

Audited Financial Statements
With Other Financial Information

West Virginia Lottery

Years Ended June 30, 2014 and 2013

WEST VIRGINIA LOTTERY

Audited Financial Statements
With Other Financial Information

Years Ended June 30, 2014 and 2013

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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, 2014 and 2013, and the related notes to the financial statements, which collectively comprise the Lottery's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in 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, 2014 and 2013, 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 11 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 schedules on pages 40 through 41 are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The accompanying schedules on pages 40 through 41 are the responsibility of management and were derived from and relate 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 schedules on pages 40 through 41 are 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 11, 2014 on our consideration of the Lottery's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Lottery's internal control over financial reporting and compliance.

Charleston, West Virginia
September 11, 2014

Management's Discussion and Analysis (Continued)

-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, 2014 and 2013. In reading the Management's Discussion and Analysis (MD & A), the current year refers to fiscal year ending June 30, 2014, and the prior year refers to fiscal year ending June 30, 2013. This analysis is to be considered in conjunction with the financial statements, which begin on page 12.

Financial Highlights

The Lottery's operating income decreased in 2014 and decreased in 2013. The 2014 and 2013 decreases were due to competition from expanded gaming activities in neighboring states. The following summary is provided below:

- Lottery revenues for the current year decreased \$114.1 million or 8.6% compared to the prior year, which decreased \$129.2 million or 8.9% from 2012.
- Commissions for the current year decreased \$54.8 million or 8.9% compared to the prior year, which decreased \$59.8 million or 8.9% from 2012.
- Gross profit for the current year decreased \$54.5 million or 9.3% compared to the prior year, which decreased \$64.3 million or 9.9% from 2012.
- Nonoperating expenses decreased \$52.9 million or 9.3% compared to the prior year, which decreased \$122.1 million or 17.6% from 2012. The predominant nonoperating expenses are the distributions to the State of West Virginia, which decreased \$46.8 million or 8.6% compared to the prior year, which decreased \$117.8 million or 17.8% from 2012.

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 decreased \$125.0 million or 40.0% compared to the prior year, which increased \$31.0 million or 11.1% from 2012, 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 \$1.5 million or 3.7% compared to the prior year which decreased by \$2.1 million or 4.9% from 2012, both due to depreciation of 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)

	<u>2014</u>	<u>2013</u>	<u>2012</u>
Current assets	\$ 187,081	\$ 312,032	\$ 280,994
Restricted assets	1,397	1,640	2,373
Capital assets, net of accumulated depreciation and amortization	<u>38,745</u>	<u>40,220</u>	<u>42,285</u>
Total assets	<u>\$ 227,223</u>	<u>\$ 353,892</u>	<u>\$ 325,652</u>

As shown in Table 2, the Lottery's current liabilities for the current year decreased \$126.8 million or 42.4% compared to the prior year, which increased \$25.3 million or 9.3% compared to 2012. These changes are due to the distribution of accumulated surplus transferred to the State of West Virginia in the current year and the accumulation of surplus transferred to the State in the prior year.

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 - investment in capital assets decreased in the current year by \$1.5 million or 3.7% compared to the prior year as a result of depreciation which decreased by \$2.1 million or 4.9% in the prior year compared to 2012 also due to depreciation. Refer to Note 4 to the financial statements for additional information on capital assets.

Net position - unrestricted fluctuated in fiscal years 2014, 2013, and 2012 as a result of rental income from tenants located in 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)

	<u>2014</u>	<u>2013</u>	<u>2012</u>
Current liabilities	\$ 172,203	\$ 299,026	\$ 273,677
Net position - restricted by enabling legislation	1,397	1,640	1,690
Net position - investment in capital assets	38,745	40,220	42,285
Net position - unrestricted	<u>14,878</u>	<u>13,006</u>	<u>8,000</u>
Total net position	<u>55,020</u>	<u>54,866</u>	<u>51,975</u>
Total liabilities and net position	<u>\$ 227,223</u>	<u>\$ 353,892</u>	<u>\$ 325,652</u>

Management's Discussion and Analysis
(Continued)

-Unaudited-

Capital Assets

Capital assets as of June 30, 2014 amounted to \$47.4 million (at cost). This investment in capital assets includes land, building, construction in progress and equipment. The total increase in capital assets for the current fiscal year was 1.2%.

Table 3
Capital Assets
(in \$000's)

	2014	2013	2012
Construction in progress	\$ 792	\$ 549	\$ 519
Land	1,434	1,434	1,434
Building	38,084	38,084	38,084
Improvements	260	260	260
Equipment	6,821	6,519	6,519
Total assets	<u>\$ 47,391</u>	<u>\$ 46,846</u>	<u>\$ 46,816</u>

Major capital asset events during the current fiscal year included the following:

- Architectural fees for renovations to three floors of the Lottery headquarters building were incurred at a cost of \$243 thousand and \$30 thousand for the years ended June 30, 2014 and 2013, respectively.
- A new finger printing system was acquired at a cost of \$302 thousand in 2014.

Additional information on capital assets can be found in Note 4 of the financial statements.

Revenues, Expenses and Changes in Fund Net Position

The content of Table 4 is a summary of activities and is related to the discussion of Table 5.

Table 4
Revenues, Expenses and Changes in Fund Net Position
(in \$000's)

	2014	2013	2012
Revenues:			
On-line games	\$ 83,069	\$ 86,986	\$ 83,613
Instant games	105,562	108,635	117,676
Racetrack video lottery	590,918	655,676	764,898
Limited video lottery	377,222	399,224	406,108
Table games	50,465	70,259	78,121
Historic resort	7,048	7,597	7,114
	<u>1,214,284</u>	<u>1,328,377</u>	<u>1,457,530</u>
Less commissions:			
On-line games	5,821	6,095	5,844
Instant games	7,390	7,604	8,239
Racetrack video lottery	336,205	370,828	424,049
Limited video lottery	184,839	195,620	198,993
Table games	22,032	30,675	33,571
Historic resort	3,455	3,705	3,671
	<u>559,742</u>	<u>614,527</u>	<u>674,367</u>

Management's Discussion and Analysis
(Continued)

-Unaudited-

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

Table 4 (Continued)
Revenues, Expenses and Changes in Fund Net Position
(in \$000's)

	<u>2014</u>	<u>2013</u>	<u>2012</u>
Less on-line prize costs	42,096	44,109	42,039
Less instant ticket prize costs	69,665	72,121	78,567
Less ticket costs	1,730	1,804	2,188
Less vendor fees and costs	<u>8,044</u>	<u>8,325</u>	<u>8,611</u>
	<u>121,535</u>	<u>126,359</u>	<u>131,405</u>
Gross profit	533,007	587,491	651,758
Administrative expenses:			
Advertising and promotions	5,755	4,622	5,680
Wages and related benefits	10,854	11,049	12,774
Telecommunications	881	983	761
Contractual and professional	4,682	4,421	5,452
Rental	267	239	423
Depreciation and amortization	2,020	2,095	1,164
Other administrative expenses	<u>1,420</u>	<u>1,454</u>	<u>1,936</u>
	25,879	24,863	28,190
Other operating income	<u>11,719</u>	<u>11,860</u>	<u>73,351</u>
Operating income	518,847	574,488	696,919
Nonoperating income (expense):			
Investment income	463	253	181
Distributions to municipalities and counties	(7,394)	(7,825)	(7,960)
Distributions for capital reinvestment	(13,397)	(18,821)	(22,900)
Distributions to the State of West Virginia	<u>(498,365)</u>	<u>(545,204)</u>	<u>(662,982)</u>
	<u>(518,693)</u>	<u>(571,597)</u>	<u>(693,661)</u>
Income before capital contribution	154	2,891	3,258
Capital contribution from the State of WV	<u>-</u>	<u>-</u>	<u>9,645</u>
Net income	154	2,891	12,903
Net position, beginning of year	<u>54,866</u>	<u>51,975</u>	<u>39,072</u>
Net position, end of year	<u>\$ 55,020</u>	<u>\$ 54,866</u>	<u>\$ 51,975</u>

Management's Discussion and Analysis
(Continued)

-Unaudited-

Sales and Prizes, Commissions, Ticket Costs and Vendor Fees

Table 5 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 2014, 2013, and 2012. Sales and gross profits fluctuated in certain categories; however, gross profit percentages remained consistent from year to year.

Table 5
Lottery Sales
(in \$000's)

	Instant			On-Line*		
	2014	2013	2012	2014	2013	2012
Gross sales	\$ 105,562	\$ 108,635	\$ 117,676	\$ 83,069	\$ 86,986	\$ 83,613
Less direct costs:						
Prizes and bonuses	69,665	72,121	78,567	42,096	44,109	42,039
Commissions	7,390	7,604	8,239	5,821	6,095	5,844
Ticket printing costs	1,730	1,804	2,188	-	-	-
Vendor fees and costs	4,510	4,537	5,038	3,534	3,788	3,573
Total direct costs	83,295	86,066	94,032	51,451	53,992	51,456
Gross Profit	\$ 22,267	\$ 22,569	\$ 23,644	\$ 31,618	\$ 32,994	\$ 32,157
Gross profit percentage	21.1%	20.8%	20.1%	38.1%	37.9%	38.5%

* On-line games include the results of Powerball® and Mega Millions which are significant components of the results described above.

	Racetrack Video Lottery			Limited Video Lottery			Total		
	2014	2013	2012	2014	2013	2012	2014	2013	2012
Gross sales	\$ 590,918	\$ 655,676	\$ 764,898	\$ 377,222	\$ 399,224	\$ 406,108			
Less direct costs:									
Prizes and bonuses	-	-	-	-	-	-	111,761	116,230	120,606
Commissions	336,205	370,828	424,049	184,839	195,620	198,993	559,742	614,527	674,367
Ticket printing costs	-	-	-	-	-	-	1,730	1,804	2,188
Vendor fees and costs	-	-	-	-	-	-	8,044	8,325	8,611
Total direct costs	336,205	370,828	424,049	184,839	195,620	198,993	681,277	740,886	805,772
Gross Profit	\$ 254,713	\$ 284,848	\$ 340,849	\$ 192,383	\$ 203,604	\$ 207,115	\$ 533,007	\$ 587,491	\$ 651,758
Gross profit percentage	43.1%	43.4%	44.6%	51.0%	51.0%	51.0%	43.9%	44.2%	44.7%

Management's Discussion and Analysis (Continued)

-Unaudited-

Instant Sales

Instant ticket sales for the current year decreased by \$3.1 million or 2.8% compared to the prior year, which decreased \$9.0 million or 7.7% from 2012. Fifty-three new games were introduced in 2014 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 were two ten-dollar and two twenty-dollar tickets introduced in 2014 after the Legislative change allowing the sale of tickets priced up to twenty dollars. There were also seven five-dollar tickets and seven three-dollar tickets introduced.

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 2014, 2013, and 2012. 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 decreased \$9.2 million or 18.9% compared to the prior year, which increased \$10.0 million or 25.9% from 2012. 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.

Mega Millions® Sales

Mega Millions® sales offers jackpots starting at \$15 million and other prizes ranging from \$1 to \$1,000,000. Sales for the current year increased \$5.6 million or 60.1% compared to the prior year, which decreased \$5.5 million or 37.1% from 2012.

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 \$295 thousand or 1.0% compared to the prior year, which decreased \$1.2 million or 3.8% from 2012.

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 5.

Management's Discussion and Analysis
(Continued)

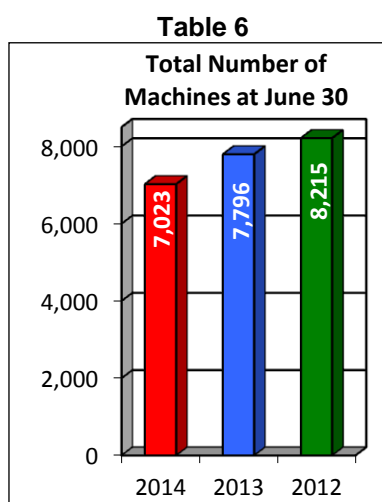
-Unaudited-

Racetrack Video Lottery

Racetrack video lottery revenues are reported as total wagers net of prizes and credits. Revenues for the current year decreased \$64.8 million or 9.9% compared to the prior year, which decreased \$109.2 million or 14.3% from 2012 due to increased competition from gaming operations in neighboring states.

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 \$34.6 million or 9.3% compared to the prior year which decreased \$53.2 million or 12.6% compared to 2012 due to the decrease in related revenues.

In fiscal year 2014, 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 6 below which illustrates the last three fiscal years.



Limited Video Lottery

Sales for the current year decreased \$22.0 million or 5.5% compared to the prior year, which decreased \$6.9 million or 1.7% from 2012. 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 \$10.8 million or 5.5% compared to the prior year decrease of \$3.4 million or 1.7% from 2012.

Table 7 illustrates the number of machines which decreased by 1,001 machines for the current year compared to the prior year decrease of 66 machines from 2012.

Management's Discussion and Analysis (Continued)

-Unaudited-

Limited Video Lottery (Continued)

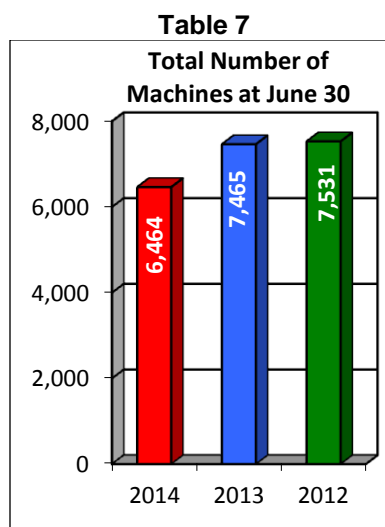


Table Games

Revenues from table games are calculated at a 35% privilege tax of adjusted gross receipts. Revenues for the current year decreased \$19.8 million or 28.2% compared to the prior year, which decreased \$7.9 million or 10.1% from 2012.

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 \$8.6 million or 28.2% compared to the prior year, which decreased \$2.9 million or 8.6% from 2012.

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 decreased \$549 thousand or 7.2% compared to the prior year, which increased \$483 thousand or 6.8% from 2012.

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 decreased \$250 thousand or 6.8% compared to the prior year, which increased \$34 thousand or 0.9% from 2012.

Other Operating Income

Refer to Table 4. 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.

Management's Discussion and Analysis (Continued)

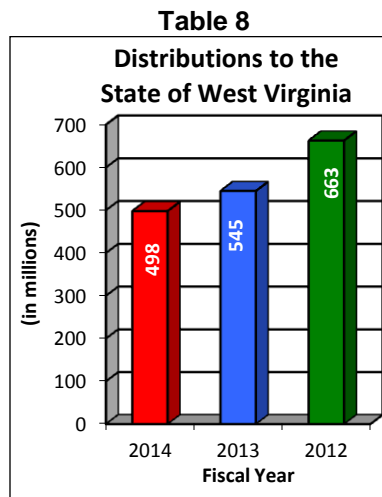
-Unaudited-

Nonoperating Income (Expense)

Refer to Table 4. 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 \$46.8 million compared to the prior year, which decreased by \$117.8 million from 2012.



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, 2014 and 2013

<u>ASSETS</u>	<u>2014</u>	<u>2013</u>
Current assets:		
Cash and cash equivalents	\$ 149,712	\$ 273,418
Accounts receivable	34,790	35,999
Inventory	633	492
Other assets	<u>1,946</u>	<u>2,123</u>
Total current assets	<u>187,081</u>	<u>312,032</u>
Noncurrent assets:		
Restricted cash and cash equivalents	1,397	1,640
Capital assets	47,391	46,846
Less accumulated depreciation and amortization	<u>(8,646)</u>	<u>(6,626)</u>
Total noncurrent assets	<u>38,745</u>	<u>40,220</u>
Total noncurrent assets	<u>40,142</u>	<u>41,860</u>
Total assets	<u>\$ 227,223</u>	<u>\$ 353,892</u>
 <u>LIABILITIES</u>		
Current liabilities:		
Accrued nonoperating distributions to the State of West Virginia	\$ 114,914	\$ 239,035
Estimated prize claims	14,983	14,144
Accounts payable	1,505	1,828
Other accrued liabilities	<u>40,801</u>	<u>44,019</u>
Total current liabilities	<u>\$ 172,203</u>	<u>\$ 299,026</u>
 <u>NET POSITION</u>		
Net position:		
Restricted by enabling legislation	\$ 1,397	\$ 1,640
Investment in capital assets	38,745	40,220
Unrestricted	<u>14,878</u>	<u>13,006</u>
Total net position	<u>\$ 55,020</u>	<u>\$ 54,866</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, 2014 and 2013

	2014	2013
Lottery revenues:		
On-line games	\$ 83,069	\$ 86,986
Instant games	105,562	108,635
Racetrack video lottery	590,918	655,676
Limited video lottery	377,222	399,224
Table games	50,465	70,259
Historic resort	7,048	7,597
	<u>1,214,284</u>	<u>1,328,377</u>
Less commissions:		
On-line games	5,821	6,095
Instant games	7,390	7,604
Racetrack video lottery	336,205	370,828
Limited video lottery	184,839	195,620
Table games	22,032	30,675
Historic resort	3,455	3,705
	<u>559,742</u>	<u>614,527</u>
Less on-line prize costs	42,096	44,109
Less instant prize costs	69,665	72,121
Less ticket costs	1,730	1,804
Less vendor fees and costs	8,044	8,325
	<u>121,535</u>	<u>126,359</u>
Gross profit	<u>533,007</u>	<u>587,491</u>
Administrative expenses:		
Advertising and promotions	5,755	4,622
Wages and related benefits	10,854	11,049
Telecommunications	881	983
Contractual and professional	4,682	4,421
Rental	267	239
Depreciation and amortization	2,020	2,095
Other administrative expenses	1,420	1,454
	<u>25,879</u>	<u>24,863</u>
Other operating income	<u>11,719</u>	<u>11,860</u>
Operating income	<u>518,847</u>	<u>574,488</u>
Nonoperating income (expense):		
Investment income	463	253
Distributions to municipalities and counties	(7,394)	(7,825)
Distributions for capital reinvestment	(13,397)	(18,821)
Distributions to the State of West Virginia	(498,365)	(545,204)
	<u>(518,693)</u>	<u>(571,597)</u>
Net income	<u>154</u>	<u>2,891</u>
Net position, beginning of year	<u>54,866</u>	<u>51,975</u>
Net position, end of year	<u>\$ 55,020</u>	<u>\$ 54,866</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, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Cash flows from operating activities:		
Cash receipts from customers and other sources	\$ 1,227,212	\$ 1,340,909
Cash payments for:		
Personnel costs	(10,932)	(10,960)
Suppliers	(13,019)	(12,852)
Other operating costs	<u>(681,302)</u>	<u>(738,824)</u>
Cash provided by operating activities	<u>521,959</u>	<u>578,273</u>
Cash flows from noncapital financing activities:		
Nonoperating distributions to the State of West Virginia	(622,486)	(522,988)
Distributions to municipalities and counties	(7,428)	(7,855)
Distributions to racetracks from racetrack capital reinvestment fund	<u>(15,795)</u>	<u>(16,506)</u>
Cash used in noncapital financing activities	<u>(645,709)</u>	<u>(547,349)</u>
Cash flows from capital and related financing activities		
Purchases of capital assets	<u>(545)</u>	<u>(30)</u>
Cash flows from investing activities:		
Investment earnings	<u>346</u>	<u>253</u>
Increase (decrease) in cash and cash equivalents	(123,949)	31,147
Cash and cash equivalents (including restricted cash and cash equivalents), beginning of year	<u>275,058</u>	<u>243,911</u>
Cash and cash equivalents (including restricted cash and cash equivalents), end of year	<u>\$ 151,109</u>	<u>\$ 275,058</u>

(Continued)

WEST VIRGINIA LOTTERY
 STATEMENTS OF CASH FLOWS
 (In Thousands)
 (Continued)
 Years Ended June 30, 2014 and 2013

	2014	2013
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 518,847	\$ 574,488
Adjustments to reconcile operating income to cash provided by operating activities:		
Depreciation and amortization	2,020	2,095
Changes in operating assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	1,209	672
Inventory	(141)	18
Other assets	294	152
Increase (decrease) in:		
Estimated prize claims	839	772
Accounts payable	(323)	(1,410)
Other accrued liabilities	(786)	1,486
	\$ 521,959	\$ 578,273
Cash provided by operating activities	\$ 521,959	\$ 578,273

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 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 internal investment pools maintained by the West Virginia Board of Treasury Investments (BTI). The West Virginia Money Market Pool pool is a 2a-7-like pool carried at amortized cost and the West Virginia Short Term Bond Pool is carried at fair value.

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

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 (See Note 13), in accordance with GAAP.

Employees fully vest in all earned but unused annual leave. The Lottery also accrues a liability for estimated obligations that may arise in connection with compensated absences at the current rate of employee pay. The Lottery's annual leave transactions for years ending June 30, 2014 and June 30, 2013 are as follows:

	Year Ending June 30	
	2014	2013
Beginning compensated absences	\$ 555,325	\$ 566,986
Leave expenses incurred	573,313	542,505
Leave expenses paid	<u>(555,325)</u>	<u>(554,166)</u>
Ending compensated absences	<u>\$ 573,313</u>	<u>\$ 555,325</u>
Compensated absences estimated to be paid in one year	<u>\$ 573,313</u>	<u>\$ 555,325</u>

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Net Position

Net position is presented as either unrestricted, restricted by enabling legislation for capital project, or as 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.

Advertising and Promotions

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

3 - CASH AND CASH EQUIVALENTS

At June 30, 2014 and 2013, the carrying amounts of deposits with financial institutions were \$473 thousand and \$1.411 million, respectively, with bank balances of \$500 thousand and \$2.282 million, 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, 2014 and 2013, 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>2014</u>	<u>2013</u>
Deposits with financial institutions	\$ 473	\$ 1,411
Cash on hand at the Treasurer's Office	21,310	53,718
Investments with BTI reported as cash equivalents	<u>129,326</u>	<u>219,929</u>
	<u>\$ 151,109</u>	<u>\$ 275,058</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 and the BTI's West Virginia Short Term Bond 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. Investments in the West Virginia Money Market Pool are available to the Lottery with overnight notice. Investments in the West Virginia Short Term Bond Pool are available to the Lottery on the first day of each month.

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

3 - CASH AND CASH EQUIVALENTS (Continued)

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. Neither the BTI itself nor the West Virginia Short Term Bond Pool has 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.

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+	\$ 234,951	11.99%
	P-1	A-1	772,107	39.40
Corporate bonds and notes	Aa3	AA-	20,000	1.02
U.S. agency bonds	Aaa	AA+	82,765	4.22
U.S. Treasury notes*	Aaa	AA+	185,065	9.45
U.S. Treasury bills *	P-1	A-1+	104,995	5.36
Negotiable certificates of deposit	NR	AA-	10,000	0.51
	P-1	A-1+	28,000	1.43
	P-1	A-1	144,000	7.35
U.S. agency discount notes	P-1	A-1+	207,484	10.59
Money market funds	Aaa	AAAM	39	0.00
Repurchase agreements (underlying securities):				
U.S. Treasury notes*	Aaa	AA+	93,284	4.76
U.S. agency notes	Aaa	AA+	76,900	3.92
			<u>\$ 1,959,590</u>	<u>100.00%</u>

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

The BTI limits the exposure to credit risk in WV Short Term Bond Pool by requiring all corporate bonds to be rated BBB- or higher by Standard & Poor's (or its equivalent). Commercial paper must be rated at least A-1 by Standard & Poor's and P-1 by Moody's. Mortgage-backed and asset-backed securities must be rated AAA by Standard & Poor's and Aaa by Moody's. The following table provides information on the credit ratings of the WV Short Term Bond Pool's investments (in thousands):

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

3 - CASH AND CASH EQUIVALENTS (Continued)

<u>Security Type</u>	<u>Credit Rating</u>		<u>Carrying Value</u>	<u>Percent of Assets</u>	
	<u>Moody's</u>	<u>S&P</u>			
Corporate asset backed securities	Aaa	AAA	\$ 91,752	11.89%	
	Aaa	NR	76,982	9.97	
	NR	AAA	71,564	9.27	
	* Caa3	D	300	0.04	
	* Caa3	NR	19	0.00	
	* Ca	CCC	321	0.04	
	* Ca	D	94	0.01	
	* NR	NR	4,024	0.52	
	Corporate bonds and notes	Aaa	AA+	7,675	0.99
		Aa1	AA+	5,005	0.65
Aa2		AA+	4,034	0.52	
Aa2		AA	9,791	1.27	
Aa2		AA-	10,055	1.30	
Aa3		AA-	23,468	3.04	
Aa3		A+	10,066	1.30	
A1		AA+	13,268	1.72	
A1		AA-	5,987	0.78	
A1		A+	38,092	4.93	
A1		A	5,122	0.66	
A1		A-	1,099	0.14	
A2		A+	9,678	1.25	
A2		A	36,840	4.77	
A2		A-	12,119	1.57	
A3		A-	12,864	1.67	
A3		A	16,082	2.08	
A3		BBB+	8,862	1.15	
A3		BBB	1,003	0.13	
Baa1		A-	12,615	1.63	
Baa1		BBB+	25,158	3.26	
Baa1		BBB	8,344	1.08	
Baa1		BBB-	1,996	0.26	
Baa2		BBB-	19,340	2.51	
Baa2		BBB+	2,006	0.26	
Baa2		BBB	11,325	1.47	
Baa2		BBB-	4,448	0.58	
Baa3		BBB+	2,200	0.29	
Baa3		BBB	7,539	0.98	
Baa3		BBB-	16,716	2.17	

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

3 - CASH AND CASH EQUIVALENTS (Continued)

<u>Security Type</u>	<u>Credit Rating</u>		<u>Carrying Value</u>	<u>Percent of Assets</u>
	<u>Moody's</u>	<u>S&P</u>		
U.S. agency bonds	Aaa	AA+	10,007	1.30
U.S. Treasury notes **	Aaa	AA+	121,559	15.75
U.S. agency mortgage backed securities ***	Aaa	AA+	38,296	4.96
Money market funds	Aaa	AAAm	<u>14,226</u>	<u>1.84</u>
			<u>\$ 771,941</u>	<u>100.00%</u>

Interest rate risk - Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment.

The overall 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.

<u>Security Type</u>	<u>Carrying Value (In Thousands)</u>	<u>Effective Duration (Days)</u>
Repurchase agreements	\$ 170,184	1
U.S. Treasury notes	185,065	47
U.S. Treasury bills	104,995	44
Commercial paper	1,007,058	33
Certificates of deposit	182,000	51
U.S. agency discount notes	207,484	38
Corporate bonds and notes	20,000	17
U.S. agency bonds	82,765	74
Money market funds	<u>39</u>	1
	<u>\$ 1,959,590</u>	

The weighted average maturity of the investments in the West Virginia Money Market Pool as of June 30, 2014, is 36 days.

The overall effective duration of the investments of the West Virginia Short Term Bond Pool cannot exceed 731 days. Maximum effective duration of individual securities cannot exceed 1,827 days (five years) from date of purchase. The following table provides information on the effective duration for the various asset types in the West Virginia Short Term Bond Pool.

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>Effective Duration (Days)</u>
US Treasury notes	\$ 121,559	315
Corporate bonds and notes	342,799	483
Corporate asset backed securities	245,056	397
U.S. agency bonds	10,007	219
U.S. agency mortgage backed securities	38,294	291
Money market funds	<u>14,226</u>	1
Total assets	<u>\$ 771,941</u>	

The effective duration of the investments in the West Virginia Short Term Bond Pool as of June 30, 2014 is 407 days.

Concentration of credit risk - West Virginia statutes prohibit the West Virginia Money Market Pool and the West Virginia Short Term Bond Pool from investing more than 5% of its assets in securities issued by one corporate name or corporate issue. At June 30, 2014, the pools did not have investments in any one private corporation or association that represented more than 5% of assets.

Custodial credit risk - At June 30, 2014, neither the West Virginia Money Market Pool nor the West Virginia Short Term Bond Pool held 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.

Foreign currency risk - Neither the West Virginia Money Market Pool nor the West Virginia Short Term Bond Pool has 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, 2012	Additions	Deletions	Historical cost at June 30, 2013	Additions	Deletions	Historical cost at June 30, 2014
Capital assets, not depreciated							
Construction in progress	\$ 519	\$ 30	\$ -	\$ 549	\$ 243	\$ -	\$ 792
Land	1,434	-	-	1,434	-	-	1,434
Capital assets, being depreciated							
Building	38,084	-	-	38,084	-	-	38,084
Improvements	260	-	-	260	-	-	260
Equipment	<u>6,519</u>	<u>-</u>	<u>-</u>	<u>6,519</u>	<u>302</u>	<u>-</u>	<u>6,821</u>
	<u>\$ 46,816</u>	<u>\$ 30</u>	<u>\$ -</u>	<u>\$ 46,846</u>	<u>\$ 545</u>	<u>\$ -</u>	<u>\$ 47,391</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,
	2012	Additions	Deletions	2013	Additions	Deletions	2014
Building	\$ 237	\$ 952	\$ -	\$ 1,189	\$ 952	\$ -	\$ 2,141
Improvements	260	-	-	260	-	-	260
Equipment	4,034	1,143	-	5,177	1,068	-	6,245
	<u>\$ 4,531</u>	<u>\$ 2,095</u>	<u>\$ -</u>	<u>\$ 6,626</u>	<u>\$ 2,020</u>	<u>\$ -</u>	<u>\$ 8,646</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 \$39,490,788 and \$48,688,807 for the years ended June 30, 2014 and 2013, respectively, and related prize costs were \$19,747,242 and \$24,344,477, respectively.

Revenues derived from the Lottery's participation in the HOT LOTTO™ game were \$5,310,353 and \$5,063,704 for the years ended June 30, 2014 and 2013, respectively, and related prize costs were \$2,655,381 and \$2,531,917, respectively.

Revenues derived from the Lottery's participation in the MEGA MILLIONS® game were \$14,850,257 and \$9,274,409 for the years ended June 30, 2014 and 2013, respectively, and related prize costs were \$7,536,658 and \$4,760,567, 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>2014</u>		<u>2013</u>	
	<u>Total Prize Reserve</u>	<u>Lottery Share</u>	<u>Total Prize Reserve</u>	<u>Lottery Share</u>
POWERBALL®	\$ 111,576	\$ 1,887	\$ 113,874	\$ 1,997
HOT LOTTO™	7,412	548	7,921	533
MEGA MILLIONS®	35,843	583	27,968	469
	<u>\$ 154,831</u>	<u>\$ 3,018</u>	<u>\$ 149,763</u>	<u>\$ 2,999</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 \$16,082,650 and \$16,342,326 at June 30, 2014 and 2013, of which the Lottery's share was \$1,617,659 and \$1,674,811, 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 Ohio, 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, 2014 and June 30, 2013 respectively.

A summary of racetrack video lottery revenues for the years ended June 30, 2014 and 2013, follows (in thousands):

	<u>2014</u>	<u>2013</u>
Total credits (bets) played	\$ 6,574,814	\$ 7,293,271
Credits (prizes) won	(5,897,773)	(6,546,860)
Promotional credits played	(85,802)	(90,346)
MWAP Contributions	<u>(321)</u>	<u>(389)</u>
Gross terminal income	590,918	655,676
Administrative costs	<u>(16,586)</u>	<u>(17,475)</u>
Net terminal income	574,332	638,201
Commissions	<u>(336,205)</u>	<u>(370,828)</u>
Racetrack video lottery revenues available for distribution	<u>\$ 238,127</u>	<u>\$ 267,373</u>

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

	<u>2014</u>	<u>2013</u>
State Lottery Fund	\$ 120,729	\$ 127,728
State Excess Lottery Revenue Fund	77,443	95,727
Capital Reinvestment Fund	6,924	8,555
Tourism Promotion Fund	7,573	8,375
Development Office Promotion Fund	2,065	2,284
Research Challenge Fund	2,754	3,045
Capitol Renovation and Improvement Fund	3,787	4,187
Parking Garage Fund	844	881

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

6 - RACETRACK VIDEO LOTTERY (Continued)

	<u>2014</u>	<u>2013</u>
Cultural Facilities and Capitol Resources Fund	1,500	1,500
Capitol Dome and Capitol Improvements Fund	3,508	4,091
Workers Compensation Debt Reduction Fund	<u>11,000</u>	<u>11,000</u>
Total nonoperating distributions	<u>\$ 238,127</u>	<u>\$ 267,373</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, 2014, the Lottery is to transfer up to \$10 million from racetrack administrative surplus funds to the Modernization Fund, and up to \$9 million for the years ended June 30, 2015 through June 30, 2020, 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, 2014 and 2013, 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, 2014 and 2013 follows (in thousands):

	<u>2014</u>	<u>2013</u>
Total credits played	\$ 4,482,939	\$ 4,728,660
Credits (prizes) won	<u>(4,105,717)</u>	<u>(4,329,436)</u>
Gross terminal income	377,222	399,224
Administrative costs	<u>(7,544)</u>	<u>(7,984)</u>
Gross profit	369,678	391,240
Commissions	(184,839)	(195,620)
Distributions to municipalities and counties	<u>(7,394)</u>	<u>(7,825)</u>
Limited video lottery revenues available for distribution	<u>\$ 177,445</u>	<u>\$ 187,795</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 3% of the adjusted gross receipts for administrative expenses. 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, 2014 and 2013 was \$144,185,524 and \$200,738,953, respectively. A summary of table games revenues for the years ended June 30, 2014 and 2013 follows (in thousands):

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

8 - TABLE GAMES (Continued)

	<u>2014</u>	<u>2013</u>
Table games privilege tax	\$ 50,465	\$ 70,259
Interest on table games fund	4	6
Administrative costs	<u>(4,326)</u>	<u>(6,022)</u>
Total available for distribution	46,143	64,243
<u>Less distributions:</u>		
Racetrack purse funds	3,605	5,018
Thoroughbred & greyhound development funds	2,884	4,015
Racing commission pension plan	1,269	1,767
Municipalities/counties	<u>14,274</u>	<u>19,875</u>
Total distributions	22,032	30,675
Table games distribution to the state debt reduction fund	<u>\$ 24,111</u>	<u>\$ 33,568</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, 2014 and 2013 follows (in thousands):

	<u>2014</u>	<u>2013</u>
Total credits played	\$ 63,726	\$ 63,594
Credits (prizes) won	(58,302)	(58,154)
Promotional credits played	(980)	(693)
MWAP contribution	<u>(3)</u>	<u>(9)</u>
Gross terminal income	4,441	4,738
Capital reinvestment	(209)	(223)
Modernization	(40)	(43)
Administrative costs	(240)	(256)
Hotel commissions	<u>(1,878)</u>	<u>(2,004)</u>
Net terminal income	<u>\$ 2,074</u>	<u>\$ 2,212</u>
Historic Resort Hotel Fund	\$ 1,319	\$ 1,407
Human Resource Benefit Fund	<u>755</u>	<u>805</u>
Total	<u>\$ 2,074</u>	<u>\$ 2,212</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, 2014 and 2013 were \$7,449,814 and \$8,168,463, respectively.

The following table shows the privilege tax and the accrued distributions (in thousands) for the years ended June 30, 2014 and 2013:

	<u>2014</u>	<u>2013</u>
Table games privilege tax	\$ 2,607	\$ 2,859
Administrative costs	<u>(335)</u>	<u>(368)</u>
Total available for distribution	<u>\$ 2,272</u>	<u>\$ 2,491</u>
Historic Resort Hotel Fund	\$ 1,900	\$ 2,083
Human Resource Benefit Fund	<u>372</u>	<u>408</u>
Total distributions	<u>\$ 2,272</u>	<u>\$ 2,491</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, 2014 and 2013:

- 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, 2014 and 2013:

	<u>2014</u>	<u>2013</u>
Historic Resort Hotel video lottery	\$ 1,319	\$ 1,407
Historic Resort table games	<u>1,900</u>	<u>2,083</u>
Historic Resort Hotel Fund net income	<u>\$ 3,219</u>	<u>\$ 3,490</u>
Municipalities/Counties	\$ 450	\$ 488
State General Revenue Fund	2,060	2,234
State Debt Reduction Fund	612	663
State Tourism Promotion Fund	<u>97</u>	<u>105</u>
Total distributions	<u>\$ 3,219</u>	<u>\$ 3,490</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, 2014 and 2013, the State Legislature budgeted \$200,086,988 and \$145,017,313 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, 2014 and 2013, the Lottery made or accrued all budgeted distributions and accrued additional distributions from the State Lottery Fund and State Excess Lottery Revenue Fund of \$112,439,263 and \$235,130,619, respectively. The Lottery does not have a legally adopted annual budget.

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, 2014 and 2013, the Lottery accrued additional distributions relating to racetrack video lottery operations in the amounts of \$510,464 and \$523,517, 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, 2014 and 2013, the Lottery accrued additional distributions relating to table games operations in the amounts of \$1,765,456 and \$2,356,869, respectively. Note 9 describes the Historic Resort Hotel statutory distributions to be made from historic resort operations. As of June 30, 2014 and 2013, the Lottery accrued additional distributions relating to Historic Resort operations of \$198,737 and \$299,233, respectively.

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

	<u>2014</u>	<u>2013</u>
<u>Budgetary distributions:</u>		
<u>Revenue Center Construction Fund:</u>		
General Purpose Account	\$ 724	\$ 14,736
<u>Administrative Operations Account:</u>		
General Purpose Account	7,500	-
<u>State Lottery Fund:</u>		
Bureau of Senior Services	94,837	42,834
Department of Education	27,451	30,612
Library Commission	11,467	12,186
Higher Education - Central Office	7,582	7,889
Tourism	8,922	7,364
Natural Resources	9,796	3,398
Division of Culture & History	5,228	5,903
Department of Education & Arts	1,812	1,840
Economic Development Authority	9,999	10,000
School Building Authority	17,996	17,997
Community and Technical College	4,997	4,995
Total State Lottery Fund	<u>200,087</u>	<u>145,018</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	18,993
Economic Development Fund	20,387	18,989
Refundable Credit - General Revenue Fund	10,000	10,000
Racing Commission	2,000	2,000
WV Department of Health and Human Resources	96,544	24,504
WV Development Office	-	400
Excess Lottery Surplus (General Fund)	27,600	27,600
Excess Lottery Surplus (Teachers Retirement Savings Realized)	<u>17,522</u>	<u>28,061</u>
Total State Excess Lottery Revenue Fund	<u>353,046</u>	<u>290,547</u>
Total Required Statutory and Budgetary Distributions	<u>561,357</u>	<u>450,301</u>
Veterans Instant Ticket Fund	<u>512</u>	<u>422</u>

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

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

	<u>2014</u>	<u>2013</u>
<u>Other racetrack video lottery distributions:</u>		
Tourism Promotion Fund	7,578	8,345
Development Office Promotion Fund	2,067	2,276
Research Challenge Fund	2,756	3,035
Capitol Renovation and Improvement Fund	3,789	4,173
Parking Garage Funds	844	879
Cultural Facilities and Capitol Resources Fund	1,500	1,500
Capitol Dome and Capitol Improvements Fund	3,511	4,069
Workers Compensation Debt Reduction Fund	<u>11,000</u>	<u>11,000</u>
	<u>33,045</u>	<u>35,277</u>
 <u>Table games distributions:</u>		
State Debt Reduction Fund	<u>24,702</u>	<u>34,044</u>
 <u>Historic resort hotel distributions:</u>		
State General Revenue Fund	2,135	2,191
State Debt Reduction Fund	635	650
Tourism Promotion Fund	<u>100</u>	<u>103</u>
Total	<u>2,870</u>	<u>2,944</u>
 Total nonoperating distributions to the State of West Virginia (cash basis)		
	622,486	522,988
 Accrued nonoperating distributions, beginning of year		
	(239,035)	(216,819)
 Accrued nonoperating distributions, end of year		
	<u>114,914</u>	<u>239,035</u>
 Total nonoperating distributions to the State of West Virginia		
	<u>\$ 498,365</u>	<u>\$ 545,204</u>

11 - RESTRICTED NET POSITION

Beginning in the year ended June 30, 2006, the West Virginia Legislature set aside certain unexpended administrative funds of the Lottery 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 entities. During the year ended June 30, 2010, the Legislature approved the use of these funds to purchase and improve an existing building. The building was acquired and improvements have been substantially completed. The unexpended balance of these funds are reported as restricted net position. Restricted net position activity is as follows for the years ended June 30, 2014 and 2013 (in thousands):

	<u>2014</u>	<u>2013</u>
Beginning restricted net position	\$ 1,640	\$ 1,690
Acquisition of assets in accordance with enabling legislation	<u>(243)</u>	<u>(50)</u>
Ending restricted net position	<u>\$ 1,397</u>	<u>\$ 1,640</u>

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

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 14.5%, 14%, and 14.5% of covered employees' salaries to the PERS for the years ended June 30, 2014, 2013, and 2012, 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 2014, 2013, and 2012, were as follows (in thousands):

	<u>2014</u>	<u>2013</u>	<u>2012</u>
Lottery contributions	\$ 1,144	\$ 1,146	\$ 1,225
Employee contributions	<u>332</u>	<u>341</u>	<u>357</u>
Total contributions	<u>\$ 1,476</u>	<u>\$ 1,487</u>	<u>\$ 1,582</u>

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 57th Street, S.E., Suite 2, Charleston, West Virginia, 25304-2345, or by calling 1-888-680-7342.

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

13 - OTHER POSTEMPLOYMENT BENEFITS (OPEB) (Continued)

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 \$176 and \$257 per employee per month for the years ending June 30, 2014 and 2013, respectively. The Lottery's ARC was \$447,726, \$445,479, and \$1,643,408 and the Lottery has paid premiums of \$317,690, \$332,615, and \$317,694, which represent 71.0%, 74.7%, and 19.3% of the ARC, respectively, for the years ending June 30, 2014, 2013, and 2012. As of June 30, 2014, 2013, and 2012, the Lottery has recorded a liability of \$4,318,481, \$4,188,445, and \$4,075,581, 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 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.

WEST VIRGINIA LOTTERY

NOTES TO FINANCIAL STATEMENTS
(Continued)**14 - RISK MANAGEMENT (Continued)**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, 2014, 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, 2014 and 2013 approximated \$267,083 and \$238,674 respectively.

The Lottery is a lessor of certain office space under the terms of cancellable operating leases to various tenants. Rental revenues for the years ended June 30, 2014 and 2013 were \$1,423,729 and \$1,377,991, respectively.

16 - COMMITMENTS

The Lottery Commission has designated unexpended administrative funds from various fiscal years for the acquisition of capital assets. As of June 30, 2014 and 2013, \$7,653,177 and \$2,003,028, respectively, are included in unrestricted net position for this purpose.

17 - NEW ACCOUNTING PRONOUNCEMENTS

GASB has 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, 2014, and the related notes to the financial statements, which collectively comprise the Lottery's basic financial statements, and have issued our report thereon dated September 11, 2014.

Internal Control over Financial Reporting

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

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the 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.

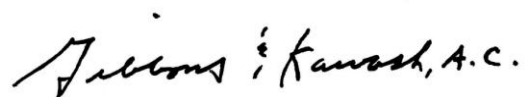
Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not 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 11, 2014

OTHER FINANCIAL INFORMATION

WEST VIRGINIA LOTTERY
 SCHEDULE OF REVENUES AND NET REVENUES OF THE
 LOTTERY FUND AND EXCESS LOTTERY FUND
 Years Ended June 30, 2014 and 2013
 (In Thousands)

	<u>2014</u>	<u>2013</u>
Gross revenues		
Instant games	\$ 105,562	\$ 108,635
On-line games	83,069	86,986
Racetrack video lottery	590,918	655,676
Limited video lottery	<u>377,222</u>	<u>399,224</u>
Total gross revenues*	<u>\$ 1,156,771</u>	<u>\$ 1,250,521</u>
Net revenues - Lottery Fund and Excess Lottery Fund**		
Lottery Fund		
Instant games	\$ 13,568	\$ 18,068
On-line games	23,915	28,681
Racetrack Video Lottery	<u>126,132</u>	<u>130,559</u>
Total Lottery Fund net revenues	163,615	177,308
Excess Lottery Fund		
Racetrack Video Lottery	77,472	95,768
Limited Video Lottery	179,952	190,408
Limited Video Lottery Fees	<u>9,351</u>	<u>9,412</u>
Total Excess Lottery Fund net revenues	266,775	295,588
Total net revenues	<u>\$ 430,390</u>	<u>\$ 472,896</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	\$ 430,390	\$ 472,896
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	564	357
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 payme	59,911	71,933
Legislatively directed transfer from Lottery Administrative Fund is not available to support debt service payments	7,500	-
Interest income on the Revenue Center Construction Fund is not available to support debt service payments	<u>-</u>	<u>18</u>
Distributions to the State of West Virginia	<u>\$ 498,365</u>	<u>\$ 545,204</u>

(Continued)

WEST VIRGINIA LOTTERY
SCHEDULE OF REVENUES AND NET REVENUES OF THE
LOTTERY FUND AND EXCESS LOTTERY FUND
Years Ended June 30, 2014 and 2013
(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.