



www.vtlottery.com

**ANNUAL
REPORT
FISCAL YEAR 2004**

1311 US Route 302 - Berlin

Barre, Vermont 05641

Phone 802-479-5686 • 800-322-8800 (in Vermont)

Fax 802-479-4294



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It is our pleasure to present the annual report on the accomplishments of the Vermont Lottery Commission (Lottery) for fiscal year (FY) 2004. The year started out on July 1, 2003 with the introduction of a new multi-jurisdictional lottery game, Powerball, to Vermont players. Powerball helped the Lottery increase its overall sales by 16.3% over FY 2003, up to \$92.4 million, a record sales year for the Lottery. This also created a \$3.4 million (6.2%) increase in the Lottery's FY 2004 contribution to the state's Education Fund, for a total of \$19.5 million.

When the General Assembly established the Lottery in 1977, after a statewide referendum, the Lottery's stated purpose in the enabling legislation was to **"produce the maximum amount of net revenue consonant with the dignity of the state and the general welfare of the people."** Thus the balance between providing funds for the state's Education Fund and a strong "Play Responsibly" message to the public.

Over the last 25 years, the Vermont Lottery has produced over \$1.1 billion in overall sales. From those sales, over \$686 million has been returned to players in the form of prizes, over \$62 million has been paid to local lottery agents in the form of commissions, and over \$320 million went to the state's General or Education Funds.

As FY 2004 was ending, the Lottery was preparing to move from its South Barre location (since 1985), and into a new leased space on the Barre-Montpelier Road. The new space will allow for the combining of existing warehouse spaces and the storage of more instant tickets on-site. This will then allow for the more timely distribution of the instant ticket product.

As we move to FY 2005, and beyond, the Lottery needs to plan for the future of its existing game mix. It needs to develop and utilize new types of games, as well as explore how to use our web site and the Internet to keep in touch with our players, and respond to their interests. These are some of the public policy questions that need to be addressed in the future, in order for the Lottery to continue growing its contribution to the state's Education Fund.

The staff and Commissioners of the Lottery are proud of their past contributions to the State of Vermont, and look forward to increasing the contributions to the Education Fund in the next fiscal year, and beyond.

Martha H. O'Connor, Chair

Alan R. Yandow, Executive Director



1976

In a 1976 referendum regarding the establishment of a state lottery, 66% of those casting ballots voted in favor of the proposal. Based on those results, Public Act No. 82 was enacted by the 1977 General Assembly establishing the Vermont Lottery Commission. The Act also provided for termination of the Lottery on June 30, 1980, unless the 1979 Assembly authorized continuation.

1978

The Vermont Lottery Commission was granted \$250,000 in seed money, which was paid back in full to the state eighteen months later. It took the Lottery seven months from the Commission's inception to produce its first ticket, Green Mountain Game, which went on sale to the public on February 14, 1978. The game was based on a weekly drawing of numbers matched to preprinted numbers on a game ticket. The Lottery's first Instant ticket, Scratch'N Match, went on sale to the public on June 20, 1978.

1979

A steady rise in lottery ticket sales resulted in approval by the 1979 legislature to continue the mission of the Vermont Lottery. Authorization providing for indefinite continuation of the Vermont Lottery was subsequently passed by the 1981 General Assembly.

1998

Since its inception, all profits generated by the Vermont Lottery were dedicated for use by the state's General Fund. In July 1998, the Vermont legislature mandated that all profits from the Lottery go to the state's Education Fund.

2004

The Vermont Lottery continued to be run by a small, efficient staff of professionals consisting of 20 full-time employees and five commissioners. It is still one of the smallest staffs of any lottery in the United States, yet it generated \$92.4 million in ticket revenue during fiscal year 2004 or \$4.62 million per employee.

The Vermont Lottery Commission consists of five members appointed by the governor with the advice and consent of the state senate. The members are appointed for a three-year term and may not have any pecuniary interest in any contract awarded pursuant to Chapter 14 of Title 31 V.S.A. The Commission is responsible for the public oversight and policies of the Vermont Lottery, and no more than three Commission members may belong to the same political party.

In fiscal year 2004, the Vermont Lottery offered six different products to customers: Instant Games, Vermont Powerball, Tri-State Megabucks, Tri-State Heads or Tails (previously Tri-State Cash Lotto) and the Tri-State Daily Numbers Games, Pick 3 and Pick 4. Vermont Lottery games are designed to provide fun and entertainment to a broad consumer base by offering an assortment of game options, multiple price points, a range of prize levels, varying odds, and a mixture of themes and play styles.

Instant Games

Instant games are sold by all licensed Vermont Lottery agents. Instant games, also referred to as “scratch off tickets,” are paper tickets with latex-covered play areas that when scratched instantly reveal if a player has won. In FY04, Instant tickets accounted for 74.5% of total lottery product sales, the largest revenue source for the Vermont Lottery. Multiple games were on the market offering players a variety of price points, play styles, prize levels, top prizes and themes. In FY04, Instant ticket cash prizes ranged from \$1 to \$55,555; other prizes included large screen plasma televisions and DVD players.



The prize payout, which is the percentage of money that goes back to players in the form of prizes, ranged from 64% to 75% per game, with an overall payout of 66.6%. This translates to approximately \$45.8 million won in prizes for the Instant product in FY04.

The Vermont Lottery released 52 Instant games in FY04. Of those games, 22 were \$1 games, 12 were \$2 games, three were \$3 games, 10 were \$5 games and five were \$10 games. Eighteen to 22 Instant games were on the market simultaneously throughout the fiscal year. An assortment of price points, themes, play styles and prize structures were offered to provide fun and entertainment to a broad consumer base.

Vermont Powerball

The Vermont Lottery began offering Powerball to Vermonters on July 1, 2003. Powerball is a multi-jurisdictional game that offers multi-million dollar jackpots. During FY04, Powerball was played in 27 states, Washington, DC and the US Virgin Islands.



In FY04 the Powerball game was played by selecting five numbers from one to 53. In addition, a sixth Powerball number was selected from one to 42. Players could also multiply their non-jackpot prizes by 2, 3, 4 or 5 by choosing to Power Play their numbers. The Power Play option cost an additional \$1 per set of numbers played. The odds of winning the jackpot were 1 in 120 million. The jackpot prize was offered in 30 annual installments or in a one-time lump

cash sum payment. The cash payment was approximately half the advertised estimated jackpot amount. Winners had 60 days from ticket validation at Lottery headquarters to select a one-time cash payment or annual installments.

Since the game's first draw on April 22, 1992, Powerball draws have been held at ITC Studios in West Des Moines, Iowa. In FY04, Powerball draws were held on Wednesday and Saturday at 10:59 PM ET. Draws were aired on WCAX TV at 11:00 PM ET.

Powerball jackpots started at an annuitized \$10 million and reached \$261.3 million in FY04. There were no jackpot winners in Vermont. Vermont Powerball players won \$2,805,730 in other prizes; this amount includes one \$500,000 winner, one \$400,000 winner, one \$200,000 winner and four \$100,000 winners.

Tri-State Megabucks

Vermont, New Hampshire and Maine formed Tri-State Megabucks in 1985. Megabucks has changed several times since 1985 to create the game that players enjoyed in FY04. When the first draw was held on September 14, 1985, players selected six numbers from one to 30, and the odds of winning the jackpot were one in 593,775. A jackpot winner was paid in 20 annual installments. There was one draw per week that was held on Saturday night. The draw was shown on live television.



In January 1986, the Megabucks game was changed to select six numbers from one to 36. The odds of winning the jackpot increased to one in 1.9 million. The draw was still held on Saturday night. In January 1988, the game was modified to select six numbers from one to 40. This increased the jackpot odds to one in 3.8 million. One draw was held weekly on Saturday night. In May 1990, the number of draws increased to twice a week, Wednesday and Saturday. The draws continued to air on live television. In June 1996, Megabucks was enhanced to include a feature called, “MegaCash.” This option allowed jackpot winners to take their share of the money available in the jackpot prize pool in a one-time-only, lump-sum payment. The cash option was approximately half of the estimated, annuitized jackpot amount.

The game format available to players in FY04 was the result of changes made to Megabucks in March 1997. At that time, the game was modified to select six numbers from one to 42. A seventh number, called the Bonus Number, was also added. The Bonus Number was drawn after the first six numbers were drawn. This seventh number created four more prize levels by adding more ways for players to match their six numbers to the seven numbers drawn. The odds of winning the jackpot increased to one in 5.2 million. The number of jackpot payments changed from 20 to 25 annual installments. MegaCash remained a jackpot payment option. Prior to fiscal year 2002, the jackpot payment option (cash or annual installments) was determined by the player at the time of purchase. This changed in FY02 to allow a jackpot winner 60 days from ticket validation at the Vermont Lottery headquarters to elect a one-time cash payment or annual installments.

In FY04, Megabucks draws were held at the New Hampshire Lottery headquarters in Concord on Wednesdays and Saturdays at 7:59 PM. Draws were not aired on television. Following the draws, winning numbers “crawls” were aired on WVNY and WNNE.

In FY04, jackpot levels started at a guaranteed annuitized \$500,000 with the highest jackpot amount won reaching \$2.08 million. Vermont had two Megabucks jackpot winners. Megabucks jackpot dollars won by Vermont players totaled \$2,334,503 or 21.5% of total Megabucks jackpot money won. Vermont’s percentage of Megabucks sales in the Tri-State region was 15.4%. The total number of Megabucks jackpot winners in Vermont since the game’s inception through the end of FY04 was 75 or 18% of the total winners in the Tri-State region. Megabucks jackpot dollars won in Vermont since the game began in 1985 and ending June 30, 2004 was \$123,326,131 or 16% of total Megabucks jackpot dollars won in the Tri-State region.

Tri-State Cash Lotto

Tri-State Cash Lotto was the secondary cash game offered to players at the beginning of FY04. The last Cash Lotto drawing was held on November 14, 2003. Cash Lotto was played by selecting six numbers from one to 36. The top prize was a fixed \$200,000 cash prize. The odds of winning the top prize were one in 1.35 million. The first draw was held on March 1, 2002. Draws were held on Tuesday and Friday night at 6:46 PM. The draws were not aired on



television. Following the draws, winning numbers “crawls” were aired on WVNY and WNNE. In FY04, there were two Cash Lotto jackpot winners in the Tri-State region. There were no Vermont jackpot winners. The amount of Cash Lotto dollars won by Vermont players in FY04 totaled \$178,116.

Tri-State Heads or Tails

Tri-State Heads or Tails was the secondary cash game that replaced Tri-State Cash Lotto.



Sales for this game began on November 16, 2003. Heads or Tails was played by selecting five numbers from one to 34 and also selecting heads or tails. The top prize was a fixed \$50,000. If a player had a winning number combination and matched heads or tails as drawn, the prize amount doubled. The odds of winning the top prize were one in 556,512. The first draw was held on November 16, 2003 with draws held daily at approximately 6:50 PM. The draws were not aired on television. Following the draws, winning numbers “crawls” were aired on WVNY and WNNE.

In FY04, there were six Tri-State Heads or Tails jackpot winners. There were no Vermont jackpot winners. The amount of Heads or Tails money won by Vermont players totaled \$352,535.

Tri-State Daily Numbers

Pick 3 was Vermont’s first on-line game. It began on November 10, 1980. Pick 3 has played the same since the game’s inception – by selecting a combination of three numbers from zero to nine. Pick 4 began on September 3, 1985 and has also played the same since its inception – by selecting a combination of four numbers from zero to nine.



The Daily Numbers games became Tri-State games on June 25, 1995. These games were drawn every night from Monday through Saturday at 6:59 PM. On June 7, 1998, a Sunday draw was added. In September 1998, a front pair/back pair feature was added. On June 29, 2003 an additional midday draw was added. In FY04, the draws were not aired on live television. Following the draws, winning numbers “crawls” were aired on WVNY and WNNE.

The amount won depends on the amount played. Pick 3 dollars won by Vermont players in FY04 totaled \$853,336 and the amount won playing Pick 4 totaled \$532,406.

Vermont Lottery Agents

In FY04, there were 782 Lottery sales agents in Vermont. Of those, 627 (total throughout the fiscal year) sold Powerball and Tri-State products. All Lottery agents sold Instant games. Agents received 6% of their total Powerball ticket sales and 5.75% of all other Lottery product sales. In addition, agents received a 1% bonus for selling winning tickets of \$500 and up (agent bonus capped at \$30,000). In FY04, the commission and bonuses paid to agents totaled \$5.4 million.

Top Five Agents in FY04 Commission Earned

1. \$46,221
2. \$41,369
3. \$36,245
4. \$35,205
5. \$26,355

Tri-State Draws

In 1997, Tri-State draws no longer aired on live television. All draw equipment was moved from WMUR-TV in Manchester, New Hampshire to the New Hampshire Lottery's draw room in Concord, New Hampshire. The New Hampshire Lottery draw room was built specifically to conduct draws. When Tri-State draws were held in

FY04, the following Tri-State employees were present: draw supervisor, draw monitor, independent auditor and law enforcement official. All draws were recorded utilizing the following recording devices: 8 mm camera, VHS recorder and 24 hour surveillance camera. After each drawing, the 8 mm footage was stored in a secure off-site facility, where it remains for 14 months.

Phone and Web site

Approximately 30 minutes after winning numbers were drawn, they were updated on the Lottery's toll free line 1-800-322-8800 (in VT) and on the Lottery's web site www.vtlottery.com.

Lottery Agents

Lottery agents received the winning numbers shortly after winning numbers were drawn. In addition, Lottery terminals provided eight days of winning numbers.

The following resources were utilized to provide winning numbers in FY04:

Television

Winning numbers crawls are shown on the following stations:

WPTZ/WNNE	7:15-7:30 PM	Tri-State Daily Numbers & Heads or Tails
	8:15-8:30 PM	Tri-State Megabucks
WVNY	7:15-7:30 PM	Tri-State Daily Numbers & Heads or Tails
	8:15-8:30 PM	Tri-State Megabucks
WCAX	11:00 PM	Powerball Drawing

Responsible Gaming

The Vermont Lottery Commission, in association with the Vermont Council on Problem Gambling, continued its support of efforts to create awareness of resources available to individuals who have concerns about gambling habits. FY04 represented the eighth consecutive year of support for this very important issue.

The Vermont Lottery's partnership with the Vermont Council on Problem Gambling began in FY97. The Lottery's history of promoting responsible gaming includes: providing the Council's toll free number on all Lottery ticket stock and play slips and encouraging responsible play in all advertising. The Lottery's first Responsible Play campaign was executed in FY99. This campaign included radio and television public service announcements, cooperative distribution of a responsible play poster and utilization of the well-known, "Please Play Responsibly" logo on marketing materials.

Responsible Play Support

The Lottery's Responsible Play campaign included the following efforts in FY04:

Partnership with the Vermont Council on Problem

Gambling: The Vermont Lottery and the Vermont Council on Problem Gambling held a strategic planning session at the start of FY04 to develop a Responsible Play plan for the fiscal year. Radio spots were created based on feedback from the Vermont Council, and a Vermont-specific Problem Gambling brochure was produced for the Vermont Council's use and statewide distribution. The Vermont Lottery and the Vermont Council maintained open lines of communication throughout the fiscal year frequently discussing the Vermont Council's needs and making adjustments as necessary.

Media Plan: The Lottery's marketing message was directed at reaching adults who may have discretionary dollars to afford participation in Vermont Lottery games. The media plan used a combination of county per capita income and county per capita in the development of its radio advertising strategy.

Television Campaign: All Vermont Lottery television spots included a message from the Lottery's Executive Director to please play Lottery games responsibly. Additionally, the "Please Play Responsibly" logo was prominently displayed in all spots.

Radio Campaign: A new radio campaign was developed in collaboration with the Vermont Council on Problem Gambling. The two new radio spots rotated with other Lottery radio commercials throughout the year. Furthermore, all Lottery radio spots included a message from the Lottery's Executive Director to, "Please Play Responsibly."

National Council on Problem Gambling: The Lottery's Executive Director Alan Yandow was elected to the Board of Directors of the National Council on Problem Gambling.

National Gambling Awareness Week: During National Gambling Awareness Week, the Lottery only aired Responsible Gaming television and radio.

Vermont Specific Brochure: The Vermont Lottery developed and printed a Vermont specific "Problem Gambling" brochure on behalf of the Vermont Council on Problem Gambling. Ten thousand brochures were printed for statewide distribution by the Lottery and for use by the Vermont Council.

Vermont Council Toll Free Funding: The Lottery provided the financial resources to pay 100% of the expense for toll free calls to the Vermont Council on Problem Gambling.

Vermont Council Reimbursement: The Lottery reimbursed the Vermont Council on Problem Gambling for costs associated with registration and attendance of Problem Gambling conferences.

Responsible Play Message: All advertising messages in print or broadcast media included a "Please Play Responsibly" message. All point-of-sale materials also included the message.

Responsible Gaming on the Website: Information about the council and links to other resources were included on the Lottery's website, www.vtlottery.com.

Logo and Toll Free Number on Lottery Tickets and Play Slips: The "Please Play Responsibly" logo and the Vermont Council's toll free number were printed on all Vermont Lottery tickets and play slips.

18+ and Responsible Message: Agents prominently displayed stickers indicating, “You must be 18 or older to purchase lottery tickets.” These stickers also included the “Please Play Responsibly” logo and the Vermont Council’s toll free number.

Advertising Guidelines: Advertising guidelines developed by the Vermont Lottery were observed in the development of all Lottery marketing materials.

Advertising Awareness

In January 2004, the Lottery commissioned the Center for Research & Public Policy (CRPP) to conduct an advertising effectiveness study to measure awareness and effectiveness of the Lottery’s advertising messages with the Vermont population. Here are some of the highlights:

Impressively, 93.7% of players reported seeing, hearing or reading Vermont Lottery advertising over the past six months. Among non-players, just less than three quarters, 72.8%, suggested the same. Messages with the highest recall included:

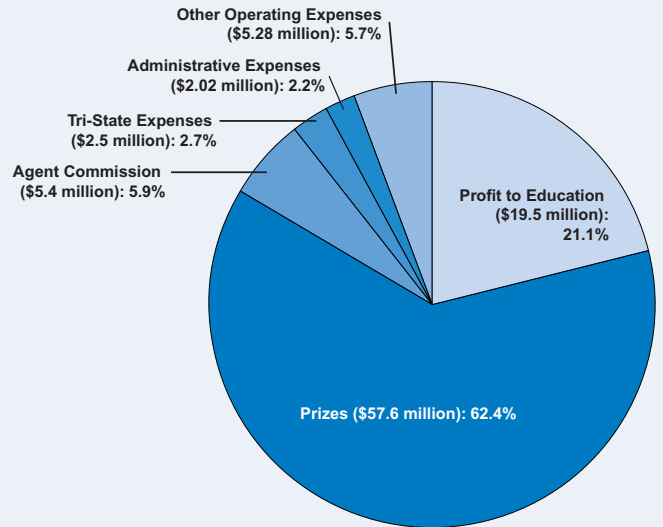
- Play Lottery games responsibly
- Lottery games are good, clean, fun
- Lottery games support education in Vermont

Among players and non-players, characteristics that were given the greatest importance were:

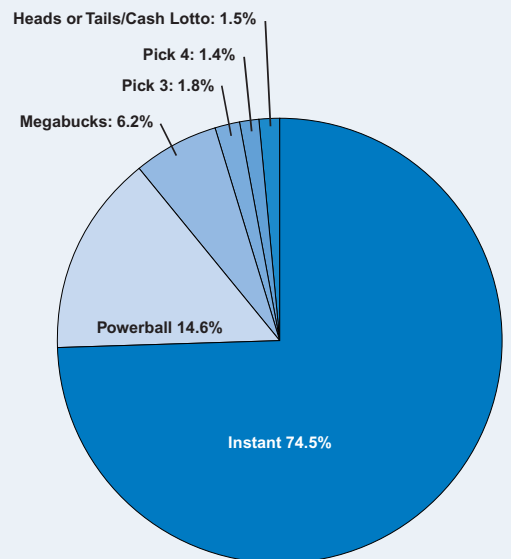
- Conveying the message that the Lottery’s profits go to the Vermont Education Fund
- Conveying the message of playing Vermont Lottery games responsibly

Based on these findings, and others outlined in the report, the Lottery effectively achieved its FY04 goal of continuing strong awareness of the responsible play message and positioning Vermont Lottery games as “good, clean, fun.” An area requiring continued effort on the Lottery’s part is to increase awareness that Lottery games support education in Vermont. This message, while receiving high recall, is of greatest importance to survey respondents and should remain an important Vermont Lottery goal.

Where the money went:



Where the sales were:



Fiscal year 04 ended with overall sales just over \$92 million, up significantly from FY03 due to the addition of the multi-jurisdictional lottery game Powerball. The total contribution to the state's Education Fund was \$19.5 million. This was a 6.2% increase over FY03. In addition to the Education Fund contribution, \$57.6 million was returned to players in the form of prizes, and \$5.4 million went to local Lottery agents as commissions on sales.

Sales

The overall results of sales this year showed an increase of 16.3%. Total sales equaled \$92,380,975.

Ticket sales were as follows:

	<u>2004</u>	<u>2003</u>
Instant	\$68,796,768	\$67,039,784
Pick 3	1,624,206	1,525,141
Pick 4	1,289,896	1,279,347
Megabucks	5,772,315	7,778,071
Heads or Tails/Cash Lotto	1,371,065	1,780,214
Powerball	<u>13,526,725</u>	<u>—</u>
Total Sales	<u>\$92,380,975</u>	<u>\$79,402,557</u>

Instant ticket sales were \$68,796,768. This was a 2.6% increase over FY03. Instant ticket sales represented 74.5% of total sales.

Pick 3 and Pick 4 combined sales were \$2,914,102, a 3.9% increase over FY03. These games represented 3.2% of total sales.

Megabucks sales were \$5,772,315 this year. This was a 25.8% decrease from FY03. Megabucks sales represented 6.2% of total sales.

Heads or Tails/Cash Lotto sales were \$1,371,065, a 23.0% decrease from FY03. These games represented 1.5% of total sales.

Powerball sales were \$13,526,725. This game was new in FY04. Powerball sales represented 14.6% of total sales.

Operating Expenses

Administrative costs for the Lottery were \$2,019,673, an increase of \$258,510 over FY03. Administrative costs included salaries, benefits, contracted services, supplies, and all other costs in the Lottery's annual budget appropriation from the legislature. This budget appropriation came from Lottery revenues.

Other operating expenses included lottery tickets, depreciation, equipment, and facilities management fees to our Powerball and Instant ticket gaming system vendor, Scientific Games, International. The total cost of operations for FY04 was \$7,321,848, an increase of \$3,052,645 over FY03, which includes the administrative costs of \$2,019,673 mentioned above.

Tri-State Expenses

The Tri-State operating, communications, and facilities management costs decreased in FY04 by \$894,493. This was due mainly to a decrease in the facilities management fee rate. This fee was calculated as a percentage of Tri-State sales, which also declined.

Prizes and Commissions

As these costs were related to sales, prize expense and local lottery agent commissions increased by 12.3% over FY03. Instant games paid an average of 67% of sales back to players, the same percent as FY03.

Net Profit

The net profit of \$19.5 million was an increase of 16.9% over FY03. The increase is attributable mainly to an increase in sales. The total contribution to the state's Education Fund in FY04 was \$19.5 million.

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Mudgett, Jennett & Krogh-Wisner, P.C.

Certified Public Accountants #435

To the Commissioners of the
Vermont Lottery Commission:

We have audited the accompanying basic financial statements of the Vermont Lottery Commission, an enterprise fund of the State of Vermont, as of and for the years ended June 30, 2004, and 2003 as listed in the table of contents. These financial statements are the responsibility of the Vermont Lottery Commission's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audits 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Vermont State Lottery and are not intended to present the financial position of the State of Vermont and the results of its operations and cash flows of its proprietary fund types and non-expendable trust funds 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 Vermont Lottery Commission as of June 30, 2004, and 2003, and the changes in its financial position and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 25, 2004, on our consideration of the Vermont Lottery Commission's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The Management's Discussion and Analysis on page 11 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board (GASB). We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

*Mudgett, Jennett &
Krogh-Wisner, P.C.*

Montpelier, Vermont
August 25, 2004

This discussion of the Vermont Lottery Commission's financial performance provides an overview of the Commission's financial activities for the fiscal year ended June 30, 2004. Please read it in conjunction with the financial statements.

The Vermont Lottery Commission is an enterprise fund of the State of Vermont. The Commission's operations are classified as business-type activities and reported in a manner similar to commercial entities.

Financial Highlights

- Gross revenues for lottery gaming activities increased by \$12,978,418 or 16.3%.
- Total operating expenses for the year increased by \$8,659,624 or 13.6%. Of this increase, prize expense increased by \$6,186,082, facilities management fees increased by \$2,747,210, agent commissions increased by \$804,166, Tri-State expenses decreased by \$894,493 and all other operating expenses decreased by \$183,341.
- Non-operating revenues decreased by \$618,785. This was due to an unrealized loss on investments.
- Net income increased by \$3,698,226.

Assets and Net Assets

The assets of the Commission are primarily cash and investments held for operating purposes. The Commission also owns furniture and equipment. Total assets at June 30, 2004, of \$7,195,992 include capital assets of \$84,786, restricted investments of \$3,835,239 and other operating assets such as cash and cash equivalents, accounts receivable and inventory of \$3,275,967. Net assets retained by the Commission are \$697,834.

Total assets at June 30, 2003 of \$6,196,005 include capital assets of \$79,666, restricted investments of \$4,371,623 and other operating assets such as cash and cash equivalents, accounts receivable and inventory of \$1,744,716. Net assets retained by the Commission at June 30, 2003 were \$397,531.

Liabilities

The Commission's liabilities consist of operating liabilities and obligations for payment of prizes to lottery winners. Total liabilities at June 30, 2004, of \$6,498,158 include long-term liabilities for prize obligations of \$2,959,067, cash advances from the State of \$300,000 and other operating liabilities of \$3,239,091.

Total liabilities at June 30, 2003, of \$5,798,474 include long-term liabilities for prize obligations of \$2,906,816, cash advances from the State of \$300,000 and other operating liabilities of \$2,591,658.

Sales	2004	2003
Instant scratch off games	\$68,796,768	\$67,039,784
Online Games:		
Pick 3	1,624,206	1,525,141
Pick 4	1,289,896	1,279,347
Cash Lotto/Heads or Tails	1,371,065	1,780,214
Powerball	13,526,725	—
Megabucks	5,772,315	7,778,071
Total Sales	<u>\$92,380,975</u>	<u>\$79,402,557</u>

Prizes

In general, prize expense by game will increase or decrease from year to year in proportion to the increase or decrease in sales for a particular game. However, the online game prize expense is also impacted by the luck of the draw. Prize expense for the instant games product category is controllable, to a large degree, by printing a predetermined number and value of winning tickets in the production of each instant game. Prize expense for all other lottery products is not predetermined. While each of these lottery products is designed to yield a certain ratio of prizes to sales over a large number of drawings, actual prize payout is determined by lottery players' luck in matching the particular set of numbers randomly selected in each drawing for each game.

	2004	2003
Prize expense—Instant games	\$45,819,723	\$45,031,460
Prize expense—Online games	\$11,766,393	\$ 6,368,573

Other Potentially Significant Factors

The financial position and operating results for 2004 were improved over 2003 due to the offering of the Powerball game beginning July 1, 2003.

The Lottery is a highly visible governmental activity. Its mission is to operate a State Lottery that will produce the maximum amount of net revenue consonant with the dignity of the State and general welfare of the people. There are a number of revenue-enhancing opportunities generally available to the lottery industry. These options, if deemed to be consonant with the general welfare of the people by those in the executive branch and/or legislature, may be considered in future years.

ASSETS

	<u>2004</u>	<u>2003</u>
Current assets:		
Cash and cash equivalents (Note 2)	\$ 1,533,023	\$ 583,725
Accounts receivable (Note 5)	1,056,015	508,252
Due from the State Education Fund	–	214,660
Inventory (Note 6)	<u>686,929</u>	<u>438,079</u>
Total current assets	<u>3,275,967</u>	<u>1,744,716</u>
Restricted and noncurrent assets:		
Investments (Note 4)	3,835,239	4,371,623
Property and equipment,		
less accumulated depreciation (Note 7)	<u>84,786</u>	<u>79,666</u>
Total restricted and noncurrent assets	<u>3,920,025</u>	<u>4,451,289</u>
 Total assets	 <u>\$ 7,195,992</u>	 <u>\$ 6,196,005</u>

LIABILITIES AND NET ASSETS

LIABILITIES:

Current liabilities:		
Accounts payable (Note 8)	\$ 1,075,756	\$ 247,524
Accrued leave	65,102	80,551
Accrued payroll	51,037	29,793
Current – Due to winners (Note 9)	463,431	349,717
Due to State Education Fund	14,452	730,713
Reserve for future and unclaimed prizes (Note 10)	1,391,803	879,715
Deferred revenue (Note 11)	<u>177,510</u>	<u>273,645</u>
Total current liabilities	<u>3,239,091</u>	<u>2,591,658</u>
 Liabilities payable from restricted assets:		
Non-current – Due to winners (Note 9)	2,959,067	2,906,816
Cash advances by State Treasurer	<u>300,000</u>	<u>300,000</u>
Total long-term liabilities	<u>3,259,067</u>	<u>3,206,816</u>
 Total liabilities	 <u>6,498,158</u>	 <u>5,798,474</u>
 NET ASSETS:		
Invested in capital assets	84,786	79,666
Unrestricted (Note 12)	<u>613,048</u>	<u>317,865</u>
Total net assets	<u>697,834</u>	<u>397,531</u>
 Total liabilities and net assets	 <u>\$ 7,195,992</u>	 <u>\$ 6,196,005</u>

	<u>2004</u>	<u>2003</u>
OPERATING REVENUE:		
Ticket sales	\$ 92,380,975	\$ 79,402,557
Agents' license fees and other receipts	8,107	9,890
Total operating revenues	<u>92,389,082</u>	<u>79,412,447</u>
OPERATING EXPENSES:		
Cash prizes	57,586,115	51,400,033
Commissions – agents	5,394,848	4,590,682
Personal services	1,068,069	1,053,634
Lottery tickets	613,330	1,528,323
Provision for future payments to winners (Note 9)	488,212	–
Other operating expenses	919,708	681,729
Depreciation	33,783	56,927
Supplies	31,896	25,800
Instant ticket dispensers	61,084	54,094
Provision for bad debts	3,650	11,774
Courier system	161,564	152,356
Facilities management fee – instant	1,729,945	701,285
Facilities management fee – online	1,718,550	–
Tri-State expenses	2,505,744	3,400,237
Total operating expenses	<u>72,316,498</u>	<u>63,656,874</u>
OPERATING INCOME	<u>20,072,584</u>	<u>15,755,573</u>
NONOPERATING REVENUES (EXPENSES):		
Loss on disposal of fixed assets	–	(3,280)
Investment income (loss)	(151,754)	470,311
Total nonoperating revenues (expenses)	<u>(151,754)</u>	<u>467,031</u>
INCOME BEFORE OPERATING TRANSFERS	19,920,830	16,222,604
NET PROFIT TRANSFERRED TO THE STATE OF VERMONT EDUCATION FUND	(19,580,527)	(16,222,604)
TRANSFER TO VERMONT DEPARTMENT OF HEALTH	<u>(40,000)</u>	<u>–</u>
INCREASE IN NET ASSETS	<u>300,303</u>	<u>–</u>
NET ASSETS , beginning of year	<u>397,531</u>	<u>397,531</u>
NET ASSETS , end of year	<u>\$ 697,834</u>	<u>\$ 397,531</u>

	<u>2004</u>	<u>2003</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from customers	\$91,737,077	\$79,502,346
Cash paid for prizes and agents' commissions	(62,302,910)	(55,989,673)
Cash paid for management fees, operations and other	(7,654,301)	(7,292,158)
Cash paid to employees for services	(1,062,274)	(793,597)
Other operating revenue	8,107	9,890
Net cash provided by operating activities	<u>20,725,699</u>	<u>15,436,808</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Operating transfers	(20,122,128)	(15,534,133)
Advances (Reimbursements) to the State Treasurer	-	(200,000)
Net cash used in noncapital financing activities	<u>(20,122,128)</u>	<u>(15,734,133)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Acquisition of property and equipment	(38,903)	(13,750)
Net cash used in capital and related financing activities	<u>(38,903)</u>	<u>(13,750)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Investment income	50,630	96,039
Proceeds from maturities of investments	334,000	434,000
Net cash provided by investing activities	<u>384,630</u>	<u>530,039</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	949,298	218,964
CASH AND CASH EQUIVALENTS , beginning of year	<u>583,725</u>	<u>364,761</u>
CASH AND CASH EQUIVALENTS , end of year	<u>\$ 1,533,023</u>	<u>\$583,725</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating income	<u>\$20,072,584</u>	<u>\$ 15,755,573</u>
Adjustments to reconcile operating income to net cash provided by operating activities –		
Depreciation	33,783	56,927
(Increase) decrease in the following assets:		
Accounts receivable	(547,763)	65,013
Inventory	(248,850)	19,944
Increase (decrease) in the following liabilities:		
Accounts payable	828,232	(476,523)
Accrued salaries and benefits	5,795	-
Due to winners	165,965	(414,375)
Reserve for future and unclaimed prizes	512,088	395,472
Deferred revenue	(96,135)	34,777
Total adjustments	<u>653,115</u>	<u>(318,765)</u>
Net cash provided by operating activities	<u>\$20,725,699</u>	<u>\$15,436,808</u>

1. Summary of significant accounting policies:

The Vermont Lottery Commission (the Lottery) was created by an enactment of the Vermont State Legislature and signed into law by the Governor on April 27, 1977. Title 31, Chapter 14 of the Vermont Statutes is the law under which the Lottery operates. The Lottery is an enterprise fund of the State of Vermont and is managed by a five-member Commission appointed by the Governor for three-year terms. The Commission, by law, has the authority to operate the State lottery, determine the type and forms of lottery games, set the price of lottery tickets, determine the number and size of prizes, select the ticket sales locations and may enter into agreements with another state or states to provide for the operation of the Lottery. Approval of the joint fiscal committee and the Governor shall be required for such contractual agreements with other states.

Fiscal operations of the Lottery commenced in October, 1977. The Lottery's net revenue was transferred to the State of Vermont's General Fund through June 30, 1998. Beginning July 1, 1998, the Lottery's revenue is committed to funding Act 60, and its net revenue is transferred to the State of Vermont Education Fund on a monthly basis.

The Lottery entered into a compact with the states of Maine and New Hampshire known as the Tri-State Lotto. The compact was enacted to implement the operation of Tri-State Lotto for the purpose of raising additional revenue for each of the party states. Vermont's portion of the Tri-State Lotto operations is accounted for by the Lottery.

In July 2003, the Lottery entered into an agreement with the Multi-State Lottery Association (MUSL) for the inclusion of the Powerball game.

A. Reporting entity – The Lottery is included in the State of Vermont's financial statements as an enterprise fund. In accordance with governmental accounting and financial reporting standards, there are no component units to be included within the Lottery's financial statements as a reporting agency.

B. Measurement focus and basis of accounting – The financial statement presentation follows the recommendations of the Governmental Accounting Standards Board (GASB) in its Statement No. 34, *Basic Financial*

Statements – and Management's Discussion and Analysis – for State and Local Governments. The Lottery uses the economic resources measurement focus and the accrual basis of accounting whereby revenues are recorded when earned and expenses are recorded when the obligation for payment is incurred. The Lottery is classified as an enterprise fund of the governmental proprietary fund type. Enterprise funds account for operations similar to private business enterprises where the intent of the Legislature is that costs are to be financed or recovered primarily through user charges, or where the Legislature has decided that periodic determination of revenue earned, expenses incurred or net income is appropriate. Under this basis of accounting and measurement focus, the Lottery applies all GASB pronouncements and Financial Accounting Standards Board (FASB) Statements and interpretations issued on or before November 30, 1989, except those that conflict with a GASB pronouncement. Governments also have the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The Lottery has elected not to follow subsequent private sector guidance.

C. Revenue recognition – Sales of instant lottery tickets are made to licensed retailers who market the tickets to the public on a commission basis. Revenue is recognized when the books of the tickets are settled with the retailers. Tickets activated, but not sold by retailers, may be returned for credit. Sales of online lottery tickets are made to licensed retailers who market the tickets through the use of computerized terminals on a commission basis. Ticket revenue is recognized weekly. Tickets sold in advance of future drawing dates are recorded as deferred revenue until the ticket becomes valid for a drawing.

D. Expenses – Commissions and fees for the instant and online games are recognized weekly. Expenses for administrative and overhead expenses of the operation of the Lottery, except agent and bank commissions, are paid from State appropriations which are derived from Lottery revenues. In addition, Vermont State Statute 658 provides that agency commissions may not exceed 5.75% of gross receipts and bank commissions may not exceed 1% of gross receipts. The statutes also provide that the Lottery must pay out no less than 50% of gross receipts as prizes.

E. Cash and cash equivalents – Cash includes demand deposits and short-term investments with a maturity date within three (3) months of the date acquired by the Lottery except for amounts included in the investment account. The balance of the overdraft in the Lottery’s account with the State Treasurer is included in cash and cash equivalents, consistent with the State financial reporting.

F. Investments – Investments with readily determinable fair values are reported at their fair values on the balance sheet. Unrealized gains and losses are included in investment income.

G. Property and equipment – Property and equipment are stated at cost, recorded as a capital asset based on the nature of the item and depreciated over the estimated useful life of the asset. Capitalized costs include freight-in, licenses, title application and any other costs required to establish the initial operation of the asset. Improvements and additions to an asset are capitalized. Maintenance and repair costs are not capitalized. Depreciation expense is calculated using the straight-line method over the estimated lives of the assets which are:

Automobiles	3 years
Office furniture and equipment	3-7 years
Improvements	10-15 years

H. Compensated absences - Lottery employees are entitled to certain compensated absences based on their length of employment. Generally, compensated absences either vest or accumulate and are accrued when they are earned. Sick leave does not accrue beyond annual use.

I. Annuities – The Lottery is the owner of two annuities that were purchased for grand prizes won by two individuals in 1995. The cost of the annuities was charged against the reserve for future prizes at the time of purchase. The annuities were purchased from the following insurance company and have the following expiration dates:

Insurance Company	Annuity Expiration Date
Keyport Life Insurance Company	November 14, 2014
Keyport Life Insurance Company	December 15, 2014

J. Estimates – The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

K. Risk management – The Lottery is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; injuries to individuals; and natural disasters. These are managed by the State of Vermont on behalf of the Lottery.

L. Advertising – Advertising costs are expensed as incurred.

2. Cash and cash equivalents:

The Lottery’s cash deposits as of June 30, consisted of:

	2004		2003	
	Carrying Amount	Institutions' Balance	Carrying Amount	Institutions' Balance
Insured – FDIC	\$ 100,400	\$ 100,400	\$ 100,784	\$ 100,784
Collateralized	1,850,394	1,867,559	12,660,066	12,551,796
Cash with State of Vermont Treasurer	(417,771)	–	(12,177,125)	–
	<u>\$ 1,533,023</u>	<u>\$ 1,967,959</u>	<u>\$ 583,725</u>	<u>\$ 12,652,580</u>

The difference between the balance per the bank and the balance per the books is due to deposits in transit and outstanding checks.

3. Cash with State of Vermont Treasurer:

Cash with the State Treasurer represents cash held by the Vermont State Treasurers' Office for the purpose of funding expenditures of the Lottery and transfers to the State of Vermont Education Fund. The expenditures are provided for by an appropriation from the State of Vermont which is derived from Lottery revenues for the operation of the Lottery. The balance in this account is reduced by transfers of net revenue of the Lottery to the State of Vermont Education Fund. There is a deficit in this account at June 30, 2004, and 2003 due to the timing of transfers out of the other cash accounts.

4. Investments/due to winners:

The Lottery purchases investments in government securities that will mature in future years to pay multi-year payment prizes won by certain instant ticket winners (see Note 9). These are held by the Trust Department of the Chittenden Bank in Burlington, Vermont, and are reported at market value. The Lottery also owns two annuity contracts purchased for winners which are reported at amortized cost. Investments at June 30, 2004 and 2003 were as follows:

	<u>2004</u>	<u>2003</u>
Money Market Funds	\$ 100,000	\$ 100,000
U.S. Treasury Strips	2,975,150	3,465,760
Annuity Contracts	760,089	805,863
	<u>\$ 3,835,239</u>	<u>\$ 4,371,623</u>

Generally accepted accounting principles require these investments to be categorized to give an indication of the level of risk assumed. Category 1 includes investments that are insured or registered or for which the securities are held in the Lottery's name. Category 2 includes uninsured and unregistered investments for which securities are held by a counter party's trust department or agent in the Lottery's name. Category 3 includes uninsured and unregistered investments for which the securities are held by a counter party or by its trust department or agent, but not in the Lottery's name. All of these investments are Category 1 investments.

Investments and Due to winners as of June 30, 2004 are \$3,835,239 and \$3,422,498, respectively. Investments and Due to winners as of June 30, 2003 are \$4,371,623 and \$3,256,533, respectively.

5. Accounts receivable:

Accounts receivable at June 30 consisted of the following:

	<u>2004</u>	<u>2003</u>
MUSL	\$ 196,334	\$ -
Tri-State	280,830	-
Sci-Games	477,365	-
Instant Agents	18,533	309,875
Instant Chains	52,513	31,538
Online Agents	5,282	147,791
Online Chains	35,406	36,620
Total	<u>1,066,263</u>	<u>525,824</u>
Less: Allowance for doubtful accounts	<u>(10,248)</u>	<u>(17,572)</u>
Net accounts receivable	<u>\$ 1,056,015</u>	<u>\$ 508,252</u>

6. Inventory:

The Lottery had inventory consisting of lottery tickets on hand and prizes valued at a cost of \$613,048 and \$73,881 at June 30, 2004, and \$340,270 and \$97,809 at June 30, 2003, respectively.

7. Property and equipment:

The following is a summary of changes in property and equipment during the fiscal years.

	<u>2004</u>					Net Property and Equipment June 30, 2004
	Balance July 1, 2003	Additions	Retirements	Balance June 30, 2004	Accumulated Depreciation	
Automobiles	\$ 161,696	\$ 32,196	\$ -	\$ 193,892	\$ (148,261)	\$ 45,631
Office furniture and equipment	97,584	6,706	-	104,290	(65,135)	39,155
	<u>\$ 259,280</u>	<u>\$ 38,902</u>	<u>\$ -</u>	<u>\$ 298,182</u>	<u>\$ (213,396)</u>	<u>\$ 84,786</u>

	<u>2003</u>					Net Property and Equipment June 30, 2003
	Balance July 1, 2002	Additions	Retirements	Balance June 30, 2003	Accumulated Depreciation	
Automobiles	\$ 184,278	\$ -	\$ (22,582)	\$ 161,696	\$ (129,413)	\$ 32,283
Office furniture and equipment	91,461	13,750	(7,627)	97,584	(50,201)	47,383
	<u>\$ 275,739</u>	<u>\$ 13,750</u>	<u>\$ (30,209)</u>	<u>\$ 259,280</u>	<u>\$ (179,614)</u>	<u>\$ 79,666</u>

8. Accounts payable:

The Lottery's accounts payable consisted of the following at June 30:

	<u>2004</u>	<u>2003</u>
Tri-State	\$ -	\$ 28,906
MUSL	159,435	-
Vendors	<u>916,321</u>	<u>218,618</u>
	<u>\$ 1,075,756</u>	<u>\$ 247,524</u>

The vendors' accounts payable includes a contractual commitment to provide additional terminals in the amount of \$777,000 to Scientific Games International.

9. Due to winners:

Presented below is a summary of requirements to maturity for long-term installment prizes due to winners awarded as of June 30, 2004, and payable through the year 2024:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Current portion:			
Fiscal year -			
2005	<u>\$ 463,431</u>	<u>\$ 70,569</u>	<u>\$ 534,000</u>
Long-term:			
Fiscal year -			
2006	439,644	94,356	534,000
2007	418,652	115,348	534,000
2008	398,723	135,277	534,000
2009	381,853	152,147	534,000
2010-2014	864,259	385,741	1,250,000
2015-2019	343,149	306,851	650,000
2020-2024	<u>112,787</u>	<u>247,213</u>	<u>360,000</u>
Total long-term portion	<u>2,959,067</u>	<u>1,436,933</u>	<u>4,396,000</u>
Total requirements to maturity	<u>\$ 3,422,498</u>	<u>\$ 1,507,502</u>	<u>\$ 4,930,000</u>

Due to winners represents annual payments owed to jackpot winners and is fully funded by investments in U.S. Government Treasury Strips and annuities that mature on a schedule coinciding with the installments (see Note 4). During the year the Lottery increased the obligation for long-term installment prizes by \$488,212 to more accurately match the present value of future payments.

10. Prize expense and reserve for future and unclaimed prizes:

By law, the Lottery must pay a minimum of 50% of gross revenue to participants in the form of prizes. Prize expense is calculated on the basis of total sales multiplied by an approved prize payout percentage. The reserve for future and unclaimed prizes is increased by the prize expense as calculated and reduced by the dollar value of prizes actually paid out. Unclaimed prizes from online games can be used for special prizes, to supplement regular prizes or in the case of instant games can be transferred to the State of Vermont Education Fund for State and local funding of public education.

For instant games, the Lottery calculated prize expense at varying percentages according to game design ranging from 64% to 75% for the year ended June 30, 2004 and 63% to 75% for the year ended June 30, 2003.

10. Prize expense and reserve for future and unclaimed prizes:

In September 1985, the states of Vermont, Maine and New Hampshire instituted Tri-State Megabucks, with a calculated prize expense of 50% of ticket sales. Megabucks ticket sales in Vermont were approximately \$5.8 million for the year ended June 30, 2004 and \$7.8 million for the year ended June 30, 2003.

In March 2002, the states of Vermont, Maine and New Hampshire began Cash Lotto replacing WIN Cash, with an estimated payout of 50% of ticket sales. The sales in Vermont were approximately \$0.5 million for the year ended June 30, 2004 and approximately \$1.8 million for the year ended June 30, 2003.

Effective July 1, 2003, the Lottery became a member of the Multi-State Lottery Association (MUSL), which operates on-line games on behalf of participating state lotteries. Each MUSL member sells game tickets through its agents and makes weekly wire transfers to the MUSL in an amount equivalent to the member's share of the estimated grand prize liability. Each MUSL member pays non-jackpot prizes directly to the winners. The MUSL operates the Powerball game, as well as the Power Play feature associated with Powerball. Participating lotteries are required to maintain deposits with MUSL for contingency reserves to protect MUSL from unforeseen prize liabilities. The money in this reserve fund is refundable to MUSL members if the MUSL disbands or if a member leaves the MUSL Board. Vermont Powerball sales were approximately \$13.5 million for the year ended June 30, 2004. On behalf of the Lottery, MUSL held in trust prize reserve accounts for Powerball and Power Play of \$159,107 and \$329 respectively for the fiscal year ended June 30, 2004.

11. Deferred revenue:

Deferred revenue consists of subscription receipts. The revenue will be recognized as the drawings are held.

12. Net assets:

Unrestricted net assets of \$613,048 is considered reserved for ticket inventory at June 30, 2004.

13. Appropriations:

The following are the cash basis appropriations compared to expenses at June 30:

	<u>2004</u>	<u>2003</u>
Appropriation	\$ 2,251,526	\$ 1,789,418
Expenditures	<u>2,104,862</u>	<u>1,747,669</u>
Variance	<u>\$ 146,664</u>	<u>\$ 41,749</u>

At June 30, 2004, \$129,087 was encumbered for personal services and leasehold improvements.

14. Retirement plan:

The Vermont State Retirement System (VSRS), a defined benefit plan, covers substantially all Lottery employees except employees hired in a temporary capacity. Membership in the system is a condition of employment. The membership consists of employees who belong to the original contributory system with a contribution range of 5.1% to 6.28% of payroll (Groups A, C and D), vested members of the non-contributory system (Group E) as well as members of a new contributory system whose current contribution rate is 3.35% (Group F). All eligible employees of the Lottery are Group F members. The total amount of employee contributions was \$24,911. The Lottery's current year payroll for all employees totaled \$780,892 while its current year's covered payroll for the plan was \$743,612. Funding and benefit information for this plan is maintained in the aggregate, not by Agency or Commission. Additional information regarding this plan is available upon request from the State of Vermont.

15. Deferred compensation:

The State offers its employees a deferred compensation plan created in accordance with section 457 of the Internal Revenue Code. The plan, available to all Lottery employees, permits them to defer a portion of their current salary until future years. The deferred compensation is not available to the employees until termination, retirement, death or an unforeseeable emergency.

In compliance with Federal mandates, the Vermont State Retirement Board adopted a Plan Trust Declaration for the State of Vermont's Deferred Compensation Plan effective January 1, 1999. The Federal mandate was established to protect the assets of deferred compensation plans by requiring the assets be placed in a trust to be used for the sole purpose of plan participants. After January 1, 1999, the plan assets are no longer considered assets of the State of Vermont.

16. Concentrations:

The Lottery utilizes Scientific Games International (SGI), a service organization, to process all its online games and generate accounting reports the Lottery uses to record this activity. The Lottery also utilizes SGI to validate and settle its instant ticket lottery games. Other service providers are available; however, an interruption in service by SGI could have an adverse impact on the Lottery's revenues.

17. Commitments:

The State of Vermont entered into a new agreement on behalf of the Lottery for office space. The lease commences September 1, 2004 for ten years. The annual rent is \$129,675 for the first five years and \$142,576 for the remaining five years through August 31, 2014. The annual rent for the years ended June 30, 2004 and June 30, 2003 was \$82,932 and \$83,030, respectively.

The Lottery has a two-year agreement with Oberthur Gaming Technologies Corporation to print instant game tickets through November 30, 2005 with an option to renew for two, one-year extensions. The total cost of the contract is not to exceed \$6.5 million.

The Lottery is contracted with Scientific Games International to provide for the operation of an online gaming system through June 30, 2010. The estimated total contract price is approximately \$45 million over the ten-year contract.

Mudgett, Jennett & Krogh-Wisner, P.C.

Certified Public Accountants #435

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

To the Commissioners of the
Vermont Lottery Commission:

We have audited the basic financial statements of the Vermont Lottery Commission as of and for the year ended June 30, 2004, and have issued our report thereon dated August 25, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

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

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Vermont Lottery Commission's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statement 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.

This report is intended solely for the information and use of the Commission, management and the State of Vermont and is not intended to be and should not be used by anyone other than those specified parties.

*Mudgett, Jennett &
Krogh-Wisner, P.C.*

Montpelier, Vermont
August 25, 2004



Vermont Lottery Staff:

Alan Yandow

Ann-Marie Mears

Beth Plante

Carole Lacasse

Connie Goss

Ellen Pulsifer

Fran McAvoy

Glenn Clifton

Gweneth Dean

Lou Chap

Mark Anderson

Mark Cayia

Mary Cassani

Meredith Putvain

Michael Lancour

Norman Duby (Retired FY05)

Pamela Morin

Sylvia Buzzell

Timothy White (FY05)

Wendy Dickinson

Vermont Lottery Commissioners:

Martha O'Connor, Chair

Brattleboro

Term Expires 06/05

Arthur Ristau, Vice Chair

Barre

Term Expires 06/07

Tom Scala, Tri-State

Representative

Brattleboro

Term Expires 06/06

Richard Bailey

Hyde Park

Term Expires 06/05

Virginia Barry

Barre

Term Expires 06/06

