

ANNUAL REPORT

South Dakota
LOTTERY™



**FISCAL YEAR 2014
ANNUAL REPORT**

A Division of the South Dakota Department of Revenue



FY2014 Annual Report

DEPARTMENT OF REVENUE

Secretary Andrew Gerlach

SOUTH DAKOTA LOTTERY

Executive Director

Norm Lingle

Deputy Executive Director

Clark Hepper

SOUTH DAKOTA LOTTERY COMMISSION

Chairman

Bob Hartford

Doyle Estes

Brent Dykstra

Roger Novotny

Jim Putnam

Jim Towler

Chuck Turbiville



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Message from the Executive Director

To the Governor, Legislature and People of South Dakota:

The 2014 Fiscal Year Annual Report of the South Dakota Lottery illustrates our performance in three revenue categories: lotto, scratch, and video lottery. As a division of the Department of Revenue, we worked hard to bring forward changes and improvements to each of these areas in order to ensure profits, remain viable and sustainable for the State of South Dakota. I'm pleased to share what our staff and the South Dakota Lottery Commission have accomplished.

Thanks to our loyal players and retail partners, the South Dakota Lottery provided \$106.2 million to funds that improve the quality of life in South Dakota. \$7.5 million was added to the Capital Construction Fund which is used to pay for rural water systems, community drinking water and wastewater improvement projects, and recycling and waste disposal programs. We also provided \$91.7 million to help lower local property taxes on owner-occupied and agricultural land by 30%, while \$6.8 million was added to the General Fund which funds local K-12 schools and state universities and technical institutes. In total, we have distributed an impressive \$2.35 billion to our beneficiaries since the start of the Lottery.

I invite you to take some time to read more about our highlights and improvements from Fiscal Year 2014. We look forward to the new games, winners and proceeds that Fiscal Year 2015 will bring.

Sincerely,



Norm Lingle
Executive Director
South Dakota Lottery



Mission Statement

To work cooperatively with our partner licensees to promote and ensure the integrity, fairness, security and honesty of lottery games, to maximize revenues for state programs and initiatives, and to ensure the Lottery remains a viable and sustainable source of revenue and entertainment for the State of South Dakota.

SALES AND REVENUES

Total fiscal year 2014 revenue distributed to state funds was over \$106 million.

	SALES	PRIZES	RETAILER COMMISSIONS	REVENUE DISTRIBUTED
Instant Tickets	\$25,517,805	\$16,759,787	\$1,444,198	\$5,362,306
Lotto Tickets	\$28,580,432	\$14,486,518	\$1,509,118	\$8,917,262
Video Lottery**	\$590,520,297	\$405,273,569	\$92,623,364	\$91,941,457
			TOTAL	\$106,221,025

**video lottery sales = cash in; prizes = cash out; private share of net machine income = retailer commission.

FY2014 REVENUE APPROPRIATIONS

Revenue from each of the three types of lottery products is designated for specific purposes. All monies from the sale of scratch tickets are transferred to the state General Fund, nearly half of which supports local K-12 schools, state universities and technical institutes.

	GENERAL FUND	CAPITOL CONSTRUCTION FUND	PROPERTY TAX REDUCTION FUND	DEPARTMENT OF SOCIAL SERVICES
Instant Tickets	\$5,362,306			
Lotto Tickets	\$1,400,000			
Video Lottery	\$75,000	\$7,517,262	\$91,697,131	\$169,326
TOTALS	\$6,837,306	\$7,517,262	\$91,697,131	\$169,326

The first \$1.4 million in revenue from lotto tickets is put into the General Fund. Anything beyond that amount is transferred to the Capital Construction Fund which filters money to the following areas:

- **Water and Environment Fund** - used for a variety of projects from drinking water and wastewater improvement to recycling to natural resource development.
- **Ethanol Fuel Fund** - provides annual production payments to qualified South Dakota ethanol producers.

- **State Highway Fund** - used for state highways and bridges.

Revenue generated from video lottery terminals, or Net Machine Income (NMI), is calculated by taking the cash put into the machines minus the prizes paid out. The NMI for each machine is split between the State of South Dakota and the licensed operator who owns the machine, each earning half of the total. Of the state's share, 49.5% is transferred to the Property Tax Reduction Fund which is used to replace local property tax revenue for

K-12 schools and lowers local property tax levies on owner-occupied and agricultural land.

The South Dakota Lottery prides itself on using every dollar earned as an investment in the future of South Dakota.

FISCAL YEAR 2014 HIGHLIGHTS

The South Dakota Lottery is constantly looking for new ideas that benefit players and grow revenue. These efforts make playing the lottery more fun and exciting and ensures the lottery remain viable and sustainable for the State of South Dakota. These incomes help to fund education, lower property taxes, and develop natural resources.

INSTANT TICKETS

The Lottery launched 33 new scratch tickets during Fiscal Year 2014 with price points ranging from \$1 to \$20. Top prizes ranged from \$500 to \$400,000.

The South Dakota Lottery has 614 scratch ticket retailers statewide, and 78 percent were convenience stores in FY2014. The remaining retailers were made up of 17 percent grocery stores and 5 percent restaurants, bars, liquor and drug stores. Sales were up .9 percent from the previous fiscal year.

PLAY IT AGAIN

The South Dakota Lottery launched “Play It Again” in April 2014. This second chance drawing program gives Lottery Players Club members the opportunity to submit non-winning tickets into a web-based drawing for chances to win cash and prizes. The drawings are offered for specific scratch ticket games or groups of games; the first eligible game

was \$10K Run, a \$2 scratch ticket.

The South Dakota Lottery is excited to be providing the Play It Again program which will extend the life of the selected scratch games, add a value feature for the player, and increase Lottery Players Club membership.



The \$10K Run grand prize drawing is set for December 18 2014, and a second drawing for all eligible \$2 and \$3 games will be held in February of 2015.

LOTTO GAMES

South Dakota offered five lotto games in FY2014. Powerball, Hot Lotto, Wild Card 2, and Mega Millions are played in multiple jurisdictions. Dakota Cash is South Dakota’s very own game.

There were 602 lotto retailers operating throughout the fiscal year. Overall lotto sales were down 10.8 percent from the previous year. Powerball sales were down 22 percent, Mega Millions was up 56 percent. Dakota Cash sales were down 10 percent. Hot Lotto sales were down 7 percent. Wild Card 2 sales were down 2 percent.

UPDATES TO MEGA MILLIONS

The South Dakota Lottery Commission approved changes to the Mega Millions lotto game during FY2014. The modifications took effect in October 2013 and resulted in an increase in prize amounts and modifications to the matrix. The game had not changed since South Dakota began offering Mega Millions in 2010.



Under the enhanced game, the starting jackpot increased from \$12 million to \$15 million and will now grow by at least \$5 million after each drawing in which the jackpot is not won. The second prize, matching all draw numbers but not the Mega Ball, increased from \$250,000 to \$1 million. The Megaplier option was expanded to include a five multiplier, creating a chance to win up to \$5 million when a player purchases the additional feature for an extra dollar.

The matrix changes created a pool of 75 white ball numbers for players to choose from, up from 56, and one Mega Ball number from a pool of 15, down from 46. This resulted in overall odds of 1 in 15 to win any prize and 1 in 259 million to win the Mega Millions jackpot.

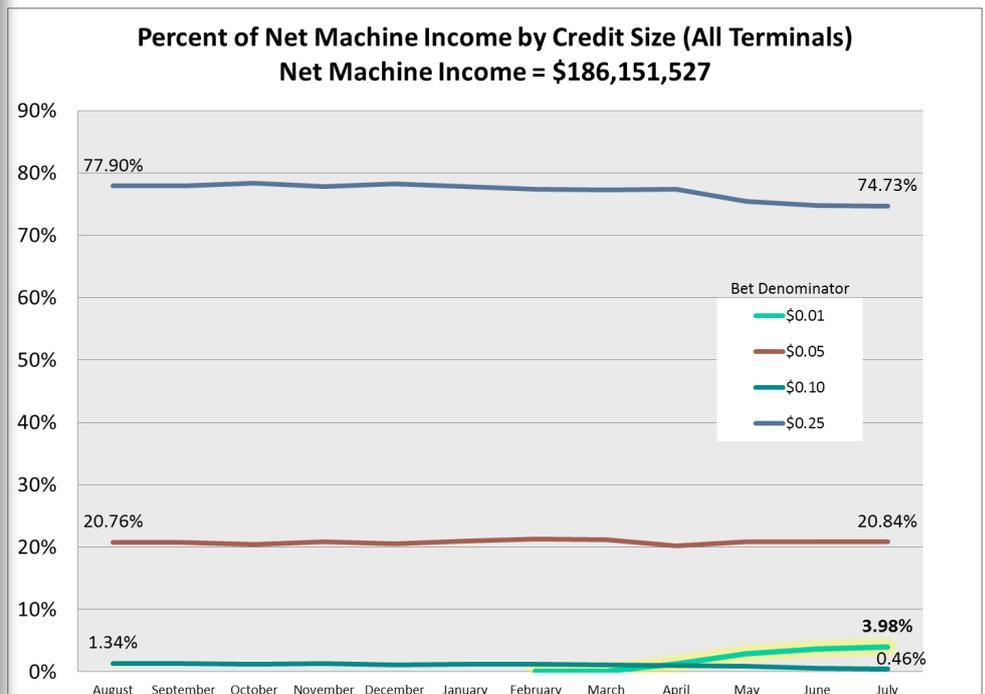
VIDEO LOTTERY

The South Dakota Lottery regulates and controls video lottery game activities through licensing procedures for the machines, machine owners, establishments, distributors, and manufacturers. The Lottery also oversees the secure central computer system and tests new terminal hardware and software. Video lottery net revenue was up .33 percent from the previous year. The average number of active video lottery machines during the year was 9,046. The average number of establishments was 1,401. Revenue from video lottery net machine income is distributed to the Property Tax Reduction Fund. A portion of machine manufacturer license fees is distributed to the General Fund.

VIDEO LOTTERY PERFORMANCE

The South Dakota Lottery made some strategic additions and revisions during the fiscal year in order to better serve video lottery players and establishments.

Penny bets for line games came into effect in February 2014, after amendments to proposed rule numbers 48:02:01:01 and 48:02:08:01 were officially adopted in May 2013. The penny and dime denominations are only



available on the newer machines.

In a study of the performance (refer to the graph on page 4) on penny game play, the penny credits show a 4% growth from February through July, while all of the credit sizes show a drop. The penny credit rose significantly and made up over 25% of the revenue during the second half of the fiscal year. Additionally, the average bet on a penny line game was 62 cents, which was higher than all the other games at the nickel level.

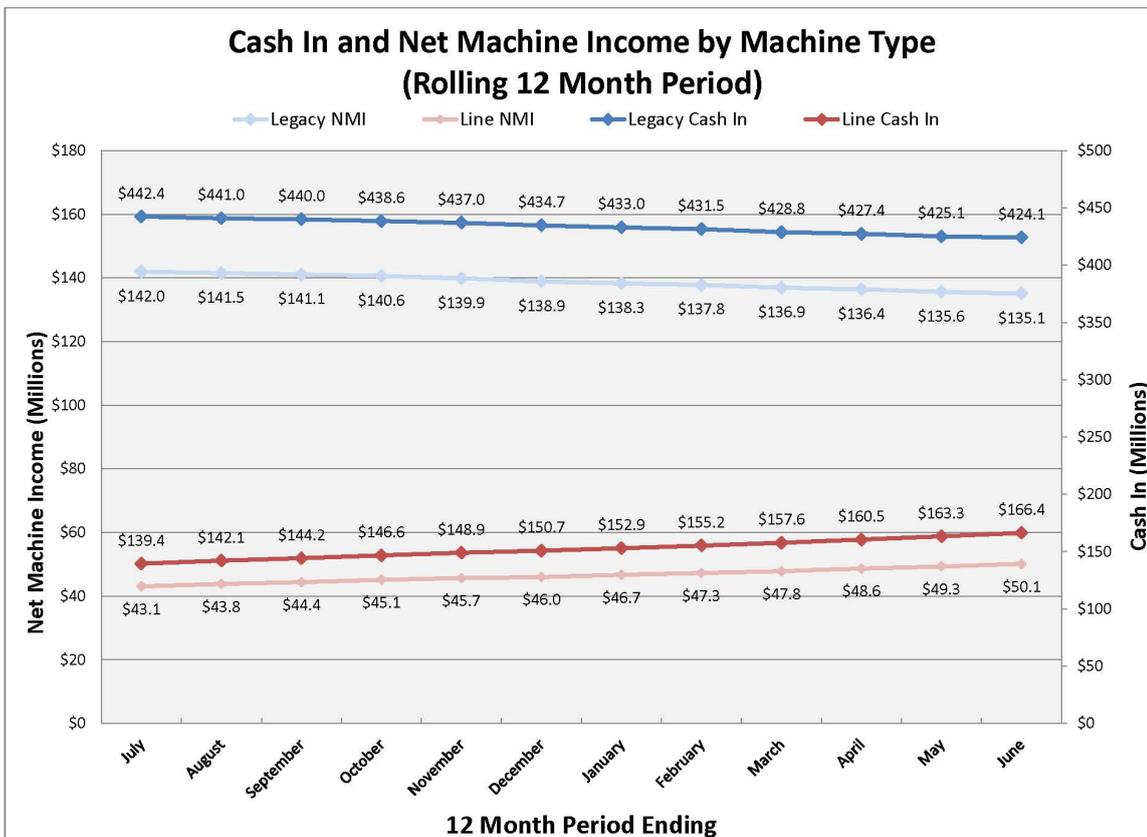
The video lottery industry in South Dakota recently introduced new line games into the field. The older legacy machines offer games like poker, keno and blackjack, while the new line game machines have players match symbols on spinning reels. In Fiscal Year 2014, the older legacy machines showed a steady decline in cash-in and Net Machine Income (NMI) over the 12 months, while the newer machines had a gradual increase. This trend shows that line games are becoming more

popular, and may suggest that players are moving from the legacy machines to the line game machines.

The South Dakota Lottery hopes to continue with innovative changes, and implemented an updated strategic plan that was approved by the South Dakota Lottery Commission in November 2013. The FY2013 Strategic Plan included nine short and long term goals that have been successfully met. As part of the new Strategic Plan, the agency has expanded the promotions policy for video lottery establishments. These changes give partners more latitude in conducting promotions in their casinos to maintain their current customer base and attract new players. Establishments must follow the framework specified in administrative rule along with a few other stipulations, but the changes would allow them to move forward with their event or promotion without the Lottery's specific permission. With the approval of

the new policy, the Commission repealed Declaratory Ruling 91-2, which was implemented in 1991 at the beginning of video lottery in South Dakota.

An ongoing project under the Strategic Plan is the development and maintenance of a marketing plan to promote video lottery and increase its player base.





PREMIER STORE

In an effort to increase sales and brand awareness, a selected retailer works with staff to saturate South Dakota Lottery branding throughout their business. The project is then completed with a heavily publicized in-store event. The South Dakota lottery introduced the first Premier Store in the state this year.

Darrell Lich, owner of EZ Mart on E. Highway 44 in Rapid City, agreed to have his store interior covered in a bright yellow advertising “wrap” that features South Dakota Lottery logos and colors. The signage can be found on overhead areas, cabinets, tabletops, front counters, storage areas, windows and floors.

Lottery officials hosted a special grand re-opening on May 2, 2014 at the EZ Mart location. The event included a ribbon cutting, two hour remote radio coverage with KSKY, scratch ticket specials, free refreshments and in-store specials. Lich also benefited from a plethora of pre-promotion marketing in anticipation of the event. The store has a fresh new look and has seen an increase in lottery sales.

The South Dakota Lottery hopes to debut more Premier Stores throughout the state in 2015.





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MARTIN L. GUINDON, CPA
AUDITOR GENERAL

INDEPENDENT AUDITOR'S 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

The Honorable Dennis Daugaard
Governor of South Dakota

and

The South Dakota Lottery Commission
State of South Dakota

We have audited, in accordance with the 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, the financial statements of the South Dakota Lottery Fund, an enterprise fund of the State of South Dakota, as of and for the years ended June 30, 2014 and 2013, and the related notes to the financial statements, which collectively comprise the South Dakota Lottery Fund's basic financial statements and have issued our report thereon dated October 31, 2014.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the South Dakota Lottery's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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 South Dakota Lottery's internal control. Accordingly, we do not express an opinion on the effectiveness of the South Dakota Lottery's internal control.

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 a 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. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the South Dakota Lottery's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and 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*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose. As required by South Dakota Codified Law 4-11-11, this report is a matter of public record and its distribution is not limited.



Martin L. Guindon, CPA
Auditor General

October 31, 2014



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MARTIN L. GUINDON, CPA
AUDITOR GENERAL

INDEPENDENT AUDITOR'S REPORT

The Honorable Dennis Daugaard
Governor of South Dakota

and

The South Dakota Lottery Commission
State of South Dakota

Report on the Financial Statements

We have audited the accompanying financial statements of the South Dakota Lottery Fund, an enterprise fund of the State of South Dakota, as of and for the years ended June 30, 2014 and 2013, and the related notes to the financial statements, as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the South Dakota Lottery, an enterprise fund of the State of South Dakota, as of June 30, 2014 and 2013, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1, the financial statements present only the South Dakota Lottery Fund and do not purport to, and do not, present fairly the financial position of the State of South Dakota, as of June 30, 2014 and 2013, the changes in its financial position, or, where applicable, its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Matters

Supplementary and Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the South Dakota Lottery's basic financial statements. The *FY2014 Highlights* and *FY2014 Sales and Revenue* sections are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The *FY2014 Highlights* and *FY2014 Sales and Revenue* sections have not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on them.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated October 31, 2014 on our consideration of the South Dakota Lottery'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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering South Dakota Lottery's internal control over financial reporting and compliance.



Martin L. Guindon, CPA
Auditor General

October 31, 2014

Financial Statements

SOUTH DAKOTA LOTTERY
STATEMENT OF NET POSITION
 June 30, 2014 and 2013

Assets	2014	2013
Current Assets:		
Cash	\$8,608,666	\$9,612,150
Restricted Cash	24,182	21,582
Total Cash	8,632,848	9,633,732
Accounts Receivable	4,844,516	4,403,348
Restricted Other Receivable	813,003	817,117
Interest Receivable	47,919	44,732
Restricted Certificates of Deposit	462,699	472,199
Total Current Assets	14,800,985	15,371,128
Noncurrent Assets:		
Capital Assets less Accumulated Depreciation/Amortization	1,786,401	2,549,011
Total Assets	16,587,386	17,920,139
Liabilities		
Current Liabilities:		
Accounts Payable	262,300	456,395
Prizes Payable	1,235,946	1,597,316
Due to the Property Tax Reduction Fund	3,545,146	3,460,463
Due to the Capital Construction Fund	1,417,262	2,387,780
Due to the General Fund	1,362,306	821,600
Due to Other Funds	96,404	66,881
Due to Other Governments	17,640	
Operator Security Deposits	486,881	493,781
Escrows Payable-Reservation Sales	64,997	68,085
Accrued Liabilities	274,365	287,578
Unearned Revenue	286,824	286,082
Total Current Liabilities	9,050,071	9,925,961
Noncurrent Liabilities:		
Accrued Liabilities	150,125	144,880
Total Liabilities	9,200,196	10,070,841
Net Position		
Net Investment in Capital Assets	1,786,401	2,549,011
Restricted for MUSL Permitted Uses	813,003	817,117
Unrestricted	4,787,786	4,483,170
Total Net Position	\$7,387,190	\$7,849,298

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

SOUTH DAKOTA LOTTERY
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET POSITION
For the Fiscal Years Ended June 30, 2014 and 2013

Operating Revenues:	FY2014	FY2013
Video Lottery Revenue	\$92,623,364	\$92,320,281
Instant Ticket Sales	25,517,805	25,298,065
On-Line Ticket Sales	28,580,432	32,048,317
Terminal License Fees	1,101,800	1,094,600
Retailer License Fees	449,210	520,350
Total Operating Revenue	<u>148,272,611</u>	<u>151,281,613</u>
 Direct Game Costs:		
Instant Prizes	16,759,787	16,213,494
On-Line Prizes	14,486,518	16,205,052
Instant Retail Commissions	1,444,198	1,421,847
On-Line Retail Commissions	1,509,118	1,709,358
Instant Ticket Print Costs	535,620	725,523
Total Direct Costs	<u>34,735,241</u>	<u>36,275,274</u>
Gross Profit	<u>113,537,370</u>	<u>115,006,339</u>
 Operating Expenses:		
Personal Services and Benefits	1,805,799	1,627,461
Travel	135,302	136,859
Advertising	799,873	659,924
Contractual Services	4,300,481	4,396,929
Supplies and Materials	166,984	149,758
Depreciation/Amortization	784,410	784,060
Bad Debt Expense		1,981
Payments to Reservations	64,997	68,085
Total Operating Expenses	<u>8,057,846</u>	<u>7,825,057</u>
Operating Income	<u>105,479,524</u>	<u>107,181,282</u>
 Non-operating Revenues (Expenses):		
Pooled Investment Income	243,118	151,658
Investment Costs	(13,199)	(11,232)
Non-operating Revenue from MUSL	14,075	110,298
Miscellaneous Revenue	35,399	21,685
Total Non-operating Revenue (Expenses)	<u>279,393</u>	<u>272,409</u>
Income Before Transfers	<u>105,758,917</u>	<u>107,453,691</u>
 Transfers:		
Transfers to the Property Tax Reduction Fund	91,697,131	91,397,079
Transfers to the General Fund	6,837,306	7,156,600
Transfers to the Capital Construction Fund	7,517,262	8,987,780
Transfers to the Department of Social Services	169,326	161,856
Total Transfers	<u>106,221,025</u>	<u>107,703,315</u>
 Special Items:		
Lotto Signs Provided by Contract Extension		1,296,600
Total Special Items	<u>0</u>	<u>1,296,600</u>
Change in Net Position	<u>(462,108)</u>	<u>1,046,976</u>
 Net Position Beginning of Year	 <u>7,849,298</u>	 <u>6,802,322</u>
 Net Position End of Year	 <u><u>\$7,387,190</u></u>	 <u><u>\$7,849,298</u></u>

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

SOUTH DAKOTA LOTTERY
STATEMENT OF CASH FLOWS

For the Fiscal Years Ended June 30, 2014 and 2013

Cash Flows from Operating Activities	FY2014	FY2013
Receipts from Customers and Users	\$147,820,174	\$151,168,369
Payments for Lottery Prizes	(31,567,874)	(32,228,926)
Payments to Suppliers	(8,303,255)	(8,557,799)
Payments for Interfund Services Used	(733,214)	(676,156)
Payments for Employee Services	(1,813,767)	(1,546,659)
Other Receipts (Payments)	(41,726)	14,828
Net Cash Provided (Used) by Operating Activities	105,360,338	108,173,657
 Cash Flows from Capital and Related Financing Activities		
Purchase of Capital Assets	(21,800)	
Net Cash Provided (Used) by Capital and Related Financing Activities	(21,800)	0
 Cash Flows from Noncapital Financing Activities		
Transfers to Other Funds	(106,566,154)	(107,812,926)
Net Cash Provided (Used) by Noncapital Financing Activities	(106,566,154)	(107,812,926)
 Cash Flows from Investing Activities		
Pooled Investment Income	239,931	157,460
Investment Costs	(13,199)	(11,232)
Net Cash Provided (Used) by Investing Activities	226,732	146,228
 Net Increase (Decrease) in Cash during the Fiscal Year	 (1,000,884)	 506,959
 Cash at Beginning of Year	 9,633,732	 9,126,773
Cash at End of Year	\$8,632,848	\$9,633,732
 Reconciliation of Operating Income to Net Cash		
Provided (Used) by Operating Activities		
Operating Income	\$105,479,524	\$107,181,282
Adjustments to Reconcile Operating Income (Loss) to Net Cash Provided by Operating Activities:		
Depreciation/Amortization Expense	784,410	784,060
Other Revenue	35,399	21,685
Non-operating Revenue from MUSL	14,075	110,298
Decrease/(Increase) in Assets:		
Accounts Receivable	(441,168)	(103,104)
Restricted Other Receivable	4,114	(25,265)
Restricted Certificates of Deposit	9,500	30,822
Increase/(Decrease) in Liabilities:		
Accounts Payable	(194,095)	605
Prizes Payable	(361,370)	145,920
Due to Other Funds	29,523	(14,870)
Due to Other Governments	17,640	(2,814)
Operator Security Deposits	(6,900)	(26,222)
Escrows Payable	(3,088)	(8,834)
Allowance for Doubtful Accounts		1,981
Accrued Liabilities	(7,968)	80,802
Unearned Revenue	742	(2,689)
Total Adjustments	(119,186)	992,375
Net Cash Provided by Operating Activities	\$105,360,338	\$108,173,657

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

SOUTH DAKOTA LOTTERY
NOTES TO THE FINANCIAL STATEMENTS
For the Fiscal Years Ended June 30, 2014 and 2013

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION. The South Dakota Lottery markets instant tickets and lotto games, and regulates video lottery to raise revenue for State programs and projects.

The South Dakota Lottery was created during the 1987 Legislative Session by the passage of Senate Bill 254. The legislation authorized the Lottery to market instant games, with sales commencing on Sept. 30, 1987.

Video Lottery was created by the passage of Senate Bill 129 during the 1989 Legislative Session. It gave the Lottery authority to license and regulate a video lottery game with play commencing on Oct. 16, 1989.

Lotto games were approved by the 1990 Legislature through the passage of Senate Bill 86. South Dakota was accepted as a member of the Multi-State Lottery Association (MUSL) in April of 1990 and began selling tickets on Nov. 15, 1990. The current lotto games offered by the Lottery are Powerball, Power Play, Mega Millions, Megaplier, Hot Lotto, Sizzler, Wild Card 2 and Dakota Cash.

BASIS OF PRESENTATION. The South Dakota Lottery Fund is accounted for as a proprietary type enterprise fund for the State of South Dakota. Proprietary funds are accounted for using the accrual basis of accounting. The accompanying financial statements are prepared in accordance with generally accepted accounting principles (GAAP) for governments as prescribed by the Governmental Accounting Standards Board (GASB). The South Dakota Lottery is considered part of the primary government as reported by the State of South Dakota. Revenues are recognized when they are earned, and expenses are recognized when they are incurred.

CASH. Cash includes cash on hand, demand deposits, and a participating interest in the State's internal investment pool held by the State Treasurer. The amount held in the State's internal investment pool is reported at fair value.

Management of the State's internal investment pool is the statutory responsibility of the South Dakota Investment Council (SDIC). The investment policy and required risk disclosures for the State's internal investment pool are presented in the SDIC's audit report which can be obtained by contacting the Department of Legislative Audit, 427 South Chapelle, C/O 500 East Capital, Pierre, South Dakota 57501.

RESTRICTED CASH. Restricted cash is the amount of operator security deposits in the form of cash on deposit with the Lottery.

ACCOUNTS RECEIVABLE. Accounts receivable (net) represents the following at June 30:

	2014	2013
Uncollected instant/on-line ticket revenues	\$1,212,489	\$876,797
Allowance for doubtful instant/on-line accounts	(14,457)	(14,457)
Uncollected video lottery revenues and fees	3,646,484	3,541,008
	\$4,844,516	\$4,403,348

RESTRICTED OTHER RECEIVABLE. The Restricted Other Receivable account represents the South Dakota Lottery's share of funds held by the Multi-State Lottery Association (MUSL) in an Unreserved Account. The earnings from

MUSL operations are deposited into this account and considered to be distributions to the member lotteries. This money may be used by a member lottery only for the purposes approved by the MUSL Board.

OPERATOR SECURITY DEPOSITS. ARSD 48:02:05:04(18) requires video lottery operators to furnish to the Lottery by July 1 of each year, security equal to one-eighteenth of the State's share of estimated annual net machine income derived from the operator's video lottery machines. Security may be in the form of a surety bond, deposit in cash, an irrevocable letter of credit, or a certificate of deposit issued by a South Dakota financial institution with the Lottery endorsed on it as a payee. As of June 30, 2014 and 2013, the amount of cash on deposit with the Lottery was \$24,182 and \$21,582 and the amount of certificates of deposit being held by the Lottery was \$462,699 and \$472,199, respectively. The amount of \$4,956,100 and \$4,939,000, respectively, was in the form of surety bond or irrevocable letter of credit and are not reported on the Statement of Net Position. The total Security Deposits on June 30, 2014 and 2013 were \$5,442,981 and \$5,432,781, respectively.

CAPITAL ASSETS. Assets are capitalized based on policies established by the South Dakota Bureau of Finance and Management. Capital assets are capitalized at cost or estimated historical cost, if the original cost is unavailable. Equipment is capitalized when the cost of individual items is \$5,000 or more. Intangible assets are capitalized when the cost of individual items is more than \$250,000. Depreciation or amortization on capital assets is computed using the straight line method over the estimated useful lives of the assets, which is 3 to 10 years for all equipment and 3 to 25 years for intangible assets. When assets are disposed of, the costs and related accumulated depreciation are removed from the accounts and any gain or loss is reflected in the results from operations in the period of disposal.

Capital Assets consisted of the following for fiscal years 2014 and 2013:

	2014				2013			
	<u>Beginning Balance</u>	<u>Additions</u>	<u>Deletions</u>	<u>Ending Balance</u>	<u>Beginning Balance</u>	<u>Additions</u>	<u>Deletions</u>	<u>Ending Balance</u>
<i>Equipment</i>	\$1,942,349	\$21,800	\$5,490	\$1,958,659	\$656,267	\$1,296,600	\$10,518	\$1,942,349
<i>Intangible Assets-Software</i>	2,313,097	-	-	2,313,097	2,313,097	-	-	2,313,097
<i>Total Capital Assets</i>	<u>4,255,446</u>	<u>21,800</u>	<u>5,490</u>	<u>4,271,756</u>	<u>2,969,364</u>	<u>1,296,600</u>	<u>10,518</u>	<u>4,255,446</u>
Less Accumulated								
Depreciation/Amortization for:								
<i>Equipment</i>	(896,851)	(553,100)	5,490	(1,444,461)	(354,619)	(552,750)	10,518	(896,851)
<i>Intangible Assets-Software</i>	(809,584)	(231,310)	-	(1,040,894)	(578,274)	(231,310)	-	(809,584)
<i>Total Accumulated</i>	<u>(1,706,435)</u>	<u>(784,410)</u>	<u>5,490</u>	<u>(2,485,355)</u>	<u>(932,893)</u>	<u>(784,060)</u>	<u>10,518</u>	<u>(1,706,435)</u>
<i>Depreciation/Amortization</i>								
<i>Total Capital Assets, Net</i>	<u>\$2,549,011</u>	<u>(\$762,610)</u>	<u>\$ -</u>	<u>\$1,786,401</u>	<u>\$2,036,471</u>	<u>\$512,540</u>	<u>\$ -</u>	<u>\$2,549,011</u>

PRIZES. Prize expense for instant games is recorded as prizes are paid. Adjustments are made based on the predetermined prize structure for each instant game as necessary. Prizes payable represents the difference between the amount of prize expense recognized and actual prizes paid.

Prize expense and prizes payable for on-line games are recorded based on actual drawing results. Prizes payable represents unpaid prizes not yet claimed or reverted.

A minimum of 50 percent of the projected revenue from the sale of lottery tickets, computed on a year-round basis, is allocated for payment of prizes. Prizes may be claimed up to 180 days after the official end of the game. Unclaimed prizes are added to the prize pools of subsequent lottery games. Reverted prizes during the fiscal years ended June 30, 2014 and 2013 were \$438,817 for on-line prizes and \$471,049 for instant prizes, and \$420,199 for on-line prizes and \$617,993 for instant prizes, respectively.

DUE TO THE PROPERTY TAX REDUCTION FUND. SDCL 42-7A-63 sets the State's percentage of net machine income

at 50 percent of which all but 0.5 percent is deposited into the Property Tax Reduction Fund. At June 30, 2014 and 2013, there was a liability to the Property Tax Reduction Fund of \$3,545,146 and \$3,460,463, respectively.

DUE TO THE GENERAL FUND AND THE CAPITAL CONSTRUCTION FUND. The Lottery maximizes net proceeds to the State from the sale of instant and on-line tickets. These net proceeds are transferred to the General Fund and Capital Construction Fund on an annual basis on or about July 1. There was a liability for instant ticket sales to the General Fund of \$1,362,306 and \$821,600, and a liability for on-line ticket sales to the Capital Construction Fund of \$1,417,262 and \$2,387,780 as of June 30, 2014 and 2013, respectively.

DUE TO OTHER FUNDS. A liability has been created for services provided by other components of state government but not yet paid as of June 30.

ESCROWS PAYABLE. The passage of House Bill 1344 by the 1989 Legislature authorized tribal governments to receive up to 50 percent of the State's revenue on lottery products sold on that reservation. Fifty percent of the State's share of revenue on the reservations has been escrowed for payment to the tribes.

ACCRUED LIABILITIES. Accrued liabilities that have been incurred but not yet paid as of June 30 include accrued wages, benefits, and retailer bonuses.

UNEARNED REVENUE. A liability has been recorded for on-line tickets sold for future drawings that were collected before June 30. A liability has also been recorded for video lottery distributor and manufacturer renewal fees owed July 1 but collected before June 30.

NET POSITION. "Net Position" is the difference between assets and liabilities. Net position is reported in three categories:

Net investment in capital assets consists of capital assets, net of accumulated depreciation/amortization and reduced by outstanding balances for bonds, notes, and other debt that is attributed to the acquisition, construction, or improvement of those assets.

Restricted net position consists of funds held by the Multi-State Lottery Association (MUSL) in an unreserved account. The earnings paid to this account are considered to be distributions to the member lotteries, but account funds may be used by a member lottery only for the purposes approved by the MUSL Board.

Unrestricted net position consists of assets that do not meet the definition of the two preceding categories.

When both restricted and unrestricted funds are eligible for use in payment of expenses, the type of expense to be incurred is analyzed to determine the best funding source based on available funds and plans for future projects.

REVENUE RECOGNITION. Sales of instant and on-line tickets are made to the public through licensed retailers. Instant ticket sales for games in progress are recorded as retailers settle (sell) the packs of tickets. Adjustments based upon the known relationship of the number of tickets sold to the number of winning tickets redeemed through the end of the accounting period are made as necessary. Instant ticket sales for ended games and on-line ticket sales are reported as the actual ticket sales made to the public through the licensed retailers.

RETAILER COMMISSIONS. Lottery retailers selling instant and on-line tickets receive a 5 percent commission on each ticket sold or distributed to the public. Instant retailers receive a 1 percent selling commission for selling instant prize winning tickets over \$101 and a 1 percent cashing commission for cashing instant prize winning tickets of \$1 up to \$100.

On-line retailers selling a jackpot winning Powerball or Mega Millions ticket may receive a bonus of \$50,000. Selling bonuses of \$20,000 and \$1,000 may be paid to retailers selling Powerball tickets of \$1,000,000 and \$10,000, respectively. Selling bonuses of \$20,000 and \$500 may be paid to retailers selling Mega Millions tickets of \$1,000,000 and \$5,000, respectively. If a retailer sells a Power Play ticket winning \$2,000,000 or \$10,000 (times the multiplier), a bonus of \$25,000 or \$1,000 times the multiplier may be paid, respectively. If a retailer sells a Megaplier ticket hitting the second prize (automatically worth \$1,000,000 regardless of the multiplier) or the \$5,000 third prize (times the multiplier), a bonus of \$25,000 or \$500 times the multiplier may be paid, respectively. Retailers who sell a Dakota Cash jackpot winning ticket may receive a bonus equal to 5 percent of the value of the winning ticket not to exceed \$5,000. Retailers who sell a Wild Card 2 jackpot winning ticket may receive a bonus equal to 1 percent of the value of the winning ticket, not to exceed \$10,000; a retailer selling a \$6,000 winning ticket may receive a bonus of \$600. Retailers who sell a Hot Lotto jackpot, \$30,000 or \$3,000 winning ticket may receive a bonus of \$10,000, \$3,000 or \$300, respectively. Retailers who sell a Sizzler jackpot, \$90,000 or \$9,000 winning ticket may receive a bonus of \$10,000, \$9,000 or \$900, respectively.

NON-OPERATING REVENUES AND EXPENSES. Revenues and expenses that result from activities not associated with the sale of lottery tickets are classified as non-operating.

NOTE 2. COMPENSATED ABSENCES

All permanent full-time employees earn annual leave. Upon termination, employees are eligible to receive compensation for their accrued annual leave balances. At June 30, 2014 and 2013, a liability existed for accumulated annual leave calculated at the employee’s June 30 pay rate in the amount of \$135,791 and \$134,998, respectively. Employees who have been continuously employed by the State of South Dakota for at least seven years prior to the date of their retirement, voluntary resignation, or death will receive payment for one-fourth of their accumulated sick leave balance. This payment is not to exceed the sum of 12 weeks of the employee’s annual compensation. At June 30, 2014 and 2013, a liability existed for accumulated sick leave, calculated at each employee’s June 30 pay rate, in the amount of \$182,540 and \$175,635, respectively. The following is a schedule of changes in compensated absences at June 30, 2014 and 2013.

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
<i>Compensated Absences Payable</i>					
Fiscal Year 2014	\$310,633	\$166,384	\$158,686	\$ 318,331	\$168,206
Fiscal Year 2013	\$259,512	\$163,564	\$112,443	\$310,633	\$165,753

NOTE 3. RETIREMENT PLAN

The South Dakota Lottery participates in the South Dakota Retirement System (SDRS), a cost-sharing, multiple-employer defined benefit pension plan established to provide retirement, disability, and survivor benefits for employees of the State and its political subdivisions. Authority for establishing, administering, and amending plan provisions is found in SDCL 3-12. The SDRS issues a publicly available financial report that includes financial statements, footnote disclosures, and required supplementary information. That report may be obtained by contacting the SDRS in writing at South Dakota Retirement System, P.O. Box 1098, Pierre, SD 57501-1098 or by calling (605) 773-3731.

State law requires employees to contribute 6 percent of their salary to the plan and the employer to contribute an amount equal to the employee’s contribution. The right to receive retirement benefits vests after three years of credited service. The South Dakota Lottery’s contributions to the SDRS for the fiscal years ended June 30, 2014, 2013, and 2012 were \$79,166, \$71,379, and \$70,844, respectively, equal to the required contributions each year.

NOTE 4. OPERATING LEASES

The South Dakota Lottery entered into agreements to lease buildings and certain equipment. Some of the operating leases contain the provision that the South Dakota Lottery may renew the operating leases at the expiration date of the lease on a year-to-year basis. In most cases, management expects that in the normal course of business, leases will be renewed or replaced by other leases of a similar nature.

The following schedule is a summary of future minimum rental payments by years required under operating leases with lease terms in excess of one year as of June 30, 2014:

Period Ending June 30:	
2015	\$63,909
2016	24,846
2017	18,780
2018	18,780
2019	18,780
Later years	59,470
Total Minimum Payments	\$204,565

Total rental expense for all operating leases for the fiscal years ended June 30, 2014 and 2013, was \$62,315 and \$67,626, respectively.

NOTE 5. VIDEO LOTTERY

Following is a summary of video lottery revenues for the fiscal years ended June 30, 2014 and 2013:

	2014	2013
Cash In	\$590,520,297	\$580,092,145
Less Cash Out	405,273,569	395,451,581
Video Lottery Net Machine Income	185,246,728	184,640,564
Less Operator and Establishment Share	92,623,364	92,320,282
Video Lottery Revenue Available to the State	92,623,364	92,320,282
Less Lottery Operating Share	926,233	923,203
Video Lottery Revenue to the Property Tax Reduction Fund	\$ 91,697,131	\$ 91,397,079

NOTE 6. TRANSFERS

Following is a summary of total transfers for the fiscal years ended June 30, 2014 and 2013: (NEXT PAGE)

Transfers Out:	2014	2013
General Fund Proceeds from Instant and On-Line	\$5,400,000	\$ 6,200,000
Capital Construction Fund Proceeds from On-Line	6,100,000	6,600,000
General Fund Proceeds from Instant and On-line not Yet Transferred	1,362,306	821,600
Capital Construction Fund Proceeds from On-Line not Yet Transferred	1,417,262	2,387,780
Video Lottery Proceeds Transferred to the Property Tax Reduction Fund	88,151,985	87,936,616
Video Lottery Proceeds to Prop. Tax Reduction Fund not Yet Transferred	3,545,146	3,460,463
Video Lottery Grant to Department of Social Services	169,326	161,856
Video Lottery Fees Transferred to the General Fund	75,000	135,000
Total Transfers Out	\$106,221,025	\$107,703,315

NOTE 7. PARTICIPATION IN THE MULTI-STATE LOTTERY ASSOCIATION

The South Dakota Lottery is a member of the Multi-State Lottery Association (MUSL), which operates the Powerball/Power Play, Wild Card 2, Hot Lotto, and Mega Millions/Megaplier games. Each MUSL member sells tickets through its licensed retailers and makes weekly wire transfers to MUSL in an amount equivalent to the member lottery's share of the prize liability less the actual low-tier prize liability.

The prize pool for Powerball is 50 percent of each drawing period's sales and up to 5 percent shall be placed into a prize reserve account. The Power Play prize pool is 49.36 percent of sales and .64 percent may be placed in a prize reserve account. The prize pool for Wild Card 2 is 57 percent of sales and 3 percent shall be placed in a prize reserve account. The prize pool for Hot Lotto is 50 percent of sales and up to 1 percent shall be placed in a prize reserve account. The Sizzler prize pool is 47.8813 percent of sales with 2.1187 percent may be placed in a prize reserve account. The prize pool for Mega Millions and Megaplier is up to 55 percent of sales and up to 5 percent of Mega Million sales shall be placed in a prize reserve account. A prize reserve fund serves as a contingency reserve to protect MUSL in cases of unforeseen liabilities. The money in a reserve fund is to be used at the discretion of the MUSL game group.

The prize reserve fund monies may be absorbed by a replacement game or are refundable to member states if MUSL or the MUSL game group disbands or if a member leaves MUSL or a game group. Members who leave must wait one year before receiving their remaining share, if any, of the prize reserve fund. The reserves are held by MUSL and are not included in these financial statements. At June 30, 2014 and 2013, the prize reserve account balances were:

Transfers Out:	2014 MUSL Balance	2014 SD Lottery Share	2013 MUSL Balance	2013 SD Lottery Share
Powerball Prize Reserve Account	\$ 76,376,927	\$ 457,309	\$78,975,475	\$ 511,875
Powerball Set Prize Reserve Account	35,199,525	227,313	34,898,046	192,759
Wild Card Prize Reserve Account	496,452	73,614	693,336	130,214
Hot Lotto Prize Reserve Account	7,411,908	338,443	7,920,821	361,585
Mega Millions Prize Reserve Account	35,842,966	173,216	27,968,381	142,209
Total MUSL Prize Reserves	\$155,327,778	\$1,269,895	\$150,456,059	\$1,338,642

Also held by MUSL is the Unreserved Account into which is deposited the earnings from MUSL operations. The earnings paid to this account are considered to be distributions to the member lotteries. This money may be used by a member lottery for the purposes approved by the MUSL Board. This account balance is recorded as a Restricted Other Receivable.

Powerball and Mega Millions jackpot winners can choose a lump sum cash payment or receive the jackpot prize over 30 annual payments. Treasury zero coupon bonds that provide payments corresponding to the member lottery's obligation to these prize winners are purchased by MUSL in the name of the member lottery. MUSL holds these bonds and will cash the bonds when due and wire the money to the member lottery's account on or before the anniversary date of the win. The Wild Card 2 jackpot is paid in cash. The Hot Lotto jackpot will be paid in a single lump sum cash payment with all initial withholding taxes paid.

NOTE 8. CONTRACTUAL ARRANGEMENTS

- A. Instant Tickets** - The South Dakota Lottery entered into a contract with Scientific Games to provide instant game tickets through August 29, 2016.
- B. Video Lottery Vendor** - The South Dakota Lottery has contracted with Scientific Games to operate a video lottery system through December 24, 2019, with possible extension through December 24, 2024.
- C. On-line Lottery Vendor** - The South Dakota Lottery has contracted with GTECH Corporation to operate an on-line lottery gaming system through August 2, 2019.

NOTE 9. RISK MANAGEMENT

The South Dakota Lottery is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Lottery is uninsured for property loss. The South Dakota Lottery participates in the various programs administered by the State of South Dakota. These risk management programs are funded through assessments charged to participating entities. The risk management programs include: 1) coverage for risks associated with automobile liability and general tort liability (including public officials' errors and omissions liability, medical malpractice liability, law enforcement liability, and products liability) through the State's Public Entity Pool for Liability Fund; 2) coverage of employee medical claims through the State's health insurance program; 3) coverage for unemployment benefits through the State's Unemployment Insurance Fund; and, 4) coverage for workers' compensation benefits through the State's Workers' Compensation Fund. Financial information relative to the self-insurance funds administered by the State is presented in the State of South Dakota Comprehensive Annual Financial Report.

NOTE 10. SPECIAL ITEM

In September 2012, the South Dakota Lottery received 600 new jackpot signs. The signs were obtained at no cost to the Lottery but were part of a 5 year contract extension with the on-line system vendor, GTECH Corporation.



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