

North Dakota Lottery  
Bismarck, North Dakota  
**Audit Report**

For the Years Ended  
June 30, 2013 and 2012

ROBERT R. PETERSON  
STATE AUDITOR

Office of the State Auditor  
Division of State Audit

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STATE AUDITOR  
ROBERT R. PETERSON



PHONE  
(701) 328 - 2241  
FAX  
(701) 328 - 1406

STATE OF NORTH DAKOTA  
**OFFICE OF THE STATE AUDITOR**  
STATE CAPITOL  
600 E. BOULEVARD AVENUE - DEPT. 117  
BISMARCK, NORTH DAKOTA 58505

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## Independent Auditor's Report

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Honorable Jack Dalrymple, Governor  
Members of the Legislative Assembly  
Honorable Wayne Stenehjem, Attorney General  
Randy Miller, Director North Dakota Lottery

### Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities of the North Dakota Lottery, a division of the Office of the Attorney General, of the state of North Dakota, as of and for the fiscal years ended June 30, 2013, and 2012, and the related notes to the financial statements, which collectively comprise the North Dakota Lottery's basic financial statements as listed in the table of contents.

### Management's Responsibility for the Financial Statements

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

### Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial

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

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

## **Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities of the North Dakota Lottery, as of June 30, 2013, and 2012, and its revenues, expenses and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

## **Emphasis of Matter**

As discussed in Note 1 to the financial statements, the financial statements of the North Dakota Lottery are intended to present the financial position, the changes in financial position, and cash flows of only that portion of the business-type activities of the state of North Dakota that is attributable to the transactions of the North Dakota Lottery. They do not purport to, and do not, present fairly the financial position of the state of North Dakota as of June 30, 2013 or 2012, or the changes in its financial position, or its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

## **Other Matters**

### *Required Supplementary Information*

Accounting principles generally accepted in the United States of America require the management's discussion and analysis on pages 4–8 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

## Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our reported dated November 12, 2013, on our considerations of the North Dakota Lottery's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the North Dakota Lottery's internal control over financial reporting and compliance.



Robert R. Peterson  
State Auditor

Bismarck, North Dakota

November 12, 2013

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## **Management's Discussion and Analysis For the Fiscal Year Ended June 30, 2013**

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The Management's Discussion and Analysis is an overview of the Lottery's financial activity for the fiscal year ended June 30, 2013. The analysis is to be considered in conjunction with the financial statements to provide an objective breakdown of the Lottery's financial activity based on facts, decisions, and conditions that presently face the director.

### Understanding the Lottery's Financial Statements

The Lottery, a division of the Office of Attorney General, is accounted for as an enterprise fund that reports all income, expense, assets, and liabilities using the accrual basis of accounting, like a private business entity. In accordance with generally accepted accounting principles, this report consists of three financial statements and explanatory notes. The financial statements are: 1) Statement of Net Position; 2) Statement of Revenues, Expenses, and Changes in Net Position; and 3) Statement of Cash Flows. The financial statements are designed to highlight the Lottery's operating activity and provide a snapshot of its financial condition.

A vital factor of the Lottery's financial statements is a statutory requirement that the Lottery transfer all net proceeds, less the amount allocated to the compulsive gambling prevention and treatment fund, amount allocated to the multi-jurisdictional drug task force grant fund, Lottery's share of a game's prize reserve pool and holdback of any reserve funds the director may need for continuing operations, to the State Treasurer on at least an annual basis for deposit in the state general fund. It is also important to note that most financial statement balances have a direct or indirect relationship to revenue. As lottery sales increase, the amount to be transferred to the state general fund would also increase. Similarly, as lottery sales increase, there is a direct increase in prizes, retailer commissions, game group dues, and vendor fees.

Most of the assets included on the Statements of Net Position represent current amounts such as cash and accounts receivable from lottery retailers. Most liabilities represent current prizes, including prizes payable to players in North Dakota and prizes payable to the Multi-State Lottery Association (MUSL) to fund grand/jackpot prizes, and an amount due to the state general fund.

### Financial Highlights

Since the Lottery began in March 2004, North Dakota players have won over \$73 million in prizes and Lottery retailers earned over \$10.9 million in sales and bonus commissions. In addition, the Lottery contributed \$55.6 million to the general fund, along with \$2 million to the Compulsive Gambling Prevention and Treatment Fund, and \$2.5 million to the Multi-Jurisdictional Drug Task Force Grant Fund.

Fiscal year 2013 generated record setting sales and record profits. The Lottery's ticket sales for the fiscal year ended June 30, 2013 were \$27,837,316 as compared to \$26,043,816 for the fiscal year ended June 30, 2012. This reflects a \$1,793,500 or 6.89% increase in ticket sales. Factors contributing to the increase in ticket sales included more high jackpots for Powerball including two jackpots exceeding \$200 million, two jackpots exceeding \$300 million and two jackpots exceeding \$500 million; and increased population and sales in the northwest part of the state due to the oil activity in that region.

Total prizes on winning tickets for the fiscal year ended June 30, 2013, were \$14,216,632, including prizes paid in North Dakota of \$7,567,690 and prizes paid to the MUSL to fund grand/jackpot prizes of \$7,089,117. In addition, North Dakota had expired prizes in the amount of \$440,175.

The Lottery's operating expenses are minimized because the Lottery blueprinted its organizational structure, functions, and gaming system features to optimize efficiency. Expenses such as salaries and fringe benefits, travel, telephone, and MUSL board dues are generally fixed. Other expenses have a direct incremental relationship to sales increases or decreases such as prizes, retailer commissions, game group dues, and vendor fees.

Total operating expenses for the fiscal year ended June 30, 2013 were \$19,713,987 as compared to \$18,877,249 for the fiscal year ended June 30, 2012. This reflects an \$836,738 or 4.4% increase in total operating expenses. The increase was mainly due to the increase in prize expense and retailer commissions.

Net proceeds earned for the fiscal year ended June 30, 2013, were \$8,288,437. The total transfer of funds equated to \$7,922,500. Of that amount, \$200,000 was transferred to the Compulsive Gambling Prevention and Treatment Fund and \$422,500, was transferred to the Multi-Jurisdictional Drug Task Force Grant Fund, leaving a balance of \$7,300,000, which was transferred to the state general fund.

- By law, effective July 1, 2005, \$50,000 must be transferred to the State Treasurer each quarter for deposit in the compulsive gambling prevention and treatment fund.
- By law, effective July 1, 2007, \$105,625 must be transferred to the State Treasurer each quarter for deposit in the multi-jurisdictional drug task force grant fund.

### Financial Position

The Lottery's net position (assets minus liabilities) is one measure of the financial health or financial position. Total net position for the fiscal year ended June 30, 2013, was \$1,864,641. This reflects a \$365,937 increase in total net position compared to the fiscal year ended June 30, 2012. \$1,286,756 of the total net position is restricted for MUSL uses. Variations in the Lottery's net position over time are indicators of its financial stability. The Lottery's total net position increased by 24.4% between fiscal years 2013 and 2012. The increase in Net Position is the result of the increase in the cash balance which is the result of increased sales.



## Overview of the Financial Statements

### Statement of Net Position Summary:

	<b>6/30/2013</b>	<b>6/30/2012</b>	<b>6/30/2011</b>
Total Current Assets	\$ 8,920,911	\$ 8,316,024	\$ 6,464,957
Total Noncurrent Assets	1,300,856	1,263,470	1,166,862
Total Assets	<u>\$ 10,221,767</u>	<u>\$ 9,579,494</u>	<u>\$ 7,631,819</u>
Total Current Liabilities	\$ 8,308,595	\$ 8,038,869	\$ 6,180,561
Total Noncurrent Liabilities	48,531	41,921	45,007
Total Liabilities	<u>\$ 8,357,126</u>	<u>\$ 8,080,790</u>	<u>\$ 6,225,568</u>
Net Position			
Net Investment in Capital Assets	\$ 14,100	\$ 18,129	\$ 22,157
Restricted	1,286,756	1,245,341	1,144,704
Unrestricted	563,785	235,234	239,390
Total Net Position	<u>\$ 1,864,641</u>	<u>\$ 1,498,704</u>	<u>\$ 1,406,251</u>

### Statement of Revenues, Expenses, and Changes in Net Position Summary:

	<b>6/30/2013</b>	<b>6/30/2012</b>	<b>6/30/2011</b>
Total Operating Revenue	\$ 27,999,486	\$ 26,587,851	\$ 23,085,242
Total Operating Expenses	19,713,987	18,877,249	17,068,826
Operating Income	\$ 8,285,499	\$ 7,710,602	\$ 6,016,416
Total Non-Operating Income	2,938	4,351	7,890
Income Before Transfers	\$ 8,288,437	\$ 7,714,953	\$ 6,024,306
Total Transfers to Other Funds	7,922,500	7,622,500	5,922,500
Change in Net Position	\$ 365,937	\$ 92,453	\$ 101,806
Total Net Position, Beginning of Year	1,498,704	1,406,251	1,304,445
<b>Total Net Position, End of Year</b>	<u>\$ 1,864,641</u>	<u>\$ 1,498,704</u>	<u>\$ 1,406,251</u>

### Revenue:

	<b>6/30/2013</b>	<b>6/30/2012</b>	<b>6/30/2011</b>
Powerball Ticket Sales	\$ 16,353,914	\$ 11,742,580	\$ 9,856,354
Mega Millions Ticket Sales	3,314,304	6,200,834	4,516,831
Hot Lotto Ticket Sales	2,912,792	2,733,144	3,470,961
Wild Card 2 Ticket Sales	1,786,280	1,459,656	1,734,355
2by2 Ticket Sales	3,470,558	3,908,727	3,425,012
Less Retailer Credit Adjustments	(532)	(1,125)	(903)
Total Ticket Sales	\$ 27,837,316	\$ 26,043,816	\$ 23,002,610
Other Operating Revenue	162,170	544,035	82,632
<b>Total Revenue</b>	<u>\$ 27,999,486</u>	<u>\$ 26,587,851</u>	<u>\$ 23,085,242</u>

Expenses:

	<u>6/30/2013</u>	<u>6/30/2012</u>	<u>6/30/2011</u>
Prizes	\$ 14,216,632	\$ 13,407,269	\$ 11,941,258
Retailer Commissions	1,359,799	1,274,067	1,125,708
Retailer Bonuses	37,000	41,000	53,250
Operating	4,100,556	4,154,913	3,948,610
<b>Total Expenses</b>	<b>\$ 19,713,987</b>	<b>\$ 18,877,249</b>	<b>\$ 17,068,826</b>

Net Proceeds:

	<u>6/30/2013</u>	<u>6/30/2012</u>	<u>6/30/2011</u>
Income before Transfers	\$ 8,288,437	\$ 7,714,953	\$ 6,024,306
Percent of Income before Transfers to Total Operating Revenue	29.6%	29.0%	26.1%

Potential Factors Affecting Future Sales

The challenge facing the Lottery is to sustain sales and net proceeds by actively promoting sales of tickets for present and new games in a very competitive retail environment.

The Lottery is unique compared to all other state lotteries because it may only conduct multi-state online games. The constitution restricts the Lottery to multi-state games. The law restricts the Lottery to online games. Therefore, the Lottery must partner with one or more other government-authorized lotteries to conduct a game. This restriction generally limits the Lottery to games administered by the MUSL. The MUSL may not have a broad range of games available to fulfill the Lottery's desired product mix or the MUSL's games may become stale. Should the MUSL dissolve, although it is not anticipated, the Lottery would not have a source of games to conduct.

Looking Ahead

The Lottery's goal is to provide a service to the citizens of North Dakota and, while considering the sensitive nature of the Lottery, promote games, and ensure the integrity, security, and fairness of its operation. To accomplish this, the Lottery must offer attractive games that add value to the Lottery's product mix, license retailers that are in convenient locations, create effective annual marketing plans, provide quality customer service to retailers and players, and control operating expenses.

To attract players, games must be interesting to play and have a broad range of player odds and starting jackpot prizes. The MUSL game groups periodically refresh their games by replacing them, or re-launching the games with new features or options. Total sales of a game are dramatically affected by the size of the game's jackpot and, to a lesser degree, on the odds of winning a prize. Larger jackpots generate higher sales. However, larger jackpots cannot be predicted or relied upon. Therefore, a variety of games with varying jackpots and odds of winning a prize is necessary to attract players.

For the fiscal year 2014, the Lottery plans to:

1. Add new features to Mega Millions that will provide better odds, more winners, and larger jackpots.
2. Return the random Power Play multiplier for Powerball.
3. Replace at least one of its online games with a new game that will complement our product mix.
4. Update lottery equipment at retailer locations; including new terminals, self-service ticket checkers, jackpot alert signs, and LCD monitors for marketing.
5. Develop and conduct innovative promotions and public awareness campaigns.
6. Conduct re-branding campaign to bring an exciting and refreshing look to the Lottery.
7. Implement an automated subscription process and Player's Club that will provide an easy way for players to manage their subscriptions and reward them for their continued patronage.

#### Contacting the Lottery

If a person has a question on any information in this report or desires additional information, please write to:

North Dakota Lottery  
Office of Attorney General  
1050 E. Interstate Ave, Suite 200  
Bismarck, ND 58503-5574

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**Statement of Net Position**  
**For the Fiscal Years Ended June 30, 2013 and 2012**

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	<b>June 30, 2013</b>	<b>June 30, 2012</b>
<b>Assets:</b>		
Current Assets:		
Cash and Cash Equivalents	\$ 8,576,270	\$ 8,003,166
Accounts Receivable	327,440	308,411
Prepaid Expenses	17,201	4,447
Total Current Assets	\$ 8,920,911	\$ 8,316,024
Noncurrent Assets:		
Reserves on Deposit	\$ 1,286,756	\$ 1,245,341
Equipment and Software, Net	14,100	18,129
Total Noncurrent Assets	\$ 1,300,856	\$ 1,263,470
<b>Total Assets</b>	<b>\$ 10,221,767</b>	<b>\$ 9,579,494</b>
<b>Liabilities:</b>		
Current Liabilities:		
Accounts Payable	\$ 163,641	\$ 230,284
Due to Other State Funds	7,324,037	7,016,102
Accrued Payroll	62,420	58,739
Prizes Payable	393,598	369,442
Deferred Revenue	364,899	364,302
Total Current Liabilities	\$ 8,308,595	\$ 8,038,869
Noncurrent Liabilities:		
Compensated Absences Payable	\$ 48,531	\$ 41,921
Total Noncurrent Liabilities	\$ 48,531	\$ 41,921
<b>Total Liabilities</b>	<b>\$ 8,357,126</b>	<b>\$ 8,080,790</b>
<b>Net Position:</b>		
Net Investment in Capital Assets	\$ 14,100	\$ 18,129
Restricted	1,286,756	1,245,341
Unrestricted	563,785	235,234
<b>Total Net Position</b>	<b>\$ 1,864,641</b>	<b>\$ 1,498,704</b>

The accompanying Notes to the Financial Statements are an integral part of this statement.

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**Statement of Revenues, Expenses, and Changes in Net Position**  
**For the Fiscal Years Ended June 30, 2013 and 2012**

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	<u>June 30, 2013</u>	<u>June 30, 2012</u>
<b>Operating Revenues:</b>		
Ticket Sales	\$ 27,837,316	\$ 26,043,816
Other Operating Revenue	162,170	544,035
Total Operating Revenues	<u>\$ 27,999,486</u>	<u>\$ 26,587,851</u>
<b>Operating Expenses:</b>		
Prizes	\$ 14,216,632	\$ 13,407,269
Retailer Commissions	1,396,799	1,315,067
Contractual Services	2,442,356	2,606,263
Marketing	583,136	611,849
Salaries and Benefits	747,353	678,964
Operating	327,711	257,837
Total Operating Expenses	<u>\$ 19,713,987</u>	<u>\$ 18,877,249</u>
Operating Income	<u>\$ 8,285,499</u>	<u>\$ 7,710,602</u>
<b>Nonoperating Revenues:</b>		
Interest Income	\$ 2,938	\$ 4,351
Total Nonoperating Revenues	<u>\$ 2,938</u>	<u>\$ 4,351</u>
Income Before Transfers	<u>\$ 8,288,437</u>	<u>\$ 7,714,953</u>
<b>Transfers to Other Funds:</b>		
Compulsive Gambling Fund	\$ 200,000	\$ 200,000
Multi-Jurisdictional Drug Task Force	422,500	422,500
State General Fund	7,300,000	7,000,000
Total Transfers to Other Funds	<u>\$ 7,922,500</u>	<u>\$ 7,622,500</u>
Change in Net Position	\$ 365,937	\$ 92,453
Total Net Position – Beginning of Year	1,498,704	1,406,251
Total Net Position – End of Year	<u>\$ 1,864,641</u>	<u>\$ 1,498,704</u>

The accompanying Notes to the Financial Statements are an integral part of this statement.

**Statement of Cash Flows**  
**For the Fiscal Years Ended June 30, 2013 and 2012**

	<b>June 30, 2013</b>	<b>June 30, 2012</b>
<b>Cash Flows from Operating Activities:</b>		
Ticket Sales	\$ 21,677,688	\$ 19,568,970
Other Revenues	80,013	542,333
Paid to Prize Winners	(2,520,681)	(1,731,499)
Paid to Vendors	(10,349,317)	(9,954,877)
Paid to Employees	(737,062)	(681,938)
Reserves on Deposit - Increase	(69,875)	(135,909)
Reserves on Deposit - Decrease	111,817	36,398
Net Cash Provided by Operating Activities	\$ 8,192,583	\$ 7,643,478
<b>Cash Flows from Noncapital Financing Activities:</b>		
Transferred to Compulsive Gambling Treatment Fund	\$ (200,000)	\$ (200,000)
Transferred to Multi-Jurisdictional Drug Task Force Fund	(422,500)	(422,500)
Transferred to State General Fund	(7,000,000)	(5,300,000)
Net Cash Used in Noncapital Financing Activities	\$ (7,622,500)	\$ (5,922,500)
<b>Cash Flows from Investing Activities:</b>		
Interest Income	\$ 3,021	\$ 4,540
Net Cash Provided by Investing Activities	\$ 3,021	\$ 4,540
<b>Cash and Cash Equivalents at Beginning of Year</b>	\$ 8,003,166	\$ 6,277,648
<b>Cash and Cash Equivalents at End of Year</b>	\$ 8,576,270	\$ 8,003,166
<b>Reconciliation of Operating Income to Net Cash Provided by Operating Activities:</b>		
Operating Income	\$ 8,285,499	\$ 7,710,602
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities:		
Depreciation	4,029	4,029
Changes in Assets and Liabilities:		
(Increase) Decrease in Accounts Receivable	(19,295)	(128,118)
(Increase) Decrease in Prepaid Expenses	(12,754)	2,275
(Increase) Decrease in Reserves on Deposit	(41,230)	(100,532)
Increase (Decrease) in Accounts Payable	(66,645)	119,263
Increase (Decrease) in Due to Other State Funds	7,935	(65,983)
Increase (Decrease) in Accrued Payroll	3,681	384
Increase (Decrease) in Prizes Payable	24,156	77,693
Increase (Decrease) in Deferred Revenue	597	26,951
Increase (Decrease) in Compensated Absences Payable	6,610	(3,086)
Total Adjustments	\$ (92,916)	\$ (67,124)
Net Cash Provided by Operating Activities	\$ 8,192,583	\$ 7,643,478
<b>Noncash Transactions:</b>		
Interest Revenue on Prize Reserves	\$ 185	\$ 105
Total Noncash Transactions	\$ 185	\$ 105

The accompanying Notes to the Financial Statements are an integral part of this statement.

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**Notes to the Financial Statements**  
**For the Fiscal Year Ended June 30, 2013**

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**Note 1 - Summary of Significant Accounting Policies**

Reporting Entity

In accordance with Governmental Accounting Standards Board (GASB) Statement No. 14, *The Financial Reporting Entity*, the Lottery should include all component units over which the Lottery exercises such aspects as (1) appointing a voting majority of an organization's governing body and (2) has the ability to impose its will on that organization or (3) the potential for the organization to provide specific financial benefits to, or impose specific burdens on the Lottery.

Based on the criteria of GASB Statement No. 14, no organization was determined to be part of the Lottery as a reporting entity. The Lottery is a division of the Office of Attorney General, which is part of the primary government of the state of North Dakota.

Basis of Accounting and Measurement Focus

The Lottery's activity is accounted for as a proprietary type enterprise fund for the state of North Dakota. A proprietary fund is accounted for using the accrual basis of accounting. Revenues are recognized when they are earned and expenses are recognized when they are incurred.

An enterprise fund is used to account for an activity that is financed and operated in a manner similar to a private business enterprise where the costs of providing goods or services to the public on a continuing basis are financed through the sale of those goods or services. The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. An enterprise fund is accounted for by using the economic resources measurement focus in which all assets and liabilities associated with the operation of the funds are included on the statement of net position. Net position is segregated into net investment in capital assets and restricted and unrestricted components. The statement of revenues, expenses, and changes in net position presents increases and decreases in total net position. The statement of cash flows presents the cash flows for operating, investing, capital, and non-capital financing activities.

According to North Dakota Century Code chapter 53-12.1, the Lottery must be self-funded and self-sustaining. As a result, general fund monies of the state may not be used or obligated to pay expenses or prizes of the Lottery.

Accounting Standards

The Lottery follows the pronouncements of the GASB, which is the nationally accepted standard-setting body for establishing generally accepted accounting principles for governmental entities.

### New Accounting Standards Adopted

GASB Statement No. 63, Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position (GASB 63), establishes a new statement of Net Position format that reports separately all assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position ( which is the net residual amount of the other elements). The Statement requires deferred outflows of resources and deferred inflows of resources to be reported separately from assets and liabilities. The financial reporting impact in the Lottery's statements was the renaming of "Net Assets" to "Net Position," including changing the name of the financial statement from "Statement of Net Assets" to "Statement of Net Position."

### Operating and Nonoperating Revenues

An enterprise fund distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the proprietary fund's principal ongoing operation. The principal operating revenue of the Lottery is sales of tickets. The principal operating expenses of the Lottery are prizes, retailer commissions, contractual services, marketing, MUSL game group dues, and salaries and fringe benefits. All revenue and expenses not meeting the criteria are reported as nonoperating income and expenses.

### Cash and Cash Equivalents

Cash and cash equivalents are defined as deposits with the Bank of North Dakota and the State Treasurer. The Lottery does not invest in marketable securities.

### Accounts Receivable

Accounts receivable primarily represents prizes due from MUSL and lottery funds due from retailers for ticket sales, less commissions and prizes on winning tickets paid by retailers. Lottery funds are collected weekly through electronic funds transfer by the Lottery from retailers' bank accounts. The Lottery has not incurred and does not project any bad debts.

### Reserves on Deposit

As of June 30, 2013, the Lottery has \$1,286,756 on deposit with the MUSL related to the Prize Reserve Pools and Unreserved Account as compared to \$1,245,341 at June 30, 2012. When both restricted and unrestricted resources are available, which is only applicable for certain MUSL related expenses, it is the Lottery's policy to generally use restricted resources first. See Note 7.

### Prepaid Expenses

The prepaid expenses of \$17,201 at June 30, 2013 are primarily rent and retailer commissions on future sales as compared to \$4,447 at June 30, 2012.



### Equipment and Software

Equipment and software are stated at cost, net of accumulated depreciation. Equipment and software with a cost of \$5,000 or more per unit are capitalized and reported in the accompanying financial statements. Depreciation is computed using the straight-line method over the estimated useful lives of the assets which range from three to seven years.

### Prizes

Prize expense is recorded based on actual drawing results.

Prizes payable represents the difference between the amount of prize expense recognized and actual prizes paid.

Players may redeem winning tickets for up to 180 days after the draw for the game. As of June 30, 2013, unclaimed prizes were \$393,598 compared to \$369,442 on June 30, 2012. Prizes that expired in fiscal years ended June 30, 2013 and 2012 were \$440,175 and \$359,817, respectively.

### Deferred Revenue

A liability has been recorded for lottery tickets sold on or before June 30, 2013 and 2012 on multi-draw tickets and subscriptions that contain plays for future draws that will occur after June 30, 2013 and 2012. The amount related to future ticket sales on multi-draw tickets were \$84,495 and \$76,045 and the amount for future sales on subscriptions were \$275,060 and \$283,085 and classified as deferred revenue. Sales of uncashed gift certificates for June 30, 2013 and 2012 were \$5,344 and \$5,172, respectively, and are also classified as deferred revenue.

### Interfund Balances and Transfers

At June 30, 2013, the Lottery had nominal accounts payable and receivable involving normal business expenses with several state agencies and had net proceeds due to be transferred to one state fund.

By law, the net proceeds of the Lottery, less the amount allocated to the Compulsive Gambling Prevention and Treatment Fund, amount allocated to the Multi-Jurisdictional Drug Task Force Grant Fund, Lottery's share of a game's prize reserve pool, and holdback of any reserve funds the director may need for continuing operations, must be transferred to the State Treasurer on at least an annual basis for deposit in the state general fund. By law, \$50,000 must be transferred to the State Treasurer each quarter for deposit in the Compulsive Gambling Prevention and Treatment Fund and \$105,625 must be transferred to the State Treasurer each quarter for deposit in the Multi-Jurisdictional Drug Task Force Grant Fund. The reserve funds held by the director are funds that are required to be transferred to the MUSL for prize reserve pools. The balance of the net proceeds is transferred to the state general fund.

### Retailer Commissions

Lottery retailers receive a 5% commission on each ticket sold or otherwise provided to players, and for subscriptions that retailers initiated. Effective January 1, 2006, the Lottery provides retailers a bonus commission, as a sales incentive, for selling jackpot/grand prize and certain high tier prize winning tickets. The Lottery does not provide retailers a commission for redeeming winning tickets. Total retailer commissions for June 30, 2013 and 2012 were \$1,396,799 and \$1,315,067, including bonus commissions of \$37,000 and \$41,000, respectively.

### Marketing and Advertising

Costs incurred for developing creative, including point-of-sale items, research, and media advertising are expensed when incurred which generally is when point-of-sale items are first distributed to retailers or advertising first takes place.

### Accumulated Unpaid Vacation, Sick Pay, and Compensatory Pay

Annual leave and sick leave are a part of permanent employees' compensation as set forth in Section 54-06-14 of the North Dakota Century Code. Annual leave is earned based on tenure of employment, within a range of a minimum of one working day per month of employment, to a maximum of two working days per month of employment, to be fixed by rules and regulations adopted by the employing unit. In general, accrued annual leave cannot exceed 30 days at April 30 each year, as set by the Office of Attorney General. Employees are paid for unused annual leave upon termination or retirement.

Sick leave is earned at the rate of one working day per month of employment. There are no limitations on the amount of sick leave that an employee can accumulate. Employees who have ten continuous years of service are paid one-tenth of their accumulated sick leave upon termination or retirement under chapter 54-52 of the North Dakota Century Code. A liability is recognized for that portion of accumulated sick leave benefits that is estimated will be taken as required by the GASB Statement No. 16, *Accounting for Compensated Absences*.

Compensatory leave is earned by employees who work overtime each week in accordance with the Office of Attorney General's policy. Generally, upon termination or retirement, employees are not eligible to receive compensation for their compensatory leave balances.

## **Note 2 - Deposits**

### **Custodial Credit Risk**

State law generally requires all state funds be deposited in the state owned Bank of North Dakota. North Dakota Century Code (NDCC) Section 21-04-01 provides that public funds belonging to or in the custody of the state shall be deposited in the Bank of North Dakota. Also, NDCC Section 6-09-07 states, "[a]ll state funds ... must be deposited in the Bank of North Dakota" or must be deposited in accordance with constitutional and statutory provisions.

The Lottery deposits at the Bank of North Dakota at June 30, 2013 and 2012 were \$8,576,270 and \$8,003,166 respectively.

These deposits are exposed to custodial credit risk as uninsured and uncollateralized. However, these deposits at the Bank of North Dakota are guaranteed by the state of North Dakota through NDCC Section 6-09-10.

### Note 3 - Compensated Absences

A summary of compensated absences follows for 2013 and 2012:

Beginning balance, July 1, 2012	\$ 41,921
Addition	6,610
Reduction	
Ending balance, June 30, 2013	<u>\$ 48,531</u>
Amount payable within one year	<u>\$ 0</u>
Beginning balance, July 1, 2011	\$ 45,007
Addition	
Reduction	3,086
Ending balance, June 30, 2012	<u>\$ 41,921</u>
Amount payable within one year	<u>\$ 0</u>

### Note 4 - Due to / Due from Other State Funds

At June 30, 2013 and 2012, accounts payable due to several state agencies and transfers of net proceeds due to the state general fund are:

	<u>2013</u>	<u>2012</u>
Due to the Department of Transportation	\$ 664	\$ 2,518
Due to the Information Technology Department	13,226	2,359
Due to the Office of Management and Budget	499	845
Due to the Office of State Tax Commissioner	9,067	8,860
Due to the Office of State Auditors	-	300
Due to the Office of Attorney General	581	1,220
Due to the state General Fund	<u>7,300,000</u>	<u>7,000,000</u>
Total	<u>\$7,324,037</u>	<u>\$7,016,102</u>

## Note 5 - Equipment and Software

A summary of changes in equipment, software, and accumulated depreciation is as follows for 2013 and 2012:

	Equipment	Software	Accumulated Depreciation	Net
Balance, June 30, 2012	\$ 43,720	\$ 32,000	\$ 57,591	\$ 18,129
Additions			4,029	4,029
Disposals				0
Balance, June 30, 2013	<u>\$ 43,720</u>	<u>\$ 32,000</u>	<u>\$ 61,620</u>	<u>\$ 14,100</u>

  

	Equipment	Software	Accumulated Depreciation	Net
Balance, June 30, 2011	\$ 43,720	\$ 32,000	\$ 53,563	\$ 22,157
Additions			4,028	4,028
Disposals				0
Balance, June 30, 2012	<u>\$ 43,720</u>	<u>\$ 32,000</u>	<u>\$ 57,591</u>	<u>\$ 18,129</u>

## Note 6 - Employee Pension Plan

The North Dakota Lottery participates in the North Dakota Public Employees' Retirement System (NDPERS) administered by the state of North Dakota. The following is a brief description of the plan.

NDPERS is a cost-sharing multiple-employer defined benefit pension plan covering substantially all classified employees of the North Dakota Lottery. The plan provides retirement, disability, and death benefits. If an active employee passes away with less than three years of credited service, a death benefit equal to the value of the employee's accumulated contributions, plus interest, is paid to the employee's beneficiary. If the employee has earned more than three years of credited service, the surviving spouse is entitled to a single payment refund, life-time monthly payments in an amount equal to 50% of the employee's accrued normal retirement benefit, or 60 monthly payments equal to the employee's accrued normal retirement benefit calculated as if the employee were age 65 the day before death occurred or monthly payments in an amount equal to the employees' accrued 100% joint and survivor retirement benefit if the member had reached normal retirement age prior to date of death. If the surviving spouse passes away before the employee's accumulated pension benefits are paid, the balance is payable to the surviving spouse's designated beneficiary.

Eligible employees who become totally disabled after a minimum of 180 days of service receive monthly disability benefits that are equal to 25% of their final average salary with a minimum benefit of \$100. To qualify under this section, the employee must meet the criteria established by the Retirement Board for being considered totally disabled.

Employees are entitled to unreduced monthly pension benefits equal to 2.00% of their final average salary for each year of service beginning when the sum of age and years of credited service equal or exceed 85, or at normal retirement age (65). The plan permits early retirement at ages 55-65, with three or more years of service.

Benefit and contribution provisions are administered in accordance with chapter 54-52 of the North Dakota Century Code. This state statute requires employee contributions of 4% (effective through December 31, 2011), 5% (effective January 1, 2012), and 6% (effective January 1, 2013) of the participant's regular compensation. During the 1983-1985 biennium the state implemented the employer pickup provision of the IRS code whereby a portion or all of the required employee contributions are made by the employer. The state is paying 4% of the full employee contribution. Employer contributions of 4.12% (effective through December 31, 2011), 5.12% (effective January 1, 2012), and 6.12% (effective January 1, 2013) of covered compensation are set by statute. The required contributions are determined using an entry age normal actuarial funding method. The North Dakota Retirement Board was created by the State Legislature and is the governing authority of NDPERS. The Lottery's required actual contribution to NDPERS for the fiscal years ended June 30, 2013, 2012 and 2011 was \$51,294, \$42,301 and \$39,293, respectively.

NDPERS issues a publicly available financial report that includes financial statements and the required supplementary information for NDPERS. The report may be obtained by writing to NDPERS; 400 East Broadway, Suite 505, PO Box 1214, Bismarck, ND 58502-1214.

#### **Note 7 - Multi-State Lottery Association**

The Lottery is a member of the MUSL which administers games on behalf of member lotteries. MUSL administers the Powerball, Mega Millions, Hot Lotto, Wild Card 2, and 2by2 games for the Lottery. Each member lottery sells game tickets through its retailers and makes weekly wire transfers to MUSL in an amount equal to the member lottery's share of the jackpot prize liability. If this results in a negative amount, the MUSL transfers funds to the Lottery. Lesser prizes are paid directly to the winners by each member lottery. The prize pools for Powerball, Powerplay, Hot Lotto, and Triple Sizzler are 50% of each drawing period's sales, after the prize reserve accounts are funded to the amounts set by the game groups. The prize pool for Wild Card 2 is 57%. The prize pool for Mega Millions is up to 51.5% of the Mega Millions and Megaplier sales. The prize pool for 2by2 is 39.5% with the prize expense being 72.5% after the free tickets. Up to 5% of sales for Powerball and 2% of sales for Wild Card 2 are deducted from the prize pool and placed in prize reserve pools. Up to 5% of sales for Mega Millions are deducted from the prize pool and placed in prize reserve pools. For Hot Lotto, up to 1% of sales is deducted from the prize pool and placed in a prize reserve pool when the jackpot prize exceeds \$2 million. An additional 2% of sales are placed in the prize reserve fund after the annuitized jackpot prize exceeds \$5 million. When the prize reserve funds exceed the designated caps, the excess amount becomes part of the jackpot prize pool.

The prize reserve funds serve as a contingency reserve to protect MUSL from unforeseen prize liabilities and the money in this reserve fund is used at the discretion of the MUSL board of directors. The prize reserve fund monies are refundable to MUSL member lotteries if MUSL dissolves or if a member lottery leaves MUSL. A member lottery leaving MUSL must wait one year before receiving their remaining share, if any, of the prize reserve funds. Any amount

remaining in the prize pools at the end of the games is carried forward to a replacement game or expended in a manner as directed by the game group. The MUSL prize reserve pool account balance and the Lottery's share of that balance are as follows:

	<u>6/30/2013</u>	<u>6/30/2012</u>
MUSL prize reserve pool account	\$150,737,031	\$153,765,966
Lottery's share of the MUSL's prize reserve pool account (on deposit)	\$ 1,185,655	\$ 1,227,597

The Lottery also has an unreserved account with MUSL. Interest earned on MUSL funds, and any unclaimed jackpot prizes may be deposited into this account and Lottery board and game group dues and other MUSL related expenses may be paid from this fund.

	<u>6/30/2013</u>	<u>6/30/2012</u>
MUSL Unreserved Account	\$16,342,326	\$17,414,201
Lottery's share of the MUSL's Unreserved Account (on deposit)	\$ 101,101	\$ 17,744

A winner of a Powerball, Mega Millions, or Hot Lotto jackpot prize may select that the prize be paid at the cash value of the prize or as an annuity. A Powerball jackpot prize is paid out in 30 installments; a Mega Millions jackpot is paid out in 26 installments; and a Hot Lotto jackpot prize in 25 installments. Powerball annuitized prizes are paid annually in thirty graduated payments (increasing each year) by a rate determined by the Powerball game group. If a jackpot winner selects annual installments for Powerball, Mega Millions, or Hot Lotto, the MUSL purchases United States government securities to fund awarded prizes. The securities are held in Winner Trust accounts with the member lottery named as the trust beneficiary. MUSL transfers cash to the member lotteries to facilitate the payment of the annual jackpot prize amount. The source of this money is a game group's grand prize pool. The assets and related liabilities are reflected in the MUSL's financial statements and, therefore, are not reflected in the Lottery's financial statements. MUSL is responsible for transferring the cash or the annuity installment amounts to the member lottery before the payment to the jackpot prize winner. The Lottery currently is not paying any prize winner any annuity prize payments. The Wild Card 2 jackpot prize and 2by2 grand prize are paid in a single cash payment. The Powerball, Mega Millions, Hot Lotto, and Wild Card 2 jackpot prizes are divided equally among multiple winning tickets among the participating state lotteries.

As a member of the MUSL board and Powerball, Mega Millions, Hot Lotto, Wild Card 2, and 2by2 game groups, the Lottery is responsible for its pro-rated share of the MUSL board dues. MUSL Board dues for fiscal years ended June 30, 2013, and 2012, were \$20,000, and \$20,000, respectively. MUSL board dues and game group dues are decreased by MUSL's non-game earnings including, interest, web advertising, and trademark license fees.

## **Note 8 - Commitments and Contingencies**

The Lottery entered into contracts with:

1. Scientific Games International, Inc. of Alpharetta, GA on February 3, 2004. The vendor provides an online lottery gaming system and related services through March 24, 2014. Payments for the fiscal years ended June 30, 2013 and 2012 totaled \$2,442,356 and \$2,606,263 respectively. The Lottery's obligation through March 24, 2012 was based on 10.63% of ticket sales. The Lottery's obligation from March 25, 2012 through March 24, 2014 is 8.8761% of ticket sales; there is no minimum fee or retainer fee.
2. H2M of Fargo was the marketing vendor from July 1, 2007 through June 30, 2012. KKBold of Bismarck began providing marketing and related services to the Lottery on July 1, 2012, and their contract runs through June 30, 2015. Payments for the fiscal years ended June 30, 2013, and 2012, totaled \$323,389 and \$405,578, respectively. The Lottery's future obligation is for actual services requested; there is no minimum fee or retainer fee. The contract can be extended by the state by written notice no later than 30 days prior to the expiration of the original contract.
3. Safety & Security Services, Inc. of Oklahoma City, OK on April 1, 2012. The vendor provides standby services and, if necessary, security of the Scientific Games International, Inc.'s computer data center on days of the drawings through March 24, 2014. The payment for the fiscal years ended June 30, 2013 and 2012 totaled \$0 and \$160, respectively. There is no minimum future compensation per year since there is no compensation for standby services. Future compensation is based only on actual services performed at the data center.

The Lottery has a contingent gain estimated at \$257,452 at June 30, 2013 from prizes that may be forfeited due to winning players not claiming them within the required time frame. This contingent gain has not been accrued in these financial statements but will be recognized when realized.

## **Note 9 - Line of Credit**

In accordance with subsection 2 of section 53-12.1-02 of the North Dakota Century Code, the Lottery has secured a short-term line of credit with the Bank of North Dakota. The law provides that the line of credit be limited to the amount of each cash prize of \$100,000 or more that relates to prize funds known to be due and forthcoming to the Lottery from other government-authorized lotteries through the MUSL. The line of credit may not exceed \$1 million in the aggregate. To date, no credit advances have been requested.

## **Note 10 - Risk Management**

The Lottery is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Lottery, as a division of the Office of Attorney General, participates in the same funds/pools established by the state for risk management issues.

The 1995 Legislative Assembly established the Risk Management Fund (RMF), an internal service fund, to provide a self-insurance vehicle for funding the liability exposures of state agencies resulting from the elimination of the state's sovereign immunity. The RMF manages the tort liability of the state, its agencies' employees, and the University System. All state agencies participating in the RMF and their fund contribution was determined using a projected cost allocation approach. The statutory liability of the state is limited to a total of \$250,000 per person and \$1 million per occurrence.

The Office of Attorney General also participates in the North Dakota Fire and Tornado Fund. The office pays an annual premium to the Fire and Tornado Fund to cover property damage to building and personal property. Replacement cost coverage is provided by estimating replacement cost in consultation with the Fire and Tornado Fund.

The Office of Attorney General also participates in the State Bonding Fund in which the office has blanket employee fidelity bond coverage in the amount of \$2 million. The State Bonding Fund did not charge any premium for this coverage.

### **Note 11 - Postretirement Benefits**

Former employees receiving retirement benefits under the Retirement Plan for Employees of the Lottery are eligible to participate in the Retiree Health Benefits Fund, a cost-sharing multiple employer plan, as administered by the Public Employees Retirement Board. During each month of employment, the Lottery contributes 1% of each employee's salary into the Retiree Health Benefits Fund. Total contributions for the fiscal years ending June 30, 2013, 2012, and 2011 were \$5,460, \$4,922, and \$4,839, respectively.

### **Note 12 - Lease Commitments**

The North Dakota Lottery entered into an operating lease for its office space at 1050 East Interstate Avenue, Suite 200, Bismarck, ND 58503-5574. Lease expenditures for the fiscal year ended June 30, 2013 and 2012 totaled \$46,613 and \$46,613, respectively. The lease expires on June 30, 2017. The future annual rental commitments are as follows:

Lease Commitments for fiscal year ended June 30, 2013:		Lease Commitments for fiscal year ended June 30, 2012:	
<u>Years Ending</u>		<u>Years Ending</u>	
2014	48,505	2013	46,613
2015	48,505	2014	48,505
2016	50,464	2015	48,505
2017	<u>50,464</u>	2016	50,464
Total	<u>\$197,938</u>	2017	<u>50,464</u>
		Total	<u>\$244,551</u>



STATE AUDITOR  
ROBERT R. PETERSON



PHONE  
(701) 328 - 2241  
FAX  
(701) 328 - 1406

STATE OF NORTH DAKOTA  
**OFFICE OF THE STATE AUDITOR**  
STATE CAPITOL  
600 E. BOULEVARD AVENUE - DEPT. 117  
BISMARCK, NORTH DAKOTA 58505

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**Independent Auditor's 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**

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Honorable Jack Dalrymple, Governor

Members of the Legislative Assembly

Honorable Wayne Stenehjem, Attorney General

Randy Miller, Director North Dakota Lottery

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of the business-type activities of the North Dakota Lottery, a division of the Office of the Attorney General of the State of North Dakota as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the North Dakota Lottery's basic financial statements, and have issued our report thereon dated November 12, 2013.

**Internal Control Over Financial Reporting**

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

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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*North Dakota Lottery*  
*For the years ended June 30, 2013 and 2012*

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

### **Compliance and Other Matters**

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

### **Purpose of this Report**

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



Robert R. Peterson  
State Auditor

Bismarck, North Dakota

November 12, 2013

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**Special Comments Requested by the Legislative Audit and Fiscal Review Committee**  
For The Year Ended June 30, 2013

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The Legislative Audit and Fiscal Review Committee requires that certain items be addressed by auditors performing audits of state agencies. These items and our responses are as follows:

***Responses to LAFRC Audit Questions***

**1. What type of opinion was issued on the financial statements?**

Unmodified.

**2. Was there compliance with statutes, laws, rules, and regulations under which the agency was created and is functioning?**

Yes.

**3. Was internal control adequate and functioning effectively?**

Yes.

**4. Were there any indications of lack of efficiency in financial operations and management of the agency?**

No.

**5. Has action been taken on findings and recommendations included in prior audit reports?**

There were no formal recommendations included in the prior audit report.

**6. Was a management letter issued? If so, provide a summary below, including any recommendations and the management responses.**

Yes, a management letter was issued and is included on page 27 of this report, along with management's response.

## **LAFRC Audit Communications**

### **1. Identify any significant changes in accounting policies, any management conflicts of interest, any contingent liabilities, or any significant unusual transactions.**

The North Dakota Lottery changed accounting policies related to the format of the statement of Net Position that reposts separately, all assets, deferred outflows of resources, liabilities, deferred inflow resources, and net position by adopting Statement of Governmental Accounting Standards (GASB Statement) No. 63, Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position, in 2013.

No management conflicts of interest were noted.

No contingent liabilities were identified.

There were no significant or unusual transactions.

### **2. Identify any significant accounting estimates, the process used by management to formulate the accounting estimates, and the basis for the auditor's conclusions regarding the reasonableness of those estimates.**

The North Dakota Lottery's financial statements do not include any significant accounting estimates.

### **3. Identify any significant audit adjustments.**

Significant audit adjustments were not necessary.

### **4. Identify any disagreements with management, whether or not resolved to the auditor's satisfaction relating to a financial accounting, reporting, or auditing matter that could be significant to the financial statements.**

None.

### **5. Identify any serious difficulties encountered in performing the audit.**

None.

### **6. Identify any major issues discussed with management prior to retention.**

This is not applicable for audits conducted by the Office of the State Auditor.

### **7. Identify any management consultations with other accountants about auditing and accounting matters.**

None.

**8. Identify any high-risk information technology systems critical to operations based on the auditor's overall assessment of the importance of the system to the agency and its mission, or whether any exceptions identified in the six audit report questions to be addressed by the auditors are directly related to the operations of an information technology system.**

ConnectND Finance, Human Resource Management System (HRMS), Games Management System (GMS), and Internal Control System (ICS) are high risk systems critical to the ND Lottery.

STATE AUDITOR  
ROBERT R. PETERSON



PHONE  
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STATE OF NORTH DAKOTA  
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## Governance Communications

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November 12, 2013

To: Honorable Wayne Stenehjem, Attorney General  
The Legislative Audit and Fiscal Review Committee

We have audited the financial statements of the North Dakota Lottery for the year ended June 30, 2013, and have issued our report thereon dated November 12, 2013. Professional standards require that we provide you with the following information related to our audit.

### **Qualitative Aspects of Accounting Practices**

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by North Dakota Lottery are described in Note 1 to the financial statements. As described in Note 1 to the financial statements, the North Dakota Lottery changed accounting policies related to the format of the statement of Net Position that reposts separately, all assets, deferred outflows of resources, liabilities, deferred inflow resources, and net position by adopting Statement of Governmental Accounting Standards (GASB Statement) No. 63, Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position, in 2013. Accordingly, the cumulative effect of the accounting change as of the beginning of the year is reported in the statement of Net Position.

We noted no transactions entered into by the governmental unit during the year for which there is a lack of authoritative guidance or consensus. There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

### **Difficulties Encountered in Performing the Audit**

We didn't encounter any difficulties in dealing with management in performing and completing our audit.

## Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. The table below summarizes an uncorrected likely misstatement of the financial statements. Management has determined that its effect is immaterial to the financial statements taken as a whole. In addition, none of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to the financial statements taken as a whole.

Account	Debit	Credit
Prepaid Expenses	\$9,314	
Operating Expenses		\$9,314

## Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

## Management Representations

We have requested certain representations from management that are included in the management representation letter dated November 12, 2013.

## Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

## Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the governmental unit's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention. It should be noted that the retention of the State Auditor is a matter of state law and is not under control of the North Dakota Lottery.

The following presents our informal recommendations.

### **Expenditures**

Informal Recommendation 13-1: We recommend the North Dakota Lottery complete their checklist for prizes of \$5,000 or greater to ensure all requirements have been completed.

### **Financial Statements**

Informal Recommendation 13-2: We recommend the preparer of the ND Lottery financial statements review all formulas used in preparing the financial statements.

Informal Recommendation 13-3: We recommend the ND Lottery establish policies and procedures to ensure management reviews and approves the financial statements, including significant adjustments and elimination entries, before they are provided to the auditors.

Management of the North Dakota Lottery agreed with these recommendations.

### **Other Matters**

With respect to the supplementary information accompanying the financial statements, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, and the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

This information is intended solely for the use of Attorney General Wayne Stenehjem, the Legislative Audit and Fiscal Review Committee, and management of the North Dakota Lottery and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,



Cindi Pedersen, CPA  
Audit Manager



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[www.nd.gov/auditor/](http://www.nd.gov/auditor/)

or by contacting the  
Division of State Audit

Office of the State Auditor  
600 East Boulevard Avenue – Department 117  
Bismarck, ND 58505-0060

(701) 328-2241