

Audited Financial Statements

West Virginia Lottery

Years Ended June 30, 2010 and 2009

Gibbons
& Kawash
Certified Public Accountants

WEST VIRGINIA LOTTERY

Audited Financial Statements

Years Ended June 30, 2010 and 2009

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INDEPENDENT AUDITORS' REPORT

West Virginia Lottery Commission
Charleston, West Virginia

We have audited the accompanying balance sheets of the West Virginia Lottery (the Lottery), a component unit of the State of West Virginia, as of and for the years ended June 30, 2010 and 2009, and the related statements of revenues, expenses and changes in fund net assets and cash flows for the years then ended. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Lottery as of June 30, 2010 and 2009, and the respective changes in financial position and cash flows thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 24, 2010, on our consideration of the Lottery'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 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.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 12 be presented to supplement the basic financial statements. Such information, although not part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in appropriate operational, economic, or historical context. We have applied certain

limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Jubbons & Kawash

September 24, 2010

Management's Discussion and Analysis

-Unaudited-

Our discussion of the West Virginia Lottery's (the Lottery) financial performance provides for an overview of the Lottery's financial activities for the fiscal years ended June 30, 2010 and 2009. In reading the Management's Discussion and Analysis (MD & A), the current year refers to fiscal year ending June 30, 2010, and the prior year refers to fiscal year ending June 30, 2009. This analysis is to be considered in conjunction with the financial statements, which begin on page 13.

Financial Highlights

The Lottery's operating income declined in 2010 and 2009. The revenue and related decreases are primarily the result of increased competition in neighboring states and the downturn in the overall economy. The following summary is provided below:

- Lottery revenues for the current year decreased \$134.9 million or 9% compared to the prior year, which decreased \$30.4 million or 2% over 2008.
- Commissions for the current year decreased \$57.4 million or 8.3% compared to the prior year, which decreased \$19.9 million or 2.8% over 2008.
- Gross profit for the current year decreased \$67.8 million or 10.1% compared to the prior year, which decreased \$8.6 million or 1.3% over 2008.
- Nonoperating expenses decreased \$49.7 million or 7.8% compared to the prior year, which decreased \$9.2 million or 1.4% over 2008. The predominant nonoperating expense is the distributions to the State of West Virginia, which decreased \$47.7 million or 7.7% compared to the prior year, which decreased \$14.5 million or 2.3% over 2008.

Using This Annual Report

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

Balance Sheets

As shown in Table 1, current assets increased \$24.4 million or 9.3% compared to the prior year, which increased \$41.7 million or 18.9% over 2008, due to the timing of distributions to the State of West Virginia at year-end.

Restricted assets decreased due to the acquisition of a Lottery headquarters building on June 30, 2010 and the accrued distribution of surplus funds from the revenue center construction fund. See Notes 11 and 12 to the financial statements for additional information on restricted assets and these special items.

Management's Discussion and Analysis
(Continued)

-Unaudited-

Balance Sheets (Continued)

Capital assets, net of accumulated depreciation and amortization, increased in 2010 by \$20 million or 606.3% and decreased by \$1.9 million or 37% in 2009 due to the acquisition of a Lottery headquarters building on June 30, 2010, which is offset by continuing depreciation of capital assets. For additional information on capital assets, please refer to Note 4 to the financial statements.

Table 1
Assets
(in \$000's)

	2010	2009	2008
Current assets	\$ 286,297	\$ 261,868	\$ 220,215
Restricted assets	8,355	69,871	58,487
Capital assets, net of accumulated depreciation and amortization	23,349	3,306	5,251
Long-term portion of investments held in trust	-	-	126
Total assets	\$ 318,001	\$ 335,045	\$ 284,079

As shown in Table 2, the Lottery's current liabilities increased \$29.8 million or 11.8% compared to the prior year, which increased \$32.3 million or 14.7% when compared to 2008 due to the timing of distributions that are reflected as accrued liabilities until actually paid.

Net assets – restricted decreased due to the acquisition of a Lottery headquarters building on June 30, 2010 and the accrued distribution of surplus funds from the revenue center construction fund. See Notes 11 and 12 to the financial statements for additional information on restricted net assets and special items.

Net assets - invested in capital assets increased in 2010 by \$20 million or 606.3% due to the acquisition of a Lottery headquarters building on June 30, 2010. Refer to Note 4 to the financial statements for additional information on capital assets.

Net assets – unrestricted changed in fiscal years 2010, 2009 and 2008 as a result of Lottery Commission orders setting aside or distributing funds committed by the Commission for acquisition of capital assets. In 2010, with the purchase of a building and land to serve as Lottery headquarters, the unrestricted net assets set aside for this purpose by Lottery Commission orders were no longer needed and were accrued for distribution to the State of West Virginia.

Management's Discussion and Analysis
(Continued)

-Unaudited-

Balance Sheets (Continued)

Table 2			
Liabilities and Net Assets			
(in \$000's)			
	<u>2010</u>	<u>2009</u>	<u>2008</u>
Current liabilities	\$ 281,618	\$ 251,857	\$ 219,594
Net assets - restricted	8,355	69,871	58,487
Net assets - invested in capital assets	23,349	3,306	5,251
Net assets - unrestricted	<u>4,679</u>	<u>10,011</u>	<u>747</u>
Total net assets	<u>36,383</u>	<u>83,188</u>	<u>64,485</u>
 Total liabilities and net assets	 <u>\$ 318,001</u>	 <u>\$ 335,045</u>	 <u>\$ 284,079</u>

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

Table 3			
Revenues, Expenses and Changes in Fund Net Assets			
(in \$000's)			
	<u>2010</u>	<u>2009</u>	<u>2008</u>
Revenues:			
On-line games	\$ 83,741	\$ 84,241	\$ 87,177
Instant games	97,483	113,854	110,862
Racetrack video lottery	746,208	848,233	897,953
Limited video lottery	397,287	412,489	411,587
Table games	31,726	34,219	15,877
Historic resort	<u>1,649</u>	<u>-</u>	<u>-</u>
	1,358,094	1,493,036	1,523,456
Less:			
Commissions:			
On-line games	5,849	5,901	6,114
Instant games	6,824	7,970	7,763
Racetrack video lottery	414,988	463,649	487,276
Limited video lottery	194,671	202,120	205,637
Table games	12,473	13,458	6,249
Historic resort	<u>847</u>	<u>-</u>	<u>-</u>
	635,652	693,098	713,039

(Continued)

Management's Discussion and Analysis
(Continued)

-Unaudited-

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

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Prizes, ticket and vendor costs:			
On-line prize costs	41,818	42,451	44,544
Instant ticket prize costs	66,165	76,998	76,625
Ticket costs	1,511	1,528	1,676
Vendor fees and costs	<u>7,744</u>	<u>5,935</u>	<u>5,928</u>
	<u>117,238</u>	<u>126,912</u>	<u>128,773</u>
Gross profit	605,204	673,026	681,644
Administrative expenses:			
Advertising and promotions	7,349	7,160	8,658
Wages and related benefits	10,921	9,645	7,885
Telecommunications	648	2,208	2,275
Contractual and professional	4,741	5,030	4,099
Rental	697	727	685
Depreciation and amortization	1,840	1,988	732
Other administrative expenses	<u>1,042</u>	<u>994</u>	<u>1,540</u>
	<u>27,238</u>	<u>27,752</u>	<u>25,874</u>
Other operating income:	<u>11,059</u>	<u>11,401</u>	<u>11,937</u>
Operating income	589,025	656,675	667,707
Nonoperating income (expense):			
Investment income	390	2,720	9,572
Nonoperating income-OPEB	-	-	472
Interest expense	-	(1)	(13)
Distributions to municipalities and counties	(7,787)	(8,085)	(8,067)
Distributions to racetracks-capital reinvestment	(11,968)	(15,983)	(17,988)
Distributions to the State of West Virginia	<u>(568,945)</u>	<u>(616,623)</u>	<u>(631,155)</u>
	<u>(588,310)</u>	<u>(637,972)</u>	<u>(647,179)</u>
Net income before special item	715	18,703	20,528
Special item - restricted net assets accrued for distribution to the State of West Virginia	(40,000)	-	-
Special item - unrestricted net assets accrued for distribution to the State of West Virginia	<u>(7,520)</u>	<u>-</u>	<u>-</u>
Net income (loss)	(46,805)	18,703	20,528
Net assets, beginning of year, as restated*	<u>83,188</u>	<u>64,485</u>	<u>43,957</u>
Net assets, end of year	<u>\$ 36,383</u>	<u>\$ 83,188</u>	<u>\$ 64,485</u>

* \$468 adjustment to OPEB liability at beginning of year in 2008.

Management's Discussion and Analysis
(Continued)

-Unaudited-

Sales and Prizes, Commissions, Ticket Costs and Vendor Fees

Table 4 compares sales (referred to as lottery revenues in financial statements), prizes, commissions, ticket printing costs, vendor fees and costs and gross profit for each lottery game category for fiscal years 2010, 2009 and 2008. Sales and gross profits fluctuated in certain categories, however, gross profit percentages remained consistent from year to year.

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

	Instant			On-Line*					
	2010	2009	2008	2010	2009	2008			
Gross sales	\$ 97,483	\$ 113,854	\$ 110,862	\$ 83,741	\$ 84,241	\$ 87,177			
Less direct costs:									
Prizes and bonuses	66,165	76,998	76,625	41,818	42,451	44,544			
Commissions	6,824	7,970	7,763	5,849	5,901	6,114			
Ticket printing costs	1,511	1,528	1,676	-	-	-			
Vendor fees and costs	4,203	4,311	3,320	3,541	2,524	2,608			
Total direct costs	78,703	89,907	89,384	51,208	50,876	53,266			
Gross Profit	\$ 18,780	\$ 23,947	\$ 21,478	\$ 32,533	\$ 33,365	\$ 33,911			
Gross profit percentage	19.30%	21.00%	19.40%	38.80%	39.60%	38.90%			
	Racetrack Video Lottery			Limited Video Lottery					
	2010	2009	2008	2010	2009	2008			
Gross sales	\$ 746,208	\$ 848,233	\$ 897,953	\$ 397,287	\$ 412,489	\$ 411,587			
Less direct costs:									
Prizes and bonuses	-	-	-	-	-	-			
Commissions	414,988	463,649	487,276	194,671	202,120	205,637			
Ticket printing costs	-	-	-	-	-	-			
Vendor fees and costs	-	-	-	-	-	-			
Total direct costs	414,988	463,649	487,276	194,671	202,120	205,637			
Gross Profit	\$ 331,220	\$ 384,584	\$ 410,677	\$ 202,616	\$ 210,369	\$ 205,950			
Gross profit percentage	44.40%	45.30%	45.70%	51.00%	51.00%	50.00%			
	Table Games			Historic Resort			Total		
	2010	2009	2008	2010	2009	2008	2010	2009	2008
Gross sales	\$ 31,726	\$ 34,219	\$ 15,877	\$ 1,649	\$ -	\$ -	\$ 1,358,094	\$ 1,493,036	\$ 1,523,456
Less direct costs:									
Prizes and bonuses	-	-	-	-	-	-	107,983	119,449	121,169
Commissions	12,473	13,458	6,249	847	-	-	635,652	693,098	713,039
Ticket printing costs	-	-	-	-	-	-	1,511	1,528	1,676
Vendor fees and costs	-	-	-	-	-	-	7,744	5,935	5,928
Total direct costs	12,473	13,458	6,249	847	-	-	752,890	820,010	841,812
Gross Profit	\$ 19,253	\$ 20,761	\$ 9,628	\$ 802	\$ -	\$ -	\$ 605,204	\$ 673,026	\$ 681,644
Gross profit percentage	60.7%	60.7%	60.6%	48.6%	0.0%	0.0%	44.6%	45.1%	44.7%

* On-line games include the results of Powerball® which is a significant component of the results described above.

Management's Discussion and Analysis (Continued)

-Unaudited-

Instant Sales

Instant ticket sales decreased in 2010 by \$16.4 million or 14.4% compared to the 2009 increase of \$3.0 million or 2.7% over 2008. Forty-two games were introduced in 2010 and approximately twenty-six game options were available for play in both years. The Lottery continues to implement the results of research and design efforts, including increased ticket font size for easier reading by players, simplified play styles for faster play and continued monitoring of the mix of play styles and colors more closely to create a better variety of game presentation available at one time. One ten-dollar and four five-dollar games were introduced in 2010, down from the previous year based on less demand from the public. There was an increase in the one-dollar and two-dollar game introductions, to meet player demand.

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

Vendor fees and costs are primarily 4.3% of instant and on-line ticket sales for 2010 and 3% for 2009 and 2008. The Lottery (as is the case with most lotteries located in North America) has elected to enter into a long-term contract to provide a central computer system, retailer terminals and related equipment to sell and cash all tickets for instant and on-line games.

Powerball® Sales

Powerball® is a multi-state lotto game offering larger jackpots with occasional jackpots in excess of \$100 million. Sales decreased in 2010 by \$2.4 million or 4.8% and decreased in 2009 by \$3.0 million or 5.6%. Sales are generally driven by the jackpot size.

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

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

Mega Millions® Sales

Mega Millions sales began in January 2010 offering jackpots starting at \$12 million and other prizes ranging from \$2 to \$250,000. Sales were \$2.7 million in 2010.

Approximately 50% of every dollar wagered goes back to the players in prizes and approximately 7% goes to retailer commissions.

All Other On-line Games

All other on-line games consist of Daily 3, Daily 4, Cash 25, Travel Keno and the multi-state game Hot Lotto™. Sales decreased in 2010 by \$755.9 thousand or 2.3% and increased slightly in 2009 by \$100 thousand or 0.3%.

Management's Discussion and Analysis (Continued)

-Unaudited-

All Other On-line Games (Continued)

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

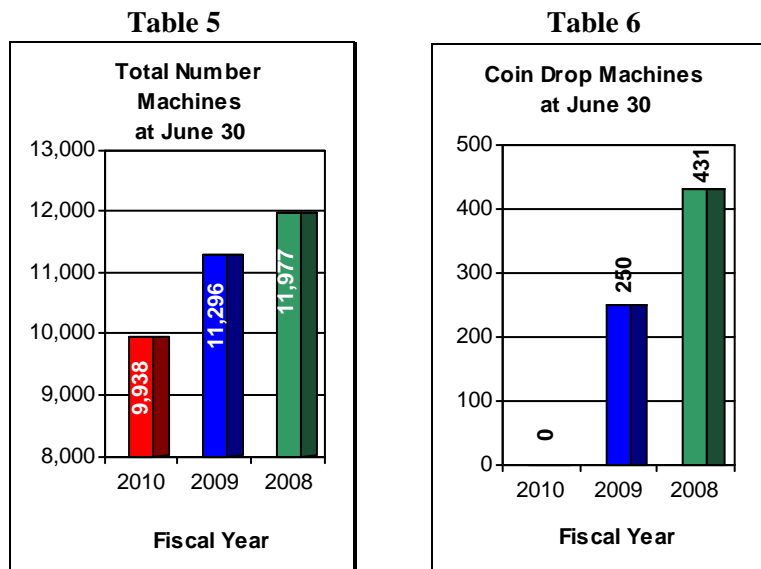
Racetrack Video Lottery

Racetrack video lottery revenues are reported net of total wagers. Revenues decreased \$102 million or 12% in 2010 and decreased \$49.7 million or 5.5% in 2009.

A portion of racetrack video lottery sales, as prescribed by statute, are paid to racetracks and other private entities associated with the racing industry and are reported as commissions. See Note 6 to the financial statements for further discussion of racetrack video lottery distributions. The decreases in commissions of \$48.7 million or 10.5% in 2010 and \$23.6 million or 4.8% in 2009 was due to the economy as well as competition from neighboring states which recently legalized video lottery games. This competition has decreased the revenue at two of the state's four race tracks licensed to operate video lottery games and which border that state.

As noted in the accompanying tables, and in following with industry trends, "coin drop" machines are being phased out in favor of ticket in ticket out (TITO) machines. This increase in TITO machines has helped to lessen the decline in racetrack video lottery revenues from competition.

The changes in active machines are presented in Tables 5 through 8 below which illustrate the fluctuations during the last three fiscal years.



Management's Discussion and Analysis
(Continued)

-Unaudited-

Racetrack Video Lottery (Continued)

Table 7

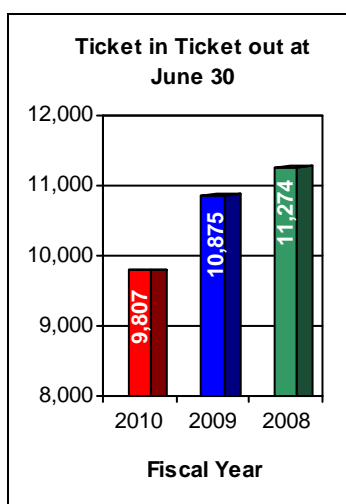
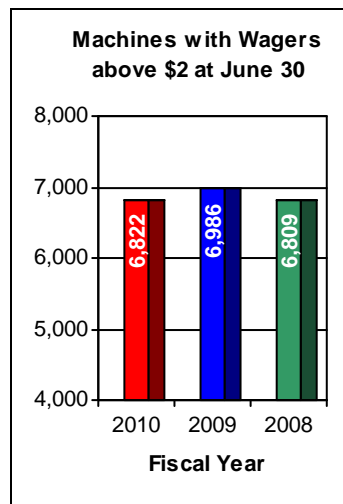


Table 8

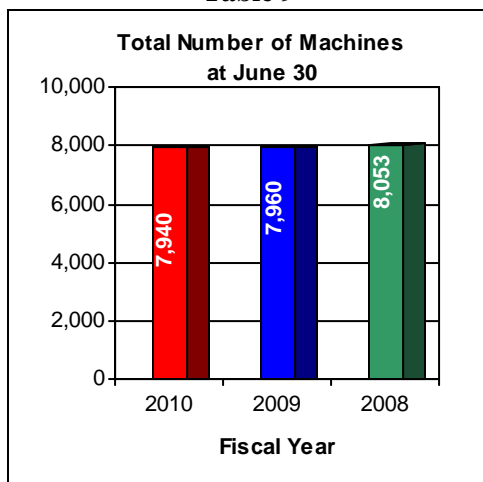


Limited Video Lottery

Sales decreased by \$15.2 million or 3.7% in 2010 over 2009, which increased slightly by \$902 thousand or 0.2% over 2008. The decrease in commissions of \$7.4 million or 3.7% in 2010 over 2009 and the decrease of \$3.5 million or 1.7% over 2008, are paid to operators and retailers as provided for by statute and have a direct correlation to changes in sales.

- Table 9 illustrates the decrease in machines by 20 in 2010 as compared to the decrease of 93 in 2009

Table 9



Management's Discussion and Analysis (Continued)

-Unaudited-

Table Games

West Virginia Lottery table games were implemented at three of the state's four racetracks during fiscal year 2010 and 2009. Revenues from table games are calculated at a 35% privilege tax of adjusted gross receipts. Revenues for 2010 were \$31.7 million and were \$34.2 million in 2009.

All table games revenues are distributed according to statute. A portion of table games revenues are paid to entities associated with the racetracks and are reported as commissions. See Note 8 to the financial statements. Commissions were \$12.5 million in 2010 and \$13.5 million in 2009.

Historic Resort

On November 4, 2008 Greenbrier County voters passed a local referendum to allow The Greenbrier Resort (Historic Resort) to implement gaming at their facility. Video lottery and table games were implemented at The Greenbrier Resort during fiscal year 2010 at a temporary site. Revenues from video lottery are calculated as defined in Note 9 to the financial statements. Revenues from table games are calculated at a 35% privilege tax of adjusted gross receipts. Combined revenues for video lottery and table games in 2010 at the Greenbrier Resort were \$1.6 million.

All revenues are distributed according to statute. A portion of revenues are paid to entities associated with the Historic Resort and are reported as commissions. Commissions were \$847 thousand in 2010.

Other Operating Income

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

Nonoperating Income (Expense)

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

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

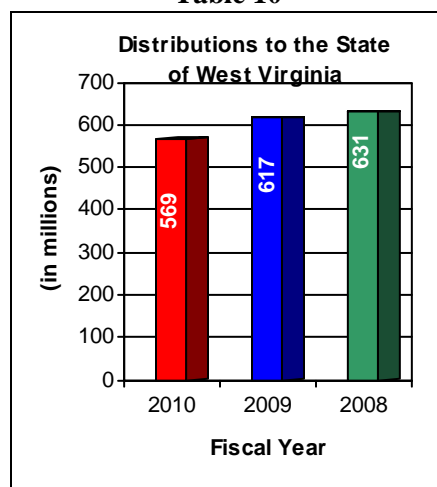
Refer to Table 10. The Lottery's payments to the State Lottery Fund and State Excess Lottery Revenue Fund decreased by \$48 million for the current fiscal year compared to a decrease of \$14 million in 2009.

Management's Discussion and Analysis (Continued)

-Unaudited-

Nonoperating Income (Expense) (Continued)

Table 10



Net Income (Loss) and Special Items

Effective June 30, 2006, the West Virginia Legislature directed the Lottery to set aside certain unexpended administrative funds of up to \$20 million per year for six years into the Revenue Center Construction Fund. In fiscal year 2010 the Lottery purchased a building and land to serve as the Lottery headquarters and it was determined that unexpended excess funds set aside in restricted net assets for the purchase of capital assets were surplus funds and would be returned by distribution to the State of West Virginia. This distribution is reported as a special item.

In June 2010, the Lottery Commission approved the distribution of funds previously set aside as unrestricted net assets for future capital asset purchases to be returned by distribution to the State of West Virginia. This distribution is also reported as a special item. Refer to Notes 11 and 12 to the financial statements for additional information.

Other Currently Known Facts

On December 5, 2009 Jefferson County, West Virginia voters passed a local referendum which allows Charles Town Races and Slots to implement table games at their facility. Charles Town Races and Slots began table games operations in July 2010.

WEST VIRGINIA LOTTERY

BALANCE SHEETS

(In Thousands)

June 30, 2010 and 2009

<u>ASSETS</u>	<u>2010</u>	<u>2009</u>
Current assets:		
Cash and cash equivalents	\$ 256,355	\$ 225,354
Accounts receivable	26,986	33,311
Inventory	683	648
Other assets	<u>2,273</u>	<u>2,555</u>
Total current assets	<u>286,297</u>	<u>261,868</u>
Noncurrent assets:		
Restricted cash and cash equivalents	8,355	69,871
Capital assets	39,524	17,641
Less accumulated depreciation and amortization	<u>(16,175)</u>	<u>(14,335)</u>
	<u>23,349</u>	<u>3,306</u>
Total noncurrent assets	<u>31,704</u>	<u>73,177</u>
Total assets	<u>\$ 318,001</u>	<u>\$ 335,045</u>
 <u>LIABILITIES AND NET ASSETS</u>		
Current liabilities:		
Accrued nonoperating distributions to the State of West Virginia	\$ 241,039	\$ 202,184
Estimated prize claims	13,128	12,938
Accounts payable	3,050	1,716
Other accrued liabilities	<u>24,401</u>	<u>35,019</u>
Total liabilities	<u>281,618</u>	<u>251,857</u>
Net assets:		
Restricted by enabling legislation	8,355	69,871
Invested in capital assets	23,349	3,306
Unrestricted	<u>4,679</u>	<u>10,011</u>
Total net assets	<u>36,383</u>	<u>83,188</u>
Total liabilities and net assets	<u>\$ 318,001</u>	<u>\$ 335,045</u>

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

WEST VIRGINIA LOTTERY

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS

(In Thousands)

Years Ended June 30, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Lottery revenues:		
On-line games	\$ 83,741	\$ 84,241
Instant games	97,483	113,854
Racetrack video lottery	746,208	848,233
Limited video lottery	397,287	412,489
Table games	31,726	34,219
Historic resort	1,649	-
	<u>1,358,094</u>	<u>1,493,036</u>
Less commissions:		
On-line games	5,849	5,901
Instant games	6,824	7,970
Racetrack video lottery	414,988	463,649
Limited video lottery	194,671	202,120
Table games	12,473	13,458
Historic resort	847	-
	<u>635,652</u>	<u>693,098</u>
Less on-line prize costs	41,818	42,451
Less instant prize costs	66,165	76,998
Less ticket costs	1,511	1,528
Less vendor fees and costs	7,744	5,935
	<u>117,238</u>	<u>126,912</u>
Gross profit	<u>605,204</u>	<u>673,026</u>
Administrative expenses:		
Advertising and promotions	7,349	7,160
Wages and related benefits	10,921	9,645
Telecommunications	648	2,208
Contractual and professional	4,741	5,030
Rental	697	727
Depreciation and amortization	1,840	1,988
Other administrative expenses	1,042	994
	<u>27,238</u>	<u>27,752</u>
Other operating income	11,059	11,401
Operating income	<u>589,025</u>	<u>656,675</u>
Nonoperating income (expense):		
Investment income	390	2,720
Interest expense	-	(1)
Distributions to municipalities and counties	(7,787)	(8,085)
Distributions for capital reinvestment	(11,968)	(15,983)
Distributions to the State of West Virginia	(568,945)	(616,623)
	<u>(588,310)</u>	<u>(637,972)</u>
Income before special item	<u>715</u>	<u>18,703</u>
Special item - restricted net assets accrued for distribution to the State of West Virginia	(40,000)	-
Special item - unrestricted net assets accrued for distribution to the State of West Virginia	(7,520)	-
Net income (loss)	<u>(46,805)</u>	<u>18,703</u>
Net assets, beginning of year	<u>83,188</u>	<u>64,485</u>
Net assets, end of year	<u>\$ 36,383</u>	<u>\$ 83,188</u>

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

WEST VIRGINIA LOTTERY

STATEMENTS OF CASH FLOWS
(In Thousands)

Years Ended June 30, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Cash flows from operating activities:		
Cash receipts from customers and other sources	\$ 1,375,478	\$ 1,507,972
Cash payments for:		
Personnel costs	(9,636)	(9,121)
Suppliers	(13,567)	(20,508)
Other operating costs	<u>(760,068)</u>	<u>(819,997)</u>
Cash provided by operating activities	<u>592,207</u>	<u>658,346</u>
Cash flows from noncapital financing activities:		
Nonoperating distributions to the State of West Virginia	(577,610)	(581,406)
Distributions to municipalities and counties	(7,797)	(8,108)
Distributions to racetracks from racetrack capital reinvestment fund	(15,822)	(15,369)
Interest paid on deferred jackpot prize obligations	<u>-</u>	<u>(1)</u>
Cash used in noncapital financing activities	<u>(601,229)</u>	<u>(604,884)</u>
Cash flows from capital and related financing activities		
Purchases of capital assets	<u>(21,883)</u>	<u>(43)</u>
Cash flows from investing activities:		
Maturities of investments held in trust	-	136
Investment earnings	<u>390</u>	<u>2,720</u>
Cash provided by investing activities	<u>390</u>	<u>2,856</u>
Increase (decrease) in cash and cash equivalents	(30,515)	56,275
Cash and cash equivalents (including restricted cash and cash equivalents), beginning of year	<u>295,225</u>	<u>238,950</u>
Cash and cash equivalents (including restricted cash and cash equivalents), end of year	<u>\$ 264,710</u>	<u>\$ 295,225</u>

(Continued)

WEST VIRGINIA LOTTERY

STATEMENTS OF CASH FLOWS
(In Thousands)
(Continued)

Years Ended June 30, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 589,025	\$ 656,675
Adjustments to reconcile operating income to cash provided by operating activities:		
Depreciation and amortization	1,840	1,988
Changes in operating assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	6,325	3,535
Inventory	(35)	(347)
Other assets	282	40
Increase (decrease) in:		
Estimated prize claims	190	(29)
Accounts payable	1,334	(977)
Other accrued liabilities	(6,754)	(2,410)
Deferred jackpot prize obligations	-	(129)
Cash provided by operating activities	<u>\$ 592,207</u>	<u>\$ 658,346</u>

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

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS

1 - LEGISLATIVE ENACTMENT

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

2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The West Virginia Lottery is accounted for as a proprietary fund special purpose government engaged in business type activities. In accordance with accounting principles generally accepted in the United States of America for governmental entities, the financial statements are prepared on the accrual basis of accounting which requires recognition of revenue when earned and expenses when incurred. As permitted by Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Lottery has elected not to adopt Financial Accounting Standards Board (FASB) statements, interpretations and Auditing Standards Updates issued after November 30, 1989, unless the GASB specifically adopts such FASB statements, interpretations or Auditing Standards Updates.

The Lottery is included in the State's basic financial statements as a proprietary fund and business type activity using the accrual basis of accounting. Because of the Lottery's presentation in these financial statements as a special purpose government engaged in business type activities, there may be differences in presentation of amounts reported in these financial statements and the basic financial statements of the State as a result of classification of balances and major fund determination.

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 certain estimates and develop assumptions that affect the amounts reported in the financial statements and related notes to financial statements. Actual results could differ from management's estimates.

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Lottery Game Operations

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

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

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

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

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

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

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Lottery Game Operations (Continued)

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

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

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

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

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Lottery Game Operations (Continued)

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

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

Cash and Cash Equivalents

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

Inventory

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

Other Assets

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

Capital Assets

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

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Capital Assets (Continued)

The Lottery leases, under a cancelable operating lease, its office and warehouse facilities. The Lottery also leases various office equipment under agreements considered to be cancelable operating leases. Rental expense for the years ended June 30, 2010 and 2009, was \$697,279 and \$727,138, respectively.

Accrued Employee Benefits

The Lottery has accrued \$500,740 and \$467,815 of vacation at June 30, 2010 and 2009, respectively, for estimated obligations that may arise in connection with compensated absences at the current rate of employee pay. Employees fully vest in all earned but unused vacation. In accordance with State personnel policies, employees hired prior to July 1, 2001, vest in unused sick leave only upon retirement, at which time such unused leave can be converted into post-retirement health care coverage or additional periods of credited service for purposes of determining retirement benefits. To the extent that eligible conversion benefits are determined, a liability has been accrued as a result of the Lottery's participation in the State's post-employment benefits plan, in accordance with GASB Statement No. 45 (See Note 14).

Net Assets

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

Operating Revenues and Expenses

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

Advertising and Promotions

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

WEST VIRGINIA LOTTERY
 NOTES TO FINANCIAL STATEMENTS
 (Continued)

3 - CASH AND CASH EQUIVALENTS

At June 30, 2010 and 2009, the carrying amounts of deposits (overdrafts) with financial institutions were (\$60) thousand and (\$23) thousand, respectively, with bank balances of \$6 and \$29 thousand, respectively, which is covered by federal depository insurance. It is the Lottery's policy to require any balances over the insured amount be collateralized with securities held by the State of West Virginia's agent in the State's name.

At June 30, 2010 and 2009, the carrying amounts of deposits with financial institutions, the State Treasurer, and the West Virginia Board of Treasury Investments (BTI) were as follows (in thousands):

	<u>2010</u>	<u>2009</u>
Deposits with financial institutions	\$ (60)	\$ (23)
Cash on hand at the Treasurer's Office	40,006	22,110
Investments with BTI reported as cash equivalents	<u>224,764</u>	<u>273,138</u>
	<u>\$ 264,710</u>	<u>\$ 295,225</u>

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

The deposits with the BTI are part of the State of West Virginia's consolidated money market pool. Investment income is pro-rated to the Lottery at rates specified by the BTI based on the balance of the deposits maintained in relation to the total deposits of all state agencies participating in the pool. Such funds are available to the Lottery with overnight notice.

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

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

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

3 - CASH AND CASH EQUIVALENTS (Continued)

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

<u>Security Type</u>	<u>Credit Rating</u>		<u>Carrying Value</u>	<u>Percent of Assets</u>
	<u>Moody's</u>	<u>S&P</u>		
Commercial paper	P1	A-1	\$ 855,844	29.75%
Corporate bonds and notes	Aa1-Aa2	AA	20,000	.70
U.S. agency bonds	Aaa	AAA	246,990	8.59
U.S. Treasury notes*	Aaa	AAA	65,153	2.26
U.S. Treasury bills *	Aaa	AAA	476,670	16.57
Negotiable certificates of deposit	P1	A-1	281,000	9.77
U.S. agency discount notes	P1	A-1	606,048	21.07
Money market funds	Aaa	AAA	150,026	5.21
Repurchase agreements, with Underlying U.S. agency and Treasury notes	Aaa	AAA	<u>174,980</u>	<u>6.08</u>
			<u>\$ 2,876,711</u>	<u>100.00%</u>

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

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

<u>Security Type</u>	<u>Carrying Value (In Thousands)</u>	<u>Weighted Average Maturity In Days</u>
Commercial paper	\$ 855,844	18
US Treasury bills	476,670	35
US Treasury notes	65,153	140
Repurchase agreements	174,980	1
U.S. Agency bonds	246,990	55
Corporate bonds and notes	20,000	19

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

3 - CASH AND CASH EQUIVALENTS (Continued)

Interest rate risk (Continued)

<u>Security Type</u>	<u>Carrying Value (In Thousands)</u>	<u>Weighted Average Maturity In Days</u>
U.S. Agency discount notes	606,048	52
Certificates of deposit	281,000	45
Money market funds	<u>150,026</u>	1
Total assets	<u>\$ 2,876,711</u>	

The combined weighted average maturity of the investments of the West Virginia Money Market Pool as of June 30, 2010, is 33 days.

Concentration of credit risk - West Virginia statutes prohibit the West Virginia Money Market Pool from investing more than 5% of its assets in securities issued by one corporate name or corporate issue. At June 30, 2010, the pool did not have investments in any one private corporation or association that represented more than 5% of assets.

Custodial credit risk - At June 30, 2010, the West Virginia Money Market Pool held no securities that were subject to custodial credit risk. Repurchase agreements are collateralized at 102%, and the collateral is held in the name of the BTI. Securities lending collateral that is reported in the BTI's audited Statement of Assets and Liabilities is invested in the lending agent's money market fund.

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

4 - CAPITAL ASSETS

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

	<u>Historical cost at June 30, 2008</u>	<u>Additions</u>	<u>Deletions</u>	<u>Historical cost at June 30, 2009</u>	<u>Additions</u>	<u>Deletions</u>	<u>Historical cost at June 30, 2010</u>
Building	\$ -	\$ -	\$ -	\$ -	\$ 20,174	\$ -	\$ 20,174
Construction in progress	285	-	(285)	-	-	-	-
Land	-	-	-	-	1,434	-	1,434
Improvements	1,120	50	-	1,170	-	-	1,170
Equipment	<u>16,193</u>	<u>278</u>	<u>-</u>	<u>16,471</u>	<u>275</u>	<u>-</u>	<u>16,746</u>
	<u>\$ 17,598</u>	<u>\$ 328</u>	<u>\$ (285)</u>	<u>\$ 17,641</u>	<u>\$ 21,883</u>	<u>\$ -</u>	<u>\$ 39,524</u>

WEST VIRGINIA LOTTERY
 NOTES TO FINANCIAL STATEMENTS
 (Continued)

4 - CAPITAL ASSETS (Continued)

	Accumulated depreciation at June 30,			Accumulated depreciation at June 30,			Accumulated depreciation at June 30,
	2008	Additions	Deletions	2009	Additions	Deletions	2010
Building	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Improvements	1,002	78	-	1,080	51	-	1,131
Equipment	11,345	1,910	-	13,255	1,789	-	15,044
	<u>\$ 12,347</u>	<u>\$ 1,988</u>	<u>\$ -</u>	<u>\$ 14,335</u>	<u>\$ 1,840</u>	<u>\$ -</u>	<u>\$ 16,175</u>

5 - PARTICIPATION IN THE MULTI-STATE LOTTERY

The Lottery is a member of the Multi-State Lottery (MUSL), which operates the semi-weekly POWERBALL® jackpot lotto game, the HOT LOTTO™ game, and MEGA MILLIONS® jackpot game on behalf of other participating lotteries. MUSL is currently comprised of 33 member state lotteries, including the District of Columbia and the United States Virgin Islands. MUSL is managed by a Board of Directors, which is comprised of the lottery directors or their designee from each of the party states. The Board of Directors' responsibilities to administer the Multi-State Lottery POWERBALL®, HOT LOTTO™, and MEGA MILLIONS® games are performed by advisory committees or panels staffed by officers and independent contractors appointed by the board. These officers and consultants serve at the pleasure of the board and the board prescribes their powers, duties and qualifications. The Executive Committee carries out the budgeting and financing of MUSL, while the board contracts the annual independent audit. A copy of the audit may be obtained by writing to the Multi-State Lottery Association, 1701-48th Street, Suite 210, West Des Moines, Iowa 50266-6723.

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

Revenues derived from the Lottery's participation in the MUSL POWERBALL® jackpot game were \$48,593,678 and \$51,016,100 for the years ended June 30, 2010 and 2009, respectively, and related prize costs were \$24,299,364 and \$25,510,333, respectively.

Revenues derived from the Lottery's participation in the HOT LOTTO™ game were \$6,447,315 and \$4,881,127 for the years ended June 30, 2010 and 2009, respectively, and related prize costs were \$3,224,120 and \$2,440,802, respectively.

Revenues derived from the Lottery's participation in the MEGA MILLIONS® game were \$2,678,674 for the year ended June 30, 2010, and related prize costs were \$1,384,136.

WEST VIRGINIA LOTTERY
 NOTES TO FINANCIAL STATEMENTS
 (Continued)

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

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

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

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

	<u>2010</u>		<u>2009</u>	
	<u>Total Prize Reserve</u>	<u>Lottery Share</u>	<u>Total Prize Reserve</u>	<u>Lottery Share</u>
POWERBALL®	\$ 113,399,532	\$ 2,385,173	\$ 112,776,975	\$ 2,380,055
HOT LOTTO™	6,491,541	392,458	5,443,110	324,177
MEGA MILLIONS®	(629,706)	(11,044)	-	-
	<u>\$ 119,261,367</u>	<u>\$ 2,766,587</u>	<u>\$ 118,220,085</u>	<u>\$ 2,704,232</u>

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

The interest earned on prize reserve fund monies is used to pay MUSL operating expenses and any amounts over and above that are credited to an unreserved fund. The Lottery records this as interest when earned. This fund had a balance of \$15,991,948 and \$19,968,618 at June 30, 2010 and 2009, of which the Lottery's share was \$1,752,719 and \$1,775,925, respectively.

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

6 - RACETRACK VIDEO LOTTERY

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

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

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

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

Amounts from the capital reinvestment fund may be distributed to each racetrack if qualifying expenditures are made within the statutory timeframe; otherwise amounts accumulated in the fund revert to the state excess lottery revenue fund. The Lottery, along with the Rhode Island and Delaware state lotteries, participate in Multi-Jurisdictional Wide Area Progressive (MWAP) video games. This allows each of the lotteries to offer a higher progressive jackpot than they could generate alone. MUSL manages the progressive games and charges each participant a MWAP contribution fee of 4% of the amount wagered.

WEST VIRGINIA LOTTERY
 NOTES TO FINANCIAL STATEMENTS
 (Continued)

6 - RACETRACK VIDEO LOTTERY (Continued)

A summary of racetrack video lottery revenues for the years ended June 30, 2010 and 2009, follows (in thousands):

	<u>2010</u>	<u>2009</u>
Total credits (bets) played	\$ 8,188,573	\$ 8,690,994
Credits (prizes) won	(7,372,586)	(7,838,424)
Promotional credits played	(66,022)	-
MWAP Contributions	<u>(3,757)</u>	<u>(4,337)</u>
Gross terminal income	746,208	848,233
Administrative costs	<u>(17,524)</u>	<u>(17,524)</u>
Net terminal income	728,684	830,709
Commissions	<u>(414,988)</u>	<u>(463,649)</u>
Racetrack video lottery revenues available for distribution	<u>\$ 313,696</u>	<u>\$ 367,060</u>

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

	<u>2010</u>	<u>2009</u>
State Lottery Fund	\$ 129,799	\$ 130,125
State Excess Lottery Revenue Fund	133,462	178,902
Capital Reinvestment Fund	11,915	15,983
Tourism Promotion Fund	9,460	10,673
Development Office Promotion Fund	2,580	2,911
Research Challenge Fund	3,440	3,881
Capitol Renovation and Improvement Fund	4,730	5,337
Parking Garage Fund	930	985
Cultural Facilities and Capitol Resources Fund	1,500	1,500
Capitol Dome and Capitol Improvements Fund	4,880	5,763
Workers Compensation Debt Reduction Fund	<u>11,000</u>	<u>11,000</u>
Total nonoperating distributions	<u>\$ 313,696</u>	<u>\$ 367,060</u>

7 - LIMITED VIDEO LOTTERY

The limited video lottery legislation established specific requirements imposing certain restrictions limiting the licensing for the operation of limited video lottery games to 9,000 terminals placed in licensed retailers. These licensed retailers must hold a qualifying permit for the sale and consumption on premises of alcohol or non-intoxicating beer. The Lottery has been charged with the administration, monitoring and regulation of these machines. The legislation further stipulates the distribution of revenues from limited gross terminal income be deposited into the state lottery fund for administrative costs. Then, the state share percentage of gross profit is to be transferred to the State Excess Lottery

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

7 - LIMITED VIDEO LOTTERY (Continued)

Revenue Fund. Such percentage is between 30 and 50 percent and is subject to change on a quarterly basis. Two percent is distributed to counties and incorporated municipalities in the manner prescribed by the statute. The remaining amount of gross profit is paid to retailers and/or operators as prescribed in the Act and is recorded as limited video lottery commissions in the financial statements. Municipal and county distributions are accounted for as nonoperating expenses. A summary of limited video lottery revenues for the years ended June 30, 2010 and 2009 follows (in thousands):

	<u>2010</u>	<u>2009</u>
Total credits played	\$ 4,659,212	\$ 4,925,431
Credits (prizes) won	<u>(4,261,925)</u>	<u>(4,512,942)</u>
Gross terminal income	397,287	412,489
Administrative costs	<u>(7,946)</u>	<u>(8,249)</u>
Gross profit	389,341	404,240
Commissions	(194,671)	(202,120)
Distributions to municipalities and counties	<u>(7,787)</u>	<u>(8,085)</u>
Limited video lottery revenues available for distribution	<u>\$ 186,883</u>	<u>\$ 194,035</u>

8 - TABLE GAMES

The passage of table games legislation allowed local referendums in each of the four counties in which a race track is located to approve table games. Three of the four race tracks were authorized to operate table games and the fourth will begin operating table games in fiscal year 2011.

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

From the gross amounts deposited into the table games fund, the Lottery, on a monthly basis retains 3% of the adjusted gross receipts for administrative expenses of which at least \$100,000 and not more than \$500,000 annually will be transferred to the Lottery's compulsive gambling treatment fund.

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

WEST VIRGINIA LOTTERY
 NOTES TO FINANCIAL STATEMENTS
 (Continued)

8 - TABLE GAMES (Continued)

A transfer of 1% of the adjusted gross receipts is made from each licensed racetrack to the county commissions of the counties where racetracks participating in licensed table games are located to be divided pro rata among the counties. A transfer of 2% of the adjusted gross receipts is made from each licensed racetrack to the governing bodies of municipalities within counties where racetracks participating in licensed table games are located as prescribed by statute. Finally, a transfer of .5% of the adjusted gross receipts to the governing bodies of municipalities in which a racetrack table games licensee is located is to be divided equally among the municipalities. The Lottery, in accordance with the enabling legislation, will distribute the remaining amounts hereinafter referred to as the net amounts in the racetrack table games funds as follows:

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

The transfer to the state debt reduction fund is included in Note 10 - Nonoperating Distributions to the State of West Virginia. The table games adjusted gross receipts for the year ended June 30, 2010 and 2009 was \$90,644,701 and \$97,768,861, respectively. A summary of table games revenues for the year ended June 30, 2010 and 2009 follows (in thousands):

	2010	2009
Table games privilege tax	\$ 31,726	\$ 34,219
Interest on table games fund	3	22
Administrative costs	(2,720)	(2,933)
Total available for distribution	29,009	31,308
 <u>Less distributions:</u>		
Racetrack purse funds	2,266	2,444
Thoroughbred & greyhound development funds	1,813	1,955
Racing commission pension plan	870	939
Municipalities/counties	7,524	8,120
Total distributions	12,473	13,458
Table games distribution to the state debt reduction fund	\$ 16,536	\$ 17,850

WEST VIRGINIA LOTTERY
 NOTES TO FINANCIAL STATEMENTS
 (Continued)

9 – HISTORIC RESORT HOTEL

In 2009, the Legislature passed Senate Bill 575 which permits video lottery and table games at a licensed historic resort hotel which is defined as “a resort hotel registered with the United States Department of the Interior as a national historic landmark in its National Registry of Historic Places having not fewer than five hundred guest rooms under common ownership and having substantial recreational guest amenities in addition to the gaming facility.”

Historic Resort Video Lottery

According to Senate Bill 575, thirty six percent (36%) of gross terminal income is allocated to Historic Resort Hotel Fund and seventeen percent (17%) of gross terminal income is allocated to the Human Resource Benefit Fund. The remaining forty-seven percent (47%) of gross terminal income is then subject to a ten percent (10%) surcharge which is allocated to separate capital reinvestment funds for the licensed historic resort hotel. After deduction of the surcharge, the remaining forty-two and three-tenths percent (42.3%) of gross terminal income is retained by the historic resort hotel. A summary of historic resort hotel video lottery revenues for year ended June 30, 2010 follows (in thousands):

	2010
Total credits played	\$ 11,333
Credits (prizes) won	(10,175)
Promotional credits played	(25)
Gross terminal income	1,133
Capital reinvestment	(53)
Administrative costs	(61)
Hotel commissions	(479)
Net terminal income	\$ 540
Historic Resort Hotel Fund	\$ 347
Human Resource Benefit Fund	193
Total	\$ 540

Historic Resort Table Games

Each historic resort hotel licensee is subject to a privilege tax of thirty five percent (35%) of adjusted gross receipts, of which thirty percent (30%) is deposited directly into the Historic Resort Hotel Fund and five percent (5%) is deposited directly into the Human Resource Benefit Fund. The historic resort hotel table games adjusted gross receipts for the year ended June 30, 2010 was \$1,475,617.

WEST VIRGINIA LOTTERY
 NOTES TO FINANCIAL STATEMENTS
 (Continued)

9 – HISTORIC RESORT HOTEL (continued)

The following table shows the month and year -to- date totals of the privilege tax and the accrued distributions (in thousands) to be transferred in the subsequent month:

	2010
Table games privilege tax	\$ 516
Administrative costs	(66)
Total available for distribution	\$ 450
Historic Resort Hotel Fund	376
Human Resource Benefit Fund	74
Total distributions	\$ 450

Historic Resort Hotel Fund

Historic Resort Hotel Fund deposits are allocated after a fifteen percent (15%) lottery administrative cost. The remaining Historic Resort Hotel Fund net income (gross deposits less 15%) are distributed as follows:

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

A summary of Historic Resort Hotel Fund revenues and related distributions is as follows (in thousands):

	2010
Historic Resort Hotel video lottery	\$ 347
Historic Resort table games	376
Historic Resort Hotel Fund net income	\$ 723
Municipalities/ Counties	101
State General Revenue Fund	463
State Debt Reduction Fund	137
State Tourism Promotion Fund	22
Total distributions	\$ 723

WEST VIRGINIA LOTTERY

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

The Lottery periodically distributes surplus funds, exclusive of amounts derived from limited video lottery and a portion of racetrack video lottery funds, to the State of West Virginia in accordance with the current governing legislation. For the years ended June 30, 2010 and 2009, the State Legislature budgeted \$164,503,245, and \$168,151,542 respectively of estimated profits of the Lottery for distributions to designated special revenue accounts of the State of West Virginia. With regard to the State Lottery Fund, legislation stipulates that debt service payments be given a priority over all other transfers in instances where estimated profits are not sufficient to provide for payment of all appropriated distributions. Debt service payments of \$1,800,000 and \$1,000,000 per month for the first ten months of each fiscal year currently have such priority. Transfers made pursuant to the State Excess Lottery Revenue Fund have similar requirements; currently debt service payments are \$3,920,843 per month for the first ten months of each fiscal year. In addition, Legislation provides that, if in any month, there is a shortage of funds in the State Excess Lottery Revenue Fund to make debt service payments, the necessary amount shall be transferred from the State Lottery Fund to cover such shortfall, after the State Lottery Fund debt service payments have been made. Repayments to the State Lottery Fund are required to be made in subsequent months as funds become available. During the years ended June 30, 2010 and 2009, the Lottery made or accrued all budgeted distributions and accrued additional distributions of \$43,420,445 and \$29,970,243, respectively. The Lottery does not have a legally adopted annual budget.

Since the enactment of the Racetrack Video Lottery Act, the Lottery is also statutorily required to distribute income from racetrack video lottery operations as described in Note 6. As of June 30, 2010 and 2009, the Lottery accrued additional distributions relating to racetrack video lottery operations in the amounts of \$228,319 and \$766,085, respectively.

Note 7 describes the Limited Video Lottery Act and the statutory distributions required to be made from limited video lottery operations. Note 8 describes the Table Games Act and the statutory distributions required to be made from table games operations. As of June 30, 2010 and 2009, the Lottery accrued additional distributions relating to table games operations in the amounts of \$1,387,400 and \$1,521,375, respectively. Note 9 describes the Historic Resort Hotel statutory distributions to be made from historic resort operations. As of June 30, 2010 the Lottery accrued additional distributions relating to Historic Resort operations of \$73,228.

A summary of the cash distributions made to certain state agencies to conform with the various legislation follows (in thousands):

	<u>2010</u>	<u>2009</u>
<u>Budgetary distributions:</u>		
<u>State Lottery Fund:</u>		
Bureau of Senior Services	\$ 57,187	\$ 58,815
Department of Education	34,343	36,636
Library Commission	11,195	11,554
Higher Education - Central Office	13,916	13,449
Tourism	7,606	7,961
Natural Resources	3,450	3,492
Division of Culture & History	5,881	5,880
Department of Education & Arts	1,192	1,213
Building Commission	8,240	9,997

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

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

	<u>2010</u>	<u>2009</u>
School Building Authority	17,997	18,000
Community and Technical College	<u>3,497</u>	<u>5,000</u>
Total State Lottery Fund	<u>164,504</u>	<u>171,997</u>
<u>State Excess Lottery Revenue Fund:</u>		
General Purpose Account	65,000	65,000
Education Improvement Fund	29,000	27,000
WV Infrastructure Council Fund	40,000	40,000
Higher Education Improvement Fund	10,000	10,000
State Park Improvement Fund	5,000	5,000
School Building Authority	19,000	19,000
Economic Development Fund	19,000	19,000
Refundable Credit - General Revenue Fund	8,371	7,372
Department of Education	45,530	-
Division of Finance (ERP)	25,000	-
Department of Environmental Protection	2,000	-
Division of Corrections	5,375	-
Racing Commission	2,500	-
Excess Lottery Surplus (General Fund)	69,588	62,900
Excess Lottery Surplus (Capitol Complex)	-	18,200
Excess Lottery Surplus (OPEB)	-	46,600
Excess Lottery Surplus (School Safety)	-	8,000
Public Defender Services	<u>11,000</u>	<u>21,000</u>
Total State Excess Lottery Revenue Fund	<u>356,364</u>	<u>349,072</u>
Total Budgetary Distributions	<u>520,868</u>	<u>521,069</u>
Veterans Instant Ticket Fund	<u>467</u>	<u>862</u>
<u>Other racetrack video lottery distributions:</u>		
Tourism Promotion Fund	9,645	10,668
Development Office Promotion Fund	2,630	2,910
Research Challenge Fund	3,507	3,879
Capitol Renovation and Improvement Fund	4,822	5,334
Parking Garage Funds	939	985
Cultural Facilities and Capitol Resources Fund	1,500	1,500
Capitol Dome and Capitol Improvements Fund	5,014	5,759
Workers Compensation Debt Reduction Fund	<u>11,000</u>	<u>11,000</u>
	<u>39,057</u>	<u>42,035</u>
Table games state reduction fund	<u>16,670</u>	<u>17,440</u>

WEST VIRGINIA LOTTERY
 NOTES TO FINANCIAL STATEMENTS
 (Continued)

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

	<u>2010</u>	<u>2009</u>
<u>Historic resort hotel distributions:</u>		
State General Revenue Fund	408	-
State Debt Reduction Fund	121	-
Tourism Promotion Fund	<u>19</u>	<u>-</u>
Total	<u>548</u>	<u>-</u>
Total nonoperating distributions to the State of West Virginia (cash basis)	577,610	581,406
Accrued nonoperating distributions, beginning of year	(202,184)	(166,967)
Accrued nonoperating distributions, end of year	241,039	202,184
Special item – restricted net assets accrued for distribution to State of West Virginia	(40,000)	-
Special item – unrestricted net assets accrued for distribution to State of West Virginia	<u>(7,520)</u>	<u>-</u>
Total nonoperating distributions to the State of West Virginia	<u>\$ 568,945</u>	<u>\$ 616,623</u>

11 - RESTRICTED NET ASSETS

On June 14, 2006, House Bill 106 was enacted by the West Virginia State Legislature to set aside unexpended administrative expenses of the Lottery up to the limits for such expenses established by the enabling legislation of traditional, racetrack video lottery, and limited video lottery games in an amount not to exceed \$20,000,000 beginning in fiscal year 2006 and each year through fiscal year 2012. These assets are to be set aside in the revenue center construction fund for the design and construction of a building in the West Virginia Capitol Complex for the use of the Lottery and certain other State of West Virginia governmental entities. The Lottery set aside interest income of \$91,452 for the year ended June 30, 2010 and \$10,817,391 with related interest income of \$566,293 for the year ended June 30, 2009.

Restricted net asset activity is as follows for the years ending June 30, 2010 and 2009 (in thousands):

	<u>2010</u>	<u>2009</u>
Begininng restricted net assets	\$ 69,871	\$ 58,487
Enabling legislation additions to net assets	-	10,817
Interest earned on restricted net assets	92	567
Aquisition of capital assets in accordance with enabling legislation	(21,608)	-
Accrued distributions of surplus restricted net assets to the State of West Virginia	<u>(40,000)</u>	<u>-</u>
Ending restricted net assets	<u>\$ 8,355</u>	<u>\$ 69,871</u>

WEST VIRGINIA LOTTERY

NOTES TO FINANCIAL STATEMENTS
(Continued)**12 – SPECIAL ITEMS**

On June 30, 2010, the Lottery purchased a building to serve as its new headquarters. Coinciding with the building purchase, the Lottery determined that certain restricted net assets and other unrestricted net asset funds previously set aside for the construction or purchase of capital assets (described in Note 11) were surplus funds and accordingly, were to be distributed to the State of West Virginia. The return of these surplus funds is recorded as a special item accrued for distribution to the State of West Virginia and represents an expense of the Lottery for the year ending June 30, 2010.

13 - RETIREMENT BENEFITS

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

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

Covered employees are required to contribute 4.5% of their salary to the PERS. The Lottery is required to contribute 11% of covered employees' salaries to the PERS. The required employee and employer contribution percentages have been established and changed from time to time by action of the State Legislature. The required contributions are not actuarially determined; however, actuarial valuations are performed to assist the Legislature in determining appropriate contributions. The Lottery and employee contributions, which equaled the required contributions for the three years ended June 2010, 2009, and 2008, were as follows (in thousands):

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Lottery contributions	\$ 832	\$ 666	\$ 556
Employee contributions	<u>312</u>	<u>290</u>	<u>237</u>
Total contributions	<u>\$ 1,144</u>	<u>\$ 956</u>	<u>\$ 793</u>

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

14 - OTHER POSTEMPLOYMENT BENEFITS (OPEB)

The GASB has issued Statement No. 43, “*Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*”, and Statement No. 45, “*Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*” (OPEB). The GASB statements are based on the premise that the “costs” of employee services should be reported during the periods when the services are rendered. The State implemented accounting and financial reporting requirements as an employer under GASB Statement No. 45. The financial statements report OPEB funded status and funding progress and any “premium subsidy” resulting from the pooling of retiree participants with active employees in the health benefit plans. For “employer” OPEB reporting the State will report “expense” on an accrual basis in the amount of the “annual required contribution” and a “liability” for the amount of the “annual required contribution” that was not actually paid.

In response to the GASB statements, the Legislature made statutory changes to create the West Virginia Retiree Health Benefit Trust Fund (RHBT), an irrevocable trust fund, in which employer contributions for future retiree health costs may be accumulated and invested, and which facilitates the separate financial reporting of OPEB. The legislation requires the RHBT to determine through an actuarial study, as prescribed by GASB Statement No. 43, the Annual Required Contribution (the ARC) which shall be sufficient to maintain the RHBT in an actuarially sound manner. The ARC shall be allocated to respective employers including the Lottery who are required by law to remit at least the minimum annual premium component of the ARC. Revenues collected by RHBT shall be used to fund current OPEB healthcare claims and administrative expenses with residual funds held in trust for future OPEB costs.

Plan Description

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

Funding Policy

The Code requires the OPEB Plan bill the participating employers 100% of the annual required contribution (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) of the plan over a period not to exceed thirty years. State of West Virginia plan employers are billed per active health policy per month.

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

14 - OTHER POSTEMPLOYMENT BENEFITS (OPEB) (Continued)

Funding Policy (Continued)

The ARC rate is \$901 and \$388 per employee per month for the years ending June 30, 2010 and 2009, respectively. The Lottery's ARC was \$1,458,892, \$620,360, and \$608,599 and the Lottery has paid premiums of \$226,212, \$185,563, and \$98,625, which represent 15.5%, 29.9%, and 16.2% of the ARC, respectively, for the years ending June 30, 2010, 2009, and 2008. The State of West Virginia, on the Lottery's behalf, contributed \$472,247 of the 2008 ARC. As of June 30, 2010 and 2009 the Lottery has recorded a liability of \$1,484,546 and \$251,867, respectively, for OPEB.

15 - RISK MANAGEMENT

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

Public Employees' Insurance Agency (PEIA)

The Lottery participates in the Public Employees Insurance Agency (PEIA) which provides an employee benefit insurance program to employees. PEIA was established by the State of West Virginia for State agencies, institutions of higher education, Boards of Education and component units of the State.

In addition, local governmental entities and certain charitable and public service organizations may request to be covered by PEIA. PEIA provides a base employee benefit insurance program which includes hospital, surgical, major medical, prescription drug and basic life and accidental death. Underwriting and rate setting policies are established by PEIA. The cost of all coverage, as determined by PEIA shall be paid by the participants. Premiums are established by PEIA and are paid monthly, and are dependent upon, among other things, coverage required, number of dependents, state vs. non state employees and active employees vs. retired employees and level of compensation. Coverage under these programs is limited to \$1 million for lifetime for health and \$10,000 of life insurance coverage.

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

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

15 - RISK MANAGEMENT (Continued)

Board of Risk and Insurance Management (BRIM)

The Lottery participates in the West Virginia Board of Risk and Insurance Management (BRIM), a common risk pool currently operating as a common risk management and insurance program for all State agencies, component units, and other local governmental agencies who wish to participate. The Lottery pays an annual premium to BRIM for its general insurance coverage. Underwriting and rate setting policies are established by BRIM. The cost of all coverage as determined by BRIM shall be paid by the participants. The BRIM risk pool retains the risk of the first \$1 million per property event and purchases excess insurance on losses above that level. Excess coverage through an outside insurer under this program is limited to \$200 million per event, subject to limits on certain property. BRIM has \$1 million per occurrence coverage maximum on all third-party liability claims.

Workers Compensation Insurance

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

16 - COMMITMENTS

The Lottery Commission has designated unexpended administrative funds for the acquisition of capital assets. As of June 30, 2010 and 2009, \$5,921,057 and \$12,817,601, respectively, are included in unrestricted net assets and invested in capital assets for this purpose.

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

West Virginia Lottery Commission
Charleston, West Virginia

We have audited the financial statements of the West Virginia Lottery (the Lottery), a component unit of the State of West Virginia, as of and for the year ended June 30, 2010, and have issued our report thereon dated September 24, 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 Lottery'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 Lottery's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Lottery'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 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.

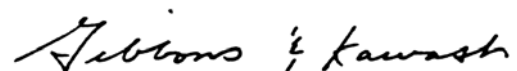
Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Lottery'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*.

We noted certain other matters that we reported to management of the Lottery in a separate letter dated September 24, 2010.

This report is intended solely for the information and use of the Lottery Commission, members of management, and the State of West Virginia, and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in cursive script that reads "Gibbons & Kawash".

September 24, 2010