

**SOUTH CAROLINA
EDUCATION LOTTERY COMMISSION**

REPORT ON FINANCIAL STATEMENTS

**FOR THE YEARS ENDED
JUNE 30, 2008 AND 2007**

State of South Carolina



Office of the State Auditor

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September 30, 2008

The Honorable Mark Sanford, Governor
and
Members of the South Carolina Education Lottery Commission
Columbia, South Carolina

This report on the audit of the financial statements of the South Carolina Education Lottery Commission for the fiscal years ended June 30, 2008 and 2007, was issued by Elliott Davis, LLC, Certified Public Accountants, under contract with the South Carolina Office of the State Auditor.

If you have any questions regarding this report, please let us know.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Richard H. Gilbert Jr.", written in a cursive style.

Richard H. Gilbert, Jr., CPA
Deputy State Auditor

RHGjr/trb

SOUTH CAROLINA EDUCATION LOTTERY COMMISSION

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Richard H. Gilbert, Jr., CPA
Interim State Auditor
State of South Carolina
Columbia, South Carolina

We have audited the accompanying statements of net assets of the South Carolina Education Lottery Commission (the Commission), a discretely presented component unit of the State of South Carolina (the State), as of June 30, 2008 and 2007 and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the management of the Commission. Our responsibility is to express an opinion on these financial statements based on our audits.

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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Commission as of June 30, 2008 and 2007, and the respective 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 5, 2008 on our consideration of the 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 audits.

The Management's Discussion and Analysis is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. 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.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements of the Commission. The schedule of business-type activities for the Statewide CAFR is supplementary information required by the South Carolina Office of the Comptroller General and is not a required part of the basic financial statements. It has been subjected to the auditing procedures applied in the audit of the basic financial statements, and in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Columbia, South Carolina
September 5, 2008

Elliott Davis, LLC

***SOUTH CAROLINA EDUCATION LOTTERY COMMISSION
MANAGEMENT'S DISCUSSION AND ANALYSIS***

Management of the South Carolina Education Lottery Commission (Commission) provides this *Management's Discussion and Analysis* of their financial performance for the readers of the Commission's financial statements. This narrative provides an overview of the Commission's financial activity for the fiscal years ended June 30, 2008 and 2007. This analysis is to be considered in conjunction with the financial statements to provide an objective analysis of the Commission's financial activities based on facts, decisions, and conditions currently facing management. These financial statements reflect only activities of the South Carolina Education Lottery Commission, a component unit of the State of South Carolina.

Understanding the Commission's Financial Statements

The Commission, an instrumentality of the State of South Carolina, is accounted for as an enterprise fund that reports all assets and liabilities using the accrual basis of accounting, much like a private business entity. In accordance with accounting principles generally accepted in the United States of America, this report consists of a series of financial statements, along with explanatory notes to the financial statements. The financial statements immediately follow this discussion and analysis by management, and are designed to highlight the Commission's net assets and changes to those assets resulting from Commission operations.

The financial statements included in this report are as follows:

- The Statement of Net Assets provides information about the Commission's assets, liabilities, and net assets.
- The Statement of Revenues, Expenses, and Changes in Net Assets provide information about the revenues and expenses as it relates to lottery operations.
- The Statement of Cash Flows summarizes the cash inflows and cash outflows of the Commission's activities.
- Notes to the Financial Statements are an integral part of the financial statements and provide additional information that is necessary to gain a comprehensive understanding of data reported in the financial statements.
- A Supplementary Schedule of Business-Type Activities for the Statewide CAFR is presented to show the revenues, expenses, remittances to the Education Lottery Account, and beginning and ending net assets.

The most important relationship demonstrated within the Commission's financial statements is the requirement that the Commission remit all net proceeds to the State Treasurer for the Education Lottery Account (ELA). Accordingly, the primary focus of these financial statements is determining net proceeds available for remittance to the Education Lottery Account, rather than the change in net assets of the Commission.

Financial Highlights

For the year ended June 30, 2008, there was an increase from the prior fiscal year of \$4.2 million in revenues from lottery operations. The Commission returned \$620.5 million to winners of lottery games and \$70.4 million was paid to retailers for commissions and incentives. Other game related expenses totaled \$17.1 million and operating expenses were \$25.1 million. Net proceeds remitted to and due to the ELA were \$265.3 million as of and for the year ended June 30, 2008.

For the year ended June 30, 2007, there was a decrease from the prior fiscal year of \$156.1 million in revenues from lottery operations. The Commission returned \$600.1 million to winners of lottery games and \$70.0 million was paid to retailers for commissions and incentives. Other game related expenses totaled \$18.1 million and operating expenses were \$27.7 million. Net proceeds remitted to and due to the ELA were \$279.2 million as of and for the year ended June 30, 2007.

For the year ended June 30, 2006, revenues from lottery operations increased from year ended June 30, 2005 by \$187.7 million. The Commission returned \$702.3 million to winners of lottery games and \$81.1 million was paid to retailers for commissions and incentives. Other game related expenses totaled \$20.4 million and operating expenses

were \$26.3 million. Net proceeds remitted to and due to the ELA were \$320.6 million as of and for the year ended June 30, 2006.

The Commission continues to introduce new games and promote existing games to keep players interested. The introduction of a new game, MegaMatch 6SM, contributed to the increase in sales. The other elements which contribute to the level of sales are varied and the Commission attempts to identify these elements while marketing products in efforts to increase sales.

S.C. Code Ann. §59-150-60(A)(18) limits the amount of advertising expense to one percent of the previous year's gross sales, and §59-150-350(A) limits annual administrative expenses to fifteen percent of total annual revenue. Actual operating costs and the related limits for FY06 to FY08 follow:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Total Revenue	\$995,955,172	\$991,739,055	\$1,147,851,700
Gross Sales	992,492,764	988,158,152	1,144,606,250
Advertising Expense Upper Limit	9,881,582	11,446,063	9,569,520
Actual Advertising Expense	8,332,591	9,866,628	8,682,936
Total Administrative Expense Upper Limit	149,393,276	148,760,858	172,177,755
Actual Total Adm. Exp. & Retailer Comm.	112,654,981	115,761,597	127,764,089

Condensed Financial Information

The summary of financial statements of the Commission is presented as follows:

Assets and Liabilities (in millions) (See Notes to Financial Statements 4 and 6)

Assets and Liabilities:

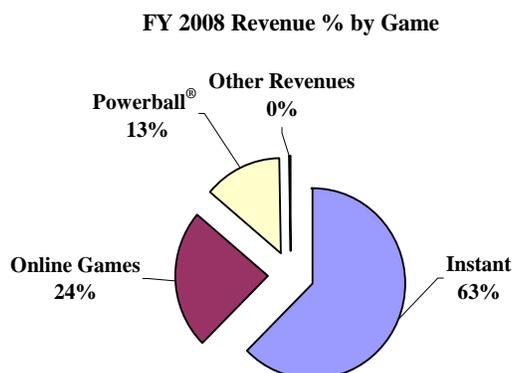
	<u>2008</u>	<u>2007</u>	<u>2006</u>
Current Assets	\$ 49.8	\$ 48.0	\$ 38.7
Noncurrent Assets:			
Capital Assets	1.2	2.6	5.6
Other Noncurrent Assets	5.0	6.2	7.4
Total Noncurrent Assets	6.2	8.8	13.0
Total Assets	56.0	56.8	51.7
Current Liabilities	53.7	53.3	45.7
Noncurrent Liabilities	0.6	0.5	0.8
Total Liabilities	54.3	53.8	46.5
Net Assets			
Capital Assets Net of Related Debt	1.2	2.6	4.7
Restricted Assets	0.5	0.4	0.5
Total Net Assets	\$ 1.7	\$ 3.0	\$ 5.2

The Commission's current assets consist primarily of cash and cash equivalents with deposits in financial institutions, accounts receivable from retailers, accounts receivable from Multi-State Lottery Association (MUSL), instant ticket inventory, and prepaid expenses. Noncurrent capital assets consist of machinery and equipment, vehicles and leasehold improvements. Other noncurrent assets consist of deposits with MUSL. Current liabilities consist primarily of amounts payable to the ELA

Commission Operations (in millions)

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Revenue - Instant games	\$ 622.9	\$ 617.5	\$ 696.5
Revenue – Online games	236.1	236.4	226.3
Revenue – Powerball®	133.5	134.3	221.8
Other Revenues	<u>3.5</u>	<u>3.5</u>	<u>3.2</u>
Total Revenues	<u>\$ 996.0</u>	<u>\$ 991.7</u>	<u>\$ 1,147.8</u>

For fiscal year 2008 the percentage of revenue by game and other is as follows:



Expense by prize and other expenses:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Retailer Commissions and Incentives	\$ 70.4	\$ 70.0	\$ 81.1
Prize expense - Instant games	442.9	428.7	482.0
Prize expense - Online games	114.1	110.2	115.5
Prize expense – Powerball®	63.5	61.2	104.9
Instant and online direct costs	17.1	18.1	20.4
Operating expenses	<u>25.1</u>	<u>27.6</u>	<u>26.3</u>
Total Expenses	<u>\$ 733.1</u>	<u>\$ 715.8</u>	<u>\$ 830.2</u>

Non-operating income and expense, net:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Interest Income	\$ 1.1	\$ 1.2	\$ 1.2
Interest Expense	<u>-</u>	<u>-</u>	<u>(0.1)</u>
Total Non-Operating Income (Expense)	<u>\$ 1.1</u>	<u>\$ 1.2</u>	<u>\$ 1.1</u>

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Remitted and due to Education Lottery Acct	\$ 265.3	\$ 279.2	\$ 320.6
Change in Net Assets	(1.4)	(2.1)	(1.9)
Ending Net Assets	1.7	3.0	5.2

All proceeds of the Commission must be remitted to the State Treasurer for the ELA with the following exceptions: 1) the cost of capital assets net of depreciation and related debt, and 2) the Restricted Fidelity Fund, derived from the

licensing fees of new retailers, which may be retained by the Commission up to \$500,000 and used to cover losses the Commission may experience due to nonfeasance, misfeasance, or malfeasance of a lottery retailer. Therefore, the net assets of the Commission will never exceed \$500,000 related to the Restricted Fidelity Fund plus the cost of capital assets, net of depreciation and related debt.

As of June 30, 2008 the balance in the Restricted Fidelity Fund was \$462,974. No transfers were made during the year for retailer losses. As of July 10, 2008 the Commission remitted \$266.1 million, including \$14.1 million in unclaimed prize funds to the State Treasurer for the ELA for the fiscal year ended June 30, 2008. Total remittances to the ELA are \$1.8 billion from inception to June 30, 2008.

Capital Assets and Long Term Debt Activity (in millions)

Net capital assets for fiscal year 2008 are \$1,201,168. Capital asset activity during the year included purchases of \$628,729 and depreciation expense of \$2,064,688. The largest capital asset item was fully depreciated during the current fiscal year, resulting in a significant decrease in depreciation expense.

Capital Assets	\$ 22.4
Less: Accumulated Depreciation	<u>21.2</u>
Net assets invested in capital assets	\$ 1.2

Net capital assets for fiscal year 2007 are \$2,645,286. Capital asset activity during the year included purchases of \$806,293 and depreciation expense of \$3,726,082.

Capital Assets	\$ 21.8
Less: Accumulated Depreciation	<u>19.2</u>
Net assets invested in capital assets	\$ 2.6

There was no long term debt activity during the current fiscal year as related to the purchase of capital assets. Long term debt has carried a zero balance as of fiscal year June 30, 2007. Additional discussion on capital assets and long term debt activity can be found in notes 4 and 6 of the financial statements.

Potential Factors Impacting Future Operations

With the addition of Florida in January 2009, Powerball® will be positioned to generate larger jackpots more quickly, stimulating the sales of that product. The Commission’s transition to a new gaming system in November 2008 will provide new opportunities for customer service on a 24-hour basis.

Contacting the Commission's Financial Management

This financial report is designed to provide a general overview of the Commission’s financial activity for all those interested in the Commission’s operations. Questions concerning any of the information provided in this report, or requests for additional financial information, should be addressed to the Director of Finance, South Carolina Education Lottery, Post Office Box 11949, Columbia, South Carolina 29211-1949.

***SOUTH CAROLINA EDUCATION LOTTERY COMMISSION
STATEMENTS OF NET ASSETS***

	For the years ended June 30,	
	2008	2007
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 10,671,077	\$ 14,331,914
Cash - Restricted fidelity fund	462,974	410,933
Retailer accounts receivable, net of allowance for doubtful accounts of \$161,455 and \$288,128 for 2008 and 2007, respectively	32,925,011	29,679,489
Accounts receivable - Multi-State Lottery	288,939	-
Accrued interest receivable - Multi-State Lottery Association	552,496	493,509
Inventory	1,933,362	2,244,238
Prepaid expenses and other current assets	3,003,800	840,332
Total current assets	49,837,659	48,000,415
NONCURRENT ASSETS		
Capital assets, net	1,201,168	2,645,286
Deposits with Multi-State Lottery Association	4,960,120	6,162,310
Total noncurrent assets	6,161,288	8,807,596
Total assets	\$ 55,998,947	\$ 56,808,011
<i>LIABILITIES</i>		
CURRENT LIABILITIES		
Due to Education Lottery Account	\$ 18,650,862	\$ 21,848,082
Prizes payable	29,005,564	23,707,759
Prizes payable - Multi-State Lottery	471,303	1,983,868
Accounts payable	3,444,399	3,863,070
Accrued liabilities	911,584	983,362
Current portion of accrued compensated absences	491,642	425,044
Deferred revenue	720,113	431,185
Total current liabilities	53,695,467	53,242,370
NONCURRENT LIABILITIES		
Accrued compensated absences	639,338	509,422
Total liabilities	54,334,805	53,751,792
<i>NET ASSETS</i>		
Net assets, invested in capital assets	1,201,168	2,645,286
Restricted - fidelity funds	462,974	410,933
Total net assets	1,664,142	3,056,219
Total liabilities and net assets	\$ 55,998,947	\$ 56,808,011

See notes to financial statements which are an integral part of these statements.

SOUTH CAROLINA EDUCATION LOTTERY COMMISSION
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

	For the years ended	
	June 30,	
	2008	2007
OPERATING REVENUES		
Instant games	\$ 622,863,738	\$ 617,473,072
On-line games	236,145,782	236,372,864
Powerball [®] games	133,483,244	134,312,216
Retailer permit fees	501,005	503,180
Retailer telephone fees	2,742,225	2,777,700
Other	219,178	300,023
Total revenue	995,955,172	991,739,055
DIRECT COSTS		
Commissions and incentives to retailers	70,432,616	70,036,326
Prize expense		
Instant games	442,920,754	428,661,025
On-line games	114,079,965	110,197,558
Powerball [™] games	63,470,068	61,227,842
Total prize expense	620,470,787	600,086,425
Instant and on-line costs	17,089,005	18,077,179
Total direct costs	707,992,408	688,199,930
Gross profit	287,962,764	303,539,125
OPERATING EXPENSES		
Advertising and promotion	8,332,591	9,866,628
Security checks	232,980	219,180
Salaries, wages and benefits	10,619,644	9,847,490
Contracted and professional services	421,040	494,705
Depreciation	2,064,688	3,726,082
Rent expense	981,250	804,196
Office supplies	179,967	211,861
Bad debt expense	-	111,356
Other general and administrative	2,301,200	2,366,594
Total operating expenses	25,133,360	27,648,092
Operating Income	262,829,404	275,891,033
NON-OPERATING INCOME (EXPENSE)		
Interest income	1,069,337	1,230,566
Gains and Losses	(2,054)	14,825
Interest expense	-	(25,091)
Total non-operating income	1,067,283	1,220,300
Change in net assets before amount remitted to and due to Education Lottery Account	263,896,687	277,111,333
REMITTED TO AND DUE TO EDUCATION LOTTERY ACCOUNT		
Change in net assets	(1,392,077)	(2,125,052)
NET ASSETS,		
BEGINNING OF YEAR	3,056,219	5,181,271
END OF YEAR	\$ 1,664,142	\$ 3,056,219

See notes to financial statements which are an integral part of these statements.

SOUTH CAROLINA EDUCATION LOTTERY COMMISSION
STATEMENTS OF CASH FLOWS

	For the years ended	
	June 30,	
	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from retailers	\$ 992,707,585	\$ 990,639,762
Cash payments to prize winners	(616,685,547)	(603,917,819)
Cash payments to suppliers for goods and services	(102,348,105)	(99,791,168)
Cash payments to employees for services	(10,386,661)	(9,656,428)
Net cash provided by operating activities	263,287,272	277,274,347
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Refunds of deposit with Multi-State Lottery	1,202,190	1,262,690
Payments to Education Lottery Account	(268,485,984)	(268,328,057)
Net cash used for noncapital financing activities	(267,283,794)	(267,065,367)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from dispositions of capital assets	6,105	18,150
Interest paid	-	(25,091)
Purchase of capital assets	(628,729)	(806,293)
Net paid for short-term and long-term debt	-	(882,359)
Net cash used for financing activities	(622,624)	(1,695,593)
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest received	1,010,350	737,057
Net cash provided by investing activities	1,010,350	737,057
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		
	(3,608,796)	9,250,444
CASH AND CASH EQUIVALENTS BEGINNING OF YEAR		
	14,742,847	5,492,403
CASH AND CASH EQUIVALENTS END OF YEAR		
	\$ 11,134,051	\$ 14,742,847
OPERATING ACTIVITIES		
Operating income	\$ 262,829,404	\$ 275,891,033
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	2,064,688	3,726,082
Changes in assets and liabilities		
Retailer accounts receivable	(3,245,522)	(660,375)
Accounts receivable - Multi-State Lottery	(288,939)	-
Inventory	310,876	1,137,246
Prepaid expenses and other assets	(2,163,468)	(5,621)
Accounts payable and accrued liabilities	(293,935)	1,471,118
Prizes payable	3,785,240	(3,831,393)
Deferred revenue	288,928	(453,743)
Net cash provided by operating activities	\$ 263,287,272	\$ 277,274,347

See notes to financial statements which are an integral part of these statements.

***SOUTH CAROLINA EDUCATION LOTTERY COMMISSION
NOTES TO FINANCIAL STATEMENTS***

NOTE 1 – REPORTING ENTITY

The *South Carolina Education Lottery Commission* (the Commission), was established as an instrumentality of the state of South Carolina (the State) with enactment of Act 59 of 2001 (the Act). The Commission is responsible for the provision of lotteries on behalf of the State in accordance with the Act. The Act established a board of nine commissioners as an organization legally separate from the State. Three commissioners are appointed by the Governor, three are appointed by the President Pro Tempore of the Senate and three are appointed by the Speaker of the House of Representatives. The Commission exercises powers comparable to those of a governing board of an entrepreneurial organization. The Commission remits “net proceeds” as defined by the Act to the State. Therefore, the Commission is reported as a discretely presented component unit in the State’s Comprehensive Annual Financial Report (CAFR).

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies of the Commission are as follows:

Method of accounting

The Commission is accounted for as an enterprise fund. Enterprise funds are used to account for activities that are financed and operated in a manner similar to private business enterprises where the costs of providing lottery games to the general public on a continuing basis are to be financed through the sale of lottery game tickets. The Act requires that all costs of providing lottery games, including capital costs, be recovered from the sale of lottery game tickets.

The Government Accounting Standards Board (GASB) is the recognized standard setting body for generally accepted accounting principles applicable to governmental proprietary activities in the United States of America. The Commission applies all applicable GASB pronouncements and all applicable Financial Accounting Standards Board (FASB) pronouncements issued on or before November 30, 1989 when not in conflict with GASB pronouncements. In accordance with GASB Statement 20, the Commission has elected not to implement FASB Statements 103 and after.

Basis of accounting

The financial statements are prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. Under this method, revenues are recognized when they are earned and expenses are recognized when they are incurred.

Use of estimates

The preparation of financial statements, in conformity with accounting principles generally accepted in the United States of America, requires management to make estimates and assumptions. The estimates and assumptions made affect the reported amounts of assets and liabilities and disclosures 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.

Operating revenues

Operating revenue is defined as revenue earned from all operations related to the selling of tickets for instant and online games.

Non-operating income

Non-operating revenue is defined as all revenue that is not generated through ticket sale operations, such as interest income.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

Revenue, accounts receivable, and deferred revenue recognition

Revenue and accounts receivable for online games are recognized when tickets are sold to the public by contracted retailers, except for online tickets sold in advance of the draw date for which deferred revenue is recorded.

Revenue and accounts receivable for instant games are recognized upon activation of ticket packs for sale by the retailers. The Commission evaluates its receivables on an ongoing basis for collectability.

Commissions

Retailers receive a commission of 7% on total sales.

Prizes

In accordance with the Act, as nearly as practical, at least 45% of ticket sales must be returned to the public in the form of prizes. Prize expense for instant ticket games is recorded as an estimate at the time the related revenue is recognized based on the predetermined prize structure for each game; periodically, the prize expense is adjusted to reflect amounts actually won. Prize expense for online games is recorded at the time the related revenue is recognized based on the known prizes.

Ticket inventories

Inventories are carried at cost (as determined by the average cost method) and consist of instant tickets located in the Commission's warehouses or held by retailers. The cost of tickets is charged to operations upon the recognition of revenue under the procedures described above.

Unclaimed prizes

Prizes must be claimed within 90 days after the last day to sell for instant games and within 180 days after the draw date for online games. Unclaimed prize money must be deposited in the Education Lottery Account each year.

Net assets

Net assets represent cumulative revenues, less expense, in excess of net proceeds remitted or payable to the ELA, as defined under the Act.

Change in net assets

Change in net assets equals net proceeds, as defined by the Act, and consists of all revenue derived from the sale of lottery game tickets or shares and all other monies derived from the lottery games, less operating expenses and prizes.

Operating expenses

Operating expenses, as defined by the Act, in the determination of net proceeds, consist of all costs of doing business including, but not limited to, prizes, commissions, and other compensation paid to lottery retailers, advertising and marketing costs, rental fees, personnel costs, capital costs, depreciation of capital assets, and other operating costs.

Cash and cash equivalents

The Commission considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. This includes cash in banks, petty cash, and cash on deposit with the South Carolina State Treasurer.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

Retailer accounts receivable

Retailer accounts receivable represents lottery proceeds due from retailers for net ticket sales, less commissions and prizes paid by the retailers. Lottery proceeds are collected weekly by the Commission from retailer bank accounts. The Commission maintains allowances for potential losses which management believes are adequate to absorb losses to be incurred in realizing the amounts recorded in the accompanying financial statements. Credit risk with respect to accounts receivable is dispersed due to the nature of the business and the large number of retailers. The Commission performs credit evaluations of all its retailers.

Accrued interest receivable

Accrued interest receivable represents interest earned from participation in the Multi-State Lottery Association. Interest is distributed annually to member lotteries on a pro rata basis.

Capital Assets

Capital assets, which consist of machinery, equipment, vehicles and leasehold improvements, are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the capital assets. Leasehold improvements are amortized over their expected useful lives or the lease term, whichever is shorter. When assets are retired or otherwise disposed of, the costs and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is reflected in the results from operations in the period of disposal. The Commission capitalizes all capital asset purchases of \$5,000 or more. The estimated useful lives used for the major asset categories are as follows:

Machinery and equipment	3 – 7 years
Vehicles	3 – 5 years
Leasehold improvements	5 – 10 years

Restricted fidelity fund

In accordance with the Act, retailers contribute a fee to a fidelity fund upon acceptance as a lottery retailer. The fund is used to cover losses the Commission may incur due to misfeasance, nonfeasance or malfeasance of retailers. At the end of each fiscal year, any amount in the fund in excess of \$500,000 is treated as net proceeds from the Commission and is payable to the Education Lottery Account (ELA). As of June 30, 2008 the balance in the Restricted Fidelity Fund was \$462,974. No transfers were made in the current fiscal year for retailer losses. The fidelity fund is held in a separate account and appears on the Statement of Net Assets as “Restricted - fidelity funds.”

Insurance

The Commission is exposed to the risk of loss related to torts; theft of, damage to, and the destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Commission combines coverage provided by the South Carolina Insurance Reserve Fund with the purchase of commercial insurance to substantially cover these risks. The amount of settlements did not exceed insurance coverage in each of the past three fiscal years. The Commission is also exposed to custodial credit risk on deposits, which is outlined in note 3.

Compensated absences

Employees earn the right to be compensated during absences for vacation and compensatory time. Unused leave benefits are paid to employees upon separation from service. The cost of vacation and compensatory time is accrued in the period in which it is earned.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

Advertising

Costs incurred for producing and communicating advertising are expensed when incurred, which generally is when the advertising first takes place.

Deposit with Multi-State Lottery Association (MUSL)

The Commission is required to maintain funds in reserve with MUSL. This reserve serves as a contingent source for prize payouts should MUSL games not generate sufficient funds to pay amounts due to prize winners. MUSL is not a financial institution.

Reclassifications

Certain prior year amounts have been reclassified to conform to current year presentation.

NOTE 3 – DEPOSITS

The Commission's cash and cash equivalents are considered to be cash-on-hand and interest bearing demand deposits held by banks and the State Treasurer.

At June 30, 2008 and 2007, the amounts of the Commission deposits were as follows:

	<u>2008</u>		<u>2007</u>	
	<u>Carrying amount</u>	<u>Bank balances</u>	<u>Carrying amount</u>	<u>Bank balances</u>
Demand deposits	\$ 10,724,117	\$ 11,553,107	\$ 14,328,629	\$ 15,012,767
Deposits held by State Treasurer	409,934	409,934	414,218	369,218
	<u>\$ 11,134,051</u>	<u>\$ 11,963,041</u>	<u>\$ 14,742,847</u>	<u>\$ 15,381,985</u>

Custodial credit risk – deposits

Custodial credit risk is the risk that in the event of a bank failure, the Commission's deposits may not be returned to it. The Commission does not have a deposit policy for custodial credit risk. As of June 30, 2008 and 2007, all of the Commission's bank balances of \$11,963,041 and \$15,381,985, respectively, were covered by FDIC insurance or by collateral held by the pledging financial institutions' trust departments in the Commission's name. Therefore, none of the Commission's bank balances were exposed to custodial credit risk, as of June 30, 2008 and 2007.

State law

The Act requires the Commission to remit to the State Treasurer all net proceeds on a monthly basis. Net proceeds are not available to the Commission for long term investment. State Code Section 11-13-60 requires full collateralization of all deposits held by the State Treasurer.

NOTE 4 – CAPITAL ASSETS

The following is a summary of changes in capital assets and accumulated depreciation during fiscal year 2008:

	<u>Balance</u> <u>June 30, 2007</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u> <u>June 30, 2008</u>
Cost				
Machinery and equipment	\$ 20,854,317	\$ 268,408	\$ (66,693)	\$21,056,032
Vehicles	68,826	-	-	68,826
Leasehold improvements	<u>955,373</u>	<u>360,321</u>	<u>-</u>	<u>1,315,694</u>
	<u>21,878,516</u>	<u>628,729</u>	<u>(66,693)</u>	<u>22,440,552</u>
Accumulated depreciation				
Machinery and equipment	(18,502,775)	(1,968,266)	58,534	(20,412,507)
Vehicles	(68,826)	-	-	(68,826)
Leasehold Improvements	<u>(661,629)</u>	<u>(96,422)</u>	<u>-</u>	<u>(758,051)</u>
	<u>(19,233,230)</u>	<u>(2,064,688)</u>	<u>58,534</u>	<u>(21,239,384)</u>
Total capital assets, net	<u>\$ 2,645,286</u>	<u>\$ (1,435,959)</u>	<u>\$ (8,159)</u>	<u>\$ 1,201,168</u>

The following is a summary of changes in capital assets and accumulated depreciation during fiscal year 2007:

	<u>Balance</u> <u>June 30, 2006</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u> <u>June 30, 2007</u>
Cost				
Machinery and equipment	\$ 20,322,081	\$ 551,136	\$ (18,900)	\$20,854,317
Vehicles	68,826	-	-	68,826
Leasehold improvements	<u>700,216</u>	<u>255,157</u>	<u>-</u>	<u>955,373</u>
	<u>21,091,123</u>	<u>806,293</u>	<u>(18,900)</u>	<u>21,878,516</u>
Accumulated depreciation				
Machinery and equipment	(14,925,527)	(3,592,823)	15,575	(18,502,775)
Vehicles	(68,826)	-	-	(68,826)
Leasehold Improvements	<u>(528,370)</u>	<u>(133,259)</u>	<u>-</u>	<u>(661,629)</u>
	<u>(15,522,723)</u>	<u>(3,726,082)</u>	<u>15,575</u>	<u>(19,233,230)</u>
Total capital assets, net	<u>\$ 5,568,400</u>	<u>\$ (2,919,789)</u>	<u>\$ (3,325)</u>	<u>\$ 2,645,286</u>

NOTE 5 – ACCRUED EXPENSES

Accrued liabilities at June 30, 2008 consist of the following:

Accrued payroll and related expenses	\$ 807,793
Accrued other expenses	<u>103,791</u>
Total Accrued	<u>\$ 911,584</u>

Accrued liabilities at June 30, 2007 consist of the following:

Accrued payroll and related expenses	\$ 771,323
Accrued paper costs	100,000
Accrued SLED costs	53,084
Accrued other expenses	<u>58,955</u>
Total Accrued	<u>\$ 983,362</u>

NOTE 6 – LONG – TERM DEBT AND COMMITMENTS

During January 2008, the Commission entered into a ten year contract with a new vendor, Intralot, to provide Gaming Services. The contract requires Intralot to provide, among other things, services and equipment for online lottery operations for yearly payments of \$6,777,900 for the life of the contract. Conversion to Intralot from Scientific Games began during the current fiscal year and will be completed on November 4, 2008. No payments were made to Intralot during the current fiscal year. The online contract with Scientific Games expires November 15, 2008.

In October 2001, the Commission entered into its first six year contract with Scientific Games, to provide, among other things, services and equipment for online lottery operations. The contract required an initial payment of \$5,287,938, which was paid. The contract also calls for monthly administrative fees of \$450,000 for the life of the contract. Under the original contract, additional payments, which were imputed for the purchase of equipment at \$140,000 and \$122,000 per month, were made for months three through twenty-six and twenty-seven through sixty-two of the contract, respectively. These additional payments were imputed to include principal and interest at 8%. A lump sum payment of \$5,270,000 was due and paid in March 2004. Title to and risk of loss for this equipment occurred upon installation and acceptance in March 2002.

In January 2005, the contract for Scientific Games to provide administrative services was extended for an additional ten and a half (10½) months through November 15, 2008. The extension requires ten monthly payments of \$450,000 with a final payment of \$225,000.

Scientific Games has provided services for the instant games contract since inception. During fiscal year 2006 the contract was rebid and Scientific Games was awarded the contract to provide instant tickets including services of marketing support, warehousing, and distribution, among other items associated with providing instant tickets. The contract period ends September 2013.

NOTE 6 – LONG – TERM DEBT AND COMMITMENTS, Continued

The balance of the long-term debt for purchase of equipment to include the imputed principal and interest was paid in full in February 2007 as follows:

<u>Principal</u>	<u>Interest</u>	<u>Payment</u>
<u>\$ 882,359</u>	<u>\$ 25,091</u>	<u>\$ 907,450</u>

The following is a summary of changes in long-term debt during fiscal year 2007:

	<u>Balance June 30, 2006</u>	<u>Proceeds</u>	<u>Payments</u>	<u>Balance June 30, 2007</u>
Long-term debt	<u>\$ 882,359</u>	<u>\$ -</u>	<u>\$ 882,359</u>	<u>\$ -</u>

NOTE 7 – ACCRUED COMPENSATED ABSENCES

The following is a summary of changes in accrued compensated absences during fiscal year 2008:

	<u>Balance June 30, 2007</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance June 30, 2008</u>
Accrued compensated absences	<u>\$ 934,466</u>	<u>\$ 758,726</u>	<u>\$ 562,212</u>	<u>\$ 1,130,980</u>

Compensated absences due in the next fiscal year is estimated at \$491,642, which is based on an average of prior year's expenses plus all compensatory time.

The following is a summary of changes in accrued compensated absences during fiscal year 2007:

	<u>Balance June 30, 2006</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance June 30, 2007</u>
Accrued compensated absences	<u>\$ 875,005</u>	<u>\$ 466,275</u>	<u>\$ 406,814</u>	<u>\$ 934,466</u>

NOTE 8 – OPERATING LEASES

The Commission has entered into operating leases for the rental of office space for its headquarters and district offices. Certain operating leases contain provisions for scheduled rental increases and are renewable at the option of the Commission.

Future minimum rental payments, to entities outside the State reporting entity, on noncancellable leases with original terms of one year or more are scheduled as follows for the year ending June 30:

<u>Fiscal Year</u>	<u>Operating leases</u>
2009	746,840
2010	765,288
2011	768,350
2012	706,430
2013	635,123
2014 thru 2016	1,841,437

Rental expenses under all operating leases including those on month-to-month terms totaled approximately \$981,250 and \$804,196 for the years ended June 30, 2008, and 2007, respectively. This includes \$107,868 and \$87,551 of vehicle rental expense to the State Fleet management.

NOTE 9 – DUE TO EDUCATION LOTTERY ACCOUNT (ELA)

In accordance with the Act, all net proceeds of the Commission are to be remitted to the ELA within the State Treasury. In accordance with the Act, net proceeds consist of all revenue derived from the sale of lottery game tickets or shares and all other monies derived from the lottery games less operating expenses and prizes. The following payables resulted from net proceeds remittances due to the ELA at June 30:

	<u>2008</u>	<u>2007</u>
Amount payable to the Education Lottery Account, beginning of year	\$ 21,848,082	\$ 10,939,754
Change in net assets subject to remittance	<u>263,896,687</u>	<u>277,111,333</u>
	<u>285,744,769</u>	<u>288,051,087</u>
Change in capital assets, net of related debt		
Capital assets, net	1,444,118	2,923,114
Long-term debt	<u>-</u>	<u>(882,359)</u>
	<u>1,444,118</u>	<u>2,040,755</u>
Net amount (collected for) paid from fidelity fund	<u>(52,041)</u>	<u>84,297</u>
Amount paid during the year	<u>(268,485,984)</u>	<u>(268,328,057)</u>
Amount payable to the Education Lottery Account, end of year	<u>\$ 18,650,862</u>	<u>\$ 21,848,082</u>

Net proceeds remittances related to the above payable were made to the Education Lottery Account in July 2008, and 2007, respectively.

NOTE 10 – EMPLOYEE RETIREMENT SYSTEMS

The Commission contributes to the South Carolina Retirement System (SCRS) cost sharing multiple-employer defined benefit plan administered by the Retirement Division of the State Budget and Control Board.

As established by Title 9-1-480 Code Laws of South Carolina, 1976 (as amended), all eligible persons, except those specifically excluded, shall become members of the retirement system as a condition of their employment. The responsibility of the administration of the system is assigned by law to the State Budget & Control Board.

SCRS offers retirement and disability benefits, cost of living adjustments on an ad-hoc basis, life insurance benefits and survivor benefits. The Plan's provisions are established under Title 9 of the SC Code of Laws.

The following is a recap of the mandated contribution rates for the current fiscal year.

	<u>SCRS</u>
Employee contributions	6.50% of salary
Employer contributions	
Retirement	9.06% of salary
Insurance surcharge	3.42% of salary
Group life insurance	.15% of salary

For the years ending June 30, 2008, and 2007 the Commission contributions to SCRS were \$918,133, and \$844,606 respectively.

All employer contributions were equal to the required contribution rates for the year. Contributions as a percentage of statewide contributions were not available for June 30, 2008.

Commission employees may participate in Sections 457 and/or 401(k) deferred compensation plans, which are available to state and local governmental employees and administered by a state approved nongovernmental third party. The plans, available to all Commission employees, permit them to defer a portion of their salary until future years. Participation in the plan is optional. The deferred compensation plans are not available to employees until termination, retirement, death or unforeseeable emergency.

Employees eligible for service retirement may participate in the Teacher and Retiree Incentive Program (TERI). TERI participants may retire and begin accumulating retirement benefits on a deferred basis without terminating employment for up to five years. Upon termination of employment or at the end of the TERI period, whichever is earlier, participants will begin receiving monthly service benefits which will include any cost of living adjustments granted during the TERI period. Because participants are considered retired during the TERI period, they do not make SCRS contributions, do not earn service credit, and are ineligible to receive group life insurance benefits or disability retirement benefits. Effective July 1, 2006, TERI participants who entered the program before July 1, 2005 do not have to contribute to SCRS as long as they are covered under the TERI program. TERI participants that continue to work after their TERI participation has ended will pay working retiree contributions like active members.

New employees may elect to participate in the Optional Retirement Program (ORP), which provides retirement and death benefits through the purchase of individual or fixed variable annuity contracts, which are issued to and become the property of the participants. To elect ORP, eligible employees must irrevocably waive SCRS membership within their first ninety days of employment.

A comprehensive annual financial report containing financial statements and required supplementary information for the South Carolina Retirement System is issued and publicly available by writing the South Carolina Retirement System, Post Office Box 11960, Columbia, South Carolina 29211-1960, or by calling (803) 737-6800, and on the website at www.retirement.sc.gov.

NOTE 11 – POST-EMPLOYMENT BENEFITS OTHER THAN PENSIONS

Plan Description

In accordance with the South Carolina Code of Laws and the annual Appropriations Act, the State provides post-employment health and dental and long-term disability benefits to retired State and school district employees and their covered dependents. The Commission contributes to the Retiree Medical Plan (RMP) and the Long-term Disability Plan (LTDP), cost-sharing multiple-employer defined benefit postemployment healthcare and long-term disability plans administered by the Employee Insurance Program (EIP), a part of the State Budget and Control Board (SBCB). Generally, retirees are eligible for the health and dental benefits if they have established at least ten years of retirement service credit. For new hires May 2, 2008 and after, retirees are eligible for benefits if they have established twenty-five years of service for 100% employer funding and fifteen through twenty-four years of service for 50% employer funding. Benefits become effective when the former employee retires under a State retirement system. Basic long-term disability (BLTD) benefits are provided to active state, public school district and participating local government employees approved for disability.

Funding Policies

Section 1-11-710 and 1-11-720 of the South Carolina Code of Laws of 1976, as amended, requires these postemployment healthcare and long-term disability benefits be funded through annual appropriations by the General Assembly for active employees to the EIP and participating retirees to the SBCB except the portion funded through the pension surcharge and provided from other applicable sources of the EIP for its active employees who are not funded by State General Fund appropriations. Employers participating in the RMP are mandated by State statute to contribute at a rate assessed each year by the Office of the State Budget, 3.42% and 3.35% of annual covered payroll for 2008 and 2007, respectively. The EIP sets the employer contribution rate based on a pay-as-you-go basis. The Commission paid approximately \$252,537 and \$237,631 applicable to the surcharge included with the employer contribution for retirement benefits for the fiscal years ended June 30, 2008 and 2007, respectively. BLTD benefits are funded through a per person premium charged to State agencies, public school districts, and other participating local governments. The monthly premium per active employee paid to EIP was \$3.23 for the fiscal years ended June 30, 2008 and 2007.

Effective May 1, 2008 the State established two trust funds through Act 195 for the purpose of funding and accounting for the employer costs of retiree health and dental insurance benefits and long-term disability insurance benefits. The South Carolina Retiree Health Insurance Trust Fund is primarily funded through the payroll surcharge. Other sources of funding include additional State appropriated dollars, accumulated EIP reserves, and income generated from investments. The Long Term Disability Insurance Trust Fund is primarily funded through investment income and employer contributions.

One may obtain complete financial statements for the benefit plans and the trust funds from Employee Insurance Program, 1201 Main Street, Suite 360, Columbia, SC 29201.

NOTE 12 – CONTINGENCIES

The Commission is subject to litigation in the ordinary course of its business. In the opinion of management and legal counsel, the outcome of such litigation will not have a material impact on the financial position or cash flows of the Commission for the year ending June 30, 2008.

NOTE 13 – TRANSACTIONS WITH STATE ENTITIES AND RELATED PARTIES

For the year ended June 30, 2008, the Commission had certain transactions with the State and various other state agencies as follows:

<u>Related Party</u>	<u>Amount</u>	<u>Nature of Transaction</u>
South Carolina Department of Revenue	\$ 7,169,613	Transfers of state tax withholding, use taxes, debt setoffs, and retailer credit checks
SLED	374,111	Security services and fees paid for background checks on employees and retailers
South Carolina State Treasurer	268,485,984	Remittances of net proceeds and unclaimed prizes
South Carolina State Treasurer	9,824,125	Transfer of payroll funds for processing
Comptroller General	30,000	Fees for payroll processing
Comptroller General	16,565	Unemployment compensation premium
South Carolina Budget & Control Board	381,880	Insurance, telephone, printing, misc. services
South Carolina Department of Social Services	38,475	Debt setoffs withheld from prize winnings
South Carolina Department of Public Safety	321,478	Security services

For the year ended June 30, 2007, the Commission had certain transactions with the State and various other state agencies as follows:

<u>Related Party</u>	<u>Amount</u>	<u>Nature of Transaction</u>
South Carolina Department of Revenue	\$ 6,322,329	Transfers of state tax withholding, use taxes, debt setoffs, and retailer credit checks
SLED	393,749	Security services and fees paid for background checks on employees and retailers
South Carolina State Treasurer	268,328,057	Remittances of net proceeds and unclaimed prizes
South Carolina State Treasurer	9,167,302	Transfer of payroll funds for processing
Comptroller General	30,000	Fees for payroll processing
Comptroller General	43,175	Unemployment compensation premium
South Carolina Budget & Control Board	328,107	Insurance, telephone, printing, misc. services
Prison Industries-Department of Corrections	21,393	Recycling services and office furniture
South Carolina Department of Social Services	44,974	Debt setoffs withheld from prize winnings
South Carolina Department of Public Safety	321,478	Security services
SC Legislative Audit Council	116,427	Legislative audit of commission operations
State Accident Fund	59,608	Workers compensation insurance premium

***SOUTH CAROLINA EDUCATION LOTTERY COMMISSION
SUPPLEMENTARY SCHEDULE OF BUSINESS-TYPE
ACTIVITIES FOR THE STATEWIDE CAFR***

	For the years ended June 30,	
	2008	2007
Charges for services	\$ 995,955,172	\$ 991,739,055
Operating grants and contributions	1,067,283	1,245,391
Less expenses	733,125,768	715,873,113
Net program revenue	263,896,687	277,111,333
Remittances out to state agencies/funds	(265,288,764)	(279,236,385)
Change in net assets	(1,392,077)	(2,125,052)
NET ASSETS - BEGINNING	3,056,219	5,181,271
NET ASSETS - ENDING	\$ 1,664,142	\$ 3,056,219

**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**

Richard H. Gilbert, Jr., CPA
Interim State Auditor
State of South Carolina

We have audited the financial statements of *South Carolina Education Lottery Commission* (the Commission), a discreetly presented component unit of the State of South Carolina (the State), as of and for the year ended June 30, 2008 and 2007, and have issued our report thereon dated September 5, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Commission's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Commission's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Commission's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

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

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the 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 management, the audit committee, and the Office of the State Auditor of South Carolina and is not intended to be and should not be used by anyone other than those specified parties.

Elliott Davis, LLC

Columbia, South Carolina
September 5, 2008

***SOUTH CAROLINA EDUCATION LOTTERY COMMISSION
SCHEDULE OF FINDINGS
For the year ended June 30, 2008***

I. SUMMARY OF AUDITOR'S RESULTS

We have issued an unqualified opinion, dated September 5, 2008 on the financial statements of the Commission as of and for the year ended June 30, 2008.

Our audit disclosed no material weaknesses relating to the audit of the Commission's financial statements.

Our audit disclosed no significant deficiencies that are not considered to be material weaknesses relating to the audit of the Commission's financial statements.

Our audit disclosed no instances of noncompliance which are material to the Commission's financial statements

II. FINANCIAL STATEMENTS FINDINGS

Our audit disclosed no findings which are required to be reported in accordance with *Government Auditing Standards*.