



FY 2012
ANNUAL
REPORT

“

“Our mission is to maximize lottery ticket sales to earn money for education in North Carolina. I’m pleased to report that in fiscal year 2012 we met that mission with a sixth year of record sales and record earnings. Best of all, all of our profits went to support great teachers, improve our places of learning and help students from four-year-olds to college reach their full potential.” ”

**Alice Garland, Executive Director
N.C. Education Lottery**

table of contents



chairman's note 4



executive director's report 6



ncel senior staff 8



our organization 10



our cause 11



our games 16



our sales 18



our advertising and marketing 20



our marketing events 21



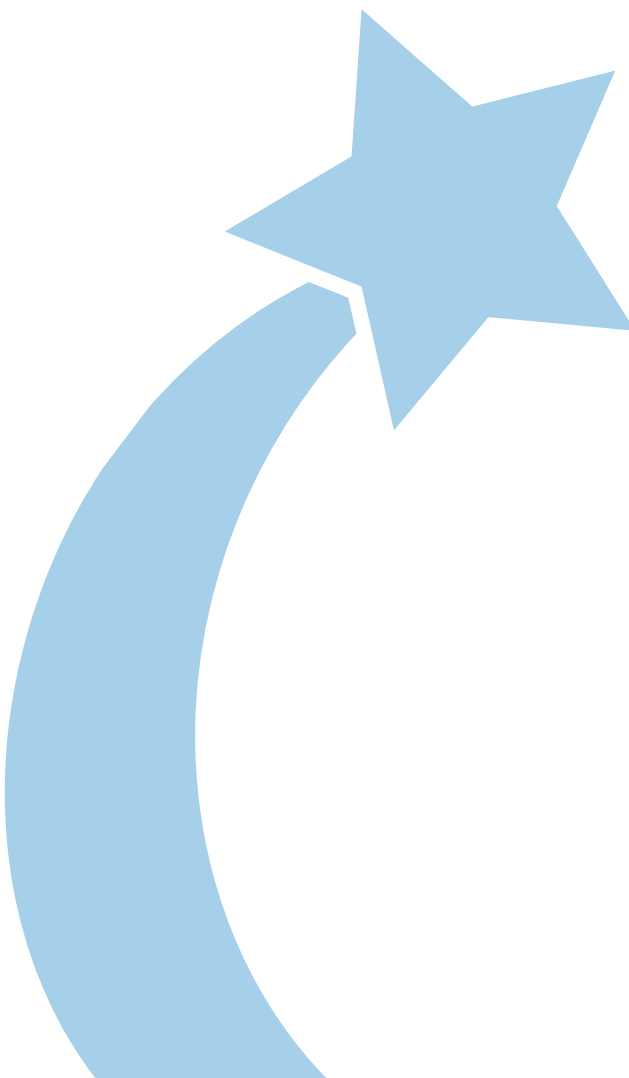
our winners 22



our commitment to responsible gaming 23



financial information 25



chairman's note



The Education Lottery finished our most recent year with a sixth record transfer to our state, \$456.8 million, bringing the total contribution in six years to \$2.45 billion. The benefits of those dollars will be felt across North Carolina communities for years to come.

Those dollars are essentially the profits of the lottery. Profits come from a business, and during my time on the Education Lottery Commission, we have worked, as much as possible, to operate the lottery as a business. Working like a business has helped meet the mission the state gave the lottery. That mission is to maximize the sale of lottery tickets to raise money for education. After paying lottery prizes and expenses, every dollar the lottery earns is a dollar the state has available to invest in one of its most important causes – education.

Across the state, those dollars have been put to good use. We got to see how some of the lottery dollars are being used during a trip in January 2012 to Alamance County. I joined others in cutting the ribbon to open a new wing of an elementary school with four new classrooms. The highlight of the trip was seeing the faces of those smiling fifth graders as they stood in line, waiting to show off their new classrooms to their parents.

One of our jobs as commissioners is keeping an eye on the bottom line. We know that every dollar we save on administrative expenses is a dollar that will be used for education. While we are allowed to spend up to 8 percent of lottery revenue on administrative expenses, I am proud we have continued to keep those expenses under 4.5 percent. We also make sure the books stay balanced. For the sixth year in a row, we have earned a clean review from independent auditors for how we have handled the finances of the lottery. Nothing is more important in the lottery business than the reputation you have for integrity. Our games are run fairly and honestly. And we account for every dollar that we handle.

My service on the lottery commission began when it was formed more than six years ago. I watched the first games begin in March 2006 and I saw the lottery grow to become one of the state's most successful sales organizations. Thanks to the guidance of my fellow commissioners and the hard work of Executive Director Alice Garland and her staff, that business is producing money that our state needs to make key investments in the education of our young people. We look forward to continuing to serve the taxpayers and children of North Carolina in the future.

N.C. Education Lottery Commission

The Education Lottery Commission consists of nine members. Five members are appointed by the governor and four by the N.C. General Assembly, of which two are recommended by the speaker of the N.C. House of Representatives, and two by the president pro tem of the N.C. Senate. Commissioners serve five-year terms and can only serve two successive terms. One member must have five years experience in law enforcement, one must be a certified public accountant, and one must have retail sales experience as an owner or manager of a sales company. Commission meetings are held once a quarter.



carla archie

Charlotte
Senior counsel,
Wells Fargo & Co.

Appointed by:
Gov. Mike Easley
Term: Jan. 9, 2009 –
Aug. 31, 2011



keith ballentine

Rocky Mount
Vice president,
Daughtridge Gas & Oil Co.

Appointed by: Speaker of the
House Thom Tillis
Term: Aug. 15, 2012 –
Aug. 31, 2017



courtney a. crowder

Raleigh
Owner,
Crowder Consulting Co.

Appointed by:
Gov. Beverly Perdue
Term: Nov. 6, 2012 –
Aug. 31, 2017

Commissioners whose terms expired in FY12 included Lawrence Spears of Raleigh and the late Bill Dowdy of Raleigh. The term of Commissioner Pam Whitaker expired in August 2012.

robert farris jr chairman

Wilson

**Attorney,
Farris and Farris, P.A.**

**Appointed by:
Gov. Mike Easley**

**Term: Sept. 22, 2005 -
Aug. 31, 2013**



barry z. dodson

*Stoneville
Certified public accountant*

*Appointed by: Senate President
Pro Tem Phil Berger*

*Term: Feb. 15, 2011 -
Aug. 31, 2013*



j. marlene hyatt

*Waynesville
Retired Superior Court Judge*

*Appointed by:
House Speaker Joe Hackney*

*Term: Aug. 18, 2009 -
Aug. 31, 2013*



david f. kirby

*Raleigh
Attorney*

*Appointed by:
Gov. Beverly Perdue*

*Term: June 28, 2012 -
Aug. 31, 2016*



jody tyson

*Snow Hill
Managing partner, Taylor-Tyson
Funeral Service*

*Appointed by: Senate President
Pro Tem Phil Berger*

*Term: July 2, 2012 -
Aug. 31, 2017*



ray warren

*Hiddenite
Retired sheriff*

*Appointed by:
Gov. Beverly Perdue*

*Term: July 10, 2012 -
Aug. 31, 2016*

Commissioners Norwood Clark of Raleigh, Bridget-Anne Hampden of Charlotte, Fern Shubert of Marshville and Cullie M. Tarleton of Blowing Rock resigned from their posts in FY12.

executive director's report

The N.C. Education Lottery: A big business for our state



Often, when I am speaking to a Kiwanis or Rotary Club about the Education Lottery, I will look over the crowd and ask this question: Would you like to invest in a company that gives you a return of 29 percent?

Heads start nodding in the crowd. And then I see looks of surprise when I say that's the return the Education Lottery makes for North Carolina. For every dollar spent on the lottery last year, we earned a profit of 29 cents. That profit went to a great cause – education.

Still, you won't see the Education Lottery on any media's list of top North Carolina companies. I guess it's hard to classify us. Are we a business? Or are we a state agency?

Well, in fact, we are both. We're a state agency that does the best it can to work every day like a business. Our business, our mission, is sales. Our job is to maximize the sales of lottery tickets to raise money for education.

If you were to rank the lottery by its sales, it would weigh in at almost \$1.59 billion. That's similar in size to Snyder's-Lance of Charlotte.

Snyder's-Lance makes great snacks. Customers buy their products for the good taste. Our product is prizes. Customers buy our products to win prizes. In our last fiscal year, we paid out \$961 million in prizes. On average, that's about \$2.6 million a day.

One way we maximize our return for education is keeping a lean organization. We have a workforce of about 237 employees. Think about that a minute. \$1.59 billion in sales. Only 237 employees.

Last year, we spent about 4 percent of our revenue on administrative costs, including the costs of our gaming system, our advertising and marketing and our salaries, benefits and operations of our six offices.


Our sales folks work with more than 6,700 retail partners. That's how many places in North Carolina where you can buy a lottery ticket. Some of our best partners are convenience stores, but you also find lottery tickets now at your local Food Lion, Harris Teeter, Rite-Aid, and even BJ Wholesale Clubs.

Retailers earn a commission of seven cents for every \$1 they collect in ticket sales. Last year, sales commissions added up to \$111.6 million. That's a good piece of North Carolina's retail economy. During some of the toughest economic times in recent history, we've increased our sales and commissions every year. Retailers can count on the lottery to bring customers into their stores.

During those tough economic times, we've also increased our return for education every year. Last year, we transferred \$457 million to the state.

When folks feel lucky and have an extra dollar or two, we hope they will give the lottery a try. We work hard to make our games fun and entertaining and to keep them honest and fair. We hope people only play for fun. And while everyone doesn't play the lottery, everyone does get to share in the benefits it provides to education and our state.

Alice Garland

A portrait of Alice Garland, Executive Director of the N.C. Education Lottery. She is a woman with short, styled grey hair, wearing black-rimmed glasses, a tan blazer over a white top, and gold jewelry including earrings, a necklace, and bracelets. She is smiling and has her arms crossed. The background shows an office environment with a dark wood cabinet, a potted plant, and a framed picture on the wall.

“With \$1.59 billion in annual revenues, the lottery has become one of the largest sales organization in the state, raising money to meet important needs in education.”

*Alice Garland
Executive Director
N.C. Education Lottery*

100 years of experience at top of education lottery



The senior staff of the N.C. Education Lottery has a combined total of 108 years of experience in the lottery business. The top executives have worked in some of the most successful lotteries in the United States – the New York, the New Jersey and the Georgia lotteries. Here are the lottery's top leaders, charted by experience, titles and areas of responsibility.

financial highlights, fy 2012

Here are the key financial highlights of the N.C. Education Lottery, from July 1, 2011 through June 30, 2012.

- **Recorded sixth straight year of record ticket sales, \$1.59 billion.**
- **Surpassed \$7.96 billion in total sales since inception.**
- **Recorded sixth straight year of record transfer to state, \$456.8 million.**
- **Surpassed \$2.45 billion in total contributions to the state and education in North Carolina since inception.**
- **Paid out \$961.5 million in prizes.**
- **Awarded a prize of \$1 million or more for the 110th time since inception.**
- **Increased number of lottery retailers to 6,787, up 2.7 percent from FY11.**
- **Paid \$111 million in commissions to retailers.**
- **Collected \$14.4 million in state income taxes from prize winnings and \$1 million in debts owed to state and local governments.**
- **Transferred \$1 million to the N.C. Department of Health and Human Services for gambling addiction, education and treatment programs.**
- **Received for sixth year in a row a clean review, or "unqualified opinion," during its annual independent financial audit.**



**18
YEARS**
sam hammett

Deputy Executive
Director, Sales

Has 18 years of experience with lotteries in Georgia and North Carolina. Responsible for all lottery ticket distribution and sales, including the management of lottery relationships with its retail and corporate partners who sell lottery tickets in more than 6,700 locations, and the operations of the lottery's six regional claims centers and warehouse.



**19
YEARS**
lou ann russell

Deputy Executive
Director, Advertising,
Marketing and
Communications

Has 19 years of experience with lotteries in Georgia and North Carolina. Responsible for the development of the lottery's brand and image as well as the promotion of its games through advertising, marketing and public relations.

Overall, about 96 cents of every dollar spent on a lottery ticket in North Carolina is reinvested in some way back into the state's economy. If you consider a dollar spent on a lottery ticket, 60 cents goes to winners, 29 cents goes to education, and seven cents go to retailers' commissions.



6
YEARS
alice garland

Executive
Director

Has six years of experience with the N.C. Education Lottery. She was named to the lottery's top post in January 2011, serving previously as deputy executive director for legislative and corporate communications. She has a combined 31 years of experience in executive posts handling government affairs and communications



35
YEARS
bill jourdain

Deputy Executive
Director, Finance,
Administration and Security

Has 35 years of experience with lotteries in New Jersey and North Carolina. Is responsible for oversight of all lottery finances, the administration of contracts, the payout of prizes to winners, the management of lottery facilities, and oversight of lottery security to protect the integrity of its games.



30
YEARS
deborah doty

Deputy Executive Director,
Management Information and
Gaming Systems

Has 30 years of experience with lotteries in New York and North Carolina. Is responsible for all technology at the lottery and for contract compliance with the lottery's main vendor, GTECH, which provides the centralized gaming system for the lottery.

NCEL Directors

Nikki Howard,
Director of Internal Audit

Quan Kirk,
General Counsel

Jaime King Fuquay,
Director of Government Affairs

Michelle Lassiter,
Director of Finance

Stacy Askew,
Director of Administration

Moe McKnight,
Director of Security

Van Denton,
Director of Communications

Tami Wiggs,
Director of Marketing

Susan Singley,
Director of Advertising

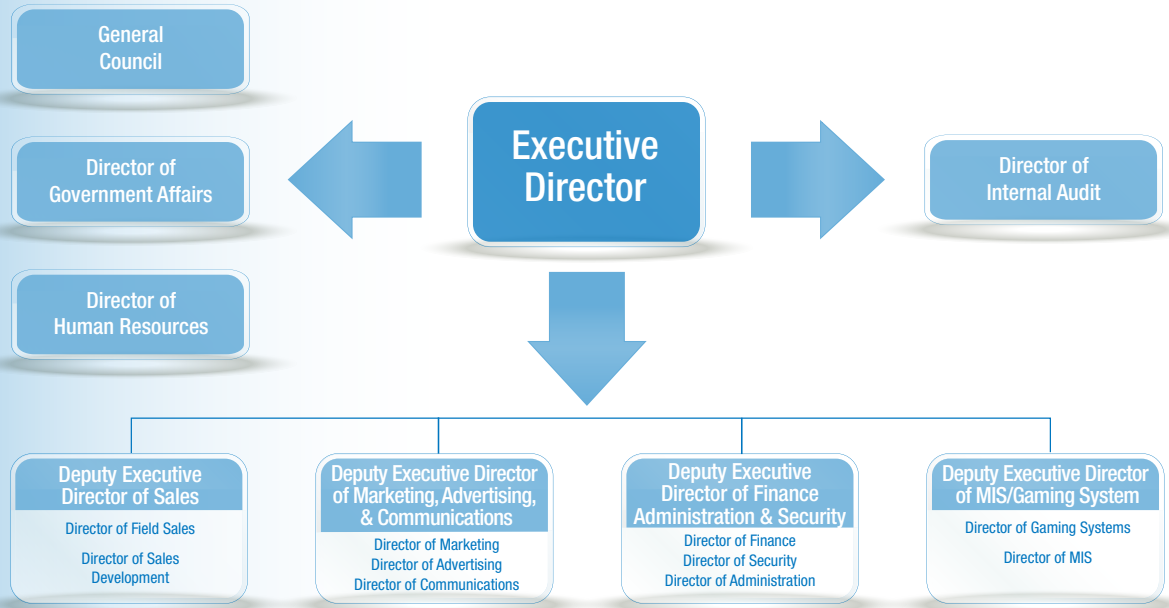
Terri Avery,
Director of Field Sales

Walter Ingram,
Director of
Sales Development

Joseph Norman,
Director of
Gaming Systems

Tony Chung,
Director of MIS

Randy Spielman,
Director of Product Development



our organization

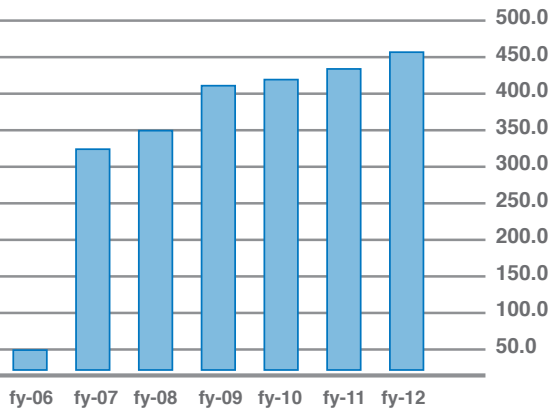
The Education Lottery primarily is a sales organization, selling tickets to an array of games associated with its drawings and instant tickets. Those operations are supported by teams with the responsibilities of paying winners their prizes, maintaining a network of more than 6,700 retailers who sell lottery tickets, keeping the lottery's financial books in order, assisting the work of its 237 employees and protecting the integrity of the games and overall lottery operations. Here's a look at the lottery's organizational structure.



ncel departments



history of transfers



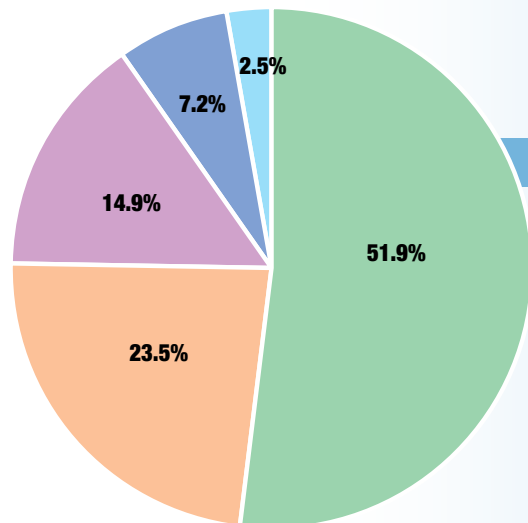
our cause



The lottery's mission to raise money to benefit North Carolina education began in the spring of 2006. In accordance with state law, funds are directed by the legislature to specific programs. Lottery funds have been used to pay for:

- **Teachers' salaries in grades K-3 with the goal of keeping class sizes as low as possible**
- **School construction projects that would otherwise have to be paid for with local property taxes**
- **At-risk four-year-olds to attend the N.C. Pre-K program, an academic environment that prepares them for kindergarten**
- **College scholarships and financial aid based on need, to help students who qualify receive higher education**

Since the start of the lottery through FY12, more than \$2.45 billion has been raised for education initiatives statewide.



fy-12 distribution to beneficiary programs



- teachers' salaries
- school construction
- prekindergarten
- need-based college scholarships
- unc need-based financial aid

teachers' salaries
in grades k-3
\$220,643,188



Anita McCauley
K-2 Teacher,
Little River
Elementary
School, Durham

“I love that moment when the light bulb comes on in the kids' heads and you can see that all the hard work and dedication has paid off ... what you're teaching them is sinking in and they really get the concept. The lottery has done a great job of helping to provide these kids a better chance to be successful.” ”





school construction
\$108,102,356



Dr. Patrick Miller,
Superintendent,
Greene County
Schools

“We would not have been able to afford the additional teachers or the new school without the lottery dollars. Those funds have been critical to our successes in Greene County.” ”

n.c. pre-k
\$63,135,709



Sophia Berongoy
Pre-K Teacher,
Little River
Elementary
School, Durham

“I have so much fun with my kids, and I learn from them just as much as they learn from me. The lottery is a great idea for North Carolina. You can really see the benefits helping the children”



need-based
college scholarships
& financial aid
\$43,596,948

Carolina at Charlotte



Leah Cameron,
Math & Secondary
Education
Student,
UNC-Charlotte

“Receiving this NCEL scholarship will help me cross the finish line in a lifelong goal. This 33 year old mother of two is so thankful for this chance you have given me.” ”

On March 30, 2012, the Mega Millions jackpot was \$656 million, the highest jackpot in world history. The Powerball jackpot exceeded \$200 million five times during FY12.

our games



The lottery's products are prizes. Our prizes come from games ranging from the two big multi-state jackpot games, Powerball and Mega Millions, to North Carolina draw games including Carolina Cash 5, Carolina Pick 4, and Carolina Pick 3, to a portfolio of instant scratch-off games with tickets from \$1 to \$20. Lottery tickets provide inexpensive fun that can pay off big for players.

Highlights of the lottery's portfolio of games in FY12.

- Released 49 new instant scratch-off games into the marketplace.
- Launched third \$20 instant mega game, \$4,000,000 Cash Blowout, with three top prizes of \$4 million and seven prizes of \$1 million.
- Started a new version of the Powerball game on Jan. 15, 2012, that provided bigger jackpots and better odds of winning them. The costs of a Powerball ticket rose from \$1 to \$2.
- Offered a suite of three "Taxes Paid" instant games that gave players the chance to win top prizes up to \$100,000 with the initial taxes paid by the lottery.
- Released new licensed games. One was an officially licensed NASCAR® scratch-off ticket called Ultimate Fan that gave players five chances to win \$100,000 instantly and included three second-chance drawings for six \$20,000 VIP trips to a race of the winner's choice. Another licensed game, Wheel of Fortune, awarded players the chance to travel to Hollywood and play in a non-broadcast version of the popular TV game show.
- Launched the Carolina Gold instant game with four top prizes of \$1 million and the lottery's largest ever second-chance drawing prize of \$1 million. The ticket also was the first to feature a QR code so players could use smartphones to learn about the \$1 million second-chance prize.

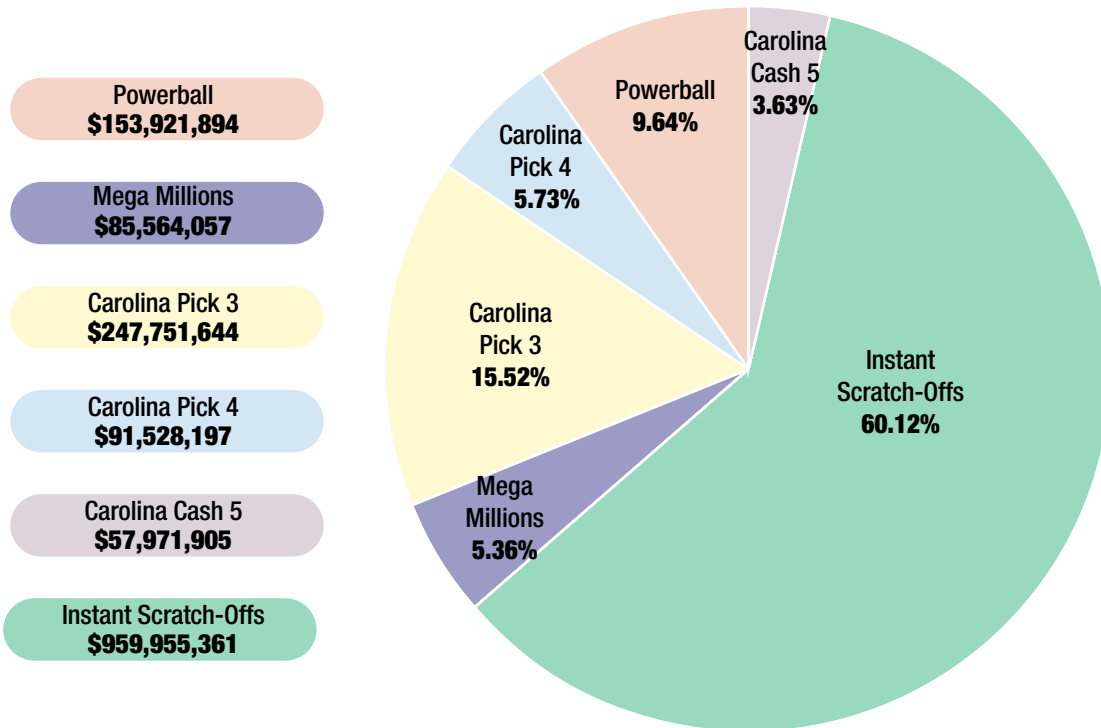


life-to-date sales by fiscal year

	Instant Games	Powerball	Mega Millions	Pick 3	Pick 4	Cash 5	Raffle	Total
FY 2012 (7/1-6/30)	\$959,955,361	\$153,921,894	\$85,564,057	\$247,751,644	\$91,528,197	\$57,971,905	-	\$1,596,693,058
FY 2011 (7/1-6/30)	\$862,090,476	\$138,670,659	\$72,847,709	\$258,443,414	\$65,309,804	\$57,757,944	\$5,986,380	\$1,461,106,386
FY 2010 (7/1-6/30)	\$855,582,267	\$198,756,717	\$25,969,303	\$222,777,592	\$57,370,252	\$60,873,168	-	\$1,421,329,299
FY 2009 (7/1-6/30)	\$798,676,404	\$209,746,679	-	\$208,883,766	\$15,793,159	\$60,011,218	-	\$1,293,111,226
FY 2008 (7/1-6/30)	\$635,880,115	\$229,255,174	-	\$147,158,304	-	\$58,516,249	\$7,369,240	\$1,078,179,082
FY 2007 (7/1-6/30)	\$494,314,534	\$258,967,883	-	\$89,541,216	-	\$36,501,699	\$10,000,000	\$889,325,332
FY 2006 (3/30-6/30)	\$198,454,677	\$27,317,594	-	-	-	-	-	\$225,772,271
Life to Date	\$4,804,953,834	\$1,216,636,600	\$184,381,069	\$1,174,555,936	\$230,001,412	\$331,632,183	\$23,355,620	\$7,965,516,654

\$1,596,693,058*
fiscal year record sales!

fiscal year sales



*All sales figures based on FY12 totals - July 1, 2011 through June 30, 2012.

Asheville

6.48% Statewide Sales

Sales for the fiscal year:
\$103,512,687.50

Retailer Commissions:
\$7,226,783.63

Number of Retailers: 586

Regional Top 5

Catamount Travel Center, *Whittier*
Double R Convenience, *Marion*
Drop-In Food Stores #5, *Forest City*
Merrimon Avenue Exxon, *Asheville*
Hot Spot # 5002, *Asheville*

Greensboro

14.62% Statewide Sales

Sales for the fiscal year:
\$233,427,508.00

Retailer Commissions:
\$16,325,397.77

Number of Retailers: 1,151

Regional Top 5

Carlton's Tanglewood, *Clemmons*
Quick Mart, *Jamestown*
Fairway One Stop #21, *Greensboro*
Kwik Buy, *Greensboro*
Ready Mart., *Asheboro*

Raleigh

39.82% Statewide Sales

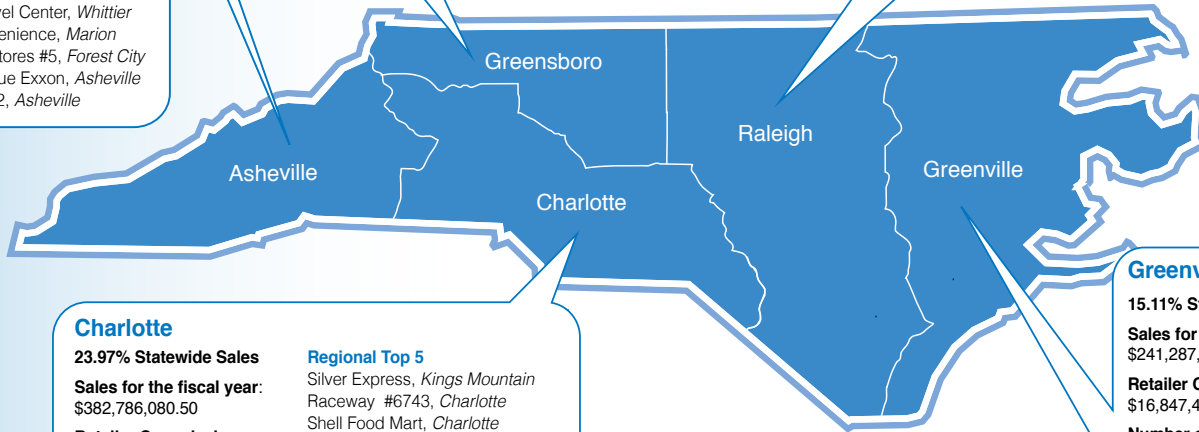
Sales for the fiscal year:
\$635,679,302.50

Retailer Commissions:
\$44,455,567.62

Number of Retailers: 2,408

Regional Top 5

Reilly Road BP Amoco, *Fayetteville*
Rose Mart #14, *Wilson*
Winners Food Mart, *Roxboro*
Bobby Taylor Oil #2, *Fayetteville*
Eagle Express, *Knightdale*



Charlotte

23.97% Statewide Sales

Sales for the fiscal year:
\$382,786,080.50

Retailer Commissions:
\$26,770,748.67

Number of Retailers: 1,803

Regional Top 5

Silver Express, *Kings Mountain*
Raceway #6743, *Charlotte*
Shell Food Mart, *Charlotte*
N & R Convenience Marts Inc, *Lumberton*
Jay's Food Mart, *Southern Pines*

Greenville

15.11% Statewide Sales

Sales for the fiscal year:
\$241,287,479.50

Retailer Commissions:
\$16,847,414.28

Number of Retailers: 826

Regional Top 5

Raceway, *Tarboro*
CJ Food Store, *Jacksonville*
Ethco Service Station, *Engelhard*
Tony's Friendly Mart #1, *Kinston*
Fuel Doc #12, *Greenville*

“The commissions for selling lottery tickets helped retailers in tough economic times, and the excitement surrounding lottery games brings customers into our stores.” ”

Zack Carlton
Carlton's Styers Ferry Grocery,
Clemmons
Member, NCEL's Retail Advisory Task Force



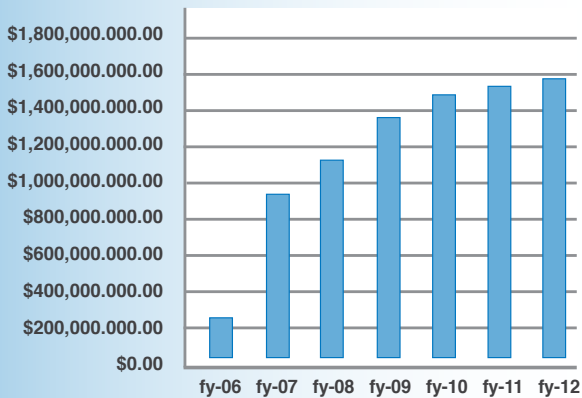
our sales

The N.C. Education Lottery's \$1.59 billion in sales in FY12 makes it one of the biggest sales organizations in the state. The lottery plays a major role in North Carolina's retail economy, with lottery tickets sold in 6,787 retail locations across the state.

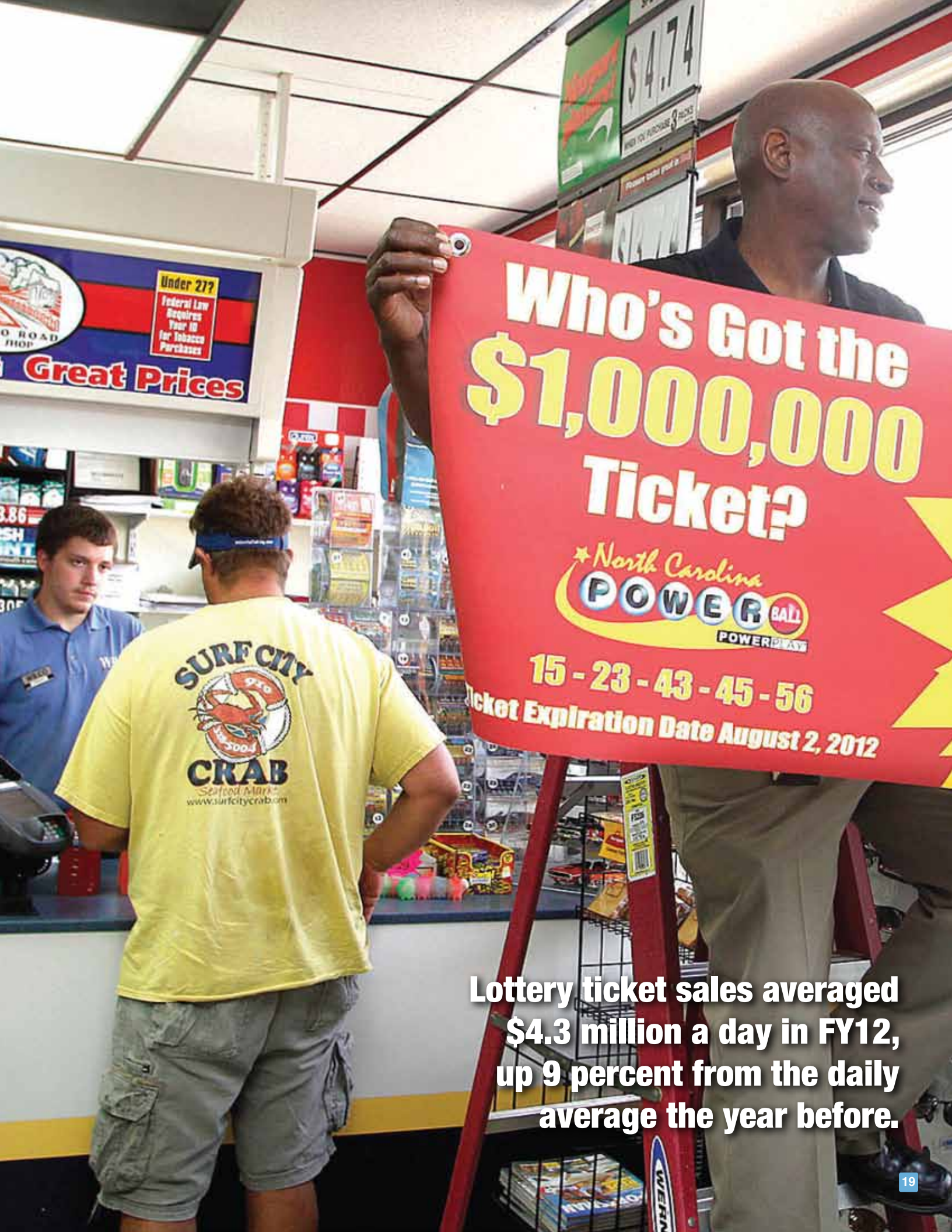
Highlights of lottery sales in FY12

- Recorded sixth straight year of record ticket sales, \$1.59 billion.
- Surpassed \$7.96 billion in total sales since inception.
- Increased number of lottery retailers to 6,787, up 2.7 percent from FY11.
- Paid \$111 million in commissions to retailers.
- Created Lottery Retailer Advisory Board made up of 11 members of the state's retail industry.
- Added a new \$10,000 incentive bonus for retailers that sell a winning instant ticket with a value of \$1 million or more.

sales by year



*All sales figures based on FY12 totals - July 1, 2011 through June 30, 2012 all retailer rankings reflect active NCEL retailers.



Who's Got the
\$1,000,000
Ticket?



15 - 23 - 43 - 45 - 56

Ticket Expiration Date August 2, 2012

Lottery ticket sales averaged
\$4.3 million a day in FY12,
up 9 percent from the daily
average the year before.



our advertising and marketing



The Education Lottery plays a significant role in the state's advertising industry with a year-round advertising program to support the sale of lottery tickets, share information on how lottery dollars benefit education and encourage responsible play. Its marketing programs support the lottery's brand and sales through sponsorship of community and cultural events, of professional and collegiate sports teams and of major sporting events.

Advertising and marketing FY12 highlights

- Received approval to start a player rewards program, called Lucke-Rewards, that allows players to get points for non-winning instant tickets and submit them for entries into weekly and monthly drawings.
- Conducted 28 marketing events across the state, including, for a fifth year, sponsorship of the NCEL 200 NASCAR Camping World Truck Series, at Charlotte Motor Speedway.
- Held the largest second-chance drawing in NCEL history, a \$1 million Carolina Gold second-chance drawing on March 28, 2012 with 610,000 entries.
- Built membership of the Lucke-Zone, a website for lottery players, to more than 118,000 subscribers and attracted more than 24,800 followers to the NCEL's main two social media channels, Facebook and Twitter.
- Approved new six-year contract for WRAL-TV of Raleigh to serve as the lottery's draw station in the production of daily drawings of Carolina Pick 3, Carolina Pick 4 and Carolina Cash 5 games.
- Approved contracts for WITN, Channel 7, in Greenville, New Bern and Washington, N.C., and WAXN, TV64 in Charlotte to join the NCEL's network of draw stations.
- Launched new \$2 Powerball game on Jan. 15, 2012 with the support of a major advertising and marketing campaign that included the NCEL's first Facebook advertising campaign.

The Education Lottery's advertising, such as this scene from a commercial supporting the lottery's Taxes Paid games, runs on television and radio stations across the state. The lottery's advertising agency is Trone Brand Energy of High Point.

our marketing events



A lucky Carolina Panthers fan wins a Carolina Panthers' jersey and prize pack as part of an Education Lottery promotion at a Panther's game at Bank of America Stadium in Charlotte in the fall of 2011. Such promotions help raise public awareness about the lottery and its contribution to education in North Carolina.

- **Community and Cultural Events:** Cabarrus County Fair, Concord; Benson Mule Days; Cleveland County Fair, Shelby; Dixie Classic Fair, Winston-Salem; N.C. Seafood Festival, Morehead City; Mumfest, New Bern; Riverfest, Wilmington; Barbecue Festival, Lexington; Azalea Festival, Wilmington; Dogwood Festival, Fayetteville; Speed Street and Taste of Charlotte, Charlotte.
- **Sporting Events:** Professional Bull Riders Inc. Built Ford Tough Series, 2011, Charlotte; Bank of America 500, Charlotte; National Hot Rod Association Four-Wide Nationals, Charlotte; NASCAR Camping World Truck Series at Rockingham; NCEL 200 NASCAR Camping World Truck Series, Charlotte; NASCAR Sprint All-Star Race, Charlotte; World of Outlaws World Finals and Sprint Car Showdown, The Dirt Track at Charlotte; History 300, Charlotte; Coca-Cola 600, Charlotte; CIAA Tournament Charlotte; and Southern Conference Tournament, Asheville.
- **Sports Sponsorships:** Carolina Hurricanes, Charlotte Bobcats, Charlotte Checkers, Carolina Panthers, Wake Forest University, Duke University, and minor league baseball, including Asheville Tourists, Carolina Mudcats, Durham Bulls, Hickory Crawdads, Kannapolis Intimidators, and Greensboro Grasshoppers.





our winners



Our players like that the lottery raises money for education, but they buy a lottery ticket hoping to win a prize. The NCEL paid out \$961.5 million in prizes in FY12 - on average \$2.6 million a day. In interviews with winners, most say they plan to use their winnings to pay bills, save for retirement or college for their kids, to donate to a favorite charity, to buy houses or cars, or to take a vacation.

Highlights of FY12 winners

The Education Lottery awarded jackpots 84 times in the Carolina Cash 5 game with an average jackpot of \$195,761. Carolina Pick 4 players received a total of \$2.7 million in prizes on Oct. 29, 2011 when the popular numbers 6-6-6-6 were drawn. Carolina Pick 3 players won a total of \$2.6 million on April 6, 2012 when the popular numbers 5-5-5 were drawn.

- Paid out prizes of \$1 million or more to 33 people. Twenty won \$1 million or more playing instant games; 11 won playing Powerball; and two won playing Mega Millions. Those winners lived in 22 North Carolina counties with three each from Durham and Forsyth counties and two each from Cabarrus, Guilford, Cleveland, Alamance, Catawba and Mecklenburg counties. One Powerball winner bought her winning ticket in North Carolina, but lives in South Carolina.
- Recorded 5th jackpot winner in a multi-state lottery game. The James Jones family of Greenville received \$57 million, half of a Mega Millions jackpot in the Sept. 30, 2011 drawing.
- Paid out the largest prize ever in a second-chance drawing, with the win going to Rodney Queen of Kernersville. The drawing was open to those entering their non-winning Carolina Gold instant tickets into the drawing.
- Gave away six VIP trips, valued at \$20,000, to NASCAR events. The experiential prizes were part of second-chance drawings offered as part of an officially licensed NASCAR instant game called Ultimate Fan.

our commitment to responsible gaming



In November 2011, the World Lottery Association, an international organization representing 140 lotteries from 90 countries, awarded the N.C. Education Lottery the Level 2 certification in its responsible gaming program. The Education Lottery was only the fourth U.S. lottery to achieve this certification. To meet the criteria for Level 2, the Education Lottery committed itself to the WLA's principles of responsible gaming. Among the NCEL's responsible gaming efforts are:

Ensuring integrity of games

Every day, the Education Lottery conducts afternoon and evening drawings for its Carolina Pick 3 and Carolina Pick 4 games, plus an evening drawing for the Carolina Cash 5 game. An independent auditor supervises each drawing. The drawing process takes more than two hours as officials go through an 80-step security checklist designed to ensure the integrity of results. The actual official drawings for the three games each evening takes about 75 seconds.

- An annual \$1 million contribution to the N.C. Problem Gaming Program. The funds not only cover the costs of the Problem Gambling Hotline, but also the care and treatment of people in the state who develop any kind of gambling problem.
- Annual sponsorship of the National Conference on Problem Gambling.
- Inclusion of a printed "Play Responsibly" message on all advertising and every lottery ticket along with the 800 number for the N.C. Problem Gambling Helpline. The number is (877) 718-5543.
- Efforts supporting the prohibition of lottery ticket sales to minors.
- Efforts to provide players easy access to the odds in Education Lottery games and information on prizes available to be won. The overall estimated odds of winning a prize are printed on each lottery ticket. The Education Lottery also lists on its website the number of prizes remaining at all prize levels in its instant games.





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), a major enterprise fund of the State of North Carolina as of and for the years ended June 30, 2012 and 2011, and the related statements of revenues, expenses and changes in net assets and cash flows, which collectively comprise the NCEL's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the NCEL's management. Our responsibility is to express opinions 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.

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, 2012 and 2011, and the changes in its financial position and its cash flows thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the NCEL as of June 30, 2012 and 2011, and the respective changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 6, 2012 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 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.

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

Raleigh, North Carolina
November 6, 2012

NORTH CAROLINA EDUCATION LOTTERY

Management's Discussion & Analysis - June 30, 2012 & 2011



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, 2012, 2011 and 2010 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 the fiscal years ended June 30, 2012, 2011 and 2010.

Financial Highlights

For fiscal year 2012, gross ticket sales totaled \$1.597 billion representing a \$135.6 million increase over fiscal year 2011. Total operating income was \$460 million, which represented an increase of \$23.8 million over fiscal year 2011. Other significant financial highlights included the following:

- North Carolina General Statute Section 18C-164 (a) requires the NCEL to transfer net proceeds from operations and any prior year surplus to the State of North Carolina four times a year. In fiscal year 2012, the sum total of these four cash transfers was \$456.8 million, the largest annual total for cash transfers in NCEL's history. Total cash transfers for fiscal years 2011 and 2010 were \$446.9 million and \$419.5 million, respectively.
- Awarded \$1 million or more to an NCEL player for the 110th time.
- Increased the number of retailers to 6,787, representing a 2.7% increase over the prior year, and provided service to our retailers on a regular basis.
- Released 49 new instant scratch-off games into the marketplace generating gross instant ticket sales of \$960 million.

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. Accordingly, the focus of the financial statements is to determine 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 revenues 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, by contracted retailers, to the general playing public. Operating expenses include the cost of prizes, retailer commissions, gaming system vendor charges, personnel, and other administrative expenses.

Included in this report are the Statements of Net Assets as of June 30, 2012 and 2011, the Statements of Revenues, Expenses, and Changes in Fund Net Assets for the periods ended June 30, 2012 and 2011, and the Statements of Cash Flows for the periods ended June 30, 2012 and 2011.

As established in House Bill 200, Section 5.4(b), 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:

Program	Distribution Percentage
Teacher's in Early Grades	51.9%
Prekindergarten Program	14.9%
Public School Building Capital Fund	23.5%
Scholarships for Needy Students	7.2%
UNC Need-Based Financial Aid	2.5%
<u>Total Distribution Percentage</u>	<u>100.0%</u>

Total Assets

Total assets at the end of fiscal year 2012 were \$96 million compared to \$67 million at the end of fiscal year 2011, representing an increase of \$29 million.

Current assets increased from \$30 million in 2011 to \$48 million in 2012, representing an increase of \$18 million. This growth resulted from an increase in Pooled Cash due to fiscal year 2012 and 2011 surplus earnings held to be dispersed in the subsequent fiscal year. In addition, there was an increase in the State Treasurer's Securities Lending Collateral. More detailed information can be found in Note 2D in the financial statements. The increase was also partially caused by an increase in accounts receivable in 2012 from 2011. This primarily represents amounts due from retailers for settlement of packs of tickets less commissions and prizes paid by the retailers. The increase is essentially due to the timing of the end of the accounting week for billing and collections from our retailers at fiscal year end. Electronic Funds Transfer is used to collect receivables weekly from retailer bank accounts that are set up in trust for the NCEL.

Current assets were also affected by a \$750 thousand increase in investments in annuity contracts.

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 \$523 thousand 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.

The NCEL's investment in capital assets, net of accumulated depreciation in 2012 was \$672 thousand which is approximately \$147 thousand lower than 2011. The majority of capital asset investments were made 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 Office of the State Controller's (OSC) policy. 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.

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

The activity for capital assets for the year ended June 30, 2012 was (in thousands):

Category	Balance July 1, 2011	Increases	Decreases	Balance June 30, 2012
Capital assets, depreciable				
Furniture	\$ 29	\$ -	\$ -	\$ 29
Equipment	2,804	310	(38)	3,076
Motorized equipment	67	-	-	67
Total capital assets, depreciable	<u>2,900</u>	<u>310</u>	<u>(38)</u>	<u>3,172</u>
Less accumulated depreciation for:				
Furniture	27	2	-	29
Equipment	1,991	450	(38)	2,403
Motorized equipment	63	5	-	68
Total accumulated depreciation	<u>2,081</u>	<u>457</u>	<u>(38)</u>	<u>2,500</u>
Total capital assets, depreciable, net	<u>819</u>	<u>(147)</u>	<u>-</u>	<u>672</u>
Capital assets, net	<u>\$ 819</u>	<u>\$ (147)</u>	<u>\$ -</u>	<u>\$ 672</u>

Total Liabilities

Total current liabilities for the NCEL were \$49 million in 2012 increasing by \$19 million from 2011. The growth in current liabilities mainly resulted from increases in trade payables to vendors, due to other funds and the obligations under State Treasurer's security lending collateral agreements. The increases in accounts payable and due to other funds can be attributed to the timing of transactions encountered in the normal course of business. The increase in the obligations under State Treasurer's security lending collateral is directly related to the NCEL having more cash on hand at year-end. Current liabilities also consist of prize awards payable, and other payables.

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.

<u>Beginning</u>	<u>Earned</u>	<u>Used</u>	<u>Ending</u>	<u>Current Liability</u>	<u>Long Term Portion</u>
\$ 1,162	\$ 1,323	\$ 1,257	\$ 1,228	\$ 162	\$ 1,066

Noncurrent liabilities also includes the present value of the annuity contracts that fund the long term installment prizes that are due to NCEL annuity prize winners that will be paid after June 30, 2013.

Net Assets and Changes in Net Assets

As required in the North Carolina State Lottery Act, net revenues of the NCEL are transferred quarterly 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)

	<u>2012</u>	<u>2011</u>	<u>2010</u>
ASSETS			
Total Current Assets	\$ 48,484	\$ 30,345	\$ 55,713
Noncurrent Assets	47,337	36,586	26,414
Total Assets	<u>95,821</u>	<u>66,931</u>	<u>82,127</u>
LIABILITIES			
Total Current Liabilities	49,338	30,217	56,092
Noncurrent Liabilities	46,483	36,714	26,035
Total Liabilities	<u>95,821</u>	<u>66,931</u>	<u>82,127</u>
NET ASSETS			
Invested in Capital Assets	672	819	1,239
Unrestricted Net Assets	<u>(672)</u>	<u>(819)</u>	<u>(1,239)</u>
Total Net Assets	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

Current liabilities consist of "Due to Other Funds" in the amount of \$10.2 million. Of this amount, \$10.1 million represents the remaining amount of the "Net Revenues" and "50% of Unclaimed Prizes" for Fiscal Year 2012 not yet transferred to the State of North Carolina as of June 30, 2012. These funds will be transferred to the state during Fiscal Year 2013. The remainder is due to other state agencies for services provided to the NCEL. Additional information on "Due to Other Funds" is found in Note 6D to the financial statements.

Revenues

Operating revenues consist of gross sales, fees and licenses net of prize tickets.

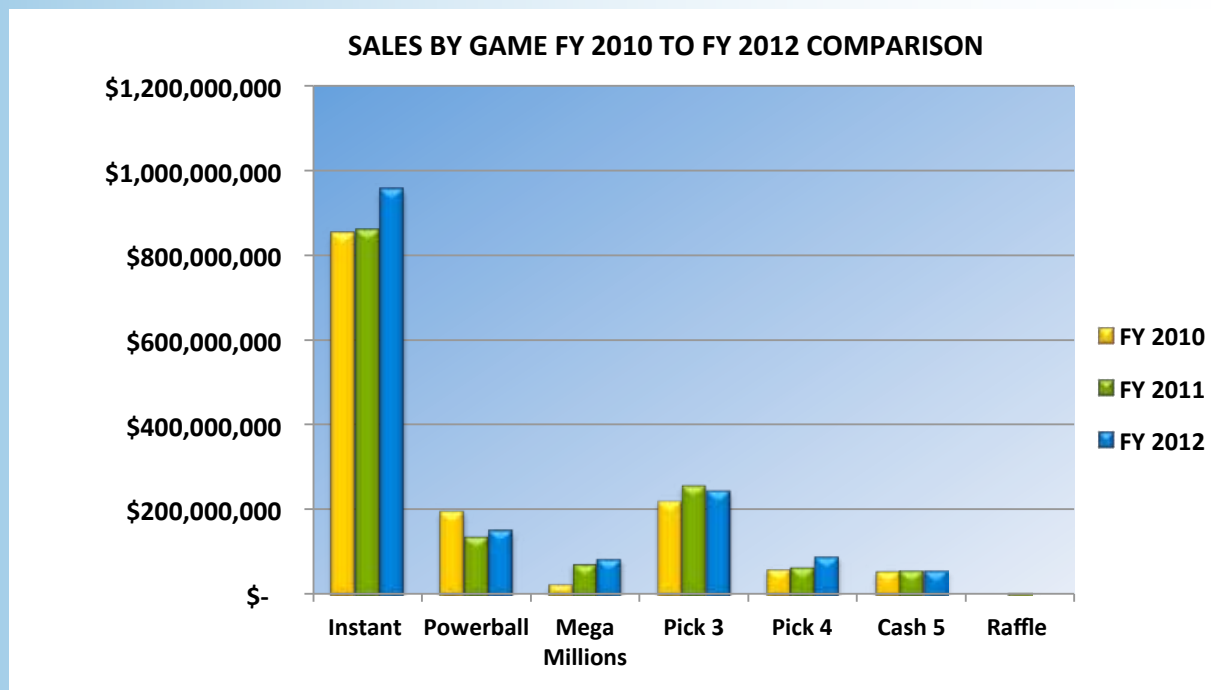
Sales

The gross lottery ticket sales for fiscal year 2012 were approximately \$1.597 billion as compared to \$1.461 billion for fiscal year 2011 and \$1.421 billion in fiscal year 2010. This represents an increase of \$136 million from 2011 and \$176 million from 2010.

Gross instant ticket sales were \$960 million for fiscal year 2012 compared with \$862 million for fiscal year 2011 and \$856 million in fiscal year 2010, an increase of \$98 million from fiscal year 2011 and \$104 million from fiscal year 2010. The increase realized during fiscal year 2012 is attributable to several factors. The NCEL continued with its second \$20 instant scratch-off mega game, \$200,000 a Year for Life, with a prize payout of 75%, which generated over \$62 million in sales during fiscal year 2012. In addition the NCEL launched its third \$20 instant scratch-off mega game, \$4 Million Cash Blowout, which generated over \$66 million in sales. The NCEL also launched its "Taxes Paid" family of tickets, with games available at three price points from \$5 and below, which combined generated sales of over \$28 million. The NCEL released several very successful licensed games during the year. The NASCAR Ultimate Fan Instant Scratch-Off was introduced and provided players the chance to win a grand prize trip package, including VIP access to a race of their choice. The NCEL launched its Wheel of Fortune Instant Scratch-Off licensed game, which awarded players the opportunity to travel to Hollywood and play in an un-televised version of the popular game show. In addition, other licensed instant games were released such as "The Three Stooges" and "Bass Pro Shop \$25,000 Cash Adventure" which also proved to be very popular.

On-line sales were \$637 million for fiscal year 2012 compared to \$599 million for fiscal year 2011 and \$566 for fiscal year 2010, representing a \$38 million increase from fiscal year 2011 and a \$71 million increase from fiscal year 2010. On-line sales benefited from high jackpots in the multi state games Mega Millions and Powerball. The Mega Millions jackpot reached a record \$640 million, with total sales of \$85.6 million, compared to \$72.6 million during fiscal year 2011. The Powerball jackpot reached over \$200 million five times during the fiscal year, which helped increase Powerball sales to \$153 million, from \$138 million the previous year. The Carolina Cash 5 top prize exceeded half a million dollars seven times during the fiscal year, resulting in increased on-line sales. The additional daily Carolina Pick 4 draw was in place for the entire fiscal year, resulting in an increase of \$26 million from the previous fiscal year.

The following chart depicts the distribution of sales by product for the fiscal years ended June 30, 2012, 2011 and 2010.



Non-operating Revenues mainly consist of investment earnings on Short-Term Investment Fund (STIF) accounts and security lending transactions, and Multi-State Lottery Association (MUSL) dividends received.

Expenses

Section 18C-162, NC General Statute stipulates that 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.

The following charts show the major components of NCEL operating expenses and transfers as a percentage of total revenues for the fiscal years ended June 30, 2012, 2011 and 2010.



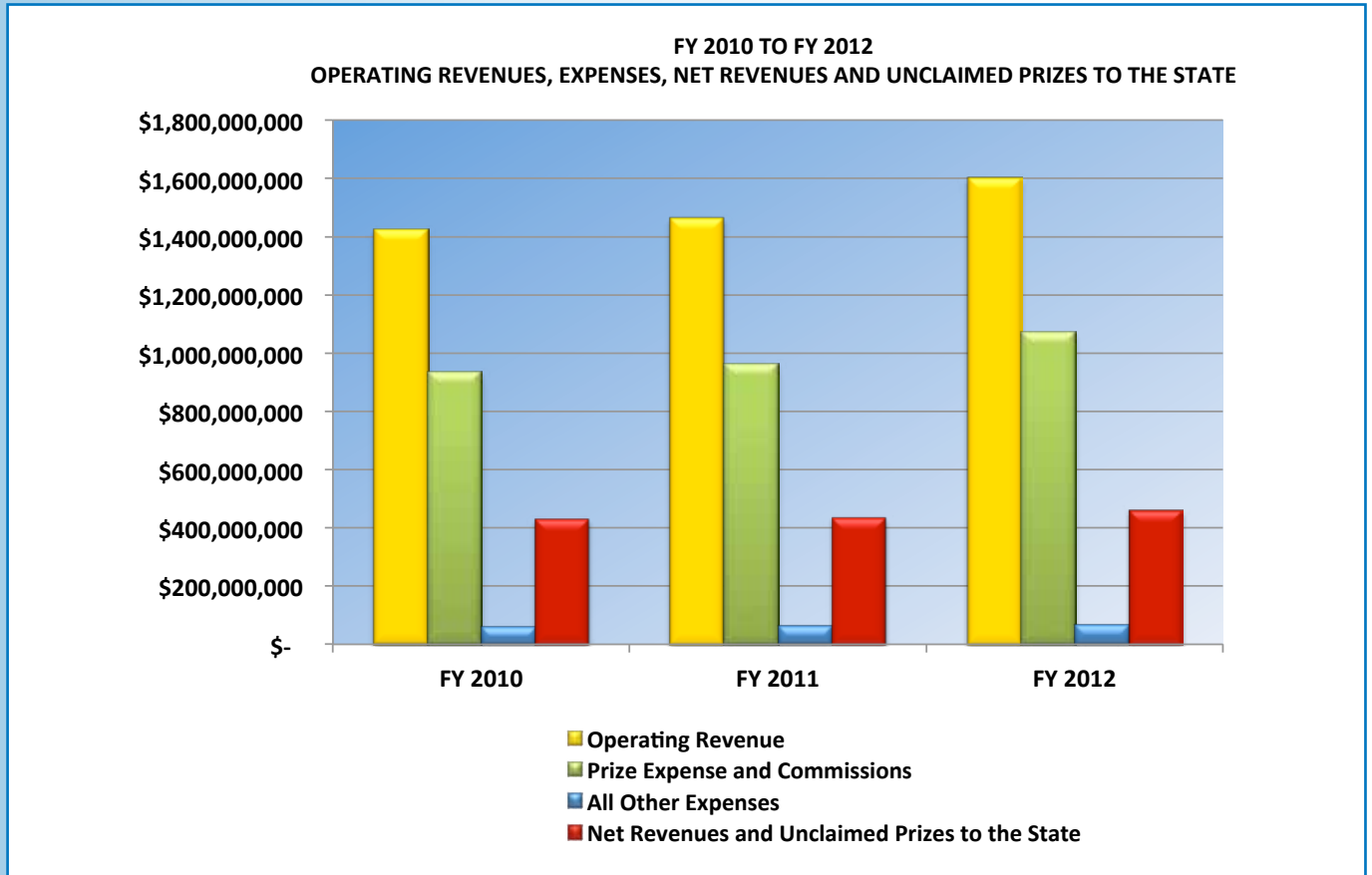
Note: Commissions percentage is calculated based upon the percentage of Sales (all others are calculated based upon the percentage of Total Revenue) per G.S. 18C-162; therefore may not equal 100%.

Prizes, commissions and gaming vendor charges all directly relate to sales. As expected, as sales have increased so have these expenses. In fiscal year 2012 total gaming expenses which consist of prizes, retailer commissions and gaming vendor charges (gaming system services), totaled \$1,099 million as compared to \$989 million and \$957 million for fiscal years 2011 and 2010, respectively. Other operating expenses, which consist of advertising and marketing, salary and benefits, professional fees, rent, maintenance, bad debt, depreciation and general administrative expenses increased to \$42.7 million in fiscal year 2012, as compared with \$39.9 million and \$36.6 million for fiscal years 2011 and 2010, respectively. Other operating expenses represented 2.6%, 2.7% and 2.6% of total operating revenues in fiscal years 2012, 2011 and 2010, respectively.

Condensed Statement of Revenues and Expenses (in thousands)

	2012	2011	2010
Operating Revenues:			
Gross Sales:	\$ 1,596,693	\$ 1,461,106	\$ 1,421,313
Less: Prize Tickets	(181)	(1,375)	(1,309)
Less: Sales/Service Bad Debt	(55)	(152)	(405)
Fees and Licenses	5,381	5,061	4,859
Total Operating Revenues	1,601,838	1,464,640	1,424,458
Operating Expenses:			
Gaming Expenses:			
Lottery Prizes	961,556	862,996	835,302
Retailer Commissions	111,624	102,127	99,340
Gaming Systems Services	26,031	23,482	22,639
Total Gaming Expenses	1,099,211	988,605	957,281
Other Operating Expenses	42,700	39,905	36,608
Total Operating Expenses	1,141,911	1,028,510	993,889
Operating Income	459,927	436,130	430,569
Nonoperating Revenues (Expenses):			
Investment Earnings, Nonoperating Revenue (Expense) and Compulsive Gambling Contribution	(458)	111	1,636
Net Revenues and Unclaimed prizes to the State	(459,469)	(436,241)	(432,205)
Total Nonoperating Revenue (Expenses)	(459,927)	(436,130)	(430,569)
Net Income	-	-	-
Change in Net Assets	-	-	-
Ending Net Assets	\$ -	\$ -	\$ -

From fiscal year 2010 to fiscal year 2012, the NCEL has achieved annual increases in revenues and transfers to the State. The following graph depicts these trends.



Budget and Economic Outlook

On June 19, 2012, the NCEL Commission approved the Fiscal Year 2013 budget for the NCEL to provide a projected \$442 million to the State's Education Lottery Fund. This projected budget is a 3.9% increase over the fiscal year 2012 budget that reflected a \$425 million transfer to the State's Education Lottery Fund. The NCEL will continue to monitor the current economic conditions in the State, and its impact upon lottery ticket sales. As per the General Assembly Fiscal Research Division: "The economic recovery has never gained full momentum. The economy has been unable to grow at, or above, average growth for a sustainable period of time. However, the probability of another recession currently remains low because the economy is posting positive, albeit not robust, economic numbers." Also "The slow growth pattern that re-emerged this spring and summer is expected to affect the rest of 2012. Most economic forecasts anticipate improving, but below-average growth in 2013." Therefore, the NCEL has constructed a conservative budget and sales forecast for the upcoming fiscal year.

A focus of the NCEL Commission is to ensure sound operations. The existence of this focus is apparent in the opinions issued by external audit firms. For the sixth 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.

Statements of Net Assets (in thousands) - June 30, 2012 & 2011

	<u>2012</u>	<u>2011</u>
ASSETS		
Current Assets:		
Cash and Cash Equivalents:		
Cash	\$ 119	\$ 105
Pooled Cash	26,381	15,672
Receivables:		
Accounts Receivable	14,797	9,897
Interest Receivable	39	30
Investment in Annuity Contracts	3,750	3,000
Inventory	4	16
Prepaid Items	335	32
State Treasurer's Security Lending Collateral	<u>3,059</u>	<u>1,593</u>
Total Current Assets	<u>48,484</u>	<u>30,345</u>
Noncurrent Assets:		
Investment in Annuity Contracts	45,417	35,620
Prepaid Items	1,248	147
Capital Assets, Depreciable (Net):		
Furniture and Equipment	3,172	2,900
Accumulated Depreciation	<u>(2,500)</u>	<u>(2,081)</u>
Total Capital Assets, Depreciable (Net)	<u>672</u>	<u>819</u>
Total Assets	<u>95,821</u>	<u>66,931</u>
LIABILITIES		
Current Liabilities:		
Accounts Payable	31,611	17,559
Accrued Payroll	412	666
Other Liabilities	263	27
Annuity Prize Award Payable - Current	3,750	3,000
Accrued Paid Time Off - Current	162	68
Due to Other Funds	10,175	7,470
Obligations Under State Treasurer's Security Lending Agreements	<u>2,965</u>	<u>1,427</u>
Total Current Liabilities	<u>49,338</u>	<u>30,217</u>
Noncurrent Liabilities:		
Annuity Prize Award Payable	45,417	35,620
Accrued Paid Time Off	<u>1,066</u>	<u>1,094</u>
Total Liabilities	<u>95,821</u>	<u>66,931</u>
NET ASSETS		
Invested in Capital Assets	672	819
Unrestricted Net Assets	<u>(672)</u>	<u>(819)</u>
Total Net Assets	<u>\$ -</u>	<u>\$ -</u>

See Notes to the Financial Statements.

Statements of Revenues, Expenses and Changes in Fund Net Assets (in thousands)

Years Ending June 30, 2012 & 2011

	<u>2012</u>	<u>2011</u>
Operating Revenues:		
Gross Sales	\$ 1,596,693	\$ 1,461,106
Less: Prize Tickets	(181)	(1,375)
Less: Sales/Service Bad Debt	(55)	(152)
Fees and Licenses	<u>5,381</u>	<u>5,061</u>
Total Operating Revenues	<u>1,601,838</u>	<u>1,464,640</u>
Operating Expenses		
Salaries, Wages, and Benefits	16,639	15,824
Lottery Prizes	961,556	862,996
Retailer Commissions	111,624	102,127
Retailer Incentive	609	592
Gaming Systems Services	26,031	23,482
Advertising	14,696	13,760
Marketing	2,512	2,358
Other Services	4,634	3,427
Furniture, Fixtures, and Equipment	762	933
Depreciation	457	624
Other General and Administrative Expenses	<u>2,391</u>	<u>2,387</u>
Total Operating Expenses	<u>1,141,911</u>	<u>1,028,510</u>
Operating Income	<u>459,927</u>	<u>436,130</u>
Nonoperating Revenues (Expenses):		
Investment Earnings	523	1,175
Compulsive Gambling Contribution	(1,000)	(1,000)
Interest to Federal Medicaid Assistance Percentage Program	-	(814)
Unclaimed Prizes to Federal Medicaid Assistance Percentage Program	-	(8,556)
Unclaimed Prizes to NC Education Lottery Fund	(11,083)	(8,623)
Net Revenues to the State of NC	(448,386)	(418,248)
Miscellaneous Nonoperating Revenue (Expenses)	<u>19</u>	<u>(64)</u>
Total Nonoperating Revenues (Expense)	<u>(459,927)</u>	<u>(436,130)</u>
Net Income	-	-
Change in Net Assets	<u>-</u>	<u>-</u>
Net Assets Beginning, July 1	<u>-</u>	<u>-</u>
Net Assets Ending, June 30	<u>\$ -</u>	<u>\$ -</u>

See Notes to the Financial Statements.

Statements of Cash Flows (in thousands) - Year Ended June 30, 2012 & 2011

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from Customers	\$ 1,485,286	\$ 1,359,272
Payments to Employees and Fringe Benefits	(16,827)	(15,468)
Payments for Prizes, Benefits and Claims	(948,310)	(873,500)
Payments to Vendors and Suppliers	(51,955)	(46,127)
Other Receipts/Payments	-	24
Net Cash Flows Provided by Operating Activities	468,194	424,201
CASH USED FOR NONCAPITAL FINANCING ACTIVITIES		
Transfers to State	(456,765)	(446,952)
Transfers to Other State Agencies	(1,000)	(1,000)
Total Cash Used for Noncapital Financing Activities	(457,765)	(447,952)
CASH USED FOR CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisition and Construction of Capital Assets	(311)	(211)
Total Cash Used for Capital and Related Financing Activities	(311)	(211)
CASH PROVIDED FROM INVESTING ACTIVITIES		
Investment Earnings	605	979
Total Cash Provided from Investing Activities	605	979
Net Increase/(Decrease) in Cash and Cash Equivalents	10,723	(22,983)
Cash and Cash Equivalents at Beginning of Year	15,777	38,760
Cash and Cash Equivalents at End of Year	\$ 26,500	\$ 15,777
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating Income	\$ 459,927	\$ 436,130
Adjustments to Reconcile Operating Income to Cash Provided by Operating Activities:		
Depreciation Expense	457	624
Other Nonoperating Income	3	12
(Increase) Decrease in Assets:		
Accounts Receivable	(4,900)	(3,249)
Inventories	12	193
Prepaid Items	(1,404)	19
Increase (Decrease) in Liabilities:		
Accounts Payable	14,052	(9,896)
Accrued Payroll and Related Liabilities	(254)	290
Other Liabilities	301	67
Total Cash Provided by Operating Activities	\$ 468,194	\$ 424,190
NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES		
Assets Acquired through the Assumption of a Liability	\$ 12,013	\$ 5,250
Change in Fair Value of Investments	72	166

See Notes to the Financial Statements.

NORTH CAROLINA EDUCATION LOTTERY

Notes to Financial Statements - June 30, 2012 & 2011

(in thousands) 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. Additional on-line games were introduced as follows:

- Carolina Pick 3 on October 6, 2006
- Carolina Cash 5 on October 27, 2006
- Carolina Pick 3 second daily draw (Monday through Saturday) on March 31, 2008
- Carolina Pick 4 on April 17, 2009
- Mega Millions on January 31, 2010
- Carolina Pick 4 second daily draw and Carolina Pick 3 second Sunday draw on February 27, 2011

The purpose of the NCEL is to generate funds to further the goal of providing enhanced educational opportunities, support school construction, and 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 the 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 for the sales of lottery products. The significant operating expenses include the cost of prizes, commissions, gaming system vendor charges, personnel, advertising 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 Statute 147-69.3(e), the State Treasurer lends securities from its investment pool to brokers-dealers and other entities (borrowers) for collateral that will be returned for the same securities in the future. The Treasurer's securities custodian manages the securities lending program. The Treasurer's custodian lent U.S. government and agency securities, FNMAs, 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.osc.nc.gov/> and clicking on "Financial Reports," or by calling the State Controller's Financial Reporting Section at (919) 707-0500.

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, 2012 and 2011.

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:

<u>Category</u>	<u>Years</u>
Equipment	5-7
Furniture	5
Computers and Software	3-5

G. Game Revenue Recognition:

For the NCEL's on-line games, POWERBALL, Mega Millions, Carolina Cash 5, Carolina Pick 4, 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).

H. Lottery Prize Expense Recognition:

For POWERBALL, Mega Millions, Carolina Cash 5, Carolina Pick 4, Carolina Pick 3, and for raffles, prize expense is recorded at 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 the 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. Prize expense for merchandise prizes is recognized as prizes are fulfilled.

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 using the following methodology:

- Manually by the retailer initiating a settlement transaction via the gaming terminal.
- Automatically by the gaming system - twenty one (21) days after pack activation.
- Automatically by the gaming system - once the fifth (5th) pack in a specific game is activated by a retailer, the oldest active pack is settled.

Operating revenues are reduced by the value of prize tickets validated during a period.

Game Revenue	2012	2011
Instant	\$ 959,955	\$ 862,090
Prize tickets	(181)	(1,375)
On-line	636,738	599,016
Bad debt write off	(51)	(148)
Damaged tickets, sales services	(4)	(4)
Total	\$ 1,596,457	\$ 1,459,579

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. Total Fees and Licenses for fiscal year 2012 and 2011 were \$5,381 and \$5,061, respectively.

B. Non-operating 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 investment earnings earned on these accounts and the related security lending collateral transactions is \$523 and \$1,175 for the years ended June 30, 2012 and 2011, respectively.

The NCEL also has miscellaneous non-operating revenue related to dividends received from MUSL which were \$50 and \$11 for the years ended June 30, 2012 and 2011, respectively. The remaining miscellaneous non-operating revenue consists of sales and marketing materials to other lotteries and other miscellaneous items.

NOTE 4 – EXPENSES**A. Operating Expenses:****1. Lottery Prize Expense:**

	2012	2011
Instant	\$ 642,075	\$ 572,157
On-line	308,398	290,839
50% of unclaimed prizes	11,083	-
Total	\$ 961,556	\$ 862,996

2. Retailer Commissions:

	2012	2011
Instant	\$ 67,092	\$ 60,237
On-line	44,532	41,890
Total	\$ 111,624	\$ 102,127

3. Retailer Incentives:

In fiscal year 2010, the State Lottery Commission approved a retailer incentive program where retailers would receive compensation for selling a top/second tier prize in the Multi-State games POWERBALL and Mega Millions and a top tier prize in Carolina Cash 5. As of December 2011, the retailer incentive program was expanded to include instant ticket prizes of over \$1 million as well. The total payments issued for the retailer incentive program for fiscal years 2012 and 2011 were \$609 and \$592, respectively.

4. 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. The Other category under Other Services also includes payments issued to Alcohol and Law Enforcement (ALE) in the amount of \$933 in fiscal year 2012 and \$795 in fiscal year 2011.

	<u>2012</u>	<u>2011</u>
Security services	\$ 11	\$ 10
Background checks	977	830
Communications, including wiring	1,250	1,093
Legal services	94	73
Travel	133	112
Other	<u>2,169</u>	<u>1,309</u>
Total	<u>\$ 4,634</u>	<u>\$ 3,427</u>

5. Furniture, Fixtures, and Equipment:

To operate a lottery, numerous items of equipment, furniture, and ticket dispensers are required. Most of these items were one time purchases to be replaced as needed at various points in the future. These items were also below our threshold for capitalization (See Note 5E) and therefore expensed. The total expenses for fiscal years 2012 and 2011 were \$762 and \$933, respectively.

6. Leases – Buildings, Offices and Other Equipment:

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:

<u>Year Ending</u>	<u>Amount</u>
2013	\$ 1,096
2014	1,131
2015	1,147
2016	1,139
2017	272
2018-2022	<u>655</u>
Total	<u>\$ 5,440</u>

The total space rental costs for the fiscal years 2012 and 2011 were \$1,091 and \$1,065, respectively. The NCEL also has several contracts for various equipment leases including instant ticket vending machines (ITVM's).

B. Non-operating Expenses:

The allocable share of the expenses arising from State Treasurer's Securities Lending Collateral program transactions, totaling \$31 and \$21 for the years ended June 30, 2012 and 2011, respectively, are included as non-operating expense. For the years ended June 30, 2012 and 2011, the remaining non-operating expenses consist of other miscellaneous non-operating items.

C. Transfers Out:

There were four significant transfers from the NCEL. One million dollars 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 State Lottery Act for the years ended June 30, 2012 and 2011 (See Note 7D).

The second transfer was \$11,083 and \$8,623 for the years ended June 30, 2012 and 2011, 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 (See Note 7C).

The third transfer was 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. “Net Revenues” were \$448,386 for fiscal year 2012 compared with \$418,248 for fiscal year 2011 (see Note 12). However, \$438,283 was transferred to the NC Education Lottery Fund for fiscal year 2012 compared with \$410,916 for fiscal year 2011. The balances remaining (\$10,103 and \$7,332 for fiscal years 2012 and 2011) were recorded as a payable to the State for both fiscal years and were transferred subsequent to fiscal year end. NC General Statute 18C-162 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.”

The NCEL made a fourth transfer during fiscal year 2011. As per legislation, the NCEL transferred \$9,370 to the State of North Carolina to fund the Federal Medical Assistance Percentage (FMAP) expenses, including \$814 in interest and \$8,556 in unclaimed prizes. This transfer was not required in fiscal year 2012.

NOTE 5 – ASSETS

A. Cash:

The cash and cash equivalents balances at June 30, 2012 and 2011 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.

At June 30, 2012 and 2011, respectively, \$26,381 and \$15,672 of the amounts 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 1.5 and 1.9 years, as of June 30, 2012 and 2011, 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.osc.nc.gov/> and clicking on “Financial Reports” or by calling the State Controller’s Financial Reporting Section at (919) 707-0500.

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, 2012 and 2011 was \$4 and \$16, respectively.

D. Investments in Annuity Contracts:

Investments in Annuity Contracts represent the present value of the contracts that fund the long term installment prizes contracted through insurance company annuities (See Note 7B). The current and long term balances are \$3,750 and \$45,417 for fiscal year 2012 and \$3,000 and \$35,620 for fiscal year 2011, respectively.

The policies of the NCEL only allow for direct purchase of annuity contracts from which the proceeds are used to fund long term installment prizes. As the NCEL is not pursuing other forms of investments, they are not currently anticipated under the policy. As a means of limiting exposure to interest rate risk, the policy only allows for direct purchase of annuity contracts which future value payments are pre-negotiated with the providers of the contracts. These contracts are not subject to foreign currency risk because the provider is required by contract to pay the full annuities. Accordingly, the NCEL does not have a policy regarding foreign currency risk since investments in products subject to this risk are not applicable to the NCEL.

The policy of the NCEL restricts direct purchase of annuity contracts to those with companies that hold minimum ratings as follows: AA by Fitch, Aa by Moody's or AA by Standard & Poor's. As of June 30, 2012, all annuities carried a rating of Aa/AA.

Maturities for investments in annuity contracts are as follows:

Maturities	2012	2011
Less than 1 year	\$ 3,750	\$ 3,000
1 to 5 years	18,750	15,000
6 to 10 years	18,750	15,000
More than 10 years	7,917	5,620
Total	\$ 49,167	\$ 38,620

E. Capital Assets:

The activity for capital assets for the year ended June 30, 2012 was:

Category	Balance July 1, 2011	Increases	Decreases	Balance June 30, 2012
Capital assets, depreciable				
Furniture	\$ 29	\$ -	\$ -	\$ 29
Equipment	2,804	310	(38)	3,076
Motorized equipment	67	-	-	67
Total capital assets, depreciable	<u>2,900</u>	<u>310</u>	<u>(38)</u>	<u>3,172</u>
Less accumulated depreciation for:				
Furniture	27	2	-	29
Equipment	1,991	450	(38)	2,403
Motorized equipment	63	5	-	68
Total accumulated depreciation	<u>2,081</u>	<u>457</u>	<u>(38)</u>	<u>2,500</u>
Total capital assets, depreciable, net	<u>819</u>	<u>(147)</u>	<u>-</u>	<u>672</u>
Capital assets, net	<u>\$ 819</u>	<u>\$ (147)</u>	<u>\$ -</u>	<u>\$ 672</u>

The activity for capital assets for the year ended June 30, 2011 was:

Category	Balance July 1, 2010	Increases	Decreases	Balance June 30, 2011
Capital assets, depreciable				
Furniture	\$ 29	\$ -	\$ -	\$ 29
Equipment	2,653	211	(60)	2,804
Motorized equipment	67	-	-	67
Total capital assets, depreciable	<u>2,749</u>	<u>211</u>	<u>(60)</u>	<u>2,900</u>
Less accumulated depreciation for:				
Furniture	23	4	-	27
Equipment	1,435	609	(53)	1,991
Motorized equipment	52	11	-	63
Total accumulated depreciation	<u>1,510</u>	<u>624</u>	<u>(53)</u>	<u>2,081</u>
Total capital assets, depreciable, net	<u>1,239</u>	<u>(413)</u>	<u>(7)</u>	<u>819</u>
Capital assets, net	<u>\$ 1,239</u>	<u>\$ (413)</u>	<u>\$ (7)</u>	<u>\$ 819</u>

Equipment expenditures for 2012 included replacements of aged instant ticket dispensers, and computer server equipment. Equipment expenditures for 2011 included upgraded MIS equipment.

NOTE 6 – LIABILITIES**A. Accounts Payable:**

This primarily represents trade payables to vendors, prize liabilities, and multi state game low-tier liability. At year end, June 30, 2012 and 2011, the balances were:

Account Type	2012	2011
Trade payables to vendors and other	\$ 3,926	\$ 5,940
Instant prize liability	8,889	4,307
Prize liability – unused unclaimed prizes	11,223	2,785
Multi state games low-tier liability	4,438	4,277
Prize liability – breakage	3,135	123
Prize liability – rollover	-	127
Total Accounts Payable	<u>\$ 31,611</u>	<u>\$ 17,559</u>

B. Other Liabilities:

Other liabilities of \$263 and \$27 for the years ended June 30, 2012 and 2011, respectively, primarily consist of federal and state withholding on prize payments, various clearing accounts, and deferred revenue.

C. Annuity Prize Awards Payable:

Annuity prize awards payable represents the present value of the contracts that fund the long term installment prizes that are due to NCEL annuity prize winners (See Note 7B). The current and long term balances are \$3,750 and \$45,417 for fiscal year 2012 and \$3,000 and \$35,620 for fiscal year 2011, respectively.

Annuity activity for both short and long term accounts during fiscal year 2012 are as follows:

	Beginning Balance	Purchases	Annuity Appreciation	Annuity Disbursements	Reclass to Short Term	Ending Balance
Short Term	\$ 3,000	\$ -	\$ -	\$ (2,700)	\$ 3,450	\$ 3,750
Long Term	35,620	11,484	1,763	-	(3,450)	45,417
Total	<u>\$ 38,620</u>	<u>\$ 11,484</u>	<u>\$ 1,763</u>	<u>\$ (2,700)</u>	<u>\$ -</u>	<u>\$ 49,167</u>

Annual activity for both short and long term accounts during fiscal year 2011 are as follows:

	Beginning Balance	Purchases	Annuity Appreciation	Annuity Disbursements	Reclass to Short Term	Ending Balance
Short Term	\$ 2,150	\$ -	\$ -	\$ (2,150)	\$ 3,000	\$ 3,000
Long Term	25,007	12,071	1,542	-	(3,000)	35,620
Total	<u>\$ 27,157</u>	<u>\$ 12,071</u>	<u>\$ 1,542</u>	<u>\$ (2,150)</u>	<u>\$ -</u>	<u>\$ 38,620</u>

D. Due to Other Funds:

As explained in Note 4C, \$10,103 and \$7,332 for the years ended June 30, 2012 and 2011, respectively, represent the amounts of the “Net Revenues” and “50% of Unclaimed Prizes” for the year not yet transferred to the State as of June 30, but will be transferred to the State subsequent to fiscal year-end. The remainder is due to other state agencies for services provided to the NCEL.

E. 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 Directors’ 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 of service on the date of separation.

Activity for the year ended June 30, 2012:

<u>Beginning</u>	<u>Earned</u>	<u>Used</u>	<u>Ending</u>	<u>Current Liability</u>	<u>Long Term Portion</u>
\$ 1,162	\$ 1,323	\$ 1,257	\$ 1,228	\$ 162	\$ 1,066

Activity for the year ended June 30, 2011:

<u>Beginning</u>	<u>Earned</u>	<u>Used</u>	<u>Ending</u>	<u>Current Liability</u>	<u>Long Term Portion</u>
\$ 1,093	\$ 1,204	\$ 1,135	\$ 1,162	\$ 68	\$ 1,094

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 and Mega Millions. As of June 30, 2012, MUSL included 33 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 calculated on POWERBALL and Mega Millions 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's 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, 2012 and 2011 the NCEL had been credited with \$10,094 and \$9,176, respectively, in the MUSL prize reserve funds.

B. Annuity Installment Prizes:

The NCEL funds long term installment prizes through the purchase of insurance company annuities. The contract holders will fund the future value of the installment prize awards over the life of the prize awarded to the player. The NCEL currently holds contracts with Met Life Insurance Company and Prudential Life Insurance Company to provide these future prize installment payments. The future value of the annuity prizes awarded as of June 30, 2012 and 2011 were \$64,550 and \$53,300, respectively.

C. Unclaimed Prizes:

As of June 30, 2012 and 2011, 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. Unclaimed prizes for Carolina Pick 4 were recorded on November 14, 2009. Unclaimed prizes for Mega Millions were recorded on August 1, 2010. The NCEL closed forty-six instant games during fiscal year 2012 resulting in \$10,226 in unclaimed prizes. In 2011, the NCEL closed thirty-seven instant games resulting in \$8,195 in unclaimed prizes.

<u>Game Type</u>	<u>2012</u>	<u>2011</u>
Instant	\$ 10,226	\$ 8,195
Powerball	5,998	3,893
Mega Millions	1,314	1,010
Carolina Cash 5	1,418	1,370
Carolina Pick 4	1,452	759
Carolina Pick 3	1,758	1,927
Raffle	-	91
Total unclaimed prizes	\$ 22,166	\$ 17,245

D. Compulsive Gambling Contribution:

The North Carolina General Statute states that, 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.” (See Note 4C)

E. 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, 2012.

The types of coverage, limits, and deductibles, as of June 30, 2012, are described below (the following chart is not shown in thousands).

Coverage Type	Limits (\$)	Deductible (\$)	Comments
Public officers and employee liability	1,000,000 /10,000,000	The first 150,000 /1,000,000 per person are paid by the Commission.	State is self-insured up to \$1,000,000; excess up to \$10,000,000 is with a private insurer.
All risk – property contents	4,707,386	5,000	
Auto – liability	1,000,000 per person /10,000,000 per accident		
Auto – comp/collision	29,470	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 to \$50 is provided to eligible employees. This self-insured death benefit program is administered by the North Carolina Department of the State Treasurer and funded via employer contributions. The employer contribution rate was .16% for the current fiscal year.

Additional details on State-administered risk management programs are disclosed 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.osc.nc.gov/> and clicking on "Financial Reports" or by calling the State Controller's Financial Reporting Section at (919) 707-0500.

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 NC Department of 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.

For the years ending June 30, 2012, 2011 and 2010, respectively, the NCEL had a total payroll of \$12,839, \$12,018, and \$11,968, of which \$12,839, \$12,018 and \$11,968 was covered under the Teachers' and State Employees' Retirement System. Total employer and employee contributions for pension benefits for the years ended June 30, 2012, 2011 and 2010, were \$1,725, \$1,314 and \$1,143, respectively. Required employer contribution rates for the years ended June 30, 2012, 2011 and 2010, were 7.44%, 4.93% and 3.57%, respectively, while employee contributions were 6% each year. The NCEL made 100% of its annual required contributions as mandated by Senate Bill 58. The contribution amounts for the years ended June 30, 2012, 2011, and 2010, were \$955, \$592 and \$425, 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.osc.nc.gov/> and clicking on "Financial Reports", or by calling the State Controller's Financial Reporting Section at (919) 707-0500.

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 the 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 \$170, \$197 and \$203 for the years ended June 30, 2012, 2011 and 2010, 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 Plan's Board of Trustees. 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 \$85, \$109 and \$134, for the years ended June 30, 2012, 2011 and 2010, 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 post-employment 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 Statute and may be amended only by the North Carolina General Assembly. The Plan does not provide for automatic post-retirement benefit increases.

The General Statute states that 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. The General Statute states that 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 2012, the NCEL contributed 5.0% of the covered payroll under the Teachers' and State Employees' Retirement System. Required contribution rates for the years ended June 30, 2011 and 2010, were 4.9% and 4.5%, respectively. The NCEL made 100% of its annual required contributions to the Plan for the years ended June 30, 2012, 2011, and 2010, which were \$642, \$589, and \$539, 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.osc.nc.gov/> and clicking on "Financial Reports", or by calling the State Controller's Financial Reporting Section at (919) 707-0500.

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 Statute, 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, 2012, the NCEL made a statutory contribution of .52% of covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program to the DIPNC. Required contribution rates for the years ended June 30, 2012, 2011 and 2010, were .52%, .52% and .52%, respectively. The NCEL made 100% of its annual required contributions to the DIPNC for the years ended June 30, 2011, 2010, and 2009, which were \$66, \$62, and \$62, 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. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.osc.nc.gov/> and clicking on "Financial Reports", or by calling the State Controller's Financial Reporting Section at (919) 707-0500.

NOTE 11 – LITIGATION

As of June 30, 2012, the NCEL is not, nor anticipates being, a party to any litigation.

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

	<u>2012</u>		
Lottery Ticket Sales	\$ 1,596,638		
Fees and Licenses	5,381		
Investment Earnings and Other Revenues	<u>523</u>		
Total Annual Revenue	1,602,542		
Less Prize Tickets	<u>(181)</u>	0%	Of Total Annual Revenue
Total Net Revenue	<u>1,602,361</u>		
Prize Expense	(961,556)	60%	Of Total Annual Revenue
Advertising	(14,696)	1%	Of Total Annual Revenue
All Other Expenses and Transfers	<u>(55,016)</u>		
Total Section 18C-162.a.3	<u>(69,712)</u>	4%	Of Total Annual Revenue
Commissions (per 18C-142)	(111,624)	7%	Of Lottery Ticket Sales
Unclaimed Prizes to The State of North Carolina	11,083		
Net Revenues to The State of North Carolina	<u>448,386</u>		
Total Revenues to The State of North Carolina	<u>\$ 459,469</u>	29%	Of Total Annual Revenue
	<u>2011</u>		
Lottery Ticket Sales	\$ 1,460,954		
Fees and Licenses	5,061		
Investment Earnings and Other Revenues	<u>1,175</u>		
Total Annual Revenue	1,467,190		
Less Prize Tickets	<u>(1,375)</u>	0%	Of Total Annual Revenue
Total Net Revenue	<u>1,465,815</u>		
Prize Expense	(862,996)	59%	Of Total Annual Revenue
Advertising	(13,760)	1%	Of Total Annual Revenue
All Other Expenses and Transfers	<u>(50,691)</u>		
Total Section 18C-162.a.3	<u>(64,451)</u>	4%	Of Total Annual Revenue
Commissions (per 18C-142)	(102,127)	7%	Of Lottery Ticket Sales
Due to FMAP & Legislative Special Revenue Fund	9,370		
Unclaimed Prizes to The State of North Carolina	8,623		
Net Revenues to The State of North Carolina	<u>418,248</u>		
Total Revenues to The State of North Carolina	<u>\$ 436,241</u>	30%	Of Total Annual Revenue

In accordance with Section § 18C-162 of the North Carolina State Lottery 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 face value of tickets or shares, as described in this Chapter shall be allocated for compensation paid to lottery game retailers.

- (b) To the extent that the expenses of the Commission are less than eight percent (8%) of total annual revenues, the Commission may allocate any surplus funds:
 - (1) To increase prize payments; or
 - (2) To the benefit of the public purposes as described in this chapter.

- (c) Unclaimed prize money shall be held separate and apart from the other revenues and allocated as follows:
 - (1) Fifty percent (50%) to enhance prizes under subdivision (a) (1) of this section.
 - (2) Fifty percent (50%) to the Education Lottery Fund to be allocated in accordance with G.S. 18C-164(c).(2005-344, s. 1; 2005-276, s. 31.1(r); 2007-323, s.5.2(c).)

Additionally, in accordance with Section § 18C-142 of the North Carolina State Lottery 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 provided 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.

The NCEL transferred \$456.8 million to the NC Education Lottery Fund for fiscal year 2012 compared with \$446.9 million for fiscal year 2011. As explained in Note 4C, \$10.2 million and \$7.3 million for fiscal years ended June 30, 2012 and 2011, respectively, were the amounts of the “Net Revenues” and “50% of Unclaimed Prizes” that were transferred to the State subsequent to the end of the respective fiscal year.

NOTE 13 – SUBSEQUENT EVENTS

The Commission of the NCEL has evaluated all subsequent events for potential recognition and disclosure through November 6, 2012, the date these financial statements will be available.

This audit required 347 audit hours at an approximate cost of \$68,790. The cost represents 0.0007% and 0.00006% of the NCEL's total assets and total expenses subjected to audit, respectively.



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), a major enterprise fund of the State of North Carolina as of and for the years ended June 30, 2012 and 2011, and the related statements of revenues, expenses, and changes in net assets and cash flows, which collectively comprise the NCEL's basic financial statements, and have issued our report thereon dated November 6, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

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, 2012 and 2011, 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.

Internal Control over Financial Reporting

Management of the NCEL is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the NCEL's internal control over financial reporting 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 deficiency in internal control 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 and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, 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.

Raleigh, North Carolina
November 6, 2012



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