



'07
Annual Report



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INTRODUCTION AND FISCAL YEAR HIGHLIGHTS FROM THE EXECUTIVE DIRECTOR

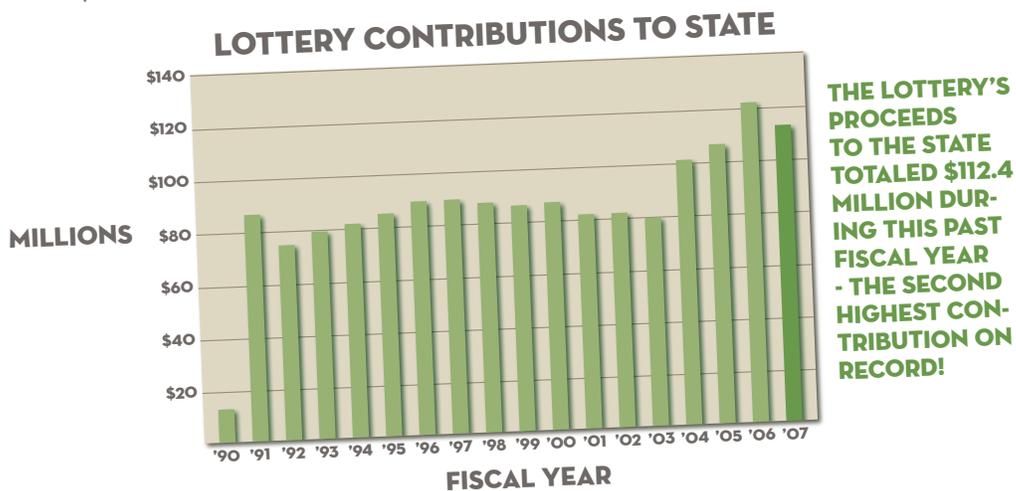


Dear Readers:

Lottery products remained popular even though our Minnesota economy was sluggish this past year. From July 1, 2006 through June 30, 2007, the Lottery achieved sales of \$422.6 million, the second highest on record. Proceeds were also the second highest ever and totaled \$112.4 million.

The \$112.4 million includes \$49.5 million to fund critical environmental programs. More than \$62 million, or 56 percent, was transferred to the state's General Fund, including \$1.9 million to the Department of Human Services to fund problem gambling treatment and prevention programs. Lottery retailers, an important partner in our sales efforts, earned \$25.2 million in commissions and incentives. Players won more than \$250 million from our Scratch and Online products.

Since its inception in 1990, the Lottery has raised more than \$1.5 billion that has benefited all of Minnesota's citizens.



During this fiscal year, I had the privilege of serving as president of the North American Association of State and Provincial Lotteries (NASPL). NASPL is a 52-member organization, consisting of government-sponsored lotteries from the United States, Canada, Mexico and the Caribbean.

During my term, I focused on the expansion of research efforts among and between the member lotteries and continued progress toward the development of initiatives to standardize lottery practices and processes. I expect these accomplishments to benefit the Minnesota State Lottery for years to come.

I'm very proud of the fact that Lottery dollars benefit everyone in Minnesota. We'll continue working hard to offer innovative and secure games that create excitement, reflect Minnesota values and maximize contributions to the state.

Sincerely,

Clint Harris
Executive Director



HOW LOTTERY DOLLARS BENEFIT MINNESOTA

During fiscal year 2007, the Lottery generated \$112.4 million for state projects and programs. Lottery money benefits all Minnesotans through the Environment & Natural Resources Trust Fund, the Game & Fish Fund, the Natural Resources Fund and the state's General Fund.

The Environment and Natural Resources Trust Fund receives 40 percent of Lottery net proceeds. Trust Fund projects help to preserve, restore and enhance Minnesota's environment. The Lottery transferred \$29.6 million to the Trust Fund during fiscal year 2007. This brings the total raised for the Trust Fund through Lottery sales to

\$428.6 million. Projects have been funded in each of Minnesota's 87 counties. During fiscal year 2007, the Legislature began appropriating funds from the Trust Fund on an annual basis. Previously, appropriations had been made for a two year period. In accordance with the state constitution, annual appropriations are limited to 5.5 percent of the fund's market value as of the previous June 30 (the fund was valued at \$493.9 million on June 30, 2007). The Trust Fund is administered by the Legislative-Citizen Commission on Minnesota Resources.



Como Lake



Marjorie McNeely Conservatory

Trust Fund grants helped finance the addition of a rain garden to treat storm water runoff, a lake aeration system to improve fish habitat and the restoration of the east shoreline to provide erosion control, landscaping and relocated parking areas and walking paths at Como Lake in St. Paul.

Grants from the Trust Fund helped finance improvements to St. Paul's Marjorie McNeely Conservatory main entrance, utilities, fern room and growing house.

More than \$1.5 billion has been generated for the state of Minnesota through Lottery sales.

92¢ OF EVERY DOLLAR SPENT ON LOTTERY TICKETS IS RETURNED TO MINNESOTANS IN THE FORM OF PRIZE MONEY, RETAILER COMMISSIONS AND CONTRIBUTIONS TO THE STATE.

Lottery money that is transferred to the state's General Fund supports state services that include public education, local government assistance, public safety and environmental protection. More than \$62 million was transferred to the state's General Fund during the fiscal year – more than \$930 million has been transferred since the Lottery's inception. This amount includes 60 percent of net proceeds, a portion of the 6.5 percent in-lieu-of-sales tax, unclaimed prizes and funds used for problem gambling treatment and prevention.

The Lottery transfers 6.5 percent of sales to the state as in-lieu-of-sales tax payments. In fiscal year 2007 these payments were allocated as follows: \$9.9 million to the Game & Fish Fund for activities that improve, enhance or protect fish and wildlife resources in Minnesota; \$9.9 million to the Natural Resources Fund to benefit state and Twin Cities metropolitan area parks and trails, local trails and the Minnesota Zoological Garden, Como Zoo and Duluth Zoo; and the remaining \$7.6 million to the General Fund. The Game & Fish Fund and the Natural Resources Fund are both administered by the Department of Natural Resources.

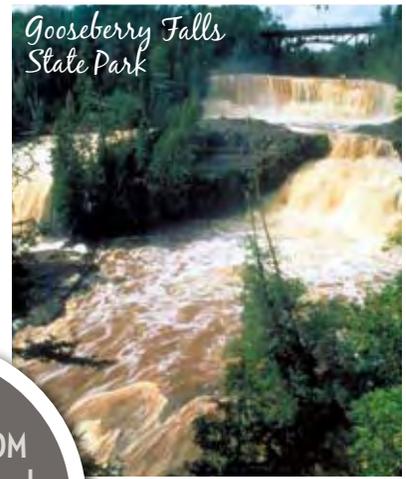


Photo courtesy of Minnesota Office of Tourism.

Visit **MNLOTTERY.COM** to see how Trust Fund projects have benefited each of Minnesota's 87 counties.

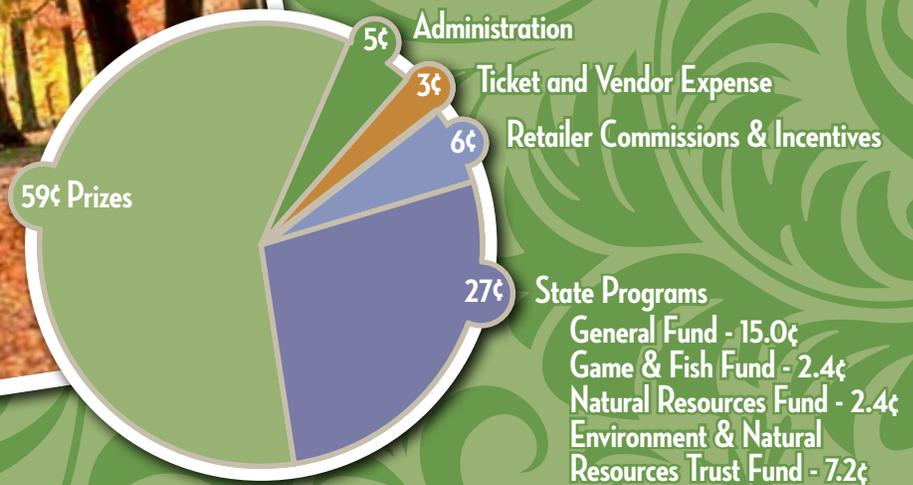
The Environment & Natural Resources Trust Fund has helped finance improvements to Gooseberry Falls State Park including land acquisition, trail construction, new office facilities, a sewer system and a beautiful new visitor's center.

FISCAL YEAR 2007 IS THE FOURTH CONSECUTIVE YEAR THAT THE LOTTERY HAS CONTRIBUTED MORE THAN \$100 MILLION TO THE STATE.

Photo courtesy of Minnesota Office of Tourism.



Environment & Natural Resources Trust Fund grants have allowed the acquisition of 185 acres of additional park land and helped build a new interpretive center at Nerstrand-Big Woods State Park.



YOUR LOTTERY DOLLAR AT WORK



GAMES & WINNERS

More than 32 million winning tickets were claimed during the fiscal year – approximately eight winning tickets for every Minnesota adult. The Lottery paid players \$250 million in prizes during the fiscal year.

LOTTERY PLAYERS HAVE CLAIMED MORE THAN \$3.7 BILLION IN PRIZES SINCE THE LOTTERY'S INCEPTION.



SCRATCH GAMES



Scratch Games continued to be a popular form of entertainment for Minnesota adults. Scratch Game sales topped \$260 million during the fiscal year. There were 46 Scratch Games introduced during the fiscal year with price points ranging from \$1 to \$10.

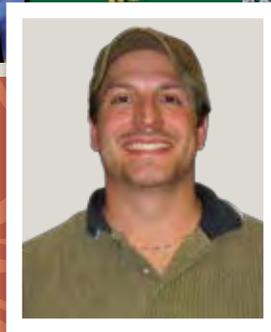


Timothy Berge
of Belle Plaine
\$250,000 Club Casino

Bill Giannelli of Marshall
\$100,000 Golden Riches



Suzanne Baumgartner
of Cottage Grove
\$100,000 Minnesota Hold 'Em



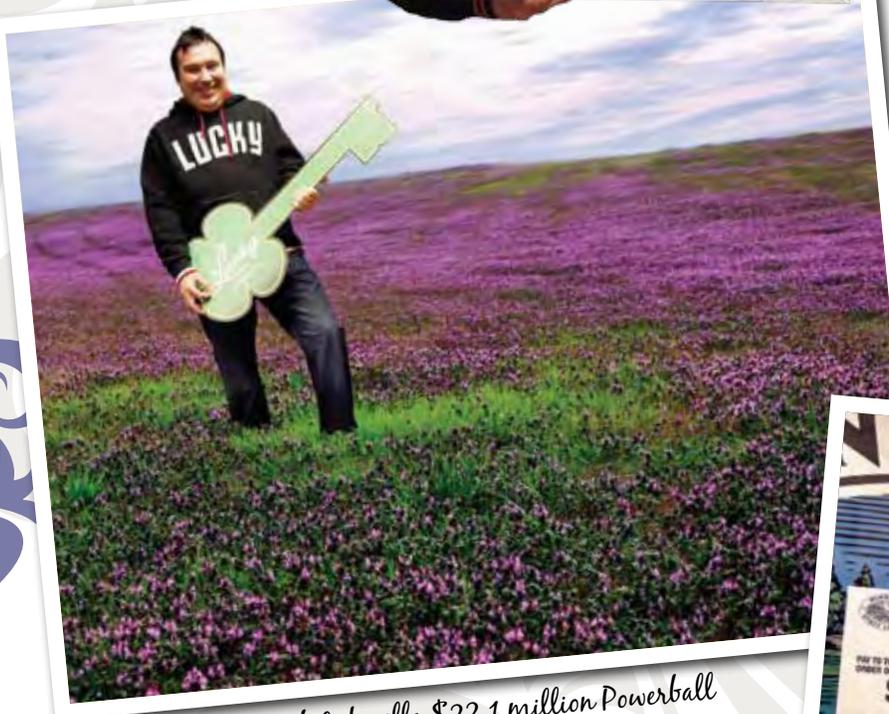
Rosa Khalife of Coon Rapids
\$2,500 The Price is Right

ONLINE GAMES



Ticket sales from Online Games (Powerball®, Hot Lotto®, Gopher 5®, Northstar Cash®, Daily 3®, G3® Games and Minnesota Millionaire Raffle) totaled \$162 million. Powerball continues to be the most popular Online Game offered in Minnesota, however, Hot Lotto, G3 Games and Northstar Cash sales increased significantly over fiscal year 2006.

Michael Hawes of Lakeville was the biggest winner of the fiscal year. Hawes won a \$47 million Powerball jackpot on Nov. 1, 2006 to become Minnesota's 19th Powerball jackpot winner. He selected the \$22.1 million cash option.



Michael Hawes of Lakeville \$22.1 million Powerball

POWERBALL JACKPOT WINNER MICHAEL HAWES WAS AWARDED A KEY TO THE CITY OF LUCKY, MN (THE LOTTERY'S PLAYERS CLUB).

CUB FOODS IN BLOOMINGTON RECEIVED A \$50,000 BONUS FOR SELLING THE WINNING JACKPOT TICKET.



District manager Russ Czapar accepts the check on behalf of Cub Foods

The Gold Team Group \$200,000 Powerball



*Kim Gale of St. Paul
\$660 Daily 3*



*Kathy Tyo of St. Paul
\$50,000 Powerball
with Power Play®*

*The Heatherton
Group of Edina
\$198,768 Gopher 5*



*The Lebeis Family
\$822,756 Gopher 5*



*Ann McGrath of Farmington
\$245,560 Gopher 5*

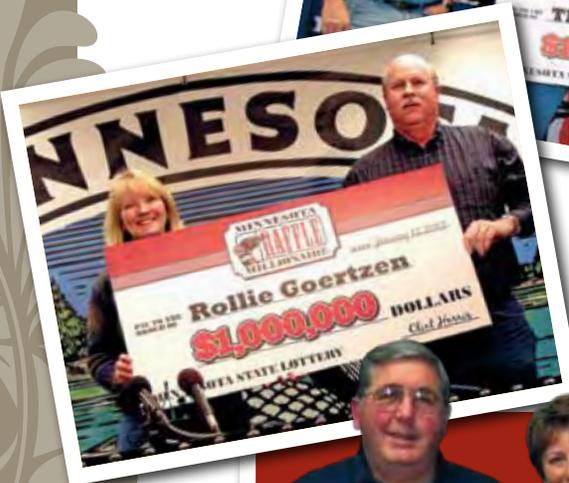
PLAYER WINS TWO JACKPOTS IN A ROW!

A Northstar Cash player matched all five numbers drawn on Feb. 10, 2007 to win the \$25,000 jackpot. The next day he did it again. A ticket that he purchased for the Feb. 11, 2007 Northstar Cash drawing matched all five winning numbers drawn on that day to win another \$25,000 jackpot! This is the only time this has happened in Minnesota on any jackpot game, and the odds of it happening are virtually incalculable. This story received media attention around the world.

MINNESOTA MILLIONAIRE RAFFLE



The Lottery launched its first raffle game, called Minnesota Millionaire Raffle, on Nov. 1, 2006 with the drawing held on New Year's Day. This short-term \$10 On-line Game offered a maximum of 500,000 tickets for sale. With two guaranteed \$1 million winners Minnesota Millionaire Raffle offered the best odds of winning a \$1 million prize of any game the Lottery has ever offered. The game was a big success and sold out on Dec. 26, 2006.





LUCKY, MN PLAYERS CLUB

Luckymn.com is the Lottery's online players club. The site, which was launched on May 3, 2006, was still very new when fiscal year 2007 began. At the start of the fiscal year, the fictional town of Lucky, MN had welcomed about 3,000 "residents" and the Lottery set a goal of having 30,000 by the end of the fiscal year. Offering fun promotions and keeping the site updated and fresh helped the Lottery exceed its goal by more than 5,000 – by the end of the fiscal year, residency surpassed 35,000.



Play What's the Difference?



\$20 million winner

\$200 million winner

Play the free online game *WHAT'S THE DIFFERENCE?* and register online – you could win \$10,000 plus Powerball tickets for a year! It's easy and fun!



Becoming a resident of Lucky, MN was a great move for Judy Hamm of Fridley! Hamm was the grand prize winner in the Minnesota Wild promotion that was open only to members of the Lottery's players club (Lucky, MN). She won a trip for two to attend a Minnesota Wild away game during the 2007-08 season!

The innovative "What's the Difference?" campaign used television ads to encourage players to visit Lucky, MN to participate in a free game that reminded players that there's no reason to wait for a record jackpot – "Powerball is always big!" The game was very popular with players and continued on the website for several months after the advertisements stopped running.

PROMOTIONS AND MARKETING CAMPAIGNS



Throughout the fiscal year, a variety of promotions and marketing efforts generated sales by attracting the attention of consumers and creating interest in Lottery products.

Attention-getting billboards, like the one at the Mall of America in Bloomington, are an effective way to remind players to purchase tickets.



*Daisy Bach of Minnesota Lake
\$200,000 Powerball*



*Larry Vieths of Goodhue
\$200,000 Powerball*



*Sandy Johnson of St. Paul
\$100,000 Minnesota Hold 'Em*

The Lottery celebrated the 72,000 winning Scratch tickets redeemed each day in Minnesota by giving away thousands of pieces of cake on July 2 at the Taste of Minnesota in St. Paul.



WITH 72,000 SCRATCH WINNERS A DAY, ANYONE CAN WIN.

The 25' by 26' cake was baked from "scratch" by Grandma's Bakery in White Bear Lake and weighed 4,116 pounds – 1,800 pounds of the total weight was frosting. Grandma's Bakery estimates that there were 6.2 million calories in the entire cake. The cake took 220 working hours to produce and received nationwide television coverage. The Lottery's advertising agency, Colle+McVoy, won two national PRSA awards for their work on this campaign.



Lottery proceeds give nature a helping hand: A television ad campaign starring Muckaday, a 652 pound black bear, helped get the message out that a portion of the Lottery net proceeds fund projects that preserve, restore and enhance our state's natural resources.



The four-week long "Viva Hot Vegas" Hot Lotto promotion was a sizzling success! The promotion was run by every lottery that participates in Hot Lotto. Minnesota's sales increase during the promotion was higher than any of the other Hot Lotto member lottery's sales. Minnesota's Hot Lotto sales during October were 28.5 percent higher than September, compared with an overall increase of 18.4 percent for the other member lotteries.

Sarah Arens of Albert Lea won \$5,000 every November for life* by playing the Lottery's Holiday for Life Scratch Game. She claimed the prize on Dec. 4, 2006. Arens, who is 31 years old, said that her sister joked that her family would have to "wrap her in bubble wrap" to ensure that she collects the prize for many years to come.

*Holiday for Life is a \$5 Scratch Game that offers players the chance to win approximately \$5,000 every November for life. Winners of the lifetime prize will receive \$7,380.07 (approximately \$5,000 after state and federal withholding taxes) upon validation of the ticket, and will receive \$7,380.07 (approximately \$5,000 after state and federal withholding taxes) on November 15 of each year for as long as they live. The winner is guaranteed to receive a minimum of ten payments (\$73,800.70 before taxes).



Ron Stein of Cedar (pictured) and Penny Tester of Staples each won a \$5,000 gift card from the Lottery's \$200,000 Gold Rush promotion.



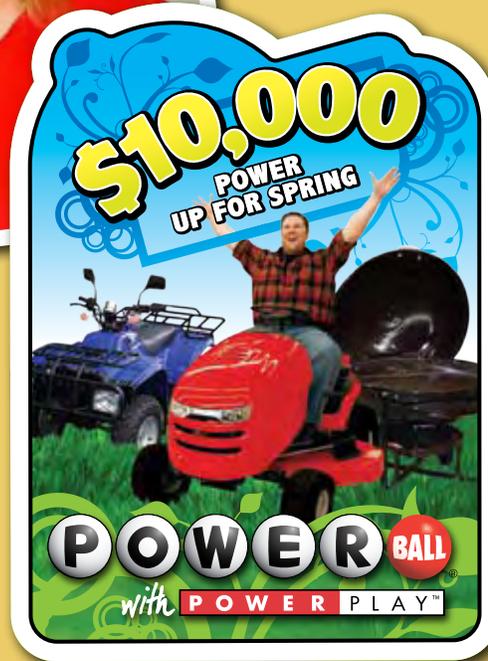
Mark Loots of Wabasha is the grand prize winner of the Lottery's Harley-Davidson® Scratch Game second-chance drawing promotion. He won a 2006 Harley-Davidson® Heritage Softail® Classic motorcycle. During this promotion, the Lottery also awarded 500 merchandise packs. All merchandise prize pack winners were automatically entered into the grand prize drawing held on Dec. 21, 2006. Loots said that he only mailed in one non-winning ticket entry during the promotion.



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*Jill Rousseau
of Eagan
\$10,000 Gift Card*



*Brandon Polifka
of Brownton
\$100,000 Minnesota
Twins™ Scratch Game*



During the month of April 2007, players could mail in non-winning Powerball with Power Play® tickets for a chance to win a \$10,000 gift card or one of two \$1,000 gift cards. Jill Rousseau of Eagan was the grand prize winner.

During the fiscal year, the Lottery began testing “wrapped” vans. The vans feature three designs that help increase Lottery awareness. The Powerball, Scratch Game and environmentally-themed designs are seen by potential players throughout Minnesota. The van wraps are less expensive than billboards and print ads, making this a cost effective advertising tool.



The Lottery participated in Twins® Fest to help generate buzz for the launch of the first ever Minnesota Twins™ Scratch Game on March 13, 2007.

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RETAILERS



More than 3,000 authorized lottery retailers, located throughout Minnesota, play a crucial role in the success of the Lottery.

Retailers receive 5.5 cents for each \$1 of ticket sales at their business, as well as 1 percent of the amount of each winning ticket cashed at their store (retailers can pay prizes up to \$599). Retailers also receive a bonus for selling qualifying top prize or jackpot-winning tickets after the prize has been claimed. One hundred thirty-seven retailers earned bonuses during the fiscal year ranging from \$83 to \$50,000. Cub Foods, 8421 Lyndale Ave. S. in Bloomington became the first store to collect a \$50,000 bonus for selling a winning Powerball jackpot ticket.

In fiscal year 2007, lottery retailers earned more than \$25.2 million in commission and incentives — an average of \$8,614 per store.

TOP 10 RETAILERS IN FISCAL YEAR 2007:

1. Metropolitan Public Airport Foundation - Minneapolis/St. Paul International Airport
2. M & H Gas, Moorhead
3. Holiday, St. Paul (Rice St.)
4. Clark on Rice, St. Paul
5. M & H Gas, St. Paul
6. Cub Foods, Maple Grove
7. Cub Foods, St. Anthony
8. SuperAmerica, Roseville (N. Lexington Ave.)
9. SuperAmerica, Blaine (University Ave. N.E.)
10. Cub Foods, Crystal



PROBLEM GAMBLING TREATMENT AND PREVENTION



The Lottery continues to actively support the treatment and the prevention of problem gambling.

The Lottery produced materials that promote responsible play and awareness of problem gambling that were distributed to all Minnesota State Lottery retailers and made available to the National Council on Problem Gambling. The Lottery worked with the Northstar Problem Gambling Alliance on a public awareness campaign for National Problem Gambling Awareness Week during March.

The Lottery was proud to sponsor the 2007 Minnesota Problem Gambling Awareness Week Conference, “Simplifying the Mystery: Bringing Hope to the Problem Gambler.” The Lottery also sponsored and participated in “Understanding Problem Gambling” conferences in Duluth, Bemidji, St. Cloud, Marshall and Rochester.

The Lottery requires that its advertising agency, Colle+McVoy, do up to 300 hours of work each year on efforts relating to problem gambling awareness. A poster that the agency designed won a People’s Choice Award at the National Council on Problem Gambling’s annual conference.

VISIT MNLOTTERY.COM FOR INFORMATION ON PROBLEM GAMBLING TREATMENT AND PREVENTION.

The Lottery remains an active member of the National Council on Problem Gambling and Northstar Problem Gambling Alliance. Lottery staff serve on the World Lottery Association’s Corporate Social Responsibility Committee and the North American Association of State and Provincial Lotteries’ Responsible Gaming Subcommittee.

In fiscal year 2007, \$1.9 million was appropriated to the Department of Human Services for problem gambling treatment and prevention, bringing the Lottery’s contributions for these efforts to \$23.6 million since 1990. Lottery contributions to problem gambling programs are determined by the Legislature.



INDEPENDENT AUDITOR'S REPORT

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KANTER**
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The Director
Minnesota State Lottery
Roseville, Minnesota

We have audited the accompanying balance sheets of the Minnesota State Lottery as of June 30, 2007 and 2006, 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 Minnesota State Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the 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 audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Minnesota State Lottery as of June 30, 2007 and 2006, and the results of its operations 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 September 25, 2007, on our consideration of the Minnesota State Lottery's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts. 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 audits.

The Management's Discussion and Analysis on pages 17 through 22 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 supplementary information. However, we did not audit the information and express no opinion on it.

*Schechter Dokken Kanter
Andrews & Selcer Ltd*

September 25, 2007

MANAGEMENT DISCUSSION & ANALYSIS



Overview of the Financial Statements

This discussion and analysis includes an overview of financial activities regarding the financial performance of the Minnesota State Lottery for the fiscal year ended June 30, 2007 and should be read in conjunction with the transmittal letter and supplementary information included in this report. This report consists of three parts: management's discussion and analysis, the basic financial statements, and the notes to the financial statements. Included below and on the following pages are the financial highlights, summary of contributions to the state, summary results of operations for years ended June 30, 2007, 2006 and 2005, and a condensed version of the Balance Sheets as of June 30, 2007, 2006 and 2005.

Financial Highlights

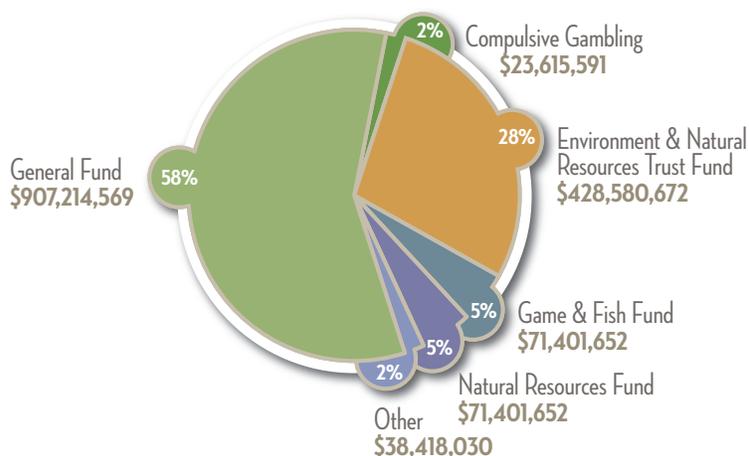
The Minnesota State Lottery's sales and contributions to the state for fiscal year 2007 were the second highest on record. Sales reached \$422.6 million, while funds transferred to the state totaled \$112.4 million. The Lottery attained this in part due to new initiatives including an integrated marketing plan that increased awareness and visibility along with a new Minnesota Millionaire Raffle game. Strong sales in combination with no significant increase in operating expense that has remained relatively constant for the last three years contributed to the \$112.4 million transferred to the state in fiscal year 2007.

Summary of Contributions to State

The Lottery contributed \$112.4 million to the state in fiscal year 2007. This was a decrease of 7.5 percent compared to \$121.5 million in fiscal year 2006, the current record, and an increase of 5.8 percent over fiscal year 2005 contributions to the state of \$106.2 million. The following table provides detail on the source of the transfers provided to the state in the last three fiscal years.

Contributions to State

	2007	2006	2005
Net Proceeds to the State	\$73,917,531	\$81,232,065	\$69,982,049
In-Lieu-of-Sales Tax	27,469,761	29,231,193	26,520,677
Compulsive Gambling Contribution	1,946,000	1,821,000	1,896,000
Unclaimed Prizes to the State	9,018,487	7,008,290	7,777,552
Unclaimed Prizes - Held in Trust	0	2,186,831	0
Total Paid to State	\$112,351,779	\$121,479,379	\$106,176,278



THE LOTTERY HAS CONTRIBUTED OVER \$1.5 BILLION TO THE STATE.

Summary Results of Operations

	2007	2006	2005
Gross Receipts	\$395,156,103	\$420,529,452	\$381,492,484
Prizes, Commissions and Ticket Costs	288,958,944	309,247,591	279,999,954
Gross Profit	106,197,159	111,281,861	101,492,530
Operating Expenses	22,933,423	22,782,405	22,571,484
Operating Income	83,263,736	88,499,456	78,921,046
Non-Operating Revenues (Expense):			
Interest Earned on Investments	1,618,282	1,366,853	734,555
Unused Compulsive Gambling Contribution	0	195,047	0
Payments to State (Not Including Sales Tax)	(84,882,018)	(90,061,355)	(79,655,601)
Total Non-Operating Revenue (Expense)	(83,263,736)	(88,499,455)	(78,921,046)
Income	\$0	\$0	\$0

Operating Income:

Fluctuations in operating income in the last three years are due mainly to the elasticity of Powerball and the propensity for players to spend significantly more dollars when jackpots exceed \$300 million. Operating income decreased \$5.2 million or 5.9 percent in fiscal year 2007 over fiscal year 2006 and increased \$4.3 million or 5.5 percent over fiscal year 2005.

The decrease in operating income was primarily due to lower Powerball sales in fiscal year 2007 compared to the previous year. Fiscal year 2006 operating income increased \$9.6 million or 12.1 percent over fiscal year 2005 due to sales that resulted from record high jackpots for Powerball of \$365 million and \$340 million. Fiscal year 2007 did not see jackpots of this level. The highest Powerball jackpot in fiscal year 2007 was \$254 million.

Operating Expenses:

Operating expenses remained relatively constant over the last three years increasing at a rate of less than one percent per year. In fiscal year 2007 operating expenses were \$22.9 million or 5.8 percent of gross receipts. This was up slightly from operating expenses in fiscal year 2006 and 2005, which was \$22.8 million and \$22.6 million, respectively.

Gross Receipts by Game

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Scratch Ticket Sales	\$260,841,696	\$267,793,640	\$253,425,269
Online Ticket Sales:			
Daily 3	13,198,769	12,958,518	13,134,177
Gopher 5	13,451,495	23,751,551	14,531,607
Powerball	86,770,299	112,184,974	89,562,348
Power Play	4,822,784	4,393,871	2,945,483
Hot Lotto	18,241,635	10,823,419	16,274,511
Northstar Cash	10,974,105	9,585,521	9,373,889
Minnesota Millionaire Raffle	4,992,260		
G3 Games	9,318,669	8,219,169	8,763,134
Operating Revenue	422,611,712	449,710,663	408,010,418
Other Income	14,152	49,982	2,743
Total Operating Revenue	422,625,864	449,760,645	408,013,161
Less In-Lieu-of-Sales Tax	27,469,761	29,231,193	26,520,677
Gross Receipts	<u>\$395,156,103</u>	<u>\$420,529,452</u>	<u>\$381,492,484</u>

Scratch Games:

Scratch Game sales were 61.7 percent of total sales in fiscal year 2007, an increase of 2.2 percent over 59.5 percent of sales in fiscal year 2006. Actual Scratch sales decreased \$7 million or 2.6 percent from \$267.8 million in fiscal year 2006 to \$260.8 million. Total sales, Scratch and Online, decreased 6.0 percent from \$449.7 million in fiscal year 2006 to \$422.6 million in fiscal year 2007. The expansion of Instant Ticket Vending Machines (ITVMs) and 20-bin ticket dispensers in fiscal year 2006 played a role in the increased percentage of Scratch sales in fiscal year 2007. ITVM sales in fiscal year 2007 were \$4.7 million, an increase of 24.8 percent from fiscal year 2006.

Scratch Game sales were 59.5 percent of total sales in fiscal year 2006. Scratch sales increased 5.7 percent over fiscal year 2005. The Lottery implemented two major new initiatives in fiscal year 2006, which contributed to the increase in Scratch sales: Instant Ticket Vending Machines (ITVMs) were introduced into supermarkets and non-traditional retailers and additional 20-bin Scratch dispensers were placed in many retailer locations. ITVM sales were \$3.8 million in fiscal year 2006.

Online Games:

Online Games sales were 38.3 percent of total sales in fiscal year 2007. Online sales decreased \$20.1 million or 11.1 percent from \$181.9 million in fiscal year 2006 to \$161.8 million in fiscal year 2007. The decrease in Online sales was mainly due to the lack of high Powerball jackpots seen in fiscal year 2007. Record sales in fiscal year 2006 resulted from two record high jackpots for Powerball of \$365 million and \$340 million. Fiscal year 2007 did not see jackpots of this level. The highest Powerball jackpot in fiscal year 2007 was \$254 million. Powerball/Power Play sales decreased 22.2 percent. Gopher 5 sales decreased 43.4 percent in fiscal year 2007. Gopher 5 experienced a large increase in fiscal year 2006; the fiscal year 2007 decrease returns Gopher 5 to approximately the fiscal year 2005 level. Northstar Cash, Daily 3, Hot Lotto, and G3 Games all experienced sales increases. The Lottery also introduced an Online Raffle game. The game launched November 1, 2006 and the drawing took place New Year's Day. Tickets were \$10 and it sold out on December 26, 2006, generating \$5 million in sales.

Online Game sales were 40.4 percent of total sales in fiscal year 2006. Powerball and Power Play sales increased 25.3 percent and 49.2 percent respectively in fiscal year 2006 over fiscal year 2005. The increase in Online sales was mainly due to the large number of high Powerball jackpots, as noted above. The higher jackpots were the result of the change to the game matrix for Powerball. Gopher 5 also experienced a matrix change which improved the odds of winning a prize, while increasing average jackpots. Gopher 5 sales increased 63.4 percent in fiscal year 2006 over fiscal year 2005. Northstar Cash saw a slight increase of 2.3 percent and Daily 3, Hot Lotto, and G3 Games all experienced sales decreases relative to fiscal year 2005.

BALANCE SHEET SUMMARY



Condensed Balance Sheet	<u>2007</u>	<u>2006</u>	<u>2005</u>
Assets:			
Cash and Cash Equivalents	\$19,678,961	\$15,494,128	\$19,081,645
Receivables	4,482,605	3,151,896	2,003,947
Capital Assets & Other Assets	<u>2,672,838</u>	<u>2,343,129</u>	<u>2,265,693</u>
Total Assets	<u>\$26,834,404</u>	<u>\$20,989,153</u>	<u>\$23,351,285</u>
Liabilities and Fund Equity:			
Due to State and State Agencies	\$14,124,440	\$10,605,584	\$11,476,341
Accounts Payable & Accrued Expenses	6,666,240	3,972,440	5,269,379
Current Accrued Prizes & Prize Annuity Liabilities	6,043,724	6,411,129	6,605,565
Unrestricted Net Assets	\$(1,403,218)	\$(1,089,022)	\$(1,095,925)
Net Assets Invested in Capital Assets	<u>1,403,218</u>	<u>1,089,022</u>	<u>1,095,925</u>
Net Assets	<u>0</u>	<u>0</u>	<u>0</u>
Total Liabilities	<u>\$26,834,404</u>	<u>\$20,989,153</u>	<u>\$23,351,285</u>

The Lottery is required to advance net proceeds to the state of Minnesota and therefore, fund equity remains unchanged from year to year. In general, short term assets and liabilities will fluctuate with the activity of games being played.

Cash and cash equivalents:

The fiscal year 2007 increase of \$4.2 million was mainly due to an increase in liabilities of \$5.8 million, particularly an increase of Net Proceeds Due to State of \$1.8 million, Unclaimed Prizes Due to State of \$2.0 million, and In-Lieu-of-Sales Tax Payable of \$2.0 million. In fiscal year 2006 there was a \$3.6 million decrease due to an increase in receivables of \$1.2 million and the reduction in liabilities of \$2.4 million.

Receivables:

Receivables increased in fiscal year 2007 by \$1.3 million which was due mainly to a timing difference between the day of the week the period ended for fiscal year 2007 versus the day of the week the period ended for fiscal year 2006. Receivables accrued for five days at the end of fiscal year 2007 versus four days at the end of fiscal year 2006. In fiscal year 2006, the increase of \$1.2 million was due mainly to a timing difference of four days versus three days at the end of the period.

Capital assets and other assets:

Additions to capital assets of \$756 thousand in fiscal year 2007 resulted from purchases of vehicles, computer equipment, express point machines and video surveillance equipment. Additions to capital assets in fiscal year 2006 were \$362 thousand mainly consisting of office equipment, software and vehicles. Retirements of capital assets in fiscal year 2007 were \$874 thousand consisting mainly of glow cube signs, computer equipment and vehicles.

Net of depreciation, total retirements were zero. Retirements of capital assets in fiscal year 2006 were \$493 thousand again consisting mainly of computer equipment and vehicles. Net of depreciation, total retirements were less than \$1 thousand.

Other assets increased by \$15 thousand in fiscal year 2007 due to an increase in pre-paid expenses of \$15 thousand and ticket inventory that was basically unchanged. Other assets increased by \$84 thousand in fiscal year 2006 due to increase in ticket inventory of \$492 thousand offset by reduction in prepaid expenses of \$408 thousand.

Due to State and State Agencies:

The fiscal year 2007 increase of \$3.5 million over fiscal year 2006 was mainly due to an increase in unclaimed prize money due to the state. The fiscal year 2006 decrease of \$870 thousand from fiscal year 2005 was due mainly to the decrease of unclaimed prize money due to the state.

Accounts payable & accrued expenses and current accrued prizes and prize annuity liabilities:

An increase of \$2.7 million for fiscal year 2007 over fiscal year 2006 was primarily due to the timing of payment for in-lieu-of-sales tax. A decrease of \$1.5 million for fiscal year 2006 over fiscal year 2005 was mainly due to a reduction in amounts owed to vendors. The vendors include the advertising agency in the amount of \$700 thousand and ticket and Online Game vendors in the amount of \$600 thousand which was not owed at the end of fiscal year 2006.



BALANCE SHEETS

JUNE 30, 2007 AND JUNE 30, 2006

<u>ASSETS:</u>	<u>2007</u>	<u>2006</u>
Current Assets:		
Cash and Cash Equivalents (Note 3)	\$19,678,961	\$15,494,128
Accounts Receivable	4,482,605	3,151,896
Scratch Ticket Inventory	874,534	874,191
Prepaid Expense	395,086	379,916
Total Current Assets	<u>25,431,186</u>	<u>19,900,131</u>
Capital Assets, Net (Note 5)	<u>1,403,218</u>	<u>1,089,022</u>
Total Assets	<u>\$26,834,404</u>	<u>\$20,989,153</u>
 <u>LIABILITIES AND NET ASSETS:</u>		
Current Liabilities:		
Net Proceeds Due to State (Note 8)	\$5,105,953	\$3,551,674
Unclaimed Prizes Due to State (Note 6)	9,018,487	7,008,290
Due to Other State Agencies	0	45,620
Accounts Payable	3,198,439	2,150,136
In-Lieu-of-Sales Tax Payable	2,131,981	162,525
Prize Liability	6,043,724	6,411,129
Compensated Absences Payable, current (Note 7)	665,826	607,005
Deferred Revenue	214,382	563,319
Total Current Liabilities	<u>26,378,792</u>	<u>20,499,698</u>
Compensated Absences Payable, Net of Current Portion (Note 7)	<u>455,612</u>	<u>489,455</u>
Commitments and Contingencies (Note 9 and 10)		
Net Assets:		
Unrestricted Net Assets	(1,403,218)	(1,089,022)
Net Assets Invested in Capital Assets (Note 8)	<u>1,403,218</u>	<u>1,089,022</u>
Total Net Assets	<u>0</u>	<u>0</u>
Total Liabilities and Net Assets	<u>\$26,834,404</u>	<u>\$20,989,153</u>

See Accompanying Notes to Financial Statements

STATEMENTS OF REVENUES, EXPENSES & CHANGES IN NET ASSETS YEARS ENDED JUNE 30, 2007 AND JUNE 30, 2006



	<u>2007</u>	<u>2006</u>
Operating Revenues:		
Scratch Ticket Sales	\$260,841,696	\$267,793,640
Online Ticket Sales	161,770,016	181,917,023
Other Income	14,152	49,982
Total Operating Revenues	<u>422,625,864</u>	<u>449,760,645</u>
Less: In-Lieu-of-Sales Tax	27,469,761	29,231,193
Gross Receipts	<u>395,156,103</u>	<u>420,529,452</u>
Direct Costs:		
Scratch Ticket Prizes	173,761,521	177,592,560
Online Ticket Prizes	76,357,952	90,204,335
Online Vendor Expense	9,869,664	11,121,657
Ticket Costs	3,720,019	3,038,105
Retailer Commissions and Incentives (Note 11)	25,249,788	27,290,934
Total Direct Costs	<u>288,958,944</u>	<u>309,247,591</u>
Gross Profit	<u>106,197,159</u>	<u>111,281,861</u>
Operating Expenses: (Note 12)		
Advertising (Note 12)	6,465,432	6,090,612
Salaries and Benefits (Note 13)	10,063,020	9,944,117
Promotion	1,872,463	1,478,677
Purchased Services	1,112,427	1,214,638
Communication	408,625	407,169
Occupancy Costs (Note 9)	1,216,350	1,777,911
Supplies and Materials	807,740	788,147
Computer and Omnipoint Maintenance	208,568	235,839
Depreciation	441,937	367,759
Other Expense	336,861	477,537
Total Operating Expenses	<u>22,933,423</u>	<u>22,782,406</u>
Operating Income	<u>83,263,736</u>	<u>88,499,455</u>
Nonoperating Revenue (Expense)		
Interest Earned on Investments	1,618,282	1,366,853
Unused Compulsive Gambling Contribution	0	195,047
Payments to State:		
Compulsive Gambling Contribution from Prize Fund (Note 10)	(1,946,000)	(1,821,000)
Unclaimed Prizes to State (Note 6)	(9,018,487)	(7,008,290)
Net Proceeds to State (Note 8)	(73,917,531)	(81,232,065)
Total Nonoperating Revenue (Expense)	<u>(83,263,736)</u>	<u>(88,499,455)</u>
Net Income	<u>0</u>	<u>0</u>
Net Assets at Beginning of Year (Note 8)	<u>0</u>	<u>0</u>
Net Assets at End of Year (Note 8)	<u>\$0</u>	<u>\$0</u>

See Accompanying Notes to Financial Statements

STATEMENT OF CASH FLOWS YEARS ENDED JUNE 30, 2007 AND JUNE 30, 2006



	2007	2006
<u>Cash Flows from Operating Activities:</u>		
Cash Received from Customers	\$420,946,218	\$448,785,530
Cash Received from Other Income	90,388	88,801
Payments to State (In-Lieu-of-Sales Tax)	(25,500,305)	(29,068,668)
Payments to Employees	(10,038,042)	(9,995,591)
Payments to Suppliers	(25,086,842)	(28,294,074)
Payments to Retailers	(25,340,176)	(27,379,734)
Payments to Prize Winners	(250,486,878)	(267,991,330)
Net Cash Provided by Operating Activities	84,584,363	86,144,934
<u>Cash Flows from Non-Capital Financing Activities:</u>		
Net Proceeds Paid to State	(72,363,252)	(81,360,786)
Compulsive Gambling Contribution Transfer	(1,946,000)	(1,821,000)
Compulsive Gambling Contribution Transfer	0	195,047
Unclaimed Prizes Transfer	(7,008,290)	(7,777,552)
Net Cash Used by Non-Capital Financing Activities	(81,317,542)	(90,764,291)
<u>Cash Flows from Capital and Related Financing Activities:</u>		
Purchases of Capital Assets	(756,133)	(361,629)
Proceeds from sale of Capital Assets	55,863	26,617
Net Cash Used by Capital Financing Activities	(700,270)	(335,012)
<u>Cash Flows from Investing Activities:</u>		
Investment Income	1,618,282	1,366,852
Net Increase (Decrease) in Cash and Cash Equivalents	4,184,833	(3,587,517)
<u>Beginning of Year Cash and Cash Equivalents</u>	15,494,128	19,081,645
<u>End of Year Cash and Cash Equivalents</u>	\$19,678,961	\$15,494,128
<u>Reconciliation of Operating Income to Net Cash Provided by Operating Activities:</u>		
Operating Income	\$83,263,736	\$88,499,455
Adjustments to Reconcile Operating Income to Net Cash provided by Operating Activities:		
Depreciation	441,937	367,759
Gain on the Disposal of Capital Assets	(55,863)	(25,843)
Net Change in Assets and Liabilities:		
Inventory	(343)	(492,737)
Other Assets	(1,345,879)	(739,551)
Current Liabilities	2,648,180	(1,269,713)
Prize Awards Payable	(367,405)	(194,436)
Net Cash Provided by Operating Activities	\$84,584,363	\$86,144,934

See Accompanying Notes to Financial Statements

NOTES TO THE FINANCIAL STATEMENTS JUNE 30, 2007 AND JUNE 30, 2006



1. ORGANIZATION OF THE MINNESOTA STATE LOTTERY

In 1988, Minnesotans voted to amend their Constitution to authorize a state-run lottery. In 1989, the Legislature approved and the Governor signed Minnesota Statutes Chapter 349A into law, officially creating the Minnesota State Lottery, the 33rd lottery in the country.

The Minnesota State Lottery (the Lottery), an enterprise fund of the state of Minnesota, is under the supervision and control of the Director of the Lottery, who is appointed by the Governor with the advice and consent of the Senate. The Lottery net proceeds and proceeds from the in-lieu-of-sales tax on tickets sales are dedicated to the General Fund, the Environment and Natural Resources Trust Fund, the Game and Fish Fund, and the Natural Resources Fund. The funds are used to enhance the state's natural resources as well as public education, local government assistance, and public safety.

Lottery revenue is generated by sales of Scratch Games and Online Games that include: Daily 3, Northstar Cash, G3 Games, Gopher 5, Powerball, Power Play, Hot Lotto, and the Minnesota Millionaire Raffle game.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Lottery is an agency of the state of Minnesota using proprietary type enterprise accounting. The financial statements are prepared in accordance with generally accepted accounting principles as applicable to governmental units. Following are the more significant accounting policies:

(a) Basis of Accounting

The financial statements of the Lottery have been prepared on the accrual basis of accounting. Revenues are recorded when they are earned and expenses are recognized as incurred.

Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting*, provides that proprietary and similar trust funds should apply all GASB pronouncements, as well as the following pronouncements issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB Pronouncements: Statements and Interpretations of the Financial Accounting Standards Board (FASB), Accounting Principles Board Opinions (APB), and Accounting Research Bulletins (ARB). As permitted by GASB Statement No. 20, the Lottery has elected not to apply FASB statements or interpretations issued on or after November 30, 1989, unless the GASB specifically adopts such statements or interpretations.

(b) Accounting Standard: GASB No. 34

In June 1999, the Governmental Accounting Standards Board (GASB) issued Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*. This Statement established updated financial reporting requirements for state and local governments. This statement also requires budgetary comparison schedules to be presented as supplementary information. The Lottery is not legally required to adopt a budget and therefore budgetary comparison schedules are not included as supplementary information.

(c) Measurement Focus

A proprietary fund is accounted for using the "economic resources" measurement focus. This means that all assets and liabilities associated with its activity are included on its balance sheet. The proprietary fund type operating statement presents increases (revenues) and decreases (expenses) in net total assets.

(d) Operating Revenue and Expenses

Operating revenue and expenses for proprietary funds such as the Lottery are revenues and expenses that result from providing services and producing and delivering goods and/or services. Operating revenues are derived from providing various types of games. Operating expenses include commissions, prize costs, other direct costs of providing lottery games, and administrative expenses.

Packs of Scratch tickets are distributed to retail sales outlets. Scratch ticket sales are recognized as operating revenue upon settlement of ticket packs by retailers and are recorded at the sale price to the consumer. Sales of Online tickets are recognized as operating revenue on the date of the draw for which the tickets were purchased. Revenues from future Online ticket draw sales are deferred until the date of the draw for which the tickets were purchased.

(e) Cash and Cash Equivalents

Cash and cash equivalents include an amount in demand deposits as well as funds held in the State Treasury and invested by the State Board of Investment.

(f) Prizes and Reserves

Scratch ticket prize expense is recognized in accordance with the predetermined prize structure for each game and is accrued when revenue is recognized. High tier prizes for certain Scratch ticket games may also be structured and paid as an annuity.

Prize expense for Daily 3 is recorded based upon the actual winners on the date of the draw. Prize expense for G3 Games are based on actual winners and are recorded at the time of sale. The prize expense for Northstar Cash is recorded at 50 percent of draw sales. The prize expense for Gopher 5 is recorded at 54 percent of draw sales; prior to September 23, 2005 it was recorded at 57 percent of draw sales.

To provide a reserve for guaranteed grand prize amounts an additional 2 percent of Gopher 5 sales, up to \$1 million, were expensed. On September 15, 2006 the method for funding the prize reserve was changed. When 54 percent of Gopher 5 draw sales and/or 50 percent of Northstar Cash exceed the guaranteed jackpot for the respective game, 2 percent of the draw sales for that game is expensed, up to \$1 million, to provide for the reserve.

Included in the Lottery Prize Liability at June 30, 2007 is a \$17,034 prize reserve which reflects funds due to the State Treasury that have been set aside in the Lottery prize fund by the Director in accordance with Minnesota Statutes, Section 349A.10, subdivision 2(b) to assure proper funding for future lottery prizes. The prize reserve at June 30, 2006 was \$156,118.

Prize expenses for Powerball, Power Play, and Hot Lotto are recorded at 50 percent of draw sales in accordance with the Multi-State Lottery Association (MUSL) prize structure. The Powerball, Power Play, and Hot Lotto prizes are paid with funds held by MUSL. MUSL has established separate prize pool reserves for Powerball, Power Play, and Hot Lotto to support payment of prizes in light of the remote possibility of claims greatly exceeding the expected amounts. In the event that the Lottery ceases to participate in one of these games, the Lottery may make claim to assets, if any, in the related prize pool reserve. The Lottery's share of these prize reserves as of June 30, 2007 was as follows:

Powerball/ Power Play	\$ 3,985,410
Hot Lotto	1,012,486
Total	<u>\$ 4,997,896</u>

These reserves held by MUSL are not included in these financial statements.

(g) Scratch Ticket Inventory

Scratch ticket inventories are carried at cost using the specific identification method. Tickets are charged to operating expense over the estimated life of each Scratch Game.

(h) Capital Assets

Assets costing five thousand dollars or more are capitalized and are carried at cost less accumulated depreciation. Depreciation is computed on the straight-line method using estimated useful lives from three to seven years. Computer equipment, printers, and software costs are depreciated over three years. Vehicles, other than the warehouse truck, are depreciated over four years. Office equipment, Online draw equipment and signs are depreciated over five years. Office furniture and the warehouse truck and equipment are depreciated over seven years. Leasehold improvements are depreciated on a straight-line basis over the shorter of the useful life or length of the lease. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts and any resulting gain or loss is recognized.

(i) In-Lieu-of-Sales Tax

From every dollar in Lottery sales, the Lottery sets aside six and one-half cents as in-lieu-of-sales tax and remits that amount monthly to the Commissioner of Revenue as required by Minnesota Statutes, Section 297A.259. Minnesota Laws 2003, Chapter 128, Article 1, Section 154, provides that for FY04 and thereafter, 27.57 percent of the in-lieu-of-sales-tax is credited to the General Fund and the remaining 72.43 percent is credited equally between the Game and Fish Fund and the Natural Resources Fund to be used for natural resources projects as specified by law.

(j) Income Taxes

The Lottery, as an agency of the state of Minnesota, is exempt from federal and state income taxes. Accordingly, the Lottery makes no provision for income taxes.

(k) Use of Estimates in the Preparation of Financial Statements

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 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. CASH AND CASH EQUIVALENTS

Minnesota Statutes, Section 349A.10, subdivision 7(a), requires the Lottery transfer all funds to a Lottery cash flow account in the State Treasury. Funds necessary to cover cash needs are transferred as needed from State Treasury to the Lottery fund. Funds in this account earn interest, which is credited monthly to the Lottery's account. Cash on deposits in the State Treasury and with financial institutions are insured. Cash on deposit is covered up to \$100,000 per institution by the federal depository insurance corporation. At times, cash balances may be in excess of the FDIC insurance limit. As a result, the financial institutions are required to pledge collateral to the Lottery in an amount equal to the funds in excess of the FDIC insurance limit.

The following table summarizes the Lottery's cash and cash equivalents at June 30, 2007 and 2006:

	<u>2007</u>	<u>2006</u>
Cash (checks issued but not yet presented for payment)	\$(1,677,782)	\$(1,283,422)
Cash on Deposit	21,356,743	16,777,550
Total Cash and Cash Equivalents	<u>\$19,678,961</u>	<u>\$15,494,128</u>

Available cash in the State Treasury is invested by the State Board of Investment. In accordance with Minnesota Statutes, Section 11A.24, the State Board of Investment must invest in obligations and stocks of U.S. and Canadian governments, their agencies and their registered corporations, short-term obligations of specified high quality, restricted participation as a limited partner in venture capital, real estate, or resource equity investments, and restricted participation in registered mutual funds. Lottery funds on deposit in the State Treasury cannot be tied to specific investment securities.

4. PRIZE ANNUITY INVESTMENTS AND PAYABLES

The prize structure of certain Scratch Games operated solely by the Lottery included prizes in the form of lifetime annuities. Since 1991, the Lottery has awarded sixteen Scratch Game annuity prizes.

In fiscal year 2007, the Lottery sold a Holiday for Life Scratch Game, in which there were four grand prizes of \$5,000 per year for life. The game ran November 21, 2006 through April 3, 2007. The last date to claim a prize for this game is April 3, 2008. As of June 30, 2007, two winners of the four grand prizes had claimed their prize. Prize expense for this game is 68.25 percent of sales of which \$123,080 was determined for each of these grand prizes. This amount has been set aside in prizes payable for the future purchase of annuities. The Lottery will purchase annuities in fiscal year 2008 after the last date to claim a prize and the total number of winners can be determined with certainty.

5. CAPITAL ASSETS

Summary of changes in capital assets for the years ended June 30, 2007 and 2006 are as follows:

	2007			
	July 1, 2006	Additions	Deletions	June 30, 2007
Depreciable Capital Assets:				
Office Equipment & Furniture	\$2,384,516	\$161,024	\$(35,731)	\$2,509,809
PC & Printer Equipment	916,289		(144,933)	771,356
Software Costs	59,965			59,965
Leasehold Improvements	1,629,259			1,629,259
Vehicles	1,041,311	218,131	(439,902)	819,540
Computer Equipment	1,452,726		(17,080)	1,435,646
Online Drawing Equipment	694,498	5,325	(45,455)	654,368
Express Point Machines		319,500		319,500
Signs	196,691	52,153	(189,466)	59,378
Warehouse Equipment	201,775			201,775
Total	<u>8,577,030</u>	<u>756,133</u>	<u>(872,567)</u>	<u>8,460,596</u>
Less - accumulated depreciation:				
Office Equipment & Furniture	2,215,721	54,703	(35,731)	2,234,693
PC & Printer Equipment	916,289		(144,933)	771,356
Software Costs	3,331	19,989		23,320
Leasehold Improvements	1,561,297	23,838		1,585,135
Vehicles	710,588	117,539	(439,902)	388,225
Computer Equipment	1,193,605	91,570	(17,080)	1,268,095
Online Drawing Equipment	525,088	98,550	(45,455)	578,183
Express Point Machines		26,625		26,625
Signs	196,691	869	(189,466)	8,094
Warehouse Equipment	165,398	8,254		173,652
Total accumulated depreciation	<u>7,488,008</u>	<u>441,937</u>	<u>(872,567)</u>	<u>7,057,378</u>
Net Capital Assets	<u>\$1,089,022</u>	<u>\$314,196</u>	<u>\$0</u>	<u>\$1,403,218</u>
	2006			
	July 1, 2005	Additions	Deletions	June 30, 2006
Depreciable Capital Assets:				
Office Equipment & Furniture	\$2,312,094	\$73,557	\$(1,135)	\$2,384,516
PC & Printer Equipment	1,184,547		(268,257)	916,290
Software Costs		59,965		59,965
Leasehold Improvements	1,634,348		(5,089)	1,629,259
Vehicles	1,028,726	218,282	(205,697)	1,041,311
Computer Equipment	1,455,535	9,824	(12,633)	1,452,726
Online Drawing Equipment	694,498			694,498
Signs	196,691			196,691
Warehouse Equipment	201,775			201,775
Total	<u>8,708,214</u>	<u>361,629</u>	<u>(492,811)</u>	<u>8,577,031</u>
Less - accumulated depreciation:				
Office Equipment & Furniture	2,150,691	66,165	(1,135)	2,215,721
PC & Printer Equipment	1,176,504	8,042	(268,258)	916,288
Software Costs		3,331		3,331
Leasehold Improvements	1,536,425	29,187	(4,316)	1,561,296
Vehicles	860,581	55,703	(205,697)	710,587
Computer Equipment	1,107,355	98,883	(12,634)	1,193,604
Online Drawing Equipment	426,893	98,195		525,088
Signs	196,691			196,691
Warehouse Equipment	157,145	8,253		165,398
Total accumulated depreciation	<u>7,612,285</u>	<u>367,759</u>	<u>(492,040)</u>	<u>7,488,004</u>
Net Capital Assets	<u>\$1,095,929</u>	<u>\$(6,130)</u>	<u>\$(771)</u>	<u>\$1,089,027</u>

6. UNCLAIMED PRIZES

Effective July 1, 2003 pursuant to Minnesota Laws 2003, 1st Special Session, Chapter 1, Article 2, Section 101, all unclaimed prizes will be transferred to the General Fund at the end of the fiscal year. The unclaimed prizes due to the State are \$9,018,487 and \$7,008,290 on June 30, 2007 and 2006, respectively.

7. COMPENSATED ABSENCES

A liability is recognized for unpaid vacation, compensatory hours, vested severance and anticipated severance pay when earned. Non-vested severance pay is estimated based upon historical trends and current demographics.

Compensated absences:	<u>Beginning</u>	<u>Additions</u>	<u>Retirements</u>	<u>Ending</u>
2007	\$1,096,460	\$927,301	\$(902,323)	\$1,121,438
2006	\$1,147,934	\$912,270	\$(963,744)	\$1,096,460

8. NET ASSETS

Within 30 days after the end of each month, the Lottery is required by Minnesota Statutes, Section 349A.10, subdivision 5 to deposit the net proceeds in the State Treasury. The monthly transfer of net proceeds leaves a zero balance in Net Assets. Net Proceeds Due to State on the accompanying balance sheets for the month ended June 30, 2007 and 2006 were \$5,105,953 and \$3,551,674, respectively. Net assets invested in capital assets consist of capital assets, net of accumulated depreciation.

9. COMMITMENTS AND CONTINGENCIES

(a) Risk Management

The Lottery is exposed to various risks of loss related to torts, theft, damage to and destruction of assets, errors and omissions, injuries to employees, and natural disasters.

The Lottery participates in the State's Risk Management Fund for property, liability, crime and automobile insurance coverage. The Lottery pays annual premiums for this coverage. The State's Risk Management Fund covers all claims above the deductible. The Lottery has not experienced any settlements in excess of coverage in the past three years.

The areas of insurance coverage, limits and deductibles as of June 30, 2007 are as follows:

<u>Coverage</u>	<u>Limits</u>	<u>Deductible</u>
Property	\$4,649,273	\$1,000
Auto		
Bodily Injury & Property Damage	\$300,000/\$1,000,000	\$500
Primary Crime		
Employee Dishonesty, Money & Securities	\$25,000	\$1,000
General Liability	\$300,000/\$1,000,000	None
Excess Crime		
Employee Dishonesty	\$1,000,000	\$25,000
Forgery or Alteration	\$1,000,000	\$500
Computer Fraud	\$1,000,000	\$5,000
Wire Transfer	\$1,000,000	\$5,000
Robbery and Safe Burglary	\$50,000	\$100

The Lottery participates in the State's workers' compensation program. The Workers' Compensation Alternative Cost Allocation Account (WCACAA) funds approximately 15 percent of the total workers' compensation costs annually.

Funds are collected up-front through a premium based on each agency's unique exposure and experience. The Lottery paid a premium of \$62,040 in fiscal year 2007 and \$120,538 in fiscal year 2006.

The Lottery purchased sixteen lifetime annuities from Principal Financial Group. If Principal Financial Group were to default on those obligations these policies would be covered under a "Guaranty Fund Law" which is administered by the State of Minnesota. The amount guaranteed per annuity is \$300,000. The Lottery may be ultimately responsible for the lifetime annuities, however, management feels that the possibility of Principal Financial Group defaulting on its obligations in a material sum in excess of the \$300,000 guaranteed by the State is remote.

(b) Operating Leases

The Lottery is committed under various leases for building and office space. The leases are classified as operating leases for accounting purposes. For the years ended June 30, 2007 and 2006, the lease expense was \$1,017,130 and \$1,223,648, respectively. This is net of sublease rental income of \$346,555 in fiscal year 2007 and \$109,024 in fiscal year 2006. Sublease rental income is included within occupancy costs on the financial statements. Future minimum lease payments for existing lease agreements are:

Year Ending June 30	Amount	Sub-lease Amount	Net
2008	\$1,311,379	\$349,553	\$961,826
2009	1,340,914	352,667	988,247
2010	1,361,254	350,216	1,011,038
2011	1,433,606	336,371	1,097,235
2012	1,144,214	336,371	807,843
2013	1,070,950	205,227	865,723
Total	\$7,662,317	\$1,930,405	\$5,731,912

(c) Sales Tax Contingency

The Lottery was subject to a sales and use tax audit in fiscal year 2006 for the period July 1, 2002 to June 30, 2005. The Lottery is currently appealing an assessed tax liability of \$734,879 with the Department of Revenue and management believes it is likely that the assessment will be overturned. Accordingly, the financial statements do not reflect this amount as an amount due for sales tax assessment. If the assessment is not overturned, the effect on the financial statements would be to increase Scratch Ticket Expense by \$734,879 and decrease Net Proceeds to State by the same amount. Because the sales tax is also payable to the State there is no change in the total amount the Lottery submits to the State.

However, it would result in a reallocation of Lottery proceeds between State funds, most likely increasing the amount going to the General fund. There is approximately \$281,000 of sales tax related to the period from July 1, 2005 to June 30, 2007 that may also be payable to the State if the Lottery does not win its appeal.

10. COMPULSIVE GAMBLING TREATMENT CONTRIBUTION PROVIDED FROM PRIZE FUND

Minnesota Laws 1998, Chapter 407, Article 8, Section 11 directed the Lottery to pay \$340,000 annually from the prize fund to a special Indian Gaming account in the State Treasury. Funds in this account are transferred to the Department of Human Services for compulsive gambling treatment programs.

Minnesota Laws 2005, 1st Special Session, Chapter 4, Article 9, section 2, subdivisions 8(e) and 9 appropriated \$1,456,000 in fiscal year 2006 and 2007 from the prize fund to the Department of Human Services for statewide compulsive gambling treatment programs.

Minnesota Laws 2006, Chapter 225, section 1 appropriated \$25,000 for fiscal year 2006 and \$150,000 for fiscal year 2007 to the Department of Human Services to be used for a grant to the state affiliate recognized by the National Council of Problem Gambling. Of the appropriation for fiscal year 2007, \$75,000 is contingent on the contribution of non-state matching funds.

Non-operating revenue of \$195,047 in fiscal year 2006 represents funds transferred from the Lottery to the Compulsive Gambling Fund, which were unused by the Agency. Therefore, the funds were returned to the Lottery.

11. RETAILER COMMISSIONS

Retailer commission is set by Minnesota Rule 7856.4030 as 5.5 percent of the price of each lottery ticket sold by a retailer and 1 percent of the amount of each winning lottery ticket cashed by a retailer.

12. STATUTORY LIMITATION ON OPERATING AND ADVERTISING EXPENSES

Gross revenue is defined in law as ticket sales and all other income less in-lieu-of-sales tax. Direct costs are expenses that are a direct function of lottery sales, which include all prize payouts, retailer commissions and incentives, amounts paid to produce and deliver scratch lottery tickets, and amounts paid to an outside vendor to operate and maintain an Online gaming system. Operating costs include all other expenses of the Lottery.

For fiscal year 2006 and thereafter, Minnesota Statutes, Section 349A.10, subdivision 3 limits the Lottery's advertising costs to 2.75 percent and operating costs to 9 percent of gross revenue. Minnesota Laws 2005, Chapter 156, Article 1, section 20, provide that notwithstanding Minnesota Statutes, section 349A.10, the operating costs of the Lottery may not exceed \$26,700,000 in fiscal year 2006 and \$27,350,000 in fiscal year 2007.

The Lottery is in compliance with the statutory limits on advertising and operating costs. Advertising costs as a percentage of gross revenue were 1.44 percent and 1.64 percent for the years ended June 30, 2006 and 2007, respectively. Operating costs as a percentage of gross revenue were 5.40 percent and 5.80 percent for the years ended June 30, 2006 and 2007, respectively.

13. RETIREMENT PLANS

The Lottery is involved in two pension programs as follows:

(a) General Plan - Defined Benefit Pension Plan - Statewide:

Plan Description: The Lottery contributes to the Minnesota State Retirement System (MSRS), which is a cost-sharing multiple-employer defined benefit pension plan administered by the MSRS. The plan provides retirement and disability benefits, annual cost of living adjustments, and death benefits to qualifying plan members and beneficiaries. Benefit provisions are established and may be amended by state statute and vest after three years of credited service. MSRS issues a publicly available financial report that includes financial statements and required supplementary information for MSRS. That report may be obtained by contacting MSRS.

Funding Policy: Plan members are required to contribute 4.0 percent of their annual covered salary and the Lottery is required to contribute at an actuarially-determined rate. The Lottery's current rate is 4.0 percent of annual covered payroll. The contribution requirements of plan members and the Lottery are established and may be amended by state statute.

The Lottery's contributions to MSRS for the years ending June 30, 2007, 2006, and 2005 were as follows:

<u>2007</u>	<u>2006</u>	<u>2005</u>
\$297,352	\$293,890	\$278,704

(b) Unclassified Plan - Defined Contribution Plan - Statewide:

Plan Description: The Lottery contributes to the MSRS, which is a multiple-employer defined contribution plan administered by the MSRS. The plan provides retirement and disability benefits, and death benefits to qualifying plan members and beneficiaries. Benefit provisions are established and may be amended by state statute and vest immediately.

MSRS issues a publicly available financial report that includes financial statements and required supplementary information for MSRS. That report may be obtained by contacting MSRS.

Funding Policy:

Plan members are required to contribute 4.0 percent of their annual covered salary and the Lottery is required to contribute 6.0 percent of the annual covered payroll. The contribution requirements of plan members and the Lottery are established and may be amended by state statute.

The Lottery's contributions to MSRS for the years ending June 30, 2007, 2006 and 2005 were as follows:

<u>2007</u>	<u>2006</u>	<u>2005</u>
\$36,403	\$34,924	\$41,018



CERTIFICATION OF CHIEF FINANCIAL OFFICER

IN CONSIDERATION OF SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002 AS IT RELATES TO THE MINNESOTA STATE LOTTERY

I, Joseph Pahl, Chief Financial Officer of the Minnesota State Lottery, certify that:

1. I have reviewed these Financial Statements for the fiscal year ended June 30, 2007 of the Minnesota State Lottery;
2. Based on my knowledge, these statements do not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by these statements;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Minnesota State Lottery as of, and for, the periods presented in these Financial Statements;
4. The Minnesota State Lottery's other certifying officer and I have disclosed, based on our most recent review of internal control over financial reporting, to the Minnesota State Lottery's auditors:
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Minnesota State Lottery's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Minnesota State Lottery's internal control over financial reporting.

Date: September 25, 2007

By:

Joseph Pahl, Chief Financial Officer

CERTIFICATION OF DIRECTOR

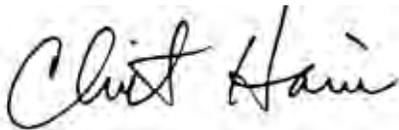


IN CONSIDERATION OF SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002 AS IT RELATES TO THE MINNESOTA STATE LOTTERY

I, Clint Harris, Executive Director of the Minnesota State Lottery, certify that:

1. I have reviewed these Financial Statements for the fiscal year ended June 30, 2007 of the Minnesota State Lottery;
2. Based on my knowledge, these statements do not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by these statements;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Minnesota State Lottery as of, and for, the periods presented in these Financial Statements;
4. The Minnesota State Lottery's other certifying officer and I have disclosed, based on our most recent review of internal control over financial reporting, to the Minnesota State Lottery's auditors:
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Minnesota State Lottery's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Minnesota State Lottery's internal control over financial reporting.

Date: September 25, 2007

By: 

Clint Harris, Director

INDEPENDENT PRACTITIONER'S SYSTRUST REPORT ON SYSTEM RELIABILITY



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To the Management of Minnesota State Lottery:

We have examined the effectiveness of the Minnesota State Lottery's (the Lottery's) controls over the reliability of its AS/400, Novell, BPCS, ACCLAIMS, and ICS systems during the period of October 1, 2006 through March 31, 2007, based on the AICPA/CICA Trust Services Criteria for systems reliability. Maintaining the effectiveness of these controls is the responsibility of the Lottery's management. Our responsibility is to express an opinion based on our examination.

A reliable system is one that is capable of operating without material error, fault, or failure during a specified period in a specified environment. The AICPA/CICA Trust Services Security and Processing Integrity Criteria are used to evaluate whether the Lottery's controls over the reliability of its AS/400, Novell, BPCS, ACCLAIMS, and ICS systems are effective.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included (1) obtaining an understanding of the Lottery's relevant security and processing integrity controls; (2) testing and evaluating the operating effectiveness of the controls; and (3) performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

In our opinion, the Lottery maintained, in all material respects, effective controls over the reliability of the AS/400, Novell, BPCS, ACCLAIMS, and ICS systems to provide reasonable assurance that:

- The System was protected against unauthorized access (both physical and logical); and
- The System processing was complete, accurate, timely, and authorized during the period of October 1, 2006 to March 31, 2007, based on the AICPA/CICA Trust Services criteria for systems reliability.

Because of inherent limitations in controls, error or fraud may occur and not be detected. Furthermore, the projection of any conclusions, based on our findings, to future periods is subject to the risk that the validity of such conclusions may be altered because of changes made to the system or controls, the failure to make needed changes to the system or controls, or a deterioration in the degree of effectiveness of the controls.

The SysTrust seal on the Lottery's Web site constitutes a symbolic representation of the contents of this report and it is not intended, nor should it be construed, to update this report or provide any additional assurance.

*Schechter Dokken Kanter
Andrews & Selcer Ltd*

Minneapolis, Minnesota
May 11, 2007

CERTIFICATE OF ACHIEVEMENT FOR EXCELLENCE IN FINANCIAL REPORTING



Certificate of Achievement for Excellence in Financial Reporting

Presented to

Minnesota State Lottery

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2006

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



President

Executive Director



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