

*North Carolina
Education Lottery
FY 2010 Annual Report*



On average, players of the North Carolina Education Lottery won almost \$2.3 million a day in prizes in 2010.



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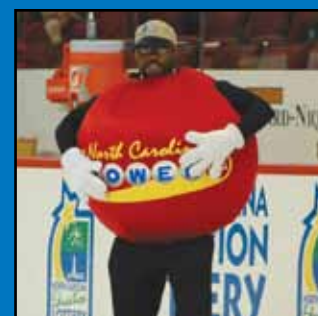
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HIGHLIGHTS OF FY2010

IN FISCAL YEAR 2010, THE N.C. EDUCATION LOTTERY...

- ... Made its largest cash transfer to education
\$419,463,000
- ... Awarded two more major jackpots
\$141 million Powerball jackpot
\$12 million Mega Millions jackpot
- ... Paid out record amount in prizes to players
\$840 million, about \$2.3 million a day
- ... Supported responsible playing
\$1 million for gambling addiction program
\$233,000 ad campaign on responsible play
- ... Built the largest retail sales team
6,212 retail locations
- Achieved highest sales ever
\$1.421 billion in ticket sales



NCEL STATE LOTTERY COMMISSION



Carla Archie
Charlotte
Senior Counsel,
Wells Fargo & Co.
Appointed by:
Gov. Mike Easley
Term: Jan. 9, 2009 –
Aug. 31, 2011



Norwood Clark
Raleigh
CPA
Appointed by:
Senate President Pro
Tem Marc Basnight
Term: Aug. 6, 2008 –
Aug. 31, 2013



Bill Dowdy
Raleigh
Retired, State Bureau
of Investigation
Appointed by:
Gov. Mike Easley
Term: Jan. 2, 2009 –
Aug. 31, 2011



**Bridget-Anne
Hampden**
Charlotte
President and CEO,
JHR & Associates LLC
Appointed by:
Senate President Pro
Tem Marc Basnight
Term: Sept. 22, 2005 –
Aug. 31, 2012



**Judge Marlene
Hyatt**
Waynesville
Retired Superior
Court Judge
Appointed by:
House Speaker
Joe Hackney
Term: Sept. 10, 2009 –
Aug. 31, 2013



Lawrence Spears
Raleigh
Owner and Broker,
Raleigh Investment
Real Estate
Appointed by:
Gov. Beverly Perdue
Term: March 20, 2009 –
Aug. 31, 2011



**Pamela
Whitaker**
Greensboro
President,
Key Resources Inc.
Appointed by:
Gov. Mike Easley
Term: Feb. 18, 2008 –
Aug. 31, 2012



**Robert Farris Jr.,
Chairman**
Wilson
Attorney,
Farris and Farris, P.A.
Appointed by:
Gov. Mike Easley
Term: Sept. 22, 2005 –
Aug. 31, 2013

Not pictured:
Max Cogburn
Asheville
Attorney,
Cogburn & Brazil
Appointed by: House
Speaker Joe Hackney
Term: Dec. 16, 2006 –
Sept. 7, 2010
Resigned to accept
Federal Judgeship.

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

COMMISSION CHAIR'S NOTE

I am pleased to report that your North Carolina Education Lottery continued to show strong growth in its fourth full year of operations despite our state's tough economic times. The Education Lottery ended the year recording the highest sales and producing the biggest return ever. Sales rose almost 10 percent, up to \$1.4 billion, and we contributed \$419 million in cash to education.

As we approach our fifth year anniversary, it is a good time to take a look at how the Education Lottery has become an institution in our state. Overall, 95 cents of every dollar spent on the lottery stays in North Carolina.

About 58 cents of every dollar is paid out to players who win prizes. In fiscal year 2010, the lottery paid out \$840 million in prizes, on average about \$2.3 million a day. We had some big winners too. Frank Griffin of Asheville became our third jackpot winner, winning \$141 million playing Powerball in February, and in May, Mike Manheim of Greensboro, became our fourth, taking home \$12 million playing our new jackpot game, Mega Millions. Some states with lotteries have never had a jackpot winner. Lucky North Carolina has already had four.

Seven cents of every dollar goes to our retailers. In FY10, that amounted to more than \$99 million in sales commissions to gas stations, convenience stores, grocery stores, and drug stores all across our state. North Carolina retailers can count on lottery sales as a reliable part of their business. We ended FY10 with 6,212 locations selling lottery tickets, a four percent increase from the year before.

But nothing is more important to us than increasing the amount of money we provide for education. Thirty cents of every dollar goes to the state, benefiting four specific education programs, including school construction, scholarships, More at Four, and teacher salaries.

The NCEL continues to get high marks for the way we handle the security of the games and the lottery's finances. For the second year in a row, the NCEL received a Certificate of Achievement for Excellence in Financial Reporting and an award for Outstanding Achievement in Popular Annual Financial Reporting from the Government Finance Officers Association of the United States and Canada. The NCEL now has received clean reviews in four of four financial audits and three of three security audits, plus our numerous and continuous internal audits.

After the year ended, we said good-bye to our first executive director, Tom Shaheen. Much of the success of the Education Lottery can be credited to Tom's leadership. He brought both a sense of fun and a sense of fair play to our lottery. Thanks to Tom, we've got a strong foundation to build on.

EXECUTIVE DIRECTOR'S NOTE



Alice Garland, deputy executive director for legislative and corporate communications, became acting executive director of the N.C. Education Lottery in August 2010 upon the resignation of the NCEL's first executive director, Tom Shaheen.

The record sales and return for education that the N.C. Education Lottery achieved in fiscal year 2010 serves as a tribute to the leadership of its first executive director, Tom Shaheen. Tom, the NCEL's first employee, got the lottery up and running in record time back in 2006 and led our first four and a half years of operations.

Tom's vision was that we have fun in this serious business of raising money for education in North Carolina, but that we keep concern for integrity and security ever present. Thanks to his leadership, talents and lottery savvy, we made this happen.

Tom was savvy about sales because he began his lottery career in sales. He understood the connection between ticket sales and prize payout for our instant games. He guided us patiently and purposely to increase prize payout, a strategy that increased overall sales and increased the return to education. In fiscal year 2010, sales topped out at more than \$1.4 billion and the cash contribution to education hit \$419 million.

Tom had a talent for marketing. He recognized the appeal a lottery ticket with North Carolina icon Ric Flair would have, negotiated a contract with Flair, and together they produced a hugely popular instant ticket. Flair appeared in a lottery commercial and attended marketing events at fairs and festivals. Players lined up to get Flair's autograph. Tom's intuition that this North Carolina icon would pay off for the lottery and for education proved solid.

As a leader, Tom taught us players should get the best value they could for every entertainment dollar they spend. The principle led to the design of extended play games and second chance drawings for non-winning tickets. Both increase a ticket's value. In FY10, our second chance drawing winners did particularly well. World Series of Poker® winner, Richard Taylor, one of 7,319 original entrants in the tournament, survived multiple rounds to win an additional \$31,647 as he finished as player No. 443. The Price is Right® second chance winner, Craig Roten, won a boat as he competed in the non-broadcast version of the show in Las Vegas.

Finally, Tom's national leadership on lottery issues paid off for North Carolina. He was an architect of the plan for Powerball states and Mega Million states to begin cross-selling their games. Just four short months after Mega Millions began here, we had our first jackpot winner, Mike Manheim. After watching the draw, his wife Faye said, "Baby, I think we won." The Manheim's win was \$12 million. Sales from the additional drawings each week have boosted lottery revenues.

All our successes in FY10 would not have happened without the great support of our retailers, our staff, and our NCEL Commission. And Tom Shaheen was there for all the action.



Tom Shaheen

Alice Garland



NCEL SENIOR STAFF

The senior leadership of the Education Lottery consists of the executive director, five deputy executive directors and twelve directors. The leaders in each of those positions are listed below and pictured from left to right in the photograph above.

- 1. Alice Garland**
Acting Executive Director and Deputy Executive Director,
Legislative and Corporate Communications
- 2. Deborah Doty**
Deputy Executive Director, Management Information
and Gaming Systems
- 3. Bill Jourdain**
Deputy Executive Director,
Finance, Administration and Security
- 4. Lou Ann Russell**
Deputy Executive Director,
Marketing and Advertising
- 5. Sam Hammett**
Deputy Executive Director, Sales
- 6. Terri Avery-Fowler**
Director, Sales
- 7. Michelle Lassiter**
Director, Finance
- 8. Quan Kirk**
Senior Director, Legal Services
- 9. Margaret Spindola-Bode**
Senior Director, Human Resources
- 10. Tony Chung**
Director, Management Information System
- 11. Susan Singley**
Director, Administration
- 12. Penny Railey**
Director, Marketing
- 13. Nikki Howard**
Director, Internal Auditor
- 14. Joe Norman**
Director, Gaming Systems
- 15. Walter Ingram,**
Director, Sales Development
- 16. Jerry Carter**
Director, Security
- 17. Van Denton**
Director, Corporate Communications



THE EDUCATION LOTTERY'S MISSION

Lotteries have a long history in North Carolina as a means to raise money for public projects. In 1759, proceeds from a lottery were used to build two Anglican churches in the state. Lottery dollars helped to complete the construction of South Building at the University of North Carolina at Chapel Hill in 1801.

In creating a state lottery in August 2005, North Carolina dedicated its proceeds to supporting four key parts of public education. Four times a year, the N.C. Education Lottery makes transfers to the state to support the following education initiatives.

1. Teacher salaries. Funds go to every school system in the state and are distributed on a per student basis. The funding, administered by the N.C. Department of Public Instruction, supports efforts to have a class size ratio of one teacher for every 18 students in grades K-3.
2. More at Four. Funds combine with general tax revenues to support a pre-school academic program for four-year-olds judged to be at risk of starting kindergarten behind their peers. The lottery dollars, administered by the Office of Early Learning within the N.C. Department of Public Instruction, cover the costs of about half the students in the program. More at Four slots are awarded to counties to cover eligible children who live there.
3. School construction. Funds are transferred to the Public School Building Capital Fund and then distributed to all 100 counties. In fiscal year 2009-10, each county received the same per-pupil share of the construction dollars. Each county decides how to use its school construction monies under a joint agreement of the local school board and county commissioners.
4. College scholarships. Funds go to provide scholarships to North Carolina universities and community colleges on a financial need basis. The program is administered by the N.C. State Education Assistance Authority. Students apply for education lottery scholarships by completing the Free Application for Federal Student Aid. Any student who qualifies for a federal Pell Grant will receive an education lottery scholarship.

In fiscal year 2010, the Education Lottery transferred \$419 million of its revenues to support these programs. The transfers brought the total amount for education since the start of the lottery to \$1.556 billion. Under the law, half of the lottery proceeds is split between teacher salaries and More at Four; 40 percent is allocated to school construction, and 10 percent for college scholarships. Through the end of fiscal year 2009-10, lottery funds have:

- Funded the salaries of 8,077 teachers in grades K-3
- Paid for 70,146 four-year-olds to attend the More at Four program
- Provided \$611 million for school construction across the state, a source of revenue that has helped many counties avoid raising property taxes to fund school capital projects
- Provided college financial aid to 91,257 students at state universities and community colleges



"School is expensive.... The North Carolina Education Lottery scholarship has made life at school not only easier, but possible. Having a scholarship means that I am getting to pursue my dreams."

*Drew Perrin, student,
UNC School of the Arts,
Winston-Salem, N.C.*

COUNTY TOTALS FY10

ALAMANCE	6,070,412	JOHNSTON	8,064,267
ALEXANDER	1,550,758	JONES	473,339
ALLEGHANY	518,323	LEE	2,923,344
ANSON	1,231,334	LENOIR	2,710,729
ASHE	1,135,339	LINCOLN	3,056,675
AVERY	751,885	MACON	1,383,288
BEAUFORT	2,046,965	MADISON	717,256
BERTIE	1,060,337	MARTIN	1,103,196
BLADEN	1,825,811	MCDOWELL	1,837,682
BRUNSWICK	3,607,302	MECKLENBURG	34,668,029
BUNCOMBE	7,346,940	MITCHELL	591,385
BURKE	4,319,942	MONTGOMERY	1,508,531
CABARRUS	8,410,641	MOORE	2,716,778
CALDWELL	3,348,070	NASH	4,502,245
CAMDEN	507,584	NEW HANOVER	7,225,378
CARTERET	2,295,556	NORTHAMPTON	913,596
CASWELL	826,944	ONSLow	6,892,987
CATAWBA	6,486,311	ORANGE	4,695,203
CHATHAM	2,359,056	PAMLICO	498,140
CHEROKEE	1,066,548	PASQUOTANK	1,702,540
CHOWAN	695,997	PENDER	2,245,677
CLAY	426,601	PERQUIMANS	515,069
CLEVELAND	4,924,132	PERSON	1,541,927
COLUMBUS	3,118,511	PITT	6,839,312
CRAVEN	3,820,760	POLK	821,621
CUMBERLAND	16,703,379	RANDOLPH	5,918,285
CURRITUCK	931,589	RICHMOND	2,322,952
DARE	1,345,042	ROBESON	7,918,895
DAVIDSON	6,752,064	ROCKINGHAM	3,751,172
DAVIE	1,923,353	ROWAN	5,641,365
DUPLIN	2,631,444	RUTHERFORD	2,968,221
DURHAM	8,258,777	SAMPSON	3,602,026
EDGEcombe	2,690,910	SCOTLAND	2,174,735
FORSYTH	13,372,851	STANLY	2,976,812
FRANKLIN	2,089,976	STOKES	2,074,327
GASTON	9,506,625	SURRY	3,269,903
GATES	502,537	SWAIN	654,803
GRAHAM	398,820	TRANSYLVANIA	954,519
GRANVILLE	2,237,173	TYRRELL	178,206
GREENE	1,022,427	UNION	9,856,265
GUILFORD	21,718,581	VANCE	2,102,694
HALIFAX	2,494,817	WAKE	34,283,258
HARNETT	4,878,022	WARREN	764,474
HAYWOOD	2,101,285	WASHINGTON	618,595
HENDERSON	3,476,333	WATAUGA	1,360,277
HERTFORD	1,153,996	WAYNE	5,989,714
HOKE	2,764,560	WILKES	3,365,011
HYDE	206,998	WILSON	3,217,694
IREDELL	6,569,557	YADKIN	1,741,050
JACKSON	1,042,924	YANCEY	671,982

North Carolina had its largest-ever Powerball jackpot winner, Frank Griffin of Asheville, claim a \$141.4 million prize in February 2010. Griffin is the state's third Powerball jackpot winner.



NEW JACKPOT WINNERS

Just months into the cross-sale era, the first jackpot-winning Mega Millions ticket in state history was sold in Greensboro for the May 28 drawing. Native North Carolinians Faye and Mike Manheim claimed their \$12 million prize at lottery headquarters in Raleigh. At a media event on July 7, Faye recounted what she said to her husband in the moments following the televised drawing: "Baby, I believe we won."

Mega Millions

FY10 Sales:
\$25,969,303.00

FY10 Prizes:
\$6,661,940.00

Just shy of four months before the Manheims' jackpot win, luck struck for a retired firefighter from Asheville – on a Powerball ticket worth a whopping \$141.4 million. While Frank Griffin's good fortune started with a ticket for the Feb. 6 drawing, he and his wife Loretta decided their unexpected win would benefit the community for years to come. Thanks to the Griffins' generosity, a state-of-the-art facility – with a price tag of more than half a million dollars – became possible for Enka High School in Candler. "For Enka softball, it's a homerun," said Frank Fraboni of WLOS-TV in Asheville. "The Powerball has snowballed into something special."

Another Powerball jackpot winner has committed a portion of his windfall toward the greater good. Jeff Wilson of Kings Mountain won \$88.1 million in the June 20, 2009 Powerball drawing. The Wilson Family Foundation established a grant to fund a monitoring program for individuals convicted of alcohol-related crimes. "It will allow us to more widely employ a proven tool in holding defendants accountable and improving community safety," said Mecklenburg Trial Court Administrator Todd Nuccio.



MEGA MILLIONS JOINS POWERBALL

History was made with the addition of Mega Millions to the NCEL's complement of games on January 31, 2010. The multistate game bears a strong resemblance to Powerball, with jackpots that can climb into the hundreds of millions and twice-weekly drawings. Before the introduction of Mega Millions, Powerball had been the sole jackpot game available in the Tar Heel State. North Carolina became one of 23 states to begin cross-selling tickets for the pair of multistate games in the fiscal year.

What better way to introduce the addition of a second "heavyweight" to the roster than to depict the giant jackpot games as sumo wrestlers? In the television spot, wrestlers painted blue (for Mega Millions) and red (for Powerball) were filmed facing off and gearing up to charge at one another. As they collide, a booming voiceover exclaims that four chances to win jackpot prizes each week is "mega-power fun."

The cross-selling program has proven to be a winner for beneficiaries, players, and retailers alike. Combined sales of Mega Millions and Powerball were nearly \$15 million greater for FY10 than sales of Powerball alone in FY09. That translated into a 7 percent boost to retailer commissions compared to totals for the previous year. In turn, these elevated figures contributed to increased returns to education and the strength of local businesses.



Powerball

FY10 Sales:
\$198,756,717.00

FY10 Prizes:
\$187,457,376.00

The addition of Mega Millions to the lottery's complement of games netted a 7% increase in jackpot game ticket sales for FY10 compared to the year before, driving record returns to education.



CAROLINA PICK 3

Carolina Pick 3 is once again giving Powerball stiff competition for the number two slot in online game sales. Carolina Pick 3 sales topped out at \$222,777,592. This was a 6 percent increase over FY09 and a 51 percent increase over FY08. Carolina Pick 3 sales now represent roughly 16 percent of total sales.

Triple numbers, a perennial player favorite, hit eight times during the year. The NCEL sees a spike in sales following every triple digit drawing, as well as more tickets reaching the liability limit of \$3 million. The Dec. 25, 2009 evening drawing resulted in a 5-5-5 combination and paid out a record-setting \$2,283,000.

Carolina Pick 3 and Carolina Pick 4 players have a different style of playing from the other three online games. Carolina Pick 3 players quick pick their numbers only six percent of the time, Carolina Pick 4 players 11 percent of the time and Carolina Cash 5 players use quick pick 65 percent of the time. As for jackpot-style games, Powerball players quick pick 73 percent of the time and Mega Millions players quick pick 78 percent of their tickets.



FY10

Pick 3 Sales:
\$222,777,592

Pick 3 Prizes:
\$110,440,310



FY10

Pick 4 Sales:
\$57,370,252

Pick 4 Prizes:
\$27,684,600

The first full year of Carolina Pick 4 resulted in \$57,370,252 in sales, accounting for roughly 4 percent of total sales in FY10. This figure is in line with the partial year sales from FY09, which were \$15,793,159 in the two and a half months after the game launched.

Carolina Pick 4 is a four-digit game where players pick a number between 0-0-0-0 and 9-9-9-9. Players have their choice of playing four different ways (Exact, Any, 50/50 or Combo) and can win from \$100 up to \$5,000 in cash prizes. It is not unusual to have twenty players a week win at the highest level of \$5,000.

The NCEL paid out 1,081 \$5,000 top prizes to "Carolina Pick 4" winners in FY10. A total of \$27,684,600 was paid out to "Carolina Pick 4" players, which is an average of \$532,396 per week.

CAROLINA PICK 4





CAROLINA CASH 5

Overall Carolina Cash 5 sales showed a slight increase over FY09, adding \$861,950 for a grand total of \$60,873,168 in FY10. Carolina Cash 5 represented four percent of total sales for the NCEL this year, dropping one percent from FY09.

One hundred and six players won the top prize in FY10 with 57 of those winning \$100,000 or more. The top prize was shared by multiple winners 16 times. Mark Hamlin of Charlotte won this fiscal year's largest top prize of \$688,283 in the Oct. 29, 2009 drawing. The top prize rolled 11 times to reach this amount, showing that Carolina Cash 5 gets exciting fast. The average top prize won in FY10 was \$160,934.

Carolina Cash 5 drawings occur nightly in concurrence with the Carolina Pick 3 and Carolina Pick 4 drawings.



FY10

Cash 5 Sales:
\$60,873,168

Cash 5 Prizes:
\$29,335,273



WRAL-TV in Raleigh is the official lottery draw station. The nightly draw is televised live from the studio. The mid-day draw is taped and available to players to view at www.wral.com shortly after the draw. In addition to WRAL, our statewide drawing station network includes WITN-TV in Greenville, WILM-TV in Wilmington, WXLV-TV in Winston-Salem and WYCW-TV in Western North Carolina.

INSTANT TICKETS

Instant tickets continued to be the NCEL's largest revenue category for FY10 at 60 percent of total game sales. Instant sales of more than \$855 million posted a 7.1 percent increase over FY09 and helped drive a 9.9 percent increase in total sales. In all, 93 major prizes of \$100,000 to \$3 million were awarded to instant winners across the state throughout the year as well.

FY10 was a year of firsts for instant tickets and none were bigger than the October debut of "\$200 Million Extravaganza" – the herald of \$20 games in North Carolina. Besides offering players a shot at five top prizes of \$3 million and ten chances to win \$1 million, the game featured the best overall odds of winning and the largest total payout of any NCEL game to date. Its popularity among players netted more than \$221.4 million in sales, which in turn shifted instant game percentage shares at other price points for the year.

Tickets such as "Mega Bucks" led \$5 games to the largest share of annual instant ticket sales at 29 percent. The return of "Cash Spectacular" and the introduction of "\$500,000 Jackpot" pushed the \$10 echelon to a 21 percent stake. The \$20 instant ticket price point – represented entirely by "\$200 Million Extravaganza" – carved out 18 percent of sales on its own. The category was rounded out by \$1, \$2 and \$3 games which amounted to 32 percent of instant tickets sold.

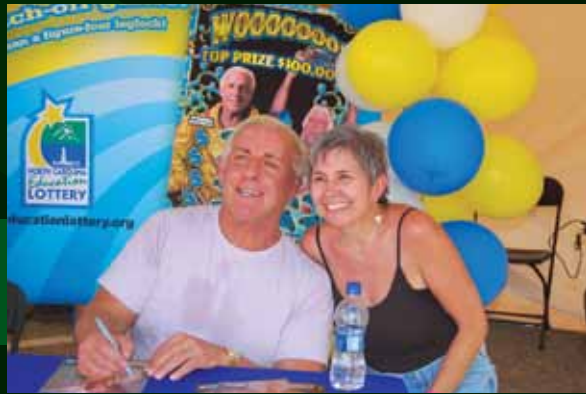
The unveiling of "Wooooooo!" – the first lottery ticket anywhere to feature the likeness of pro wrestler Ric Flair – headlined as the year's most famous first. True to the achievements of the legendary grappler from North Carolina, the \$5 game was also a top performer with net sales of more than \$15.5 million. Other standout games on the performance index included the \$1 game "Stocking Stuffer" and the \$3 game "Match & Win" which yielded sales of more than \$5.9 million and \$10.2 million respectively.

Online became the sole mode of entry for second-chance drawings in FY10. In November, "Super Monopoly" ushered North Carolina players into an era of playable online games that represented additional entries into a second-chance drawing for a single non-winning ticket. Other branded games that attracted second-chance entries were reissues of "Mustang Fever" and "Harley-Davidson®" as well as first runs of "The Price is Right®" and "World Series of Poker®." Second-chance drawings via online entry proved popular with players; more than 1.2 million such entries were made.



FY10 instant ticket sales were up 74% since FY07.





facebook.com/
nc.educationlottery.org



twitter.com/
nc.educationlottery.org

Launching in the fall of 2009, the NCEL's social media program became a new way to exchange information with the public. More than 6,000 players joined the conversation in the fiscal year.

NCEL GETTING THE WORD OUT

The excitement of sporting events. The spirit of regional festivals. The popularity of name brands and social media websites. NCEL marketing and advertising elaborated on traditional methods and leveraged emerging mediums to bring the fun of lottery games to people across the state in FY10.

The most significant development of the year to highlight was the addition of Mega Millions to the NCEL's complement of games. Similar to Powerball in many ways, two drawings per week give Mega Millions players the chance to win multi-million dollar jackpots. Television, radio and point of sale materials with the tagline "More Fun Than One!" were disseminated to introduce North Carolina players to the new game.

The campaign to promote "\$200 Million Extravaganza" – North Carolina's first-ever \$20 game – made "the big ticket" a big hit. Marketing and advertising touted the unprecedented qualities the game had to offer players: the best overall odds of winning and the largest payout of any game to date. The game launched on October 6 with five top prizes of \$3 million and ten chances to win \$1 million, plus millions of dollars in other prizes.

Promotions revolving around the Ric Flair-themed scratch-off game attracted legions of fans to the NCEL booth at the Cleveland County Fair, Dixie Classic Fair and Morehead City Seafood Festival. Lines stretched down the street and around the corner as people waited for hours to get an autograph and photo with the professional wrestling legend from Charlotte. The ticket, named "Wooooooo!" after Flair's signature yell, was the first lottery game anywhere to bear the champion's legendary likeness.

Sports partnerships were a focus and success yet again. Many thousands of sports fans experienced the brand in person at events by way of minor league baseball and hockey games; athletic sponsorships with CIAA basketball, Wake Forest and Duke Universities; and professional contests featuring the Carolina Hurricanes and Charlotte Bobcats. In all, the NCEL implemented 28 events and sponsorships, resulting in over 145 on-site sale date opportunities to increase exposure and brand recognition, as well as drive awareness and knowledge of games.

For a third straight year, the NCEL sponsored the North Carolina Education Lottery 200 at the NASCAR® Camping World Truck Series, at Charlotte Motor Speedway, part of the NASCAR® Sprint All-Star Race Weekend. Two lucky fans won the opportunity to participate as the honorary starter and grand marshal for the race, and joined the Mega Millions and Powerball mascots on pit row – and on the track – before the action got underway.

A greater selection of branded game offerings relied on expanded support for product launches, second chance drawings and winner events. At locations across North Carolina, communications conducted presentations where "Mustang Fever" and "Harley-Davidson®" winners accepted the keys to their brand-new wheels. Grand prize winners of "The Price is Right®" and "World Series of Poker®" travelled to the bright lights of Las Vegas for chances to win even bigger prizes.

The NCEL began sharing and receiving information with players through social media channels to advance broader marketing, advertising and communications objectives. Twitter followers got instant updates about where winning tickets were recently sold while players commented, asked questions, and watched videos of big winners share the details of their good fortune on Facebook. The ensuing conversation grew at a healthy pace; the NCEL's combined social media audience surpassed 6,000 by close of the fiscal year.

From the mountains to the coast of North Carolina, 28 events and sponsorships were implemented, resulting in over 145 on-site sale date opportunities.

The NCEL began installations of its first Lottery To Go Machines, or LTGs, in FY2010. The machines are self-service kiosks that dispense instant scratch-off tickets as well as Quick Pick tickets for Powerball, Mega Million and Carolina Cash 5 using a touch screen. Players also can use play slips at the machines to play their own numbers for Carolina Pick 3, Carolina Cash 4, Carolina Cash 5, Powerball and Mega Millions. Players must scan their drivers' licenses to ensure they are 18 or older before they can buy lottery tickets from the machines. The first LTG was installed on March 30, 2010 in Realo Drugs in Kinston and others were later installed at eight BJ's Warehouse Clubs and a Walgreens in Maxton.



RETAILER SPOTLIGHT

Cross Road Express, Durham

Cross Road Express may be a small store in square footage, but thanks to their positive attitude about the North Carolina Education Lottery, they are very big in sales. Players are greeted by the NCEL point of sale plastered service counter and lottery dispensers as soon as they enter the store. The location started selling lottery in 2007, with 12 dispensers. Today they have 36 dispensers and are one of the top selling retailers in Durham.

Due to their outstanding sales, the location recently received an Enterprise Series Multimedia Monitor, which is a color video screen that, when attached to a licensed NCEL terminal, displays an array of player-centered information. The staff is excited to have it as another POS option in their store as it allows regular lottery customers to enjoy checking daily winning numbers, daily jackpots and viewing game information without standing in line.

Nick Desai, the store's owner, doesn't miss the opportunity to ask every customer if they would like to purchase a lottery ticket. They know their players by name and believe that, by cashing winning tickets, their players will return regularly to purchase gas and other products. The store also posts winning tickets redeemed in their location so players will see them as a lucky location. All of Cross Road Express' efforts add up to strong sales and great customer relationships.

OUR WINNING RETAILERS

The partnership between the NCEL and its retailers is invaluable to the success of the lottery. The lottery retailers are on the front line everyday providing the service of selling tickets, cashing out winning tickets under \$600 and helping players understand the games.

One of the key factors behind the NCEL's record year in ticket sales was the growth in the number of retailers across the state. The number of retailers grew from 6,000 on June 30, 2009 to 6,212 on June 30, 2010. Each new retail location generates sales each week, so as the base of retailers grows so does the number of tickets sold.

Retailers receive a 7 percent commission for selling lottery tickets. The total commissions paid out to retailers in FY10 were \$99,339,829. The average commission paid to retailers was \$15,919. Many retailers find that their lottery sales become a reliable source of revenues for their businesses.

Fiscal year 2010 also brought a technological advance to many NCEL retailers as the NCEL added a new multimedia display – called Enterprise Series Multimedia Display or "ESMM" for short – capable of showing digital streaming content featuring customized lottery announcements. More than 3,000 of the displays were installed in retailers across the state, with more scheduled for installation in FY11.

The slide show presentation allows lottery players at retail locations to easily get such information as:

- Jackpot amounts
- Winning numbers
- New game announcements
- Big winner spotlights
- Beneficiary information
- Amber Alerts

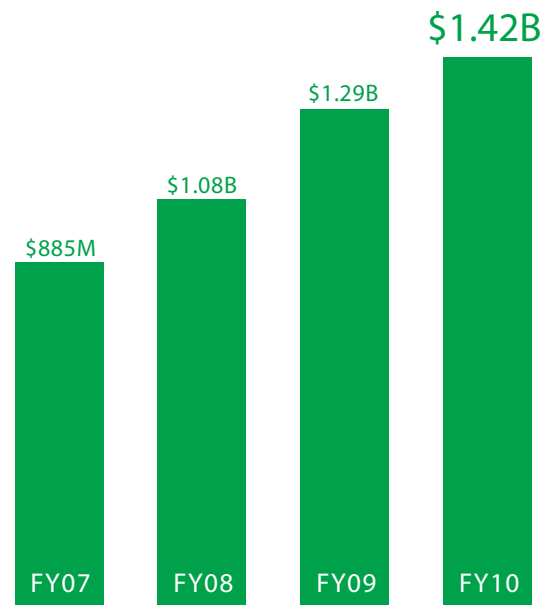


Finally, in FY10 the NCEL began a retailer incentive program. The program rewards retailers for selling online game tickets that result in a certain monetary prize threshold. Incentives are pari-mutuel and are shared equally if there is more than one selling retailer.

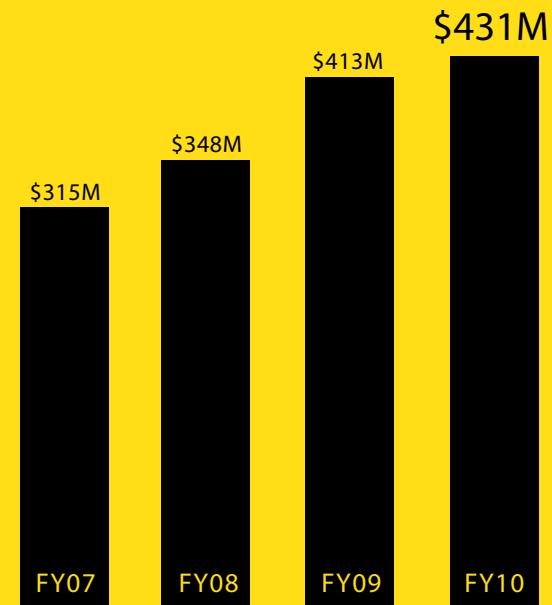
TOP 20 SALES FY10

- | | |
|--|---------------------|
| 1. <i>Rose Mart #14</i> | <i>Wilson</i> |
| 2. <i>Reilly Road BP Amoco</i> | <i>Fayetteville</i> |
| 3. <i>Raceway</i> | <i>Tarboro</i> |
| 4. <i>Tony's Friendly Mart #1</i> | <i>Kinston</i> |
| 5. <i>Catamount Travel Center</i> | <i>Whittier</i> |
| 6. <i>O'Ryans Quik Stop</i> | <i>Roxboro</i> |
| 7. <i>The Food Mart #17</i> | <i>Raleigh</i> |
| 8. <i>Bobby Taylor Oil #2</i> | <i>Fayetteville</i> |
| 9. <i>C Mini Mart #3</i> | <i>Raleigh</i> |
| 10. <i>Ponderosa Exxon</i> | <i>Fayetteville</i> |
| 11. <i>Carlton's Tanglewood</i> | <i>Clemmons</i> |
| 12. <i>Fairway One Stop #21</i> | <i>Greensboro</i> |
| 13. <i>Bobby Taylor Oil #4</i> | <i>Fayetteville</i> |
| 14. <i>Church St Convenience Mart</i> | <i>Rocky Mount</i> |
| 15. <i>Value Mart</i> | <i>Sanford</i> |
| 16. <i>Cigarettes & More</i> | <i>Charlotte</i> |
| 17. <i>Kangaroo Express #3077</i> | <i>Rocky Mount</i> |
| 18. <i>Cross Road Express</i> | <i>Durham</i> |
| 19. <i>The Border Station</i> | <i>Moyock</i> |
| 20. <i>Spring Forest BP/Fiddlestix</i> | <i>Raleigh</i> |

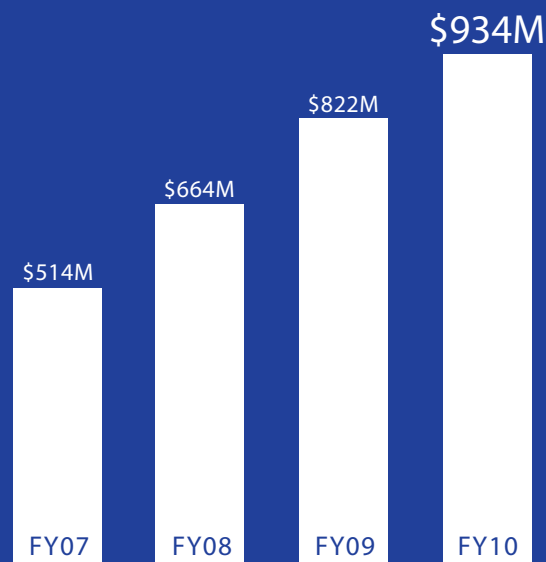
PERFORMANCE COMPARISON



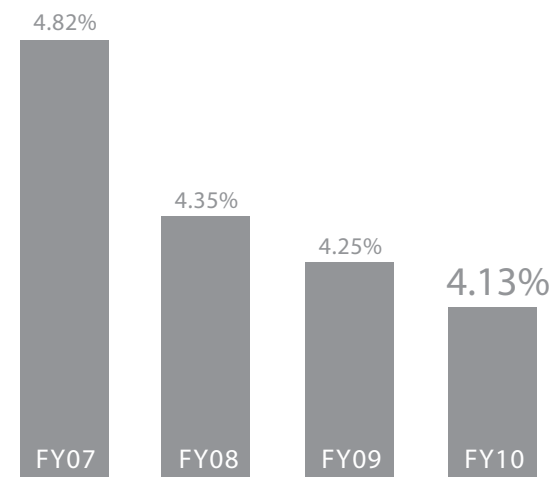
ANNUAL SALES



BENEFICIARY FUNDS



PRIZES & COMMISSIONS

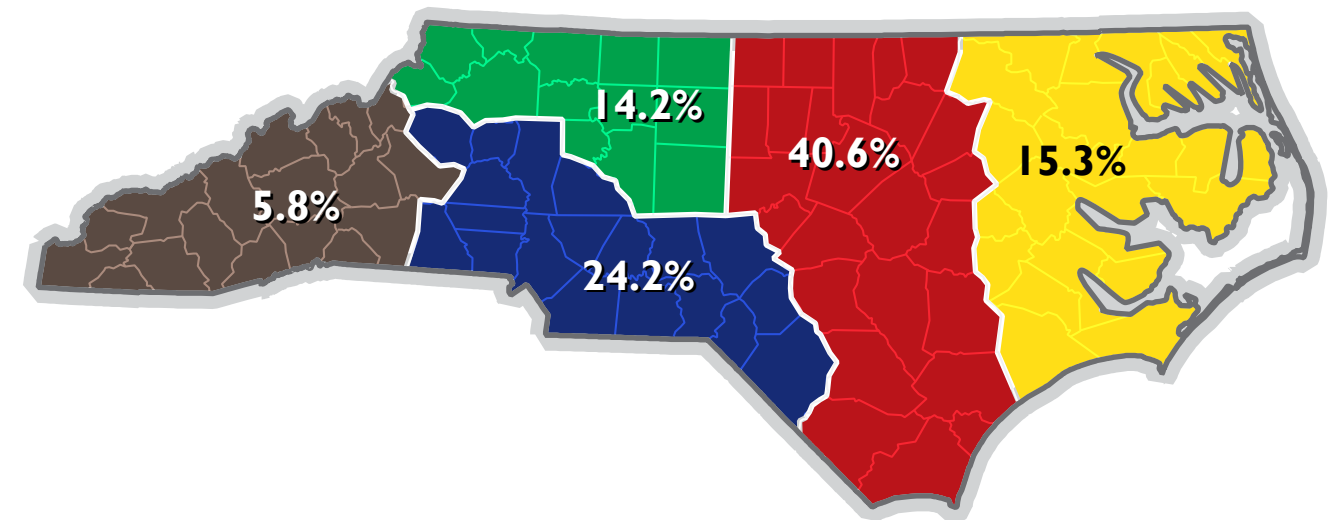


EXPENSES

BENEFICIARY FUNDS FIGURES ARE INCLUSIVE OF NET REVENUES AND UNCLAIMED PRIZES TO THE STATE. EXPENSES ARE REPRESENTED AS A PERCENTAGE OF TOTAL REVENUE. COMPREHENSIVE DATA FOR THESE CHARTS IS AVAILABLE IN THE FINANCIAL SECTION OF THIS ANNUAL REPORT.

SALES BY REGION

	ASHEVILLE	GREENSBORO	CHARLOTTE	RALEIGH	GREENVILLE	TOTAL
INSTANT	59,446,430.00	125,137,857.00	223,129,941.00	331,587,068.00	116,264,771.00	855,566,067.00 (60.20%)
POWERBALL	13,624,430.00	30,966,901.00	58,978,795.00	74,043,944.00	21,142,647.00	198,756,717.00 (13.98%)
MEGA MILLIONS	1,660,284.00	4,189,172.00	7,339,630.00	9,911,967.00	2,868,250.00	25,969,303.00 (1.83%)
PICK 3	3,275,734.50	24,008,148.00	29,920,696.00	110,591,203.00	54,981,810.50	222,777,592.00 (15.67%)
PICK 4	1,061,218.00	7,302,044.50	9,169,792.00	26,531,611.00	13,305,586.50	57,370,252.00 (4.04%)
CASH 5	3,493,330.00	9,728,641.00	15,454,995.00	23,796,767.00	8,399,435.00	60,873,168.00 (4.28%)
TOTAL	\$82,561,426.50	\$201,332,763.50	\$343,993,849.00	\$576,462,560.00	\$216,962,500.00	\$1,421,313,099.00



SALES BY CATEGORY

	INSTANT	POWERBALL	MEGA MILLIONS	PICK 3	PICK 4	CASH 5	RAFFLE	TOTAL
FY10	855,566,067.00	198,756,717.00	25,969,303.00	222,777,592.00	57,370,252.00	60,873,168.00		1,421,313,099.00
FY09	798,676,404.00	209,746,679.00		208,883,766.00	15,793,159.00	60,011,218.00		1,293,111,226.00
FY08	635,880,115.00	229,255,174.00		147,158,304.00		58,516,249.00	7,369,240.00	1,078,179,082.00
FY07	490,564,474.00	258,967,883.00		89,541,216.50		36,501,699.00	10,000,000.00	885,575,272.50
FY06	202,204,737.00	27,317,594.00						229,522,331.00
TOTAL	\$2,982,891,797.00	\$924,044,047.00	\$25,969,303.00	\$668,360,878.50	\$73,163,411.00	\$215,902,334.00	\$17,369,240.00	\$4,907,701,010.50



COMMUNITY PROGRAMS

The N.C. Education Lottery has several programs and initiatives where it uses its resources to help out in the community. They include:

- Play Responsibly Program. Each lottery ticket carries the play responsibly message and provides an 800 number for a state-operated problem gambling hotline. The Education Lottery provides \$1 million a year to the state Department of Health and Human Services to operate its problem gambling program. The program is open to anyone in North Carolina with a gambling problem. DHHS reports annually to the North Carolina Education Lottery Commission regarding the use of this program. The NCEL also promotes Play Responsibly during Problem Awareness Week.
- No sales to minor education efforts. Sales of lottery tickets to minors under the age of 18 are not allowed in North Carolina. NCEL emphasizes that message to its retail partners through its sales efforts and through its public communications initiatives. Those efforts include issuing media releases with public reminders about the no sales to minors law, training retailers who sell lottery tickets to check IDs and supporting the annual campaign of the National Council on Problem Gambling and the International Centre for Youth Gambling Problems and High Risk Behaviors at McGill University to emphasize that lottery tickets should not be purchased as holiday gifts for minors.
- Amber Alerts. Lottery terminals across the state carry Amber Alerts whenever they are issued as part of the NCEL's partnership with the N.C. Center for Missing Persons. The partnership means that more than 6,200 retailers who sell lottery tickets get Amber Alert messages on their lottery terminals. Retailers are asked to print out the Amber Alert and post it at their stores. A full screen, rotating Amber Alert message also appears on the multimedia displays at many lottery retailers where customers can see them. Amber Alerts also are posted on the homepage of the N.C. Education Lottery's website.



Independent Auditors' Report

To the Commissioners
North Carolina Education Lottery
Raleigh, North Carolina

We have audited the accompanying statements of net assets of the North Carolina Education Lottery (NCEL), a major enterprise fund of the State of North Carolina as of June 30, 2010 and 2009, and the related statements of revenues, expenses and changes in fund net assets and cash flows for the years then ended. These financial statements are the responsibility of the NCEL's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Note 2, the financial statements present only the NCEL and do not purport to, and do not, present fairly the financial position of the State of North Carolina, as of and for the years ended June 30, 2010 and 2009, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In 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, 2010 and 2009, and the respective changes in its financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 9, 2010 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.

As discussed in the notes to the financial statements, management has recorded certain annuity contracts in the prior year in which management has determined that the legal liability for the pay out of those contracts still rests with the NCEL. Accordingly, assets and liabilities for the year ended June 30, 2009 have been restated to properly reflect the annuity contracts.

The management's discussion and analysis is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

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

Cherry, Bekert + Holland L.L.P.

Raleigh, North Carolina
November 9, 2010

North Carolina Education Lottery

Management's Discussion & Analysis - June 30, 2010 & 2009

The following is a discussion and analysis of the financial performance of the North Carolina Lottery Commission [aka, North Carolina Education Lottery (NCEL) for the fiscal years ended June 30, 2010, 2009 and 2008 and should be read in conjunction with the transmittal letter and the financial statements, including the footnotes. This report consists of three parts: management's discussion and analysis, the basic financial statements and the notes to the financial statements. Included below and on the following pages are the financial highlights, summary of contributions to the state, and summary results of operations for years ended June 30, 2010, 2009 and 2008.

Financial Highlights

For fiscal year 2010, gross ticket sales again surpassed \$1 billion totaling \$1.421 billion representing a \$128.2 million increase over 2009. Total revenues earned for the state were \$431 million, which represented an increase of \$19 million over fiscal year 2009. Other significant financial highlights include the following:

- § 18C-164 (a) requires the NCEL to transfer net proceeds from operations and any prior year surplus to the State Education Lottery Fund four times a year. In fiscal year 2010 the sum total of these four cash transfers was \$419.5 million, the largest annual total for cash transfers in NCEL's history. Total cash transfers for fiscal years 2009 and 2008 were \$417.3 million and \$350.9 million respectively.
- We launched our second multi-state game, Mega Millions on January 31st.
- Awarded jackpots to two more North Carolinians in multi-state online games, bringing the total number of jackpot winners to four.
- Awarded \$1 million or more to a NCEL player for the 77th time.
- This year we increased the number of retailers to 6,267, representing a 4% increase over the prior year, and provided service to our retailers on a regular basis.
- We created 42 new instant scratch-off games and released them every two to four weeks.

Overview of the Financial Statements

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

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

Included in this report are the Statements of Net Assets as of June 30, 2010 and 2009, the Statements of Revenues, Expenses, and Changes in Fund Net Assets for the periods ended June 30, 2010 and 2009, and the Statements of Cash Flows for the periods ended June 30, 2010 and 2009. As established in House Bill 1023, Section 18C-164, the NCEL transfers its net assets to the Office of State Budget and Management (OSBM) for credit to the State's Education Lottery Fund. Education Lottery Funds are distributed by OSBM in the following manner:

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

Total Assets

Total assets at the end of fiscal year 2010 were \$82 million compared to \$76 million at the end of fiscal year 2009, representing an increase of \$6 million.

Current assets decreased from \$62 million in 2009 to \$56 million in 2010, representing a decrease of \$6 million. This decline resulted from a decrease in the State Treasurer's Security Lending Collateral, more detailed information can be found in Note 2D in the financial statements. The decrease was partially offset by increases in accounts receivable in 2010 from 2009. This primarily represents amounts due from retailers for settlement of packs of tickets less commissions and prizes paid by the retailers. The increase is essentially due to the timing of the end of the accounting week for billing and collections from our retailers at year end. Electronic Funds Transfer is used to collect receivables weekly from retailer bank accounts that are set up in trust for the NCEL.

Current assets were also affected by a \$5.5 million increase in cash and cash equivalents and a \$1.05 million increase in investments in annuity contracts.

The Short Term Investment portfolio has the general characteristics of a demand deposit account in that participants may deposit additional cash at any time and may withdraw cash at any time without prior notice or penalty. All deposits are combined with other State agencies and invested by the State Treasurer until needed to cover disbursements. Investments are limited to those authorized for the State's General Fund, pursuant to NC General Statute 147-69.1. Interest earned of \$1.48 million on these balances is recorded as non-operating revenue. Earnings on the accounts are credited on a monthly basis. The allocable share of the revenues arising from State Treasurer's Securities Lending Collateral program transactions are also included as non-operating revenue.

The NCEL's investment in capital assets, net of accumulated depreciation in 2010 was \$1.2 million which is approximately \$71,000 lower than 2009. The majority of capital asset investments were during our first full year of operation in 2007. The investment in capital assets includes game equipment, data processing equipment, telephone equipment, software and fixtures. The capitalization of all items including equipment, computers, and furniture follows 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.

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

The activity for capital assets for the year ended June 30, 2010 was (in thousands):

Category	Balance July 1, 2009	Increases	Decreases	Balance June 30, 2010
Capital assets, depreciable				
Furniture	\$ 29	\$ -	\$ -	\$ 29
Equipment	2,606	529	(482)	2,653
Motorized equipment	67	-	-	67
Total capital assets, depreciable	2,702	529	(482)	2,749
Less accumulated depreciation for:				
Furniture	18	5	-	23
Equipment	1,336	564	(465)	1,435
Motorized equipment	38	14	-	52
Total accumulated depreciation	1,392	583	(465)	1,510
Total capital assets, depreciable, net	1,310	(54)	(17)	1,239
Capital assets, net	\$ 1,310	\$ (54)	\$ (17)	\$ 1,239

Total Liabilities

Total current liabilities for the NCEL were \$56 million in 2010 decreasing by \$6.1 million from 2009. The reduction in current liabilities mainly resulted from decreases in the State Treasurer's Security Lending Collateral. Current liabilities also consist of annuity installment prizes due to be paid in the next fiscal year; trade payables to vendors, prize awards payable, and other payables.

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

Beginning	Earned	Used	Ending	Current Liability	Long Term Portion
\$ 1,274	\$ 1,135	\$ 1,316	\$ 1,093	\$ 65	\$ 1,028

Noncurrent liabilities also includes the present value of the annuity contracts that fund the long term installment prizes that are due to NCEL annuity prize winners that will be paid after June 30, 2011.

Net Assets and Changes in Net Assets

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

Condensed Statement of Net Assets (in thousands)			
	2010	2009	2008
ASSETS			
Total Current Assets	\$ 55,881	\$ 62,068	\$ 79,843
Noncurrent Assets	26,246	13,728	5,864
Total Assets	82,127	75,796	85,707
LIABILITIES			
Total Current Liabilities	56,092	62,147	80,235
Noncurrent Liabilities	26,035	13,649	5,472
Total Liabilities	82,127	75,796	85,707
NET ASSETS			
Invested in Capital Assets	1,239	1,310	1,487
Unrestricted Net Assets	(1,239)	(1,310)	(1,487)
Total Net Assets	\$ -	\$ -	\$ -

Current liabilities consist of "Due to Other Funds" in the amount of \$18.1 million. This amount represents the remaining amount of the "Net Revenues" for Fiscal Year 2010 not yet transferred to the State of North Carolina as of June 30, 2010, but will be transferred to the state during Fiscal Year 2011. Also included, \$45 thousand due other state agencies for services provided to the NCEL. Additional information on the Due to Other Funds is found in Note 6D to the financial statements.

Revenues

Operating revenues consist of gross sales, fees and licenses.

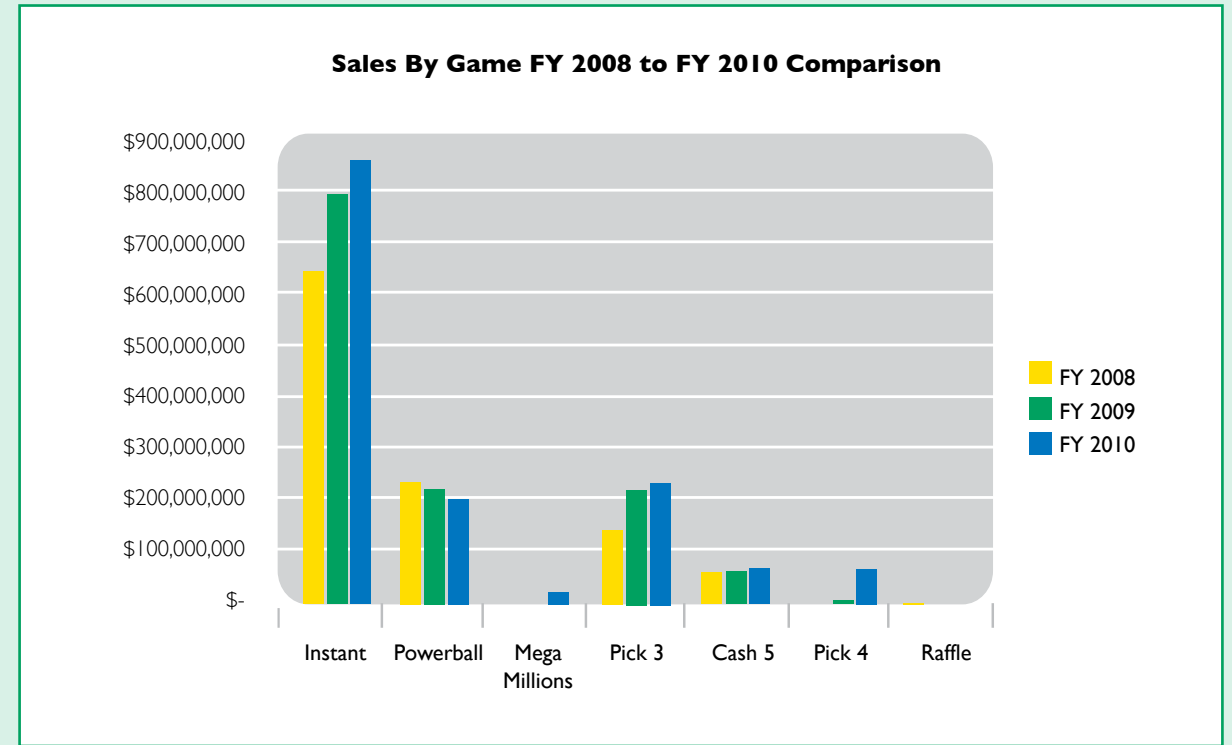
Sales

Total gross lottery ticket sales for the fiscal year 2010 were approximately \$1.421 billion as compared to \$1.293 billion in fiscal year 2009. This represents an increase of over \$128 million from 2009 and \$343 million over 2008.

Gross instant ticket sales increased significantly during fiscal year 2010 to \$855.6 million, up \$56.9 million over fiscal year 2009 and \$217.7 million over fiscal year 2008. The 7.1% increase over fiscal year 2009 realized in fiscal year 2010 is attributable to several factors. The NCEL launched its first \$20 Instant Scratch-off mega game; \$200 Million Extravaganza, with a prize payout of 75% which generated over \$150 million in sales during fiscal year 2010. The NCEL released several very successful licensed games during the year: The World Series of Poker Instant Scratch-Off was introduced and provided players the chance to win a grand prize trip package including a seat at the 2010 WSOP® Main Event. The NCEL launched its Price is Right Instant Scratch-Off licensed game, which awarded players the opportunity to travel to Las Vegas and play in an un-televised version of the popular game show. In addition, the NCEL partnered with former professional wrestler and North Carolina icon Ric Flair to release the "Woool!" Instant Scratch-Off game, which proved to be a great success.

On-line sales during fiscal year 2010 grew to \$566 million, a \$71.3 million increase over fiscal year 2009 and a \$123.4 million increase over fiscal year 2008. On-line sales benefited from four jackpots over \$200 million for Powerball during the year. The largest single sales day for Powerball was August 19, 2009 with sales of \$3.8 million. The NCEL also commenced selling Mega Million tickets on January 31, 2010, with total sales of \$25.9 million during 2010. The Carolina Cash 5 top prize exceeded \$1 million for the first time in March, resulting in an increase in on-line sales. The NCEL launched its newest daily online game, Carolina Pick 4 last year, which had sales of \$15.8 million to the end of the fiscal year. With Carolina Pick 4 in place for the entire year in 2010 its sales increased to \$57.3 million.

The following chart depicts the distribution of sales by product for the fiscal years ending June 30, 2010, 2009 and 2008.

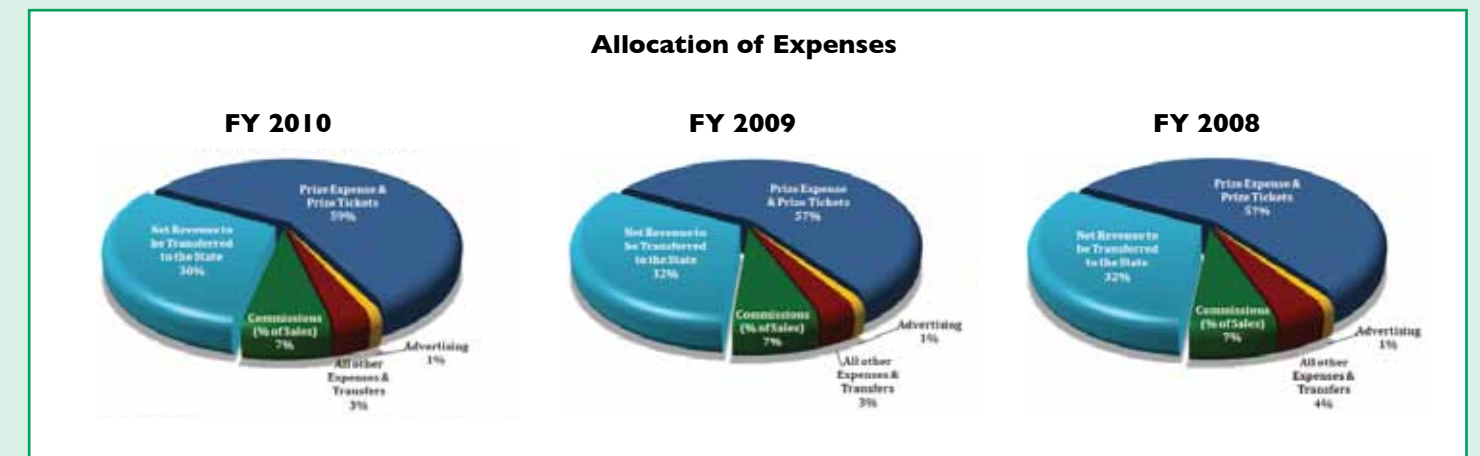


Nonoperating Revenues consist of investment earnings from the Short Term Investment Fund held at the State Treasurer's Office, Multi-State Lottery Association (MUSL) dividends received, and proceeds from the sale of start-up and other marketing materials to other state lotteries.

Expenses

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

The following charts show the major components of NCEL operating expenses and transfers as a percentage of total revenues for the June 30, 2010, 2009 and 2008 fiscal years:



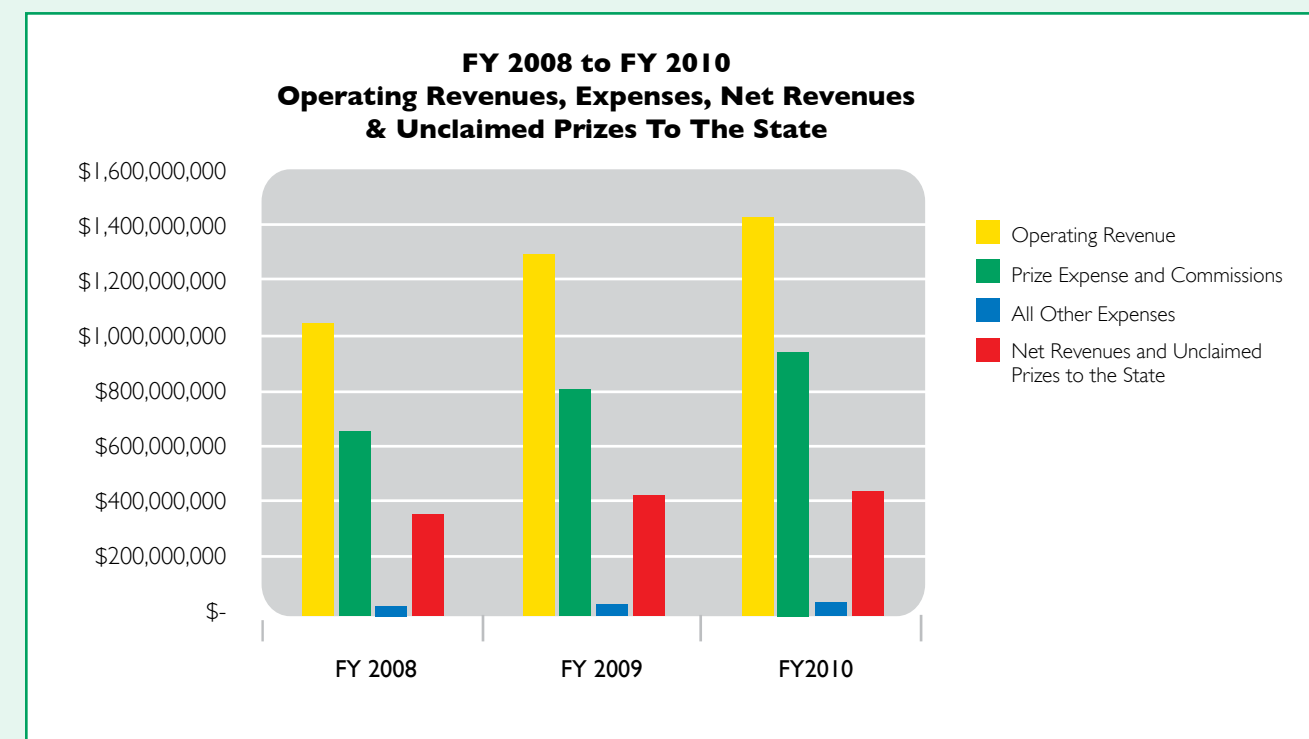
Note: Commissions percentage is calculated based on the percent of Sales (all others calculated based on percentage of Total Revenue) per G.S. 18c; therefore may not equal 100%.

Prizes, commissions and gaming vendor charges all directly relate to sales. As expected, as sales have increased so have these expenses. In fiscal year 2010 total gaming expenses which consist of prizes, retailer commissions and gaming vendor charges (gaming system services) totaled \$957 million as compared to \$843 million and \$681 million in fiscal years 2009 and 2008 respectively. Other operating expenses, which consist of advertising and marketing, salary and benefits, professional fees, rent, maintenance, bad debt, depreciation and general administrative expenses increased to \$36.6 million in fiscal year 2010 as compared to \$34.1 million and \$28.5 million in fiscal year 2009 and 2008 respectively. Other operating expenses represented 2.6%, 2.7% and 2.7% of total operating revenues in fiscal years 2010, 2009 and 2008 respectively.

Condensed Statement of Revenues and Expenses (in thousands)

	2010	2009	2008
Operating Revenues:			
Gross Sales:	\$ 1,421,313	\$ 1,293,111	\$ 1,078,179
Less: Prize Tickets	(1,309)	(9,580)	(29,733)
Less: Sales/Service Bad Debt	(405)	(91)	(97)
Fees and Licenses	4,859	4,663	4,782
Total Operating Revenues	1,424,458	1,288,103	1,053,131
Operating Expenses:			
Gaming Expenses:			
Lottery Prizes	835,302	731,690	588,485
Retailer Commissions	99,340	90,366	75,371
Gaming Systems Services	22,639	20,599	17,286
Total Gaming Expenses	957,281	842,655	681,142
Other Operating Expenses	36,608	34,135	28,504
Total Operating Expenses	993,889	876,790	709,646
Operating Income	430,569	411,313	343,485
Nonoperating Revenues (Expenses):			
Investment Earnings, Nonoperating Revenue (Expense) and Compulsive Gambling Contribution	1,636	2,616	4,825
Net Revenues and Unclaimed prizes to the State	(432,205)	(413,929)	(348,310)
Total Nonoperating Revenue (Expenses)	(430,569)	(411,313)	(343,485)
Net Income	-	-	-
Net Assets	\$ -	\$ -	\$ -

From fiscal year 2008 to fiscal year 2010, the NCEL has achieved year over year increases in revenues and transfers to the State. The following graph depicts these trends.



Budget and Economic Outlook

On June 16, 2010, the Commission approved the Fiscal Year 2011 budget for the NCEL to provide a projected \$441 million to the State's Education Lottery Fund. This projected budget is a 5% increase over the fiscal year 2009 budget of \$419 million for transfer to the State's Education Lottery Fund. The NCEL will continue to monitor the current economic conditions in the State of North Carolina, and its impact on lottery ticket sales. As per the General Assembly Fiscal Research Division: "The nation is coming out of the longest, sustained period of economic contraction since the depression of the 1930's. Given the length and severity of the recession, one might expect a robust recovery similar to what occurred coming out of the 81-82 recession (6% growth). We are unlikely to see that type of robust expansion anytime soon because of the structural problems that sent us into a recession; housing and financial, take much longer to correct and are historically followed by a much slower, prolonged recovery phases." Also "A quarter-over-quarter improvement in the economy is expected, albeit at a slow rate. During this phase of the recovery the capacity of the economy to absorb any new shocks regardless of the origin could cause the growth to stall and possibly lead to another contraction." Therefore, the NCEL has constructed a conservative budget and sales forecast for the upcoming fiscal year.

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

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

Requests for Information

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

Statements of Net Assets (in thousands) - June 30, 2010 & 2009

	2010	Restated 2009
ASSETS		
Current Assets:		
Cash and Cash Equivalents:		
Cash	\$ 96	\$ 119
Pooled Cash	38,664	33,124
Receivables:		
Accounts Receivable	6,648	4,919
Interest Receivable	110	138
Investment in Annuity Contracts	2,150	1,100
Inventory	209	293
Prepaid Items and Deferred Charges	198	-
State Treasurer's Security Lending Collateral	7,806	22,375
Total Current Assets	55,881	62,068
Noncurrent Assets:		
Investment in Annuity Contracts	25,007	12,418
Capital Assets, Depreciable (Net):		
Furniture and Equipment	2,749	2,702
Accumulated Depreciation	(1,510)	(1,392)
Total Capital Assets, Depreciable (Net)	1,239	1,310
Total Assets	82,127	75,796
LIABILITIES		
Current Liabilities:		
Accounts Payable	26,161	29,406
Accrued Payroll	379	332
Other Payables	1,321	2,266
Annuity Prize Award Payable	2,150	1,100
Accrued Paid Time Off - Current	65	43
Due to Other Funds	18,127	6,625
Obligations Under State Treasurer's Security Lending Agreements	7,889	22,375
Total Current Liabilities	56,092	62,147
Noncurrent Liabilities:		
Annuity Prize Award Payable	25,007	12,418
Accrued Paid Time Off	1,028	1,231
Total Liabilities	82,127	75,796
NET ASSETS		
Invested in Capital Assets	1,239	1,310
Unrestricted Net Assets	(1,239)	(1,310)
Total Net Assets	\$ -	\$ -

See Notes to the Financial Statements.

Statements of Revenues, Expenses and Changes in Fund Net Assets (in thousands)
Years Ending June 30, 2010 & 2009

	2010	2009
Operating Revenues:		
Gross Sales	\$ 1,421,313	\$ 1,293,111
Less: Prize Tickets	(1,309)	(9,580)
Sales/Service Bad Debt	(405)	(91)
Fees and Licenses	4,859	4,663
Total Operating Revenues	1,424,458	1,288,103
Operating Expenses		
Salaries, Wages, and Benefits	15,299	14,694
Lottery Prizes	835,302	731,690
Retailer Commissions	99,340	90,366
Retailer Incentive	394	-
Gaming Systems Services	22,639	20,599
Advertising	11,792	11,172
Marketing	2,239	1,751
Other Services	3,555	2,975
Furniture, Fixtures, and Equipment	376	249
Depreciation	583	544
Other General and Administrative Expenses	2,370	2,750
Total Operating Expenses	993,889	876,790
Operating Income	430,569	411,313
Nonoperating Revenues (Expenses):		
Investment Earnings and Other Miscellaneous Revenue	2,699	4,251
Compulsive Gambling Contribution	(1,000)	(1,000)
Unclaimed Prizes to NC Education Lottery Fund	(14,894)	(19,901)
Net Revenues to the State of NC	(417,311)	(394,028)
Miscellaneous Nonoperating Expenses	(63)	(635)
Total Nonoperating Revenues (Expense)	(430,569)	(411,313)
Net Income	-	-
Change in Net Assets	-	-
Net Assets Beginning, July 1	-	-
Net Assets Ending, June 30	\$ -	\$ -

See Notes to the Financial Statements.

North Carolina Education Lottery

Notes To Financial Statements (in thousands) - June 30, 2010 & 2009

Statements of Cash Flows (in thousands) - Year Ended June 30, 2010 & 2009

	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from Customers	\$ 1,323,356	\$ 1,206,591
Payments to Employees and Fringe Benefits	(15,432)	(14,644)
Payments for Prizes, Benefits and Claims	(839,959)	(751,430)
Payments to Vendors and Suppliers	(42,980)	(37,688)
Other Receipts/Payments	13	8
Net Cash Flows Provided by Operating Activities	424,998	402,837
CASH USED FOR NONCAPITAL FINANCING ACTIVITIES		
Transfers to State Education Fund	(419,465)	(410,868)
Transfers to Other State Agencies	(1,000)	(1,000)
Total Cash Used for Noncapital Financing Activities	(420,465)	(411,868)
CASH USED FOR CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisition and Construction of Capital Assets	(529)	(367)
Proceeds from Sale of Capital Assets	1	-
Total Cash Used for Capital and Related Financing Activities	(528)	(367)
CASH PROVIDED FROM INVESTING ACTIVITIES		
Investment Earnings	1,512	3,886
Total Cash Provided from Investing Activities	1,512	3,886
Net Increase/(Decrease) in Cash and Cash Equivalents	5,517	(5,512)
Cash and Cash Equivalents at Beginning of Year	33,243	38,755
Cash and Cash Equivalents at End of Year	\$ 38,760	\$ 33,243
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating Income	\$ 430,569	\$ 411,313
Adjustments to Reconcile Operating Income to Cash Provided by Operating Activities:		
Depreciation Expense	583	545
Nonoperating Income - MUSL Dividend	29	7
Other Nonoperating Income	(16)	1
(Increase) Decrease in Assets:		
Accounts Receivable	(1,729)	8,809
Inventories	84	617
Prepaid Items	(198)	-
Increase (Decrease) in Liabilities:		
Accounts Payable	(4,157)	(18,549)
Accrued Payroll and Related Liabilities	(134)	50
Other Liabilities	(33)	44
Total Cash Provided by Operating Activities	\$ 424,998	\$ 402,837
NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES		
Assets Acquired through the Assumption of a Liability	\$ 34,964	\$ 35,893

See Notes to the Financial Statements.

NOTE 1 - Organization

The North Carolina State Lottery Commission [aka, North Carolina Education Lottery (NCEL)] was created with the enactment of House Bill 1023 effective August 31, 2005 as an independent, self-supporting, and revenue-raising agency of the State of North Carolina (the State). The NCEL commenced operations on March 30, 2006 with the sale of instant scratch-off tickets. In March 2006, the NCEL joined the Multi-State Lottery Association (MUSL) composed of a group of U.S. lotteries that combine jointly to sell on-line POWERBALL lottery tickets. POWERBALL sales began on May 30, 2006. Additional on-line games were introduced as follows:

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

The purpose of the NCEL is to generate funds to further the goal of providing enhanced educational opportunities, support school construction, and fund college and university scholarships. The operations of the NCEL are overseen by a nine member commission, five of whom are appointed by the Governor and four of whom are appointed by the General Assembly.

NOTE 2 - Summary Of Significant Accounting Policies

A. Reporting Entity:

For financial reporting purposes, the North Carolina Education Lottery is a major enterprise fund of the primary government of the State of North Carolina and is reported as such in the Comprehensive Annual Financial Report (CAFR) of the State. These financial statements for the NCEL are separate and apart from those of the State of North Carolina and do not present the financial position of the State nor changes in the State's financial position and cash flows.

B. Basis of Presentation:

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

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

C. Cash and Cash Equivalents:

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

D. State Treasurer's Securities Lending Collateral:

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

Based on the authority provided in General Statutes 147-69.3(e), the State Treasurer lends securities from its investment pools to brokers-dealers and other entities (borrowers) for collateral that will be returned for the same securities in the future. The Treasurer's securities custodian manages the securities lending program. 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.

The NCEL was informed by the North Carolina Office of State Controller that an adjustment was needed to investment earnings as a result of unrealized losses in securities lending collateral. Securities lending disclosures are determined by GASB Statement 28. During fiscal year 2009, with the investment markets downturn, situations occurred related to securities lending investment activity that resulted in the State experiencing unrealized losses on the investment of cash collateral received for securities lent. This situation had never occurred prior to fiscal year 2009. Participants in State investment pools bear the risk of loss. Therefore, each participant has been allocated a share of the fiscal year 2009 unrealized loss, and a share of current fiscal year 2010 unrealized loss. The overall net effect of the transactions was recorded as an adjustment to Net Revenues to the State of North Carolina in the amount of \$82.

Additional details on the State Treasurer's securities lending program are included in the State of North Carolina's Comprehensive Annual Financial Report. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.osc.nc.gov/> and clicking on "Financial Reports," or by calling the State Controller's Financial Reporting Section at (919) 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, 2010 and 2009.

F. Capital Assets:

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

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

G. Game Revenue Recognition:

For the NCEL's on-line games, POWERBALL, Mega Millions, Carolina Cash 5, Carolina Pick 4, Carolina Pick 3, and raffles offered, revenue is recognized at the time of sale on a daily basis. For instant games, revenue is recognized at the time a pack of tickets is settled (See Note 3A.1 – Game Revenue).

H. Lottery Prize Expense Recognition:

For POWERBALL, Mega Millions, Carolina Cash 5, Carolina Pick 4, Carolina Pick 3, and for raffles, prize expense is recorded at 50 percent of sales on a daily basis. For instant games, prize expense is accrued based on the final production prize structure percentage provided by the gaming vendor for each game and recorded daily on value of packs settled. Certain games include free tickets (prize tickets) which entitle the holder to exchange one instant ticket for another of equal value. For the instant games with prize tickets, the final prize structure percentage used is adjusted to eliminate the value of the prize tickets. Prize expense for merchandise prizes is recognized as prizes are fulfilled.

I. Use of Estimates:

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

NOTE 3 – Revenue

A. Operating Revenue:

1. Game Revenue:

Instant packs are settled using the following methodology:

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

Game Revenue	2010	2009
Instant	\$ 855,566	\$ 798,676
Less Prize Tickets	(1,309)	(9,580)
On-line	565,747	494,435
Bad debt write off	(396)	(86)
Damaged tickets, Sales services	(9)	(5)
Total	\$ 1,419,599	\$ 1,283,440

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

2. Fees and Licenses:

The majority of Fees and Licenses represent a weekly retailer communication fee charged to active retailers for terminal satellite communications and an application fee for new retailers and changes in ownership. Total Fees and Licenses for 2010 and 2009 were \$4,859 and \$4,663 respectively.

B. Non-operating Revenue:

The cash accounts of the NCEL are Short-term Investment Fund (STIF) Accounts which are interest bearing accounts held with the NC State Treasurer. Investments are limited to those authorized for the State's General Fund, pursuant to NC General Statute 147-69.1. The interest earned on these balances is recorded as non-operating revenue, and is \$1,484, and \$3,608 for the years ended June 30, 2010 and 2009, respectively. 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 \$29, and \$7 for the years ended June 30, 2010 and 2009, respectively. The remaining \$184, for the year ended June 30, 2010 is predominately comprised of sales of marketing and start up materials to other lotteries. The remaining \$1 for the year ended June 30, 2009 is composed of miscellaneous items. Non-operating revenues are netted against non-operating expenses, with the exception of securities lending collateral program transactions on the financial statements.

NOTE 4 – Expenses

A. Operating Expenses:

1. Lottery Prize Expense:

Prize Expense	2010	2009
Instant	\$ 546,911	\$ 474,111
On-line	273,497	237,678
50% of unclaimed prizes	14,894	19,901
Total	\$ 835,302	\$ 731,690

2. Retailer Commissions:

Commissions	2010	2009
Instant	\$ 59,777	\$55,788
On-line	39,563	34,578
Total	\$ 99,340	\$ 90,366

3. Retailer Incentives

In fiscal year 2010, the Lottery Commission approved a retailer incentive program where retailers would receive compensation for selling a top tier prize or second tier prize in the Multi-State games POWERBALL and Mega Millions and a top tier prize in Carolina Cash 5. The total paid in the retailer incentive program in fiscal year 2010 was \$394.

4. Other Services:

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

	2010	2009
Security services	\$ 11	\$ 10
Background checks	797	849
Communications, including wiring	1,328	1,032
Legal services	42	14
Travel	79	104
Other	1,298	966
Total	\$ 3,555	\$ 2,975

5. Furniture, Fixtures, and Equipment:

To operate a lottery, numerous items of equipment, furniture, and ticket dispensers are required. Most of these items were one time purchases to be replaced as needed at various points in the future. These items were also below our threshold for capitalization (see Note 5E – Capital Assets) and therefore expensed. The total for these expenses was \$376 in fiscal year 2010 and \$249 in fiscal year 2009.

6. Leases – Buildings, Offices and Other Equipment:

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

Year Ending	Amount
2011	\$ 1,065
2012	682
2013	699
2014	702
2015	713
2016-2020	751
Total	\$ 4,612

The total space rental costs for the year ended June 30, 2010 was \$1,034 and \$858 for the year ended June 30, 2009 respectively. The NCEL also has several contracts for various equipment leases.

B. Non-operating Expenses:

The allocable share of the expenses arising from State Treasurer's Securities Lending Collateral program transactions, totaling \$63 and \$635 for the years ended June 30, 2010 and 2009 respectively, are also included as non-operating expense. In addition, for year ended June 30, 2010 the NCEL incurred an expense of \$200 to the Internal Revenue Service (IRS) for an assessment made under IRC Section 6651 for the late deposit of withheld federal income tax. This non-operating expense resulted from an accounting processing change made in early 2008 that resulted in a short delay in remitting withheld income tax to the IRS. The NCEL is currently appealing this charge. For the year ended June 30, 2010, the remaining \$16 non-operating expense resulted from a loss on a sale of property and equipment.

C. Transfers Out:

There were three significant transfers out of the NCEL. \$1,000 was transferred to the NC Department of Health and Human Services for a gambling addiction education and treatment program as stipulated in the North Carolina Lottery Act for years ended June 30, 2010 and 2009 (Note 7D).

The second transfer is \$14,894 and \$19,901 for the years ended June 30, 2010 and 2009, respectively, from unclaimed prizes during the year. The North Carolina State Lottery Act requires the NCEL to transfer "Fifty percent (50%)" of unclaimed prizes to the NC Education Lottery Fund each year (Note 7C).

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 \$417,311 and \$394,028 of June 30, 2010 and 2009 "Net Revenues" (see Note 12), respectively, \$398,015 and \$387,474 respectively, was actually transferred to the NC Education Lottery Fund. The remaining was recorded as a payable to the State, but remained in the NCEL. The remaining \$18,059 and \$6,554 for the years ended June 30, 2010 and 2009, respectively, were transferred subsequent to year-end. NC General Statute 18C states: "The funds remaining in the North Carolina State Lottery Fund after receipt of all revenues to the Lottery Fund and after accrual of all obligations of the Commission for prizes and expenses shall be considered to be the net revenues of the North Carolina State Lottery Fund."

NOTE 5 – Assets**A. Cash:**

The cash and cash equivalents balances at June 30, 2010 and 2009 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, 2010 and 2009, respectively, \$38,664 and \$33,124 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 and 1.8 years as of June 30, 2010 and 2009 respectively. Assets and shares of

the Short-Term Investment Fund are valued at amortized cost, which approximates fair value. Deposit and investment risks associated with the State Treasurer's Investment Pool (which includes the State Treasurer's Short-Term Investment Fund) are included in the State of North Carolina's Comprehensive Annual Financial Report. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.osc.nc.gov/> and clicking on "Financial Reports" or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

B. Accounts Receivable:

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

C. Inventory:

Inventory for the NCEL consists of all merchandise prizes that are paid for before distribution, inventory is reduced as prizes are fulfilled. Inventory as of June 30, 2010 was \$209, and \$293 as of June 30, 2009, respectively.

D. Investment in Annuity Contracts:

Investments in Annuity Contracts represent the present value of the contracts that fund the long term installment prizes contracted through insurance company annuities (See Note 7B). The current and long term balances are \$2,150 and \$25,007 for fiscal year 2010 and \$1,100 and \$12,418 for fiscal year 2009 respectively.

E. Capital Assets:

The activity for capital assets for the year ended June 30, 2010 was:

Category	Balance July 1, 2009	Increases	Decreases	Balance June 30, 2010
Capital assets, depreciable				
Furniture	\$ 29	\$ -	\$ -	\$ 29
Equipment	2,606	529	(482)	2,653
Motorized equipment	67	-	-	67
Total capital assets, depreciable	2,702	529	(482)	2,749
Less accumulated depreciation for:				
Furniture	18	5	-	23
Equipment	1,336	564	(465)	1,435
Motorized equipment	38	14	-	52
Total accumulated depreciation	1,392	583	(465)	1,510
Total capital assets, depreciable, net	1,310	(54)	(17)	1,239
Capital assets, net	\$ 1,310	\$ (54)	\$ (17)	\$ 1,239

The activity for capital assets for the year ended June 30, 2009 was:

Category	Balance July 1, 2008	Increases	Decreases	Balance June 30, 2009
Capital assets, depreciable				
Furniture	\$ 29	\$ -	\$ -	\$ 29
Equipment	2,239	367	-	2,606
Motorized equipment	67	-	-	67
Total capital assets, depreciable	2,335	367	-	2,702
Less accumulated depreciation for:				
Furniture	11	7	-	18
Equipment	813	523	-	1,336
Motorized equipment	24	14	-	38
Total accumulated depreciation	848	544	-	1,392
Total capital assets, depreciable, net	1,487	(177)	-	1,310
Capital assets, net	\$ 1,487	\$ (177)	\$ -	\$ 1,310

Equipment expenditures for 2010 include fire suppression systems, three random number generators and an upgraded telephone system in the regional offices. Equipment expenditures for 2009 include Carolina Pick 4 draw machines and an upgraded telephone system.

NOTE 6 – Liabilities

A. Accounts Payable:

This primarily represents trade payables to vendors, prize liabilities, and multi state game low-tier liability. At year end, June 30, 2010 and 2009, the balances were:

Type Account	2010	2009
Trade payables to vendors	\$ 5,103	\$ 4,607
Instant prize liability	4,278	8,987
Prize liability- unused unclaimed prizes	8,175	7,294
Multi state games low-tier liability	4,098	3,449
Prize liability – breakage	4,371	5,068
Prize liability – rollover	133	-
Other	3	1
Total accounts payable	\$ 26,161	\$ 29,406

B. Other Payables:

This represents amounts due to MUSL of \$1,181 and \$2,108 for the years ended June 30, 2010 and 2009, respectively for the NCEL's share of POWERBALL and Mega Millions jackpot prizes. The remainder resulted from federal and state withholding on prize payments, and various clearing accounts.

C. Annuity Prize Awards Payable:

Annuity Prize awards payable represent the present value of the contracts that fund the long term installment prizes that are due to NCEL annuity prize winners (See Note 7B). The current and long term balances are \$2,150 and \$25,007 for fiscal year 2010 and \$1,100 and \$12,418 for fiscal year 2009 respectively.

Annuity activity for both short and long term accounts during fiscal year 2010 are as follows:

	Beginning Balance 7/1/09	Purchases	Annuity Appreciation	Annuity Disbursements	Reclass to Short Term	Ending Balance 6/30/10
Short Term	\$ 1,100	\$ -	\$ -	\$ (1,100)	\$ 2,150	\$ 2,150
Long Term	12,418	13,726	1,013	-	(2,150)	25,007
Total Annuities	\$ 13,518	\$ 13,726	\$ 1,013	\$ (1,100)	\$ -	\$ 27,157

D. Due to Other Funds:

As explained in Note 4C, \$18,059 and \$6,554 for the years ended June 30, 2010 and 2009, respectively, represents the amounts of the "Net Revenues" and "50% of Unclaimed Prizes" for the year not yet transferred to the State as of June 30, but will be transferred to the State subsequent to year-end. The remainder is due to other state agencies for services provided to the NCEL.

E. Accrued Paid Time Off:

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

Activity for the year ended June 30, 2010:

Beginning	Earned	Used	Ending	Current Liability	Long Term Portion
\$ 1,274	\$ 1,135	\$ 1,316	\$ 1,093	\$ 65	\$ 1,028

Activity for the year ended June 30, 2009:

Beginning	Earned	Used	Ending	Current Liability	Long Term Portion
\$ 1,152	\$ 1,112	\$ 990	\$ 1,274	\$ 43	\$ 1,231

NOTE 7 – Other Important Items

A. Deposits with Multi-State Lottery Association (MUSL):

MUSL is a voluntary association created for the purpose of administering joint, multi-jurisdictional lottery games, such as POWERBALL and Mega Millions. Through June 30, 2010, MUSL includes 31 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 and Mega Millions sales. The net amount of the 50% prize expense less the amount required to pay low-tier prizes within the State is paid to MUSL. This payment is to cover the NCEL's share of current jackpot prizes based on the NCEL's percent of sales for each drawing and the NCEL's share of the prize reserve fund. The prize reserve fund serves as a contingency reserve to protect all MUSL members including the NCEL from unforeseen prize liabilities. All prize reserve funds remitted, and the related interest earnings, will be returned to the NCEL upon leaving MUSL, less any portion of unanticipated prize claims which may have been paid from the fund. As of June 30, 2010 and 2009, the NCEL had been credited with \$7,921 and \$6,906 in the MUSL prize reserve funds.

B. Annuity Installment Prizes:

The NCEL funds long term installment prizes through the purchase of insurance company annuities. The contract holders will fund the future value of the installment prize awards over the life of the prize awarded to the player. The NCEL currently holds contracts with Met Life Insurance Company and Prudential Life Insurance Company to provide these future prize installment payments. The future value of the annuity prizes awarded as of June 30, 2010 is \$39,300 and \$21,450 as of June 30, 2009.

C. Unclaimed Prizes:

As of June 30, 2010 and 2009, the NCEL had unclaimed prizes from both online and instant games. The first POWERBALL draw after the NCEL started selling tickets was on May 31, 2006, and therefore, the NCEL began recognizing unclaimed prizes on November 27, 2006 (180 days after the first draw). The first Carolina Pick 3 unclaimed prizes were recorded on April 4, 2007 and the first unclaimed prizes for Carolina Cash 5 were recorded on April 25, 2007. Unclaimed prizes for Carolina Pick 4 were recorded on November 14, 2009. Unclaimed prizes for Mega Millions were not recorded, since the end of the fiscal year was less than 180 days after the first draw on February 2, 2010. The NCEL closed forty-six instant games during the 2010 fiscal year resulting in \$20,088 in unclaimed prizes.

Game Type	2010	2009
Instant	\$ 20,088	\$ 29,953
Powerball	5,066	5,594
Carolina Cash 5	1,917	2,322
Carolina Pick 4	668	-
Carolina Pick 3	2,049	1,933
Raffle	-	-
Total unclaimed prizes	\$ 29,788	\$ 39,802

D. Compulsive Gambling Contribution:

By North Carolina General Statute the NCEL must make "a transfer of \$1,000 annually to the Department of Health and Human Services (DHHS) for gambling addiction education and treatment programs." (See Note 4C)

E. Limitations on Operating and Advertising Expenses:

As established in North Carolina General Statute 18C-162(a)(3); "No more than eight percent (8%) of the total annual revenues, as described in this Chapter, shall be allocated for payment of expenses of the Lottery. Advertising expenses shall not exceed one percent (1%) of the total annual revenues." The one percent for advertising expenses is included in the eight percent maximum for Lottery expenses. Total annual revenues include proceeds from the sale of lottery tickets, interest earned by the NCEL, and all other funds credited to the Lottery from any source.

NOTE 8 – Risk Management

The NCEL is exposed to various risks of loss related to torts; theft of, damage to, and the destruction of assets; errors and omissions; injuries to employees; and natural disasters. The NCEL participates in the State's Risk Management Program for property, liability, crime and automobile coverage, and pays an annual premium for this coverage. The Lottery has not experienced any losses during the year ended June 30, 2010.

The types of coverage, limits, and deductibles as of June 30, 2010 are described below (the following chart is not shown in thousands).

Type Coverage	Limits (\$)	Deductible (\$)	Comments
Public officers and employee liability	1,000,000/10,000,000	The first 150,000 /1,000,000 per person is paid by the Commission.	State is self-insured up to \$1,000,000; excess up to \$10,000,000 is with a private insurer.
All risk – property contents	4,244,182	5,000	
Auto – liability	1,000,000 per person/ 10,000,000 per accident		
Auto – comp/collision	29,470	50 100	Comp. deductible Collision deductible
Theft, disappearance, destruction	250,000	2,500	Inside premises
Theft, disappearance, destruction	50,000	2,500	Outside premises
Computer fraud	5,000,000	75,000	+10% over \$75,000
Employee dishonesty	5,000,000	75,000	+10% over \$75,000
Forgery and alteration	100,000	2,500	
Robbery and safe burglary – money/securities	500,000	1,000	

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

The North Carolina Workers' Compensation Program provides benefits to workers injured on the job. All employees of the State are included in the program. When an employee is injured, the NCEL's primary responsibility is to arrange for and provide the necessary treatment for work related injury. The State is self-insured for workers' compensation. A third party administrator processes workers' compensation claims. State agencies, including the NCEL, contribute to a fund administered by the Office of the State Controller to cover their workers' compensation claims. The third party administrator receives a per case administration fee and draws down State funds to make medical and indemnity payments on behalf of the State in accordance with the North Carolina Workers' Compensation Act.

Term life insurance of \$25 to \$50 is provided to eligible employees. This self-insured death benefit program is administered by the North Carolina Department of the State Treasurer and funded via employer contributions. The employer contribution rate was .16% for the current fiscal year.

Additional details on State-administered risk management programs are disclosed in the State of North Carolina's Comprehensive Annual Financial Report. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.osc.nc.gov/> and clicking on "Financial Reports" or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

NOTE 9 – Pension and Deferred Compensation Plans**A. Retirement Plan:**

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

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

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

For the years ending June 30, 2010, 2009 and 2008, respectively, the NCEL had a total payroll of \$11,968, \$11,696, and \$10,862 of which \$11,968, \$11,240 and \$10,340 was covered under the Teachers' and State Employees' Retirement System. Total employer and employee contributions for pension benefits for the year ended June 30, 2010, 2009 and 2008 were \$1,143, \$1,052 and \$805, respectively. Required employer contribution

rates for the years ended June 30, 2010, 2009 and 2008, were 3.57%, 3.36% and 3.05%, respectively, while employee contributions were 6% each year. The NCEL made 100% of its annual required contributions for the years ended June 30, 2010, 2009, and 2008, which were \$425, \$378 and \$313, respectively.

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

B. Supplemental Retirement Income Plan:

IRC Section 401(k) Plan – All full-time employees are eligible to enroll in the Supplemental Retirement Income Plan, a defined contribution plan, created under Internal Revenue Code Section 401(k). All costs of administering the plan are the responsibility of plan participants. The Plan is provided by Prudential Retirement, administered by the NC Department of the State Treasurer and sponsored by the State of North Carolina. The effective date of participation was January 30, 2006. The voluntary contributions by employees amounted to \$203, \$206 and \$194 for the years ended June 30, 2010, 2009 and 2008, respectively.

C. Deferred Compensation Plan:

IRC Section 457 Plan – The State of North Carolina offers its permanent employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457 through the North Carolina Public Employee Deferred Compensation Plan (the "Plan"). The Plan permits each participating employee to defer a portion of his or her salary until future years. The deferred compensation is available to employees upon separation from service, death, disability, retirement or financial hardships if approved by the Board of Trustees of the Plan. The Board, a part of the North Carolina Department of State Treasurer, maintains a separate fund for the exclusive benefit of the participating employees and their beneficiaries, the North Carolina Public Employee Deferred Compensation Trust Fund. The Board also contracts with an external third party to perform certain administrative requirements and to manage the trust fund's assets. All costs of administering and funding the Plan are the responsibility of the Plan participants. The effective date of participation was January 30, 2006. The voluntary contributions by employees amounted to \$134, \$80 and \$67 for the years ended June 30, 2010, 2009 and 2008.

NOTE 10 – Other Postemployment Benefits**A. Health Care for Long-Term Disability Beneficiaries and Retirees:**

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

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

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

For the current fiscal year the NCEL contributed 4.5% of the covered payroll under the Teachers' and State Employees' Retirement System. Required contribution rates for the years ended June 30, 2009 and 2008, were 4.5% and 4.1%, respectively. The NCEL made 100% of its annual required contributions to the Plan for the years ended June 30, 2010, 2009, and 2008, which were \$539, \$461, and \$421, respectively.

The NCEL assumes no liability for retiree health care benefits provided by the programs other than its required contribution.

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

B. Long-Term Disability:

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

Disability income benefits are funded by actuarially determined employer contributions that are established in the Appropriations Bill by the General Assembly. For the fiscal year ended June 30, 2010, the NCEL made a statutory contribution of .52% of covered payroll under the Teachers' and

State Employees' Retirement System and the Optional Retirement Program to the DIPNC. Required contribution rates for the years ended June 30, 2010, 2009 and 2008 were .52%, .52% and .52%, respectively. The NCEL made 100% of its annual required contributions to the DIPNC for the years ended June 30, 2010, 2009, and 2008, which were \$62, \$58, and \$54, respectively. The NCEL assumes no liability for long-term disability benefits under the Plan other than its contribution.

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

NOTE 11 – Litigation

As of June 30, 2010, 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

		2010	
Lottery Ticket Sales	\$ 1,420,908		
Fees and Licenses	4,859		
Investment Earnings and Other Revenues	2,699		
Total Annual Revenue	1,428,466		
Less Prize Tickets	(1,309)	0%	Of Total Annual Revenue
Total Net Revenue	1,427,157		
Prize Expense	(835,302)	59%	Of Total Annual Revenue
Advertising	(11,792)	1%	Of Total Annual Revenue
All Other Expenses and Transfers	(48,518)		
Total Section 18C-162.a.3	(60,310)	4%	Of Total Annual Revenue
Commissions (per 18C-142)	(99,340)	7%	Of Lottery Ticket Sales
Unclaimed Prizes to The State of North Carolina	14,894		
Net Revenues to The State of North Carolina	417,311		
Total Revenues to The State of North Carolina	\$ 432,205	30%	Of Total Annual Revenue

		2009	
Lottery Ticket Sales	\$ 1,293,020		
Fees and Licenses	4,663		
Investment Earnings and Other Revenues	4,251		
Total Annual Revenue	1,301,934		
Less Prize Tickets	(9,580)	1%	Of Total Annual Revenue
Total Net Revenue	1,292,354		
Prize Expense	(731,690)	56%	Of Total Annual Revenue
Advertising	(11,172)	1%	Of Total Annual Revenue
All Other Expenses and Transfers	(45,197)		
Total Section 18C-162.a.3	(56,369)	4%	Of Total Annual Revenue
Commissions (per 18C-142)	(90,366)	7%	Of Lottery Ticket Sales
Unclaimed Prizes to The State of North Carolina	19,901		
Net Revenues to The State of North Carolina	394,028		
Total Revenues to The State of North Carolina	\$ 413,929	32%	Of Total Annual Revenue

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

- (a) The Commission shall allocate revenues to the North Carolina State Lottery Fund in order to increase and maximize the available revenues for education purposes, and to the extent practicable, shall adhere to the following guidelines:
 - (1) At least fifty percent (50%) of the total annual revenues, as described in this Chapter, shall be returned to the public in the form of prizes.
 - (2) At least thirty-five percent (35%) of the total annual revenues, as described in this Chapter, shall be transferred as provided in G.S. 18C-164.
 - (3) No more than eight percent (8%) of the total annual revenues, as described in this Chapter, shall be allocated for payment of expenses of the Lottery. Advertising expenses shall not exceed one percent (1%) of the total annual revenues.
 - (4) No more than seven percent (7%) of the total annual revenues, as described in this Chapter, shall be allocated for compensation paid to lottery game retailers.
- (b) To the extent that the expenses of the Commission are less than eight percent (8%) of total annual revenues, the Commission may allocate any surplus funds:
 - (1) To increase prize payments; or
 - (2) To the benefit of the public purposes as described in this chapter.
- (c) Unclaimed prize money shall be held separate and apart from the other revenues and allocated as follows:
 - (1) Fifty (50%) to enhance prizes under subdivision (a)(1) of this section.
 - (2) Fifty (50%) to the Education Lottery Fund to be allocated in accordance with G.S. 18C-164(c). (2005-344, s. 1; 2005-276, s. 31.1(r); 2007-323, s.5.2(c).)

Additionally, in accordance with Section § 18C 142 of the 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 provided by the State.
- (3) All other funds credited or appropriated to the Commission from any sources.
- (4) Interest earned by the North Carolina Lottery Fund.

As of September 30, 2010 the NCEL transferred \$419.5 million, \$407.4 million and \$344.8 million for the years ended June 30, 2010, 2009 and 2008, respectively, to the NC Education Lottery Fund. As explained in Note 4C, \$18.0 million, \$6.5 million and \$3.5 million for the years ended June 30, 2010, 2009 and 2008, respectively, is the amount of the "Net Revenues" and "50% of Unclaimed Prizes" for the year not yet transferred to the state as of June 30, but will be transferred during the subsequent fiscal year.

NOTE 13 – Changes In Financial Accounting and Reporting

For the fiscal year ended June 30, 2010, the NCEL implemented the following pronouncement issued by the Governmental Accounting Standards Board (GASB):

GASB Statement No. 51, Accounting and Financial Reporting for Intangible Assets.

GASB Statement No. 51 provides needed guidance regarding how to identify, account for, and report intangible assets. This Statement requires that all intangible assets not specifically excluded by its scope provisions be classified as capital assets. Accordingly, existing authoritative guidance related to the accounting and financial reporting for capital assets should be applied to these intangible assets, as applicable. This pronouncement provides additional guidance that specifically addresses the unique nature of intangible assets, including 1) establishing a specified conditions approach to recognizing intangible assets that are internally generated, 2) providing guidance on recognizing internally generated computer software, and 3) establishing specific guidance for the amortization of intangible assets.

NOTE 14 – Reclassifications and Restatements

During fiscal year 2010 the NCEL began reporting a liability for long term annuity winners. The liability for the prizes is offset by investments in annuity contracts, which fund the long term installment prizes. Restatements of assets and liabilities for year ended June 30, 2009 was completed to provide the same information. Additional information on the long term prize liability and investments can be found in Notes 5D, 6C, and 7B.

NOTE 15 – Subsequent Events

The Commission NCEL has evaluated all subsequent events for potential recognition and disclosure through November 1, 2010 the date these financial statements were available to be issued.



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 statements of net assets of the North Carolina Education Lottery (NCEL), a major enterprise fund of the State of North Carolina as of June 30, 2010 and 2009, and the related statements of revenues, expenses, and changes in fund net assets and cash flows for the years then ended, and have issued our report thereon dated November 9, 2010. 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.

The financial statements present only the NCEL and do not purport to, and do not, present fairly the financial position of the State of North Carolina, as of and for the years ended June 30, 2010 and 2009, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Internal Control over Financial Reporting

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 deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

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

Compliance and Other Matters

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

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

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

Raleigh, North Carolina
November 9, 2010

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