

**SOUTH CAROLINA
EDUCATION LOTTERY COMMISSION**

REPORT ON FINANCIAL STATEMENTS

**FOR THE YEARS ENDED
JUNE 30, 2007 AND 2006**

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, 2007 and 2006 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, 2007 and 2006, and the changes in financial position and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 7, 2007 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 state-wide 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 7, 2007

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

Management of the 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 year ended June 30, 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.

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 most important relationship demonstrated within the Commission's financial statements is the requirement that the Commission transfer 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 transfer to the Education Lottery Account, rather than the change in net assets of the Commission.

Financial Highlights

For the year ended June 30, 2007, there was a decrease from the prior fiscal year of \$156.1 million in revenues from lottery games. 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 transferred to and due to the Education Lottery Account were \$279.2 million as of and for the year ended June 30, 2007.

For the year ended June 30, 2006, revenues from lottery games 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 transferred to and due to the Education Lottery Account were \$320.6 million as of and for the year ended June 30, 2006.

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

| | <u>2007</u> | <u>2006</u> | <u>2005</u> |
|--------------------------|-------------|-------------|-------------|
| Capital Assets | \$ 2.6 | \$ 5.6 | \$ 8.7 |
| Current and Other Assets | <u>54.2</u> | <u>46.1</u> | <u>57.5</u> |
| Total Assets | 56.8 | 51.7 | 66.2 |
| Current Liabilities | 53.3 | 45.7 | 57.3 |
| Long-term Liabilities | <u>0.5</u> | <u>0.8</u> | <u>1.9</u> |
| Total Liabilities | 53.8 | 46.5 | 59.2 |

| | | | |
|------------------------------------|------------|------------|------------|
| Net Assets | | | |
| Capital Assets Net of Related Debt | 2.6 | 4.7 | 6.5 |
| Restricted Assets | <u>0.4</u> | <u>0.5</u> | <u>0.5</u> |
| Total Net Assets | 3.0 | 5.2 | 7.0 |

Commission Operations

| | <u>2007</u> | <u>2006</u> | <u>2005</u> |
|---|--------------|--------------|--------------|
| Sales by game and other revenues: | | | |
| Revenue - Instant games | 617.5 | 696.5 | 578.8 |
| Revenue – Online games | 236.4 | 226.3 | 199.2 |
| Revenue – Powerball® | 134.3 | 221.8 | 178.9 |
| Other Revenues | <u>3.5</u> | <u>3.2</u> | <u>3.2</u> |
| Total Revenues | 991.7 | 1,147.8 | 960.1 |
| Expense by prize and other expenses: | | | |
| Retailer Commissions and Incentives | 70.0 | 81.1 | 67.5 |
| Prize expense - Instant games | 428.7 | 482.0 | 396.7 |
| Prize expense - Online games | 110.2 | 115.5 | 96.1 |
| Prize expense – Powerball® | 61.2 | 104.9 | 80.9 |
| Instant and online direct costs | 18.1 | 20.4 | 18.2 |
| Operating expenses | <u>27.6</u> | <u>26.3</u> | <u>23.7</u> |
| Total Expenses | 715.8 | 830.2 | 683.1 |
| Non-operating income and expense: | | | |
| Interest Income | 1.2 | 1.2 | 0.6 |
| Interest Expense | <u>(0.0)</u> | <u>(0.1)</u> | <u>(0.2)</u> |
| Total Non-Operating Income (Expense) | 1.2 | 1.1 | 0.4 |
| Net proceeds transferred to and due to ELA | 279.2 | 320.6 | 279.7 |
| Change in Net Assets | (2.1) | (1.8) | (2.3) |
| Ending Net Assets | 3.0 | 5.2 | 7.0 |

All proceeds of the Commission must be transferred to the State Treasurer for the Education Lottery Account 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 lottery retailers. 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, 2007 the balance in the Restricted Fidelity Fund was \$410,933. A transfer was made during the year in the amount of \$135,771 to cover retailer losses. As of July 12, 2007 the Commission had transferred \$286.4 million, including \$16.4 million in unclaimed prize funds to the State Treasurer for the Education Lottery Account for the fiscal year ended June 30, 2007. Total net proceeds transferred to the Education Lottery Account are \$1.5 billion from inception to June 30, 2007.

Capital Assets and Long Term Debt Activity (in millions)

| | |
|---------------------------------------|-------------|
| Capital Assets | 21.9 |
| Less: Accumulated Depreciation | <u>19.3</u> |
| Net assets invested in capital assets | 2.6 |

The long term debt activity as related to the purchase of capital assets had a zero balance as of June 30, 2007. There was a six year contract for purchase of equipment and the last payment on the contract was made during the year. Additional discussion on capital assets and long term debt activity can be found in notes 4 and 6 of the financial statements.

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***

| | JUNE 30, | |
|--|-----------------|---------------|
| | 2007 | 2006 |
| <i>ASSETS</i> | | |
| CURRENT ASSETS | | |
| Cash and cash equivalents | \$ 14,331,914 | \$ 4,997,173 |
| Cash - Restricted fidelity fund | 410,933 | 495,230 |
| Retailer accounts receivable, net of allowance for doubtful accounts of \$288,128 and \$229,058 for 2007 and 2006, respectively | 29,679,489 | 29,019,114 |
| Accrued interest receivable - Multi-State Lottery | 493,509 | - |
| Inventory | 2,244,238 | 3,381,484 |
| Prepaid expenses and other current assets | 840,332 | 834,711 |
| Total current assets | 48,000,415 | 38,727,712 |
| CAPITAL ASSETS, net | 2,645,286 | 5,568,400 |
| DEPOSIT WITH MULTI-STATE LOTTERY | 6,162,310 | 7,425,000 |
| Total assets | \$ 56,808,011 | \$ 51,721,112 |
| <i>LIABILITIES</i> | | |
| CURRENT LIABILITIES | | |
| Due to Education Lottery Account | 21,848,082 | 10,939,754 |
| Prizes payable | 23,707,759 | 28,506,282 |
| Prizes payable - Multi-State Lottery | 1,983,868 | 1,016,738 |
| Accounts payable | 3,863,070 | 2,369,867 |
| Accrued liabilities | 983,362 | 1,064,908 |
| Current portion of accrued compensated absences | 425,044 | 443,056 |
| Current portion of long-term debt | - | 882,359 |
| Deferred revenue | 431,185 | 884,928 |
| Total current liabilities | \$ 53,242,370 | \$ 46,107,892 |
| ACCRUED COMPENSATED ABSENCES | 509,422 | 431,949 |
| Total liabilities | 53,751,792 | 46,539,841 |
| <i>NET ASSETS</i> | | |
| Invested in capital assets, net of related debt | 2,645,286 | 4,686,041 |
| Restricted - fidelity funds | 410,933 | 495,230 |
| Total net assets | \$ 3,056,219 | \$ 5,181,271 |

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, | |
| | 2007 | 2006 |
| OPERATING REVENUES | | |
| Instant games | \$ 617,473,072 | \$ 696,459,836 |
| On-line games | 236,372,864 | 226,336,340 |
| Powerball games | 134,312,216 | 221,810,074 |
| Retailer permit fees | 503,180 | 505,230 |
| Retailer telephone fees | 2,777,700 | 2,690,863 |
| Other | 300,023 | 49,357 |
| Total revenue | 991,739,055 | 1,147,851,700 |
| DIRECT COSTS | | |
| Commissions and incentives to retailers | 70,036,326 | 81,065,367 |
| Prize expense | | |
| Instant games | 428,661,025 | 481,989,311 |
| On-line games | 110,197,558 | 115,450,912 |
| Powerball games | 61,227,842 | 104,901,331 |
| Total prize expense | 600,086,425 | 702,341,554 |
| Instant and on-line costs | 18,077,179 | 20,378,890 |
| Total direct costs | 688,199,930 | 803,785,811 |
| Gross profit | 303,539,125 | 344,065,889 |
| OPERATING EXPENSES | | |
| Advertising and promotion | 9,866,628 | 8,682,936 |
| Security checks | 219,180 | 216,860 |
| Salaries, wages and benefits | 9,847,490 | 9,119,334 |
| Contracted and professional services | 494,705 | 685,931 |
| Depreciation | 3,726,082 | 3,647,532 |
| Rent expense | 804,196 | 711,261 |
| Office supplies | 211,861 | 160,318 |
| Bad debt expense | 111,356 | 691,200 |
| Other general and administrative | 2,366,594 | 2,404,460 |
| Total operating expenses | 27,648,092 | 26,319,832 |
| Operating Income | 275,891,033 | 317,746,057 |
| NON-OPERATING INCOME (EXPENSE) | | |
| Interest income | 1,230,566 | 1,233,565 |
| Gains on disposal of capital assets | 14,825 | 12,549 |
| Interest expense | (25,091) | (129,139) |
| Total non-operating income | 1,220,300 | 1,116,975 |
| Change in net assets before transfers to and due to Education Lottery Account | 277,111,333 | 318,863,032 |
| TRANSFERS TO AND DUE TO EDUCATION LOTTERY ACCOUNT | 279,236,385 | 320,629,929 |
| Change in net assets | (2,125,052) | (1,766,897) |
| NET ASSETS, | | |
| BEGINNING OF YEAR | 5,181,271 | 6,948,168 |
| END OF YEAR | \$ 3,056,219 | \$ 5,181,271 |

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, | |
| | 2007 | 2006 |
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Cash received from retailers | \$ 990,639,762 | \$ 1,147,639,131 |
| Cash payments to prize winners | (603,917,819) | (700,450,398) |
| Cash payments to suppliers for goods and services | (99,791,168) | (119,221,465) |
| Cash payments to employees for services | (9,656,428) | (9,280,317) |
| Net cash provided by operating activities | <u>277,274,347</u> | <u>318,686,951</u> |
| CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES | | |
| Refunds of excess deposits with Multi-State Lottery | 1,262,690 | 328,026 |
| Payments to Education Lottery Account | (268,328,057) | (330,934,444) |
| Net cash used for noncapital financing activities | <u>(267,065,367)</u> | <u>(330,606,418)</u> |
| CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES | | |
| Proceeds from dispositions of capital assets | 18,150 | 45,747 |
| Interest paid | (25,091) | (129,139) |
| Purchase of capital assets | (806,293) | (539,072) |
| Net cash paid for short-term and long-term debt | (882,359) | (1,334,861) |
| Net cash used for capital and related financing activities | <u>(1,695,593)</u> | <u>(1,957,325)</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Interest received | 737,057 | 1,233,565 |
| Net cash provided by investing activities | <u>737,057</u> | <u>1,233,565</u> |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | | |
| | 9,250,444 | (12,643,227) |
| CASH AND CASH EQUIVALENTS BEGINNING OF YEAR | | |
| | <u>5,492,403</u> | <u>18,135,630</u> |
| END OF YEAR | | |
| | <u>\$ 14,742,847</u> | <u>\$ 5,492,403</u> |
| OPERATING ACTIVITIES | | |
| Operating income | 275,891,033 | 317,746,057 |
| Adjustments to reconcile operating income to net cash provided by operating activities | | |
| Depreciation | 3,726,082 | 3,647,532 |
| Changes in assets and liabilities | | |
| Retailer accounts receivable | (660,375) | (1,608,765) |
| Accounts receivable - Multi-State Lottery | - | 1,509,562 |
| Inventory | 1,137,246 | (976,629) |
| Prepaid expenses and other assets | (5,621) | (572,055) |
| Accounts payable and accrued liabilities | 1,471,118 | (2,836,541) |
| Prizes payable | (3,831,393) | 1,891,156 |
| Deferred revenue | (453,743) | (113,366) |
| Net cash provided by operating activities | <u>\$ 277,274,347</u> | <u>\$ 318,686,951</u> |

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 transfers "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 that 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 on-line games.

Non-operating income

Non-operating revenue is defined as all revenue that is not generated through ticket sales 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 on-line games are recognized when tickets are sold to the public by contracted retailers, except for on-line tickets sold in advance of the draw date for which deferred revenue is recorded.

Revenue and accounts receivable for instant scratch 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 on-line 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 specific identification method) and consist of scratch 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 game-end (end of sales) for instant games and within 180 days after the draw date for on-line games. Unclaimed prize money must be deposited in the Education Lottery Account each year.

Net assets

Net assets represent cumulative revenues less expenses in excess of net proceeds transferred or payable to the Education Lottery Account, 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.

Accrued interest receivable

Accrued interest receivable represents interest earned from participation in the Multi-State Lottery. 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 three to five years. 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 assets purchases of \$1,000 or more.

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. A transfer was made during the year in the amount of \$135,771 to cover retailer losses in accordance with the Act. At June 30, 2007, the balance in the fidelity fund was \$410,933. The fidelity fund is held in a separate account and appears on the Statement of Net Assets as restricted fidelity fund cash and in net assets as restricted fidelity funds.

Insurance

The Commission is exposed to various risks 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 years.

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.

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 (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.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

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, 2007 and 2006, the amounts of the Commission deposits were as follows:

| | <u>2007</u> | | <u>2006</u> | |
|----------------------------------|-----------------------------|-----------------------------|----------------------------|----------------------------|
| | <u>Carrying amount</u> | <u>Bank balances</u> | <u>Carrying amount</u> | <u>Bank balances</u> |
| Demand deposits | \$ 14,328,629 | \$ 15,012,767 | \$ 5,123,669 | \$ 7,217,440 |
| Deposits held by State Treasurer | <u>414,218</u> | <u>369,218</u> | <u>368,734</u> | <u>368,734</u> |
| | <u>\$ 14,742,847</u> | <u>\$ 15,381,985</u> | <u>\$ 5,492,403</u> | <u>\$ 7,586,174</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, 2007 and 2006, all of the Commission's bank balances of \$15,381,985 and \$7,586,174, 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, 2007 and 2006.

State law

The Act requires the Commission to transfer 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 2007:

| | <u>Balance</u> | | | <u>Balance</u> |
|---------------------------|----------------------------|------------------------------|--------------------------|----------------------------|
| | <u>June 30, 2006</u> | <u>Additions</u> | <u>Deletions</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 4 - CAPITAL ASSETS, Continued

The following is a summary of changes in capital assets and accumulated depreciation during fiscal year 2006:

| | Balance | | | Balance |
|---------------------------|----------------------------|------------------------------|---------------------------|----------------------------|
| | June 30, 2005 | Additions | Deletions | June 30, 2006 |
| Cost | | | | |
| Machinery and equipment | \$ 19,888,398 | \$ 480,205 | \$ (46,522) | \$20,322,081 |
| Vehicles | 68,826 | - | - | 68,826 |
| Leasehold improvements | 641,349 | 58,867 | - | 700,216 |
| | <u>20,598,573</u> | <u>539,072</u> | <u>(46,522)</u> | <u>21,091,123</u> |
| Accumulated depreciation | | | | |
| Machinery and equipment | (11,424,731) | (3,514,120) | 13,324 | (14,925,527) |
| Vehicles | (65,326) | (3,500) | - | (68,826) |
| Leasehold Improvements | (398,458) | (129,912) | - | (528,370) |
| | <u>(11,888,515)</u> | <u>(3,647,532)</u> | <u>13,324</u> | <u>(15,522,723)</u> |
| Total capital assets, net | <u>\$ 8,710,058</u> | <u>\$ (3,108,460)</u> | <u>\$ (33,198)</u> | <u>\$ 5,568,400</u> |

NOTE 5 - ACCRUED EXPENSES

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 |
| Other | 58,955 |
| | <u>\$ 983,362</u> |

Accrued liabilities at June 30, 2006 consist of the following:

| | |
|--------------------------------------|----------------------------|
| Accrued payroll and related expenses | \$ 658,869 |
| Accrued audit fees | 193,507 |
| Accrued SLED costs | 112,985 |
| Other | 99,547 |
| | <u>\$ 1,064,908</u> |

NOTE 6 - LONG-TERM DEBT AND COMMITMENTS

In October 2001, the Commission entered into a six year contract with a vendor, to provide among other things, services and equipment for on-line 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 of \$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 the vendor to provide administrative services was extended for an additional ten and a half (10½) months through November 15, 2008. The extension will require ten monthly payments of \$450,000 with a final payment of \$225,000.

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> |

The following is a summary of changes in long-term debt during fiscal year 2006:

| | <u>Balance June 30, 2005</u> | <u>Proceeds</u> | <u>Payments</u> | <u>Balance June 30, 2006</u> |
|----------------|----------------------------------|-----------------|---------------------|----------------------------------|
| Long-term debt | <u>\$ 2,217,220</u> | <u>\$ -</u> | <u>\$ 1,334,861</u> | <u>\$ 882,359</u> |

NOTE 7 - ACCRUED COMPENSATED ABSENCES

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> |

Compensated absences due in the next fiscal year is estimated at \$425,044, 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 2006:

| | <u>Balance June 30, 2005</u> | <u>Additions</u> | <u>Deductions</u> | <u>Balance June 30, 2006</u> |
|------------------------------|----------------------------------|-------------------|-------------------|----------------------------------|
| Accrued compensated absences | <u>\$ 854,257</u> | <u>\$ 426,879</u> | <u>\$ 406,131</u> | <u>\$ 875,005</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> |
|-------------------------------|------------------------------------|
| 2008 | \$ 665,283 |
| 2009 | 685,040 |
| 2010 | 700,696 |
| 2011 | 704,786 |
| 2012 and after | 2,813,516 |

Rental expenses under all operating leases including those on month-to-month terms totaled approximately \$804,196 and \$711,261 for the years ended June 30, 2007, and 2006, respectively. This includes \$87,551 and \$63,463 of vehicle rental expense to the State Fleet management.

NOTE 9 - DUE TO EDUCATION LOTTERY ACCOUNT

In accordance with the Act, all net proceeds of the Commission are to be transferred to the Education Lottery Account 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 transfers due to the Education Lottery Account at June 30:

| | <u>2007</u> | <u>2006</u> |
|--|-----------------------------|-----------------------------|
| Amount payable to the Education Lottery Account, beginning of year | \$ 10,939,754 | \$ 21,244,269 |
| Change in net assets subject to transfer | <u>277,111,333</u> | <u>318,863,032</u> |
| | <u>288,051,087</u> | <u>340,107,301</u> |
| Change in capital assets, net of related debt | | |
| Capital assets, net | 2,923,114 | 3,141,658 |
| Long-term debt | <u>(882,359)</u> | <u>(1,334,861)</u> |
| | <u>2,040,755</u> | <u>1,806,797</u> |
| Net amount (collected for) paid from fidelity fund | <u>84,297</u> | <u>(39,900)</u> |
| Amount paid during the year | <u>(268,328,057)</u> | <u>(330,934,444)</u> |
| Amount payable to the Education Lottery Account, end of year | <u>\$ 21,848,082</u> | <u>\$ 10,939,754</u> |

Net proceeds transfers related to the above payable were made to the Education Lottery Account in July 2007, and 2006, 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 | 8.05% of salary |
| Insurance surcharge | 3.35% of salary |
| Group life insurance | .15% of salary |

For the years ending June 30, 2007, 2006, and 2005 the Commission contributions to SCRS were \$844,606, \$721,520, and \$710,153 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, 2007.

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.

NOTE 11 - 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, 2007.

NOTE 12 -TRANSACTIONS WITH STATE ENTITIES AND RELATED PARTIES

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 | Transfers 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 |

For the year ended June 30, 2006, 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 | \$ 6,152,393 | Transfers of state tax withholding, use taxes and debt setoffs |
| SLED | 277,926 | Security services and fees paid for background checks on employees and retailers |
| South Carolina State Treasurer | 330,934,444 | Transfers of net proceeds and unclaimed prizes |
| South Carolina State Treasurer | 8,551,465 | Transfer of payroll funds for processing |
| Comptroller General | 30,000 | Fees for payroll processing |
| Comptroller General | 24,648 | Unemployment compensation premium |
| South Carolina Budget & Control Board | 251,828 | Insurance, telephone, printing, misc. services |
| Prison Industries-Department of Corrections | 5,679 | Recycling services and office furniture |
| South Carolina Department of Social Services | 12,183 | Debt setoffs withheld from prize winnings |
| South Carolina Department of Public Safety | 306,181 | Security services |
| SC Legislative Audit Council | 116,426 | Legislative audit of commission operations |
| CB Richard Ellis | 485,215 | Rent for offices used in commission operations, building owned by commission chair |

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

| | For the years ended | |
|---------------------------------------|----------------------------|----------------------------|
| | June 30, | |
| | 2007 | 2006 |
| Charges for services | \$ 991,739,055 | \$ 1,147,851,700 |
| Operating grants and contributions | 1,245,391 | 1,246,114 |
| Less expenses | <u>715,873,113</u> | <u>830,234,782</u> |
| Net program revenue | 277,111,333 | 318,863,032 |
| Transfers out to state agencies/funds | <u>(279,236,385)</u> | <u>(320,629,929)</u> |
| Change in net assets | (2,125,052) | (1,766,897) |
| NET ASSETS - BEGINNING | <u>5,181,271</u> | <u>6,948,168</u> |
| NET ASSETS - ENDING | <u>\$ 3,056,219</u> | <u>\$ 5,181,271</u> |

**INDEPENDENT AUDITORS' 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 discretely presented component unit of the State of South Carolina (the State), as of and for the year ended June 30, 2007 and 2006, and have issued our report thereon dated September 7, 2007. 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.

Columbia, South Carolina
September 7, 2007

***SOUTH CAROLINA EDUCATION LOTTERY COMMISSION
SCHEDULE OF FINDINGS
For the years ended June 30, 2007 and 2006***

I. SUMMARY OF AUDITORS' RESULTS

We have issued an unqualified opinion, dated September 7, 2007 on the financial statements of the Commission as of and for the year ended June 30, 2007 and 2006.

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*.