ARKANSAS LOTTERY COMMISSION

Annual Financial Report

June 30, 2010

LEGISLATIVE JOINT AUDITING COMMITTEE

Attachment E

Arkansas Lottery Commission

ANNUAL FINANCIAL REPORT

FOR THE YEAR ENDED JUNE 30, 2010

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Sen. Bobby L. Glover
Senate Co-Chair
Rep. Johnny Hoyt
House Co-Chair
Sen. Bill Pritchard
Senate Co-Vice Chair
Rep. Beverly Pyle
House Co-Vice Chair

Arkansas

Roger A. Norman, JD, CPA, CFE
Legislative Auditor

LEGISLATIVE JOINT AUDITING COMMITTEE

DIVISION OF LEGISLATIVE AUDIT

INDEPENDENT AUDITOR'S REPORT

Arkansas Lottery Commission
Legislative Joint Auditing Committee

We have audited the accompanying financial statements of the major fund of the Arkansas Lottery Commission, a Commission of Arkansas State government, as of and for the year ended June 30, 2010, as listed in the table of contents. These financial statements are the responsibility of agency management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Agency's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As indicated above, the financial statements of the Arkansas Lottery Commission are intended to present the financial position and the changes in financial position and cash flows of the major fund of the State that is attributable to the transactions of the Arkansas Lottery Commission. They do not purport to, and do not, present fairly the financial position of the State as of June 30, 2010, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

[redacted]

In accordance with *Government Auditing Standards*, we have also issued our report dated October 19, 2010 on our consideration of the Arkansas Lottery Commission's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

DIVISION OF LEGISLATIVE AUDIT

Roger A. Norman

Roger A. Norman, JD, CPA, CFE
Legislative Auditor

Little Rock, Arkansas
October 19, 2010
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Attachment E

Arkansas

Roger A. Norman, JD, CPA, CFE
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LEGISLATIVE JOINT AUDITING COMMITTEE
DIVISION OF LEGISLATIVE AUDIT

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*

Arkansas Lottery Commission
Legislative Joint Auditing Committee

We have audited the financial statements of the major fund of the Arkansas Lottery Commission (the "Agency"), a Commission of Arkansas State government, as of and for the year ended June 30, 2010, and have issued our report thereon dated October 19, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

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 entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over financial reporting, described in the accompanying Schedule of Findings and Responses as items *2010-1* and *2010-2* that we consider to be significant deficiencies in internal control over financial reporting. 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.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Agency's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Attachment E

SCHEDULE OF FINDINGS AND RESPONSES

2010-1

Ark. Code Ann. § 23-115-206(a)(6) requires the Agency to "prepare the financial statements, including the related notes to the financial statements, of the commission in accordance with generally accepted accounting principles (GAAP) and in accordance with guidelines and timelines established by the Chief Fiscal Officer of the State to permit incorporation into the state's financial statements and to permit the audit of the state's financial statements and the commission's financial statements in a timely manner;". The Agency did not prepare the June 30, 2010 financial statements and related notes in accordance with GAAP. The failure to prepare the financial statements and related notes in accordance with GAAP resulted in errors and omissions that could adversely affect the inclusion of the Arkansas Lottery Commission Financial Statements and related notes in the State's Comprehensive Annual Financial Report.

We recommend the Agency strengthen internal control over financial reporting by ensuring appropriate employees are qualified and knowledgeable of all applicable Governmental Accounting Standards and prepare the financial statements and related notes in accordance with GAAP.

Management response: The ALC has received guidance from DLA for the past year on the preparation of financial statements and the development of a financial accounting and reporting system. The assistance was used and relied upon to develop interim financial statements that were presented periodically to stakeholders as required by state law. Those interim financial reports utilized a format that was informative as to ALC's financial condition and results of operations from the books and records of the Agency. An emphasis of these financial reports was on the computation of net proceeds available to fund scholarships. This reporting system was then used to prepare our annual report.

The ALC was informed at a meeting with DLA on October 16, 2010, that the format used for the preparation of interim financial statements did not conform to the requirements of Ark. Code Ann. §23-115-206, i.e., the *format* of the financial statements and the related footnotes must conform to generally accepted accounting principles.

As a result of this finding, all financial statements are being reformatted to meet this requirement. The financial information contained in the original format was correct and accurate.

2010-2

Ark. Code Ann. § 23-115-205(a)(20) states that the Commission may enter into contracts with the terms and conditions as necessary. In addition, Ark. Code Ann. § 23-115-701(e)(1) states that each major procurement contract shall be filed with the Arkansas Lottery Commission Legislative Oversight Committee (LOC) for review before the execution date of the contract. The Commission approved and LOC reviewed the instant ticket lottery game service contract with a stated cost of 1.75% of net sales. Subsequent to this review, Management entered into a *Recital of Selected Options* with a cost of 1.92% of net sales plus an additional cost of 1.5% of the prize fund. The estimated cost of the *Recital of Selected Options* compared to the original reviewed price proposal is an estimated additional $3.9 million per year. In addition to the *Recital of Selected Options*, Management entered into three licensing agreements with the vendor with a total estimated cost of $671,861. The subsequent *Recital of Selected Options* and three licensing agreements were not approved by the Commission or reviewed by LOC. Lack of appropriate review of contracts and modifications of contracts could lead to a lack of transparency to the LOC and public.

We recommend the Agency ensure compliance with State law by submitting appropriate documents for review by the Arkansas Lottery Commission Legislative Oversight Committee.

Management response: The Arkansas Scholarship Lottery Act ("Act") grants the ALC the power to "enter into contracts of terms and conditions that the commission determines." Ark. Code Ann. §23-115-205(a)(20). The Act further allows the ALC to "arrange for the solicitation and receipt of competitive bids for major procurement contracts," with the specific requirement that these proposed major procurement contracts be filed with the Arkansas Lottery Legislative Oversight Committee ("LOC") for review before the execution date of the major procurement contract. Ark. Code Ann. §23-115-701(c)(2) and (e)(1).

Management response: (Continued)

On June 19, 2009, the ALC published an Instant Ticket Lottery Game Services Request for Proposal ("RFP") with two (2) subsequent addendums. This RFP was drafted and published by the commission with intent of providing the ALC with maximum flexibility to provide Arkansans with an innovative, diverse and large catalogue of instant ticket games and products to choose from with the goal of operating the lottery in a manner which maximized revenues as was required under Ark. Code Ann. §23-115-102(2)(B). In fact, Section 2.1 of the RFP specifically expresses the ALC objective to "provide for innovation and the ability to respond to changes in the industry and the demands of the marketplace." In light of the legislative intent noted in the Act and the stated objectives of the ALC, the RFP included provisions which invited prospective vendors to submit additional and alternate pricing for items included within their catalogue, including, but not limited to, other products and games. Section 1.26 of the RFP specifically states "Vendors may expand items to identify all proposed services. A separate listing, which must include pricing, may be submitted with summary pricing." This invitation for additional pricing was in addition to the percentage of net sales pricing requested. In light of these provisions, it was clearly the intent of the ALC to invite, and contract for, additional and alternate options under the contract for the efficient and effective operations of the lottery. Additionally, it was the stated intent of the ALC to solicit this pricing for the specific purpose of binding vendors to those prices during the term of the contract to avoid potential future increases in game or product prices based on market demand.

In response to the RFP, Scientific Games International ("SGI") submitted an Instant Ticket Lottery Game Services Technical Proposal, Start-Up Marketing Plan and Official Proposal Price Sheet ("Response"). This Response included a lump sum price for net sales percentage, a listing of each component part and services that comprised the lump sum price and a listing of additional invited options from the catalogue of games, products and services offered by SGI. In addition to other services, including Play It Again and Second Chance Drawing Administration, the additional invited options contained a "Licensed property table" which included one hundred and forty four (144) licensed property games for the ALC to choose from during the course of the seven (7) year contract.

Upon receipt of the various RFP responses from SGI, GTECH and Pollard Banknote, an evaluation team of lottery professionals began the intensive evaluation process of reviewing all proposals submitted in light of the information requested in the RFP. The evaluation included review of and scoring for the alternate and additional products and games submitted by vendors.

At the conclusion of the evaluation process, the evaluations and scoring were submitted to the ALC for review. The RFP and Response were reviewed by the ALC on August 5, 2009. After review of the RFP, the Response, the notes and scores compiled by the panel of experts evaluating the vendor responses and thorough discussion of the response from the three vendors, the ALC voted to award the instant ticket contract to SGI, contingent upon review by the LOC. All documents reviewed by the ALC in making its decisions to award the contract to SGI were provided to the LOC for review. This included all RFP and Response documents. On August 13, 2009, the Instant Ticket contract documents were reviewed by the LOC.

In light of the foregoing, access to and the use of the licensed property portfolio of SGI is already included in the contract between the parties based on the fact that the information has been reviewed, considered and approved by the ALC and reviewed by the LOC. These additional and alternate products and games were requested by the ALC, provided by SGI in response, evaluated and approved by the ALC and sent to the LOC for review. Based on the content of the documents approved by the contracting parties, and the content of the document sent to the LOC for review, it is the obvious intent of both parties that these items be included in the terms of the contract.

Even if one were to assume that the narrow and rigid interpretation of the contract between the ALC and SGI is correct, the fact remains that the additional and alternate invited options submitted by SGI were included in the original documents submitted to the LOC for review. These items have already been evaluated and approved by the ALC and forwarded with the contract documents to the LOC for review. These documents included the licensed property catalogue owned by the vendor. Under the definition for "major procurement contract" as set forth in Ark. Code Ann. §23-115-103(14)(A)(vi), which includes contracts over seventy five thousand dollars ($75,000.00) for "tickets," each term included in the licensing agreements cited by the DLA have been reviewed under the law.

Accordingly, under either scenario noted above, no further review is required under the law.

We have evaluated the validity of the Agency's response to finding 2010-2 and it remains our position the LOC review of the items noted in 2010-2 are required under State law.

We also noted certain additional matters that we have reported to management of the Agency in a separate letter dated October 19, 2010.

The Agency's response to the findings identified in our audit, excluding management letter findings is described above. We did not audit the Agency's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Legislative Joint Auditing Committee, state executive and oversight management, agency management, Arkansas Lottery Commission and other parties as required by Arkansas Code and is not intended to be and should not be used by anyone other than these specified parties. However, pursuant to Ark. Code Ann. § 10-4-417, all reports presented to the Legislative Joint Auditing Committee are matters of public record and distribution is not limited.

DIVISION OF LEGISLATIVE AUDIT

Charles F. Fiser

Charles F. Fiser, CPA
Deputy Legislative Auditor

Little Rock, Arkansas
October 19, 2010

Arkansas

Roger A. Norman, JD, CPA, CFE
Legislative Auditor

LEGISLATIVE JOINT AUDITING COMMITTEE

DIVISION OF LEGISLATIVE AUDIT

MANAGEMENT LETTER

Arkansas Lottery Commission
Legislative Joint Auditing Committee

As a management service, we would like to communicate the following items that came to our attention during the audit. The purpose of such comments is to provide constructive feedback and guidance, in an effort to assist management in maintaining a satisfactory level of compliance with the state constitution, laws and regulations and achieve adequate internal controls. These matters were discussed previously with Agency officials during the course of our audit fieldwork and at the exit conference.

1. Ark. Code Ann. § 23-115-403(f)(1) prohibits the payment of lottery prizes to certain individuals who are members of the Commission, employees of the Commission, or member of the immediate family of a Commissioner or employee of the Commission. Currently, the Agency conducts prize payment reviews for Powerball and Mega Millions prize payments of $10,000 or more and second chance drawings for instant games. The Agency does not review prize payments for instant ticket games nor prize payments below $10,000 for online games. In a review of the database used to perform the prize payment review, it was noted that current information within the database required to comply with State law is incomplete. Management utilizes social security numbers to aid in compliance with State law, but 75% of the employees and relatives did not have a social security number listed including the Executive Director, Vice President of Gaming, and 12 other employees. An additional requirement for the database was the address of the prohibited player. In the review of the database, 15% of the employees and relatives had incomplete information including six employees. In addition, four employees were not included in the database. Failure to comply with State law could allow inappropriate lottery prize payments and loss of integrity for the Arkansas Lottery Commission.

   We recommend the Agency obtain information from commission members, employees and others deemed necessary to complete the comprehensive database and conduct the prize payment reviews required by State law.

2. Ark. Code Ann. § 23-115-303 (e) and (f) requires each person considered for employment by the Commission submit to a state and federal background check. Arkansas Code further states that the Commission cannot employ anyone who has been convicted or entered a plea agreement for certain criminal offenses. Nineteen individuals employed by the Commission were selected for review; of which, all background checks were completed subsequent to the first day of employment. The failure to complete the background checks prior to employment resulted in the employment and subsequent termination of two individuals with previous criminal offenses.

   We recommend the Agency develop policies and procedures to ensure criminal background checks are received prior to employment.

3. Ark. Code Ann. § 23-115-206(a)(1) requires the Commission to establish effective internal controls. To effectively establish internal controls, management should communicate policy and procedures to all staff. Management did not communicate the policy and procedures for the accrual and use of compensatory time to exempt staff until August 3, 2010 for time purportedly earned between July 1 and November 30, 2009. Subsequent to the issuance of the formal policy, numerous changes were made by management including a suspension of compensatory time usage. In addition, management was unable to properly account for the potential compensatory time resulting in ten different versions of compensatory time being submitted for audit. Due to the numerous changes made to the compensatory time policy, at the end of audit fieldwork, it remains unclear what the Agency had established as policy. The failure to establish and communicate policy has led to confusion with the 23 affected employees and has created a potential liability for some staff, who may be required to reimburse the Agency for compensatory time already taken.

   We recommend the Agency strengthen internal controls by communicating applicable policies and procedures to staff in a timely manner. We further recommend the Agency obtain guidance from the Chief Fiscal Officer of the State regarding reimbursement of any overpayments that may be determined.

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4. Acts 605 and 606 of 2009, as amended, known as the Arkansas Scholarship Lottery Act, set the executive director's salary at $141,603 with multipliers of up to 2.5 times resulting in a maximum salary of $354,007. Ark. Code Ann. § 23-115-304(b) states, "A commission employee's salary for retirement purposes shall be the amount determined by the commission as authorized by the General Assembly and shall not include any multipliers used to increase a person's salary as authorized by the General Assembly." The Commission paid retirement contributions based on the Executive Director's salary including multipliers. Ark. Code Ann. § 23-115-304(b) may be in conflict with general legislation applicable to the Arkansas Public Employees Retirement System (APERS) as related to the definition of compensation for retirement purposes, Ark. Code Ann. § 24-4-101, and calculations of benefits, Ark. Code Ann. § 24-4-601. Based on the advice of APERS, the Commission remitted an additional $29,184 for retirement contributions based on the total amount of the Executive Director's salary of $324,000.

   We recommend the Agency seek legal guidance as to the applicability of Ark. Code Ann. §§ 23-115-304(b), 24-4-101, 24-4-601. In addition, the Agency should seek reimbursement for any overpayment that may be determined.

5. Review of travel reimbursements, travel credit card statements, and supporting documentation revealed the following:

   - The Executive Director submitted ten requests for travel reimbursement totaling $4,534 during the fiscal year; five of which, totaling $3,470, lacked proper approval by a designated travel supervisor.

   - Travel payments/reimbursements totaling $16,189 were made that are in conflict with State laws and travel regulations.

     1. Hotel expenses were paid above the Federal per diem rate without prior authorization by the Agency's Executive Director. We noted 22 instances totaling $9,616 that are in violation of R1-19-4-903 of the Financial Management Guide, which states "lodging costs exceeding the rates listed in the Federal Travel Directory may not be paid without a letter of authorization by the administrative head of the agency and must include a justification as to why it was in the best interest of the State to exceed the standard reimbursement rate."

     2. Five charges totaling $1,872 made to the travel credit card were not supported by adequate documentation, the documentation did not match the amount charged, nor did the documentation appear to be an original. This appears to be in violation of Ark. Code Ann. § 19-4-902(b) which states "the responsibility of the administrative head of any agency to keep on file in the place of business of the agency, subject to audit, copies of all supporting documents and required receipts for expenses incurred in connection with the travel authorizations and allowances for persons traveling on behalf of the agency."

     3. Documentation used to support travel credit card statements/TR-1 reimbursements for airline ticket purchases were screen prints from an airline/travel booking website that were printed prior to an actual flight confirmation. We noted seven instances totaling $2,814 that are in violation of Ark. Code Ann. § 19-4-902(b).

     4. The business purpose was not adequately documented for travel expenses totaling $1,423 paid on behalf of, or reimbursed to, the Vice President of Gaming. Exceeding the conference room rate by $103 per night, additional hotel charges totaling $309 were incurred during a conference in New York. In addition, hotel costs and meals totaling $1,114 were incurred beyond the dates of the conference.

     5. We also noted $464 in other reimbursements that are in conflict with various State laws and travel regulations including: receipts not matching the dates listed on the travel reimbursement form, excess mileage reimbursement, exceeding the Federal per diem daily rate for meals incurred during overnight travel, reimbursement for meals without having overnight travel, and reimbursement for tips above the 15% allowed by State law.

   We recommend the Agency strengthen internal controls related to travel expenditures by requiring all travel expenditures be adequately documented. Agency personnel that travel as part of their job duties should be trained on the various State travel regulations and management should establish procedures to ensure compliance with State law and regulations. Furthermore, we suggest that the Executive Director remit his requests for travel reimbursement to an appropriate travel supervisor for review and approval.

6. Review of payroll and related records revealed the Agency made improper retroactive payments to two employees for periods 12/13/09 through 3/28/10 and 5/01/10 totaling $6,296. Ark. Code Ann. § 19-4-1610 states "no increase in the rate of pay, either by paying the full amount of the maximum salary or by placing an employee in a position calling for a greater salary, shall be construed as authorizing the payment of any retroactive salary to the employee" except for "salary payments made to correct an administrative error". However, the retroactive pay was for time before the effective dates of the position reclassifications.

   We recommend that the Agency ensure that retroactive payments be supported by appropriate documentation and seek recovery of the amounts overpaid.

7. The Control Objectives for Information and Related Technology (COBIT) Delivery and Support Domain 11 outlines the best practices for ensuring financial data is complete, accurate and valid. Controls should be in place to ensure proper management review and/or approval of all financial transactions. Additionally, financial accounting software processing ability should be adequate to meet the control environment needs of the entity. The Agency's financial accounting software and related procedures contains the following deficiencies:

   - The software allows a valid financial transaction to be deleted in a manner that completely erases the transaction from the original financial records. The only information about the deleted transaction is kept in an audit log file. There is no documentation to indicate that management is reviewing the audit log file to determine that transaction deletion was properly approved and appropriate for the circumstances.

   - The software only has the capability to identify seven payroll deductions on an employee's remuneration statement, however many employees have more than seven deductions. Additionally, Agency staff must account for some payroll deductions outside the accounting software and adjust federal reporting forms accordingly.

   - The software does not have adequate controls to prevent or detect a salary overpayment for a position's pay grade maximum in accordance with Ark. Code Ann. § 21-5-101. In addition, the software lacks the ability to limit the maximum number of employees authorized by §§ 23-115-305, -307.

   These situations could allow errors or fraud to occur and not be detected in a timely basis.

   We recommend that the Agency work with the application vendor to implement additional controls that will strengthen the control environment.

8. Review of internal controls over cash receipts for the collection of retailer fidelity fees totaling $18,775 and retailer application fees totaling $161,381, identified controls that were not operating as designed. All incoming mail is to be processed by the Security Division which includes entering all checks received into the mail check log which is maintained on SharePoint and approved by the Treasurer. The mail and checks are subsequently to be distributed to the appropriate departments for processing. During our test, we noted that checks were being deposited that had not been processed through the security division; all checks were not deposited timely; and, although the check log was being approved by the Treasurer, the Treasurer does not receive copies of the checks or other documents to ensure that the check log is complete.

   We recommend the Agency strengthen internal controls over cash receipts.

9. Review of internal controls over disbursements revealed that controls over procurement are inadequate. The Agency's policy requires a Vice-President's approval for non-procurement card purchases over $500. However, the Agency's policy also states that approval is considered to have occurred with the Vice President's manual signature on the check. This control is ineffective since the check would not be signed until after the purchase had occurred and the item had been received. The Agency's controls appear to be minimal compared to best practices and have the potential to allow unauthorized or unallowable purchases and/or liabilities to be incurred by the Agency.

   We recommend the Agency ensure that proper controls are in place and operating effectively by adequately reviewing all supporting documentation for purchases prior to the disbursement of funds.

10. The instant ticket lottery game service contract requires a fee paid to the vendor of 1.5% of the prize fund for the costs associated with the Points for Prizes™ program. The Agency paid the vendor $3.3 million to operate the program during the year ended June 30, 2010. Agency personnel were unable to provide an adequate explanation as to calculation of the fee and specifically, how to determine the value of the prize fund. Agency personnel appeared to lack knowledge required to calculate the fee independent of the vendor. The Agency's inability to understand and recalculate the fee could cause vendor overpayments to occur thus reducing funds available for scholarships.

    We recommend the Agency strengthen internal controls surrounding the Points for Prizes™ program by ensuring Agency employees adequately review and understand the methodology for calculating payments to the instant ticket lottery game service vendor.

11. Travel regulation R1-19-4-903 states mileage shall be reimbursed and computed using map mileage. The auditor was unable to adequately test marketing sales representatives' travel due to insufficient documentation. Information provided on the employees' travel reimbursement forms was vague and/or incomplete limiting the Agency's ability to properly review the supporting documentation prior to payment. In addition, the auditor was unable to verify miles traveled in order to recalculate mileage reimbursement for accuracy. Travel reimbursements for marketing sales representatives totaled $198,983, including one employee who was reimbursed $18,858 for 44,900 miles driven during a ten month period of time. Insufficient supporting documentation could allow errors or misappropriation of assets to occur and go undetected by the Agency, leading to overpayments made to Agency employees.

    We recommend the Agency implement procedures requiring adequate documentation of travel made by the Agency's marketing sales representatives to allow for a proper review of travel reimbursements.

This letter is intended solely for the information and use of the Legislative Joint Auditing Committee, state executive and oversight management, agency management, Arkansas Lottery Commission and other parties as required by Arkansas Code and is not intended to be and should not be used by anyone other than these specified parties. However, pursuant to Ark. Code Ann. § 10-4-417, all reports presented to the Legislative Joint Auditing Committee are matters of public record and distribution is not limited.

DIVISION OF LEGISLATIVE AUDIT

Charles F. Fiser

Charles F. Fiser, CPA
Deputy Legislative Auditor

Little Rock, Arkansas
October 19, 2010

Arkansas Lottery Commission
Statement of Net Assets
June 30, 2010

ASSETS

Current assets:	
Cash and cash equivalents	$ 6,758,242
Restricted Assets:	
Cash and cash equivalents	76,740,583
Accounts receivable	14,289,726
Prepaid items	5,119
Total current assets	97,793,670
Noncurrent assets:	
Restricted assets:	
Cash and cash equivalents	18,831
Deposit with Multi-State Lottery Association	457,268
Capital assets:	
Equipment	509,147
Leasehold improvements	481,103
Less accumulated depreciation	(122,642)
Total noncurrent assets	1,343,707
Total assets	$ 99,137,377

LIABILITIES

Current liabilities:	
Accounts payable	$ 746,237
Prizes payable	14,150,176
Accrued and other liabilities	924,717
Due to other funds	371,659
Due to Arkansas Department of Higher Education	82,799,809
Compensated absences	482,927
Deferred revenue	274,307
Total current liabilities	99,749,832
Noncurrent liabilities:	
Net postemployment benefits payable	230,022
Total liabilities	99,979,854

NET ASSETS

Net assets:	
Invested in capital assets	867,607
Restricted for:	
Deposit with Multi-State Lottery Association	457,268
Retailer fidelity fund	18,831
Unrestricted	(2,186,183)
Total net assets (deficit)	(842,477)
Total liabilities and net assets	$ 99,137,377

The notes to the financial statements are an integral part of this statement.

Attachment E

Arkansas Lottery Commission
Statement of Revenues, Expenses, and Changes in Net Assets
For the Year Ended June 30, 2010

Operating revenues:	
Instant ticket sales	$ 335,487,156
Online ticket sales	48,211,299
Retailer application, fidelity, and service fees	867,023
Other revenue	5,650
Total operating revenues	384,571,128
Operating expenses:	
Instant game prizes	224,341,940
Online game prizes	23,381,100
Retailer commissions	21,578,603
Gaming contract costs	20,448,694
Compensation and benefits	6,118,300
Marketing, advertising, and promotions	4,352,303
General and administrative expenses	1,841,340
Services provided by other agencies	278,349
Legal and professional services	115,862
Depreciation	122,643
Total operating expenses	302,579,134
Operating income	81,991,994
Nonoperating revenues (expense):	
Interest income	181,807
Income before transfers	82,173,801
Transfers to:	
Arkansas Department of Health	(200,000)
Arkansas Department of Higher Education	(82,799,809)
Total transfers	(82,999,809)
Change in net assets	(826,008)
Total net assets (deficit) - beginning	(16,469)
Total net assets (deficit) - ending	$ (842,477)

The notes to the financial statements are an integral part of this statement.

Arkansas Lottery Commission
Statement of Cash Flows
For the Year Ended June 30, 2010

Cash flows from operating activities:	
Cash received from retailers and others	$ 370,120,513
Payments for prizes	(231,877,356)
Payments to gaming vendors	(22,766,421)
Payments to retailers for commissions	(20,594,364)
Payments to employees	(5,114,532)
Payments for marketing and advertising	(3,515,419)
Payments for other expenses	(1,914,665)
Net cash provided by operating activities	84,337,756
Cash flows from noncapital financing activities:	
Repayment of interagency advances	(6,000,000)
Cash flows from capital and related financing activities:	
Acquisition of capital assets	(990,250)
Cash flows from investing activities:	
Interest income	181,807
Net increase in cash and cash equivalents	77,529,313
Cash and cash equivalents - beginning	5,988,343
Cash and cash equivalents - ending	$ 83,517,656
Reconciliation of operating income to net cash provided by operating activities:	
Operating income	$ 81,991,994
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation	122,642
Net changes in assets and liabilities:	
(Increase) decrease in:	
Accounts receivable	(14,289,726)
Prepaid	(5,119)
MUSL Reserves	(457,268)
Increase (decrease) in:	
Accounts payable	746,237
Prizes payable	14,150,176
Accrued and other liabilities	924,717
Due to other funds	396,869
Compensated absences	482,927
Deferred revenue	274,307
Net cash provided by operating activities	$ 84,337,756

The notes to the financial statements are an integral part of this statement.

Attachment E

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. Reporting Entity

The Arkansas Lottery Commission (ALC) was created by Acts 605 and 606 of 2009 for the purpose of establishing, operating, and regulating State lotteries as authorized by the Arkansas Constitution. The primary purpose of the Act is to supplement higher education scholarships with net proceeds from State lottery operations. The ALC is charged with overseeing the lottery operations of the state and consists of nine members with three members appointed by each of the following: the Governor, the Speaker of the House of Representatives, and the President Pro Tempore of the Senate.

The ALC is a self-supporting, revenue-raising agency of the state. The Commission commenced sales of instant scratch-off tickets, Powerball®, Cash 3 and Mega Millions®, on September 28, October 31, December 14, 2009 and January 31, 2010, respectfully. Powerball® and Mega Millions® online sales are offered through the Multi-State Lottery Association (MUSL).

For financial reporting purposes, the Lottery is a major enterprise fund of the primary government of the State of Arkansas and is reported as such in the Comprehensive Annual Financial Report (CAFR) of the State. These financial statements for the ALC are separate and apart from those of the State and do not present the financial position of the State nor changes in the State's financial position and cash flows.

b. Basis of Presentation

The Arkansas Lottery Commission (ALC) is accounted for as a proprietary type enterprise fund. Enterprise funds operate more like a commercial business such as: (1) where the costs of providing goods and services to the general public on a continuing basis are to be financed through user charges; or (2) where the periodic determination of net income is considered appropriate.

c. Basis of Accounting

Basis of accounting refers to the timing of recognition of revenue and expenses in the accounts and reporting in the financial statements. The financial statements are prepared on the accrual basis of accounting in accordance with generally accepted accounting principles. Under this method, revenues are recognized when they are earned and expenses are recognized when they are incurred.

Private-sector standards of accounting and financial reporting, published by the FASB which were issued on or before November 30, 1989, are followed in the enterprise fund financial statements to the extent that such standards do not conflict with standards issued by the GASB. As permitted by the GASB, ALC has elected not to adopt FASB guidance issued after November 30, 1989, unless the GASB specifically adopts such FASB Statements or Interpretations. New GASB Statements and Interpretations are adopted in the years they become effective.

As an enterprise fund, the ALC is accounted for using the economic resources measurement focus. All assets and liabilities related to its operations are included on its statement of net assets, and its operating statement includes all revenues (increases) and expenses (decreases) in total assets. Operating revenues and expenses generally relate to the ALC's primary ongoing operations of selling lottery tickets and redeeming prizes; all revenues and expenses not meeting this definition are reported as nonoperating. The principal operating revenues of the ALC are charges to retailers for sales of lottery products. The significant operating expenses include the cost of prizes, commissions, gaming system vendor charges, personnel, marketing/advertising, and other administrative expenses.

d. ***Cash and Cash Equivalents***

Cash and cash equivalents include demand accounts, impress accounts, and cash on hand, all certificates of deposit with maturities at purchase of 90 days or less and all short-term instruments with maturities at purchase of 90 days or less.

e. ***Accounts Receivable***

Accounts Receivable represents amounts due from retailers for activation of ticket packs, less commissions and prizes paid by the retailers and amounts due from retailers plus sales of online games. Electronic Funds Transfer is used to collect receivables weekly from retailer bank accounts that were set up in trust for the Arkansas Lottery Commission.

f. ***Capital Assets***

Capital assets are stated at cost less accumulated depreciation. The Arkansas Lottery Commission (ALC) follows the policy of the Arkansas Department of Finance and Administration and uses a capitalization threshold of two thousand five hundred dollars ($2,500.00) and useful life extending beyond one year. Depreciation on capital assets is computed using the straight-line method over the following estimated useful lives:

Data processing equipment:	5 years
Furniture, fixtures, and equipment:	5 to 7 years
Vehicles:	5 years
Leasehold improvements:	over the initial term of the lease

When capital assets are retired or otherwise disposed of, the costs and related accumulated depreciation are removed from the accounts and any resulting gain or loss is reflected in the Statement of Revenues, Expenses, and Changes in Net Assets, in the period of disposal. ALC did not dispose of capital assets during the year ended June 30, 2010.

g. ***Net Assets***

Net Assets include categories for net investments in capital assets, Multi-State Lottery Association (MUSL) reserves, and restricted net assets for the Retailer Fidelity Fund. The net investment in capital assets category represents the purchases of capital assets, recorded at cost less accumulated depreciation. The restricted net assets for MUSL reserves represents funds set aside to fund Powerball and Mega Millions prizes in the event of multiple grand prize winners.

h. ***Revenue Recognition***

Lottery games are sold to the public by contracted retailers. Revenue is recognized when online tickets are sold to players and when books of instant scratch-off tickets are activated for sale by the retailer.

Deferred Revenue – Funds collected from retailers for online game tickets sold in advance of the game drawings are recorded as deferred revenue and recognized as revenue once the related drawing occurs.

i. ***Commissions***

Retailers receive a commission of five percent on all instant tickets settled and online tickets sold. In addition, (1) retailers receive a cashing commission of one percent of each one dollar redeemed up to the cashing limit of $500 per ticket, and (2) retailers receive a selling commission of one percent of a prize amount of $10,000 or more on each ticket validated and paid to a player. The maximum selling commission is $50,000.

j. ***Prizes and Unclaimed Prizes***

For instant scratch-off games, prize expense is accrued based on the end of production prize structure percentage provided by the gaming vendor for each game and recorded based on value of packs activated for sale by retailers. Prize expense for merchandise prizes is recognized as invoiced by the gaming vendor. Any prize that remains unclaimed 90 days after a scratch-off game is closed is considered unclaimed. There were three games closed during May 2010, and the related unclaimed prize will be recorded in August 2010.

Prize expenses for online games are based upon prizes won by the players and are recorded as revenue is recognized. Any prize that remains unclaimed at the end of the 180-day period following a draw is considered to be unclaimed.

Unclaimed prize money totaling $245,991 was credited to Net Proceeds for deposit into the Education Trust Account. All unclaimed prize money reduces overall prize expense.

k. ***Compensated Absences***

Employees earn the right to be compensated during absences for vacation, illness, and unused special compensatory leave earned for hours worked on legal holidays, as well as for excessive hours worked during Arkansas Lottery Commission (ALC) start-up operations. Compensated absences for annual leave, legal holidays banked and comp time from start-up operations are recorded as a liability when the benefits are earned. Compensated absences for sick leave are calculated based on the vesting method for employees that are eligible for retirement benefits. Within the limits established by law or rule, unused leave benefits are paid to employees upon separation from State service for vacation, banked holidays, and eligible sick leave, but not for compensatory leave earned during ALC start-up operations. The compensated absences amounts are based on current year-end salary rates and include employer social security contributions at current rates.

l. ***Self-Insurance***

The Arkansas Lottery Commission participates in the various self-insurance programs established by the State for property and casualty losses and employee health insurance. Insurance coverage includes property, general liability, automobile liability, workers' compensation, state unemployment, court-awarded attorney fees, and Federal civil rights actions. Property is self-insured for actual cash value to an aggregate of $1.5 million per loss event for all perils. Losses from earthquake and flood are also subject to an annual aggregate loss for the state of $1 million. Workers' compensation is provided in compliance with the applicable law. The employee health and dental insurance program provides for payment of medical claims of employees and covered dependents.

m. ***Use of Estimates***

The preparation of financial statements in conformity with Generally Accepted Accounting Principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, restricted net assets, revenues, and expenses, and disclosures of contingent assets and liabilities. Actual results could differ from those estimates.

n. ***Bad Debt Expense***

Bad debt expense is recognized when a lottery retailer's uncollected revenue is past due and in excess of amounts deemed to be collectable. The amount of expense is based on an accounts receivable aged analysis and the amount of surety bond and fidelity fund account coverage available to offset the potential loss. The Arkansas Lottery Commission did not record bad debt expense for fiscal year ended June 30, 2010.

o. ***Due to Arkansas Department of Higher Education***

The Act requires the Arkansas Lottery Commission to deposit each month's Net Proceeds into an Education Trust Account by the 15th of the following month. This amount is accrued as a liability on the Statement of Net Assets using accrual basis accounting as required by GAAP. However, the amount actually deposited into the Education Trust Account is computed using cash basis revenues for monies received from retailers. The Act requires these funds to be held in trust for the funding of higher education scholarships.

2. ***DEPOSITS***

Arkansas Code Annotated requires that agencies holding monies not deposited in the State Treasury (cash fund agencies), other than the institutions of higher learning, abide by the recommendations of the State Board of Finance as to the best investment decisions of any idle cash balances. The State Board of Finance promulgated certain cash management and investments standards and procedures, effective September 1, 1990, as referenced by the Department of Finance and Administration within the Financial Management Guide for use by all State agencies.

The stated primary goal of state cash management is the protection of principal, while maximizing investments and minimizing non-interest bearing balances. Deposits are to be made within the borders of the State of Arkansas and placed with an Arkansas Bank or Savings and Loan Association. Policy requires a minimum of four (4) bids to be sought on interest bearing deposits, in order to obtain the highest rate possible.

Policy states that funds may be maintained in demand deposit accounts for the purposes of meeting day-to-day operating expenditures. It is suggested that service charges associated with this type of account can generally be avoided by maintaining required minimum balances or compensating balances in other accounts. A single checking account should be sufficient for each cash fund. Funds in excess of immediate expenditure requirements (excluding minimum balances) should not remain in non-interest bearing accounts.

Arkansas Lottery Commission (ALC) has a seven-year contract with Bank of the Ozarks to provide banking services to its operations. The contract has the provision that all banking services be provided to ALC at no cost. Additionally, the contract calls for interest to be paid on all ALC deposits at a rate of 20 basis points over the Federal Funds Target rate with a floor of 55 basis points. During the year ended June 30, 2010, ALC was paid 55 basis points on all ALC deposits. All cash and equivalents at June 30, 2010 were held in accounts at the Bank of the Ozarks. As agreed to in their contract, the Bank of the Ozarks has agreed to pledge collateral on all accounts of ALC in an amount to exceed the State requirement of 102 percent of deposits. As of June 30, 2010, total collateral pledged to ALC was $90,794,665 to secure total bank balances of $84,777,110.

Custodial Credit Risk – Custodial credit risk for deposits is the risk that, in the event of the failure of a depository institution, the Agency will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. The Agency has adopted the State Board of Finance Policy requiring the use of depository insurance and collateralization procedures to manage the risk that deposits may not be returned. It is the opinion of management that none of Arkansas Lottery Commission's bank balances of $84,777,110 were exposed to custodial credit risk as of June 30, 2010.

3. EDUCATION TRUST ACCOUNT

Each month on or before the 15th day, the Arkansas Lottery Commission shall deposit the net proceeds of the previous month into a trust account. The Education Trust Account is restricted for higher education scholarships administered by Arkansas Department of Higher Education (ADHE). Funds are transferred to ADHE based on scholarship needs reported to the Arkansas Lottery Commission. The Education Trust Account is shown as a restricted cash and cash equivalent on the Statement of Net Assets; the balance at June 30, 2010 is $76,740,583.

4. ACCOUNTS RECEIVABLE

Management believes that an allowance for uncollectable accounts is not necessary at June 30, 2010. Subsequent collections, sufficient surety bond and fidelity fund account balances are sufficient to cover past due accounts. Amounts due from retailers are summarized as follows:

Amount due for activated instant scratch-off tickets, not yet settled	$ 10,235,754
Amount due for sales for the 10 days ending 6/30/10	3,981,912
Past due accounts	72,060
Total accounts receivable	$ 14,289,726

Attachment E

5. *FIDELITY FUND ACCOUNT*

In accordance with the Act, Arkansas Lottery Commission (ALC) has set and assesses an annual fidelity fund fee of $10. Fidelity fund proceeds are held in a separate demand deposit account and are classified as restricted on the Statement of Net Assets. These funds may be used to cover losses incurred as a result of the nonfeasance, malfeasance, or misfeasance of ALC retailers. ALC did not sustain losses that were charged to the fidelity fund during the year ended June 30, 2010. At the end of each fiscal year, fidelity funds exceeding $500,000 may be treated as net proceeds from the ALC, subject to deposit into the Educational Trust Account. The balance of the Fidelity Fund Account at June 30, 2010 was $18,831.

6. *MULTI-STATE LOTTERY ASSOCIATION RESERVES*

In July 2009, the ALC joined the Multi-State Lottery Association (MUSL), composed of a group of U.S. lotteries that combine jointly to sell online Powerball and Mega Millions lottery tickets. The chief executive officer of each member lottery serves on the MUSL board of directors.

Powerball sales began on October 31, 2009. Mega Millions sales began on January 31, 2010. As a member of MUSL, the ALC is required to contribute to various prize reserve funds maintained by MUSL. The prize reserve funds serve as a contingency reserve to protect MUSL from unforeseen prize payments. MUSL periodically reallocates the prize reserve funds among the states based on relative Powerball and Mega Millions sales levels. All remaining funds remitted, and the related interest earnings (net of administrative costs), will be returned to the ALC upon leaving MUSL, less any portion of unanticipated prize claims that may have been paid from the fund. As of June 30, 2010, the ALC had deposits with MUSL of $457,268, representing ALC's deposits of reserve funds.

A copy of the MUSL financial statements may be obtained by submitting a written request to MUSL, 4400 N.W. Urbandale Drive, Urbandale, Iowa 50322.

7. *CAPITAL ASSETS*

The activity for capital assets for the year ended June 30, 2010, was:

Capital assets	Balance July 1, 2009	Additions	Deletions	Balance June 30, 2010
Equipment		$ 509,147		$ 509,147
Leasehold improvements		481,103		481,103
Total capital assets		990,249		990,249
Less accumulated depreciation for:				
Equipment		63,563		63,563
Leasehold improvements		59,079		59,079
Total accumulated depreciation		122,642		122,642
Capital assets, net	0	$ 867,607	0	$ 867,607

8. LIABILITIES

a. Prizes Payable:

Prizes payable at June 30, 2010, consisted of instant and online game prizes as well as related state and federal withholdings. Instant ticket prizes are estimated based on the end of production prize structure provided by Scientific Games. Prize payable by category is as follows:

Instant ticket prizes	$ 12,555,812
Powerball prizes	1,125,860
Mega Millions prizes	268,634
Income tax withholdings	134,900
Cash 3 prizes	64,970
Total	$ 14,150,176

b. Due to Other Funds

The Act requires that the Arkansas Department of Higher Education (ADHE) be reimbursed for the administrative costs associated with the administering of scholarships funded with lottery proceeds. The amount recorded as administrative cost is listed in the table below.

The Division of Legislative Audit (DLA) is required by law to perform an annual audit of the Arkansas Lottery Commission's (ALC) financial position. The law also states that ALC shall reimburse DLA at an hourly rate set by the Legislative Joint Auditing Committee for work performed. The amount due to DLA is listed in the table below.

The amounts listed below due to the Department of Finance and Administration as well as the Department of Information Systems is due to services performed by these Agencies within the normal course of business for the Arkansas Lottery Commission.

ADHE	$ 216,849
Division of Legislative Audit	107,100
Department of Finance & Administration	10,028
Department of Information Systems	37,682
Total	$ 371,659

c. Due to Education Trust Account

The Arkansas Lottery Commission is required by law to deposit each month's Net Proceeds into an Education Trust Account. Net Proceeds is defined under the Act as lottery proceeds less operating expenses. Net Proceeds for the year ended June 30, 2010 were $82,799,809.

d. Accrued Liabilities and Compensated Absences

Vendor payables and accrued liabilities consist of amounts due to gaming vendors and other vendors for operating costs of the lottery and also accrued payroll earned as of June 30, 2010.

In the enterprise fund financial statements, the Commission accrues liabilities for compensated absences as services are incurred and benefits accrue to employees. The compensated absences payable to ASL employees for annual, sick, and compensatory leave at June 30, 2010, totaled $482,927. The net changes to compensated absences payable during the year ended June 30, 2010 totaled $482,927.

e. ***Deferred Online Revenue***

Funds collected from retailers for online game tickets sold in advance of the game drawings are recorded as deferred revenue and recognized as revenue once the related drawing occurs. Deferred revenue at June 30, 2010 is summarized as follows:

Powerball	$ 187,860
Mega Millions	81,201
Cash 3	5,246
Net proceeds	$ 274,307

9. ONLINE GAME REVENUE

Online game tickets are produced through terminals at lottery retailer locations based on player instructions for number selection. Drawings are conducted to determine winning number combinations. Online game sales as of June 30, 2010 consisted of the following:

Powerball	$ 34,998,429
Mega Millions	7,935,615
Cash 3	5,277,255
Total	$ 48,211,299

10. OPERATING LEASES

The Arkansas Lottery Commission has entered into operating leases for the rental of office space for its headquarters, as well as its three district claim centers. These leases are renewable at the option of ALC at the end of their initial terms. The office which houses the ALC headquarters is currently under a six-year lease, expiring August 31, 2015. The claim center leases are five-year terms, ending on various dates in 2014. Annual rent expense for the year ended June 30, 2010 was $217,429.

Future minimum rental payments as of June 30, 2010 are scheduled as follows:

2011	$ 433,518
2012	445,061
2013	456,740
2014	468,553
2015	438,405
2016	69,673

11. COMPULSIVE GAMBLING CONTRIBUTION

The Act requires Arkansas Lottery Commission to make an annual transfer of at least $200,000 to the Department of Health for the treatment of compulsive gambling disorder and educational programs related to compulsive gambling disorder.

12. RETIREMENT PLANS

a. Plan Description

ALC contributes to the Arkansas Public Employees' Retirement System (APERS), a cost-sharing multiple-employer defined benefit pension plan administered by the Board of Trustees of the Arkansas Public Employees' Retirement System. APERS provides retirement and disability benefits, annual redetermination of benefit adjustments, and survivor benefits to plan members and beneficiaries. The Constitution of Arkansas, Article 5, vests with the General Assembly the legislative power. This power includes the enactment and amendment of benefit provisions of APERS as published in Chapters 2, 3, and 4 of Title 24 of the Arkansas Code Annotated. The Arkansas Public Employees' Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for APERS. That report may be obtained by writing to Arkansas Public Employees' Retirement System, One Union National Plaza, 124 West Capitol, Little Rock, Arkansas, 72201 or by calling 1-501-682-7855.

b. Funding Policy

Contributory plan members are required to contribute 5% of their annual covered salary. ASL is required to contribute to this plan for all covered State employees at the rate of 11.00% of annual covered payroll. The contribution requirements of plan members are established and may be amended by the Arkansas General Assembly. The contribution requirements of ASL are established and may be amended by the Board of Trustees of the Arkansas Public Employees' Retirement System. ALC's contributions to APERS for the year ended June 30, 2010 were $436,304 and employee contributions were $187,750.

13. CONTRACTUAL ARRANGEMENTS AND OTHER COMMITMENTS

Arkansas Lottery Commission (ALC) has contracted with two vendors, INTRALOT Corporation (INTRALOT) and Scientific Games, Inc. (SGI), for its online lottery game services, gaming system, and instant ticket lottery games services.

INTRALOT operates the gaming network that consists of approximately 1,910 instant and online retailer ticket terminals and associated software. In accordance with its contract, INTRALOT receives the negotiated fee on the selling price of online tickets sold and on instant ticket settlements. During the year ended June 30, 2010, INTRALOT was compensated at the rate of 2.45 percent for all online and instant ticket game sales. ALC has a seven-year contract with INTRALOT which includes an option for renewal of up to three additional times in one-year increments or a portion thereof. The contractor's compensation for online game services for the fiscal year ended June 30, 2010 was $9,843,732.

SGI prints, warehouses, and distributes the instant game tickets to retailers. In accordance with its contract, SGI receives the negotiated fee on the selling price of all instant ticket settlements. During the year ended June 30, 2010, SGI was compensated $7,578,966 which represents a rate of 1.92 percent of sales for these services. Additionally SGI is paid a fee of 1.50 percent of the prize fund for the Points for Prizes program; this fee totaled $3,278,544 for fiscal year ended June 30, 2010. This program provides merchandise prizes awarded to players based upon tickets registered by the players. In addition, SGI provides other products and services for which ALC pays various contracted fees. ALC has a seven-year contract with SGI, ending in 2016.

14. CONTINGENCIES

There are pending lawsuits to which the Arkansas Lottery Commission is a party, both as a Plaintiff and Defendant, as a result of matters which have arisen in the ordinary course of business. The final outcome of the lawsuits is not presently determinable. ALC management does not anticipate the resolution of these matters to have a material adverse effect on the financial condition of ASL.

15. POSTEMPLOYMENT BENEFITS OTHER THAN PENSIONS

In June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, which became effective with the fiscal year ending June 30, 2008. The Statement establishes standards for the measurement, recognition and display of other Postemployment Benefits (OPEB). The statement has been implemented prospectively by the State of Arkansas (State).

The Arkansas Lottery Commission net OPEB liability at June 30, 2010 totaled $230,022. Net OPEB liability is based on the Agency's number of employees participating in insurance coverage as a pro rata share of the total budgeted positions for the State. The net change to the OPEB liability during the year ended June 30, 2010 totaled $230,022.

16. DEFICIT NET ASSETS

The Arkansas Lottery Commission had a $2,186,183 million deficit in net assets as of June 30, 2010. The deficit is due to a difference in the manner in which net proceeds is calculated. Specifically, net proceeds were calculated in accordance with Arkansas Scholarship Lottery Act. The Act is not consistent with generally accepted accounting principles, which is the method used for presentation of the financial statements. The difference in accounting methods resulted in a higher calculation of net proceeds amount used for scholarship funding and the corresponding liability, thus resulting in a deficit in net assets.