



Report of Independent Auditors and  
Financial Statements for

**Arizona State Lottery**  
A Proprietary Fund of the State of Arizona  
June 30, 2014 and 2013

**MOSS ADAMS<sub>LLP</sub>**

Certified Public Accountants | Business Consultants

*Acumen. Agility. Answers.*

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## REPORT OF INDEPENDENT AUDITORS

To the Commissioners of  
Arizona State Lottery  
Phoenix, Arizona

### **Report on the Financial Statements**

We have audited the accompanying financial statements of the business-type activities of the Arizona State Lottery (the "Lottery") as of and for the years ended June 30, 2014 and 2013 and the related notes to the financial statements, which collectively comprise the Lottery's basic financial statements as listed in the table of contents.

### ***Management's Responsibility for the Financial Statements***

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

### ***Auditor's Responsibility***

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

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

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

### ***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial positions of the Lottery, as of June 30, 2014 and 2013, and the changes in financial position, and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

### ***Other Matters***

#### ***Required Supplementary Information***

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 4 through 8 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in conformity with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

#### ***Other Supplemental Information***

Our audit was conducted for the purpose of forming opinions about the financial statements of the Arizona State Lottery. The supplemental schedule of gross profit by game on pages 20 through 25 are presented for purposes of additional analysis and are not a required part of the financial statements. The schedule of gross profit by game is the responsibility of management and was derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in conformity with auditing standards general accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

**Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we also have issued our report dated December 9, 2014 on our consideration of the Lottery's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Lottery's internal control over financial reporting and compliance.

*Moss Adams LLP*

Scottsdale, Arizona  
December 9, 2014

**ARIZONA STATE LOTTERY  
A PROPRIETARY FUND OF THE STATE OF ARIZONA  
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)**

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This discussion and analysis of the Lottery's financial statements is a required component of financial reporting under Governmental Accounting Standards and was prepared by Arizona Lottery Management. It provides an overview of financial activities as of and for the year ended June 30, 2014, and should be read in conjunction with the Lottery's financial statements and notes to the financial statements.

This annual report consists of three types of financial statements and accompanying notes that provide explanations and details of accounting policies, account balances and activities. Account balances and activities are shown as of and for the years ended June 30, 2014 and 2013. The statement of net position; the statement of revenues, expenses, and changes in net position; and the notes are presented using the accrual method of accounting. Under this method, financial transactions are recorded when earned or incurred regardless of when cash is received or disbursed. The statement of cash flows reflects cash receipts and disbursements during the same 12-month period.

The statement of net position provides information about the assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position of the Lottery. Assets consist of cash, substantially all held by the State Treasurer, amounts owed to the Lottery from licensed Lottery retailers and other State agencies, ticket inventory, and property. Liabilities represent amounts owed by the Lottery to vendors, to employees for wages and benefits, to prize winners, and to other State funds. Fund net position represents the portion of the Lottery's assets that are not encumbered by liabilities. It serves as an indicator of the net worth of the Lottery.

A summary of the financial results of operations for the 12-month period is presented in the statement of revenues, expenses, and changes in net position. Operating revenues include sales of Lottery tickets, retailer licensing fees, and commissions earned on the sales of Lottery tickets at Lottery offices, and special events. Direct costs and administrative expenses comprise the operating expenses section of this statement. Direct costs are variable expenses that fluctuate with the level of sales. Marketing and overhead costs are included in the administrative expenses category.

Nonoperating revenues consist of interest earned on prize fund cash investments from the State Treasurer, interest credited to the Lottery's Multistate Lottery Association (MUSL) unreserved account for interest earned on prize reserves at MUSL and income recognized from common stock. The transfer's category includes transfers to other state funds as required by Lottery statutes.

The statement of cash flows includes cash receipts and disbursements from operating, noncapital financing, and investment earnings. This statement also includes a reconciliation of operating income presented on the accrual basis of accounting to net cash provided by operating activities. The notes to the financial statements present information on accounting policies, transfers and statutory requirements, commitments, contingencies, and retirement benefits. These notes are an integral part of the financial statements.

**ARIZONA STATE LOTTERY**  
**A PROPRIETARY FUND OF THE STATE OF ARIZONA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)**

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**Sales Activities**

Revenues from the sale of Lottery products for the fiscal year ended June 30, 2014 were higher than Fiscal Year 2013 and also a Lottery record high. As shown in the financial statements, sales increased 4.5% from the prior year, from \$693.0 million in Fiscal Year 2013 to \$723.9 million in the current year. Sales of Scratchers<sup>SM</sup>, Instant Tabs, Mega Millions<sup>®</sup>, Fantasy 5, AON, and Pick 3 all showed increases while Powerball<sup>®</sup>, The Pick, Cash 4, 2 By 2, and Weekly Winnings sales decreased.

The following table compares Lottery product sales between fiscal years. Sales are presented in millions of dollars.

<u>Product Sales</u>	<u>FY 2013</u>	<u>FY 2014</u>	<u>Changes</u>	<u>Percentage</u>
Scratchers (including economic development)	\$ 436.6	\$ 483.9	\$ 47.3	10.83%
Powerball	151.2	113.0	(38.2)	-25.26%
Mega Millions	32.4	56.3	23.9	73.77%
The Pick	33.0	30.4	(2.6)	-7.88%
Fantasy 5	15.8	16.4	0.6	3.80%
Pick 3	8.5	9.2	0.7	8.24%
Weekly Winnings	7.9	5.7	(2.2)	-27.85%
Instant Tabs	3.9	4.4	0.5	12.82%
2 By 2	3.1	2.9	(0.2)	-6.45%
AON	-	1.7	1.7	100.00%
Cash 4	0.6	-	(0.6)	-100.00%
Total	<u>\$ 693.0</u>	<u>\$ 723.9</u>	<u>\$ 30.9</u>	<u>4.46%</u>

**Total Revenues**

Other operating revenues for the year ended June 30, 2014, were \$340,246 compared to \$1,216,059 for the year ended June 30, 2013. Other operating revenue is comprised of license fees and other miscellaneous revenue. Total operating revenues were \$724.3 million for the year ended June 30, 2014, as compared to \$694.2 million for the year ended June 30, 2013. As mentioned above, the increase was due to an increase in sales revenues.

Nonoperating revenues for the year ended June 30, 2014, were \$104,669 as compared to \$79,161 for the year ended June 30, 2013. Nonoperating revenue is comprised of interest earned on invested cash and periodic recognition of commissions earned by the Lottery.

**ARIZONA STATE LOTTERY  
A PROPRIETARY FUND OF THE STATE OF ARIZONA  
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)**

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**Major Expenses**

\$525.5 million of the Lottery's total operating expenses of \$548.8 million for the year ended June 30, 2014 were incurred in direct support of the sales of Lottery games.

\$493.4 million of the Lottery's total operating expenses of \$516.4 million for the year ended June 30, 2013 were incurred in direct support of the sales of Lottery games. These expenses include prize expense, retailer commissions and incentives, purchases of Scratchers tickets, compensation to the vendor for Scratchers ticket distribution, and compensation to the vendor who maintains and supports the on-line gaming system.

The following table compares the game related expenses between fiscal years. All expenses are presented in millions of dollars.

<b>Game Related Expenses</b>	<b>FY 2013</b>	<b>FY 2014</b>	<b>Differences</b>	<b>Percentage</b>
Prize expense	\$ 426.1	\$ 456.4	\$ 30.3	7.1%
Retailer commissions	47.1	49.2	2.1	4.5%
On-line system expenses	9.3	8.7	(0.6)	-6.5%
Scratchers system and Distribution expenses	4.4	4.9	0.5	11.4%
Tickets purchased	6.5	6.3	(0.2)	-3.1%
<b>Total</b>	<b>\$ 493.4</b>	<b>\$ 525.5</b>	<b>\$ 32.1</b>	<b>6.5%</b>

The increase in game related expenses is reflective of the increase in product sales. See the product sales schedule above.

Of the \$23.3 million in Fiscal Year 2014 in other operating expenses, \$15.1 million was used for advertising and promotion and \$5.9 million was used to compensate Lottery employees. In comparison, of the \$23.0 million in Fiscal Year 2013 in other operating expenses, \$14.8 million was used for advertising and promotion and \$5.9 million was used to compensate Lottery employees.

**Transfers to Other State Funds**

Note 3 to the financial statements details the amounts transferred to other State Funds. In Fiscal Year 2014 the Lottery transferred \$175.6 million to other State Funds. In comparison, in Fiscal Year 2013 the Lottery transferred \$177.8 million to other State Funds.



**ARIZONA STATE LOTTERY  
A PROPRIETARY FUND OF THE STATE OF ARIZONA  
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)**

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**Other Financial Information**

<b>Statement of Net Position</b>	<b>FY 2013</b>	<b>FY 2014</b>
Current assets	\$ 86.3	\$ 58.5
Capital assets	3.8	3.7
Other assets - deposits	9.3	9.9
Total assets	99.4	72.1
Current liabilities	88.8	61.5
Net position	\$ 10.6	\$ 10.6

The Lottery's total assets at June 30, 2014 were \$72.1 million. Assets consisted of cash held substantially by the State Treasurer of \$45.0 million, receivables from Lottery retailers for the sale of Lottery products of \$7.6 million, Scratchers ticket and pull tab inventory of \$5.9 million, net investment in capital assets of \$3.7 million, and a deposit with MUSL of \$9.9 million.

Comparable figures at June 30, 2013 were \$99.4 million. Assets consisted of cash held substantially by the State Treasurer of \$76 million, receivables from Lottery retailers for the sale of Lottery products of \$6.4 million, Scratchers ticket and pull tab inventory of \$3.9 million, net investment in capital assets of \$3.8 million, and a deposit with MUSL of \$9.3 million.

Total liabilities at June 30, 2014, were \$61.5 million, consisting of \$3.8 million in accounts payable and accrued expenses, prize liabilities of \$14.2 million, and amounts due to other State Funds of \$43.5 million. All of the Lottery's liabilities were current liabilities.

The Lottery's total liabilities at June 30, 2013, were \$88.8 million, consisting of \$5.8 million in accounts payable and accrued expenses, prize liabilities of \$12.2 million, and amounts due to other State Funds of \$70.8 million. All of the Lottery's liabilities were current liabilities.

Total net position at June 30, 2014, was \$10.6 million, which is consistent with the amount of total net position reported at June 30, 2013.

In the sixth special session of the State Legislature in 2010, amendments were made to the Lottery statutes allowing the State to issue Lottery Revenue Bonds. These bonds provide additional working capital to pay appropriated expenditures of the State's General Fund. The bonds are payable solely from and secured by pledged revenues consisting of, until July 1, 2012, amounts distributable to the State General Fund from the Lottery pursuant to Lottery law, and from and after July 1, 2012 all Lottery revenues deposited to the Lottery fund net of Lottery operating expenses. (See Note 3 to the financial statements.)

**ARIZONA STATE LOTTERY  
A PROPRIETARY FUND OF THE STATE OF ARIZONA  
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)**

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**BUDGETARY HIGHLIGHTS**

The Lottery's budget is set by the legislative appropriations process on a biennial basis. The budgets for Fiscal Years 2013 and 2014 were set in the regular legislative session of 2012. The Lottery's Fiscal Year 2014 budget was amended in the regular legislative session of 2013. The Lottery's appropriation for sales-related expenditures is based on approved percentages of projected revenues and is allowed to increase for these items without a supplemental appropriations request if actual revenues exceed projected revenues. The appropriation does not include an amount for prizes because Lottery statutes set this amount at "not less than 50% of the total annual revenues accruing from the sale of Lottery tickets or shares."

The Lottery's appropriation was \$99.4 million at the beginning of the year and decreased to \$98.7 million, as actual revenues were more than budgeted projections.

**CONTACTING THE LOTTERY'S FINANCIAL MANAGEMENT**

This management's discussion and analysis (MD&A) is designed to provide Arizona citizens, Arizona government officials, our players, retailers, and other interested parties with an overview of the Lottery's financial activity for Fiscal Year 2014 and to demonstrate the Lottery's accountability for the money it received from the sale of Lottery products.

If you have questions about the MD&A or need additional information, contact the Arizona Lottery's Director of Audit and Accounting, 4740 East University, Phoenix, Arizona 85034.

**ARIZONA STATE LOTTERY**  
**A PROPRIETARY FUND OF THE STATE OF ARIZONA**  
**STATEMENTS OF NET POSITION**

	ASSETS	
	June 30,	
	2014	2013
<b>CURRENT ASSETS</b>		
Cash, substantially all held by the State Treasurer	\$ 44,979,474	\$ 76,000,899
Accounts receivable, net of allowance for doubtful accounts of \$145,000 as of June 30, 2014 and 2013	7,622,594	6,396,051
Scratch ticket inventory	5,796,754	3,741,527
Pull tab inventory	159,858	205,697
Total current assets	<u>58,558,680</u>	<u>86,344,174</u>
<b>CAPITAL ASSETS</b>		
Land and land improvements	1,268,695	1,268,695
Buildings	4,022,983	3,923,817
Furniture, fixtures, and equipment	2,643,912	2,555,224
Intangible assets	599,324	599,324
Less accumulated depreciation and amortization	<u>(4,836,092)</u>	<u>(4,561,393)</u>
Total capital assets	<u>3,698,822</u>	<u>3,785,667</u>
<b>OTHER ASSETS</b>		
Deposit - MUSL	<u>9,862,147</u>	<u>9,304,016</u>
Total assets	<u>\$ 72,119,649</u>	<u>\$ 99,433,857</u>
<b>LIABILITIES AND NET POSITION</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable	\$ 3,428,498	\$ 5,536,411
Accrued expenses	321,568	289,389
Prize liability	14,253,788	12,236,088
Due to other funds	14,424,657	17,855,177
Due to other state funds	<u>29,072,838</u>	<u>52,898,492</u>
Total current liabilities	<u>61,501,349</u>	<u>88,815,557</u>
<b>NET POSITION</b>		
Net investment in capital assets	3,698,822	3,785,667
Unrestricted	<u>6,919,478</u>	<u>6,832,633</u>
Total net position	<u>\$ 10,618,300</u>	<u>\$ 10,618,300</u>

**ARIZONA STATE LOTTERY**  
**A PROPRIETARY FUND OF THE STATE OF ARIZONA**  
**STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION**

	Years Ended June 30,	
	2014	2013
<b>OPERATING REVENUES</b>		
Ticket sales		
Scratchers	\$ 483,895,812	\$ 436,599,601
Powerball	113,038,643	151,219,355
Mega Millions	56,295,451	32,370,173
The Pick	30,384,743	32,998,104
Fantasy 5	16,409,700	15,762,206
Pick 3	9,203,729	8,547,584
Weekly Winnings	5,679,494	7,903,108
Instant Tab	4,394,742	3,865,494
2 By 2	2,916,108	3,094,844
AON	1,735,874	-
Cash 4	-	578,346
Total ticket sales	<u>723,954,296</u>	<u>692,938,815</u>
Other operating revenues	<u>340,246</u>	<u>1,216,059</u>
Total operating revenues	<u>724,294,542</u>	<u>694,154,874</u>
<b>OTHER EXPENSES</b>		
Direct costs		
Prize expense	456,420,391	426,143,442
Retailer commissions and incentives	49,218,413	47,086,481
Online system expense	8,656,709	9,341,528
Scratcher system and distribution expenses	4,896,106	4,367,836
Tickets purchased	<u>6,300,627</u>	<u>6,471,398</u>
Total direct costs	525,492,246	493,410,685
Advertising and promotion	15,063,260	14,756,557
Wages and related expenses	5,890,182	5,923,481
Contract services	530,382	374,098
Depreciation	274,699	190,983
Administrative expenses	<u>1,527,790</u>	<u>1,771,923</u>
Total operating expenses	<u>548,778,559</u>	<u>516,427,727</u>
<b>OPERATING INCOME</b>	175,515,983	177,727,147
<b>NONOPERATING REVENUES - Investment income and other</b>	<u>104,669</u>	<u>79,161</u>
<b>INCOME BEFORE TRANSFERS</b>	175,620,652	177,806,308
<b>TRANSFERS TO OTHER STATE FUNDS</b>	<u>175,620,652</u>	<u>177,806,308</u>
Change in net position	-	-
<b>NET POSITION - beginning of year</b>	<u>10,618,300</u>	<u>10,618,300</u>
<b>NET POSITION - end of year</b>	<u>\$ 10,618,300</u>	<u>\$ 10,618,300</u>

See accompanying notes.

**ARIZONA STATE LOTTERY**  
**A PROPRIETARY FUND OF THE STATE OF ARIZONA**  
**STATEMENTS OF CASH FLOWS**

	Years Ended June 30,	
	2014	2013
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Cash received from retailers-net of validations, commissions, and incentives	\$ 333,643,674	\$ 529,554,908
Cash received from other sources	15,394,305	12,663,535
Cash payments for prizes and related taxes	(133,527,122)	(323,915,100)
Cash payments to suppliers of goods or services	(41,214,303)	(36,378,905)
Cash payments to employees	(5,905,721)	(5,920,312)
Net cash provided by operating activities	<u>168,390,833</u>	<u>176,004,126</u>
<b>CASH FLOWS USED BY NONCAPITAL FINANCING ACTIVITIES</b>		
Payments to beneficiaries per Arizona Statutes	<u>(199,446,300)</u>	<u>(156,152,193)</u>
<b>CASH FLOWS USED BY CAPITAL FINANCING ACTIVITIES</b>		
Payments for acquisition of capital assets	<u>(59,788)</u>	<u>(224,256)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Receipts of interest	<u>93,830</u>	<u>70,313</u>
Net (decrease) increase in cash	(31,021,425)	19,697,990
CASH AT BEGINNING OF YEAR	<u>76,000,899</u>	<u>56,302,909</u>
CASH AT END OF YEAR	<u>\$ 44,979,474</u>	<u>\$ 76,000,899</u>
<b>RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES</b>		
Operating income	\$ 175,515,983	\$ 177,727,147
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	274,699	190,983
Changes in operating assets and liabilities		
Accounts receivable	(1,226,543)	(1,006,630)
Ticket and pull tab inventory	(2,009,388)	(821,417)
Deposit - MUSL	(558,131)	(53,284)
Accounts payable and accrued expenses	(2,192,967)	1,092,630
Prizes payable and due to other funds	(1,412,820)	(1,125,303)
Net cash provided by operating activities	<u>\$ 168,390,833</u>	<u>\$ 176,004,126</u>

**ARIZONA STATE LOTTERY**  
**A PROPRIETARY FUND OF THE STATE OF ARIZONA**  
**NOTES TO BASIC FINANCIAL STATEMENTS**

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**Note 1 – Nature of Operations and Summary of Significant Accounting Policies**

The Arizona State Lottery (the "Lottery") was created by enactment of Title 5, Chapter 5 to the Arizona Revised Statutes (ARS), which was an initiative measure approved by the voters of the State of Arizona (the "State") in 1980. The Lottery commenced operations in 1981. The accompanying financial statements present information as to the transactions of the Lottery.

For the period July 1, 2013 through June 30, 2014, the Lottery held 44 instant games (games 770, 792, 804, 805, 807-809, 811-813, 818, 820-824, 830, 831, 833-841, 844-849, 852, 855, 858, 863, 867, 869, 886, 887, 888). During 2014, the Lottery continued the "Pick 3," "Fantasy 5," "The Pick," "Powerball," "Mega Millions," "2 By 2", "Weekly Winnings", and "Cash 4" on-line games. As required, the Lottery has deposits with "Powerball," and "Mega Millions," multistate on-line lottery games, of \$9.8 million at June 30, 2014. The Lottery also sold instant tab lottery tickets to non-profit organizations. These games are printed and sold by the Lottery, though are administered and paid out by the purchasing non-profit organizations. The Lottery prepares its financial statements in accordance with accounting principles generally accepted in the United States of America.

**State Lottery Fund** – The State Lottery Fund (the "Fund"), which is a proprietary fund of the State, accounts for revenues received from the sale of lottery tickets and the receipt of license fees. The Fund is operated in a manner similar to a private business enterprise where the governing body has decided that periodic determination of revenues earned, expenses incurred, and net income is appropriate for capital maintenance, management control, accountability, or other purposes. Activities accounted for in the proprietary fund follows all applicable Governmental Accounting Standards Board pronouncements. The Fund accounts for prize payments, operational expenses (including consulting), promotional, advertising expenses, and transfers of monies to other State funds. Receipts from each type of lottery game are allocated as follows:

- Not less than 50% of the total annual revenue from Lottery ticket sales is apportioned for the payment of prizes to the holders of winning tickets for the period July 1, 2013 to June 30, 2014.
- Not more than 18.5% is apportioned for payment of Lottery operating expenditures as defined by Arizona Revised Statute 5-555. Legislation enacted in 2008 set this limit and also removed a 4% cap on advertising expenditures.

**Cash and investments** – Substantially all the Lottery's cash is held by the State Treasurer for pooled investment purposes. Statutes require the State Treasurer to invest these pooled funds in obligations of the U.S. government and are recorded at fair value.

**Accounts receivable** – Retailers are billed weekly for tickets sold. Payments from retailers are mainly received through electronic withdrawals from retailer accounts one week after the amounts are billed. Accounts receivable represents amounts that have been billed but not yet collected. An allowance for doubtful accounts is recorded in the amount of any balances that are not paid by retailers, generally one week after amounts are billed.

**ARIZONA STATE LOTTERY**  
**A PROPRIETARY FUND OF THE STATE OF ARIZONA**  
**NOTES TO BASIC FINANCIAL STATEMENTS**

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**Note 1 – Nature of Operations and Summary of Significant Accounting Policies (continued)**

**Ticket inventory** – Ticket inventory is stated at cost, which represents the amount incurred by the Lottery for purchasing the tickets.

**Capital assets** – Capital assets of the Fund, which consists principally of buildings, land, land improvements, and office furniture and equipment are stated at historical cost. The Lottery defines capital assets as assets with an individual cost of more than \$5,000. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets' lives are not capitalized. Expenditures for normal repairs and maintenance are charged to operations as incurred, whereas expenditures for major renewals, replacements, and betterments are capitalized and depreciated. Depreciation is computed using the straight-line method. Capital assets are depreciated on the following basis:

Buildings	40 years
Improvements	40 years
Fixtures and equipment	3–10 years
Intangible assets	6 years

**Investments and investment income** – Investments are reported at fair value on the statement of net position as determined by quoted market prices with any realized or unrealized gains and losses reported in the statement of revenues, expenses, and changes in net position. Investment income from all investments is recognized by the Lottery in the period it is earned and gains and losses are recognized as revenue in the period in which they occur. Investment income also includes earnings on invested cash held by the State Treasurer and invested prize, reserves held by the Multistate Lottery Association (MUSL).

**Sales and revenue recognition** – Revenue is recognized and the related direct expenses of ticket sales, including prize expense, are accrued based upon the known relationship of the amount of ticket sales to the amount of prizes for each game. This method of measuring revenue is necessary in order to properly match revenues and expenses. The Lottery's operating revenues result from exchange transactions associated with the principle activity of the fund. Non-operating revenues result from non-exchange transactions or from ancillary activities of the fund.

**ARIZONA STATE LOTTERY  
A PROPRIETARY FUND OF THE STATE OF ARIZONA  
NOTES TO BASIC FINANCIAL STATEMENTS**

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**Note 1 – Nature of Operations and Summary of Significant Accounting Policies (continued)**

**Prize expense and prize liability** – Instant ticket prize expense is estimated and recognized when ticket packs are settled and is based on the design of the game. Game designs include certain guaranteed prizes in each pack of tickets and prizes placed randomly by the gaming vendor. When validations for the game have ended, differences between estimated and actual prizes awarded for the randomly placed tickets are adjusted to prize expense and prize liability. Prize expense for draw games is recognized as drawings are held, based on the estimated or known cost of the prize payments. Prize expense is adjusted as prizes are claimed and the actual cost of the prize is known. Prize liabilities for prizes are recorded when the prize expense is recognized. The prize liability represents a liability for prizes which are unclaimed for games in progress. Prizes unclaimed for 180 days after the drawing date are forfeited by the ticket holder. The prize liability also includes forfeited unclaimed prizes of approximately \$5,000,000 at June 30, 2014. The Lottery retains 70% of all forfeited unclaimed prizes, under State statute, for supplemental prizes in subsequent lottery games. State statute also requires that 30% of all forfeited unclaimed prizes be transferred to the Court Appointed Special Advocate Account, a fund within the State's General Fund.

**Compensated absences** – Vacation leave vests with the employee as it is earned. Employees may carry forward only the amount of vacation benefits equal to the maximum allowable accumulated credits for the preceding calendar year. Accordingly, at June 30, 2014 and 2013, the Fund's accounts payable and accrued expenses balance includes an accrual of vacation pay and related benefits of \$321,568 and \$289,389, respectively. Upon termination or retirement, an employee will be compensated for accumulated leave up to a maximum of 240 hours, dependent upon accumulated time and the individual's benefits associated with their rank as defined by State personnel rule #R2-5-403. Payment will be based on the individual's rate of pay at termination or retirement. Upon death, the same benefits shall be paid to the employee's beneficiary.

**Use of estimates** – The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Note 2 – Cash and Investments Held by the State Treasurer**

All cash is deposited or invested with the Arizona State Treasurer (Treasurer). The Treasurer is part of the State's financial reporting entity and issues a separately published Annual Financial Report. A copy of the Treasurer's Annual Financial Report can be obtained from its Web site at [www.aztreasury.gov](http://www.aztreasury.gov) or by contacting the Treasurer's Office at 1700 West Washington St., 151 Floor, Phoenix, AZ, 85007-2812.



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**Note 2 - Cash and Investments Held by the State Treasurer (continued)**

A.R.S. requires state agencies' monies to be deposited with the Treasurer, and further requires those deposits to be invested in various pooled funds. Cash and investments held by the Treasurer represent the Board's portion of those monies. The Treasurer invests idle monies of the state agencies in an internal investment pool (Pool 3) and distributes interest to the participants. Interest earned from these invested monies is allocated monthly based on the average daily balance. Participant shares in the pool are purchased and sold based on the net asset value of the shares, and a participant's portion of the pool is not identified with specific investments. Accordingly, the Board's portion of these deposits and investments approximates the Board's value of pool shares. The Treasurer's internal investment Pool 3 is not required to be registered (and is not registered) with the Securities and Exchange Commission under the Investment Company Act of 1940. In accordance with A.R.S. §35-311, the State Board of Investments reviews the activities and performance of the pool monthly.

At June 30, 2014 and 2013, the Lottery's deposits with the Treasurer were as follows:

	<u>2014</u>	<u>2013</u>
Cash	\$ 28,528,603	\$ 60,903,204
Investment - Pool 3	<u>16,450,871</u>	<u>15,097,695</u>
Total cash and investments held by State Treasurer	<u>\$ 44,979,474</u>	<u>\$ 76,000,899</u>

**Note 3 - Transfers and Statutory Requirements**

As required by ARS Section 5-505, the Lottery made transfers during the years ended June 30 as follows:

	<u>2014</u>	<u>2013</u>
General Fund	\$ 111,300,048	\$ 118,150,673
Healthy Arizona	18,120,000	19,615,800
Mass Transit (LTAF)	11,262,600	11,224,800
University Bond Fund	17,572,624	11,041,186
Heritage Fund	10,000,000	10,000,000
Commerce Authority Arizona Competes Fund	3,500,000	3,500,000
Court-appointed Special Advocate Fund	2,565,380	2,973,849
Economic Security Homeless Services	1,000,000	1,000,000
Department of Gaming	<u>300,000</u>	<u>300,000</u>
Total transfers to other State funds	<u>\$ 175,620,652</u>	<u>\$ 177,806,308</u>

These transactions met the minimum percentage requirements imposed upon the Lottery by statute.

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**Note 4 – Capital Assets**

Capital asset activity for the year ended June 30, 2014 is as follows:

	Beginning Balance	Increases	Decreases	Transfers	Ending Balance
Capital assets, not being depreciated:					
Land	\$ 937,830	\$ -	\$ -	\$ -	\$ 937,830
Construction in progress	-	12,897	-	-	12,897
Capital assets, being depreciated:					
Land improvements	330,865	-	-	-	330,865
Buildings	3,923,817	86,269	-	-	4,010,086
Furniture, fixtures, and equipment	2,555,224	88,688	-	-	2,643,912
Intangible assets	599,324	-	-	-	599,324
Total capital assets	<u>8,347,060</u>	<u>187,854</u>	<u>-</u>	<u>-</u>	<u>8,534,914</u>
Less accumulated depreciation for:					
Land improvements	(330,865)	-	-	-	(330,865)
Buildings	(1,966,651)	(97,657)	-	-	(2,064,308)
Furniture, fixtures, and equipment	(2,263,877)	(77,155)	-	-	(2,341,032)
Intangible assets	-	(99,887)	-	-	(99,887)
Total accumulated depreciation	<u>(4,561,393)</u>	<u>(274,699)</u>	<u>-</u>	<u>-</u>	<u>(4,836,092)</u>
Total capital assets, net	<u>\$ 3,785,667</u>	<u>\$ (86,845)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 3,698,822</u>

Capital asset activity for the year ended June 30, 2013 is as follows:

	Beginning Balance	Increases	Decreases	Transfers	Ending Balance
Capital assets, not being depreciated:					
Land	\$ 937,830	\$ -	\$ -	\$ -	\$ 937,830
Intangible assets	-	599,324	-	-	599,324
Construction in progress	59,938	-	-	(59,938)	-
Capital assets, being depreciated:					
Land improvements	330,865	-	-	-	330,865
Buildings	3,648,272	275,545	-	-	3,923,817
Furniture, fixtures, and equipment	2,532,245	22,979	-	-	2,555,224
Total capital assets	<u>7,509,150</u>	<u>897,848</u>	<u>-</u>	<u>(59,938)</u>	<u>8,347,060</u>
Less accumulated depreciation for:					
Land improvements	(330,865)	-	-	-	(330,865)
Buildings	(1,879,660)	(86,991)	-	-	(1,966,651)
Furniture, fixtures, and equipment	(2,159,884)	(103,993)	-	-	(2,263,877)
Total accumulated depreciation	<u>(4,370,409)</u>	<u>(190,984)</u>	<u>-</u>	<u>-</u>	<u>(4,561,393)</u>
Total capital assets, net	<u>\$ 3,138,741</u>	<u>\$ 706,864</u>	<u>\$ -</u>	<u>\$ (59,938)</u>	<u>\$ 3,785,667</u>

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**Note 5 - Pledged Revenues**

The Lottery has pledged portions of its gross revenues towards the payment of debt service on the State Lottery Revenue Bonds Series 2010A issued by the State. These bonds provide additional working capital to the State to pay appropriated expenditures of the State's General Fund. The bonds are payable solely from and secured by pledged revenues consisting of, until July 1, 2012, amounts distributable to the State General Fund from the Lottery pursuant to Lottery law, and from and after July 1, 2012, all Lottery revenues deposited to the Lottery Fund net of operating expenses of the Lottery. At June 30, 2014, pledged revenues totaled approximately \$174,373,800, of which \$37,499,750 was required to be transferred to cover debt service. Future pledged revenues required to be transferred to pay all remaining debt service for the bonds through final maturity of July 1, 2029 is approximately \$638,000,000.

**Note 6 - Commitments**

The Lottery enters into various contracts for goods and services during the normal course of its business. All contacts and purchasing activity are subject to the Arizona State Procurement Code and the rules of the Arizona State Procurement Office. All contracts have incorporated into them the "Standard Terms and Conditions" as required by the Arizona State Procurement Office. These terms and conditions in all the contracts allow for cancellation for lack of funding in the current fiscal year or next fiscal year. The contract may also be terminated for the Lottery's convenience at any time with no penalty when it is in the best interest of the State. The Lottery entered into a five-year contract with G-Tech Services, Inc. for computer processing services at a base contract rate of 3.8012% of on-line sales in September 2011.

**Note 7 - Loss Contingencies**

Annuities are purchased for all prizes over \$400,000 for which winners will receive the jackpot in annual installments for The Pick on-line game. The annuities are purchased from qualifying insurance companies, which have the highest ratings from among A.M. Best Company, Standard & Poor's, Moody's, Duff & Phelps, or Weiss. Purchases of annuities transfer liabilities for prizes to the insurance company. However, the Lottery may incur liabilities for prizes in the event of a default of an insurance company. Aggregate future payments to prize winners on existing annuities totaled \$42,501,487 at June 30, 2014. Approximately \$38,189,352 of the total aggregate future payments at June 30, 2014, relate to annuities purchased from five separate insurance companies, of which \$12,362,000 relates to a single insurance company.

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**Note 7 – Loss Contingencies (continued)**

Tort claims against the Lottery, its agents, officers, and employees who are acting in the scope and course of their employment with the Lottery are covered pursuant to the State Risk Management statute, ARS § 41-621. There is no limit to that coverage. Therefore, as to any claims based on tort, there is no contingent liability to the budget of the Lottery. The Lottery is involved in various legal proceedings, which arose in the normal course of business. Management of the Lottery does not believe that the ultimate resolution of these matters will have a material effect on the financial position, results of operations, or cash flows of the Lottery.

**Note 8 – Retirement and Pension Plan**

Permanent, full-time employees of the Lottery are covered by the Arizona State Retirement Plan (the "Plan"), a retirement plan administered by the Arizona State Retirement System (ASRS), which is a multiple-employer, cost-sharing pension plan. The Comprehensive Annual Financial Report of the ASRS can be obtained by accessing [www.azasrs.gov](http://www.azasrs.gov). The Plan was established by the State to provide benefits for employees of the State and employees of participating political subdivisions and school districts. The Plan became effective on July 1, 1971. By actuarial computation, employee member contributions to the Plan were fixed at 11.60%, 10.90% and 10.75% (rate includes 0.12%, 0.24%, and 0.25%, for long-term disability) of their compensation for the years ended June 30, 2014, 2013, and 2012, with the contributions made through payroll deduction. Employee contributions vest immediately. Total contributions to the Plan for the years ended June 30, 2014, 2013, and 2012; by the Lottery's covered employees were approximately \$445,000, \$439,000, and \$417,000, respectively.

Matching employer member contributions were actuarially determined and fixed at 11.60%, 10.90%, and 10.75% (rate includes 0.12%, 0.24%, and 0.25% for long-term disability) of the compensation of all employee members for the years ended June 30, 2014, 2013, and 2012. Total matching contributions to the Plan for the years ended June 30, 2014, 2013, and 2012 by the Lottery were approximately \$445,000, \$439,000, and \$417,000, respectively. In the event the Plan's actuary determines that additional contributions are needed in order to amortize an unfunded accrued liability, every employer member will be required to contribute the revised contribution percentage that is set by the Plan.

All full-time employees of the Lottery are required to become members of the Plan. The Lottery's total payroll for employees covered by this Plan for the years ended June 30, 2014, 2013, and 2012, was \$4,061,132, \$4,159,662, and \$4,050,304, respectively. Contributions to the Plan by the Lottery for its covered employees become fully vested immediately after membership in the Plan. All required employer contributions were made to the Plan within 30 days after June 30, 2014.

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**Note 9 - Major Vendors**

The Lottery has 3 vendors that represent approximately 90% and 81% of its purchases for the years ended June 30, 2014 and 2013, respectively.

**SUPPLEMENTARY INFORMATION**

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	<u>\$50 Million Money Mania Game 770</u>		<u>Table Stakes Game 792</u>		<u>Wild 8's Game 804</u>	
Ticket Sales	<u>\$ 65,073,990</u>	100%	<u>\$ 5,057,505</u>	100%	<u>\$ 1,612,744</u>	100%
Direct Expenses:						
Commissions	<u>4,229,809</u>	6.50%	<u>328,741</u>	6.50%	<u>104,830</u>	6.50%
Prizes - low tier	22,658,763	34.82%	2,149,444	42.50%	870,882	54.00%
Prizes - high tier	<u>22,540,350</u>	34.64%	<u>1,420,550</u>	28.09%	<u>90,840</u>	5.63%
Total prizes	<u>45,199,113</u>	69.46%	<u>3,569,994</u>	70.59%	<u>961,722</u>	59.63%
Ticket purchases	487,139	0.00%	61,805	1.22%	37,849	2.35%
Advertising	<u>228,510</u>		<u>-</u>		<u>-</u>	0.00%
Total direct expenses	<u>50,144,571</u>	77.06%	<u>3,960,540</u>	78.31%	<u>1,104,401</u>	68.48%
Gross profit by game	<u>\$ 14,929,419</u>	22.94%	<u>\$ 1,096,965</u>	21.69%	<u>\$ 508,343</u>	31.52%
	<u>Fast 25's Game 805</u>		<u>Just 4 Fun Game 807</u>		<u>Instant Payday Fame 808</u>	
Ticket Sales	<u>\$ 1,596,600</u>	100%	<u>\$ 1,244,327</u>	100%	<u>\$ 1,425,202</u>	100%
Direct Expenses:						
Commissions	<u>103,781</u>	6.50%	<u>80,884</u>	6.50%	<u>92,639</u>	6.50%
Prizes - low tier	878,130	55.00%	659,493	53.00%	790,989	55.50%
Prizes - high tier	<u>78,700</u>	4.93%	<u>83,880</u>	6.74%	<u>62,480</u>	4.38%
Total prizes	<u>956,830</u>	59.93%	<u>743,373</u>	59.74%	<u>853,469</u>	59.88%
Ticket purchases	37,868	2.37%	34,084	2.74%	34,660	2.43%
Advertising	<u>-</u>	0.00%	<u>-</u>	0.00%	<u>-</u>	0.00%
Total direct expenses	<u>1,098,479</u>	68.80%	<u>858,341</u>	68.98%	<u>980,768</u>	68.82%
Gross profit by game	<u>\$ 498,121</u>	31.20%	<u>\$ 385,986</u>	31.02%	<u>\$ 444,434</u>	31.18%
	<u>Color of Money Game 809</u>		<u>Black Cherry Doubler Game 811</u>		<u>Total 7 &amp; Win Game 812</u>	
Ticket Sales	<u>\$ 2,359,220</u>	100%	<u>\$ 5,947,475</u>	100%	<u>\$ 2,488,460</u>	100%
Direct Expenses:						
Commissions	<u>153,349</u>	6.50%	<u>386,588</u>	6.50%	<u>161,750</u>	6.50%
Prizes - low tier	1,144,222	48.50%	2,527,881	42.50%	1,138,473	45.75%
Prizes - high tier	<u>383,200</u>	16.24%	<u>1,632,390</u>	27.45%	<u>474,350</u>	19.06%
Total prizes	<u>1,527,422</u>	64.74%	<u>4,160,271</u>	69.95%	<u>1,612,823</u>	64.81%
Ticket purchases	64,267	2.72%	56,894	0.96%	48,880	1.96%
Advertising	<u>-</u>	0.00%	<u>-</u>	0.00%	<u>-</u>	0.00%
Total direct expenses	<u>1,745,038</u>	73.97%	<u>4,603,753</u>	77.41%	<u>1,823,453</u>	73.28%
Gross profit by game	<u>\$ 614,182</u>	26.03%	<u>\$ 1,343,722</u>	22.59%	<u>\$ 665,007</u>	26.72%

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	Diamond Crossword Game 813		2X Cash Game 815		Black Pearls Game 818	
Ticket Sales	<u>\$ 23,869,605</u>	100%	<u>\$ 2,415,770</u>	100%	<u>\$ 5,761,100</u>	100%
Direct Expenses:						
Commissions	<u>1,551,525</u>	6.50%	<u>157,025</u>	6.50%	<u>374,475</u>	6.50%
Prizes - low tier	9,547,842	40.00%	1,171,648	48.50%	2,520,870	43.76%
Prizes - high tier	<u>7,056,720</u>	29.56%	<u>391,750</u>	16.22%	<u>1,495,400</u>	25.96%
Total prizes	<u>16,604,562</u>	69.56%	<u>1,563,398</u>	64.72%	<u>4,016,270</u>	69.71%
Ticket purchases	217,303	0.91%	48,876	2.02%	122,826	2.13%
Advertising	<u>-</u>	0.00%	<u>-</u>	0.00%	<u>-</u>	0.00%
Total direct expenses	<u>18,373,390</u>	76.97%	<u>1,769,299</u>	73.24%	<u>4,513,571</u>	78.35%
Gross profit by game	<u>\$ 5,496,215</u>	23.03%	<u>\$ 646,471</u>	26.76%	<u>\$ 1,247,529</u>	21.65%
	Bingo Game 820		Crossword Game 821		Cash Blast Game 822	
Ticket Sales	<u>\$ 20,504,298</u>	100%	<u>\$ 30,992,786</u>	100%	<u>\$ 6,147,425</u>	100%
Direct Expenses:						
Commissions	<u>1,332,779</u>	6.50%	<u>2,014,531</u>	6.50%	<u>399,584</u>	6.50%
Prizes - low tier	10,969,799	53.50%	15,496,393	50.00%	2,612,453	42.50%
Prizes - high tier	<u>2,126,560</u>	10.37%	<u>4,531,850</u>	14.62%	<u>1,667,450</u>	27.12%
Total prizes	<u>13,096,359</u>	63.87%	<u>20,028,243</u>	64.62%	<u>4,279,903</u>	69.62%
Ticket purchases	318,392	1.55%	477,556	1.54%	61,802	1.01%
Advertising	<u>-</u>	0.00%	<u>-</u>	0.00%	<u>-</u>	0.00%
Total direct expenses	<u>14,747,530</u>	71.92%	<u>22,520,330</u>	72.66%	<u>4,741,289</u>	77.13%
Gross profit by game	<u>\$ 5,756,768</u>	28.08%	<u>\$ 8,472,456</u>	27.34%	<u>\$ 1,406,136</u>	22.87%
	Bingo Boxes Game 823		Bejeweled Game 824		Triple Cash Crossword Game 830	
Ticket Sales	<u>\$ 14,630,445</u>	100%	<u>\$ 6,227,440</u>	100%	<u>\$ 12,178,110</u>	100%
Direct Expenses:						
Commissions	<u>950,980</u>	6.50%	<u>404,787</u>	6.50%	<u>791,578</u>	6.50%
Prizes - low tier	5,852,178	40.00%	2,802,348	45.00%	5,256,886	43.17%
Prizes - high tier	<u>4,162,315</u>	28.45%	<u>1,516,979</u>	24.36%	<u>2,459,335</u>	20.19%
Total prizes	<u>10,014,493</u>	68.45%	<u>4,319,327</u>	69.36%	<u>7,716,221</u>	63.36%
Ticket purchases	292,064	2.00%	251,873	4.04%	140,794	1.16%
Advertising	<u>-</u>	0.00%	<u>78,033</u>	1.25%	<u>-</u>	0.00%
Total direct expenses	<u>11,257,537</u>	76.95%	<u>5,054,020</u>	81.16%	<u>8,648,593</u>	71.02%
Gross profit by game	<u>\$ 3,372,908</u>	23.05%	<u>\$ 1,173,420</u>	18.84%	<u>\$ 3,529,517</u>	28.98%



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	Red Hot 7s Game 831		Cool 7's Game 833		Arizona Black Special Game 834	
Ticket Sales	\$ 10,390,384	100%	\$ 1,543,406	100%	\$ 1,742,964	100%
Direct Expenses:						
Commissions	675,375	6.50%	100,323	6.50%	113,295	6.50%
Prizes - low tier	5,714,711	55.00%	790,999	51.25%	888,912	51.00%
Prizes - high tier	1,016,778	9.79%	134,960	8.74%	152,050	8.72%
Total prizes	6,731,489	64.79%	925,959	59.99%	1,040,962	59.72%
Ticket purchases	132,416	1.27%	37,868	2.45%	119,228	6.84%
Advertising	-	0.00%	-	0.00%	53,352	3.06%
Total direct expenses	7,539,280	72.56%	1,064,150	68.95%	1,326,837	76.13%
Gross profit by game	\$ 2,851,104	27.44%	\$ 479,256	31.05%	\$ 416,127	23.87%

	Arizona Black Select Game 835		Arizona Black Limited Game 836		Arizona Black Elite Game 837	
Ticket Sales	\$ 3,063,972	100%	\$ 8,276,970	100%	\$ 10,025,900	100%
Direct Expenses:						
Commissions	199,158	6.50%	538,005	6.50%	651,684	6.50%
Prizes - low tier	1,489,026	48.60%	3,517,714	42.50%	3,258,418	32.50%
Prizes - high tier	486,300	15.87%	2,220,700	26.83%	4,175,800	41.65%
Total prizes	1,975,326	64.47%	5,738,414	69.33%	7,434,218	74.15%
Ticket purchases	150,080	4.90%	269,556	3.26%	196,584	1.96%
Advertising	53,352	1.74%	53,352	0.64%	53,352	0.53%
Total direct expenses	2,377,916	77.61%	6,599,327	79.73%	8,335,838	83.14%
Gross profit by game	\$ 686,056	22.39%	\$ 1,677,643	20.27%	\$ 1,690,062	16.86%

	Arizona Black Exclusive Game 838		Ultimate Crossword Game 839		Pocket Cash Crossword Game 840	
Ticket Sales	\$ 15,003,700	100%	\$ 16,767,130	100%	\$ 24,987,700	100%
Direct Expenses:						
Commissions	975,241	6.50%	1,089,863	6.50%	1,624,202	6.50%
Prizes - low tier	4,405,086	29.36%	6,706,852	40.00%	9,995,080	40.00%
Prizes - high tier	6,363,630	42.41%	5,714,600	34.08%	7,394,540	29.59%
Total prizes	10,768,716	71.77%	12,421,452	74.08%	17,389,620	69.59%
Ticket purchases	238,085	1.59%	134,584	0.80%	228,261	0.91%
Advertising	53,352	0.36%	-	0.00%	-	0.00%
Total direct expenses	12,035,394	80.22%	13,645,899	81.38%	19,242,083	77.01%
Gross profit by game	\$ 2,968,306	19.78%	\$ 3,121,231	18.62%	\$ 5,745,617	22.99%

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**SUPPLEMENTAL SCHEDULES OF GROSS PROFIT BY GAME**  
**FOR GAMES EXPIRING DURING THE YEAR**  
**YEAR ENDED JUNE 30, 2014**

	Slingo Trio Game 841		Lucky New Year Game 843		Three Queens Game 844	
Ticket Sales	\$ 9,960,185	100%	\$ 1,981,658	100%	\$ 1,199,276	100%
Direct Expenses:						
Commissions	647,413	6.50%	128,808	6.50%	77,955	3.93%
Prizes - low tier	3,486,065	35.00%	971,012	49.00%	593,643	29.96%
Prizes - high tier	3,422,070	34.36%	313,150	15.80%	127,950	6.46%
Total prizes	6,908,135	69.36%	1,284,162	64.80%	721,593	36.41%
Ticket purchases	152,082	1.53%	52,757	2.66%	33,587	1.69%
Advertising	-	0.00%	-	0.00%	-	0.00%
Total direct expenses	7,707,630	77.38%	1,465,727	73.96%	833,135	42.04%
Gross profit by game	\$ 2,252,555	22.62%	\$ 515,931	26.04%	\$ 366,141	18.48%
	Double Doubler Game 845		Plants Vs Zombies Game 846		9s In A Line Game 847	
Ticket Sales	\$ 1,450,267	100%	\$ 1,902,746	100%	\$ 1,489,824	100%
Direct Expenses:						
Commissions	94,270	6.50%	123,678	6.50%	96,841	6.50%
Prizes - low tier	710,631	49.00%	932,346	49.00%	774,708	52.00%
Prizes - high tier	158,500	10.93%	286,140	15.04%	116,540	7.82%
Total prizes	869,131	59.93%	1,218,486	64.04%	891,248	59.82%
Ticket purchases	33,587	2.32%	90,682	4.77%	37,855	2.54%
Advertising	-	0.00%	-	0.00%	-	0.00%
Total direct expenses	996,988	68.75%	1,432,846	75.30%	1,025,944	68.86%
Gross profit by game	\$ 453,279	31.25%	\$ 469,900	24.70%	\$ 463,880	31.14%
	Lucky Horseshoe Bingo Game 848		Let's Make a Deal Game 849		\$500,000 Riches Game 852	
Ticket Sales	\$ 13,760,700	100%	\$ 5,713,600	100%	\$ 22,060,180	100%
Direct Expenses:						
Commissions	894,449	6.50%	371,386	6.50%	1,433,912	0.00%
Prizes - low tier	5,504,280	40.00%	2,571,120	45.00%	6,093,039	0.00%
Prizes - high tier	4,073,650	29.60%	1,268,360	22.20%	9,557,800	0.00%
Total prizes	9,577,930	69.60%	3,839,480	67.20%	15,650,839	0.00%
Ticket purchases	289,036	2.10%	330,224	5.78%	117,132	0.00%
Advertising	-	0.00%	5,881	0.10%	-	
Total direct expenses	10,761,415	78.20%	4,546,971	79.58%	17,201,883	0.00%
Gross profit by game	\$ 2,999,285	21.80%	\$ 1,166,629	20.42%	\$ 4,858,297	0.00%

**ARIZONA STATE LOTTERY**  
**A PROPRIETARY FUND OF THE STATE OF ARIZONA**  
**SUPPLEMENTAL SCHEDULES OF GROSS PROFIT BY GAME**  
**FOR GAMES EXPIRING DURING THE YEAR**  
**YEAR ENDED JUNE 30, 2014**

	Triple Dough Game 855		Jack's Jackpot Game 858		Fireball Game 863	
Ticket Sales	\$ 2,134,140	100%	\$ 5,537,355	100%	\$ 2,825,976	100%
Direct Expenses:						
Commissions	138,719	6.50%	359,931	6.50%	183,688	6.50%
Prizes - low tier	896,339	42.00%	2,353,379	42.50%	1,370,598	48.50%
Prizes - high tier	472,990	22.16%	1,479,700	26.72%	454,350	16.08%
Total prizes	1,369,329	64.16%	3,833,079	69.22%	1,824,948	64.58%
Ticket purchases	50,305	2.36%	49,369	0.89%	48,885	1.73%
Advertising	-	0.00%	-	0.00%	-	0.00%
Total direct expenses	1,558,353	73.02%	4,242,379	76.61%	2,057,521	72.81%
Gross profit by game	\$ 575,787	26.98%	\$ 1,294,976	23.39%	\$ 768,455	27.19%
	Red Hot Crossword Game 867		\$100,000 taxes Paid Game 869		Naughty Or Nice Crossword Game 886	
Ticket Sales	\$ 16,420,840	100%	\$ 9,601,480	100%	\$ 2,966,774	100%
Direct Expenses:						
Commissions	1,067,355	6.50%	624,096	6.50%	192,840	6.50%
Prizes - low tier	6,568,336	40.00%	3,120,497	32.50%	1,453,719	49.00%
Prizes - high tier	5,657,500	34.45%	4,123,536	42.95%	483,350	16.29%
Total prizes	12,225,836	74.45%	7,244,033	75.45%	1,937,069	65.29%
Ticket purchases	135,857	0.83%	62,858	0.65%	87,156	2.94%
Advertising	-	0.00%	-	0.00%	60,564	2.04%
Total direct expenses	13,429,048	81.78%	7,930,987	82.60%	2,277,629	76.77%
Gross profit by game	\$ 2,991,792	18.22%	\$ 1,670,493	17.40%	\$ 689,145	23.23%
	Money Tree Game 887		Holiday Riches Game 888			
Ticket Sales	\$ 5,967,755	100%	\$ 7,067,170	100%		
Direct Expenses:						
Commissions	387,906	6.50%	459,366	6.50%		
Prizes - low tier	2,834,691	47.50%	2,826,868	40.00%		
Prizes - high tier	1,338,850	22.43%	2,523,800	35.71%		
Total prizes	4,173,541	69.93%	5,350,668	75.71%		
Ticket purchases	182,553	3.06%	129,645	1.83%		
Advertising	-	0.00%	61,464	0.87%		
Total direct expenses	4,744,000	79.49%	6,001,143	84.92%		
Gross profit by game	\$ 1,223,755	20.51%	\$ 1,066,027	15.08%		

**THE ARIZONA STATE LOTTERY**  
**A COMPONENT UNIT OF THE STATE OF ARIZONA**  
**SUPPLEMENTAL SCHEDULES OF GROSS PROFIT BY GAME**  
**FOR GAMES EXPIRING DURING THE YEAR**  
**YEAR ENDED JUNE 30, 2014**

	The Pick/The Pick Extra Drawings January 1, 2013 to December 31, 2013		Fantasy 5/Fantasy 5 Extra Drawings January 1, 2013 to December 31, 2013		Powerball Drawings January 1, 2013 to December 31, 2013	
Ticket Sales	\$ 33,761,559	100%	\$ 16,902,322	100%	\$ 139,737,873	100%
Direct Expenses:						
Commissions	2,194,491	6.50%	1,098,643	6.50%	9,082,957	6.50%
Total prizes	17,201,809	50.95%	8,730,719	51.65%	69,868,937	50.00%
Online system expenses	1,255,165	3.72%	625,386	3.70%	5,170,301	3.70%
Advertising	320,281	0.95%	-	0.00%	1,857,103	1.33%
Total direct expenses	<u>20,971,746</u>	62.12%	<u>10,454,748</u>	61.85%	<u>85,979,298</u>	61.53%
Gross profit by game	<u>\$ 12,789,813</u>	37.88%	<u>\$ 6,447,574</u>	38.15%	<u>\$ 53,758,575</u>	38.47%
	Pick 3 Drawings January 1, 2013 to December 31, 2013		Mega Millions January 1, 2013 to December 31, 2013		Weekly Winnings January 1, 2013 to December 31, 2013	
Ticket Sales	\$ 8,784,080	100%	\$ 48,497,871	100%	\$ 7,512,980	100%
Direct Expenses:						
Commissions	570,961	6.50%	3,152,354	6.50%	488,344	6.50%
Total prizes	4,392,040	50.00%	24,742,319	51.02%	3,756,490	50.00%
Online system expenses	322,248	3.67%	1,794,421	3.70%	277,980	3.70%
Advertising	-	0.00%	1,693,224	3.49%	215,862	2.87%
Total direct expenses	<u>5,285,249</u>	60.17%	<u>31,382,318</u>	64.71%	<u>4,738,676</u>	63.07%
Gross profit by game	<u>\$ 3,498,831</u>	39.83%	<u>\$ 17,115,553</u>	35.29%	<u>\$ 2,774,304</u>	36.93%
	2 By 2 January 1, 2013 to December 31, 2013					
Ticket Sales	\$ 3,203,748	100%				
Direct Expenses:						
Commissions	208,244	6.50%				
Total prizes	1,659,540	51.80%				
Online system expenses	118,539	3.70%				
Advertising	-	0.00%				
Total direct expenses	<u>1,986,323</u>	62.00%				
Gross profit by game	<u>\$ 1,217,425</u>	38.00%				

NOTE: After the announced completion of ticket sales for each game, customers have a 180-day period in which they can redeem their winning tickets. The above gross profit information includes games in which the 180-day grace period expired during the fiscal year ended June 30, 2014.

Economic Development games are denoted with (\*)

**REPORT OF INDEPENDENT AUDITORS ON INTERNAL CONTROL OVER FINANCIAL  
REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT  
OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH  
GOVERNMENT AUDITING STANDARDS**

To the Commissioners of  
Arizona State Lottery  
Phoenix, Arizona

We have audited, in conformity with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the business-type activities of the Arizona State Lottery (the "Lottery"), as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise the Lottery's basic financial statements, and have issued our report thereon dated December 9, 2014.

**Internal Control Over Financial Reporting**

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

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify certain deficiencies in internal control, described in the accompanying *Schedule of Findings and Responses* as items 2014-01 and 2014-02 that we consider to be significant deficiencies.

### **Compliance and Other Matters**

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

The Arizona Lottery's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Responses. We did not audit the Arizona Lottery's responses and accordingly, we express no opinion on it.

This report is intended solely for the information and use of management, Commissioners of the Arizona State Lottery, and others within the entity and is not intended to be, and should not be, used by anyone other than these specified parties.

*Moss Adams LLP*

Scottsdale, Arizona  
December 9, 2014

**ARIZONA STATE LOTTERY  
A PROPRIETARY FUND OF THE STATE OF ARIZONA  
SCHEDULE OF FINDINGS AND RESPONSES  
YEAR ENDED JUNE 30, 2014**

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**2014-01 – Accounting and Reporting Components of Net Position (Significant Deficiency)**

**Criteria:** We believe that paragraph 12.123 of the American Institute of Certified Public Accountants, (AICPA) State and Local Government Audit and Accounting Guide provides the relevant accounting guidance for liabilities for prizes and forfeitures of unclaimed prizes. Forfeitures of unclaimed prizes should be recognized as a gain (net against prize expense) as of the date the claim is forfeited according to the provisions of a State's stated regulations. Many States have regulations with regard to how forfeited unclaimed prizes must be utilized. For example some States require all forfeited unclaimed prizes to be transferred to another State fund or agency having a different mission. Arizona Revised Statutes 5-568 states the following:

*Disposition of unclaimed prize money*

*Unclaimed prize money for the prize on a winning ticket or share shall be retained for the person entitled to the prize for one hundred eighty days after the drawing in which the prize was won in the case of a drawing prize and for one hundred eighty days after the announced end of the game in question in the case of a prize determined in any manner other than by means of a drawing. If a claim is not made for the money within the applicable period, seventy per cent of the prize money shall be held in the state lottery prize fund for use as additional prizes in future games and thirty per cent shall be transferred monthly to the court appointed special advocate fund established by section 8-524.*

We believe the State's statute places a restriction on the use of forfeited prizes. Restricted net position should be reported when constraints placed on net position are either externally imposed by grantors, creditors, contributors, or by laws or enabling legislation. The restriction to use unclaimed prizes that are forfeited represents a specific purpose, does not represent a liability in our view, rather it is the underlying transaction exchange transaction resulting from the sale of lottery tickets for games in progress that creates a liability, defined by GASB's Concept Statement No. 4, *Elements of Financial Statements*, as the present obligation to sacrifice resources.

**Condition:** The previously balance reported as liabilities for prizes was comprised of several components of the Lottery's Prize Fund. These components consisted of unclaimed forfeited prizes, accumulated prize fund balance, accumulated investment earnings of the prize fund and flows of the prize fund. Certain of these components do not appear related to a present obligation for prizes. The Arizona Lottery retains and reports unclaimed prizes as a liability.

**Context:** Management's estimate of liability attributable to only prizes is approximately \$14 million. A portion of this estimate is attributable to forfeited prizes is approximately \$5 million.

**Effect:** We believe the liability for prizes has been overstated and that components of net position are understated or other liabilities exist.

**ARIZONA STATE LOTTERY  
A PROPRIETARY FUND OF THE STATE OF ARIZONA  
SCHEDULE OF FINDINGS AND RESPONSES  
YEAR ENDED JUNE 30, 2014**

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**Cause:** We do not believe management had fully considered the applicable accounting and financial reporting guidance for prizes or components of net position.

**Recommendation:** We recommend that management review the underlying nature and agreements for each significant reported balance and assess reporting restricted components of net position and review/revise its accounting policies with regard to activities of the *Prize Fund*. Those policies should reflect the use of resources in conformity with State statute while also considering the financial condition of the Lottery.

**Views of responsible officials and planned corrective actions:** Management will review accounting policies for activities in the Prize Fund. The Lottery has been consistent in its reporting of prize liability since the Lottery's inception and that reporting is similar to reporting used by other state lotteries. We agreed with the auditor to revise the presentation of prize liability this year and will seek to find an appropriate presentation in future years.

The Lottery also believes that forfeited prizes are properly included in prize liability. Some of those forfeited prizes are committed to prize subsidies for Scratchers games that began in FY13 and are continuing into FY14 and the balance of forfeited prizes will be used to subsidize other games before the end of FY14. The Lottery has historically subsidized Scratchers by \$6 to \$8 million annually. The Lottery also has an ongoing commitment to fund a \$1 million jackpot for the Pick game. It is currently taking from twelve to fourteen draws to fully fund jackpot payouts from sales. Any subsidy would come from forfeited prizes.

**2014-02 – Regularly Review Third-Party Service Reports (Significant Deficiency)**

**Criteria:** Service organizations are entities that provide outsourcing activities that are relevant to the control environments at user organizations. A Type II SSAE 16 report is an independent report on the design and operating effectiveness of key controls at a service organization. A Type II SSAE 16 provides assurance to user organizations that the control objectives relating to the services provided by their service organization are suitably designed and operating effectively throughout the examination period.

**Condition and Context:** The Lottery utilizes reports and systems of GTECH, a service organization; however GTECH does not currently provide a Type II SSAE 16 report to the Lottery.

**Effect:** Errors, if any, in the reports provided to the Lottery by GTECH may not be detected in a timely manner.

**Cause:** GTECH does not appear to have a Type II SSAE 16 report available for the Lottery.



**ARIZONA STATE LOTTERY  
A PROPRIETARY FUND OF THE STATE OF ARIZONA  
SCHEDULE OF FINDINGS AND RESPONSES  
YEAR ENDED JUNE 30, 2014**

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**Recommendation:** We recommended that management obtain and review SSAE 16/SAS 70 annually to ensure service providers have sufficient controls in place and are operating effectively given the significance of the information provided by GTECH to the Lottery.

**Views of responsible officials and planned corrective actions:** With the present on-line contract GTECH was required to provide, within the first year but not before six months, the Arizona Lottery with a SAS 70 report. This report was to study the controls put into place by GTECH Arizona. The Arizona Lottery was able to approve the contractor that GTECH proposed to use for the SAS 70 report. The cost associated with this project was placed on the winner of the on-line contract. It was a built-in expense as it is quite expensive to produce. The Lottery is always attempting to make sure all systems and processes are followed, not only by the rules set forth by the Lottery but, also with the rules set forth under the Multi State Lottery agreement. The Lottery's internal auditing department verifies all changes made to the GTECH process and programs. These changes are reviewed and tested before they are implemented. The Arizona Security department also observes the process several times a year to ensure compliance with existing rules and processes. To start a SSAE 16/SAS 70 report outside of the contract would place an undue financial burden upon the Lottery as it is not required by contract to be performed by GTECH. If it is indeed necessary this will be made an ongoing requirement placed in the upcoming RFP for the on-line contract.