

South Dakota Lottery FY2007 Annual Report



More than \$1.5 billion raised to help fund education,
lower property taxes, and develop natural resources.



FY2007 Annual Report

Table of Contents

FY07 Highlights..... 1

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..... 3

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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Generating fun and funds in FY07!

A sweet ride in FY07

Scratch and lotto players rake in over \$22 million

Although hundreds of lucky players won big with Lottery games in FY07, few were happier than Roger and Reva Pownell of Huron.

They picked up a Mustang Money scratch ticket at the State Fair and the next thing they knew they were driving the sporty yellow beauty home. Three other scratch players won Mustang convertibles.



Four lucky Hot Lotto players were riding high in FY07 as well. Julie Pigors, Michael Trudeau, Leona Schuldt and Mark Rudebusch each won a Las Vegas trip for two in the Viva Las Vegas second-chance drawing.

Linda Lawrence, Richard Dunn and Dianna Venable were more than pleased with their Dakota Cash jackpot wins. Dunn said his \$181,657 prize “was just about the right amount.”

Michael Gomez, Ronald Daily and “The Crew” were thrilled to snag \$200,000 Powerball prizes. “The Crew” is a group of now-retired teachers who also won a Dakota Cash jackpot in 1993.

Where the money goes

Advancing into its third decade of providing revenues for important state programs and projects, here’s a look at the Lottery’s contributions to date.

Since 1987, the Lottery has provided more than \$381 million to the state General Fund. Each year, half of the entire General Fund is used to support local K-12 schools and state universities and technical institutes.

The Lottery has provided more than \$1.1 billion to the Property Tax Reduction Fund, which reduces local property taxes on owner-occupied and agricultural land by 30 percent.

The Lottery has provided more than \$25 million to the Capital Construction Fund. Local communities use these funds to pay for rural water systems, community drinking water and wastewater improvement projects, and recycling and waste disposal programs.



Retailers profit too



Lottery retail partners earned over \$2.17 million in commissions. Lottery retailers selling instant and on-line tickets receive a five percent commission on each ticket sold or distributed to the public. Instant retailers receive a one percent selling commission for selling instant prize winning tickets over \$101 and a one percent cashing commission for cashing instant prize winning tickets of \$1 up to \$100.

Retailers selling top lotto prizes earn additional bonuses up to \$50,000.

Instant tickets

The Lottery launched 25 new instant ticket games during fiscal year 2007. At the close of the year, there were 608 licensed instant ticket retailers across the state.

Although sales were down slightly from the previous year, substantial expense reductions resulted in a 22 percent increase in revenues to the state. Revenue from the sale of instant tickets is distributed to the General Fund.

Lotto tickets

South Dakota currently offers four lotto games. Powerball, Wild Card 2 and Hot Lotto are multi-state games. Dakota Cash is played only in South Dakota. At the end of FY07, there were 429 licensed lotto retailers.

Dakota Cash, Wild Card 2 and Hot Lotto all generated exceptionally high sales in the fiscal year, offsetting diminished Powerball sales due to a lack of noteworthy jackpot runs. Lotto games reported an overall increase of lotto sales of more than 3 percent from fiscal year 2006. The first \$1.4 million of revenue from the sale of lotto tickets is distributed to the General Fund and the balance is distributed to the Capital Construction Fund.

Video Lottery

The Lottery regulates and controls the video lottery game activities through licensing procedures for the machines, machine owners, and establishments as well as a comprehensive secure central computer system.

Video lottery sales (cash in) increased slightly in fiscal year 2007. The average number of active video lottery machines during the year was 8,849 and the average number of licensed establishments was 1,477.

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.

Sales and Revenues

Total fiscal year 2007 Lottery revenue distributed to state funds was more than \$121 million.

	Sales	Prizes	Retailer Commissions	Revenue Distributed
Instant Tickets	\$18,218,910	\$11,381,996	\$1,020,560	\$4,288,644
Lotto Tickets	\$21,590,530	\$10,940,311	\$1,156,546	\$6,211,689
Video Lottery**	\$652,685,841	\$429,912,222	\$111,386,810	\$110,567,773
			Total:	\$121,068,106

** Video lottery sales are cash in; prizes are cash out; private share of net machine income is retailer commission

Revenue Distribution

	General Fund	Cap. Construct. Fund	Property Tax Reduction Fund	Dept. of Human Services
Instant Tickets	\$4,288,644			
Lotto Tickets	\$1,400,000	\$4,811,689		
Video Lottery	\$60,000		\$110,293,773	\$214,000
Totals:	\$5,748,644	\$4,811,689	\$110,293,773	\$214,000



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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, 2007 and 2006 and have issued our report thereon dated January 16, 2008. 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 as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the South Dakota Lottery's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the South Dakota Lottery's internal control over financial reporting.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

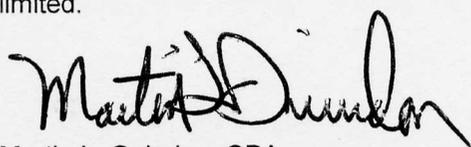
Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the 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 16, 2008.

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 16, 2008



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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, 2007 and 2006, 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, 2007 and 2006, 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, 2007 and 2006, 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 16, 2008, 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 16, 2008

SOUTH DAKOTA LOTTERY
STATEMENT OF NET ASSETS
June 30, 2007 and 2006

Assets	2007	2006
Current Assets:		
Cash	\$7,342,607	\$6,148,683
Accounts Receivable	5,071,863	5,223,102
Restricted Other Receivable	987,781	973,632
Interest Receivable	144,551	100,414
Certificates of Deposit	430,530	376,996
Securities Lending Collateral	1,277,199	784,843
Total Current Assets	15,254,531	13,607,670
Noncurrent Assets:		
Capital Assets less Accumulated Depreciation	18,305	29,269
Total Assets	15,272,836	13,636,939
Liabilities		
Current Liabilities:		
Accounts Payable	457,577	457,550
Prizes Payable	1,174,322	1,188,617
Due to the Property Tax Reduction Fund	4,260,627	4,386,510
Due to the Capital Construction Fund	1,011,689	497,285
Due to the General Fund	288,644	419,476
Due to Other Funds	65,108	88,857
Operator Security Deposits	453,230	398,796
Escrows Payable-Reservation Sales	39,707	50,623
Accrued Liabilities	201,702	202,297
Deferred Revenue	131,264	211,846
Securities Lending Collateral Liability	1,277,199	784,843
Total Current Liabilities	9,361,069	8,686,700
Noncurrent Liabilities:		
Accrued Liabilities	107,240	103,623
Total Liabilities	9,468,309	8,790,323
Net Assets		
Invested in Capital Assets, net of Related Debt	18,305	29,269
Restricted for MUSL Permitted Uses	987,781	973,632
Unrestricted	4,798,441	3,843,715
Total Net Assets	\$5,804,527	\$4,846,616

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, 2007 and 2006

	FY2007	FY2006
Operating Revenues:		
Video Lottery Revenue	\$111,407,852	\$110,767,826
Instant Ticket Sales	18,218,910	18,522,369
On-Line Ticket Sales	21,590,530	20,915,248
Terminal License Fees	1,006,400	981,900
Retailer License Fees	325,853	310,500
Total Operating Revenue	<u>152,549,545</u>	<u>151,497,843</u>
Direct Game Costs:		
Instant Prizes	11,381,996	11,837,622
On-Line Prizes	10,940,311	10,537,268
Instant Retail Commissions	1,020,560	1,037,083
On-Line Retail Commissions	1,156,546	1,189,763
Instant Ticket Print Costs	406,831	912,710
Total Direct Costs	<u>24,906,244</u>	<u>25,514,446</u>
Gross Profit	<u>127,643,301</u>	<u>125,983,397</u>
Operating Expenses:		
Personal Services and Benefits	1,357,310	1,322,339
Travel	127,376	142,083
Advertising	556,968	653,113
Contractual Services	4,141,871	4,518,681
Supplies and Materials	145,114	150,731
Depreciation	10,964	7,930
Payments to Reservations	39,707	50,623
Total Operating Expenses	<u>6,379,310</u>	<u>6,845,500</u>
Operating Income	<u>121,263,991</u>	<u>119,137,897</u>
Non-operating Revenues (Expenses):		
Pooled Investment Income	733,337	299,859
Broker Rebate Expense	(119,763)	(49,618)
Non-operating Revenue from MUSL	138,031	136,592
Miscellaneous Revenue	10,421	13,675
Total Non-operating Revenue (Expenses)	<u>762,026</u>	<u>400,508</u>
Income Before Transfers	<u>122,026,017</u>	<u>119,538,405</u>
Transfers:		
Transfers to the Property Tax Reduction Fund	110,293,773	109,660,148
Transfers to the General Fund	5,748,644	4,964,476
Transfers to the Capital Construction Fund	4,811,689	4,197,285
Transfers to the Department of Human Services	214,000	177,826
Total Transfers	<u>121,068,106</u>	<u>118,999,735</u>
Change in Net Assets	<u>957,911</u>	<u>538,670</u>
Total Net Assets - Beginning	<u>4,846,616</u>	<u>4,307,946</u>
Total Net Assets - Ending	<u><u>\$5,804,527</u></u>	<u><u>\$4,846,616</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, 2007 and 2006

	FY2007	FY2006
Cash Flows from Operating Activities		
Receipts from Customers and Users	\$152,567,226	\$151,055,093
Payments for Lottery Prizes	(22,296,018)	(21,828,380)
Payments to Suppliers	(6,731,408)	(7,604,417)
Payments for Interfund Services Used	(834,846)	(853,567)
Payments for Employee Services	(1,354,288)	(1,358,644)
Other Receipts (Payments)	84,238	11,123
Net Cash Provided (Used) by Operating Activities	<u>121,434,904</u>	<u>119,421,208</u>
Cash Flows from Capital and Related Financing Activities		
Purchase of Capital Assets		(24,736)
Net Cash Provided (Used) by Capital and Related Financing Activities	<u>0</u>	<u>(24,736)</u>
Cash Flows from Noncapital Financing Activities		
Transfers to Other Funds	(120,810,417)	(118,651,253)
Net Cash Provided (Used) by Noncapital Financing Activities	<u>(120,810,417)</u>	<u>(118,651,253)</u>
Cash Flows from Investing Activities		
Pooled Investment Income	689,200	258,618
Security Lending Rebate Fees	(119,763)	(49,618)
Net Cash Provided (Used) by Investing Activities	<u>569,437</u>	<u>209,000</u>
Net Increase (Decrease) in Cash during the Fiscal Year	1,193,924	954,219
Cash at Beginning of Year	6,148,683	5,194,464
Cash at End of Year	<u>\$7,342,607</u>	<u>\$6,148,683</u>
Reconciliation of Operating Income to Net Cash Provided (Used) by Operating Activities		
Operating Income	\$121,263,991	\$119,137,897
Adjustments to Reconcile Operating Income (Loss) to Net Cash Provided by Operating Activities:		
Depreciation Expense	10,964	7,930
Other Revenue	10,421	13,675
Non-operating Revenue from MUSL	138,031	136,592
Decrease/(Increase) in Assets:		
Accounts Receivable	151,239	(429,150)
Restricted Other Receivable	(14,149)	(73,398)
Certificates of Deposit	(53,534)	18,400
Prepays		10,575
Increase/(Decrease) in Liabilities:		
Accounts Payable	27	118,216
Prizes Payable	(14,295)	501,209
Due to Other Funds	(23,749)	(12,306)
Operator Security Deposits	54,434	(38,000)
Escrows Payable	(10,916)	4,751
Accrued Liabilities	3,022	(36,305)
Deferred Revenue	(80,582)	61,122
Total Adjustments	<u>170,913</u>	<u>283,311</u>
Net Cash Provided by Operating Activities	<u>\$121,434,904</u>	<u>\$119,421,208</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, 2007 and 2006

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 by the passage of Senate Bill 0254 during the 1987 Legislative Session. The South Dakota Lottery was authorized to market instant 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 began selling tickets on November 15, 1990. The current lotto games offered by the Lottery are Powerball, Power Play, Hot Lotto, Wild Card 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 South Dakota Lottery fund applies 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 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 South Dakota Comprehensive Annual Financial Report.

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

	<u>2007</u>	<u>2006</u>
<i>Uncollected instant/on-line ticket revenues</i>	\$ 780,742	\$ 793,409
<i>Allowance for doubtful instant/on-line accounts</i>	(14,933)	(14,933)
<i>Uncollected video lottery revenues and fees</i>	4,306,054	4,444,626
	<u>\$5,071,863</u>	<u>\$5,223,102</u>

Restricted Other Receivable The Restricted Other Receivable account represents the South Dakota Lottery's share of funds held by the Multi-State Lottery (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 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

SOUTH DAKOTA LOTTERY
NOTES TO THE FINANCIAL STATEMENTS
For the Fiscal Years Ended June 30, 2007 and 2006

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, 2007 and 2006, the amount of certificates of deposit being held by the Lottery was \$430,530 and \$376,996, respectively. The amount of \$6,142,800 and \$5,956,200, respectively, was in the form of surety bond, deposit in cash, or irrevocable letter of credit. The total Security Deposits on June 30, 2007 and 2006, were \$6,573,330 and \$6,333,196, respectively.

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.

All securities loans can be terminated on demand by either the SDIC or the borrower. 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 restrictions on the amount of the loans exist or can be made. The amount reported as Securities Lending Collateral of \$1,277,199 and \$784,843 and Securities Lending Collateral Liability of \$1,277,199 and \$784,843 on the statement of net assets represents the Lottery's share of the SDIC total as of June 30, 2007 and 2006, 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. 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.

Capital Assets consisted of the following for fiscal years 2007 and 2006:

	<u>2007</u>				<u>2006</u>			
	Beginning <u>Balance</u>	<u>Additions</u>	<u>Deletions</u>	Ending <u>Balance</u>	Beginning <u>Balance</u>	<u>Additions</u>	<u>Deletions</u>	Ending <u>Balance</u>
<i>Equipment</i>	\$ 959,572	\$ -	\$ -	\$ 959,572	\$ 941,091	\$ 24,736	\$ 6,255	\$ 959,572
<i>Less: Accumulated Depreciation</i>	(930,303)	(10,964)	-	(941,267)	(928,628)	(7,930)	(6,255)	(930,303)
<i>Total Capital Assets</i>	\$ 29,269	\$(10,964)	\$ -	\$ 18,305	\$ 12,463	\$ 16,806	\$ -	\$ 29,269

SOUTH DAKOTA LOTTERY
NOTES TO THE FINANCIAL STATEMENTS
For the Fiscal Years Ended June 30, 2007 and 2006

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 year ended June 30, 2007 and 2006, were \$648,335 for on-line prizes and \$603,007 for instant prizes, and \$369,240 for on-line prizes and \$182,996 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 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, 2007 and 2006, there was a liability to the Property Tax Reduction Fund in the amount of \$4,260,627 and \$4,386,510, respectively.

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 \$288,644 and \$419,476 and a liability for on-line ticket sales to the Capital Construction Fund in the amount of \$1,011,689 and \$497,285 as of June 30, 2007 and 2006, 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 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.

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

Deferred 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 Assets The difference between assets and liabilities is "Net Assets." Net assets are reported in three categories:

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

SOUTH DAKOTA LOTTERY
NOTES TO THE FINANCIAL STATEMENTS
For the Fiscal Years Ended June 30, 2007 and 2006

Restricted net assets consist of funds held by the Multi-State Lottery (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 assets consist 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 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 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 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 \$50,000. Selling bonuses of \$10,000 and \$1,000 may be paid to retailers selling Powerball tickets of \$200,000 and \$10,000, respectively. If a retailer sells a Power Play ticket winning \$200,000 or \$10,000 (each times the multiplier), a bonus of \$20,000 or \$1,000 times the Power Play multiplier, respectively, may be paid. 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, and a retailer selling a \$5,000 winning ticket may receive a bonus of \$500. 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.

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

Annual leave is earned by all employees. Upon termination, employees are eligible to receive compensation for their accrued annual leave balances. At June 30, 2007 and 2006, a liability existed for accumulated annual leave calculated at the employee's June 30 pay rate in the amount of \$98,162 and \$96,687, 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 twelve weeks of the employee's annual compensation. At June 30, 2007 and 2006, a liability existed for accumulated sick leave, calculated at each employee's June 30 pay rate in the amount of \$127,509 and \$121,926, respectively. The following is a schedule of changes in compensated absences at June 30, 2007 and 2006.

SOUTH DAKOTA LOTTERY
NOTES TO THE FINANCIAL STATEMENTS
For the Fiscal Years Ended June 30, 2007 and 2006

	Beginning		Ending	Due
	<u>Balance</u>	<u>Additions</u>	<u>Reduction</u> <u>s</u>	<u>Within</u> <u>One Year</u>
<i>Compensated Absences Payable</i>				
<i>Fiscal Year 2007</i>	\$ 218,613	\$ 90,828	\$ 83,770	\$ 225,671
<i>Fiscal Year 2006</i>	248,913	88,201	118,501	218,613

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 South Dakota Codified Law 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 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 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, 2007, 2006, and 2005 were \$63,376, \$63,762, and \$62,743, 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, 2007:

<u>Period Ending June 30:</u>	
2008	\$ 65,353
2009	60,794
2010	5,948
2011	0
2012	0
Total Minimum Payments	<u>\$ 132,095</u>

Total rental expense for all operating leases for the fiscal years ended June 30, 2007 and 2006, was \$120,037 and \$118,247, respectively.

SOUTH DAKOTA LOTTERY
NOTES TO THE FINANCIAL STATEMENTS
For the Fiscal Years Ended June 30, 2007 and 2006

NOTE 5. VIDEO LOTTERY

Following is a summary of video lottery revenues for the fiscal years ended June 30, 2007 and 2006:

	<u>2007</u>	<u>2006</u>
Cash In	\$ 652,685,841	\$ 646,727,956
Less Cash Out	429,870,139	425,192,304
Video Lottery Net Machine Income	<u>222,815,702</u>	<u>221,535,652</u>
Less Operator and Establishment Share	111,407,851	110,767,826
Video Lottery Revenue Available to the State	<u>111,407,851</u>	<u>110,767,826</u>
Less Lottery Operating Share	1,114,078	1,107,678
Video Lottery Revenue to the Property Tax Reduction Fund	<u>\$ 110,293,773</u>	<u>\$ 109,660,148</u>

NOTE 6. TRANSFERS

Following is a summary of total transfers for the fiscal years ended June 30, 2007 and 2006:

Transfers Out:	<u>2007</u>	<u>2006</u>
General Fund Proceeds from Instant and On-Line	\$ 5,400,000	\$ 4,500,000
Capital Construction Fund Proceeds from On-Line	3,800,000	3,700,000
General Fund Proceeds from Instant and On-line not Yet Transferred	288,644	419,476
Capital Construction Fund Proceeds from On-Line not Yet Transferred	1,011,689	497,285
Video Lottery Proceeds Transferred to the Property Tax Reduction Fund	106,033,146	105,273,638
Video Lottery Proceeds to Prop. Tax Reduction Fund not Yet Transferred	4,260,627	4,386,510
Video Lottery Grant to Department of Human Services	214,000	177,826
Video Lottery Fees Transferred to the General Fund	60,000	45,000
Total Transfers Out	<u>\$121,068,106</u>	<u>\$118,999,735</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 prize reserve fund. At June 30, 2007 and 2006, the MUSL Powerball prize reserve fund had a balance of \$69,701,252 and \$75,178,923, respectively, of which the South Dakota Lottery's share was \$401,405 and \$459,000, respectively. The set prize reserve fund had a balance of \$24,779,750 and \$24,941,590, respectively, of which the South Dakota Lottery's share was \$125,825 and \$135,000,

SOUTH DAKOTA LOTTERY
NOTES TO THE FINANCIAL STATEMENTS
For the Fiscal Years Ended June 30, 2007 and 2006

respectively. The Wild Card 2 prize reserve fund had a balance of \$1,013,600 and \$1,172,140, respectively, of which the South Dakota Lottery's share was \$215,714 and \$226,942, respectively. The Hot Lotto prize reserve fund had a balance of \$3,543,064 and \$1,616,069, respectively, of which the South Dakota Lottery's share was \$150,362 and \$59,204, respectively. These reserves are held by MUSL and are not included in these financial statements.

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.

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, 2007 and 2006, 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.

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, 2009.

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 South Dakota 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.