV of the Constitution of the State of Oregon.

**II. Stewardship and Legal Compliance**

**A. Budgetary Compliance**

The Oregon State Lottery is exempt from State of Oregon Budget Laws. Accordingly, the Commission adopts an annual financial plan. Revenue, and revenue driven expenses are amended by quarterly Oregon Economic and Revenue Forecasts, produced by the State's Office of Economic Analysis in conjunction with Lottery staff. The supplementary section contains a schedule comparing actual revenues and expenses to the amended fiscal year 2004 Business Plan.

**B. Use of Revenues and Net Revenues**

Article XV of the Constitution of the State of Oregon requires that all Lottery revenues shall be used to pay prizes and expenses of the Lottery. Any remaining proceeds shall be used to benefit the public purposes of economic development, public education, or restoring and protecting parks, beaches, watersheds and critical fish and wildlife habitats. ORS 461.500 requires that at least 84 percent of the total annual revenues be returned to the public in the form of prizes and net revenues benefiting the public purposes of the Constitution, that at least 50 percent of the total annual revenues be returned to the public in the form of prizes, and that no more than 16 percent may be allocated for the payment of administrative expense.<sup>1</sup> For fiscal year 2004 the Lottery operated within legal constraints.

	<u>Traditional Lottery</u>	<u>Video Lottery</u>	<u>Total</u>	
<b>Revenues</b>				
Sales (Net of Provision for Bad Debt)	\$362,273,627	\$8,587,471,486	\$8,949,745,113	
Other Income	(2,388,791)	1,692,326	(696,465)	
<b>Distributable Revenue</b>	<u>\$359,884,836</u>	<u>\$8,589,163,812</u>	<u>\$8,949,048,648</u>	
<b>Distribution of Revenues</b>				
Prizes	\$232,122,621	\$8,056,615,570	\$8,288,738,191	92.62%
Income Paid/Due to Economic Development Department	67,428,730	313,151,025	380,579,755	4.26%
<b>Total Returned to the Public</b>	<u>\$299,551,351</u>	<u>\$8,369,766,595</u>	<u>\$8,669,317,946</u>	
Administrative Expense	59,503,739	209,397,217	268,900,956	3.00%
Retained for Contingency Reserve	829,746	10,000,000	10,829,746	0.12%
<b>Total Revenue Distribution</b>	<u>\$359,884,836</u>	<u>\$8,589,163,812</u>	<u>\$8,949,048,648</u>	100.00%

<sup>1</sup> Attorney General Opinion #8220 advises that ORS 461.548 regarding Video Lottery proceeds is unconstitutional and not applicable. It is not included here.

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2004**

Actual prizes paid to the public are \$8,282,648,200 (prize expense less unclaimed prizes), which is 92.55 percent of the distributable revenues.

**C. Unclaimed Prizes**

ORS 461.500 requires all unclaimed prizes to be allocated to the benefit of public purpose. Lottery practice is to declare known prizes as unclaimed when they have not been validated within one year of the end of the game or one year from the draw date. In fiscal year 2004 prizes in the amount of \$6,089,991 were determined to be unclaimed and were either transferred or accrued for transfer to the Economic Development Fund.

**D. Contingency Reserve**

ORS 461.510 (4) and Administrative Rule 177-10-045 allows for the creation of a contingency reserve. The Lottery Commission has set a limit of \$95 million for the contingency reserve. In fiscal year 2004 \$10,829,746 of profit was retained by the Lottery, leaving the June 30, 2004 unrestricted balance at \$51,805,080. This balance is reported as Unrestricted Net Assets on the Balance Sheet.

**E. Transfers to Economic Development Fund**

The Transfers to Economic Development Fund amount shown on the Statement of Revenues, Expenses, and Changes in Fund Net Assets equals the Income Before Transfers amount less the \$10,829,746 retained by the Lottery. Actual cash transferred to the Economic Development Fund during fiscal year 2004 is \$364,719,912. Transfer amounts remaining are included in the current liability Due to Economic Development Fund shown on the Balance Sheet. The following schedule reconciles the amounts.

	<u>Balance Owning at June 30, 2003</u>	<u>Income Amounts Accrued</u>	<u>Unclaimed Prize Amounts Accrued</u>	<u>Cash Paid to Economic Development</u>	<u>Balance Remaining at June 30, 2004</u>
<b>Net Income</b>	\$92,516,470	\$381,409,501		\$(359,317,017)	\$114,608,954
<b>Prior Period Adjustment</b>		(829,746)		829,746	
<b>Contingency Reserve</b>	-	-			-
<b>Unclaimed Prizes</b>	<u>1,188,725</u>		<u>\$6,089,991</u>	<u>(6,232,641)</u>	<u>1,046,075</u>
	<u>\$93,705,195</u>	<u>\$380,579,755</u>	<u>\$6,089,991</u>	<u>\$(364,719,912)</u>	<u>\$115,655,029</u>

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2004**

**III. Detailed Notes**

**A. Prior Period Adjustment**

In October 2003 the Lottery discovered that \$829,746 of prize expense for an October 2002 Megabucks winner was not recorded in the June 30, 2003 financial statements. Accordingly, the error is recognized on the Statement of Revenues, Expenses, and Changes in Fund Net Assets as a correction to the Net Assets as of June 30, 2003.

**B. Cash and Cash Equivalents**

The State Treasurer maintains the Oregon Short Term Fund (OSTF), a cash and investment pool available for use by state agencies and local governments. The bank balance includes cash held in demand accounts and amounts invested in the OSTF. The book balance of cash on deposit with the State Treasurer as of June 30, 2004, was \$170,327,964 and the bank balance was \$173,230,802. The difference between the balances consists of deposits in transit and outstanding checks. State Treasurer demand deposit accounts and time certificates of deposit investments are insured or collateralized for at least 25 percent of the balance in excess of FDIC coverage, as is required by state statute. Other investment securities in this fund are held by the Treasurer's agent in the name of the State of Oregon.

Cash deposits with MUSL are to pay Oregon's proportionate share of MUSL's prize reserve pool and annual operating expenses. Cash held by MUSL is uncollateralized or collateralized with securities held by the pledging financial institution or by its trust department or agent but not in the state's name. As of June 30, 2004 the book balance was \$2,336,371 and the bank balance was \$2,336,371. The bank balance is disclosed separately in MUSL's financial report for the fiscal year ended June 30, 2004. To obtain a copy please refer to Note IV.

**C. Investments**

Statute and the Oregon Investment Council govern Oregon's investment policies. The State Treasurer is the investment officer for the Council and is responsible for the funds on deposit in the State Treasury. Investments with the State Treasurer are held with the State Treasurer's agent in the name of the State of Oregon and segregated in the Treasurer's records in Lottery's name.

During fiscal year 1994 the Lottery began purchasing U.S. Government securities to fund Megabucks "Original Plan" jackpot prizes in a manner similar to the Multi-State Lottery. (Original Plan jackpot prizes are paid annually for a period of 20 to 25 years.) Certain deferred prizes arising from other on-line and Scratch-It games were also funded this way during fiscal years 1996, 1997, 1999, 2000, 2002, 2003 and 2004. The State Treasurer purchases and holds the securities on behalf of the Lottery. Any difference between the matured value of securities and the actual

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2004**

liability occurs because securities must be purchased in \$1,000 increments, while certain annual installments were not an even multiple of \$1,000. Interest earnings between the maturity and prize payment date is expected to fund any difference.

Investments for prize payments are reported on the balance sheet at fair value in accordance with the provisions of GASB Statement Number 31. Investments included U.S. Government securities that had a fair value of \$98,077,731 as of June 30, 2004. Investments held for Oregon MUSL winners included U.S. Government securities that had a fair value of \$23,317,867 as of June 30, 2004. As of June 30, 2004, the fair value of all investments that will mature in the upcoming year is \$13,051,207 and the long-term portion was \$108,344,391.

The decrease in fair value for all investments for the fiscal year ended June 30, 2004 was \$2,746,257 and is included on the Statement of Revenues, Expenses, and Changes in Fund Net Assets.

**D. Securities Lending**

The Lottery's cash balances are invested in the Oregon Short Term Fund (OSTF), as is the cash of other state agencies. In accordance with State of Oregon investment policies, state agencies may participate in securities lending and the state has, through Securities Lending Authorization Agreements, authorized its custodians to act as agents in the lending of the state's securities pursuant to a form of a loan agreement. There were no significant violations of the provisions of securities lending agreements.

During fiscal year 2004 the state's custodians lent short-term and fixed income securities and received as collateral U.S. dollar cash. Borrowers were required to deliver collateral for each loan equal to at least 102 percent of the fair value of the loaned security. The state did not have the ability to pledge or sell collateral securities absent a borrower default and the state did not impose any restrictions during the fiscal year on the amount of the loans the custodians made on its behalf. The state, through its Securities Lending Agreements, is fully indemnified against borrower default. There were no losses during the year from the failure of borrowers to return loaned securities and no recoveries of amounts from prior losses.

During the year, the state and borrowers maintained the right to terminate all securities lending transactions on demand. As a consequence, the maturities of investments made with cash collateral during the year generally did not match the maturities of their securities loans. On June 30, 2004, the state had no credit risk exposure to borrowers related to securities on loan.

As of June 30, 2004, the fair value of all OSTF securities on loan was \$3,777,513,663 and the total cash collateral received for the securities was \$3,861,375,953. The fair value of all investments purchased with the cash collateral

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2004**

received was \$3,861,704,642. The Lottery's allocated portion of the securities on loan and the related collateral is presented in the following schedule of investments.

**E. Schedule of Investments**

Lottery's investments are categorized to give an indication of the level of risk assumed by an entity at year-end. Category 1 includes investments that are insured or registered with securities held by the Lottery or its agent in the Lottery's name. Category 2 includes uninsured and unregistered investments, with the securities held by the counter party's trust department or agent in the Lottery's name. Category 3 includes uninsured and unregistered investments with the securities held by the counter party or by its trust department or agent, but not in the Lottery's name.

<b><u>INVESTMENTS AS OF JUNE 30, 2004</u></b>				
<b>Investments</b>	<b>Category</b>			<b>Fair Value</b>
	<b>1</b>	<b>2</b>	<b>3</b>	
Investments not on Securities Loan:				
U.S. Government and Agency Securities	\$80,893,684	-	-	\$80,893,684
<b>Subtotal</b>	\$80,893,684	\$-	\$-	\$80,893,684
<b>Investments Not Categorized</b>				
Investments Held by Broker Dealers Under Securities Loans with Cash Collateral:				
U.S. Government and Agency Securities				\$120,307,006
Securities Lending Short-Term Collateral Investment Pool				122,794,106
Subtotal				\$323,994,796
<b>Less:</b>				
Securities Lending Cash Collateral				(122,956,562)
Balances Treated as Cash and Cash Equivalents on Balance Sheet				(79,642,636)
<b>Total Investments</b>				<u>\$121,395,598</u>

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2004**

**F. Capital Assets**

Capital asset activity for the year ended June 30, 2004 is shown in the following schedule.

	<b>Beginning Balance</b>	<b>Additions</b>	<b>Disposals</b>	<b>Ending Balance</b>
<b>Depreciable Capital Assets</b>				
Equipment	\$ 44,788,806	\$ 11,515,408	\$ (755,095)	\$ 55,549,119
Vehicles	3,823,487	93,801	(331,500)	3,585,788
Building and Improvements	10,968,538	10,063	-	10,978,601
Leasehold Improvements	71,436	-	-	71,436
Leased Assets	593,934	-	-	593,934
Computer Software	1,098,565	293,193	-	1,391,758
<b>Total Assets Being Depreciated</b>	<b>\$ 61,344,766</b>	<b>\$ 11,912,465</b>	<b>\$ (1,086,595)</b>	<b>\$ 72,170,636</b>
<b>Accumulated Depreciation</b>				
Equipment	\$ 30,522,868	\$ 3,177,959	\$ (734,787)	\$ 32,966,040
Vehicles	1,969,784	522,528	(268,159)	2,224,153
Building and Improvements	1,951,966	321,255	-	2,273,221
Leasehold Improvements	35,946	10,337	-	46,283
Leased Assets	554,339	39,596	-	593,935
Computer Software	516,331	355,753	-	872,084
<b>Total Accumulated Depreciation</b>	<b>\$ 35,551,234</b>	<b>\$ 4,427,428</b>	<b>\$ (1,002,946)</b>	<b>\$ 38,975,716</b>
<b>Net Value of Depreciable Assets</b>	<b>\$ 25,793,532</b>	<b>\$ 7,485,037</b>	<b>\$ (83,649)</b>	<b>\$ 33,194,920</b>

**G. Non-Current Liabilities**

As of June 30, 2004, there were 56 deferred prizes for Oregon Lottery game winners and seven for Multi-State Lottery game winners. Investments are owned to provide income and cash flow to meet the payment requirements [see Note III(C)]. Prize payment liabilities are recognized at the purchase price of investments needed to fund the annual payments and increase as the value of the corresponding investment grows (see Note I(B)2). The number of years remaining for payments ranges from four to 28 years. The following schedule reflects the activity in the non-current prize liability as well as the amounts due in the next year. Current prize liability shown on the Balance Sheet includes \$16,122,712 in estimated and actual prizes won that have not yet been claimed.

	<b>Beginning Balance</b>	<b>Increases</b>	<b>Decreases</b>	<b>Ending Balance</b>	<b>Due Within One Year</b>
Lottery Games	\$90,734,032	\$9,283,514	\$10,928,412	\$89,089,134	\$8,988,597
MUSL Games	23,503,054	-	4,247,797	19,255,257	4,062,610
<b>Total</b>	<b>\$114,237,086</b>	<b>\$9,283,514</b>	<b>\$15,176,209</b>	<b>\$108,344,391</b>	<b>\$13,051,207</b>

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2004**

**H. Video Net Revenue**

Video lottery revenue and prize expense are reported at net (\$8,587,581,757 - \$8,056,615,570 = \$530,966,187) in the Statement of Revenues, Expenses, and changes in Fund Net Assets.

The following reconciles cash amounts and reported amounts for Video Lottery gaming:

	<u>Revenue</u>		<u>Prize Expense</u>
Cash Received	\$ 1,447,778,120	Cash Paid Out	\$ 916,811,933
Dollars Won and Played	<u>7,139,803,637</u>	Dollars Won and Played	<u>\$ 7,139,803,637</u>
<b>Total Revenue</b>	<b>\$ 8,587,581,757</b>	<b>Total Prizes</b>	<b>\$ 8,056,615,570</b>

**IV. Joint Ventures**

The Multi-State Lottery Association (MUSL) was established September 16, 1987. The current MUSL members are: Arizona Lottery, California Lottery, Connecticut Lottery Corporation, Colorado Lottery, D.C. Lottery and Charitable Games Control Board, Delaware State Lottery, Hoosier Lottery, Idaho Lottery, Iowa Lottery, Kansas Lottery, Kentucky Lottery Corporation, Louisiana Lottery Corporation, Maine Lottery, Minnesota State Lottery, Missouri Lottery, Montana Lottery, Nebraska Lottery, New Hampshire Sweepstakes Commission, New Mexico Lottery Authority, North Dakota Lottery, Oregon Lottery, Pennsylvania Lottery, Rhode Island Lottery, South Carolina Education Lottery, South Dakota Lottery, Tennessee Education Lottery, Vermont Lottery, U.S. Virgin Islands Lottery, Wisconsin Lottery, and the West Virginia Lottery.

MUSL is governed by a board, on which each member lottery is represented. Each member lottery has one vote. The Board's responsibilities to administer multi-state lottery games are performed by a product group, advisory committees or panels staffed by officers and independent contractors as appointed by the Board. These officers and consultants serve at the pleasure of the Board and the Board prescribes their powers, duties, and qualifications. The Executive Committee carries out the budgeting and financing of MUSL, while the Board contracts annually with an independent auditor.

Each member lottery pays an allocated share of MUSL's operating expenses. The Board and Product Group determine a percentage of gross MUSL game sales that are aggregated in a common prize pool. The revenues derived by each member lottery that are not allocated to the common prize pool and MUSL's operating expenses will be the revenue of that member lottery. Upon termination of the MUSL's existence, if such termination should occur, the member lottery would receive any proceeds determined available for distribution by the Board.

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2004**

The fiscal year end for MUSL is June 30. Long-term liabilities of MUSL are limited to lottery prize annuities due, which are fully funded through investments in U.S. Government Securities.

The Oregon Lottery's share of MUSL's operating expenses for the fiscal year ended June 30, 2004 was \$200,019.

The following schedule presents the summarized financial activity of MUSL as of June 30, 2004 and 2003. Complete separate financial statements for MUSL may be obtained from the Multi-State Lottery Association, Attention: Chuck Strutt, 4400 NW Urbandale Drive, Urbandale, Iowa 50322.

	<i>(In thousands)</i>	
	<b>2004</b>	<b>2003</b>
Assets	<u>\$1,202,963</u>	<u>\$1,372,587</u>
<b>Total Assets</b>	<b><u>\$1,202,963</u></b>	<b><u>\$1,372,587</u></b>
Liabilities	\$1,202,740	\$1,372,302
Net Assets – Unrestricted	<u>223</u>	<u>285</u>
<b>Liabilities and Net Assets</b>	<b><u>\$1,202,963</u></b>	<b><u>\$1,372,587</u></b>
Unrestricted Revenues	\$5,910	\$5,397
Unrestricted Expenses	<u>5,972</u>	<u>5,417</u>
<b>Change in Unrestricted Net Assets</b>	<b><u>(\$62)</u></b>	<b><u>(\$20)</u></b>

**V. Lease Commitments**

Financial reporting and accounting procedures differ between operating leases and capital leases. Operating leases are rental agreements where the payments are chargeable as rent and recorded in expense accounts. Capital leases contain a bargain purchase clause and are accounted for similar to purchases on contract. The property is capitalized at the present value of the lease payments when the lease is incurred and a corresponding liability is recorded.

**A. Capital Leases**

**1. Mainframe Computer System**

In September 1998 a lease purchase agreement was signed between the Lottery and Leasetec Corporation for hardware and software capable of tracking all gaming activity. The first monthly payment was for December 1998 and the final monthly payment was made November 1, 2003. At the end of the five-year lease period and with payment of the final lease payment, the Lottery owned the system. Lease payments in fiscal year 2004 totaled \$45,088, which included \$503 in interest. The gross value of the computer system is \$593,934 and is

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2004**

shown on the Balance Sheet under Leased Assets. The lease agreement was assigned to Koch Financial Corporation in December 1998.

**B. Operating Leases**

**1. Long-term Leases**

As of June 30, 2004, there were four lease agreements in effect that have a non-cancelable lease term in excess of one year. The agreements cover land for the Salem headquarters, gaming computer systems, and a storage facility used as an area depot. The term ends for those agreements are 2015, 2008, and 2007, respectively. The land for the Salem headquarters is leased from the State of Oregon, Department of Administrative Services. The computer system and storage facility are leased through private companies. The minimum lease payments are reported in Section C.

**2. Short term Leases**

The Lottery also had signed agreements for video lottery terminal rentals, storage facility rentals throughout the state, and copy machine rentals. These agreements are cancelable, the longest period for cancellation being 180-day notice. Minimum lease payments are not reported for these leases but the lease expense for fiscal year ending June 30, 2004 is shown in Section D.

**C. Schedule of Future Minimum Lease Payments**

The schedule below shows required lease payments.

Fiscal Year	Operating Leases
2005	\$ 9,039,754
2006	9,042,093
2007	9,049,929
2008	7,873,021
2009	47,829
2010-2014	239,145
2015	43,843
<b>Total Minimum Lease Payments</b>	<b>\$35,335,614</b>

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2004**

**D. Schedule of Lease Expense**

The following schedule shows lease expense for the fiscal year ending June 30, 2004:

	<b>Lease/Rent Expense</b>
Video Lottery Terminals	\$ 1,898,145
Gaming Computer Systems	9,843,026
Land for Salem Headquarters	47,829
Storage Facilities	142,886
Copy Machines	60,101
<b>Total Lease/Rent Expense</b>	<b>\$11,991,987</b>

**VI. Other Commitments and Contingencies**

**A. Contracts for Purchase of Video Lottery Terminals**

**1. WMS Gaming Inc.**

In Fiscal Year 2004 the Lottery signed an agreement with WMS Gaming Inc. to purchase 1,500 video lottery terminals for \$12,568,275. By June 30, 2004, all of the terminals had been received.

Under the contract, \$2,387,972 of the purchase price will only become due if certain criteria are met. Criteria include software updates delivered by March 31, 2005 and achievement of certain average sales levels on the machines by June 30, 2005.

**2. Spielo Manufacturing Inc.**

On April 27, 2004, the Lottery entered into an agreement with Spielo Manufacturing Inc. for the purchase video lottery terminals. The agreement requires the purchase of 2,000 terminals between April 27 and December 31, 2004. The total purchase price for the contract is \$17,600,000. At the time of delivery \$14,080,000 is due. The remaining \$3,520,000 will become due only if software updates are delivered by February 1, 2005 and certain average sales levels on the machines are achieved by December 1, 2005.

As of June 30, 2004, no terminals had been received under this contract.

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2004**

**VII. Unemployment Benefits**

State agencies are subject to the Department of Employment Act. State employees who qualify are entitled to benefit payments during periods of unemployment. Each state agency is required to reimburse the Department of Employment for benefit payments made to their former employees. There appears to be no practical method of estimating the amount of future benefit payments that may be made to former employees for wage credits earned prior to June 30, 2004. Consequently, this potential obligation is not included in the accompanying financial statements. Total reimbursements for the fiscal year 2004 were \$60,562.

**VIII. Employee Retirement Plan**

Lottery employees hired after August 28, 2003 participate in the Oregon Public Service Retirement Plan (OPSRP), which is a part of the Public Employees Retirement System (PERS). Employees hired on or before this date are PERS members. All Lottery employees who work over 600 hours per year are eligible to participate in the plans after completing six months of employment with a PERS/OPSRP covered employer. Both plans require an actuarially determined contribution from the employer and an employee contribution of 6 percent of covered salary. The Lottery pays an employee's contribution as allowed by law. Both plans are administered by the Public Employees Retirement Board under the guidelines of *Oregon Revised Statutes*, Chapter 238 and 238A. Both plans provide retirement benefits and cost-of-living adjustments, as well as disability, post-employment healthcare, and death benefits to plan members and beneficiaries. A copy of the Oregon Public Employees Retirement System annual financial report may be obtained by writing to the Oregon Public Employee Retirement System, PO Box 23700, Tigard, Oregon 97281-3700.

**A. Defined Benefit Plans**

Oregon Public Service Retirement Plan (OPSRP)

The Pension Program of OPSRP is a cost-sharing multiple-employer defined benefit pension plan. The Lottery is required by statute to contribute actuarially computed amounts as determined by the PERS Board. Rates are subject to change as a result of actuarial valuations. The rate for a covered employee's salary for fiscal year 2004 was 8.04 percent. Lottery contributions equaled required contributions for the year ending June 30, 2004 and were \$299.

Public Employees Retirement System (PERS)

PERS plan members also participate in a cost-sharing multiple-employer defined benefit pension plan. The Lottery is required by statute to contribute actuarially computed amounts as determined by the PERS Board. The rates are subject to change as a result of subsequent actuarial valuations. The rate charged in fiscal year 2004 for PERS was 11.31 percent of each covered employee's salary for amounts earned through October 2003. In November 2003 the rate dropped to 4.71 percent of each covered employee's salary. The amounts contributed by the Lottery for the

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2004**

employer's contribution and the employee's contribution for prior years and through December 31, 2003, for the years ended June 30, 2004, 2003 and 2002, were approximately \$1,745,000, \$2,818,000, and \$2,797,000, respectively, and equaled required contributions.

**B. Defined Contribution**

Individual Account Program (IAP)

The Individual Account Program (IAP) is the defined contribution portion of OPSRP. The IAP is administered by the PERS Board. It is applicable to non-PERS members as of August 29, 2003 and applicable to active PERS members as of January 1, 2004. The new law requires employers paying this portion for employees to continue the practice through December 21, 2005. PERS members retain their PERS accounts existing before January 1, 2004 and employee contributions through December 31, 2003 were deposited in the members account. Lottery contributions equaled required contributions for employee shares for the year ending June 30, 2004 and were \$505,667.

**C. Other Charges**

The Lottery also is required to pay a share of the debt service requirements for a \$2 billion bond issued to reduce the unfunded liability of PERS. PERS began collection of the amounts in May 2004 at a rate of 7.39 percent of each covered employee's salary. Lottery contributions for debt service requirements for the year ending June 30, 2004, were \$203,770.

**IX. Insurance**

The State of Oregon administers property and casualty insurance programs covering state government through its Central Services Fund (Insurance Fund). The Insurance Fund services claims for direct physical loss or damage to state property; tort liability claims brought against the state, its officers, employees, or agents; worker's compensation' employee dishonesty; and faithful performance coverage for certain key positions required by law to be covered, and other key positions.

As a state agency, the Lottery participates in the Insurance Fund. The cost of servicing insurance claims and payment is covered by charging an assessment to each state entity based on its share of services provided in a prior period. The total statewide assessment for each coverage type is based on independent biennial actuarial forecasts and administrative costs, less any available fund balance in the Insurance Fund from the prior biennium. Lottery's fiscal year 2004 share of the 2003-2005 biennial assessment was \$777,011.

**SUPPLEMENTARY INFORMATION**

**-UNAUDITED-**

**STATE OF OREGON  
OREGON STATE LOTTERY  
SUPPLEMENTARY INFORMATION  
BUDGETARY BASIS INCOME STATEMENT  
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

The Oregon State Lottery is exempt from State of Oregon budget laws. Accordingly, the Oregon State Lottery Commission adopts an annual financial plan. The following schedule compares actual revenues and expenses to the fiscal year 2004 financial plan, which has been amended to reflect quarterly Oregon Economic and Revenue Forecasts.

	<u>Actual</u>	<u>Budget</u>	<u>Variance Favorable/ (Unfavorable)</u>
<b><u>Revenue</u></b>			
Scratch It	\$ 132,731,374	\$ 132,149,000	\$ 582,374
Breakopen	2,630,176	2,646,000	(15,824)
Megabucks	46,473,330	45,310,000	1,163,330
Powerball	45,974,759	44,032,000	1,942,759
Sports Action	10,063,790	10,064,000	(210)
Scoreboard	1,087,911	1,121,000	(33,089)
Keno	116,478,125	116,222,000	256,125
Pick 4	1,381,483	1,362,000	19,483
Win For Life	5,475,972	5,423,000	52,972
Video Lottery (Gross Receipts)	<u>8,587,581,757</u>	<u>8,648,420,000</u>	<u>(60,838,243)</u>
<b>Total Revenue</b>	<b>\$8,949,878,677</b>	<b>\$9,006,749,000</b>	<b>\$(56,870,323)</b>
Prize Expense	<u>8,291,484,448</u>	<u>8,354,585,000</u>	<u>63,100,552</u>
<b>Net Revenue</b>	<b>\$ 658,394,229</b>	<b>\$ 652,164,000</b>	<b>\$ 6,230,229</b>
<b><u>Direct Expenses</u></b>			
Retailer Commissions	\$ 200,968,893	\$ 204,148,000	\$ 3,179,107
Game Vendor Charges	11,816,144	10,711,000	(1,105,144)
Tickets	4,459,738	5,043,000	583,262
Advertising	6,481,679	6,461,220	(20,459)
Sales Support	1,332,869	1,574,245	241,376
Maintenance and Supplies	3,169,391	4,597,000	1,427,609
Research	435,827	453,000	17,173
Depreciation	<u>2,639,936</u>	<u>5,236,860</u>	<u>2,596,924</u>
<b>Total Direct Expense</b>	<b>\$ 231,304,477</b>	<b>\$ 238,224,325</b>	<b>\$ 6,919,848</b>
<b>Gross Profit</b>	<b>\$ 427,089,752</b>	<b>\$ 413,939,675</b>	<b>\$ 13,150,077</b>

-UNAUDITED-

STATE OF OREGON  
OREGON STATE LOTTERY  
SUPPLEMENTARY INFORMATION  
BUDGETARY BASIS INCOME STATEMENT  
FOR THE FISCAL YEAR ENDED JUNE 30, 2004

	<u>Actual</u>	<u>Budget</u>	<u>Variance Favorable/ (Unfavorable)</u>
<b><u>Indirect Revenue</u></b>			
Other Income	<u>\$ 1,916,229</u>	<u>\$ 500,000</u>	<u>\$ 1,416,229</u>
<b><u>Indirect Expenses</u></b>			
Public Information	\$ 3,124,828	\$ 3,241,400	\$ 116,572
Personal Services	24,700,179	26,422,000	1,721,821
Services and Supplies	7,991,865	9,564,649	1,572,784
Depreciation	<u>1,779,608</u>	<u>1,625,987</u>	<u>(153,651)</u>
<b>Total Indirect Expenses</b>	<u>\$ 37,596,480</u>	<u>\$ 40,854,036</u>	<u>\$ 3,257,556</u>
<b>Net Profit</b>	<u>\$391,409,501</u>	<u>\$373,585,639</u>	<u>\$17,823,862</u>

\*Budget adopted by Commission and adjusted by Economic Forecasts throughout the year.



## **OTHER REPORTS**





---

*Auditing for a Better Oregon*

The Honorable Ted Kulongoski  
Governor of Oregon  
254 State Capitol  
Salem, Oregon 97310-4047

Kerry Tymchuck, Chairman  
Oregon State Lottery Commission  
500 Airport Road SE  
Salem, Oregon 97301

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

We have audited the financial statements of the state of Oregon State Lottery (Lottery), as of and for the year ended June 30, 2004, and have issued our report thereon dated October 29, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered the Lottery's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting, which we have reported to management of the Lottery in a separate letter.

Compliance and Other Matters

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

This report is intended solely for the information and use of the Oregon State Lottery Commission, the Oregon State Lottery's management, the governor of the state of Oregon and the Oregon Legislative Assembly and is not intended to be and should not be used by anyone other than these specified parties.

OREGON AUDITS DIVISION

A handwritten signature in black ink, appearing to read "Bill Bradbury". The signature is written in a cursive style with a long, sweeping tail on the final letter.

Bill Bradbury  
Secretary of State

October 29, 2004

## FACTS ABOUT THE SECRETARY OF STATE AUDITS DIVISION

---

The Oregon Constitution provides that the Secretary of State shall be, by virtue of his office, Auditor of Public Accounts. The Audits Division exists to carry out this duty. The division reports to the elected Secretary of State and is independent of the Executive, Legislative, and Judicial branches of Oregon government. The division audits all state officers, agencies, boards, and commissions and oversees audits and financial reporting for local governments.

### Directory of Key Officials

*State Auditor* Cathy Pollino, CGFM, MBA  
*Deputy State Auditor* Charles A. Hibner, CPA  
*Deputy State Auditor* Mary E. Wenger, CPA

### Audit Team

Kelly L. Olson, CPA, Audit Manager  
Julianne Kennedy, CPA  
Alan J. Bell, MBA  
Natalie D. Naas

**This report, which is a public record, is intended to promote the best possible management of public resources.**

If you received a copy of an audit report and no longer need it, you may return it to the Audits Division. We maintain an inventory of past audit reports. Your cooperation helps us save on printing costs.

Oregon Audits Division  
Public Service Building  
255 Capitol Street NE • Suite 500  
Salem, Oregon 97310

**We invite comments on our reports through our Hotline or Internet address.**

Ph. 503-986-2255  
Hotline: 800-336-8218  
Internet: [Audits.Hotline@state.or.us](mailto:Audits.Hotline@state.or.us)

<http://www.sos.state.or.us/audits/audithp.htm>

*The courtesies and cooperation extended by officials and employees of the Oregon State Lottery Commission during the course of this audit were commendable and sincerely appreciated.*

***Auditing to Protect the Public Interest and Improve Oregon Government***

