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SOUTH CAROLINA EDUCATION LOTTERY

REPORT ON FINANCIAL STATEMENTS

**FOR THE YEARS ENDED
JUNE 30, 2004 AND 2003**

State of South Carolina



Office of the State Auditor

1401 MAIN STREET, SUITE 1200
COLUMBIA, S.C. 29201

THOMAS L. WAGNER, JR., CPA
STATE AUDITOR

(803) 253-4160
FAX (803) 343-0723

September 28, 2004

The Honorable Mark Sanford, Governor
and
Members of the South Carolina Education Lottery Commission
Columbia, South Carolina

This report on the audit of the financial statements of the South Carolina Education Lottery for the fiscal year ended June 30, 2004, was issued by Elliott Davis, LLC, Certified Public Accountants, under contract with the South Carolina Office of the State Auditor.

If you have any questions regarding this report, please let us know.

Respectfully submitted,

A handwritten signature in cursive script that reads "Tom Wagner".

Thomas L. Wagner, Jr., CPA
State Auditor

TLWjr/cwc

SOUTH CAROLINA EDUCATION LOTTERY

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

The Commission
South Carolina Education Lottery
Columbia, South Carolina

We have audited the accompanying statements of net assets of the ***South Carolina Education Lottery*** (the SCEL), a component unit of the State of South Carolina, as of June 30, 2004 and 2003 and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the management of the SCEL. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the ***South Carolina Education Lottery*** as of June 30, 2004 and 2003, and the changes in financial position and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 10, 2004 on our consideration of the SCEL's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The Management's Discussion and Analysis is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the financial statements of the SCEL. The schedule of business-type activities for the state-wide CAFR is supplementary information required by the South Carolina Office of the Comptroller General. It has been subjected to the auditing procedures applied in the audit of the basic financial statements, and in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

Elliott Davis LLC

Elliott Davis, LLC
August 10, 2004

***SOUTH CAROLINA EDUCATION LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS***

Management of the Lottery provides this *Management's Discussion and Analysis* of their financial performance for the readers of the Lottery's financial statements. This narrative provides an overview of the Lottery's financial activity for the fiscal year ended June 30, 2004. This analysis is to be considered in conjunction with the financial statements to provide an objective analysis of the Lottery's financial activities based on facts, decisions, and conditions currently facing management.

Understanding the Lottery's Financial Statements

The Lottery, an instrumentality of the State of South Carolina, is accounted for as an enterprise fund that reports all assets and liabilities using the accrual basis of accounting, much like a private business entity. In accordance with accounting principles generally accepted in the United States of America, this report consists of a series of financial statements, along with explanatory notes to the financial statements. The financial statements immediately follow this discussion and analysis by management and are designed to highlight the Lottery's net assets and changes to those assets resulting from Lottery operations.

The most important relationship demonstrated within the Lottery's financial statements is the requirement that the Lottery transfer all net proceeds to the State Treasurer for the Education Lottery Account. Accordingly, the primary focus of these financial statements is determining net proceeds available for transfer to the Education Lottery Account, rather than the change in net assets of the Lottery.

Financial Highlights

The Lottery's net assets increased by \$3.4 million primarily as a result of a lump-sum payment made on the debt. Revenues from lottery games increased by \$225.7 million. We returned \$552.3 to winners of lottery games and \$67 million was paid to retailers for commissions and incentives. Other game related expenses were \$20.4 million and operating expenses were \$23.6 million. Transfers to the Education Lottery Account were \$287 million.

Assets and Liabilities (in millions) (See Notes to Financial Statements 4 and 6)

	<u>2004</u>	<u>2003</u>
Capital Assets	\$ 12.2	\$ 15.2
Other Assets	72.6	51.3
Current Liabilities	72.7	56.7
Long-term Liabilities	2.9	3.5
Net Assets		
Capital Assets Net of Related Debt	8.8	5.4
Restricted Assets	0.4	0.4

The debt is related to the original purchase of the retailer terminals. The on-line vendor agreed to a deferred payment plan. A balloon payment of \$5.27 million was made in March, 2004.

Lottery Operations

	<u>2004</u>	<u>2003</u>
Gaming Revenues	\$ 950.0	\$ 724.3
Other Revenues	3.4	2.8
Prizes Expense	552.3	415.7
Retailer Commissions and Incentives	67.0	51.1
Other Direct Game Costs	20.4	19.3
Other Operating Expenses	23.6	21.7

All proceeds of the Lottery must be transferred to the State Treasurer for the Education Lottery Account with the following exceptions: 1) the cost of property and equipment net of depreciation and related debt, and 2) the Restricted Fidelity Fund, derived from the licensing fees of new retailers, which may be retained by the Lottery up to \$500,000 and used to cover losses the commission may experience due to nonfeasance, misfeasance, or malfeasance of a lottery retailer. Therefore, the net assets of the Lottery will never exceed \$500,000 related to the Restricted Fidelity Fund plus the cost of property and equipment, net of depreciation and related debt. As of July 14, 2004 the Lottery had transferred \$270.5 million related to operations and \$16.5 million in unclaimed prize funds to the State Treasurer for the Education Lottery Account for the fiscal year ended June 30, 2004. Total transfers to the Education Lottery Account are \$588 million from inception to June 30, 2004.

Potential Factors Impacting Future Operations

Management expanded the Carolina 5 game to have three evening draws per week rather than two. For FY05, management is considering a six number game and an instant game that would pay out as an annuity in the fourth quarter of FY05.

Contacting the Lottery's Financial Management

This financial report is designed to provide a general overview of the Lottery's financial activity for all those interested in the Lottery's operations. Questions concerning any of the information provided in this report, or requests for additional financial information, should be addressed to the Director of Finance, South Carolina Education Lottery, Post Office Box 11949, Columbia, South Carolina 29211-1949.

**SOUTH CAROLINA EDUCATION LOTTERY
STATEMENTS OF NET ASSETS**

	JUNE 30,	
	2004	2003
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 18,265,609	\$ 13,942,944
Cash - Restricted fidelity fund	402,269	361,733
Retailer accounts receivable, net of allowance for doubtful accounts of \$166,000 and \$-0- for 2004 and 2003, respectively	23,389,638	32,146,558
Accounts receivable - Multi-State Lottery	23,277,101	-
Inventory	2,005,888	2,282,333
Prepaid expenses and other current assets	93,761	264,777
Total current assets	67,434,266	48,998,345
CAPITAL ASSETS, net	12,236,025	15,171,651
DEPOSIT WITH MULTI-STATE LOTTERY	5,127,408	2,290,309
Total assets	84,797,699	66,460,305
LIABILITIES		
CURRENT LIABILITIES		
Due to Education Lottery Account	18,083,373	17,818,473
Prizes payable	24,220,162	23,610,910
Prizes payable - Multi-State Lottery	23,277,101	-
Accounts payable	3,957,426	5,963,787
Accrued liabilities	1,004,726	880,906
Accrued compensated absences	117,385	270,000
Current portion of long-term debt	1,232,559	6,275,056
Deferred revenue	766,454	1,869,482
Total current liabilities	72,659,186	56,688,614
LONG -TERM DEBT	2,217,220	3,449,775
ACCRUED COMPENSATED ABSENCES	732,778	513,363
Total liabilities	75,609,184	60,651,752
NET ASSETS		
Invested in capital assets, net of related debt	8,786,246	5,446,820
Restricted - fidelity funds	402,269	361,733
Total net assets	\$ 9,188,515	\$ 5,808,553

See notes to financial statements which are an integral part of these statements.

SOUTH CAROLINA EDUCATION LOTTERY
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

	For the years ended	
	June 30,	
	2004	2003
REVENUES		
Instant games	\$ 537,339,766	\$ 426,311,967
On-line games	180,480,976	144,151,438
Powerball games	232,186,929	153,849,870
Retailer permit fees	496,555	327,813
Retailer telephone fees	2,596,384	2,044,924
Other	62,037	223,518
Total revenue	<u>953,162,647</u>	<u>726,909,530</u>
DIRECT COSTS		
Commissions and incentives to retailers	<u>66,950,403</u>	<u>51,136,250</u>
Prize expense		
Instant games	359,887,245	274,301,493
On-line games	87,533,205	68,466,302
Powerball games	104,866,608	72,949,460
Total prize expense	<u>552,287,058</u>	<u>415,717,255</u>
Instant and on-line costs	<u>20,385,780</u>	<u>19,253,048</u>
Total direct costs	<u>639,623,241</u>	<u>486,106,553</u>
Gross profit	<u>313,539,406</u>	<u>240,802,977</u>
OPERATING EXPENSES		
Advertising and promotion	6,729,307	6,405,304
Security checks	176,910	117,950
Salaries, wages and benefits	8,707,090	7,871,294
Contracted and professional services	623,115	450,097
Depreciation	3,522,001	3,322,198
Rent expense	866,110	798,651
Office supplies	167,448	158,581
Bad debt expense	271,092	-
Other general and administrative	1,967,306	1,797,326
Total operating expenses	<u>23,030,379</u>	<u>20,921,401</u>
Operating Income	<u>290,509,027</u>	<u>219,881,576</u>
NON-OPERATING INCOME (EXPENSE)		
Interest income	225,481	223,287
Interest expense	(602,948)	(815,892)
Total non-operating expense	<u>(377,467)</u>	<u>(592,605)</u>
Change in net assets before transfers to and due to Education Lottery Account	290,131,560	219,288,971
TRANSFERS TO AND DUE TO EDUCATION LOTTERY ACCOUNT	<u>286,751,598</u>	<u>220,056,527</u>
Change in net assets	3,379,962	(767,556)
NET ASSETS,		
BEGINNING OF YEAR	<u>5,808,553</u>	<u>6,576,109</u>
END OF YEAR	<u>\$ 9,188,515</u>	<u>\$ 5,808,553</u>

See notes to financial statements which are an integral part of these statements.

**SOUTH CAROLINA EDUCATION LOTTERY
STATEMENTS OF CASH FLOWS**

	For the years ended	
	June 30,	
	<u>2004</u>	<u>2003</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from retailers	\$ 937,539,438	\$ 716,284,432
Cash payments to prize winners	(528,400,705)	(404,389,058)
Cash payments to suppliers for goods and services	(99,569,179)	(79,469,411)
Cash payments to employees for services	(8,644,675)	(7,360,383)
Net cash provided by operating activities	<u>300,924,879</u>	<u>225,065,580</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Payments to fund deposit with Multi-State Lottery	(2,837,099)	(2,290,309)
Payments to Education Lottery Account	(286,486,698)	(213,133,348)
Net cash used for noncapital financing activities	<u>(289,323,797)</u>	<u>(215,423,657)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from dispositions of capital assets	8,612	-
Interest paid	(602,948)	(886,945)
Net paid for short-term and long-term debt	(6,275,052)	(864,108)
Net cash used for financing activities	<u>(6,869,388)</u>	<u>(1,751,053)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest received	225,481	226,039
Purchase of capital assets	(593,974)	(1,650,926)
Net cash used for investing activities	<u>(368,493)</u>	<u>(1,424,887)</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	4,363,201	6,465,983
CASH AND CASH EQUIVALENTS		
BEGINNING OF YEAR	<u>14,304,677</u>	<u>7,838,694</u>
END OF YEAR	<u>\$ 18,667,878</u>	<u>\$ 14,304,677</u>
OPERATING ACTIVITIES		
Operating income	\$ 290,509,027	\$ 219,881,576
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	3,522,001	3,322,198
Gain on dispositions of capital assets	(1,012)	-
Changes in assets and liabilities		
Retailer accounts receivable	8,756,920	(12,273,297)
Inventory	276,445	(385,855)
Prepaid expenses and other assets	171,016	(30,164)
Accounts payable and accrued liabilities	(1,815,742)	1,574,726
Prizes payable	609,252	11,328,197
Deferred revenue	(1,103,028)	1,648,199
Net cash provided by operating activities	<u>\$ 300,924,879</u>	<u>\$ 225,065,580</u>

See notes to financial statements which are an integral part of these statements.

SOUTH CAROLINA EDUCATION LOTTERY NOTES TO FINANCIAL STATEMENTS

NOTE 1 - REPORTING ENTITY

The *South Carolina Education Lottery* (the SCEL), a component unit of the State of South Carolina, was established as an instrumentality of the state with the enactment of the South Carolina Lottery for Education Act (the Act) on June 29, 2001 and began development operations upon enactment. The SCEL is responsible for the provision of lotteries on behalf of the State of South Carolina in accordance with the Act.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies of the SCEL are as follows:

Method of accounting

The SCEL 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 where the costs of providing lottery games to the general public on a continuing basis are to be financed through the sale of lottery game tickets. The Act requires that all costs of providing lottery games, including capital costs, be recovered from the sale of lottery game tickets. The SCEL is reported as a discretely presented component unit within the State of South Carolina's Comprehensive Annual Financial Report (CAFR) due to the fact that the State appoints members of the SCEL's Commission.

The Government Accounting Standards Board (GASB) is the recognized standard setting body for accounting principles generally accepted applicable to governmental proprietary activities in the United States of America. The SCEL applies all applicable GASB pronouncements and all applicable Financial Accounting Standards Board (FASB) pronouncements issued on or before November 30, 1989 when not in conflict with GASB pronouncements. In accordance with GASB Statement 20, the SCEL has elected not to implement FASB Statements 103 and after.

Basis of accounting

The financial statements are prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. Under this method, revenues are recognized when they are earned and expenses are recognized when they are incurred.

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities 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 and accounts receivable recognition

Revenue and accounts receivable for on-line games are recognized when tickets are sold to the public by contracted retailers, except for tickets sold in advance of the draw date for which deferred revenue is recorded.

(Continued)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

Revenue and accounts receivable recognition, (Continued)

Revenue and accounts receivable for instant scratch games are recognized upon activation of ticket packs for sale by the retailers. The SCEL evaluates its receivables on an ongoing basis for collectability.

Commissions

Retailers receive a commission of 7% on total sales.

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 ticket games is recorded as an estimate at the time the related revenue is recognized based on the predetermined prize structure for each game; periodically, the prize expense is adjusted to reflect amounts actually won. Prize expense for on-line games is recorded at the time the related revenue is recognized based on the known prizes.

Ticket inventories

Inventories are carried at cost (as determined by the specific identification method) and consist of scratch tickets located in the SCEL's warehouses or held by retailers. The cost of tickets is charged to operations upon the recognition of revenue under the procedures described above.

Unclaimed prizes

Prizes must be claimed within 90 days after game-end (end of sales) for instant games and within 180 days after the draw date for on-line games. Unclaimed prize money must be deposited in the Education Lottery Account each year.

Net assets

Net assets represent cumulative revenues less expenses in excess of net proceeds transferred or payable to the Education Lottery Account, as defined under the Act.

Net proceeds

Net proceeds, as defined by the Act, consist of all revenue derived from the sale of lottery game tickets or shares and all other monies derived from the lottery games, less operating expenses and prizes.

Operating expenses

Operating expenses, as defined by the Act, in the determination of net proceeds, consist of all costs of doing business including, but not limited to, prizes, commissions and other compensation paid to lottery retailers, advertising and marketing costs, rental fees, personnel costs, capital costs, depreciation of property and equipment and other operating costs.

Cash and cash equivalents

The SCEL 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 cash on deposit with the South Carolina State Treasurer.

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 by the SCEL from retailer bank accounts.

(Continued)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

Capital Assets

Capital assets, which consist of machinery, equipment, vehicles and leasehold improvements, are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of two to five 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. The SCEL capitalizes all property and equipment purchases of \$1,000 or more.

Restricted fidelity fund

In accordance with the Act, retailers contribute a fee to a fidelity fund upon acceptance as a SCEL retailer. The fund is used to cover losses the SCEL may incur due to misfeasance, nonfeasance or malfeasance of retailers. At the end of each fiscal year, any amount in the fund in excess of \$500,000 is treated as net proceeds from the SCEL and is payable to the Education Lottery Account. At June 30, 2004, no amounts were available for transfer as net proceeds. The fidelity fund is held in a separate account and appears on the balance sheet as restricted fidelity fund cash and in net assets as restricted fidelity funds.

Insurance

The SCEL is exposed to various risks of loss related to torts; theft of, damage to, and the destruction of assets; errors and omissions; injuries to employees; and natural disasters. The SCEL combines coverage provided by the South Carolina Insurance Reserve Fund with the purchase of commercial insurance to substantially cover these risks.

Compensated absences

Employees earn the right to be compensated during absences for vacation and compensatory time. Unused leave benefits are paid to employees upon separation from service. The cost of vacation and compensatory time is accrued in the period in which it is earned.

Advertising

Costs incurred for producing and communicating advertising are expensed when incurred, which generally is when the advertising first takes place.

Deposit with Multi-State Lottery (MUSL)

The SCEL is required to maintain funds in reserve with MUSL. This reserve serves as a contingent source for prize payouts should MUSL games not generate sufficient funds to pay amounts due to prize winners. MUSL is not a financial institution.

Accounts receivable/prizes payable - Multi-State Lottery

During June 2004, a MUSL prize in the amount of \$23,277,101 was won as the result of an on-line drawing. The cash prize, which is funded by MUSL and passed through to the prize winner by SCEL, had not been paid to the prize winner or received by SCEL as of June 30, 2004. Therefore, a receivable from MUSL and an offsetting prize payable has been recorded in the amount of \$23,277,101. The amounts were subsequently received and paid.

Reclassifications

Certain prior year amounts have been reclassified to conform with current year presentation.

NOTE 3 - CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of interest bearing demand deposits. The deposits are categorized to indicate the level of risk assumed by the SCEL at year end. Category A includes deposits insured or collateralized with securities held by the SCEL or its agent in the SCEL's name. Category B includes deposits that are collateralized with securities held by the pledging financial institution's trust department or agency in the SCEL's name. Category C includes uncollateralized deposits, including any bank balance that is collateralized with securities held by the pledging financial institution, or by its trust department or agent, but not in the SCEL's name.

At June 30, 2004 cash and cash equivalents were as follows:

	<u>A</u>	<u>B</u>	<u>C</u>	<u>Bank Balance</u>	<u>Fair Value</u>
Demand deposits	<u>\$ 18,816,920</u>	<u>\$ -</u>	<u>\$ -</u>	\$ 18,816,920	\$ 18,285,020
Deposits held by State Treasurer				<u>382,858</u>	<u>382,858</u>
Total cash and cash equivalents				<u>\$19,199,778</u>	<u>\$ 18,667,878</u>

At June 30, 2003 cash and cash equivalents were as follows:

	<u>A</u>	<u>B</u>	<u>C</u>	<u>Bank Balance</u>	<u>Fair Value</u>
Demand deposits	<u>\$ 15,682,390</u>	<u>\$ -</u>	<u>\$ -</u>	\$ 15,682,390	\$ 13,983,215
Deposits held by State Treasurer				<u>321,462</u>	<u>321,462</u>
Total cash and cash equivalents				<u>\$16,003,852</u>	<u>\$ 14,304,677</u>

NOTE 4 - CAPITAL ASSETS

The following is a summary of changes in capital assets and accumulated depreciation during fiscal year 2004:

	<u>Balance June 30, 2003</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance June 30, 2004</u>
Property and equipment				
Machinery and equipment	\$ 19,271,419	\$ 576,143	\$ (10,939)	\$ 19,836,623
Vehicles	68,826	-	-	68,826
Leasehold improvements	<u>623,518</u>	<u>17,831</u>	<u>-</u>	<u>641,349</u>
	<u>19,963,763</u>	<u>593,974</u>	<u>(10,939)</u>	<u>20,546,798</u>
Accumulated depreciation				
Machinery and equipment	(4,623,983)	(3,370,988)	3,340	(7,991,631)
Vehicles	(26,012)	(22,942)	-	(48,954)
Leasehold Improvements	<u>(142,117)</u>	<u>(128,071)</u>	<u>-</u>	<u>(270,188)</u>
	<u>(4,792,112)</u>	<u>(3,522,001)</u>	<u>3,340</u>	<u>(8,310,773)</u>
Total property and equipment, net	<u>\$ 15,171,651</u>	<u>\$ (2,928,027)</u>	<u>\$ (7,599)</u>	<u>\$ 12,236,025</u>

(Continued)

NOTE 4 - CAPITAL ASSETS, Continued

The following is a summary of changes in capital assets and accumulated depreciation during fiscal year 2003:

	<u>Balance</u> <u>June 30, 2002</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u> <u>June 30, 2003</u>
Property and equipment				
Machinery and equipment	\$ 17,685,875	\$ 1,585,544	\$ -	\$ 19,271,419
Vehicles	47,826	21,000	-	68,826
Leasehold improvements	579,136	44,382	-	623,518
	<u>18,312,837</u>	<u>1,650,926</u>	<u>-</u>	<u>19,963,763</u>
Accumulated depreciation				
Machinery and equipment	(1,445,559)	(3,178,424)	-	(4,623,983)
Vehicles	(6,570)	(19,442)	-	(26,012)
Leasehold Improvements	(17,785)	(124,332)	-	(142,117)
	<u>(1,469,914)</u>	<u>(3,322,198)</u>	<u>-</u>	<u>(4,792,112)</u>
Total property and equipment, net	<u>\$ 16,842,923</u>	<u>\$ (1,671,272)</u>	<u>\$ -</u>	<u>\$ 15,171,651</u>

NOTE 5 - ACCRUED EXPENSES

Accrued liabilities at June 30, 2004 consists of the following:

Accrued payroll and related expenses	\$ 942,926
Other	61,800
	<u>\$ 1,004,726</u>

Accrued liabilities at June 30, 2003 consists of the following:

Accrued payroll and related expenses	\$ 722,712
Other	158,194
	<u>\$ 880,906</u>

NOTE 6 - LONG -TERM DEBT AND COMMITMENTS

In October 2001, the SCEL entered into a six year contract with a vendor, to provide amongst other things, services and equipment to operate their on-line lottery. The contract required an initial payment of \$5,287,938, which has been paid. The contract also calls for monthly administrative fees of \$450,000 for the life of the contract. Additional payments, which have been imputed for the purchase of equipment of \$140,000 and \$122,000 per month, will be made for months three through twenty-six and twenty-seven through sixty-two of the contract, respectively. These additional payments have been imputed to include principal and interest at 8%. A lump sum payment of \$5,270,000 was due and paid in March 2004. Title to and risk of loss for this equipment occurred upon installation and acceptance in March 2002.

(Continued)

NOTE 6 - LONG-TERM DEBT AND COMMITMENTS, Continued

At June 30, 2004, the future maturities of the imputed principal and interest payments on the equipment are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Payment</u>
2005	\$ 1,232,559	\$ 231,438	\$ 1,463,997
2006	1,334,864	129,136	1,464,000
2007	<u>882,356</u>	<u>25,088</u>	<u>907,444</u>
	<u>\$ 3,449,779</u>	<u>\$ 385,662</u>	<u>\$ 3,835,441</u>

The following is a summary of changes in long-term debt during fiscal year 2004:

	<u>Balance June 30, 2003</u>	<u>Proceeds</u>	<u>Payments</u>	<u>Balance June 30, 2004</u>
Long-term debt	<u>\$ 9,724,831</u>	<u>\$ -</u>	<u>\$ 6,275,052</u>	<u>\$ 3,449,779</u>

The following is a summary of changes in long-term debt during fiscal year 2003:

	<u>Balance June 30, 2002</u>	<u>Proceeds</u>	<u>Payments</u>	<u>Balance June 30, 2003</u>
Long-term debt	<u>\$ 10,588,939</u>	<u>\$ -</u>	<u>\$ 864,108</u>	<u>\$ 9,724,831</u>

NOTE 7 - ACCRUED COMPENSATED ABSENCES

The following is a summary of changes in accrued compensated absences during fiscal year 2004:

	<u>Balance June 30, 2003</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance June 30, 2004</u>
Accrued compensated absences	<u>\$ 783,363</u>	<u>\$ 474,192</u>	<u>\$ 407,392</u>	<u>\$ 850,163</u>

The following is a summary of changes in accrued compensated absences during fiscal year 2003:

	<u>Balance June 30, 2002</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance June 30, 2003</u>
Accrued compensated absences	<u>\$ 333,940</u>	<u>\$ 829,710</u>	<u>\$ 380,287</u>	<u>\$ 783,363</u>

NOTE 8 - OPERATING LEASES

The SCEL 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 SCEL.

Future minimum rental payments, to entities outside the State of South Carolina reporting entity, on noncancellable leases with original terms of one year or more are scheduled as follows for the year ending June 30:

	<u>Operating leases</u>
2005	\$ 717,418
2006	339,548
2007	65,770
2008	4,042

Rental expenses under all operating leases including those on month-to-month terms totaled approximately \$866,000 and \$799,000 for the year ended June 30, 2004 and 2003, respectively. This includes \$84,669 and 76,577 of vehicle rental expense to the State of South Carolina Fleet management.

NOTE 9 - DUE TO EDUCATION LOTTERY ACCOUNT

In accordance with the Act, all net proceeds of the SCEL are to be transferred to the Education Lottery Account within the South Carolina State Treasury. In accordance with the Act, net proceeds consist of all revenue derived from the sale of lottery game tickets or shares and all other monies derived from the lottery games less operating expenses and prizes. The following payables resulted from transfers due to the Education Lottery Account at June 30:

	<u>2004</u>	<u>2003</u>
Amount payable to the Education Lottery Account, beginning of year	\$ 17,818,473	\$ 10,895,294
Change in net assets subject to transfer	<u>290,131,560</u>	<u>219,288,971</u>
	<u>307,950,033</u>	<u>230,184,265</u>
Change in capital assets, net of related debt		
Property and equipment, net	2,935,626	1,671,272
Long-term debt	<u>(6,275,052)</u>	<u>(864,108)</u>
	<u>(3,339,426)</u>	<u>807,164</u>
Amount collected for fidelity fund	<u>(40,536)</u>	<u>(39,608)</u>
Amount paid during the year	<u>(286,486,698)</u>	<u>(213,133,348)</u>
Amount payable to the Education Lottery Account, end of year	<u>\$ 18,083,373</u>	<u>\$ 17,818,473</u>

Transfers related to the above payable were made to the Education Lottery Account in July 2004.

NOTE 10 - EMPLOYEE RETIREMENT SYSTEMS

The SCEL contributes to the South Carolina Retirement System (SCRS) cost sharing multiple-employer defined benefit plan administered by the Retirement Division of the State Budget and Control Board.

As established by Title 9-1-480 Code Laws of South Carolina, 1976 (as amended), all eligible persons, except those specifically excluded, shall become members of the retirement system as a condition of their employment. The responsibility of the administration of the system is assigned by law to the State Budget & Control Board.

SCRS offers retirement and disability benefits, cost of living adjustments on an ad-hoc basis, life insurance benefits and survivor benefits. The Plan's provisions are established under Title 9 of the SC Code of Laws.

The following is a recap of the mandated contribution rates for the current fiscal year.

	<u>SCRS</u>
Employee contributions	6% of salary
Employer contributions	7.55% of salary

For the years ending June 30, 2004, 2003 and 2002 the SCEL contributions to SCRS were \$699,039; \$605,768 and \$359,533, respectively.

All employer contributions were equal to the required contribution rates for the year. Contributions as a percentage of statewide contributions were not available for June 30, 2004.

A comprehensive annual financial report containing financial statements and required supplementary information for the South Carolina Retirement System is issued and publicly available by writing the South Carolina Retirement System, Post Office Box 11960, Columbia, South Carolina 29211-1960.

NOTE 11 - CONTINGENCIES

The SCEL 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 SCEL for the year ending June 30, 2004.

***SOUTH CAROLINA EDUCATION LOTTERY
SUPPLEMENTARY SCHEDULE OF BUSINESS-TYPE
ACTIVITIES FOR THE STATEWIDE CAFR***

	For the years ended	
	June 30,	
	<u>2004</u>	<u>2003</u>
Charges for services	\$ 953,162,647	\$ 726,909,530
Operating grants and contributions	225,481	223,287
Less expenses	<u>663,256,568</u>	<u>507,843,846</u>
Net program revenue	290,131,560	219,288,971
Transfers out to state agencies/funds	<u>(286,751,598)</u>	<u>(220,056,527)</u>
Change in net assets	3,379,962	(767,556)
NET ASSETS - BEGINNING	<u>5,808,553</u>	<u>6,576,109</u>
NET ASSETS - ENDING	<u>\$ 9,188,515</u>	<u>\$ 5,808,553</u>



**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE AND ON INTERNAL CONTROL
OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS
PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

To the Commission
of the *South Carolina Education Lottery*

We have audited the financial statements of the *South Carolina Education Lottery* (the SCEL), a component unit of the State of South Carolina, as of and for the years ended June 30, 2004 and 2003. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

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

Internal Control Over Financial Reporting

In planning and performing our audits, we considered the SCEL's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the audit committee, management of the SCEL and the State Auditor of Public Accounts of South Carolina and is not intended to be and should not be used by anyone other than these specified parties.

Elliott Davis LLC

August 10, 2004

***SOUTH CAROLINA EDUCATION LOTTERY
SCHEDULE OF FINDINGS
For the year ended June 30, 2004***

SCHEDULE OF AUDITOR'S RESULTS

We have issued an unqualified opinion, dated August 10, 2004 on the financial statements of the South Carolina Education Lottery as of and for the year ended June 30, 2004.

Our audit disclosed no instances of noncompliance which are material to the South Carolina Education Lottery's financial statements.

Our audit disclosed no reportable conditions or material weaknesses relating to the audit of the financial statements.

FINDINGS RELATING TO THE FINANCIAL STATEMENTS

Our audit disclosed no findings which are required to be reported in accordance with *Government Auditing Standards*.