



MAKING A DIFFERENCE FOR EDUCATION

# 2007 ANNUAL REPORT

Rolling Through Our First Full Year...

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## COMMISSION CHAIR'S NOTE

It is with great pride that I present this second annual report of the North Carolina Education Lottery. In the first 15 months, we have generated more than \$375 million to support education programs in our state. Few lotteries have achieved such strong returns in their first year.

The money from the North Carolina Education Lottery is making a meaningful difference for education in our state. According to the NC Department of Public Instruction, the money was used to fund:

- 2,525 teaching positions to reduce class size;
- 18,000 slots in the More at Four academic pre-k program covering all 100 counties; and
- 70 school renovation projects.

In addition, the North Carolina State Education Assistance Authority estimates it will hand out 32,000 Education Lottery Scholarships for college students for the 2007-2008 year. The scholarships go to students who qualify for a federal Pell Grant and can only be used at North Carolina public and private universities and community colleges.

A focus of the Commission in its first year has been to ensure sound operations. The Commission has undergone two audits. Delahanty Consulting LLC, an independent security organization, conducted our first security audit and determined that the controls designed by the North Carolina Education Lottery are adequate and operating as intended. The State Auditor also contracted with Cherry, Bekaert, and Holland LLP to conduct the FY07 financial audit and the Lottery received an unqualified opinion.

The year ahead will bring us exciting new changes for the North Carolina Education Lottery. The 2007 General Assembly provided us more flexibility in instant ticket prize payouts. I believe this change will enable us to secure more funds to support education in the coming year. I look forward to working with the Commission members, policy makers and elected officials to continue to make the Lottery an important source for key education initiatives. We must continually evaluate and improve our efforts if we are going to be successful in ensuring that North Carolina's schools are top in the nation.



*John R. Morfitt*



# NCEL COMMISSION

*Front Row*

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

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

**Bob Farris** - Attorney, Wilson - term expires 8/31/08 (appointed by Governor Easley)

*Back Row*

**Eddie Speas** - Attorney, Raleigh - term expires 8/31/11 (appointed by Governor Easley)

**Bob Appleton** - Associate Professor Emeritus of Accounting, University of North Carolina at Wilmington, Wilmington - term expires 8/31/08 (appointed by President Pro Tem of Senate)

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

*Not Pictured*

**Linda Carlisle** - Retired Businesswoman, Greensboro - term expired 8/31/07 (appointed by Governor Easley)

**Jim Woodward** - Chancellor Emeritus, University of North Carolina at Charlotte, Charlotte - term expires 8/31/08 (appointed by Speaker of House)

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

## EXECUTIVE DIRECTOR'S NOTE

Thank You  
North Carolina!  
-The Students

I am proud to tell the citizens of North Carolina that education in the state received more than \$325 million (including \$12 million carry over from FY06) in FY07 transfers from the North Carolina Education Lottery. These are tremendous numbers. Lottery dollars help cover costs that would otherwise be covered by state and local taxes. We met the goal of transferring 35 percent of total revenues.

Lottery staff worked hard to bring in these revenues. Following Powerball, we launched two North Carolina online games: Carolina Pick 3 and Carolina Cash 5. This meant purchasing draw equipment, choosing a local drawing station and arranging for stations in each media market to air the draws, hiring an independent auditor to monitor the draws, designing logos and playslips, training retailers, and most importantly educating players. Both games added nicely to our total revenues with steady sales.

In addition to launching these two new games, we increased the number of retailers to just over 5800. We created new instant scratch-off games and introduced them every two to three weeks. We moved into our permanent offices. We had a live Powerball drawing in conjunction with a Durham Bulls baseball game in August. We had our first second chance drawing in which we gave away all expense paid trips to a NASCAR® race of the winners' choosing. Our actions were all focused on building and maintaining the fun and excitement of the games.

We also worked to be good stewards of the public's money and to focus efforts on implementing state laws. In that regard, we received a favorable report with no findings in our second financial audit. We were diligent in our efforts to prevent sales to minors. We worked with our retailers to help them make their facilities handicap accessible. We worked closely with the Department of Health and Human Services on their problem gambling program and on National Problem Gambling Awareness Week.

The success of this North Carolina Education Lottery has been a team effort. The North Carolina Education Lottery Commission, staff, retailers, and players all share in the influx of new money to education, in the smooth introduction of new games, and in the steadiness of our operations. I thank them all.



*Thomas R. Shaheen*



## SENIOR STAFF

### *First Row*

**Tom Shaheen**, Executive Director

### *Second Row*

**Sam Hammett**, Deputy Executive Director, Sales

**Deborah Doty**, Deputy Executive Director,  
Management Information and Gaming Systems

**Margaret Spindola-Bode**, Director, Human Resources

### *Third Row*

**Carla Archie**, Deputy Executive Director,  
Legal and Security

**Pamela Walker**, Director, Corporate Communications

**Nikki Howard**, Internal Auditor

**Tony Chung**, Director, MIS

### *Fourth Row*

**Alice Garland**, Deputy Executive Director,  
Legislative and Corporate Communications

**Dina Charland**, Director, Gaming Systems

**Lou Ann Russell**, Deputy Executive Director,  
Advertising and Marketing

**Robin Diehl**, Deputy Executive Director,  
Finance and Administration

### *Fifth Row*

**Bill Enlow**, Director, Administration

**Penny Railey**, Director, Marketing

**Jerry Carter**, Director, Security

**Kim McLaurin**, Director, Sales

**Jim Knight**, Director, Finance

### *Not Pictured*

**Terri Avery**, Director, Sales

# BENEFICIARIES



## WHAT THE LEGISLATION SAYS

More than \$375 million!!! This represents the amount of money the North Carolina Education Lottery (NCEL) raised for education programs since inception through the end of FY07.

These dollars funded at-risk four year olds in the More at Four program, classroom teachers in grades K-3 to bring class size down to 18 students, school construction, and college scholarships for need-based students. The North Carolina Lottery Act directs the distribution of these dollars. The NCEL transfers the money directly to the State Lottery Fund. From there the Office of State Budget and Management disburses the dollars on a quarterly basis to either the Department of Public Instruction (DPI) or the State Education Assistance Authority (SEAA). DPI disburses the dollars to the More at Four program, to schools for K-3 classroom teachers and to counties for school construction programs. SEAA handles the college scholarship program. The chart below shows the combined total received by each county in these programs.

The More at Four program and class size reduction receive 50 percent of the dollars, school construction 40 percent, and college scholarships 10 percent.

More than 18,000 four year olds participate in the More at Four program which helps prepare at-risk children for kindergarten. More than 2,500 teachers brought class sizes down. Local schools used lottery dollars to replace roofs, install security systems, purchase land for new schools, renovate existing schools and expand existing schools to add more classrooms.

## COUNTY TOTALS

ALAMANCE	\$3,781,321	CUMBERLAND	\$14,258,321	JONES	\$586,082
ALEXANDER	957,442	CURRITUCK	608,678	LEE	2,551,577
ALLEGHANY	443,578	DARE	802,106	LENOIR	2,583,572
ANSON	1,298,009	DAVIDSON	4,796,943	LINCOLN	2,333,145
ASHE	1,063,091	DAVIE	1,460,903	MACON	882,232
AVERY	702,840	DUPLIN	2,316,694	MADISON	452,682
BEAUFORT	1,571,697	DURHAM	7,702,717	MARTIN	1,094,423
BERTIE	855,626	EDGECOMBE	2,350,162	MCDOWELL	1,337,166
BLADEN	2,160,140	FORSYTH	11,889,619	MECKLENBURG	31,239,653
BRUNSWICK	2,127,082	FRANKLIN	1,708,610	MITCHELL	460,759
BUNCOMBE	4,972,229	GASTON	8,212,438	MONTGOMERY	1,336,123
BURKE	3,798,579	GATES	571,708	MOORE	1,820,052
CABARRUS	6,929,897	GRAHAM	190,747	NASH	3,773,176
CALDWELL	2,205,835	GRANVILLE	2,014,476	NEW HANOVER	6,010,377
CAMDEN	527,626	GREENE	959,273	NORTHAMPTON	969,170
CARTERET	1,682,267	GUILFORD	18,268,438	ONSLOW	3,592,277
CASWELL	710,722	HALIFAX	2,214,251	ORANGE	3,909,593
CATAWBA	4,350,054	HARNETT	4,231,036	PAMLICO	429,191
CHATHAM	1,710,607	HAYWOOD	1,236,832	PASQUOTANK	1,242,109
CHEROKEE	863,595	HENDERSON	2,317,776	PENDER	1,382,420
CHOWAN	597,738	HERFORD	1,105,764	PERQUIMANS	409,573
CLAY	337,382	Hoke	1,978,317	PERSON	1,512,626
CLEVELAND	5,063,754	HYDE	155,351	PITT	5,682,810
COLUMBUS	2,972,549	IREDELL	4,416,210		
Craven	2,587,157	JACKSON	1,010,530		
		JOHNSTON	6,667,159		





POLK	\$698,866
RANDOLPH	4,071,735
RICHMOND	2,678,782
ROBESON	6,939,260
ROCKINGHAM	3,509,403
ROWAN	4,769,529
RUTHERFORD	2,403,685
SAMPSON	2,955,996
SCOTLAND	2,155,568
STANLY	2,702,486
STOKES	2,116,097
SURRY	3,179,159
SWAIN	491,336
TRANSYLVANIA	708,747
TYRRELL	193,491
UNION	5,592,251
VANCE	1,826,092

WAKE	\$20,893,941
WARREN	691,339
WASHINGTON	730,661
WATAUGA	1,071,022
WAYNE	6,100,830
WILKES	3,204,070
WILSON	2,957,140
YADKIN	1,617,292
YANCEY	567,565
<b>TOTAL</b>	<b>\$318,269,856</b>

Total doesn't include dollars transferred to beneficiary programs but not disbursed to counties.

**“Without the scholarship from the Lottery, I would not have been able to finish school on my initial schedule. The scholarship came at a critical time for me.”**

**– Zoe Playe, Meredith College**

## BENEFICIARY STATS

School Construction .....	\$130,159,590
More at Four .....	\$74,827,365 (received by counties)
Class Size Reduction.....	\$78,063,786
College Scholarships.....	\$35,219,115

# INSTANT SCRATCH-OFFS



In FY07, instant scratch-off tickets made up 56 percent of total lottery sales. The Lottery continues to offer a variety of games at various price points.

“Summertime Cash” and “Ruby Red 7’s” were so popular with players the games had to be reordered. “Sweetheart Cash” flew off the shelves. “Crossword” attracted players to the instant scratch-off games who had not played before. These are just some of the many success stories of the instant scratch-off tickets. “Lighthouse Loot,” “Bar B Que Bucks,” “Blue Ridge Riches,” “Winter Green,” “Downhome Dollars,” “Tarheel Treasures,” and “Outer Banks Bucks” featured scenes or items depicting North Carolina. “Merry Money” and “Lucky Times 7” sold for \$10 and paid the highest top prize to date, \$200,000 and \$250,000 respectively, on an instant scratch-off ticket.

“NASCAR®” and “\$150,000 Anniversary Cash” were launched in celebration of the first anniversary of the North Carolina Education Lottery. The NCEL partnered with one of NC’s favorite sports with the introduction of the “NASCAR®” ticket featuring four drivers: Jeff Gordon, Kasey Kahne, Dale Earnhardt, Jr., and Jimmie Johnson. Kasey Kahne was on hand to unveil the tickets at an anniversary celebration in Concord. “NASCAR®” was also the first ticket to feature a second chance drawing. In two drawings, players won a trip to a NASCAR® race of their choosing, all expenses paid.

With the first full year of operations complete, instant scratch-off tickets continued to generate excitement and form the backbone of lottery sales.



## GAME STATS

Total instant scratch-off sales .....	\$490,564,474
56% of total sales	
Prizes paid.....	\$253,440,626
New games introduced .....	51

## CAROLINA PICK 3



Carolina Pick 3, it's the name, it's the instructions. The North Carolina Education Lottery launched Carolina Pick 3 on October 6, 2006, less than six months after start-up and a little more than four months after Powerball. Players can play for \$0.50 or \$1 and can win in any, exact or 50/50 order. Depending upon the option they select, players can win from \$40 to \$500 daily.

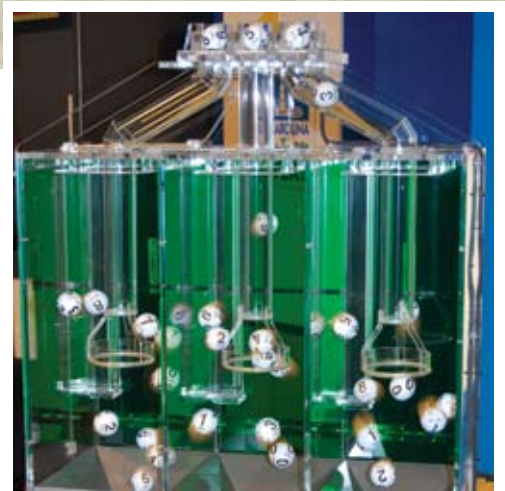
Because a 3-digit game is a complex game, lottery staff devoted time to training staff, retailers and players. We placed a training module on the web page, created a training video to show at our regional offices, and required all retailers to attend a training session before being allowed to sell Carolina Pick 3 in their stores.

Staff went to malls across the state and staged promotions where players could learn about the game and have a chance to win logo items. We developed TV, radio and point-of-sale advertising to announce the launch of the games and to provide information on how to play. We answered hundreds of calls from players about this new game.

Our efforts proved successful as sales have been steady since inception.

WRAL-TV in Raleigh won the bid to be the official lottery draw station. The studio created a stage for the drawing and provided draw talent. The drawings take place at 11:22pm every night. We demonstrated the draw machines for the media.

Along with WRAL-TV, we developed a statewide drawing station network consisting of WITN-TV-Greenville, WCNC-TV-Charlotte, WILM-TV-Wilmington, and WYCW-TV-Western NC.



## GAME STATS

Total sales (partial year) .....	\$89,541,217
10% of total sales	
Total prizes paid.....	\$38,632,890

# CAROLINA CASH 5



Carolina Cash 5 gets exciting fast. Mr. John Eagles of Southport can testify to this as the winner of \$731,836. It took only 16 nightly draws for \$50,000 to roll to \$731,836.

The North Carolina Education Lottery launched Carolina Cash 5 on October 27. Players choose five numbers from 1 to 39. They can pick their own numbers or let the computer pick their numbers, known as quick pick. The minimum top prize is \$50,000 and it rolls until it is won. Prizes for picking three, four, or five of the numbers are pari-mutuel, meaning they are shared equally among all winners of that prize level. The prize for matching two numbers is a set payout of \$1.

Lottery staff also went to malls to promote this new game and help players understand how the game is played. Advertising created special ads to promote the game and to educate players about the rolling top prize. Calls from players increased significantly as they began checking on the numbers drawn.

The Carolina Cash 5 draw occurs nightly at the same time as the Carolina Pick 3 drawing and is carried on the drawing station network.



## GAME STATS

Total sales (partial year) .....	\$36,501,699
4% of total sales	
Total prizes paid.....	\$16,552,449
Top tier prizes won .....	61
Top tier prize amount \$50,000 to \$731,836	

# NC POWERBALL



Jackie Alston from Halifax, North Carolina won \$74.5 million. That says it all. She was North Carolina's first Powerball jackpot winner. The anticipation and excitement grew at the lottery as we waited three months for Ms. Alston to identify herself and claim her prize. She spent the time pulling together a team of advisors in preparation for this big win.

Wayburn Allen, a store clerk, printed out two Powerball tickets with the same set of numbers. She ended up purchasing one of the tickets because the player only wanted one. That set of numbers matched the 5 white balls, so Ms. Allen won \$200,000 as a result of buying that extra ticket. This quirk of fate landed her a spot on the Ellen DeGeneres show.

Five lucky players PowerPlayed their way to \$1 million by spending one additional dollar, picking all 5 white balls and having the multiplier wheel land on the number 5.

Sales jumped as the Powerball jackpot rose to \$240 million in January and to \$183 million in March.

North Carolina hosted a live Powerball drawing on August 26, 2006 on the American Tobacco Campus in Durham after a Durham Bulls baseball game. A large crowd gathered to join the festivities and watch this live draw.





## GAME STATS

Total sales .....	\$258,967,883
29% of total sales	
Total prizes paid.....	\$100,173,668
Jackpot winners.....	1
Match 5 winners at \$200,000 .....	52
Match 5 winners PowerPlaying to \$400,000 to \$1 million .....	23
Match 4 numbers plus Powerball winners at \$10,000 .....	297
Match 4 numbers plus Powerball winners PowerPlaying to \$20,000 to \$50,000 .....	90

# PROMOTIONS/ADVERTISING

What is more exciting than having Kasey Kahne autograph NASCAR® lottery tickets? Seeing “Rubbin’ is racin’, Scratchin’ is playin’” on a 120’ by 50’ banner in the stadium at Lowe’s Motor Speedway. The North Carolina Education Lottery was already participating in NASCAR® events such as races and Speed Street when we decided to carry the relationship further and have a NASCAR® themed ticket. This ticket was a perfect tie-in to North Carolina race fans and provided the first opportunity for second chance drawings as well.

In conjunction with the NASCAR® ticket, the NCEL celebrated our one year anniversary by unveiling the first anniversary ticket at events in Concord and Raleigh.

Staff traveled the state teaching players how to play our many games. They conducted “buy, spin, and win” ambassador programs to teach Carolina Pick 3 and Carolina Cash 5. They promoted the lottery at the Alltel Pavillion and at seven state universities and the CIAA tournament in our first venture into sports marketing sponsorships. They watched the balls drop at the live Powerball drawing at the American Tobacco Campus, next to the Durham Bulls baseball stadium. They promoted our first “Crossword” instant scratch-off ticket by using radio promotions and unique point of sale items including grocery store cart ads and drinking cups for coffee shops, and our very own NCEL Dell™ Crossword Puzzle Book.

Sizzlin’ Millionaire Raffle tickets went on sale May 11, 2007. North Carolina’s first raffle started the summer, sizzlin’ off the shelf and selling out in less than seven weeks and four days before the drawing. The raffle proved so popular, over 23,000 players tried to purchase tickets after they sold out.

This game offered North Carolina’s players the best odds of winning \$1 million on any game offered by the lottery. Overall prizes included four \$1 million winners, five \$100,000 winners, and 500 \$1,000 winners.

Meanwhile the staff worked hard to develop advertising and media strategies for the broadest statewide appeal and reach. The humorous and informative TV and radio spots helped launch our newest games.

In addition, we provided winner awareness through a TV commercial with a fun take-off on the “big checks” winners receive when they collect their prizes. We produced TV and radio ads cautioning North Carolinians to play responsibly. And we educated the public about the contribution of the lottery to education each time we made a quarterly transfer through the Office of State Budget and Management to education programs.





<b>PROMOTIONAL STATS</b>	
Product launch events .....	20
Festival/Event sponsorships .....	5
Sports marketing sponsorships .....	10
Live Powerball drawing .....	1
Total Raffle sales .....	\$10,000,000
1% of total sales	
Total Raffle tickets sold .....	500,000

# RETAILERS



Retailers are key to the success of the North Carolina Education Lottery. We proudly take notice when our retailers do something special. Retailers that have increased their sales by the highest percentage in the region compared to the previous quarter have earned the title of “Stellar Seller.” Also, one location per region per quarter earned the title of S.T.A.R. (Spectacular Technique Achieving Retailer) based on our sales representatives’ recommendations for a store’s unique sales promotion technique.



**Dunn's Gas & Grocery** owner Dallas Johnson says he is always looking for ways to make his customers happy. He had hats made for players (left) who win \$50 or more.

Michael Aloia, owner of **The Corner Market** in Jefferson says suggestive selling is part of the reason for his S.T.A.R. status. His sales associates (bottom left) ask every customer who comes through the door if they want to buy a lottery ticket.

**Super Stop II** in Vanceboro gives a free cup of coffee to every person who buys \$5 worth of instant scratch-off tickets. They encourage players to sit around and talk and play.



# STELLAR SELLERS & S.T.A.R.s

## 4th QUARTER 06-07

### Stellar Sellers

Aztex #203 - Asheville Region - Robbinsville - 66.89%  
 Village Mart - Charlotte Region - Rockingham - 75.24%  
 Lowes Food #180 - Greensboro Region - West Jefferson - 80.33%  
 Ocean Highway Country Store - Greenville Region - Holly Ridge - 79.59%  
 Food Lion #1593 - Raleigh Region - Sunset Beach - 82.65%

### S.T.A.R.s

Kwik Mart #109 - Greenville Region - Jacksonville  
 Williamson's Country Store - Raleigh Region - Bullock  
 Goldies - Greensboro Region - Thomasville  
 Merrimon Avenue Exxon - Asheville Region - Asheville  
 Smokers Depot # 7 - Charlotte Region - Kannapolis

## 3rd QUARTER

### Stellar Sellers

Aztex # 204 - Asheville Region - Waynesville - 83.6%  
 Danny's Exxon - Greensboro Region - Thomasville - 122.06%  
 Waxhaw In N Out - Charlotte Region - Waxhaw - 95%  
 Crabtree Valley/BP - Raleigh Region - Raleigh - 96.38%  
 Rhems Mini Mart - Greenville Region - New Bern - 104.38%

### S.T.A.R.s

Georges Mini Mart - Asheville Region - Asheville  
 The Corner Market - Greensboro Region - Jefferson  
 Murphy USA - Charlotte Region - Wadesboro  
 Jeffries - Raleigh Region - Rocky Mount  
 Rookie's Sports Bar - Greenville Region - Jacksonville

## 2nd QUARTER

### Stellar Sellers

BP in Andrews - Asheville Region - Andrews - 80.35%  
 5th Avenue Speed Mart - Greensboro Region - Lexington - 262.92%  
 GA Mart - Charlotte Region - Charlotte - 122.14%  
 Spring Hope Fresh Fair - Raleigh Region - Spring Hope - 133.48%  
 Scooters In & Out - Greenville Region - Littleton - 180.10%

### S.T.A.R.s

Double R Convenience - Asheville Region - Marion  
 Shop N Save - Charlotte Region - Mooresville  
 Summit & Rankin Variety - Greensboro Region - Greensboro  
 Dunn's Gas & Grocery - Raleigh Region - Four Oaks  
 Whites Cross Grocery - Greenville Region - Colerain

## 1st QUARTER

### Stellar Sellers

Fred's General Mercantile Co. - Asheville Region - Beech Mountain - 69.95%  
 Lowes Food Store #188 - Greensboro Region - Jamestown - 93.87%  
 Food Lion #1242 - Charlotte Region - Charlotte - 121.41%  
 D&L Auction & Realty - Raleigh Region - Shallotte - 151.86%  
 Southland Trading Corporation - Greenville Region - Moyock - 149.04%

### S.T.A.R.s

Food Lion #149 - Raleigh Region - Clayton  
 Thrifty Mart - Asheville Region - Morganton  
 Dunn's Auto Service Center - Charlotte Region - Biscoe  
 Jackson Oil and Parts Inc. - Greensboro Region - Winston-Salem  
 Super Stop II - Greenville Region - Vanceboro

NCEL retailers that have increased their sales each quarter by the highest percentage in the region compared to the previous quarter have earned the title of "Stellar Seller."



**Double R Convenience** in Marion has players pick lucky numbers out of a box in case players need help selecting the numbers they want to play. If a player is undecided on which instant scratch-off game they want, they can pick a number and then buy the game with the corresponding number.

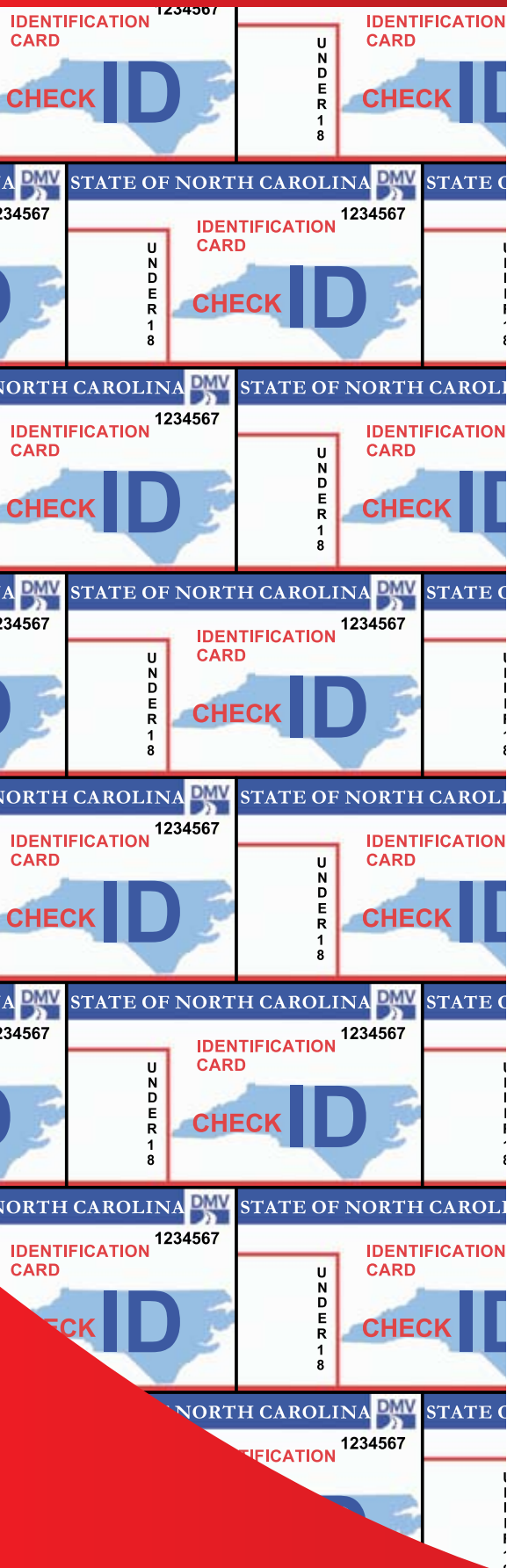


There is no mistaking that you can play the lottery at **Smokers Depot #7** in Kannapolis. Owner Bharat Patel had the entire store painted to look like an NCEL "Play Here" sign and he features winners and new games on the wall.

## RETAILER STATS

Number of retailers .....5802  
 Total commissions paid ..... \$61,932,162

# COMMUNITY RESPONSIBILITY



While our focus is raising money for education, there are other activities the North Carolina Education Lottery champions. For instance...

“Our sales stop for red. No lottery sales to minors.” (North Carolina driver’s licenses have a red border if the driver is under age 18.) This was a constant refrain from lottery offices to retailers to players. Every advertising and promotional item has a “must be 18 to play” message. We delivered flyers to the retailers and required that they sign the flyer as proof that they understood the law. We put stickers on every retail terminal with a “players must be 18 or older to play” message. We put messages on the terminals for the retailers to read as a reminder and we flashed messages on the terminal lighted electronic display (LEDs) on the instant ticket vending machines. We end calls with retailers with a “must be 18 to play” message. We have a compliance process in place that is triggered when a store clerk receives a citation for underage sales. There is no doubt that we are serious about preventing underage sales.

“Play responsibly.” We partner with the Department of Health and Human Services Problem Gambling staff by funding their efforts with a \$1 million annual contribution. We work closely with that staff to increase public awareness during National Problem Gambling Awareness Week. We devote advertising dollars to a play responsibly ad whenever the Powerball jackpot reaches high levels. Every ad includes a tag line with the Problem Gambling helpline number.

In addition, the NCEL has placed great emphasis on our minority participation efforts. At the end of the fiscal year, lottery staff was 72 percent minority, with 56 percent female, 35 percent African-American, 3 percent Hispanic and 1 percent Asian. Lottery staff worked to be visible through participation in minority trade shows and business organizations. We maintain a list of minority businesses who have indicated a desire to do business with the NCEL. We conducted a Minority Business Conference to give these entities an opportunity to learn about the lottery and meet key lottery staff.

The NCEL also partnered with the North Carolina Center for Missing Persons by participating in the Amber Alert program. Amber Alerts are intended to provide the media and the public with immediate and up-to-date information when children are abducted. When an Amber Alert is issued, the NCEL sends the message to retailers through their lottery terminals. In addition, the NCEL scrolls a message on the video display for customers to read. The messages run until there is an update or cancellation.

# PLAYERS MUST BE 18 OR OLDER TO PLAY

Debe de ser 18 años o mas para jugar

MACHINE DOES NOT GIVE CHANGE



Executive Director Tom Shaheen delivered the message "play responsibly" using "excess hot sauce" as an example of why moderation is important.



# REGIONAL SALES



Total gross sales for the fiscal year reached \$885.6 million. Approximately 5,800 retailers helped the NCEL generate those sales.

NCEL retailers run the gamut from apparel stores to supermarkets, while most lottery retailers are convenience stores with gas pumps. We do have some interesting and different trade styles, some of which are sports clubs, a tax office, a dry cleaners, several mechanics and one Mailbox Plus.



## TOP 10 RETAILERS

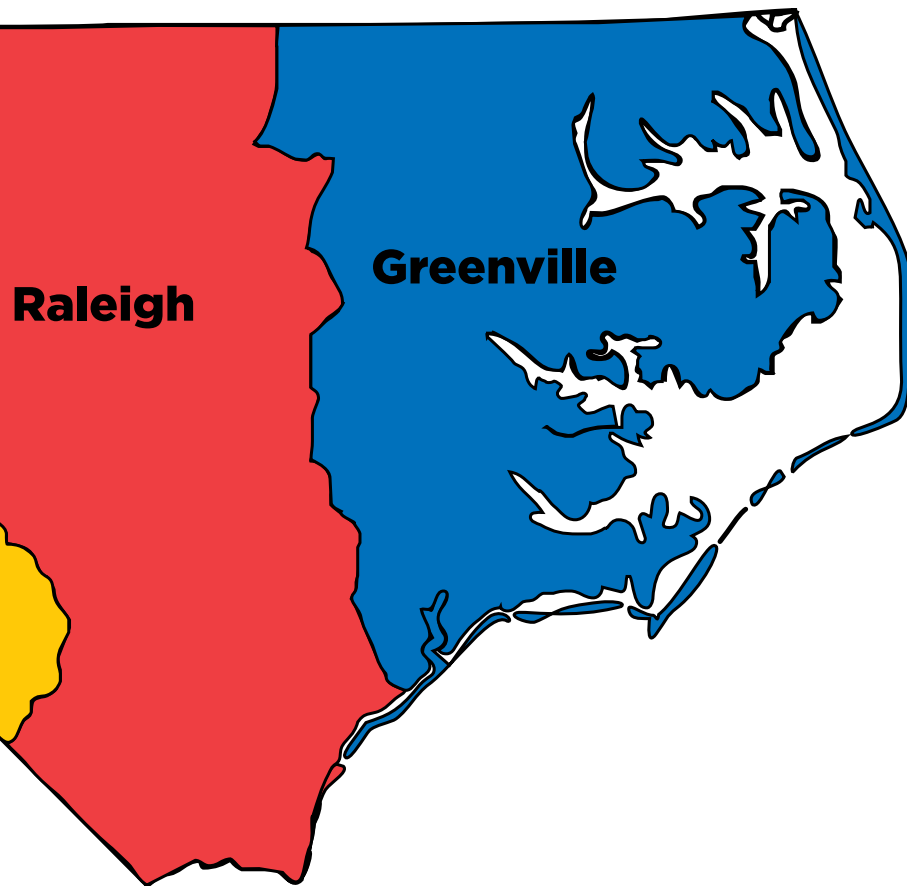
Sales FY07		
C Mini Mart #3	Raleigh	\$875,392.50
Bobby Taylor Oil #2	Fayetteville	\$756,290.00
Rosemart #14	Wilson	\$744,767.50
O'Ryans Quik Stop	Roxboro	\$740,232.00
Dunn's Gas & Grocery, Inc.	Four Oaks	\$712,780.00
West Webb Curb Market	Burlington	\$681,774.50
Fuel Doc #12	Greenville	\$676,696.50
Catamount Travel Center	Whittier	\$658,408.00
Dunn's Auto Service Center	Dunn	\$620,143.00
Piggly Wiggly #78	Biscoe	\$618,988.50



# SALES BY REGION

## Summary of Sales by Region FY 2007

	Instant Games	Powerball	Pick 3	Cash 5	Raffle	TOTAL
<b>Asheville</b>	\$36,395,195.00	\$16,895,749.00	\$1,978,528.00	\$1,846,921.00	\$585,140.00	\$57,701,533.00
<b>Greensboro</b>	\$81,301,896.00	\$41,342,149.00	\$10,921,496.50	\$5,345,096.00	\$1,539,240.00	\$140,449,878.00
<b>Charlotte</b>	\$129,835,896.00	\$69,479,019.00	\$13,461,572.50	\$8,506,229.00	\$2,623,620.00	\$223,906,337.00
<b>Raleigh</b>	\$179,183,727.00	\$100,853,776.00	\$43,895,832.00	\$15,422,010.00	\$4,119,980.00	\$343,475,325.00
<b>Greenville</b>	\$63,847,759.00	\$30,397,190.00	\$19,283,787.50	\$5,381,443.00	\$1,132,020.00	\$120,042,199.00
	<b>\$490,564,474.00</b>	<b>\$258,967,883.00</b>	<b>\$89,541,216.50</b>	<b>\$36,501,699.00</b>	<b>\$10,000,000.00</b>	<b>\$885,575,272.00</b>
<b>% of TOTAL SALES</b>	<b>56</b>	<b>29</b>	<b>10</b>	<b>4</b>	<b>1</b>	<b>100</b>



## TOP 10 COUNTIES

### Sales FY07

<b>Wake</b>	\$73,053,681.00
<b>Mecklenburg</b>	\$57,359,986.00
<b>Guilford</b>	\$50,873,771.00
<b>Cumberland</b>	\$40,901,880.00
<b>Forsyth</b>	\$32,880,498.50
<b>Durham</b>	\$26,047,633.50
<b>New Hanover</b>	\$19,966,869.00
<b>Pitt</b>	\$19,824,273.00
<b>Catawba</b>	\$18,721,354.00
<b>Alamance</b>	\$18,440,382.50

## SELLING RETAILER STATS

Number of Retailers Active and Selling as of 6/30/07

Asheville.....	451
Charlotte.....	1549
Greensboro.....	1002
Greenville.....	754
Raleigh.....	2046
<b>Grand Total.....</b>	<b>5802</b>



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

STATE OF NORTH CAROLINA  
**Office of the State Auditor**

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## AUDITOR'S TRANSMITTAL

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

This report presents the results of the financial statement audit of North Carolina Education Lottery (the Lottery), an enterprise fund of the State of North Carolina, for the period ended June 30, 2007. Cherry, Bekaert, and Holland, L.L.P. performed this audit under contract with the Office of the State Auditor and their report is submitted herewith.

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

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

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

November 27, 2007



## Independent Auditors' Report

To the Commissioners  
North Carolina Education Lottery  
Raleigh, North Carolina

We have audited the accompanying statement of net assets of the North Carolina Education Lottery (NCEL) as of June 30, 2007, and the related statements of revenues, expenses, and changes in fund net assets and cash flows for the year then ended. These financial statements are the responsibility of the NCEL's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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. 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 audit provides a reasonable basis for our opinion.

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 June 30, 2007, and the changes in its financial position and its cash flows for the year 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, 2007, and the respective changes in its financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 15, 2007, on our consideration of the NCEL's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

*Cherry Bekaert & Holland LLP*

Raleigh, North Carolina  
October 15, 2007

# MANAGEMENT'S DISCUSSION AND ANALYSIS

JUNE, 30 2007

The following is a discussion and analysis of the financial performance of the North Carolina Lottery Commission [aka, North Carolina Education Lottery (NCEL)] for the fiscal year ended June 30, 2007. This section provides an overview of the NCEL's operations and should be read in conjunction with the transmittal letter and the financial statements, including the footnotes.

A comparison of the fiscal years ended June 30, 2007 and 2006 has not been presented due to the fiscal year 2006 representing only approximately 3 months of sales compared to 12 months in fiscal year 2007.

## Financial Highlights

- Life to date sales surpassed \$1 billion with earnings for the Education Lottery Fund totaling over \$377 million since inception.
- The first instant game lottery ticket began selling on March 30, 2006.
- The first multi-state on-line game (POWERBALL) tickets began selling on May 30, 2006.
- Began selling the NCEL's first online game, Carolina Pick 3, tickets on October 6, 2006.
- Began selling the NCEL's second online game, Carolina Cash 5, tickets on October 27, 2006.
- Began selling the NCEL's first raffle game Sizzlin' Millionaire tickets on May 11, 2007.
- This fiscal year alone, NCEL earned over \$314 million in net revenues for educational purposes in North Carolina through June 30, 2007.

In the first 15 months, we earned more than \$377 million to support education programs in our State. Few lotteries have achieved such strong returns in their first year. We met the goal of transferring 35 percent of total revenues.

With these dollars, over 18,000 at-risk four year olds received training through the More-at-Four program, classrooms received 2,525 teachers in grades K-3 to reduce class size, schools initiated over 70 construction projects, and approximately 30,000 students received college scholarships. These are tremendous numbers. Lottery dollars help cover costs that would otherwise be covered by State and local taxes. Lottery staff worked hard to bring in these revenues.

We launched our own online games: Carolina Pick 3 and Carolina Cash 5. This meant purchasing our own ball machines and balls, choosing a local draw station and arranging for stations in each media market to show the draws, hiring an independent auditor to monitor the draws, designing logos and play slips, training retailers, and most importantly educating players.

In addition to launching these two new games, we increased the number of retailers to close to 5800 and serviced those retailers on a regular basis. We created new instant scratch-off games and introduced them every two to three weeks. We moved into our permanent offices. We had a live POWERBALL drawing in association with a Durham Bulls ballgame in July. We had our first second chance drawing in which we gave away all expenses paid trips to a NASCAR race of the winner's choosing. Our actions were all focused on building and maintaining the fun and excitement of the games.

We also worked to be good stewards of the public's money and to focus efforts on implementing State laws. In that regard, we received a clean report in our first annual audit. We were diligent in our efforts to prevent sales to players under the age of 18. We worked with our retailers to make their facilities handicap accessible. We worked closely with the Department of Health and Human Services on their problem gambling program and on National Problem Gambling Awareness Week.

The success of this North Carolina Education Lottery has been a team effort. The North Carolina Education Lottery Commission, staff, retailers, and players all share in the influx of new money to education, in the smooth introduction of new games, and in the steadiness of our operations.

### Overview of the Financial Statements

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

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

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

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

### Total Assets

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 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 *North Carolina General Statute 147-69.1*. Interest earned on these balances of \$4,044,195 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 nonoperating revenue.

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.

The NCEL's investment in capital assets, net of accumulated depreciation in 2007 was \$1.2 million. 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 North Carolina's Office of State Controller's policies. The NCEL defines capital assets as assets with an initial unit cost of \$5,000 or greater and an estimated useful life of two or more years. Capital assets are carried at cost less accumulated depreciation.

To continue with start-up to operate a new lottery, numerous items of equipment, furniture, and ticket dispensers were 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 and therefore expensed. The total for these expenses was \$1,433,472. Additional information on the NCEL's capital assets can be found in Note 5 to the financial statements.

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

Category	Balance July 1, 2006	Increases	Decreases	Balance June 30, 2007
Capital Assets, Nondepreciable				
Improvements in Progress	\$ 194,745	\$ -	\$ 194,745	\$ -
<b>Total Capital Assets, Nondepreciable</b>	<b>194,745</b>	<b>-</b>	<b>194,745</b>	<b>-</b>
Capital Assets, Depreciable				
Furniture	-	28,944	-	28,944
Equipment	483,809	1,179,035	11,000	1,651,844
Motorized Equipment	22,147	45,542	-	67,689
<b>Total Capital Assets, Depreciable</b>	<b>505,956</b>	<b>1,253,521</b>	<b>11,000</b>	<b>1,748,477</b>
Less Accumulated Depreciation for:				
Furniture	-	3,717	-	3,717
Equipment	73,983	376,832	1,000	449,815
Motorized Equipment	2,215	10,363	-	12,578
<b>Total Accumulated Depreciation</b>	<b>76,198</b>	<b>390,912</b>	<b>1,000</b>	<b>466,110</b>
<b>Total Capital Assets, Depreciable, Net</b>	<b>429,758</b>	<b>862,609</b>	<b>10,000</b>	<b>1,282,367</b>
<b>Capital Assets, Net</b>	<b>\$624,503</b>	<b>\$862,609</b>	<b>\$204,745</b>	<b>\$ 1,282,367</b>

#### Total Liabilities

Liabilities for the NCEL consist primarily of trade payables to vendors, instant ticket prize liability and POWERBALL low-tier liability.

	2007
Trade Payables to Vendors	\$ 3,109,047
Instant Prize Liability	35,633,208
Prize Liability - Unused Unclaimed Prizes	8,036,895
POWERBALL Low-Tier Liability	4,562,625
Prize Liability - Breakage	4,943,060
Other	22,737
<b>Total Other Payables</b>	<b>\$56,307,572</b>

Other payables represents amounts due Multi-State Lottery Association (MUSL) for the NCEL's share of POWERBALL jackpot prizes, federal and State withholding on prize payments, and various clearing accounts.

MUSL is a voluntary association created for administering joint, multi-jurisdictional lottery games, such as POWERBALL. MUSL currently includes 29 state lotteries, the District of Columbia and the U.S. Virgin Islands. The chief executive officer of each member lottery serves on the MUSL board of directors. Additional information regarding MUSL can be found in Note 7A to the financial statements.

	2007
Due to MUSL	\$ 3,255,240
Federal Withholding	46,939
State Withholding	1,837
Other	28,803
<b>Total</b>	<b>\$ 3,332,819</b>

# MANAGEMENT'S DISCUSSION AND ANALYSIS

JUNE, 30 2007

Commonly referred to as 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 liability for compensated absences is \$80,397 and non-current liability is \$784,094.

## Compensated Absences

Beginning	Earned	Used	Ending	Current Liability	Long Term Portion
\$523,680	\$942,978	\$602,167	\$864,491	\$80,397	\$784,094

### Net Assets and Changes in Net Assets

A comparison of the fiscal years ended June 30, 2007 and 2006 has not been presented as changes in net assets due to the fiscal year 2006 representing only approximately 3 months of sales compared to 12 months in fiscal year 2007.

## Condensed Statement of Net Assets

2007

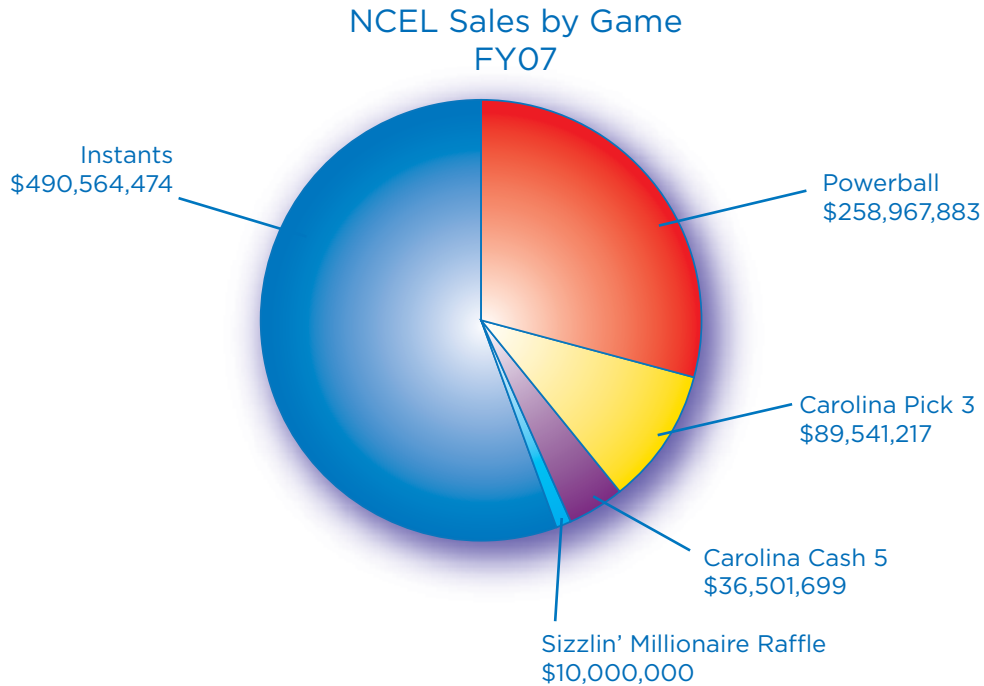
ASSETS	
Current Assets:	
Cash and Cash Equivalents	\$ 49,565,713
Receivables	11,459,541
Inventory	795,094
State Treasurer's Security Lending Collateral	56,939,954
Total Current Assets	118,760,302
Capital Assets, Depreciable (Net)	1,282,367
<b>Total Assets</b>	<b>\$120,042,669</b>
LIABILITIES	
Current Liabilities:	
Accounts Payable	59,736,473
Due to Other Funds	2,582,148
Obligations Under State Treasurer's Security Lending Agreements	56,939,954
Total Current Liabilities	119,258,575
Noncurrent Liabilities	784,094
<b>Total Liabilities</b>	<b>\$120,042,669</b>
NET ASSETS	
Invested in Capital Assets	1,282,367
Unrestricted Net Assets	(1,282,367)
<b>Total Net Assets</b>	<b>\$ -</b>

In "Due to Other Funds," \$2,543,012 of this liability represents the amount of the "Net Revenues" for Fiscal Year 2007 not yet transferred to the NC Education Fund as of

June 30, 2007, but will be transferred during Fiscal Year 2008. The remainder is due other State agencies for services provided to the NCEL. Additional information on the Due to Other Funds is found in Note 6C to the financial statements.

**Sales**

Total gross lottery sales for the fiscal year ended June 30, 2007 were approximately \$885 million. The following chart depicts the distribution of sales by product for the fiscal year ended June 30, 2007.



The instant ticket marketing strategy included multiple game introductions, along with \$1, \$2, \$5 and \$10 price points.

POWERBALL sales for the year were approximately \$259 million and North Carolina was fortunate to have a \$74 million POWERBALL Jackpot winner last fall.

Carolina Pick 3 and Carolina Cash 5 games added to our total revenues with steady sales. The Carolina Cash 5 top prize has rolled as high as \$731,836.

<b>Condensed Statement of Revenues and Expenses</b>		<b>2007</b>
Operating Revenue		\$ 866,194,905
Prizes and Commissions		(513,723,755)
Gross Profit		352,471,150
Operating Expenses		(41,709,658)
Operating Income		310,761,492
Nonoperating Revenue (Expense)		
Investment Earnings and Other Miscellaneous Revenue		8,544,200
Miscellaneous Nonoperating		(3,938,924)
Income Before Transfers		315,366,768
Transfers Out		(315,366,768)
<b>Net Revenue</b>		<b>\$ -</b>

**Budget and Economic Outlook**

On June 13, 2007, the Commission approved the Fiscal Year 2008 budget for the NCEL to provide \$341.5 million to the State's Education Lottery Fund.

At this time, the NCEL has three on-line (POWERBALL, Carolina Pick 3, and Carolina Cash 5) games and introduced over sixty-four instant games. The NCEL had a very successful introduction of its first online raffle and plans to offer another one in Fiscal Year 2008.

A focus of the Commission in its first year has been to ensure sound operations. The Commission has under gone two audits. Delahanty Consulting LLC, an independent security organization, conducted our first security audit and determined that the controls designed by the North Carolina Education Lottery are adequate and operating as intended. The State Auditor also contracted with an outside CPA firm to conduct the Fiscal Year 2006 financial audit which resulted in a clean opinion.

**Conditions Expected to Impact Future Operations**

The year ahead will bring us exciting new changes for the North Carolina Education Lottery.

Subsequent to June 30, 2007, the 2007 General Assembly approved new legislation to provide the NCEL with more flexibility in instant ticket prize payouts. This change will enable us to secure more funds to support education in the coming year.

**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

JUNE, 30 2007

<b>ASSETS</b>	
Current Assets:	
Cash and Cash Equivalents:	
Cash	\$ 62,468
Pooled Cash	49,503,245
Receivables:	
Accounts Receivable	11,053,513
Interest Receivable	406,028
Inventory	795,094
State Treasurer's Security Lending Collateral	56,939,954
<b>Total Current Assets</b>	<b>118,760,302</b>
Capital Assets, Depreciable (Net):	
Machinery and Equipment	1,748,477
Accumulated Depreciation	(466,110)
<b>Total Capital Assets, Depreciable (Net)</b>	<b>1,282,367</b>
<b>Total Assets</b>	<b>120,042,669</b>
<b>LIABILITIES</b>	
Current Liabilities:	
Accounts Payable	56,307,572
Accrued Payroll	15,685
Other Payables	3,332,819
Accrued Paid Time Off - Current	80,397
Due to Other Funds	2,582,148
Obligations Under State Treasurer's Security Lending Agreements	56,939,954
<b>Total Current Liabilities</b>	<b>119,258,575</b>
Noncurrent Liabilities:	
Accrued Paid Time Off	784,094
<b>Total Liabilities</b>	<b>120,042,669</b>
<b>NET ASSETS</b>	
Invested in Capital Assets	1,282,367
Unrestricted Net Assets	(1,282,367)
<b>Total Net Assets</b>	<b>\$ -</b>

See notes to the Financial Statements.



## STATEMENT OF REVENUE, EXPENSES & CHANGES IN FUND NET ASSETS

Year Ending June 30, 2007

Operating Revenues:	
Gross Sales:	\$ 885,575,273
Less: Prize Tickets	(23,900,666)
Fees and Licenses	4,520,298
<b>Total Operating Revenues</b>	<b>866,194,905</b>
Operating Expenses:	
Salaries, Wages, and Benefits	12,278,891
Lottery Prizes	451,791,593
Retailer Commissions	61,932,162
Gaming Systems Services	14,315,486
Advertising	7,809,998
Marketing	952,990
Other Services	3,038,184
Furniture, Fixtures, and Equipment	1,433,472
Depreciation	390,912
Other General and Administrative Expenses	1,489,725
<b>Total Operating Expenses</b>	<b>555,433,413</b>
Operating Income	310,761,492
Nonoperating Revenues (Expenses):	
Investment Earnings and Other Miscellaneous Revenue	8,544,200
Miscellaneous Nonoperating Expenses	(3,938,924)
Income Before Transfers	315,366,768
Transfers Out	(315,366,768)
Change in Net Assets	-
Net Assets, July 1, 2006	-
Net Assets, June 30, 2007	\$ -

See notes to the Financial Statements.

## STATEMENT OF CASH FLOWS

Year Ending June 30, 2007

<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>	
Receipts from Customers	\$803,256,088
Payments to Employees and Fringe Benefits	(11,923,977)
Payments for Prizes, Benefits and Claims	(406,234,906)
Payments to Vendors and Suppliers	(30,964,060)
Other Receipts/Payments	569,080
<b>Net Cash Flows Provided by Operating Activities</b>	<b>354,702,225</b>
<b>CASH USED FOR NONCAPITAL FINANCING ACTIVITIES</b>	
Transfers to State Education Fund	(325,396,577)
Transfers to Other State Agencies	(1,012,910)
<b>Total Cash Used for Noncapital Financing Activities</b>	<b>(326,409,487)</b>
<b>CASH USED FOR CAPITAL AND RELATED FINANCING ACTIVITIES</b>	
Acquisition and Construction of Capital Assets	(1,058,778)
Proceeds from Sale of Capital Assets	10,000
<b>Total Cash Used for Capital and Related Financing Activities</b>	<b>(1,048,778)</b>
<b>CASH PROVIDED FROM INVESTING ACTIVITIES</b>	
Investment Earnings	3,821,855
<b>Total Cash Provided from Investing Activities</b>	<b>3,821,855</b>
<b>Net Increase in Cash and Cash Equivalents</b>	<b>31,065,815</b>
Cash and Cash Equivalents at Beginning of Year	
Cash and Cash Equivalents at End of Year	\$ 49,565,713
<b>RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	
Operating Income	\$ 310,761,492
Adjustments to Reconcile Operating Income to Cash Provided by Operating Activities:	
Depreciation Expense	390,912
Nonoperating Income - MUSL Dividend	554,694
Other Nonoperating Income	6,386
(Increase) Decrease in Assets:	
Accounts Receivable	(1,006,655)
Inventories	(795,094)
Increase (Decrease) in Liabilities:	
Accounts Payable	44,435,577
Accrued Payroll and Related Liabilities	354,913
<b>Total Cash Provided by Operating Activities</b>	<b>\$354,702,225</b>
<b>NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES</b>	
Assets Acquired through the Assumption of a Liability	\$ 56,939,954

See notes to the Financial Statements.

# NOTES TO FINANCIAL STATEMENTS

JUNE, 30 2007

## NOTE 1 - ORGANIZATION

The North Carolina State Lottery Commission [aka, North Carolina Education Lottery (NCEL)] was created with the enactment of House Bill 1023 effective August 31, 2005, as an independent, self-supporting, and revenue-raising agency of the State of North Carolina (the State). The purpose of the NCEL is to generate funds to further the goal of providing enhanced educational opportunities so that all students in the public schools can achieve their full potential, to support school construction, and to fund college and university scholarships. The operations of the NCEL are overseen by a nine member commission, five of whom are appointed by the Governor and four of whom are appointed by the General Assembly.

The NCEL commenced operations on March 30, 2006 with the sale of instant scratch-off tickets. In March 2006, the NCEL joined the Multi-State Lottery Association (MUSL) composed of a group of U.S. lotteries that combine jointly to sell on-line POWERBALL lottery tickets. POWERBALL sales began on May 30, 2006. Carolina Pick 3 online game sales began on October 6, 2006, and Carolina Cash 5 online game sales began on October 27, 2006. The NCEL's first online raffle began sales on May 11, 2007.

## 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 NCEL is accounted for as an enterprise fund of the State of North Carolina. The financial statements are prepared on the accrual basis of accounting in a manner similar to a private enterprise. The NCEL elected to apply all applicable Governmental Accounting Standards Board (GASB) pronouncements as well as Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. As permitted by GASB Statement Number 20, the NCEL elected not to apply FASB statements or interpretations issued on or after November 30, 1989, unless specifically adopted by GASB.

As an enterprise fund, the NCEL is accounted for using the "economic resources" measurement focus. This means that all the assets and liabilities related to its operations are included on its statement of net assets, and its operating statement includes all revenues (increases) and expenses (decreases) in total assets. The NCEL distinguishes operating from nonoperating revenues and expenses. Operating revenues and expenses generally relate to the NCEL's primary ongoing operations of selling lottery tickets and redeeming prizes; all revenues and expenses not meeting this definition are reported as non-operating. The principal operating revenues of the NCEL are charges to retailers for sales of lottery products. The significant operating expenses include the cost of prizes, commissions, gaming system vendor charges, personnel, and other administrative expenses.

In June 1999, GASB approved Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*. This statement requires that the financial statements include a Management's Discussion and Analysis (MD&A) section providing an analysis of the NCEL's overall financial position and results of operations.

**C. Cash and Cash Equivalents** - Cash and cash equivalents include regional office deposited operating funds, imprest funds, and deposits held by the State Treasurer in the State Treasurer's Short-Term Investment portfolio. The Short-Term Investment portfolio maintained by the State Treasurer has the general characteristics of a demand deposit account in that participants may deposit additional cash at any time and also may withdraw cash at any time without prior notice or penalty.

**D. State Treasurer's Securities Lending Collateral** - While the NCEL does not directly engage in securities lending transactions, it deposits certain funds with the State Treasurer's Short-Term Investment Fund which participates in securities lending activities. Based on the State Treasurer's allocation of these transactions, the NCEL recognizes its allocable share of the assets and liabilities related to these transactions on the accompanying financial statements as "State Treasurer's Securities Lending Collateral" and "Obligations Under State Treasurer's Securities Lending Agreements." The NCEL's allocable share of these assets and liabilities is based on the NCEL's year end deposit balance per the State Treasurer's records.

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

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

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

**E. Allowance for Doubtful Accounts** - An allowance for doubtful accounts has not been established because there are no indications of significant delinquencies from the collection of retailer accounts as of June 30, 2007.

**F. Capital Assets** - The NCEL defines capital assets as assets with an initial unit cost of \$5,000 or greater and an estimated useful life of two or more years. This definition conforms to the policy of the NC Office of State Controller. Depreciation is computed using the straight-line method over the estimated lives of the assets. The NCEL uses the half year convention. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation will be removed from the books and any resulting gain or loss reflected in operations of the period of disposal. Capital assets are carried at cost less accumulated depreciation. The estimated useful lives by general category are as follows:

# NOTES TO FINANCIAL STATEMENTS

JUNE, 30 2007

Category	Years
Buildings and Improvements	30
Equipment	5-7
Furniture	5
Computers and Software	3-5

- G. Game Revenue Recognition** - For the NCEL's on-line games, POWERBALL, Carolina Cash 5, Carolina Pick 3, and raffle, 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.
- H. Lottery Prize Expense Recognition** - For POWERBALL, Carolina Cash 5, Carolina Pick 3, and the Sizzlin' Millionaire Raffle, 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 value of packs settled. Certain games include free tickets (prize tickets) which entitle the holder to exchange one instant ticket for another of equal value. For the instant games with prize tickets, the final prize structure percentage used is adjusted to eliminate the value of the prize tickets.
- I. Use of Estimates** - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

## NOTE 3 - REVENUE

### A. Operating Revenue

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

Gross Revenue	2007
Instant	\$490,564,474
On-line	395,010,799
<b>Total</b>	<b>\$885,575,273</b>

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

### B. Nonoperating Revenue

The cash accounts of the NCEL are Short-term Investment Fund (STIF) Accounts which are interest bearing accounts held with the NC State Treasurer. Investments are limited to those authorized for the State's General Fund, pursuant to *North Carolina General Statute 147-69.1*. The \$4,044,195 interest earned on these balances is recorded as non-operating revenue. Earnings on the accounts are credited on a monthly basis. The allocable share of the revenue arising from the State Treasurer's Securities Lending Collateral program is included as investment earnings. This also reflects a dividend from MUSL of \$554,694. The remaining \$6,502 is composed of miscellaneous items.

## NOTE 4 - EXPENSES

### A. Operating Expenses

**Lottery Prize Expense** - There was approximately eight months activity for online games Cash 5 and Pick 3 for Fiscal Year 2007.

Prize Expense	2007
Instant	\$ 257,459,893
On-line	194,331,700
<b>Total</b>	<b>\$ 451,791,593</b>

### Retailer Commission

Commissions	2007
Instant	\$ 34,307,874
On-line	27,624,288
<b>Total</b>	<b>\$ 61,932,162</b>

**Other Services** - The principal expenses included are: security services, background checks, communications, legal services, travel, marketing, and costs for temporary employees for start-up.

	2007
Security Services	\$ 406,868
Background Checks	701,443
Communications, Including Wiring	768,898
Legal Services	139,143
Travel	102,057
Other	919,775
	<b>\$ 3,038,184</b>

**Furniture, Fixtures, and Equipment** - To continue with start-up to operate a new lottery, numerous items of equipment, furniture, and ticket dispensers were 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 5C - Capital Assets) and therefore expensed. The total for these expenses was \$1,433,472 in Fiscal Year 2007.

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

Year Ending (June 30)	Amount
2008	\$ 825,373
2009	843,281
2010	857,884
2011	872,407
2012	646,355
2013-2017	2,724,920
<b>Total</b>	<b>\$6,770,220</b>

The total space rental costs for the year ended June 30, 2007, was \$836,341.

- B. Nonoperating Expenses - The allocable share of the expenses arising from State Treasurer's Securities Lending Collateral program transactions, totaling \$3,938,809, are also included as nonoperating expense. The remaining \$115 is composed of miscellaneous items.

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

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

The second transfer is \$8,036,895 from unclaimed prizes during the year. The North Carolina State Lottery Act requires the NCEL to transfer "Fifty percent (50%)" of unclaimed prizes to the NC Education Lottery Fund each year (Note 7B).

The third transfer is in compliance with the North Carolina State Lottery Act. This Act requires all "Net Revenues" of the NCEL to be transferred to the NC Education Lottery Fund for the educational purposes set forth in the legislation. Of the \$306,316,963 of current year "Net Revenues" (see Note 12) for the period ended June 30, 2007, \$303,773,951 was actually transferred to the NC Education Lottery Fund. The remaining was recorded as a payable to the State, but remained in the NCEL. The remaining \$2,543,012 will be transferred during October, 2007.

*North Carolina General Statute* 18C states: "The funds remaining in the North Carolina State Lottery Fund after receipt of all revenues to the Lottery Fund and after accrual of all obligations of the Commission for prizes and expenses shall be considered to be the net revenues of the North Carolina State Lottery Fund."

There were other miscellaneous transfers of \$12,910.

**NOTE 5 - ASSETS**

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

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

At June 30, 2007, \$49,503,245 of the amount shown on the Statement of Net Assets as cash and cash equivalents represents the NCEL's equity position in the State Treasurer's Short-Term Investment Fund. The Short-Term Investment Fund (a portfolio within the State Treasurer's Investment Pool, an external investment pool that is not registered with the Securities and Exchange Commission and does not have a credit rating) had a weighted average maturity of 1.6 years as of June 30, 2007. Assets and shares of the Short-Term Investment Fund are valued at amortized cost, which approximates fair value. Deposit and investment risks associated with the State Treasurer's Investment Pool (which includes the State Treasurer's Short-Term Investment Fund) are included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.ncosc.net/> and clicking on "Financial Reports," or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

- B. Accounts Receivable** - Accounts Receivable primarily represents amounts due from retailers for settlement of packs of tickets less commissions and prizes paid by the retailers. Electronic Funds Transfer is used to collect receivables weekly from retailer bank accounts that were set up in trust for the NCEL.

# NOTES TO FINANCIAL STATEMENTS

JUNE, 30 2007

C. **Capital Assets** – The activity for capital assets for the year ended June 30, 2007 was:

Category	Balance July 1, 2006	Increases	Decreases	Balance June 30, 2007
Capital Assets, Nondepreciable				
Improvements in Progress	\$ 194,745	\$ -	\$ 194,745	\$ -
<b>Total Capital Assets, Nondepreciable</b>	<b>194,745</b>	<b>-</b>	<b>194,745</b>	<b>-</b>
Capital Assets, Depreciable				
Furniture	-	28,944	-	28,944
Equipment	483,809	1,179,035	11,000	1,651,844
Motorized Equipment	22,147	45,542	-	67,689
<b>Total Capital Assets, Depreciable</b>	<b>505,956</b>	<b>1,253,521</b>	<b>11,000</b>	<b>1,748,477</b>
Less Accumulated Depreciation for:				
Furniture	-	3,717	-	3,717
Equipment	73,983	376,832	1,000	449,815
Motorized Equipment	2,215	10,363	-	12,578
<b>Total Accumulated Depreciation</b>	<b>76,198</b>	<b>390,912</b>	<b>1,000</b>	<b>466,110</b>
<b>Total Capital Assets, Depreciable, Net</b>	<b>429,758</b>	<b>862,609</b>	<b>10,000</b>	<b>1,282,367</b>
<b>Capital Assets, Net</b>	<b>\$624,503</b>	<b>\$862,609</b>	<b>\$204,745</b>	<b>\$ 1,282,367</b>

## NOTE 6 - LIABILITIES

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

Type Account	2007
Trade Payables to Vendors	\$ 3,109,047
Instant Prize Liability	35,633,208
Prize Liability- Unused Unclaimed Prizes	8,036,895
POWERBALL Low-Tier Liability	4,562,625
Prize Liability – Breakage	4,943,060
Other	22,737
<b>Total Accounts Payable</b>	<b>\$56,307,572</b>

B. **Other Payables** – This represents amounts due MUSL for the NCEL's share of POWERBALL jackpot prizes, federal and state withholding on prize payments, and various clearing accounts.

Account	2007
Due to MUSL	\$ 3,255,240
Federal Withholding	46,939
State Withholding	1,837
Other	28,803
<b>Total Other Payables</b>	<b>\$ 3,332,819</b>

C. **Due to other funds** – As explained in NOTE 4C, \$2,543,012 of this represents the amount of the "Net Revenues" for Fiscal Year 2007 not yet transferred to the NC Education Fund as of June 30, 2007, but will be transferred during Fiscal Year 2008. The remainder is due other State agencies for services provided to the NCEL.

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

Commonly referred to as Compensated Absences, a liability is recorded to reflect the balances for unpaid Paid Time Off (PTO) earned.

## Compensated Absences

Beginning	Earned	Used	Ending	Current Liability	Long Term Portion
\$523,680	\$942,978	\$602,167	\$864,491	\$80,397	\$784,094

### 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. MUSL currently includes 29 state lotteries, the District of Columbia and the U.S. Virgin Islands. The chief executive officer of each member lottery serves on the MUSL board of directors.

As a member of MUSL, the NCEL is required to contribute to various prize reserve funds maintained by MUSL. These contributions are included in the 50% prize expense computed on POWERBALL sales. The net amount of the 50% prize expense less the amount required to pay low-tier prizes within the State is paid to MUSL. This payment is to cover the NCEL’s share of current jackpot prizes based on the NCEL’s percent of sales for each drawing and the NCEL share of the prize reserve fund. The prize reserve fund serves as a contingency reserve to protect all MUSL members including the NCEL from unforeseen prize liabilities. All prize reserve funds remitted, and the related interest earnings, will be returned to the NCEL upon leaving MUSL, less any portion of unanticipated prize claims which may have been paid from the fund. As of June 30, 2007, the NCEL had been credited with \$2,385,406 in the MUSL prize reserve funds.

- B. Unclaimed Prizes** – As of June 30, 2007, the NCEL had unclaimed prizes from both online and instant games. The first POWERBALL draw after the NCEL started selling tickets was on May 31, 2006, and therefore, began recognizing unclaimed prizes on November 27, 2006. Both Carolina Cash 5 and Carolina Pick 3 had unclaimed prizes during the year. The first Carolina Pick 3 unclaimed prizes were recorded on

April 4, 2007, and the first unclaimed prizes for Carolina Cash 5 were recorded on April 25, 2007. The NCEL closed four instant games during the year resulting in approximately \$9.5 million in unclaimed prizes.

Type Game	2007
POWERBALL	\$ 5,747,837
Carolina Cash 5	332,305
Carolina Pick 3	408,030
Instant	9,585,618
<b>Total unclaimed prizes</b>	<b>\$16,073,790</b>

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

### NOTE 8 – RISK MANAGEMENT

The NCEL is exposed to various risks of loss related to torts; theft of, damage to, and the destruction of assets; errors and omissions; injuries to employees; and natural disasters. The NCEL participates in the State’s Risk Management Program for property, liability, crime and automobile coverage, and pays an annual premium for this coverage. The Lottery has not experienced any losses during the year ended June 30, 2007.

The types of coverage, limits, and deductibles as of June 30, 2007, are described below:

Type Coverage	Limits (\$)	Deductible (\$)	Comments
Public Officers and Employee Liability	500,000/ 5,000,000	-	
All Risk – Property Contents	2,575,222	500	Except for theft, then \$1,000 per occurrence
Auto- Bodily Injury and Property Damage	500,000/ 5,000,000	-	
Theft, Disappearance, Destruction	250,000	2,500	Inside premises
Theft, Disappearance, Destruction	50,000	2,500	Outside premises
Computer Fraud	5,000,000	50,000	+10% over \$50,000
Employee Dishonesty	5,000,000	50,000	+10% over \$50,000
Forgery and Alteration	100,000	-	
Robbery and Safe Burglary-money/securities	500,000	1,000	

# NOTES TO FINANCIAL STATEMENTS

JUNE, 30 2007

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

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

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

## NOTE 9 - PENSION AND DEFERRED COMPENSATION PLANS

- A. Retirement Plan** - Teachers' and State Employees' Retirement Plans - The NCEL contributes to the statewide Teachers' and State Employees' Retirement System (TSERS), a cost sharing defined benefit pension plan administered by the North Carolina State Treasurer. TSERS provides retirement benefits to plan members and beneficiaries. Article 1 of

G.S. Chapter 135 assigns the NCEL to establish and amend benefit provisions to the North Carolina General Assembly. The TSERS is included in the Comprehensive Annual Financial Report (CAFR) for the State of North Carolina. The State's CAFR includes financial statements and required supplementary information for TSERS. That report may be obtained in writing to the Office of the State Controller, 1410 Mail Service Center, Raleigh, North Carolina 27699-1410, or by calling (919) 981-5454.

Plan members are required to contribute 6% of their annual covered salary, and the NCEL is required to contribute an actuarially determined rate. The current rate is 2.66% of covered payroll. The contribution requirements of the plan members and the NCEL are established and may be amended by the North Carolina General Assembly. The NCEL's contributions to TSERS for the years ended June 30, 2007 and 2006 were \$257,402 and \$262,018, respectively, equal to the required contributions for each year.

- B. Supplemental Retirement Income Plan** - IRC Section 401(k) Plan - All full-time employees are eligible to enroll in the Supplemental Retirement Income Plan, a defined contribution plan, created under Internal Revenue Code Section 401(k). All costs of administering the plan are the responsibility of plan participants. The Plan is provided by Prudential Retirement, administered by the NC Department of the State Treasurer and sponsored by the State of North Carolina. The effective date of participation was January 30, 2006.
- C. Deferred Compensation Plan** - IRC Section 457 Plan - The State of North Carolina offers its permanent employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457 through the North Carolina Public Employee Deferred Compensation Plan (the "Plan"). The Plan permits each participating employee to defer a portion of his or her salary until future years. The deferred compensation is available to employees upon separation from service, death, disability, retirement or financial hardships if approved by the Board of Trustees of the Plan. The Board, a part of the North Carolina Department of Administration, 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.

## NOTE 10 - OTHER POSTEMPLOYMENT BENEFITS

- A. Health Care for Long-Term Disability Beneficiaries and Retirees** - The NCEL participates in state administered programs which provide 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 Fund.

These benefits were established by Chapter 135, Article 3, Part 3, of the General Statutes and may be amended only by the North Carolina General Assembly. Funding for the health care benefit for long-term disability beneficiaries and retirees is financed on a pay-as-you-go basis. The NCEL contributed 3.80% of the covered payroll under the Teachers' and State Employees' Retirement Fund for these health care benefits. For the fiscal year ended June 30, 2007, the NCEL's total contribution to the Plan was \$367,713. 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 is disclosed in the State of North Carolina's *Comprehensive Annual Financial Report*.

- B. Long-Term Disability** - The NCEL participates in the Disability Income Plan of North Carolina (DIPNC). Established by Chapter 135, Article 6, of the General Statutes, the DIPNC provides short-term and long-term disability benefits to eligible members of the Teachers' and State Employees' Retirement Fund. Long-term disability income benefits are advance funded on an actuarially determined basis using the one-year term cost method. For the fiscal year ended June 30, 2007, the NCEL made a contribution to fund disability benefits of 0.52% or \$50,319. Additional detailed information about the DIPNC is disclosed in the State of North Carolina's *Comprehensive Annual Financial Report*.

## NOTE 11 - LITIGATION

As of June 30, 2007, 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

Lottery Ticket Sales	\$885,575,273	
Fees, Licenses and Fines	4,520,298	
Investment Earnings and Other Revenues	8,544,200	
<b>Total Annual Revenue</b>	<b>898,639,771</b>	
Less Prize Tickets	(23,900,666)	3% of Total Annual Revenue
<b>Total Net Revenue</b>	<b>874,739,105</b>	
Prize Expense	(451,791,593)	51% of Total Annual Revenue
Advertising	(7,809,998)	1% of Total Annual Revenue
All Other Expenses and Transfers	(38,851,494)	
<b>Total Section 18C-162.a.3</b>	<b>(46,661,492)</b>	<b>5% of Total Annual Revenue</b>
Commissions (Per 18C-142)	(61,932,162)	7% of Lottery Ticket Sales
Unclaimed Prizes to NC Education Lottery Fund	8,036,895	
Net Revenues To NC Education Lottery Fund	306,316,963	
<b>Total Revenues to NC Education Fund</b>	<b>\$314,353,858</b>	<b>35% of Total Annual Revenue</b>

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

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

Additionally, in accordance with Section § 18C-142 of the NCEL Act, Compensation for lottery game retailers, "The amount of compensation paid to lottery game retailers for their sales of lottery tickets or shares shall be seven percent (7%) of the retail price of the tickets or shares sold for each lottery game."§ 18C-161. Types of income to the North Carolina State Lottery Fund.

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

As of September 19, 2007 the NCEL transferred \$311,810,846 for the year ended June 30, 2007 to the NC Education Lottery Fund. As explained in Note 4C, \$2,543,012 is the amount of the "Net Revenues" for Fiscal Year 2007 not yet transferred to the NC Education Fund as of June 30, 2007, but will be transferred during Fiscal Year 2008.

**NOTE 13 – SUBSEQUENT EVENT**

Subsequent to June 30, 2007, the 2007 General Assembly approved legislation to provide the NCEL with more flexibility in prize payouts. This change will enable the NCEL to secure more funds to support education in the coming year.

The legislation can be found in SL2007-323, H1473 2007 Appropriations Act, Section 5.2(c) G.S. § 18C-162.



**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 statement of net assets of the North Carolina Education Lottery (NCEL) as of June 30, 2007, and the related statements of revenues, expenses, and changes in fund net assets and cash flows for the year then ended, and have issued our report thereon dated October 15, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Internal Control over Financial Reporting**

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

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

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

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

**Compliance and Other Matters**

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

We noted certain matters that we reported to management of the NCEL in a separate letter dated October 15, 2007.

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.

Handwritten signature of Cherry Bekaert & Holland, C.P.A.

Raleigh, North Carolina  
October 15, 2007

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