

Report No. 2007-05

February 28, 2007



Charles A. Hibner, Director, Audits Division

Bill Bradbury, Secretary of State

# Secretary of State Audit Report

Enterprise Fund of the  
State of Oregon

**Oregon State Lottery**

For the Fiscal Year Ended June 30, 2006



**Office of the Secretary of State**

Bill Bradbury  
Secretary of State

Jean Straight  
Deputy Secretary of State



**Audits Division**

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

Steven Ungar, 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, 2006, 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.

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, 2006



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**FINANCIAL SECTION**



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**INDEPENDENT AUDITOR'S REPORT**

We have audited the accompanying financial statements of the Oregon State Lottery (Lottery), as of and for the year ended June 30, 2006, 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 I, the 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, 2006, the changes in its financial position or 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, 2006, and the changes in its financial position and its 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, 2006, on our consideration of the Oregon State 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, 2006

STATE OF OREGON  
**OREGON STATE LOTTERY**  
**BALANCE SHEET**  
JUNE 30, 2006

**Assets**

Current Assets:

Cash and Cash Equivalents	\$ 256,969,851
Investments for Prize Payments at Fair Value	13,803,038
Securities Lending Cash Collateral	67,414,058
Accounts Receivable – Net of Allowance for Doubtful Accounts of \$313,684	17,099,984
Ticket Inventory	2,663,188
Prepaid Expenses	1,294,207

Total Current Assets	359,244,326
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Non-Current Assets:

Cash and Cash Equivalents - Restricted by Multi-State Lottery	2,306,745
Investments for Prize Payments at Fair Value	101,676,685

Capital Assets:

Equipment	96,048,101
Vehicles	3,920,439
Building and Improvements	11,120,757
Leasehold Improvements	71,436
Computer Software	7,626,639

Less Accumulated Depreciation and Amortization	(47,411,182)
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Total Non-Current Assets	175,359,620
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<b>Total Assets</b>	<b>\$ 534,603,946</b>
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**Liabilities and Net Assets**

Current Liabilities:

Accounts Payable	\$ 7,328,015
Compensated Absences	1,370,737
Deposit Liability	205,167
Prize Liability	29,519,535
Obligations Under Securities Lending	67,414,058
Due to Economic Development Fund	159,358,923

Total Current Liabilities	265,196,435
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Non-Current Liabilities:

Compensated Absences	456,912
Deferred Prize Liability	101,676,685

Total Non-Current Liabilities	102,133,597
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Total Liabilities	\$ 367,330,032
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Net Assets:

Invested in Capital Assets	\$ 71,376,190
Unrestricted Net Assets	95,897,724
Total Net Assets	167,273,914

<b>Total Liabilities and Net Assets</b>	<b>\$ 534,603,946</b>
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*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, 2006

<b>Operating Revenues:</b>	
Scratch-It Instant Tickets (Net of Returns)	\$ 127,244,323
Breakopen Instant Tickets	1,671,571
On-Line – Megabucks	37,771,877
On-Line – Powerball (MUSL)	59,070,621
On-Line – Sports Action	12,105,674
On-Line – Keno	116,240,045
On-Line – Pick 4	1,405,501
On-Line – Win For Life	5,914,469
On-Line – Scoreboard	643,913
On-Line – Lucky Lines	1,018,520
Video Lottery (Net Receipts)	732,888,437
Provision for Bad Debts	(29,002)
Total Operating Revenues	<u>1,095,945,949</u>
<b>Operating Expenses:</b>	
Prizes	236,638,134
Retailer Commissions	218,013,134
Game Vendor Charges	10,227,113
Tickets	4,461,315
Advertising	6,434,796
Public Information	3,858,646
Sales Support	1,772,169
Salaries and Wages	26,995,520
Research	573,088
Services and Supplies	10,902,866
Depreciation and Amortization	11,019,875
Total Operating Expenses	<u>530,896,656</u>
Operating Income	<u>\$ 565,049,293</u>
<b>Nonoperating Revenues (Expenses)</b>	
Interest	\$ 11,207,424
Investment Income/(Loss)	(2,849,641)
Other Income	248,177
Investment Expenses – Securities Lending	(2,998,549)
Total Nonoperating Revenues (Expenses)	<u>\$ 5,607,411</u>
Income Before Transfers	<u>\$ 570,656,704</u>
Transfers To the Economic Development Fund	531,032,111
Change in Net Assets	39,624,593
Net Assets – July 1, 2005	127,649,321
Net Assets – June 30, 2006	<u><u>\$ 167,273,914</u></u>

*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, 2006

<b>Cash Flows from Operating Activities:</b>	
Receipts from Customers	\$ 1,093,213,400
Payments to Employees for Services	(26,835,621)
Payments to Suppliers	(256,852,036)
Payments to Prize Winners	(238,639,520)
Net Cash Provided (Used) in Operating Activities	<u>570,886,223</u>
<b>Cash Flows from Noncapital Financing Activities:</b>	
Transfers to Economic Development Fund	(483,640,880)
Other Income	572,215
Net Cash Provided (Used) in Noncapital Financing Activities	<u>(483,068,665)</u>
<b>Cash Flows from Capital and Related Financing Activities:</b>	
Acquisition of Capital Assets	(35,022,762)
Proceeds from Disposition of Capital Assets	158,262
Net Cash Provided (Used) in Capital and Related Financing Activities	<u>(34,864,500)</u>
<b>Cash Flows from Investing Activities:</b>	
Purchases of Investments	(9,221,620)
Proceeds from Sales and Maturities of Investments	13,404,008
Interest on Investments and Cash Balances	11,207,424
Interest Expense from Securities Lending	(2,998,549)
Net Cash Provided (Used) in Investing Activities	<u>12,391,263</u>
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	65,344,321
<b>Cash and Cash Equivalents - Beginning</b>	<u>193,932,275</u>
<b>Cash and Cash Equivalents - Ending</b>	<u>\$ 259,276,596</u>
<b>Reconciliation of operating income to net cash provided (used) by operating activities:</b>	
Operating Income (Loss)	<u>\$ 565,049,293</u>
Adjustments to reconcile operating income to net cash provided (used) by operating activities	
Depreciation and Amortization	\$ 11,019,875
Net Changes in Assets and Liabilities:	
(Increase) / Decrease in Accounts Receivable	(2,732,549)
(Increase) / Decrease in Ticket Inventory	94,864
(Increase) / Decrease in Prepaid Expenses	(527,562)
Increase / (Decrease) in Accounts Payable	(431,252)
Increase / (Decrease) in Compensated Absences Liability	159,899
Increase / (Decrease) in Deposit Liability	111,225
Increase / (Decrease) in Prize Liability	(1,857,570)
Total Adjustments	<u>5,836,930</u>
Net Cash Provided (Used) by Operating Activities	<u>\$ 570,886,223</u>
<b>Noncash Investing and Capital and Related Financing Activities:</b>	
Net Change in Fair Value of Investments	<u>\$ (2,849,641)</u>
<b>Total Noncash Investing and Capital and Related Financing Activities</b>	<u>\$ (2,849,641)</u>

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



STATE OF OREGON  
**OREGON STATE LOTTERY**  
**NOTES TO THE FINANCIAL STATEMENTS**  
JUNE 30, 2006

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, 2006**

**1. Sales Revenue Recognition**

Revenues for on-line games (Megabucks<sup>SM</sup>, Powerball<sup>®</sup>, Keno, Win for Life<sup>SM</sup>, Sports Action<sup>SM</sup>, Scoreboard<sup>SM</sup>, Pick 4<sup>SM</sup>, and Lucky Lines<sup>SM</sup>) 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 \$1,339,799 in fiscal year 2006.

**2. Prize Expense Recognition**

Instant ticket prize expense is recognized when ticket packs are activated and is based on game structure. Since prizes over \$26 are randomly placed throughout the population of tickets for each game and some tickets will be lost, destroyed, or unredeemed for other reasons, there will be differences between amounts accrued and the amounts actually paid. When validations for the game have closed, these differences will reduce prize expense and prize liability.

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 fiscal year.

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2006**

**a. Cash and Cash Equivalents**

Cash and cash equivalents include cash on hand, test cash held by employees, 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.

**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 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 Scratch-It<sup>SM</sup> instant 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. 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 (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 (winning shares known to be sold and not presented for payment within one year from the draw date or official end of a game) 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 eight 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 compensation 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, 2006, and includes applicable tax and retirement costs.

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2006**

The total liability for the Lottery as of June 30, 2006 was \$1,827,649. It is estimated that 25 percent of this liability will be used in years subsequent to 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)).

**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 2006 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 2006 the Lottery operated within legal constraints.

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<sup>1</sup> Attorney General Opinion #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, 2006**

	<u>Traditional Lottery</u>	<u>Video Lottery</u>	<u>Total</u>	
<b>Revenues</b>				
Sales (Net of Provision for Bad Debt)	\$ 363,085,580	\$ 10,928,760,793	\$ 11,291,846,373	
Other Distributable Income	(1,840,387)	7,324,994	5,484,607	
<b>Total Distributable Revenue</b>	<b>\$ 361,245,193</b>	<b>\$ 10,936,085,787</b>	<b>\$ 11,297,330,980</b>	
<b>Distribution of Revenues</b>				
<b>Revenues Returned to the Public</b>				
Prizes	\$ 236,638,134	\$ 10,195,900,424	\$ 10,432,538,558	92.35%
Transfers Paid/Due to Economic Development Department	68,947,500	462,084,611	531,032,111	4.70%
<b>Total Revenues Returned to the Public</b>	<b>\$ 305,585,634</b>	<b>\$ 10,657,985,035</b>	<b>\$ 10,963,570,669</b>	
<b>Administrative Expenses</b>	<b>58,349,526</b>	<b>235,786,192</b>	<b>294,135,718</b>	<b>2.60%</b>
<b>Retained for Contingency Reserve</b>	<b>(2,689,967)</b>	<b>42,314,560</b>	<b>39,624,593</b>	<b>0.35%</b>
<b>Total Revenue Distribution</b>	<b>\$ 361,245,193</b>	<b>\$ 10,936,085,787</b>	<b>\$ 11,297,330,980</b>	<b>100.00%</b>

Actual prizes paid to the public are \$10,427,554,914 (prize expense less unclaimed prizes), which is 92.30 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 prizes as unclaimed when it is known that winning shares have been sold and they have not been redeemed within one year of the end of the game or one year from the draw date. In fiscal year 2006, prizes in the amount of \$4,993,644 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 2006, \$39,624,593 of profit was retained by the Lottery, leaving the June 30, 2006 unrestricted balance at \$95,897,724. This balance is reported as Unrestricted Net Assets on the Balance Sheet. The following table shows the liquidity detail of the Unrestricted Net Assets:

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2006**

Inventory, Prepaid Expenses, Non-current Cash Equivalents	\$ 6,264,140
Committed for Asset Purchases (See discussion in Note VI)	46,300,538
Committed for Approved Capital Purchases (Non-Video Lottery Terminal)	2,481,113
Available for Future Investment	40,851,933
<b>Total Unrestricted Net Assets</b>	<b>\$ 95,897,724</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 \$39,624,593 retained by the Lottery. Actual cash transferred, including unclaimed prizes, during fiscal year 2006 is \$483,640,880. 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, 2005</b>	<b>Amounts Accrued</b>	<b>Cash Paid to Economic Development</b>	<b>Balance Remaining at June 30, 2006</b>
<b>Income</b>	\$ 105,528,494	\$ 531,032,111	\$ 478,643,327	\$ 157,917,278
<b>Unclaimed Prizes</b>	1,445,554	4,993,644	4,997,553	1,441,645
	<u>\$ 106,974,048</u>	<u>\$ 536,025,755</u>	<u>\$ 483,640,880</u>	<u>\$ 159,358,923</u>

**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, 2006, was \$256,956,285 and the OSTF reported balance was \$260,025,908. 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

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2006**

with the OSTF can be obtained from the OSTF financial statements available from the “Current OSTF Financial Statement” link at its website:

<http://www.ost.state.or.us/about/boards/OSTF/About.htm>

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 reported 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, 2006. To obtain a copy refer to Note IV.

As of June 30, 2006, the book and MUSL balance was \$2,306,745.

**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 prizes 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.

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 \$115,479,723 as of June 30, 2006. As of June 30, 2006, the fair value of all investments that will mature in the upcoming year is \$13,803,038; the long-term portion was \$101,676,685.

The decrease in fair value for all investments for the fiscal year ended June 30, 2006 was \$2,849,641 and is shown on the Statement of Revenues, Expenses, and Changes in Fund Net Assets as Investment Income/(Loss).

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2006**

**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. Of the Lottery investments \$41,575,677 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.

Concentration of credit risk is defined as the risk of loss attributed to investments in one single issuer. The \$41,575,677 of investments in the RFC represents 36 percent of the Lottery's investment holdings. The Lottery does not have investment policies since Statute and the Oregon Investment Council govern those policies.

**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 affects 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.

	<b>Investment Maturity in Years</b>				<b>Total Fair Value</b>
	<b>Less than 1 Year</b>	<b>1-5 Years</b>	<b>6-10 Years</b>	<b>More Than 10 Years</b>	
<b>RFC</b>	\$ 4,424,762	\$ 17,096,108	\$ 16,043,748	\$ 4,011,059	\$ 41,575,677
<b>US Treasury Obligations</b>	9,378,276	28,028,935	16,181,265	20,315,570	73,904,046
<b>Total Investments</b>	<u>\$ 13,803,038</u>	<u>\$ 45,125,043</u>	<u>\$ 32,225,013</u>	<u>\$ 24,326,629</u>	<u>\$115,479,723</u>

**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 2006 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.

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2006**

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, 2006, the State had no credit risk exposure to borrowers related to securities on loan.

Security lending balances of the OSTF for fiscal year 2006 can be obtained in the financial statements for the OSTF available on its 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 as of June 30, 2006 is presented in the following schedule:

	<b><u>Securities Lending Balances</u></b>		
	Securities on	Cash Collateral	Fair Value of
	Loan at Fair Value		Invested Collateral
Lottery Share OSTF	\$ 32,428,754	\$ 33,095,589	\$ 33,065,929
Lottery Investments	33,613,735	34,318,469	34,173,773
Total Security Loans	<u>\$ 66,042,489</u>	<u>\$ 67,414,058</u>	<u>\$ 67,239,702</u>

**D. Capital Assets**

Capital asset activity for the year ended June 30, 2006 is shown in the following schedule:

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2006**

	<b>Beginning</b>			
	<b>Balance</b>	<b>Additions</b>	<b>Disposals</b>	<b>Ending Balance</b>
<b><u>Depreciable Capital Assets</u></b>				
Equipment	\$ 73,031,715	\$ 30,406,284	\$ (7,389,898)	\$ 96,048,101
Vehicles	3,808,061	596,749	(484,371)	3,920,439
Building and Improvements	11,042,710	78,047	-	11,120,757
Leasehold Improvements	71,436	-	-	71,436
Computer Software	3,684,957	3,941,682	-	7,626,639
<b>Total Assets Being Depreciated</b>	<b>\$ 91,638,879</b>	<b>\$ 35,022,762</b>	<b>\$ (7,874,269)</b>	<b>\$ 118,787,372</b>
<b><u>Accumulated Depreciation</u></b>				
Equipment	\$ 37,703,187	\$ 9,109,076	\$ (7,372,659)	\$ 39,439,604
Vehicles	2,199,928	303,192	(322,697)	2,180,423
Building and Improvements	2,594,605	324,062	-	2,918,667
Leasehold Improvements	54,145	7,669	-	61,814
Computer Software	1,534,798	1,275,876	-	2,810,674
<b>Total Accumulated Depreciation</b>	<b>\$ 44,086,663</b>	<b>\$ 11,019,875</b>	<b>\$ (7,695,356)</b>	<b>\$ 47,411,182</b>
<b>Net Value of Depreciable Assets</b>	<b>\$ 47,552,216</b>	<b>\$ 24,002,887</b>	<b>\$ (178,913)</b>	<b>\$ 71,376,190</b>

**E. Non-Current Liabilities**

As of June 30, 2006, there were 65 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 two 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 \$15,716,497 in estimated and actual prizes won that have not yet been claimed.

	<b><u>Non-Current Liabilities</u></b>					
	<b>Beginning Balance</b>	<b>Increases</b>		<b>Decreases</b>	<b>Ending Balance</b>	<b>Due Within One</b>
	<b>July 1, 2005</b>	<b>Increases</b>	<b>Decreases</b>	<b>June 30, 2006</b>	<b>Year</b>	
Compensated Absences	\$ 1,667,750	\$ 408,862	\$ 248,963	\$ 1,827,649	\$ 1,370,737	
Prizes	138,047,435	841,299,077	848,150,292	\$ 131,196,220	\$ 29,519,535	
<b>Total</b>	<b>\$ 139,715,185</b>	<b>\$ 841,707,939</b>	<b>\$ 848,399,255</b>	<b>\$ 133,023,869</b>	<b>\$ 30,890,272</b>	

**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 during fiscal year 2006:

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2006**

<u>Revenue</u>		<u>Prize Expense</u>	
Cash Received	\$ 2,067,853,303	Cash Paid Out	\$ 1,334,964,866
Dollars Won and Played	8,860,935,558	Dollars Won and Played	8,860,935,558
<b>Total Revenue</b>	<b><u>\$ 10,928,788,861</u></b>	<b>Total Prizes</b>	<b><u>\$ 10,195,900,424</u></b>
<b>Net Revenue = \$732,888,437</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 its 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 Carolina Education Lottery, North Dakota Lottery, Oklahoma 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, 2006. Long-term liabilities of MUSL are limited to 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, 2006 was \$97,795.

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2006**

The following schedule presents the summarized financial activity of MUSL as of June 30, 2006 and 2005. 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>2006</u>	<u>2005</u>
Assets	\$ 1,054,180	\$ 1,138,782
<b>Total Assets</b>	<u>\$ 1,054,180</u>	<u>\$ 1,138,782</u>
Liabilities	\$ 1,053,968	\$ 1,138,556
Net Assets - Unrestricted	<u>212</u>	<u>226</u>
<b>Liabilities and Net Assets</b>	<u>\$ 1,054,180</u>	<u>\$ 1,138,782</u>
Unrestricted Revenues	\$ 2,694	\$ 3,521
Unrestricted Expenses	<u>2,708</u>	<u>3,518</u>
<b>Change in Unrestricted Net Assets</b>	<u>\$ (14)</u>	<u>\$ 3</u>

**V. Lease Commitments**

Operating leases are rental agreements in which the payments are expensed as rent.

**A. Long-term Operating Leases**

As of June 30, 2006, 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 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>
2007	\$ 9,623,589
2008	9,228,245
2009	1,819,065
2010	1,819,065
2011	638,241
2012-2015	187,330
<b>Total Minimum Lease Payments</b>	<u><b>\$ 23,315,535</b></u>

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2006**

**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 an 180-day notice.

**C. Fiscal Year 2006 Operating Lease Expense**

The following schedule shows lease expense for the fiscal year ending June 30, 2006:

	<b>Lease/Rent Expense</b>
Video Lottery Terminals	\$ 111,264
Gaming Computer Systems	10,042,014
Land for Salem Headquarters	53,808
Storage Facilities	143,748
Office Machines	62,281
<b>Total Lease/Rent Expense</b>	<b>\$ 10,413,115</b>

**VI. Other Commitments and Contingencies**

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

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

	<b>Commitment Balance Remaining at June 30, 2006</b>
WMS Gaming Inc.	\$ 16,405,800
Spielo Manufacturing Inc.	1,588,048
International Gaming Technologies	28,306,690
	<b>\$ 46,300,538</b>

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2006**

**1. WMS Gaming Incorporated**

In April 2006, the Lottery signed Amendment Number Three, which modified the original purchase agreement with WMS Gaming Inc. signed in November 2003. The Lottery has agreed to purchase 1200 VLT's with a total purchase price of \$13,045,800. Additionally, the Lottery agreed to purchase bases for each terminal at cost plus 10 percent (\$360,000) and purchase the initial set of software for \$1,500,000. Delivery is expected to begin in November 2006.

Included in Amendment Number Three is an option to purchase software upgrades to previously purchased video lottery terminals. This option was exercised in June 2006 for the amount of \$1,500,000. The software will be delivered in Fiscal Year 2007.

**2. Spielo Manufacturing Incorporated**

In May of 2005, the Lottery signed a contract amendment to purchase software upgrades for terminals purchased in prior years. The price is \$735,000 and is subject to Lottery approval before acceptance. If accepted, the software purchase price will be payable in July 2006. The Lottery also agreed to purchase memory upgrades for 2300 terminals purchased in prior years. The total cost is not to exceed \$855,600. The Lottery received a small number of these upgrades in June 2006.

**3. International Gaming Technologies**

In March 2006, the Lottery entered into Amendment Number 9, which modified an agreement effective in August 2001. The amendment commits the Lottery to purchase 2300 video lottery terminals, bases and network interface cards. The total purchase amount is \$25,631,200. A small number of these terminals were received in 2006.

In the same amendment, the Lottery agreed to purchase software upgrades for 300 previously purchased terminals for \$180,000. Lottery intends to order an additional 2300 Network Interface Cards for previously purchased terminals for \$920,000.

The Lottery is still completing purchases included in Amendment Number 4, which was signed in May 2005. In Fiscal Year 2007, the Lottery is committed to purchase \$2,400,000 in software upgrades to previously purchased 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

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2006**

agency is required to reimburse the Department of Employment for benefit payments made to its 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, 2006. Consequently, this potential obligation is not included in the accompanying financial statements. Total reimbursements for the fiscal year 2006 were \$16,070.

**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 the 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 2006 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 was 8.04 percent through February 28, 2006 and 4.43 percent through June 30, 2006. Lottery contributions for the year ending June 30, 2006 were approximately \$97,000. Contributions for fiscal year 2005 were approximately \$44,000.

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. During fiscal year 2006 the Lottery contributed 8.69 percent of covered salary. The Lottery contributed approximately \$1,388,000 for the employer portion in fiscal year 2006. The amounts contributed by the Lottery for both the employer's contribution and the

**Oregon State Lottery**  
**Notes to the Financial Statements (continued)**  
**June 30, 2006**

employee's contribution for the fiscal years 2005 and 2004 were approximately \$799,000 and \$1,745,000, 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. Contributions made prior to establishment of the IAP remain in the members' PERS accounts. Lottery contributions for employee shares for the year ending June 30, 2006 were approximately \$1,038,000, and for fiscal year 2005 were approximately \$977,000.

**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. Lottery contributions for debt service requirements for the year ending June 30, 2006 were approximately \$1,122,000, and for fiscal year 2005 approximately \$1,149,000.

**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 2006 share of the 2005-2007 biennial assessment was \$521,959.

Insurance recoveries during the fiscal year totaled \$34,111 and are included in "Other Income" shown on the financial statements. This amount includes recoveries from the Insurance Fund as well as amounts received from other insurers.



**SUPPLEMENTARY INFORMATION**



**STATE OF OREGON**  
**OREGON STATE LOTTERY**  
**SUPPLEMENTARY INFORMATION**  
**BUDGETARY BASIS INCOME STATEMENT\***  
**FOR THE FISCAL YEAR ENDED JUNE 30, 2006**  
*(See Note II(A) - Legal Compliance)*

	<u>Actual</u>	<u>Budget</u>	<u>Variance</u> <u>Favorable/</u> <u>(Unfavorable)</u>
<b><u>Revenue</u></b>			
Scratch It	\$ 127,244,323	\$ 127,300,000	\$ (55,677)
Breakopen	1,671,571	1,674,000	(2,429)
Megabucks	37,771,877	37,201,000	570,877
Powerball	59,070,621	59,911,000	(840,379)
Sports Action	12,105,674	12,106,000	(326)
Scoreboard	643,913	644,000	(87)
Keno	116,240,045	117,780,000	(1,539,955)
Pick 4	1,405,501	1,405,000	501
Win For Life	5,914,469	5,949,000	(34,531)
Lucky Lines	1,018,520	925,000	93,520
Video Lottery (Gross Receipts)	10,928,788,861	10,934,231,000	(5,442,139)
<b>Total Revenue</b>	<b>\$ 11,291,875,375</b>	<b>\$11,299,126,000</b>	<b>\$ (7,250,625)</b>
Prize Expense	10,435,388,200	10,445,997,200	10,609,000
<b>Net Revenue</b>	<b>\$ 856,487,175</b>	<b>\$ 853,128,800</b>	<b>\$ 3,358,375</b>
<b><u>Direct Expenses</u></b>			
Retailer Commissions	\$ 218,013,133	\$ 212,419,000	\$ (5,594,133)
Game Vendor Charges	10,227,113	10,495,256	268,143
Tickets	4,461,315	4,552,000	90,685
Advertising	6,434,796	7,038,040	603,244
Sales Support	1,772,169	2,078,529	306,360
Game Equipment/Parts & Maintenance	2,744,653	4,234,209	1,489,556
Research	573,088	571,950	(1,138)
Depreciation	8,920,343	11,335,575	2,415,232
Public Information	200,570	225,000	24,430
<b>Total Direct Expense</b>	<b>\$ 253,347,180</b>	<b>\$ 252,949,559</b>	<b>\$ (397,621)</b>
<b>Gross Profit</b>	<b>\$ 603,139,995</b>	<b>\$ 600,179,241</b>	<b>\$ 2,960,754</b>
<b><u>Indirect Revenue</u></b>			
Other Income	<b>\$ 8,305,247</b>	<b>\$ 1,194,300</b>	<b>\$ 7,110,947</b>
<b><u>Indirect Expenses</u></b>			
Public Information	\$ 3,658,076	\$ 3,887,900	\$ 229,824
Personal Services	26,995,520	29,181,975	2,186,455
Services & Supplies	8,035,410	10,415,756	2,380,346
Depreciation	2,099,532	2,208,775	109,243
<b>Total Indirect Expenses</b>	<b>\$ 40,788,538</b>	<b>\$ 45,694,406</b>	<b>\$ 4,905,868</b>
<b>Net Profit</b>	<b>\$ 570,656,704</b>	<b>\$ 555,679,135</b>	<b>\$ 14,977,569</b>

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



## **OTHER REPORTS**



**Office of the Secretary of State**

Bill Bradbury  
Secretary of State

Jean Straight  
Deputy Secretary of State



**Audits Division**

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The Honorable Ted Kulongoski  
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Steven Ungar, 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, 2006, and have issued our report thereon dated November 3, 2006. 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 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.

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 those specified parties.

OREGON AUDITS DIVISION

Bill Bradbury  
Secretary of State

November 3, 2006

# **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	William K. Garber, MPA, CGFM
Deputy Director	Mary E. Wenger, CPA

## **Audit Team**

V. Dale Bond, CPA, CFE, CISA Audit Manager  
Raul Valdivia, CPA, CFE  
Nicole Real  
Byron Williams

This report, a public record, is intended to promote the best possible management of public resources. Copies may be obtained from:

internet: <http://www.sos.state.or.us/audits/index.html>

phone: 503-986-2255

mail: Oregon Audits Division  
255 Capitol Street NE, Suite 500  
Salem, OR 97310

*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***

