

**FY 2008
ANNUAL
REPORT**

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NCEL COMMISSION

John McArthur - Commission Chair

Senior Vice President, Progress Energy
term expires 8/31/11
(appointed by Governor Easley)

Bob Farris

Attorney, Wilson
term expires 8/31/13
(appointed by Governor Easley)

Max Cogburn

Attorney, Asheville
term expires 8/31/12
(appointed by Speaker of House)

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President and CEO of JHR &
Associates, LLC, Charlotte
term expires 8/31/12
(appointed by President Pro Tem of Senate)

Pamela Whitaker

President, Key Resources, Inc.,
term expires 8/31/12
(appointed by Governor Easley)

Eddie Speas (not pictured)

Attorney, Raleigh
term expires 8/31/11
(appointed by Governor Easley)

Bryan Beatty

Secretary, Crime Control and
Public Safety, Raleigh
term expires 8/31/11
(appointed by Governor Easley)

Bob Appleton

Associate Professor Emeritus of Accounting,
UNC at Wilmington, Wilmington
term expires 8/31/08
(appointed by President Pro Tem of Senate)

Jim Woodward (not pictured)

Chancellor Emeritus,
UNC at Charlotte, Charlotte
term expires 8/31/08
(appointed by Speaker of House)

Commission Chair's NOTE



In fiscal year 2008, the North Carolina Education Lottery transferred more than \$350 million to support education in our state, a twelve percent increase over last year. These dollars are supporting four important programs identified by the General Assembly, including More at Four, pre-kindergarten for at-risk four year olds; class size reduction for grades K-3; school construction; and financial need-based college scholarships.

Our success in 2008 was driven in part by additional flexibility granted by the Legislature to better manage instant ticket prize payouts.

This flexibility allowed us to increase sales and increase the amount of support for education despite a downturn in the economy.

In addition to our focus on maximizing sales and revenue, we also focus on integrity and security. Both our fiscal year financial audit and security audit resulted in clean audits with no material findings. These audits are an indication of the hard work and dedication of the staff and a source of great pride for the organization.

Our first performance audit, completed by the North Carolina State Auditor in April, identified four minor recommendations related to business operations. We are implementing a plan to address these recommendations which should be completed by the end of 2008.

The North Carolina Education Lottery Commission is dedicated to continuing our excellent track record. The commission members and the staff will continue to work collaboratively with the Governor and the Legislature to ensure that our state's lottery program operates with the highest standards of integrity and security while providing as much money as possible to support education at all levels.

In closing, I would like to give special thanks to the North Carolina Education Lottery staff and especially to Tom Shaheen, whose excellent management skillfully guides the operations. They work tirelessly to ensure that our lottery program is among the best in the country from an operational and ethical standpoint. Their hard work and dedication drive increasing lottery sales each year, bringing additional resources to education in our state. They deserve to be proud of the continuing success of the North Carolina Education Lottery.

A handwritten signature in black ink that reads "John R. McArthur". The signature is written in a cursive, flowing style.



NCEL SENIOR STAFF

Tom Shaheen

Executive Director

Margaret Spindola-Bode

Director, Human Resources

Nikki Howard

Internal Auditor

Sam Hammett

Deputy Executive Director, Sales

Terri Avery

Director, Sales

Deborah Doty

Deputy Executive Director, Management
Information and Gaming Systems

Tony Chung

Director, MIS

Joe Norman

Director, Gaming Systems

Fenita Shepard

Deputy Executive Director,
Legal and Security

Jerry Carter

Director, Security

Quan Kirk

Director, Legal Services

Alice Garland

Deputy Executive Director,
Legislative and Corporate Communications

Pamela Walker

Director, Corporate Communications

Lou Ann Russell

Deputy Executive Director,
Marketing and Advertising

Penny Railey

Director, Marketing

Robin Diehl

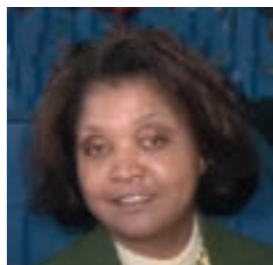
Deputy Executive Director,
Finance and Administration

Bill Enlow

Director, Administration

Jim Knight

Director, Finance



**In memory of
Kim McLaurin,
Director of Sales.**

Executive Director's NOTE



It's hard to believe that the North Carolina Education Lottery has completed its second full year. The days...and nights of long "to do" lists and heavy schedules don't seem that far away.

We passed several major milestones and had some fun along the way. By June 30, 2008 we had transferred over \$350 million to education, meeting the amount appropriated by the North Carolina Legislature. This brought the transfer since inception to over \$725 million. On May 3, 2008 total sales topped \$2 billion and on June 7, 2008 fiscal year sales topped \$1 billion.

Our focus in FY2008 was on sales. To that end, we added several new features. We conducted two vehicle giveaways: five Ford Mustangs and six Harley-Davidson® Fatboys®. The Mustangs were part of a Carolina Cash 5 special promotion and proved to be extremely popular. Three of the Fatboys® were prizes on our Harley-Davidson® instant scratch-off ticket and three were prizes in a second chance drawing. This ticket flew off the shelves.

The 2007 Legislature provided us the opportunity to increase our instant ticket prize payout. We began to change the prize structure on tickets in the fall but it was January before we felt the full impact. We launched the \$100 Million Cash Spectacular ticket on January 8 and saw immediate results with superior sales of this ticket. February, 2008 was the first month where sales for the month topped \$100 million.

On March 31, 2008 we added a mid-day draw to our popular Carolina Pick 3 game. This addition boosted Carolina Pick 3 sales and did not detract from sales for the evening draw. And on May 16, 2008 the NCEL 200 NASCAR® Craftsman Truck Series race took place at the Lowe's Motor Speedway in Concord.

Again, all of this could not have been accomplished without the support of our retailers. They continue to promote and sell lottery tickets with enthusiasm.

We really don't know how to slow down at the lottery. Staff is dedicated, energized, and always looking for ways to boost sales and raise money for education. We are proud of FY08 and look forward to FY09 as another good year for sales.

A handwritten signature in dark ink, appearing to read "Tom Shaheen".



WHAT The Legislation Says

Over \$725 million in a little over two years! The North Carolina Education Lottery (NCEL) is extremely excited about raising this amount for education in North Carolina.

As outlined in the North Carolina Lottery Act, the North Carolina Legislature has the authority to determine how the education lottery net proceeds will be spent. They have not changed the initial four programs designated to receive funds in the 2005 Lottery Act: pre-kindergarten programs for at-risk four year olds; one teacher per 18 students in grades K-3; school construction; and need-based college scholarships.

The NCEL transfers net proceeds quarterly to the Office of State Budget and Management which then disburses the funds to the four education programs. The Department of Public Instruction administers the funds with the exception of need-based college scholarships, which is administered by the State Education Assistance Authority (SEAA).

The More at Four program, the designated pre-kindergarten program for at-risk four year olds, receives the dollars in their regular allotments from the Department of Public Instruction as do school systems for the class size reduction dollars. The Department posts the school construction dollars on their web page and banks the dollars for the counties that choose to do so. Each county decides when and how to use their school construction dollars. By the end of FY08, counties had initiated 235 construction projects utilizing lottery dollars.

Students apply for an education lottery scholarship by completing the Free Application for Federal Student Aid (FAFSA). Any student who qualifies for the federal Pell grant will receive an education lottery scholarship. SEAA awards scholarships for the next school year with the current fiscal year dollars.



“This scholarship will enable me to focus more on studying and I will not have to worry about getting a job, which I have had to do in the past!”

- Chantell Felder, NC State College Student



County TOTALS FY08

ALAMANCE	\$4,523,565	HALIFAX	2,452,533	ORANGE	4,214,763	SURRY	3,203,248
ALEXANDER	1,173,876	HARNETT	4,320,213	PAMLICO	372,686	SWAIN	484,657
ALLEGHANY	414,853	HAYWOOD	1,557,196	PASQUOTANK	1,297,209	TRANSYLVANIA	725,761
ANSON	1,340,245	HENDERSON	2,400,251	PENDER	1,616,900	TYRRELL	177,445
ASHE	925,870	HERTFORD	1,104,560	PERQUIMANS	403,451	UNION	8,809,969
AVERY	673,432	HOKE	2,360,160	PERSON	1,491,079	VANCE	2,011,239
BEAUFORT	1,466,243	HYDE	194,311	PITT	6,244,547	WAKE	23,124,087
BERTIE	1,097,927	IREDELL	4,610,381	POLK	633,185	WARREN	675,153
BLADEN	1,693,442	JACKSON	789,402	RANDOLPH	4,250,560	WASHINGTON	722,377
BRUNSWICK	2,893,474	JOHNSTON	7,311,208	RICHMOND	2,381,819	WATAUGA	1,117,325
BUNCOMBE	5,261,821	JONES	511,761	ROBESON	8,207,947	WAYNE	5,936,639
BURKE	3,571,531	LEE	2,834,609	ROCKINGHAM	3,732,100	WILKES	3,015,879
CABARRUS	7,583,238	LENOIR	2,734,066	ROWAN	5,237,727	WILSON	3,093,461
CALDWELL	2,385,663	LINCOLN	2,346,218	RUTHERFORD	2,306,841	YADKIN	1,716,639
CAMDEN	390,789	MACON	1,111,456	SAMPSON	3,434,821	YANCEY	511,102
CARTERET	1,607,033	MADISON	553,786	SCOTLAND	2,154,594	Unknown	111,035
CASWELL	903,240	MARTIN	1,050,457	STANLY	2,850,656	DPI Admin Cost	5,628,567
CATAWBA	4,628,419	MCDOWELL	1,380,018	STOKES	2,118,513	TOTAL	\$349,658,992
CHATHAM	2,304,806	MECKLENBURG	32,822,476				
CHEROKEE	869,460	MITCHELL	505,936				
CHOWAN	509,532	MONTGOMERY	1,398,303				
CLAY	331,185	MOORE	1,926,042				
CLEVELAND	5,000,949	NASH	4,291,462				
COLUMBUS	3,195,125	NEW HANOVER	5,558,771				
CRAVEN	2,764,202	NORTHAMPTON	1,009,263				
CUMBERLAND	16,626,570	ONSLow	5,166,613				
CURRITUCK	654,068						
DARE	942,838						
DAVIDSON	4,931,253						
DAVIE	1,810,258						
DUPLIN	2,333,312						
DURHAM	7,941,340						
EDGECOMBE	2,466,364						
FORSYTH	12,510,759						
FRANKLIN	1,995,376						
GASTON	8,964,687						
GATES	540,621						
GRAHAM	322,174						
GRANVILLE	2,188,997						
GREENE	981,648						
GUILFORD	20,623,374						



INSTANT SCRATCH OFFS

Instant scratch-off games became much more exciting in FY08 due to a change approved by the North Carolina Legislature, allowing the NCEL to pay out more in prizes. In January, 2008, the full impact of this change was felt immediately with our \$10 ticket, “\$100 Million Cash Spectacular.” This was our first ticket to award a top prize of \$1 million, paid as an annuity with 20 installments of \$50,000. This game created a great deal of excitement with players, retailers and the NCEL staff. When possible, the NCEL presented the top prize winners their big check at media events conducted at the selling retailer.

A Wide Range of Fun!

Our “7’s” series tickets also proved popular with players. Seven remains a lucky number for most people. We offered “7’s” games at \$1, \$2, and \$5 price points and all sold well. These included Junior Ruby Red 7’s, Super 7’s, Emerald Green 7’s, and Tic Tac 7’s.



Ahoy Matey!

Players also had fun with our Big Ol' Bucks series of tickets, including Big Ol' Bucks, Jingle Big Ol' Bucks and Junior Big Ol' Bucks. BOB the pirate and his trusty parrot showcased these tickets for us in a series of advertisements.





A Spectacular Start to 2008

For the total year, instant scratch-off tickets represented 59 percent of total sales and brought in \$635,880,115 in revenue.

The \$100 Million Cash Spectacular instant ticket was the first big ticket unveiled after the change in instant ticket prize payouts. This ticket contributed to a 79 percent increase in sales of instant scratch-off tickets from the first half of the year to the second half, due to the increase in the allowed prize payout. For the first half of the fiscal year, instant sales represented 51 percent of total sales. For the second half, they represented 64 percent of total sales.



Harley-Davidson® Game

The Harley-Davidson® ticket quickly followed the \$100 Million Cash Spectacular ticket and included three Harley-Davidson® Fat Boy® motorcycles as prizes on the ticket and three more Fat Boy® motorcycles available through second chance drawings. Retailers could hardly keep this ticket on their shelves.



The big news in FY08 was the addition of a daytime Carolina Pick 3 draw. From the beginning of the game, players asked for a daytime draw in addition to the nightly draw. On March 31 we answered the request of players and added a 3pm draw.

Just like the existing 11:22pm nightly draw, the midday draw is conducted at WRAL-TV studios in Raleigh, our draw partner. However, the midday draw does not occur on Sundays and is not televised. Instead, players can watch a video of the draw online within minutes of the draw taking place or obtain the draw results through a variety of outlets including the player hotline, the NCEL web page, drawing station web pages or lottery retailers. In addition to WRAL-TV in Raleigh, our draw station network includes WITN-TV-Greenville, WCNC-TV-Charlotte, WILM-TV-Wilmington, and WYCW-TV-Western NC.

We experienced an immediate increase in sales with the addition of a midday draw, a bump that has continued throughout the remainder of the fiscal year. Through March 30, 2008 Carolina Pick 3 sales averaged \$369,281 per day. From March 31 through the end of the fiscal year, sales averaged \$499,732 per day and the midday draw occurs only six days per week.

Carolina Pick 3 sales topped out at \$147,158,304 for the fiscal year, representing 14 percent of total sales.



1,000.00 PICK 3



2-3-07
Willa Williams



6-10-07 1500.00
DANNY Poston

CAROLINA
PICK 3

NOW

2 DAILY DRAWINGS!

EVERYDAY EXCEPT SUNDAY

* Draw Times:
NEW 3pm, Monday-Saturday
11:22pm, Monday-Sunday



5 WNCN
WITN-7
10 WILM
CAROLINAS
CW
WYOM-TV/DT

nc-educationlottery.org

TELEvised EVENING DRAWINGS ONLY.
Must be 18 to play. Net proceeds benefit education.
Odds of winning \$500 are 1 in 1,000. Problem Gambling Helpline: 877-718-5543.



Carolina Cash 5 experienced Mustang Madness. In a highly successful promotion, players who purchased a \$5 Carolina Cash 5 ticket received an entry into one of five drawings for Ford Mustangs. Altogether the NCEL received 403,000 entries for one of the five Mustangs. Each Mustang was delivered to the player at the store where the player purchased the winning entry. In addition, the store received a banner announcing that they sold the winning Mustang ticket.



Dallas Eccles of Clemmons, NC

Carolina Cash 5 drawings take place nightly, seven nights a week. The top prize begins at \$50,000 and increases with each draw when no player matches the five numbers drawn. The top prize was hit 86 times from \$50,000 to \$856,998. Melvin Smith of Greenville won the record Carolina Cash 5 top prize to date and record payout to a single winner on November 11, 2007.

Carolina Cash 5 sales topped at \$58,516,249 for the fiscal year, representing 5 percent of total sales.



Beverly Black of Greensboro, NC



Phil Morgan of Seagrove, NC



Bernard Ricks of Clayton, NC



Hermon Jackson of Clayton, NC



Powerball is the big jackpot game.

We had two large jackpots in the fiscal year: \$300 million on August 25, 2007 and \$275 million on March 15, 2008. These large jackpots had an immediate impact on sales. The largest single sales day was August 25, 2007 with Powerball sales that day of over \$5 million.

Over the fiscal year, 370 players won top tier prizes. Fifty-two players matched all five white balls to win at least \$200,000. Fourteen of those players purchased the Power Play option for an additional dollar. Power Play is a feature that multiplies winnings from two to five times, increasing winnings to between \$400,000 and \$1 million. One lucky winner, Clifton Jones of Whiteville, picked all five white balls and Power Played during our "10X" promotion when there was a "10" on the multiplier wheel so his \$200,000 winnings multiplied to \$2 million!

Three hundred and eighteen players matched four white balls and the Powerball to win at least \$10,000. Thirty-eight of those Power Played and increased their winnings to between \$20,000 and \$100,000. The two lucky players who Power Played to \$100,000 played when a "10" was on the multiplier wheel.

On September 26, 2007 thirty-two players picked four white balls and the Powerball, based on a recently broadcast television show on lotteries. This large number of winners was replicated nationally for Powerball players in other states who had all watched the same show.

For the second time, Powerball came to North Carolina for a live Powerball draw. On May 17, 2008 at Lowe's Motor Speedway, Powerball conducted the draw live during the All Star weekend. This event was part of our promotion of a new instant scratch-off ticket, Speedway Riches, and our sponsorship of the NCEL 200 Craftsman Truck Series race.

Powerball sales reached \$229,255,174 for the fiscal year, representing 21 percent of total sales.



Players winning \$100,000 or more must come to Headquarters in Raleigh to claim their prize. The “Prize Patrol” has great fun meeting these winners and hearing their stories. The winners’ room has a winners’ board where pictures are posted and that encourages winners to have their picture taken.

Raffle MANIA

As additional online offerings, on July 4, 2007 the NCEL conducted the Sizzlin’ Millionaire Raffle and then on December 27, 2007 the NCEL conducted the Merry Millionaire Raffle. These raffles offered the best odds for a player to win \$1 million. In both raffles, there were five \$1 million winners.



NCEL Hits the Road For Fun & Education

The NCEL is constantly looking for new venues for introducing the education lottery to potential players. North Carolina has a rich heritage of local festivals and fairs into which the NCEL tapped. In addition, we showed our support of the sporting arena in North Carolina through our sponsorship of racing, basketball and minor league baseball statewide. Each event offered an opportunity to meet new players, explain our games, and talk about the benefits to education.

NCEL promotion specialists covered the state throughout the year, conducting over 20 events and promotional activities. With event sponsorships ranging from the Cleveland County Fair in Shelby to Riverfest in Wilmington, the staff worked tirelessly at creating exciting player promotions that meshed with overall goals and provided grass roots promotional opportunities to show community support.

The NCEL also scored points with Charlotte Bobcats fans. The full court press was a way for the NCEL to add to its efforts to make education a winner in North Carolina. The partnership included promotional events at ten of the Bobcats games where fans could win prizes. The NCEL also sold tickets at those games and ran radio advertisements on the Bobcats Radio Network including WNMX-FM.

NCEL showed its racing spirit by partnering with Lowe's Motor Speedway for three exciting weekends of racing action in October and May, including the sponsorship of the Craftsman's Truck Series Race, the NCEL 200. Multiple events and promotions gave race fans the opportunity to interact with the NCEL, learn about how the lottery education money has been distributed, and help raise more money for education through ticket purchases.

The promotions team also staged events at the retailer locations for both the Mustang Madness Carolina Cash 5 promotion and the Harley-Davidson® Fat Boy® Motorcycle promotion and for the \$100 Million Cash Spectacular top prize winner presentations.

The \$100 Million Cash Spectacular instant scratch-off ticket, the ticket with the highest prize payout of the year, provided the advertising team the opportunity to get spectacular with our advertising. The \$100 Million Cash Spectacular ad had a Broadway musical theme, using dancers and singers.

Statewide newspaper, point-of-sale materials and beneficiary brochures helped communicate the beneficiary message by highlighting how dollars were distributed at a regional level. TV completed the education message by highlighting the four recipient programs.





RETAILERS HELP Ring Up Success



Retailers remain the backbone of the NCEL, selling our tickets and providing a “face” to the lottery on a daily basis. They have constant contact with our players. They are on the front line everyday.

The number of retailers selling tickets grew from 5,812 on July 1, 2007 to 5,860 on June 30, 2008. Retailers receive a seven percent commission for selling lottery tickets. In FY08, we paid \$75,370,562 in commissions. The average commission paid to retailers was \$13,354.78.

On average, NCEL sales representatives visit retail outlets on a two week cycle. In these visits, they provide retailers with promotion and merchandising ideas and explain how new games work. They assist retailers with instant ticket inventory management and point-of-sale displays. They provide game information and tips on how to improve sales.

In support of our retailers, we provide retailers selling winning tickets of \$1,000 or more certificates to display in their stores. We conduct on-site promotions at retailers to educate players about new games. We conduct media events at retailers to recognize winners of special promotions such as Mustang Madness or Harley-Davidson® and winners of \$100 Million Cash Spectacular.

Semi-annually we recognize retailers who have the largest percentage increase in sales from the previous six months - these are Stellar Sellers. And we recognize retailers implementing unique sales promotion techniques - these are STARs - Spectacular Technique Achieving Retailer.



NCEL: More Than A Game

The NCEL continued to emphasize our critical community messages: play responsibly and no sales to minors.

The play responsibly message is one that we repeat frequently. It is on all point-of-sale materials and in our television and radio ads. We provide the problem gambling helpline toll-free number on all printed materials. In talking with players, we remind them that playing the lottery is entertainment and fun and should be approached as such.

We provide \$1 million annually to the Department of Health and Human Services (DHHS) for their problem gambling program. DHHS uses the funds to cover the cost of a toll-free helpline number and to pay for counseling services for people who contact them and are in need of help.

We have made “No sales to minors” a cornerstone message with our retailers from time to time. Periodically, our sales representatives wear shirts bearing that message. We have provided retailers with stickers for their terminals and for the back of their ticket dispensers. We place reminders in our retailer newsletter. We made buttons for retailers with this message imprinted on them. We were vigorous in pushing this message.

The NCEL has an active minority participation effort. Our staff, at the end of the fiscal year, was 77.5 percent minority with 33.3 percent female, 39.2 percent African-American, 2.7 percent Hispanic and 2.3 percent Asian. We conducted our annual Minority Business Conference in order to ensure that we are reaching out to minority businesses with information on how to do business with the education lottery. Eighteen percent of our business is conducted with minority vendors including disabled vendors.

We also continue our participation in the Amber Alert program, the national program to help locate missing children. We receive the Amber Alert messages and immediately forward a message to all lottery terminals statewide which the retailers can print out and post. We also change the terminal screen message which can be read by any customer in the store.



North Carolina Department of Administration



AMBER™
ALERT



PLAYERS MUST BE 18
OR OLDER TO PLAY
Debe de ser 18 años o mas para jugar
MACHINE DOES NOT GIVE

THE NUMBERS Tell the FY08 Story

SALES BY REGION

REGION	INSTANT	POWERBALL	PICK 3	CASH 5	RAFFLE	TOTAL
Asheville	\$50,132,761	\$15,502,057	\$2,906,485	\$3,256,854	\$354,260	\$72,152,417
Greensboro	97,955,265	36,545,601	16,933,130	8,977,179	1,188,860	161,600,035
Charlotte	174,580,209	65,242,481	21,363,648	14,143,607	1,975,840	277,305,785
Raleigh	233,830,070	87,104,298	73,044,717	23,710,199	3,175,040	420,864,324
Greenville	79,381,810	24,860,737	32,910,324	8,428,410	675,240	146,256,521
TOTAL	635,880,115	229,255,174	147,158,304	58,516,249	7,369,240	1,078,179,082
% OF SALES	58.98%	21.26%	13.65%	5.43%	0.68%	100.00%

Comparison FY2007 to FY2008 Sales

	FY07	FY08
INSTANT	\$490,564,474	\$635,880,115
PICK 3	89,541,216	147,158,304
CASH 5	36,501,699	58,516,249
POWERBALL	258,967,883	229,255,174
RAFFLE	10,000,000	7,369,240
TOTAL	\$885,575,272	\$1,078,179,082

TOP TEN RETAILERS Sales FY08

Rose Mart #14	Wilson	\$1,788,360
Dunn's Auto Service Center	Biscoe	1,387,266
C Mini Mart #3	Raleigh	1,153,834
West Webb Curb Market	Burlington	1,053,711
Catamount Travel Center	Whittier	1,024,685
O'Ryans Quik Stop	Roxboro	954,599
Reilly Road BP Amoco	Fayetteville	929,052
Tony's Friendly Mart #1	Kinston	899,689
Bobby Taylor Oil #2	Fayetteville	897,113
The Border Station	Moyock	894,331

TOP TEN COUNTIES Sales FY08

Wake	\$89,479,489
Mecklenburg	70,058,103
Guilford	57,135,866
Cumberland	49,321,358
Forsyth	37,253,776
Durham	31,460,968
New Hanover	23,738,285
Gaston	23,406,002
Alamance	23,363,266
Catawba	23,243,948



Leslie W. Merritt, Jr., CPA, CFP
State Auditor

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AUDITOR'S TRANSMITTAL

The Honorable Michael F. Easley, Governor
The General Assembly of North Carolina
North Carolina State Lottery Commission

This report presents the results of the financial statement audit of North Carolina Education Lottery (the Lottery), an enterprise fund of the State of North Carolina, for the period ended June 30, 2008. Cherry, Bekaert, and Holland, L.L.P. performed this audit under contract with the Office of the State Auditor and their report is submitted herewith.

General Statute 18C-116 requires the State Auditor to conduct an annual audit of the Lottery's accounts and transactions. General Statute 147-64.7 allows the State Auditor to obtain the services of independent public accountant to carry out its duties and functions.

North Carolina General Statutes require the State Auditor to make audit reports available to the public. Copies of audit reports issued by the Office of the State Auditor may be obtained through one of the options listed in the back of this report.

Leslie W. Merritt, Jr., CPA, CFP
State Auditor

November 12, 2008



Independent Auditors' Report

To the Commissioners
North Carolina Education Lottery
Raleigh, North Carolina

We have audited the accompanying statements of net assets of the North Carolina Education Lottery (NCEL) as of June 30, 2008 and 2007, and the related statements of revenues, expenses and changes in fund net assets and cash flows for the years then ended. These financial statements are the responsibility of the NCEL'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 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 opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the NCEL as of June 30, 2008 and 2007, and the respective changes in its financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2, the financial statements present only the NCEL and do not purport to, and do not, present fairly the financial position of the State of North Carolina, as of and for the years ended June 30, 2008 and 2007, and the changes in its financial position and its 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 October 15, 2008, on our consideration of the NCEL's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, 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 accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

CHERRY, BEKAERT & HOLLAND, L.L.P.

Raleigh, North Carolina
October 15, 2008

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2008 and 2007

The following is a discussion and analysis of the financial performance of the North Carolina Lottery Commission [aka, North Carolina Education Lottery (NCEL)] for the fiscal years ended June 30, 2008 and 2007 and should be read in conjunction with the financial statements, including the footnotes. 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, and summary results of operations for years ended June 30, 2008 and 2007.

Financial Highlights

For fiscal year 2008, net ticket sales surpassed \$1 billion representing a \$192.5 million dollar increase over 2007. Total revenues earned for the NC Education Lottery fund were \$348.3 million, which represented an increase of \$34 million over fiscal year 2007. Other significant financial highlights include the following:

- Due to increases in instant prize payouts, gross tickets sales for fiscal year 2008 increased by 21.7% over 2007.
- Prize expense increased \$136.7 million during fiscal year 2008. This expense increases or decreases proportionally to ticket sales and represented approximately 55% of gross ticket sales.
- This year we increased the number of retailers to over 5800 and provided service to our retailers on a regular basis.
- We created 51 new instant scratch-off games and introduced them every two to three weeks.

Overview of the Financial Statements

This financial report is designed to inform the public and other interested parties of the financial results of the NCEL and show its accountability in meeting the legislated mandate to generate funds to further the goal of providing enhanced educational opportunities so that all students in the public schools can achieve their full potential. Accordingly, the focus of the financial statements is determining funds available for payment to the State's Education Lottery Fund. It is important to note that most financial statement balances have a direct or indirect relationship to revenue. As lottery sales increase, the amount paid to the State's Education Lottery Fund also increases. Similarly, increases in revenue generally result in direct increases to cost of sales including, but not limited to, prize expense, retailer commission expense and gaming system vendor charges.

The NCEL is a major enterprise fund of the primary government of the State of North Carolina. The financial statements were prepared on the accrual basis of accounting in a manner similar to a private business entity. The principal operating revenues of the NCEL are sales of lottery products. Operating expenses include the cost of prizes, retailer commissions, gaming system vendor charges, personnel, and other administrative expenses.

Included in this report is the Statement of Net Assets as of June 30, 2008 and 2007, the Statement of Revenues, Expenses, and Changes in Fund Net Assets for the periods ended June 30, 2008 and 2007, and the Statement of Cash Flows for the periods ended June 30, 2008 and 2007.

As established in House Bill 1023, Section 18C-164, the NCEL transfers its net assets to the Office of State Budget and Management (OSBM) for credit to the State's Education Lottery Fund. Education Lottery Funds are distributed by OSBM in the following manner:

- "(1) A sum equal to fifty percent (50%) to support reduction of class size in early grades to class size allotments not exceeding 1:18 in order to eliminate achievement gaps and to support academic prekindergarten programs for at risk four year olds who would otherwise not be served in a high quality education program in order to help those four year olds be prepared developmentally to succeed in school.*
- (2) A sum equal to forty percent (40%) to the Public School Building Capital Fund in accordance with G.S. 115C-546.2.*
- (3) A sum equal to ten percent (10%) to the State Educational Assistance Authority to fund college and university scholarships in accordance with Article 35A of Chapter 115C of the General Statutes."*

Total Assets

Total assets at the end of fiscal year 2008 were \$81 million compared to \$120 million at the end of fiscal year 2007, representing a decrease of \$39 million.

Current assets decreased from \$119 million in 2007 to \$79 million in 2008, representing a decrease of \$40 million. This decrease is primarily due to a \$10.8 million decrease in cash and cash equivalents and a \$31 million decrease in deposits held by the State Treasurer in the State Treasurer's Short Term Investment portfolio. These decreases were due to the transfers to the State Education Fund before year end.

The Short Term Investment portfolio has the general characteristics of a demand deposit account in that participants may deposit additional cash at any time and may withdraw cash at any time without prior notice or penalty. All deposits are combined with other State agencies and invested by the State Treasurer until needed to cover disbursements. Investments are limited to those authorized for the State's General Fund, pursuant to NC General Statute 147-69.1. Interest earned of \$5.2 million on these balances is recorded as non-operating revenue. Earnings on the accounts are credited on a monthly basis. The allocable share of the revenues arising from State Treasurer's Securities Lending Collateral program transactions are also included as non-operating revenue.

A \$2.7 million increase in accounts receivable in 2008 over 2007 primarily represents amounts due from retailers for settlement of packs of tickets less commissions and prizes paid by the retailers. The increase is primarily due to the timing of the end of the accounting week for billing and collections from our retailers at year end. Electronic Funds Transfer is used to sweep receivables weekly from retailer bank accounts that are set up in trust for the NCEL.

The NCEL's investment in capital assets, net of accumulated depreciation, in 2008 was \$1.5 million which is approximately \$200,000 higher than 2007. The majority of capital asset investments were during our first full year of operation in 2007. The investment in capital assets includes game equipment, data processing equipment, telephone equipment, software and fixtures. The capitalization of all items including equipment, computers, and furniture follows the North Carolina Office of the State Controller's policies. The NCEL defines capital assets as assets with an initial unit cost of \$5,000 or greater and an estimated useful life of two or more years. Capital assets are carried at cost less accumulated depreciation.

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2008 and 2007 (continued)

Additional information on the NCEL's capital assets can be found in Notes 2F and 5D to the financial statements.

The activity for capital assets for the year ended June 30, 2008 (in thousands) was:

Category	Balance July 1, 2007	Increases	Decreases	Balance June 30, 2008
Capital Assets, Depreciable				
Furniture	\$ 29	\$ -	\$ -	\$ 29
Equipment	1,652	587	-	2,239
Motorized Equipment	67	-	-	67
Total Capital Assets, Depreciable	1,748	587	-	2,335
Less Accumulated Depreciation for:				
Furniture	4	7	-	11
Equipment	450	363	-	813
Motorized Equipment	12	12	-	24
Total Accumulated Depreciation	466	382	-	848
Total Capital Assets, Depreciable, Net	1,282	205	-	1,487
Capital Assets, Net	\$ 1,282	\$ 205	\$ -	\$ 1,487

Total Liabilities

Total current liabilities for the NCEL were \$80 million in 2008 decreasing by \$39 million from 2007. The change is due primarily to the decrease in the obligations under the State Treasurer's Security Lending Collateral. Current liabilities consist primarily of trade payables to vendors, instant ticket prize liability, Powerball low-tier liability and obligations under State Treasurer's Lending Agreements. See Total Assets for an explanation of the State Treasurer's Security Lending Agreements. More detailed information can be found in Note 2D in the financial statements.

Noncurrent liabilities are Accrued Paid Time Off or Compensated Absences. A liability is recorded to reflect the balances for unpaid Paid Time Off (PTO) earned, which is provided to employees for use whenever vacation, sick leave, personal leave or bereavement leave is requested and approved. Current and noncurrent liability for Accrued Paid Time Off is shown below in thousands.

Activity for the year ended June 30, 2008:

Beginning	Earned	Used	Ending	Current Liability	Noncurrent Portion
\$ 864	\$ 1,839	\$ 1,551	\$ 1,152	\$ 57	\$ 1,095

Net Assets and Changes in Net Assets

As required in the Lottery Act, net revenues of the NCEL are transferred four times a year to the NC Education Lottery Fund at the Office of State Budget and Management. At year end, Net Revenues /Assets are zero for the NCEL. There are no changes in the Net Assets from year to year.

Condensed Statement of Net Assets (in thousands)	2008	2007
ASSETS		
Total Current Assets	\$ 79,443	\$ 118,760
Capital Assets, Depreciable (Net)	1,487	1,282
Total Assets	80,930	120,042
LIABILITIES		
Total Current Liabilities	79,835	119,258
Noncurrent Liabilities	1,095	784
Total Liabilities	80,930	120,042
NET ASSETS		
Invested in Capital Assets	1,487	1,282
Unrestricted Net Assets	(1,487)	(1,282)
Total Net Assets	\$ -	\$ -

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2008 and 2007

Current liabilities consist of "Due to Other Funds" in the amount of \$3.5 million which represents the amount of the "Net Revenues" for Fiscal Year 2008 not yet transferred to the NC Education Fund as of June 30, 2008, but will be transferred during Fiscal Year 2009. The remainder is due other state agencies for services provided to the NCEL. Additional information on the Due to Other Funds is found in NOTE 6C to the financial statements.

Revenues

Operating revenues consist of gross sales, fees and licenses.

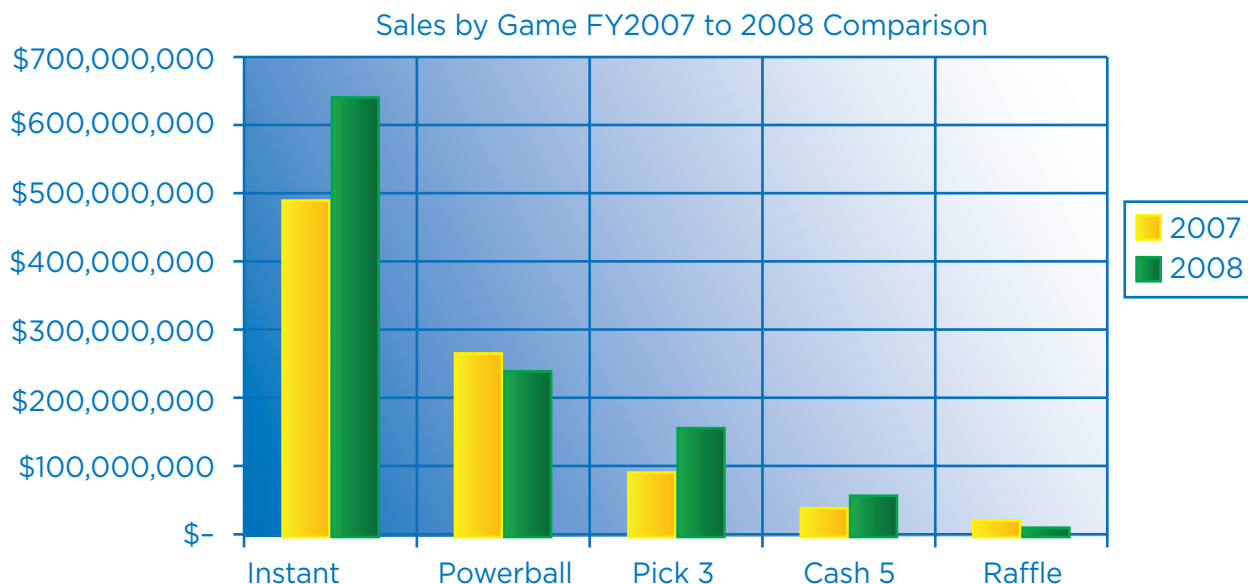
Sales

Total gross lottery ticket sales for the fiscal year 2008 were approximately \$1.078 billion as compared to \$885.5 million in fiscal year 2007. This represents an increase of over \$192.5 million.

Gross instant ticket sales increased significantly during fiscal year 2008, up \$145 million over one year ago. The 30% increase is attributable to several factors. The NCEL launched its first \$10 Instant Scratch-off mega game, \$100 Million Cash Spectacular, with a 73% prize payout and ten \$1 million top prizes. This new game contributed to our first \$100 million month in total sales in February. The extremely successful merchandise game, Harley-Davidson Instant Scratch-Off, provided players the chance to win six Harley-Davidson Fat Boy Motorcycles, cash, and merchandise and was so well received the final drawing was moved up due to the game selling out faster than anticipated.

On-line sales during fiscal year 2008 grew by \$47 million to \$442 million. Fiscal year 2007 on-line sales were \$395 million. On-line sales benefited from two big jackpots for Powerball during the year. The largest single sales day for Powerball was August 25, 2007 with sales of \$5,154,000. Carolina Pick 3's new additional daytime drawing began on March 31, 2008 and provided an immediate increase in sales that continued throughout the remainder of the fiscal year. Sales for Carolina Pick 3 increased 17% per day from the two months preceding to the two months following the additional drawing. The Carolina Cash 5 promotion "Mustang Madness" offered players the chance to win five Ford Mustangs and provided the NCEL a 13% increase in sales during the promotional window. The Carolina Cash 5 top prize reached a record of \$857 thousand in November, resulting in an increase of on-line sales.

The following chart depicts the distribution of sales by product for the fiscal years ending June 30, 2008 and 2007.



Nonoperating Revenues consist of investment earnings from the Short Term Investment Fund held at the State Treasurer's office, and Multi-State Lottery Association (MUSL) dividends received.

Expenses

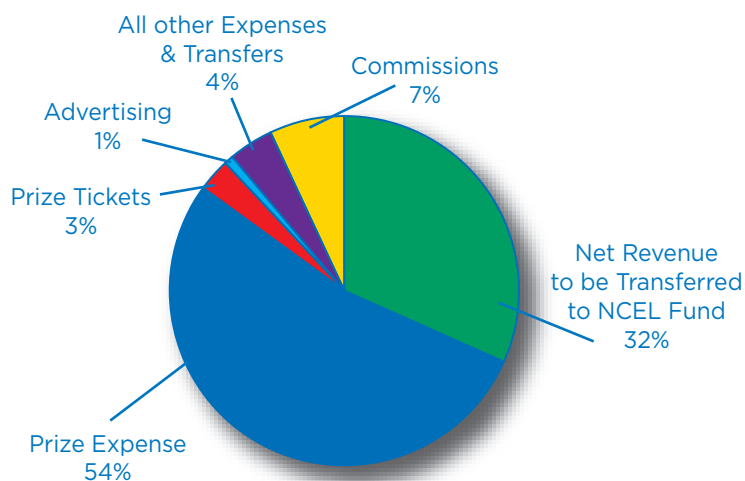
Section 18C-162, NC General Statutes stipulates no more than 8% of the total annual revenues shall be allocated for payment of expenses of the Lottery. Advertising expenses shall not exceed 1% of the total annual revenues.

MANAGEMENT'S DISCUSSION AND ANALYSIS

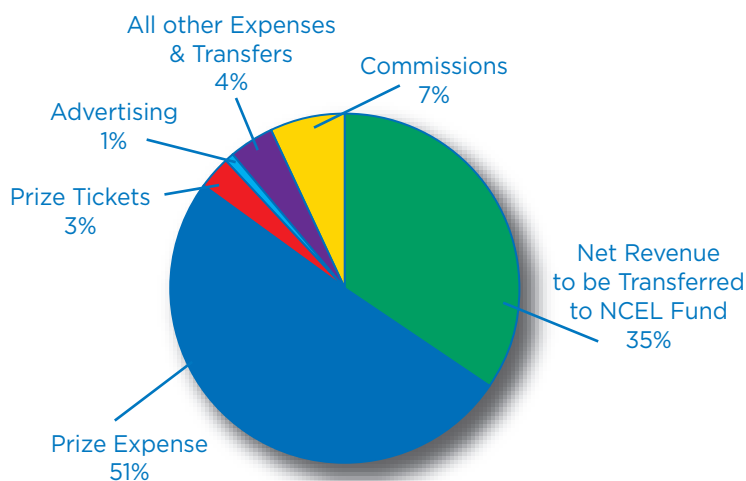
June 30, 2008 and 2007 (continued)

The following chart shows the major components of NCEL operating expenses and transfers as a percentage of total revenues for the June 30, 2008 and 2007 fiscal years:

Allocation of Expenses FY2008



Allocation of Expenses FY2007



Prizes, retailer commissions and gaming vendor charges all directly relate to sales. As expected, as sales have increased, so have these expenses. In fiscal year 2008, prizes, commissions and gaming vendor charges increased to \$681 million from \$528 million in 2007. The other expenses, which consist of advertising, salary and benefits, professional fees, rent, maintenance, bad debt, depreciation and transfers, have remained stable at 5% of Total Annual Revenues over the past two years. Fiscal years 2008 and 2007 administrative expenses were \$50 million and \$47 million respectively.

Condensed Statement of Revenues and Expenses	2008	2007
Operating Revenues		
Gross Sales	\$ 1,078,082	\$ 885,575
Less: Prize Tickets	(29,733)	(23,901)
Fees and Licenses	4,782	4,521
Total Operating Revenues	1,053,131	866,195
Operating Expenses		
Salaries, Wages, and Benefits	13,793	12,279
Lottery Prizes	588,485	451,792
Retailer Commissions	75,371	61,932
Gaming Systems Services	17,286	14,315
Advertising	8,619	7,810
Marketing	1,220	953
Other Services	2,576	3,038
Furniture, Fixtures, and Equipment	240	1,433
Depreciation	382	391
Other General and Administrative Expenses	1,674	1,490
Total Operating Expenses	709,646	555,433
Operating Income	343,485	310,762
Nonoperating Revenue (Expense)		
Investment Earnings and Miscellaneous Revenue (Expense)	5,825	4,605
Income Before Transfers	349,310	315,367
Transfers Out	(349,310)	(315,367)
Net Assets	\$ 0	\$ 0

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2008 and 2007

Budget and Economic Outlook

On May 21, 2008, the Commission approved the Fiscal Year 2009 budget for the NCEL to provide a projected \$385.5 million to the State's Education Lottery Fund. This projected budget is a 22% increase over the fiscal year 2008 budget of \$341.5 million for transfer to the State's Education Lottery Fund. Actual transfer in 2008 was over \$348.3 million to education.

A focus of the Commission at start up was to ensure sound operations. This focus continues today and is apparent in audits conducted by outside firms. The Commission has undergone several audits this fiscal year. Delehanty Consulting LLC, an independent security organization, conducted our second security audit and determined that the controls designed by the North Carolina Education Lottery are adequate and operating as intended.

The Office of the State Auditor spent several months conducting a performance audit to answer three questions: (1) whether NCEL uses performance management best practices; (2) whether management compensation is comparable to lotteries in other states; and (3) whether NCEL employee and vendor ethnic diversity reflects the ethnic diversity of North Carolina's population. The performance audit noted that the NCEL has exceeded the Lottery Act's minority participation requirements.

Since inception, the NCEL has not had a formal documented revenue forecasting methodology due to a lack of sales history. For the fiscal year 2009 budget, the NCEL applied a more formal approach to forecasting revenues utilizing two years of history. At start-up, the focus was on getting the organization up and running as quickly as possible with the greatest offering of game choices available to players in order to maximize the amount of money raised for education. The NCEL began writing a strategic plan in fiscal year 2008 which will benefit the organization in fiscal year 2009 and beyond.

For the third consecutive year, the State Auditor contracted with an outside CPA firm to conduct the fiscal year financial audit, which resulted in an unqualified opinion.

Requests for Information

Any request for information about this report should be sent to the Public Information Officer at the North Carolina Education Lottery, 2100 Yonkers Road, Raleigh, North Carolina 27604.

STATEMENT OF NET ASSETS (in thousands)

June 30, 2008 and 2007

ASSETS	2008	2007
Current Assets:		
Cash and Cash Equivalents:		
Cash	\$ 75	\$ 62
Pooled Cash	38,680	49,503
Receivables:		
Accounts Receivable	13,728	11,054
Interest Receivable	418	406
Inventory	910	795
State Treasurer's Security Lending Collateral	25,632	56,940
Total Current Assets	79,443	118,760
Capital Assets, Depreciable (Net):		
Machinery and Equipment	2,335	1,748
Accumulated Depreciation	(848)	(466)
Total Capital Assets, Depreciable (Net)	1,487	1,282
Total Assets	80,930	120,042
LIABILITIES		
Current Liabilities:		
Accounts Payable	48,221	56,308
Accrued Payroll	405	16
Other Payables	1,956	3,333
Accrued Paid Time Off - Current	57	80
Due to Other Funds	3,564	2,581
Obligations Under State Treasurer's Security Lending Agreements	25,632	56,940
Total Current Liabilities	79,835	119,258
Noncurrent Liabilities:		
Accrued Paid Time Off	1,095	784
Total Liabilities	80,930	120,042
NET ASSETS		
Invested in Capital Assets	1,487	1,282
Unrestricted Net Assets	(1,487)	(1,282)
Total Net Assets	\$ -	\$ -

See notes to the Financial Statements.

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS (in thousands)

Years Ended June 30, 2008 and 2007

	2008	2007
Operating Revenues		
Gross Sales	\$ 1,078,082	\$ 885,575
Less: Prize Tickets	(29,733)	(23,901)
Fees and Licenses	4,782	4,521
Total Operating Revenues	1,053,131	866,195
Operating Expenses		
Salaries, Wages, and Benefits	13,793	12,279
Lottery Prizes	588,485	451,792
Retailer Commissions	75,371	61,932
Gaming Systems Services	17,286	14,315
Advertising	8,619	7,810
Marketing	1,220	953
Other Services	2,576	3,038
Furniture, Fixtures, and Equipment	240	1,433
Depreciation	382	391
Other General and Administrative Expenses	1,674	1,490
Total Operating Expenses	709,646	555,433
Operating Income	343,485	310,762
Nonoperating Revenue (Expenses)		
Investment Earnings and Other Miscellaneous Revenue	8,897	8,544
Miscellaneous Nonoperating Expenses	(3,072)	(3,939)
Income Before Transfers	349,310	315,367
Transfers Out	(349,310)	(315,367)
Change in Net Assets	-	-
Net Assets Beginning, July 1	-	-
Net Assets Ending, June 30	\$ -	\$ -

See notes to the Financial Statements.

STATEMENT OF CASH FLOWS (in thousands)

Years Ended June 30, 2008 and 2007

CASH FLOWS FROM OPERATING ACTIVITIES	2008	2007
Receipts from Customers	\$ 975,093	\$ 803,256
Payments to Employees and Fringe Benefits	(13,117)	(11,924)
Payments for Prizes, Benefits and Claims	(598,203)	(406,235)
Payments to Vendors and Suppliers	(31,484)	(30,964)
Other Receipts/Payments	548	569
Net Cash Flows Provided by Operating Activities	332,837	354,702
CASH USED FOR NONCAPITAL FINANCING ACTIVITIES		
Transfers to State Education Fund	(347,327)	(325,397)
Transfers to Other State Agencies	(1,000)	(1,013)
Total Cash Used for Noncapital Financing Activities	(348,327)	(326,410)
CASH USED FOR CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisition and Construction of Capital Assets	(587)	(1,059)
Proceeds from Sale of Capital Assets	-	10
Total Cash Used for Capital and Related Financing Activities	(587)	(1,049)
CASH PROVIDED FROM INVESTING ACTIVITIES		
Investment Earnings	5,267	3,822
Total Cash Provided from Investing Activities	5,267	3,822
Net Increase/(Decrease) in Cash and Cash Equivalents	(10,810)	31,065
Cash and Cash Equivalents at Beginning of Year	49,565	18,500
Cash and Cash Equivalents at End of Year	\$ 38,755	\$ 49,565
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating Income	\$ 343,485	\$ 310,762
Adjustments to Reconcile Operating Income to Cash Provided by Operating Activities:		
Depreciation Expense	382	391
Nonoperating Income - MUSL Dividend	544	554
Other Nonoperating Income	2	6
(Increase) Decrease in Assets:		
Accounts Receivable	(2,674)	(1,007)
Inventories	(115)	(795)
Increase (Decrease) in Liabilities:		
Accounts Payable	(9,481)	44,436
Accrued Payroll and Related Liabilities	677	355
Other Liabilities	17	-
Total Cash Provided by Operating Activities	\$ 332,837	\$ 354,702
NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES		
Assets Acquired through the Assumption of a Liability	\$ 25,632	\$ 56,940

See notes to the Financial Statements.

NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2008 and 2007

NOTE 1 - ORGANIZATION

The North Carolina State Lottery Commission [aka, North Carolina Education Lottery (NCEL)] was created with the enactment of House Bill 1023 effective August 31, 2005 as an independent, self-supporting, and revenue-raising agency of the State of North Carolina (the State). The NCEL commenced operations on March 30, 2006, with the sale of instant scratch-off tickets. In March 2006, the NCEL joined the Multi-State Lottery Association (MUSL) composed of a group of U.S. lotteries that combine jointly to sell on-line POWERBALL lottery tickets. POWERBALL sales began on May 30, 2006. Carolina Pick 3 online game sales began on October 6, 2006, and Carolina Cash 5 online game sales began on October 27, 2006. A second daily (Monday through Saturday) Carolina Pick 3 drawing was added on March 31, 2008. Sales for the NCEL's second online raffle ran from November 14, 2007 through December 26, 2007.

The purpose of the NCEL is to generate funds to further the goal of providing enhanced educational opportunities so that all students in the public schools can achieve their full potential, to support school construction, and to fund college and university scholarships. The operations of the NCEL are overseen by a nine member commission, five of whom are appointed by the Governor and four of whom are appointed by the General Assembly.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

- A. Reporting Entity** - For financial reporting purposes, the North Carolina Education Lottery is a major enterprise fund of the primary government of the State of North Carolina and is reported as such in the Comprehensive Annual Financial Report (CAFR) of the State. These financial statements for the NCEL are separate and apart from those of the State of North Carolina and do not present the financial position of the State nor changes in the State's financial position and cash flows.
- B. Basis of Presentation** - The financial statements are prepared on the accrual basis of accounting in a manner similar to a private enterprise. The NCEL elected to apply all applicable Governmental Accounting Standards Board (GASB) pronouncements as well as Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. As permitted by GASB Statement Number 20, the NCEL elected not to apply FASB statements or interpretations issued on or after November 30, 1989, unless specifically adopted by GASB.
- As an enterprise fund, the NCEL is accounted for using the "economic resources" measurement focus. This means that all the assets and liabilities related to its operations are included on its statement of net assets, and its operating statement includes all revenues (increases) and expenses (decreases) in total assets. The NCEL distinguishes operating from non-operating revenues and expenses. Operating revenues and expenses generally relate to the NCEL's primary ongoing operations of selling lottery tickets and redeeming prizes; all revenues and expenses not meeting this definition are reported as non-operating. The principal operating revenues of the NCEL are charges to retailers for sales of lottery products. The significant operating expenses include the cost of prizes, commissions, gaming system vendor charges, personnel, and other administrative expenses.
- C. Cash and Cash Equivalents** - Cash and cash equivalents include regional office deposited operating funds, imprest funds, and deposits held by the State Treasurer in the State Treasurer's Short Term Investment portfolio. The Short Term Investment portfolio maintained by the State Treasurer has the general characteristics of a demand deposit account in that participants may deposit additional cash at any time and also may withdraw cash at any time without prior notice or penalty.
- D. State Treasurer's Securities Lending Collateral** - While the NCEL does not directly engage in securities lending transactions, it deposits certain funds with the State Treasurer's Short-Term Investment Fund which participates in securities lending activities. Based on the State Treasurer's allocation of these transactions, the NCEL recognizes its allocable share of the assets and liabilities related to these transactions on the accompanying financial statements as "State Treasurer's Securities Lending Collateral" and "Obligations Under State Treasurer's Securities Lending Agreements." The NCEL's allocable share of these assets and liabilities is based on the NCEL's year end deposit balance per the State Treasurer's records.

Based on the authority provided in General Statutes 147-69.3(e), the State Treasurer lends securities from its investment pools to brokers-dealers and other entities (borrowers) for collateral that will be returned for the same securities in the future. The Treasurer's custodian manages the securities lending program. During the year, the Treasurer's custodian lent U.S. government and agency securities, GNMA's, corporate bonds and notes for collateral. The Treasurer's custodian is permitted to receive cash, U.S. government and agency securities, or irrevocable letters of credit as collateral for the securities lent.

The collateral is initially pledged at 102 percent of the market value of the securities lent, and additional collateral is required if its value falls to less than 100 percent of the market value of the securities lent. There are no restrictions on the amount of loans that can be made. Substantially all security loans can be terminated on demand by either the State Treasurer or the borrower.

Additional details on the State Treasurer's securities lending program are included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.ncosc.net> and clicking on "Financial Reports," or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

- E. Allowance for Doubtful Accounts** - An allowance for doubtful accounts has not been established because there are no indications of significant delinquencies from the collection of retailer accounts as of June 30, 2008 and 2007.
- F. Capital Assets** - The NCEL defines capital assets as assets with an initial unit cost of \$5,000 or greater and an estimated useful life of two or more years. This definition conforms to the policy of the NC Office of State Controller. Depreciation is computed using the straight-line method over the estimated lives of the assets. The NCEL uses the half year convention. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation will be removed from the books and any resulting gain or loss reflected in operations of the period of disposal. Capital assets are carried at cost less accumulated depreciation. The estimated useful lives by general category are as follows:

Category	Years
Equipment	5-7
Furniture	5
Computers and Software	3-5

NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2008 and 2007 (continued)

- G. Game Revenue Recognition** - For the NCEL's on-line games, POWERBALL, Carolina Cash 5, Carolina Pick 3, and raffles offered, revenue is recognized at the time of sale on a daily basis. For instant games, revenue is recognized at the time a pack of tickets is settled (SEE NOTE 3A(1) - Game Revenue).
- H. Lottery Prize Expense Recognition** - For POWERBALL, Carolina Cash 5, Carolina Pick 3, and for raffles, prize expense is recorded at approximately 50 percent of sales on a daily basis. For instant games, prize expense is accrued based on the final production prize structure percentage provided by the gaming vendor for each game and recorded daily on value of packs settled. Certain games include free tickets (prize tickets) which entitle the holder to exchange one instant ticket for another of equal value. For the instant games with prize tickets, the final prize structure percentage used is adjusted to eliminate the value of the prize tickets.
- 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 and disclosure of contingent assets and liabilities as of the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

NOTE 3- REVENUE

A. Operating Revenue

- 1. Game Revenue** - Instant packs are settled manually by the retailer or automatically by the gaming system 21 days after pack activation, whichever is earlier. Operating revenues are reduced by the value of prize tickets validated during a period.

Gross Revenue	2008	2007
Instant	\$ 635,880	\$ 490,564
On-line	442,299	395,011
Bad Debt Write Off	(89)	-
Damaged Tickets	(8)	-
Total	\$ 1,078,082	\$ 885,575

2. Fees and Licenses - The majority of Fees and Licenses represent a weekly retailer communication fee charged to active retailers for terminal satellite communications and an application fee for new retailers and changes in ownership.

B. Nonoperating Revenue

The cash accounts of the NCEL are Short-term Investment Fund (STIF) Accounts which are interest bearing accounts held with the NC State Treasurer. Investments are limited to those authorized for the State's General Fund, pursuant to NC General Statute 147-69.1. The interest earned on these balances is recorded as nonoperating revenue, and is \$5,278 and \$4,044 for the years ended 2008 and 2007, respectively. Earnings on the accounts are credited on a monthly basis. The allocable share of the revenue arising from the State Treasurer's Securities Lending Collateral program is included as investment earnings. This also reflects a dividend from MUSL of \$544 and \$554 for the years ended 2008 and 2007, respectively. The remaining \$3 and \$7 for the years ended June 30, 2008 and 2007, respectively, is composed of miscellaneous items.

NOTE 4 - EXPENSES

A. Operating Expenses

1. Lottery Prize Expense

Prize Expense	2008	2007
Instant	\$ 350,165	\$ 257,460
On-line	221,531	194,332
50% of Unclaimed Prizes	16,789	-
Total	\$ 588,485	\$ 451,792

2. Retailer Commissions

Commissions	2008	2007
Instant	\$ 44,441	\$ 34,308
On-line	30,930	27,624
Total	\$ 75,371	\$ 61,932

NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2008 and 2007

3. Other Services - The principal expenses included are: security services, background checks, communications, legal services, travel, financial audit services, network support, and costs for temporary employees.

	2008	2007
Security Services	\$ 17	\$ 407
Background Checks	699	701
Communications, Including Wiring	708	769
Legal Services	79	139
Travel	92	102
Other	981	920
	\$ 2,576	\$ 3,038

4. Furniture, Fixtures, and Equipment - While establishing our new lottery, numerous initial items of equipment, furniture, and ticket dispensers were required. Most of these items were one time purchases during fiscal year 2007, but will be replaced as needed. These items were below our threshold for capitalization (see NOTE 2F - Capital Assets) and therefore expensed. The total for these expenses was \$240 in Fiscal Year 2008 and \$1,433 in Fiscal Year 2007.

5. Leases - Buildings and Offices - The NCEL has entered into various operating leases through the North Carolina State Department of Administration for building and office facilities. These leases are for initial terms of seven to ten years. Projected lease payments for these facilities are:

Year Ending (June 30)	Amount
2009	\$ 854
2010	868
2011	881
2012	638
2013	639
2014-2018	2,094
Total	\$5,974

The total space rental costs for the year ended June 30, 2008 was \$838 and was \$836 for the year ended June 30, 2007.

B. Nonoperating Expenses - The allocable share of the expenses arising from State Treasurer's Securities Lending Collateral program transactions, totaling \$3,072 and \$3,939 for the years ended June 30, 2008 and 2007, respectively, are also included as nonoperating expense.

C. Transfers Out - There were three significant transfers out of the NCEL.

\$1,000 was transferred to the NC Department of Health and Human Services for a gambling addiction education and treatment program as stipulated in the North Carolina Lottery Act (Note 7C) for both years ended June 30, 2008 and 2007.

The second transfer is \$16,789 and \$8,037 for the years ended June 30, 2008 and 2007, respectively, from unclaimed prizes during the year. The North Carolina State Lottery Act requires the NCEL to transfer "Fifty percent (50%)" of unclaimed prizes to the NC Education Lottery Fund each year (Note 7B).

The third transfer is in compliance with the North Carolina State Lottery Act. This Act requires all "Net Revenues" of the NCEL to be transferred to the NC Education Lottery Fund for the educational purposes set forth in the legislation. Of the \$331,521 and \$306,317 of June 30, 2008 and 2007 "Net Revenues," respectively, (see Note 12), \$328,020 and \$303,774, respectively, was actually transferred to the NC Education Lottery Fund. The remaining was recorded as a payable to the State, but remained in the NCEL. The remaining \$3,501 and \$2,543 for the years ended June 30, 2008 and 2007, respectively, were transferred subsequent to year-end. NC General Statute 18C states: "The funds remaining in the North Carolina State Lottery Fund after receipt of all revenues to the Lottery Fund and after accrual of all obligations of the Commission for prizes and expenses shall be considered to be the net revenues of the North Carolina State Lottery Fund."

NOTE 5 - ASSETS

A. Cash - The cash and cash equivalents balances at June 30, 2008 and 2007 include no undeposited receipts on hand.

Unless specifically exempt, the NCEL is required by North Carolina General Statute 147-77 to deposit moneys received with the State Treasurer or with a depository institution in the name of the State Treasurer. Except as noted above, all NCEL funds are deposited with the State Treasurer. The NCEL has no deposit policy concerning credit risk, as all deposits are held by the State Treasurer.

NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2008 and 2007 (continued)

At June 30, 2008 and 2007, respectively, \$38,680 and \$49,503 of the amount shown on the Statement of Net Assets as cash and cash equivalents represents the NCEL's equity position in the State Treasurer's Short-Term Investment Fund. The Short-Term Investment Fund (a portfolio within the State Treasurer's Investment Pool, an external investment pool that is not registered with the Securities and Exchange Commission and does not have a credit rating) had a weighted average maturity of 2.9 and 1.6 years as of June 30, 2008 and 2007, respectively. Assets and shares of the Short-Term Investment Fund are valued at amortized cost, which approximates fair value. Deposit and investment risks associated with the State Treasurer's Investment Pool (which includes the State Treasurer's Short-Term Investment Fund) are included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.ncosc.net/> and clicking on "Financial Reports" or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

- B. Accounts Receivable** - Accounts Receivable primarily represents amounts due from retailers for settlement of packs of tickets less commissions and prizes paid by the retailers. Electronic Funds Transfer is used to collect receivables weekly from retailer bank accounts that were set up in trust for the NCEL.
- C. Inventory** - Inventory for the NCEL consists of all merchandise prizes that are paid for before distribution, inventory is reduced as prizes are fulfilled. Inventory as of June 30, 2008 was \$910 and \$795 as of June 30, 2007.
- D. Capital Assets** - The activity for capital assets for the year ended June 30, 2008 was:

Category	Balance July 1, 2007	Increases	Decreases	Balance June 30, 2008
Capital Assets, Depreciable				
Furniture	\$ 29	\$ -	\$ -	\$ 29
Equipment	1,652	587	-	2,239
Motorized Equipment	67	-	-	67
Total Capital Assets, Depreciable	1,748	587	-	2,335
Less Accumulated Depreciation for:				
Furniture	4	7	-	11
Equipment	450	363	-	813
Motorized Equipment	12	12	-	24
Total Accumulated Depreciation	466	382	-	848
Total Capital Assets, Depreciable, Net	1,282	205	-	1,487
Capital Assets, Net	\$ 1,282	\$ 205	\$ -	\$ 1,487

The activity for capital assets for the year ended June 30, 2007 was:

Category	Balance July 1, 2006	Increases	Decreases	Balance June 30, 2007
Capital Assets, Nondepreciable				
Improvements in Progress	\$ 194	\$ -	\$ 194	\$ -
Total Capital Assets, Nondepreciable	194	-	194	-
Capital Assets, Depreciable				
Furniture	-	29	-	29
Equipment	484	1,179	11	1,652
Motorized Equipment	22	45	-	67
Total Capital Assets, Depreciable	506	1,253	11	1,748
Less Accumulated Depreciation for:				
Furniture	-	4	-	4
Equipment	74	377	1	450
Motorized Equipment	2	10	-	12
Total Accumulated Depreciation	76	391	1	466
Total Capital Assets, Depreciable, Net	430	862	10	1,282
Capital Assets, Net	\$ 624	\$ 862	\$ 204	\$ 1,282

NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2008 and 2007

Equipment expenditures for 2008 include storage area networks (SAN) in Greensboro and Raleigh offices for disaster recovery and improvement of network efficiency.

NOTE 6 - LIABILITIES

A. Accounts Payable - This primarily represents trade payables to vendors, prize liabilities, and Powerball low-tier liability. At year end, June 30, 2008 and 2007, the balances were:

Type Account	2008	2007
Trade Payables to Vendors	\$ 3,413	\$ 3,109
Instant Prize Liability	25,434	35,633
Prize Liability- Unused Unclaimed Prizes	9,279	8,037
POWERBALL Low-Tier Liability	5,318	4,563
Prize Liability - Breakage	4,742	4,943
Other	35	23
Total Accounts Payable	\$ 48,221	\$ 56,308

B. Other Payables - This represents amounts due to MUSL of \$1,846 and \$3,255 for the years ended June 30, 2008 and 2007, respectively for the NCEL's share of POWERBALL jackpot prizes. The remainder resulted from federal and state withholding on prize payments, and various clearing accounts.

C. Due to Other Funds - As explained in NOTE 4C, \$3,501 and \$2,543 for the years ended June 30, 2008 and 2007, respectively, represents the amounts of the "Net Revenues" for the year not yet transferred to the NC Education Fund as of June 30, but will be transferred subsequent to year-end. The remainder is due other state agencies for services provided to the NCEL.

D. Accrued Paid Time Off - Paid time off (PTO) is provided to employees for use whenever vacation, sick leave, personal leave or bereavement leave is requested and approved. Under this policy, every calendar year, on January 1st, a specific amount of PTO will be credited to Director's and above PTO accounts. All other employees' PTO accounts will be credited on a monthly basis as earned. Employees must be employed at least one year to receive pay for accrued leave balances. Directors and above will be paid out accrued leave balances upon separation provided they have attained a minimum of six (6) months' service on the date of separation.

Activity for the year ended June 30, 2008:

Beginning	Earned	Used	Ending	Current Liability	Long Term Portion
\$ 864	\$ 1,839	\$ 1,551	\$ 1,152	\$ 57	\$ 1,095

Activity for the year ended June 30, 2007:

Beginning	Earned	Used	Ending	Current Liability	Long Term Portion
\$ 524	\$ 943	\$ 603	\$ 864	\$ 80	\$ 784

NOTE 7 - OTHER IMPORTANT ITEMS

A. Deposits with Multi-State Lottery Association (MUSL) - MUSL is a voluntary association created for the purpose of administering joint, multi-jurisdictional lottery games, such as POWERBALL. Through June 30, 2008, MUSL includes 29 state lotteries, the District of Columbia and the U.S. Virgin Islands. The chief executive officer of each member lottery serves on the MUSL board of directors.

As a member of MUSL, the NCEL is required to contribute to various prize reserve funds maintained by MUSL. These contributions are included in the 50% prize expense computed on POWERBALL sales. The net amount of the 50% prize expense less the amount required to pay low-tier prizes within the State is paid to MUSL. This payment is to cover the NCEL's share of current jackpot prizes based on the NCEL's percent of sales for each drawing and the NCEL share of the prize reserve fund. The prize reserve fund serves as a contingency reserve to protect all MUSL members including the NCEL from unforeseen prize liabilities. All prize reserve funds remitted, and the related interest earnings, will be returned to the NCEL upon leaving MUSL, less any portion of unanticipated prize claims which may have been paid from the fund. As of June 30, 2008 and 2007, respectively, the NCEL had been credited with \$4,505 and \$2,369 in the MUSL prize reserve funds.

B. Unclaimed Prizes - As of June 30, 2008 and 2007, the NCEL had unclaimed prizes from both online and instant games. The first POWERBALL draw after the NCEL started selling tickets was on May 31, 2006, and therefore, the NCEL began recognizing unclaimed prizes on November 27, 2006 (180 days after the first draw). The first Carolina Pick 3 unclaimed prizes were recorded on April 4, 2007 and the first unclaimed prizes for Carolina Cash 5 were recorded on April 25, 2007. The NCEL closed forty three instant games during the 2008 fiscal year resulting in approximately \$22.8 million in unclaimed prizes. Amounts shown below are in thousands.

NOTES TO FINANCIAL STATEMENTS (in thousands)
June 30, 2008 and 2007 (continued)

Type Game	2008	2007
Instant	\$ 22,792	\$ 9,586
POWERBALL	7,598	5,748
Carolina Cash 5	1,892	333
Carolina Pick 3	1,150	408
Raffle	73	-
Total unclaimed prizes	\$ 33,505	\$ 16,075

- C. Compulsive Gambling Contribution** - By North Carolina General Statute the NCEL must make "a transfer of \$1,000 annually to the Department of Health and Human Services (DHHS) for gambling addiction education and treatment programs." (Note 4C)
- D. Limitations on Operating and Advertising Expenses** - As established in North Carolina General Statute 18C-162(a)(3); "No more than eight percent (8%) of the total annual revenues, as described in this Chapter, shall be allocated for payment of expenses of the Lottery. Advertising expenses shall not exceed one percent (1%) of the total annual revenues." The one percent for advertising expenses is included in the eight percent maximum for Lottery expenses. Total annual revenues include proceeds from the sale of lottery tickets, interest earned by the NCEL, and all other funds credited to the Lottery from any source.

NOTE 8 - RISK MANAGEMENT

The NCEL is exposed to various risks of loss related to torts; theft of, damage to, and the destruction of assets; errors and omissions; injuries to employees; and natural disasters. The NCEL participates in the State's Risk Management Program for property, liability, crime and automobile coverage, and pays an annual premium for this coverage. The Lottery has not experienced any losses during the year ended June 30, 2008.

The types of coverage, limits, and deductibles as of June 30, 2008 are described below (the following chart is not shown in thousands).

Type Coverage	Limits (\$)	Deductible (\$)	Comments
Public Officers and Employee Liability	1,000,000/5,000,000	-	State is self-insured up to \$1,000,000; excess up to \$5,000,000 is with a private insurer.
All Risk - Property Contents	3,006,000	500	Except for theft, then \$1,000 per occurrence
Auto- Bodily Injury and Property Damage	500,000/5,000,000	50 100	Comp. deductible Collision deductible
Theft, Disappearance, Destruction	250,000	2,500	Inside premises
Theft, Disappearance, Destruction	50,000	2,500	Outside premises
Computer Fraud	5,000,000	75,000	+10% over \$75,000
Employee Dishonesty	5,000,000	75,000	+10% over \$75,000
Forgery and Alteration	100,000	2,500	
Robbery and Safe Burglary-money/securities	500,000	1,000	

Employees and retirees are provided health care coverage by the State of North Carolina's Comprehensive Major Medical Plan. This employee benefit plan is funded by employer and employee contributions.

The North Carolina Workers' Compensation Program provides benefits to workers injured on the job. All employees of the State are included in the program. When an employee is injured, the NCEL's primary responsibility is to arrange for and provide the necessary treatment for work related injury. The State is self-insured for workers' compensation. A third party administrator processes workers' compensation claims. State agencies, including the NCEL, contribute to a fund administered by the office of the State Controller to cover their workers' compensation claims. The third party administrator receives a per case administration fee and draws down State funds to make medical and indemnity payments on behalf of the State in accordance with the North Carolina Workers' Compensation Act. Term life insurance of \$25,000 to \$50,000 is provided to eligible employees. This self-insured death benefit program is administered by the Department of the State Treasurer and funded via employer contributions.

Additional details on State-administered risk management programs are disclosed in the State of North Carolina's *Comprehensive Annual Financial Report*.

NOTE 9 - PENSION AND DEFERRED COMPENSATION PLANS

- A. Retirement Plan** - Each permanent full-time employee, as a condition of employment, is a member of the Teachers' and State Employees' Retirement System (TSERS) and is automatically enrolled in the Teachers' and State Employees' Retirement System.

The Teachers' and State Employees' Retirement System is a cost sharing multiple-employer defined benefit pension plan established by the State to provide pension benefits for employees of the State, its component units and local boards of education. The plan is administered by the North Carolina State Treasurer.

Benefit and contribution provisions for the Teachers' and State Employees' Retirement System are established by *North Carolina General Statutes* 135-5 and 135-8 and may be amended only by the North Carolina General Assembly. Employer and member contribution rates are set each year by the North Carolina General Assembly based on annual actuarial valuations.

NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2008 and 2007 (continued)

For the years ending June 30, 2008 and 2007, respectively, the NCEL had a total payroll of \$10,862 and \$9,720, of which \$10,340 and \$9,677 was covered under the Teachers' and State Employees' Retirement System. Total employer and employee contributions for pension benefits for the year were \$805 and \$621, respectively. Required employer contribution rates for the years ended June 30, 2008, 2007 and 2006, were 3.05%, 2.66% and 2.34%, respectively, while employee contributions were 6% each year. The NCEL made 100% of its annual required contributions for the years ended June 30, 2008, 2007 and 2006, which were \$313, \$257 and \$262, respectively.

The Teachers' and State Employees' Retirement System's financial information is included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.ncosc.net/> and clicking on "Financial Reports", or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

- B. Supplemental Retirement Income Plan** - IRC Section 401(k) Plan - All full-time employees are eligible to enroll in the Supplemental Retirement Income Plan, a defined contribution plan, created under Internal Revenue Code Section 401(k). All costs of administering the plan are the responsibility of plan participants. The Plan is provided by Prudential Retirement, administered by the NC Department of the State Treasurer and sponsored by the State of North Carolina. The effective date of participation was January 30, 2006. The voluntary contributions by employees amounted to \$194 and \$115 for the years ended June 30, 2008 and 2007, respectively.
- C. Deferred Compensation Plan** - IRC Section 457 Plan - The State of North Carolina offers its permanent employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457 through the North Carolina Public Employee Deferred Compensation Plan (the "Plan"). The Plan permits each participating employee to defer a portion of his or her salary until future years. The deferred compensation is available to employees upon separation from service, death, disability, retirement or financial hardships if approved by the Board of Trustees of the Plan. The Board, a part of the North Carolina Department of State Treasurer, maintains a separate fund for the exclusive benefit of the participating employees and their beneficiaries, the *North Carolina Public Employee Deferred Compensation Trust Fund*. The Board also contracts with an external third party to perform certain administrative requirements and to manage the trust fund's assets. All costs of administering and funding the Plan are the responsibility of the Plan participants. The effective date of participation was January 30, 2006. The voluntary contributions by employees amounted to \$67 and \$50 for the years ended June 30, 2008 and 2007, respectively.

NOTE 10 - OTHER POSTEMPLOYMENT BENEFITS

- A. Health Care for Long-Term Disability Beneficiaries and Retirees** - The NCEL participates in the Comprehensive Major Medical Plan (the Plan), a cost-sharing, multiple-employer defined benefit health care plan that provides postemployment health insurance to eligible former employees. Eligible former employees include long-term disability beneficiaries of the Disability Income Plan of North Carolina and retirees of the Teachers' and State Employees' Retirement System. Coverage eligibility varies depending on years of contributory membership service in the retirement system prior to disability or retirement.

The Plan's benefit and contribution provisions are established by Chapter 135-7, Article 1, and Chapter 135, Article 3, of the General Statutes and may be amended only by the North Carolina General Assembly. The Plan does not provide for automatic post-retirement benefit increases.

By General Statute, a Retiree Health Benefit Fund (the Fund) has been established as a fund in which accumulated contributions from employers and any earnings on those contributions shall be used to provide health benefits to retired and disabled employees and applicable beneficiaries. By statute, the Fund is administered by the Board of Trustees Teachers' and State Employees' Retirement System and contributions to the fund are irrevocable. Also by law, Fund assets are dedicated to providing benefits to retired and disabled employees and applicable beneficiaries and are not subject to the claims of creditors of the employers making contributions to the Fund. Contribution rates to the Fund, which are intended to finance benefits and administrative expenses on a pay-as-you-go basis, are determined by the General Assembly in the Appropriations Bill.

For the current fiscal year the NCEL contributed 4.1% of the covered payroll under the Teachers' and State Employees' Retirement System. Required contribution rates for the years ended June 30, 2008, 2007 and 2006, were 4.1%, 3.8% and 3.8%, respectively. The NCEL made 100% of its annual required contributions to the Plan for the years ended June 30, 2008, 2007 and 2006, which were \$421, \$368 and \$144, respectively. The NCEL assumes no liability for retiree health care benefits provided by the programs other than its required contribution.

Additional detailed information about these programs can be located in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.ncosc.net/> and clicking on "Financial Reports", or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

- B. Long-Term Disability** - The NCEL participates in the Disability Income Plan of North Carolina (DIPNC), a cost-sharing, multiple-employer defined benefit plan, to provide short-term and long-term disability benefits to eligible members of the Teachers' and State Employees' Retirement System. Benefit and contribution provisions are established by Chapter 135, Article 6, of the General Statutes, and may be amended only by the North Carolina General Assembly. The plan does not provide for automatic post-retirement benefit increases.

Disability income benefits are funded by actuarially determined employer contributions that are established in the Appropriations Bill by the General Assembly. For the fiscal year ended June 30, 2008 and 2007, the NCEL made a statutory contribution of .52% of covered payroll under the Teachers' and State Employees' Retirement System. Required contribution rates for the years ended June 30, 2008, 2007 and 2006, were .52%, .52% and .52%, respectively. The NCEL made 100% of its annual required contributions to the DIPNC for the years ended June 30, 2008, 2007 and 2006, which were \$54, \$50 and \$20, respectively. The NCEL assumes no liability for long-term disability benefits under the Plan other than its contribution.

Additional detailed information about the DIPNC is disclosed in the State of North Carolina's *Comprehensive Annual Financial Report*.

NOTE 11 - LITIGATION

As of June 30, 2008, the NCEL is not, nor anticipates being, a party to any litigation.

NOTES TO FINANCIAL STATEMENTS (in thousands)
June 30, 2008 and 2007 (continued)

NOTE 12 - ALLOCATION OF TOTAL ANNUAL REVENUES/TRANSFERS TO NC EDUCATION LOTTERY FUND

2008		
Lottery Ticket Sales	\$ 1,078,082	
Fees and Licenses	4,782	
Investment Earnings and Other Revenues	8,897	
Total Annual Revenue	1,091,761	
Less Prize Tickets	(29,733)	3% of Total Annual Revenue
Total Net Revenue	1,062,028	
Prize Expense	(588,485)	54% of Total Annual Revenue
Advertising	(8,619)	1% of Total Annual Revenue
All Other Expenses and Transfers	(41,243)	
Total Section 18C-162.a.3	(49,862)	5% of Total Annual Revenue
Commissions (Per 18C-142)	(75,371)	7% of Lottery Ticket Sales
Unclaimed Prizes to NC Education Lottery Fund	16,789	
Net Revenues To NC Education Lottery Fund	331,521	
Total Revenues to NC Education Fund	\$ 348,310	32% of Total Annual Revenue
2007		
Lottery Ticket Sales	\$ 885,575	
Fees and Licenses	4,521	
Investment Earnings and Other Revenues	8,544	
Total Annual Revenue	898,640	
Less Prize Tickets	(23,901)	3% of Total Annual Revenue
Total Net Revenue	874,739	
Prize Expense	(451,792)	50% of Total Annual Revenue
Advertising	(7,810)	1% of Total Annual Revenue
All Other Expenses and Transfers	(38,851)	
Total Section 18C-162.a.3	(46,661)	5% of Total Annual Revenue
Commissions (Per 18C-142)	(61,932)	7% of Lottery Ticket Sales
Unclaimed Prizes to NC Education Lottery Fund	8,037	
Net Revenues To NC Education Lottery Fund	306,317	
Total Revenues to NC Education Fund	\$ 314,354	35% of Total Annual Revenue

NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2008 and 2007 (continued)

In accordance with Section § 18C-162 of the NCEL Act: Allocation of revenues.

(a) The Commission shall allocate revenues to the North Carolina State Lottery Fund in order to increase and maximize the available revenues for education purposes, and to the extent practicable, shall adhere to the following guidelines:

- (1) At least fifty percent (50%) of the total annual revenues, as described in this Chapter, shall be returned to the public in the form of prizes.
- (2) At least thirty-five percent (35%) of the total annual revenues, as described in this Chapter, shall be transferred as provided in G.S. 18C-164.
- (3) No more than eight percent (8%) of the total annual revenues, as described in this Chapter, shall be allocated for payment of expenses of the Lottery. Advertising expenses shall not exceed one percent (1%) of the total annual revenues.
- (4) No more than seven percent (7%) of the total annual revenues, as described in this Chapter, shall be allocated for compensation paid to lottery game retailers.

Additionally, in accordance with Section § 18C-142 of the NCEL Act, Compensation for lottery game retailers, "The amount of compensation paid to lottery game retailers for their sales of lottery tickets or shares shall be seven percent (7%) of the retail price of the tickets or shares sold for each lottery game."

§ 18C-161. Types of income to the North Carolina State Lottery Fund.

- (1) All proceeds from the sale of lottery tickets or shares.
- (2) The funds for initial start-up costs provide by the State.
- (3) All other funds credited or appropriated to the Commission from any sources.
- (4) Interest earned by the North Carolina Lottery Fund.

As of September 30, 2008 the NCEL transferred \$344,809 and \$311,811 for the years ended June 30, 2008 and 2007, respectively to the NC Education Lottery Fund. As explained in NOTE 4C, \$3,501 and \$2,543 for the years ended June 30, 2008 and 2007, respectively, is the amount of the "Net Revenues" for the year not yet transferred to the NC Education Fund as of June 30, but will be transferred during the subsequent fiscal year.

NOTE 13 - CHANGES IN FINANCIAL ACCOUNTING AND REPORTING

For the fiscal year ended June 30, 2008, the NCEL implemented the following pronouncements issued by the Governmental Accounting Standards Board (GASB):

GASB Statement No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions.

GASB Statement No. 50, Pension Disclosures.

GASB Statement No. 45 requires cost-sharing employers to recognize OPEB expense for their contractually required contributions to the plan generally consistent with the approach adopted in GASB Statement No. 27, Accounting for Pensions by State and Local Governmental Employers, with modifications to reflect differences between pension benefits and OPEB.

GASB Statement No. 50 aligns the financial reporting requirements for pensions with those of other postemployment benefits, to conform with GASB Statement No. 45. This Statement amends GASB Statement 27 to require note disclosure of the employer contribution rates and percentage of the amount contributed for the current and preceding two years and to disclose how the required contribution rates are established.

NOTE 14 - RECLASSIFICATIONS

Certain reclassifications have been made to the 2007 financial statements to conform to the current year presentation.



Independent Auditors' 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 Commissioners
North Carolina Education Lottery
Raleigh, North Carolina

We have audited the accompanying statements of net assets of the North Carolina Education Lottery (NCEL) as of June 30, 2008 and 2007, and the related statements of revenues, expenses, and changes in fund net assets and cash flows for the years then ended, and have issued our report thereon dated October 15, 2008. 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.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the NCEL's internal control over financial reporting as a basis for designing our audit procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the NCEL's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the NCEL's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the NCEL's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the NCEL's financial statements is more than inconsequential will not be prevented or detected by the NCEL's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the NCEL's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

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

This report is intended solely for the information and use of management, the Commissioners, others within the organization, and the State of North Carolina and is not intended to be and should not be used by anyone other than these specified parties.

CHERRY, BEKAERT & HOLLAND, L.L.P.

Raleigh, North Carolina
October 15, 2008

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