



2011

Annual Report





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Fiscal Year 2011 Highlights

Economy and smoking ban prompt new video lottery games

In the midst of an economic downturn, South Dakota voters decided on Nov. 2, 2010 by a two to one margin to ban smoking in restaurants, bars and casinos.

The revenue loss had video lottery establishment owners and operators considering ways to make up for lost profits. The Lottery took action as well. By March of 2011, the drop in video lottery revenues sparked the South Dakota Lottery Commission to clarify administrative rules for implementing “line-up” games. Newly licensed machine manufacturers jumped on the bandwagon, submitting fresh games with bright, bold graphics and interactive play features for approval into the South Dakota market.

Scratch ticket sales highest in nearly 25 years

Players continued to enjoy the thrill of scratch tickets during FY2011. Sales topped the previous year by 10 percent and were only bested by the sales of FY1987, the year of the Lottery’s inception.

For its first five years, the Lottery offered only \$1 tickets. In FY2011, the \$3 ticket was tops in sales; the \$20 game garnered 7 percent of the total scratch ticket market.

Failsafe barcodes and keyless validations implemented in the spring simplified ticket checking for players and retailers.

Lotto games reward players and provide bonuses to retailers

The recently launched Mega Millions game proved profitable due to two huge jackpot runs. The biggest run peaked with an astounding \$380 million jackpot. The run generated much chatter, but it also generated incremental sales as well, with player interest lingering long after the jackpot had been hit. The Mega Million game also instituted an automatic \$1 million prize for players winning the second-level prize with the Mega Ball multiplier option.

Lottery expands digital presence in FY2011

Web-based advertising, enhancements to the ESMM slide show, and better use of the agency’s website were components implemented by the Lottery this fiscal year to expand its electronic marketing efforts.

In the fall of 2010 and spring of 2011, flash ads were utilized on the main websites of South Dakota’s two largest newspapers. Three ads appeared for two-week runs in conjunction with traditional print advertising. The flash ads garnered 110,000 impressions.

Several of the slides displayed on the ESMM monitors in all Lottery retailers received an upgrade in FY2011. The Beneficiary Awareness and Players Club slides were redesigned as editable displays, allowing the Lottery to update graphics and information in a more timely manner.

Winners of note

FY2011 got off on the right foot with two jackpot hits in the first two weeks. Marlene Hanson of Langford was the winner of a \$161,475 Wild Card jackpot, and a week later Kevin Barber of Sioux Falls won a \$123,390 Dakota Cash jackpot. Norma Hiller of Sioux Falls won the year’s biggest lotto jackpot, winning \$681,453 in the Wild Card game.

Randi Mosset of Sioux Falls and Troy Opdahl of Hazel won big on Cash Stash tickets worth \$300,000 each. The Cash Stash game, which launched in FY2011, offered the largest top scratch prize ever offered.

Fiscal Year 2011 Sales and Revenues

Instant tickets

The Lottery launched 28 exciting new instant ticket games during FY2011 with price points ranging from \$1 to \$20. Top prizes ranged from \$500 to \$300,000.

Of the 599 retailers statewide, 75 percent were convenience stores, 15 percent were grocery stores, and the remaining 10 percent were restaurants, bars, liquor and drug stores.

Lotto games

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

There were 584 lotto retailers throughout the year. Lotto sales were down 1.7 percent from the previous year.

Video Lottery

The 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 down 11 percent from the previous year. The average number of active video lottery machines during the year was 9,114. The average number of establishments was 1,507.

Revenue from video lottery net machine income is distributed to the Property Tax Reduction Fund and to the Department of Human Services. A portion of machine manufacturer license fees is distributed to the General Fund.

Sales and Revenues

Total fiscal year 2011 Lottery revenue distributed to state funds was nearly \$108 million.

	Sales	Prizes	Retailer Commissions	Revenue Distributed
Instant Tickets	\$22,220,512	\$14,528,449	\$1,253,533	\$4,709,525
Lotto Tickets	\$24,950,957	\$12,647,216	\$1,317,531	\$8,171,703
Video Lottery**	\$583,419,926	\$391,650,298	\$95,884,814	\$95,097,079
			Total:	\$107,978,307

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

Revenue Distribution

	General Fund	Capitol Construction Fund	Property Tax Reduction Fund	Department of Human Services
Instant Tickets	\$4,709,332			
Lotto Tickets	\$1,400,000	\$6,771,896		
Video Lottery**	\$15,000		\$94,925,966	\$156,113
Totals:	\$6,124,332	\$6,771,896	\$94,925,966	\$156,113



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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 Dennis Daugaard
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, 2011 and 2010 and have issued our report thereon dated January 9, 2012. 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 *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the 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 South Dakota Lottery in a separate letter dated January 9, 2012.

This report is intended solely for the information and use of management and members of the South Dakota Legislature 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.

A handwritten signature in black ink, appearing to read "Martin L. Guindon". The signature is fluid and cursive, with a large initial "M" and "G".

Martin L. Guindon, CPA
Auditor General

January 9, 2012



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MARTIN L. GUINDON, CPA
AUDITOR GENERAL

INDEPENDENT AUDITOR'S REPORT

The Honorable Dennis Daugaard
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, 2011 and 2010, 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 present only the financial position and changes in financial position and cash flows 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, 2011 and 2010, 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, 2011 and 2010, 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 9, 2012, 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 9, 2012

SOUTH DAKOTA LOTTERY
STATEMENT OF NET ASSETS
June 30, 2011 and 2010

Assets	2011	2010
Current Assets:		
Cash	\$8,130,866	\$8,026,410
Restricted Cash	16,700	42,500
Total Cash	8,147,566	8,068,910
Accounts Receivable	3,990,950	4,836,486
Restricted Other Receivable	791,920	808,223
Interest Receivable	70,475	81,032
Restricted Certificates of Deposit	456,378	461,705
Total Current Assets	13,457,289	14,256,356
Noncurrent Assets:		
Capital Assets less Accumulated Depreciation/Amortization	2,387,196	2,746,139
Total Assets	15,844,485	17,002,495
Liabilities		
Current Liabilities:		
Accounts Payable	389,026	291,162
Prizes Payable	1,210,355	1,447,429
Due to the Property Tax Reduction Fund	3,316,840	4,196,376
Due to the Capital Construction Fund	1,771,896	1,772,583
Due to the General Fund	1,009,332	1,097,123
Due to Other Funds	72,814	89,289
Due to Other Governments	10,828	10,828
Operator Security Deposits	473,078	504,205
Escrows Payable-Reservation Sales	69,569	70,930
Accrued Liabilities	217,563	222,996
Deferred Revenue	151,578	157,890
Total Current Liabilities	8,682,051	9,860,811
Noncurrent Liabilities:		
Accrued Liabilities	114,899	113,302
Total Liabilities	8,796,950	9,974,113
Net Assets		
Invested in Capital Assets	2,387,196	2,746,139
Restricted for MUSL Permitted Uses	791,920	808,223
Unrestricted	3,868,419	3,474,020
Total Net Assets	\$7,047,535	\$7,028,382

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, 2011 and 2010

	FY2011	FY2010
Operating Revenues:		
Video Lottery Revenue	\$95,884,814	\$107,728,412
Instant Ticket Sales	22,220,512	20,151,392
On-Line Ticket Sales	24,950,957	25,392,506
Terminal License Fees	1,039,600	1,034,000
Retailer License Fees	343,325	325,650
Total Operating Revenue	<u>144,439,208</u>	<u>154,631,960</u>
Direct Game Costs:		
Instant Prizes	14,528,449	12,677,200
On-Line Prizes	12,647,216	12,841,729
Instant Retail Commissions	1,253,533	1,129,283
On-Line Retail Commissions	1,317,531	1,402,704
Instant Ticket Print Costs	522,195	412,879
Total Direct Costs	<u>30,268,924</u>	<u>28,463,795</u>
Gross Profit	<u>114,170,284</u>	<u>126,168,165</u>
Operating Expenses:		
Personal Services and Benefits	1,434,022	1,459,070
Travel	126,771	144,231
Advertising	477,520	532,256
Contractual Services	3,900,661	4,487,690
Supplies and Materials	128,794	66,378
Depreciation/Amortization	364,433	186,018
Bad Debt Expense	3,963	896
Payments to Reservations	69,569	70,930
Total Operating Expenses	<u>6,505,733</u>	<u>6,947,469</u>
Operating Income	<u>107,664,551</u>	<u>119,220,696</u>
Non-operating Revenues (Expenses):		
Pooled Investment Income	311,426	612,719
Non-operating Revenue from MUSL	12,307	22,643
Miscellaneous Revenue	9,176	15,291
Total Non-operating Revenue (Expenses)	<u>332,909</u>	<u>650,653</u>
Income Before Transfers	<u>107,997,460</u>	<u>119,871,349</u>
Transfers:		
Transfers to the Property Tax Reduction Fund	94,925,966	106,651,129
Transfers to the General Fund	6,124,332	6,142,123
Transfers to the Capital Construction Fund	6,771,896	6,772,583
Transfers to the Department of Human Services	156,113	214,000
Total Transfers	<u>107,978,307</u>	<u>119,779,835</u>
Change in Net Assets	<u>19,153</u>	<u>91,514</u>
Total Net Assets - Beginning	<u>7,028,382</u>	<u>6,936,868</u>
Total Net Assets - Ending	<u><u>\$7,047,535</u></u>	<u><u>\$7,028,382</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, 2011 and 2010

	FY2011	FY2010
Cash Flows from Operating Activities		
Receipts from Customers and Users	\$145,217,053	\$155,178,944
Payments for Lottery Prizes	(27,355,807)	(25,457,407)
Payments to Suppliers	(6,959,512)	(7,327,537)
Payments for Interfund Services Used	(692,145)	(838,645)
Payments for Employee Services	(1,437,858)	(1,475,179)
Other Receipts (Payments)	(63,247)	(19,689)
Net Cash Provided (Used) by Operating Activities	<u>108,708,484</u>	<u>120,060,487</u>
Cash Flows from Capital and Related Financing Activities		
Purchase of Capital Assets	(5,490)	(2,900,000)
Net Cash Provided (Used) by Capital and Related Financing Activities	<u>(5,490)</u>	<u>(2,900,000)</u>
Cash Flows from Noncapital Financing Activities		
Transfers to Other Funds	(108,946,321)	(118,422,387)
Net Cash Provided (Used) by Noncapital Financing Activities	<u>(108,946,321)</u>	<u>(118,422,387)</u>
Cash Flows from Investing Activities		
Pooled Investment Income	321,983	650,231
Net Cash Provided (Used) by Investing Activities	<u>321,983</u>	<u>650,231</u>
Net Increase (Decrease) in Cash during the Fiscal Year	78,656	(611,669)
Cash at Beginning of Year	8,068,910	8,680,579
Cash at End of Year	<u>\$8,147,566</u>	<u>\$8,068,910</u>
Reconciliation of Operating Income to Net Cash		
Provided (Used) by Operating Activities		
Operating Income	\$107,664,551	\$119,220,696
Adjustments to Reconcile Operating Income (Loss) to Net Cash Provided by Operating Activities:		
Depreciation/Amortization Expense	364,433	186,018
Other Revenue	9,176	15,291
Non-operating Revenue from MUSL	12,307	22,643
Decrease/(Increase) in Assets:		
Accounts Receivable	855,723	366,539
Restricted Other Receivable	16,303	(15,539)
Restricted Certificates of Deposit	5,327	(74,652)
Increase/(Decrease) in Liabilities:		
Accounts Payable	97,864	54,051
Prizes Payable	(237,074)	272,311
Due to Other Funds	(16,475)	281
Due to Other Governments	(10,828)	828
Operator Security Deposits	(31,127)	82,352
Escrows Payable	(1,361)	22,339
Allowance for Doubtful Accounts	(10,187)	896
Accrued Liabilities	(3,836)	(16,109)
Deferred Revenue	(6,312)	(77,458)
Total Adjustments	<u>1,043,933</u>	<u>839,791</u>
Net Cash Provided by Operating Activities	<u>\$108,708,484</u>	<u>\$120,060,487</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, 2011 and 2010

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 South Dakota Lottery fund follows all Governmental Accounting Standards Board (GASB) pronouncements and those Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins that were issued on or before Nov. 30, 1989, except for those that conflict with a GASB pronouncement. 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 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:

	<u>2011</u>	<u>2010</u>
<i>Uncollected instant/on-line ticket revenues</i>	\$ 632,646	\$ 596,298
<i>Allowance for doubtful instant/on-line accounts</i>	(8,703)	(18,890)
<i>Uncollected video lottery revenues and fees</i>	3,367,007	4,259,078
	\$3,990,950	\$4,836,486

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.

SOUTH DAKOTA LOTTERY
NOTES TO THE FINANCIAL STATEMENTS
For the Fiscal Years Ended June 30, 2011 and 2010

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, 2011 and 2010, the amount of cash on deposit with the Lottery was \$16,700 and \$42,500 and the amount of certificates of deposit being held by the Lottery was \$456,378 and \$461,705, respectively. The amount of \$5,804,800 and \$5,828,100, respectively, was in the form of surety bond or irrevocable letter of credit and are not reported on the Statement of Net Assets. The total Security Deposits on June 30, 2011 and 2010 were \$6,277,878 and \$6,332,305, 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.

The South Dakota Lottery obtained a new Video Lottery Central Monitoring and Control System (VLCS) from Scientific Games on December 24, 2009. The Lottery made an upfront payment to Scientific Games of \$2,900,000. This included the hardware for a primary, back-up and test system, a perpetual license to use the VLCS communications protocol and a license to use Scientific Games system software.

Capital Assets consisted of the following for fiscal years 2011 and 2010:

	<u>2011</u>				<u>2010</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>	\$ 673,256	\$ 5,490	\$ 16,097	\$ 662,649	\$ 105,244	\$586,903	\$ 18,891	\$ 673,256
<i>Intangible Assets-Software</i>	2,313,097	-	-	2,313,097	-	2,313,097	-	2,313,097
<i>Total Capital Assets</i>	<u>2,986,353</u>	<u>5,490</u>	<u>16,097</u>	<u>2,975,746</u>	<u>105,244</u>	<u>2,900,000</u>	<u>18,891</u>	<u>2,986,353</u>
<i>Less Accumulated Depreciation/Amortization for:</i>								
<i>Equipment</i>	(124,560)	(15,743)	16,097	(124,206)	(73,087)	(70,364)	18,891	(124,560)
<i>Intangible Assets-Software</i>	(115,654)	(348,690)	-	(464,344)	-	(115,654)	-	(115,654)
<i>Total Accumulated Depreciation/Amortization</i>	<u>(240,214)</u>	<u>(364,433)</u>	<u>16,097</u>	<u>(588,550)</u>	<u>(73,087)</u>	<u>(186,018)</u>	<u>18,891</u>	<u>(240,214)</u>
<i>Total Capital Assets, Net</i>	<u>\$2,746,139</u>	<u>(\$358,943)</u>	<u>\$ -</u>	<u>\$2,387,196</u>	<u>\$ 32,157</u>	<u>\$2,713,982</u>	<u>\$ -</u>	<u>\$2,746,139</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, 2011 and 2010 were \$407,863 for on-line prizes and \$392,302 for instant prizes, and \$464,039 for on-line prizes and \$462,607 for instant prizes, respectively.

SOUTH DAKOTA LOTTERY
NOTES TO THE FINANCIAL STATEMENTS
For the Fiscal Years Ended June 30, 2011 and 2010

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, 2011 and 2010, there was a liability to the Property Tax Reduction Fund of \$3,316,840 and \$4,196,376, 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 \$1,009,332 and \$1,097,123, and a liability for on-line ticket sales to the Capital Construction Fund of \$1,771,896 and \$1,772,583 as of June 30, 2011 and 2010, 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.

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. "Net Assets" are the difference between assets and liabilities. Net assets are reported in three categories:

Invested in capital assets, net of related debt 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 assets consist 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 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 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.

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On-line retailers selling a jackpot winning Powerball or Mega Millions 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, or Mega Millions tickets of \$250,000 and \$10,000, respectively. If a retailer sells a Power Play ticket winning \$200,000 or \$10,000 (each times the multiplier) or a Megaplier ticket winning \$250,000 or \$10,000 (each times the multiplier), a bonus of \$20,000 or \$1,000 times the multiplier, respectively, may be paid. 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 \$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. Retailers who sell a Sizzler jackpot winning ticket or a \$30,000 winning ticket may receive a bonus of \$10,000 or \$3,000, 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

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, 2011 and 2010, a liability existed for accumulated annual leave calculated at the employee's June 30 pay rate in the amount of \$109,930 and \$106,766, 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, 2011 and 2010, a liability existed for accumulated sick leave, calculated at each employee's June 30 pay rate, in the amount of \$133,965 and \$133,026, respectively. The following is a schedule of changes in compensated absences at June 30, 2011 and 2010.

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
<i>Compensated Absences Payable</i>					
<i>Fiscal Year 2011</i>	\$ 239,792	\$ 137,099	\$ 132,996	\$ 243,895	\$ 128,996
<i>Fiscal Year 2010</i>	253,595	131,637	145,440	239,792	126,490

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, 2011, 2010, and 2009 were \$66,335, \$68,256, and \$68,000, respectively, equal to the required contributions each year.

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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, 2011:

<u>Period Ending June 30:</u>	
2012	\$ 62,175
2013	7,521
Total Minimum Payments	<u>\$69,696</u>

Total rental expense for all operating leases for the fiscal years ended June 30, 2011 and 2010, was \$72,024 and \$124,151, respectively.

NOTE 5. VIDEO LOTTERY

Following is a summary of video lottery revenues for the fiscal years ended June 30, 2011 and 2010:

	<u>2011</u>	<u>2010</u>
Cash In	\$ 583,419,926	\$ 642,214,243
Less Cash Out	391,650,298	426,757,417
Video Lottery Net Machine Income	<u>191,769,628</u>	<u>215,456,826</u>
Less Operator and Establishment Share	95,884,814	107,728,413
Video Lottery Revenue Available to the State	<u>95,884,814</u>	<u>107,728,413</u>
Less Lottery Operating Share	958,848	1,077,284
Video Lottery Revenue to the Property Tax Reduction Fund	<u>\$ 94,925,966</u>	<u>\$ 106,651,129</u>

NOTE 6. TRANSFERS

Following is a summary of total transfers for the fiscal years ended June 30, 2011 and 2010:

Transfers Out:	<u>2011</u>	<u>2010</u>
General Fund Proceeds from Instant and On-Line	\$ 5,100,000	\$ 5,000,000
Capital Construction Fund Proceeds from On-Line	5,000,000	5,000,000
General Fund Proceeds from Instant and On-line not Yet Transferred	1,009,332	1,097,123
Capital Construction Fund Proceeds from On-Line not Yet Transferred	1,771,896	1,772,583
Video Lottery Proceeds Transferred to the Property Tax Reduction Fund	91,609,126	102,454,753
Video Lottery Proceeds to Prop. Tax Reduction Fund not Yet Transferred	3,316,840	4,196,376
Video Lottery Grant to Department of Human Services	156,113	214,000
Video Lottery Fees Transferred to the General Fund	15,000	45,000
Total Transfers Out	<u>\$107,978,307</u>	<u>\$119,779,835</u>

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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, Mega Millions/Megaplier, 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, Hot Lotto and Megaplier consists of 50 percent of each drawing period's sales. The prize pool for Power Play is 49.5 percent of sales, the prize pool for Mega Millions is up to 55 percent of sales, and the prize pool for Sizzler is 47.42 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, 1.5 percent for Sizzler, 2.5 percent of Mega Millions, and 0.5 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 MUSL in cases of unforeseen liabilities. The money in this reserve fund 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 who leave must wait one year before receiving their remaining share, if any, of the prize reserve fund. At June 30, 2011 and 2010, the MUSL Powerball prize reserve fund had a balance of \$97,413,591 and \$84,281,999, respectively, of which the South Dakota Lottery's share was \$611,235 and \$449,601, respectively. The set prize reserve fund had a balance of \$25,000,000 and \$29,117,533, respectively, of which the South Dakota Lottery's share was \$155,200 and \$149,867, respectively. The Wild Card 2 prize reserve fund had a balance of \$979,918 and \$980,273, respectively, of which the South Dakota Lottery's share was \$203,732 and \$174,751, respectively. The Hot Lotto prize reserve fund had a balance of \$7,441,187 and \$6,491,541, respectively, of which the South Dakota Lottery's share was \$333,562 and \$265,150, respectively. At June 30, 2011 and 2010, the Mega Millions prize reserve had a balance of \$9,146,437 and (\$629,706), respectively, of which the South Dakota Lottery's share was \$42,394 and (\$4,362), 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 Nov. 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 that time, 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 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, and will be divided equally among all jackpot winners for a specific drawing. The Hot Lotto and Mega Millions jackpot prize can be taken as cash or annuity and is divided equally among multiple winners.

As of June 30, 2011 and 2010, MUSL had purchased zero coupon bonds to fund installment payments for the South Dakota Lottery aggregating \$0 and \$12,466,937, respectively. The total purchase price of these bonds was \$6,509,238 and the final installment payment was made on April 8, 2010.

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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, 2014, with possible extension 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.