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Secretary of State

An Enterprise Fund of the  
State of Oregon

**OREGON STATE LOTTERY**

For the Year Ended June 30, 2005



Audits Division

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# Secretary of State

An Enterprise Fund of the  
State of Oregon

## **OREGON STATE LOTTERY**

For the Year Ended June 30, 2005



**Audits Division**

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*Auditing for a Better Oregon*

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

Kerry Tymchuck, Chair  
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, 2005, 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 an other matter, which we reported to the Lottery Commission 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

Charles A. Hibner, CPA  
Director

November 3, 2005



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**FINANCIAL SECTION**





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500 Airport Road SE  
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### **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, 2005, 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Lottery's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 IA, 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 are 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, 2005, 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, 2005, 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 November 3, 2005, 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 Oregon State Lottery's basic financial statements. The Budgetary Basis Income Statement, as listed in the table of contents, 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

Bill Bradbury  
Secretary of State

November 3, 2005

STATE OF OREGON  
**OREGON STATE LOTTERY**  
**BALANCE SHEET**  
JUNE 30, 2005

**Assets**

Current Assets

Cash and Cash Equivalents	\$ 191,759,891
Investments for Prize Payments at Fair Value	13,231,803
Securities Lending Cash Collateral	70,746,672
Accounts Receivable – Net of Allowance for Doubtful Accounts of \$422,846	14,670,823
Ticket Inventory	2,758,052
Prepaid Expenses	<u>766,645</u>

Total Current Assets \$ 293,933,886

Non-Current Assets

Cash and Cash Equivalents – Restricted by Multi-State Lottery	\$ 2,172,384
Investments for Prize Payments at Fair Value	109,279,949
Capital Assets:	
Equipment	73,031,715
Vehicles	3,808,061
Building and Improvements	11,042,710
Leasehold Improvements	71,436
Computer Software	3,684,957
Less Accumulated Depreciation and Amortization	<u>(44,086,663)</u>

Total Non-Current Assets \$ 159,004,549

**Total Assets** **\$ 452,938,435**

**Liabilities and Net Assets**

Current Liabilities

Accounts Payable	\$ 7,759,267
Compensated Absences	1,167,425
Deposit Liability	93,942
Prize Liability	28,767,487
Obligations Under Securities Lending	70,746,672
Due to Economic Development Fund	<u>106,974,048</u>

Total Current Liabilities \$ 215,508,841

Non-Current Liabilities

Compensated Absences	\$ 500,325
Deferred Prize Liability	<u>109,279,949</u>

Total Non-Current Liabilities \$ 109,780,274

**Total Liabilities** **\$ 325,289,115**

Net Assets

Invested in Capital Assets	\$ 47,552,216
Unrestricted Net Assets	<u>80,097,104</u>

**Total Net Assets** **\$ 127,649,320**

**Total Liabilities and Net Assets** **\$ 452,938,435**

*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, 2005

**Operating Revenues**

Scratch-It Instant Tickets (Net of Returns)	\$ 133,241,896
Breakopen Instant Tickets	2,185,157
On-Line – Megabucks	48,283,356
On-Line – Powerball (MUSL)	35,004,855
On-Line – Sports Action	11,292,930
On-Line – Keno	122,196,298
On-Line – Pick 4	1,386,714
On-Line – Win For Life	5,559,882
On-Line – Scoreboard	1,022,163
Video Lottery (Net Receipts)	579,650,266
Provision for Bad Debts	<u>(294,516)</u>
<b>Total Operating Revenues</b>	<b>\$ <u>939,529,001</u></b>

**Operating Expenses**

Prizes	\$ 245,125,049
Retailer Commissions	195,994,718
Game Vendor Charges	10,908,009
Tickets	4,318,728
Advertising	6,846,259
Public Information	3,106,149
Sales Support	1,215,887
Salaries and Wages	25,009,434
Research	416,628
Services and Supplies	10,143,892
Depreciation and Amortization	<u>6,918,109</u>
<b>Total Operating Expenses</b>	<b>\$ <u>510,002,862</u></b>

**Operating Income**

**\$ 429,526,139**

**Nonoperating Revenues (Expenses)**

Interest	\$ 4,959,592
Investment Income	10,903,385
Other Income	366,477
Investment Expenses – Securities Lending	<u>(1,525,023)</u>
<b>Total Nonoperating Revenues (Expenses)</b>	<b>\$ <u>14,704,431</u></b>

**Income Before Transfers**

**\$ 444,230,570**

Transfers To the Economic Development Fund

401,581,250

**Change in Net Assets**

**\$ 42,649,320**

**Net Assets – July 1, 2004**

85,000,000

**Net Assets – June 30, 2005**

**\$ 127,649,320**

*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, 2005

<b><u>Cash Flows from Operating Activities</u></b>	
Receipts from Customers	\$ 943,384,057
Payments to Employees for Services	(24,954,518)
Payments to Suppliers	(234,421,390)
Payments to Prize Winners	<u>(239,100,758)</u>
<b>Net Cash Provided (Used) in Operating Activities</b>	<b>\$ <u>444,907,391</u></b>
<b><u>Cash Flows from Noncapital Financing Activities</u></b>	
Transfers to Economic Development Fund	\$ (415,846,854)
Other Income	<u>311,619</u>
<b>Net Cash Provided (Used) in Noncapital Financing Activities</b>	<b>\$ <u>(415,535,235)</u></b>
<b><u>Cash Flows from Capital and Related Financing Activities</u></b>	
Acquisition of Capital Assets	(21,450,819)
Proceeds from Disposition of Capital Assets	<u>110,777</u>
<b>Net Cash Provided (Used) in Capital and Related Financing Activities</b>	<b>\$ <u>(21,340,042)</u></b>
<b><u>Cash Flows from Investing Activities</u></b>	
Purchases of Investments	\$ (3,356,769)
Proceeds from Sales and Maturities of Investments	13,144,000
Interest on Investments and Cash Balances	4,959,592
Interest Expense from Securities Lending	<u>(1,525,023)</u>
<b>Net Cash Provided (Used) in Investing Activities</b>	<b>\$ <u>13,221,800</u></b>
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	<b>\$ 21,253,914</b>
<b>Cash and Cash Equivalents – Beginning</b>	<b>\$ <u>172,678,361</u></b>
<b>Cash and Cash Equivalents – Ending</b>	<b>\$ <u>193,932,275</u></b>
<b><u>Reconciliation of operating income to net cash provided (used) by operating activities</u></b>	
Operating Income (Loss)	\$ 429,526,139
<b><u>Adjustments to reconcile operating income to net cash provided (used) by operating activities</u></b>	
Depreciation and Amortization	6,918,109
Net Changes in Assets and Liabilities:	
(Increase) / Decrease in Accounts Receivable	3,855,056
(Increase) / Decrease in Ticket Inventory	(60,008)
(Increase) / Decrease in Prepaid Expenses	301,428
Increase / (Decrease) in Accounts Payable	(336,111)
Increase / (Decrease) in Compensated Absences Liability	54,916
Increase / (Decrease) in Deposit Liability	(1,376,429)
Increase / (Decrease) in Prize Liability	<u>6,024,291</u>
<b>Total Adjustments</b>	<b>\$ <u>15,381,252</u></b>
<b>Net Cash Provided (Used) by Operating Activities</b>	<b>\$ <u>444,907,391</u></b>
<b><u>Noncash Investing and Capital and Related Financing Activities</u></b>	
Net Change in Fair Value of Investments	\$ <u>10,903,385</u>
<b>Total Noncash Investing and Capital and Related Financing Activities</b>	<b>\$ <u>10,903,385</u></b>

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



**State of Oregon**  
**OREGON STATE LOTTERY**  
**Notes to the Financial Statements**  
**June 30, 2005**

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, 2005**

**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(F).

All revenues are reported net of free plays and discounts given. Discounts and free plays totaled \$1,633,553 in fiscal year 2005.

**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(F).

**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 Equivalent**

Cash and cash equivalents include cash on hand, test cash held by employees, cash and investments held by the State Treasury in the Oregon

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2005**

Short-Term Fund and cash held by the Lottery's Fiscal Agent. Deposits are carried at cost.

**b. Investments**

Investments at year-end include investments held by the State Treasurer to fund long-term prize payouts. 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**

Most retailers who sell Lottery products are required to remit weekly proceeds (Sunday through Saturday), less commissions, on the following Wednesday. Corporate accounts, those with several individual retailers, are required to remit the second Wednesday following the end of the business week.

Accounts Receivable are 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.

**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.

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2005**

The estimated life, of the major classes of property and equipment currently being depreciated, ranges from three through forty years.

**4. Liabilities**

**a. Prize Liability**

Prize liability is recorded when the prize expense is recognized (see Note I(B)2). 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 may 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 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, 2005, and includes applicable tax and retirement costs. The total liability for the Lottery as of June 30, 2005 was \$1,667,750. It is estimated that 30 percent of this liability will be used in years after fiscal year 2006.

**5. Net Assets**

All Lottery net assets are restricted to uses allowed in Article XV of the Constitution of the State of Oregon. (See note II(B)).

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2005**

**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 items, and expenses that are related to revenue, are amended by quarterly Oregon Economic and Revenue Forecasts that are 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 2005 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 2005, the Lottery operated within legal constraints.

	<u>Traditional Lottery</u>	<u>Video Lottery</u>	<u>Total</u>	
<b><u>Revenues</u></b>				
Sales (Net of Provision for Bad Debt)	\$ 360,162,143	\$ 9,188,709,775	\$ 9,548,871,918	
Other Distributable Income	11,704,644	4,438,174	16,142,818	
<b>Total Distributable Revenue</b>	<b>\$ 371,866,787</b>	<b>\$ 9,193,147,949</b>	<b>\$ 9,565,014,736</b>	
<b><u>Distribution of Revenues</u></b>				
<b>Revenues Returned to the Public</b>				
Prizes	\$ 245,125,049	\$ 8,609,342,917	\$ 8,854,467,966	92.57%
Transfers Paid/Due to Economic Development Department	68,323,867	333,257,383	401,581,250	4.20%
<b>Total Revenues Returned to the Public</b>	<b>\$ 313,448,916</b>	<b>\$ 8,942,600,300</b>	<b>\$ 9,256,049,216</b>	
<b>Administrative Expenses</b>	58,806,200	207,510,000	266,316,200	2.78%
<b>Retained for Contingency Reserve</b>	(388,329)	43,037,649	42,649,320	0.45%
<b>Total Revenue Distribution</b>	<b>\$ 371,866,787</b>	<b>\$ 9,193,147,949</b>	<b>\$ 9,565,014,736</b>	100.00%

<sup>1</sup> Attorney General Opinion No. 8220 advises that ORS 461.548 regarding Video Lottery proceeds is unconstitutional and is not applicable. It is not included here.

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2005**

Actual prizes paid to the public are \$8,848,883,342 (prize expense less unclaimed prizes), which is 92.51 percent of distributable revenues.

**C. Unclaimed Prizes**

ORS 461.500 requires all unclaimed prizes to be allocated to the benefit of public purpose. Lottery administrative rules 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 2005, prizes in the amount of \$5,584,624 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. In June 2005, the Lottery Commission approved a contingency reserve amount such that the cash available for investment does not exceed \$45,000,000. In fiscal year 2005, \$42,649,320 of profit was retained by the Lottery, leaving the June 30, 2005 unrestricted balance at \$80,097,104. This balance is reported as Unrestricted Net Assets on the Balance Sheet. The following table shows the liquidity detail of the Unrestricted Net Assets:

Non-current Cash Equivalents, Inventory, and Prepaid Expenses	\$ 5,697,081
Committed for Asset Purchases (See discussion in Note VI)	31,019,751
Available for Future Investment	43,380,272
<b>Total Unrestricted Net Assets</b>	<b>\$ 80,097,104</b>

**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 \$42,649,320 retained by the Lottery. Actual cash transferred, including unclaimed prizes, during fiscal year 2005 is \$415,846,854. Any transfer amounts remaining are included on the Balance Sheet in the current liability, Due to Economic Development Fund. The following schedule reconciles the amounts:

	<b>Balance Owning at June 30, 2004</b>	<b>Income Amounts Accrued</b>	<b>Unclaimed Prize Amounts Accrued</b>	<b>Cash Paid to Economic Development</b>	<b>Balance Remaining at June 30, 2005</b>
<b>Income</b>	\$ 114,608,953	\$ 401,581,250	\$ -	\$ (410,661,709)	\$ 105,528,494
<b>Unclaimed Prizes</b>	1,046,075	-	5,584,624	(5,185,145)	1,445,554
	<u>\$ 115,655,028</u>	<u>\$ 401,581,250</u>	<u>\$ 5,584,624</u>	<u>\$ (415,846,854)</u>	<u>\$ 106,974,048</u>

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2005**

**III. Detailed Notes**

**A. 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. Lottery uses the OSTF for all deposits. The book balance of cash on deposit with the State Treasurer as of June 30, 2005, was \$191,747,097 and the OSTF reported balance was \$194,834,216. The difference between the balances consists of deposits in transit and outstanding checks. State Treasurer demand deposit accounts are insured or collateralized for at least 25 percent of the balance in excess of FDIC coverage, as is required by state statute. Balances in excess of the FDIC insurance and collateral are considered exposed to custodial risk. Custodial risk for deposits is defined as the risk that, in the event of failure of the bank the OSTF will be unable to recover the total amount of deposits. Since the OSTF is a pool, Lottery's share of the risk is difficult to estimate. More information on the custodial risk of deposits with the OSTF can be obtained from the OSTF financial statements available at their website:

<http://www.ost.state.or.us/About/Boards/OSTF/Financial%20Statements/OSTF-6-30-2005.pdf>.

Cash deposits with MUSL are to pay Oregon's proportionate share of MUSL's prize reserve pool and annual operating expenses. Member deposits held by MUSL are held as uncollateralized cash under a custodial trust agreement, or invested in accordance with the Board adopted investment policy. All of MUSL's investments are explicitly guaranteed by the U.S. Government. Further information regarding the risk of deposits with MUSL can be viewed in MUSL's financial report for the fiscal year ended June 30, 2005. To obtain a copy refer to Note IV.

As of June 30, 2005, the book and MUSL balance was \$2,172,384.

**B. Investments**

The Lottery holds U.S. Government securities to fund long-term prize payouts for both MUSL and Oregon Lottery games. 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 purchase and holding of the investments 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, or the Oregon State Lottery. Investments in the name of the State of Oregon are segregated in the Treasurer's records in Lottery's name. Securities for MUSL game winners are purchased by MUSL and ownership is transferred to the Lottery. The securities are held by the State Treasurer's agent in the Lottery's name.

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2005**

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

Investments for prize payments are reported on the balance sheet at fair value. Investments are in U.S. Government securities that had a fair value of \$122,511,752 as of June 30, 2005. As of June 30, 2005 the fair value of all investments that will mature in the upcoming year is \$13,231,803 and the long-term portion was \$109,279,949.

The increase in fair value for all investments for the fiscal year ended June 30, 2005 was \$10,903,385 and is shown on the Statement of Revenues, Expenses, and Changes in Fund Net Assets as Investment Income.

**1. Credit and Concentration of Credit Risk**

Credit risk is defined as the risk that an issuer or other counterparty to an investment will not fulfill its obligations. All Lottery investments are in U.S. Government obligations and 64.6 percent (\$79,181,874) are guaranteed by the U.S. Government.

Concentration of credit risk is defined as the risk of loss attributed to investments in one single issuer. Of the Lottery investments, 35.4 percent (\$43,329,878) are in the Resolution Funding Corporation (RFC), a Federal Agency, and are not guaranteed by the U.S. Government. The current credit rating for the RFC is AAA.

**2. Interest Rate Risk**

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The length of time until maturity effects the exposure of the investment to fair value fluctuations. The following table shows the segmented time distribution of the fair value of all Lottery investments.

	<u>Investment Maturity in Years</u>				<u>Total Fair Value</u>
	<u>Less than 1 Year</u>	<u>1-5 Years</u>	<u>6-10 Years</u>	<u>More Than 10 Years</u>	
<b>RFC</b>	\$ 883,778	\$ 16,395,228	\$ 20,018,647	\$ 6,032,225	\$ 43,329,878
<b>US Treasury Obligations</b>	12,348,025	30,012,543	15,984,343	20,836,963	79,181,874
<b>Total Investments</b>	<u>\$ 13,231,803</u>	<u>\$ 46,407,771</u>	<u>\$ 36,002,990</u>	<u>\$ 26,869,188</u>	<u>\$ 122,511,752</u>

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2005**

**C. Securities Lending**

In accordance with State of Oregon investment policies, state agencies may participate in securities lending and the State Treasurer 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 2005 the State's custodians lent short-term and fixed income securities and received as collateral U.S. dollar-denominated cash. Borrowers were required to deliver cash collateral for each loan equal to not less than 102 percent of the market value of the loaned security. 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 losses due to borrower default. There were no losses during the year from the failure of borrowers to return loaned securities.

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, 2005, the State had no credit risk exposure to borrowers related to securities on loan.

Security lending balances of the OSTF for fiscal year 2005 can be obtained in the financial statements for the OSTF available on their website (see Note III(A)).

All investments on loan are U.S. Government and Agency securities. The Lottery's allocated portion of the OSTF securities on loan and Lottery owned investments on loan is presented in the following schedule:

<b><u>Securities Lending Balances</u></b>			
	Securities on Loan at Fair Value	Cash Collateral Received	Fair Value of Invested Collateral
Lottery Share OSTF	\$ 33,724,986	\$ 34,426,365	\$ 34,330,799
Lottery Investments	35,576,332	36,320,307	36,146,128
Total Security Loans	<u>\$ 69,301,318</u>	<u>\$ 70,746,672</u>	<u>\$ 70,476,927</u>

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2005**

**D. Capital Assets**

Capital asset activity for the year ended June 30, 2005, is shown in the following schedule:

	<b>Beginning Balance</b>	<b>Additions</b>	<b>Disposals</b>	<b>Ending Balance</b>
<b><u>Depreciable Capital Assets</u></b>				
Equipment	\$ 56,143,053	\$ 18,454,337	\$ (1,565,675)	\$ 73,031,715
Vehicles	3,585,788	639,174	(416,901)	3,808,061
Building and Improvements	10,978,601	64,109	-	11,042,710
Leasehold Improvements	71,436	-	-	71,436
Computer Software	1,391,758	2,293,199	-	3,684,957
<b>Total Assets Being Depreciated</b>	<b>\$ 72,170,636</b>	<b>\$ 21,450,819</b>	<b>\$ (1,982,576)</b>	<b>\$ 91,638,879</b>
<b><u>Accumulated Depreciation</u></b>				
Equipment	\$ 33,559,975	\$ 5,674,461	\$ (1,531,249)	\$ 37,703,187
Vehicles	2,224,153	251,688	(275,913)	2,199,928
Building and Improvements	2,273,221	321,384	-	2,594,605
Leasehold Improvements	46,283	7,862	-	54,145
Computer Software	872,084	662,714	-	1,534,798
<b>Total Accumulated Depreciation</b>	<b>\$ 38,975,716</b>	<b>\$ 6,918,109</b>	<b>\$ (1,807,162)</b>	<b>\$ 44,086,663</b>
<b>Net Value of Depreciable Assets</b>	<b>\$ 33,194,920</b>	<b>\$ 14,532,710</b>	<b>\$ (175,414)</b>	<b>\$ 47,552,216</b>

**E. Non-Current Liabilities**

As of June 30, 2005, there were 61 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(B)]. 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 three to 29 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 \$15,535,684 in estimated and actual prizes won that have not yet been claimed.

	<b><u>Non-Current Liabilities</u></b>				<b>Due Within</b>
	<b>Beginning Balance</b>	<b>Increases</b>	<b>Decreases</b>	<b>Ending Balance</b>	<b>One Year</b>
Lottery Games	\$ 89,089,134	\$ 13,072,985	\$ 8,871,836	\$ 93,290,283	\$ 9,185,706
MUSL Games	19,255,257	735,256	4,000,847	15,989,666	4,046,097
<b>Total</b>	<b>\$ 108,344,391</b>	<b>\$ 13,808,241</b>	<b>\$ 12,872,683</b>	<b>\$ 109,279,949</b>	<b>\$ 13,231,803</b>

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2005**

**F. Video Net Revenue**

Video lottery revenue and prize expense are reported net 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	\$ 1,568,540,777	Cash Paid Out	\$ 988,890,511
Dollars Won and Played	7,620,452,406	Dollars Won and Played	7,620,452,406
<b>Total Revenue</b>	<b><u>\$ 9,188,993,183</u></b>	<b>Total Prizes</b>	<b><u>\$ 8,609,342,917</u></b>
<b>Net Revenue = \$579,650,266</b>			

**IV. Joint Ventures**

The Multi-State Lottery Association (MUSL) was established September 16, 1987 to coordinate lottery games with larger prizes than the individual states could offer by themselves. Each participating state sells their choice of MUSL products and keeps all profits earned. Participating states contribute amounts necessary to fund the estimated and actual prizes won, reserve prize pools and the operating expenses of MUSL. 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. The current MUSL members are: Arizona 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 through product groups, 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 and the Board contracts annually with an independent auditor.

The fiscal year end for MUSL is June 30, 2005. Long-term liabilities of MUSL are limited to prize annuities due which are fully funded through investments in U.S. Government Securities.

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2005**

The Oregon Lottery's share of MUSL's operating expenses for the fiscal year ended June 30, 2005 was \$89,772.

The following schedule presents the summarized financial activity of MUSL as of June 30, 2005 and 2004. 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>	
	<u>2005</u>	<u>2004</u>
Assets	\$ 1,138,782	\$ 1,202,963
<b>Total Assets</b>	<u>\$ 1,138,782</u>	<u>\$ 1,202,963</u>
Liabilities	\$ 1,138,556	\$ 1,202,740
Net Assets - Unrestricted	<u>226</u>	<u>223</u>
<b>Liabilities and Net Assets</b>	<u>\$ 1,138,782</u>	<u>\$ 1,202,963</u>
Unrestricted Revenues	\$ 3,521	\$ 5,910
Unrestricted Expenses	<u>3,518</u>	<u>5,972</u>
<b>Change in Unrestricted Net Assets</b>	<u>\$ 3</u>	<u>\$ (62)</u>

**V. Lease Commitments**

Operating leases are rental agreements where the payments are expensed as rent.

**A. Long-term Operating Leases**

As of June 30, 2005, four lease agreements were 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 agreement terms end in fiscal year 2015, 2011 and 2008, 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 future minimum lease payments are reported in the following schedule:

<b>Future Minimum Lease Payments</b>	
<u>Fiscal Year</u>	<u>Operating Leases</u>
2006	\$ 9,129,213
2007	9,163,464
2008	9,196,070
2009	1,819,065
2010	1,819,065
2011-2015	825,571
<b>Total Minimum Lease Payments</b>	<u><b>\$ 31,952,448</b></u>

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2005**

**B. Short-term Operating 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.

**C. Fiscal Year 2005 Operating Lease Expense**

The following schedule shows lease expense for the fiscal year ending June 30, 2005:

	<b>Lease/Rent Expense</b>
Video Lottery Terminals	\$ 622,735
Gaming Computer Systems	9,930,929
Land for Salem Headquarters	47,829
Storage Facilities	141,712
Copy Machines	58,082
<b>Total Lease/Rent Expense</b>	<b>\$ 10,801,287</b>

**VI. Other Commitments and Contingencies**

**A. Contracts for Purchase of Video Lottery Terminals (VLT's)**

The following schedule shows amounts committed by the Lottery for upcoming capital purchases. Detail regarding the contracts follows the schedule.

	<b>Purchase Commitment Amount</b>
WMS Gaming Inc.	\$ 1,885,241
Spielo Manufacturing Inc.	4,809,510
International Gaming Technologies	24,325,000
	<b>\$ 31,019,751</b>

**1. WMS Gaming Incorporated**

In Fiscal Year 2004, the Lottery signed an agreement with WMS Gaming Inc. to purchase 1,500 video lottery terminals for \$12,568,275. All of the terminals have been received. Under the contract, certain amounts of the purchase price were held back and are not due unless certain sales criteria are met. Currently, \$1,885,241 is still being held by the Lottery. The amount may become due if contractual conditions are met during fiscal year 2006.

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2005**

**2. Spielo Manufacturing Incorporated**

On April 27, 2004, the Lottery entered into an agreement with Spielo Manufacturing Inc. for the purchase of 2,000 video lottery terminals. The total purchase price for the contract is \$17,600,000. All of the terminals have been received. Under the contract, certain amounts of the purchase price were held back and are not due unless certain sales criteria are met. Currently, \$2,640,000 is still being held by the Lottery. The amount may become due during fiscal year 2006 if contractual sales conditions are met.

In May of 2005, the Lottery signed an agreement to purchase an additional 300 terminals under the terms of the April 27, 2004 agreement for a total price of \$2,794,500. This purchase is not subject to the hold-back clauses in the original agreement. As of June 30, 2005, the Lottery had received 146 of the terminals. The remaining terminals are expected to be received and paid for in fiscal year 2006. The purchase commitment remaining is \$1,434,510.

Included in the contract amendment is the purchase of a software upgrade for the terminals purchased under the original and amended contract. The price is \$735,000 and is subject to Lottery approval before acceptance. If accepted, the software purchase price will be due on or before July 2006.

**3. International Gaming Technologies**

In May of 2005, the Lottery entered into an agreement with International Gaming Technologies to purchase 2000, I-960 model VLT's for \$18,700,000; and 150, 8828 model VLT's for \$1,125,000. None of the terminals were received before June 30, 2005. The Lottery will hold back \$1,870,000 of the purchase price of the I-960 models. This amount will become due if the vendor meets specific delivery dates in August and September, 2005 and the software on the terminals meets Lottery's quality standards.

Included in the contract is the purchase of one software upgrade for the I-960 models and two software upgrades for the 8828 models. The purchase price for the I-960 upgrade is \$1,200,000 and delivery is due to the Lottery in November, 2006. The purchase prices of the 8828 upgrades are \$1,750,000 and \$1,200,000. The delivery due dates are November 2005 and January 2007, respectively.

The Lottery has agreed to pay \$350,000 for assistance from IGT in deployment of the I-960 terminals.

**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

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2005**

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, 2005. Consequently, this potential obligation is not included in the accompanying financial statements. Total reimbursements for the fiscal year 2005 were \$7,215.

**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.

Lottery contributions for fiscal year 2005 equaled what was required.

**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 2005 was 8.04 percent. Lottery contributions for the year ending June 30, 2005 were approximately \$44,000. Contributions for fiscal year 2004 were approximately \$300.

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. From July 2004 through May 2005 the Lottery paid 4.71 percent of covered salary for the employer share. In June the rate changed to 8.69 percent. The Lottery contributed approximately \$799,000 for the employer portion in fiscal year 2005. The amounts contributed by the Lottery for both the employer's contribution and the employee's

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2005**

contribution for the fiscal years 2004 and 2003 were approximately \$1,745,000, and \$2,818,000 respectively.

**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 31, 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 for employee shares for the year ending June 30, 2005 were approximately \$977,000 and for fiscal year 2004 were approximately \$506,000.

**C. Other Charges**

The Lottery is also 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. The rate changed to 6.71 percent in December 2004. Lottery contributions for debt service requirements for the year ending June 30, 2005 was approximately \$1,149,000 and for fiscal year 2004, was approximately \$204,000.

**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 2005 share of the 2003-2005 biennial assessment was \$777,012.

**SUPPLEMENTARY INFORMATION**



-UNAUDITED-

**STATE OF OREGON  
OREGON STATE LOTTERY  
SUPPLEMENTARY INFORMATION  
BUDGETARY BASIS INCOME STATEMENT\*  
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

The Oregon State Lottery is exempt from State of Oregon budget laws. Accordingly, the Commission adopts an annual financial plan. The following schedule compares actual revenues and expenses to the fiscal year 2005 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	\$ 133,241,896	\$ 132,728,000	\$ 513,896
Breakopen	2,185,157	2,187,000	(1,843)
Megabucks	48,283,355	46,354,000	1,929,355
Powerball	35,004,855	33,095,000	1,909,855
Sports Action	11,292,930	11,293,000	(70)
Scoreboard	1,022,163	1,022,000	163
Keno	122,196,298	120,378,000	1,818,298
Pick 4	1,386,714	1,342,000	44,714
Win For Life	5,559,882	5,492,000	67,882
Video Lottery (Gross Receipts)	9,188,993,183	9,316,939,000	(127,945,817)
<b>Total Revenue</b>	<b>\$ 9,549,166,433</b>	<b>\$9,670,830,000</b>	<b>\$(121,663,567)</b>
Prize Expense	8,843,564,580	8,984,273,000	140,708,420
<b>Net Revenue</b>	<b>\$ 705,601,853</b>	<b>\$686,557,000</b>	<b>\$19,044,853</b>
<b><u>Direct Expenses</u></b>			
Retailer Commissions	\$ 195,994,718	\$ 193,504,000	\$ (2,490,718)
Game Vendor Charges	10,908,009	10,364,000	(544,009)
Tickets	4,318,728	5,380,000	1,061,272
Advertising	6,846,259	6,668,020	(178,239)
Sales Support	1,215,887	1,633,196	417,309
Game Equipment/Parts & Maintenance	2,206,950	3,856,190	1,649,240
Research	416,628	466,795	50,167
Depreciation	5,324,977	6,781,871	1,456,894
<b>Total Direct Expense</b>	<b>\$ 227,232,156</b>	<b>\$ 228,654,072</b>	<b>\$ 1,421,916</b>
<b>Gross Profit</b>	<b>\$ 478,369,697</b>	<b>\$ 457,902,928</b>	<b>\$ 20,466,769</b>
<b><u>Indirect Revenue</u></b>			
Other Income	\$ 3,290,100	\$ 1,435,000	\$ 1,855,100
<b><u>Indirect Expenses</u></b>			
Public Information	\$ 3,106,149	\$ 3,323,665	\$ 217,516
Personal Services	25,009,434	26,880,667	1,871,233
Services & Supplies	7,720,512	9,318,982	1,598,470
Depreciation	1,593,132	1,381,150	(211,982)
<b>Total Indirect Expenses</b>	<b>\$ 37,429,227</b>	<b>\$ 40,904,464</b>	<b>\$ 3,475,237</b>
<b>Net Profit</b>	<b>\$ 444,230,570</b>	<b>\$ 418,433,464</b>	<b>\$ 25,797,106</b>

\*Budget adopted by Commission and adjusted by Department of Administrative Services, Economic Forecasts, published throughout the year.



## **OTHER REPORTS**





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*Auditing for a Better Oregon*

The Honorable Ted Kulongoski  
Governor of Oregon  
254 State Capitol  
Salem, Oregon 97301-4047

Kerry Tymchuck, Chairman  
Oregon 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 Oregon State Lottery (Lottery), as of and for the year ended June 30, 2005, and have issued our report thereon dated November 3, 2005. 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 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.

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*.

We noted an other matter that we reported to the Lottery Commission in a separate letter dated February 13, 2006.

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

Bill Bradbury  
Secretary of State

November 3, 2005

# **FACTS ABOUT THE SECRETARY OF STATE AUDITS DIVISION**

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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**

*Director* Charles A. Hibner, CPA  
*Deputy Director* Mary E. Wenger, CPA

## **Audit Team**

Nancy L. Young, CPA, CISA, CFE, Audit Manager  
Diane Farris, CPA  
Natalie D. Naas  
Nicole D. Real

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Hotline: 800-336-8218  
Internet: <http://www.sos.state.or.us/audits/audithp.htm>

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

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

