

**GOVERNMENT OF THE DISTRICT OF COLUMBIA  
LOTTERY AND CHARITABLE GAMES CONTROL BOARD**

**FINANCIAL STATEMENTS AND MANAGEMENT'S DISCUSSION AND ANALYSIS  
(WITH INDEPENDENT AUDITOR'S REPORT THEREON)**

**SEPTEMBER 30, 2014 AND 2013**

**BERTSMITH  
& Co.**

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*Certified Public Accountants and Management Consultants*

**GOVERNMENT OF THE DISTRICT OF COLUMBIA**  
**LOTTERY AND CHARITABLE GAMES CONTROL BOARD**  
SEPTEMBER 30, 2014 and 2013

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## INDEPENDENT AUDITOR'S REPORT

To the Mayor and Members of  
The Council of the Government of the District of Columbia, and  
The Lottery and Charitable Games Control Board  
Washington, D.C.

### Report on the Financial Statements

We have audited the accompanying statements of net position of the District of Columbia Lottery and Charitable Games Control Board (the Lottery), an enterprise fund of the Government of the District of Columbia, as of and for the years ended September 30, 2014 and 2013, and the related statements of revenues, expenses, and changes in net position and cash flows for the years then ended and the related notes to the financial statements, which collectively comprise the Lottery's basic financial statements..

### 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 opinions on these financial statements based on our audit. 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 of 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 opinions.

## **Opinions**

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the Lottery as of September 30, 2014 and 2013, and the changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

## **Emphasis of Matter**

As discussed in Note 1 to the financial statements, the financial statements present only the Lottery enterprise fund and do not purport to, and do not present fairly the financial position of the District of Columbia as of September 30, 2014 and 2013, the changes in its financial position or, where applicable its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles. Our opinion is not modified with respect to the matter.

## **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 13, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Government Accounting Standards Board, who considers it to be an essential part of the financial reporting for placing the basic financial statement in an appropriate operational, economic or historic 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 Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated December 18, 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 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* in considering the Lottery's internal control over financial reporting and compliance.

*Bert Smith & Co*

Washington, D.C.  
December 18, 2014

**GOVERNMENT OF THE DISTRICT OF COLUMBIA**  
**LOTTERY AND CHARITABLE GAMES CONTROL BOARD**  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
(UNAUDITED)  
SEPTEMBER 30, 2014 and 2013  
*(Dollar Amounts in Thousands)*

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The discussion and analysis of the D.C. Lottery and Charitable Games Control Board's (the Lottery) financial performance provides an overview of its financial activities for the fiscal year ended September 30, 2014 and 2013. This discussion and analysis should be read in conjunction with the attached financial statements.

**Background and Other Significant Information**

The Lottery was established by Public Law 3-172 as an independent agency of the Government of the District of Columbia (District). In accordance with law, the Lottery is responsible for generating revenues through the sale of lottery products and is required to remit monthly gaming revenues less prizes, operating expenses and a reserve not to exceed 2% of annual prize payments to the General Fund of the District.

The Lottery's financial transactions are accounted for as an enterprise fund in the District's basic financial statements.

**Financial Highlights**

- Gross revenues from lottery gaming activities decreased by \$26,420 or 10.90% from the prior year amount.
- The Agency generated ticket sales of \$216,018 for a decrease of \$26,412 or 10.90% less than the prior year total of \$242,430.
- Total operating expenses decreased by \$13,195 or 7.58% primarily because of lower prize payouts and the lack of an instant ticket contract.
- The prize payouts in 2014 decreased by \$8,153 or 6.30% compared to 2013 and reflected a payout rate of 56.14% of ticket sales versus 53.39% the prior year.
- The contractor's fees were reduced by \$3,486 or 29.84% from the prior year.
- Transfers to the District's General Fund decreased by \$13,348 equivalent to 19.54% below the prior year's total.

To effectively understand the Lottery's operations and to assess its financial activities, the reader must be aware of individual game sales, related prize expenses and payout percentages, the impact on change in net position and resulting transfer to the District's General Fund. Prize payouts and the volume of Powerball and Mega Million sales have the most dramatic impact on transfer levels but are beyond the control of management.

**Using This Financial Report**

This financial report consists of a series of financial statements, prepared in accordance with GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*. These statements focus on the financial condition, the results of operations, and cash flows of the Lottery as a whole.

One of the most important questions asked about the Lottery's finances is whether or not they have improved as a result of the year's activities. The key to understanding this core question is the Statement of Net Position; the Statement of Revenues, Expenses, and Changes in Net Position; and the Statement of Cash Flows. These statements present financial information in a form that is similar to that used by commercial entities.

**GOVERNMENT OF THE DISTRICT OF COLUMBIA**  
**LOTTERY AND CHARITABLE GAMES CONTROL BOARD**  
MANAGEMENT'S DISCUSSION AND ANALYSIS (*Continued*)  
**(UNAUDITED)**  
SEPTEMBER 30, 2014 and 2013  
(*Dollar Amounts in Thousands*)

The Lottery's net position (the difference between assets and liabilities) is an indicator of the improvement or erosion of financial health. The Statement of Net Position includes all assets and liabilities. It is prepared under the economic resources measurement focus and the accrual basis of accounting, whereby revenues are recognized when earned and expenses are recognized when the related liability is incurred.

The Statement of Revenues, Expenses and Changes in Net Position present the revenues earned and the expenses incurred during each year. Activities are reported as either operating or non-operating. Another important factor to consider when evaluating financial viability is the Lottery's ability to meet financial obligations as they come due. The Statement of Cash Flows present information related to cash inflows and outflows summarized by operating, capital and non-capital financing and investing activities.

**Financial Analysis**

The Lottery's net position increased by \$150, \$45, and \$108 for the years ended September 30, 2014, 2013 and 2012, respectively. The following is a summary of the Lottery's financial information as of and for the years ended September 30, 2014, 2013, and 2012.

**Table 1: Summary of Net Position**  
(*In Thousands*)

	<b>September 30</b>		
	<b>2014</b>	<b>2013</b>	<b>2012</b>
<b>Assets:</b>			
Current and Other Assets	\$ 14,067	\$ 15,482	\$ 14,294
Capital Assets (net of accumulated depreciation)	270	427	480
Restricted Investments	6,282	10,200	16,381
Total Assets	<u>\$ 20,619</u>	<u>\$ 26,109</u>	<u>\$ 31,155</u>
<b>Liabilities:</b>			
Accounts Payable and Accrued Expenses	\$ 3,390	\$ 4,762	\$ 4,222
Unearned Revenues	66	136	99
Accrued Prizes and Commissions	6,599	6,879	6,366
Obligations for Unpaid Prizes – Short-term	2,962	4,010	7,306
Obligations for Unpaid Prizes – Long-term	3,320	6,190	9,075
Total Liabilities	<u>\$ 16,337</u>	<u>\$ 21,977</u>	<u>\$ 27,068</u>
<b>Net Position:</b>			
Net Investment in Capital Assets	\$ 270	\$ 427	\$ 480
Unrestricted	4,012	3,705	3,607
Total Net Position	<u>\$ 4,282</u>	<u>\$ 4,132</u>	<u>\$ 4,087</u>

**GOVERNMENT OF THE DISTRICT OF COLUMBIA**  
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MANAGEMENT'S DISCUSSION AND ANALYSIS (*Continued*)  
**(UNAUDITED)**  
SEPTEMBER 30, 2014 and 2013  
(*Dollar Amounts in Thousands*)

**Table 2: Summary of Revenues, Expenses, and Changes in Net Position**  
(*In Thousands*)

	<b>Years Ended September 30</b>		
	<b>2014</b>	<b>2013</b>	<b>2012</b>
Operating Revenues:			
Gaming Revenues	\$ 216,040	\$242,460	\$249,675
Operating Expenses:			
Prizes	121,272	129,425	137,313
Other	39,666	44,708	45,872
Total Operating Expenses	160,938	174,133	183,185
Operating Income	55,102	68,327	66,490
Non-operating Revenues – Interest and Dividends Income before Transfers	14	32	22
	55,116	68,359	66,512
Transfers to the District's General Fund	(54,966)	(68,314)	(66,404)
Change in Net Position	\$ 150	\$ 45	\$ 108

Unrestricted net position was \$4,012, \$3,705 and \$3,607 at September 30, 2014, 2013 and 2012, which represent an increase of \$307, \$98 and \$106, respectively. Current and other assets decreased by \$1,415 in 2014, increased by \$1,188 in 2013 and decreased by \$1,140 in 2012, respectively. Total liabilities decreased \$5,640 or 25.66%, \$5,091 or 18.81%, \$7,777 or 22.32% for years ended September 30, 2014, 2013 and 2012, respectively; primarily the result of decreases in the Lottery's obligations for unpaid prizes. The Multistate Lottery Association (MUSL) purchases U.S. government securities in the name of the Lottery for Lotto America and Powerball jackpot winners from the District of Columbia. Jackpot winners have the option of accepting the cash value of the jackpot amount or annuity payments for 25 years. The restricted investments balance of \$6,282, \$10,200 and \$16,381 in 2014, 2013 and 2012, respectively, represents the net present value of securities totaling \$6,522, \$10,522 and \$16,780 in 2014, 2013 and 2012, respectively, to fund future annuity installment payments. The restricted investments value decreased by \$3,918, \$6,181 and \$6,531 during 2014, 2013 and 2012, respectively, due to payments of \$4,010 \$6,248 and \$6,875, net of unrealized gains of \$153, \$255 and \$492 in 2014, 2013 and 2012, respectively. Accretion of investments totaled negatives of \$60 in 2014, \$188 in 2013 and \$150 in 2012, respectively. Corresponding amounts are recorded as obligations for unpaid prizes.

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MANAGEMENT'S DISCUSSION AND ANALYSIS (*Continued*)  
**(UNAUDITED)**  
SEPTEMBER 30, 2014 and 2013  
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**Table 3: Gaming Revenues, Prizes, Commissions and Transfers**  
(*In Thousands*)

Index Class	Gaming Revenue	Prizes	Agents' Commissions	Contractor Fee	Advertising	Gross Margin	Transfers
<b>Fiscal Year 2014</b>							
DC 3	46,171	(22,600)	(2,985)	-	-	20,586	12,500
DC FIVE	16,683	(8,648)	(950)	-	-	7,085	2,625
DC FOUR	56,924	(27,281)	(3,537)	-	-	26,106	18,700
FAST PLAY	9,669	(7,249)	(682)	-	-	1,738	300
HOT LOTTO	3,560	(1,733)	(202)	-	-	1,625	1,475
INSTANT	40,420	(29,094)	(3,062)	-	-	8,264	7,021
KENO	11,585	(7,391)	(797)	-	-	3,397	1,950
MEGA MILLIONS	8,880	(4,293)	(523)	-	-	4,064	2,975
POWERBALL	11,850	(5,648)	(719)	-	-	5,483	6,955
RACE 2 RICHES	7,731	(5,368)	(535)	-	-	1,828	400
TAP-N-PLAY	2,545	(1,967)	(185)	-	-	393	65
OTHER	22	-	-	-	-	-	-
<b>Total</b>	<b>216,040</b>	<b>(121,272)</b>	<b>(14,177)</b>	<b>(8,195)</b>	<b>(5,742)</b>	<b>66,654</b>	<b>54,966</b>
<b>Fiscal Year 2013</b>							
DC 3	49,113	(26,080)	(3,160)	-	-	19,873	19,128
DC FIVE	16,151	(6,917)	(902)	-	-	8,332	6,171
DC FOUR	60,055	(25,599)	(3,609)	-	-	30,847	25,169
FAST PLAY	9,100	(4,546)	(644)	-	-	3,910	583
HOT LOTTO	3,395	(1,653)	(160)	-	-	1,582	1,021
INSTANT	57,157	(40,346)	(4,288)	-	-	12,523	5,047
KENO	11,793	(7,712)	(814)	-	-	3,267	2,937
MEGA MILLIONS	6,195	(3,091)	(349)	-	-	2,755	1,706
POWERBALL	20,592	(8,311)	(1,104)	-	-	11,177	5,386
RACE 2 RICHES	8,076	(5,081)	(560)	-	-	2,435	1,060
TAP-N-PLAY	803	(89)	(7)	-	-	707	105
OTHER	30	-	-	-	-	-	-
<b>Total</b>	<b>242,460</b>	<b>(129,425)</b>	<b>(15,597)</b>	<b>(11,681)</b>	<b>(6,036)</b>	<b>79,721</b>	<b>68,314</b>
<b>Fiscal Year 2012</b>							
DC 3	53,070	(26,707)	(3,689)	-	-	22,674	17,040
DC DAILY SIX	-	9	-	-	-	9	9
DC FIVE	15,098	(7,331)	(848)	-	-	6,919	5,189
DC FOUR	65,668	(32,433)	(3,975)	-	-	29,260	22,589
FAST PLAY	5,724	(3,993)	(403)	-	-	1,328	892
HOT LOTTO	2,747	(874)	(210)	-	-	1,664	1,432
INSTANT	59,940	(39,668)	(4,423)	-	-	15,848	5,709
KENO	12,478	(8,095)	(856)	-	-	3,527	2,303
MEGA MILLIONS	10,628	(5,413)	(567)	-	-	4,648	3,595
POWERBALL	17,136	(7,927)	(939)	-	-	8,271	6,576
RACE 2 RICHES	7,143	(4,881)	(495)	-	-	1,767	1,070
OTHER	43	-	-	-	-	-	-
<b>Total</b>	<b>249,675</b>	<b>(137,313)</b>	<b>(16,404)</b>	<b>(11,764)</b>	<b>(5,743)</b>	<b>78,451</b>	<b>66,404</b>

**GOVERNMENT OF THE DISTRICT OF COLUMBIA**  
**LOTTERY AND CHARITABLE GAMES CONTROL BOARD**  
MANAGEMENT'S DISCUSSION AND ANALYSIS (*Continued*)

**(UNAUDITED)**

SEPTEMBER 30, 2014 and 2013

*(Dollar Amounts in Thousands)*

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Table 3 provides a comparison of sales, prizes, agent commissions, gross margin, and transfers to the District's General Fund generated by each lottery product offered. Overall gaming revenues totaled \$216,040, \$242,460 and \$249,675 in fiscal years 2014, 2013 and 2012, respectively. Prize expenses decreased \$8,153 or 6.30% in 2014, \$7,888 or 5.74% in 2013 and increased \$11,453 or 9.1% in 2012. Total prize payouts as a percentage of gaming revenue was 56.14%, 53.38% and 55% in 2014, 2013 and 2012, respectively. Agents' commissions decreased \$1,358 in 2014, \$807 in 2013 and increased \$1,635 in 2012, respectively, due to the respective decreases and increases in ticket sales and prize payouts.

**DC THREE** --- DC Three is a daily three-digit game in which players may wager 50 cents or one dollar with nine ways to win prizes ranging from 25 to 500 dollars. In 2014, sales totaled \$46,171 for a \$2,942 or 5.99% reduction over 2013. Sales in 2013 were \$49,113 for a \$3,937 or 7.46% reduction over 2012. Sales were \$53,070 in 2012 for a \$313 or 0.59% decline from the 2011 sales level of \$53,383. The game continues to be impacted by the economic downturn and demographic changes in the District's population. The Lottery Board continues to strategically implement marketing and promotional campaigns in an attempt to stabilize and enhance sales for the game.

Prizes amounted to \$22,600 in 2014, for a \$3,480 or 13.34% decrease over the prior year. Prizes amounted to \$26,080 in 2013, for a \$627 or 2.35% decrease over 2012. Prizes amounted to \$26,707 in 2012, for a \$312 or 1.18% increase from the \$26,395 expensed in 2011. Agent or retailer commissions expense decreased by \$175 primarily due to the noted decrease in sales. Net proceeds to the District's General Fund in 2014 totaled \$12,500 for a \$6,628 or 34.65% decrease compared to the prior year. The transfer in 2013 was \$19,128 or a 12.25% increase compared to 2012. Transfer was \$17,040 in 2012 and represented a \$35 decrease over the \$17,075 generated in 2011. The DC Three game accounted for 21.38% of total gaming revenue and 25.57% of the overall gross margin. The game reflected an increase of 1.08% in gaming revenue percentage contribution and an increase of 6.0% in gross margin percentage contribution due to lower sales, prizes and agent/retailer commissions than prior year totals.

**DC FOUR** --- DC Four is a daily four-digit game with a fixed payout. Players may wager 50 cents or one dollar for a chance to win seven different ways. Ticket sales totaled \$56,924 in 2014 for a \$3,131 or 5.21% decrease of the 2013 tickets sales of \$60,055. Ticket sales were \$60,055 in 2013 for a \$5,613 or 8.55% decrease from 2012 ticket sales of \$65,668. Ticket sales in 2012 were \$300 or a 0.46% increase from the \$65,368 generated in 2011. The game continues to be impacted by economic conditions, demographic changes in the District and sales erosion to the DC Five game.

Prizes in 2014 totaled \$27,281, an increase of \$1,682 or 6.57% from the prior year. FY 2013 total prize expense was \$25,599, representing a \$6,834 or 21.07% reduction over the \$32,433 paid out in 2012. In 2012, prizes represented a decrease of \$278 or 0.85% over 2011. Transfers to the District's General Fund in 2014 totaled \$18,700 for a \$6,469 or 25.70% decrease from the \$25,169 transferred in 2013. Transfers to the District's General Fund in 2013 represented a \$2,582 or 11.42% increase over the \$22,589 transferred in 2012. In 2012, the transfer totaled \$22,589 for a \$974 or 4.5% increase from the \$21,615 transferred in 2011. The increase in prize payouts and a reduction in sales account for the decrease in the transfer amount. The DC Four game was responsible for 26.35% of total gaming revenue and 39.2% of the overall gross margin. The 1.58% increase in gaming revenue contribution rate and .6% increase in gross margin contribution percentages from over the prior year amounts can be directly associated to lower ticket sales and commissions.

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**(UNAUDITED)**

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*(Dollar Amounts in Thousands)*

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**DC FIVE** -- DC Five is a daily five-digit game with a fixed payout. Players may wager 50 cents or one dollar for a chance to win thirteen different ways. Players select a number within the range 00000 to 99999. Tickets may be purchased for the next draw or up to seven consecutive draws for the mid-day and nightly drawings. Players also have the option for advance day play. This feature allows a player to place a bet for a specific day in the future. The DC Five game was launched effective July 19, 2009.

In 2014, ticket sales totaled \$16,683 which represents a \$532 or 3.29% increase over the prior year. Prizes and agent/retailer commissions in 2014 amounted to \$8,648 and \$950, respectively. The result was an increase in prizes of \$1,731 or 25.03% and an increase to commissions of \$48 or 5.32% over the prior year. The game generated \$2,625 in transfer to the District's General Fund in 2014 or \$3,546 or 57.46% less than 2013. The increase in prize payouts essentially accounts for the decrease in the transfer.

Sales totaled \$16,151 in 2013 which represented a \$1,053 or 6.97% increase over 2012's total of \$15,098. Ticket sales totaled \$15,098 in 2012 and represented a \$2,221 or 17.25% increase over 2011. Prizes and agent/retailer commissions in 2013 and 2012 amounted to \$6,917 and \$7,331 and \$902 and \$848. The game generated \$6,171 and \$5,189 in transfer to the District's General Fund in 2013 and 2012, respectively.

**POWERBALL** --- The Powerball game is a five out of fifty-nine plus one out of thirty-nine online lottery game that pays a grand prize on an annuitized pari-mutuel basis or as a cash lump sum payment and all other prizes on a fixed basis. All annuitized prizes are paid in thirty annual graduated installments. The Powerball game is sponsored by the Multi-State Lottery Association (MUSL), a conglomerate of thirty states, the District of Columbia and Virgin Islands, that combines resources and sales to offer larger jackpots. Party lotteries pool their sales and other resources, but otherwise account for operations separately. The latest prize structure matrix change to the game was January 4, 2009.

Powerball sales totaled \$11,850 in 2014 representing an \$8,742 or 42.45% decrease from the \$20,592 generated in 2013. The decrease in ticket sales can be attributed to the lack of higher jackpots which decreased player participation and sales volume. Powerball sales are jackpot driven and high jackpots impact sales levels. Prizes amounted to \$5,648 in 2014 representing a \$2,663 or 32.04% decrease from the \$8,311 expensed in 2013. Powerball prizes are expensed at the rate of 50.0% of sales intake offset by lapsed prizes. Prize expense decreased due to lower sales intake in 2014. The decrease in ticket sales, plus the decrease in prizes and operating costs accounts for the \$1,569 increase in transfer to the District's General Fund to \$6,955 from the \$5,386 transferred in 2013.

Powerball sales totaled \$20,592 in 2013 representing a \$3,456 or 20.17% increase over the \$17,136 generated in 2012. The Multi-State Lottery Association and Mega Millions conglomerates agreed to allow respective member states to cross sell tickets in January 2010. The increment in ticket sales can be attributed to the number of higher jackpots that increased player participation and sales volume. Powerball sales are jackpot driven and high jackpots impact sales levels. Prizes amounted to \$8,311 in 2013 representing a \$384 or 4.84% increase over the \$7,927 expensed in 2012. Prize expense increased due to higher sales intake in 2013 and was reduced by lapsed prizes. The increase in ticket sales, plus the increase in prizes and operating costs accounts for the \$1,190 decrease in transfer to the District's General Fund to \$5,386 from the \$6,576 transferred in 2012.

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Prizes amounted to \$7,927 in 2012 representing a \$1,378 or 21.05% increase over the \$6,548 expensed in 2011. Powerball prizes are expensed at the rate of 50.0% of sales intake offset by lapsed prizes. Prize expense increased proportionate to sales intake in 2012 and was reduced by lapsed prizes. The increase in ticket sales offset by lower operating costs accounted for the \$1,501 increment in transfer to the District's General Fund to \$6,576 from the \$5,075 transferred in 2011.

**MEGA MILLIONS** --- The Mega Millions game is a five out of fifty-six plus one out of forty-six online lottery game that pays a grand prize or a cash lump sum payment and all other prizes on a fixed basis. All annuity prizes are paid in twenty-six annual installments. Some states offer a megaplier feature to increase non-jackpot prizes by 2, 3, or 4 times. The Mega Millions game is sponsored by the Mega Millions Group, a conglomerate of twelve states, and participating MUSL members that combine resources and sales to offer larger jackpots. All Mega Millions transactions of the Lottery are handled through the Multi-State Lottery Association. Party lotteries pool their sales and other resources, but otherwise account for operations separately. The Lottery began selling Mega Millions tickets effective January 31, 2010.

Mega Million sales totaled \$8,880 in 2014 representing a \$2,685 or 43.34% increase of the \$6,195 generated in 2013. The increase in ticket sales can be attributed to higher jackpots that increase player participation and sales volume. Mega Million sales are jackpot driven and high jackpots impact sales levels. Prizes amounted to \$4,293 in 2014 representing a \$1,202 or 38.89% increase over the \$3,091 expensed in 2013. Prizes were expensed at the rate of 48.34% of overall ticket sales in 2014. The noted increase in ticket sales offset by overall operating costs resulted in a transfer to the District's General Fund of \$2,975 in 2014 or \$1,268 more than the \$1,707 produced in 2013.

Mega Millions sales totaled \$6,195 in 2013 representing a \$4,433 or 41.71% decrease from the \$10,628 generated in 2012. The decrease in ticket sales can be attributed to the lack of high jackpots that increases player participation and sales volume. Mega Million sales are jackpot driven and high jackpots impact sales levels. Prizes amounted to \$3,091 and \$5,413 respectively, in 2013 and 2012. Mega Millions prizes were expensed at rates ranging from 49.9% to 50.0% of regular and megaplier sales 2013 and 2012. Ticket sales offset by overall operating costs resulted in a transfer to the District's General Fund of \$1,707 in 2013 or \$1,888 less than the \$3,595 produced in 2012.

**KENO** --- Keno is a 10/20/80 game with fixed prizes. Players choose to play from 1 to 10 spots, with each spot having a different prize structure. Players select twenty numbers from a field of 80 numbers. Draws are held every four minutes during valid game times. Payouts range from five dollars to 100,000 dollars. Tier 1 prizes start as a fixed payout and transitions to a pari-mutuel payout when the number of winners per draw exceeds 10. The game is supplemented by Keno Spin which features a multiplier option to the game's prizes. The Keno game continues to be impacted by the changing demographics in the District of Columbia, inability to add new social settings and the economy. The Keno game is offered at all agent/retailers locations and experienced some cannibalization to Lottery's new Race 2 Riches game. The game continues to be marketed through targeted awareness and promotional campaigns.

Ticket sales for Keno totaled \$11,585 in 2014 representing a \$208 or 1.76% decrease of the 2013 sales total of \$11,793. Prizes expense decreased by \$321 to \$7,391 in 2014 when compared to the \$7,712 expensed in 2013. Agent/retailer commissions totaled \$797 or 2.09% less than the \$814 expensed in 2013. Transfers to the District's General Fund decreased \$987 to \$1,950 in 2014 from the \$2,937 transferred in 2013. The decrease in transfer can be attributed to a higher prize payout percentage.

**GOVERNMENT OF THE DISTRICT OF COLUMBIA**  
**LOTTERY AND CHARITABLE GAMES CONTROL BOARD**  
MANAGEMENT'S DISCUSSION AND ANALYSIS (*Continued*)  
**(UNAUDITED)**  
SEPTEMBER 30, 2014 and 2013  
(*Dollar Amounts in Thousands*)

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Ticket sales for Keno totaled \$11,793 in 2013 representing a \$685 or 5.49% decrease from the 2012 sales total of \$12,478. Prizes expense decreased by \$383 to 7,712 in 2013 when compared to the \$8,095 expensed in 2012. Transfers to the District's General Fund increased 634 to \$2,937 in 2013 from the \$2,303 transferred in 2012.

Keno sales totaled \$12,478 in 2012 representing a \$933 or 8.08% increase over the 2011 sales total of \$11,525. Prizes expense increased by \$733 to \$8,095 in 2012 when compared to the \$7,362 expensed in 2011. Overall operating expenses excluding prizes increased by a net amount of \$82 representing an increase to advertising costs to market and promote the game offset by decreases in other expenses in proportion to sales decline. Transfers to the District's General Fund increased \$138 to \$2,303 in 2012 from the \$2,165 transferred in 2011.

**HOT LOTTO** --- Hot Lotto is a five out of thirty-nine plus one out of nineteen online lottery game that pays a grand prize, at the election of the player at time of ticket purchase, either on an annuitized pari-mutuel or cash option basis. All other prizes are paid on a fixed basis. Prizes are expensed at the rate of 50.0% of sales intake less lapsed prizes. The Hot Lotto game is sponsored by the Multi-State Lottery Association (MUSL), a conglomerate of thirteen states and the District of Columbia, which combines resources and sales to offer larger jackpots. The initial jackpot starts at \$1 million and drawings are held every Wednesday and Saturday. Party lotteries pool their sales and other resources, but otherwise account for operations separately.

Hot Lotto ticket sales increased to \$3,560 in 2014, representing a \$165 or 4.86% increase over the \$3,395 generated in 2013. The increase in sales in 2014 over the prior year's total is primarily the result of higher jackpots. The prize expense increased \$80 from \$1,653 to \$1,733 or 4.84%. The agent/retailer commission expenses totaled \$202 and reflected a \$42 or 26.25% increase in 2014 over the \$160 expensed in 2013. The \$454 increase in transfers to the District's General Fund in 2014 over the 2013 transfer amount of \$1,021 can be primarily attributed to a decrease in the prize payout percentage.

Hot Lotto ticket sales increased to \$3,395 in 2013, representing a \$648 or 23.59% increase over the \$2,747 generated in 2012. The increase in sales in 2013 over prior year's total is primarily the result of higher jackpots. Prize expense increased to \$1,653 and the agents/retailer commission expenses totaled \$160 and reflected a \$50 or 23.81% decrease in 2013 from the \$210 expensed in 2012. The advertising cost reduced by over 69% while the professional services fees decreased by almost 27%. Other operating expenses essentially remained the same as prior year amounts. The \$411 decrease in transfers to the District's General Fund in 2013 to \$1,021 from the 2012 transfer amount of \$1,432 can be primarily attributed to huge increase in the game prize expense.

Ticket sales amounted to \$2,747 in 2012, representing a \$577 or 17.35% decrease from the \$3,324 generated in 2011. The drop in sales in 2012 from the prior year's total is primarily the result of lower jackpots. Prizes and agent/retailer commissions expenses totaled \$1,084 and reflected a \$707 or 39.0% decrease in 2012 from the \$1,791 expensed in 2011. Other operating expenses essentially remained the same as prior year amounts. The \$222 increase in transfers to the District's General Fund in 2012 to \$1,432 over the 2011 transfer amount of \$1,210 can be primarily attributed to a huge drop in advertising costs and the game prize expense.

**GOVERNMENT OF THE DISTRICT OF COLUMBIA**  
**LOTTERY AND CHARITABLE GAMES CONTROL BOARD**  
MANAGEMENT'S DISCUSSION AND ANALYSIS (*Continued*)  
**(UNAUDITED)**  
SEPTEMBER 30, 2014 and 2013  
(*Dollar Amounts in Thousands*)

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**DC DAILY SIX** --- The DC Daily Six game is a six out of thirty-nine numbers online lotto type game that pays fixed prize payouts ranging from one dollar to 250,000 dollars. Players receive two boards (set of six numbers) for one dollar. Drawings are held nightly seven days a week and players can purchase tickets for the next draw only or the next draw and up to 42 consecutive drawings in predetermined increments. The Division 1 prize payout is fixed for the first four winners. If the number of winners exceeds four then all Division 1 winners share the maximum payout of \$1 million. Payouts for Divisions 2 through 6 are fixed.

Ticket sales for the DC Daily Six game were discontinued effective November 22, 2010 and associated gaming revenue amounted to \$486 in 2011. Prizes and other operating expenses totaled \$181 resulting in transfers to the District's General Fund of \$305. The game was replaced by the Race 2 Riches game in the lottery's portfolio of games. In 2013, there was no revenue for this game. The only transaction for this game in FY 2012 was a reduction in prize expenses and that resulted in a transfer of \$9 in 2012.

**RACE 2 RICHES** --- Race 2 Riches is an interactive horseracing game with the opportunity to win up to \$1,000. Drawings or races are held every four minutes seven days a week during regular operating hours. The Race 2 Riches game was launched effective November 23, 2010.

Race 2 Riches ticket sales amounted to \$7,731 in 2014, representing a \$345 or 4.27% decrease from the \$8,076 generated in 2013. The decrease in sales in 2014 from the prior year's total is primarily because of the lack of a long term instant ticket contract and a huge decrease in instant ticket sales. Instant ticket sales indirectly affect the lottery games portfolio. Prize expense increased to \$5,368 in 2014 from \$5,081 in 2013 which represented a \$287 or 5.65% increase over 2013. The \$660 decrease in transfers to the District's General Fund in 2014 to \$400, is less than the 2013 transfer amount of \$1,060. The decrease in the transfer can be primarily attributed to the increased game prize expense.

Race2Riches ticket sales amounted to \$8,076 in 2013, representing a \$933 or 13.06% increase over the \$7,143 generated in 2012. The increase in sales in 2013 over prior year's total is primarily because of increased visibility in retailer/ agent locations, as well as, equipment expansion. Prize expense increased from \$5,081 in 2013 from \$4,881 in 2012 which represented a \$200 or 4.10% increase over 2012. The \$10 decrease in transfers to the District's General Fund in 2013 to \$1,060 from the 2012 transfer amount of \$1,070 can be primarily attributed to the increased game prize expense.

**FAST PLAY** --- Fast Play games are a series of instant-style games printed and played through agents/retailers online terminals. Fast Play tickets have a variety of games and each ticket is randomly drawn from a separate pool of tickets. Tickets cost and prizes vary depending on the version of game played. The Fast Play games' prizes are set at a fixed payout level. The player asks the agent/retailer for a specific type of Fast Play game and the ticket is generated at the terminal. The player knows immediately if he/she is a winner or not. Fast Play games were launched effective April 3, 2011.

Ticket sales amounted to \$9,669 in 2014, an increase of \$569 or 6.25% over the \$9,100 in 2013. Prize and agent/retailer commissions totaled \$7,931, \$5,190 and \$4,396 for 2014, 2013 and 2012, respectively. Transfer to the District's General Fund amounted to \$300, \$583 and \$892 for 2014, 2013 and 2012, respectively.

**GOVERNMENT OF THE DISTRICT OF COLUMBIA**  
**LOTTERY AND CHARITABLE GAMES CONTROL BOARD**  
MANAGEMENT'S DISCUSSION AND ANALYSIS (*Continued*)  
**(UNAUDITED)**  
SEPTEMBER 30, 2014 and 2013  
(*Dollar Amounts in Thousands*)

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**TAP-N-PLAY** --- Tap-N-Play games are touch activated, interactive, instant win style online games played through self-service terminal (MP). Players use the touch screen of the terminal to choose the games and game parameters (price points, numbers, play board etc.). The games are presented in high-quality graphic animations and sounds. Tap-N-Play games launched on April 5, 2013, with 2 games, and are being expanded to accommodate various play styles and themes. Currently, D.C. Lottery offers eight (8) different types of games with \$1, \$2, \$3, \$5, \$10 and \$20 price points. Play style includes number/symbol match, bingo, reveal symbol, double or nothing and high/low. Overall odds of winning are 1 in 3.66.

Ticket sales amounted to \$2,545 and \$803 in 2014 and for the five (5) months in 2013, respectively. The prize expense was \$1,967 and \$89 and amounted to a 77.29% and 11.08% prize payout rate in 2014 and 2013, respectively. Agent/retailer commissions were \$185 in 2014 and \$7 in 2013. Transfers to the District's General Fund were \$65 and \$105 and represented 1.18% and 13.08% of sales for 2014 and 2013, respectively. The decrease in the transfer to the General Fund is primarily because of a high prize payout.

**INSTANT TICKETS** --- Instant or scratch games are designed to allow a player the opportunity to determine if he/she is an instant winner at the time of ticket purchase. The price of tickets and prize structure are determined before the production of tickets. Instant ticket sales amounted to \$40,420 in 2014 representing a \$16,737 or 29.28% decrease of the 2013 sales of \$57,157.

Prizes in 2014 totaled \$29,094 for an \$11,252 or 27.89% decrease from the \$40,346 expensed in 2013. Agent/retailer commissions totaled \$3,062 in 2014 for a \$1,226 or 28.59% decrease from the \$4,288 expensed in 2013. Transfers to the District's General Fund increased to \$7,021 in 2014, more than the \$5,047 generated in 2013. This was primarily the result of a decrease in operating expenses.

Prizes in 2013 totaled \$40,346 for a \$678 or 1.71% increase over the \$39,668 expensed in 2012. Agent/retailer commissions totaled \$4,288 in 2013 for a \$135 or 3.05% decrease from the \$4,423 expensed in 2012. Transfers to the District's General Fund decreased \$662 to \$5,047 in 2013 over the \$5,709 generated in 2012 as a result of a decrease in game revenue and an increase in prize expense.

Instant ticket sales amounted to \$59,940 in 2012 representing a \$3,834 or 6.83% increase over 2011 sales of \$56,106. Prizes in 2012 totaled \$39,668 for a \$2,084 or 5.54% increase over the \$37,584 expensed in 2011. Overall operating costs, less prizes and agent/retailer commissions totaled \$7,357 and represented a \$1,597 increase over the \$5,760 expensed in 2011. The \$1,597 increase in other operating costs can be attributed to higher gaming contractor fees, advertising and administrative cost allocations to the game. Transfers to the District's General Fund increased \$9 to \$5,709 in 2012 over the \$5,700 generated in 2011 as a result of ticket sales increase.

The Lottery has been able to stimulate sales through a combination of offering higher price point games, designing games with higher prize payouts to increase winning opportunities for players, and providing a full complement of available tickets at all agent locations. The prize payout rate averaged 72.05% and 70.58% as a percentage of tickets sold in 2014 and 2013, respectively. The D.C. Lottery lost its instant tickets vendor contract in July, 2013 and currently; still do not have a long term instant ticket contract.

**GOVERNMENT OF THE DISTRICT OF COLUMBIA**  
**LOTTERY AND CHARITABLE GAMES CONTROL BOARD**  
MANAGEMENT'S DISCUSSION AND ANALYSIS (*Continued*)  
**(UNAUDITED)**  
SEPTEMBER 30, 2014 and 2013  
(*Dollar Amounts in Thousands*)

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**INTEREST, DIVIDENDS AND OTHER INCOME**

All idle cash of the Lottery is invested through the District's General Fund Pooled Investments Account. Powerball, Mega Millions and Hot Lotto receipts transferred to MUSL to fund major jackpots are invested in securities prior to jackpots being hit and earnings are allocated annually to party lotteries. Interest and dividend income, shown separately in the financial statements, has decreased by \$18 and increased by \$10 and \$2 in 2014, 2013 and 2012, respectively. Interest income has been severely impacted by market conditions, the national economy, and other factors beyond the control of individual entities.

Other income decreased \$8 to \$22 in 2014. It also decreased \$13 to \$30 and \$248 to \$43 in 2013 and 2012. Collection of bonding fees receipts from agents was discontinued during the fiscal year 2011 and totaled \$28 in 2010. Refunds from MUSL as a result of rebalancing reserve funds and distributions of excess contributions by participating members amounted to \$0, \$0, and \$0 in 2014, 2013, and 2012 respectively.

**Charitable Gaming Activities**

The Lottery also oversees charitable gaming activities to include the licensing and regulation of charitable and other not-for-profit organizations conducting bingo, raffles, and other fund-raising activities within the District of Columbia. The mission of the Lottery with respect to charitable gaming is to insure that only qualified organizations are licensed to conduct fund-raising activities and that they are carried out in accordance with existing laws, rules and regulations. Revenues generated through the issuance of licenses, processing fees, etc. are not intended to cover costs associated with overseeing program activities.

**Contacting the Lottery**

Interested parties can contact the D.C. Lottery at D.C. Lottery and Charitable Games Control Board, 2235 Shannon Place, S.E., Fifth Floor, Washington, D.C. 20020.

**GOVERNMENT OF THE DISTRICT OF COLUMBIA**  
**LOTTERY AND CHARITABLE GAMES CONTROL BOARD**  
**STATEMENTS OF NET POSITION**  
**SEPTEMBER 30, 2014 and 2013**  
*(Dollar Amounts in Thousands)*

	<u>2014</u>	<u>2013</u>
<b>ASSETS</b>		
<b>Current Assets:</b>		
Cash and Cash Equivalents	\$ 9,318	\$ 8,856
Accounts Receivable, net	4,746	6,619
Prepaid Expenses and Other	3	7
Restricted Investments	<u>2,962</u>	<u>4,012</u>
Total Current Assets	<u>17,029</u>	<u>19,494</u>
<b>Non-current Assets:</b>		
Capital Assets, net	270	427
Restricted Investments	<u>3,320</u>	<u>6,188</u>
Total Non-current Assets	<u>3,590</u>	<u>6,615</u>
Total Assets	<u>20,619</u>	<u>26,109</u>
<b>LIABILITIES</b>		
<b>Current Liabilities:</b>		
Accounts Payable	1,999	3,205
Compensation Liabilities	195	423
Unearned Revenue	66	136
Accrued Prizes and Commissions	6,599	6,879
Other Accrued Liabilities	798	719
Obligations for Unpaid Prizes - Current Portion	<u>2,962</u>	<u>4,010</u>
Total Current Liabilities	<u>12,619</u>	<u>15,372</u>
<b>Non-current Liabilities:</b>		
Obligations for Unpaid Prizes - Noncurrent Portion	3,320	6,190
Compensated Absences	<u>398</u>	<u>415</u>
Total Non-current Liabilities	<u>3,718</u>	<u>6,605</u>
Total Liabilities	<u>16,337</u>	<u>21,977</u>
<b>Net Position</b>		
Net Investment in Capital Assets	270	427
Unrestricted	<u>4,012</u>	<u>3,705</u>
Total Net Position	<u>\$ 4,282</u>	<u>\$ 4,132</u>

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

**GOVERNMENT OF THE DISTRICT OF COLUMBIA**  
**LOTTERY AND CHARITABLE GAMES CONTROL BOARD**  
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION  
YEARS ENDED SEPTEMBER 30, 2014 and 2013  
*(Dollar Amounts in Thousands)*

	<u>2014</u>	<u>2013</u>
<b>Operating Revenues</b>		
Instant Games	\$ 40,420	\$ 57,157
On-Line Games	175,598	185,273
License and Permit Fees	22	30
	<hr/>	<hr/>
Total Operating Revenues	216,040	242,460
	<hr/>	<hr/>
<b>Operating Expenses</b>		
Prizes	121,272	129,425
Agent Commissions	14,177	15,597
Contractor Fees	8,195	11,681
Advertising	5,742	6,036
	<hr/>	<hr/>
Total Direct Costs	149,386	162,739
	<hr/>	<hr/>
Salaries	6,731	6,657
Professional	1,163	1,369
Administration	3,501	3,162
Depreciation	157	206
	<hr/>	<hr/>
Total Operating Expenses	160,938	174,133
	<hr/>	<hr/>
<b>Operating Income</b>	55,102	68,327
Interest Income	14	32
	<hr/>	<hr/>
<b>Net Income Before Transfers</b>	55,116	68,359
Transfer to General Fund	(54,966)	(68,314)
	<hr/>	<hr/>
<b>Change In Net Position</b>	150	45
	<hr/>	<hr/>
<b>Net Position, Beginning of Year</b>	4,132	4,087
	<hr/>	<hr/>
<b>Net (Deficit) Position, End of Year</b>	<u>\$ 4,282</u>	<u>\$ 4,132</u>

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

**GOVERNMENT OF THE DISTRICT OF COLUMBIA**  
**LOTTERY AND CHARITABLE GAMES CONTROL BOARD**  
**STATEMENTS OF CASH FLOWS**  
**YEARS ENDED SEPTEMBER 30, 2014 and 2013**  
*(Dollar Amounts in Thousands)*

	<b>2014</b>	<b>2013</b>
<b>Operating Activities:</b>		
Cash Receipts from Customers	\$ 217,821	\$ 242,129
Cash Receipts from Others	22	30
Cash Payments to Vendors	(19,725)	(21,731)
Cash Payments to Employees	(6,975)	(6,634)
Cash Payments for Prizes and Commissions	(135,729)	(144,510)
<b>Net Cash Provided by Operating Activities</b>	55,414	69,284
<b>Cash Flows From Capital and Related Financing Activities</b>		
Acquisition of Fixed Assets	(-)	(153)
<b>Net Cash Used in Capital and Related Financing Activities</b>	(-)	(153)
<b>Cash Flows From Non-Capital Financing Activities</b>		
Transfers Out to the General Fund	(54,966)	(68,314)
<b>Net Cash Used in Non-Capital Financing Activities</b>	(54,966)	(68,314)
<b>Cash Flows From Investing Activities</b>		
Interest and Dividends	14	32
<b>Net Cash Provided By Investing Activities</b>	14	32
<b>Net Increase in Cash</b>	462	849
Cash and Cash Equivalents - Beginning of Year	8,856	8,007
Cash and Cash Equivalents - End of Year	\$ 9,318	\$ 8,856
<b>Reconciliation of Operating Income to Net Cash Provided by Operating Activities:</b>		
Operating Income	\$ 55,102	\$ 68,327
Amortization and Depreciation	157	206
<i>Decrease (Increase) in Assets:</i>		
Receivables	1,873	(337)
Prepaid Expenses	4	(2)
<i>Increase (Decrease) in Liabilities:</i>		
Accounts Payable	(1,206)	754
Compensation Liabilities	(245)	23
Deferred Revenue	(70)	37
Accrued Prizes	(280)	513
Other Current Liabilities	79	(237)
<b>Net Cash Provided by Operating Activities</b>	\$ 55,414	\$ 69,284
<b>Non-cash Investing and Financing Activities:</b>		
Obligations for Unpaid Prizes by Restricted Investments	\$ 6,282	\$ 10,200

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

**GOVERNMENT OF THE DISTRICT OF COLUMBIA**  
**LOTTERY AND CHARITABLE GAMES CONTROL BOARD**  
NOTES TO FINANCIAL STATEMENTS  
SEPTEMBER 30, 2014 and 2013  
*(Dollar Amounts in Thousands)*

**NOTE 1      SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

(a) **Organization** --- The Lottery and Charitable Games Control Board (the Lottery) was established by Public Law 3-172 as an independent agency of the Government of the District of Columbia (the District). In accordance with the law, the Lottery must remit its monthly gaming revenues, less prizes, operating expenses and a reserve not to exceed 2% of projected annual prize payments to the General Fund of the District.

(b) **Measurement Focus and Basis of Accounting** --- The Lottery's basic financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. The economic measurement focus reports all assets and liabilities associated with the operations and are included on the Statements of Net Position.

(c) **New Accounting Standards Adopted** --- In fiscal year 2014, the Lottery implemented the following pronouncements issued by the Government Accounting Standards Board (GASB):

- Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*.

This statement improves accounting and financial reporting by state and local governments that extend and receive nonexchange financial guarantees.

A nonexchange financial guarantee is a guarantee of an obligation of a legally separate entity or individual, including a blended or discretely presented component unit, which requires the guarantor to indemnify a third party obligation holder under specified conditions. The provisions of this Statement should be applied to financial statements of all state and local governments.

This statement does not apply to guarantees related to special assessment debt within the scope of Statement No. 6, *Accounting and Financial Reporting for Special Assessments*.

The requirements of GASB Statement No. 70 are effective for periods beginning after June 15, 2013. The Lottery's fiscal year began October 1, 2013.

The implementation had no reporting impact on the Lottery's net position or changes in net position for the year ended September 30, 2014 because the Lottery did not extend or receive any nonexchange financial guarantees.

(d) **Basis of Presentation** --- The Lottery's financial transactions are accounted for as an enterprise fund in the District's financial statements. The accompanying financial statements are only those of the Lottery and are not intended to present the financial position, changes in financial position, and cash flows of the District taken as a whole. The District provides certain legal, central accounting and other services to the Lottery. The costs and revenue associated with these services are not reflected in these financial statements.

- (e) **Cash and Cash Equivalents** --- The Lottery participates in the District's pooled cash program whereby cash that is not needed for immediate disbursement is pooled with that of the District's and used to purchase current investments. In accordance with the law, the District may invest the pooled cash directly in, or through repurchase agreements, obligations of the United States or its agencies, which are fully guaranteed by the federal government, and in certificates of deposit, which are issued by federally insured banks. In accordance with District policies, substantially all deposits in the pooled cash program were insured or collateralized with securities held by the District or its agent in the District's name. Interest income from the investment of pooled cash is allocated to the Lottery based on the amount the Lottery invests in the pool. The Lottery considers the pooled cash to be cash equivalents for the purpose of cash flows because the pool may not hold the securities for more than 91 days. Cash and cash equivalents at September 30, 2014 and 2013, respectively, were \$9,318 and \$8,856.
- (f) **Investments** -- Investments in U.S. government and agency securities are recorded at market value which approximates fair value.
- (g) **Revenue and Accounts Receivable Recognition** --- Revenue for the traditional lottery is recognized when tickets are sold to the public. Revenue and accounts receivable from the Lottery's contractors are recognized when sales reports are received.
- (h) **Allowance for Uncollectible Accounts** --- The Lottery establishes an allowance for uncollectible accounts for all accounts receivable over 180 days old.
- (i) **Unclaimed Prizes** --- Prizes must be claimed within 180 days following the drawing date for each game. Prizes unclaimed beyond this period are forfeited by the ticket holder. Total prizes lapsed amounted to \$2,539 for the fiscal year 2014. These forfeited prizes are netted against prize expense in the Statement of Revenues, Expenses and Changes in Net Position.
- (j) **Capital Assets** --- Capital assets are recorded at cost. The cost of major remodeling, betterments, and improvements of \$5 and greater are capitalized. Repairs and maintenance costs are expensed as incurred. When capital assets are retired or sold, the cost and related accumulated depreciation are removed from the appropriate property and equipment accounts, and resulting gains or losses are recorded.

Amortization and depreciation expense are calculated using the straight-line method over the following estimated useful lives:

<u>Category</u>	<u>Estimated Useful Life</u>
Machinery and Equipment	5-8 years
Office Furniture and Fixtures	5-8 years
Leasehold Improvements	5-15 years

- (k) **Gaming Revenue** --- Gaming revenue consists of ticket sales and other related revenue including dividends and interest income, penalties assessed on delinquent agents' accounts, and charitable gaming fees. Revenue from online tickets is recorded as gaming revenue when the drawings are held. Online tickets sold in advance are recorded as unearned revenue until the drawings are held. Revenue is recorded when an online ticket is sold if the sale is not associated with a subsequent drawing. Revenue from instant tickets is recorded as gaming revenue when related packs are activated.

- (l) **Games and Prizes** --- The Lottery's main sources of income are from on-line and instant games. On-line games comprise of DC Three, DC Four, DC Five, Powerball, Mega Millions, Hot Lotto, Keno, Race2Riches, Fast Play and Tap-N-Play. The games are managed by Intralot through a contracted agreement with the Lottery.
- (m) **Prize Expense** --- Instant tickets prize expense is based on the prize payout percentage for each instant lottery game and is accrued as the related gaming revenue is earned. Prize expenses for online games, excluding the Powerball, Hot Lotto, Mega Millions, and Fast Play, are accrued based on the draw liability associated with drawings for the specific games. Powerball and Hot Lotto prize expenses are recorded at the rate of 50% of ticket sales. Mega Millions prize expenses recorded at rates ranging from 50% to 52.5% of regular and MegaPlier sales. Fast Play prize expenses are recorded when applicable winning tickets are sold. The accrued prize liability represents a payable for prize amounts that have not been claimed as of the fiscal year-end. Prize expense for all games is reduced by the sum of lapsed prizes not claimed during the required period of 180 days from the sales draw date for online games and the respective game closing date for instant games.
- (n) **Compensated Absences** --- The Lottery permits employees to accumulate earned but unused vacation and sick pay benefits depending on the employee's length of service. Employees may not accumulate more than 240 hours of vacation benefits. The Lottery accrues for accumulated vacation as the benefits are earned by employees.

There is no maximum limit on the amount of unused sick pay benefits employees may accumulate. The Lottery does not accrue for non-vesting accumulating rights to receive sick pay benefits. Lottery employees participating in the Federal Civil Service Retirement System program may convert sick pay benefits to additional service time at the rate of one month for every 176 hours of sick leave not used at the point of retirement.

- (o) **Use of Estimates** --- The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

## NOTE 2 ACCOUNTS RECEIVABLE

The components of accounts receivable as of September 30, 2014 and 2013 are as follows:

	<u>2014</u>	<u>2013</u>
Due from Agents:		
Online Games	\$ 2,832	\$ 1,261
Instant Games	2,018	5,360
Total Due from Agents	<u>4,850</u>	<u>6,621</u>
Other	<u>78</u>	<u>78</u>
Total Accounts Receivable	4,928	6,699
Allowance for Doubtful Accounts	<u>(182)</u>	<u>(80)</u>
	<u>\$ 4,746</u>	<u>\$ 6,619</u>

### NOTE 3 CAPITAL ASSETS

A summary of capital assets as of September 30, 2014 and 2013 is as follows:

	<b>Balance as of October 1, 2013</b>	<b>Additions</b>	<b>Reductions</b>	<b>Balance as of September 30, 2014</b>
<b>Cost:</b>				
Machinery and Equipment	\$ 3,035	\$ -	\$ -	\$ 3,035
Office Furniture and Fixtures	20	-	-	20
Leasehold Improvements	758	-	-	758
Total Cost	<u>3,813</u>	<u>-</u>	<u>-</u>	<u>3,813</u>
<b>Less: Accumulated Depreciation</b>				
Machinery and Equipment	2,608	157	-	2,765
Office Furniture and Fixtures	20	-	-	20
Leasehold Improvements	758	-	-	758
Total Accumulated Depreciation	<u>3,386</u>	<u>157</u>	<u>-</u>	<u>3,543</u>
Capital Assets – Net	<u>\$ 427</u>			<u>\$ 270</u>
	<b>Balance as of October 1, 2012</b>	<b>Additions</b>	<b>Reductions</b>	<b>Balance as of September 30, 2013</b>
<b>Cost:</b>				
Machinery and Equipment	\$ 2,882	\$ 153	\$ -	\$ 3,035
Office Furniture and Fixtures	20	-	-	20
Leasehold Improvements	758	-	-	758
Total Cost	<u>3,660</u>	<u>153</u>	<u>-</u>	<u>3,813</u>
<b>Less: Accumulated Depreciation</b>				
Machinery and Equipment	2,402	206	-	2,608
Office Furniture and Fixtures	20	-	-	20
Leasehold Improvements	758	-	-	758
Total Accumulated Depreciation	<u>3,180</u>	<u>206</u>	<u>-</u>	<u>3,386</u>
Capital Assets – Net	<u>\$ 480</u>			<u>\$ 427</u>

### NOTE 4 MULTI-STATE LOTTERY ASSOCIATION

#### (a) Background

The Lottery is a member of the Multi-State Lottery Association (MUSL). MUSL has thirty-three (33) members and administers multi-state lottery games. Powerball was initiated on April 20, 1992 and is a semi-weekly pari-mutuel drawing with a minimum grand prize of \$20,000. MUSL previously administered the Lotto-America game, which was terminated on April 18, 1992. Hot Lotto was implemented on April 5, 2004 and is a semi-weekly pari-mutuel drawing with a minimum grand prize of \$1,000. All MUSL members remit a portion of their Powerball and Hot Lotto revenue to MUSL for the prize payments and administrative expenses of the respective games.

#### (b) Restricted Investments and Obligations for Unpaid Prizes

Lotto-America and Powerball jackpot prizes are payable to winners in annual installments over 20 to 25 years. The Lottery is responsible for sending the annual payments to Lotto-America and Powerball winners who purchased their winning tickets from the Lottery. MUSL is responsible for providing the Lottery cash to fund these installment payments.

As of September 30, 2014 and 2013, MUSL had purchased for the Lottery, U.S. government securities aggregating \$6,522 and \$10,522, respectively to fund future installment payments for the Lottery's Lotto-America and Powerball winners.

The market value of these securities was \$6,282 and \$10,200 as of September 30, 2014 and 2013, respectively. The investments provide the Lottery cash payments corresponding to the Lottery's obligations to the prize winners. The Lottery has reflected the market value of the securities as restricted investments and as corresponding obligations for unpaid prizes on the statements of net position. All restricted investments are insured and registered or are held by the Lottery or its agent in the Lottery's name.

As of September 30, 2014, the Lottery had the following investments and maturities:

Investment Type	Fair Value	Less Than 1	1-5	6-10	More Than 10
U.S. Government and Agency Securities	\$6,282	\$2,962	\$2,647	\$673	\$ -

As of September 30, 2013, the Lottery had the following investments and maturities:

Investment Type	Fair Value	Less Than 1	1-5	6-10	More Than 10
U.S. Government and Agency Securities	\$10,200	\$4,010	\$5,191	\$999	\$ -

These investments are obligations explicitly guaranteed by the U.S. government and are held for prize annuities based on quoted market prices. The fair value of the liabilities is based on current interest rates of the related U.S. government security held to fund annuity obligations. MUSL's investment policy limits its exposure to credit risk by investing only in securities that are backed by the full faith and credit of the U.S. government or its agencies.

As of September 30, 2014 and 2013, the Lottery had an interest in a SEC 2a7 pooled government cash management fund of \$10 and \$1,058, respectively; the pool was not rated.

The prize pool for Powerball consists of 50% of each drawing period's sales. Two percent of the prize pool is placed in a prize reserve fund and a set prize reserve fund. These reserve funds serve as contingency funds to protect MUSL from unforeseen liabilities. As of September 30, 2014 and 2013, the total Powerball prize reserve fund was approximately \$76,377 and \$75,316, respectively, of which the Lottery's share was approximately \$494 and \$605, respectively. In addition, the total Powerball set aside prize reserve fund as of September 30, 2014 and 2013 was approximately \$35,200 and \$34,957, respectively, of which the Lottery's share was approximately \$215 and \$244, respectively.

The balance remaining in the reserve funds are refundable to MUSL members if a member leaves or if MUSL disbands. If a member leaves, the member must wait a year before their portion of the prize reserve funds is returned. The balance in the reserve funds may be used at the discretion of MUSL's Board of Directors. Accordingly, the Lottery's share of the reserve funds is not reflected in the accompanying financial statements.

The prize pool for Mega Millions consists of 50% of each drawing period's sales. Two percent of the prize pool is placed in a prize reserve fund and a set prize reserve fund. These reserve funds serve as contingency funds to protect MUSL from unforeseen liabilities. As of September 30, 2014 and 2013, the total Mega Millions prize reserve fund was approximately \$36,659 and \$29,962 of which the Lottery's share was approximately \$356 and \$338, respectively.

The balance remaining in the reserve funds are refundable to MUSL members if a member leaves or if MUSL disbands. If a member leaves, the member must wait a year before their portion of the prize reserve funds is returned. The balance in the reserve funds may be used at the discretion of MUSL's Board of Directors. Accordingly, the Lottery's share of the reserve funds is not reflected in the accompanying financial statements.

The prize pool for Hot Lotto consists of 50% of each drawing period's sales. The 50% contribution to the prize pool is distributed to grand prizes and a prize reserve fund based on the following jackpot levels:

- \$1,000,000 to \$2,000,000 52.5763% to grand prize
- \$2,000,000 to \$5,000,000 52.5763% to grand prize plus 1.00% to prize reserve fund
- \$5,000,000 to 10,000,000 52.5763% to grand prize plus 3.00% to prize reserve fund

The prize reserve fund serves as a contingency fund to protect MUSL from unforeseen liabilities. As of September 30, 2014 and 2013, the total Hot Lotto prize reserve fund was approximately \$7,606 and \$7,200, respectively, of which the Lottery's share was approximately \$334 and \$323, respectively. The balance in the prize reserve fund may be used at the discretion of the MUSL's Board of Directors. The Lottery's share of the prize reserve fund is not reflected in the accompanying financial statements.

#### NOTE 5 OBLIGATIONS FOR UNPAID PRIZES

Powerball jackpot prizes are paid in 20 or 25 year installments. The first installment is paid approximately two weeks after the prize is claimed. The subsequent annual payments are funded with U.S. Treasury Strips purchased by MUSL for the Lottery. Jackpot prize payables represent the future annual prize payments valued at cost plus accrued interest (present value of securities held to maturity) of the investment securities funding the payments.

	<b>Jackpot</b>	
	<b>Year Ended September 30,</b>	
	<b>2014</b>	<b>2013</b>
Jackpot Prizes Payable:		
Due Within One Year	\$ 2,962	\$ 4,010
Due in Subsequent Years	3,320	6,190
Total (Present Value)	6,282	10,200
Add: Interest to Maturity	240	322
Jackpot Prizes Payable at Maturity	<u>\$ 6,522</u>	<u>\$ 10,522</u>

The unamortized discount on the prizes payable is based on interest rates which range from 0.546% to 2.357% and reflect the interest rates earned by the investments held to fund the related liabilities.

The aggregate amount of prizes payable due in each of the five years following September 30, 2014, and the five year incremental totals thereafter, is as follows:

2015	\$ 2,972
2016	1,150
2017	400
2018	400
2019	400
2020 - 2022	<u>1,200</u>
Total	<u>\$ 6,522</u>

The following schedule presents the changes in prizes payable:

<b>Balance as of October 1, 2012</b>	\$ 16,381
Increase	506
Decrease	<u>(6,687)</u>
<b>Balance as of October 1, 2013</b>	10,200
Increase	240
Decrease	<u>(4,158)</u>
<b>Balance as of September 30, 2014</b>	<u>\$ 6,282</u>

#### NOTE 6 GAMING REVENUES AND EXPENSES

Gaming revenues and expenses for the fiscal years ended September 30, 2014 and 2013 were as follows:

Index Class	Gaming Revenue	Prizes	Agent Commissions	Contractor Fees	Advertising	Gross Margin
<b>Fiscal Year 2014</b>						
DC 3	46,171	(22,600)	(2,985)	-	-	20,586
DC FIVE	16,683	(8,648)	(950)	-	-	7,085
DC FOUR	56,924	(27,281)	(3,537)	-	-	26,106
FAST PLAY	9,669	(7,249)	(682)	-	-	1,738
HOT LOTTO	3,560	(1,733)	(202)	-	-	1,625
INSTANT	40,420	(29,094)	(3,062)	-	-	8,264
KENO	11,585	(7,391)	(797)	-	-	3,397
MEGA MILLIONS	8,880	(4,293)	(523)	-	-	4,064
POWERBALL	11,850	(5,648)	(719)	-	-	5,484
RACE 2 RICHES	7,731	(5,368)	(535)	-	-	1,828
TAP-N-PLAY	2,545	(1,967)	(185)	-	-	393
OTHER	22	-	-	-	-	-
<b>Total</b>	<b>216,040</b>	<b>(121,272)</b>	<b>(14,177)</b>	<b>(8,195)</b>	<b>(5,742)</b>	<b>66,654</b>
<b>Fiscal Year 2013</b>						
DC 3	49,113	(26,080)	(3,160)	-	-	19,873
DC FIVE	16,151	(6,917)	(902)	-	-	8,332
DC FOUR	60,055	(25,599)	(3,609)	-	-	30,847
FAST PLAY	9,100	(4,546)	(644)	-	-	3,910
HOT LOTTO	3,395	(1,653)	(160)	-	-	1,582
INSTANT	57,157	(40,346)	(4,288)	-	-	12,522
KENO	11,793	(7,712)	(814)	-	-	3,267
MEGA MILLIONS	6,195	(3,091)	(349)	-	-	2,755
POWERBALL	20,592	(8,311)	(1,104)	-	-	11,177
RACE 2 RICHES	8,076	(5,081)	(560)	-	-	2,435
TAP-N-PLAY	803	(89)	(7)	-	-	707
OTHER	30	-	-	-	-	-
<b>Total</b>	<b>242,460</b>	<b>(129,425)</b>	<b>(15,597)</b>	<b>(11,681)</b>	<b>(6,036)</b>	<b>79,721</b>

**NOTE 7            TRANSFERS TO THE DISTRICT’S GENERAL FUND**

The District Budget Act (PL 4-162) (the Act) of 1983 requires the Lottery to transfer its revenues less expenses and less a reserve not to exceed 2% of annual prize payments to the General Fund of the District. The Mayor may approve a change in the reserve limit, as necessary, upon the request of the Lottery. During the fiscal years ended September 30, 2014 and 2013, the Lottery’s net transfers to the General Fund of the District were \$54,966 and \$68,314, respectively. The Lottery was in compliance with the Act for the fiscal years ended September 30, 2014 and 2013.

**NOTE 8            LONG-TERM LIABILITIES**

The following summarizes long-term liabilities at September 30, 2014 and 2013:

	<b>Balance</b> <b>@</b> <b>9/30/2013</b>	<b>Additions</b>	<b>Reductions</b>	<b>Balance</b> <b>@</b> <b>9/30/2014</b>	<b>Amount</b> <b>Due Within</b> <b>One Year</b>
Obligations for Unpaid Prizes	\$ 10,200	\$ -	\$ (3,918)	\$ 6,282	\$ 2,962
Compensated Absences	415	-	(17)	398	-
Total Long-term Liabilities	<u>\$ 10,615</u>	<u>\$ -</u>	<u>\$ (3,935)</u>	<u>\$ 6,680</u>	<u>\$ 2,962</u>

  

	<b>Balance</b> <b>@</b> <b>9/30/2012</b>	<b>Additions</b>	<b>Reductions</b>	<b>Balance</b> <b>@</b> <b>9/30/2013</b>	<b>Amount</b> <b>Due Within</b> <b>One Year</b>
Obligations for Unpaid Prizes	\$ 16,381	\$ -	\$ (6,181)	\$ 10,200	\$ 4,010
Compensated Absences	416	-	(1)	415	-
Total Long-term Liabilities	<u>\$ 16,797</u>	<u>\$ -</u>	<u>\$ (6,182)</u>	<u>\$ 10,615</u>	<u>\$ 4,010</u>

**NOTE 9            RETIREMENT PROGRAMS**

**(a) *Defined Benefit Pension Plan***

The majority of the full-time Lottery employees hired before October 1, 1987 are covered by the Federal Civil Service Retirement System (5 U.S.C. 8331). The Federal Civil Service Retirement System is a cost-sharing multiple employer pension plan.

The U.S. Office of Personnel Management is responsible for administering the Federal Civil Service Retirement System, including collecting the contributions and disbursing the benefits.

In accordance with the Balance Budget Act of 1997 (Public Law 105-33), the Lottery contributes 7.00% and employees contribute 7.25% of employees’ covered compensation to the Federal Civil Service Retirement System. Contributions by the Lottery amounted to \$60 and \$61 for the years ended September 30, 2014 and 2013, respectively. The number of Lottery employees covered under the Federal Civil Service Retirement System is 6.

**(b) *Defined Contribution Plan***

All full-time employees hired after September 30, 1987 are covered by the District-sponsored defined contribution plan. Employees do not contribute to this plan and are eligible to participate after one year of service. The Lottery contributes 5% of an eligible employee’s base salary, which amounted to \$287 and \$265 for the fiscal years ended September 30, 2014 and 2013, respectively.

Contributions and earnings vest fully after four years of service following a one-year waiting period. Contributions and earnings are forfeited if separation occurs before five years of credited service. These contributions are not considered assets of the Lottery or the District, which have no further liability to this plan.

**(c) *Deferred Compensation Plan***

Lottery employees are eligible to participate in the District-sponsored deferred compensation plan (D.C. Code 47-3601) created in accordance with Internal Revenue Code Section 457. Employees may defer an amount equal to or less than 100% of includible compensation or \$17.5 in 2014 and 2013. Maximum annual contribution amounts are determined and set by the Internal Revenue Service (IRS). Compensation deferred and income earned is taxable when paid or made available to the participant or beneficiary upon retirement, death, termination, or unforeseeable emergency. Contributions are not assets of the Lottery or District, which have no further liability to the plan.

**NOTE 10 COMMITMENTS AND CONTINGENCIES**

**(a) *Operating Leases***

The Lottery leased certain facilities under a ten (10) year long-term, non-cancelable, and operating lease which began May 8, 2008. Effective December 12, 2014, the Lottery moved into new facilities provided under a new fifteen year lease with the same lessor. Future minimum rental commitments are as follows:

<u>Year Ending September 30</u>	<u>Amount</u>
2015	\$ 1,774
2016	1,818
2017	1,864
2018	1,910
2019	1,958
2020-2024	10,550
2025-2029	9,188
Total	<u>\$ 29,062</u>

Rent expense for the fiscal years ended September 30, 2014 and 2013 was as follows:

	<u>2014</u>	<u>2013</u>
Rent Expense	<u>\$ 2,556</u>	<u>\$ 2,457</u>

**(b) *Annuity Contracts***

The winner of a \$1 million DC Black instant ticket in 2012 was awarded an annuity prize payable in annual installments over 20 years, with the first payment made by the Lottery. The Lottery entered into an agreement with an insurance company under which the Lottery purchased an annuity under contract that provides payments corresponding to its obligations to the prize winner. Future installment payments will be made directly to the winner by the insurance company, thus neither the present value of the annuity nor the present value of related future payments are reflected in the accompanying financial statements. The Lottery will be liable for such future payments if the insurance company defaults on its payments.

**(c) *Risk of Loss***

The Lottery is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Lottery or District covers all of the Lottery's claim settlements and judgments out of the Lottery revenues or the District's General Fund resources.

**NOTE 11      RELATED PARTY TRANSACTIONS**

The Lottery usually has related party transactions with the Office of the Chief Financial Officer (OCFO) to provide financial and managerial oversight. These services included, but were not limited to, internal audit and internal security, legal, human resources, procurement, financial management, and executive management oversight services. As a result of the Lottery's lack of an instant ticket contract and its substantial decline in transfers to the General Fund, the contractual services assessment was waived in fiscal year 2014 by the Office of Management Administration. The annual contractual cost was \$-0- and \$1,142 in fiscal years 2014 and 2013, respectively.

Other services provided by District Government entities to the Lottery include central processing of payroll, accounting, computer technology services, and the handling of intra-district transactions for rent, telephone, security guard services, etc. Personnel costs for these services are budgeted and accounted for as part of the respective entity's regular operations.

**NOTE 12      LITIGATION**

The Lottery is a defendant in legal claims arising from its normal operations. While the ultimate outcome of unsolved lawsuits cannot be predicted at the time, it is the opinion of management and in-house counsel that the disposition of any litigation in which the Lottery is involved will not have a material adverse effect on the financial position, results of operations, or cash flows of the Lottery.

**NOTE 13      SUBSEQUENT EVENTS**

Lottery did not have any subsequent events that based on the facts and circumstances, required recording or disclosure in the financial statements for the year ended September 30, 2014. Events and transactions were evaluated through December 18, 2014, the date the financial statements were available to be issued.



**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**

To the Mayor and Members of  
The Council of the Government of the District of Columbia, and  
The Lottery and Charitable Games Control Board  
Washington, D.C.

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 District of Columbia Lottery and Charitable Games Control Board (the Lottery), an enterprise fund of the Government of the District of Columbia, as of and for the year ended September 30, 2014 and 2013 and the related notes to the financial statement as listed in the table of contents, and have issued our report thereon dated December 18, 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 opinions 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 entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or 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. We consider the deficiency described in the accompanying schedule of findings and responses to be a significant deficiency (2014-1).

**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, and contracts, 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*.

### **The Lottery's Response to Findings**

The Lottery's response to the finding identified in our audit is described in the accompanying schedule of findings and responses. The Lottery's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

### **Purpose of the Report**

The purpose of the report is solely to describe the scope of our testing of internal controls and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Lottery'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 Lottery's internal control and compliance. Accordingly this communication is not suitable for any other purpose.

**Bert Smith & Co**

Washington, D.C.

December 18, 2014

**GOVERNMENT OF THE DISTRICT OF COLUMBIA  
LOTTERY AND CHARITABLE GAMES CONTROL BOARD  
SCHEDULE OF FINDINGS AND RESPONSES**

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**2014-1**                      **Weakness in Internal Controls over Instant Scratch Tickets - *Significant Deficiency***

**Condition:**                      The controls over the inventorying and monitoring of the Instant Scratch Tickets were inadequate and could not preclude the occurrence of either intentional or unintentional errors in the recording and reporting of ticket sales. There was no process in place to monitor the tickets ordered and mailed to retailers, as well as those tickets which were obtained by the retailers from the Lottery’s cash and carry locations. Tickets remained “in transit” without follow-up from the Lottery’s personnel. In one instance, we noted that a retailer accumulated 1,765 packs of instant scratch tickets; 125 packs with a value of \$36,800 were compromised without being activated, 800 packs were recovered by the Lottery, while 840 packs with a value of \$247,500 could not be accounted for.

We understand that the current policy of requiring the retailers to make payment on the tickets 90 days after activation or after 90% of the lower prizes had been claimed, whichever came first, has been replaced by a more restrictive timeframe and percentage ceiling. While this change maybe positive, it does not eliminate the ability of retailers to engage in the fraudulent compromising of the process, by activating only those packs that contain “winning tickets”.

**Criteria:**                      Best practices require the existence of internal controls to ensure that the inventory of instant scratch tickets is properly accounted for and that revenue is recognized when measurable in a timely manner. A robust internal control environment will reduce if not prevent the opportunities for fraud; this should therefore be the aim of the agency.

**Cause:**                      The Lottery had not implemented proper internal controls to safeguard the integrity of the Instant Scratch Tickets program. The Lottery’s personnel were not adequately training in warehousing, distributing and monitoring of the Lottery’s instant scratch tickets. In addition, the ticket activation policy leaves room for improprieties.

**Effect:**                      Revenue may be understated. The compromised tickets were not activated and therefore not recognized as revenue by the gaming system.

**Recommendations:**                      The Lottery should establish procedures to ensure that its tickets stock is properly classified once it leaves the warehouse. “In transit” should refer to tickets en route to the retailers’ location, subsequently, the tickets should be registered as “issued” once the ticket order is scanned into the system, followed by “activated” when the retailer releases them for sale within the store.

The Lottery should also implement procedures to ensure the ticket stock of retailers is monitored to ensure tickets are being regularly activated and not being hoarded and/or compromised. A timeframe should be established within which tickets ordered must be activated. This would ensure that activations cover the entire population of tickets issued to a retailer and prevent tickets from being compromised without with revenue recognition process (i.e. activation).

**GOVERNMENT OF THE DISTRICT OF COLUMBIA**  
**LOTTERY AND CHARITABLE GAMES CONTROL BOARD**  
SCHEDULE OF FINDINGS AND RESPONSES (*Continued*)

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**Management's  
Response:**

The D.C. Lottery concurs, in part, with the finding.

We disagree with the statement that our new, more restrictive time frame and other measures that the Lottery took do not eliminate the ability of retailers to engage in the fraudulent compromising of the process. As noted by the independent auditor under the "Cause" section of the finding, the DCLB was forced to take over the warehousing and distribution of Scratch Tickets as a result of losing its instant ticket vendor and contract. DCLB had no prior warehousing and distribution experience and put measures in place that it believed to be operationally efficient and effective, based on some of the industry's best practices. It was in fact, DCLB who discovered this compromising activity and subsequently took the necessary steps to mitigate the damages and correct the issue. As a result of a thorough investigation by DCLB's security staff, DCLB was able to identify and analyze where in the process of distributing tickets we needed to implement tighter controls. DCLB, along with assistance from its Risk Officer, has since developed and implemented several new key measures in the process and they are as follows:

- Dedicated an employee to oversee retailer inventory ordering and monitor the regulated receipt time frame of distributed inventory. *This measure will dissolve the ability of a retailer to order inventory at will and prevent the stock piling of that inventory. It also eliminates the allowance of inventory sitting in an "in transit" status beyond a 24 hour time frame.*
- Promulgating of new regulations that require retailer acceptance of distributed inventory within 24 hours of receipt and the activation of that inventory within 30 days of issuance. *These measures will provide DCLB the leverage to perform these inventory "status" changes in our inventory management system should the retailer fail to adhere to the regulated time frames. The measures also allow DCLB to take administrative action on the retailers for failure to adhere.*
- Replaced the 90/90 billing rule with an 80/45 billing rule. The 90/90 rule allowed retailers to be invoiced once 90% of the low tier prizes were awarded or 90 days after activation of the inventory (whichever occurs first). The new 80/45 rule allows DCLB to invoice retailers once 80% of low tier prizes are awarded or 45 days after activation (whichever occurs first). *This measure allows DCLB to invoice and collect payment for distributed inventory much timelier, which increases cash flow to support operations and the general fund. It also helps to reconcile a retailer's inventory needs with their inventory wants.*
- Realign the warehouse/inventory management responsibility from the Sales Department to the Agency Fiscal Office. *This measure allows technical and financial oversight of inventory by individuals who have the finance and accounting background and expertise to evaluate and analyze processes which have financial impact, and translate that activity into financial transactions.*

The D.C. Lottery is committed to eradicating this finding and feel we have a plan already in place that will accomplish this task, as well as, prevent any such future findings.