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February 20, 2012

Mr. Karl B. Browning, Executive Director
The State Lottery Commission of Indiana
1302 N. Meridian Street
Indianapolis, IN 46202

Dear Mr. Browning:

We have received the audit report prepared by E.C. Ortiz & Co., LLP., Certified Public Accountants, for the period July 1, 2010 to June 30, 2011. Per the auditors' opinion, the audit was conducted in accordance with auditing standards generally accepted in the United States of America and the financial statements included in the report present fairly the financial condition of The State Lottery Commission of Indiana as of June 30, 2011 and the results of its operations for the period then ended, on the basis of accounting described in the report.

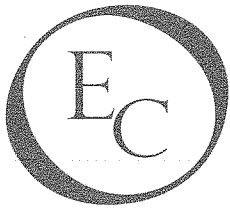
The Independent Public Accountants' report is filed with this letter in our office as a public record.

STATE BOARD OF ACCOUNTS

**THE STATE LOTTERY
COMMISSION OF INDIANA
FINANCIAL STATEMENTS
As of and for the years ended
JUNE 30, 2011 AND 2010
(With Independent Auditors' Report)**

**THE STATE LOTTERY COMMISSION OF INDIANA
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E.C. ORTIZ & CO., LLP
CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

To the State Lottery Commission of Indiana:

We have audited the accompanying statements of net assets of the State Lottery Commission of Indiana (the "Commission") as of June 30, 2011 and 2010, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the management of the Commission. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Commission as of June 30, 2011 and 2010, 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 a report dated September 27, 2011 on our consideration of the Commission's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, 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.

Management's Discussion and Analysis and Required Supplementary Information, as listed in the Table of Contents, is not a required part of the basic financial statements, but are supplementary information required by the accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information, and we do not express an opinion on it.

E. C. Ortiz & Co. LLP

September 27, 2011

MANAGEMENT'S DISCUSSION AND ANALYSIS

The management of The State Lottery Commission of Indiana ("Commission") offers readers of the Commission's annual financial report, a narrative overview of its performance during the fiscal years ended June 30, 2011 and 2010. Please read it in conjunction with the financial statements and related footnote disclosures, which follow this section.

Financial Highlights

- Fiscal year 2011 ("FY 11") ticket sales were \$791 million, an increase of approximately \$51 million or 7% from fiscal year 2010 ("FY 10"). The net increase in sales is primarily attributable to a \$43 million increase in scratch-off sales, a \$24 million increase in Mega Millions sales, a \$7 million increase in Hoosier Lotto sales, and \$2 million in Tag 6 sales, which was introduced in March 2011, along with a \$29 million decrease in Powerball sales. Fiscal year 2010 ("FY 10") ticket sales were \$740 million, an increase of approximately \$7 million or 1% from fiscal year 2009 ("FY 09"). The net increase in sales is primarily attributable to \$12 million in Mega Millions sales, which was introduced in February FY 10, and a \$10 million increase in Quick Draw ticket sales. The economic downturn in FY 09 continued in FY 10 and largely affected the \$9 million decrease in scratch-off sales. Hoosier Lotto, Daily Games, Mix & Match, and pull-tab sales all had sales decreases, while Powerball had a slight increase in FY 10.
- Prize expenses for FY 11 increased \$39 million from FY 10. This 8% increase is directly related to the 7% increase in sales mentioned above. Prize expenses for FY 10 increased \$3 million from FY 09. The less than 1% increase in prize expenses is directly related to the 1% increase in sales as mentioned above.
- Indirect gaming expense for FY 11, which includes retailer commissions, ticket printing costs, advertising and promotion, on-line professional services, and Instant Ticket Vending Machine ("ITVM") lease and courier services, increased approximately \$6 million from FY 10. This increase is due primarily to retailer commissions and instant ticket printing expenses, which are directly related to the increase in sales mentioned above. Indirect gaming expense for FY 10 increased approximately \$1 million from FY 09. This increase is due primarily to retailer commissions, which are directly related to the increase in sales mentioned above.
- Other operating expenses in FY 11, which include salaries, benefits and general and administrative expenses, decreased \$1 million or 5% compared to that of FY 10 mainly due to employee incentive payments and retirement expenses. Other operating expenses in FY 10 decreased \$2 million or 10% compared to those for FY 09 mainly due to legal expenses.
- In FY 11, non-operating revenues, net of expenses, decreased approximately \$9 million from FY 10. This decrease was related to the change in fair value of investments in U.S. Treasury securities held by the Commission to fund long-term prizes. Non-operating revenues, net of expenses, increased approximately \$5 million in FY 10 over FY 09. Approximately \$6 million was related to the change in fair value of investments in U.S. Treasury securities held by the Commission to fund long-term prizes. Interest income decreased less than \$1 million in FY 10 from FY 09 due to a decrease in short-term interest rates.
- FY 11 net income of \$188 million represents a \$2 million decrease from FY 10. FY 10 net income of \$190 million represents an \$11 million increase from FY 09.

Overview of the Financial Statements

The Commission is accounted for as an enterprise fund, reporting transactions using the accrual basis of accounting similar to a business entity. This discussion and analysis is intended to serve as an introduction to the Commission's financial statements, along with corresponding note disclosures and other supplementary information.

By law, the Commission is required to transfer all of its surplus revenues to the State of Indiana. In FY 10, this was done on a quarterly basis. As of September FY 11, the Commission began transferring the surplus revenues on a monthly basis. As a result, the net assets of the Commission consist of an amount set aside for future cash flow needs and the net book value of funds invested in capital assets. To assess the Commission's financial position and financial health, the reader of these financial statements should pay particular attention to changes in the components of assets and liabilities as set forth in the statements of net assets, and in changes in operating revenues, expenses and distributions as set forth in the statements of revenues, expenses and changes in net assets. In addition, the statements of cash flows are intended to provide information about the cash receipts, cash payments and net changes in cash resulting from operating, financing and investing activities.

Financial Analysis of the Commission

Net Assets and Changes in Net Assets

Net assets represent the difference between total assets and total liabilities. Because the Commission is required by law to make transfers of its surplus revenues to the State of Indiana, the change in net assets does not necessarily reflect the results of the Commission's operating activities.

Condensed Statements of Net Assets (in millions of dollars)

	June 30,		
	2011	2010	2009
Current assets	\$ 86	\$ 115	\$ 100
Restricted assets	9	8	8
Long-term investments	127	111	103
Capital assets—net	<u>2</u>	<u>2</u>	<u>2</u>
Total assets	<u>224</u>	<u>236</u>	<u>213</u>
Current liabilities	96	127	107
Long-term liabilities	<u>123</u>	<u>104</u>	<u>101</u>
Total liabilities	<u>219</u>	<u>231</u>	<u>208</u>
Net assets			
Unrestricted	3	3	3
Invested in capital assets	<u>2</u>	<u>2</u>	<u>2</u>
Total net assets	<u>\$ 5</u>	<u>\$ 5</u>	<u>\$ 5</u>

Condensed Statements of Revenues, Expenses and Changes in Net Assets
(in millions of dollars)

	June 30,		
	2011	2010	2009
Operating revenues	\$ 791	\$ 740	\$ 733
Operating - direct games expenses	(495)	(456)	(453)
Operating - indirect games expenses	(87)	(81)	(81)
Other operating expenses	(18)	(19)	(21)
Operating income	191	184	178
Non-operating revenues	(3)	6	1
Net income prior to distributions	188	190	179
Distributions	(188)	(190)	(179)
Changes in net assets	-	-	-
Net assets - beginning of year	5	5	5
Net assets - ending of year	\$ 5	\$ 5	\$ 5

Assets

The FY 11 decrease of \$12 million in total assets from FY 10 was primarily the result of a decrease in cash and cash equivalents, which is a result of the timing of payments to the Indiana State Treasurer and vendors, and an increase in current and long-term investments.

The FY 10 increase of \$23 million in total assets over FY 09 was primarily the result of increases in cash and cash equivalents and long-term investments and a decrease in accounts receivable.

Liabilities

Current liabilities decreased by \$31 million in FY 11 from FY 10 primarily as a result of the timing of payments to the Indiana State Treasurer and an increase in accounts payable. Long-term liabilities increased \$19 million in FY 11 over FY 10. This increase is due to the annuity prizes won in FY 11, but not paid until after FY 11.

Current liabilities increased by \$20 million in FY 10 over FY 09 primarily as a result of increased prize reserves and the timing of payments to winners and to the Indiana State Treasurer. Long-term liabilities increased \$3 million in FY 10 over FY 09. This increase is due to the annuity prizes won in FY 10, but not paid until after FY 10.

Net assets

Net assets consist of unrestricted income retained for the future cash flow needs of the Commission and capital assets. The Commission's total net assets at June 30, 2011, 2010 and 2009 were \$5 million.

Sales and Prize Expense
(in millions of dollars)

	Scratch-Off			Pull-Tab		
	2011	2010	Change	2011	2010	Change
Operating Revenues	\$ 508	\$ 465	\$ 43	\$ 11	\$ 9	\$ 2
Game Prizes	347	314	33	7	6	1
Gross Margin	<u>\$ 161</u>	<u>\$ 151</u>	<u>\$ 10</u>	<u>\$ 4</u>	<u>\$ 3</u>	<u>\$ 1</u>
	Powerball			Hoosier Lotto		
	2011	2010	Change	2011	2010	Change
Operating Revenues	\$ 86	\$ 115	\$ (29)	\$ 61	\$ 54	\$ 7
Game Prizes	41	55	(14)	34	31	3
Gross Margin	<u>\$ 45</u>	<u>\$ 60</u>	<u>\$ (15)</u>	<u>\$ 27</u>	<u>\$ 23</u>	<u>\$ 4</u>
	Mega Millions			Daily Games		
	2011	2010	Change	2011	2010	Change
Operating Revenues	\$ 36	\$ 12	\$ 24	\$ 64	\$ 62	\$ 2
Game Prizes	18	6	12	32	29	3
Gross Margin	<u>\$ 18</u>	<u>\$ 6</u>	<u>\$ 12</u>	<u>\$ 32</u>	<u>\$ 33</u>	<u>\$ (1)</u>
	Mix & Match			Quick Draw		
	2011	2010	Change	2011	2010	Change
Operating Revenues	\$ 5	\$ 6	\$ (1)	\$ 18	\$ 17	\$ 1
Game Prizes	4	4	-	11	11	-
Gross Margin	<u>\$ 1</u>	<u>\$ 2</u>	<u>\$ (1)</u>	<u>\$ 7</u>	<u>\$ 6</u>	<u>\$ 1</u>
	Tag 6			Total		
	2011	2010	Change	2011	2010	Change
Operating Revenues	\$ 2	\$ -	\$ 2	\$ 791	\$ 740	\$ 51
Game Prizes	1	-	1	495	456	39
Gross Margin	<u>\$ 1</u>	<u>\$ -</u>	<u>\$ 1</u>	<u>\$ 296</u>	<u>\$ 284</u>	<u>\$ 12</u>

Sales and Prize Expense
(in millions of dollars)

	Scratch-Off			Pull-Tab		
	2010	2009	Change	2010	2009	Change
Operating Revenues	\$ 465	\$ 474	\$ (9)	\$ 9	\$ 11	\$ (2)
Game Prizes	314	319	(5)	6	7	(1)
Gross Margin	\$ 151	\$ 155	\$ (4)	\$ 3	\$ 4	\$ (1)
	Powerball			Hoosier Lotto		
	2010	2009	Change	2010	2009	Change
Operating Revenues	\$ 115	\$ 114	\$ 1	\$ 54	\$ 55	\$ (1)
Game Prizes	55	55	-	31	33	(2)
Gross Margin	\$ 60	\$ 59	\$ 1	\$ 23	\$ 22	\$ 1
	Mega Millions			Daily Games		
	2010	2009	Change	2010	2009	Change
Operating Revenues	\$ 12	\$ -	\$ 12	\$ 62	\$ 63	\$ (1)
Game Prizes	6	-	6	29	30	(1)
Gross Margin	\$ 6	\$ -	\$ 6	\$ 33	\$ 33	\$ -
	Mix & Match			Quick Draw		
	2010	2009	Change	2010	2009	Change
Operating Revenues	\$ 6	\$ 9	\$ (3)	\$ 17	\$ 7	\$ 10
Game Prizes	4	5	(1)	11	4	7
Gross Margin	\$ 2	\$ 4	\$ (2)	\$ 6	\$ 3	\$ 3
	Total					
	2010	2009	Change			
Operating Revenues	\$ 740	\$ 733	\$ 7			
Game Prizes	456	453	3			
Gross Margin	\$ 284	\$ 280	\$ 4			

The tables above compare FY 11, FY 10 and FY 09 sales, prize expense and gross margin for major lottery game categories. FY 11 sales increased in the scratch-off, pull-tab, Hoosier Lotto, Mega Millions, Daily Games and Quick Draw product lines. Tag 6 was introduced as a new game in March of FY 11. Sales decreased for the Powerball and Mix & Match product lines.

The FY 11 increase in scratch-off ticket sales is a reflection of an increased focus on game design, ticket distribution and product management. The FY 10 decrease in scratch-off ticket sales was a reflection of the economic downturn.

Powerball is a multi-state lotto game offering large jackpot prizes. The Commission participates in this game along with 43 other United States lotteries, including the District of Columbia and the U.S. Virgin Islands. Powerball sales decreased in FY 11 by approximately \$29 million to \$86 million. The primary reason for the decrease in ticket sales was lower average jackpots than in FY 10. Another factor that contributed to this decrease was the introduction of new states to Powerball, especially Illinois, Michigan and Ohio, which caused border sales loss in FY 11 as compared to FY 10. Mega Millions' high jackpot levels in

FY 11 may have also contributed to the decrease in Powerball sales as they are very similar games. Powerball sales increased in FY 10 by approximately \$1 million to \$115 million. The primary reason for the increase in ticket sales was larger average jackpots than in FY 09.

Mega Millions is also a multi-state lotto game offering large jackpot prizes. The Commission participates in this game along with 42 other United States lotteries, including the District of Columbia and the U.S. Virgin Islands. Mega Millions, beginning in February 2010, recorded sales of approximately \$36 million in FY 11 and \$12 million in FY 10.

Hoosier Lotto is a smaller lotto game available only in Indiana. Sales increased during FY 11 by approximately \$7 million. This increase is due to two larger than average jackpots in FY 11. Sales decreased during FY 10 by approximately \$1 million.

The “Daily Games” consists of the Daily 3, Daily 4 and Lucky 5 games. The Daily Games and pull-tab categories had slightly increasing sales levels in FY 11 and slightly decreasing sales levels in FY 10.

Mix & Match had a slight decrease in sales in FY 11 and had decreasing sales of \$3 million in FY 10.

In FY 11, Quick Draw had a slight increase in sales. In FY 10, Quick Draw’s first full year, it had a \$10 million increase in sales.

Prize Expense

In general, prize expense by game will increase or decrease from year to year in proportion to the increase or decrease in ticket sales for the corresponding game. However, prize expense can also be impacted by the luck of the draw or by changes to the game design.

Total prize expense in FY 11 of \$495 million increased 8% over FY 10 prize expense of \$456 million. Total prize expense in FY 10 of \$456 million increased less than 1% over FY 09 prize expense of \$453 million. Notable variances in prize expense are discussed below.

- FY 11 scratch-off game prize expense increased 11% or \$33 million. This increase is directly related to the increase in scratch-off sales as discussed earlier. FY 10 scratch-off game prize expense decreased 2% or \$5 million. This decrease is directly related to the decrease in scratch-off sales as discussed earlier.
- On-line game prize expense increased 4% or \$5 million in FY 11 as compared to FY 10. Such increase is directly related to a full year of Mega Millions. On-line game prize expense increased 7% or \$9 million in FY 10 as compared to FY 09. Such increase is directly related to a full year of Quick Draw and the introduction of Mega Millions.

Indirect Game Expenses and Other Operating Expenses

Indirect Game Expenses and Other Operating Expenses for the Year Ended June 30, (in millions of dollars)

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Indirect game expenses:			
Retailer commissions	\$ 56	\$ 51	\$ 51
Ticket printing costs	9	8	8
Advertising and promotion	12	11	11
On-line professional services	7	8	7
ITVM lease and courier services	<u>3</u>	<u>3</u>	<u>4</u>
	<u>87</u>	<u>81</u>	<u>81</u>
Other operating expenses:			
Salaries, wages, and benefits	13	14	14
General and administrative	<u>5</u>	<u>5</u>	<u>7</u>
	<u>18</u>	<u>19</u>	<u>21</u>
Total indirect game and other operating expenses	<u>\$ 105</u>	<u>\$ 100</u>	<u>\$ 102</u>

Overall, indirect game and other operating expenses increased \$5 million from FY 10 to FY 11. This is due to the fluctuations in retailer commissions, which are directly related to the increase or decrease in all ticket sales as retailers earn a commission on each ticket sold. Indirect game and other operating expenses decreased slightly from FY 09 to FY 10. These fluctuations are attributed to high legal expenses in FY 09.

Other

The Commission is not aware of any facts, decisions or conditions, other than those disclosed in the accompanying financial statements, that are expected to have a significant effect on financial position or results of operations.

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**THE STATE LOTTERY COMMISSION OF INDIANA
STATEMENTS OF NET ASSETS
AS OF JUNE 30, 2011 AND 2010**

	2011	2010
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 47,896,357	\$ 78,349,103
Investments — current portion	12,024,544	10,790,011
Accounts receivable — net	22,112,127	21,686,165
Prepaid expenses	3,768,748	3,997,913
Accrued interest receivable	103	384
Ticket inventory	<u>401,773</u>	<u>450,197</u>
Total current assets	<u>86,203,652</u>	<u>115,273,773</u>
NONCURRENT ASSETS:		
Long-term investments — less current portion	126,761,064	111,274,579
Restricted assets	8,397,985	7,978,058
Capital assets — net	<u>2,354,611</u>	<u>1,431,761</u>
Total noncurrent assets	<u>137,513,660</u>	<u>120,684,398</u>
TOTAL	<u><u>\$ 223,717,312</u></u>	<u><u>\$ 235,958,171</u></u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES:		
Accounts payable:		
State	\$ 10,659,871	\$ 52,628,937
Trade	19,919,057	8,016,070
Current portion of prize liability	62,813,388	64,196,564
Deferred revenue	870,240	441,556
Other accrued expenses	<u>1,611,507</u>	<u>1,871,971</u>
Total current liabilities	95,874,063	127,155,098
LONG-TERM LIABILITIES — Prize liability less current portion	<u>122,843,249</u>	<u>103,803,073</u>
Total liabilities	<u>218,717,312</u>	<u>230,958,171</u>
NET ASSETS:		
Unrestricted	2,645,389	3,568,239
Invested in capital assets	<u>2,354,611</u>	<u>1,431,761</u>
Total net assets	<u>5,000,000</u>	<u>5,000,000</u>
TOTAL	<u><u>\$ 223,717,312</u></u>	<u><u>\$ 235,958,171</u></u>

See notes to financial statements.

THE STATE LOTTERY COMMISSION OF INDIANA
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2011 AND 2010

	2011	2010
OPERATING REVENUES:		
Instant ticket sales — net	\$ 519,307,182	\$ 474,217,486
On-line ticket sales	<u>272,139,361</u>	<u>266,121,987</u>
Total operating revenues	<u>791,446,543</u>	<u>740,339,473</u>
OPERATING EXPENSES:		
Direct game expenses:		
Instant game prizes	354,353,552	320,293,579
On-line games prizes	<u>140,162,169</u>	<u>136,002,921</u>
	<u>494,515,721</u>	<u>456,296,500</u>
Indirect game expenses:		
Retailer commissions	56,241,137	51,076,592
Ticket printing costs	9,484,181	7,890,401
Advertising and promotion	11,635,171	11,074,138
On-line professional services	7,581,656	8,327,371
ITVM lease and courier services	<u>2,651,596</u>	<u>2,923,645</u>
	<u>87,593,741</u>	<u>81,292,147</u>
Total game expenses	<u>582,109,462</u>	<u>537,588,647</u>
OTHER OPERATING EXPENSES:		
Salaries, wages, and benefits	13,343,070	14,243,704
General and administrative	<u>4,505,750</u>	<u>5,041,522</u>
Total other operating expenses	<u>17,848,820</u>	<u>19,285,226</u>
Total operating expenses	<u>599,958,282</u>	<u>556,873,873</u>
OPERATING INCOME	<u>191,488,261</u>	<u>183,465,600</u>
NON-OPERATING REVENUES:		
Interest income	135,975	161,451
Net increase (decrease) in fair value of investments	(3,499,418)	5,853,879
Other income - net	<u>105,551</u>	<u>176,574</u>
Total non-operating revenues (expenses) -net	<u>(3,257,892)</u>	<u>6,191,904</u>
NET INCOME PRIOR TO DISTRIBUTIONS	<u>188,230,369</u>	<u>189,657,504</u>
DISTRIBUTIONS:		
Distributions to the State	(177,570,498)	(137,028,567)
Distributions to be paid to the State	<u>(10,659,871)</u>	<u>(52,628,937)</u>
Total distributions	<u>(188,230,369)</u>	<u>(189,657,504)</u>
CHANGES IN NET ASSETS	-	-
NET ASSETS — Beginning of year	<u>5,000,000</u>	<u>5,000,000</u>
NET ASSETS — Ending of year	<u>\$ 5,000,000</u>	<u>\$ 5,000,000</u>

See notes to financial statements.

**THE STATE LOTTERY COMMISSION OF INDIANA
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2011 AND 2010**

	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from ticket sales	\$ 791,419,648	\$ 742,673,222
Payments to ticket winners	(476,858,721)	(441,322,751)
Payments to employees	(13,603,534)	(13,811,390)
Payments of suppliers	<u>(79,128,121)</u>	<u>(83,074,337)</u>
Net cash provided by operating activities	<u>221,829,272</u>	<u>204,464,744</u>
CASH FLOWS FROM NONCAPITAL AND RELATED FINANCING ACTIVITIES:		
Distributions to the State	(230,199,435)	(183,860,863)
Other income	105,551	176,574
Net increase (decrease) in restricted assets	<u>(419,927)</u>	<u>74,711</u>
Net cash used in noncapital and related financing activities	<u>(230,513,811)</u>	<u>(183,609,578)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Purchase of capital assets	(1,757,227)	(572,662)
Proceeds from the sale of capital assets	<u>73,200</u>	<u>34,590</u>
Net cash used in capital and related financing activities	<u>(1,684,027)</u>	<u>(538,072)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of investments	(25,804,376)	(9,153,007)
Investment maturities	5,583,940	5,518,992
Interest income	<u>136,256</u>	<u>272,872</u>
Net cash used in investing activities	<u>(20,084,180)</u>	<u>(3,361,143)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(30,452,746)	16,955,951
CASH AND CASH EQUIVALENTS — Beginning of year	<u>78,349,103</u>	<u>61,393,152</u>
CASH AND CASH EQUIVALENTS — End of year	<u>\$ 47,896,357</u>	<u>\$ 78,349,103</u>

(Continued)

**THE STATE LOTTERY COMMISSION OF INDIANA
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2011 AND 2010**

	2011	2010
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating income	\$ 191,488,261	\$ 183,465,600
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	790,794	1,289,327
Change in provision for doubtful accounts	(17,676)	(57,300)
Change in provision for ticket returns	(547,736)	3,204,234
Loss (gain) on sale of fixed assets	(29,617)	26,018
Changes in certain assets and liabilities:		
Accounts receivable	139,450	(360,271)
Instant ticket inventory	48,424	(47,885)
Prepaid expenses	229,165	(466,279)
Accounts payable — trade	11,902,987	2,484,170
Deferred revenue	428,684	(478,932)
Other accrued expenses	(260,464)	432,313
Prize liability	<u>17,656,700</u>	<u>14,973,749</u>
Net cash provided by operating activities	<u>\$ 221,828,972</u>	<u>\$ 204,464,744</u>
SCHEDULE OF NONCASH INVESTING, CAPITAL, AND RELATED FINANCING ACTIVITIES —		
Net increase (decrease) in fair value of investments	<u>\$ (3,499,418)</u>	<u>\$ 5,853,879</u>

See notes to financial statements.

(Concluded)

**THE STATE LOTTERY COMMISSION OF INDIANA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2011 AND 2010**

1. REPORTING ENTITY

The State Lottery Commission of Indiana (the “Commission”) was established by Public Law No. 341, as amended, as listed in Indiana Code Section 4, Article 30 in May 1989 (“Lottery Article”). The Commission is a component unit of the State of Indiana (the “State”) and is reported as an enterprise fund in the State’s Comprehensive Annual Financial Report (“CAFR”).

The Commission offers various on-line games, including Hoosier Lotto, Powerball, Mega Millions, Daily 3, Daily 4, Lucky 5, Mix & Match, Quick Draw and Tag 6. On-line tickets, which are generated from a terminal, require a subsequent drawing of numbers to determine winners. The Commission also offers numerous scratch-off and assorted pull-tab ticket games. Scratch-off games have preprinted tickets that require players to scratch off a coating to reveal the play area. Pull-tab games have preprinted tickets that require players to pull open tabs to reveal the play area.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting — The Commission’s financial statements are prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America (“Generally accepted accounting principles”). Under this method, revenues are recognized when earned and expenses are recognized when incurred. In accordance with Governmental Accounting Standards Board (“GASB”) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Commission is required to follow all applicable Governmental Accounting Standards Board pronouncements.

Operating revenues, such as sale of lottery tickets, result from exchange transactions associated with the principal activity of the Commission. Exchange transactions are those in which each party receives and gives up essentially equal values. Nonoperating revenues, such as interest income and changes in fair value of investments, result from nonexchange transactions or ancillary activities.

Estimates — The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and 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.

Revenue Recognition — Ticket revenue for on-line games is recognized on the date of the draw for which the ticket was purchased. Scratch-off and pull-tab ticket revenue, less an allowance for returns, is recognized at the time tickets are shipped to retailers. Certain scratch-off ticket games include free ticket prizes that entitle the holder to exchange one ticket for another of equal value. The selling price of free tickets reduces scratch-off ticket revenue when tickets are redeemed by retailers.

Cash and Cash Equivalents — Cash and cash equivalents consist of cash on deposit and short-term, highly liquid investments, with original maturity dates of three months or less. Short term investments may include direct obligations of the U.S. government or government agencies, short-term commercial paper or various money market funds composed exclusively of investment vehicles previously described.

Investments — The Treasurer of the State, on behalf of the Commission, is permitted to invest Commission funds in direct obligations of the U.S. Treasury or insurance annuities to fund future installment prize obligations. Investments are recorded at fair value, except for the insurance annuities, at June 30, 2011 and 2010. The insurance annuities are considered to be nonparticipating interest-earning contracts and are carried at accreted cost.

Accounts Receivable, Net — Accounts receivable represent proceeds due from retailers for net ticket sales, less commissions and prizes redeemed by retailers. Accounts receivable is reduced by an allowance for ticket returns and an allowance for doubtful accounts. Allowance for ticket returns is based on recent actual returns associated with scratch-off and pull-tab game ticket returns and was \$7,198,142 and \$7,745,878 as of June 30, 2011 and 2010, respectively. Allowance for doubtful accounts is based on management's estimate of retailer receivables that will not be collected and was \$93,658 and \$111,334 as of June 30, 2011 and 2010, respectively.

Prepaid Expenses — Expenses benefiting future accounting periods include payments for rent, insurance, equipment and software maintenance, retirement, sponsorships and prize packages.

Restricted Assets — Restricted assets consist principally of cash and investments held in prize reserve accounts for Megamillion and Powerball as required by the Multi State Lottery Association (MUSL).

Capital Assets — Capital assets are stated at cost. Capital assets are defined as assets that have a useful life of at least three years and a cost equal to or greater than \$1,000 individually or \$5,000 in aggregate. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. Generally, data processing equipment and software are depreciated over a minimum of three years. Vehicles are depreciated over four years. Most of the other assets are depreciated over five years. Depreciation expense was \$790,794 and \$1,289,327 for the years ended June 30, 2011 and 2010, respectively.

Ticket Inventory — Ticket inventory consists of certain scratch-off and all pull-tab tickets purchased by the Commission under an agreement for new games that have not yet been sold to retailers. These inventories are carried at cost, using the specific identification method. Tickets are expensed upon shipment to licensed retailers.

The Commission has an agreement with its primary scratch-off ticket vendor whereby the Commission pays for scratch-off tickets issued to Commission retailers. Any scratch-off tickets not issued to retailers for sale are not paid for by the Commission. The Commission receives a refund for any tickets returned by retailers to the Commission. Therefore, the Commission does not have any risk of loss in the event the tickets become damaged or lost and tickets are not treated as inventory by the Commission.

Prize Liability — Prize liability includes an estimate of sold and unclaimed scratch-off, pull-tab and on-line game winners as of June 30, 2011 and 2010, as well as installment amounts payable to past scratch-off, on-line game, and game show winners. Installment prizes are recorded at a discount based on interest rates that range from approximately 3% to 6%, which is reflective of the interest rate earned on the investments held to fund the related liabilities.

For scratch-off and pull-tab games, a liability is recorded when the Commission ships the tickets to the licensed retailers. The accrual is based on the specified prize payout structure established for each game. Instant game prizes must be claimed within 180 days after the declared end-of-game date or they will be forfeited. The liability for on-line draw games is determined based on the actual winning numbers drawn and the number of wagers placed for each draw date. Additional liability for Hoosier Lotto is determined by the level of the jackpot that could be won on a given draw date. All on-line game

prizes must be claimed within 180 days of the date of the selection event or they will be forfeited. Unclaimed prize money is included in the current portion of prize liability in the accompanying statements of net assets. All unclaimed prize money during FY 11 and FY 10 was used to offset future prizes. Therefore, the unclaimed prize balance as of the June 30, 2011 and 2010 was \$0.

Net Assets — As stated in the Lottery Article, funds in excess of the amounts necessary to pay prizes and expenses for the operation of the Commission are to be distributed per a statutory schedule to the Indiana State Treasurer. During FY 11 the Commission began transferring on a monthly basis versus quarterly which caused 14 months of net income to be transferred to the state in FY 11 as compared to 12 months in FY 10. The Commission has set aside amounts that it estimates are necessary to meet future cash flow needs of the Commission until the next transfer to the Indiana State Treasurer. These amounts have been reflected in the accompanying financial statements as unrestricted net assets.

The Lottery Article requires that the Indiana State Treasurer distribute \$30 million annually to the Indiana State Teachers' Retirement Fund to pay a portion of the current pension obligations, and \$30 million annually to the State Pension Relief Fund to assist cities and towns in the payment of current and future pension obligations. The balance of the amount distributed to the Indiana State Treasurer is deposited into the State's Build Indiana Fund, to be distributed to state and local capital projects and for the Lottery/Gaming Surplus Account. In FY 11, the Indiana State Treasurer distributed \$35 million to the Indiana State Teachers' Retirement Fund and the State Pension Relief Fund. Distributions to the State's Build Indiana Fund totaled \$160,199,435 and \$123,860,863 for the years ended June 30, 2011 and 2010, respectively.

Net assets invested in capital assets consist of capital assets, net of accumulated depreciation.

Commissions and Bonuses — Retailers earn a 6.0% sales commission on on-line game tickets and a 5.5% sales commission on scratch-off and pull-tab game tickets. Retailers earn a 1.0% cashing commission for redeeming winning tickets and the lesser of 1.0% or \$100,000 for selling winning jackpot tickets. Additionally, retailers are eligible for a quarterly bonus based on their scratch-off and pull tab sales over the preceding 13-week period.

Contractor Fees — The Commission has contracted with Scientific Games, Inc. ("Sci Games") for the majority of its gaming systems and supplies.

The Commission entered into a contract, with an effective date of January 13, 1999 through August 27, 2010, with Sci Games for the operation of the gaming network that consists of approximately 4,000 instant and on-line retailer ticket terminals and associated software. That contract required the Commission to pay 3% of gross on-line ticket revenue to Sci Games for the above services. The Commission entered into a new contract with Sci Games, with an effective date of August 28, 2010, that required the Commission to pay 3.1375% of on-line ticket revenue to Sci Games for the above services.

The Commission entered into a contract, with an effective date of April 24, 2001, with Sci Games for the printing and distribution of scratch-off tickets. Sci Games receives 1.3855 % of net scratch-off ticket revenue for games that were released prior to January 1, 2008. Sci Games receives 1.3655% of net scratch-off ticket revenue for games released between January 1, 2008 and October 6, 2010. Sci Games receives 1.4661% of net scratch-off ticket revenue for games released on or after October 7, 2010.

Prize Expense — Prize expense for scratch-off and pull-tab games is recognized based on the predetermined prize structure of each game. Generally, prize expense for the on-line draw games is based on the actual winning numbers drawn and the number of wagers placed for each draw. Additional

liability for Hoosier Lotto is determined by the level of the jackpot that could be won on a given draw date.

3. DEPOSITS AND INVESTMENTS

The Commission applies GASB Statement No. 40, *Deposits and Investments*, which provides guidance on disclosure information relating to investment credit risk, investment maturity information, interest rate sensitivity and foreign exchange exposure. The Commission was not subject to interest rate sensitivity of foreign exchange exposure for the years ended June 30, 2011 and 2010.

Deposits — The Commission’s investment policy establishes cash and investment guidelines for the deposit of funds. The Commission is authorized to make deposits in commercial banks, savings and loan institutions, obligations of the U.S. Treasury and U.S. Agencies, money market funds with portfolios of securities issued or guaranteed by the United States of America or agreements to repurchase these same obligations, and short-term commercial paper.

The carrying amount of the Commission’s deposits and outstanding checks with financial institutions at June 30, 2011 and 2010, totaled \$47,896,357 and \$78,349,103, respectively, while bank balances totaled \$48,825,687 and \$78,601,214, respectively. The bank balances are categorized as insured by the FDIC or collateralized with securities held by the Commission in its name.

The insured, collateralized, and the uninsured, uncollateralized cash balances carried during the year represent the compensating balances that are required to be maintained at banks in exchange for goods received or services provided.

Investments — The Lottery Article states that money that the Commission anticipates will be available for the payment of prizes on a deferred basis may be invested in direct U.S. Treasury obligations or insurance annuities. Investments are reported at fair value, except for insurance annuities, using quoted market prices. Insurance annuities are carried at cost. Changes in the fair value of the investments are recognized as non-operating revenue or expense in the statements of revenues, expenses and changes in net assets. The net change in the fair value of U.S. treasury obligations for the years ended June 30, 2011 and 2010 was (\$3,499,418) and \$5,853,879, respectively. Investments in insurance annuity contracts, at rates yielding approximately 3% to 6%, relate to deferred prize obligations.

As of June 30, 2011, the Commission had the following investments and maturities:

	Fair Value	Investment Maturities (in Years)			
		< 1 Year	1–5 Years	6–10 Years	> 10 Years
U.S. government securities	\$ 113,154,288	\$ 8,041,544	\$ 38,252,737	\$ 30,798,866	\$ 36,061,141
Certificates of deposit	<u>385,000</u>	<u>385,000</u>	-	-	-
	113,539,288	8,426,544	38,252,737	30,798,866	36,061,141
	Carrying Value				
Insurance annuities	<u>25,631,320</u>	<u>3,983,000</u>	<u>11,234,412</u>	<u>9,096,738</u>	<u>1,317,170</u>
Total investments	<u>\$ 139,170,608</u>	<u>\$ 12,409,544</u>	<u>\$ 49,487,149</u>	<u>\$ 39,895,604</u>	<u>\$ 37,378,311</u>

As of June 30, 2010, the Commission had the following investments and maturities:

	Fair Value	Investment Maturities (in Years)			
		< 1 Year	1–5 Years	6–10 Years	> 10 Years
U.S. government securities	\$ 93,592,216	\$ 6,607,011	\$ 31,356,306	\$ 25,678,284	\$ 29,950,615
Certificates of deposit	<u>385,000</u>	<u>385,000</u>	<u>-</u>	<u>-</u>	<u>-</u>
	93,977,216	6,992,011	31,356,306	25,678,284	29,950,615
	Carrying Value				
Insurance annuities	<u>28,472,374</u>	<u>4,183,000</u>	<u>12,174,907</u>	<u>9,550,095</u>	<u>2,564,372</u>
Total investments	<u>\$ 122,449,590</u>	<u>\$ 11,175,011</u>	<u>\$ 43,531,213</u>	<u>\$ 35,228,379</u>	<u>\$ 32,514,987</u>

A reconciliation of cash, cash equivalents, and investments per the balance sheet to the deposits and investments previously presented is as follows as of June 30:

	2011	2010
Balance Sheet:		
Cash and cash equivalents	\$ 47,896,357	\$ 78,349,103
Investments (current)	12,024,544	10,790,011
Investments (long-term)	126,761,064	111,274,579
Restricted assets *	<u>385,000</u>	<u>385,000</u>
Total	<u>\$ 187,066,965</u>	<u>\$ 200,798,693</u>
Notes to the Financial Statements:		
Deposits	\$ 47,896,357	\$ 78,349,103
Investments (current and long-term)	<u>139,170,608</u>	<u>122,449,590</u>
Total	<u>\$ 187,066,965</u>	<u>\$ 200,798,693</u>

* included as a component of the restricted assets balance in the accompanying statements of net assets.

The following table provides information on the credit ratings associated with the Commission's investments as of June 30, 2011 and 2010:

	S&P	Fitch	Moody's	A.M. Best	Balance at June 30, 2011	Percent of Total	Balance at June 30, 2010	Percent of Total
U.S. government securities	AAA	AAA	Aaa	unrated	\$ 113,154,288	81%	\$ 93,592,216	76%
Certificate of Deposits	unrated	unrated	unrated	unrated	385,000	0%	385,000	0%
Insurance annuities	AA-	AA-	A1	A+	<u>25,631,320</u>	<u>19%</u>	<u>28,472,374</u>	<u>24%</u>
Total investments					<u>\$ 139,170,608</u>	<u>100%</u>	<u>\$ 122,449,590</u>	<u>100%</u>

The Commission is not limited on the amount it can invest in U.S. Treasury Bills, repurchase agreements, money market funds or an interest bearing checking account. No more than \$5 million may be invested in securities for any one government agency (i.e. Federal Home Loan Bank, Federal National Mortgage Association, Federal Farm Credit Bank, and Federal Home Loan Mortgage Corporation) and no more than \$20 million in the aggregate. No more than \$5 million may be invested in commercial paper for any one company and no more than \$20 million in the aggregate. Commercial paper must be rated P-1 (Moody) or A-1 (S & P) at the time of purchase. More than 5% of the Commission's investments are in each of the following: United States Treasury Strips, Key Bank NOW Account and AEGON Institutional Markets annuities.

For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Commission will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. In 2011, the \$139 million of investments is not held by the Commission. Investments totaling \$113 million are held by the Indiana State Treasurer; therefore, these investments are not considered to have custodial credit risk. The remaining \$26 million of investments are held by outside counterparties. In 2010, the \$122 million of investments was not held by the Commission. Investments totaling \$94 million were held by the Indiana State Treasurer; therefore, these investments were not considered to have custodial credit risk. The remaining \$28 million of investments were held by outside counterparties.

4. CAPITAL ASSETS

A summary of the Commission's capital assets at June 30, 2011 and 2010 is as follows:

	Balances at June 30, 2010	Increases	Decreases	Balances at June 30, 2011
Vehicles	\$ 1,439,786	\$ 236,642	\$ (309,684)	\$ 1,366,744
Furniture, fixtures, and equipment	2,735,808	1,061,255	(170,210)	3,626,853
Data processing equipment	<u>2,419,181</u>	<u>459,330</u>	<u>(18,331)</u>	<u>2,860,180</u>
 Total capital assets — being depreciated	 <u>6,594,775</u>	 <u>1,757,227</u>	 <u>(498,225)</u>	 <u>7,853,777</u>
 Less accumulated depreciation:				
Vehicles	(930,332)	(244,151)	307,617	(866,866)
Furniture, fixtures, and equipment	(2,644,007)	(83,174)	128,832	(2,598,349)
Data processing equipment	<u>(1,588,675)</u>	<u>(463,469)</u>	<u>18,193</u>	<u>(2,033,951)</u>
 Total accumulated depreciation	 <u>(5,163,014)</u>	 <u>(790,794)</u>	 <u>454,642</u>	 <u>(5,499,166)</u>
 Total capital assets — net	 <u>\$ 1,431,761</u>	 <u>\$ 966,433</u>	 <u>\$ (43,583)</u>	 <u>\$ 2,354,611</u>
	 Balances at June 30, 2009	 Increases	 Decreases	 Balances at June 30, 2010
Vehicles	\$ 1,481,871	\$ 195,395	\$ (237,480)	\$ 1,439,786
Furniture, fixtures, and equipment	2,881,742	13,077	(159,011)	2,735,808
Data processing equipment	<u>2,167,920</u>	<u>364,190</u>	<u>(112,929)</u>	<u>2,419,181</u>
 Total capital assets — being depreciated	 <u>6,531,533</u>	 <u>572,662</u>	 <u>(509,420)</u>	 <u>6,594,775</u>
 Less accumulated depreciation:				
Vehicles	(958,600)	(205,877)	234,145	(930,332)
Furniture, fixtures, and equipment	(2,260,091)	(485,654)	101,738	(2,644,007)
Data processing equipment	<u>(1,103,808)</u>	<u>(597,796)</u>	<u>112,929</u>	<u>(1,588,675)</u>
 Total accumulated depreciation	 <u>(4,322,499)</u>	 <u>(1,289,327)</u>	 <u>448,812</u>	 <u>(5,163,014)</u>
 Total capital assets — net	 <u>\$ 2,209,034</u>	 <u>\$ (716,665)</u>	 <u>\$ (60,608)</u>	 <u>\$ 1,431,761</u>

The Commission removed \$358,039 and \$361,230 of fully depreciated capital assets during FY11 and FY10, respectively.

5. PRIZE LIABILITY

The prize liability relating to past game show, scratch-off, pull-tab and on-line winners, including an estimate of unclaimed instant and on-line winners at June 30, 2011 and 2010 is as follows:

	2011	2010
Installment prizes liability	\$ 134,884,249	\$ 114,608,073
Scratch-off game liability	44,053,890	37,270,453
Pull tab game liability	2,057,862	1,510,194
On-line game liability	<u>4,660,636</u>	<u>14,610,917</u>
Total prize liability	185,656,637	167,999,637
Less current portion	<u>(62,813,388)</u>	<u>(64,196,564)</u>
Noncurrent portion	<u>\$ 122,843,249</u>	<u>\$ 103,803,073</u>

Future payments of prize liability as of June 30, 2011, are as follows:

Fiscal Years Ending June 30	Long Term Liability	Other Accrued Prize Liability	Total
2012	\$ 12,041,000	\$ 50,772,388	\$ 62,813,388
2013	11,491,000	-	11,491,000
2014	11,171,000	-	11,171,000
2015	10,921,000	-	10,921,000
2016	10,821,000	-	10,821,000
2017–2021	53,564,000	-	53,564,000
2022–2026	42,809,000	-	42,809,000
2027–2031	20,595,000	-	20,595,000
2032–2036	13,793,000	-	13,793,000
2037-2040	<u>6,607,000</u>	<u>-</u>	<u>6,607,000</u>
Total	193,813,000	50,772,388	244,585,388
Less unamortized discount	<u>(58,928,751)</u>	<u>-</u>	<u>(58,928,751)</u>
Total at present value	134,884,249	50,772,388	185,656,637
Less current portion	<u>(12,041,000)</u>	<u>(50,772,388)</u>	<u>(62,813,388)</u>
Total long-term portion at present value	<u>\$ 122,843,249</u>	<u>\$ -</u>	<u>\$ 122,843,249</u>

Prize liability installments are discounted to their present value at date of award. This discounted value approximates fair value. Interest is not paid on prizes.

6. OPERATING LEASES

The Commission leases office space, under noncancelable operating leases, in each of its regional offices and at its headquarters located in Indianapolis under initial lease terms of one to 10 years, and warehouse space for its ticket inventory. The Commission also leases office equipment on terms ranging from two to five years, including a scratch-off ticket vending machine lease. Total rental expense was \$2,415,188 and \$2,118,168 for the years ended June 30, 2011 and 2010, respectively.

The future minimum rental payments required under noncancelable operating leases with original terms in excess of one year are as follows:

Fiscal Years Ending June 30	
2012	\$ 1,135,267
2013	630,030
2014	632,940
2015	664,949
2016	664,949
2017 - 2021	<u>3,409,009</u>
Total	<u>\$7,137,144</u>

7. COMMITMENTS AND CONTINGENCIES

Commitments — The Commission is a member of the Multi-State Lottery Association (“MUSL”), an unincorporated government-benefit voluntary association created for the purpose of administering joint lottery games. MUSL currently consists of 33 state and district lotteries (“member lotteries”) and operates the on-line Powerball game and manages the Mega Millions game for its participating member lotteries. Under separate agreements between MUSL and each lottery, the member lotteries sell tickets for this game and remit a percentage of sales to prize winners or to MUSL for payment of prizes.

As a member of MUSL, the Commission is required to contribute to various prize reserve funds held by MUSL. Accounts were established by MUSL as a contingency reserve to fund prizes in excess of the game prize structure and to protect all member lotteries and MUSL from any unforeseen liabilities. All funds remitted, and the related interest earned, will be returned to the Commission upon leaving MUSL, less any portion of unanticipated prize claims that may have been paid from the funds. As of June 30, 2011 and 2010, the Commission’s balance of prize reserve funds, included in restricted assets in the accompanying statement of net assets, was \$8,009,432 and \$7,591,094, respectively.

Restricted assets also contain the Retailers Bonding Fund, with a balance as of June 30, 2011 and 2010, of \$388,553 and \$386,964, respectively.

Litigation — Periodically, the Commission is subject to certain legal and administrative actions that arise in the normal course of its operations. As of June 30, 2011, the Commission’s management believes that the ultimate outcome of any pending legal matters will not have a material adverse impact on the Commission’s financial position.

8. RETIREMENT PLANS

Deferred Compensation Plan — The Commission offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all employees, allows an employee to contribute a minimum of \$15 per paycheck or 1% of eligible earning (percentage withholding must equal at least \$15) and a maximum of 100% of includible compensation (subject to Internal Revenue Service limitations). Employees are immediately vested in their contributions. Contributions by plan participants during the fiscal years ended June 30, 2011 and 2010 were approximately \$274,384 and \$278,795, respectively.

The Commission made a matching contribution of \$15 per paycheck for each employee participating in the 457 Deferred Compensation Plan into a 401(a) Incentive Match Plan through January 2010. Employees are immediately vested in the employer match made by the Commission. Contributions by the Commission during the fiscal years ended June 30, 2011 and 2010 were approximately \$0 and \$19,575, respectively.

Defined Benefit Pension Plan — The Commission has adopted a single-employer defined benefit pension plan. Article 30 of the state statute of Indiana assigns the Commission to establish and amend benefit provisions. An independent contractor administers the Employees' Pension Plan of the State Lottery Commission of Indiana (the "Plan"). The Plan covers virtually all of the Commission's full time employees over the age of 21, providing retirement, death, and disability benefits. Upon employee retirement at age 65, the Plan provides annual benefits equal to 2% of an employee's average salary earned during the highest five consecutive years of employment multiplied by the number of full-time years of employment up to a maximum of 25 years. Participants become fully vested after four years of service. Employees cannot contribute to the plan. The plan permits retirees to choose their form of distribution from several alternatives including a lump sum option.

During FY 07, the Plan was amended to (a) change the Plan's accounting year-end to June 30 in order to make it consistent with the Commission's fiscal year-end and (b) modify the benefits available to participants who elect early retirement. Now, early retirement benefits will be reduced by 5% for each year that benefit commencement precedes the participant's 65th birthday. Previously, the reductions were based on an actuarial table. As a result of the change in the Plan's accounting year-end noted above, the actuarial valuation date was changed from January 1, to July 1. Additionally, the Plan was "fresh started" as of July 1, 2006 and the Plan's funding method was changed to entry age normal.

The Commission applies Governmental Accounting Standards Board ("GASB") Statement No. 50, *Pension Disclosures, an amendment of GASB Statements No. 25 and No. 27* and GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*. GASB Statement No. 50 requires the disclosure of the funded status of the plan as of the most recent valuation date and a reference linking the funded status disclosure in the notes to financial statements to the required schedule of funding progress in the Required Supplementary Information (RSI). GASB Statement No. 27 requires that the measurement of pension expense for a period be similar to the required contributions for that period and related information reported be consistent. The resulting pension asset (liability) required to comply with the provisions of GASB Statement No. 27 was determined in accordance with this statement and is included in the accompanying statements of net assets as Prepaid Expenses in the amount of \$2,159,259 for 2011 and \$2,602,343 for 2010.

The Commission's annual pension cost and net pension obligation to the Plan is as follows:

	Year Ended June 30, 2011	Year Ended June 30, 2010	Year Ended June 30, 2009	Year Ended June 30, 2008
Annual required contribution	\$ 894,186	\$ 1,146,464	\$ 824,943	\$ 561,405
Interest on net pension obligation	(370,863)	(345,412)	(352,997)	(382,574)
Adjustment to annual required contribution	<u>428,842</u>	<u>394,840</u>	<u>399,278</u>	<u>428,571</u>
Annual pension cost	952,165	1,195,892	871,224	607,402
Contributions made	<u>(1,129,491)</u>	<u>(1,514,023)</u>	<u>(776,417)</u>	<u>(237,693)</u>
(Decrease) increase in net pension obligation	(177,326)	(318,131)	94,807	369,709
Net pension asset (obligation), beginning	<u>(4,635,785)</u>	<u>(4,317,654)</u>	<u>(4,412,461)</u>	<u>(4,782,170)</u>
Net pension asset (obligation), end	<u>\$ (4,813,111)</u>	<u>\$ (4,635,785)</u>	<u>\$ (4,317,654)</u>	<u>\$ (4,412,461)</u>
Percentage of annual pension cost contributed	126.3%	132.1%	94.1%	42.3%

The annual required contribution and contribution rate for the current year was determined as part of the July 1, 2011 actuarial valuation using the normal entry age actuarial cost method. In prior years, the frozen entry age cost method was used. The actuarial assumptions included (a) an investment return assumption of 8.0% per year (Note: the post-retirement investment return assumption is reduced to 5% per year to reflect the effect of the plan's lump sum option) and (b) an annual 4.0% increase in salary assumption. The amortization method used is a level dollar amount on a closed basis over 10 years. The actuarial value of assets was determined using market value.

As of July 1, 2006, the Commission had an unfunded actuarial accrued liability of \$3,105,530. The Commission made a one-time payment of \$3,000,000 in October 2006 to fund the unfunded pension liability. In June 2005, the Commission made a one-time payment of \$1,430,839 to fund the unfunded liability as of January 1, 2005. These amounts are included in prepaid expenses on the statement of net assets as of June 30, 2011 and 2010 and are being amortized ratably over a ten year period in the statement of revenues, expenses and changes in net assets.

The Commission's eight-year trend information, by Plan year, is as follows:

Plan Year Ended	Annual Required Contribution	Actual Employer Contribution	Percentage Contributed	Net Pension Asset
December 31, 2004	719,136	719,136	100.0	(110,367)
December 31, 2005	887,737	1,991,460	224.3	(1,210,467)
Six months ended June 30, 2006	217,407	756,656	348.0	(1,729,849)
June 30, 2007	958,889	4,026,480	419.9	(4,782,170)
June 30, 2008	561,405	237,693	42.3	(4,412,461)
June 30, 2009	824,943	776,417	94.1	(4,317,654)
June 30, 2010	1,146,464	1,514,023	132.1	(4,635,785)
June 30, 2011	894,186	1,129,491	126.3	(4,813,111)

REQUIRED SUPPLEMENTARY INFORMATION

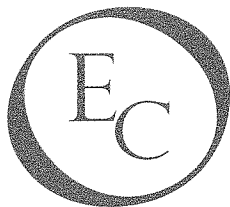
THE STATE LOTTERY COMMISSION OF INDIANA

REQUIRED SUPPLEMENTARY INFORMATION SCHEDULE OF FUNDING PROGRESS FOR PENSION PLAN *

Valuation Date	Valuation of Assets (a)	Accrued Liability ** (b)	Unfunded Accrued Liability (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	Unfunded Liability as % of Payroll ((b-a)/c)
1/1/2004	7,673,634	9,362,428	1,688,794	82.0	8,395,882	20.1
1/1/2005	8,254,981	9,909,288	1,654,307	83.3	9,302,333	17.8
1/1/2006	9,146,422	9,597,771	451,349	95.3	6,676,472	6.8
7/1/2006	9,684,229	12,789,759	3,105,530	75.7	7,331,750	42.4
7/1/2007	14,212,236	12,825,945	(1,386,291)	110.8	7,798,129	(17.8)
7/1/2008	12,656,765	12,920,838	264,073	98.0	8,591,645	3.1
7/1/2009	8,871,453	12,524,241	3,652,788	70.8	8,467,374	43.1
7/1/2010	10,085,843	11,986,403	1,900,560	84.1	7,335,049	25.9
7/1/2011	12,443,439	12,948,905	505,466	96.1	7,978,173	6.3

* Prior to July 1, 2006, determined under the Frozen Entry Age Actuarial Cost Method, as defined in Statement #27 of the Governmental Accounting Standards Board. Effective July 1, 2006, determined under the Entry Age Normal Actuarial Cost Method, as defined in Statement #27 of the Governmental Accounting Standards Board. The amortization of the Unfunded Actuarial Accrued Liability is based on a 30 - year closed period from July 1, 2006.

** The Unfunded Accrued Liability was "fresh started" as of January 1, 2001.



**INDEPENDENT AUDITORS' 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**

To the State Lottery Commission of Indiana:

We have audited the financial statements of the State Lottery Commission of Indiana ("Commission") as of and for the year ended June 30, 2011 and 2010, and have issued our report thereon dated September 27, 2011. 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

Management of the Commission is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Commission's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Commission's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Commission's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. *A material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Commission's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations – specifically Indiana Code, Title 4, Article 30, contracts, 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 State Lottery Commission of Indiana and management and is not intended to be and should not be used by anyone other than these specified parties.

E. C. Gutiz & Co. LLP

September 27, 2011