

DISTRICT OF COLUMBIA LOTTERY AND CHARITABLE GAMES CONTROL BOARD

FINANCIAL STATEMENTS AND MANAGEMENT'S DISCUSSION AND ANALYSIS

**(WITH INDEPENDENT AUDITOR'S
REPORT THEREON)**

YEARS ENDED SEPTEMBER 30, 2006 AND 2005

TCBA

THOMPSON, COBB, BAZILIO & ASSOCIATES, PC

Main Office

1101 15th Street, NW
Suite 400
Washington, DC 20005
PH 202.737.3300
FX 202.737.2684

West Coast Office

21250 Hawthorne Blvd.
Suite 500
Torrance, CA 90503
PH 310.792.7001
FX 310.792.7004

Other Office Locations: Bowie, MD ▪ Atlanta, GA ▪ Hartford, CT ▪ Philadelphia, PA

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

Table of Contents

	Page
Independent Auditor's Report	1
Management's Discussion and Analysis	3
Basic Financial Statements	
Statements of Net Assets	14
Statements of Revenues, Expenses, and Change in Net Assets	15
Statements of Cash Flows	16
Notes to Financial Statements	17
Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	27

THOMPSON, COBB, BAZILIO & ASSOCIATES, PC
Certified Public Accountants and Management, Systems, and Financial Consultants

■ Main Office:

1101 15th Street, N.W.
Suite 400
Washington, DC 20005
(202) 737-3300
(202) 737-2684 Fax

□ Regional Office:

100 Pearl Street
14th Floor
Hartford, CT 06103
(860) 249-7246
(860) 275-6504 Fax

□ Regional Office:

21250 Hawthorne Boulevard
Suite 500
Torrance, CA 90503
(310) 792-7001
(310) 792-7004 Fax

Independent Auditor's Report

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

We have audited the accompanying financial statements of the District of Columbia Lottery and Charitable Games Control Board, an enterprise fund of the Government of the District of Columbia, as of and for the years ended September 30, 2006 and 2005, as listed in the Table of Contents. These financial statements are the responsibility of the District of Columbia Lottery and Charitable Games Control Board management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

As discussed in note 2, the financial statements only present the District of Columbia Lottery and Charitable Games Control Board and do not purport to, and do not, present fairly the financial position of the Government of the District of Columbia as of September 30, 2006 and 2005, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the District of Columbia Lottery and Charitable Games Control Board, as of September 30, 2006 and 2005, 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 a report dated January 19, 2007 on our consideration of District of Columbia Lottery and Charitable Games Control Board's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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 supplementary information. However, we did not audit the information and express no opinion on it.

Washington, DC
January 19, 2007

Thompson, Cobb, Bazilio & Associates, PC

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

Management's Discussion and Analysis

September 30, 2006 and 2005

(Dollar amounts in thousands)

The discussion and analysis of the D.C. Lottery and Charitable Games Control Board's (the Lottery) financial performance provides an overview of its financial activities for the fiscal year ended September 30, 2006. This discussion and analysis should be read in conjunction with the attached financial statements.

Background and Other Significant Information

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

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

Financial Highlights

- Gross revenue from lottery gaming activities increased by \$31,460 or 13.39% from prior year amounts;
- The Lottery generated record ticket sales of \$266,203 for an aggregate increase of \$32,772 or 14.04% over prior year totals;
- Total operating expenses increased \$29,841 or 18.19% as a result of overall increase in ticket sales and record payout in prizes for the D.C. Four game of 58.86%;
- Transfers to the District's General Fund increased \$2,350 equivalent to 3.29% of the prior year's total.

To effectively understand the Lottery's operations and to assess its financial activities, the reader must pay attention to individual game sales, related prize expenses and payout percentages, and the resulting impact on change in net assets or amounts transferred to the District. Prize payouts and Powerball sales have the most dramatic effect on transfer levels but are beyond the control of management.

Using This Financial Report

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

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

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

Management's Discussion and Analysis

September 30, 2006 and 2005

(Dollar amounts in thousands)

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

The Statements of Revenues, Expenses and Change in Net Assets present the revenues earned and the expenses incurred during each year. Activities are reported as either operating or non-operating.

Another important factor to consider when evaluating financial viability is the Lottery's ability to meet financial obligations as they come due. The Statements of Cash Flows present information related to cash inflows and outflows summarized by operating, capital and noncapital financing and investing activities.

Financial Analysis

The Lottery's net assets increased by \$59 and \$66 for the years ended September 30, 2006 and 2005, respectively. The following is a summary of the Lottery's financial information as of and for the years ended September 30, 2006, 2005, and 2004.

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

	September 30		
	2006	2005	2004
Assets:			
Current and other assets	\$ 16,513	\$ 13,397	\$ 14,562
Capital assets, net of accumulated depreciation	382	771	1,030
Restricted investments	52,584	59,449	66,481
Total assets	69,479	73,617	82,073
Liabilities:			
Accounts payable and accrued expenses	3,215	2,663	3,852
Deferred revenues	184	450	306
Accrued prizes and commissions	9,795	7,413	7,858
Obligations for unpaid prizes	52,584	59,449	66,481
Total liabilities	65,778	69,975	78,497
Net assets:			
Invested in capital assets	382	771	1,030
Unrestricted	3,319	2,871	2,546
Total net assets	\$ 3,701	\$ 3,642	\$ 3,576

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

Management's Discussion and Analysis

September 30, 2006 and 2005

(Dollar amounts in thousands)

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

	Years Ended September 30		
	2006	2005	2004
Operating revenues:			
Gaming revenues	\$ 266,391	\$ 234,931	\$ 241,133
Operating expenses:			
Prizes	146,687	120,525	122,318
Other	47,220	43,541	45,620
Total operating expenses	193,907	164,066	167,938
Operating income	72,484	70,865	73,195
Non-operating revenues – interest and dividends	1,375	651	319
Income before transfers	73,859	71,516	73,514
Transfers to the District's General Fund	(73,800)	(71,450)	(73,500)
Change in net assets	\$ 59	\$ 66	\$ 14

Unrestricted net assets were \$3,319, \$2,871 and \$2,546 at September 30, 2006, 2005 and 2004, respectively, which represented increases of \$448, \$325, and \$338 respectively. Current assets increased by \$3,116 in 2006 and decreased \$1,165 in 2005. Total liabilities decreased \$4,197 or 6.00% for the year ended September 30, 2006 and \$8,522 or 10.86% for the year ended September 30, 2005 primarily due to the decrease in the Lottery's obligations for unpaid prizes.

The Multi-State Lottery Association (MUSL) purchases U.S. government securities in the name of the Lottery for Lotto America and Powerball jackpot winners from the District of Columbia. Jackpot winners have the option of accepting the cash value of the jackpot amount or annuity payments for 25 years. The restricted investments balance of \$52,584, \$59,449 and \$66,481 in 2006, 2005 and 2004, respectively, represents the net present value of securities totaling \$62,875, \$71,507, and \$80,137 in 2006, 2005 and 2004, respectively, to fund future annuity installment payments. The restricted investment value decreased by \$6,865 and \$7,032 during 2006 and 2005, respectively, due to payments of \$8,631 and net unrealized losses of \$580 and \$2,088 in 2006 and 2005, respectively, and the accretion of investments totaling \$2,346 and \$3,687 in 2006 and 2005, respectively. Corresponding amounts are recorded as obligations for unpaid prizes.

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

Management's Discussion and Analysis

September 30, 2006 and 2005

(Dollar amounts in thousands)

Table 3: Gaming revenues, Prizes, Commissions and Transfers

2006												
	Lucky Numbers	D.C. Four	Powerball	Quick Cash	Hot Five	Keno	Hot Lotto	Daily 6	D.C. Rolling Cash 5	Instant Games	Others	Total
Gaming revenues	\$ 70,310	\$ 80,014	\$ 51,770	\$ --	\$ 554	\$ 13,165	\$ 2,432	\$ 4,738	\$ 3,435	\$ 39,785	\$ 188	\$ 266,391
Prizes	(34,203)	(47,099)	(24,977)	86	(209)	(7,975)	(1,158)	(2,616)	(2,056)	(26,480)	--	(146,687)
Agent's commissions	(4,541)	(4,643)	(2,828)	3	(33)	(875)	(152)	(293)	(211)	(2,961)	--	(16,534)
Gross margin	\$ 31,566	\$ 28,272	\$ 23,965	\$ 89	\$ 312	\$ 4,315	\$ 1,122	\$ 1,829	\$ 1,168	\$ 10,344	\$ 188	\$ 103,170
Transfers	\$ 25,250	\$ 20,000	\$ 18,310	\$ 85	\$ 235	\$ 3,120	\$ 815	\$ 1,265	\$ 300	\$ 4,420	\$ --	\$ 73,800
2005												
	Lucky Numbers	D.C. Four	Powerball	Quick Cash	Hot Five	Extra Games	Keno	Hot Lotto	Daily 6	Instant Games	Others	Total
Gaming revenues	\$ 68,601	\$ 74,138	\$ 31,537	\$ 3,931	\$ 4,535	\$ --	\$ 11,865	\$ 2,200	\$ 514	\$ 36,110	\$ 1,500	\$ 234,931
Prizes	(32,525)	(35,025)	(14,682)	(3,945)	(2,297)	3	(7,228)	(1,091)	(672)	(23,063)	--	(120,525)
Agent's commissions	(4,406)	(4,204)	(1,702)	(234)	(279)	--	(793)	(124)	(36)	(2,666)	--	(14,444)
Gross margin	\$ 31,670	\$ 34,909	\$ 15,153	\$ (248)	\$ 1,959	\$ 3	\$ 3,844	\$ 985	\$ (194)	\$ 10,381	\$ 1,500	\$ 99,962
Transfers	\$ 25,750	\$ 26,825	\$ 10,695	\$ (640)	\$ 1,320	\$ --	\$ 2,660	\$ 620	\$ (630)	\$ 4,850	\$ --	\$ 71,450
2004												
	Lucky Numbers	D.C. Four	Powerball	Quick Cash	Hot Five	Extra Games	Keno	Hot Lotto	Instant Games	Others	Total	
Gaming revenues	\$ 69,512	\$ 71,587	\$ 40,871	\$ 4,161	\$ 4,345	\$ 143	\$ 9,711	\$ 1,356	\$ 38,940	\$ 506	\$ 241,132	
Prizes	(32,955)	(33,190)	(19,142)	(2,715)	(2,008)	(77)	(5,892)	(682)	(25,657)	--	(122,318)	
Agent's commissions	(4,545)	(4,115)	(2,235)	(232)	(274)	(9)	(656)	(73)	(2,869)	--	(15,008)	
Gross margin	\$ 32,012	\$ 34,282	\$ 19,494	\$ 1,214	\$ 2,063	\$ 57	\$ 3,163	\$ 601	\$ 10,414	\$ 506	\$ 103,806	
Transfers	\$ 24,175	\$ 26,275	\$ 14,150	\$ 720	\$ 1,620	\$ 23	\$ 1,950	\$ --	\$ 4,587	\$ --	\$ 73,500	

Table 3 provides a comparison of sales, prizes, agent commissions, gross margin, and transfers to the District's General Fund generated by each lottery product offered. Overall gaming revenues totaled \$266,391, \$234,931 and \$241,132 in fiscal years 2006, 2005 and 2004, respectively. Prize expenses increased by \$26,162 or 21.71% in 2006 and decreased by \$1,793 in 2005. Total prize payouts as a percentage of gaming revenue increased to 55.10% in 2006 in comparison to 51.30% in 2005. Agents/retailers commissions increased by \$2,090 in 2006 and decreased by \$564 in 2005, due to the related increases and decreases in ticket sales and prize payouts.

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

Management's Discussion and Analysis

September 30, 2006 and 2005

(Dollar amounts in thousands)

Lucky Numbers

Lucky Numbers is a daily three-digit game in which players may wager 50 cents or one dollar with nine ways to win prizes ranging from 25 to 500 dollars. Sales totaled \$70,310 in 2006 representing a \$1,709 or 2.49% increase over the prior year's sales level of \$68,601. The Lottery Board strategically implemented marketing campaigns during the fiscal year to help stabilize and to enhance sales for the game.

Prizes increased to \$34,203 in 2006, an increase of \$1,678 or 5.16% from the \$32,525 expensed in 2005. Agents/retailers commission expense increased by \$135 due to the related increase in ticket sales and prize payouts in 2006. Net proceeds to the District's General Fund totaled \$25,250 in fiscal year 2006, a \$500 decrease from the \$25,750 generated in 2005. The decrease in transfer amount can essentially be attributed to the net decrease in investment and miscellaneous income from the prior year's total. The Lucky Numbers game accounted for 26.39% of total gaming revenue and 30.60% of the overall gross margin reflecting a slight decline in percentages contribution from the prior year due to increased sales in other games.

In 2005, sales totaled \$68,601 for a \$911 or 1.31% decrease over the prior year's sales level of \$69,512. The decrease represented a continuance of the game's declining sales trend for several years.

Prizes decreased to \$32,525 in 2005, representing a decrease of \$430 or 1.30% from the \$32,955 expensed in 2004. Agents/retailers commissions decreased \$138 due to reduced ticket sales and prize payouts in 2005. Net proceeds to the District's General Fund totaled \$25,750, a \$1,475 increase from the \$24,175 generated in 2004. The increase in transfer amount can be primarily attributed to the decrease in prize payouts and commissions and the recording of over \$1.0 million in net miscellaneous income to the game in 2005. The Lucky Numbers game accounted for 29.20% of total gaming revenue and 31.68% of the overall gross margin.

DC Four

DC Four is a daily four-digit game with a fixed payout. Players may wager 50 cents or one dollar for a chance to win eleven different ways. Ticket sales totaled \$80,014 in 2006 representing a \$5,876 or 7.93% increase over the \$74,138 generated in 2005.

Prizes totaled \$47,099 in 2006, representing an increase of \$12,074 or 34.47% over the \$35,025 in prizes reported in 2005. The prize payout percentage for the game reached a record 58.86% of tickets sold compared to 47.24% in 2005. Operating costs increased by \$631 over the prior year's total primarily due to increases in agent/retailer commissions and gaming contractual fees offset by a net decline in other expenses. The increase in sales and related prize expense contributed to a \$6,637 or 19.01% decrease in gross margin when compared to the prior year. Net proceeds to the District's General Fund totaled \$20,000, a decrease of \$6,825 or 25.44% from the \$26,825 transferred in 2005. The DC Four game accounted for 30.04% of total gaming revenue and 27.40% of the overall gross margin. Declines in the percentage of gaming revenue and contribution to gross margin from prior year amounts can be directly attributed to increased sales in other games and higher prize payouts.

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

Management's Discussion and Analysis

September 30, 2006 and 2005

(Dollar amounts in thousands)

In 2005 sales totaled \$74,138 for a \$2,551 or 3.56% increase over the \$71,587 recorded in 2004. Prizes totaled \$35,025 in 2005, an increase of \$1,835 or 5.53% over the \$33,190 reported the prior year. Other operating costs increased \$259 over 2004 amounts primarily due to increased agents/retailer commissions, contractual and other miscellaneous expenses. Increased sales offset by the increase in related prizes resulted in a \$627 increase to the gross margin when compared to the prior year. Net proceeds to the District's General Fund totaled \$26,825, an increase of \$550 or 2.09% over the \$26,275 transferred in 2004. The game's activities accounted for 31.56% of total gaming revenue and 34.92% of the overall gross margin in 2004.

Powerball

The Powerball game is a five out of fifty-three plus one out of forty-two online lottery game that pays a grand prize on an annuitized pari-mutuel basis and all other prizes on a fixed basis. The Powerball game is sponsored by the Multi-State Lottery Association (MUSL), a conglomerate of thirty states and the District of Columbia, which combines resources and sales to offer larger jackpots. Party lotteries pool their sales and other resources, but otherwise account for operations separately. The prize structure matrix for the game was changed effective August 28, 2005 to increase the chances for second tier winners to receive greater sums once the jackpot reaches a maximum level.

Powerball sales of \$51,770 in 2006 and represented a \$20,233 or 64.16% increase over the \$31,537 generated in 2005. The Powerball game is jackpot driven and high jackpots impact sales levels. The increase in sales can be attributed to five jackpots surpassing the \$200 million mark in 2006 compared to only two jackpots eclipsing the \$200 million mark in 2005.

Prizes amounted to \$24,977 for the year representing an increase of \$10,295 or 70.12% in relation to the \$14,682 expensed in 2005. Powerball prizes are expensed at the rate of 50.0% of sales intake offset by lapsed prizes. Accordingly, the increase in prize expense is in proportion to increased ticket sales. Other expenses, less prizes and agents/retailer commissions, increased \$1,204 primarily the result of higher advertising costs, gaming fees, and administrative cost allocations in 2006. Increased ticket sales offset by additional expenses over 2005 totals account for the \$7,615 or 71.20% increase in transfers to the District's General Fund to \$18,310 from the \$10,695 transferred in 2005.

Powerball sales of \$31,537 in 2005 represented a \$9,334 or 22.84% decline from the \$40,871 generated in 2004. The decrease in sales can be attributed to only two jackpots surpassing the \$200 million mark in 2005 compared to four jackpots in the \$100 to \$222 million range in 2004.

Prizes amounted to \$14,682 in 2005 and represented a \$4,460 or 23.30% reduction in proportion to ticket sales when compared to the \$19,142 expensed in 2004. Other expenses, excluding prizes and agents/retailer commissions, decreased \$925 as a result of lower advertising costs, gaming fees, and administrative costs allocations in 2005. The decline in sales partially offset by the related decrease in overall expenses account for the \$3,455 or 24.42% reduction in transfer to the General Fund from \$14,150 in 2004 to \$10,695 in 2005.

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

Management's Discussion and Analysis

September 30, 2006 and 2005

(Dollar amounts in thousands)

Quick Cash

The Quick Cash game is a six out of thirty-nine numbers daily online lotto type game that pays fixed prize payouts ranging from 10 dollars to 250,000 dollars. Players receive three boards (set of six numbers) for one dollar. Quick Cash ticket sales were discontinued effective August 27, 2005. The game's activity consisted solely of recorded lapsed prizes and reduced agents/retailer commissions totaling \$89 and resulting transfer to the District's General Fund of \$85 in 2006.

Prizes in 2005 amounted to \$3,945 representing a \$1,230 or 45.30% increase over prize payments of \$2,715 in 2004. The increase was resulted from the payout of twelve top prizes of \$250, with the abnormal phenomenon of one player winning six times on two tickets. Net proceeds and transfers to the District's General Fund decreased from \$720 in 2004 to a negative \$640 in 2005 as a result of the higher prize payouts.

Hot Five

The Hot Five game is a five out of thirty-three numbers online lotto type game that pays fixed prize payouts ranging from one dollar to 25,000 dollars. Player receives one wager (set of five numbers) for the sum of one dollar. Hot Five game sales were discontinued effective November 19, 2005 which accounts for the decrease in overall gaming activities from the prior year. Sales amounted to \$554 offset by operating expenses of \$319 resulted in transfer to the District's General Fund of \$235.

Hot Five sales increased \$190 to \$4,535 or 4.37% over the \$4,345 generated in 2004. Overall operating expenses increased \$488 in 2005 primarily as the result of additional prizes and advertising costs. The increase in sales offset by the increase in operating expenses account for the \$300 or 18.52% reduction in the 2005 transfer to the District's General Fund amount to \$1,320 from the \$1,620 transferred in 2004.

Keno

Keno is a 10/20/80 game with fixed prizes. Players choose to play from 1 to 10 spots, with each spot having a different prize structure. Players select twenty numbers from a field of 80 numbers. Draws are held every four minutes during valid game times. Payouts range from five dollars to 100,000 dollars. Tier 1 prizes start as a fixed payout and transitions to a pari-mutuel payout when the number of winners per draw exceeds 10. The game is supplemented by Keno Spin which features a multiplier option to the game's prizes.

Ticket sales totaled \$13,165 in 2006 and represented a \$1,300 or 10.96% increase over the 2005 sales level of \$11,865. The Keno game's sales increase can be attributed to its newness and continued introduction to larger player base through targeted awareness campaigns.

Prize expense totaled \$7,975 for a \$747 or 10.33% increase in comparison to the 2005 amount of \$7,228. The increase in prizes expense was in correlation the increased sales volume for the year. Overall operating expenses less prizes and agents/retailer commission expenses were equivalently the same for both years. The increase of \$460 in net proceeds and transfers to the District's General Fund to \$3,120 in 2006 over the \$2,660 transferred in 2005 can be directly attributed to increased gross margin.

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

Management's Discussion and Analysis

September 30, 2006 and 2005

(Dollar amounts in thousands)

Ticket sales totaled \$11,865 or \$2,154 more in 2005 than the \$9,711 generated in 2004. The increase in sales can be primarily attributed to more Keno locations and implementation of the Keno Spin feature. Prizes expense increased \$1,336 to \$7,228 in 2005 from the previous year's total of \$5,892. The increase in sales offset by additional prizes and marginal increase in other operating expenses culminated into net proceeds and transfers to the District's General Fund of \$2,660, an increase of \$710 over the transferred amount of \$1,950 in 2004.

Hot Lotto

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

Ticket sales amounted to \$2,432 in 2006 and represented a \$232 or 10.53% increase over the 2005 sales level of \$2,200. The increase in sales over prior year totals is the result of additional states joining the MUSL sponsored game and resultant ability to offer larger jackpots.

Prizes and agents/retailer commission expenses of \$1,310 in 2006 and \$1,215 in 2005 were essentially in proportion to increased ticket sales. Other operating expenses reflected a minor decrease of approximately \$100. The \$195 increase in transfers to the District's General Fund to \$815 in 2006 from the \$620 transferred in 2005 can be attributed to increased gross margin and reduction in other operating expenses.

Hot Lotto sales increased \$844 to \$2,200 in 2005 in comparison to the \$1,356 produced over approximately six-full months of operations in 2004. Total operating expenses of \$1,577 in 2005 only reflected a marginal increase of \$88 to total expenses of \$1,489 for 2004. Advertising and start-up costs to launch the game contributed to the high operating costs level in 2004 and resulting net loss of \$133. Increased revenue and lower operating expenses in proportion to sales translated into net proceeds and transfers to the General Fund of \$620 in 2005.

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

Management's Discussion and Analysis

September 30, 2006 and 2005

(Dollar amounts in thousands)

D.C. Daily Six

The D.C. Daily Six game is a six out of thirty-nine numbers online lotto type game that pays fixed prize payouts ranging from one dollar to 250,000 dollars. Players receive two boards (set of six numbers) for one dollar. Drawings are held nightly seven days a week and players can purchase tickets for the next draw only or the next draw and up to 42 consecutive drawings in predetermined increments. The Division 1 prize payout is fixed for the first four winners. If the number of winners exceeds four then all Division 1 winners share the maximum payout of \$1 million. Payouts for Divisions 2 through 6 are fixed. The D.C. Daily Six game launched effective August 28, 2005 and replaced the Quick Cash game in the Lottery Board's portfolio of games.

Ticket sales totaled \$4,738 in 2006 from the \$514 generated the prior year due to introduction of the game during the last five weeks of operation in 2005. Overall operating expenses amounted to \$3,472 in 2006 versus the \$1,144 expensed the prior year and culminated into transfers to the District's General Fund of \$1,265, or a \$1,895 increase over the negative transfer amount of \$630 in 2005. The increase in transfer can be attributed to increased gross margin due to sales increase, reduction in launch costs, and four Division 1 winner for the full year compared to two Division 1 winners during the earlier weeks of operations in 2005.

Sales totaled \$514 over the approximate five weeks of operations in 2005. Prize expenses amounted to \$672 or 130.74% of sales as a result of two Division 1 winners during the first two weeks of operations. Advertising costs to launch the game and other start-up costs primarily account for other operating expenses totaling \$472. These transactions culminated into a net loss and negative transfer amount to the General Fund of \$630 in 2005.

D.C. Rolling Cash Five

The D.C. Rolling Cash Five game is a five out of thirty-five numbers online lotto type game that pays fixed prize payouts ranging from one dollar to generated jackpot amount. Player receives one wager (set of five numbers) for the sum of one dollar. Drawings are held nightly seven days a week and players can purchase tickets for the next draw only or the next draw and up to 42 consecutive drawings in predetermined increments. Division 1 grand prize winnings are para-mutual and varied depending on number of players and winners. Prize payouts for Divisions 2 through winners are fixed. The DC Rolling Cash Five game was launched effective November 20, 2005 and replaced the Hot Five game.

Sales amounted to \$3,435 for the approximate ten and one-third months of operations in 2006 offset by operating costs of \$3,126. Overall operating results generated transfers to the District's General Fund totaling \$300.

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

Management's Discussion and Analysis

September 30, 2006 and 2005

(Dollar amounts in thousands)

Instant Games

Instant or scratch games are designed to allow a player the opportunity to determine if he/she is an instant winner at the time of ticket purchase. The price of tickets and prize structure are determined before the production of tickets. Instant ticket sales amounted to \$39,785 in 2006 representing a \$3,675 or 10.18% increase over 2005 sales of \$36,110. The increase in sales can be attributed to the Lottery's concentration on offering higher price point tickets and prize payouts to maintain market share and providing a full complement of available tickets to all agent locations.

Prizes in 2006 totaled \$26,480 and resulted in \$3,417 or a 14.82% increase from the \$23,063 amount expensed in 2005. Overall operating costs, less prizes and commissions, totaled \$5,918 and represent an increase of \$438 from the prior year's amount of \$5,480, primarily due to higher contractual and ticket distribution costs. Transfers to the General Fund of \$4,420 in 2006 represent a decrease of \$430 from the transfer amount of \$4,850 reported in 2005 and can be directly associated to the increase in operating costs.

Instant ticket sales of \$36,110 in 2005 were \$2,830 or 7.27% lower than 2004 sales of \$38,940. Prizes in 2005 totaled \$23,063 and resulted in a decrease of \$2,594 or 10.11% from the \$25,657 in prizes paid in 2004. Operating costs, less prizes and commissions, totaled \$5,515 and represented a \$297 decrease from the prior year's amount of \$5,812 primarily due to lower contractual and administrative expenses. Transfers to the District's General Fund of \$4,850 represented an increase of \$263 over the transfer amount of \$4,587 reported in 2004.

The Lottery has been able to stimulate sales over the past few years through games designed with higher prize payouts and the introduction of games with various price points up to 20 dollars. The average prize payout rate in 2006 was 66.56% versus 63.87% in 2005.

Interest, Dividends and Other Income

All idle cash of the Lottery is invested through the District's General Fund Pooled Investments Account. Powerball receipts transferred to MUSL to fund major jackpots are invested in securities prior to jackpots being hit, and earnings are allocated quarterly to party lotteries. Interest and dividend income, shown separately in the financial statements, increased by \$724 and \$332 in 2006 and 2005, respectively and decreased by \$103 in 2004. Interest and dividend income is impacted by various market conditions, the national economy, and other factors beyond the control of individual entities.

Other income decreased by \$1,312 to \$188 in 2006 from \$1,500 in 2005. Other income in 2005 included \$1,163 representing bonding fees receipts from agents to cover delinquent receivable balances. Bonding fees receipts were deposited to a Miscellaneous Trust Fund in the name of the Lottery Board and recorded on the books of the District of Columbia in prior years. Funds were requested and used to write-off delinquent and uncollectible periodically. The Lottery implemented a policy to recognize receipts as revenue in the period of received in 2005. Funds totaling \$121 in 2006 and \$1,163 in 2005, consisting of \$941 transferred from the Miscellaneous Trust Fund and \$222 in funds collected from agents, were recorded as revenue. Refunds from MUSL as a result of rebalancing reserve funds and distributions of excess contributions by participating members amounted to \$33 and \$306 in 2006 and 2005, respectively.

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

Management's Discussion and Analysis

September 30, 2006 and 2005

(Dollar amounts in thousands)

Charitable Gaming Activities

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

Contacting the Lottery

Interested parties can contact the D.C. Lottery at D.C. Lottery and Charitable Games Control Board, 2101 Martin Luther King Jr. Avenue, S.E. Washington, D.C. 20020.

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

Statements of Net Assets

September 30, 2006 and 2005

(Dollar amounts in thousands)

Assets	2006	2005
Current assets:		
Cash and cash equivalents	\$ 11,410	\$ 8,225
Accounts receivable, net	5,094	4,783
Inventory	-	369
Prepaid expenses and other	9	20
Restricted investments	8,631	8,631
Total current assets	<u>25,144</u>	<u>22,028</u>
Non-current assets:		
Capital assets, net	382	771
Restricted investments	43,953	50,818
Total non-current assets	<u>44,335</u>	<u>51,589</u>
Total assets	<u>69,479</u>	<u>73,617</u>
Liabilities		
Current liabilities:		
Accounts payable	2,754	2,218
Compensation liabilities	458	466
Deferred revenues	184	450
Accrued prizes and commissions	9,795	7,413
Other accrued liabilities	3	(21)
Obligations for unpaid prizes - current portion	8,631	8,631
Total current liabilities	<u>21,825</u>	<u>19,157</u>
Obligations for unpaid prizes - non-current portion	43,953	50,818
Total liabilities	<u>65,778</u>	<u>69,975</u>
Net Assets		
Invested in capital assets, net of related debt	382	771
Unrestricted	3,319	2,871
Total net assets	<u>\$ 3,701</u>	<u>\$ 3,642</u>

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

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

Statements of Revenues, Expenses, and Change in Net Assets

Years Ended September 30, 2006 and 2005

(Dollar amounts in thousands)

	<u>2006</u>	<u>2005</u>
Operating revenues:		
Gaming revenues	\$ 266,391	\$ 234,931
Operating expenses:		
Prizes	146,687	120,525
Agent's commissions	16,534	14,444
Contractor fees	14,410	14,078
Advertising	5,249	4,935
Administration	10,638	9,684
Amortization and depreciation	389	400
Total operating expenses	<u>193,907</u>	<u>164,066</u>
Operating income	72,484	70,865
Non-operating revenues - interest and dividends	1,375	651
Income before transfers	73,859	71,516
Transfers to District General Fund	<u>(73,800)</u>	<u>(71,450)</u>
Change in net assets	59	66
Net assets, beginning of year	<u>3,642</u>	<u>3,576</u>
Net assets, end of year	<u>\$ 3,701</u>	<u>\$ 3,642</u>

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

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

Statements of Cash Flows

Years Ended September 30, 2006 and 2005

(Dollar amounts in thousands)

	2006	2005
Operating activities:		
Cash receipts from customers	\$ 265,625	\$ 233,155
Cash receipts from others	188	1,500
Cash payments to vendors	(23,820)	(23,441)
Cash payments to employees	(5,545)	(6,336)
Cash payments for prizes and commissions	(160,838)	(135,414)
Net cash provided by operating activities	75,610	69,464
Capital and related financing activities - acquisition of fixed assets	-	(141)
Non-capital financing activities - transfers out	(73,800)	(71,450)
Investing activities - interest and dividends	1,375	651
Net increase (decrease) in cash	3,185	(1,476)
Cash and cash equivalents - beginning of year	8,225	9,701
Cash and cash equivalents - end of year	\$ 11,410	\$ 8,225
Reconciliation of operating income to net cash provided by operating activities:		
activities:		
Operating income	\$ 72,484	\$ 70,865
Amortization and depreciation	389	400
Decrease (increase) in assets:		
Receivables	(311)	(421)
Inventory	369	116
Prepaid expenses	12	(6)
Increase (decrease) in liabilities:		
Accounts payable	536	(732)
Compensation liabilities	(8)	(428)
Deferred revenue	(267)	144
Accrued prizes	2,382	(445)
Other current liabilities	24	(29)
Net cash provided by operating activities	\$ 75,610	\$ 69,464

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

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

**Notes to Financial Statements
September 30, 2006 and 2005
(Dollar amounts in thousands)**

(1) Organization

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

(2) Summary of Significant Accounting Policies

(a) Basis of Presentation

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

(b) Basis of Accounting

The accompanying financial statements are prepared on the accrual basis of accounting. Under this method, revenues are reported when earned and expenses are reported at the time the related liabilities are incurred. In accordance with Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Lottery has elected not to follow the Financial Accounting Standards Board (FASB) Statements and Interpretations, APB Opinions, and Accounting Research Bulletins issued after November 30, 1989.

(c) Cash and Cash Equivalents

The Lottery participates in the District's pooled cash program whereby cash that is not needed for immediate disbursement is pooled with that of the District and used to purchase current investments. In accordance with the law, the District may invest the pooled cash directly in, or through repurchase agreements, obligations of the United States or its agencies, which are fully guaranteed by the federal government, and in certificates of deposit, which are issued by federally insured banks. In accordance with District policies, substantially all deposits in the pooled cash program were insured or collateralized with securities held by the District or its agent in the District's name. Interest income from the investment of pooled cash is allocated to the Lottery based on the amount the Lottery invests in the pool. The Lottery considers the pooled cash to be cash equivalents for the purpose of cash flows because the pool may not hold the securities for more than 91 days. Cash and cash equivalents at September 30, 2006 and 2005 respectively, were \$11,410 and \$8,225.

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

**Notes to Financial Statements
September 30, 2006 and 2005
(Dollar amounts in thousands)**

(d) Inventory

Inventory, consisting of instant lottery tickets, is valued at cost using the specific identification basis. The costs of the instant lottery tickets are recorded as an expense when the tickets are sold. The Lottery changed to the percentage of sales method in October 2005 whereby the ticket vendor produces and distributes instant tickets for a set percentage of each ticket's sales price.

(e) Capital Assets

Capital assets are recorded at cost. The cost of major remodeling, betterments, and improvements of \$5 and greater are capitalized. Repairs and maintenance costs are expensed as incurred. When capital assets are retired or sold, the cost and related accumulated depreciation are removed from the appropriate property and equipment accounts, and resulting gains or losses are recorded.

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

<u>Category</u>	<u>Estimated Useful Life</u>
Machinery and equipment	5-8 years
Office furniture and fixtures	5-8 years
Leasehold improvements	5-15 years

(f) Gaming Revenue

Revenue from online tickets is recorded as gaming revenue when the drawings are held. Online tickets sold in advance are recorded as deferred revenue until the drawings are held. Revenue from instant tickets is recorded as gaming revenue when the tickets are activated.

(g) Prize Expense

Instant tickets prize expense is based on the prize payout percentage for each instant lottery game and is accrued as the related gaming revenue is earned. Prize expenses for online games, excluding the Powerball and Hot Lotto games, are accrued based on the draw liability associated with drawings for the specific games. Powerball and Hot Lotto prize expenses are recorded at the rate of 50% of ticket sales. The accrued prize liability represents a payable for prize amounts that have not been claimed as of each fiscal year-end. Prize expense for all games is reduced by the sum of lapsed prizes not claimed during the required period of one year from the sales draw date for online games and the respective game closing date for instant games.

(h) Compensated Absences

The Lottery permits employees to accumulate earned but unused vacation and sick pay benefits depending on the employee's length of service. Employees may not accumulate more than 240 hours of vacation benefits. The Lottery accrues for accumulated vacation as the benefits are earned by employees.

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

**Notes to Financial Statements
 September 30, 2006 and 2005
 (Dollar amounts in thousands)**

There is not a maximum limitation on the amount of unused sick pay benefits that employees may accumulate. The Lottery does not accrue for non-vesting accumulating rights to receive sick pay benefits. At the time of retirement, unused sick pay benefits are credited at the rate of 30 days for each month of service and are added to the retirees' years of service in the retirement programs.

(i) Use of Estimates

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

(3) Accounts Receivable

The components of accounts receivable as of September 30, 2006 and 2005 are as follows:

Description	2006	2005
Due from agents:		
Online games	\$ 1,374	1,477
Instant games	3,544	3,541
Total due from agents	4,918	5,018
Other	176	20
Total accounts receivable	5,094	5,038
Less allowance for doubtful accounts	—	(255)
Total accounts receivable, net	\$ 5,094	4,783

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

**Notes to Financial Statements
 September 30, 2006 and 2005
 (Dollar amounts in thousands)**

(4) Capital Assets

A summary of capital assets as of September 30, 2006 and 2005 is as follows:

	<u>Balance as of October 1, 2005</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance as of September 30, 2006</u>
Cost:				
Machinery and equipment	\$ 3,100	\$ ---	\$ 635	\$ 2,465
Office furniture and fixtures	321	---	301	20
Lease hold improvements	758	---	---	758
Total cost	<u>4,179</u>	<u>---</u>	<u>936</u>	<u>3,243</u>
Less – accumulated depreciation				
Machinery and equipment	2,480	334	635	2,179
Office furniture and fixtures	315	2	301	16
Lease hold improvements	613	53	---	666
Total accumulated depreciation	<u>3,408</u>	<u>389</u>	<u>936</u>	<u>2,861</u>
Capital assets – net	<u>\$ 771</u>			<u>\$ 382</u>
	<u>Balance as of October 1, 2004</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance as of September 30, 2005</u>
Cost:				
Machinery and equipment	\$ 2,959	\$ 141	\$ ---	\$ 3,100
Office furniture and fixtures	321	---	---	321
Lease hold improvements	758	---	---	758
Total cost	<u>4,038</u>	<u>141</u>	<u>---</u>	<u>4,179</u>
Less – accumulated depreciation				
Machinery and equipment	2,139	341	---	2,480
Office furniture and fixtures	313	2	---	315
Lease hold improvements	556	57	---	613
Total accumulated depreciation	<u>3,008</u>	<u>400</u>	<u>---</u>	<u>3,408</u>
Capital assets – net	<u>\$ 1,030</u>			<u>\$ 771</u>

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

**Notes to Financial Statements
 September 30, 2006 and 2005
 (Dollar amounts in thousands)**

(5) Multi-State Lottery Association

(a) Background

The Lottery is a member of the Multi-State Lottery Association (MUSL). MUSL has thirty-one (31) members and administers a multi-state lottery game. Powerball, the current game, was initiated on April 20, 1992 and is a semiweekly pari-mutuel drawing with a minimum grand prize of \$15,000. MUSL previously administered the Lotto-America game, which was terminated on April 18, 1992. All MUSL members remit a portion of their Powerball revenue to MUSL for the prize payments and administrative expenses of Powerball.

(b) Restricted Investments and Obligations for Unpaid Prizes

Lotto-America and Powerball jackpot prizes of \$250 or greater are payable to the winner in annual installments over 25 years. The Lottery is responsible for sending the annual payments to Lotto-America and Powerball winners who purchased their winning tickets from the Lottery. MUSL is responsible for providing the Lottery cash to fund these installment payments.

As of September 30, 2006 and 2005, MUSL had purchased for the Lottery, U.S. government securities aggregating \$62,875 and \$71,507, respectively to fund future installment payments for the Lottery's Lotto-America and Powerball winners.

The market value of these securities was \$52,584 and \$59,449 as of September 30, 2006 and 2005, respectively. The investments provide the Lottery cash payments corresponding to the Lottery's obligations to send the annual installments to the prize winners. The Lottery has reflected the market value of the securities as restricted investments and as corresponding obligations for unpaid prizes on the statements of net assets. All restricted investments are insured and registered or are held by the Lottery or its agent in the Lottery's name.

During fiscal 2003, the Lottery adopted GASB Statement No. 40, *Deposits and Investment Risk Disclosures*. As of September 30, 2006, the Lottery had the following investments and maturities:

<u>Investment Type</u>	<u>Investment Maturities (in Years)</u>				
	<u>Fair Value</u>	<u>Less Than 1</u>	<u>1 - 5</u>	<u>6 - 10</u>	<u>More Than 10</u>
U.S. Government and Agency Securities	\$ 52,584	\$ 5,854	\$ 33,835	\$ 11,249	\$ 1,646

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

As of September 30, 2006, the Lottery had an interest in a SEC 2a7 pooled government cash management fund of \$1,061 and the pool was not rated.

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

**Notes to Financial Statements
September 30, 2006 and 2005
(Dollar amounts in thousands)**

(c) MUSL Prize Reserves

The prize pool for Powerball consists of 50% of each drawing period's sales. Two percent of the prize pool is placed in a prize reserve fund and a set prize reserve fund. These reserve funds serve as contingency funds to protect MUSL from unforeseen liabilities. As of September 30, 2006 and 2005, the total Powerball prize reserve fund was approximately \$75,927 and \$73,532, respectively, of which the Lottery's share was approximately \$1,452 and \$1,496. In addition, the total Powerball set prize reserve fund as of September 30, 2006 and 2005, was approximately \$26,339 and \$25,000, respectively, of which the Lottery's share was approximately \$438 and \$440.

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

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

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

The prize reserve fund serves as a contingency fund to protect MUSL from unforeseen liabilities. As of September 30, 2006, the total Hot Lotto prize reserve fund was approximately \$2,005 of which the Lottery's share was approximately \$90. The balance in the prize reserve fund may be used at the discretion of the MUSL's Board of Directors. The Lottery's share of the prize reserve fund is not reflected in the accompanying financial statements.

(6) Obligations for Unpaid Prizes

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

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

**Notes to Financial Statements
 September 30, 2006 and 2005
 (Dollar amounts in thousands)**

	Year ended September 30, 2006 Jackpot	Year ended September 30, 2005 Jackpot
Jackpot prizes payable:		
Due within one year	\$ 8,631	\$ 8,631
Due in subsequent years	43,953	50,818
Total (present value)	52,584	59,449
Add: Interest to maturity	10,291	12,058
Jackpot prizes payable at maturity	\$ 62,875	\$ 71,507

The following schedule presents the changes in prizes payable:

Balance as of October 1, 2004	\$	66,481
Increase		1,599
Decrease		(8,631)
		59,449
Balance as of September 30, 2005		59,449
Increase		1,766
Decrease		(8,631)
		52,584
Balance as of September 30, 2006	\$	52,584

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

**Notes to Financial Statements
 September 30, 2006 and 2005
 (Dollar amounts in thousands)**

(7) Gaming Revenues, Prizes and Commissions

Gaming revenues, prizes and commissions for the fiscal years ended September 30, 2006 and 2005 were as follows:

2006												
	Lucky Numbers	D.C. Four	Powerball	Quick Cash	Hot Five	Keno	Hot Lotto	Daily 6	D.C. Rolling Cash 5	Instant Games	Others	Total
Gaming revenues	\$ 70,310	\$ 80,014	\$ 51,770	\$ --	\$ 554	\$ 13,165	\$ 2,432	\$ 4,738	\$ 3,435	\$ 39,785	\$ 188	\$ 266,391
Prizes	(34,203)	(47,099)	(24,977)	86	(209)	(7,975)	(1,158)	(2,616)	(2,056)	(26,480)	—	(146,687)
Agent's commissions	(4,541)	(4,643)	(2,828)	3	(33)	(875)	(152)	(293)	(211)	(2,961)	—	(16,534)
Gross margin	<u>\$ 31,566</u>	<u>\$ 28,272</u>	<u>\$ 23,965</u>	<u>\$ 89</u>	<u>\$ 312</u>	<u>\$ 4,315</u>	<u>\$ 1,122</u>	<u>\$ 1,829</u>	<u>\$ 1,168</u>	<u>\$ 10,344</u>	<u>\$ 188</u>	<u>\$ 103,170</u>
2005												
	Lucky Numbers	D.C. Four	Powerball	Quick Cash	Hot Five	Extra Games	Keno	Hot Lotto	Daily 6	Instant Games	Others	Total
Gaming revenues	\$ 68,601	\$ 74,138	\$ 31,537	\$ 3,931	\$ 4,535	\$ —	\$ 11,865	\$ 2,200	\$ 514	\$ 36,110	\$ 1,500	\$ 234,931
Prizes	(32,525)	(35,025)	(14,682)	(3,945)	(2,297)	3	(7,228)	(1,091)	(672)	(23,063)	—	(120,525)
Agent's commissions	(4,406)	(4,204)	(1,702)	(234)	(279)	—	(793)	(124)	(36)	(2,666)	—	(14,444)
Gross margin	<u>\$ 31,670</u>	<u>\$ 34,909</u>	<u>\$ 15,153</u>	<u>\$ (248)</u>	<u>\$ 1,959</u>	<u>\$ 3</u>	<u>\$ 3,844</u>	<u>\$ 985</u>	<u>\$ (194)</u>	<u>\$ 10,381</u>	<u>\$ 1,500</u>	<u>\$ 99,962</u>

(8) Transfers to the General Fund of the District

The District Budget Act (PL 4-162) (the Act) of 1983 requires the Lottery to transfer its revenues less expenses and less a reserve not to exceed 2% of annual prize payments to the General Fund of the District. The Mayor may approve a change in the reserve limit, as necessary, upon the request of the Lottery. During the fiscal years ended September 30, 2006 and 2005, the Lottery's net transfers to the General Fund of the District were \$73,800 and \$71,450 respectively. The Lottery was in compliance with the Act for the fiscal years ended September 30, 2006 and 2005.

(9) Retirement Programs

(a) Defined Benefit Pension Plan

The majority of the full-time Lottery employees hired before October 1, 1987 are covered by the Federal Civil Service Retirement System (5 U.S.C. 833 1). The Federal Civil Service Retirement System is a cost-sharing multiple employer pension plan.

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

In accordance with the Balance Budget Act of 1997 (Public Law 105-33), the Lottery contributes 8.51% and employees contribute 7.25% of employees' covered compensation to the Federal Civil Service Retirement System. The Lottery's contribution decreased to 7.50% in October 2002 and to 7.00% in January 2003. Contributions by the Lottery amounted to \$90

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

**Notes to Financial Statements
 September 30, 2006 and 2005
 (Dollar amounts in thousands)**

and \$105 for the years ended September 30, 2006 and 2005, respectively. The number of Lottery employees covered under the Federal Civil Service Retirement System is 17.

(b) Defined Contribution Plan

All full-time employees hired after September 30, 1987 are covered by the District-sponsored defined contribution plan. Employees do not contribute to this plan and are eligible to participate after one year of service. The Lottery contributes 5% of an eligible employee's base salary, which amounted to \$201 and \$197 for the fiscal years ended September 30, 2006 and 2005, respectively.

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

(c) Deferred Compensation Plan

Lottery employees are eligible to participate in the District-sponsored deferred compensation plan (D.C. Code 47-3601) created in accordance with Internal Revenue Code Section 457. Employees may defer up to 25% of their compensation, not to exceed \$14. Compensation deferred and income earned is taxable when paid or made available to the participant or beneficiary upon retirement, death, termination, or unforeseeable emergency. Contributions are not assets of the Lottery or District, which have no further liability to the plan.

(10) Commitments and Contingencies

(a) Operating Leases

The Lottery leases certain facilities under long-term, non-cancelable, and operating leases that expire in fiscal year 2007. The total future minimum rental commitments as of September 30, 2006 are \$413.

Rent expense for the fiscal years ended September 30, 2006 and 2005 was as follows:

	2006	2005
Gross rental expense	\$ 1,301	\$ 1,266
Less income from subleases	(170)	(170)
Net rent expense	\$ 1,131	\$ 1,096

(b) Risk of Loss

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

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

**Notes to Financial Statements
September 30, 2006 and 2005
(Dollar amounts in thousands)**

(c) *Annuity Contracts*

Prizes awarded for the Lucky Lotto game, which ended effective May 1, 1989, are payable to the winners in annual installments over 10 or 20 years. The first installment payments were made by the Lottery at the time of the drawing. The Lottery had entered into agreements with insurance companies under which the Lottery purchased annuities contracts that provide the annual installment payments to the Lucky Lotto prize winners. As the insurance companies are responsible for the annual installment payments, neither the present value of the annuities nor the present value of the related future payments is reflected in the accompanying financial statements. The Lottery would be liable for such future installment payments if the insurance companies were to default on their payments. As of September 30, 2006 and 2005, future installment payments due to Lucky Lotto winners were approximately \$762 and \$1,950 respectively. As of September 30, 2006, final installment payments due to all instant lottery winners had been paid.

During 1991, Executive Life Insurance Company (ELIC), with whom the Lottery holds two annuities, was placed into conservancy with the Los Angeles, California Superior Court (Superior Court). In 1993, the Superior Court approved the terms of a rehabilitation plan and the purchase of ELIC by the Aurora National Life Insurance Company. As a result, the Lottery is required to fund a percentage of the annual installment payments for these annuities. The Lottery expensed \$68 during the year ending September 30, 2005 representing the final payment for its share of annual installment payments to these Lucky Lotto winners.

(11) Related Party Transactions

During fiscal year 2005, the Lottery had related party transactions with the Office of the Chief Financial Officer (OCFO) to provide financial and managerial oversight. These services included, but were not limited to, internal audit and internal security, legal, human resources, procurement, financial management, and executive management oversight services. The annual contractual cost for these services was \$926 and \$815 in 2006 and 2005, respectively.

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

THOMPSON, COBB, BAZILIO & ASSOCIATES, PC
Certified Public Accountants and Management, Systems, and Financial Consultants

■ Main Office:

1101 15th Street, N.W.
Suite 400
Washington, DC 20005
(202) 737-3300
(202) 737-2684 Fax

□ Regional Office:

100 Pearl Street
14th Floor
Hartford, CT 06103
(860) 249-7246
(860) 275-6504 Fax

□ Regional Office:

21250 Hawthorne Boulevard
Suite 500
Torrance, CA 90503
(310) 792-7001
(310) 792-7004 Fax

**Independent Auditor's Report on Internal Control over
Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial
Statements Performed in Accordance with *Government Auditing Standards***

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

We have audited the basic financial statements of the Lottery and Charitable Games Control Board (the Lottery), an enterprise fund of the Government of the District of Columbia (District), as of and for the year ended September 30, 2006, and have issued our report thereon dated January 19, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Lottery's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion 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 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.

Compliance and Other Matters

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

We noted certain matters that we reported to management of the Lottery in a separate letter dated January 19, 2007.

This report is intended solely for the information and use of the Mayor, the Council, and the Inspector General of the Government of the District of Columbia and management of the Lottery, and is not intended to be, and should not be used by anyone other than these specified parties.

Washington, DC
January 19, 2007

Thompson, Cobb, Bazilio & Associates, PC