

Audited Financial Statements  
With Other Financial Information

West Virginia Lottery

Years Ended June 30, 2013 and 2012

WEST VIRGINIA LOTTERY

Audited Financial Statements  
With Other Financial Information

Years Ended June 30, 2013 and 2012

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## INDEPENDENT AUDITOR'S REPORT

West Virginia Lottery Commission  
Charleston, West Virginia

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

We have audited the accompanying financial statements of the West Virginia Lottery (the Lottery), a component unit of the State of West Virginia, as of and for the years ended June 30, 2013 and 2012, and the related notes to the financial statements, which collectively comprise the Lottery's basic financial statements as listed in the table of contents.

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

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

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

Our responsibility is to express an opinion on these financial statements based on our 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 audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

### ***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the West Virginia Lottery, as of June 30, 2013 and 2012, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.



## Other Matters

### *Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 10 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

### *Other Information*

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Lottery's basic financial statements. The accompanying schedule on page 38 is presented for purposes of additional analysis and is not a required part of the basic financial statements.

The accompanying schedule on page 38 is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the accompanying schedule on page 38 is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

## Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated September 19, 2013 on our consideration of the Lottery's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Lottery's internal control over financial reporting and compliance.

Charleston, West Virginia  
September 19, 2013

## Management's Discussion and Analysis

-Unaudited-

Our discussion of the West Virginia Lottery's (the Lottery) financial performance provides for an overview of the Lottery's financial activities for the fiscal years ended June 30, 2013 and 2012. In reading the Management's Discussion and Analysis (MD & A), the current year refers to fiscal year ending June 30, 2013, and the prior year refers to fiscal year ending June 30, 2012. This analysis is to be considered in conjunction with the financial statements, which begin on page 11.

### **Financial Highlights**

The Lottery's operating income decreased in 2013 and increased in 2012. The 2013 decrease was due to competition from expanded gaming activities in neighboring states. The increase in 2012 was due to Limited Video Lottery bid fees for permits issued for the second 10-year period beginning July 1, 2013. The following summary is provided below:

- Lottery revenues for the current year decreased \$129.2 million or 8.9% compared to the prior year, which increased \$65.1 million or 4.7% from 2011.
- Commissions for the current year decreased \$59.8 million or 8.9% compared to the prior year, which increased \$28.7 million or 4.4% from 2011.
- Gross profit for the current year decreased \$64.3 million or 9.9% compared to the prior year, which increased \$36.4 million or 5.9% from 2011.
- Nonoperating expenses decreased \$122.1 million or 17.6% compared to the prior year, which increased \$99.4 million or 16.7% from 2011. The predominant nonoperating expense is the distributions to the State of West Virginia, which decreased \$117.8 million or 17.8% compared to the prior year, which increased \$97.7 million or 17.3% from 2011.

### **Using This Annual Report**

The Lottery is a component unit of the State of West Virginia, and is accounted for as a proprietary type enterprise fund using the accrual basis of accounting much like a private business entity. As such, this report consists of a series of financial statements, along with explanatory notes to the financial statements. To assess the Lottery's financial position, the reader of these statements should pay particular attention to changes in the components of assets and liabilities as set forth in the Statements of Net Position and changes in operating revenues, expenses and nonoperating distributions to the State of West Virginia as set forth in the Statements of Revenues, Expenses and Changes in Fund Net Position.

### **Statements of Net Position**

As shown in Table 1, current assets for the current year increased \$31.0 million or 11.1% compared to the prior year, which decreased \$50.4 million or 15.2% from 2011, due to the timing of distributions to the State of West Virginia at year-end.

Restricted net position continued to decrease as a result of activities related to capital spending for the Lottery headquarters building and the accrued distribution of surplus funds from the revenue center construction fund. See Note 11 to the financial statements for additional information on restricted net position.

Capital assets, net of accumulated depreciation and amortization, decreased in the current year by \$2.1 million or 4.9% compared to the prior year due to depreciation of the Lottery headquarters building which increased by \$11.9 million or 39.0% from the prior year compared to 2011 due to the improvements made to the Lottery headquarters building. For additional information on capital assets, please refer to Note 4 to the financial statements.

**Management's Discussion and Analysis**  
(Continued)

-Unaudited-

**Statements of Net Position (Continued)**

**Table 1**  
Assets  
(in \$000's)

	2013	2012	2011
Current assets	\$ 312,032	\$ 280,994	\$ 331,382
Restricted assets	1,640	2,373	4,324
Capital assets, net of accumulated depreciation and amortization	<u>40,220</u>	<u>42,285</u>	<u>30,421</u>
Total assets	<u>\$ 353,892</u>	<u>\$ 325,652</u>	<u>\$ 366,127</u>

As shown in Table 2, the Lottery's current liabilities for the current year increased \$25.3 million or 9.3% compared to the prior year, which decreased \$53.4 million or 16.3% compared to 2011 due to the Limited Video Lottery bid fees that were reflected as deferred revenue until the new permits became effective on July 1, 2011. The increase in current year liabilities was due to the accumulation of prior year surplus transfers to the State of West Virginia combined with current year accrued transfers.

Net position - restricted by enabling legislation decreased due to the refurbishing of the Lottery headquarters building. See Note 11 to the financial statements for additional information on restricted net position.

Net position - net investment in capital assets decreased in the current year by \$2.1 million or 4.9% compared to the prior year as a result of depreciation which increased by \$11.9 million or 39.0% in the prior year compared to 2011 due to refurbishing the Lottery headquarters building. Refer to Note 4 to the financial statements for additional information on capital assets.

Net position - unrestricted changed in fiscal years 2013, 2012, and 2011 as a result of rental income from tenants located at the Lottery headquarters building and the Lottery's administrative allowance from table games exceeding the actual operating expenses.

**Table 2**  
Liabilities and Net Position  
(in \$000's)

	2013	2012	2011
Current liabilities	\$ 299,026	\$ 273,677	\$ 327,055
Net position - restricted by enabling legislation	1,640	1,690	2,039
Net position - net investment in capital assets	40,220	42,285	30,421
Net position - unrestricted	<u>13,006</u>	<u>8,000</u>	<u>6,612</u>
Total net position	<u>54,866</u>	<u>51,975</u>	<u>39,072</u>
Total liabilities and net position	<u>\$ 353,892</u>	<u>\$ 325,652</u>	<u>\$ 366,127</u>

**Management's Discussion and Analysis**  
(Continued)

-Unaudited-

**Revenues, Expenses and Changes in Fund Net Position**

The content of Table 3 is a summary of activities and is related to the discussion of Table 4.

**Table 3**  
Revenues, Expenses and Changes in Fund Net Position  
(in \$000's)

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Revenues:			
On-line games	\$ 86,986	\$ 83,613	\$ 77,870
Instant games	108,635	117,676	115,697
Racetrack video lottery	655,676	764,898	726,952
Limited video lottery	399,224	406,108	397,544
Table games	70,259	78,121	68,154
Historic resort	<u>7,597</u>	<u>7,114</u>	<u>6,232</u>
	1,328,377	1,457,530	1,392,449
Less commissions:			
On-line games	6,095	5,844	5,457
Instant games	7,604	8,239	8,098
Racetrack video lottery	370,828	424,049	404,945
Limited video lottery	195,620	198,993	194,797
Table games	30,675	33,571	29,288
Historic resort	<u>3,705</u>	<u>3,671</u>	<u>3,126</u>
	614,527	674,367	645,711
Less on-line prize costs	44,109	42,039	40,374
Less instant ticket prize costs	72,121	78,567	80,333
Less ticket costs	1,804	2,188	2,275
Less vendor fees and costs	<u>8,325</u>	<u>8,611</u>	<u>8,372</u>
	126,359	131,405	131,354
Gross profit	587,491	651,758	615,384
Administrative expenses:			
Advertising and promotions	4,622	5,680	9,481
Wages and related benefits	11,049	12,774	11,978
Telecommunications	983	761	648
Contractual and professional	4,421	5,452	4,588
Rental	239	423	649
Depreciation and amortization	2,095	1,164	1,501
Other administrative expenses	<u>1,454</u>	<u>1,936</u>	<u>1,346</u>
	24,863	28,190	30,191
Other operating income	<u>11,860</u>	<u>73,351</u>	<u>11,805</u>
Operating income	574,488	696,919	596,998
Nonoperating income (expense):			
Investment income	253	181	297
Distributions to municipalities and counties	(7,825)	(7,960)	(7,792)
Distributions for capital reinvestment	(18,821)	(22,900)	(21,558)
Distributions to the State of West Virginia	<u>(545,204)</u>	<u>(662,982)</u>	<u>(565,256)</u>
	(571,597)	(693,661)	(594,309)
Income before capital contribution	2,891	3,258	2,689

**Management's Discussion and Analysis**  
(Continued)

-Unaudited-

**Revenues, Expenses and Changes in Fund Net Position (Continued)**

**Table 3 (Continued)**  
Revenues, Expenses and Changes in Fund Net Position  
(in \$000's)

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Capital contribution from the State of WV	-	9,645	-
Net income	2,891	12,903	2,689
Net position, beginning of year	<u>51,975</u>	<u>39,072</u>	<u>36,383</u>
Net position, end of year	<u>\$ 54,866</u>	<u>\$ 51,975</u>	<u>\$ 39,072</u>

**Sales and Prizes, Commissions, Ticket Costs and Vendor Fees**

Table 4 compares sales (referred to as lottery revenues in financial statements), prizes, commissions, ticket printing costs, vendor fees and costs and gross profit for each lottery game category for fiscal years 2013, 2012, and 2011. Sales and gross profits fluctuated in certain categories; however, gross profit percentages remained consistent from year to year.

**Table 4**  
Lottery Sales  
(in \$000's)

	<u>Instant</u>			<u>On-Line*</u>		
	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>
Gross sales	\$ 108,635	\$ 117,676	\$ 115,697	\$ 86,986	\$ 83,613	\$ 77,870
Less direct costs:						
Prizes and bonuses	72,121	78,567	80,333	44,109	42,039	40,374
Commissions	7,604	8,239	8,098	6,095	5,844	5,457
Ticket printing costs	1,804	2,188	2,275	-	-	-
Vendor fees and costs	4,537	5,038	4,987	3,788	3,573	3,385
Total direct costs	<u>86,066</u>	<u>94,032</u>	<u>95,693</u>	<u>53,992</u>	<u>51,456</u>	<u>49,216</u>
Gross profit	<u>\$ 22,569</u>	<u>\$ 23,644</u>	<u>\$ 20,004</u>	<u>\$ 32,994</u>	<u>\$ 32,157</u>	<u>\$ 28,654</u>
Gross profit percentage	<u>20.8%</u>	<u>20.1%</u>	<u>17.3%</u>	<u>37.9%</u>	<u>38.5%</u>	<u>36.8%</u>
* On-line games include the results of Powerball® and Mega Millions which are significant components of the results described above.						
	<u>Racetrack Video Lottery</u>			<u>Limited Video Lottery</u>		
	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>
Gross sales	\$ 655,676	\$ 764,898	\$ 726,952	\$ 399,224	\$ 406,108	\$ 397,544
Less direct costs:						
Prizes and bonuses	-	-	-	-	-	-
Commissions	370,828	424,049	404,945	195,620	198,993	194,797
Ticket printing costs	-	-	-	-	-	-
Vendor fees and costs	-	-	-	-	-	-
Total direct costs	<u>370,828</u>	<u>424,049</u>	<u>404,945</u>	<u>195,620</u>	<u>198,993</u>	<u>194,797</u>
Gross profit	<u>\$ 284,848</u>	<u>\$ 340,849</u>	<u>\$ 322,007</u>	<u>\$ 203,604</u>	<u>\$ 207,115</u>	<u>\$ 202,747</u>
Gross profit percentage	<u>43.4%</u>	<u>44.6%</u>	<u>44.3%</u>	<u>51.0%</u>	<u>51.0%</u>	<u>51.0%</u>

**Management's Discussion and Analysis**  
(Continued)

-Unaudited-

**Sales and Prizes, Commissions, Ticket Costs and Vendor Fees (Continued)**

**Table 4**  
Lottery Sales  
(in \$000's)

	Table Games			Historic Resort			Total		
	2013	2012	2011	2013	2012	2011	2013	2012	2011
Gross sales	\$70,259	\$78,121	\$68,154	\$7,597	\$7,114	\$6,232	\$ 1,328,377	\$ 1,457,530	\$ 1,392,449
Less direct costs:									
Prizes and bonuses	-	-	-	-	-	-	116,230	120,606	120,707
Commissions	30,675	33,571	29,288	3,705	3,671	3,126	614,527	674,367	645,711
Ticket printing costs	-	-	-	-	-	-	1,804	2,188	2,275
Vendor fees and costs	-	-	-	-	-	-	8,325	8,611	8,372
Total direct costs	<u>30,675</u>	<u>33,571</u>	<u>29,288</u>	<u>3,705</u>	<u>3,671</u>	<u>3,126</u>	<u>740,886</u>	<u>805,772</u>	<u>777,065</u>
Gross profit	<u>\$ 39,584</u>	<u>\$ 44,550</u>	<u>\$ 38,866</u>	<u>\$ 3,892</u>	<u>\$ 3,443</u>	<u>\$ 3,106</u>	<u>\$ 587,491</u>	<u>\$ 651,758</u>	<u>\$ 615,384</u>
Gross profit percentage	<u>56.3%</u>	<u>57.0%</u>	<u>57.0%</u>	<u>51.2%</u>	<u>48.4%</u>	<u>49.8%</u>	<u>44.2%</u>	<u>44.7%</u>	<u>44.2%</u>

**Instant Sales**

Instant ticket sales for the current year decreased by \$9.0 million or 7.7% compared to the prior year, which increased \$2.0 million or 1.7% from 2011. Forty-six new games were introduced in 2013 and approximately twenty-four game options were available for play in the field in both years. The Lottery continues to implement the results of research and design efforts, including licensed or trademarked games, new play styles and continued monitoring of the mix of play styles and colors closely to create the best variety of game presentation available at one time. There was one ten-dollar ticket introduced in 2013. Four five-dollar games were introduced in 2013.

Instant prizes and commissions have a direct correlation to sales, therefore, as sales increase, so do the related prizes and commissions paid by the Lottery. Prize expenses for instant games are controllable by designing and printing a predetermined number and value of winning tickets. While each game has a designed prize payout structure, the overall amount paid as prize expense is consistent.

Vendor fees and costs are primarily 4.3% of instant and on-line ticket sales for 2013, 2012, and 2011. The Lottery (as is the case with most lotteries located in North America) has elected to enter into a long-term contract with a vendor to provide a central computer system, retailer terminals and related equipment to sell and cash all tickets for instant and on-line games.

**Powerball® Sales**

Powerball® is a \$2 Multi-State (MUSL) Lottery game designed to grow large jackpot amounts, with occasional jackpots in excess of \$400 million. Sales for the current year increased \$10.0 million or 25.9% compared to the prior year, which increased \$3.0 million or 8.5% from 2011. Sales are generally driven by the jackpot size.

Prize costs are 50% of sales and over time such prize payouts generally reflect the design of the game and the related mathematical odds of winning.

Traditional retailers are those retailers licensed by the Lottery to sell instant and on-line games (which includes Powerball®) and by statute were paid 7% of such sales.

## Management's Discussion and Analysis (Continued)

-Unaudited-

### **Mega Millions® Sales**

Mega Millions sales offers jackpots starting at \$12 million and other prizes ranging from \$2 to \$250,000. Sales for the current year decreased \$5.5 million or 37.1% compared to the prior year, which increased \$3.8 million or 35.1% from 2011.

Approximately 50% of every dollar wagered goes back to the players in prizes and by statute 7% of sales are paid to retailer commissions.

### **All Other On-line Games**

All other on-line games consist of Daily 3, Daily 4, Cash 25, Travel Keno and the Multi-State game Hot Lotto™. Sales for the current year decreased \$1.2 million or 3.8% compared to the prior year, which decreased \$1.1 million or 3.5% from 2011.

In general, prize costs by game will increase or decrease from year-to-year in proportion to the sales for a particular game. Prizes and commissions have remained consistent as presented in Table 4.

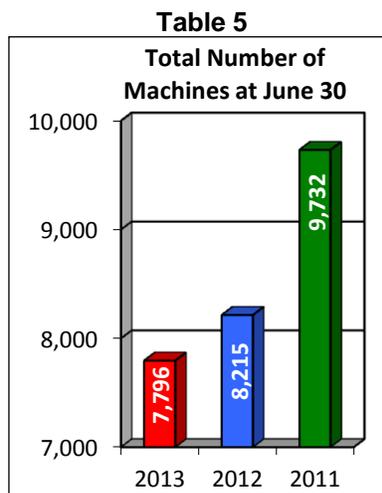
### **Racetrack Video Lottery**

Racetrack video lottery revenues are reported as total wagers net of prizes and credits. Revenues for the current year decreased \$109.2 million or 14.3% compared to the prior year, which increased \$37.9 million or 5.2% from 2011.

A portion of racetrack video lottery sales, as prescribed by statute, are paid to racetracks and other private entities associated with the racing industry and are reported as commissions. See Note 6 to the financial statements for further discussion of racetrack video lottery distributions. Commissions in the current year decreased \$53.2 million or 12.6% compared to the prior year due to competition from neighboring states which increased \$19.1 million or 4.7% compared to 2011 due to mild weather conditions and an improved economy.

In following with industry trends, "coin drop" machines have been phased out in favor of ticket in ticket out (TITO) machines. The TITO machines have helped to lessen the decline in racetrack video lottery revenues from competition.

In fiscal year 2013, increased competition from gaming operations in neighboring states has led the racetracks to re-evaluate their gaming environments which have resulted in changes to the gaming floors. The changes in active machines are presented in Table 5 below which illustrates the last three fiscal years.



## Management's Discussion and Analysis (Continued)

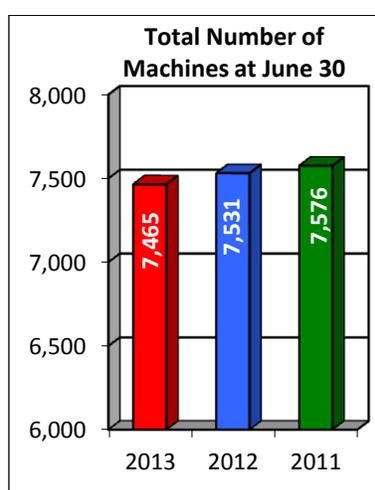
-Unaudited-

### Limited Video Lottery

Sales for the current year decreased \$6.9 million or 1.7% compared to the prior year, which increased \$8.6 million or 2.2% from 2011. Commissions are paid to operators and retailers as provided for by statute and have a direct correlation to changes in sales. For the current year, commissions decreased \$3.4 million or 1.7% compared to the prior year increase of \$4.2 million or 2.2% from 2011.

Table 6 illustrates the number of machines which decreased by 66 machines for the current year compared to the prior year decrease of 45 machines from 2011.

**Table 6**



### Table Games

Revenues from table games are calculated at a 35% privilege tax of adjusted gross receipts. Revenues for the current year decreased \$7.9 million or 10.1% compared to the prior year, which increased \$10.0 million or 14.6% from 2011.

All table games revenues are distributed according to statute. A portion of table games revenues are paid to entities associated with the racetracks and are reported as commissions. See Note 8 to the financial statements. Commissions for the current year decreased \$2.9 million or 8.6% compared to the prior year, which increased \$4.3 million or 14.6% from 2011.

### Historic Resort

Video Lottery revenues from Historic Resort are calculated as defined in Note 9 to the financial statements. Revenues from Historic Resort table games are calculated at a 35% privilege tax of adjusted gross receipts.

Combined revenues of video lottery and table games at the Historic Resort for the current year increased \$483 thousand or 6.8% compared to the prior year, which increased \$882 thousand or 14.2% from 2011.

All revenues are distributed according to statute. A portion of revenues are paid to entities associated with the Historic Resort and are reported as commissions. Commissions for the current year increased \$34 thousand or 0.9% compared to the prior year, which increased \$545 thousand or 17.4% from 2011.

## Management's Discussion and Analysis (Continued)

-Unaudited-

### **Other Operating Income**

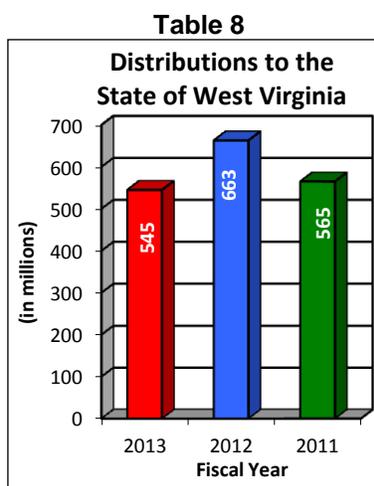
Refer to Table 3. Changes in other operating income are primarily related to fees collected for the permitting and licensure of manufacturers, operators, retailers and service technicians. Every May 1, a \$1,000 permit fee is assessed on each limited video lottery permit held by operators and retailers.

### **Nonoperating Income (Expense)**

Refer to Table 3. Nonoperating expenses reflect a 2% distribution to counties and incorporated municipalities of net terminal income from limited video lottery operations. This distribution will fluctuate with any changes in limited video lottery revenues.

A portion of net revenue from racetrack video lottery is accrued and distributed to each racetrack for capital improvements.

Refer to Table 8. The Lottery's distributions to the State of West Virginia for the current fiscal year decreased by \$117.8 million compared to the prior year, which increased by \$97.7 million from 2011.



### **Net Income**

In March 2011, the Lottery entered into a construction commitment for the renovation of its newly acquired headquarters. It was determined that the Lottery's resources were insufficient to satisfy the terms of the construction commitment. For the year ended June 30, 2012, the West Virginia Legislature appropriated an additional \$9.6 million to the Lottery from the Revenue Center Construction Fund to satisfy the requirements of the construction commitment. This amount is reflected as a capital contribution on the Statements of Revenues, Expenses, and Changes in Fund Net Position.

### **Requests for Information**

This financial report is designed to provide a general overview of the Lottery's operations. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to Deputy Director of Finance and Administration, West Virginia Lottery, 900 Pennsylvania Avenue, Charleston WV 25302.

WEST VIRGINIA LOTTERY  
STATEMENTS OF NET POSITION  
(In Thousands)

June 30, 2013 and 2012

<u>ASSETS</u>	<u>2013</u>	<u>2012</u>
Current assets:		
Cash and cash equivalents	\$ 273,418	\$ 241,538
Accounts receivable	35,999	36,671
Inventory	492	510
Other assets	<u>2,123</u>	<u>2,275</u>
Total current assets	<u>312,032</u>	<u>280,994</u>
Noncurrent assets:		
Restricted cash and cash equivalents	1,640	2,373
Capital assets	46,846	46,816
Less accumulated depreciation and amortization	<u>(6,626)</u>	<u>(4,531)</u>
Total noncurrent assets	<u>40,220</u>	<u>42,285</u>
Total noncurrent assets	<u>41,860</u>	<u>44,658</u>
Total assets	<u>\$ 353,892</u>	<u>\$ 325,652</u>
 <u>LIABILITIES</u>		
Current liabilities:		
Accrued nonoperating distributions to the State of West Virginia	\$ 239,035	\$ 216,819
Estimated prize claims	14,144	13,372
Accounts payable	1,828	3,238
Other accrued liabilities	<u>44,019</u>	<u>40,248</u>
Total current liabilities	<u>\$ 299,026</u>	<u>\$ 273,677</u>
 <u>NET POSITION</u>		
Net position:		
Restricted by enabling legislation	\$ 1,640	\$ 1,690
Net investment in capital assets	40,220	42,285
Unrestricted	<u>13,006</u>	<u>8,000</u>
Total net position	<u>\$ 54,866</u>	<u>\$ 51,975</u>

The accompanying notes are an integral part of these financial statements.

## WEST VIRGINIA LOTTERY

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND NET POSITION  
(In Thousands)

Years Ended June 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
Lottery revenues:		
On-line games	\$ 86,986	\$ 83,613
Instant games	108,635	117,676
Racetrack video lottery	655,676	764,898
Limited video lottery	399,224	406,108
Table games	70,259	78,121
Historic resort	7,597	7,114
	<u>1,328,377</u>	<u>1,457,530</u>
Less commissions:		
On-line games	6,095	5,844
Instant games	7,604	8,239
Racetrack video lottery	370,828	424,049
Limited video lottery	195,620	198,993
Table games	30,675	33,571
Historic resort	3,705	3,671
	<u>614,527</u>	<u>674,367</u>
Less on-line prize costs	44,109	42,039
Less instant prize costs	72,121	78,567
Less ticket costs	1,804	2,188
Less vendor fees and costs	8,325	8,611
	<u>126,359</u>	<u>131,405</u>
Gross profit	<u>587,491</u>	<u>651,758</u>
Administrative expenses:		
Advertising and promotions	4,622	5,680
Wages and related benefits	11,049	12,774
Telecommunications	983	761
Contractual and professional	4,421	5,452
Rental	239	423
Depreciation and amortization	2,095	1,164
Other administrative expenses	1,454	1,936
	<u>24,863</u>	<u>28,190</u>
Other operating income	<u>11,860</u>	<u>73,351</u>
Operating income	<u>574,488</u>	<u>696,919</u>
Nonoperating income (expense):		
Investment income	253	181
Distributions to municipalities and counties	(7,825)	(7,960)
Distributions for capital reinvestment	(18,821)	(22,900)
Distributions to the State of West Virginia	(545,204)	(662,982)
	<u>(571,597)</u>	<u>(693,661)</u>
Income before capital contribution	<u>2,891</u>	<u>3,258</u>
Capital contribution from the State of WV	<u>-</u>	<u>9,645</u>
Net income	<u>2,891</u>	<u>12,903</u>
Net position, beginning of year	<u>51,975</u>	<u>39,072</u>
Net position, end of year	<u>\$ 54,866</u>	<u>\$ 51,975</u>

The accompanying notes are an integral part of these financial statements.

## WEST VIRGINIA LOTTERY

STATEMENTS OF CASH FLOWS  
(In Thousands)

Years Ended June 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
Cash flows from operating activities:		
Cash receipts from customers and other sources	\$ 1,340,909	\$ 1,465,130
Cash payments for:		
Personnel costs	(10,960)	(11,402)
Suppliers	(12,852)	(16,229)
Other operating costs	<u>(738,824)</u>	<u>(809,710)</u>
Cash provided by operating activities	<u>578,273</u>	<u>627,789</u>
Cash flows from noncapital financing activities:		
Nonoperating distributions to the State of West Virginia	(522,988)	(647,508)
Distributions to municipalities and counties	(7,855)	(7,927)
Distributions to racetracks from racetrack capital reinvestment fund	<u>(16,506)</u>	<u>(18,888)</u>
Cash used in noncapital financing activities	<u>(547,349)</u>	<u>(674,323)</u>
Cash flows from capital and related financing activities		
Purchases of capital assets	<u>(30)</u>	<u>(13,028)</u>
Cash flows from investing activities:		
Investment earnings	<u>253</u>	<u>181</u>
Increase (decrease) in cash and cash equivalents	31,147	(59,381)
Cash and cash equivalents (including restricted cash and cash equivalents), beginning of year	<u>243,911</u>	<u>303,292</u>
Cash and cash equivalents (including restricted cash and cash equivalents), end of year	<u>\$ 275,058</u>	<u>\$ 243,911</u>

(Continued)

WEST VIRGINIA LOTTERY  
 STATEMENTS OF CASH FLOWS  
 (In Thousands)  
 (Continued)

Years Ended June 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 574,488	\$ 696,919
Adjustments to reconcile operating income to cash provided by operating activities:		
Depreciation and amortization	2,095	1,164
Changes in operating assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	672	(6,888)
Inventory	18	(13)
Other assets	152	(141)
Increase (decrease) in:		
Estimated prize claims	772	1,361
Accounts payable	(1,410)	(1,202)
Deferred permit fees	-	(58,863)
Other accrued liabilities	<u>1,486</u>	<u>(4,548)</u>
Cash provided by operating activities	<u>\$ 578,273</u>	<u>\$ 627,789</u>
Schedule of non-cash investing and financing activities:		
Capital contributions from the State of West Virginia	<u>\$ -</u>	<u>\$ 9,645</u>

The accompanying notes are an integral part of these financial statements.

WEST VIRGINIA LOTTERY  
NOTES TO FINANCIAL STATEMENTS

## 1 - LEGISLATIVE ENACTMENT

The West Virginia Lottery (the Lottery) was established by the State Lottery Act (the Act) passed April 13, 1985, which created a fund in the State Treasury designated as the "State Lottery Fund." The purpose of the Act was to establish and implement a state-operated lottery under the supervision of a state lottery commission (the Commission) and a Director. The Commission, consisting of seven members, and the Director are appointed by the Governor. Under the Act, the Commission has certain powers and the duty to establish rules for conducting games, to select the type and number of gaming systems or games, to enter into contracts and agreements, and to do all acts necessary or incidental to the performance of its duties and exercise of its power and duty to operate the Lottery in a highly efficient manner. The Act provides that a minimum annual average of 45% of the gross amount received from each lottery shall be allocated for prizes and also provides for certain limitations on expenses necessary for operation and administration of the Lottery. To the extent available, remaining net profits are to be distributed to the State of West Virginia (the State) and local governments as required by law. As the State is able to impose its will over the Lottery, the Lottery is considered a component unit of the State and its financial statements are presented in the comprehensive annual financial report of the State as a discretely presented component unit.

## 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Basis of Presentation

The West Virginia Lottery is accounted for as a proprietary fund special purpose government engaged in business type activities. In accordance with accounting principles generally accepted in the United States of America for governmental entities, the financial statements are prepared on the accrual basis of accounting which requires recognition of revenue when earned and expenses when incurred.

### Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make certain estimates and develop assumptions that affect the amounts reported in the financial statements and related notes to financial statements. Actual results could differ from management's estimates.

### Lottery Game Operations

The West Virginia Lottery derives its revenues from four basic types of lottery games: instant, on-line, video type games, and table games. The Lottery develops multiple game themes and prize structures to comply with its enabling legislation, including aggregate annual minimum prize provisions. All bonded retailers and agents comprised principally of grocery and convenience stores serve as the primary distribution channel for instant and on-line lottery sales to the general public.

The Lottery has contracted with a private vendor to manufacture, distribute, and provide data processing support for instant and on-line lottery games. Under the terms of the agreements, the Lottery pays a percentage of gross revenues for the processing and manufacturing of the games.

Revenue from instant games is recognized when game tickets are sold to the retailers, and the related prize expense is recorded based on the specific game prize structure. Instant ticket sales and related prizes do not include the value of free plays issued for the purpose of increasing the odds of winning a prize.

WEST VIRGINIA LOTTERY  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

**2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Lottery Game Operations (Continued)

Sales of on-line lottery tickets are made by licensed agents to the public with the use of computerized terminals. On-line games include POWERBALL®, a multi-state “jackpot” game; HOT LOTTO™, a multi-state “lotto” game; MEGA MILLIONS®, a multi-state lotto game; Cash25 “lotto” game; Daily 3 and 4 “numbers” games; and Travel, an online “keno” game. Revenue is recognized when the agent sells the tickets to the public. Prize expense is recognized on the basis of actual drawing results.

Commissions are paid to instant game retailers and on-line agents at the rate of seven percent of gross sales. A portion of the commission not to exceed one and one quarter percent of gross sales may be paid from unclaimed prize moneys. The amount paid from unclaimed prize moneys is credited against prize costs. In addition, retailers and agents are paid limited bonus incentives that include prize shares on winning tickets they sold and a ticket cashing bonus on winning tickets they cash. On a weekly basis, retailers and agents must remit amounts due to the Lottery. Retailers may not be able to order additional instant tickets if payment has not been made for the previous billing period, while an agent's on-line terminal may be rendered inactive if payment is not received. No one retailer or agent accounts for a significant amount of the Lottery's sales or accounts receivable. Historically credit losses have been nominal and no allowance for doubtful accounts receivable is considered necessary.

Racetrack video lottery is a self-activated video version of lottery games. The board-operated games allow a player to place bets for the chance to be awarded credits which can either be redeemed for cash or be replayed as additional bets. The games allow a player to use coins, currency, tokens, or tickets, to place bets for the chance to receive coins, tokens, or ticket awards which may be redeemed for cash or used for replay in the games. The racetrack video lottery games' prize structures are designed to award prizes, or credits, at a stipulated rate of total bets played, and prize expense is netted against total video credits played. The Lottery recognizes as racetrack video lottery revenue “gross terminal income” equivalent to all wagers, net of related prizes. Amounts required by statute to be paid to private and local government entities are reported as commissions.

Racetrack video lottery legislation has established specific requirements for racetrack video lottery and imposed certain restrictions limiting the licensing for the operation of racetrack video lottery games to horse and dog racetracks in West Virginia, subject to local county elections permitting the same. The legislation further stipulates the distribution of revenues from racetrack video lottery games, and requires any licensed racetrack to be responsible for acquiring the necessary equipment and bearing the risk associated with the costs of operating and marketing the games.

Limited video lottery is also a self-activated video version of lottery games located in limited licensed retailer areas restricted for adult amusement. The games allow a player to use currency to place bets for the chance to receive free games or vouchers which may be redeemed for cash. The limited video lottery games' prize structures are designed to award prizes, at a stipulated rate of total bets played, and prize expense is netted against total video credits played. The Lottery recognizes as limited video lottery revenue “gross terminal income” equivalent to all wagers, net of related prizes. Amounts required by statute to be paid to private entities are reported as commissions. Limited video lottery permit holders are statutorily responsible for acquiring equipment and bearing the risk associated with the costs of operating the games.

WEST VIRGINIA LOTTERY  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

**2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Lottery Game Operations (Continued)

Table games legislation has established specific requirements for table games and imposed certain restrictions limiting the licensing for operation of table games to horse and dog racetracks and a historic resort in West Virginia, subject to local county elections permitting the same. Each location licensed as an agent of the Commission to operate West Virginia table games shall have written rules of play for each table game it operates which must be approved by the Commission. All wagers and pay-offs of winning wagers shall be made according to those rules of play. For the privilege of holding a table games license, there is levied a privilege tax of thirty-five percent of each licensee's adjusted gross receipts from the operation of Lottery table games which the Lottery records as revenue. Amounts required by statute to be paid to private and local government entities are reported as commissions. The legislation further stipulates the distribution of revenues from West Virginia table games, and requires any licensed location to be responsible for acquiring the necessary equipment and bearing the risk associated with the costs of operating and marketing the games.

Historic resort lottery games are a combination of self-activated video lottery games as well as table games which are located at a licensed historic resort hotel as defined by the WV Code. Video lotteries at the historic resort are board-operated games that allow a player to place bets for the chance to be awarded credits which can either be redeemed for cash or be replayed as additional bets. The video lottery games allow a player to use coins, currency, tokens, or tickets, to place bets for the chance to receive coins, tokens, or ticket awards which may be redeemed for cash or used for replay in the games.

The historic resort video lottery games' prize structures are designed to award prizes, or credits, at a stipulated rate of total bets played, and prize expense is netted against total video credits played. The Lottery recognizes video lottery revenue consisting of "gross terminal income" equivalent to all wagers, net of related prizes; and historic resort table games revenue consisting of a privilege tax of thirty-five percent of adjusted gross receipts for the operation of table game as historic resort lottery revenues.

Amounts required by statute to be paid to the private and local government entities are reported as commissions. The Lottery Act as amended has established specific requirements for historic resort video and table games lotteries and imposed certain restrictions limiting the licensing for operation of historic resort lottery games in West Virginia, subject to local county elections permitting the same. The legislation further stipulates the distribution of revenues from historic resort lottery games, and requires the licensed historic resort to be responsible for acquiring the necessary equipment and bearing the risk associated with the costs of operating and marketing the games.

Cash and Cash Equivalents

Cash and cash equivalents consist primarily of deposits on hand with the State Treasurer of West Virginia and interest-earning deposits in a State internal investment pool maintained by the West Virginia Board of Treasury Investments (BTI). The BTI pool is a 2a-7-like pool carried at amortized cost which approximates the fair value of the underlying securities.

Inventory

Inventory consists of instant game tickets available for sale to approved Lottery retailers and are carried at cost as determined by the specific identification method.

WEST VIRGINIA LOTTERY  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

**2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Other Assets

Other assets consist of deposits restricted for payment of certain Multi-State Lottery Association activities and prepaid expenses.

Capital Assets

The Lottery has adopted a policy of capitalizing assets with individual amounts exceeding \$25,000 and a useful life greater than one year. These assets include a building, leasehold improvements, and purchased equipment comprised principally of technology property, office furnishings and equipment necessary to administer lottery games, and are carried at cost. Depreciation is computed by the straight-line method over the estimated economic useful lives of the assets, which are as follows:

Building	40 years
Leasehold improvements	5 years
Equipment	3-5 years

The Lottery leases, under a cancelable operating lease, various office spaces for field operations. The Lottery also leases various office equipment under agreements considered to be cancelable operating leases.

Accrued Employee Benefits

The Lottery incurred annual leave expenses of \$542,505 and \$546,984, and paid \$554,166 and \$503,306, respectively, for the years ending June 30, 2013 and 2012. The Lottery has accrued \$555,325, \$566,986, and \$523,308 of earned but unused annual leave time at June 30, 2013, 2012, and 2011, respectively, for estimated obligations that may arise in connection with compensated absences at the current rate of employee pay. Employees fully vest in all earned but unused annual leave. In accordance with State personnel policies, employees hired prior to July 1, 2001, vest in unused sick leave only upon retirement, at which time such unused leave can be converted into post-retirement health care coverage or additional periods of credited service for purposes of determining retirement benefits. To the extent that eligible conversion benefits are determined, a liability has been accrued as a result of the Lottery's participation in the State's post-employment benefits plan, in accordance with GAAP.

Net Position

Net position is presented as either unrestricted, restricted by enabling legislation for capital project, or as net investment in capital assets which represents the net book value of all property and equipment of the Lottery. When an expense is incurred for purposes for which both restricted and unrestricted net position is available, restricted resources are applied first.

Operating Revenues and Expenses

Operating revenues and expenses for proprietary funds such as the Lottery are revenues and expenses that result from providing services and producing and delivering goods and/or services. Operating revenues for the Lottery are derived from providing various types of lottery games. Operating expenses include commissions, prize costs, other direct costs of providing lottery games, and administrative expenses. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

WEST VIRGINIA LOTTERY  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

**2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Advertising and Promotions

The Lottery expenses the costs of advertising and promotions as they are incurred.

**3 - CASH AND CASH EQUIVALENTS**

At June 30, 2013 and 2012, the carrying amounts of deposits with financial institutions were \$1,411 thousand and \$477 thousand, respectively, with bank balances of \$2,282 and \$524 thousand, respectively. Deposits up to \$250 thousand are insured by the Federal Depository Insurance Corporation. Any balances over the insured amount are collateralized with securities held by the State of West Virginia's agent in the State's name.

At June 30, 2013 and 2012, the carrying amounts of deposits with financial institutions, the State Treasurer, and the West Virginia Board of Treasury Investments (BTI) were as follows (in thousands):

	<u>2013</u>	<u>2012</u>
Deposits with financial institutions	\$ 1,411	\$ 477
Cash on hand at the Treasurer's Office	53,718	42,350
Investments with BTI reported as cash equivalents	<u>219,929</u>	<u>201,084</u>
	<u>\$ 275,058</u>	<u>\$ 243,911</u>

The State Treasurer has statutory responsibility for the daily cash management activities of the State's agencies, departments, boards and commissions and transfers funds to the BTI for investment in accordance with West Virginia statutes, policies set by the BTI and by provisions of bond indentures and trust agreements when applicable.

The Lottery's cash balances are invested by the BTI in the BTI's West Virginia Money Market Pool. Investment income is pro-rated to the Lottery at rates specified by the BTI based on the balance of the deposits maintained in relation to the total deposits of all state agencies participating in the pool. Such funds are available to the Lottery with overnight notice.

**Credit risk** - Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The West Virginia Money Market Pool has been rated AAAm by Standard & Poor's. A fund rated "AAAm" has extremely strong capacity to maintain principal stability and to limit exposure to principal losses due to credit, market, and/or liquidity risks. "AAAm" is the highest principal stability fund rating assigned by Standard & Poor's. The BTI itself has not been rated for credit risk by any organization.

The BTI limits the exposure to credit risk in the West Virginia Money Market Pool by requiring all corporate bonds to be rated AA- by Standard & Poor's (or its equivalent) or higher. Commercial paper must be rated A-1 by Standard & Poor's and P1 by Moody's. Additionally, the pool must have at least 15% of its assets in United States Treasury issues.

WEST VIRGINIA LOTTERY  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

**3 - CASH AND CASH EQUIVALENTS (Continued)**

The following table provides information on the credit ratings of the West Virginia Money Market Pool's investments (in thousands):

Security Type	Credit Rating		Carrying Value	Percent of Assets
	Moody's	S&P		
Commercial paper	P-1	A-1+	\$ 243,538	9.76%
	P-1	A-1	726,857	29.12
Corporate bonds and notes	Aa3	AA-	10,000	0.40
U.S. agency bonds	Aaa	AA+	66,603	2.67
U.S. Treasury notes*	Aaa	AA+	279,755	11.21
U.S. Treasury bills *	P-1	A-1+	34,993	1.40
Negotiable certificates of deposit	Aa1	AA-	10,000	0.40
	Aa2	A+	9,000	0.36
	Aa3	AA-	15,000	0.60
	P-1	A-1+	50,000	2.00
	P-1	A-1	160,000	6.41
	P-2	A-1	15,000	0.60
U.S. agency discount notes	P-1	A-1+	445,784	17.86
Money market funds	Aaa	AAA m	200,012	8.02
Repurchase agreements (underlying securities):				
U.S. Treasury notes*	Aaa	AA+	188,826	7.57
U.S. agency notes	Aaa	AA+	40,500	1.62
			<u>\$ 2,495,868</u>	<u>100.00%</u>

\* U.S. Treasury issues are explicitly guaranteed by the United States government and are not subject to credit risk.

**Interest rate risk** - Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The weighted average maturity of the investments of the West Virginia Money Market Pool cannot exceed 60 days. Maximum maturity of individual securities cannot exceed 397 days from date of purchase, except for government floating rate notes, which can be up to 762 days. The following table provides the weighted average maturities for the various asset types in the West Virginia Money Market Pool.

Security Type	Carrying Value (In Thousands)	Weighted Average Maturity In Days
Repurchase agreements	\$ 229,326	3
US Treasury notes	279,755	132
US Treasury bills	34,993	77
Commercial paper	970,395	43
Certificates of deposit	259,000	66
U.S. Agency discount notes	445,784	47

WEST VIRGINIA LOTTERY  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

**3 - CASH AND CASH EQUIVALENTS (Continued)**

<u>Security Type</u>	<u>Carrying Value (In Thousands)</u>	<u>Weighted Average Maturity In Days</u>
Corporate bonds and notes	10,000	60
U.S. agency bonds and notes	66,603	139
Money market funds	<u>200,012</u>	1
Total assets	<u>\$ 2,495,868</u>	

The weighted average maturity of the investments of the West Virginia Money Market Pool as of June 30, 2013, is 52 days.

**Concentration of credit risk** - West Virginia statutes prohibit the West Virginia Money Market Pool from investing more than 5% of its assets in securities issued by one corporate name or corporate issue. At June 30, 2013, the pool did not have investments in any one private corporation or association that represented more than 5% of assets.

**Custodial credit risk** - At June 30, 2013, the West Virginia Money Market Pool held no securities that were subject to custodial credit risk. Repurchase agreements are collateralized at 102%, and the collateral is held in the name of the BTI. Securities lending collateral that is reported in the BTI's audited Statement of Assets and Liabilities is invested in the lending agent's money market fund.

**Foreign currency risk** - The West Virginia Money Market Pool has no securities that are subject to foreign currency risk.

**4 - CAPITAL ASSETS**

A summary of capital asset activity is as follows (in thousands):

	Historical cost at June 30, 2011	Additions	Deletions	Historical cost at June 30, 2012	Additions	Deletions	Historical cost at June 30, 2013
Capital assets, not depreciated							
Construction in progress	\$ 8,444	\$ 10,075	\$ (18,000)	\$ 519	\$ 30	\$ -	\$ 549
Land	1,434	-	-	1,434	-	-	1,434
Capital assets, being depreciated							
Building	20,174	17,910	-	38,084	-	-	38,084
Improvements	1,170	-	(910)	260	-	-	260
Equipment	<u>7,743</u>	<u>3,067</u>	<u>(4,291)</u>	<u>6,519</u>	<u>-</u>	<u>-</u>	<u>6,519</u>
	<u>\$ 38,965</u>	<u>\$ 31,052</u>	<u>\$ (23,201)</u>	<u>\$ 46,816</u>	<u>\$ 30</u>	<u>\$ -</u>	<u>\$ 46,846</u>

WEST VIRGINIA LOTTERY  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

**4 - CAPITAL ASSETS (Continued)**

	Accumulated depreciation at June 30,			Accumulated depreciation at June 30,			Accumulated depreciation at June 30,
	2011	Additions	Deletions	2012	Additions	Deletions	2013
Building	\$ -	\$ 237	\$ -	\$ 237	\$ 952	\$ -	\$ 1,189
Improvements	1,142	3	(885)	260	-	-	260
Equipment	<u>7,402</u>	<u>827</u>	<u>(4,195)</u>	<u>4,034</u>	<u>1,143</u>	<u>-</u>	<u>5,177</u>
	<u>\$ 8,544</u>	<u>\$ 1,067</u>	<u>\$ (5,080)</u>	<u>\$ 4,531</u>	<u>\$ 2,095</u>	<u>\$ -</u>	<u>\$ 6,626</u>

**5 - PARTICIPATION IN THE MULTI-STATE LOTTERY**

The Lottery is a member of the Multi-State Lottery (MUSL), which operates the semi-weekly POWERBALL® jackpot lotto game, the HOT LOTTO™ game, and MEGA MILLIONS® jackpot game on behalf of other participating lotteries. MUSL is currently comprised of 33 member state lotteries, including the District of Columbia and the United States Virgin Islands. MUSL is managed by a Board of Directors, which is comprised of the lottery directors or their designee from each of the party states. The Board of Directors' responsibilities to administer the Multi-State Lottery POWERBALL®, HOT LOTTO™, and MEGA MILLIONS® games are performed by advisory committees or panels staffed by officers and independent contractors appointed by the board. These officers and consultants serve at the pleasure of the board and the board prescribes their powers, duties and qualifications. The Executive Committee carries out the budgeting and financing of MUSL, while the board contracts the annual independent audit. A copy of the audit may be obtained by writing to the Multi-State Lottery Association, 4400 N.W. Urbandale Drive, Urbandale, Iowa 50322.

Each MUSL member sells game tickets through its agents and makes weekly wire transfers to the MUSL in an amount equivalent to the total prize pool less the amount of prizes won in each state. Lesser prizes are paid directly to the winners by each member lottery. The prize pool for POWERBALL®, HOT LOTTO™, and MEGA MILLIONS® is 50% of each drawing period's sales, with minimum jackpot levels.

Revenues derived from the Lottery's participation in the MUSL POWERBALL® jackpot game were \$48,688,807 and \$38,686,528 for the years ended June 30, 2013 and 2012, respectively, and related prize costs were \$24,344,477 and \$19,344,184, respectively.

Revenues derived from the Lottery's participation in the HOT LOTTO™ game were \$5,063,704 and \$4,736,542 for the years ended June 30, 2013 and 2012, respectively, and related prize costs were \$2,531,917 and \$2,368,526, respectively.

Revenues derived from the Lottery's participation in the MEGA MILLIONS® game were \$9,274,409 and \$14,746,963 for the years ended June 30, 2013 and 2012, respectively, and related prize costs were \$4,760,567 and \$7,594,900, respectively.

MUSL places a percentage of game sales from each game in separate prize reserve funds that serve as a contingency reserve to protect the respective MUSL Product Groups from unforeseen prize liabilities. These funds can only be used at the discretion of the respective MUSL Product Group. Once the prize reserve funds exceed the designated limit, the excess becomes part of that particular prize pool. Prize reserve fund monies are refundable to MUSL Product Group members if the MUSL disbands or, after one year, if a member leaves the MUSL. The applicable sales percentage contribution as well as the reserve fund limit for the MUSL games is as follows (in thousands):

WEST VIRGINIA LOTTERY  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

**5 - PARTICIPATION IN THE MULTI-STATE LOTTERY (Continued)**

	<u>POWERBALL®</u>	<u>HOT LOTTO™</u>	<u>MEGA MILLIONS®</u>
Required Contribution (% of sales)	2%	3%	1%
Reserve Fund Cap	\$125,000	\$9,000	45,000

The Lottery's share of the prize reserve fund balances with MUSL as of June 30, were as follows (in thousands):

	<u>2013</u>		<u>2012</u>	
	Total		Total	
	<u>Prize Reserve</u>	<u>Lottery Share</u>	<u>Prize Reserve</u>	<u>Lottery Share</u>
POWERBALL ®	\$ 113,874	\$ 1,997	\$ 126,481	\$ 2,386
HOT LOTTO ™	7,921	533	7,383	486
MEGA MILLIONS ®	27,968	469	18,828	331
	<u>\$ 149,763</u>	<u>\$ 2,999</u>	<u>\$ 152,692</u>	<u>\$ 3,203</u>

Lottery prize reserves held by the MUSL are invested according to a Trust agreement the Lottery has with MUSL outlining investment policies. The policies restrict investments to direct obligations of the United States Government, perfected repurchase agreements, and obligations issued or guaranteed as to payment of principal and interest by agencies or instrumentalities of the United States Government, and mutual funds of approved investments. The average portfolio maturity is never more than one year, except that up to one third of the portfolio may have an average maturity of up to two years. The maximum maturity for any one security does not exceed five years.

The interest earned on prize reserve fund monies is used to pay MUSL operating expenses and any amounts over and above the expenses are credited to an unreserved fund. The Lottery records this interest when earned. This fund had a balance of \$16,342,326 and \$17,414,201 at June 30, 2013 and 2012, of which the Lottery's share was \$1,674,811 and \$1,537,522, respectively.

**6 - RACETRACK VIDEO LOTTERY**

The racetrack video lottery legislation stipulates the distribution of racetrack video lottery revenues. This legislation has been amended since inception to restate revenue distribution based on revenue benchmarks. Initially, four percent (4%) of gross terminal revenue is allocated for lottery administrative costs. Sixty-six percent (66%) of net terminal revenue (gross less 4%) is allocated in lieu of commissions to: the racetracks (47%); other private entities associated with the racing industry (17%); and the local county and municipal governments (2%). The remaining thirty-four percent (34%) of net terminal revenue is allocated for distribution to the State as specified in the Racetrack Video Lottery Act or subsequent State budget, as described in Note 10 titled "Nonoperating Distributions to the State of West Virginia."

The first benchmark occurs when the current year net terminal revenue meets the fiscal year 1999 net terminal revenue. The counties and incorporated municipalities split 50/50 the two percent (2%) net terminal revenue.

The second benchmark occurs when the current year gross terminal revenue meets the fiscal year 2001 gross terminal revenue. The four percent (4%) is no longer allocated for lottery administrative costs; instead the State receives this for distribution as specified by legislation or the State budget.

WEST VIRGINIA LOTTERY  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

**6 - RACETRACK VIDEO LOTTERY (Continued)**

The final benchmark occurs when the current year net terminal revenue meets the fiscal year 2001 net terminal revenue. At this point a 10% surcharge is applied to net terminal revenue, with 58% of the surcharge allocated for distribution to the State as specified by legislation or the State budget, and 42% of the surcharge allocated to separate capital reinvestment funds for each licensed racetrack. After deduction of the surcharge, 55% of the net terminal revenue is allocated in lieu of commissions to: the racetracks (42%); other private entities associated with the racing industry (11%); and the local county and incorporated municipality governments (2%). The remaining net terminal revenue (45%) is allocated for distribution to the State as specified in the Racetrack Video Lottery Act or subsequent State budget, as described in Note 10.

Amounts from the capital reinvestment fund may be distributed to each racetrack if qualifying expenditures are made within the statutory timeframe; otherwise amounts accumulated in the fund revert to the state excess lottery revenue fund. The Lottery, along with the Rhode Island and Delaware state lotteries, participate in Multi-Jurisdictional Wide Area Progressive (MWAP) video games. This allows each of the lotteries to offer a higher progressive jackpot than they could generate alone. MUSL manages the progressive games and charges each participant a MWAP contribution fee which is a percentage of the amount wagered. This fee was of 0.75% for years ended June 30, 2013 and June 30, 2012 respectively.

A summary of racetrack video lottery revenues for the years ended June 30, 2013 and 2012, follows (in thousands):

	<u>2013</u>	<u>2012</u>
Total credits (bets) played	\$ 7,293,271	\$ 8,434,745
Credits (prizes) won	(6,546,860)	(7,575,505)
Promotional credits played	(90,346)	(93,869)
MWAP Contributions	<u>(389)</u>	<u>(473)</u>
Gross terminal income	655,676	764,898
Administrative costs	<u>(17,475)</u>	<u>(17,524)</u>
Net terminal income	638,201	747,374
Commissions	<u>(370,828)</u>	<u>(424,049)</u>
Racetrack video lottery revenues available for distribution	<u>\$ 267,373</u>	<u>\$ 323,325</u>

A summary of racetrack video lottery revenues paid or accrued for certain State funds to conform with the legislation follows (in thousands):

	<u>2013</u>	<u>2012</u>
State Lottery Fund	\$ 127,728	\$ 130,125
State Excess Lottery Revenue Fund	95,727	141,408
Capital Reinvestment Fund	8,555	12,623
Tourism Promotion Fund	8,375	9,683
Development Office Promotion Fund	2,284	2,641
Research Challenge Fund	3,045	3,521
Capitol Renovation and Improvement Fund	4,187	4,842
Parking Garage Fund	881	940

WEST VIRGINIA LOTTERY  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

**6 - RACETRACK VIDEO LOTTERY (Continued)**

	<u>2013</u>	<u>2012</u>
Cultural Facilities and Capitol Resources Fund	1,500	1,500
Capitol Dome and Capitol Improvements Fund	4,091	5,042
Workers Compensation Debt Reduction Fund	<u>11,000</u>	<u>11,000</u>
Total nonoperating distributions	<u>\$ 267,373</u>	<u>\$ 323,325</u>

On March 12, 2011, the Legislature passed Senate Bill 550 which provides for the creation of the Racetrack Modernization Fund. The Modernization Fund is available to reimburse the licensed tracks \$1 for every \$2 spent on the costs of facility modernization. For each year ended June 30, 2011 through June 30, 2020, the Lottery is to transfer up to \$10 million from racetrack administrative surplus funds to the Modernization Fund which is allocated to each track on a pro rata basis according to their administrative contribution for the fiscal year. For the years ended June 30, 2013 and 2012, the Lottery transferred \$10 million to the Racetrack Modernization Fund.

**7 - LIMITED VIDEO LOTTERY**

The limited video lottery legislation established specific requirements imposing certain restrictions limiting the licensing for the operation of limited video lottery games to 9,000 terminals placed in licensed retailers. These licensed retailers must hold a qualifying permit for the sale and consumption on premises of alcohol or non-intoxicating beer. The Lottery has been charged with the administration, monitoring and regulation of these machines. The legislation further stipulates the distribution of revenues from limited gross terminal income be deposited into the state lottery fund for administrative costs. Then, the state share percentage of gross profit is to be transferred to the State Excess Lottery Revenue Fund. Such percentage is between 30 and 50 percent and is subject to change on a quarterly basis. Two percent is distributed to counties and incorporated municipalities in the manner prescribed by the statute. The remaining amount of gross profit is paid to retailers and/or operators as prescribed in the Act and is recorded as limited video lottery commissions in the financial statements. Municipal and county distributions are accounted for as nonoperating expenses. A summary of limited video lottery revenues for the years ended June 30, 2013 and 2012 follows (in thousands):

	<u>2013</u>	<u>2012</u>
Total credits played	\$ 4,728,660	\$ 4,781,734
Credits (prizes) won	<u>(4,329,436)</u>	<u>(4,375,626)</u>
Gross terminal income	399,224	406,108
Administrative costs	<u>(7,984)</u>	<u>(8,122)</u>
Gross profit	391,240	397,986
Commissions	(195,620)	(198,993)
Distributions to municipalities and counties	<u>(7,825)</u>	<u>(7,960)</u>
Limited video lottery revenues available for distribution	<u>\$ 187,795</u>	<u>\$ 191,033</u>

WEST VIRGINIA LOTTERY  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

## 8 - TABLE GAMES

The passage of table games legislation allowed local referendums in each of the four counties in which a race track is located to approve table games. All four counties have authorized table games at their respective tracks.

Table games include blackjack, roulette, craps, and various types of poker. The Lottery receives a privilege tax of 35% of adjusted gross receipts, from each licensed racetrack, which is deposited weekly into the Lottery's racetrack table games fund.

From the gross amounts deposited into the table games fund, the Lottery, on a monthly basis retains a percentage of the adjusted gross receipts for administrative expenses. This percentage was 3% for the year ended June 30, 2013 and 4% for the year ended June 30, 2012. From the administrative allowance, at least \$100,000 and not more than \$500,000 annually will be transferred to the Lottery's compulsive gambling treatment fund.

The Lottery then transfers 2.5% of adjusted gross receipts from all thoroughbred and greyhound racetracks participating in licensed table games to the special funds established by each racetrack table games licensee for the payment of regular racetrack purses to be divided equally among each licensee. A transfer of 2% of the adjusted gross receipts is made from all licensed racetracks to the thoroughbred development fund and the greyhound breeding development fund to be divided pro rata among the development funds.

Transfers of 2% of the adjusted gross receipts are made from each licensed racetrack to the county commissions of the counties where racetracks participating in licensed table games are located to be divided pro rata among the counties. Transfers of 3% of the adjusted gross receipts are made from each licensed racetrack to the governing bodies of municipalities within counties where racetracks participating in licensed table games are located as prescribed by statute. Finally, a transfer of .5% of the adjusted gross receipts to the governing bodies of municipalities in which a racetrack table games licensee is located is to be divided equally among the municipalities. The Lottery, in accordance with the enabling legislation, will distribute the remaining amounts hereinafter referred to as the net amounts in the racetrack table games funds as follows:

- A transfer of 4%, into a special fund to be established by the West Virginia Racing Commission to be used for payment into the pension plan for all employees of each licensed racing association.
- A transfer of 10%, to be divided and paid in equal shares, to each county commission in the state where table games are not located.
- A transfer of 10%, to be divided and paid in equal shares, to the governing bodies of each municipality in the state where table games are not located.
- A transfer of 76%, to the state debt reduction fund.

The transfer to the state debt reduction fund is included in Note 10. The table games adjusted gross receipts for the year ended June 30, 2013 and 2012 was \$200,738,953 and \$223,203,230, respectively. A summary of table games revenues for the years ended June 30, 2013 and 2012 follows (in thousands):

WEST VIRGINIA LOTTERY  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

**8 - TABLE GAMES (Continued)**

	<u>2013</u>	<u>2012</u>
Table games privilege tax	\$ 70,259	\$ 78,121
Interest on table games fund	6	5
Administrative costs	<u>(6,022)</u>	<u>(8,928)</u>
Total available for distribution	64,243	69,198
<u>Less distributions:</u>		
Racetrack purse funds	5,018	5,580
Thoroughbred & greyhound development funds	4,015	4,464
Racing commission pension plan	1,767	1,875
Municipalities/counties	<u>19,875</u>	<u>21,652</u>
Total distributions	30,675	33,571
Table games distribution to the state debt reduction fund	<u>\$ 33,568</u>	<u>\$ 35,627</u>

**9 - HISTORIC RESORT HOTEL**

Senate Bill 575 authorizes video lottery and table games at a licensed historic resort hotel which is defined as “a resort hotel registered with the United States Department of the Interior as a national historic landmark in its National Registry of Historic Places having not fewer than five hundred guest rooms under common ownership and having substantial recreational guest amenities in addition to the gaming facility.”

Historic Resort Video Lottery

According to Senate Bill 575, thirty six percent (36%) of gross terminal income is allocated to Historic Resort Hotel Fund and seventeen percent (17%) of gross terminal income is allocated to the Human Resource Benefit Fund. The remaining forty-seven percent (47%) of gross terminal income is then subject to a ten percent (10%) surcharge which is allocated to separate capital reinvestment funds for the licensed historic resort hotel. After deduction of the surcharge, the remaining forty-two and three-tenths percent (42.3%) of gross terminal income is retained by the historic resort hotel. A summary of historic resort hotel video lottery revenues for the years ended June 30, 2013 and 2012 follows (in thousands):

	<u>2013</u>	<u>2012</u>
Total credits played	\$ 63,594	\$ 68,993
Credits (prizes) won	(58,154)	(63,583)
Promotional credits played	(693)	(458)
MWAP contribution	<u>(9)</u>	<u>(1)</u>
Gross terminal income	4,738	4,951
Capital reinvestment	(223)	(233)
Modernization	(43)	(45)
Administrative costs	(256)	(267)
Hotel commissions	<u>(2,004)</u>	<u>(2,094)</u>
Net terminal income	<u>\$ 2,212</u>	<u>\$ 2,312</u>
Historic Resort Hotel Fund	\$ 1,407	\$ 1,470
Human Resource Benefit Fund	<u>805</u>	<u>842</u>
Total	<u>\$ 2,212</u>	<u>\$ 2,312</u>

WEST VIRGINIA LOTTERY  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

**9 - HISTORIC RESORT HOTEL (Continued)**

Historic Resort Table Games

Each historic resort hotel licensee is subject to a privilege tax of thirty five percent (35%) of adjusted gross receipts, of which thirty percent (30%) is deposited directly into the Historic Resort Hotel Fund and five percent (5%) is deposited directly into the Human Resource Benefit Fund. The historic resort hotel table games adjusted gross receipts for the years ended June 30, 2013 and 2012 were \$8,168,463 and \$6,182,748, respectively.

The following table shows the privilege tax and the accrued distributions (in thousands) for the years ended June 30, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Table games privilege tax	\$ 2,859	\$ 2,164
Administrative costs	<u>(368)</u>	<u>(278)</u>
Total available for distribution	<u>\$ 2,491</u>	<u>\$ 1,886</u>
Historic Resort Hotel Fund	2,083	1,577
Human Resource Benefit Fund	<u>408</u>	<u>309</u>
Total distributions	<u>\$ 2,491</u>	<u>\$ 1,886</u>

Historic Resort Hotel Fund

Historic Resort Hotel Fund deposits are allocated after a fifteen percent (15%) lottery administrative cost. The remaining Historic Resort Hotel Fund net income (gross deposits less 15%) are distributed as follows for the years ended June 30, 2013 and 2012:

- 64% is paid to the State of West Virginia General Revenue Fund;
- 19% is paid to the State Debt Reduction Fund;
- 3% is paid to the State of West Virginia Tourism Promotion Fund;
- 4% is paid to the county where the gaming facility is located;
- 2.5% is paid to the municipality where the gaming facility is located as prescribed by statute;
- 2.5% is divided and paid in equal shares to the remaining municipalities in the county where the gaming facility is located;
- 2.5% is divided and paid in equal shares, to each county commission in the state where the gaming facility is not located;
- 2.5% is divided and paid in equal shares, to each municipality in the State not already receiving a distribution.

WEST VIRGINIA LOTTERY  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

**9 - HISTORIC RESORT HOTEL (Continued)**

A summary of Historic Resort Hotel Fund revenues and related distributions is as follows (in thousands) for the years ended June 30, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Historic Resort Hotel video lottery	\$ 1,407	\$ 1,470
Historic Resort table games	<u>2,083</u>	<u>1,577</u>
Historic Resort Hotel Fund net income	<u>\$ 3,490</u>	<u>\$ 3,047</u>
Municipalities/ Counties	\$ 488	\$ 427
State General Revenue Fund	2,234	1,950
State Debt Reduction Fund	663	579
State Tourism Promotion Fund	<u>105</u>	<u>91</u>
Total distributions	<u>\$ 3,490</u>	<u>\$ 3,047</u>

**10 - NONOPERATING DISTRIBUTIONS TO THE STATE OF WEST VIRGINIA**

The Lottery periodically distributes surplus funds, exclusive of amounts derived from limited video lottery and a portion of racetrack video lottery funds, to the State of West Virginia in accordance with the current governing legislation. For the years ended June 30, 2013 and 2012, the State Legislature budgeted \$145,017,313 and \$166,297,857 respectively of estimated profits of the Lottery for distributions to designated special revenue accounts of the State of West Virginia. With regard to the State Lottery Fund, legislation stipulates that debt service payments be given a priority over all other transfers in instances where estimated profits are not sufficient to provide for payment of all appropriated distributions. Debt service payments of \$1,800,000, \$1,000,000, and \$500,000 per month for the first ten months of each fiscal year currently have such priority. Transfers made pursuant to the State Excess Lottery Revenue Fund have similar requirements; currently debt service payments are \$5,300,000 per month for the first ten months of each fiscal year. In addition, Legislation provides that, if in any month, there is a shortage of funds in the State Excess Lottery Revenue Fund to make debt service payments, the necessary amount shall be transferred from the State Lottery Fund to cover such shortfall, after the State Lottery Fund debt service payments have been made. Repayments to the State Lottery Fund are required to be made in subsequent months as funds become available. For the years ended June 30, 2013 and 2012, the Lottery made or accrued all budgeted distributions and accrued additional distributions from the State Lottery Fund and State Excess Lottery Revenue Fund of \$235,130,619 and \$197,864,036, respectively. The Lottery does not have a legally adopted annual budget.

Additional distributions to the State of West Virginia of \$724,201 and \$15,442,553 have been accrued from the Revenue Center Construction Fund at June 30, 2013 and 2012, respectively. These amounts reflect monies remaining in the Revenue Center Construction Fund available for appropriation at the end of each year.

Since the enactment of the Racetrack Video Lottery Act, the Lottery is also statutorily required to distribute income from racetrack video lottery operations as described in Note 6. As of June 30, 2013 and 2012, the Lottery accrued additional distributions relating to racetrack video lottery operations in the amounts of \$523,517 and \$437,406, respectively.

WEST VIRGINIA LOTTERY  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

**10 - NONOPERATING DISTRIBUTIONS TO THE STATE OF WEST VIRGINIA (Continued)**

Note 7 describes the Limited Video Lottery Act and the statutory distributions required to be made from limited video lottery operations. Note 8 describes the Table Games Act and the statutory distributions required to be made from table games operations. As of June 30, 2013 and 2012, the Lottery accrued additional distributions relating to table games operations in the amounts of \$2,356,869 and \$2,832,824, respectively. Note 9 describes the Historic Resort Hotel statutory distributions to be made from historic resort operations. As of June 30, 2013 and 2012, the Lottery accrued additional distributions relating to Historic Resort operations of \$299,233 and \$240,936, respectively.

A summary of the required statutory and budgeted distributions to certain state agencies to conform with the various legislation follows (in thousands):

	<u>2013</u>	<u>2012</u>
<u>Budgetary distributions:</u>		
<u>Revenue Center Construction Fund:</u>		
Division of Highways	\$ -	\$ 15,000
General Purpose Account	14,736	-
	<u>14,736</u>	<u>15,000</u>
 <u>State Lottery Fund:</u>		
Bureau of Senior Services	42,834	64,797
Department of Education	30,612	30,573
Library Commission	12,186	11,268
Higher Education - Central Office	7,889	8,208
Tourism	7,364	7,359
Natural Resources	3,398	3,388
Division of Culture & History	5,903	5,873
Department of Education & Arts	1,840	1,839
Economic Development Authority	10,000	9,995
School Building Authority	17,997	18,000
Community and Technical College	4,995	4,997
Total State Lottery Fund	<u>145,018</u>	<u>166,297</u>
 <u>State Excess Lottery Revenue Fund:</u>		
General Purpose Account	65,000	65,000
Education Improvement Fund	29,000	29,000
WV Infrastructure Council Fund	46,000	46,000
Higher Education Improvement Fund	15,000	15,000
State Park Improvement Fund	5,000	5,000
School Building Authority	18,993	19,000
Economic Development Fund	18,989	18,989
Refundable Credit - General Revenue Fund	10,000	10,000
Department of Education	-	47,139
Racing Commission	2,000	2,000
WV Department of Health and Human Resources	24,504	-
WV Development Office	400	1,000
Excess Lottery Surplus (General Fund)	27,600	62,900
Excess Lottery Surplus (Teachers Retirement Savings Realized)	<u>28,061</u>	<u>34,216</u>
Total State Excess Lottery Revenue Fund	<u>290,547</u>	<u>355,244</u>
Total Required Statutory and Budgetary Distributions	<u>450,301</u>	<u>536,541</u>
 Veterans Instant Ticket Fund	<u>422</u>	<u>566</u>

WEST VIRGINIA LOTTERY  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

**10 - NONOPERATING DISTRIBUTIONS TO THE STATE OF WEST VIRGINIA (Continued)**

	<u>2013</u>	<u>2012</u>
<u>Other racetrack video lottery distributions:</u>		
Tourism Promotion Fund	8,345	9,800
Development Office Promotion Fund	2,276	2,673
Research Challenge Fund	3,035	3,563
Capitol Renovation and Improvement Fund	4,173	4,900
Parking Garage Funds	879	945
Cultural Facilities and Capitol Resources Fund	1,500	1,500
Capitol Dome and Capitol Improvements Fund	4,069	5,127
Workers Compensation Debt Reduction Fund	<u>11,000</u>	<u>11,000</u>
	<u>35,277</u>	<u>39,508</u>
 <u>Table games distributions:</u>		
State Debt Reduction Fund	<u>34,044</u>	<u>35,650</u>
 <u>Historic resort hotel distributions:</u>		
State General Revenue Fund	2,191	1,839
State Debt Reduction Fund	650	546
Tourism Promotion Fund	<u>103</u>	<u>86</u>
Total	<u>2,944</u>	<u>2,471</u>
 Total required statutory and budgeted distributions to the State of West Virginia		
	522,988	614,736
Distributed July 2011	<u>-</u>	<u>32,772</u>
Total nonoperating distributions to the State of West Virginia (cash basis)	522,988	647,508
 Accrued nonoperating distributions, beginning of year		
	(216,819)	(210,990)
 Accrued nonoperating distributions, end of year		
	239,035	216,819
Capital contribution from State of West Virginia	<u>-</u>	<u>9,645</u>
Total nonoperating distributions to the State of West Virginia	<u>\$ 545,204</u>	<u>\$ 662,982</u>

**11 - RESTRICTED NET POSITION**

House Bill 106 was enacted by the West Virginia State Legislature to set aside unexpended administrative expenses of the Lottery up to the limits for such expenses established by the enabling legislation of traditional, racetrack video lottery, and limited video lottery games in an amount not to exceed \$20,000,000 beginning in the year ended June 30, 2006 and for each year thereafter through June 30, 2012. These assets were set aside in the revenue center construction fund for the design and construction of a building in the West Virginia Capitol Complex to be used by the Lottery and certain other State of West Virginia governmental entities. In the year ended June 30, 2010, the Legislature approved the purchase of and improvements to an existing building not located in the West Virginia Capitol Complex.

WEST VIRGINIA LOTTERY  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

**11 - RESTRICTED NET POSITION (Continued)**

The Lottery then entered into a construction commitment for the renovation of its new headquarters. It was determined that the Lottery's resources were insufficient to satisfy the terms of the construction commitment. For the year ended June 30, 2012, the West Virginia Legislature appropriated an additional \$9.6 million to the Lottery from the Revenue Center Construction Fund to satisfy the requirements of the construction commitment. This amount was reflected as a capital contribution on the Statements of Revenues, Expenses, and Changes in Fund Net Position.

Restricted net position activity is as follows for the years ending June 30, 2013 and 2012 (in thousands):

	<u>2013</u>	<u>2012</u>
Beginning restricted net position	\$ 1,690	\$ 2,039
Legislative appropriation	-	9,645
Acquisition of assets in accordance with enabling legislation	<u>(50)</u>	<u>(9,994)</u>
Ending restricted net position	<u>\$ 1,640</u>	<u>\$ 1,690</u>

**12 - RETIREMENT BENEFITS**

All full-time Lottery employees are eligible and required to participate in the State of West Virginia Public Employees' Retirement System (PERS), a cost-sharing multiple-employer defined benefit public employee retirement system. The PERS is one of several plans administered by the West Virginia Consolidated Public Retirement Board (CPRB) under the direction of its Board of Trustees, which consists of the Governor, State Auditor, State Treasurer, Secretary of the Department of Administration, and nine members appointed by the Governor. CPRB prepares separately issued financial statements for each retirement system it administers, which can be obtained from Consolidated Public Retirement Board, 4101 MacCorkle Avenue S.E., Charleston, West Virginia 25304-1636 or by calling 1-800-654-4406.

Employees who retire at or after age sixty with five or more years of contributory service or who retire at or after age fifty-five and have completed twenty-five years of credited service with age and credited service equal to eighty or greater are eligible for retirement benefits as established by State statute. Retirement benefits are payable monthly for life, in the form of a straight-line annuity equal to two percent of the employee's final average salary, multiplied by the number of years of the employee's credited service at the time of retirement.

Covered employees are required to contribute 4.5% of their salary to the PERS. The Lottery is required to contribute 14%, 14.5%, and 12.5% of covered employees' salaries to the PERS for the years ended June 30, 2013, 2012, and 2011, respectively. The required employee and employer contribution percentages have been established and changed from time to time by action of the State Legislature. The required contributions are not actuarially determined; however, actuarial valuations are performed to assist the Legislature in determining appropriate contributions. The Lottery and employee contributions, which equaled the required contributions for the three years ended June 2013, 2012, and 2011, were as follows (in thousands):

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Lottery contributions	\$ 1,146	\$ 1,225	\$ 1,017
Employee contributions	<u>341</u>	<u>357</u>	<u>339</u>
Total contributions	<u>\$ 1,487</u>	<u>\$ 1,582</u>	<u>\$ 1,356</u>

WEST VIRGINIA LOTTERY  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

### 13 - OTHER POSTEMPLOYMENT BENEFITS (OPEB)

#### Plan Description

The Lottery participates in the West Virginia Other Postemployment Benefits Plan (OPEB Plan) of the West Virginia Retiree Health Benefit Trust Fund, a cost-sharing multiple-employer defined benefit postemployment healthcare plan administered by the West Virginia Public Employee Insurance Agency (WVPEIA). The OPEB Plan provides retiree post-employment health care benefits for participating state and local government employers. The provisions of the Code of West Virginia, 1931, as amended (the Code), assigns the authority to establish and amend benefit provisions to the WVPEIA board of trustees. The WVPEIA issues a publicly available financial report that includes financial statements and required supplementary information for the OPEB Plan. That report may be obtained by writing to Public Employees Insurance Agency, 601 57<sup>th</sup> Street, S.E., Suite 2, Charleston, West Virginia, 25304-2345, or by calling 1-888-680-7342.

#### Funding Policy

The Code requires the OPEB Plan bill the participating employers 100% of the annual required contribution (ARC), an amount actuarially determined in accordance with the parameters of GAAP. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) of the plan over a period not to exceed thirty years. State of West Virginia plan employers are billed per active health policy per month.

The ARC rate is \$257 and \$961 per employee per month for the years ending June 30, 2013 and 2012, respectively. The Lottery's ARC was \$445,479, \$1,643,408, and \$1,560,274 and the Lottery has paid premiums of \$332,615 \$317,694, and \$294,952, which represent 74.7%, 19.3%, and 18.9% of the ARC, respectively, for the years ending June 30, 2013, 2012, and 2011. As of June 30, 2013, 2012, and 2011, the Lottery has recorded a liability of \$4,188,445, \$4,075,581, and \$2,749,868, respectively, for OPEB.

### 14 - RISK MANAGEMENT

The Lottery is exposed to various risks of loss related to torts; theft of, or damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Lottery participates in several risk management programs administered by the State of West Virginia and other providers. Each of the state administered risk pools have issued separate audited financial reports on their operations. Those reports include the required supplementary information regarding the reconciliation of claims liabilities by type of contract and ten-year claim development information. Complete financial statements of the individual risk pools can be obtained directly from their respective administrative offices.

#### Public Employees' Insurance Agency (PEIA)

The Lottery participates in the Public Employees Insurance Agency (PEIA) which provides an employee benefit insurance program to employees. PEIA was established by the State of West Virginia for State agencies, institutions of higher education, Boards of Education and component units of the State. In addition, local governmental entities and certain charitable and public service organizations may request to be covered by PEIA. PEIA provides a base employee benefit insurance program which includes hospital, surgical, major medical, prescription drug and basic life and accidental death. Underwriting and rate setting policies are established by PEIA. The cost of all coverage, as determined by PEIA shall be paid by the participants. Premiums are established by PEIA and are paid monthly, and are

WEST VIRGINIA LOTTERY  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

**14 - RISK MANAGEMENT (Continued)**

Public Employees' Insurance Agency (PEIA) (Continued)

dependent upon, among other things, coverage required, number of dependents, state vs. non state employees and active employees vs. retired employees and level of compensation. Coverage under these programs is limited to \$1 million for lifetime for health and \$10,000 of life insurance coverage.

The PEIA risk pool retains all risks for the health and prescription features of its indemnity plan. PEIA has fully transferred the risks of coverage of the Managed Care Organization (MCO) Plan to the plan provider, and has transferred the risks of the life insurance coverage to a third party insurer. PEIA presently charges equivalent premiums for participants in either the indemnity plan or the MCO Plan. Altogether, PEIA insures approximately 205,000 individuals, including participants and dependents.

Board of Risk and Insurance Management (BRIM)

The Lottery participates in the West Virginia Board of Risk and Insurance Management (BRIM), a risk pool currently operating as a risk management and insurance program for all State agencies, component units, and other local governmental agencies who wish to participate. The Lottery pays an annual premium to BRIM for its general insurance coverage. Underwriting and rate setting policies are established by BRIM. The cost of all coverage as determined by BRIM shall be paid by the participants. The BRIM risk pool retains the risk of the first \$1 million per property event and purchases excess insurance on losses above that level. Excess coverage through an outside insurer under this program is limited to \$200 million per event, subject to limits on certain property. BRIM has \$1 million per occurrence coverage maximum on all third-party liability claims. During the year ended June 30, 2013, no changes in coverage were made and paid claims did not exceed coverage.

Workers Compensation Insurance

The Lottery carries workers compensation insurance coverage through a commercial insurance carrier. The commercial insurance carrier is paid a monthly rated premium to provide compensation for injuries sustained in the course of employment.

**15 - LEASING ACTIVITY**

The Lottery leases, under cancelable operating leases, various office spaces for field operations. The Lottery also leases various office equipment under agreements considered to be cancelable operating leases. Rental expense for the fiscal years ended June 30, 2013 and 2012 approximated \$238,674 and \$422,571, respectively.

The Lottery is a lessor of certain office space under the terms of non-cancellable operating leases to various tenants. Rental revenues for the years ended June 30, 2013 and 2012 were \$1,377,991 and \$984,034, respectively. Expected future rental income (in thousands) under the leases with terms in excess of one year are as follows:

<u>Year Ended June 30</u>	<u>Rental Income</u>
2014	\$ 932
2015	<u>232</u>
Total	<u>1,155</u>

WEST VIRGINIA LOTTERY  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

**16 - COMMITMENTS**

The Lottery Commission has designated unexpended administrative funds from various fiscal years for the acquisition of capital assets. As of June 30, 2013 and 2012, \$2,003,028 and \$3,193,044, respectively, are included in unrestricted net position for this purpose.

**17 - NEW ACCOUNTING PRONOUNCEMENTS**

Management has adopted Governmental Accounting Standards Board (GASB) Statement No. 63 *Financial reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources and identifies net position as the residual of all elements presented on the statements of net position. GASB 63 also amends net asset reporting requirements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets.

Management has also adopted GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, which established accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources (expenses or expenditures) or inflows of resources (revenues), certain items that were previously reported as assets and liabilities. The Lottery does not report any deferred outflows of resources or deferred inflows of resources and no balances or activity have been reclassified as a result of this change in accounting standard.

GASB has also issued Statement No. 68, *Accounting and Financial Reporting for Pensions*, which will be effective for the Lottery's June 30, 2015 financial statements. Statement 68 will require the Lottery to recognize a liability equal to its proportionate share of the net pension liability of the Public Employees Retirement System. The Lottery has not yet determined the effect this statement will have on its financial statements.

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

West Virginia Lottery Commission  
Charleston, West Virginia

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the West Virginia Lottery (the Lottery), as of and for the year ended June 30, 2013 and the related notes to the financial statements, which collectively comprise the Lottery's basic financial statements, and have issued our report thereon dated September 19, 2013.

#### **Internal Control over Financial Reporting**

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

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

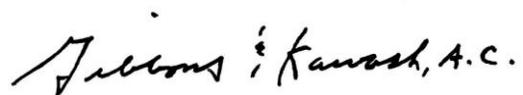
Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

#### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Lottery's financial statements are free from 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*.

### **Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Charleston, West Virginia  
September 19, 2013

SCHEDULE OF REVENUES AND NET REVENUES OF THE  
 LOTTERY FUND AND EXCESS LOTTERY FUND  
 Years Ended June 30, 2013 and 2012  
 (In Thousands)

	<u>2013</u>	<u>2012</u>
Gross revenues		
Instant games	\$ 108,635	\$ 117,676
On-line games	86,986	83,613
Racetrack video lottery	655,676	764,898
Limited video lottery	<u>399,224</u>	<u>406,108</u>
Total gross revenues*	<u>\$ 1,250,521</u>	<u>\$ 1,372,295</u>
Net revenues - Lottery Fund and Excess Lottery Fund**		
Lottery Fund		
Instant games	\$ 18,068	\$ 19,190
On-line games	28,681	26,582
Racetrack Video Lottery	<u>130,559</u>	<u>132,568</u>
Total Lottery Fund net revenues	177,308	178,340
Excess Lottery Fund		
Racetrack Video Lottery	95,768	141,440
Limited Video Lottery	190,408	193,860
Limited Video Lottery Fees	<u>9,412</u>	<u>71,330</u>
Total Excess Lottery Fund net revenues	295,588	406,630
Total net revenues	<u>\$ 472,896</u>	<u>\$ 584,970</u>
Reconciliation of Lottery Fund and Excess Lottery Fund net revenues to distributions to the State of West Virginia		
Lottery Fund and Excess Lottery Fund net revenues as reported above	\$ 472,896	\$ 584,970
Net revenues from the sale of Veteran's Instant tickets are transferred to the Veteran's Instant Ticket Fund and are not available to support debt service payments	357	575
Statutory transfers from Racetrack Video Lottery, Racetrack Table Games, and Historic Resort Lottery are not net revenues of the Lottery Fund or Excess Lottery Fund and are not available to support debt service payments	71,933	77,418
Interest income on the Revenue Center Construction Fund is not available to support debt service payments	<u>18</u>	<u>19</u>
Distributions to the State of West Virginia	<u>\$ 545,204</u>	<u>\$ 662,982</u>

(Continued)

SCHEDULE OF REVENUES AND NET REVENUES OF THE  
LOTTERY FUND AND EXCESS LOTTERY FUND

Years Ended June 30, 2013 and 2012

(In Thousands)

(Continued)

\* Total gross revenues exclude gross revenues from Table Games and Historic Resort Lotteries as these gross revenues are entirely statutorily distributed and do not produce net revenues.

\* \*

The Lottery Fund and the Excess Lottery Fund are statutorily created funds which receive net revenues from certain operations of the Lottery. For purposes of this schedule, net revenues are described as gross revenue (as indicated above) plus interest, less prizes, commissions, administrative charges, and other statutorily required distributions. See note 6 and note 7 to the financial statements for further description of statutorily required distributions. The net revenues received by the Lottery Fund and the Excess Lottery Fund are available to support debt service payments of the State of West Virginia as well as other purposes as appropriated by the West Virginia Legislature. For additional information see Note 10 of the Notes to the Financial Statements.