Arizona State Lottery, A Component Unit of the State of Arizona

Financial Statements as of and for the Year Ended June 30, 2008, Supplemental Schedule for the Year Ended June 30, 2008, and Independent Auditors' Report

ARIZONA STATE LOTTERY,
A COMPONENT UNIT OF THE STATE OF ARIZONA

TABLE OF CONTENTS

	Page
INTRODUCTION SECTION — Letter of Transmittal	i–ii
INDEPENDENT AUDITORS' REPORT	1–2
MANAGEMENT'S DISCUSSION AND ANALYSIS	3–6
FINANCIAL STATEMENTS AS OF AND FOR THE YEAR ENDED JUNE 30, 2008:	
Statement of Net Assets	7
Statement of Revenues, Expenses, and Changes in Fund Net Assets	8
Statement of Cash Flows	9
Notes to Financial Statements	10–14
SUPPLEMENTAL SCHEDULE FOR THE YEAR ENDED JUNE 30, 2008 —	15
Schedule of Gross Profit by Game for Games Expiring During the Year	16–21

Janice K. Brewer
Governor

J. Art Macias, Jr.
Executive Director

January 23, 2009

Dear Arizona Lottery Commissioners:

The Arizona Lottery is pleased to submit its audited financial statements as of and for the year ended June 30, 2008, as prepared by the Lottery Accounting Department and audited by Deloitte & Touche LLP. The Lottery is responsible for the accuracy and completeness of all data and disclosures in this report. To the best of our knowledge, the information presented is accurate and complete in all material respects and fairly depicts the financial position of the Arizona Lottery. This report includes a statement of net assets of the Arizona Lottery, the related statement of revenues, expenses, and changes in fund net assets; the statement of cash flows; footnotes related to the financial reports; and the supplemental schedule of gross profit by game.

The audit of the Arizona Lottery was performed under the authority of A.R.S. § 5-505 and A.R.S. § 5-524, which require an annual audit of the Lottery.

The Arizona Lottery was created in 1980 when Arizona voters approved a ballot initiative adding Title 5, Chapter 5 to the Arizona Revised Statutes. The Lottery began selling instant "scratch-off" tickets in July 1981 and during its 27 years of operation has offered a variety of instant and on-line products. The Lottery operates as an agency of the State of Arizona and is reported as an enterprise fund within the state's Comprehensive Annual Financial Report. The fund is operated in a manner similar to a private business enterprise.

In fiscal year 2008, the Arizona Lottery had revenues of $472.9 million from Lottery ticket sales, 2.3% more than last fiscal year, and an income before transfers of $144.6 million, 3.3% more than last fiscal year. More than $262 million was paid to our players in prizes and our retail partners received $31.3 million for sales commissions. In its 27 years of operation, the Lottery has produced nearly $6.9 billion in Lottery ticket sales.

In fiscal year 2008, the Arizona Lottery made transfers to other State Funds of $34.5 million for the Local Transportation Assistance Fund, $7.7 million for the County Assistance Fund, $20.0 million for the Heritage Fund, $3.6 million for the Economic Development Fund, $0.3 million

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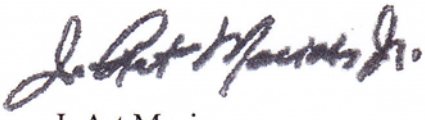
for the Department of Gaming, $21.3 million for the Healthy Arizona Fund, $1.0 million to the Department of Economic Security for homeless shelters and $53.5 million was transferred to the State General Fund for allocation by the state legislature. In addition, from the Lottery Prize Fund, over $2.6 million was transferred to the Court Appointed Special Advocate (CASA). In total, $144.5 million was transferred to other State Funds for fiscal year 2008. In its 27 years of operation, the Lottery has returned over $2.2 billion to its beneficiaries.

Further financial results for fiscal year 2008 are detailed in Management's Discussion and Analysis, included in this report.

Sincerely,



J. Art Macias
Executive Director

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INDEPENDENT AUDITORS' REPORT

To the Commissioners of
Arizona State Lottery
Phoenix, Arizona

We have audited the accompanying statement of net assets of Arizona State Lottery (the "Lottery"), a component unit of the State of Arizona, as of June 30, 2008 (with comparative totals as of June 30, 2007), and the related statements of revenues, expenses, and changes in fund net assets and of cash flows for the year then ended (with comparative totals for the year ended June 30, 2007). These financial statements are the responsibility of the Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year comparative totals information has been derived from the Lottery's 2007 financial statements and, in our report dated February 27, 2008, we expressed an unqualified opinion on those financial statements.

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 of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the respective financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Lottery's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Lottery as of June 30, 2008, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying required supplementary information, management's discussion and analysis, is presented on pages 3 through 6 and is not a required part of the basic financial statements, but is supplementary accounting information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the Lottery's management. 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 we do not express an opinion on it.

Our audit was conducted for the purpose of forming an opinion on the Lottery's basic financial statements. The accompanying schedule of gross profit by game is presented for purposes of additional analysis and is not a required part of the basic financial statements. This schedule is the responsibility of the Lottery's management. Such information has been subjected to the auditing procedures applied by us

in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 23, 2009, on our consideration of the Lottery's internal control over financial reporting and our tests of its compliance and other matters. The purpose of that report is to describe the scope of our 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 read in conjunction with this report in considering the results of our audit.

Deloitte & Touche LLP

January 23, 2009

ARIZONA STATE LOTTERY,
A COMPONENT UNIT OF THE STATE OF ARIZONA
PROPRIETARY FUND — ENTERPRISE FUND

MANAGEMENT'S DISCUSSION AND ANALYSIS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2008

This discussion and analysis of the Lottery's financial statements is a required component of financial reporting under *Government Accounting Standards* and was prepared by Arizona Lottery Management. It provides an overview of financial activities as of and for the year ended June 30, 2008, and should be read in conjunction with the Lottery's financial statements and notes to the financial statements.

This annual report consists of three types of financial statements and accompanying notes that provide explanations and details of accounting policies, account balances and activities. Account balances and activities are shown as of and for the year ended June 30, 2008, with comparative totals for June 30, 2007. The statement of net assets; the statement of revenues, expenses, and changes in Fund net assets; and the notes are presented using the accrual method of accounting. Under this method, financial transactions are recorded when earned or incurred regardless of when cash is received or disbursed. The statement of cash flows reflects cash receipts and disbursements during the same 12-month periods.

The statement of net assets provides information about the assets and liabilities of the Lottery. Assets consist of cash, substantially all held by the State Treasurer, amounts owed to the Lottery from licensed Lottery retailers and other State agencies, ticket inventory, and property. Liabilities represent amounts owed by the Lottery to vendors, to employees for wages and benefits, to prize winners, and to other State funds. Fund net assets represent the portion of the Lottery's assets that are not encumbered by liabilities. It serves as an indicator of the net worth of the Lottery.

A summary of the financial results of operations for the 12-month periods is presented in the statement of revenues, expenses, and changes in Fund net assets. Operating revenues include sales of Lottery tickets, retailer licensing fees, and commissions earned on the sales of Lottery tickets at Lottery offices, and special events. Direct costs and administrative expenses comprise the operating expenses section of this statement. Direct costs are variable expenses that fluctuate with the level of sales. Marketing and overhead costs are included in the administrative expenses category.

Nonoperating revenues consist of interest earned on prize fund cash investments from the State Treasurer and interest credited to the Lottery's Multistate Lottery Association (MUSL) unreserved account for interest earned on prize reserves at MUSL. The transfers category includes transfers to other state funds as required by Lottery statutes.

The statement of cash flows includes cash receipts and disbursements from operating, noncapital financing, and investment earnings. This statement also includes a reconciliation of operating income presented on the accrual basis of accounting to net cash provided by operating activities.

The notes to the financial statements present information on accounting policies, transfers and statutory requirements, commitments, contingencies, and retirement benefits. These notes are an integral part of the financial statements.

Sales Activities

Revenues from the sale of Lottery products for the fiscal year ended June 30, 2008 were higher than Fiscal Year 2007. As shown in the financial statements, sales increased 2.3% from the prior year, from $462.2 million in Fiscal Year 2007 to $472.9 million in the current year. The increases in Powerball®, The Pick, Pick 5™, and Pick 3™ sales, and the introduction of the Arizona Raffle™ and Fast Play™ games more than offset the decrease in Scratchers℠ sales.

The following table compares Lottery product sales between fiscal years. Sales are presented in millions of dollars.

Product Sales	FY 2008	FY 2007	Difference	Percentage
Scratchers (including economic development)	$252.5	$261.0	-$8.5	-3.3%
Powerball	130.4	127.3	3.1	2.4%
The Pick	52.6	52.4	0.2	0.4%
Pick 5	14.2	12.6	1.6	12.7%
Arizona Raffle	11.9		11.9	100.0%
Pick 3	9.5	8.9	0.6	6.7%
Fast Play	1.8		1.8	100.0%
Total	$472.9	$462.2	$10.7	2.3%

Total Revenues

Nonoperating revenues for the year ended June 30, 2008, were approximately $1,135,100 as compared to approximately $780,100 for the year ended June 30, 2007. Nonoperating revenue is comprised of interest earned on invested cash and periodic recognition of commissions earned by the Lottery.

Total revenues were $474.2 million for the year ended June 30, 2008, as compared to $463.1 million for the year ended June 30, 2007. As mentioned above, most of the increase was due to an increase in sales revenues.

Major Expenses

$309.6 million of the Lottery's total operating expenses of $329.6 million for the year ended June 30, 2008 were incurred in direct support of the sales of Lottery games. These expenses include prize expense, retailer commissions and incentives, purchases of Scratchers tickets, compensation to the vendor for Scratchers ticket distribution, and compensation to the vendor who maintains and supports the on-line gaming system.

In comparison, $303.1 million of the Lottery's total operating expenses of $323.1 million for the year ended June 30, 2007, were game-related expenses.

The following table compares the game-related expenses between fiscal years. All expenses are presented in millions of dollars.

Game Related Expenses	FY 2008	FY 2007	Difference	Percentage
Prize Expense	$262.5	$257.5	$5.0	1.9%
Retailer Commissions	31.3	31.1	0.2	0.6%
On-line System Expenses	8.9	8.2	0.7	8.5%
Scratchers System and Distribution Expenses	2.1	2.2	-0.1	-4.5%
Tickets Purchased	4.8	4.1	0.7	17.1%
Total	$309.6	$303.1	$6.5	2.1%

The increase in prize expense, retailer commissions, and on-line system expenses is reflective of the increase in product sales. See the product sales schedule above. The increase in tickets purchased is related to the higher number of Scratchers games ended during the period and the inclusion of higher price point tickets that are costlier to print into the sales mix.

The Lottery's contract with an outside vendor for Scratchers ticket distribution and accounting services resulted in decreased costs of approximately $66,600 over last fiscal year because of lower Scratchers sales.

Of the $20.0 million in Fiscal Year 2008 in other operating expenses, $10.8 million was used for advertising and promotion and $6.1 million was used to compensate Lottery employees. In comparison, of the $19.9 million in Fiscal Year 2007 other operating expenses, $10.7 million was used for advertising and promotion and $6.1 million was used to compensate Lottery employees.

Transfers to Other State Funds

Note 3 to the financial statements details the amounts transferred to other State Funds. The Lottery transferred $144.5 million to other State Funds. The increase in product sales of $10.7 million in this fiscal year resulted in an increase of $4.6 million in the amount transferred to other State Funds. This year's transfers were $17.6 million above the minimum transfers required in Lottery Statutes.

Other Financial Information

Statement of Net Assets	FY 2008	FY 2007
Current Assets	$64.5	$68.1
Capital Assets	4.0	4.1
Other Assets — Deposit	7.8	7.1
Total Assets	76.3	79.3
Current Liabilities	64.8	68.0
Net Assets	$11.5	$11.3

The Lottery's total assets at June 30, 2008, were $76.3 million. Assets consisted of cash held substantially by the State Treasurer of $55.8 million, receivables from Lottery retailers for the sale of Lottery products of $5.2 million, Scratchers ticket inventory of $3.5 million, net investment in fixed assets of $4.0 million, and a deposit with MUSL of $7.8 million.

Comparable figures at June 30, 2007, were $79.3 million in total assets, including $59.8 million in cash held by the State Treasurer, $4.3 million in receivables from retailers, $3.9 million in Scratchers ticket inventory, net investment in fixed assets of $4.2 million, and a MUSL deposit of $7.1 million.

Total liabilities at June 30, 2008, were $64.8 million, consisting of $3.6 million in accounts payable and accrued expenses, prize liabilities of $34.3 million, and amounts due to other State Funds of $26.9 million. All of the Lottery's liabilities were current liabilities.

The Lottery's total liabilities at June 30, 2007, were $68.0 million, which consisted of $4.5 million of accounts payable and accrued expenses, prize liabilities of $33.5 million, and amounts due to other State Funds of $30.0 million. All liabilities were current liabilities.

Total net assets at June 30, 2008, were $11.5 million, an increase of $0.1 million or .9% over total net assets at June 30, 2007. $7.4 million of the Lottery's total net assets are unrestricted.

BUDGETARY HIGHLIGHTS

The Lottery's budget is set by the legislative appropriations process on a biennial basis. The budgets for Fiscal Years 2008 and 2007 were set in the regular legislative session of 2007. The Lottery's budget was amended in the regular legislative session of 2008. The Lottery's appropriation for sales-related expenditures is based on approved percentages of projected revenues and is allowed to increase for these items without a supplemental appropriations request if actual revenues exceed projected revenues. The appropriation does not include an amount for prizes because Lottery statutes set this amount at "not less than 50% of the total annual revenues accruing from the sale of Lottery tickets or shares."

The Lottery's appropriation was $70.2 million at the beginning of the year and decreased to $69.6 million, as actual revenues did not meet budgeted projections.

CONTACTING THE LOTTERY'S FINANCIAL MANAGEMENT

This management's discussion and analysis (MD&A) is designed to provide Arizona citizens, Arizona government officials, our players, retailers, and other interested parties with an overview of the Lottery's financial activity for Fiscal Year 2008 and to demonstrate the Lottery's accountability for the money it received from the sale of Lottery products.

If you have questions about the MD&A or need additional information, contact the Arizona Lottery's Director of Audit and Accounting, 4740 East University, Phoenix, Arizona 85034.

J. Art Macias, Jr.
Executive Director

William B. Kaehler
Director of Accounting and Audit

ARIZONA STATE LOTTERY,
A COMPONENT UNIT OF THE STATE OF ARIZONA
PROPRIETARY FUND — ENTERPRISE FUND

STATEMENT OF NET ASSETS
AS OF JUNE 30, 2008
(With comparative totals for June 30, 2007)

	2008	2007
ASSETS		
CURRENT ASSETS:		
Cash — substantially all held by the State Treasurer	$55,850,443	$59,850,581
Accounts receivable — net of allowance for doubtful accounts of $145,000 and $145,000 in 2008 and 2007, respectively	5,172,990	4,265,176
Scratch ticket inventory	3,514,250	3,946,174
Total current assets	64,537,683	68,061,931
CAPITAL ASSETS:		
Land	937,830	937,830
Land improvements	330,865	330,865
Buildings	3,602,783	3,488,840
Furniture, fixtures, and equipment	2,376,841	2,577,775
Construction in progress	45,489	118,319
Less accumulated depreciation	(3,292,008)	(3,298,892)
Total capital assets	4,001,800	4,154,737
OTHER ASSETS — Deposit — Powerball	7,747,729	7,128,149
TOTAL	$76,287,212	$79,344,817
LIABILITIES		
CURRENT LIABILITIES:		
Accounts payable and accrued expenses	$ 3,644,267	$ 4,472,896
Prize liability	34,273,436	33,484,616
Due to other state funds	26,879,603	30,005,031
TOTAL	64,797,306	67,962,543
NET ASSETS		
INVESTED IN CAPITAL ASSETS	4,001,800	4,154,737
UNRESTRICTED	7,488,106	7,227,537
TOTAL	$11,489,906	$11,382,274

See notes to financial statements.

ARIZONA STATE LOTTERY,
A COMPONENT UNIT OF THE STATE OF ARIZONA
PROPRIETARY FUND — ENTERPRISE FUND

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS
FOR THE YEAR ENDED JUNE 30, 2008
(With comparative totals for the year ended June 30, 2007)

	2008	2007
OPERATING REVENUES:		
Ticket sales:		
Scratchers	$ 239,227,853	$ 250,680,198
Economic development	13,220,586	10,338,253
Powerball	130,424,083	127,278,294
The Pick	52,552,416	52,410,989
Pick 5	14,191,389	12,566,113
Arizona Raffle	11,943,120	
Pick 3	9,530,550	8,926,133
Fast Play	1,847,281	
Total ticket sales	472,937,278	462,199,980
Other operating revenues	114,916	100,213
Total operating revenues	473,052,194	462,300,193
OPERATING EXPENSES:		
Direct costs:		
Prize expense	262,486,159	257,493,027
Retailer commissions and incentives	31,312,957	31,121,336
On-line system expense	8,890,551	8,171,753
Scratcher system and distribution expenses	2,107,944	2,174,504
Tickets purchased	4,756,628	4,152,149
Total direct costs	309,554,239	303,112,769
Advertising and promotion	10,816,867	10,683,681
Wages and related expenses	6,095,428	6,118,238
Contract services	348,976	368,051
Depreciation	316,099	260,370
Administrative expenses	2,447,080	2,531,722
Total operating expenses	329,578,689	323,074,831
OPERATING INCOME	143,473,505	139,225,362
NONOPERATING REVENUES — Interest earnings	1,135,098	780,136
INCOME BEFORE TRANSFERS	144,608,603	140,005,498
TRANSFERS TO OTHER STATE FUNDS	144,500,971	139,914,976
CHANGE IN FUND NET ASSETS	107,632	90,522
FUND NET ASSETS — Beginning of year	11,382,274	11,291,752
FUND NET ASSETS — End of year	$ 11,489,906	$ 11,382,274

See notes to financial statements.

ARIZONA STATE LOTTERY,
A COMPONENT UNIT OF THE STATE OF ARIZONA
PROPRIETARY FUND — ENTERPRISE FUND

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2008
(With comparative totals for the year ended June 30, 2007)

	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from retailers — net of commissions and incentives	$ 262,696,646	$ 248,496,403
Cash received from other sources	10,412,785	40,594,066
Cash payments for prizes and related taxes	(93,863,066)	(117,034,564)
Cash payments to supplies of goods or services	(29,955,778)	(27,743,259)
Cash payments to employees	(6,087,607)	(6,131,058)
Net cash provided by operating activities	143,202,980	138,181,588
CASH FLOWS USED BY NONCAPITAL FINANCING ACTIVITIES — Cash payments to beneficiaries per Lottery Statutes	(147,626,398)	(134,890,430)
CASH FLOWS USED BY CAPITAL FINANCING ACTIVITIES — Payments for acquisition of capital assets	(163,161)	(738,038)
CASH FLOWS FROM INVESTING ACTIVITIES — Receipts of interest	586,441	681,724
NET (DECREASE) INCREASE IN CASH	(4,000,138)	3,234,844
CASH — Beginning of year	59,850,581	56,615,737
CASH — End of year	$ 55,850,443	$ 59,850,581
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating income	$ 143,473,505	$ 139,225,362
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	316,099	260,370
Loss on disposal of equipment	43,589	7,337
Changes in assets and liabilities:		
Accounts receivable and due from other State agencies	(402,748)	(677,569)
Ticket inventory	431,924	(1,048,939)
Deposit — Powerball	(619,580)	187,686
Accounts payable and accrued expenses	(828,629)	1,598,669
Prizes and withholdings payable	788,820	(1,371,328)
Total adjustments	(270,525)	(1,043,774)
NET CASH PROVIDED BY OPERATING ACTIVITIES	$ 143,202,980	$ 138,181,588

See notes to financial statements.

1. DESCRIPTION OF OPERATIONS

The Arizona State Lottery (the "Lottery") was created by enactment of Title 5, Chapter 5 to the Arizona Revised Statutes (ARS), which was an initiative measure approved by the voters of the State of Arizona in 1980. The Lottery commenced operations in 1981. The Lottery is a component unit of the State of Arizona (the "State"). The accompanying financial statements present information as to the transactions of the Lottery.

The financial statements include prior-year comparative information, but the notes to the financial statements omit prior-year information required for a presentation in conformity with generally accepted accounting principles. Accordingly, such prior-year information should be read in conjunction with the Lottery's financial statements for the year ended June 30, 2007, from which the information was derived.

For the period July 1, 2007 through June 30, 2008, the Lottery held 105 instant games (games 439, 453, 468, 478, 480-481, 483-485, 487, 489-491, 496, 498, 499-506, 508-535, 537-544, 546-547, 549-565, 567-590, 598, 600, and 603), four of which were Economic Development games (games 499, 502, 553 and 572). During 2008, the Lottery introduced its "Arizona Raffle" game, which was held twice during the fiscal year. During 2008, the Lottery continued the "Pick 3," "Pick 5," "The Pick," and "Powerball" on-line games, and introduced the "Fast Play" on-line game. As required, the Lottery has a deposit with "Powerball," a multistate on-line lottery game, of $7,747,729 at June 30, 2008.

2. SIGNIFICANT ACCOUNTING POLICIES

The Lottery prepares its financial statements in accordance with accounting principles generally accepted in the United States of America.

State Lottery Fund — The State Lottery Fund (the "Fund"), which is an Enterprise Fund of the State of Arizona, accounts for revenues received from the sale of lottery tickets and the receipt of license fees. The Fund is operated in a manner similar to a private business enterprise where the governing body has decided that periodic determination of revenues earned, expenses incurred, and net income is appropriate for capital maintenance, management control, accountability, or other purposes. Activities accounted for in the proprietary fund follow all applicable Government Accounting Standards Board pronouncements as well as applicable Financial Accounting Standards Board pronouncements issued on or before November 30, 1989. The Fund accounts for prize payments, operational expenses, including consulting, promotional, and advertising expenses, and transfers of monies to other State funds. Receipts from each type of lottery game are to be allocated as follows:

- Not less than 50% of the total annual revenue from lottery ticket sales is apportioned for the payment of prizes to the holders of winning tickets for the period July 1, 2007 to June 30, 2008.

- During the period of July 1, 2007 to June 30, 2008, not less than 29% of receipts for "Pick 5," "Pick 3," "The Pick" and "Powerball," and not less than 21.5% of receipts for instant games must be apportioned for transfer to a designated State fund.

- Expenditures related to promotional or advertising services are restricted to not more than 4.0% of the total annual gross revenues of the Lottery. Legislative appropriation further restricted advertising expenditures during 2008 to 2.7% of the gross revenues or $11 million, whichever is less. All other receipts can be used by the Lottery for operations, subject to legislative appropriation, or transferred to other State funds.

In addition, State statute requires that 30% of all unclaimed prizes be transferred to the Court Appointed Special Advocate Account, a fund within the State's General Fund.

Ticket Sales and Revenue Recognition — Revenue is recognized and the related direct expenses of ticket sales are accrued based upon the known relationship of the amount of ticket sales to the amount of prizes for each game. This method of measuring revenue is necessary in order to properly match revenues and expenses.

Property and Equipment — Property and equipment of the Fund, which consists principally of buildings, land, land improvements, and office furniture and equipment are stated at historical cost. Expenditures for normal repairs and maintenance are charged to operations as incurred, whereas expenditures for major renewals, replacements, and betterments are capitalized and depreciated. Depreciation is provided for as follows:

	Method	Estimated Useful Life
Buildings	Straight-line	40 years
Land improvements	Straight-line	20 years
Furniture, fixtures, and computer equipment	Straight-line	5–7 years

Investment Income — Investment income from all investments is recognized in the Fund, which includes invested cash held by the State Treasurer and invested prize reserves held by the Multistate Lottery Association.

Ticket Inventory — Ticket inventory is stated at cost, which represents the amount incurred by the Lottery for purchasing the tickets.

Cash — Substantially all the Lottery's cash is held by the State Treasurer for pooled investment purposes. Statutes require the State Treasurer to invest these pooled funds in obligations of the U.S. government and are recorded at fair value.

Compensated Absences — Vacation leave vests with the employee as it is earned. Employees may carry forward only the amount of vacation benefits equal to the maximum allowable accumulated credits for the preceding calendar year. Accordingly, at June 30, 2008, the Fund's accounts payable and accrued expenses balance includes an accrual of vacation pay and related benefits of $320,940. Upon termination or retirement, an employee will be compensated for accumulated leave up to a maximum of 240 hours, dependent upon accumulated time and the individual's benefits associated with their rank as defined by State personnel rule #R2-5-403. Payment will be based on the individual's rate of pay at termination or retirement. Upon death, the same benefits shall be paid to the employee's beneficiary.

Use of Estimates — The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets

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

3. TRANSFERS AND STATUTORY REQUIREMENTS

The Lottery made the following transfers during the year ended June 30, 2008, as required by ARS Section 5-505.

Transfers to the State of Arizona:	
County assistance fund	$ 7,650,000
Court appointed special advocate account	2,612,271
Department of gaming	300,000
Economic development commission fund	3,605,500
General fund	53,500,800
Healthy Arizona fund	21,320,700
Heritage fund	20,000,000
Local transportation assistance fund	34,511,700
Department of economic security — homeless shelters	1,000,000
Total transfers to other State of Arizona funds	$144,500,971

These transactions met the minimum percentage requirements imposed upon the Lottery by statute.

4. CAPITAL ASSETS

Capital assets activity for the year ended June 30, 2008, was as follows:

	Beginning Balance	Increases	Decreases	Transfers	Ending Balance
Capital assets:					
Land	$ 937,830	$ -	$ -	$ -	$ 937,830
Land improvements	330,865				330,865
Buildings	3,488,840		(8,514)	122,457	3,602,783
Furniture, fixtures, and equipments	2,577,775	113,535	(314,469)		2,376,841
Construction in progress	118,319	49,627		(122,457)	45,489
Total capital assets	7,453,629	163,162	(322,983)	-	7,293,808
Less accumulated depreciation for:					
Land improvements	(329,894)	(485)			(330,379)
Buildings	(1,377,435)	(102,272)			(1,479,707)
Furniture, fixtures, and equipments	(1,591,563)	(213,342)	322,983		(1,481,922)
Total accumulated depreciation	(3,298,892)	(316,099)	322,983	-	(3,292,008)
Total capital assets — net	$ 4,154,737	$(152,937)	$ -	$ -	$ 4,001,800

5. PRIZE LIABILITY

Prize liability activity for the year ended June 30, 2008, was as follows:

	Balance July 1, 2007	Increases	Decreases	Balance June 30, 2008
Prize liability	$33,484,616	$265,123,205	$(264,334,385)	$34,273,436

6. COMMITMENTS

The Lottery enters into various contracts for goods and services during the normal course of its business. All contacts and purchasing activity are subject to the Arizona State Procurement Code and the rules of the Arizona State Procurement Office. All contracts have incorporated into them the "Standard Terms and Conditions" as required by the Arizona State Procurement Office. These terms and conditions in all the contracts allow for cancellation for lack of funding in the current fiscal year or next fiscal year. The contract may also be terminated for the Lottery's convenience at any time with no penalty when it is in the best interest of the State.

Net rental expense for the year ended June 30, 2008, was $60,287.

Effective September 1, 2006, the Lottery entered into a five-year contract with G-Tech Services, Inc. for computer processing services at a base contract rate of 3.5455% of on-line sales.

7. CONTINGENCIES

Annuities are purchased for all prizes over $400,000 for which winners will receive the jackpot in annual installments for The Pick on-line game. These annuities are purchased from qualifying insurance companies, which have the highest ratings from among A.M. Best Company, Standard & Poor's, Moody, Duff & Phelps, or Weiss. The Lottery may incur future liabilities on these annuities. Aggregate future payments to prize winners on existing annuities totaled approximately $98,655,156 at June 30, 2008. Approximately $76,926,787 of the total aggregate future payments at June 30, 2008, relate to annuities purchased from five separate insurance companies, of which approximately $22,409,756 relates to a single insurance company.

Tort claims against the Lottery, its agents, officers, and employees who are acting in the scope and course of their employment with the Lottery are covered pursuant to the State Risk Management statute, A.R.S. § 41-621. There is no limit to that coverage. Therefore, as to any claims based on tort, there is no contingent liability to the budget of the Arizona Lottery.

The Lottery is involved in various legal proceedings, which arose in the normal course of business. Management of the Lottery does not believe that the ultimate resolution of these matters will have a material effect on the financial position, results of operations, or cash flows of the Lottery.

8. RETIREMENT PLAN

Permanent, full-time employees of the Lottery are covered by the Arizona State Retirement Plan (the "Plan"), a retirement plan administered by the Arizona State Retirement System (ASRS), which is a multiple employer, cost-sharing pension plan. The Comprehensive Annual Financial Report of the ASRS can be obtained by accessing www.azasrs.gov. The Plan was established by the State to provide benefits for employees of the State and employees of participating political subdivisions and school

districts. The Plan became effective on July 1, 1971. By actuarial computation, employee member contributions to the Plan were fixed at 9.10%, 8.60%, and 6.90% of their compensation for the years ended June 30, 2008, 2007, and 2006, respectively, with the contributions made through payroll deduction. Employee contributions vest immediately. Total contributions to the Plan for the years ended June 30, 2008, 2007, and 2006, by the Lottery's covered employees were $397,693, $382,129, and $287,330, respectively.

Matching employer member contributions were actuarially determined and fixed at 9.10%, 8.60%, and 6.90% of the compensation of all employee members for the years ended June 30, 2008, 2007, and 2006, respectively. Total matching contributions to the Plan for the years ended June 30, 2008, 2007, and 2006 by the Lottery were $397,693, $382,129, and $287,330, respectively. In the event the Plan's actuary determines that additional contributions are needed in order to amortize an unfunded accrued liability, every employer member will be required to contribute the revised contribution percentage that is set by the Plan.

All full-time employees of the Lottery are required to become members of the Plan. The Lottery's total payroll for employees covered by this Plan for the years ended June 30, 2008, 2007, and 2006 was $4,422,107, $4,495,661, and $4,272,430, respectively. Contributions to the Plan by the Lottery for its covered employees become fully vested immediately after membership in the Plan. All required employer contributions were made to the Plan within 30 days after June 30, 2008.

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SUPPLEMENTAL SCHEDULE

ARIZONA STATE LOTTERY,
A COMPONENT UNIT OF THE STATE OF ARIZONA

SUPPLEMENTAL SCHEDULE OF GROSS PROFIT BY GAME
FOR GAMES EXPIRING DURING THE YEAR ENDED JUNE 30, 2008

	Game 431*		Game 431		Game 439	
TICKET SALES	$10,639,035	100.00 %	$ 8,999,889	100.00 %	$20,922,260	100.00 %
DIRECT EXPENSES:						
Commissions	691,538	6.50	584,996	6.50	1,359,947	6.50
Prizes — low tier	5,745,079	54.00	4,859,940	54.00	11,507,243	55.00
Prizes — high tier	892,950	8.39	886,050	9.85	1,001,630	4.79
Total prizes	6,638,029	62.39	5,745,990	63.85	12,508,873	59.79
Ticket purchases	177,991	1.67	171,170	1.90	272,263	1.30
Advertising			1,497	0.02		
Total direct expenses	7,507,558	70.56	6,503,653	72.26	14,141,083	67.59
GROSS PROFIT BY GAME	$ 3,131,477	29.43	$ 2,496,236	27.74	$ 6,781,177	32.41

	Game 451		Game 468		Game 478	
TICKET SALES	$ 1,227,017	100.00 %	$16,128,010	100.00 %	$ 3,838,540	100.00 %
DIRECT EXPENSES:						
Commissions	79,757	6.50	1,048,322	6.50	249,505	6.50
Prizes — low tier	576,698	47.00	6,938,270	43.02	1,996,041	52.00
Prizes — high tier	109,401	8.92	2,739,233	16.98	301,850	7.86
Total prizes	686,099	55.92	9,677,503	60.00	2,297,891	59.86
Ticket purchases	28,740	2.34	156,786	0.97	156,702	4.08
Advertising						
Total direct expenses	794,596	64.76	10,882,611	67.48	2,704,098	70.45
GROSS PROFIT BY GAME	$ 432,421	35.24	$ 5,245,399	32.52	$ 1,134,442	29.55

	Game 479		Game 481		Game 483	
TICKET SALES	$10,134,505	100.00 %	$63,559,134	100.00 %	$13,208,340	100.00 %
DIRECT EXPENSES:						
Commissions	658,746	6.50	4,131,344	6.50	858,544	6.50
Prizes — low tier	4,560,528	45.00	30,476,605	47.95	6,163,892	46.67
Prizes — high tier	1,984,725	19.58	7,532,050	11.85	2,146,050	16.25
Total prizes	6,545,253	64.58	38,008,655	59.80	8,309,942	62.91
Ticket purchases	131,249	1.30	1,145,693	1.80	200,224	1.52
Advertising						
Total direct expenses	7,335,248	72.38	43,285,692	68.10	9,368,710	70.93
GROSS PROFIT BY GAME	$ 2,799,257	27.62	$20,273,442	31.90	$ 3,839,630	29.07

* Portion of game designated for economic development

(Continued)

ARIZONA STATE LOTTERY,
A COMPONENT UNIT OF THE STATE OF ARIZONA

SUPPLEMENTAL SCHEDULE OF GROSS PROFIT BY GAME
FOR GAMES EXPIRING DURING THE YEAR ENDED JUNE 30, 2008

	Game 484		Game 485		Game 487	
TICKET SALES	$ 21,722,190	100.00 %	$ 1,177,977	100.00 %	$ 10,912,260	100.00 %
DIRECT EXPENSES:						
Commissions	1,411,942	6.50	76,570	6.50	709,297	6.50
Prizes — low tier	6,197,341	28.53	541,869	46.00	4,364,904	40.00
Prizes — high tier	6,696,301	30.83	121,650	10.33	2,830,750	25.94
Total prizes	12,893,642	59.36	663,519	56.33	7,195,654	65.94
Ticket purchases	142,030	0.65	36,872	3.13	72,483	0.66
Advertising						
Total direct expenses	14,447,614	66.51	776,961	65.96	7,977,434	73.11
GROSS PROFIT BY GAME	$ 7,274,576	33.49	$ 401,016	34.04	$ 2,934,826	26.89

	Game 489		Game 491		Game 496	
TICKET SALES	$ 2,332,606	100.00 %	$ 2,205,330	100.00 %	$ 1,208,789	100.00 %
DIRECT EXPENSES:						
Commissions	151,620	6.50	143,348	6.50	78,572	6.50
Prizes—low tier	1,212,955	52.00	1,146,772	52.00	628,570	52.00
Prizes—high tier	185,520	7.95	96,875	4.39	45,600	3.77
Total prizes	1,398,475	59.95	1,243,647	56.39	674,170	55.77
Ticket purchases	41,596	1.78	47,099	2.14	34,731	2.87
Advertising						
Total direct expenses	1,591,691	68.23	1,434,094	65.03	787,473	65.14
GROSS PROFIT BY GAME	$ 740,915	31.76	$ 771,236	34.97	$ 421,316	34.85

	Game 498		Game 499		Game 500	
TICKET SALES	$ 2,580,972	100.00 %	$ 3,204,759	100.00 %	$ 14,231,860	100.00 %
DIRECT EXPENSES:						
Commissions	167,763	6.50	208,310	6.50	925,071	6.50
Prizes—low tier	1,109,817	43.00	1,532,945	47.83	3,986,344	28.01
Prizes—high tier	445,240	17.25	454,450	14.18	5,140,270	36.12
Total prizes	1,555,057	60.25	1,987,395	62.01	9,126,614	64.13
Ticket purchases	67,018	2.60	93,187	2.91	306,701	2.16
Advertising					627,558	4.41
Total direct expenses	1,789,838	69.35	2,288,892	71.42	10,985,944	77.20
GROSS PROFIT BY GAME	$ 791,134	30.65	$ 915,867	28.58	$ 3,245,916	22.81

(Continued)

ARIZONA STATE LOTTERY,
A COMPONENT UNIT OF THE STATE OF ARIZONA

SUPPLEMENTAL SCHEDULE OF GROSS PROFIT BY GAME
FOR GAMES EXPIRING DURING THE YEAR ENDED JUNE 30, 2008

	Game 501		Game 502		Game 503	
TICKET SALES	$ 1,352,370	100.00 %	$ 8,413,490	100.00 %	$ 1,052,182	100.00 %
DIRECT EXPENSES:						
Commissions	87,906	6.50	546,877	6.50	68,393	6.50
Prizes — low tier	676,185	50.00	2,847,125	33.84	494,526	47.00
Prizes — high tier	72,072	5.33	2,216,750	26.35	97,750	9.29
Total prizes	748,257	55.33	5,063,875	60.19	592,276	56.29
Ticket purchases	39,089	2.89	71,036	0.84	40,134	3.81
Advertising						
Total direct expenses	875,252	64.72	5,681,788	67.53	700,803	66.60
GROSS PROFIT BY GAME	$ 477,118	35.28	$ 2,731,702	32.47	$ 351,379	33.40

	Game 504		Game 505		Game 506	
TICKET SALES	$ 1,090,882	100.00 %	$ 1,607,940	100.00 %	$ 1,456,998	100.00 %
DIRECT EXPENSES:						
Commissions	70,909	6.50	104,516	6.50	94,705	6.50
Prizes — low tier	545,441	50.00	771,811	48.00	692,074	47.50
Prizes — high tier	69,750	6.39	175,400	10.91	186,200	12.78
Total prizes	615,191	56.39	947,211	58.91	878,274	60.28
Ticket purchases	39,084	3.58	65,744	4.09	44,253	3.03
Advertising						
Total direct expenses	725,184	66.47	1,117,471	69.50	1,017,232	69.81
GROSS PROFIT BY GAME	$ 365,698	33.52	$ 490,469	30.50	$ 439,766	30.18

	Game 508		Game 509		Game 511	
TICKET SALES	$ 2,175,472	100.00 %	$ 5,527,895	100.00 %	$ 4,506,980	100.00 %
DIRECT EXPENSES:						
Commissions	141,406	6.50	359,315	6.50	292,956	6.50
Prizes — low tier	1,044,227	48.00	2,499,162	45.21	2,034,000	45.13
Prizes — high tier	245,800	11.30	821,650	14.86	642,950	14.27
Total prizes	1,290,027	59.30	3,320,812	60.07	2,676,950	59.40
Ticket purchases	44,020	2.02	64,781	1.17	187,414	4.16
Advertising					17,720	0.39
Total direct expenses	1,475,453	67.82	3,744,908	67.74	3,175,040	70.45
GROSS PROFIT BY GAME	$ 700,019	32.18	$ 1,782,987	32.25	$ 1,331,940	29.55

(Continued)

ARIZONA STATE LOTTERY,
A COMPONENT UNIT OF THE STATE OF ARIZONA

SUPPLEMENTAL SCHEDULE OF GROSS PROFIT BY GAME
FOR GAMES EXPIRING DURING THE YEAR ENDED JUNE 30, 2008

	Game 512		Game 513		Game 514	
TICKET SALES	$ 2,988,219	100.00 %	$ 1,102,458	100.00 %	$ 2,014,955	100.00 %
DIRECT EXPENSES:						
Commissions	194,236	6.50	71,660	6.50	130,874	6.50
Prizes — low tier	1,523,992	51.00	523,668	47.50	818,273	40.61
Prizes — high tier	331,740	11.10	130,350	11.82	398,100	19.76
Total prizes	1,855,732	62.10	654,018	59.32	1,216,373	60.37
Ticket purchases	45,223	1.52	43,107	3.91	69,580	3.45
Advertising					89,387	4.44
Total direct expenses	2,095,191	70.12	768,785	69.73	1,506,214	74.76
GROSS PROFIT BY GAME	$ 893,028	29.88	$ 333,673	30.27	$ 508,741	25.25

	Game 516		Game 517		Game 518	
TICKET SALES	$ 1,534,595	100.00 %	$ 1,350,983	100.00 %	$ 1,178,724	100.00 %
DIRECT EXPENSES:						
Commissions	99,751	6.50	87,815	6.50	76,618	6.50
Prizes — low tier	690,568	45.00	736,287	54.50	618,832	52.50
Prizes — high tier	477,152	31.09	74,440	5.51	47,200	4.00
Total prizes	1,167,720	76.09	810,727	60.01	666,032	56.50
Ticket purchases	124,052	8.08	41,657	3.08	44,172	3.75
Advertising	21,471	1.40	90,308	6.68	90,308	7.66
Total direct expenses	1,412,994	92.07	1,030,507	76.27	877,130	74.41
GROSS PROFIT BY GAME	$ 121,601	7.92	$ 320,476	23.72	$ 301,594	25.59

	Game 520		Game 521		Game 523	
TICKET SALES	$ 1,599,876	100.00 %	$ 1,840,252	100.00 %	$ 939,232	100.00 %
DIRECT EXPENSES:						
Commissions	103,993	6.50	119,616	6.50	61,051	6.50
Prizes — low tier	799,938	50.00	901,723	49.00	483,706	51.50
Prizes — high tier	93,050	5.82	192,701	10.47	43,490	4.63
Total prizes	892,988	55.82	1,094,424	59.47	527,196	56.13
Ticket purchases	39,214	2.45	40,026	2.18	40,236	4.29
Advertising						
Total direct expenses	1,036,195	64.77	1,254,066	68.15	628,483	66.92
GROSS PROFIT BY GAME	$ 563,681	35.23	$ 586,186	31.85	$ 310,749	33.09

(Continued)

ARIZONA STATE LOTTERY,
A COMPONENT UNIT OF THE STATE OF ARIZONA

SUPPLEMENTAL SCHEDULE OF GROSS PROFIT BY GAME
FOR GAMES EXPIRING DURING THE YEAR ENDED JUNE 30, 2008

	Game 527		Game 528		Game 529	
TICKET SALES	$ 2,874,680	100.00 %	$ 2,408,034	100.00 %	$ 655,795	100.00 %
DIRECT EXPENSES:						
Commissions	186,854	6.50	156,522	6.50	42,628	6.50
Prizes — low tier	1,351,100	47.00	1,167,896	48.50	327,898	50.00
Prizes — high tier	360,079	12.53	256,151	10.64	37,349	5.70
Total prizes	1,711,179	59.53	1,424,047	59.14	365,247	55.70
Ticket purchases	63,833	2.22	50,285	2.08	39,214	5.98
Advertising						
Total direct expenses	1,961,866	68	1,630,854	68	447,089	68
GROSS PROFIT BY GAME	$ 912,814	31.75	$ 777,180	32.27	$ 208,706	31.82

	Game 532		Game 533		Game 534	
TICKET SALES	$ 1,123,965	100.00 %	$ 1,543,984	100.00 %	$ 2,653,530	100.00 %
DIRECT EXPENSES:						
Commissions	73,059	6.50	100,359	6.50	172,481	6.50
Prizes — low tier	483,305	43.00	694,793	45.00	1,127,752	42.50
Prizes — high tier	161,950	14.41	239,800	15.53	590,550	22.26
Total prizes	645,255	57.41	934,593	60.53	1,718,302	64.76
Ticket purchases	55,681	4.95	58,903	3.82	72,483	2.73
Advertising						
Total direct expenses	773,995	68.86	1,093,855	70.85	1,963,266	73.99
GROSS PROFIT BY GAME	$ 349,970	31.14	$ 450,129	29.15	$ 690,264	26.01

	Game 535		Game 537		Game 539	
TICKET SALES	$ 829,186	100.00 %	$ 975,724	100.00 %	$ 2,077,022	100.00 %
DIRECT EXPENSES:						
Commissions	53,898	6.50	63,423	6.50	135,006	6.50
Prizes — low tier	414,593	50.00	487,862	50.00	996,971	48.00
Prizes — high tier	48,700	5.87	60,780	6.23	275,788	13.28
Total prizes	463,293	55.87	548,642	56.23	1,272,759	61.28
Ticket purchases	46,440	5.61	43,215	4.43	54,072	2.61
Advertising					82,189	3.96
Total direct expenses	563,631	67.98	655,280	67.16	1,544,026	74.35
GROSS PROFIT BY GAME	$ 265,555	32.03	$ 320,444	32.84	$ 532,996	25.66

(Continued)

ARIZONA STATE LOTTERY,
A COMPONENT UNIT OF THE STATE OF ARIZONA

SUPPLEMENTAL SCHEDULE OF GROSS PROFIT BY GAME
FOR GAMES EXPIRING DURING THE YEAR ENDED JUNE 30, 2008

	Game 543		Game 546		Game 547	
TICKET SALES	$ 987,790	100.00 %	$ 1,711,756	100.00 %	$ 1,651,838	100.00 %
DIRECT EXPENSES:						
Commissions	64,207	6.50	111,264	6.50	107,369	6.50
Prizes — low tier	498,835	50.50	753,173	44.00	735,068	44.50
Prizes — high tier	62,320	6.31	261,160	15.26	235,301	14.24
Total prizes	561,155	56.81	1,014,333	59.26	970,369	58.74
Ticket purchases	43,296	4.38	46,281	2.70	46,281	2.80
Advertising						
Total direct expenses	668,658	67.69	1,171,878	68.46	1,124,019	68.04
GROSS PROFIT BY GAME	$ 319,132	32.31	$ 539,878	31.54	$ 527,819	31.95

	Pick Drawings January 1, 2007 to December 31, 2007		Pick 5 Drawings January 1, 2007 to December 31, 2007		Powerball Drawings January 1, 2007 to December 31, 2007	
TICKET SALES	$53,370,586	100.00 %	$13,513,003	100.00 %	$130,567,659	100.00 %
DIRECT EXPENSES:						
Commissions	3,469,075	6.50	878,335	6.50	8,486,889	6.50
Total prizes	27,865,258	52.21	6,866,219	50.81	65,283,830	50.00
O/L System Expenses	2,129,154	3.99	538,685	3.99	5,175,347	3.96
Advertising	1,442,548	2.70	410,543	3.04	820,927	0.63
Total direct expenses	34,906,035	65.40	8,693,782	64.34	79,766,993	61.09
GROSS PROFIT BY GAME	$18,464,551	34.60	$ 4,819,221	35.66	$ 50,800,666	38.91

	Pick 3 Drawings January 1, 2007 to December 31, 2007		Arizona Raffle Drawings January 1, 2007 to December 31, 2007		Fast Play Drawings January 1, 2007 to December 31, 2007	
TICKET SALES	$ 9,394,503	100.00 %	$ 7,000,000	100.00 %	$ 268,881	100.00 %
DIRECT EXPENSES:						
Commissions	610,636	6.50	455,000	6.50	17,408	6.47
Total prizes	4,697,252	50.00	3,500,000	50.00	153,485	57.08
O/L System Expenses	374,167	3.98	282,254	4.03	10,842	4.03
Advertising	389,523	4.15	824,892	11.78	147,036	54.68
Total direct expenses	6,071,578	64.63	5,062,146	72.32	328,771	122.27
GROSS PROFIT BY GAME	$ 3,322,925	35.37	$ 1,937,854	27.68	$ (59,890)	(22.27)

NOTE: After the announced completion of ticket sales for each game, customers have a 180-day period in which to redeem their winning tickets. The above gross profit information includes games in which the 180-day grace period expired during the fiscal year ended June 30, 2008.

(Concluded)