

FY2005 Annual Report



Table of Contents

Directory 1

About the Lottery 2

Sales and Revenues 3

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* 4

Independent Auditor’s Report 5

Statement of Net Assets 6

Statement of Revenues, Expenses, and Changes in Fund Net Assets 7

Statement of Cash Flows 8

Notes to the Financial Statements 9



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South Dakota Lottery

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About the Lottery

The South Dakota Lottery markets instant tickets and lotto games, and regulates video lottery to raise revenue for state programs and projects. In the 18 years the Lottery has been in operation, more than \$1.3 billion in revenue has been distributed.

The Lottery is a Division of the Department of Revenue and Regulation and operates under the oversight of the seven-member South Dakota Lottery Commission. The Commission meets quarterly to establish policy within the legal framework set by the Legislature. It reviews and approves major contracts and procurements and consults on the management and operation of all aspects of the Lottery.

The Lottery has 33 employees; its central office is in Pierre with regional sales and redemption offices in Sioux Falls and Rapid City and a sales representative's office in Aberdeen.

July 1, 2004 - June 30, 2005 Fiscal Year Highlights

- Norman Lingle was appointed the Lottery's executive director by Secretary of the Department of Revenue and Regulation Gary Viken.
- A contract extension for lotto services resulted in a 2.3 percent rate reduction as well as a new digital communications network and newer lotto terminals.
- A new contract for scratch ticket printing services resulted in a 35 percent rate reduction.
- Digital store signs announcing jackpot amounts were replaced throughout the state.
- The Lottery tested and approved a new video lottery machine, the IGT Game King.

Scratch

Scratch game sales reached levels in FY05 that have not been witnessed in 15 years. Three holiday games -- Happy Holidays, Winter Green and Dakota Holidays -- were the year's best sellers and helped boost seasonal sales to new heights. FY05 boasted a nearly 6 percent increase in scratch sales over the previous year.



Powerball

The state's most popular lotto game, Powerball, continued to draw the highest sales in FY05. Because the game produced only three sizable jackpot runs during the year, sales lagged 24 percent behind FY04. Players won over \$5 million in prizes. Three players won Match Five prizes of \$100,000.



Dakota Cash

South Dakota's very own lotto game, Dakota Cash, witnessed an impressive jackpot run in spring of 2005, which helped boost sales 17 percent above those of the previous year. Five players picked up jackpot prizes. The luckiest, Diane Borgheiinck of Rosholt, won \$245,550 in March of 2005.



Wild Card

The state's second-longest running multi-state game produced a sales boost of 8 percent. John Schamber of Milbank won \$264,837 in early November 2005. He was the state's fifth Wild Card jackpot winner



Hot Lotto

Hot Lotto exhibited a noteworthy 37 percent gain over FY04 sales. Hot Lotto drew interest by producing the year's biggest jackpot win. Following a 30-week jackpot run, Shirley Vehle of Sioux Falls claimed the \$9,130,000 jackpot in June of 2005, the third largest prize ever awarded by the South Dakota Lottery.



Video Lottery

Player interest in video lottery has not wavered in the games' 18-year history. In FY05, net machine income gained 2 percent over the previous year.

Sales and Revenue

In FY2005, Lottery revenue distributed to state funds was more than \$119 million, representing a 3 percent increase over FY2004.

Scratch Tickets

Over 600 licensed instant ticket retailers sell scratch tickets across the state. Retailers receive a 5 percent commission for selling tickets, a 1 percent commission for cashing winning tickets with prizes up to \$100 and 1 percent for selling winning tickets with prizes of more than \$100.

Scratch ticket sales generated over \$3.2 million in revenue, which is distributed to the General Fund.

Lotto Games

The state's 364 licensed lotto retailers also receive a 5 percent commission for selling tickets, plus varying bonuses for selling larger winning tickets.

A total of \$3.7 million in revenue from the sales of lotto tickets was generated for the state. By law, the first \$1.4 million of revenue was deposited into the General Fund. The balance of \$2.3 million was distributed to the Capital Construction Fund, which finances ethanol production incentives, water and environment programs and state highway projects.

Video Lottery

The Lottery regulates video lottery game activities through licensing procedures for the machines, machine owners and operators, and establishments, as well as a comprehensive secure central computer system. The average number of active video lottery machines during FY2005 was 8,564; the average number of licensed establishments was 1,433.

The revenue from video lottery is calculated on net machine income, which is cash-in (sales) minus cash-out (prizes). Net machine income is divided equally between the state and machine operators on a 50/50 split.

Over \$112 million was distributed from video lottery to the state. Revenue of \$109.1 million net machine income was distributed to the Property Tax Reduction Fund. Also, a \$3 million one-time transfer, appropriated by the legislature, and a portion of machine manufacturer license fees were distributed to the General Fund.

FY2005 Lottery Sales and Revenues

	Sales	Prizes	Retailer Commissions	Revenue Distributed
Instant Tickets	\$16,153,801	\$10,090,640	\$904,900	\$3,218,429
Lotto Tickets	16,346,911	8,262,512	865,895	3,708,789
Video Lottery*	643,074,402	422,599,978	110,237,212	112,393,840**
Totals				\$119,321,058

*Video lottery sales are cash in; prizes are cash out; private share of net machine income is retailer commission. **This includes a one-time transfer of \$3 million from the video lottery operating fund to the General Fund.

FY2005 Lottery Revenue Distribution

	General Fund	Capital Construction Fund	Property Tax Reduction Fund	Dept. of Human Services*
Instant Tickets	\$3,218,429			
Lotto Tickets	1,400,000	2,308,789		
Video Lottery	3,045,000**		109,134,840	214,000
Totals	\$7,663,429	\$2,308,789	\$109,134,840	\$214,000

*The Lottery annually provides the South Dakota Department of Human Services funding for problem gambling treatment services. Funding comes from the Lottery's 0.5 percent of net machine income for administration. **This includes a one-time transfer of \$3 million from the video lottery operating fund to the General Fund.



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MARTIN L. GUINDON, CPA
AUDITOR GENERAL

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 M. Michael Rounds
Governor of South Dakota

and

South Dakota Lottery Commission
State of South Dakota

We have audited the financial statements of the South Dakota Lottery Fund of the State of South Dakota, as of and for the fiscal years ended June 30, 2005 and 2004, and have issued our report thereon dated January 13, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the South Dakota Lottery's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the South Dakota Lottery Fund's financial statements are free of 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*.

We noted certain matters that we reported to management of the South Dakota Lottery Fund in a separate letter dated January 13, 2006.

This report is intended solely for the information and use of management, members of the South Dakota Legislature, and the citizens of South Dakota and is not intended to be and should not be used by anyone other than those specified. However, this report is a matter of public record and its distribution is not limited.

Martin L. Guindon, CPA
Auditor General

January 13, 2006



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MARTIN L. GUINDON, CPA
AUDITOR GENERAL

INDEPENDENT AUDITOR'S REPORT

The Honorable M. Michael Rounds
Governor of South Dakota

and

South Dakota Lottery Commission
State of South Dakota

We have audited the accompanying financial statements of the South Dakota Lottery Fund, as of and for the fiscal years ended June 30, 2005 and 2004, as listed in the Table of Contents. These financial statements are the responsibility of the South Dakota Lottery Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

The financial statements of the South Dakota Lottery Fund are intended to present the financial position, and changes in financial position and cash flows, of the business type activities of the State that is attributable to the transactions of the South Dakota Lottery Fund. They do not purport to, and do not, present fairly the financial position of the State of South Dakota as of June 30, 2005 and 2004, and the changes in its financial position and its cash flows, where applicable, for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the South Dakota Lottery Fund as of June 30, 2005 and 2004, and the respective changes in financial position and cash flows thereof for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 13, 2006, 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 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.

Martin L. Guindon, CPA
Auditor General

January 13, 2006

SOUTH DAKOTA LOTTERY
STATEMENT OF NET ASSETS
June 30, 2005 and 2004

Assets	FY2005	FY2004
Current Assets:		
Cash and Cash Equivalents	\$5,194,464	\$8,530,366
Accounts Receivable	4,793,952	4,844,418
Interest Receivable	59,173	58,235
Certificates of Deposit	395,396	368,296
Securities Lending Collateral	361,230	1,686,152
Prepays	10,575	
Total Current Assets	10,814,790	15,487,467
Noncurrent Assets:		
Capital Assets less Accumulated Depreciation	12,463	15,182
Total Assets	\$10,827,253	\$15,502,649
Liabilities		
Current Liabilities:		
Accounts Payable	\$339,334	\$357,670
Prizes Payable	687,408	764,343
Due to the Property Tax Reduction Fund	4,177,571	4,321,871
Due to the Capital Construction Fund	308,789	723,094
Due to the General Fund	468,429	668,115
Due to Other Funds	101,163	77,814
Operator Security Deposits	436,796	440,896
Escrows Payable-Reservation Sales	45,872	43,238
Accrued Liabilities	223,618	209,425
Deferred Revenue	150,724	99,570
Securities Lending Collateral Liability	361,230	1,686,152
Total Current Liabilities	7,300,934	9,392,188
Noncurrent Liabilities:		
Accrued Liabilities	118,607	106,491
Total Liabilities	\$7,419,541	\$9,498,679
Net Assets		
Invested in Capital Assets, net of Related Debt Unrestricted	\$12,463	\$15,182
	3,395,249	5,988,788
Total Net Assets	\$3,407,712	\$6,003,970

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

SOUTH DAKOTA LOTTERY
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS
For the Fiscal Years Ended June 30, 2005 and 2004

	FY2005	FY2004
Operating Revenues:		
Video Lottery Revenue	\$110,237,213	\$108,378,228
Instant Ticket Sales	16,153,801	15,262,714
On-Line Ticket Sales	16,346,911	18,877,696
Terminal License Fees	954,300	937,800
Retailer License Fees	262,650	284,975
Total Operating Revenue	143,954,875	143,741,413
Direct Game Costs:		
Instant Prizes	10,090,640	9,631,687
On-Line Prizes	8,262,512	9,502,748
Instant Retail Commissions	904,900	854,571
On-Line Retail Commissions	865,895	1,005,030
Instant Ticket Print Costs	757,901	532,247
Total Direct Costs	20,881,848	21,526,283
Gross Profit	123,073,027	122,215,130
Operating Expenses:		
Personal Services and Benefits	1,380,896	1,330,363
Travel	133,398	127,742
Advertising	623,556	518,783
Contractual Services	3,911,253	4,368,871
Supplies and Materials	492,441	94,689
Depreciation	2,719	2,014
Bad Debts Expense	4,258	
Payments to Reservations	45,872	43,238
Total Operating Expenses	6,594,393	6,485,700
Operating Income	116,478,634	115,729,430
Non-operating Revenues (Expenses):		
Pooled Investment Income	262,528	96,702
Broker Rebate Expense	(37,755)	(21,648)
Powerball Rebalancing Refund	12,815	340,173
Miscellaneous Revenue	8,578	8,613
Total Non-operating Revenue (Expenses)	246,166	423,840
Income Before Transfers	116,724,800	116,153,270
Transfers:		
Transfers to the Property Tax Reduction Fund	109,134,840	107,294,446
Transfers to the General Fund	7,663,429	4,848,115
Transfers to the Capital Construction Fund	2,308,789	3,423,094
Transfers to the Department of Human Services	214,000	202,462
Total Transfers	119,321,058	115,768,117
Change in Net Assets	(2,596,258)	385,153
Total Net Assets - Beginning	6,003,970	5,618,817
Total Net Assets - Ending	\$3,407,712	\$6,003,970

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, 2005 and 2004

	FY2005	FY2004
Cash Flows from Operating Activities		
Receipts from Customers and Users	\$144,033,109	\$144,005,255
Payments for Lottery Prizes	(18,392,524)	(19,209,378)
Payments to Suppliers	(6,879,390)	(6,715,307)
Payments for Interfund Services Used	(829,213)	(854,889)
Payments for Employee Services	(1,354,587)	(1,314,599)
Other Receipts (Payments)	(57,783)	304,139
Net Cash Provided (Used) by Operating Activities	<u>116,519,612</u>	<u>116,215,221</u>
Cash Flows from Capital and Related Financing Activities		
Purchase of Capital Assets		(7,055)
Net Cash Provided (Used) by Capital and Related Financing Activities		<u>(7,055)</u>
Cash Flows from Noncapital Financing Activities		
Transfers to Other Funds	(120,079,349)	(114,794,690)
Net Cash Provided (Used) by Noncapital Financing Activities	<u>(120,079,349)</u>	<u>(114,794,690)</u>
Cash Flows from Investing Activities		
Pooled Investment Income	261,590	107,250
Security Lending Rebate Fees	(37,755)	(21,648)
Net Cash Provided (Used) by Investing Activities	<u>223,835</u>	<u>85,602</u>
Net Increase (Decrease) in Cash and Cash Equivalents During the Fiscal Year	(3,335,902)	1,499,078
Cash and Cash Equivalents at Beginning of Year	8,530,366	7,031,288
Cash and Cash Equivalents at End of Year	<u>\$5,194,464</u>	<u>\$8,530,366</u>
Reconciliation of Operating Income to Net Cash Provided (Used) by Operating Activities		
Operating Income	\$116,478,634	\$115,729,430
Adjustments to Reconcile Operating Income (Loss) to Net Cash Provided by Operating Activities:		
Depreciation Expense	2,719	2,014
Other Revenue	8,578	8,613
Powerball Rebalancing Refund	12,815	340,173
Decrease/(Increase) in Assets:		
Accounts Receivable	50,466	202,320
Certificates of Deposit	(27,100)	409,152
Prepays	(10,575)	9,609
Increase/(Decrease) in Liabilities:		
Accounts Payable	(18,336)	(39,520)
Prizes Payable	(76,935)	54,832
Due to Other Funds	23,349	(7,984)
Operator Security Deposits	(4,100)	(403,652)
Escrows Payable	2,634	(6,781)
Accrued Liabilities	26,309	15,764
Deferred Revenue	51,154	(98,749)
Total Adjustments	<u>40,978</u>	<u>485,791</u>
Net Cash Provided by Operating Activities	<u>\$116,519,612</u>	<u>\$116,215,221</u>

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, 2005 and 2004

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization The South Dakota Lottery Fund was created by the passage of Senate Bill 0254 during the 1987 Legislative Session. The South Dakota Lottery was authorized to market instant win games, with sales commencing on September 30, 1987.

Video Lottery was created by the passage of Senate Bill 0129 during the 1989 Legislative Session. The South Dakota Lottery was authorized to license and regulate a video lottery game with play commencing on October 16, 1989.

The 1990 Legislature approved lotto games with the passage of Senate Bill 0086. In April of 1990, South Dakota was accepted as a member of the Multi-State Lottery Association (MUSL) and on November 15, 1990, South Dakota began selling MUSL's Lotto*America game. Powerball replaced Lotto*America on April 19, 1992. Powerball was a 5 of 45 plus 1 of 45 game, with drawings twice a week. On November 5, 1997, Powerball changed to a 5 of 49 plus 1 of 42 game. The Power Play multiplier became available on March 3, 2001, and is an option to each Powerball play. A multiplier of 1, 2, 3, 4 or 5 was randomly selected during each drawing and would multiply the Powerball set prize amounts (except the jackpot) for players who purchased the option and won a set prize. On October 6, 2002, the Powerball matrix changed to 5 of 53 and 1 of 42. The Power Play multiplier also changed to one of 2, 3, 4 or 5.

Sales of Dakota Cash, South Dakota's own lotto game, with a minimum jackpot of \$20,000, began on April 12, 1993. Dakota Cash is a 5 of 35 lotto game with drawings twice a week. The prize pool is 50 percent of each drawing period's sales. Two percent is put in a prize reserve fund until a cap of \$200,000 is reached. At June 30, 2005 and 2004, the prize reserve fund had a balance of \$191,490 and \$189,609, respectively.

The South Dakota Lottery joined with the Montana and Idaho lotteries to offer Tri-West Lotto on February 21, 1994. Tri-West Lotto was a 6 of 41 lotto game with a prize pool of 50 percent of sales. After February 4, 1995, the game became a 6 of 33 lotto game with a prize pool of 55 percent of sales. Tri-West Lotto was replaced by Wild Card on February 1, 1998. Wild Card was a 6 of 38 plus a 1 of 52 lotto game and also had a prize pool of 55 percent of sales. On May 22, 1999, Wild Card was replaced by Wild Card 2, a 5 of 31 plus a 1 of 16 lotto game with a prize pool of 55 percent of sales. Wild Card 2 drawings are held twice a week.

The South Dakota Lottery began selling MUSL's Daily Millions game on September 16, 1996. Daily Millions was an all-cash lotto game played 7 days a week with a fixed top prize of \$1 million. To play Daily Millions, 2 numbers were drawn from 3 separate pools of 21 each. Daily Millions ended and Cash 4 Life began on March 30, 1998. The Cash 4 Life game allowed 15 sets of 4 numbers between 00 and 99 and was played 7 days a week. On September 8, 2000, Cash 4 Life was replaced by Rolldown, a 5 of 55 lotto game. Drawings were held 3 days a week. If there was no jackpot prize winner, the jackpot rolled down to all other prize levels. On April 7, 2002, Rolldown was replaced by Hot Lotto, a 5 of 39 plus 1 of 19 lotto game with drawings held 2 times a week.

The purpose of the Lottery is to provide additional monies to fund vital public projects and programs.

SOUTH DAKOTA LOTTERY
NOTES TO THE FINANCIAL STATEMENTS
For the Fiscal Years Ended June 30, 2005 and 2004

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 proprietary funds apply all FASB Statements and Interpretations issued after November 30, 1989, except for those that conflict with or contradict GASB pronouncements. 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. The financial statements are prepared in accordance with generally accepted accounting principles for proprietary (enterprise) funds.

Cash and Cash Equivalents The Lottery's cash and cash equivalents represent cash on hand, demand deposits and a participating interest in the State's pooled investment fund held by the State Treasurer. Management of the State's pooled investment fund is the statutory responsibility of the South Dakota Investment Council (SDIC). Investments in the State's pooled investment fund consist primarily of commercial paper rated A1 or P2 or better, short-term U.S. Treasury obligations, bank certificates of deposit and money market funds. Cash held by the State Treasurer of \$5,181,270 and \$8,522,149 was invested in the State's pooled investment fund and represented 0.65% and 1.06% of the net assets of the pooled investment fund as of June 30, 2005 and 2004, respectively.

The Lottery's participating interest in the State's pooled investment fund is reported at fair value.

Securities Lending Transactions State statutes and the South Dakota Investment Council (SDIC) policies permit the use of investments for securities lending transactions. These transactions involve the lending of securities to broker-dealers and other entities for collateral, in the form of cash or securities with the simultaneous agreement to return the collateral for the same securities in the future. The cash collateral is reinvested by the lending agent in accordance with contractual investment guidelines that are designed to ensure the safety of principal and obtain a moderate rate of return. The investment guidelines include very high credit quality standards and also allow for a portion of the collateral investments to be invested with short-term securities. The earnings generated from the collateral investments, less the amount of rebates paid to the dealers, results in gross earnings from lending activities, which is then split on a percentage basis with the lending agent.

At year end, no credit risk exposure to borrowers existed because the amounts owed the borrowers exceeded the amounts the borrowers owed. The contract with the lending agent requires them to indemnify if the borrowers fail to return the loaned securities (and the collateral is inadequate to replace the securities lent).

The securities loans can be terminated on demand by either the SDIC or the borrower, although the average term of the loans is one business day. The term to maturity of the securities loans is matched with the term to maturity of the investments of the cash collateral by investing in a variety of short-term investments.

The ability to pledge or sell collateral securities can be made without borrower default. In addition, no restriction on the amount of the loans exists or can be made. The amount reported as Securities Lending Collateral of \$361,230 and \$1,686,152 and Securities Lending Collateral Liability of \$361,230 and \$1,686,152 on the statement of net assets represents the Lottery's share of the SDIC total as of June 30, 2005 and 2004, respectively.

SOUTH DAKOTA LOTTERY
NOTES TO THE FINANCIAL STATEMENTS
For the Fiscal Years Ended June 30, 2005 and 2004

Operator Security Deposits ARSD 48:02:05:04(18) requires video lottery operators to furnish security to the Lottery by July 1 of each year 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, 2005 and 2004, the amount of certificates of deposit being held by the Lottery was \$395,396 and \$368,296, respectively. The amount of \$6,086,270 and \$5,992,100, respectively, was in the form of surety bond, deposit in cash, or irrevocable letter of credit. The total Security Deposits on June 30, 2005 and 2004, were \$6,481,666 and \$6,360,396, respectively.

Accounts Receivable Accounts receivable (net) represents the following at June 30:

	<u>2005</u>	<u>2004</u>
<i>Uncollected instant/on-line ticket revenues</i>	\$ 559,797	\$ 473,069
<i>Allowance for doubtful instant/on-line accounts</i>	(14,933)	(18,689)
<i>Uncollected video lottery revenues and fees</i>	4,249,088	4,390,038
	<u>\$4,793,952</u>	<u>\$4,844,418</u>

Capital Assets 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. Depreciation 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 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.

Due to the General Fund and Due to the Capital Construction Fund The Lottery shall maximize net proceeds to the state from the sale of instant and on-line tickets. These net proceeds are transferred to the General Fund/Capital Construction Fund on an annual basis on or about July 1. There was a liability for instant ticket sales to the General Fund in the amount of \$468,429 and \$668,115 and a liability for on-line ticket sales to the Capital Construction Fund in the amount of \$308,789 and \$723,094 as of June 30, 2005 and 2004, respectively.

Due to the Property Tax Reduction Fund SDCL 42-7A-63 sets the state's percentage of net machine income at fifty percent (50%) of which all but one-half of one percent (0.5%) of net machine income shall be deposited into the Property Tax Reduction Fund. At June 30, 2005 and 2004, there was a liability to the Property Tax Reduction Fund in the amount of \$4,177,571 and \$4,321,871, respectively.

Deferred Revenue A liability has been recorded for on-line tickets sold for future drawings that were collected before June 30.

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

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 books 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

SOUTH DAKOTA LOTTERY
NOTES TO THE FINANCIAL STATEMENTS
For the Fiscal Years Ended June 30, 2005 and 2004

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.

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.

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 fifty percent (50%) 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, 2005 and 2004, were \$322,290 for on-line prizes and \$376,607 for instant prizes, and \$366,645 for on-line prizes and \$313,279 for instant prizes, respectively.

Escrows Payable During the 1989 Legislative Session, HB 1344 passed which authorizes tribal governments to receive up to fifty percent (50%) of the state's revenue on lottery products sold on that reservation. Fifty percent (50%) of the state's share of revenue on the reservations has been escrowed for payment to them.

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.

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

On-line retailers selling a jackpot winning Powerball ticket may receive a bonus of \$30,000. Selling bonuses of \$5,000 and \$500 may be paid to retailers selling Powerball tickets of \$100,000 and \$5,000, respectively. Retailers who sell a Dakota Cash jackpot winning ticket may receive a bonus equal to five percent (5%) 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 one percent (1%) of the value of the winning ticket, not to exceed \$10,000. Retailers who sell a Hot Lotto jackpot winning ticket or a \$10,000 winning ticket may receive a bonus of \$10,000 and \$1,000, respectively.

NOTE 2. ANNUAL AND SICK LEAVE

Annual leave is earned by all employees. Upon termination, employees are eligible to receive compensation for their accrued annual leave balances. At June 30, 2005 and 2004, a liability existed for accumulated annual leave calculated at the employee's June 30 pay rate in the amount of \$111,544 and \$101,291, 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,

SOUTH DAKOTA LOTTERY
NOTES TO THE FINANCIAL STATEMENTS
For the Fiscal Years Ended June 30, 2005 and 2004

such payment not to exceed the sum of twelve weeks of employee's annual compensation. At June 30, 2005 and 2004, a liability existed for accumulated sick leave for twenty-five (25) and twenty-four (24) employees, respectively, calculated at the employee's June 30 pay rate in the amount of \$133,838 and \$125,158, respectively. A potential liability also existed for unvested sick leave at June 30, 2005 and 2004, in the amount of \$4,933 and \$7,592, respectively, of which \$3,532 and \$5,436, respectively, has been accrued.

NOTE 3. 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, 2005:

<u>Period Ending June 30:</u>	
2006	\$ 95,589
2007	49,890
2008	47,305
2009	44,250
2010	<u>5,948</u>
Total Minimum Payments	<u><u>\$ 242,982</u></u>

Total rental expense for all operating leases for the fiscal years ended June 30, 2005 and 2004, was \$117,869 and \$115,309, respectively.

NOTE 4. EMPLOYEES' RETIREMENT SYSTEM

The South Dakota Lottery participates in the South Dakota Retirement System (SDRS), a cost-sharing, multiple employer defined benefit pension plan. The SDRS provides retirement, disability and survivor benefits for employees of the State of South Dakota and its political subdivisions. The right to receive retirement benefits vests after three years of credited service. Authority for establishing, administering and amending plan provisions are found in South Dakota Codified Law 3-12. The SDRS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to the SDRS, P.O. Box 1098, Pierre, SD 57501-1098 or by calling (605) 773-3731.

Employees are required by state statute to contribute 6 percent of their salary to the plan. State statute also requires the employer to contribute an amount equal to the employee's contribution. The South Dakota Lottery's contributions to the SDRS for the fiscal years ended June 30, 2005, 2004, and 2003 were \$62,743, \$61,762, and \$59,290, respectively, equal to the required contributions each year.

NOTE 5. VIDEO LOTTERY

SOUTH DAKOTA LOTTERY
NOTES TO THE FINANCIAL STATEMENTS
For the Fiscal Years Ended June 30, 2005 and 2004

Following is a summary of video lottery revenues for the fiscal years ended June 30, 2005 and 2004:

	<u>2005</u>	<u>2004</u>
Cash In	\$ 643,074,402	\$ 630,327,297
Less Cash Out	422,599,978	413,570,841
Video Lottery Net Machine Income	<u>220,474,424</u>	<u>216,756,456</u>
Less Operator and Establishment Share	110,237,212	108,378,228
Video Lottery Revenue Available to the State	<u>110,237,212</u>	<u>108,378,228</u>
Less Lottery Operating Share	1,102,372	1,083,782
Video Lottery Revenue to the Property Tax Reduction Fund	<u>\$ 109,134,840</u>	<u>\$ 107,294,446</u>

NOTE 6. TRANSFERS

Following is a summary of total transfers for the fiscal years ended June 30, 2005 and 2004:

Transfers Out:	<u>2005</u>	<u>2004</u>
General Fund Proceeds from Instant and On-Line	\$ 4,150,000	\$ 4,150,000
Capital Construction Fund Proceeds from On-Line	2,000,000	2,700,000
General Fund Proceeds from Instant and On-line not Yet Transferred	468,429	668,115
Capital Construction Fund Proceeds from On-Line not Yet Transferred	308,789	723,094
Video Lottery Proceeds Transferred to the Property Tax Reduction Fund	104,957,269	102,972,575
Video Lottery Proceeds to Prop. Tax Reduction Fund not Yet Transferred	4,177,571	4,321,871
Video Lottery Proceeds Transferred to the General Fund (One-time Tran)	3,000,000	
Video Lottery Grant to Department of Human Services	214,000	202,462
Video Lottery Fees Transferred to the General Fund	45,000	30,000
Total Transfers Out	<u>\$119,321,058</u>	<u>\$115,768,117</u>

NOTE 7. PARTICIPATION IN THE MULTI-STATE LOTTERY

The South Dakota Lottery is a member of the Multi-State Lottery (MUSL), which operates the Powerball/Power Play, Hot Lotto, and Wild Card 2 games. Each MUSL member sells tickets through its licensed retailers and makes weekly wire transfers to the 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 and Hot Lotto consists of 50 percent of each drawing period's sales. The prize pool for Power Play is 49.3 percent of sales. The prize pool for Wild Card 2 is 55 percent of each drawing period sales with all cash prizes. Two percent of sales for Powerball and Wild Card 2 and 1.5 percent for Power Play are placed in a prize reserve fund. For Hot Lotto, up to 1 percent of sales is placed in a prize reserve fund after the annuitized jackpot exceeds \$2 million. An additional 2 percent of sales is placed in a prize reserve fund after the annuitized jackpot exceeds \$5 million. The prize reserve fund serves as a contingency reserve to protect the MUSL in cases of unforeseen liabilities. The money in this reserve is to be used at the discretion of the MUSL Board of Directors.

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 leaving must wait one year before receiving their remaining share, if any, of the

SOUTH DAKOTA LOTTERY
NOTES TO THE FINANCIAL STATEMENTS
For the Fiscal Years Ended June 30, 2005 and 2004

prize reserve fund. At June 30, 2005 and 2004, the MUSL Powerball prize reserve fund had a balance of \$73,049,064 and \$68,267,775, respectively, of which the South Dakota Lottery's share was \$493,000 and \$488,547, respectively. The set prize reserve fund had a balance of \$24,999,967 and \$25,582,357, respectively, of which the South Dakota Lottery's share was \$145,000 and \$162,267, respectively. The Wild Card 2 prize reserve fund had a balance of \$1,172,140 and \$990,926, respectively, of which the South Dakota Lottery's share was \$226,942 and \$224,860. At June 30, 2005 and 2004, the Hot Lotto prize reserve fund had a balance of \$1,058,225 and \$199,909, respectively, of which the South Dakota Lottery's share was \$37,298 and \$7,763, respectively. The reserves held by MUSL are not included in these financial statements.

Prior to November 5, 1997, the Powerball jackpot was payable to the winner(s) in annual installments over 20 years, with the first payment being made by the member lottery starting at the time of the drawing. Since November 5, 1997, players can choose one lump-sum cash payment or receive the jackpot prize over 25 annual payments. Treasury zero coupon bonds that provide payments corresponding to the member lottery's obligation to these prize winners are purchased by the MUSL in the name of the member lottery. MUSL will hold 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, and will be divided equally among all jackpot winners for a specific drawing. The Hot Lotto jackpot prize can be taken as cash or annuity and is divided equally among multiple winners.

As of June 30, 2005 and 2004, the MUSL had purchased, for the South Dakota Lottery, zero coupon bonds to fund installment payments aggregating \$12,466,937. The total purchase price of these bonds was \$6,509,238.

MUSL made a refund to the Lottery on May 4, 2005, and on October 24, 2003, in the amount of \$12,815 and \$374,180, respectively. These refunds were made by reallocating the reserve shares between all member lotteries. These amounts were recorded as current year transactions except for \$340,173 of the FY04 amount which was recorded as a refund of prior years' operating funds used as the start-up payment.

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 30, 2007, with possible extension through August 30, 2010.
- B. On-line and Video Lottery Vendor - The South Dakota Lottery has contracted with Scientific Games to operate an on-line lottery system and a video lottery system through August 2, 2006, with possible extension through August 2, 2009.