

ANNUAL REPORT

FISCAL YEAR 2005



Profits benefit the
Vermont Education Fund.

www.vtlottery.com



It is our pleasure to present the annual report on the accomplishments of the Vermont Lottery Commission (Lottery) for fiscal year (FY) 2005. With a slight increase in sales (another record sales year), and a reduction in operating expenses, the Lottery was able to increase the FY 2005 contribution to the state's Education Fund by 4%, for a total of \$20.4 million.

When the General Assembly established the Lottery in 1977, after a statewide referendum, the Lottery's stated purpose in the enabling legislation was to ***"produce the maximum amount of net revenue consonant with the dignity of the state and the general welfare of the people."*** Thus the balance between providing funds for the state's Education Fund and a strong ***"Play Responsibly"*** message to the public.

Over the last 27 years, the Vermont Lottery has produced over \$1.2 billion in overall sales. From those sales, approximately \$744 million has been returned to players in the form of prizes, over \$67 million has been paid to local lottery agents in the form of commissions, and over \$340 million went to the state's General or Education Funds.

In FY 2005, the Lottery moved from its South Barre location (since 1985), and into a new leased space on the Barre-Montpelier Road. This refurbished space in the "old Harry's" building allowed for the combining of existing warehouse spaces and the storage of more Instant tickets on-site. This allows for the more timely distribution of the Instant ticket product.

As we move to FY 2006, and beyond, the Lottery needs to plan for the future of its existing game mix. It needs to develop and utilize new types of games, as well as explore how to use our web site and the Internet to keep in touch with our players, and respond to their interests. These are some of the public policy questions that need to be addressed in the future, in order for the Lottery to continue growing its contribution to the state's Education Fund.

The staff and Commissioners of the Lottery are proud of their past contributions to the State of Vermont, and look forward to increasing the contributions to the Education Fund in the next fiscal year, and beyond.

Martha H. O'Connor, Chair

Alan R. Yandow, Executive Director



1976

In a 1976 referendum regarding the establishment of a state lottery, 66% of those casting ballots voted in favor of the proposal. Based on those results, Public Act No. 82 was enacted by the 1977 General Assembly establishing the Vermont Lottery Commission. The Act also provided for termination of the Lottery on June 30, 1980, unless the 1979 Assembly authorized continuation.

1978

The Vermont Lottery Commission was granted \$250,000 in seed money, which was paid back in full to the state eighteen months later. It took the Lottery seven months from the Commission's inception to produce its first ticket, Green Mountain Game, which went on sale to the public on February 14, 1978. The game was based on a weekly drawing of numbers matched to preprinted numbers on a game ticket. The Lottery's first Instant ticket, Scratch'N Match, went on sale to the public on June 20, 1978.

1979

A steady rise in lottery ticket sales resulted in approval by the 1979 legislature to continue the mission of the Vermont Lottery. Authorization providing for indefinite continuation of the Vermont Lottery was subsequently passed by the 1981 General Assembly.

1998

Since its inception, all profits generated by the Vermont Lottery were dedicated for use by the state's General Fund. In July 1998, the Vermont legislature mandated that all profits from the Lottery go to the state's Education Fund.

2005

The Vermont Lottery continued to be run by a small, efficient staff of professionals consisting of 20 full-time employees and five Commissioners. It is still one of the smallest staffs of any lottery in the United States, yet it generated \$92.6 million in ticket revenue during fiscal year 2005 or \$4.63 million per employee.

The Vermont Lottery Commission consists of five members appointed by the governor, with the advice and consent of the state senate. The members are appointed for a three-year term and may not have any pecuniary interest in any contract awarded pursuant to Chapter 14 of Title 31 V.S.A. The Commission is responsible for the public oversight and policies of the Vermont Lottery and no more than three Commission members may belong to the same political party.

Martha O'Connor, Chair
Brattleboro
Term Expires 06/08

Tom Scala, Tri-State Chair
Brattleboro
Term Expires 06/06

Virginia Barry
Barre
Term Expires 06/06

Arthur Ristau, Vice Chair
Barre
Term Expires 06/07

Richard Bailey
Hyde Park
Term Expires 06/08

In fiscal year 2005, the Vermont Lottery offered seven different products to customers: Instant Games, Vermont Powerball, Tri-State Megabucks, Tri-State Heads or Tails (ended June 25, 2005), Tri-State Daily Numbers Games, Pick 3/Pick 4, and Tri-State/Vermont Triple Play (started June 26, 2005). Vermont Lottery games are designed to provide fun and entertainment to a broad consumer base by offering an assortment of game options, multiple price points, a range of prize levels, varying odds, and a mixture of themes and play styles.

Instant Games

Instant Games are sold by all licensed Vermont Lottery agents. Instant Games, also referred to as “scratch off” tickets are paper tickets with latex-covered play areas that instantly reveal if a player has won when scratched. In FY05, Instant Tickets accounted for 76.9% of total lottery product sales, the largest revenue source for the Vermont Lottery. Multiple games were on the market simultaneously offering players a variety of price points, play styles, prize levels, top prizes and themes. In FY05, Instant ticket cash prizes ranged from \$1 to \$50,000.



The prize payout, which is the percentage of money that goes back to the player in the form of prizes, ranged from 64% to 75% per game, with an overall payout of 66.27%. This translates to approximately \$47.2 million won in prizes for the Instant product in FY05.

The Vermont Lottery released 54 Instant Games in FY05. Of those games, 18 were \$1 games, 16 were \$2 games, two were \$3 games, 14 were \$5 games and four were \$10 games. Eighteen to 22 Instant Games were on the market simultaneously throughout the fiscal year.

Vermont Powerball

The Vermont Lottery began offering Powerball to consumers on July 1, 2003. Powerball is a multi-jurisdictional game that offers multi-million dollar jackpots. In FY05, Powerball was played in 27 states, Washington, DC and the US Virgin Islands.



In FY05, Powerball was played by selecting five numbers from one to 53. In addition, a sixth Powerball number was selected from one to 42. Players could also multiply their non-jackpot prize by 2, 3, 4 or 5 by selecting the Power Play option. The Power Play option cost an additional \$1 per set of numbers played. The odds of winning the jackpot were 1 in 120 million. The jackpot prize was offered in 30 annual installments or in a one-time lump sum cash payment.

The cash payment was approximately half the advertised estimated jackpot amount. Winners had 60 calendar days

from the date of the winning draw to select a one-time cash payment or annual installments.

Since the game's first draw on April 22, 1992 Powerball draws have been held at ITC Studios in West Des Moines, Iowa. In FY05, Powerball draws were held on Wednesday and Saturday at 10:59 PM ET. Draws were aired in Vermont on WCAX at 11:00 PM ET.

Powerball jackpots started at an annuitized \$10 million and reached \$220.3 million in FY05. There were no jackpot winners in Vermont. Vermont Powerball players won \$3,477,609 in other prizes including one \$500,000 winner, one \$400,000 winner and five \$100,000 winners.

Tri-State Megabucks

Vermont, New Hampshire and Maine formed Tri-State Megabucks in 1985.



The Megabucks game has changed several times since 1985 to create the game that players enjoyed in FY05. When the first draw was held on September 14, 1985, players selected six numbers from one to 30, and the odds of winning the jackpot were one in 593,775. A jackpot winner was paid in 20 annual installments. There was one draw per week which was held on Saturday night. The draw was shown on live television.

In January 1986, the Megabucks game was changed to select six numbers from one to 36. The odds of winning the jackpot increased to one in 1.9 million. The draw was still held on Saturday night. In January 1988, the game was modified to select six numbers from one to 40. This increased the jackpot odds to one in 3.8 million. One draw was held weekly on Saturday night. In May, 1990, the number of draws increased to twice a week, Wednesday and Saturday. The draws continued to air on live television.

In June 1996, Megabucks was enhanced to include a feature called, “MegaCash.” This option allowed jackpot winners to take their share of the money available in the jackpot prize pool in a one-time-only, lump sum payment. The cash option was approximately half of the estimated, annuitized jackpot amount.

The game format that was available to players in FY05 was the result of changes made to Megabucks in March 1997. At that time, the game was modified to select six numbers from one to 42. A seventh number, called the Bonus Number, was also added. The Bonus Number was drawn after the first six numbers were drawn. This seventh number created four more prize levels by adding more ways for players to match their six numbers to the seven numbers drawn. The odds of winning the jackpot increased to one in 5.2 million. The number of jackpot payments changed from 20 to 25 annual installments. MegaCash remained a jackpot payment option. Prior to fiscal year 2002, the jackpot payment option (cash or annual installments) was determined by the player at the time of purchase. This changed in FY02 to allow a jackpot winner 60 days from ticket validation at Vermont Lottery headquarters to elect a one-time cash payment or annual installments.

In FY05 Megabucks draws were held at New Hampshire Lottery headquarters in Concord on Wednesday and Saturday at 7:59 PM. Draws were not aired on television. Following the draws, winning numbers “crawls” were aired on WPTZ/WNNE, FOX 44 and WVNY.

In FY05 jackpot levels started at a guaranteed annuitized \$500,000 with the highest jackpot amount won reaching \$6.4 million. Vermont had no Megabucks jackpot winners. Megabucks prizes won by Vermont players totaled \$1,101,787 or 17% of total Megabucks non-jackpot money won. Vermont’s percentage of Megabucks sales in the Tri-State region was 16.5%. The total number of Megabucks jackpot winners in Vermont since the game’s inception through the end of FY05 was 75 or 18% of the total winners in the Tri-State region. Megabucks jackpot dollars won in Vermont since the game began in 1985 and ending June 30, 2005 was \$123,326,131 or 16% of total Megabucks jackpot dollars won in the Tri-State region.

Tri-State Heads or Tails

Tri-State Heads or Tails was the secondary cash game that replaced Cash Lotto. Sales for this game began on November 16, 2004.



Heads or Tails was played by selecting five numbers from one to 34 and also selecting heads or tails. The top prize was a fixed \$50,000. If a player had a winning number combination and matched heads or tails as drawn, the prize amount doubled. The odds of winning the top prize were one in 556,512. The first draw was held on November 16,

2004 with draws held daily at approximately 6:50 PM. The last draw was held on June 25, 2005. The draws were not aired on television. Following the draws, winning numbers “crawls” were aired on WPTZ/WNNE, FOX 44 and WVNY.

In FY05, there were 11 Tri-State Heads or Tails jackpot winners. There were two Vermont jackpot winners. The amount of Heads or Tails money won by Vermont players totaled \$631,827.

Tri-State/Vermont Triple Play

Triple Play sales began on June 26, 2005, the last week of FY05. This \$2 cash game replaced Tri-State Heads or Tails and is the Lottery’s first combined Tri-State and Vermont game. The game was played by selecting five numbers from one to 45. The top prize was a rolling jackpot starting at a guaranteed \$30,000. The odds of winning the top prize were one in 1,221,759. The first draw was held on June 28, 2005. Draws were conducted Tuesday and Friday evenings at 6:50 PM. The draws were not aired on television. Following the draws, winning numbers “crawls” were aired on WPTZ/WNNE, FOX 44 and WVNY.



Tri-State Daily Numbers

Pick 3 was Vermont’s first on-line game. It began on November 10, 1980. Pick 3 has played the same since the game’s inception – by selecting a combination of three numbers from zero to nine. Pick 4 began on September 3, 1985 and has also played the same since its inception – by selecting a combination of four numbers from zero to nine.



The Daily Numbers games became Tri-State games on June 25, 1995. These games were drawn every night from Monday through Saturday at 6:59 PM. On June 7, 1998, a Sunday draw was added. In September 1998, a front pair/back pair feature was added. On June 29, 2003 an additional midday draw was added. In FY05, the draws were not aired on live television. Following the draws, winning numbers “crawls” were aired on WPTZ/WNNE, FOX 44 and WVNY.

The amount won depends on the amount played. Pick 3 dollars won by Vermont players in FY05 totaled \$747,976 and the amount won playing Pick 4 totaled \$553,799.

Vermont Lottery Agents

In FY05, there were 761 Lottery sales agents in Vermont. Of those, 622 (total throughout the fiscal year) sold Powerball and Tri-State products. All Lottery agents sold Instant games. Agents received 6% of their total Powerball ticket sales and 5.75% of all other Lottery product sales. In addition, agents received a 1% bonus for selling winning tickets of \$500 and up (agent bonus capped at \$30,000). In FY05, the commission and bonuses paid to agents totaled \$5.4 million.

Top Five Agents in FY05 Commission Earned

- 1. \$46,031 4. \$26,594
- 2. \$36,544 5. \$26,308
- 3. \$31,703

Tri-State Draws

In 1997, Tri-State draws no longer aired on live television. All draw equipment was moved from WMUR-TV in Manchester, NH (where the draws were held previously) to the New Hampshire Lottery’s draw room in Concord, NH. The New Hampshire Lottery draw room was built specifically to conduct draws. When Tri-State draws were held in FY05, the following Tri-State employees were present: draw supervisor, draw monitor and independent auditor. All draws were recorded utilizing the following recording

devices: 8 mm camera, VHS recorder and 24 hour surveillance camera. After each drawing, the 8 mm footage was stored in a secure off-site facility, where it remains for 14 months.

Phone & Website

Approximately 30 minutes after a draw was conducted, winning numbers were updated on the Lottery’s toll free line 1-800-322-8800 (in VT) and on the Lottery’s website www.vtlottery.com.

Lottery Agents

Lottery agents received the winning numbers shortly after a draw was conducted. In addition, the Lottery terminal could provide eight days of winning numbers.



Television

Winning number crawls shown on the following stations in FY05:

WPTZ/WNNE	7:20-7:30 PM 8:20-8:30 PM	Tri-State Daily Numbers & Heads or Tails Tri-State Megabucks
FOX 44	7:28 PM (7-8:00 Sun) 8:15-8:30 PM	Tri-State Daily Numbers & Heads or Tails Tri-State Megabucks
WVNY	7:15-7:35 PM 8:00-8:45 PM	Tri-State Daily Numbers & Heads or Tails Tri-State Megabucks
WCAX	11:00 PM	Powerball Drawing

Responsible Gaming

During FY05, The Vermont Lottery Commission, in association with the National Council on Problem Gambling, began its ninth year in support of efforts to create awareness of available resources to individuals who have concerns about gambling habits.

Responsible Play Support

The Lottery's "Responsible Play" campaign included the following efforts in FY05:

Partnership with the Vermont Council on Problem

Gambling: At the start of FY05, the Vermont Lottery and the Vermont Council on Problem Gambling (VCPG) developed a Responsible Play plan. The Vermont Lottery and the VCPG maintained open lines of communication throughout the year, frequently discussing the Vermont Council's needs and made necessary adjustments.

Television Campaign: All television ads produced for the Vermont Lottery included a "please play responsibly" message. In addition, a television ad called, "The Photo," was produced by the Vermont Lottery in collaboration with VCPG, and aired during National Gambling Awareness Week. The ad was offered to other state and local Councils on Problem Gambling. Twenty-seven councils requested the television ad to air during National Gambling Awareness Week. For these efforts, the Vermont Lottery received the 2005 Government Award from the National Council on Problem Gambling.

Radio Campaign: All radio ads produced for the Vermont Lottery included a "please play responsibly" message. In addition, the Lottery produced a radio ad in conjunction with "The Photo" television ad. Five percent of the Lottery's radio media was reserved for Responsible Play spots. In addition, many radio stations aired additional spots as public service announcements at no additional cost.

Vermont Specific Brochure & Poster: On behalf of the VCPG, the Vermont Lottery developed and printed a Vermont-specific problem gambling brochure. Brochures and posters were provided to the VCPG and distributed to Lottery agents throughout the state.

National Council on Problem Gambling: The Lottery's Executive Director, Alan Yandow, served on the Board of Directors of the National Council on Problem Gambling.

National Gambling Awareness Week: During National Gambling Awareness Week, the Lottery only aired Responsible Gaming television and radio.

Vermont Council Toll-Free Funding: The Lottery provided the financial resources to pay 100% of the expenses for toll-free calls to the VCPG.

Vermont Council Reimbursement: The Lottery reimbursed the VCPG for costs associated with registration and attendance of conferences dealing with the issue of problem gambling.

Responsible Play Message: All print, broadcast and point of sale produced included the "please play responsibly" message.

Responsible Gaming on the Web Site: Information about the VCPG and links for other resources were included on the Lottery's web site: www.vtlottery.com.

Logo and Toll-Free Number on Lottery Tickets and Play Slips: The "please play responsibly" logo and the VCPG's toll-free number were printed on all Vermont Lottery tickets and play slips.

18+ and Responsible Message: Agents prominently displayed "You must be 18 or older to purchase lottery tickets" stickers. These stickers included the "please play responsibly" logo and the Vermont Council's toll-free number.

Advertising Guidelines: Advertising guidelines developed by the Vermont Lottery were observed in the development of all Lottery marketing materials.

Advertising Strategy: The Vermont Lottery's FY05 advertising strategy continued to focus on the fun of playing Lottery games and support of the positioning line, "Put a little play in your day." Promoting Lottery games as a fun entertainment choice was achieved creatively by showing consumers doing fun or funny things to brighten their day and then suggesting they "put a little play in their day" by playing a Vermont Lottery game. The advertisements also reinforced that the proceeds go to the Vermont Education Fund. The Lottery's Executive Director, Alan Yandow, continued to deliver the Responsible Play message.

Media Strategy: The media goals established for FY05 were to provide a consistent level of advertising, at minimum effective frequency levels, among the target audiences, in order to maintain awareness of Vermont Lottery and Tri-State products. The media campaign consisted of a combination of "base game advertising" – in which the Lottery's base games (Powerball, Megabucks, Instant Games) were advertised throughout the year and "promotional advertising" – in which media dollars went to support specific, short term promotions.

The media target audience was defined as adults 25-54 in order to minimize reaching consumers under 18.

Television was used as the primary vehicle for advertising because of its ability to reach the largest number of consumers quickly, more effectively communicate the product brand and deliver the advertising message with sight, sound and motion. Radio was used as a support vehicle because of its ability to reach a consumer closer to the "point of purchase."

Advertising Awareness

In January 2004, the Lottery commissioned the Center for Research & Public Policy (CRPP) to conduct an advertising effectiveness study to measure awareness of the Lottery's advertising messages among the Vermont population. Here are some of the highlights:

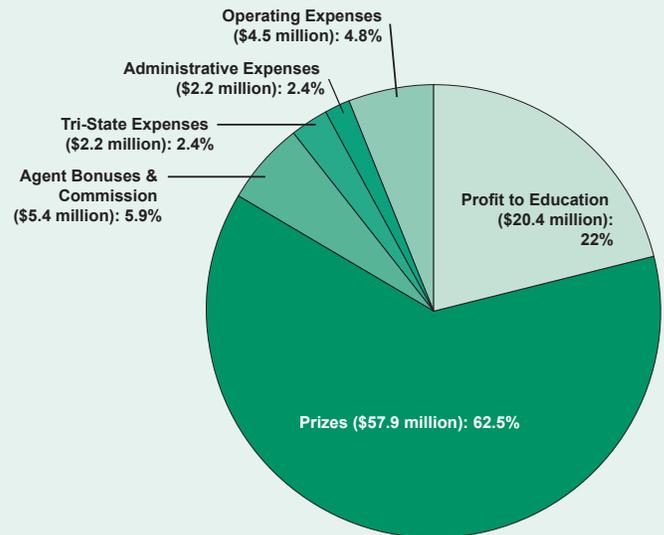
93.7% of players reported seeing, hearing or reading Vermont Lottery advertising over the past 6 months. Among non-players, just less than three quarters, 72.8% suggested the same. Messages with the highest recall include:

- Play Lottery games responsibly
- Lottery games are good, clean, fun
- Lottery games support education in Vermont

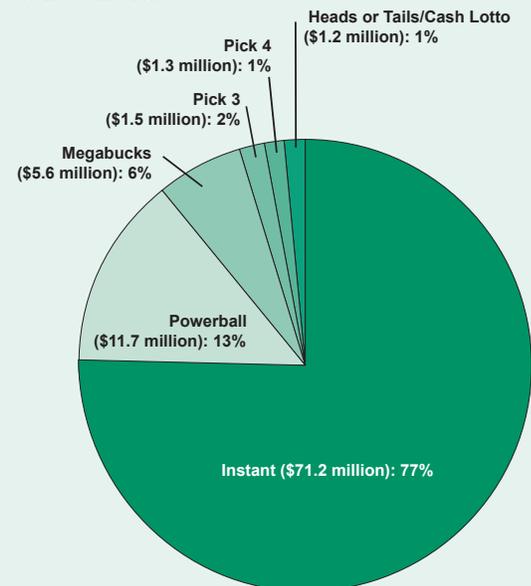
Among players and non-players characteristics that were given the greatest importance are:

- Conveying the message that the Lottery's profits go to the Vermont Education Fund
- Conveying the message of playing Vermont Lottery games responsibly

Where the money went:



Where the sales were:



Fiscal year 2005 ended with overall sales over \$92 million, up slightly from FY04. The total contribution to the state's Education Fund was \$20.4 million. This was a 4.0% increase over FY04. In addition to the Education Fund contribution, \$57.9 million was returned to players in the form of prizes, and \$5.4 million went to local lottery agents as commissions on sales.

Sales

The overall results of sales this year showed an increase of 0.2%. Total sales equaled \$92,589,803. Ticket sales were as follows:

	<u>2005</u>	<u>2004</u>
Instant	\$71,206,087	\$68,796,768
Pick 3	1,545,110	1,624,206
Pick 4	1,267,283	1,289,896
Megabucks	5,640,665	5,772,315
Heads or Tails/Cash Lotto	1,180,938	1,371,065
Powerball	11,749,720	13,526,725
Total Sales	<u>\$92,589,803</u>	<u>\$92,380,975</u>

Instant ticket sales were \$71,206,087. This was a 3.5% increase over FY04. Instant ticket sales represented 77% of total sales.

Pick 3/Pick 4 combined sales were \$2,812,393, a 3.5% decrease from FY04. These games represented 3% of total sales.

Megabucks sales were \$5,640,665 this year. This was a 2.3% decrease from FY04. Megabucks sales represented 6% of total sales.

Heads or Tails sales were \$1,180,938, a 13.8% decrease from Heads or Tails and Cash Lotto combined in FY04. Heads or Tails represented 1% of total sales.

Powerball sales were \$11,749,720, a 13.1% decrease from FY04. Powerball sales represented 13% of total sales.

The Lottery received license fees and other receipts of \$9,806 and investment income of \$16,989. A loss on disposal of fixed assets was recorded in the amount of \$10,393.

Operating Expenses

Administrative costs for the Lottery were \$2,217,761, an increase of \$198,088 over FY04. Administrative costs included salaries, benefits, contracted services, and supplies which were included in the Lottery's annual budget appropriation from the Legislature. This budget appropriation came from Lottery revenues.

Other operating expenses included lottery tickets, depreciation, equipment, and facilities management fees to our online (Powerball and Tri-State games) and Instant ticket gaming system vendor, Scientific Games, International. The total cost of operations for FY05 was \$6,694,636, a decrease of \$627,212 from FY04, which includes the administrative costs of \$2,217,761 mentioned above.

Tri-State Expenses

The Tri-State operating, communications, and facilities management costs totaled \$2,237,573, a decrease of \$268,171 from FY04. This was due mainly to the decrease in the facilities management fee. This fee was calculated as a percentage of Tri-State sales, which also declined.

Prizes and Commissions

As these costs were related to sales, prize expense and local lottery agent commissions increased by \$338,591 or .5% over FY04. Instant games paid an average of 66% of sales back to players. The total prizes paid to players in FY05 was \$57,895,819; and the total commissions paid to Agents was \$5,423,735.

Net Profit

The net profit of \$20,354,442 was an increase of 4% over FY04. The increase is attributable mainly to a decrease in expenses. The total contribution to the state's Education Fund in FY04 was \$19,580,527.

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**Mudgett
Jennett &
Krogh-Wisner, P.C.**
Certified Public Accountants #435

The Commissioners
Vermont Lottery Commission

We have audited the accompanying basic financial statements of the Vermont Lottery Commission, an enterprise fund of the State of Vermont, as of and for the years ended June 30, 2005, and 2004 as listed in the table of contents. These financial statements are the responsibility of the Vermont Lottery Commission's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audits 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 audits 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 audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Vermont State Lottery and are not intended to present the financial position of the State of Vermont and the results of its operations and cash flows of its proprietary fund types and non-expendable trust funds 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 Vermont Lottery Commission as of June 30, 2005, and 2004, and the changes in its financial position and its cash flows for the 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 July 29, 2005, on our consideration of the Vermont Lottery Commission's internal control over financial reporting and 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 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.

The Management's Discussion and Analysis on pages 12 through 13 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board (GASB). We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Montpelier, Vermont
July 29, 2005

*Mudgett, Jennett &
Krogh-Wisner, P.C.*

This discussion of the Vermont Lottery Commission's financial performance provides an overview of the Commission's financial activities for the fiscal year ended June 30, 2005. Please read it in conjunction with the financial statements.

The Vermont Lottery Commission is an enterprise fund of the State of Vermont. The Commission's operations are classified as business-type activities and reported in a manner similar to commercial entities.

Financial Highlights

- Gross revenues for lottery gaming activities increased by \$210,527 or .2%.
- Total operating expenses for the year decreased by \$586,740 or .8%. Of this decrease, prize expense increased by \$309,704, facilities management fees decreased by \$993,270, agent commissions increased by \$28,887, Tri-State expenses decreased by \$268,171 and all other operating expenses increased by \$336,110.
- Non-operating revenues increased by \$158,350. Non-operating revenue in FY04 included an unrealized loss on investments.
- Income before operating transfers (net revenue) increased by \$955,617.

Assets and Net Assets

The assets of the Commission are primarily cash and investments held for operating purposes. Total assets at June 30, 2005, of \$7,595,352 include capital assets of \$140,419, restricted investments of \$3,544,094 and other operating assets such as cash and cash equivalents, accounts receivable and inventory of \$3,910,839. Net assets retained by the Commission are \$1,102,971.

Total assets at June 30, 2004, of \$7,195,992 include capital assets of \$84,786, restricted investments of \$3,835,239 and other operating assets such as cash and cash equivalents, accounts receivable and inventory of \$3,275,967. Net assets retained by the Commission at June 30, 2004 were \$697,834.

Liabilities

The Commission's liabilities consist of operating liabilities and obligations for payment of prizes to lottery winners. Total liabilities at June 30, 2005, of \$6,492,381 include long-term liabilities for prize obligations of \$2,704,201, cash advances from the State of \$300,000 and other operating liabilities of \$3,488,180.

Total liabilities at June 30, 2004, of \$6,498,158 include long-term liabilities for prize obligations of \$2,959,067, cash advances from the State of \$300,000 and other operating liabilities of \$3,239,091.

Sales

	<u>2005</u>	<u>2004</u>
Instant scratch off games	\$71,206,087	\$68,796,768
Online Games:		
Pick 3	1,545,110	1,624,206
Pick 4	1,267,283	1,289,896
Heads or Tails/Cash Lotto	1,180,938	1,371,065
Powerball	11,749,720	13,526,725
Megabucks	<u>5,640,665</u>	<u>5,772,315</u>
Total Sales	<u>\$92,589,803</u>	<u>\$92,380,975</u>

Prizes

In general, prize expense by game will increase or decrease from year to year in proportion to the increase or decrease in sales for a particular game. However, the online game prize expense is also impacted by the luck of the draw. Prize expense for the instant games product category is controllable, to a large degree, by printing a predetermined number and value of winning tickets in the production of each instant game. Prize expense for all other lottery products is not predetermined. While each of these lottery products is designed to yield a certain ratio of prizes to sales over a large number of drawings, actual prize payout is determined by lottery players' luck in matching the particular set of numbers randomly selected in each drawing for each game.

	<u>2005</u>	<u>2004</u>
Prize expense - Instant scratch off games	\$47,187,537	\$45,819,723
Prize expense - Online games	<u>10,708,282</u>	<u>11,766,392</u>
	<u>\$57,895,819</u>	<u>\$57,586,115</u>

Other Potentially Significant Factors

The financial position and operating results for 2005 were improved over 2004 despite declining sales in the Powerball game.

The Lottery is a highly visible governmental activity. Its mission is to operate a State Lottery that will produce the maximum amount of net revenue consonant with the dignity of the State and general welfare of the people. There are a number of revenue-enhancing opportunities generally available to the lottery industry. These options, if deemed to be consonant with the general welfare of the people by those in the executive branch and/or legislature, may be considered in future years.

ASSETS	<u>2005</u>	<u>2004</u>
Current assets:		
Cash and cash equivalents (Note 2)	\$ 2,788,797	\$ 1,533,023
Accounts receivable (Note 5)	512,799	1,056,015
Due from the State Education Fund	11,632	-
Inventory (Note 6)	597,611	686,929
Total current assets	<u>3,910,839</u>	<u>3,275,967</u>
Restricted and noncurrent assets:		
Investments (Note 4)	3,544,094	3,835,239
Property and equipment, less accumulated depreciation (Note 7)	140,419	84,786
Total restricted and noncurrent assets	<u>3,684,513</u>	<u>3,920,025</u>
 Total assets	 <u>\$ 7,595,352</u>	 <u>\$ 7,195,992</u>
 LIABILITIES AND NET ASSETS		
LIABILITIES:		
Current liabilities:		
Accounts payable (Note 8)	\$ 1,372,372	\$1,075,756
Accrued leave	71,446	65,102
Accrued payroll	56,325	51,037
Current - Due to winners (Note 9)	470,847	463,431
Due to State Education Fund	-	14,452
Reserve for future and unclaimed prizes (Note 10)	1,349,503	1,391,803
Deferred revenue (Note 11)	167,687	177,510
Total current liabilities	<u>3,488,180</u>	<u>3,239,091</u>
Liabilities payable from restricted assets:		
Non-current - Due to winners (Note 9)	2,704,201	2,959,067
Cash advances by State Treasurer	300,000	300,000
Total long-term liabilities	<u>3,004,201</u>	<u>3,259,067</u>
 Total liabilities	 <u>6,492,381</u>	 <u>6,498,158</u>
 NET ASSETS:		
Invested in capital assets	140,419	84,786
Unrestricted (Note 12)	962,552	613,048
Total net assets	<u>1,102,971</u>	<u>697,834</u>
 Total liabilities and net assets	 <u>\$ 7,595,352</u>	 <u>\$7,195,992</u>

STATEMENTS OF
REVENUES, EXPENSES & CHANGES IN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2005 AND 2004

	<u>2005</u>	<u>2004</u>
OPERATING REVENUE:		
Ticket sales	\$ 92,589,803	\$ 92,380,975
Agents' license fees and other receipts	9,806	8,107
Total operating revenues	<u>92,599,609</u>	<u>92,389,082</u>
 OPERATING EXPENSES:		
Cash prizes	57,895,819	57,586,115
Commissions - agents	5,423,735	5,394,848
Personal services	1,105,961	1,068,069
Lottery tickets	1,178,335	613,330
Provision for future payments to winners (Note 9)	-	488,212
Other operating expenses	672,057	430,097
Advertising	414,601	489,611
Depreciation	85,114	33,783
Supplies	25,142	31,896
Instant ticket dispensers	53,137	61,084
Provision for bad debts	-	3,650
Courier system	183,059	161,564
Facilities management fee - instant	782,004	1,729,945
Facilities management fee - online	1,673,221	1,718,550
Tri-State expenses	2,237,573	2,505,744
Total operating expenses	<u>71,729,758</u>	<u>72,316,498</u>
 OPERATING INCOME	 <u>20,869,851</u>	 <u>20,072,584</u>
 NONOPERATING REVENUES (EXPENSES):		
Loss on disposal of fixed assets	(10,393)	-
Investment income (loss)	16,989	(151,754)
Total nonoperating revenues (expenses)	<u>6,596</u>	<u>(151,754)</u>
 INCOME BEFORE OPERATING TRANSFERS	 20,876,447	 19,920,830
 NET PROFIT TRANSFERRED TO THE STATE OF VERMONT EDUCATION FUND	 (20,354,442)	 (19,580,527)
CAPITAL CONTRIBUTION TO OTHER FUND	(26,868)	-
TRANSFER TO VERMONT DEPARTMENT OF HEALTH	<u>(90,000)</u>	<u>(40,000)</u>
 INCREASE IN NET ASSETS	 405,137	 300,303
 NET ASSETS, beginning of year	 <u>697,834</u>	 <u>397,531</u>
 NET ASSETS, end of year	 \$ <u>1,102,971</u>	 \$ <u>697,834</u>

STATEMENTS OF
CASH FLOWS

FOR THE YEARS ENDED JUNE 30, 2005 AND 2004 • PAGE 1 OF 2

	<u>2005</u>	<u>2004</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from customers	\$ 93,123,196	\$ 91,737,077
Cash paid for prizes and agents' commissions	(63,519,986)	(62,302,910)
Cash paid for management fees, operations and other	(6,922,513)	(7,654,301)
Cash paid to employees for services	(1,094,329)	(1,062,274)
Other operating revenue	<u>9,806</u>	<u>8,107</u>
Net cash provided by operating activities	<u>21,596,174</u>	<u>20,725,699</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Operating transfers	(20,497,394)	(20,122,128)
Net cash used in noncapital financing activities	<u>(20,497,394)</u>	<u>(20,122,128)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Acquisition of property and equipment, net	(151,140)	(38,903)
Net cash used in capital and related financing activities	<u>(151,140)</u>	<u>(38,903)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Investment income	60,683	50,630
Proceeds from maturities of investments, net	<u>247,451</u>	<u>334,000</u>
Net cash provided by investing activities	<u>308,134</u>	<u>384,630</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	1,255,774	949,298
CASH AND CASH EQUIVALENTS, beginning of year	<u>1,533,023</u>	<u>583,725</u>
CASH AND CASH EQUIVALENTS, end of year	\$ <u><u>2,788,797</u></u>	\$ <u><u>1,533,023</u></u>

	<u>2005</u>	<u>2004</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating income	\$ <u>20,869,851</u>	\$ <u>20,072,584</u>
Adjustments to reconcile operating income to net cash provided by operating activities -		
Depreciation	85,114	33,783
(Increase) decrease in the following assets:		
Accounts receivable	543,216	(547,763)
Inventory	89,318	(248,850)
Increase (decrease) in the following liabilities:		
Accounts payable	296,616	828,232
Accrued salaries and benefits	11,632	5,795
Due to winners	(247,450)	165,965
Reserve for future and unclaimed prizes	(42,300)	512,088
Deferred revenue	(9,823)	(96,135)
Total adjustments	<u>726,323</u>	<u>653,115</u>
Net cash provided by operating activities	\$ <u><u>21,596,174</u></u>	\$ <u><u>20,725,699</u></u>

1. Summary of significant accounting policies:

The Vermont Lottery Commission (the Lottery) was created by an enactment of the Vermont State Legislature and signed into law by the Governor on April 27, 1977. Title 31, Chapter 14 of the Vermont Statutes is the law under which the Lottery operates. The Lottery is an enterprise fund of the State of Vermont and is managed by a five-member Commission appointed by the Governor for three-year terms. The Commission, by law, has the authority to operate the State lottery, determine the type and forms of lottery games, set the price of lottery tickets, determine the number and size of prizes, select the ticket sales locations and may enter into agreements with another state or states to provide for the operation of the Lottery. Approval of the joint fiscal committee and the Governor shall be required for such contractual agreements with other states.

Fiscal operations of the Lottery commenced in October, 1977. The Lottery's net revenue was transferred to the State of Vermont's General Fund through June 30, 1998. Beginning July 1, 1998, the Lottery's revenue is committed to funding public education, and Lottery net revenue is transferred to the State of Vermont Education Fund on a monthly basis.

The Lottery entered into a compact with the states of Maine and New Hampshire known as the Tri-State Lotto. The compact was enacted to implement the operation of Tri-State Lotto for the purpose of raising additional revenue for each of the party states. Vermont's portion of the Tri-State Lotto operations is accounted for by the Lottery.

In July 2003, the Lottery entered into an agreement with the Multi-State Lottery Association (MUSL) for the inclusion of the Powerball game.

A. Reporting entity - The Lottery is included in the State of Vermont's financial statements as an enterprise fund. In accordance with governmental accounting and financial reporting standards, there are no component units to be included within the Lottery's financial statements as a reporting agency.

B. Measurement focus and basis of accounting - The financial statement presentation follows the recommendations of the Governmental Accounting Standards Board (GASB) in its Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*. The Lottery uses the economic resources measurement focus and the accrual basis of accounting whereby revenues are recorded when earned and expenses are recorded when the obligation for payment is incurred. The Lottery is classified as an enterprise fund of the governmental proprietary fund type. Enterprise funds account for operations similar to private business enterprises where the intent of the Legislature is that costs are to be financed or recovered primarily through user charges, or where the Legislature has decided that periodic determination of revenue earned, expenses incurred or net income is appropriate. Under this basis of accounting and measurement focus, the Lottery applies all GASB pronouncements and Financial Accounting Standards Board (FASB) Statements and interpretations issued on or before November 30, 1989, except those that conflict with a GASB pronouncement. Governments also have the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The Lottery has elected not to follow subsequent private sector guidance.

1. Summary of significant accounting policies (continued):

C. Revenue recognition - Sales of instant lottery tickets are made to licensed retailers who market the tickets to the public on a commission basis. Revenue is recognized when the books of the tickets are settled with the retailers. Tickets activated, but not sold by retailers, may be returned for credit. Sales of online lottery tickets are made to licensed retailers who market the tickets through the use of computerized terminals on a commission basis. Ticket revenue is recognized weekly. Tickets sold in advance of future drawing dates are recorded as deferred revenue until the ticket becomes valid for a drawing.

D. Expenses - Commissions and fees for the instant and online games are recognized weekly. Expenses for administrative and overhead expenses of the operation of the Lottery, except agent and bank commissions, are paid from State appropriations which are derived from Lottery revenues. In addition, Vermont State Statute Title 31, Chapter 14, §658 provides that agency commissions may not exceed 6.25% of gross receipts and bank commissions may not exceed 1% of gross receipts. The statutes also provide that the Lottery must pay out no less than 50% of gross receipts as prizes.

E. Cash and cash equivalents - Cash includes demand deposits and short-term investments with a maturity date within three (3) months of the date acquired by the Lottery except for amounts included in the investment account.

F. Investments - Investments with readily determinable fair market values are reported at their fair market values on the balance sheet. Prior to fiscal year 2005, unrealized gains and losses were included in investment income. In fiscal year 2005, the Lottery adopted a policy to retain in net assets the unrealized gains and losses on long-term investments held for the purpose of paying long-term installment prizes due to winners. This policy is consistent with the provision for apportionment of Lottery revenues in Title 31, Chapter 14, §654 (11)(A).

G. Property and equipment - Property and equipment are stated at cost, recorded as a capital asset based on the nature of the item and depreciated over the estimated useful life of the asset. Capitalized costs include freight-in, licenses, title application and any other costs required to establish the initial operation of the asset. Improvements and additions to an asset are capitalized. Maintenance and repair costs are not capitalized. Depreciation expense is calculated using the straight-line method over the estimated lives of the assets which are:

Automobiles	3 years
Office furniture and equipment	3-7 years
Improvements	10-15 years

H. Compensated absences - Lottery employees are entitled to certain compensated absences based on their length of employment. Generally, compensated absences either vest or accumulate and are accrued when they are earned. Sick leave does not accrue beyond annual use.

I. Advertising - Advertising costs are expensed as incurred.

1. Summary of significant accounting policies (continued):

J. Annuities - The Lottery is the owner of two annuities that were purchased for grand prizes won by two individuals in 1995. The cost of the annuities was charged against the reserve for future prizes at the time of purchase. The annuities were purchased from the following insurance company and have the following expiration dates:

<u>Insurance Company</u>	<u>Annuity Expiration Date</u>
Keyport Life Insurance Company	November 14, 2014
Keyport Life Insurance Company	December 15, 2014

K. Estimates - The preparation of financial statements 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.

L. Risk management - The Lottery is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; injuries to individuals; and natural disasters. These are managed by the State of Vermont on behalf of the Lottery.

2. Cash and cash equivalents:

The Lottery's cash deposits as of June 30, consisted of:

	<u>2005</u>		<u>2004</u>	
	<u>Carrying Amount</u>	<u>Institutions' Balance</u>	<u>Carrying Amount</u>	<u>Institutions' Balance</u>
Insured - FDIC	\$ 100,000	\$ 100,000	\$ 100,400	\$ 100,400
Collateralized	983,933	754,397	1,850,394	1,867,559
Uncollateralized/uninsured	138,316	138,517	-	-
Cash with State of Vermont Treasurer (Note 3)	<u>1,566,548</u>	<u>-</u>	<u>(417,771)</u>	<u>-</u>
	<u>\$ 2,788,797</u>	<u>\$ 992,914</u>	<u>\$ 1,533,023</u>	<u>\$1,967,959</u>

The difference between the balance per the bank and the balance per the books is due to deposits in transit and outstanding checks. Collateralized amounts are held by the pledging bank's trust department in the Lottery's name.

3. Cash with State of Vermont Treasurer:

Cash with the State Treasurer represents cash held by the Vermont State Treasurers' Office for the purpose of funding expenditures of the Lottery and transfers to the State of Vermont Education Fund. The expenditures are provided for by an appropriation from the State of Vermont which is derived from Lottery revenues for the operation of the Lottery. The balance in this account is reduced by transfers of net revenue of the Lottery to the State of Vermont Education Fund. There is a surplus in this account at June 30, 2005, and a deficit at June 30, 2004 due to timing of transfers out of the other cash accounts.

4. Investments/due to winners:

Investments at June 30, 2005 and 2004 were as follows:

	<u>2005</u>	<u>2004</u>
Money Market Funds	\$ 100,000	\$ 100,000
U.S. Treasury Strips	2,732,746	2,975,150
Annuity contracts	<u>711,348</u>	<u>760,089</u>
	<u>\$ 3,544,094</u>	<u>\$ 3,835,239</u>

Interest rate risk - The Lottery purchases investments in government securities that will mature in future years to pay multi-year payment prizes won by certain instant ticket winners (see Note 9). These are held by the Trust Department of the Chittenden Bank in Burlington, Vermont, and are reported at market value. The Lottery also owns two annuity contracts purchased for winners which are reported at amortized cost. Because these investments are scheduled to be paid to winners as they mature, the Lottery does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Credit, and custodial credit risk - Investments in the two annuity contracts are both with Keyport Life Insurance Company (see Note 1.J.). These contracts are unrated.

Investments and Due to winners as of June 30, 2005 are \$3,544,094 and \$3,175,048, respectively. Investments and Due to winners as of June 30, 2004 are \$3,835,239 and \$3,422,498, respectively.

5. Accounts receivable:

Accounts receivable at June 30 consisted of the following:

	<u>2005</u>	<u>2004</u>
MUSL	\$ 394,055	\$ 196,334
Tri-State	-	280,830
Sci-Games	-	477,365
Instant Agents	24,857	18,533
Instant Chains	66,006	52,513
Online Agents	5,714	5,282
Online Chains	<u>32,415</u>	<u>35,406</u>
Total	523,047	1,066,263
Less: Allowance for doubtful accounts	<u>(10,248)</u>	<u>(10,248)</u>
Net accounts receivable	<u>\$ 512,799</u>	<u>\$1,056,015</u>

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2005 AND 2004

VERMONT LOTTERY COMMISSION
ANNUAL REPORT
FISCAL YEAR 2005

6. Inventory:

The Lottery had inventory consisting of lottery tickets on hand and prizes valued at a cost of \$593,506 and \$4,105 at June 30, 2005 and \$613,048 and \$73,881 at June 30, 2004, respectively.

7. Property and equipment:

The following is a summary of changes in property and equipment during the fiscal years.

2005							
	Balance July 1, 2004	Additions & Adjustments	Transfers	Retirements	Balance June 30, 2005	Accumulated Depreciation	Net Property & Equipment June 30, 2005
Computer equipment	\$ 27,888	\$ 22,442	\$ -	\$ (9,091)	\$ 41,239	\$ (37,116)	\$ 4,123
Furniture & fixtures	9,808	50,549	-	(4,243)	56,114	(35,039)	21,075
Automobiles	193,892	-	(148,075)	(45,817)	-	-	-
Other equipment	37,119	97,664	-	(12,424)	122,359	(46,443)	75,916
Leasehold improvements	29,475	42,635	-	(21,850)	50,260	(10,955)	39,305
	<u>\$ 298,182</u>	<u>\$ 213,290</u>	<u>\$ (148,075)</u>	<u>\$ (93,425)</u>	<u>\$ 269,972</u>	<u>\$ (129,553)</u>	<u>\$ 140,419</u>

2004							
	Balance July 1, 2003	Additions & Adjustments	Transfers	Retirements	Balance June 30, 2004	Accumulated Depreciation	Net Property & Equipment June 30, 2004
Automobiles	\$ 161,696	\$ 32,196	\$ -	\$ -	\$ 193,892	\$ (148,261)	\$ 45,631
Other	97,584	6,706	-	-	104,290	(65,135)	39,155
	<u>\$ 259,280</u>	<u>\$ 38,902</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 298,182</u>	<u>\$ (213,396)</u>	<u>\$ 84,786</u>

8. Accounts payable:

The Lottery's accounts payable consisted of the following at June 30:

	<u>2005</u>	<u>2004</u>
Tri-State	\$ 132,626	\$ -
MUSL	417,342	159,435
Vendors	822,404	916,321
	<u>\$1,372,372</u>	<u>\$1,075,756</u>

9. Due to winners:

Presented below is a summary of requirements to maturity for long-term installment prizes due to winners awarded as of June 30, 2005, and payable through the year 2025:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Current portion:			
Fiscal year -			
2006	\$ 470,847	\$ 63,153	\$ 534,000
Long-term:			
Fiscal year -			
2007	450,629	83,371	534,000
2008	431,476	102,524	534,000
2009	413,388	120,612	534,000
2010	246,624	83,376	330,000
2011-2015	832,364	317,636	1,150,000
2016-2020	234,347	265,653	500,000
2021-2025	95,373	184,627	280,000
Total long-term portion	<u>2,704,201</u>	<u>1,157,799</u>	<u>3,862,000</u>
Total requirements to maturity	<u>\$3,175,048</u>	<u>\$1,220,952</u>	<u>\$4,396,000</u>

Due to winners represents annual payments owed to jackpot winners and is fully funded by investments in U.S. Government Treasury Strips and annuities that mature on a schedule coinciding with the installments (see Note 4).

10. Prize expense and reserve for future and unclaimed prizes:

By law, the Lottery must pay a minimum of 50% of gross revenue to participants in the form of prizes. Prize expense is calculated on the basis of total sales multiplied by an approved prize payout percentage. The reserve for future and unclaimed prizes is increased by the prize expense as calculated and reduced by the dollar value of prizes actually paid out. Unclaimed prizes from online games can be used for special prizes, to supplement regular prizes or in the case of instant games can be transferred to the State of Vermont Education Fund for State and local funding of public education.

10. Prize expense and reserve for future and unclaimed prizes (continued):

For instant games, the Lottery calculated prize expense at varying percentages according to game design ranging from 64% to 75% for the years ended June 30, 2005 and 2004.

In September 1985, the states of Vermont, Maine and New Hampshire instituted Tri-State Megabucks, with a calculated prize expense of 50% of ticket sales. Megabucks ticket sales in Vermont were approximately \$5.7 million for the year ended June 30, 2005 and \$5.8 million for the year ended June 30, 2004.

The Lottery began offering the Pick 3 and Pick 4 daily numbers games in November 1980 and September 1985 respectively with calculated prize expense of 50% of ticket sales. Effective June 1995 the daily numbers games, Pick 3 and Pick 4, became Tri-State games. Pick 3 and Pick 4 sales in Vermont were approximately \$2.8 million for the year ended June 30, 2005 and \$2.9 for the year ended June 30, 2004.

Effective July 1, 2003, the Lottery became a member of the Multi-State Lottery Association (MUSL), which operates online games on behalf of participating state lotteries. Each MUSL member sells game tickets through its agents and makes weekly wire transfers to the MUSL in an amount equivalent to the member's share of the estimated grand prize liability. Each MUSL member pays non-jackpot prizes directly to the winners. The MUSL operates the Powerball game, as well as the Power Play feature associated with Powerball. Participating lotteries are required to maintain deposits with MUSL for contingency reserves to protect MUSL from unforeseen prize liabilities. The money in this reserve fund is refundable to MUSL members if the MUSL disbands or if a member leaves the MUSL Board. Vermont Powerball sales were approximately \$11.7 million for the year ended June 30, 2005 and approximately \$13.5 million for the year ended June 30, 2004. On behalf of the Lottery, MUSL held in trust prize reserve accounts for Powerball and Power Play of \$144,214 and \$201,793 respectively for the fiscal year ended June 30, 2005 and \$159,107 and \$329 respectively for the fiscal year ended June 30, 2004.

In November 2003, the states of Vermont, Maine, and New Hampshire began Heads or Tails replacing Cash Lotto with an estimated payout of 50% of ticket sales. The sales in Vermont for Cash Lotto were approximately \$0.5 million for the year ended June 30, 2004. The sales in Vermont for Heads or Tails were approximately \$1.2 million for the year ended June 30, 2005 and \$.9 million for the year ended June 30, 2004.

11. Deferred revenue:

Deferred revenue consists of subscription receipts for the Megabucks game and Advance tickets sold for the Powerball game. The revenue will be recognized as the drawings are held.

12. Net assets:

Net assets invested in capital assets includes furniture, equipment and leasehold improvements net of depreciation of \$140,419. Unrestricted net assets at June 30, 2005, include net assets reserved for ticket inventory of \$593,506 and for unrealized gains on investments held for the purpose of paying long-term installment prizes due to winners of \$369,046. These reserves are consistent with the provision for apportionment of Lottery revenues in Title 31, Chapter 14, §654(11)(A) & (B).

13. Appropriations:

The following are the cash basis appropriations compared to expenses at June 30:

	<u>2005</u>	<u>2004</u>
Appropriation	\$2,356,901	\$2,251,526
Expenditures	<u>2,354,906</u>	<u>2,104,862</u>
Variance	<u>\$ 1,995</u>	<u>\$ 146,664</u>

At June 30, 2005, \$1,785 was encumbered for personal services. At June 30, 2004, \$129,087 was encumbered for personal services and leasehold improvements.

14. Retirement plan:

The Vermont State Retirement System (VSRS), a defined benefit plan, covers substantially all Lottery employees except employees hired in a temporary capacity. Membership in the system is a condition of employment. The membership consists of employees who belong to the original contributory system with a contribution range of 5.1% to 6.28% of payroll (Groups A, C and D), vested members of the non-contributory system (Group E) as well as members of a new contributory system whose current contribution rate is 3.35% (Group F). All eligible employees of the Lottery are Group F members. The total amount of employer contributions was \$75,911. The Lottery's current year payroll for all employees totaled \$811,246 while its current year's covered payroll for the plan was \$786,637. Funding and benefit information for this plan is maintained in the aggregate, not by Agency or Commission. Additional information regarding this plan is available upon request from the State of Vermont.

15. Deferred compensation:

The State offers its employees a deferred compensation plan created in accordance with section 457 of the Internal Revenue Code. The plan, available to all Lottery employees, permits them to defer a portion of their current salary until future years. The deferred compensation is not available to the employees until termination, retirement, death or an unforeseeable emergency.

In compliance with Federal mandates, the Vermont State Retirement Board adopted a Plan Trust Declaration for the State of Vermont's Deferred Compensation Plan effective January 1, 1999. The Federal mandate was established to protect the assets of deferred compensation plans by requiring the assets be placed in a trust to be used for the sole purpose of plan participants. After January 1, 1999, the plan assets are no longer considered assets of the State of Vermont.

16. Concentrations:

The Lottery utilizes Scientific Games International (SGI), a service organization, to process all its online games and generate accounting reports the Lottery uses to record this activity. The Lottery also utilizes SGI to validate and settle its instant ticket lottery games. Other service providers are available; however, an interruption in service by SGI could have an adverse impact on the Lottery's revenues.

17. Commitments:

The State of Vermont entered into a new agreement on behalf of the Lottery for office space. The lease commenced September 1, 2004 for ten years. The annual rent is \$129,675 for the first five years and \$142,576 for the remaining five years through August 31, 2014. The annual rent for the years ended June 30, 2005 and June 30, 2004 was \$122,463 and \$82,932, respectively.

The Lottery has a two-year agreement with Oberthur Gaming Technologies Corporation to print instant game tickets through November 30, 2005 with an option to renew for two, one year extensions. The total cost of the contract is not to exceed \$6.5 million.

The Lottery is contracted with Scientific Games International to provide for the operation of an online gaming system through June 30, 2010. The estimated total contract price is approximately \$45 million over the ten-year contract.

**Mudgett
Jennett &
Krogh-Wisner, P.C.**
Certified Public Accountants #435

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

The Commissioners
Vermont Lottery Commission

We have audited the basic financial statements of the Vermont Lottery Commission as of and for the year ended June 30, 2005, and have issued our report thereon dated July 29, 2005. 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 Vermont Lottery Commission's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statement being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Commission'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*.

This report is intended solely for the information and use of the Commission, management and the State of Vermont and is not intended to be and should not be used by anyone other than those specified parties.

Montpelier, Vermont
July 29, 2005

*Mudgett, Jennett &
Krogh-Wisner, P.C.*



Vermont Lottery Staff:

Alan Yandow

Mark Cayia

Ann-Marie Mears

Mary Cassani

Beth Plante

Meredith Putvain

Carole Lacasse

Michael Lancour

Connie Goss

Norman Duby (Retired FY05)

Ellen Pulsifer

Pamela Morin

Fran McAvoy

Sylvia Buzzell

Glenn Clifton

Timothy White (FY05)

Gweneth Dean

Wendy Dickinson

Lou Chap

Mark Anderson



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ANNUAL REPORT

FISCAL YEAR
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