

**Bureau of State Lottery, State of Michigan
(an Enterprise Fund of the State of Michigan)**

Financial Report
with Supplementary Information

For the six-month periods ended March 31, 2014 and 2013

Bureau of State Lottery, State of Michigan

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Independent Auditor's Report

Mr. M. Scott Bowen, Commissioner
Bureau of State Lottery, State of Michigan
and
Mr. Doug Ringler, CPA, CIA
Auditor General, State of Michigan

Report on the Financial Statements

We have audited the accompanying financial statements of the Bureau of State Lottery, State of Michigan (an Enterprise Fund of the State of Michigan) (the "Lottery"), a proprietary fund of the State of Michigan, as of and for the six-month periods ended March 31, 2014 and 2013 and the related notes to the financial statements, which collectively comprise the Bureau of State Lottery, State of Michigan's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Mr. M. Scott Bowen, Commissioner
Bureau of State Lottery, State of Michigan
and
Mr. Doug Ringler, CPA, CIA
Auditor General, State of Michigan

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Bureau of State Lottery, State of Michigan as of March 31, 2014 and 2013 and the changes in its financial position and its cash flows for the six-month periods then ended, in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

We draw attention to Note 1, which explains that these financial statements present only the Bureau of State Lottery, State of Michigan and do not purport to, and do not, present fairly the financial position of the State of Michigan as of March 31, 2014 and 2013, the changes in its financial position, and the changes in its cash flows thereof for the six-month periods then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplemental Information

Accounting principles generally accepted in the United States of America require that the management's discussion analysis on pages 4-14 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, which 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.

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Bureau of State Lottery, State of Michigan's basic financial statements. The other supplementary information, as identified in the table of contents, is presented for the purpose of additional analysis and is not a required part of the basic financial statements.

The other supplemental information, as identified in the table of contents, is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the other supplemental information, as identified in the table of contents, is fairly stated in all material respects in relation to the basic financial statements as a whole.

Mr. M. Scott Bowen, Commissioner
Bureau of State Lottery, State of Michigan
and
Mr. Doug Ringler, CPA, CIA
Auditor General, State of Michigan

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated June 20, 2014 on our consideration of the Bureau of State Lottery, State of Michigan's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Bureau of State Lottery, State of Michigan's internal control over financial reporting and compliance.

Plante & Moran, PLLC

June 20, 2014

Bureau of State Lottery, State of Michigan Management's Discussion and Analysis

The following discussion of the Bureau of State Lottery, State of Michigan's (the "Lottery") financial performance provides an overview of the Lottery's financial activities for the six months ended March 31, 2014. Please read it in conjunction with the financial statements, which begin on page 15.

Using This Report

The Lottery is accounted for as an enterprise activity/proprietary fund, reporting on all of the activity's assets and liabilities using the accrual basis of accounting, much like a private business entity. As such, this semi-annual report consists of a series of financial statements, along with explanatory notes to the financial statements and supplementary schedules. The Statement of Net Position on page 15 and the Statement of Revenues, Expenses and Changes in Net Position on page 16, report the Lottery's net position and their changes.

By law, the Lottery is required to deposit all of its net income each fiscal year to either the State School Aid Fund (for income related to Lottery gaming activities) or the General Fund (for income related to Charitable Gaming activities). As a result, the net position of the Lottery consists largely of capital assets (leasehold improvements and equipment) and unrealized gains on investments held to fund future payments due on Lottery prizes that are annuities. To assess the Lottery's financial position and financial health, the reader of these statements should pay particular attention to changes in the components of assets and liabilities as set forth in the Statement of Net Position, and in changes in operating revenues, expenses, and disbursement expenses to other funds as set forth in the Statement of Revenues, Expenses, and Changes in Net Position. In addition, the reader should also refer to the accompanying notes to the financial statements.

Financial Highlights

- Operating revenues for Lottery gaming activities increased by \$89.3 million, or 7.3% from the comparable six-month period in the last fiscal year.
- Total revenues for all activities (including non-operating) increased \$92.7 million or 7.6% from the comparable six-month period in the last fiscal year.
- Non-operating revenues increased by \$3.4 million. The increase is attributable to the changing market values during this six-month period.
- Total operating expenses for the six-month period increased \$68.2 million or 8.0% over the comparable six-month period in the last fiscal year.
- Total expenses (including non-operating) for all activities increased \$88.9 million or 7.2%.
- Total non-operating expenses increased by \$20.7 million, or 5.4%. Of that amount, net income to be disbursed to the General Fund related to Charitable Gaming activities decreased by \$1.0 million or 41.7%, while net income from Lottery gaming activities disbursed to the State School Aid Fund increased by \$22.6 million or 6.1%.

Bureau of State Lottery, State of Michigan
Management's Discussion and Analysis

Net Position

A summary of the Lottery's net position is presented below:

Table 1 - Net Position
(in millions)

	March 2014	March 2013	March 2012
Current and other assets	\$ 207.4	\$ 211.6	\$ 257.0
Investments - noncurrent	191.2	215.2	228.2
Capital assets (net of accumulated depreciation)	0.7	0.8	0.4
Total assets	399.3	427.6	485.6
Current liabilities	187.3	195.6	239.7
Long-term liabilities	195.0	201.7	220.0
Total liabilities	382.3	397.3	459.7
Net position			
Net investment in capital assets	0.7	0.8	0.4
Restricted for unrealized gains on investments	17.0	30.3	25.9
Unrestricted (deficit)	(0.7)	(0.8)	(0.4)
Total net position	\$ 17.0	\$ 30.3	\$ 25.9

As shown in Table 1 above, the Lottery's net position decreased since March 2013, from \$30.3 million to \$17.0 million, a decrease of \$13.3 million. The change from March 2012 to March 2013 was an increase of net position by \$4.4 million. The respective increase and decrease noted above are both primarily attributable to the restricted for unrealized gains or loss on investments due to changes in the market value of those investments that the Lottery holds to fund future payments due on annuitized lottery prizes. Additional detailed information on investments may be found in Note 3 in the accompanying financial statements.

Capital assets consist of equipment and leasehold improvements. For the six months ended March 2014, net capital assets decreased by \$0.1 million since March 2013 and increased by approximately \$0.4 million since March 2012. Additional detailed information on capital assets may be found in Note 4 in the accompanying financial statements.

Bureau of State Lottery, State of Michigan Management's Discussion and Analysis

Accounting principles dictate that the Lottery record in the financial records the gain or loss related to the change in market value of investments. U.S. Treasury zero-coupon bonds and State of Michigan General Obligation Capital Appreciation Bonds have been purchased for the payment of installment prize awards and are generally held to maturity. The unrealized gain on investments is not available for disbursement to the School Aid Fund. Therefore, the difference between the market value of these investments and the amortized book value is recorded as a restriction for unrealized gains on investments.

A detail of the Lottery's liabilities is presented in Table 2 below:

Table 2 - Liabilities
(in millions)

	March 2014	March 2013	March 2012
Current:			
Warrants authorized and warrants outstanding	\$ 4.0	\$ 1.1	\$ 1.2
Accounts payable and other liabilities	19.9	17.5	16.3
Due to other state agencies	77.0	75.4	100.6
Prize awards payable (net of discount)	86.4	101.6	121.6
Total current	187.3	195.6	239.7
Non-current:			
Prize awards payable (net of discount)	193.4	200.1	218.5
Compensated absences	1.5	1.4	1.2
Supplemental retirement	0.1	0.2	0.3
Total non-current	195.0	201.7	220.0
Total liabilities	\$ 382.3	\$ 397.3	\$ 459.7

Non-current liabilities consist principally of prize liability for prizes paid in installments over several years. For the six months ended March 2014, long-term prize liability decreased by \$6.7 million or 3.3% from March 2013 and decreased by \$18.4 million or 8.4% from March 2012. The decrease from March 2013 to March 2014 and March 2012 to March 2013 are attributable to the maturing of some long-term prize liabilities as well as minimal additions to the pool of annuitized installment prizes. Refer to Note 6 in the accompanying financial statements for more information.

Bureau of State Lottery, State of Michigan
Management's Discussion and Analysis

A summary of the Lottery's change in net position for the six-month periods ended March 31 is presented in Table 3 below:

Table 3 - Changes in Net Position
(in millions)

	March 2014	March 2013	March 2012
Operating revenues	\$ 1,314.7	\$ 1,225.4	\$ 1,258.1
Operating expenses:			
Prizes and direct game expenses			
Prizes less unclaimed prizes	(764.2)	(709.0)	(709.6)
Commissions and game related expenses	(126.1)	(115.1)	(116.6)
Total prizes and direct game expenses	(890.3)	(824.1)	(826.2)
Income before other operating expenses	424.4	401.3	431.9
Other operating expenses	(27.0)	(25.0)	(25.1)
Operating income	397.4	376.3	406.8
Non-operating revenues and (expenses):			
Investment and interest revenues	4.7	5.1	5.6
Investment and interest expenses	(5.1)	(6.0)	(6.9)
Unrealized gain (loss) on investments	(0.9)	(4.7)	(4.5)
School Aid Fund disbursement expense	(395.1)	(372.5)	(401.2)
General Fund disbursement expense	(1.4)	(2.4)	(3.9)
Community Health disbursement expense	(0.5)	(0.5)	(0.5)
Net non-operating revenue (expense)	(398.3)	(381.0)	(411.4)
Change in net position	(0.9)	(4.7)	(4.6)
Total net position beginning of period	17.9	35.0	30.5
Total net position end of period	\$ 17.0	\$ 30.3	\$ 25.9

Because the Lottery is required by law to deposit all of its net income (excluding the unrealized gain or loss on investments discussed above) to the School Aid Fund or General Fund, change in net position does not reflect the result of the Lottery's operating activities. The \$395.1 million disbursement expense to the School Aid Fund reflects the Lottery's operating activities for the six months ended March 2014. There was an increase in disbursement expense to the School Aid Fund of \$22.6 million or 6.1% from March 2013. For the six months ended March 2013, there was a decrease of \$28.7 million or 7.2% from March 2012. The disbursement expense to the General Fund reflects Charitable Gaming activities for the six months ended March 2014. Charitable Gaming activities experienced a decrease in net revenues for the six-month period ended March 2014 compared to March 2013 and March 2012. Charitable Gaming net income is disbursed annually to the General Fund.

**Bureau of State Lottery, State of Michigan
Management's Discussion and Analysis**

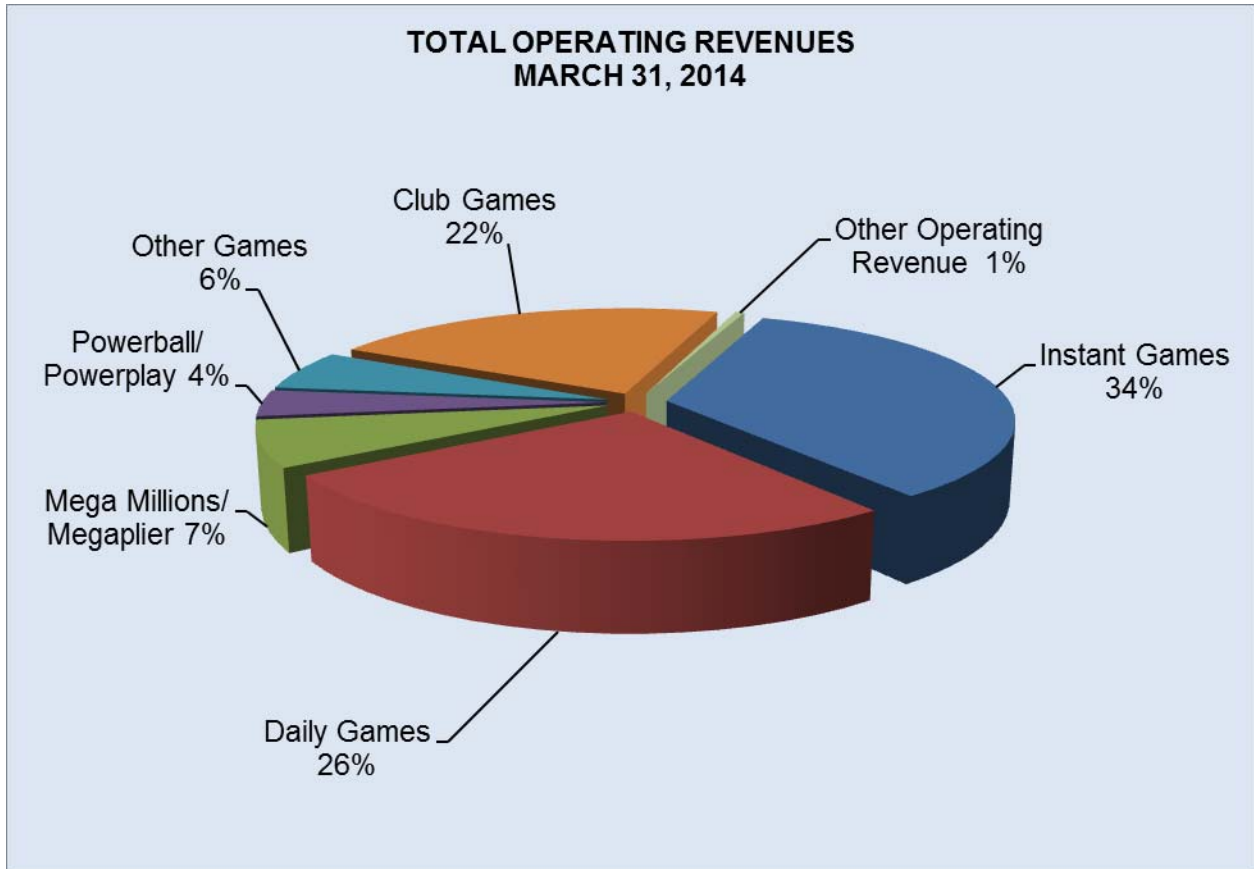
Disbursements to other funds for the six-month periods ended March 31 are detailed in Table 4 below:

Table 4 - Disbursements to Other Funds
(in millions)

	March 2014	March 2013	March 2012
School Aid Fund	\$ 395.1	\$ 372.5	\$ 401.2
General Fund	1.4	2.4	3.9
Community Health	0.5	0.5	0.5
Total Disbursements to Other Funds	\$ 397.0	\$ 375.4	\$ 405.6

Revenues

The following chart shows the major sources and the percentages of operating revenues for the six months ended March 2014:



Bureau of State Lottery, State of Michigan Management's Discussion and Analysis

A detail of the Lottery's revenues for the six-month periods ended March 31 is presented in Table 5 below:

Table 5 - Revenues
(in millions)

	March 2014	March 2013	March 2012
Operating revenues:			
Instant tickets	\$ 446.7	\$ 402.4	\$ 390.8
Daily games	338.0	331.5	345.3
Mega Millions/Megaplier	90.3	45.9	109.3
Powerball/Power Play	55.7	90.4	56.5
Club games	292.9	289.3	280.3
Other games	84.8	58.4	66.5
Other operating revenue	6.3	7.5	9.4
Total operating revenues	<u>1,314.7</u>	<u>1,225.4</u>	<u>1,258.1</u>
Non-operating revenues:			
Unrealized loss on investments	\$ (0.9)	\$ (4.7)	\$ (4.5)
Amortization on bonds	4.7	5.1	5.6
Total non-operating revenues	<u>3.8</u>	<u>0.4</u>	<u>1.1</u>
Total revenues	<u><u>\$ 1,318.5</u></u>	<u><u>\$ 1,225.8</u></u>	<u><u>\$ 1,259.2</u></u>

Operating revenues, primarily Lottery ticket sales, for the six months ended March 2014 increased over March 2013. The increase in the six months ended March 2014 over March 2013 was \$89.3 million or 7.3%. The decrease in the six months ended March 2013 from March 2012 was \$32.7 million or 2.6%.

Instant game ticket sales increased by \$44.3 million or 11.0% for the six months ended March 2014 over March 2013 and increased in the six months ended March 2013 over March 2012 by \$11.6 million or 3.0%. The instant sales increase can be attributed to enhanced prize structures which provide more prizes with increased odds of winning.

Mega Millions is a multi-state lotto game offering larger jackpots with an occasional "mega-jackpot". The states participating in Mega Millions with Michigan are California, Georgia, Illinois, Maryland, Massachusetts, New Jersey, New York, Ohio, Texas, Virginia, Washington, and the Multi-State Lottery Association (MUSL), an association of governmental lotteries. Sales, for the six months ended March 2014, increased by \$44.4 million or 96.7% compared to the six months ended March 2013. Sales in March 2013 decreased \$63.4 million or 58.0% over March 2012. The March 2014 increase is primarily due to having several larger jackpot pools compared to March 2013, including a jackpot over \$600 million which is the second highest jackpot in Mega Millions history. Megaplier, introduced in December 2010, is an add-on to Mega Millions whereby players have an opportunity to increase their non-jackpot winnings.

Bureau of State Lottery, State of Michigan Management's Discussion and Analysis

Powerball is a multi-state game, similar to Mega Millions, offering larger jackpots. Participating in Powerball is MUSL and the Mega Million's Lotteries for a total of 43 states, Washington D.C., and the U.S. Virgin Islands. Sales for the six months ended March 2014 decreased by \$34.7 million or 38.4% compared to the six months ended March 2013 and increased in the six months ended March 2013 over March 2012 by \$33.9 million or 60.0%. Power Play is an add-on game to Powerball whereby players can multiply non-jackpot prizes from two to five times.

Club games include Club Keno, Club Keno Kicker, Pull-Tabs, and The Jack. The Club Games sales for the first six months in 2014 increased by \$3.6 million or 1.2% from the six months ended March 2013. Sales in March 2013 increased \$9.0 million or 3.2% from the six months ended March 2012. The 2014 and 2013 sales increase is attributable to efforts being focused on increasing awareness of Club Keno "To Go" and further supported by the promotion of the Lottery mobile applications for iPhone and Android enabling players to be able to watch Club Keno drawings anywhere.

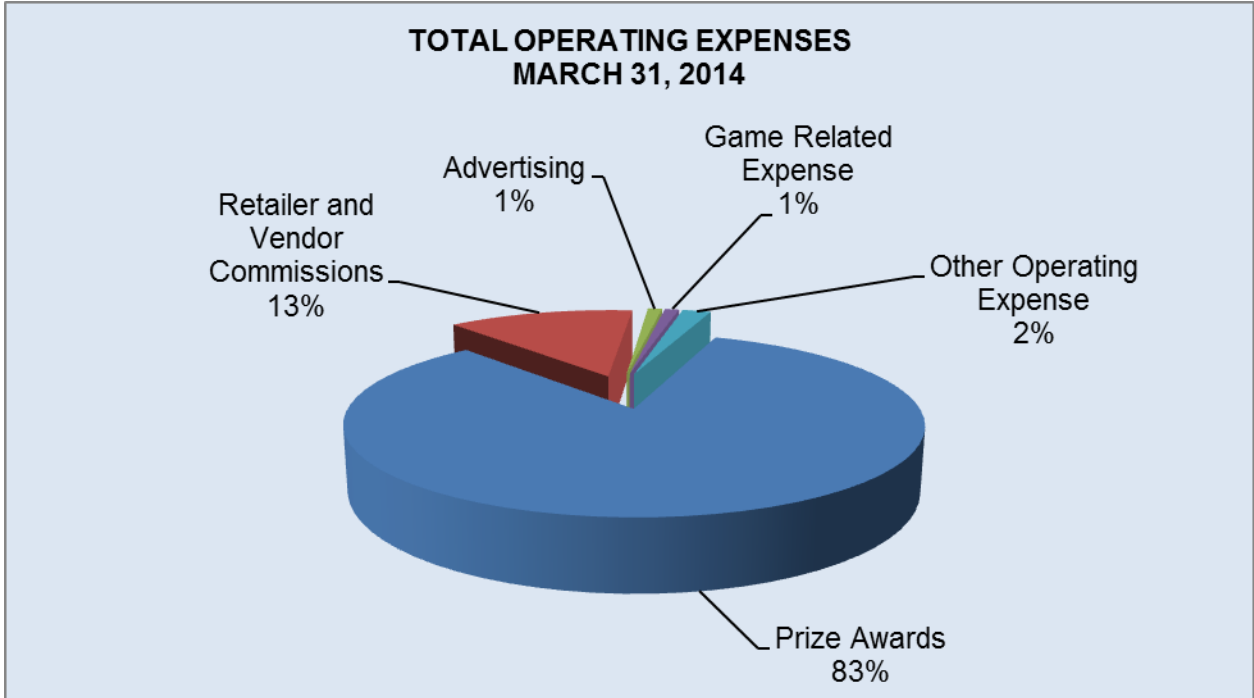
Other games consist of Lotto 47, Fantasy Five, Keno, Raffle, and Poker Lotto. Poker Lotto was added to the Lottery's game portfolio on October 19, 2013. This new game includes a nightly drawing plus a chance to win instantly all in one ticket. Lottery numbers are replaced with five playing cards and the five cards are randomly selected from a standard 52-card deck. The player can win up to \$5,000 instantly at the time of purchase if the cards form a winning poker hand and they can also win up to \$100,000 nightly by matching the winning cards drawn. Other games sales experienced an increase by \$26.4 million or 45.2% for the six months ended March 2014 over the six months ended March 2013 primarily because of the addition of Poker Lotto. Sales in March 2013 decreased \$8.1 million or 12.2% from the six months ended March 2012. During the six months ended March 2014, Raffle consisted of one Tax Free Raffle, a \$10 game.

The increase in non-operating revenues for the six-month period ended March 2014 compared to March 2013 resulted from a decrease in the unrealized loss on investments. As previously discussed, the unrealized gain or loss on investments is a reflection of the market value of the investments and does not impact the disbursement to the School Aid Fund. The decrease in bond amortization from March 2013 to March 2014 and March 2012 to March 2013 is due to a decreasing bond portfolio from maturing investments, as well as the fact that most prize winners have elected the cash option instead of installment payments. There was no change in Other Income from March 2012 to March 2013. Additional detailed information on investments may be found in Note 3 in the accompanying financial statements.

Bureau of State Lottery, State of Michigan Management's Discussion and Analysis

Expenses

The following chart shows prizes, game costs, and operating expenses as a percentage of total operating expenses for the six months ended March 2014:



Bureau of State Lottery, State of Michigan Management's Discussion and Analysis

A detail of the Lottery's expenditures for the six-month periods ended March 31 are presented in Table 6 below:

Table 6 - Expenses
(in millions)

	March 2014	March 2013	March 2012
Prizes:			
Instant prizes	\$ 311.5	\$ 271.8	\$ 259.2
Online prizes	277.8	264.1	280.0
Club game prizes	190.4	189.0	183.4
Total prizes	779.7	724.9	722.6
Less: unclaimed prizes	15.5	15.9	13.0
Net prize awards	764.2	709.0	709.6
Direct game expenses:			
Retailer commissions	94.3	87.8	88.6
Vendor commissions	19.7	17.4	17.2
Game related expenses	12.1	9.9	10.8
Total direct game expenses	126.1	115.1	116.6
Other operating expenses:			
Salaries, wages and benefits	11.0	11.0	9.8
Other professional services	4.7	4.3	3.5
Printing and supplies	0.7	0.8	0.9
Other general and administrative	1.5	1.4	1.4
Promotion and advertising	9.1	7.5	9.5
Total other operating expenses	27.0	25.0	25.1
Total operating expenses	917.3	849.1	851.3
Non-operating expenses:			
Amortization of prize discount	5.1	6.0	6.9
School Aid Fund disbursement	395.1	372.5	401.2
General Fund disbursement	1.4	2.4	3.9
Community Health disbursement	0.5	0.5	0.5
Total non-operating expenses	402.1	381.4	412.5
Total expenses	\$ 1,319.4	\$ 1,230.5	\$ 1,263.8

The Daily Games prize payout decreased overall for the six months ended March 2014 over the six months ended March 2013. Daily 3 prize payout had a decrease to 47.7% for the six months ended March 2014, compared to 51.8% for March 2013 and 48.7% for March 2012. Daily 4 prize payout decreased to 45.0% for the six months ended March 2014, compared to 46.4% for March 2013 and 44.3% for March 2012. Daily games are designed to yield an average prize payout of 50.0% and combined, the games averaged a payout of 46.2% for the six months ended March 2014.

The Club Games prize payout percentage slightly decreased for the six months ended March 2014 to 65.0% compared to 65.3% from March 2013 and 65.4% from March 2012. The higher Club Games payout is an important part of the appeal of this style of game in this market. The other draw games have an anticipated payout between 50.0% and 60.9% to include the new draw game Poker Lotto.

Bureau of State Lottery, State of Michigan Management's Discussion and Analysis

Instant games overall payout for the six months ended March 2014 is 69.7% from 67.5% for the six months ended March 2013, and 66.3% for the six months ended March 2012. The games vary in payout percentage depending on selling price of a ticket for a game. Instant game prize payouts range from 60.0% for a \$1 game to 77.9% for a \$30 game.

Retailer commissions have increased commensurate with higher overall sales. Vendor commissions have increased commensurate with higher overall sales and due to an increase in higher interactive games commission. Interactive games are play-for-fun games that are played on the web and mobile devices. Game related expenses have increased by \$2.2 million or 22.2% for the six months ended March 2014 compared to the six months ended March 2013 and decreased by \$.9 million or 8.3% for the six months ended March 2013 compared to the six months ended March 2012.

Other operating expenses have increased by \$2.0 million or 8.0% for the six months ended March 2014 compared to the six months ended March 2013 and decreased by \$.1 million or .4% for the six months ended March 2013 compared to the six months ended March 2012.

Unclaimed Prizes

By law, Lottery prizes not claimed within one year of their drawing date are to be disbursed to the State School Aid Fund.

The Lottery recognizes the value of unclaimed prizes using an allowance methodology. Under this method, historical averages are utilized to estimate the amount of prizes awarded during the current year that will not be paid out due to claims not being filed for those prizes. The amounts estimated under the allowance method are recorded as a reduction of current year prize expense to match true prize expense to related sales.

Unclaimed prizes for the six months ended March 2014 decreased by \$.4 million compared to the six months ended March 2013 and increased by \$2.9 million compared to the six months ended March 2013 from the six months ended March 2012.

Charitable Gaming

A detail of the Lottery's charitable gaming revenues, expense, and net income for the six-month periods ended March 31 are presented in Table 7 below:

Table 7 - Charitable Gaming Revenue, Expense, and Net Income
(in millions)

	March 2014	March 2013	March 2012
Gross revenue	\$ 5.9	\$ 6.9	\$ 7.5
Operating expenses	(4.5)	(4.5)	(3.6)
Net income	\$ 1.4	\$ 2.4	\$ 3.9

Bureau of State Lottery, State of Michigan Management's Discussion and Analysis

Charitable Gaming activities overseen by the Lottery include the licensing and regulation of charitable and certain other not-for-profit organizations that conduct bingo games and raffles for fund-raising purposes. By Executive Order 2012-4 dated April 2012, all millionaire party licensing and regulation activities were transferred from the Lottery to the Michigan Gaming Control Board. According to the Executive Order, Millionaire party licensing revenue shall be remitted to the Lottery and all necessary expenses shall be financed by the Lottery. Charitable Gaming revenues decreased by \$1.0 million or 14.5% for the six months ended March 2014 compared to March 2013 and decreased by \$0.6 million or 8.0% from the six months ended March 2012 to March 2013.

The Lottery also oversees the distribution and sale of break-open tickets (also for fund-raising purposes) to these same organizations. The decrease in revenues is primarily due to a decrease in sales of break-open tickets.

The mission of the Lottery with respect to charitable gaming activities is to ensure that only qualified organizations are licensed to conduct fund-raising activities and that said activities are conducted in accordance with existing laws, rules and regulations. Revenues received through the issuance of licenses and from the distribution of break-open tickets are intended to cover the costs of overseeing the program activities and are not intended as a primary goal to generate revenue for the State. Any revenue in excess of program costs is disbursed annually to the State's General Fund.

Contacting the Lottery's Financial Management

This financial report is designed to provide the Legislature and the executive branch of government, the public, and other interested parties with an overview of the financial results of the Lottery's activities and to show the Lottery's accountability for the money it receives. Percentages presented in the Management's Discussion and Analysis are based on the rounded figures presented in the tables. If you have questions about this report or need additional financial information, contact the Deputy Commissioner for Administration at the Michigan Lottery, PO Box 30023, Lansing, Michigan 48909.

Bureau of State Lottery, State of Michigan
Statement of Net Position
March 31, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Assets		
Current assets		
Equity in State Treasurer's Common Cash Fund	\$ 65,276,492	\$ 89,892,897
Investments, at fair value	30,969,636	37,739,733
Accounts receivable - net	101,516,409	75,988,812
Inventory	9,649,795	8,026,379
Other current assets	<u>22,057</u>	<u>13,407</u>
Total current assets	<u>207,434,389</u>	<u>211,661,228</u>
Noncurrent assets		
Investments, at fair value	<u>191,175,645</u>	<u>215,183,512</u>
Capital assets		
Leasehold improvements and equipment	4,628,569	5,025,026
Accumulated depreciation	<u>(3,961,970)</u>	<u>(4,242,918)</u>
Total capital assets	<u>666,599</u>	<u>782,108</u>
Total noncurrent assets	<u>191,842,244</u>	<u>215,965,620</u>
Total assets	<u>399,276,633</u>	<u>427,626,848</u>
Liabilities		
Current liabilities		
Warrants outstanding	3,006,723	54,882
Warrants authorized	1,009,927	1,042,872
Accounts payable and other liabilities	19,915,336	17,523,454
Due to other State Agencies	77,005,583	75,405,436
Prize awards payable - net of discount	<u>86,357,033</u>	<u>101,583,115</u>
Total current liabilities	<u>187,294,602</u>	<u>195,609,759</u>
Noncurrent liabilities		
Prize awards payable - net of discount	193,465,032	200,160,716
Accrual for compensated absences, less current portion	1,471,261	1,369,689
Accrual for supplemental retirement, less current portion	<u>77,733</u>	<u>180,293</u>
Total noncurrent liabilities	<u>195,014,026</u>	<u>201,710,698</u>
Total liabilities	<u>382,308,628</u>	<u>397,320,457</u>
Net Position		
Net investment in capital assets	666,599	782,108
Restricted for unrealized gains on investments	16,968,005	30,306,391
Unrestricted (deficit)	<u>(666,599)</u>	<u>(782,108)</u>
Total net position	<u>\$ 16,968,005</u>	<u>\$ 30,306,391</u>

See Accompanying Notes to the Financial Statements

Bureau of State Lottery, State of Michigan
Statement of Revenues, Expenses and Changes in Net Position
For the Six Months Ended March 31, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Operating revenues		
Ticket sales	\$ 1,308,449,574	\$ 1,217,863,128
Charitable gaming and other	6,277,308	7,517,577
Total operating revenues	<u>1,314,726,882</u>	<u>1,225,380,705</u>
Operating expenses		
Prize awards	779,698,383	724,919,066
Less - unclaimed prizes	<u>(15,508,586)</u>	<u>(15,949,863)</u>
Net prize awards	764,189,797	708,969,203
Retailer and vendor commission	114,001,146	105,246,148
Game related expenses	12,069,946	9,856,403
Depreciation expense	107,386	102,650
Other operating expenses	<u>26,898,515</u>	<u>24,934,917</u>
Total operating expenses	<u>917,266,790</u>	<u>849,109,321</u>
Operating income	<u>397,460,092</u>	<u>376,271,384</u>
Non-operating revenues		
Investment revenue - net	3,702,584	390,901
Interest on equity in State Treasurer's Common Cash Fund	<u>41,501</u>	<u>58,073</u>
Total non-operating revenues	<u>3,744,085</u>	<u>448,974</u>
Non-operating expenses		
Bank fees	(1,828)	(2,163)
Amortization of prize award obligation discount	(5,145,992)	(5,981,448)
Loss on disposal of assets	<u>(1,402)</u>	<u>-</u>
Total non-operating expenses before disbursements	<u>(5,149,222)</u>	<u>(5,983,611)</u>
Disbursements to School Aid Fund	(395,097,553)	(372,548,426)
Disbursements to General Fund	(1,413,030)	(2,362,010)
Disbursements to Community Health	<u>(495,000)</u>	<u>(495,000)</u>
Total disbursements	<u>(397,005,583)</u>	<u>(375,405,436)</u>
Total non-operating expenses	<u>(402,154,805)</u>	<u>(381,389,047)</u>
Net non-operating revenue (expense)	<u>(398,410,720)</u>	<u>(380,940,073)</u>
Change in net position	<u>(950,628)</u>	<u>(4,668,689)</u>
Total net position at beginning of period	<u>17,918,633</u>	<u>34,975,080</u>
Total net position at end of period	<u>\$ 16,968,005</u>	<u>\$ 30,306,391</u>

See Accompanying Notes to the Financial Statements

Bureau of State Lottery, State of Michigan
Statement of Cash Flows
For the Six Months Ended March 31, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Cash Flows From Operating Activities		
Cash collections from customers	\$ 1,294,128,764	\$ 1,224,491,870
Payments to employees	(10,868,767)	(10,679,122)
Payments to suppliers	(21,509,434)	(17,999,756)
Payments to prize winners	(798,018,634)	(726,120,003)
Payments for retailer and vendor commissions	(114,001,146)	(105,246,148)
	<u>349,730,783</u>	<u>364,446,841</u>
Cash Flows From Noncapital Financing Activities		
Disbursements to other funds	<u>(320,000,000)</u>	<u>(300,000,000)</u>
Cash Flows From Capital and Related Financing Activities		
Acquisition of capital assets	<u>(21,145)</u>	<u>(626,497)</u>
Cash Flows From Investing Activities		
Proceeds from maturities of investment securities	20,519,000	23,519,000
Purchase of investments	-	(10,354,812)
Interest received	19,444	44,666
Bank fees	(1,828)	(2,163)
	<u>20,536,616</u>	<u>13,206,691</u>
Net cash provided by investing activities	<u>20,536,616</u>	<u>13,206,691</u>
Net increase in cash and cash equivalents	<u>50,246,254</u>	<u>77,027,035</u>
Cash and cash equivalents at beginning of period	<u>12,023,515</u>	<u>12,810,980</u>
Cash and cash equivalents at end of period	<u>\$ 62,269,769</u>	<u>\$ 89,838,015</u>

Continued
See Accompanying Notes to the Financial Statements

Bureau of State Lottery, State of Michigan
Statement of Cash Flows
For the Six Months Ended March 31, 2014 and 2013

	2014	2013
Reconciliation of operating income to net cash provided by operating activities		
Operating income	\$ 397,460,092	\$ 376,271,384
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation expense	107,386	102,650
Bad debt expense	30,430	76,640
Amortization of prize award obligation discount	(5,145,992)	(5,981,448)
Net changes in assets and liabilities:		
Inventory	(1,773,395)	(1,234,423)
Receivables from retailers	(20,598,118)	(888,834)
Warrants authorized, compensated absences, accounts payable and other liabilities	8,333,225	7,270,224
Prize awards payable - net	(28,682,845)	(11,169,352)
Net cash provided by operating activities	\$ 349,730,783	\$ 364,446,841
Reconciliation of cash and cash equivalents		
Cash and cash equivalents at beginning of period		
Equity in State Treasurer's Common Cash Fund	\$ 12,909,672	\$ 12,974,439
Warrants outstanding	(886,157)	(163,459)
Net cash and cash equivalents at beginning of period	\$ 12,023,515	\$ 12,810,980
Cash and cash equivalents at end of period		
Equity in State Treasurer's Common Cash Fund	\$ 65,276,492	\$ 89,892,897
Warrants outstanding	(3,006,723)	(54,882)
Net cash and cash equivalents at end of period	\$ 62,269,769	\$ 89,838,015
Schedule of noncash investing, capital, and financing activities		
Decrease in fair value of investments	\$ (950,628)	\$ (4,668,689)
Disbursements to other funds (accrual)	(77,005,583)	(75,405,436)
Total noncash investing, capital, and financing activities	\$ (77,956,211)	\$ (80,074,125)

Concluded
See Accompanying Notes to the Financial Statements

Bureau of State Lottery, State of Michigan

Notes to Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The Bureau of State Lottery (the "Lottery") was established by Michigan Compiled Laws Section 432.5 under authority of Article 5, Section 4, of the State Constitution.

Public Act 95 of 1996 allows the Lottery to participate in joint enterprises, such as multi-state lotteries, with other sovereignties. Michigan, a Mega Millions state, participates in Powerball and Power Play, and Raffle multi-state lottery games, with the Multi-State Lottery Association (MUSL), an association of governmental lotteries. The association is comprised of a combination of MUSL Lotteries and Mega Millions Lotteries. Michigan also participates in Mega Millions, a jointly operated multi-state lottery comprised of 11 states: California, Georgia, Illinois, Maryland, Massachusetts, Michigan, New Jersey, New York, Ohio, Virginia, Washington and MUSL. Net income from Mega Millions, Megaplier, Powerball and Power Play is disbursed to the School Aid Fund.

Basis of Presentation

The Lottery is classified as an enterprise fund of the State of Michigan. Accordingly, the Lottery's financial statements are included in the State's Comprehensive Annual Financial Report. The accompanying financial statements are not intended to present the financial position and results of operations of the State of Michigan or its enterprise funds.

Basis of Accounting

The financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. The Lottery distinguishes operating revenue and expenses from non-operating items. The principal operating revenue of the Lottery is primarily comprised of sales from instant and draw game tickets. Operating expenses mainly consist of payments to instant and draw game prize winners and commissions to retailer agents and vendors. All other revenues and expenses are reported as non-operating. Excess revenue over expenses is designated for payment to the State School Aid Fund, except for unrealized gains on investments, excess of revenue over expenses from charitable gaming activities and up to \$1 million per year to the Department of Community Health for gambling addiction programs which are designated for payment to the State General Fund.

Revenue Recognition

Revenue is recognized for instant and pull tab games when tickets are activated by retailers. For draw games, revenue is recognized and the related direct expenses of ticket sales are accrued based upon the known relationship of the amount of ticket sales to the amount of prizes for each game. This method of measuring revenue is necessary in order to properly match revenues and expenses.

Statement of Cash Flows

For the purposes of the statement of cash flows, the Lottery considers equity in the State Treasurer's Common Cash pool, net of warrants outstanding, to be cash equivalents.

Bureau of State Lottery, State of Michigan

Notes to Financial Statements

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 at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Equity in State Treasurer's Common Cash Fund

The State Treasurer manages the State's Common Cash pool, which is used by the Lottery. The pooling of cash allows the Treasurer to invest monies not needed to pay immediate obligations so that investment earnings on available cash are maximized. Investments of the pool are not segregated by fund; rather, each contributing fund's balance is treated as equity in the pool and presented in this report as "Equity in State Treasurer's Common Cash."

Investment policies and risk categorization are included in the State of Michigan's Comprehensive Annual Financial Report.

Investments

Investments are reported at fair value. Investments are in U.S. Treasury zero-coupon bonds and State of Michigan General Obligation Capital Appreciation Bonds, Series 2009B (Michigan CAB Bonds). These investments are purchased to meet future installment payments to prize winners. Gains and losses are generally not realized on investments, as it is the Lottery's and State Treasurer's policy to hold the Lottery's investments to maturity or liquidation. The difference between the fair value and the amortized cost is reflected as a restriction of net position for unrealized gains on investments.

Inventory

Inventory consists of instant game tickets, pull tab game tickets and charity game tickets on hand and for sale at year end as well as merchandise prizes for games that have not started as of March 31, 2014 and 2013. The inventory is valued at cost, primarily using the weighted average method.

Provision for Doubtful Accounts

The Lottery establishes an allowance for bad debt for retailer receivables greater than 90 days old. A bad debt expense is recorded when the allowance is established for these receivables. The amount of the allowance for doubtful accounts totaled \$1,323,390 as of March 31, 2014 and \$1,308,073 as of March 31, 2013.

Capital Assets

The Lottery has established a \$5,000 threshold for capitalization of purchases of assets, which include equipment and leasehold improvements, and are reported in the Statement of Net Position. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Depreciation of equipment is computed using the straight-line method over five years, the estimated useful life of the assets. The Lottery has established a \$200,000 threshold for intangible assets such as constructed computer software.

Bureau of State Lottery, State of Michigan

Notes to Financial Statements

Information technology equipment including constructed computer software is depreciated over three years, the estimated useful life of the assets. Building leasehold improvements are depreciated over the lesser of eight years, the estimated useful life of the improvements, and the lease term. The costs of normal maintenance and repairs that do not add to the value of assets or materially extend asset lives are not capitalized.

Advance Wagers

All draw games may be played on an advance wager basis. An associated liability is recognized for all wagers received for drawings to be conducted after the end of the reporting period.

Warrants Authorized and Warrants Outstanding

Most of the Lottery's disbursements are made through warrants issued by the State. Warrants requested by the Lottery are charged to the Lottery's equity in the State Treasurer's Common Cash Fund as they clear the State Treasurer's account. Therefore, warrants outstanding represent drafts issued against the State Treasurer's account, which have not cleared. Warrants requested by the Lottery, but not yet issued by the State, are reported as warrants authorized.

Unclaimed Prizes

Prizes not claimed within one year after the drawing date or after the expiration date indicated on the back of the instant and pull tab tickets, are forfeited by the ticket holder. The Lottery estimates the amount of winning draw game, instant, and pull tab tickets which will not be claimed within one year after the drawing date for draw tickets or after the expiration date for instant and pull tab tickets. All unclaimed prizes are disbursed to the State School Aid Fund as provided by State statute.

Net Position

Net position represents the difference between assets, deferred outflows of resources, liabilities and deferred inflows of resources in accordance with Governmental Accounting Standards Board (GASB) Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. Net investment in capital assets consists of equipment and leasehold improvements and deferred inflows and outflows of resources attributable to the acquisition, construction, or improvement of those assets or related to debt. The difference between the fair value of investments and the amortized book value of investments is reported as restricted for unrealized gains on investments and is not available for disbursement to the School Aid Fund in accordance with Public Act 239.

NOTE 2 - EQUITY IN STATE TREASURER'S COMMON CASH

The Lottery participates in the State Treasurer's Common Cash pool. The investment authority for the pool is found in Michigan Compiled Laws Sections 21.141 – 21.147. The pool functions as both a cash management pool and a demand deposit account. The State Treasurer may invest surplus funds belonging to the State in the bonds, notes, and other evidences of indebtedness of the United States Government, and its agencies and in prime commercial paper. The Treasurer invests excess cash in short-term investments or cash equivalents.

Bureau of State Lottery, State of Michigan

Notes to Financial Statements

The following paragraphs provide disclosures about deposits and investments of the State Treasurer's Common Cash Fund:

Common Cash Deposits

Custodial Credit Risk

The custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the State's deposits may not be recovered.

Deposits are exposed to custodial credit risk if they are not covered by depository insurance and the deposits are:

- a. Uncollateralized
- b. Collateralized with securities held by the pledging financial institution, or
- c. Collateralized with securities held by the pledging financial institution's trust department or agent but not in the depositor-government's name.

The State Treasurer's policy requires the following criteria to lessen the custodial credit risk: all financial institutions holding the State's money must pledge collateral equal to the amount of the account balance for all demand and time deposits to secure State funds. A bank, savings and loan association or credit union holding State funds must be organized under the laws of Michigan or federal law and maintain a principal office or branch office in the State of Michigan. No deposit in any financial organization may be in excess of 50 percent of the net worth of the organization.

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of deposits.

Michigan Compiled Laws Section 487.714 requires State deposits to be held in a financial institution which maintains a principal office or branch office located in the State of Michigan.

No deposits were exposed to foreign currency risk, as precluded by State policy.

Common Cash Investments

Risk

In accordance with GASB Statement No. 40, *Deposit and Investment Risk Disclosures*, investments also require certain disclosures regarding policies and practices with respect to the risks associated with them. Custodial credit risk, credit risk, and interest rate risk are discussed in the following paragraphs:

Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of a failure of the counterparty, the State will not be able to recover the value of the investment or collateral securities that are in the possession of the outside party.

Bureau of State Lottery, State of Michigan

Notes to Financial Statements

Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the government and are held by either:

The counterparty, or

The counterparty's trust department or agent but not in the government's name.

The State Treasurer does not have an investment policy for managing custodial credit risk. At March 31, 2014 and 2013, common cash investments were not exposed to custodial credit risk.

Credit Risk

Credit risk is the risk that an issuer or another counterparty to an investment will not fulfill its obligations.

Prime commercial paper investments must be rated A-1 or P-1 at the time of purchase as rated by the two major rating services: Standard & Poor's (A-1) and Moody's (P-1). Borrowers must have at least \$400 million in commercial paper outstanding, and the State Treasurer may not invest in more than 10% of the borrower's outstanding debt. The investments are further limited to \$200 million in any borrower, unless the borrower has an A-1+ rating in which case the investment is not to exceed \$300 million. As of March 31, 2014 and 2013, the Lottery does not hold any investments in commercial paper.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment.

The State Treasurer's policy states that cash equivalents are invested in short-term fixed income securities with an average weighted maturity of less than one year to provide liquidity and safety of principal from capital market and default risk.

NOTE 3 - INVESTMENTS

Investments totaling \$222,145,281 at March 31, 2014 and \$252,923,245 at March 31, 2013 are in the form of U.S. Treasury zero-coupon bonds and State of Michigan General Obligation Capital Appreciation Bonds, series 2009B (Michigan CAB bonds).

These investments were purchased to fund future payments due to annuity prize winners. The bonds are reported at fair value. The corresponding liability to the prize winners is recorded in prizes payable and is disclosed in Note 6. Cash receipts from the maturity of investments totaled \$20,519,000 in the six-month period ended March 31, 2014 and \$23,519,000 in the six-month period ended March 31, 2013.

Bureau of State Lottery, State of Michigan
Notes to Financial Statements

Investments at March 31 consist of the following:

	<u>2014</u>	<u>2013</u>
U.S. Treasury zero-coupon bonds	\$ 162,009,991	\$ 168,895,514
Michigan CAB bonds	<u>60,135,290</u>	<u>84,027,731</u>
Total investments	<u>\$ 222,145,281</u>	<u>\$ 252,923,245</u>

As reported on the Statement of Net Position:

	<u>2014</u>	<u>2013</u>
Current investments	\$ 30,969,636	\$ 37,739,733
Noncurrent investments	<u>191,175,645</u>	<u>215,183,512</u>
Total Investments	<u>\$ 222,145,281</u>	<u>\$ 252,923,245</u>

Policy Disclosures

Investment authority with regard to the State Lottery Fund is delegated to the State Treasurer per Michigan Compiled Laws Section 432.41. This authority is the same investment authority with regard to the State's pension (and other employee benefit) trust funds which is found in Michigan Compiled Laws Section 38.1133. The law allows the State Treasurer, as investment fiduciary, to make diverse investments in stocks, corporate and government bonds and notes, mortgages, real estate, venture capital, and other investments.

The law has prudence standards and requires that the assets shall be invested solely in the interest of the participants and beneficiaries. The Lottery's policy is to invest solely in U.S. Treasury zero-coupon bonds and Michigan CAB bonds and hold them to maturity.

Interest Rate Risk

Investments in prize annuities at March 31, 2014 and 2013 consist of the following:

March 31, 2014

Maturities In Years	Investments in United	Interest Rate Low to High	Investments in	Interest Rate Low to High
	States Treasury Zero-Coupon Bonds		Michigan CAB Bonds	
Less than 1	\$ 15,207,188	0.19% to 7.16%	\$ 15,762,448	4.97% to 5.36%
1-5	55,934,611	0.30% to 7.19%	29,539,630	5.57% to 7.65%
6-10	42,896,781	1.50% to 4.99%	8,656,454	7.88% to 8.25%
11-15	27,029,621	3.99% to 4.84%	2,884,011	8.29% to 8.39%
16-20	17,714,939	4.35% to 4.75%	3,292,747	8.39% to 8.39%
21-25	<u>3,226,851</u>	4.58% to 4.79%	-	-
Fair Market Value	<u>\$ 162,009,991</u>		<u>\$ 60,135,290</u>	

Bureau of State Lottery, State of Michigan
Notes to Financial Statements

March 31, 2013

Maturities In Years	Investments in United States Treasury Zero-Coupon Bonds		Interest Rate Low to High		Investments in Michigan CAB Bonds	Interest Rate Low to High	
Less than 1	\$	13,158,691	0.79%	to 7.14%	\$	24,581,041	4.33% to 4.90%
1-5		58,342,223	0.19%	to 7.19%		37,577,893	4.97% to 7.01%
6-10		40,016,544	1.24%	to 4.99%		13,985,588	7.15% to 8.20%
11-15		29,942,955	3.84%	to 4.84%		3,962,627	8.25% to 8.38%
16-20		21,199,729	4.33%	to 4.71%		3,920,582	8.39% to 8.39%
21-25		6,235,372	4.58%	to 4.79%		-	-
Fair Market Value	\$	<u>168,895,514</u>			\$	<u>84,027,731</u>	

Interest rate risk is the risk that changes in interest rates of debt investments will adversely affect the fair value of those investments. The State does not have a policy regarding interest rate risk for long-term debt investments. The investments are subject to fluctuations in fair value due to interest rate risk, but these bonds are held to maturity to satisfy the annual installment obligations to the prize winners. The fair value at maturity is the face value of the bonds regardless of the fluctuations in value during the time period that the investments are outstanding, thus minimizing the interest rate risk, if held to maturity.

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Investment grade, as defined in MCL Section 38.1132, includes investments in the top four major grades, as determined by two national rating services. The State Treasurer's policy is to use Standard & Poor's (AAA, AA, A, BBB) and Moody's (Aaa, Aa, A, Baa). The Lottery's policy is that all long-term fixed income investments, unless unrated, must be investment-grade at the time of purchase unless specific requirements are met.

U.S. Treasury zero-coupon bonds are explicitly guaranteed by the U.S. government and credit quality ratings are therefore not required. The Lottery's procedure to invest in this type of bond does not require a specific credit rating, but credit quality is inherently high as the bonds are explicitly guaranteed by the U. S. government. As of March 31, 2014 and March 31, 2013, the Lottery's investments in Michigan CAB bonds were rated AA- by Standard & Poor's and Aa2 by Moody's.

Concentration of Credit Risk

Investments are in U.S. Treasury zero-coupon bonds and Michigan CAB bonds. U.S. Treasury zero-coupon bonds are guaranteed by the United States government. Therefore, there is no concentration of credit risk for those types of bonds. As of March 31, 2014, Investments in Michigan CAB bonds account for 27.1% of the total investments as compared to 33.2% as of March 31, 2013. This decrease is due to the maturities of Michigan CAB bonds during this six-month period.

Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the Lottery will not be able to recover the value of the investments that are in the possession of an outside party.

Bureau of State Lottery, State of Michigan
Notes to Financial Statements

Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the entity, and are held by either the counterparty or by the counterparty's trust department or agent, but not in the entity's name. The Lottery does not have any of these types of investments.

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of investments or deposits. As of March 31, 2014 and 2013, the Lottery had no investments subject to foreign currency risk.

NOTE 4 - CAPITAL ASSETS

A summary of capital asset activity for the six months ended March 31, 2014 and 2013 was as follows:

<u>Period Ended</u>	<u>Beginning Balance</u>	<u>Additions</u>	<u>Deletions</u>	<u>Ending Balance</u>
<u>March 31, 2014</u>				
Capital assets being depreciated:				
Leasehold improvements	\$ 1,955,989	\$ -	\$ -	\$ 1,955,989
Equipment	3,175,510	21,145	524,075	2,672,580
Total capital assets being depreciated	<u>5,131,499</u>	<u>21,145</u>	<u>524,075</u>	<u>4,628,569</u>
Less: accumulated depreciation				
Leasehold improvements	1,939,329	1,602	-	1,940,931
Equipment	2,437,928	105,784	522,673	2,021,039
Total accumulated depreciation	<u>4,377,257</u>	<u>107,386</u>	<u>522,673</u>	<u>3,961,970</u>
Total capital assets being depreciated, net	<u>\$ 754,242</u>	<u>\$ (86,241)</u>	<u>\$ 1,402</u>	<u>\$ 666,599</u>
<u>Period Ended</u>	<u>Beginning Balance</u>	<u>Additions</u>	<u>Deletions</u>	<u>Ending Balance</u>
<u>March 31, 2013</u>				
Capital assets being depreciated:				
Leasehold improvements	\$ 1,955,989	\$ -	\$ -	\$ 1,955,989
Equipment	2,442,540	626,497	-	3,069,037
Total capital assets being depreciated	<u>4,398,529</u>	<u>626,497</u>	<u>-</u>	<u>5,025,026</u>
Less: accumulated depreciation				
Leasehold improvements	1,936,126	1,602	-	1,937,728
Equipment	2,204,142	101,048	-	2,305,190
Total accumulated depreciation	<u>4,140,268</u>	<u>102,650</u>	<u>-</u>	<u>4,242,918</u>
Total capital assets being depreciated, net	<u>\$ 258,261</u>	<u>\$ 523,847</u>	<u>\$ -</u>	<u>\$ 782,108</u>

Bureau of State Lottery, State of Michigan
Notes to Financial Statements

NOTE 5 - DISAGGREGATION OF PAYABLE BALANCE

Accounts payable and other liabilities at March 31, 2014 and 2013, were as follows:

	<u>2014</u>	<u>2013</u>
Accounts payable - vendors	\$ 13,953,750	\$ 11,654,081
Retailer security deposits/accounts payable	2,680,499	2,464,571
Accrued intragovernmental expenses	1,768,799	1,951,814
Accrued salaries	909,233	748,154
Compensated absences	500,495	602,275
Supplemental retirement	<u>102,560</u>	<u>102,559</u>
Total	<u>\$ 19,915,336</u>	<u>\$ 17,523,454</u>

NOTE 6 - PRIZE AWARDS

Installment prize awards are recorded at their present value using discount rates ranging from 3.5% to 7.0%. U.S. Treasury zero-coupon bonds and State of Michigan General Obligation Capital Appreciation Bonds have been purchased to provide for the payment of installment prize awards in addition to cash maintained in the State's common cash fund. Prize awards payable as of March 31 were as follows:

	<u>2014</u>	<u>2013</u>
Current - at face amount	\$ 87,200,404	\$ 102,635,487
Less - unamortized discount	<u>(843,371)</u>	<u>(1,052,372)</u>
Current - at present value	<u>86,357,033</u>	<u>101,583,115</u>
Long-term - at face amount	290,776,800	304,355,500
Less - unamortized discount	<u>(97,311,768)</u>	<u>(104,194,784)</u>
Long-term - at present value	<u>193,465,032</u>	<u>200,160,716</u>
Total	<u>\$ 279,822,065</u>	<u>\$ 301,743,831</u>

Bureau of State Lottery, State of Michigan
Notes to Financial Statements

Installment prize awards payable as of March 31, 2014 are summarized as follows:

2015	\$ 31,014,700
2016	26,713,600
2017	19,760,200
2018	16,618,200
2019	14,604,200
2020-2024	70,211,000
2025-2029	55,541,600
2030-2034	50,861,600
2035-2039	21,052,800
2040-2044	5,293,600
2045-2049	3,700,000
2050-2054	2,780,000
2055-2059	1,976,000
2060-2064	520,000
2065-2069	520,000
2070-2074	520,000
2075-2079	104,000
Total	<u>321,791,500</u>
Less - unamortized discount	<u>(98,155,139)</u>
Total installment prize awards payable at present value	223,636,361
Noninstallment prize awards payable	56,185,704
Total prize awards payable	<u><u>\$ 279,822,065</u></u>

Long-term liability activity of installment prize awards payable for the six-month periods ended March 31 was as follows:

Period Ended	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year at Present Value
March 31 2014	\$ 238,362,595	\$ 7,856,999	\$ 22,583,233	\$ 223,636,361	\$ 30,171,329
March 31 2013	\$ 251,693,697	\$ 10,918,513	\$ 25,635,433	\$ 236,976,777	\$ 36,816,061

NOTE 7 - COMPENSATED ABSENCES

The Lottery records as a liability estimated vested vacation, sick pay and longevity. Employees are granted vacation pay in varying amounts based on length of service. Accumulated unused vacation pay is paid to employees or their beneficiaries upon death, retirement or resignation. Sick leave accrues for all employees at the rate of four hours for each two-week period worked. Up to 50% of accumulated, unused sick leave of employees hired prior to October 1, 1980 is paid to the employees or their beneficiaries upon death, retirement or resignation. For employees hired after September 30, 1980, unused sick leave is forfeited upon termination of employment. In accordance with state Civil Service Rules, longevity compensation payments, which are separate from regular compensation, are paid based on employee years of service. The Lottery accrues for vacation, vested sick leave of employees hired prior to October 1, 1980, and longevity to be paid upon death, retirement or resignation during the period of active employment.

Bureau of State Lottery, State of Michigan
Notes to Financial Statements

The State instituted a banked leave time program October 12, 2003 through November 5, 2005 whereby eligible employees worked a regular schedule but received pay for a reduced number of hours. The banked leave time program was reinstated February 21, 2010 through September 4, 2010 for non-represented employees. Upon an employee's separation, death or retirement from State service, unused banked leave time hours shall be contributed by the State to the employee's account within the State's 401(k) plans, and if applicable, to the State's 457 plans. The banked leave liability is valued at the pay rates in effect as of March 31, 2014.

Long-term liability activity of these benefits for the six-month periods ended March 31 was as follows:

Period Ended	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year	Long-term Liability
March 31 2014	\$ 1,849,911	\$ 497,410	\$ 375,565	\$ 1,971,756	\$ 500,495	\$ 1,471,261
2013	\$ 1,779,996	\$ 379,083	\$ 187,115	\$ 1,971,964	\$ 602,275	\$ 1,369,689

NOTE 8 - PENSION AND POST-EMPLOYMENT BENEFITS

Lottery employees are included in either the Defined Benefit Plan (Plan 1) or Defined Contribution Plan (Plan 2) as described below.

Defined Benefit Plan (Plan 1)

The Lottery's employees hired prior to March 31, 1997 are enrolled in a noncontributory defined benefit plan through the State Employees' Retirement System upon meeting certain eligibility requirements. Changes in Public Act 264 of 2011 to the defined benefit plan granted members a choice regarding their future retirement plan. Members could voluntarily pay 4% of compensation to remain in this pension plan for future service or become a participant in the defined contribution plan for future years of service. Member elections were implemented on April 26, 2012. Generally, qualified participants in the defined benefit plan are eligible for pension, dental, vision and major medical coverage. A member may retire with an age and service allowance after completing: (1) at least 10 years of credited service and (2) attaining the minimum retirement age of 60, or at least age 55 with 30 years of service credit. Pension benefits are determined using 1.5% times a member's final average compensation, calculated as the average of a member's monthly pay during the period of 36 consecutive months of credited service producing the highest monthly average multiplied by length of service. Employees become vested for retiree health insurance benefits with 10 or more years of service.

Defined Contribution Plan (Plan 2)

The Lottery's employees hired after March 31, 1997 are enrolled in a defined contribution plan through the State Employees' Retirement System upon meeting certain eligibility requirements. Changes in Public Act 264 of 2011 included an option for former vested and non-vested members of the defined benefit plan to voluntarily elect to enroll in the defined contribution plan including those former employees returning to state employment between January 1, 2012 and January 1, 2014. Also, those currently in the defined contribution plan were given the option to change their retirement health care. Members could keep the graded premium subsidy to accrue credit toward insurance premiums in retirement, or choose the Personal Healthcare Fund plan to pay healthcare expenses in retirement. Generally, qualified participants in the defined contribution plan are eligible to retire at age 55, with 30 years of service or at age 60 with 10 years of service.

Bureau of State Lottery, State of Michigan
Notes to Financial Statements

The Lottery contributes a mandatory 4% of the employees' salary and matches up to an additional 3% of the employees' contributions. Participants in this plan are 100% vested for any employee contributions. Participants become vested for 50% of the employer contributions after two years of service, 75% after three years of service and 100% after four years of service. Employees become vested for retiree health insurance benefits with ten or more years of service.

The cost of these pension and other post-employment benefits is allocated to the Lottery as a percentage of gross payroll. Beginning with the October 25, 2012 pay date, the contribution rate to fund the unfunded actuarial accrued liability (UAAL) of Other Post-Employment Benefits (OPEB) was applied to combined payrolls of the defined benefit and defined contribution plans in accordance with MCL 38.38(3). The payroll for the Lottery employees covered by Plan 1 and Plan 2 was \$5,805,743, \$5,846,466, and \$5,396,696, for the six months ended March 31, 2014, 2013 and 2012, respectively. The Lottery's allocated contribution requirements and contributions actually made were \$3,605,313, \$3,407,698, and \$2,222,078, for the six months ended March 31, 2014, 2013, and 2012, respectively. Contributions represent approximately 62.1%, 58.3%, and 41.2% of covered payroll during 2014, 2013, and 2012, respectively.

Public Act 185 of 2010 established a supplemental pension for all State of Michigan employees who qualified and retired under the 2010 incentive.

Supplemental Retirement

State of Michigan employees who retired under this incentive agreed to forfeit the lump-sum payment of their accumulated annual, sick, and other deferred leave time payouts and will instead receive an equal amount through a supplemental pension payment over 60 monthly installments beginning January 1, 2011. The amount of the 60 monthly charges, once calculated, should remain constant unless (a) the retiree dies without a designated pension beneficiary, in which case a lump sum of the remaining balance will be paid out to the refund beneficiary, (b) the retiree returns to work, in which case the supplemental pension benefit will be suspended, or (c) there was an error in the initial calculation which required correction after benefit payments began.

Long-term liability activity of these benefits for the six-month period ended March 31 was as follows:

Period Ended March 31	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year	Long- Term Liability
2014	\$ 231,573		\$ 51,280	\$ 180,293	\$ 102,560	\$ 77,733
2013	\$ 334,132		\$ 51,279	\$ 282,853	\$ 102,560	\$ 180,293

Additional detail and data regarding Plan 1 and Plan 2 descriptions, vesting and eligibility requirements, actuarial cost methods and assumptions, funding requirements, accounting policies, three-year historical trend information, and other postemployment benefits are provided in the State of Michigan Comprehensive Annual Financial Report and detailed financial reports issued by the Office of Retirement Systems. The reports may be obtained by writing to the Department of Technology, Management and Budget, Office of Retirement Services, 7150 Harris Dr., P.O. Box 30171, Lansing, MI 48909 or by calling (517) 322-5103.

Bureau of State Lottery, State of Michigan
Notes to Financial Statements

NOTE 9 - LEASE AND RENTAL COMMITMENTS

The total operating lease payments on long-term lease commitments for the six months ended March 31, 2014 and 2013 were \$105,315 and \$105,315, respectively. These leases represent leases for buildings. There were no capital lease obligations.

A summary of remaining minimum building lease commitments follows:

Year	Operating Leases		
	Six Months Ending March 31,	Six Months Ending September 30,	Year Ending September 30,
2014	\$ 105,315	\$ 105,315	\$ 210,630
2015	105,315	82,065	187,380
2016	77,415	77,415	154,830
2017	77,415	77,415	154,830
2018	47,005	31,800	78,805
2019	31,800	31,800	63,600
2020-2023	63,600	42,400	106,000
	<u>\$ 507,865</u>	<u>\$ 448,210</u>	<u>\$ 956,075</u>

The total rent and lease expenses paid for all buildings for the six months ended March 31, 2014 and 2013 were \$548,422 and \$538,051, respectively.

NOTE 10 - RISK MANAGEMENT

The Lottery is exposed to various risks related to torts, property damage and destruction, errors and omissions, workers' compensation and unemployment compensation. The State of Michigan has elected not to purchase commercial insurance for many of the risks of losses to which the Lottery is exposed, but to self-insure for such risks. More detailed information on risk management is available in the State of Michigan's Comprehensive Annual Financial Report.

NOTE 11 - COMMITMENTS AND CONTINGENCIES

The Lottery has contracted with a third party to provide for the operation of the gaming system through January 19, 2015. The contract rate was 1.2757% of sales through July 31, 2012. Per an amendment effective August 1, 2012, additional equipment was acquired, increasing this rate to 1.32587% through January 19, 2014 and to 1.23017% from January 20, 2014 through January 19, 2015. Per an addendum signed December 31, 2011, a gaming service was contracted for a player card loyalty prepaid debit card program known as the WonCard which was implemented on July 30, 2013. The compensation for this program is 2.0% for the WonCard validations of \$600 or less that are automatically credited to the WonCard.

From time to time, the Lottery is party to lawsuits and claims arising in the normal course of business. The Lottery has defended and intends to continue to defend these actions vigorously and believes, based on currently available information, that adverse settlements, if any, will not be material to its financial position or results of operations.

Bureau of State Lottery, State of Michigan
Notes to Financial Statements

NOTE 12 - TRANSACTIONS WITH OTHER STATE AGENCIES

As a State agency, the Lottery is required to utilize services, supplies, and equipment provided by other State agencies. The following is a summarization of these charges for the six months ended March 31, 2014 and 2013:

March 31, 2014

Department of Technology, Management and Budget:

Information Technology		
Direct costs	\$ 2,282,094	
Lansing Metropolitan Area Network (LMAN)	10,442	
Michigan.gov portal web charges	117,687	
Overhead	156,434	
Total Information Technology Charges	<u>\$ 2,566,657</u>	
Support services (including Internal audit)	183,950	
Space rental - Lottery Central, Detroit, Saginaw offices	448,639	
Vehicle and travel services	328,639	
Other - Telephone, mailing and other offices services	185,752	
Total Department of Technology, Management and Budget		\$ 3,713,637
Gaming Control Board		1,174,808
Civil Service Commission		184,138
Department of Treasury		381,348
Attorney General		164,350
Other Agencies		<u>4,868</u>
Total all State agencies		<u>\$ 5,623,149</u>

March 31, 2013

Department of Technology, Management and Budget:

Information Technology:		
Direct costs	\$ 2,204,897	
Lansing Metropolitan Area Network (LMAN)	7,942	
Michigan.gov portal web charges	107,914	
Overhead	223,627	
Total Information Technology Charges	<u>\$ 2,544,380</u>	
Support services (including Internal audit)	134,550	
Space rental - Lottery Central, Detroit, Saginaw offices	429,659	
Vehicle and travel services	406,144	
Other - Telephone, mailing and other offices services	139,982	
Total Department of Technology, Management and Budget		\$ 3,654,715
Gaming Control Board		1,026,485
Civil Service Commission		166,440
Department of Treasury		245,380
Attorney General		130,681
Other Agencies		<u>6,814</u>
Total all State agencies		<u>\$ 5,230,515</u>

Bureau of State Lottery, State of Michigan
Notes to Financial Statements

NOTE 13 – UPCOMING ACCOUNTING PRONOUNCEMENTS

In June 2012, the GASB issued GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*. Statement No. 68 requires governments providing defined benefit pensions to recognize their unfunded pension benefit obligation as a liability for the first time, and to more comprehensively and comparably measure the annual costs of pension benefits. This net pension liability that will be recorded on the government-wide, proprietary and discretely presented component units statements will be computed differently than the current unfunded actuarial accrued liability, using specific parameters set forth by the GASB. The Statement also enhances accountability and transparency through revised note disclosures and required supplementary information (RSI). The Lottery is currently evaluating the impact this standard will have on the financial statements when adopted. The provisions of this Statement are effective for financial statements for the 2014-2015 fiscal year.

Bureau of State Lottery, State of Michigan
Supplementary Schedule of Revenues and Expenses
For the Six Months Ended March 31, 2014 and 2013

		2014		2013	
		Amount	Percent of Sales	Amount	Percent of Sales
Lottery ticket sales:	Daily 3	\$ 161,069,542	12.3%	\$ 157,975,732	13.0%
	Daily 4	176,974,502	13.5%	173,539,739	14.2%
	Lotto 47	21,311,722	1.6%	21,677,242	1.8%
	Mega Millions	86,063,379	6.6%	43,543,273	3.6%
	Megaplier	4,225,757	0.3%	2,343,840	0.2%
	Powerball	53,282,316	4.1%	87,317,620	7.2%
	Power Play	2,391,862	0.2%	3,085,234	0.3%
	Keno	5,235,810	0.4%	5,800,630	0.5%
	Fantasy Five	27,717,573	2.1%	27,077,283	2.2%
	Raffle	4,094,230	0.3%	3,795,950	0.3%
	Club Keno	201,190,826	15.4%	199,048,640	16.3%
	Club Keno Kicker	70,517,792	5.4%	68,677,567	5.6%
	The Jack	5,251,163	0.4%	5,793,965	0.5%
	Poker Lotto	26,397,416	2.0%	-	0.0%
	Pull-Tab tickets	16,024,638	1.2%	15,776,393	1.3%
	Instant tickets	446,701,046	34.2%	402,410,020	33.0%
Total lottery ticket sales		<u>1,308,449,574</u>	<u>100.0%</u>	<u>1,217,863,128</u>	<u>100.0%</u>
Prize awards:	Daily 3	76,745,496	5.9%	81,800,038	6.7%
	Daily 4	79,567,785	6.1%	80,564,534	6.6%
	Lotto 47	12,168,129	0.9%	11,805,979	1.0%
	Mega Millions/Megaplier	45,719,810	3.5%	22,464,365	1.8%
	Powerball/Power Play	27,978,818	2.1%	46,638,709	3.8%
	Keno	2,084,347	0.2%	2,936,762	0.2%
	Fantasy Five	14,205,125	1.1%	14,384,553	1.2%
	Raffle	2,505,575	0.2%	2,505,340	0.2%
	Club Keno/Kicker/Jack	178,451,275	13.6%	177,317,742	14.6%
	Players Club all games	735,492	0.1%	985,492	0.1%
	Merchandise	4,498	0.0%	(251)	0.0%
	Poker Lotto	16,115,723	1.2%	-	0.0%
	Pull-Tab tickets	11,963,330	0.9%	11,710,375	1.0%
	Instant tickets	311,452,980	23.8%	271,805,428	22.3%
Total prize awards		<u>779,698,383</u>	<u>59.6%</u>	<u>724,919,066</u>	<u>59.5%</u>
Less: unclaimed prizes		<u>(15,508,586)</u>	<u>-1.2%</u>	<u>(15,949,863)</u>	<u>-1.3%</u>
Net prize awards		<u>764,189,797</u>	<u>58.4%</u>	<u>708,969,203</u>	<u>58.2%</u>
Gross margin		<u>544,259,777</u>	<u>41.6%</u>	<u>508,893,925</u>	<u>41.8%</u>
Retailer and vendor commission expense		<u>(114,001,146)</u>	<u>-8.7%</u>	<u>(105,246,148)</u>	<u>-8.6%</u>
Game related expense		<u>(12,069,946)</u>	<u>-0.9%</u>	<u>(9,856,403)</u>	<u>-0.8%</u>
Net ticket revenue		<u>418,188,685</u>	<u>32.0%</u>	<u>393,791,374</u>	<u>32.4%</u>
Other operating expense		<u>(22,475,664)</u>	<u>-1.7%</u>	<u>(20,514,426)</u>	<u>-1.7%</u>
Other miscellaneous revenue		<u>334,041</u>	<u>0.0%</u>	<u>632,426</u>	<u>0.1%</u>
Net lottery operating income		<u>396,047,062</u>	<u>30.3%</u>	<u>373,909,374</u>	<u>30.8%</u>

Continued

Bureau of State Lottery, State of Michigan
Supplementary Schedule of Revenues and Expenses
For the Six Months Ended March 31, 2014 and 2013

	2014		2013	
	Amount	Percent of Sales	Amount	Percent of Sales
Charitable gaming				
Charitable gaming revenue	5,943,267	0.5%	6,885,151	0.6%
Charitable gaming expense	<u>(4,530,237)</u>	<u>-0.3%</u>	<u>(4,523,141)</u>	<u>-0.4%</u>
Net charitable gaming income	<u>1,413,030</u>	<u>0.2%</u>	<u>2,362,010</u>	<u>0.2%</u>
Non-operating revenues (expenses)				
Amortization expense - prize discount	(5,145,992)	-0.4%	(5,981,448)	-0.5%
Amortization revenue - investment discount	4,653,212	0.4%	5,059,590	0.4%
Unrealized (loss) on investments	(950,628)	-0.1%	(4,668,689)	-0.4%
Interest revenue - common cash fund	41,501	0.0%	58,073	0.0%
Bank fees	(1,828)	0.0%	(2,163)	0.0%
Loss on disposal of assets	(1,402)	0.0%	-	0.0%
Disbursement to School Aid Fund	(395,097,553)	-30.2%	(372,548,426)	-30.6%
Disbursement to General Fund	(1,413,030)	-0.1%	(2,362,010)	-0.2%
Disbursement to Community Health	(495,000)	0.0%	(495,000)	0.0%
Net non-operating revenues (expenses)	<u>(398,410,720)</u>	<u>-30.4%</u>	<u>(380,940,073)</u>	<u>-31.3%</u>
Change in net position	<u>\$ (950,628)</u>	<u>0.1%</u>	<u>\$ (4,668,689)</u>	<u>-0.3%</u>

Concluded

Bureau of State Lottery, State of Michigan
Supplementary Schedule of Other Operating Expenses
For the Six Months Ended March 31, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Salaries and wages	\$ 5,877,663	\$ 6,027,466
Employee benefits and taxes	5,144,933	4,955,586
Promotion and advertising	9,126,173	7,453,800
Printing and supplies, including purchase of charitable gaming tickets	747,672	783,477
Other contractual services	4,655,161	4,307,950
Building rent and leases	548,422	538,051
Travel	439,417	438,222
Utilities	137,454	138,157
Postage	122,467	122,673
Equipment maintenance and rental	67,955	92,006
Bad debt expense	30,430	76,640
Interest paid on security deposits	<u>768</u>	<u>889</u>
Total	<u>\$ 26,898,515</u>	<u>\$ 24,934,917</u>

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*

Independent Auditor's Report

To Management and Mr. M. Scott Bowen, Commissioner
Bureau of State Lottery, State of Michigan
and
Mr. Doug Ringler, CPA, CIA
Auditor General, State of Michigan

We have audited, in accordance with the 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 of the Bureau of State Lottery, State of Michigan (the "Lottery"), a proprietary fund of the State of Michigan, as of and for the six-month periods ended March 31, 2014 and 2013 and related notes to the financial statements, which collectively comprise the Lottery's basic financial statements, and have issued our report thereon dated June 20, 2014.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Bureau of State Lottery, State of Michigan's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Lottery's internal control. Accordingly, we do not express an opinion on the effectiveness of the Lottery's internal control.

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 Lottery's financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

To Management and Mr. M. Scott Bowen, Commissioner
Bureau of State Lottery, State of Michigan
and
Mr. Doug Ringler, CPA, CIA
Auditor General, State of Michigan

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Bureau of State Lottery, State of Michigan's financial statements are free from 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*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Lottery's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Lottery's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Plante & Moran, PLLC

East Lansing, Michigan
June 20, 2014