

Georgia Lottery Corporation

*Management's Discussion and Analysis for the
Years Ended June 30, 2014 and 2013, Financial
Statements as of and for the Years Ended June 30,
2014 and 2013, and Independent Auditor's Report*

GEORGIA LOTTERY CORPORATION

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INDEPENDENT AUDITOR'S REPORT

**The Board of Directors
of the Georgia Lottery Corporation:**

Report on the Financial Statements

We have audited the accompanying financial statements of the **Georgia Lottery Corporation** (the "GLC"), a component unit of the State of Georgia, as of and for the years ended June 30, 2014 and 2013, and the related notes to the financial statements, which collectively comprise the GLC's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

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

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 3 through 14 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Mauldin & Jenkins, LLC

Atlanta, Georgia
October 8, 2014

Management's Discussion and Analysis

As management of the Georgia Lottery Corporation (the "GLC"), we offer readers of the GLC's financial statements this narrative overview and analysis of the financial activities for the fiscal years ended June 30, 2014 and June 30, 2013. We encourage readers to consider the information presented here in conjunction with the financial statements, which begin on page 15.

Financial Highlights

The GLC had a record year of sales and profits in fiscal year 2014. Gross ticket sales were \$ 4.022 billion in fiscal year 2014. For the 2013 fiscal year, gross ticket sales were \$3.912 billion. For fiscal year 2014, the net proceeds paid to the Lottery for Education Account were \$945.1 million. The net proceeds paid to the Lottery for Education represent an increase of \$17.6 million as compared to the prior year. For fiscal year 2013 net proceeds paid were \$927.5 million, which represented an increase of \$26.2 million over fiscal year 2012. Other significant financial highlights include the following:

- For fiscal year 2014, gross tickets sales increased by \$110.0 million, a 2.8 % increase as compared to 2013. For fiscal year 2013, gross tickets sales increased by \$77.5 million, a 2.0% increase as compared to 2012.
- Prize expense increased \$81.4 million during fiscal year 2014 and increased \$42.6 million in fiscal year 2013. This expense usually increases or decreases in direct proportion to ticket sales and represented approximately 60% of gross ticket sales in fiscal years 2014 and 60% in 2013. Prize expense represented approximately 60% of gross ticket sales in 2012.
- Direct gaming expenses, which include retailer commissions, contractor fees, advertising, retailer merchandising and marketing, and gaming equipment increased \$10.6 million in fiscal year 2014. These expenses also fluctuate in proportion to ticket sales and represented approximately 8.9% of gross ticket sales in 2014 and 8.8% in 2013. For fiscal year 2013, direct gaming expenses increased 6.4 million above 2012. These expenses represented approximately 8.9% of gross ticket sales in 2012.
- Operating expenses remained at less than 1% of gross ticket sales for fiscal years 2014 and 2013. Fiscal year 2014 operating expenses increased \$2.7 million above 2013 expenses. Fiscal year 2013 operating expenses increased \$0.8 million as compared to fiscal year 2012. Operating expenses remained at less than 1% of gross ticket sales for fiscal years 2013 and 2012.
- Nonoperating expenses, net of revenues, increased \$3.7 million in 2014 as compared to 2013. This increase is attributable to the increase in payments due to Lottery for Education Account over the prior fiscal year, offset by the change in the fair value of grand prize investments held by the GLC for funding future grand prize payments, and a slight decrease in interest revenue. Nonoperating expenses, net of revenues, increased \$67.7 million in 2013 as compared to 2012. This increase is attributable to the increase in payments due to Lottery for Education Account over the prior fiscal year, offset by the change in the fair value of grand prize investments held by the GLC for funding future grand prize payments, and a slight decrease in interest revenue.
- COAM contributed \$10.2 million in revenues from licensing fees, fines, and penalties in fiscal year 2014, generating \$6.9 million in net proceeds and returning \$5.0 million to the Lottery for Education Account. The remaining \$1.9 million was held in retained earnings to support fiscal year 2015 expenses associated with implementation of a centralized gaming system.

Overview of the Financial Statements

The GLC is accounted for as an enterprise fund, reporting transactions using the accrual basis of accounting similar to a business entity. This discussion and analysis is intended to serve as an introduction to the GLC's basic financial statements, along with the notes to the financial statements. The statements of net position on page 16, the statements of revenues, expenses, and changes in net position on page 17, and the statements of cash flows on pages 18 and 19 report the GLC's net position and changes therein. The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the financial statements. The notes to the financial statements begin on page 20 of this report.

The GLC pays its net proceeds each fiscal year to the General Fund of the state treasury for credit to the Lottery for Education Account. As a result, the GLC's net position consist of funds invested in capital assets and unrestricted net position. Unrestricted net position normally results from the inclusion of capital costs in the determination of net proceeds (as required by the Georgia Lottery for Education Act), COAM retained earnings, and the cumulative effect of periodic adjustments to recognize the fair value of grand prize investments which are held to fund grand prizes payable. The GLC expects to hold these investments to maturity to meet our future grand prize winner obligations and, therefore, will not realize any gains or losses related to the current value of these investments for distribution as net proceeds. The reader of these financial statements should review the assets and liabilities in the statements of net position and the operating revenues and expenses and the payment to and due to Lottery for Education Account in the statements of revenues, expenses, and changes in net position to assess the GLC's financial position as of June 30, 2014 and 2013, and the results of its operations for the years then ended.

Financial Analysis

Assets

At the end of fiscal year 2014, total assets were \$591.0 million compared to \$599.1 million at the end of fiscal year 2013, representing a decrease of \$8.1 million. Total assets at the end of fiscal year 2013, were \$599.1 million compared to \$648.3 million at the end of fiscal year 2012, representing a decrease of \$49.2 million.

Current assets increased from \$347.3 million in 2013 to \$366.4 million in 2014, representing an increase of \$19.1 million. This increase is due to a \$10.6 million increase in retailer accounts receivable, an \$8.5 million increase in cash and cash equivalents and a \$1.7 million increase in prepaid and other assets, offset by a decrease in restricted COAM fund cash of \$1.7 million. The increase in cash and cash equivalents was due primarily to cash receipts of \$6.9 million from COAM for 2015 renewal fees recorded as unearned revenue on the fiscal year 2014 Statement of Net Position and \$1.9 million in net COAM receipts held as retained earnings. The increase in retailer accounts receivable was due to the timing of the accounting week for billing and collections from our retailers at year-end. Current assets decreased from \$353.3 million in 2012 to \$347.3 million in 2013, representing a decrease of \$6.0 million. This decrease is primarily due to a \$15.7 million decrease in cash and cash equivalents and a \$1.5 million decrease in prepaid and other assets, offset by a \$9.5 million increase in retailer accounts receivable. The increase in retailer accounts receivable and decrease in cash and cash equivalents were due to the timing of the accounting week for billing and collections from our retailers at year-end.

In fiscal year 2014, noncurrent assets decreased from \$251.9 million in 2013 to \$224.7 million in 2014, representing a decrease of \$27.2 million. This decrease is due to grand prize investments decreasing from \$248.0 million in 2013 to \$219.4 million in 2014, a decrease of \$28.6 million. The decrease resulted from payments to grand prize winners totaling \$34.5 million, and a \$3.8 million decrease in the fair value of investments, offset by \$9.7 million in interest earned on current-year maturities. Net capital assets increased

from \$3.9 million in 2013 to \$5.3 million in 2014. The increase resulted from traditional GLC capital procurements of \$2.1 million, \$0.7 million associated with implementation of the COAM licensing renewal system, and \$0.2 million for office construction less depreciation expense of \$1.6 million.

In fiscal year 2013, noncurrent assets decreased from \$295.0 million in 2012 to \$251.9 million in 2013, representing a decrease of \$43.1 million. This decrease is due to grand prize investments decreasing from \$290.9 million in 2012 to \$248.0 million in 2013, a decrease of \$42.9 million. The decrease resulted from payments to grand prize winners totaling \$36.1 million, and a \$17.7 million decrease in the fair value of investments, offset by \$10.9 million in interest earned on current-year maturities. Capital assets decreased from \$4.1 million in 2012 to \$3.9 million in 2013. The decrease resulted from capital asset purchases of \$1.5 million less depreciation expense of \$1.7 million.

Liabilities

Total liabilities at the end of fiscal year 2014 were \$569.1 million compared to \$575.4 million at the end of fiscal year 2013, representing a decrease of \$6.3 million. Total liabilities at the end of fiscal year 2013 were \$575.4 million compared to \$606.9 million at the end of fiscal year 2012, representing a decrease of \$31.5 million.

Current liabilities increased from \$346.7 million in 2013 to \$364.2 million in 2014, an increase of \$17.5 million. The increase is primarily due to an \$11.4 million increase in prizes payable for prizes won and due to winners not yet claimed, a \$5.2 million increase in unearned COAM revenue associated with receipt of 2015 renewal fees in advance of the licensing period, and a \$1.7 million increase in funds due to the Lottery for Education Account, partially offset by a decrease in accounts payable and accrued liabilities of \$0.8 million.

Current liabilities decreased from \$352.3 million in 2012 to \$346.7 million in 2013, a decrease of \$5.6 million. The decrease is primarily due to a \$30.1 million decrease in prizes payable, offset by a \$20.2 million increase in the funds due to the Lottery for Education Account, a \$2.3 million increase in accounts payable and accrued liabilities, and \$0.2 million increase in the retailer escrow liability. The decrease in prizes payable was primarily due to a \$21.3 million decrease in the deferred prize expense liability for several online games (*Cash 3*, *Cash 4*, *Decades of Dollars*, *Keno!*, *Mega Millions*, and *Powerball*), and a \$10.6 million decrease in prizes payable for prizes won and due to winners not yet claimed. These decreases were partially offset by an increase of \$1.5 million in expired *Powerball* prizes and a combined \$0.3 million increase in deferred sales and commissions and tax withholding for prize payments. The increase in funds due to the Lottery for Education Account resulted from higher fourth quarter sales in fiscal year 2013 versus 2012. The increase in accounts payable and accrued liabilities was primarily due to higher year-end accrued payments of \$0.9 million owed to other vendors at June 30, 2013 as compared to June 30, 2012.

Noncurrent liabilities decreased \$23.7 million from \$228.7 million in 2013 to \$205.0 million in 2014. Noncurrent liabilities principally consist of grand prizes payable, which represent the amount to be paid to grand prize winners over future years. In fiscal year 2014, grand prizes payable decreased \$25.0 million below 2013, from \$225.6 million to \$200.6 million. The decrease was primarily attributable to winner payments, net of interest earned on current-year maturities, that became due and payable in fiscal year 2014 as an annual payment obligation to our grand prize winners. The decrease was partially offset by an increase of \$1.2 million in the noncurrent portion of other long-term liabilities. The GLC has purchased or will purchase U.S. Treasury securities to fund future payment obligations.

Noncurrent liabilities decreased \$25.9 million from \$254.6 million in 2012 to \$228.7 million in 2013. Noncurrent liabilities principally consist of grand prizes payable, which represent the amount to be paid to grand prize winners over future years. In fiscal year 2013, grand prizes payable decreased \$25.2 million below 2012, from \$250.8 million to \$225.6 million. The decrease was primarily attributable to grand prize

payables of \$25.2 million (winner payments net of interest earned on current-year maturities) became due and payable in fiscal year 2013 as an annual payment obligation to our grand prize winners, thus reducing the long-term liabilities. The GLC has purchased or will purchase U.S. Treasury securities to fund future payment obligations.

Net Position and Changes in Net Position

Net position decreased \$1.9 million in 2014 from \$23.8 million in fiscal year 2013, to an end of year balance of \$21.9 million. This decrease resulted from a \$3.8 million unrealized change in the fair market value of grand prize investments held by the GLC for the funding of future grand prize payments offset by \$1.9 million held in retained earnings to support fiscal year 2015 expenses associated with implementation of a centralized gaming system. Accounting principles generally accepted in the United States of America require the GLC to record its grand prize investments at fair value, and the change in the fair value is recorded as nonoperating revenue (expense) annually. The GLC classifies the decreases and increases in fair value as unrealized, due to the investments generally being held to maturity to fund future prize obligations. Inclusion of capital costs in the determination of net proceeds is required by the Georgia Lottery for Education Act.

Net position decreased \$17.7 million in 2013 from \$41.5 million in fiscal year 2012, to an end of year balance of \$23.8 million. This decrease resulted from a \$17.7 million unrealized change in the fair market value of grand prize investments held by the GLC for the funding of future grand prize payments. Accounting principles generally accepted in the United States of America require the GLC to record its grand prize investments at fair value, and the change in the fair value is recorded as nonoperating revenue (expense) annually. The GLC classifies the decreases and increases in fair value as unrealized, due to the investments generally being held to maturity to fund future prize obligations.

Sales

Total lottery ticket sales for fiscal year 2014 were \$4.022 billion, as compared to \$3.912 billion in 2013. This represents an increase of \$110.0 million, with instant games showing an increase of \$96.8 million while online games increased by \$13.2 million. The instant sales increase was primarily attributable to the introduction of a new \$30 instant game. The increase in online sales was due to the introduction of a new online game, *All or Nothing* and a significant increase in Mega Millions sales due to multiple large jackpots, offset by a larger decline in *Powerball* sales caused by a lack of major jackpot opportunities. Collectively, sales for all other draw games increased by \$6.8 million for fiscal year 2014. Average weekly gross ticket sales for fiscal year 2014 were \$77.4 million versus \$75.2 million in 2013. Finally, the iHope card continues to show promise. The iHOPE™ Discover® card is a prepaid debit card that permits cardholders to load funds onto their online account for use in purchasing tickets on the Georgia Lottery's website. Prizes up to and including \$5,000 are automatically paid to the player's account. The iHope card realized \$17.3 million in top up activity since inception and recorded average weekly sales of \$0.4 million per week during 4th quarter, 2014.

Gross instant ticket sales increased \$96.8 million during fiscal year 2014, from \$2.631 billion in 2013 to \$2.727 billion in 2014. The GLC's administration of a sound marketing strategy, continuous development and introduction of new instant ticket games, and effective management of the instant product mix led to the 3.7% increase in ticket sales for 2014 versus 2013. Additionally, the GLC introduced a *Play It Again* promotion in 2014. This promotion allows players with non-winning \$1 and \$2 tickets to enter into a secondary draw with second chance cash and experiential prizes approximating \$3 million. Management will continue its efforts to provide players with new and exciting instant and online games.

Instant tickets at the \$1, \$2, and \$3 price points generated approximately \$203 million, \$414 million, and \$172 million in sales, respectively, in fiscal year 2014. Some of our most successful instant games at the

lower price points, included *\$1 Junior Jumbo Bucks*, *\$1 Anniversary Edition Junior Jumbo Bucks*, *\$2 Jumbo Bucks Classic*, *\$2 Anniversary Edition Jumbo Bucks*, *\$2 10X The Money Holiday Edition*, *\$2 \$1,000 A Week for Life*, *\$3 Lady Jumbo Bucks*, and *\$3 Jumbo Bucks Crossword*.

Ticket sales at the \$5 price point totaled \$559 million in fiscal year 2014, representing the second largest instant game segment. New instant games introduced during 2014 at the \$5 price point included *Anniversary Edition Jumbo Bucks*, *Atlanta Falcons Big Win!*, *Right On The Money*, *20X The Money Holiday Edition*, *Lucky Streak*, *Cash Winfall \$5*, *Match & Win*, *Cash Clover*, *\$2,000 A Week For Life*, *\$600,000 Rich*, *Stacks of Green*, *\$20 Million Blowout*, *\$50,000 Big Money*, and *Mega Money Madness*. Collectively, these new \$5 instant games produced over \$342 million in ticket sales. The two top selling \$5 instant games in fiscal year 2014 were *Anniversary Edition Giant Jumbo Bucks* and *Giant Jumbo Bucks*, which contributed \$64 million and \$57 million in revenue, respectively.

Instant games at the \$10 price point provided approximately \$546 million in revenue, representing the third largest instant game segment. The GLC introduced six new games at this price point in fiscal year 2014 including *50X The Money*, *Anniversary Edition Jumbo Bucks*, *Cash Winfall \$10*, *Maximum Fortune*, *Cash King*, and *Million \$\$ Match*. Collectively, these new \$10 instant games produced nearly \$278 million in ticket sales.

The \$20 price point category was the largest segment in terms of overall instant sales in fiscal year 2014, contributing \$624 million in ticket revenue. During fiscal year 2014, the GLC introduced four new \$20 instant games, including *100X The Money Holiday Edition*, *Lucky Loot*, *\$7,500 A Week For Life*, and *Maximum Money Madness* which contributed over \$194 million in ticket sales.

In fiscal year 2014, the GLC introduced its first \$30 instant game, the *\$10 Million Cash Spectacular*, in an ongoing effort to expand our core market. Sales in this category were the primary growth driver for the fiscal year, contributing \$210 million.

The GLC offered five families of instant games in fiscal year 2014. Each of these families demonstrated strong player appeal. The *Anniversary Edition Jumbo* family included *\$1 Anniversary Jr. Edition*, *\$2 Anniversary Jumbo Bucks*, *\$5 Anniversary Giant Jumbo*, and *\$10 Anniversary Jumbo* games and contributed approximately \$241 million. The *X Times The Money Holiday Edition* family included *\$1 5X The Money*, *\$2 10X The Money*, *\$5 20X The Money*, and *\$20 100X The Money* games and contributed approximately \$127 million. The *Week For Life* family consisted of *\$1 \$500 A Week For Life*, *\$2 \$1,000 A Week For Life*, *\$5 \$2,000 A Week For Life*, and *\$20 \$7,500 A Week For Life* games and contributed \$116 million. The *Cash Winfall* family included the *Cash Winfall \$1*, *\$2*, *\$5*, and *\$10* games and contributed \$57 million. Finally, the *Money Madness* family consisted of *\$1 Mini Money Madness*, *\$2 Money Madness*, *\$5 Mega Money Madness*, and *\$20 Maximum Money Madness* and contributed \$24 million.

Gross instant ticket sales increased \$45.7 million during fiscal year 2013, from \$2.585 billion in 2012 to \$2.631 billion in 2013.

Instant tickets at the \$1, \$2, and \$3 price points generated approximately \$207 million, \$430 million, and \$175 million in sales, respectively, in fiscal year 2013. Some of our most successful instant games at the lower price points, other than holiday games, included *\$1 Junior Jumbo Bucks*, *\$1 5X The Money*, *\$1 Lucky 7's*, *\$2 Jumbo Bucks Classic*, *\$2 10X The Money*, *\$2 Money Multiplier*, *\$3 Cherry*, *Orange*, *Lemon Doubler Cashword*, *\$3 7 Times Lucky*, and *\$3 Jumbo Bucks Bingo*.

Ticket sales at the \$5 price point totaled \$570 million in fiscal year 2013. New instant games introduced during 2013 at the \$5 price point included *Cash Deluxe*, *Cash Payout*, *\$500,000 Green*, *Hidden Treasure*, *\$400,000 Bonanza*, *GOLD*, *\$550,000 Grand Money*, *Silver 7's*, *Lucky Bucks*, *Elegant Riches*, and *Mega*

Money Madness. Collectively, these new \$5 instant games produced over \$248 million in ticket sales. The two top selling \$5 instant games in fiscal year 2013 were *Giant Jumbo Bucks* and *20X The Money*, which contributed \$54 million and \$52 million in revenue, respectively.

Instant games at the \$10 price point provided approximately \$606 million in revenue, and the GLC offered players ten games at this price point in fiscal year 2013 including *Monopoly Millionaire*, *\$1,000,000 Benjamins*, *\$1,000,000 Grand Casino*, *\$2 10X The Money Holiday Edition*, *\$2 \$1,000 A Week For Life*, *\$2 Jumbo Bucks Classic*, *\$2 Anniversary Edition Jumbo Bucks*, *\$3 Lady Jumbo Bucks*, *\$2 Jumbo Bucks Classic*, and *\$2 10X The Money*,

Sales of the \$20 price point category continued as a significant part of the overall sales and product mix in fiscal year 2013 by contributing \$642 million in ticket revenue, an increase of over \$143 million from fiscal year 2012 and the largest contributor to instant ticket sales. During fiscal year 2013, the GLC had several \$20 instant games on sale, including *100X The Money*, *Georgia Lottery's 20th Anniversary Extravaganza*, *Millionaire Jumbo Bucks*, *\$7 Million Jackpot*, *Maximum Green*, *\$3,000,000 Taxes Paid*, *Super Millions*, *\$100 Million Lucky Fortunes*, and a holiday-themed game, *Millionaire Jingle Jumbo Bucks*.

The GLC's four holiday-themed instant games offered from late October 2012 through early 2013 and based on our popular Jumbo Bucks line of core instant games, demonstrated strong player appeal and contributed approximately \$155 million in ticket sales. The games include *\$1 Junior Jingle Bucks*, *\$2 Jingle Bucks*, *\$5 Giant Jingle Bucks*, and *\$20 Millionaire Jingle Jumbo Bucks*.

For fiscal year 2014, online game sales were \$1.295 billion, an increase of \$13.2 million, or 1.1% above the 2013 online sales of \$1.281 billion. For fiscal year 2013, online game sales were \$1.281 billion, an increase of \$31.8 million, or 2.5% above the 2012 online sales of \$1.250 billion.

Cash 3 sales increased by \$5.1 million to \$481.9 million in 2014 compared to \$476.8 million in 2013. *Cash 3* is a twice-daily drawing game whereby the player chooses a three-digit number and wins a specified fixed amount if his or her numbers are selected in the draw. The aggregate prize amount per draw varies based on the number of winners. The actual prize payout experienced was approximately 49% for fiscal year 2014 and 48% for fiscal year 2013. Historically, as the prize amount won for this game increases above or decreases below the industry average of 50% of sales, a corresponding increase or decrease in sales will occur.

Cash 3 sales increased by \$8.0 million to \$476.8 million in 2013 compared to \$468.8 million in 2012. The actual prize payout experienced was approximately 48% for fiscal year 2013 and 52% for fiscal year 2012. Historically, as the prize amount won for this game increases above or decreases below the industry average of 50% of sales, a corresponding increase or decrease in sales will occur. However, *Cash 3* sales increased while payout decreased in this case, and the increase was likely due to high payouts on *Cash 4* driving sales increases in both games, which have the same core player base.

In fiscal year 2014, *Mega Millions* sales increased \$35.1 million or approximately 37.6% to \$128.4 million compared to \$93.3 million in 2013. *Mega Millions* produced the second highest jackpot in history in December, 2013 at \$648 million, as well as jackpot levels of \$414 million in March, 2014 and \$190 million in October, 2013. A Georgia resident was one of two winners that shared the \$648 million jackpot. This frequency of large jackpots is what led to the *Mega Millions* sales increase. *Mega Millions* is a multi-state lottery game operated with nine other states—California, Illinois, Massachusetts, Michigan, New Jersey, New York, Ohio, Virginia, and Washington. Texas and Maryland withdrew from the Mega Millions Consortium during 2014. Through an agreement with the Mega Millions Consortium and the Multi-State Lottery Association (MUSL), MUSL members are allowed to cross-sell tickets for the *Mega Millions* game. Drawings are held twice weekly on Tuesday and Friday. In November 2010, the GLC added the *Megaplier* feature to *Mega Millions*. *Megaplier* is an add-on feature that increases players' non-jackpot prizes for an

additional \$1 per play. Depending on the *Megaplier* number selected during the draw, players have the opportunity to multiply their winnings by two, three, or four times. Winning *Mega Millions* with *Megaplier* tickets matching 5 of 5 numbers automatically win \$1 million, regardless of which *Megaplier* is drawn. In October, 2013, the game matrix was changed. The draw matrix changed from 5 winning numbers from a set of 56 balls to 5 winning numbers from a set of 75 balls. The minimum jackpot for *Mega Millions* was raised to \$15 million, minimum jackpot increments of \$5 million were established, and the *Megaplier* multiplier was increased to up to five times for non-jackpot winners.

In fiscal year 2013, *Mega Millions* sales decreased \$65.7 million or approximately 41.3% to \$93.3 million compared to \$159.0 million in 2012. *Mega Millions* produced only two jackpots over \$100 million in 2013 and neither exceeded \$200 million. The infrequency of large jackpots led to the *Mega Millions* sales decline during a year when *Powerball* experienced several large jackpots which led to a *Powerball* increase slightly above the decrease the GLC experienced with *Mega Millions*.

Powerball sales decreased \$45.2 million to \$132.5 million in 2014 compared to \$177.7 million in 2013. The game experienced no large jackpots compared to the previous year. *Powerball* is a multi-state lottery online game operated by the Multi-State Lottery Association (MUSL). Through a cross-sell agreement between MUSL and participating *Mega Millions* states, the GLC began selling tickets for the *Powerball* online game during fiscal year 2010, on January 30, 2010. Drawings are held twice weekly on Wednesday and Saturday. Five winning numbers are drawn from a set of 59 white balls and one number is drawn from a second set of 35 red balls. Additionally, players can choose the *PowerPlay* option to increase their non-jackpot prizes for an additional \$1 per play, per draw. Non-jackpot prize tiers are fixed at multiples of four, three, or two from the base prize depending on the specific tier level. In January, 2014, the variable *PowerPlay* feature was changed to increase the multiplier factor to up to five times the prize winnings for non-jackpot winners.

Powerball sales increased \$66.7 million to \$177.7 million in 2013 compared to \$111.0 million in 2012. Several large jackpots helped drive this sales increase, including a record \$590 million jackpot in May 2013, and a \$588 million jackpot in November 2012. Additionally, there were four other *Powerball* jackpots that exceeded \$200 million. Additionally, some of the increase was due to *Powerball's* price point being \$2 the entire year in 2013, versus slightly less than six months during fiscal year 2012.

In fiscal year 2014, *Cash 4* sales increased \$3.3 million, from \$209.3 million in 2013 to \$212.6 million in 2014. *Cash 4* is a twice-daily drawing game whereby the player chooses a four-digit number and wins a specified fixed amount if his or her numbers are selected in the draw. The aggregate prize amount per draw varies based on the number of winners. Actual prize payouts in fiscal years 2014 and 2013 were approximately 42% and 57%, respectively. Historically, as the prize amount won for this game increases above or decreases below the industry average of 50% of sales, a corresponding increase or decrease in sales will occur.

In fiscal year 2013, *Cash 4* sales increased \$13.6 million, from \$195.7 million in 2012 to \$209.3 million in 2013.

Win For Life ended in 2014. The final draw was held February 22, 2014. Sales decreased by \$2.9 million to \$4.7 million in 2014, compared to 2013 sales of \$7.6 million. *Win For Life* was a multi-state fixed prize online game operated in conjunction with the Virginia Lottery. Drawings were held twice weekly on Wednesday and Saturday. Six winning numbers followed by one “free ball” number were drawn from a single set of 42 balls. By matching the six winning numbers, players won the top prize of \$1,000 a week for life payable in quarterly payments of \$13,000. Players matching five of the six winning numbers plus the “free ball” number won the second tier prize of \$1,000 a week for one year. Matching the “free ball” number also increased other lower level prize amounts.

Win For Life sales declined by \$1.2 million to \$7.6 million in 2013, compared to 2012 sales of \$8.8 million.

Decades of Dollars sales declined by \$2.9 million to \$13.5 million in fiscal year 2014, compared to \$16.4 million in fiscal year 2013. *Decades of Dollars* is a multi-state fixed prize online game operated in conjunction with lotteries in Arkansas, Kentucky, and Virginia. Drawings are held twice weekly on Monday and Thursday. Six winning numbers are drawn from a single set of 47 balls. By matching the six winning numbers, players win the top prize and may choose to receive the prize as \$250,000 each year for 30 years, payable annually or the one-time cash option amount of \$4,000,000 at the time the prize is claimed. Players matching five of the six winning numbers win the second tier prize of \$10,000 payable in one payment. By matching 2, 3, or 4 winning numbers, players can win lower tier prizes, ranging from \$2 to \$100.

Decades of Dollars sales declined by \$3.6 million to \$16.4 million in fiscal year 2013, compared to \$20.0 million in fiscal year 2012.

Fantasy 5 sales increased by \$3.7 million to \$98.7 million in fiscal year 2014 compared to \$95.0 million in 2013. *eZmatch* sales declined \$0.7 million in fiscal year 2014 to \$4.9 million from \$5.6 in fiscal year 2013. *Fantasy 5* is a pari-mutuel online game where players pick 5 numbers from a field of 39, and players have the option to add *eZmatch* for an additional \$1, where matching their *Fantasy 5* numbers to any of the *eZmatch* numbers can win players up to 5 times on each ticket with instant cash prizes from \$4 to \$500. In September, 2013, the minimum *Fantasy 5* jackpot was raised to \$100,000 with a guaranteed second draw jackpot of \$150,000.

Fantasy 5 sales were approximately flat at \$95.0 million in fiscal year 2013, compared to \$95.0 million from in 2012. Additionally, *eZmatch* sales declined \$1.0 million in fiscal year 2013 to \$5.6 million from \$6.6 in fiscal year 2012.

Georgia FIVE sales declined \$1.0 million, from \$10.0 million in fiscal year 2013 to \$9.0 million in fiscal year 2014. *Georgia FIVE* is a fixed prize online game where players pick their own five numbers, in a single PLAY area - one from each vertical column of 0 to 9 or have their numbers randomly selected through the terminal by requesting a Quik Pik lottery ticket. Players win by matching their numbers to the winning number(s) drawn in the exact order and position in a single play. By matching all five of your numbers in exact order to the winning numbers, players win the top prize of \$10,000. Other opportunities to win prizes are available by matching one or more numbers in a specific order and position sequence/order, with prizes ranging from \$1 to \$225.

Georgia FIVE sales declined \$0.6 million, from \$10.6 million in fiscal year 2012 to \$10.0 million in fiscal year 2013.

Keno! sales increased \$3.6 million to \$193.2 million in fiscal year 2014, compared to \$189.6 million in fiscal year 2013. *Keno!* sales continue to be driven by the continued success of *Keno! Bonus Hours* promotions and the *Keno! To Go Initiative*. *Keno! To Go* allows players to purchase a ticket and then watch the drawings on their computer or smartphone.

Keno! sales increased \$15.3 million to \$189.6 million in fiscal year 2013, compared to \$174.3 million in fiscal year 2012.

In March, 2014, the GLC introduced a new online game, *All or Nothing*. This represents the first new online game launch in five years. *All or Nothing* contributed \$15.4 million in gross revenue in its first year, averaging \$895K per week in gross sales. *All or Nothing* is a fixed prize payout online game where players select their own 12 numbers from a population of 1 to 24, or have their numbers randomly selected through

the terminal by requesting a Quik Pik lottery ticket. Each play is \$2. Players win a top prize of \$250,000 by matching all twelve numbers or none of the twelve numbers, hence All or Nothing. Other opportunities to win prizes are available by matching one, two, three, four, eight, nine, ten, or eleven numbers. Drawings are held four times daily.

Other Operating Revenue

Other operating revenue includes online fees, COAM licensing revenue, and other miscellaneous revenue. Other operating revenue increased by \$10.2 million in fiscal year 2014, totaling \$14.5 million versus \$4.3 million in 2013. The increase is due to \$10.2 million received related to COAM licensing revenue, fines and penalties collected during fiscal year 2014. Other operating revenue was \$4.3 million in fiscal year 2013 versus \$4.4 million in 2012, a decrease of \$0.1 million.

Prize Expense

Gross prize expense for instant games increased to \$1.793 billion in fiscal year 2014 from \$1.712 billion in 2013, an increase of \$81.0 million (approximately 4.7%). The increase resulted from significantly higher instant sales, particularly at the \$20 and \$30 price point games which offer higher prize payouts. Gross prize expense for instant games increased to \$1.712 billion in fiscal year 2013 from \$1.679 billion in 2012, an increase of \$33.0 million (approximately 1.9%). Instant games prize expense is managed through the number of tickets printed for each game and value of prizes at each price point, as determined prior to ticket production. Prize expense is recognized based on an established prize structure and related percentage of sales for each game introduced and is recognized when products are made available for sale to the public. The increase in instant game prize expense is a result of the increase in sales of the higher price point games as a percentage of total instant sales. The increase in the prize expense for higher price point games, which offer a larger prize payout than lower price point games, is negligible as a component of gross instant ticket sales.

Instant game prize expense is reduced by applying unclaimed prizes recognized during the fiscal year. For fiscal year 2014, prize expense, net of unclaimed prizes for instant games, totaled \$1.754 billion as compared to \$1.674 billion in 2013, and \$1.648 billion in 2012. Gross instant prize expense was reduced by \$39.3 million, \$38.1 million, and \$31.3 million by using unclaimed prizes in 2014, 2013, and 2012, respectively.

Prize expense for online games generally increases or decreases each year in direct proportion to ticket sales of the related game. For pari-mutuel online games (*Mega Millions* jackpot prize, *Powerball* jackpot prize, and *Fantasy 5*), actual prize expense is recognized as a percentage of ticket sales. For games with fixed prize payouts (*Cash 3*, *Cash 4*, *Decades of Dollars*, *Georgia FIVE*, *Mega Millions* secondary tier prizes, *Powerball* secondary tier prizes, *eZmatch*, *Win For Life*, *Keno!*, and *All or Nothing*), actual prize expense is impacted by the number and prize value of winning tickets. To recognize prize expense on a consistent basis for these games, the GLC recognizes prize expense based on the greater of actual prizes paid or the estimated payout experience over the life of the game or based on industry averages. The GLC has established prize liability limits, per draw, for non pari-mutuel games.

Total online prize expense increased \$1.4 million in 2014 to \$660.3 million compared to \$658.9 million in 2013. For fiscal year 2013, total online prize expense increased \$17.2 million to \$658.9 million compared to \$641.7 million in 2012. The net increase/decrease is comprised of the following increases and decreases by game as follows:

- Prize expense for *Cash 3* increased \$2.5 million in fiscal year 2014 as compared to 2013. Prize expense for *Cash 3* increased \$3.9 million in fiscal year 2013 as compared to 2012. The recognized expense percentage was adjusted from 50% in 2011 to 49% in 2012 in conjunction with an analysis of actual prize payouts since liability caps were implemented.

- Prize expense for *Mega Millions* increased \$17.5 million in 2014 versus 2013, in direct proportion to the increase in sales. Prize expense for *Mega Millions* decreased \$32.8 million in 2013 versus 2012.
- Prize expense for *Powerball* decreased \$22.6 million in fiscal year 2014 as compared to 2013, in direct proportion to the decrease in sales. For fiscal year 2013, prize expense for *Powerball* increased \$33.4 million as compared to 2012.
- Prize expense for *Cash 4* decreased \$1.6 million in 2014 over 2013. Prize expense for *Cash 4* increased \$6.6 million in 2013 over 2012. The recognized expense percentage was adjusted from 48.75% in 2013 to 47.25% in 2014 in conjunction with an analysis of actual prize payouts since liability caps were implemented.
- Prize expense for *Fantasy 5* decreased \$0.8 million in 2014 versus 2013. Prize expense for *Fantasy 5* increased \$0.1 million to \$42.8 million in 2013 versus 2012. *eZmatch* prize expense decreased \$0.4 million in fiscal year 2014 as compared to 2013. Prize expense for *eZmatch* decreased \$0.7 million in fiscal year 2013 as compared to 2012.
- Prize expense for *Georgia FIVE* decreased \$0.5 million in 2014 compared to 2013, consistent with the decrease in gross sales. Prize expense for *Georgia FIVE* decreased \$0.3 million in 2013 versus fiscal year 2012.
- Prize expense for *Keno!* increased \$6.2 million in 2014 as compared to 2013. Prize expense for *Keno!* increased \$9.9 million in 2013 as compared to 2012.
- Prize expense for *Win For Life* decreased \$5.8 million in fiscal year 2014 as compared to 2013. This decrease was attributable to ending the game in February, 2014. Prize expense for *Win For Life* decreased \$0.6 million in fiscal year 2013 as compared to 2012.
- Prize expense for *Decades of Dollars* decreased \$1.7 million to \$8.1 million in fiscal year 2014 consistent with the decrease in sales. In fiscal year 2013, prize expense for *Decades of Dollars* decreased \$2.1 million versus fiscal year 2012.
- Prize expense for *All or Nothing* in the first year was \$8.6 million. The game launched in March, 2014.

Direct Gaming and Operating Expenses

Direct gaming expenses usually change in proportion with changes in ticket sales. For fiscal year 2014, increased ticket sales resulted in corresponding increases in contractor (vendor) fees and retailer commissions and a slight increase in retailer merchandising and marketing as compared to 2013. For fiscal year 2013, increased ticket sales resulted in a corresponding increase in contractor (vendor) fees and a slight increase in retailer merchandising and marketing compared to 2012.

Retailer commissions for fiscal year 2014 were \$239.3 million compared to \$233.2 million in 2013, and \$228.7 million in 2012. This represents a \$6.1 million increase in fiscal year 2014 versus 2013, and \$4.5 million increase in 2013 as compared to 2012. For fiscal year 2014, the GLC paid its retailers a set 6% commission percentage for selling lottery tickets. Due to legislative changes with the passing of House Bill 326 in March of fiscal year 2011, the GLC began compensating its retailers at a fixed commission percentage of 6% for selling tickets. Cashing bonuses for validating and paying winning prizes up to \$600 and winning ticket jackpot incentives on certain online games were discontinued.

Contractor (vendor) fees primarily represent payments made to our two major suppliers of the gaming products, systems, and services, and three other suppliers of instant ticket printing, website development, and

property licensing. The payments made to our two major suppliers are determined based on a percentage of sales formula. Contracts with our major vendor contracts for Online Gaming Systems and Services and Instant Ticket Printing and Associated Services are in force until September 2018. The contract extension provides lower vendor fees resulting from the reduction in the charges for services provided to the GLC. Payments made to the other suppliers are based on contract terms. In fiscal year 2014, contractor (vendor) fees were \$76.4 million as compared to \$74.5 million in 2013, representing an increase of \$1.9 million. The increase was primarily attributable to increased ticket sales in fiscal year 2014. In fiscal year 2013, contractor (vendor) fees were \$74.5 million as compared to \$70.9 million in 2012, representing an increase of \$3.6 million.

Advertising expense increased \$0.8 million to \$19.6 million in 2014 from \$18.8 million in 2013. The GLC's advertising agency, BBDO, provided marketing services including creative conception, production and shipment of television and radio advertising, point-of-sale materials, digital and print advertising, premium giveaway items, website creative, and the placement of media for various lottery games and marketing initiatives during fiscal year 2014. Additionally, BBDO provided marketing, planning and execution of several experiential sponsorships, including the Atlanta Falcons Halftime Event, the Atlanta Hawks Halftime Event, the July 4th media sponsorship, the 20th Anniversary promotional events, and various other executions. BBDO also employed Images USA to provide production and translation for radio advertising, point-of-sale and instant games. Advertising expense decreased \$1.8 million to \$18.8 million in 2013 from \$20.6 million in 2012.

Retailer merchandising and marketing expenses increased \$0.2 million from \$19.3 million in 2013 to \$19.5 million in 2014. In fiscal year 2013, retailer merchandising and marketing expenses increased \$0.1 million from \$19.2 million in 2012 to \$19.3 million in 2013. These expenses are associated with marketing campaigns supporting new lottery games and features, special promotions for retailer partnerships, various second chance drawings, and media production expenses to increase player awareness.

The GLC invested \$1.6 million in Gemini self-service merchandising units and Express Point Plus ticket checkers in fiscal year 2014 to enhance our point-of-sale presence in major corporate retailers and facilitate the *Keno! To Go Initiative* experience at higher volume retail establishments.

Operating expenses increased by \$2.7 million to \$37.4 million in 2014 from \$34.7 million in 2013. The increase in operating expenses resulted primarily from the implementation of COAM which contributed \$3.3 million of operating expenses, partially offset by a decrease of \$0.6 million in bad debt expense for the traditional lottery. Operating expenses increased \$0.8 million to \$34.7 million in 2013 from \$33.9 million in 2012. The \$0.8 million increase in operating expenses resulted from increases of \$0.7 million in personnel costs, \$0.3 million in professional fees and \$0.3 million in bad debt expense, partially offset by decreases of \$0.2 million in depreciation expense, \$0.2 million in telecommunications expense and \$0.1 million in rental expense. The GLC continually looks for opportunities to improve productivity in conducting its operations.

Nonoperating Revenues (Net of Expenses)

Nonoperating revenues, net of expenses, consist primarily of payments due to Lottery for Education Account, interest revenue, and the change in the fair value of grand prize investments held by the GLC for funding of future grand prize payments. The increases or decreases in the fair value of grand prize investments are the result of current period market fluctuations. For fiscal year 2014, nonoperating revenues, net of expenses, increased \$3.7 million from \$945.0 million in 2013 to \$948.7 million in 2014. The increase in nonoperating revenues, net of expenses is attributable to a \$17.6 million increase in payments due to Lottery for Education

Account, as well as a \$13.9 million change in the unrealized gain or loss of grand prize investments held by the GLC for funding of future grand prize payments.

For fiscal year 2013, nonoperating expenses, net of revenues, increased \$67.7 million from \$877.3 million in 2012 to \$945.0 million in 2013. The increase in nonoperating expenses, net of revenues is attributable to a \$26.1 million increase in payments due to Lottery for Education Account as well as a \$41.6 million change in the unrealized gain or loss of grand prize investments held by the GLC for funding of future grand prize payments.

Significant Factors Impacting Next Year

The GLC strives to stay relevant in the marketplace by providing lottery products and regulatory oversight of COAMs that align with our mission of maximizing revenues for the State of Georgia and its specific education programs funded through our proceeds. During the upcoming fiscal year, the GLC plans to expand its product portfolio by offering players new games, such as a new national online game, add-on features to existing games like the Bulls-Eye option for Keno!, and other initiatives which may be launched in fiscal year 2015. The GLC will continue to explore and pursue other strategic business initiatives, such as expanding our product distribution channels by enabling more games on the GLC's internet portal and developing a mobile roadmap.

In April 2013, Georgia House Bill 487 was signed into law and transferred responsibility for administration, enforcement, and licensing of coin-operated amusement machines to the GLC. On June 12, 2014, the GLC awarded a vendor contract to INTRALOT Inc. for the development and implementation of a centralized accounting and communications network that will be connected to all Class B machines. During fiscal year 2015, the onboarding of Class B machines is scheduled to occur, allowing the GLC to begin revenue sharing.

Contacting the GLC's Financial Management

This financial report is designed to provide the state of Georgia, the public, and other interested parties with an overview of the financial results of the GLC's activities and to show the GLC's accountability for conducting business in a fiscally responsible manner. If you have questions about this report or require additional financial information, contact the GLC's Corporate Affairs Division at the Georgia Lottery.

GEORGIA LOTTERY CORPORATION

(A Component Unit of the State of Georgia)

STATEMENTS OF NET POSITION AS OF JUNE 30, 2014 AND 2013

	<u>2014</u>	<u>2013</u>
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 192,363,000	\$ 183,762,000
Restricted fidelity fund cash	6,000	173,000
Restricted retailers' escrow fund cash	6,889,000	6,830,000
Restricted COAM fund cash	-	1,673,000
Retailer accounts receivable—net	163,652,000	153,055,000
Prepaid expenses and other assets	<u>3,448,000</u>	<u>1,768,000</u>
Total current assets	<u>366,358,000</u>	<u>347,261,000</u>
NONCURRENT ASSETS:		
Grand prize investments	219,353,000	247,965,000
Capital assets - net	<u>5,313,000</u>	<u>3,916,000</u>
Total noncurrent assets	<u>224,666,000</u>	<u>251,881,000</u>
TOTAL ASSETS	<u>\$ 591,024,000</u>	<u>\$ 599,142,000</u>
LIABILITIES AND NET POSITION		
CURRENT LIABILITIES:		
Due to Lottery for Education Account	\$ 238,858,000	\$ 237,144,000
Prizes payable	97,448,000	86,028,000
Accounts payable and accrued liabilities	14,047,000	14,822,000
Restricted fidelity fund	6,000	173,000
Restricted retailers' escrow fund	6,889,000	6,830,000
Unearned COAM revenue	<u>6,919,000</u>	<u>1,673,000</u>
Total current liabilities	<u>364,167,000</u>	<u>346,670,000</u>
NONCURRENT LIABILITIES:		
Grand prizes payable	200,569,000	225,577,000
Noncurrent portion of other long-term liabilities	<u>4,409,000</u>	<u>3,123,000</u>
Total noncurrent liabilities	<u>204,978,000</u>	<u>228,700,000</u>
Total liabilities	<u>569,145,000</u>	<u>575,370,000</u>
NET POSITION		
Invested in capital assets	5,313,000	3,916,000
Unrestricted	<u>16,566,000</u>	<u>19,856,000</u>
Total net position	<u>21,879,000</u>	<u>23,772,000</u>
TOTAL LIABILITIES AND NET POSITION	<u>\$ 591,024,000</u>	<u>\$ 599,142,000</u>

See Notes to financial statements.

GEORGIA LOTTERY CORPORATION

(A Component Unit of the State of Georgia)

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION FOR THE YEARS ENDED JUNE 30, 2014 AND 2013

	<u>2014</u>	<u>2013</u>
OPERATING REVENUES:		
Ticket sales	\$ 4,022,201,000	\$ 3,912,156,000
Less tickets provided as prizes	<u>(282,279,000)</u>	<u>(276,224,000)</u>
Net ticket sales	3,739,922,000	3,635,932,000
Online fees	4,276,000	4,255,000
COAM fees	10,190,000	0
Other	<u>77,000</u>	<u>82,000</u>
Net operating revenues	<u>3,754,465,000</u>	<u>3,640,269,000</u>
OPERATING EXPENSES:		
Prizes	2,413,844,000	2,332,453,000
Retailer commissions and bonuses	239,322,000	233,222,000
Contractor fees	76,390,000	74,499,000
Advertising	19,563,000	18,796,000
Salaries and benefits	25,923,000	24,694,000
Retailer merchandising and marketing	19,532,000	19,270,000
Rent, utilities, and maintenance	4,882,000	4,906,000
Depreciation	1,597,000	1,711,000
Professional fees	1,601,000	1,224,000
Gaming Equipment	1,620,000	0
Other	<u>3,386,000</u>	<u>2,217,000</u>
Total operating expenses	<u>2,807,660,000</u>	<u>2,712,992,000</u>
Operating income	<u>946,805,000</u>	<u>927,277,000</u>
NONOPERATING REVENUES (EXPENSES):		
Payments to and due to Lottery for Education Account	(945,097,000)	(927,478,000)
Interest revenue	200,000	201,000
Net increase (decrease) in fair value of grand prize investments	<u>(3,801,000)</u>	<u>(17,713,000)</u>
Total nonoperating revenues (expenses)	<u>(948,698,000)</u>	<u>(944,990,000)</u>
Change in net position	(1,893,000)	(17,713,000)
NET POSITION — Beginning of year	<u>23,772,000</u>	<u>41,485,000</u>
NET POSITION — End of year	<u>\$ 21,879,000</u>	<u>\$ 23,772,000</u>

See Notes to financial statements.

GEORGIA LOTTERY CORPORATION

(A Component Unit of the State of Georgia)

STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED JUNE 30, 2014 AND 2013

	<u>2014</u>	<u>2013</u>
OPERATING ACTIVITIES:		
Cash received from customers	\$ 3,729,326,000	\$ 3,626,473,000
Other operational cash received	4,353,000	4,338,000
COAM cash received	10,190,000	1,673,000
Cash paid to prize winners	(2,436,928,000)	(2,398,460,000)
Cash paid to retailers	(239,322,000)	(233,222,000)
Cash paid to contractors and employees	(135,121,000)	(133,086,000)
Other operating payments	(13,841,000)	(9,132,000)
	<u>918,657,000</u>	<u>858,584,000</u>
NONCAPITAL FINANCING ACTIVITIES:		
Payments to Lottery for Education Account	(943,383,000)	(907,263,000)
Payments to DHBDD	(200,000)	(200,000)
	<u>(943,583,000)</u>	<u>(907,463,000)</u>
CAPITAL AND RELATED FINANCING ACTIVITIES:		
Purchases of property and equipment	(3,015,000)	(1,542,000)
Proceeds from disposals of property and equipment	54,000	19,000
	<u>(2,961,000)</u>	<u>(1,523,000)</u>
INVESTING ACTIVITIES:		
Interest received	200,000	201,000
Maturities of grand prize investments	34,507,000	36,138,000
	<u>34,707,000</u>	<u>36,339,000</u>
NET INCREASE (DECREASE) IN CASH, CASH EQUIVALENTS, AND RESTRICTED CASH	6,820,000	(14,063,000)
CASH, CASH EQUIVALENTS, AND RESTRICTED CASH—Beginning of year	<u>192,438,000</u>	<u>206,501,000</u>
CASH, CASH EQUIVALENTS, AND RESTRICTED CASH—End of year	<u>\$ 199,258,000</u>	<u>\$ 192,438,000</u>

Continued

GEORGIA LOTTERY CORPORATION

(A Component Unit of the State of Georgia)

STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED JUNE 30, 2014 AND 2013

	<u>2014</u>	<u>2013</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating income	\$ 946,805,000	\$ 927,277,000
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	1,597,000	1,711,000
Provision for doubtful retailer accounts	186,000	817,000
Gains (Losses) on disposals of property and equipment	(54,000)	(19,000)
Changes in assets and liabilities:		
Retailer accounts receivable	(10,783,000)	(10,275,000)
Prepaid expenses and other assets	(1,680,000)	1,457,000
Accounts payable and accrued liabilities	483,000	1,465,000
Prizes payable	11,620,000	(29,935,000)
Grand prizes payable	(34,704,000)	(36,072,000)
Restricted fidelity fund	(168,000)	156,000
Restricted Retailer Escrow	59,000	155,000
Unearned COAM Revenue	5,246,000	1,673,000
Other liabilities	50,000	174,000
Net cash provided by operating activities	<u>\$ 918,657,000</u>	<u>\$ 858,584,000</u>
SCHEDULE OF NONCASH INVESTING, CAPITAL, AND RELATED FINANCING ACTIVITIES:		
Increase (decrease) in fair value of investments	\$ (3,801,000)	\$ (17,713,000)
Accretion of grand prizes payable	<u>9,696,000</u>	<u>10,902,000</u>
Total noncash investing, capital, and related financing activities	<u>\$ 5,895,000</u>	<u>\$ (6,811,000)</u>

See Notes to financial statements.

GEORGIA LOTTERY CORPORATION

NOTES TO THE FINANCIAL STATEMENTS

AS OF AND FOR THE YEARS ENDED JUNE 30, 2014 AND 2013

1. REPORTING ENTITY

The Georgia Lottery Corporation (the “GLC”) was established as an instrumentality of the state with the enactment of the Georgia Lottery for Education Act (the “Act”) on November 2, 1992. The GLC is responsible for the provision of lotteries on behalf of the State of Georgia in accordance with the Act and is a component unit of the State of Georgia.

The GLC’s ticket sales include instant ticket sales and online ticket sales for *Cash 3, Cash 4, Georgia FIVE, Fantasy 5, eZmatch, Keno!, Mega Millions, Powerball, Win for Life, Decades of Dollars, and All or Nothing.*

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation—The GLC is accounted for as an enterprise fund. Enterprise funds are used to account for activities that are financed and operated in a manner similar to private business enterprises: (1) where the costs of providing goods and services to the general public on a continuing basis are to be financed through user charges or (2) where the periodic determination of net income is considered appropriate.

Basis of Accounting—The financial statements are reported using the economic resources measurement focus and the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America (“generally accepted accounting principles”). Under this method, revenues are recognized when earned and expenses are recognized and recorded when a liability is incurred, regardless of the timing of cash flows. The Governmental Accounting Standards Board (“GASB”) establishes generally accepted accounting principles for governmental entities and pronouncements of the GASB are followed by the GLC.

Use of Estimates—The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue Recognition—Lottery games are sold to the public by contracted retailers. Revenue is recognized for online games when tickets are sold to players and the related draw has occurred. Revenue is recognized for instant games when the product is made available for sale to the public, which is based on ticket activations by the retailers. Certain games include free tickets, which entitle the holder to exchange one ticket for another of equal value. The selling price of free tickets reduces ticket revenue when the prize is claimed by a player.

Revenue and Expenses—Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues generally result from providing services in connection with a proprietary fund’s principal ongoing operations. The principal operating revenues of the Georgia Lottery Corporation’s enterprise fund are primarily revenues from ticket sales, COAM licensing fees, and online fees. “Operating expenses” are defined under the Act as “all costs of doing business, including, but not limited to, prizes, commissions, and other compensation paid to retailers, advertising and marketing costs, personnel costs, capital costs, depreciation of property and equipment, funds for compulsive gambling education and treatment, amounts held in or paid from a fidelity fund, and other operating costs.” All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses. The principal nonoperating revenues and expenses of the Georgia Lottery Corporation’s enterprise fund are primarily interest income revenue, payments to and due to the Lottery for Education Account (an expense), and the net increase (revenue) or decrease (expense) in the fair value of grand prize investments.

Commissions and Bonuses— During fiscal years 2014 and 2013, retailers received a sales commission of 6% on all games. On March 15, 2011, Georgia House Bill 326 was enacted into law, which effectively eliminated all cashing bonuses and retailer incentive payments, and provided for sales commissions at a rate of 6% for all games.

Contractor Fees—The GLC has contracted with two vendors for the majority of the gaming systems and supplies.

The GLC entered into a seven-year vendor contract effective September 7, 2003, with GTECH Corporation (“GTECH”) for the operation of the gaming network that consists of over 10,300 retailer ticket terminals and associated software. On November 12, 2008, the GLC amended and extended this contract until September 11, 2013. Under the amended contract, GTECH receives a fee of 1.15% of net ticket revenue. A second amendment and extension of the contract with GTECH was entered into on September 24, 2012, and provides for continuation of the fee of 1.15% of net ticket revenue from September 12, 2013 through September 11, 2016, and after this date a fee of 0.99% of net ticket revenue will be applied from September 12, 2016 through September 11, 2018. Additionally, the amended contract provides for new services associated with the Player Direct Program, which includes the new iHope Debit Card and internet wagering that was launched on November 25, 2012. The amended contract also provides for IVR (interactive voice response) services.

The GLC entered into a seven-year vendor contract effective September 7, 2003, with Scientific Games, Inc. for the printing and distribution of instant game tickets. On November 12, 2008, the GLC amended and extended this contract until September 10, 2013. Under the amended contract, Scientific Games, Inc. received a fee of 1.2875% of net instant game tickets distributed to retailers through December 31, 2008. After that date, the fee lowered to 1.1781% through December 31, 2009. From January 1, 2010 through June 30, 2010, the rate was 1.15%, and the rate for fiscal year 2011 was 1.10%. This rate continued through December 31, 2011. On June 15, 2011, the GLC amended and extended this contract until September 10, 2018. Under the amended contract, Scientific Games, Inc. will receive a fee of .99% of net instant game tickets distributed to retailers beginning January 1, 2012 until the end of the contract.

The GLC entered into a vendor contract effective January 27, 2006, with Pollard Banknote Limited Partnership (“Pollard”) for the printing of various instant game tickets for which the vendor has exclusive rights. Pollard receives a fee based on the quantity of instant tickets printed. The original contract ended June 30, 2011, but was extended three additional years until June 30, 2014. The contract was not extended in 2014. Pollard did not print any instant games in fiscal year 2014. Pollard printed

five instant ticket games during fiscal year 2013, which were \$2 *Cashword IV*, \$2 *Cashword V*, \$2 *Cashword VI*, \$3 *Cherry, Orange, Lemon Doubler Cashword*, and \$5 *Cadillac Riches*.

Prizes—In accordance with the Act, as nearly as practical, at least 45% of ticket sales must be returned to the public in the form of prizes. Prize expense for instant games is recognized based on the predetermined prize structure for each game. Generally, prize expense for *Cash 3*, *Cash 4*, *Georgia FIVE*, *Mega Millions*, *Powerball*, *eZmatch*, *Keno!*, *Decades of Dollars*, the *Win For Life*, and *All or Nothing* online games is recognized based on the estimated payout experience over the life of the games or the industry averages. Prize expense for *Fantasy 5* is recorded on a pari-mutuel basis according to the game structure based on a percentage of revenue recognized.

Mega Millions, *Win For Life*, and the *Decades of Dollars* online games are multi-state lottery games operated by member lotteries. The *Mega Millions*, *Win For Life*, and the *Decades of Dollars* prizes are shared based on contributions to the prize pools by the member lotteries. Grand prize investments for jackpot winners who purchased tickets in Georgia are held by the GLC.

The *Powerball* grand prize is a shared prize from contributions to the prize pool by all member lotteries of the Multi-State Lottery Association (“MUSL”) and certain Mega Millions states including Georgia which sell *Powerball* tickets without being a member of MUSL. All *Powerball* grand prizes won by players who purchased tickets in Georgia are funded by investments purchased by MUSL. The investments are held by MUSL in trust for the GLC and are paid in 20 annual installments. Investments of \$1,195,000 and \$2,384,000 included in the GLC’s grand prize investments in the statements of net position at June 30, 2014 and 2013, respectively, were held by MUSL in trust. The GLC withdrew from MUSL on August 31, 1996. During fiscal year 2010, the GLC, along with the other participating Mega Millions states, entered into an agreement with the Multi-State Lottery Association (MUSL) authorizing the cross-sell of tickets for the *Powerball* game. Ticket sales under the cross-sell agreement began on January 31, 2010, and the first *Powerball* drawing including participating Mega Millions states was held on February 1, 2010.

Unclaimed Prizes—Prizes must be claimed no later than 90 days after game-end for instant games and within 180 days after the draw date for online games. An estimate of the unclaimed prizes is based upon the historical experience rate as a percentage of ticket sales. In accordance with the Act, \$200,000 of unclaimed prizes must be transferred to the Department of Behavioral Health and Developmental Disabilities for the treatment of compulsive gambling and related educational programs. Transfers for this purpose for each fiscal year have been \$200,000. The remainder of unclaimed prizes is used to fund future prizes or special prize promotions, as defined by the statute.

Net Position—Net position represents cumulative revenues less expenses in excess of net proceeds transferred to the Lottery for Education Account, as defined under the Act (see Note 7). Net position includes funds invested in capital assets and unrestricted net position. Unrestricted net position normally results from the inclusion of capital costs in the determination of net proceeds as required by the Act and the cumulative effect of periodic adjustments to recognize the fair value of grand prize investments held to fund grand prizes payable. Grand prize investments are purchased to finance future payments to *Win For Life*, *Mega Millions*, *Powerball*, *Decades of Dollars*, and certain instant game grand prize winners. Any increases or decreases in the fair value of these investments are determined to be unrealized and will not affect (i) the future ability to hold these investments or (ii) the amount of funds available for distribution to the Lottery for Education Account. Unrealized gains on grand prize investments at June 30, 2014 and 2013 were \$19,971,000 and \$23,772,000, respectively, resulting in a net change of (\$3,801,000) in the fair value of grand prize investments.

Cash and Cash Equivalents—The GLC considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. This includes cash in banks, petty cash, and balances on account in Georgia Fund 1.

Retailer Accounts Receivable—Retailer accounts receivable represents lottery proceeds due from retailers for net ticket sales less commissions and prizes paid by the retailers. Lottery proceeds are collected weekly from retailer bank accounts held in trust for the GLC. An allowance for doubtful accounts is established based on management’s estimate of retailer receivables that will not be collected. At June 30, 2014 and 2013, the allowance for uncollectible retailer receivables was \$ \$3,124,000 and \$3,073,000, respectively.

Capital Assets—Capital assets are stated at cost less accumulated depreciation. Depreciation on capital assets is computed using the straight-line method over the estimated useful lives of three to ten years. Leasehold improvements are amortized over their expected useful lives or the lease term, whichever is shorter. When assets are retired or otherwise disposed of, the costs and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is reflected in the results from operations in the period of disposal.

Fidelity Fund—In accordance with the Act, retailers contribute a fee to a fidelity fund upon acceptance as a GLC retailer. The GLC is reimbursed from available funds for any losses incurred as a result of the misfeasance or malfeasance of GLC retailers. At the end of each year, any amount in the fund in excess of \$500,000 is treated as net proceeds from the GLC subject to transfer to the Lottery for Education Account. There were no fidelity funds available for transfer as net proceeds for the years ended June 30, 2014 and 2013. The fidelity fund proceeds are held in a separate account and are presented in the statements of net position as restricted fidelity fund cash and in liabilities as restricted fidelity funds.

Retailer Escrow Fund—Retailers pledge cash deposits to an escrow funds management service offered by a commercial bank selected by the GLC. This is one of the acceptable forms of Financial Security Deposits from Retailers pursuant to Section 19 of the Georgia Lottery for Education Act, Chapter 2 of the GLC Policies entitled ‘Retailer Rules and Regulations,’ and Chapter 8.2 of the GLC Policies entitled ‘Retailer Credit and Financial Security Policy,’ and appropriate Executive Orders. The GLC is reimbursed from available funds for any losses incurred as a result of the misfeasance or malfeasance of GLC retailers. The retailers’ escrow funds are not subject to transfer to the Lottery for Education Account. The retailer escrow fund proceeds are held in a separate account and are presented in the statements of net position as restricted retailer escrow fund cash and in liabilities as restricted retailer escrow funds.

Coin Operated Amusement Machines (COAM)

House Bill 487 was signed into law in April, 2013 which transferred oversight responsibility for licensing and managing coin operated amusement machines across the state of Georgia from the Georgia Department of Revenue to the GLC. The COAM industry is comprised of masters (machine owners) and locations (machine operators). The GLC deployed an internally developed licensing application system in May, 2014. As of June 30, 2014, approximately 1,200 owners and 5,000 operators have applied for licenses via this online system. In June, 2014, the GLC Board of Directors accepted the recommendation of the COAM Advisory Board and awarded a contract to develop and implement a centralized COAM accounting system to INTRALOT, Inc. During fiscal year 2014, COAM contributed \$10.2 million in licensing fees, fines, and penalties. COAM contributed an additional \$6.9 million in renewal fees in advance of the fiscal year 2015 licensing period. Under House Bill 487, net revenue from COAM licensing renewal received by the GLC in fiscal year 2014 was for procurement of a centralized accounting system designed to account for all licensed COAMs throughout the State. The Board of

Directors approved returning \$5.0 million of the 2014 net proceeds to the Lottery for Education Account due to savings obtained in the centralized system contract. The GLC retained \$1.9 million for expenses associated with implementation of the centralized accounting system

Compensated Absences—Employees earn the right to be compensated during absences for vacation and illness. Unused leave benefits are paid to employees upon separation from service. The cost of vacation and vested sick leave benefits is accrued in the period in which it was earned. In March 2005, the GLC adopted a new policy concerning payments of accrued sick leave upon termination. Sick leave accrued by employees prior to March 1, 2005, and not used prior to termination is paid at a 50% rate upon termination. No payments will be made for sick leave accrued after March 1, 2005, and not used by the employee before termination.

Budget—Georgia Statute requires the GLC to submit to the Office of Planning and Budget (“OPB”) and the State Auditor, annually by June 30, a proposed operating budget for the next fiscal year. Additionally, the GLC is required to submit to the OPB annually, on September 1, a proposed operating budget for the GLC and an estimate of net proceeds for the succeeding fiscal year. The GLC complied with these requirements in 2014 and 2013.

3. CASH, CASH EQUIVALENTS, AND GRAND PRIZE INVESTMENTS

During the year ended June 30, 2005, the GLC adopted the provisions of SGAS No. 40, *Deposit and Investment Risk Disclosures*, which amends SGAS No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*, which recognizes that deposits and investments of state and local governments are exposed to risks that have the potential to result in losses. This statement establishes and modifies disclosure requirements related to investment and deposit risks; accordingly, the GLC’s note disclosures on cash, cash equivalents, and investments are in conformity with the provisions of SGAS No. 40. Following “exception-based reporting,” the GLC is not required to disclose risks that do not apply to it.

Cash—Cash is held in demand deposits at various financial institutions. The majority of the GLC’s daily operating cash is held in a master operating account with Bank of America. Other miscellaneous cash accounts for accounts payable, prizes payable, retailer return items, district offices, promotions, payroll, and petty cash are held in accounts with Bank of America, except for the Columbus district office account which is held with SunTrust Bank. At June 30, 2014, the GLC’s Master Operating Account had a book balance of \$36,036,000 and a bank balance of \$35,802,000. This includes COAM cash consisting of a book balance of \$12,632,000 and a bank balance of \$16,087,000. At June 30, 2014, the other miscellaneous accounts had a bank balance of \$427,000 and net book balance of (\$2,288,000) which was primarily due to outstanding checks for the accounts payable and prize check zero balance cash accounts. This includes COAM cash consisting of a book balance of (\$13,000) and a bank balance of \$25,000. The net carrying value and bank balance of all GLC cash accounts as of June 30, 2014 were \$33,748,000 and \$36,229,000 respectively. At June 30, 2013, the GLC’s Master Operating Account had a book balance of \$5,677,000 and a bank balance of \$7,421,000. At June 30, 2013, the other miscellaneous accounts had a bank balance of \$449,000 and net book balance of (\$1,795,000) which was primarily due to outstanding checks for the accounts payable and prize check zero balance cash accounts. The net carrying value and bank balance of all GLC cash accounts as of June 30, 2013 were \$3,882,000 and \$7,870,000 respectively. These deposits were entirely insured by FDIC insurance or collateralized by investment securities held by the GLC’s agent in the GLC’s name.

Cash Equivalents—Cash equivalents represent surplus cash invested in Georgia Fund 1 administered by the State of Georgia’s Office of the State Treasurer. The voluntary fund is a short-term investment vehicle that is available for use by state entities and local governments. Georgia Fund 1 invests its assets

in U.S. Treasury bills, U.S. Treasury notes, securities issued by federal agencies and instrumentalities, banker's acceptances, and repurchase agreements.

The Georgia Fund 1 is an external investment pool that is not registered with the Securities and Exchange Commission (SEC), but does operate in a manner consistent with the SEC's Rule 2a7 of the Investment Company Act of 1940. The Office of the State Treasurer manages Georgia Fund 1 in accordance with policies and procedures established by state law and the State Depository Board, the oversight Board for the Office of the State Treasurer. This investment is valued at the pool's share price, \$1.00 per share. The Georgia Fund 1 is an AAf rated investment pool by Standard & Poor's, and the portfolio's weighted average maturity is sixty-two (62) days at June 30, 2014. Under SGAS No. 40, since these funds represent an externally managed pool it is not exposed to custodial credit risk, and therefore, no custodial credit risk disclosures are required. The GLC's investment in Georgia Fund 1 was approximately \$158,615,000 and \$179,880,000 at June 30, 2014 and 2013, respectively. Interest earned on the GLC's investments was approximately \$183,000 and \$201,000 for the years ended June 30, 2014 and 2013, respectively.

Other Deposits— Cash maintained in the Retailer Escrow Fund bank account had bank and book balances of \$6,953,000 and \$6,889,000, respectively, as of June 30, 2014. Cash maintained in the Fidelity Fund bank account has bank and book balances of \$47,000 and \$6,000, respectively, as of June 30, 2014. Cash maintained in the restricted COAM fund has zero balances as of June 30, 2014. Cash maintained in the Retailer Escrow Fund bank account had bank and book balances of \$6,928,000 and \$6,830,000, respectively, as of June 30, 2013. Cash maintained in the Fidelity Fund bank account has bank and book balances of \$121,000 and \$173,000, respectively, as of June 30, 2013. Cash maintained in the restricted COAM fund had a book balance of \$1,673,000 at June 30, 2013. The Retailer Escrow Fund and the restricted COAM fund accounts were maintained with Bank of America and the Fidelity Fund account was maintained with Carver State Bank and each account was entirely insured by FDIC insurance or collateralized by investment securities held by the GLC's agent in the GLC's name.

Grand Prize Investments—All grand prize investments represent funds held to pay grand prize winners who are entitled to multiyear payments. Grand prize investments are recorded at their fair values, based on quoted market prices. Increases or decreases in the fair value of these investments are recorded as nonoperating revenue (expense).

Grand prize investments at June 30, 2014 and 2013, consist of the following:

	Fair Value	
	2014	2013
U.S. Treasury securities	\$ 218,158,000	\$ 245,581,000
Government agencies	<u>1,195,000</u>	<u>2,384,000</u>
	<u>\$ 219,353,000</u>	<u>\$ 247,965,000</u>

Grand prize investments are not presented as current assets, as they are not part of the GLC's current operations. Changes in grand prize investments for the years ended June 30, 2014 and 2013 consisted of the following:

Fair value—June 30, 2012	\$ 290,914,000
Purchases	-
Payments to grand prize winners	(36,138,000)
Investments sold	-
Interest earned on current-year maturities	10,902,000
Change in fair value	<u>(17,713,000)</u>
Fair value—June 30, 2013	<u>247,965,000</u>
Purchases	-
Payments to grand prize winners	(34,507,000)
Investments sold	-
Interest earned on current-year maturities	9,696,000
Change in fair value	<u>(3,801,000)</u>
Fair value—June 30, 2014	<u>\$ 219,353,000</u>

Custodial credit risk for Deposits—Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. State statutes require all deposits and investments (other than federal or state government instruments) to be collateralized by depository insurance, obligations of the U.S. government, or bonds of public authorities, counties, or municipalities. As of June 30, 2014, all deposits are considered insured.

Investments—The GLC's investments consist of U.S. Treasury Strips (principal and interest) that are held to maturity to fund grand prize winners for several online games, including *Lotto Georgia*, *The Big Game*, *Mega Millions*, *Lotto South*, and *Win For Life*, and various Instant Games with annuity prizes such as *Georgia's \$500 Million Club*. In addition, MUSL (Multistate Lottery Association) holds U.S. government agency securities on behalf of the GLC that are held to maturity to fund Georgia's two Powerball grand prize winners. At June 30, 2014, the GLC's investment balances consisted of:

<u>Investment Type</u>	<u>Fair Value</u>	<u>Maturity</u>
U.S Treasury Strips	\$ 218,158,000	Weighted average maturity of 6.8 years
U.S Government Agencies	<u>1,195,000</u>	Weighted average maturity of 0.3 years
Total	<u>\$ 219,353,000</u>	

U.S Treasury Strips held by the GLC are AAA-rated and current holdings mature quarterly beginning August 2014 through August 2039. U.S. government agency securities held for the GLC by MUSL are AAA-rated with maturities beginning in July 2014 and ending in May 2015.

Interest Rate Risk—The GLC’s deposits in the master operating account with Bank of America are subject to fluctuations in short-term interest rates. The GLC purchases investments to fund future prize payments at fixed amounts for grand prize winner obligations, as detailed in Note 5, Grand Prizes Payable. Periodic market fluctuations affect the fair value of grand prize investments. The GLC expects to hold grand prize investments to maturity to meet future grand prize payments and, therefore, will not realize any gains or losses related to the changes in the market. The only exposure that the GLC has in regards to interest rate sensitivity is for the GLC’s master operating account, since there is no investment related impact on the GLC resulting from the effect of interest rate changes on grand prize investments.

Credit Risk—State laws limit the investment sources available to the GLC to United States Treasury securities, federal agency securities, state of Georgia securities, repurchase or reverse repurchase agreements, bank certificates of deposits, Georgia Fund 1, life insurance annuity contracts, and investments that would be permissible for the legal reserves of domestic life insurance companies under the laws of the state of Georgia.

Custodial Credit Risk—For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the GLC will not be able to recover the value of its investments in the possession of an outside party. The GLC’s investments in U.S. Treasury Strips include strips with a fair value of \$58,283,000 that were purchased from Bank of America and are also held by Bank of America in a safekeeping account on the behalf of the GLC.

4. CAPITAL ASSETS

Capital assets at June 30, 2014 and 2013 consisted of the following:

	June 30, 2013	Increases	Decreases	June 30, 2014
Capital assets:				
Furniture and fixtures	\$ 2,837,000	\$ 18,000	\$ -	\$ 2,855,000
Computer and communications equipment	11,912,000	591,000	(76,000)	12,427,000
Vehicles	3,083,000	334,000	(207,000)	3,210,000
Leasehold improvements	3,729,000	1,022,000	-	4,751,000
COAM improvements	-	223,000	-	223,000
Software	3,235,000	827,000	-	4,062,000
Other assets	1,709,000	-	-	1,709,000
Gaming Equipment	245,000	-	-	245,000
	<u>26,750,000</u>	<u>3,015,000</u>	<u>(283,000)</u>	<u>29,482,000</u>
Total capital assets at historical cost				
Less accumulated depreciation	<u>(22,834,000)</u>	<u>(1,597,000)</u>	<u>262,000</u>	<u>(24,169,000)</u>
Capital assets—net	<u>\$ 3,916,000</u>	<u>\$ 1,418,000</u>	<u>\$ (21,000)</u>	<u>\$ 5,313,000</u>

	Balance at June 30, 2012	Increases	Decreases	Balance at June 30, 2013
Capital assets:				
Furniture and fixtures	\$ 2,778,000	\$ 59,000	\$ -	\$ 2,837,000
Computer and communications equipment	11,638,000	619,000	(345,000)	11,912,000
Vehicles	3,124,000	475,000	(516,000)	3,083,000
Leasehold improvements	3,416,000	313,000	-	3,729,000
Software	3,159,000	76,000	-	3,235,000
Other assets	1,709,000	-	-	1,709,000
Gaming Equipment	245,000	-	-	245,000
	<u>26,069,000</u>	<u>1,542,000</u>	<u>(861,000)</u>	<u>26,750,000</u>
Total capital assets at historical cost				
Less accumulated depreciation	<u>(21,956,000)</u>	<u>(1,711,000)</u>	<u>833,000</u>	<u>(22,834,000)</u>
Capital assets—net	<u>\$ 4,113,000</u>	<u>\$ (169,000)</u>	<u>\$ (28,000)</u>	<u>\$ 3,916,000</u>

5. GRAND PRIZES PAYABLE

Grand prizes payable is recorded at the net present value of the U.S. Treasury securities purchased for each jackpot winner. Grand prizes payable was accreted by approximately \$9,696,000 and \$10,902,000 for the years ended June 30, 2014 and 2013, respectively. Grand prizes payable are not presented as current liabilities, as they are not part of the GLC's current operations.

Future payments of grand prizes payable at June 30, 2014, are scheduled as follows:

2015	\$ 26,726,000
2016	22,717,000
2017	19,216,000
2018	15,934,000
2019	15,446,000
2020-2024	74,000,000
2025-2029	49,626,000
2030-2034	23,337,000
2035-2039	14,326,000
2040-2044	<u>4,150,000</u>
	265,478,000
Less imputed interest	<u>(64,909,000)</u>
Net present value of grand prizes payable	<u>\$ 200,569,000</u>

The Omnibus Consolidated and Emergency Supplemental Appropriations Act, 1999 (the "Omnibus Act") was enacted into federal law on October 21, 1998. Included in this Omnibus Act is a Special Rule for Cash Options for Receipt of Qualified Prizes ("Special Rule"). Pursuant to the Special Rule, the GLC may extend to recipients of "qualified prizes" the opportunity, within a certain period after the drawing, to select a lump-sum payment equivalent to the cash value of an annuitized prize. Qualified prizes, as defined in the Omnibus Act, include multiple-year payments of a minimum of ten years.

Claimants of qualified prizes, as defined in the GLC Rules and Regulations, on or after the date of enactment of the Omnibus Act, can make an irrevocable election to receive a lump-sum cash payment equivalent of the annuitized prize within 60 days of the claim date. Grand prizes payable at June 30, 2014, consist of no qualified prizes under this provision of the Special Rule.

6. OPERATING LEASES

The GLC has entered into operating leases for the rental of office space for its headquarters and district offices. Certain operating leases contain provisions for scheduled rental increases and are renewable at the option of the GLC.

Future minimum rental payments on noncancellable leases with original terms of one year or more are scheduled as follows:

<u>Year Ending June 30,</u>	<u>Operating Leases</u>
2015	\$ 2,432,000
2016	2,223,000
2017	2,223,000
2018	2,266,000
2019	2,284,000
2020 - 2023	<u>9,520,000</u>
	20,948,000
Less sublease revenues	<u>(4,781,000)</u>
Total	<u>\$16,167,000</u>

Rental expense under all operating leases totaled approximately \$2,524,000 and \$2,582,000 for the years ended June 30, 2014 and 2013, respectively.

7. DUE TO LOTTERY FOR EDUCATION ACCOUNT

In accordance with the Act, all net proceeds of the GLC are due to the Lottery for Education Account within the state of Georgia Treasury. Net proceeds is defined under the Act as “all revenue derived from the sale of lottery tickets or shares and all other monies derived from the GLC less operating expenses.” Any unrealized gain or loss resulting from changes in fair value of grand prize investments does not represent funds received from GLC operations and is excluded from determination of “net proceeds.”

“Operating expenses” are defined under the Act as “all costs of doing business, including, but not limited to, prizes, commissions, and other compensation paid to retailers, advertising and marketing costs, personnel costs, capital costs, depreciation of property and equipment, funds for compulsive gambling education and treatment, amounts held in or paid from a fidelity fund, and other operating costs.”

Net proceeds and operating expenses for the years ended June 30, 2014 and 2013, are summarized as follows:

	<u>2014</u>	<u>2013</u>
Operating revenues:		
Ticket sales	\$ 4,022,201,000	\$ 3,912,156,000
Less tickets provided as prizes	(282,279,000)	(276,224,000)
Net ticket sales	3,739,922,000	3,635,932,000
Online fees and other revenues	4,353,000	4,337,000
COAM Licensing fees	10,190,000	0
Interest revenue and other	200,000	201,000
GLC proceeds	<u>3,754,665,000</u>	<u>3,640,470,000</u>
Operating expenses—as defined:		
Gaming	2,770,271,000	2,678,240,000
Operating	37,389,000	34,752,000
Other	3,215,000	1,742,000
Total operating expenses—as defined	<u>2,810,875,000</u>	<u>2,714,734,000</u>
Net proceeds before distribution of unrestricted net position	<u>943,790,000</u>	<u>925,736,000</u>
Other:		
Funds resulting from current year capital purchases	3,015,000	-
Funds resulting from previous years' capital purchases	-	1,542,000
Funds for current year compulsive gambling education and treatment	200,000	-
Funds for previous years' compulsive gambling education and treatment	-	200,000
Total other	<u>3,215,000</u>	<u>1,742,000</u>
Net proceeds subject to transfer	<u>\$ 947,005,000</u>	<u>\$ 927,478,000</u>
Amount due to Lottery for Education Account for year	\$ 947,005,000	\$ 927,478,000
COAM Retained Earnings	(1,908,000)	0
Amount paid during year	<u>(706,239,000)</u>	<u>(690,334,000)</u>
Amount due to Lottery for Education Account for year	<u>\$ 238,858,000</u>	<u>\$ 237,144,000</u>

8. EMPLOYEE BENEFITS

401(k) Defined Contribution Plan—Effective July 1, 1998, House Bill 441 was enacted into law, allowing the Georgia Lottery Corporation to participate in the Deferred Compensation Plan offered by the state of Georgia for public employees pursuant to Section 401(k) of the Internal Revenue Code.

There were 294 GLC employees participating in the 401(k) plan at June 30, 2014. For the years ended June 30, 2014 and 2013, GLC contributed \$1,340,000 and \$1,305,000 to the plan, respectively. Contributions by plan participants during fiscal years ended June 30, 2014 and 2013 were \$682,000 and \$641,000, respectively.

457 Deferred Compensation Plan—Beginning in December 1994, the GLC offered its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all full-time employees at their option, permits participants to defer a portion of their salary until future years. The deferred compensation is not available to participants until termination, retirement, death, or unforeseeable emergency.

Section 1448 of the Small Business Job Protection Act of 1996 added Subsection (g) to Section 457 of the Internal Revenue Service Code to provide that all assets and income under a Section 457(b) plan that are maintained by a state or local government employer must be held in trust for the exclusive benefit of plan participants and their beneficiaries. In September, 2013, the GLC transferred custodianship of the plan's assets from Nationwide Retirement Services to Great-West Financial. As of June 30, 2014 and 2013, the fair value of the plan's assets was \$3,554,000 and \$2,896,000, respectively. Contributions by participants during the years ended June 30, 2014 and 2013 were \$196,000 and \$200,000, respectively.

Compensated Absences— At June 30, 2014 and 2013, the balance for compensated absences was \$3,143,000 and \$3,030,000, respectively. The year-end balances are comprised of earned and unused vacation and sick leave hours. At separation, employees are compensated for all earned vacation and any remaining sick leave hours accrued prior to March 1, 2005. Increases to the compensated absences balance represent vacation and sick leave hours earned by employees and decreases represent their usage of leave.

During the year ended June 30, 2014, employees earned and used leave totaling \$1,427,000 and \$1,314,000 respectively. During the year ended June 30, 2013, employees earned and used leave totaling \$1,336,000 and \$1,145,000, respectively. The current portion of the compensated absence liability, expected to be due within one year of the statement date, June 30, 2014, is estimated using historical trends. At June 30, 2014 and 2013, the estimated current portion of the compensated absences liability was \$148,000 and \$255,000, respectively.

9. CONTINGENCIES

The GLC is subject to litigation in the ordinary course of its business. In the opinion of management and legal counsel, the outcome of such litigation will not have a material impact on the financial position or cash flows of the GLC.

10. RISK MANAGEMENT

The GLC is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; and injuries to employees. The GLC obtains umbrella insurance coverage for property, liability, vehicle fleet, workers' compensation, and unemployment compensation through the State of Georgia's Department of Administrative Services ("DOAS"). The GLC purchased additional commercial insurance for certain company-owned vehicles. DOAS, as a component of the State of Georgia, utilizes self-insurance programs established by individual agreement, statute or administrative action to provide property insurance covering fire and extended coverage and automobile insurance and to pay losses that might occur from such causes; liability insurance for employees against personal liability for damages arising out of performance of their duties; survivors' benefits for eligible members of the Employees' Retirement System; consolidating processing of unemployment compensation claims against state agencies and the payment of sums due to the Department of Labor; and workers' compensation statutes of the State of Georgia. These self-insurance funds are accounted for as internal service funds of the State of Georgia where assets are set aside for claim settlements. The majority of the risk management programs are funded by assessments charged to participating organizations. A limited amount of commercial insurance is purchased by the self-insurance funds applicable to property, employee and automobile liability, fidelity, and certain other risks to limit the exposure to catastrophic losses. Otherwise, the risk management programs service all claims against the state for injuries and property damage.

Financial information relative to self-insurance funds is presented in the financial reports of the Department of Administrative Services and the Employees' Retirement System for the years ended June 30, 2014 and 2013.

Annually, the GLC negotiates and currently contracts with CIGNA for its employee health insurance coverage and Guardian Life for dental and vision coverage. Unum is the provider for short-term disability, long-term disability, and term life insurance coverage. The GLC's health, dental, and vision insurance plans are funded by contributions from plan participants and by GLC employer contributions.

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