

2012 TENNESSEE LOTTERY
ANNUAL REPORT

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Letter from the Board Chair and the President and CEO

On behalf of the Tennessee Education Lottery Corporation, we are proud to present a detailed overview of fiscal year 2011–2012 — a stellar year that resulted in a record-high transfer to education of **\$323.4 million**. This impressive accomplishment, a **10.2 percent** increase over the previous year, is directly attributable to the hard work and dedication of the many Lottery stakeholders, including an outstanding Lottery team committed to our core mission of making higher education more accessible to Tennessee students. We are proud to report that more than **100,000 students** earned scholarships and grants to institutions of higher learning during the past year. These awards help students pursue their dreams and extend their education beyond the high school level — all of which contributes to long-term economic success and shared prosperity across the great state of Tennessee.



The past fiscal year produced record totals across the board, further solidifying the momentum that began the moment tickets went on sale January 20, 2004. In addition to the record transfer to education, the fiscal year represented the Corporation's *eighth consecutive year* of record total sales, which soared to **\$1.31 billion**. This figure, an increase of more than \$124.6 million over 2010–2011, brought total sales since inception to more than **\$9.1 billion**. With total education funding now at more than **\$2.39 billion**, total prizes won at more than **\$5.4 billion**, and total retailer commissions at more than **\$594 million**, the Lottery has brought great benefits to players, businesses and students alike, from Memphis to Mountain City, and every place in between.



During this period of robust growth, the Lottery continued to innovate and expand programs to better serve the lottery-playing public. This past year saw the Lottery's successful debut in the world of social media ([facebook.com/tnlottery](https://www.facebook.com/tnlottery)) and the development of "VIP Rewards," an increasingly popular affinity program that allows Tennessee Lottery players to earn points they can redeem for a wide-range of merchandise in the "VIP Store." We anticipate even more creativity and improvements in the coming year — it is how we remain innovative!

The successes of this past year would not have been possible without the inspired leadership of two members of the Board of Directors, both of whom were original Board members and whose terms came to a close on June 30, 2011. Our great respect, admiration and appreciation go to Jim Hill of Chattanooga, who served as a Director since 2003 and as Board Chair for the past two years; and Marvell Mitchell of Memphis, who served as Vice Chair during that same period. Thank you, Jim and Marvell, for volunteering so much of your time and talent, your vision and experience; all of which helped guide us to the level of success we detail in the coming pages. With their departure came new Board Member Craig Powers of Memphis, whom we warmly welcomed and immediately put to work!

Please take a moment to review details of our 2011–2012 fiscal year, which includes the Lottery's audited financial statements. As always, we remain dedicated to our mission of responsibly maximizing dollars for the education programs we fund and proud of our role in assisting so many Tennesseans.

Thank you for your continued support in this effort.



Keith Simmons, Chair of the Board of Directors



Rebecca Hargrove, President and CEO

8
YEARS
OF RECORD SALES



OVER
\$2.39
BILLION
RAISED FOR
EDUCATION

EDUCATION
FUNDING
TOP \$323
MILLION

TENNESSEE LOTTERY
MEGA
MILLIONS
WORLD-RECORD
\$656 MILLION
JACKPOT



MORE THAN
100,000
SCHOLARSHIPS
AWARDED
IN 2012

\$3,000,000!
MEGA
CASH
LARGEST INSTANT GAME JACKPOT

TENNESSEE
POWERBALL
POWER PLAY
\$2 POWERBALL
CREATES BIGGER
JACKPOTS

MORE THAN
600,000
GRANTS OR
SCHOLARSHIPS TO
IN-STATE EDUCATION
INSTITUTIONS
HAVE BEEN AWARDED
SINCE THE LOTTERY'S
INCEPTION IN 2004.



Education Programs

When Tennesseans voted to create a statewide lottery, the primary objective was to raise funds to help more Tennessee students attend higher education institutions throughout the state. The Lottery has successfully worked to meet this goal, becoming a useful and relied-upon source of funding for thousands of Tennessee students and their families. Since the first awards were given in the fall of 2004, Lottery-funded programs have grown to include 11 different scholarships and grants, multiple after-school programs, and an energy-efficient schools initiative.

According to the Tennessee Student Assistance Corporation, which administers the Tennessee Education Lottery Scholarship (TELS) program, an all-time high of **\$313 million** was awarded to nearly **104,000 students** this past year, which includes approximately **17,000 students** in dual enrollment classes. This brought the total of Lottery-funded awards to more than 600,000 since the program began.

Details about these recipients include:



Board of Regents System (four-year)	28,767
Board of Regents Community Colleges (two-year)	25,210
University of Tennessee System	21,283
Technology Centers	12,734
Independent Four-Year Programs	15,251
Independent Two-Year Programs	13
Private/Business Trade	662
Totals	103,920*

In addition, Lottery funds were used to support **78** after-school programs that served approximately 23,000 students in the **2011–2012** academic year.

For additional information about Lottery-funded programs, visit SeeHowItAddsUp.com.

**Note: Totals represent a distinct count of students and are not always a sum of the numbers in the section. Students can attend multiple institutions throughout an academic year, but these students are only counted once in each section total. Totals include dual enrollment students. SOURCE: Tennessee Student Assistance Corporation*

Games

With the growing number of entertainment options available, it is imperative for the Lottery to keep its games innovative and exciting. The Corporation does just that by soliciting input from both players and retailers, evaluating designs for new games, and staying current on industry trends and best practices.

Revenues from drawing-style games, flat in recent years, came to life during fiscal year 2011–2012, driven largely by a world-record \$656 million *Mega Millions* jackpot and the launch of the newly-designed *Powerball* game, in which the price point was increased to two dollars to increase jackpots and improve the odds of winning. These factors and others helped produce a strong 9.9 percent increase in sales for these games. Other drawing-style games, such as *Tennessee Cash*, also enjoyed a notable year — just one example being an exciting week in July during which three consecutive jackpots were won.

Consistent with the long-running trend, sales from instant games comprised more than 80 percent of the Lottery’s total sales during the past year. The introduction of 43 new such games was met with great favor by Lottery players and pushed instant sales up 10.6 percent over the previous year.

Details of all game sales during fiscal year 2011–12 include:

Instant Tickets	\$ 1,049,604,000
Powerball	\$ 102,751,000
Mega Millions	\$ 53,958,000
Cash 3	\$ 57,974,000
Cash 4	\$ 27,693,000
Tennessee Cash	\$ 19,223,000

In addition to instant and online games, the Lottery awarded nearly \$4 million in three “*Play It Again!*” drawings, the Lottery’s program that provides players a second chance to win cash prizes by entering eligible non-winning instant tickets via the Lottery’s website. Players also won a variety of merchandise and cash prizes through other Second Chance drawings associated with licensed property games such as *Wheel Of Fortune*®, *Tennessee Titans*, *Monopoly*™ and *Camaro*™. By combining *Play It Again!* with other games, every eligible Tennessee Lottery non-winning instant ticket offers a second chance to win.



Players and Winners

While students and their families benefit from Lottery-funded education programs, those who play the games find fun in the experience and benefit from a large variety of prizes. During fiscal year 2011–2012, players won **\$803 million**, bringing the total won since inception to more than **\$5.4 billion**. Of the many thousands of lucky winning tickets sold during the fiscal year, 13 were prizes of \$1 million or more, bringing the total since inception to 91 such winning tickets.

Although some big winners choose to avoid publicity, such as two players who each won \$2 million playing *\$2 Million Bonanza*, Lottery staff frequently encounter tears of happiness and expressions of joy while on-hand to photograph the smiling faces and oversized checks when players present winning tickets and collect their prizes.



Teresa Flournoy and family were thrilled with their luck – and their \$200,000 Play It Again! win!

Teresa Flournoy of Jackson won \$200,000 by entering a non-winning ticket into the Lottery’s Play It Again! program, which gives players a second chance to play and win cash prizes.



Willard Henderson and his family were thrilled to celebrate with CEO Rebecca Hargrove.

Willard Henderson, who won \$1 million playing *Powerball* in May, brought his family with him from Manchester to claim his prize and meet President and CEO Rebecca Hargrove.



Paige Barton-Cantrell brought her daughter to the Lottery’s Nashville HQ to claim her big prize.

Paige Barton-Cantrell of Antioch, who won \$250,000 from a *Mega Millions* drawing held in July, said the big win wouldn’t change many of her usual activities. According to Mrs. Barton-Cantrell, her husband was surprised to see her still clipping coupons after she won. “That’s how I’m going to save this money!” she said.

Other innovations designed this year to keep players engaged included the Lottery’s successful debut in the world of social media (see www.facebook.com/tnlottery) and the development of “VIP Rewards,” an increasingly popular affinity program that allows Tennessee Lottery players to earn points they can then redeem for a wide range of merchandise in the “VIP Store” (see www.tnlottery.com).

Retailers



The Lottery's network of nearly 5,000 dedicated retailers is the key sales channel for Lottery products. This vital group earned more than **\$85.5 million** in commissions and retailer bonuses during the past year, pushing the totals earned to over **\$594 million** since inception. As the primary point of contact with players throughout the state, not only do retailers sell the Lottery's many games, but they also assist the TEL by providing valuable feedback about player likes and interests, market trends, and frequently asked questions. In turn, Lottery Sales Representatives provide retailers with hands-on training, marketing strategies, attractive signage, and other valuable selling tips to make the most of their relationship with the Tennessee Lottery.



Retailer Suman Javid of Chattanooga received a \$5,000 bonus for selling a \$1 million winning Powerball ticket.



Lottery retailers such as these Tiger Mart employees help players celebrate the fun a big win can bring.

The TEL also maintains a toll-free helpline and website specifically for retailers, distributes a quarterly retailer newsletter, and holds regular meetings with its "Retailer Advisory Board." This Board is made up of retailer representatives from across the state who meet regularly with Lottery staff to share ideas to assist the Lottery in pursuing its charge of maximizing dollars for education programs. Members of the 2011–2012 Board were Adnan "Adam" Mohammad, Holston Tobacco; Asa Hazelwood, Pilot Travel Centers LLC; Doug Ballinger, Walnut Grove Market; Kun "Duke" An, Antioch Shell Gas Station; Jimmy Keen, BP One Stop; Karim "Kenny" Boghani, Ian's Market; Maurece McDowell, Lonsdale Market & Deli; Anish "Mike" Najhawan, Kwik Stop Super Mercado; Rex Bintz, Schnucks Markets; Roy Wesson, M&R Grocery #2; Tommy Hunt, E-Z Stop Food Marts; William "Sonny" Boyce, Murfreesboro Wine & Liquors; and Tony Vincent, Fairview Shell Market.



Equal Business Opportunity Programs

In addition to producing record returns, the Tennessee Education Lottery Corporation is committed to a diverse and inclusive workplace, including the active engagement and participation of the minority business community. Among a host of other efforts, the Corporation also gains valuable insight from its “Advisory Council on Minority Business Participation,” a wide-ranging group of Tennesseans helping to create strategies to develop and enhance economic development and educational opportunities for minority-owned businesses. Members of the 2011–2012 Council were Elizabeth Courtney of Nashville; Mark Deathridge of Knoxville; Vernon Grose of Memphis; Willie Martin of Memphis; Garry McNabb of Cookeville; A. Gregory Ramos of Nashville; and Craig Powers of Memphis.

As it has every year since inception, the Corporation and its three major procurement vendors exceeded statutory and contractual goals set for its Equal Business Opportunity program during fiscal year 2011–2012. During this period, 30 percent, or \$663,950, of the Lottery’s non-major procurement items were purchased from minority businesses. The Buntin Group, GTECH Corporation, and Scientific Games International exceeded their contractual minority business participation goals by paying an average of 25 percent of dollars earned, or more than \$8.2 million, to minority-owned businesses. Details about each major procurement vendor’s revenue earned from the Lottery paid to minority businesses during the past fiscal year include:

- The Buntin Group:** 25 percent, or \$1,619,000
- GTECH:** 23 percent, or \$3,487,000
- Scientific Games:** 28 percent, or \$3,168,000



These vendors support the Corporation’s commitment to diversity in other ways, as well. For example, The Buntin Group, GTECH, and Scientific Games continued their sponsorship of and active involvement in the Lottery’s annual Summer Internship Program for students attending the state’s historically black colleges and universities.

It should be noted that the Lottery’s network of 4,983 retailer partners also represents an impressive level of diversity. Based on sampling of the retailer contracts, 728 (15%) answered the optional question identifying their minority status. Of the responses received, 145 (19.9%) were Not a Minority; 36 (5%) were African-American; 397 (54.5%) were Asian-American; 12 (1.7%) were Hispanic American; 6 (.8%) were Native American; and 132 (18.1%) were Women Owned.

And finally, the Lottery’s diverse workforce continued to represent the community at large. During the 2011–2012 fiscal year, of the 158 employees of the Tennessee Education Lottery Corporation, 53 percent were women; 47 percent were men; 51 percent were minority*; and 49 percent were non-minority.

The commitment to equal business opportunities and a diverse and inclusive workforce has been a critical component of the Corporation’s success. Through such efforts, the Lottery continues to broaden its impact and enhance its mission to provide funding for education programs in Tennessee.

*Minority represents those employees who chose to identify themselves as African-American, Hispanic, American Indian, Alaskan Native or Other.

Management/Organization

A Board of Directors, appointed by the Governor and confirmed by the General Assembly, provides governance and sets overall policy for the Tennessee Education Lottery Corporation. Directors for fiscal year 2011–2012 were: Keith Simmons, Chair; Jim Ripley, Vice Chair; Elizabeth Seigenthaler Courtney, Garry McNabb, Lowell Perry, Jr., and Craig Powers.

The Corporation is also led by a team of skilled, experienced, and dedicated professionals charged with meeting the objectives designed to maximize dollars for education in Tennessee.

EXECUTIVE DIVISION: Rebecca Hargrove, *President and CEO*

In addition to overseeing the daily operations of the Tennessee Education Lottery Corporation, the President and CEO is responsible for developing a broad vision for the organization and ensuring that strategies to achieve all objectives are implemented.

The Executive Division is also responsible for:

- *Advertising Strategy* — Develops and oversees all advertising initiatives
- *Corporate Affairs*—Manages internal and external communications, including player services, media/public relations and social media; and Legislative/government affairs, including serving as liaison to state and local government officials
- *Internal Controls*—Reports and works directly with the Board of Directors to ensure adequate internal controls are in place to provide integrity and accountability in the operation of the Lottery through objective analysis

Tom Jurkovich, Vice President, Corporate Affairs

Khristie Stoecklein, Vice President, Internal Controls (dual reporting to the Board of Directors and the CEO)

LEGAL DIVISION: Wanda Young Wilson, *Executive Vice President and General Counsel*

The Legal Division includes:

- *Human Resources*—Responsible for payroll and benefits, managing employee and employment-related processes
- *Legal Services*—Provides legal advice and assistance to management and the Board of Directors, serves as the corporate records keeper, oversees litigation, develops policies and procedures, and manages contract compliance
- *Security*—Responsible for physical and intellectual property security
- *Retailer Contract Administration*—Manages all functions of retailer applications and contracts
- *Corporate Services*—Responsible for daily functions such as mail, reception and supplies

Cynthia Fitzgerald, Vice President, Legal Services for Compliance

David Jennings, Vice President, Security

Craig Miller, Vice President, Human Resources

Andrew Morin, Vice President, Legal Services for Corporate Transactions

Management/Organization

SALES AND MARKETING DIVISION: Sidney Chambers, *Executive Vice President*

The Sales and Marketing Division oversees all aspects of the Lottery sales operation, including:

- *Sales and Marketing*—Manages all sales activity and field marketing
- *Retailer Sales and Services*—Provides all facets of customer service for retailer network
- *Corporate Accounts*—Manages corporate accounts
- *Promotions and Special Events*—Promotes the TEL at a variety of functions throughout the state
- *Warehouse Management and Distribution*
- *District Offices*—Manages the TEL's four District offices

Joe Hills, Vice President, Sales

FINANCE AND INFORMATION SYSTEMS: Andy Davis, *Chief Financial and Information Systems Officer*

Finance and Information Systems is responsible for the following:

- Financial, product and retailer accounting
- Prize validation, statutory and financial reporting
- Cash management, budgeting, accounts receivables
- Procurement, facilities management and risk services
- Game drawings, including online and second-chance drawing activities
- Gaming systems and operations oversight
- Network and telecommunication systems and services
- Software systems and quality assurance

Lucretia Kirk, Vice President, Information Systems

Vicki Updike, Vice President, Finance



1st (bottom) row (L to R): Sidney Chambers, Wanda Young Wilson, Rebecca Hargrove, Andy Davis
2nd (top) row (L to R): Joe Hills, Lucretia Kirk, Vicki Updike, Khristie Stoecklein, Andrew Morin,
Cynthia Fitzgerald, David Jennings, Craig Miller, Tom Jurkovich



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COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
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JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-1402
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Independent Auditor's Report

November 26, 2012

The Honorable Bill Haslam, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
Board of Directors
Tennessee Education Lottery Corporation
Plaza Tower Metro Center
200 Athens Way
Nashville, Tennessee 37228

Ladies and Gentlemen:

We have audited the accompanying statements of net assets of the Tennessee Education Lottery Corporation, a component unit of the State of Tennessee, as of June 30, 2012, and June 30, 2011, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the corporation's management. Our responsibility is to express an opinion on these financial statements, based on our audits.

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

Auditor's Opinion Letter

November 26, 2012

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overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Tennessee Education Lottery Corporation as of June 30, 2012, and June 30, 2011, and the changes in its financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 15 through 24 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 basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during the audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

In accordance with generally accepted government auditing standards, we have also issued our report dated November 26, 2012, on our consideration of the corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts 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 generally accepted government auditing standards and should be considered in assessing the results of our audit.

Sincerely,



Arthur A. Hayes, Jr., CPA
Director

AAH/rs

• **Financials** •

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- 29** Notes to the Financial Statements

Management's Discussion and Analysis

The Tennessee Education Lottery Corporation ("TEL") offers the following Management Discussion and Analysis ("MD&A") to the readers of the financial statements. This narrative overview provides an objective analysis of the TEL's financial activity for the fiscal years ended June 30, 2012 and 2011, with comparative information presented for the fiscal year ended June 30, 2010. The overview should be considered in conjunction with the independent auditor's report, the accompanying audited financial statements and notes to the financial statements.

UNDERSTANDING THE TEL'S FINANCIAL STATEMENTS

The TEL, a quasi-public instrumentality, is a component unit of the State of Tennessee. The TEL's activities are accounted for as a business-type activity using the full accrual basis of accounting, similar to a private business entity. In accordance with accounting principles generally accepted in the United States of America, this report consists of a series of comparative financial statements, along with notes to the financial statements designed to highlight the TEL's net assets and changes therein resulting from business operations.

The financial statements are comprised of three components:

- **The Statements of Net Assets** – Reflects the TEL's financial position at June 30, 2012 and June 30, 2011.
- **The Statements of Revenues, Expenses, and Changes in Net Assets** – Reports revenues and expenses incurred in relation to the sale of lottery products, as well as other non-gaming related activity for the fiscal years ended June 30, 2012 and June 30, 2011.
- **The Statements of Cash Flows** – Outlines the cash inflows and outflows related to the activity of selling lottery products and other business related activities for the fiscal years ended June 30, 2012 and June 30, 2011.

The Notes to the Financial Statements document additional information essential for readers to gain a comprehensive understanding of the data provided in the TEL's financial statements.

The TEL's primary business purpose is to generate revenues to fund college scholarships for residential Tennessee students attending higher educational institutions within the state. Accordingly, the main focus of the financial statements is determining funds available for payment to the State of Tennessee's Lottery for Education Account. Furthermore, in addition to funding this account, the TEL's unclaimed prize funds are deposited to the After-School Programs special account which benefits after-school programs throughout the state of Tennessee.

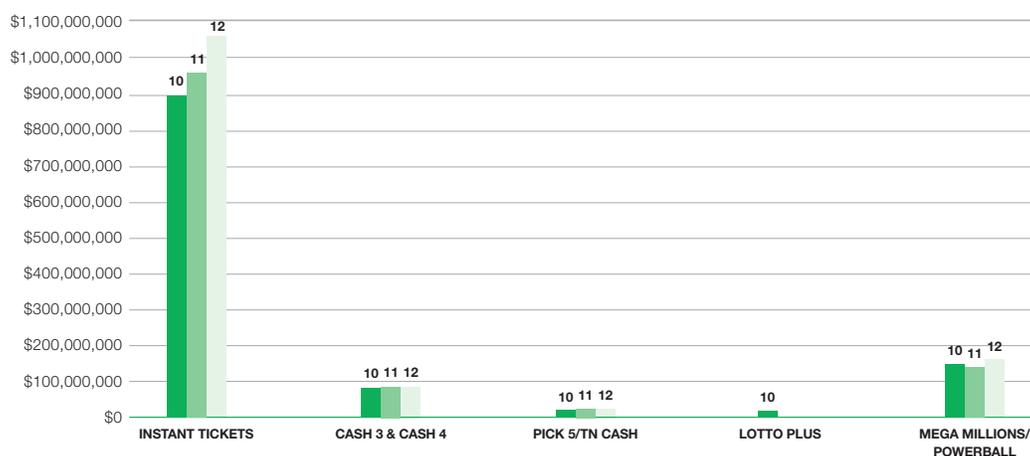
FISCAL YEAR 2012 FINANCIAL HIGHLIGHTS

The Tennessee Education Lottery set new records for fiscal year ended June 30, 2012. Showing impressive gains, the TEL produced more than \$323.4 million for education in the state of Tennessee for the fiscal year ended June 30, 2012. This was an *increase* of 10.2% over the prior year's record-setting return of \$293.5 million for fiscal year ended June 30, 2011.

Driving the increase in education funds transferred was another record-setting achievement of over \$1.31 billion in total gross sales. This marked an impressive \$124.6 million (10.5%) *increase* over the previous fiscal year revenues of \$1.18 billion, not to mention the sixth straight year that the TEL has reached gross sales of over \$1 billion. Total education funding since ticket sales began in January 2004 now stands at more than \$2.39 billion; with total sales surpassing \$9.1 billion.

Management's Discussion and Analysis

TENNESSEE EDUCATION LOTTERY GROSS TICKET REVENUES FISCAL YEAR 2012 COMPARISON TO 2011 AND 2010



As in recent prior years, upward movement in instant ticket sales was the primary factor fueling our sales growth. Management attributes this to the effectiveness of its instant ticket marketing strategy which emphasizes offering more, as well as a broad spectrum of, games and prizes to lottery players. Accordingly, the TEL launched 43 new instant ticket games at varying price points that were met with great favor by the players during fiscal year 2012. As added variety to its traditionally themed games, the TEL also introduced several licensed property games [i.e., *Uno*[™] (\$5), *Wheel of Fortune*[®] (\$5), and *Camaro*[™] (\$5)]. TEL also introduced *\$1,000,000 Casino* (\$20) in addition to the spotlight game *\$3,000,000 Mega Cash* (\$20) giving players more choices at the \$20 price point. In September 2011, the TEL added *Jumbo Jumbo Bucks* (\$10) to the popular “*Jumbo Bucks*” family of instant ticket games which continued to be extremely popular in fiscal year 2012. In fiscal year 2012, TEL expanded its offering in the extended play games with *Tennessee Slingo* (\$3) and *\$100,000 Crossword* (\$5).

Other innovations in fiscal year 2012 included the TEL's launch of “*VIP Rewards*,” a popular program allowing lottery players to earn points for non-winning instant tickets, and then redeem these points for a wide range of merchandise in the “*VIP Store*.” This program enhanced the benefits currently offered in our popular *Play It Again!* second chance program.

Cash 3 sales in fiscal year 2012 remained relatively consistent with those of fiscal year 2011. *Cash 4* sales increased by 8.4% largely in part due to higher payouts during fiscal year 2012.

Sales for *Tennessee Cash* increased \$3.2 million year-over-year as a result of a full year of sales. *Tennessee Cash* is TEL's in-state, cash jackpot, drawing-style game. The sales for this game are driven by the size of the jackpot. In fiscal year 2012, TEL experienced ten jackpots in excess of \$300 thousand compared to seven the prior year for this game.

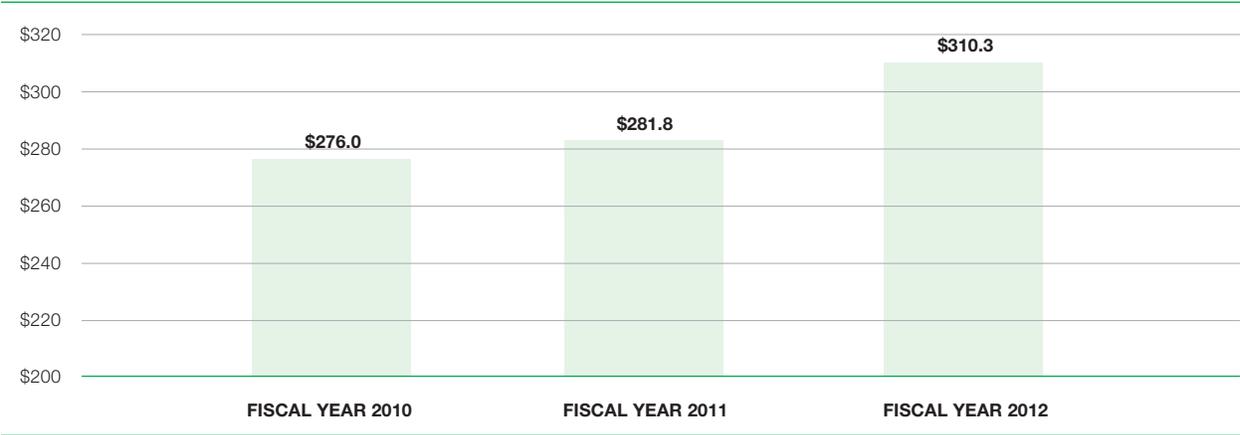
In January 2010, the TEL introduced to the market an additional multi-jurisdictional jackpot game, *Mega Millions*. In March of fiscal year 2012, *Mega Millions* experienced a world record jackpot of \$656 million which significantly contributed to the 19% sales increase for this game in fiscal year 2012. Sales for *Mega Millions* in fiscal year 2012 were \$53.9 million compared to \$45.3 million the prior year.

In January 2012, *Powerball* was relaunched at the \$2 price point. Along with the price point change, three *Powerball* jackpots exceeding \$225 million plus one exceeding \$336 million contributed to the 13.6% increase in *Powerball* sales in fiscal year 2012. *Powerball* sales were \$102.8 million in fiscal year 2012 compared to \$90.4 million in fiscal year 2011.

The TEL generated \$310.3 million for the Lottery for Education Account in fiscal year 2012, compared to \$281.8 million in fiscal year 2011 and \$276.0 million in fiscal year 2010.

Management’s Discussion and Analysis

TENNESSEE EDUCATION LOTTERY PROCEEDS FOR THE LOTTERY FOR EDUCATION ACCOUNT (IN MILLIONS)



The amounts deposited to the After-School Programs special account are derived from unclaimed instant and drawing-style game prizes at fiscal year-end. Prizes not claimed within 90 days of the announced game-end date for instant games, and within 180 days for all drawing-style games, are forfeited as unclaimed prizes.

The TEL records estimated unclaimed prizes for each instant game within the month the game is closed and reconciles the actual amounts when the claim period ends. For drawing-style games, the TEL records the actual unclaimed amounts determined after the expiration of the related claim period for the draw.

In fiscal year 2012, the TEL recognized \$13.1 million for the After-School Programs special account as compared to \$11.6 million in fiscal year 2011, and \$12.9 million in fiscal year 2010. The increase in fiscal year 2012 After-School Programs special account resulted primarily from three large unclaimed jackpot prizes, two in *Tennessee Cash* and one in *Powerball*.

TENNESSEE EDUCATION LOTTERY PROCEEDS FOR THE AFTER-SCHOOL PROGRAMS ACCOUNT (IN MILLIONS)



Management's Discussion and Analysis

CONDENSED STATEMENT OF NET ASSETS

Assets	JUNE 30, 2012	INCREASE/ (DECREASE)	JUNE 30, 2011	INCREASE/ (DECREASE)	JUNE 30, 2010
<i>Current assets</i>					
Cash	\$ 72,227,000	\$ 5,813,000	\$ 66,414,000	\$ (1,908,000)	\$ 68,322,000
Retailer accounts receivable, net	60,046,000	6,536,000	53,510,000	5,804,000	47,706,000
Other	7,752,000	744,000	7,008,000	521,000	6,487,000
Total current assets	140,025,000	13,093,000	126,932,000	4,417,000	122,515,000
<i>Non-current assets</i>					
Other	2,904,000	559,000	2,345,000	48,000	2,297,000
Capital assets, net	1,101,000	81,000	1,020,000	(339,000)	1,359,000
Total non-current assets	4,005,000	640,000	3,365,000	(291,000)	3,656,000
Total assets	144,030,000	13,733,000	130,297,000	4,126,000	126,171,000
Liabilities					
<i>Current liabilities</i>					
Due to Lottery for Education Account	76,350,000	6,069,000	70,281,000	(1,385,000)	71,666,000
Due to After-School Programs Account	13,089,000	1,445,000	11,644,000	(1,250,000)	12,894,000
Prizes payable	45,759,000	4,862,000	40,897,000	6,595,000	34,302,000
Accounts payable and accrued liabilities	5,009,000	1,377,000	3,632,000	(27,000)	3,659,000
Deferred liabilities	720,000	(272,000)	992,000	226,000	766,000
Total current liabilities	140,927,000	13,481,000	127,446,000	4,159,000	123,287,000
<i>Non-current liabilities</i>					
Non-current portion of Due to After-School Programs Account	-	-	-	-	-
Non-current portion of other liabilities	3,090,000	240,000	2,850,000	(27,000)	2,877,000
Total non-current liabilities	3,090,000	240,000	2,850,000	(27,000)	2,877,000
Total liabilities	144,017,000	13,721,000	130,296,000	4,132,000	126,164,000
Net Assets					
Investment in capital assets	1,101,000	81,000	1,020,000	(339,000)	1,359,000
Unrestricted assets	(1,101,000)	(81,000)	(1,020,000)	339,000	(1,359,000)
Restricted assets	13,000	12,000	1,000	(6,000)	7,000
Total net assets	\$ 13,000	\$ 12,000	\$ 1,000	\$ (6,000)	\$ 7,000

OVERVIEW OF FINANCIAL POSITION

ASSETS: The \$13.7 million increase in total assets at June 30, 2012 and \$4.13 million increase in total assets at June 30, 2011, were primarily due to the noted increase in lottery ticket sales for the related fiscal years resulting in increased cash, and the subsequent timing of collection of the relevant Retailer Accounts Receivable balances.

Management's Discussion and Analysis

LIABILITIES: The \$13.7 million increase in total liabilities at June 30, 2012 relates primarily to increased fiscal year 2012 ticket sales, resulting in higher net proceeds payable to the Lottery for Education Account, and more prizes payable to players.

The \$4.13 million increase in total liabilities at June 30, 2011, related primarily to increased fiscal year 2011 ticket sales, and more prizes payable to players.

CONDENSED STATEMENT OF REVENUES & EXPENSES

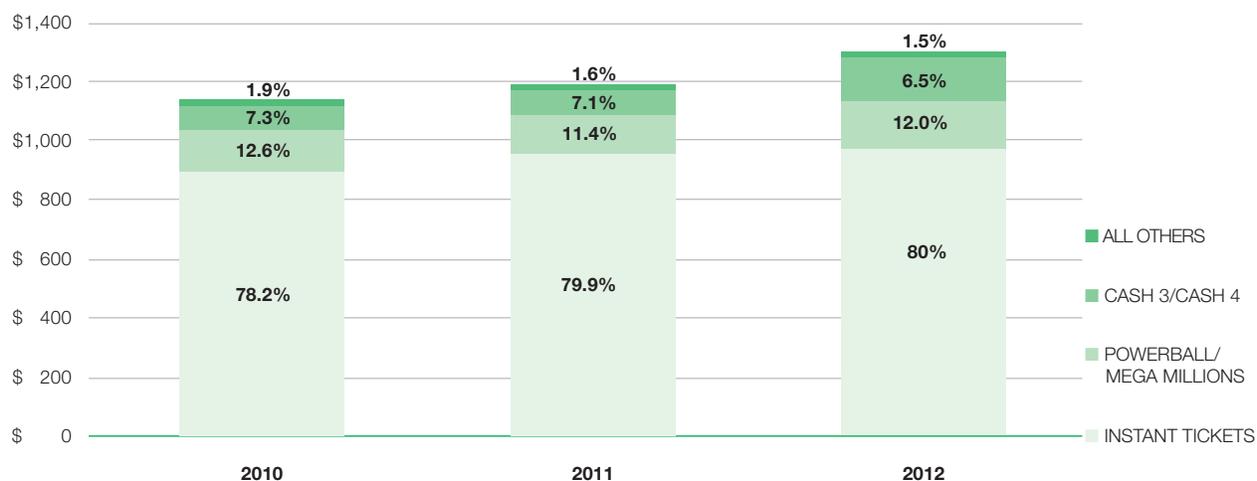
	JUNE 30, 2012	INCREASE/ (DECREASE)	JUNE 30, 2011	INCREASE/ (DECREASE)	JUNE 30, 2010
<i>Revenues:</i>					
Instant games	\$1,049,604,000	\$ 100,894,000	\$ 948,710,000	\$ 58,437,000	\$ 890,273,000
Online games	261,600,000	23,753,000	237,847,000	(10,270,000)	248,117,000
Less instant/promotional tickets provided as prizes	(94,350,000)	(10,372,000)	(83,978,000)	(6,068,000)	(77,910,000)
Games revenue, net	1,216,854,000	114,275,000	1,102,579,000	42,099,000	1,060,480,000
Bad debt recoveries/(expense), net	(999,000)	(760,000)	(239,000)	135,000	(374,000)
Retailer service fees	3,197,000	(199,000)	3,396,000	(14,000)	3,410,000
Interest income	68,000	(42,000)	110,000	(101,000)	211,000
Other revenue	1,505,000	866,000	639,000	143,000	496,000
Total revenues	1,220,625,000	114,140,000	1,106,485,000	42,262,000	1,064,223,000
<i>Expenses:</i>					
Cost of sales	880,922,000	83,432,000	797,490,000	36,951,000	760,539,000
General, administrative and other operating expenses	16,217,000	756,000	15,461,000	695,000	14,766,000
Other expenses	36,000	(14,000)	50,000	12,000	38,000
Proceeds to After-School Program Account	13,089,000	1,445,000	11,644,000	(1,250,000)	12,894,000
Proceeds to Lottery for Education Account	310,349,000	28,503,000	281,846,000	5,867,000	275,979,000
Total expenses	1,220,613,000	114,122,000	1,106,491,000	42,275,000	1,064,216,000
Change in net assets	12,000	18,000	(6,000)	(13,000)	7,000
Total net assets, beginning of year	1,000	(6,000)	7,000	7,000	-
Total net assets, end of year	\$ 13,000	\$ 12,000	\$ 1,000	\$ (6,000)	\$ 7,000

Management’s Discussion and Analysis

REVENUES

Gross lottery ticket sales for the fiscal years ended June 30, 2012, 2011, and 2010, were \$1.311 billion, \$1.187 billion, and \$1.138 billion, respectively. The following chart depicts the distribution of sales by product for the three fiscal years ended June 30:

**TENNESSEE EDUCATION LOTTERY
SALES BY MAJOR PRODUCT PER FISCAL YEAR
(IN MILLIONS)**



GROSS INSTANT TICKET sales for fiscal year 2012 were \$1.049 billion, which represents a 10.6% increase over fiscal year 2011 instant ticket sales of \$948.7 million. Gross instant ticket sales for 2011 of \$948.7 million represented a 6.6% increase over 2010 instant ticket sales of \$890.3 million. Instant tickets represent approximately 80% of total gross sales in fiscal years 2012 and 2011, and approximately 78% in 2010. The year-over-year increase in gross instant ticket sales is attributed to the instant ticket marketing strategy, which involves ongoing introduction of multiple games, including special themed games, and higher price point games with higher prize payouts. The games most popular with the players in 2012 were the six games within the “*Jumbo Bucks*” family of games, followed by *\$3,000,000 Mega Cash*.

POWERBALL sales for the fiscal years 2012, 2011, and 2010, were \$102.8 million, \$90.4 million and \$127.9 million, respectively. These amounts represent approximately 8%, 8%, and 11% of gross ticket sales, respectively, for each fiscal year.

Powerball is a multi-jurisdictional drawing-style lottery game operated in the following jurisdictions in addition to Tennessee: Arizona, Arkansas, Colorado, Connecticut, Delaware, District of Columbia, Florida, Idaho, Iowa, Indiana, Kansas, Kentucky, Louisiana, Maine, Minnesota, Missouri, Montana, Nebraska, New Hampshire, New Mexico, North Carolina, North Dakota, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, South Dakota, US Virgin Islands, Vermont, Wisconsin, and West Virginia. Starting on January 31, 2010, ten (10) states in the *Mega Millions* lottery consortium group began selling *Powerball* tickets as part of a cross-sell agreement with MUSL members. Those states were Georgia, Illinois, Maryland, Massachusetts, Michigan, New Jersey, New York, Texas, Virginia, and Washington. On April 16, 2010, Ohio, also a member of the *Mega Millions* consortium, started cross-selling *Powerball* tickets as well.

Management's Discussion and Analysis

MEGA MILLIONS is a multi-jurisdictional drawing-style lottery game administered by a lottery consortium group. The group includes the following state lotteries: California, Georgia, Illinois, Maryland, Massachusetts, Michigan, New Jersey, New York, Ohio, Texas, Virginia, and Washington. Tennessee and certain other MUSL lottery members are authorized to sell the *Mega Millions* game by the consortium as part of a cross-sell agreement. Tennessee began sales for the game in January 2010. Sales for fiscal years 2012, 2011, and 2010 were \$53.9 million, \$45.3 million, and \$15.9 million, respectively.

CASH 3 sales for fiscal years 2012, 2011, and 2010, were \$57.9 million, \$58.1 million, and \$57.2 million, respectively. These amounts represent approximately 5% of gross ticket sales, respectively, for each of the noted fiscal years.

CASH 4 sales were \$27.7 million, \$25.5 million, and \$25.6 million, in the years 2012, 2011, and 2010, respectively. These amounts represent approximately 2% of gross ticket sales for each of the noted fiscal years.

TENNESSEE CASH, a drawing-style, jackpot driven game, was introduced on October 3, 2010. Ticket sales for 2012 were \$19.2 million and 2011 were \$16.0 million.

PICK 5 sales were \$2.5 million in fiscal year 2011. The game was ended in October 2010.

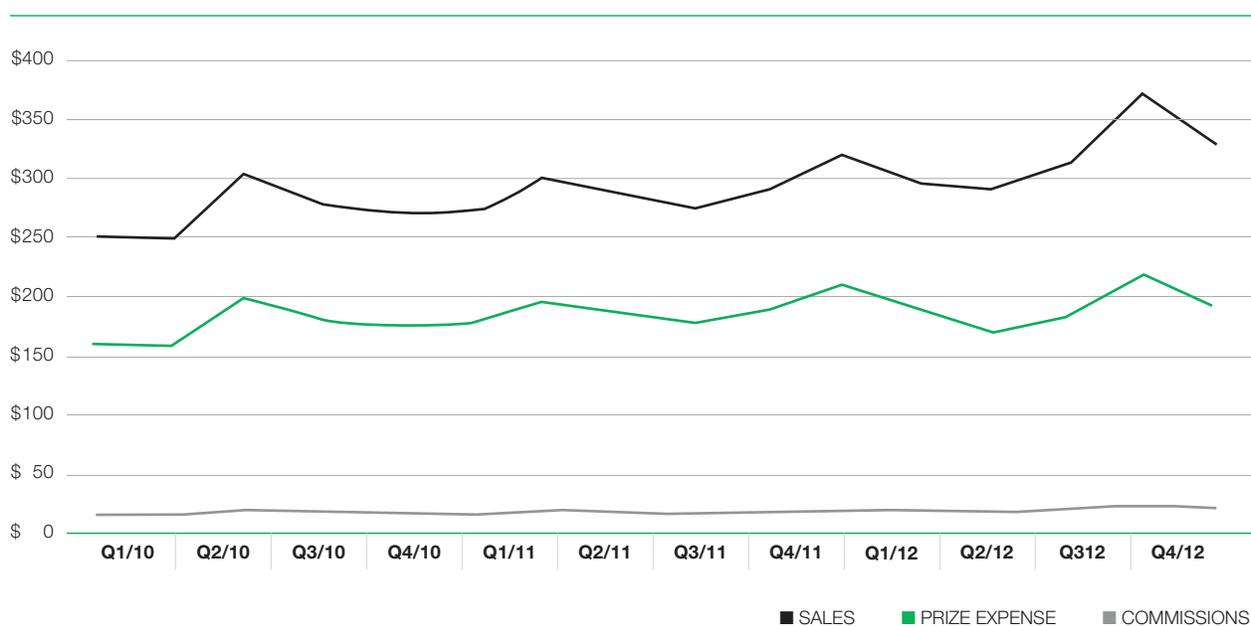
LOTTO PLUS, a TEL drawing-style game, was ended in January 2010, due to the declining profitability and the conflicting draw schedule with *Mega Millions*. Sales were \$9.5 million in fiscal year 2010.

Management’s Discussion and Analysis

COST OF SALES

Cost of sales is comprised of prize expense net of unclaimed prizes, retailer commissions, contractor fees, and other marketing costs. As the following chart depicts, these expenses are relational to and change in direct proportion with changes in ticket sales:

TENNESSEE EDUCATION LOTTERY
FISCAL YEARS 2012, 2011 AND 2010 – BY QUARTER
SALES AND SIGNIFICANT COSTS OF SALES
(IN MILLIONS)



GROSS PRIZE EXPENSE was \$770.6 million, \$695.1 million, and \$664.0 million in the years 2012, 2011, and 2010, respectively. Increases of \$75.5 million in 2012 and \$31.1 million in 2011 reflect the increases in overall ticket sales realized in the related period.

INSTANT GAMES PRIZE EXPENSE is managed through the number of tickets printed for each game and value of prizes as determined prior to ticket production. Prize expense is recorded based on an established prize structure and related percentage of sales for each game introduced and is recognized when products are made available for sale to the public. The aggregated prize payout for all instant games was 67.0%, 66.6%, and 66.4%, of instant game sales, net of free tickets for 2012, 2011, and 2010, respectively.

GROSS PRIZE EXPENSE FOR DRAWING-STYLE games generally increases or decreases in direct proportion to ticket sales of the related game and is recorded at the time of the related draw. The aggregated prize payout for all drawing-style games were 50.3%, 50.2%, and 50.1%, for 2012, 2011, and 2010, respectively.

RETAILER COMMISSIONS were \$85.5 million, \$77.5 million, and \$74.3 million, for the years ended June 30, 2012, 2011, and 2010, respectively. Consistent with the cost driver relationship of ticket sales to retailer commissions, the increases of \$8.0 million in 2012 and \$3.2 million in 2011, reflect the increases in overall ticket sales realized in the related period.

Management's Discussion and Analysis

Retailers are compensated a set commission percentage of 6.5% on all instant tickets settled and drawing-style tickets sold. They also receive an additional 1% bonus for cashing *Cash 3* and *Cash 4* ticket prizes. Additionally, the TEL will pay a bonus of \$25,000 to a retailer who sells a single jackpot winning ticket for *Powerball* or *Mega Millions*; however, if there are multiple winning *Powerball* or *Mega Millions* jackpot winning tickets sold in Tennessee in a single drawing, the \$25,000 selling bonus will be proportionately divided among the respective retailers based on the number of winning tickets sold by the retailer. The TEL will also pay a \$5,000 bonus to retailers selling any drawing-style game ticket where the prize won is equal to or greater than \$1 million. No *Powerball* or *Mega Millions* jackpot ticket selling bonuses were paid during the last three fiscal years. Drawing-style game ticket selling bonuses equating \$15,000, \$50,000, and \$60,000 were awarded for fiscal years 2012, 2011, and 2010, respectively.

CONTRACTOR FEES for fiscal years 2012, 2011, and 2010, were \$26.3 million, \$23.8 million, and \$22.6 million, respectively. The TEL has retained two contractors, one for the operation of its gaming systems and network; and one for the manufacturing, warehousing and distribution of its instant ticket games. As compensation, the instant ticket vendor receives 1.07% of the selling price of all instant ticket activations, whereas the gaming systems and network vendor receives 1.24% of the selling price of drawing-style gaming tickets sold, and on instant ticket activations net of free instant tickets available as prizes.

ADVERTISING COSTS incurred by the TEL were \$8.3 million, \$9.4 million and \$9.4 million, for the fiscal years 2012, 2011, and 2010, respectively. These costs are significantly influenced by budget directives and constraints. On a continuous basis, management strives to achieve an optimal balance between these costs and obtained benefits while keeping the costs relatively consistent with prior year amounts. The decrease in fiscal year 2012 is directly attributable to the execution and timing of contracts during the latter part of the fiscal year.

GENERAL, ADMINISTRATIVE AND OTHER OPERATING EXPENSES

General, administrative, and other operating expenses were \$16.2 million, \$15.5 million, and \$14.8 million, for the fiscal years 2012, 2011, and 2010, respectively. For each of these years, the five (5) major expense components were depreciation, personnel, professional fees, property and telecommunications expenses. These expenses do not change in direct proportion with revenues, but are instead significantly influenced by budget directives and constraints, and current business and economic conditions. In view of these factors, moderate variances in these expenses are expected to occur over fiscal periods. Nevertheless, to the most reasonable extent possible, TEL's management team works diligently to control these expenses to be relatively consistent year-over-year.

Management's Discussion and Analysis

POTENTIAL FACTORS IMPACTING FUTURE RESULTS

The TEL's mission is to maximize revenues for the purpose of maximizing payments to the Lottery for Education Account. A continuous assessment of Tennessee's economic environment and the TEL's own product lines and operations are essential to accomplish this mission. The following considerations have been presented to inform those interested in the TEL's operations about factors that could potentially affect future results:

- The TEL will continue to introduce new and/or enhanced instant and drawing-style game product offerings, as well as explore the expansion of our licensed property games that are gaining nationwide popularity.
- The TEL will continually review the prize payout percentages for its instant game products to ensure we are receiving the highest actual net proceeds for each game and/or price point category.
- The TEL will continue to enhance its promotional offerings and player affinity programs to improve brand awareness and increase player participation in our games.

CONTACTING THE TEL'S FINANCIAL MANAGEMENT

This financial report is designed to provide the State of Tennessee, the public, and other interested parties with an overview of the financial results of the TEL's activities and to show the TEL's accountability for conducting business in a fiscally responsible manner. If you have questions about this report or require additional financial information, contact the TEL's Finance Department at the following address:

Tennessee Education Lottery Corporation

Plaza Tower Metro Center
200 Athens Way, Suite 200
Nashville, Tennessee 37228

TENNESSEE EDUCATION LOTTERY CORPORATION
STATEMENTS OF NET ASSETS
AS OF JUNE 30, 2012 AND JUNE 30, 2011

ASSETS	JUNE 30, 2012	JUNE 30, 2011
CURRENT ASSETS		
Cash (Note 2)	\$ 72,214,000	\$ 66,413,000
Restricted fidelity fund cash	13,000	1,000
Retailer accounts receivable, net	60,046,000	53,510,000
Prepaid expenses and other assets	7,608,000	6,904,000
Prize annuity investments (Note 3)	144,000	104,000
Total current assets	140,025,000	126,932,000
NON-CURRENT ASSETS		
Prepaid expenses and other assets	15,000	35,000
Prize annuity investments (Note 3)	2,889,000	2,310,000
Capital assets, net of depreciation of \$4,356,000 and \$4,149,000 (Note 4)	1,101,000	1,020,000
Total noncurrent assets	4,005,000	3,365,000
TOTAL ASSETS	144,030,000	130,297,000
LIABILITIES		
CURRENT LIABILITIES		
Due to Lottery for Education Account (Note 7)	76,350,000	70,281,000
Due to After-School Programs Account (Note 8)	13,089,000	11,644,000
Prizes payable	45,615,000	40,793,000
Accounts payable	480,000	173,000
Prize annuities payable (Note 3 and 10)	144,000	104,000
Accrued liabilities (Note 10)	4,529,000	3,459,000
Deferred rent (Note 6 and 10)	61,000	61,000
Deferred revenue	659,000	931,000
Total current liabilities	140,927,000	127,446,000
NON-CURRENT LIABILITIES		
Prize annuities payable (Note 3 and 10)	2,889,000	2,310,000
Accrued liabilities (Note 10)	-	181,000
Deferred rent (Note 6 and 10)	201,000	359,000
Total non-current liabilities	3,090,000	2,850,000
TOTAL LIABILITIES	144,017,000	130,296,000
NET ASSETS		
Investment in capital assets	1,101,000	1,020,000
Unrestricted assets:		
Capital assets	(1,101,000)	(1,020,000)
Restricted assets:		
Restricted for uncollectible retailer receivables	13,000	1,000
TOTAL NET ASSETS	\$ 13,000	\$ 1,000

See notes to financial statements.

TENNESSEE EDUCATION LOTTERY CORPORATION
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2012 AND JUNE 30, 2011

	JUNE 30, 2012	JUNE 30, 2011
OPERATING REVENUES		
Ticket sales, net	\$ 1,310,205,000	\$ 1,186,318,000
Less tickets provided as prizes	(94,350,000)	(83,978,000)
Net ticket sales	1,215,855,000	1,102,340,000
Retailer service fees	3,197,000	3,396,000
Other	1,457,000	594,000
Net operating revenues	1,220,509,000	1,106,330,000
OPERATING EXPENSES		
Available prizes	770,568,000	695,149,000
Current year actual unclaimed prizes (Note 8)	(13,089,000)	(11,644,000)
Net prizes	757,479,000	683,505,000
Retailer commissions and bonuses	85,526,000	77,457,000
Contractor fees	26,280,000	23,794,000
Advertising	8,289,000	9,393,000
Salaries and benefits	12,682,000	11,755,000
Retailer merchandising and marketing	3,348,000	3,341,000
Rent, utilities, and maintenance	1,712,000	1,659,000
Depreciation	495,000	740,000
Professional fees	286,000	346,000
General administrative and other operating	1,042,000	961,000
Total operating expenses	897,139,000	812,951,000
Operating income	323,370,000	293,379,000
NON-OPERATING REVENUES (EXPENSES)		
Interest revenue	68,000	110,000
Retailer fees for future uncollectible retailer receivables	48,000	45,000
Fidelity fund retailer non-feasance recoupments (Note 1)	(36,000)	(50,000)
Proceeds to After-School Programs Account (Note 8)	(13,089,000)	(11,644,000)
Proceeds to Lottery for Education Account (Note 7)	(310,349,000)	(281,846,000)
Total non-operating revenues (expenses)	(323,358,000)	(293,385,000)
Change in Net Assets	12,000	(6,000)
NET ASSETS, beginning of year	1,000	7,000
NET ASSETS, end of year	\$ 13,000	\$ 1,000

See notes to financial statements.

TENNESSEE EDUCATION LOTTERY CORPORATION
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2012 AND JUNE 30, 2011

	JUNE 30, 2012	JUNE 30, 2011
OPERATING ACTIVITIES		
Cash received from customers	\$ 1,209,093,000	\$ 1,096,798,000
Other operating cash received	4,578,000	3,934,000
Cash paid for prizes	(752,440,000)	(677,295,000)
Cash paid to/on behalf of gaming vendors	(26,213,000)	(23,701,000)
Cash paid to retailers	(85,513,000)	(77,467,000)
Cash paid for advertising	(8,164,000)	(9,938,000)
Cash paid to/on behalf of employees	(12,481,000)	(11,563,000)
Other operating payments	(6,325,000)	(6,285,000)
Net cash provided by operating activities	322,535,000	294,483,000
NON-CAPITAL FINANCING ACTIVITIES		
Payments to Lottery for Education Account	(304,280,000)	(283,231,000)
Payments to After-School Programs Account	(11,644,000)	(12,894,000)
Fidelity fund cash received from retailers	57,000	50,000
Fidelity fund cash refunded to retailers	(9,000)	(6,000)
Fidelity fund cash non-feasance recoupments	(36,000)	(50,000)
Net cash used in non-capital financing activities	(315,912,000)	(296,131,000)
CAPITAL AND RELATED FINANCING ACTIVITIES		
Purchase of property and equipment	(295,000)	(409,000)
Proceeds from disposal of capital assets	51,000	39,000
Net cash used in capital and related financing activities	(244,000)	(370,000)
INVESTING ACTIVITIES		
Purchase of prize annuity	(634,000)	-
Interest income	68,000	110,000
Net cash used in/provided by investing activities	(566,000)	110,000
NET CASH PROVIDED BY/(USED IN) ALL ACTIVITIES	5,813,000	(1,908,000)
CASH at beginning of year	66,414,000	68,322,000
CASH at end of year	\$ 72,227,000	\$ 66,414,000
Reconciliation of cash on the statement of net assets		
Cash	\$ 72,214,000	\$ 66,413,000
Restricted fidelity fund cash	13,000	1,000
Cash at end of year	\$ 72,227,000	\$ 66,414,000

See notes to financial statements.

TENNESSEE EDUCATION LOTTERY CORPORATION
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2012 AND JUNE 30, 2011

RECONCILIATION OF NET OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES	JUNE 30, 2012	JUNE 30, 2011
Operating income	\$ 323,370,000	\$ 293,379,000
Adjustments to reconcile operating income to net cash provided by operating activities:		
Bad debt expense	998,000	239,000
Depreciation	495,000	740,000
Gain on disposal of capital assets	(50,000)	(34,000)
Changes in assets and liabilities:		
Retailer accounts receivable	(7,536,000)	(6,044,000)
Prepays and other assets	(684,000)	(500,000)
Accounts payable and accrued liabilities	914,000	40,000
Prizes annuities investments	634,000	-
Prizes payable	4,823,000	6,595,000
Deferred rent	(157,000)	(158,000)
Deferred revenue	(272,000)	226,000
Net cash provided by operating activities	<u>\$ 322,535,000</u>	<u>\$ 294,483,000</u>
NON-CASH INVESTING ACTIVITIES		
Increase/(Decrease) in fair value of prize annuity investments	<u>\$ 141,000</u>	<u>\$ 225,000</u>

See notes to financial statements.

Notes to the Financial Statements (As of and for the Years Ended June 30, 2012 and June 30, 2011)

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION AND DESCRIPTION OF REPORTING ENTITY — Effective June 11, 2003, the Tennessee Education Lottery Implementation Law (the “Act”), *Tennessee Code Annotated*, Sections 4-51-101, et.seq., was signed into law, creating the Tennessee Education Lottery Corporation (the “TEL”). Pursuant with the Act, the TEL was incorporated in the State of Tennessee as a body, politic and corporate, and a quasi-public instrumentality.

The TEL is considered a component unit of the State of Tennessee as the state has financial accountability for fiscal matters as follows:

1. The board of directors is appointed by the governor;
2. Upon dissolution of the TEL, title to all TEL property shall vest in the State of Tennessee; and
3. The TEL provides financial benefits to the state in the form of deposit payments to the state treasury.

The accompanying financial statements present information only as to the transactions of the programs of the TEL. The TEL is reported as a discretely presented component unit within the State of Tennessee’s *Comprehensive Annual Financial Report*, which may be viewed at <http://tennessee.gov/finance/act/cafr.html>.

The TEL is responsible for the provision of lotteries on behalf of the State of Tennessee in accordance with the Act and is deemed to be acting, in all respects, for the benefit of the people of the State of Tennessee.

On January 20, 2004, the TEL began lottery ticket sales. During the years ended June 30, 2012 and 2011, the TEL’s lottery sales included a variety of instant ticket games and online, terminal-based, ticket games: Cash 3, Cash 4, Pick 5, Tennessee Cash, Powerball, and Mega Millions. Effective, October 1, 2010, Pick 5 was discontinued and replaced with the in-state jackpot game, Tennessee Cash.

BASIS OF PRESENTATION – The accompanying financial statements have been prepared in conformity with the accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board. Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in the financial statements to the extent those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. The TEL has elected to follow subsequent private-sector guidance subject to this same limitation.

BASIS OF ACCOUNTING AND MEASUREMENT FOCUS – Basis of accounting refers to the timing of recognition of revenues and expenses in the accounts and reporting in the financial statements, and the measurement focus refers to what transactions and events should be recorded. The financial statements are reported using the accrual basis of accounting and the economic resources measurement focus in accordance with accounting principles generally accepted in the United States of America. Under this method, revenues are recognized when they are earned, and expenses are recognized when a liability is incurred, regardless of the timing of related cash flows.

REVENUE RECOGNITION – Lottery games are sold to the public by contracted retailers. Revenue is recognized for instant games when retailers make them available for sale to the public, as indicated by the retailers’ activation of tickets.

Revenue for terminal-based online games is recognized based on the game characteristics. For online games where the prize expense is determinable only upon occurrence of the related draw, revenues for sold tickets are recognized when the related drawing occurs. Also, amounts collected from retailers in advance of the draw are recorded as deferred revenue and recognized once the drawing occurs.

Revenues for online games where both prize expense and the draw date are known prior to ticket sales occurring are recognized at the time of the sale.

Notes to the Financial Statements (As of and for the Years Ended June 30, 2012 and June 30, 2011)

Certain instant and online games include free ticket prizes that entitle the holder to exchange a winning ticket for another of equal value. The selling price of the game ticket awarded as a prize reduces ticket revenue when the related winning ticket is validated.

Revenues are presented net of Bad Debt Expense.

NET ASSETS – Net assets represent cumulative revenues less expenses and required beneficiary program payments in accordance with the Act (see Notes 7 and 8). Net assets include funds invested in capital assets, restricted assets and unrestricted net assets.

CASH – Cash includes cash in banks, petty cash, and deposits on account in the State of Tennessee Local Government Investment Pool (LGIP) (see Note 2).

RETAILER ACCOUNTS RECEIVABLE – Retailer accounts receivable represents lottery proceeds due from retailers for ticket sales net of commissions due to and prizes paid by the retailers, and allowance for bad debt.

Lottery proceeds are collected weekly from retailer bank accounts established in trust for the TEL. Amounts not collected upon the established collection date are deemed delinquent. Delinquent accounts are reviewed periodically by TEL management. Accounts outstanding more than 180 days from the most recent date of delinquency or date of last payment are considered doubtful. At June 30, 2012 and 2011, the Allowance for Doubtful Accounts was \$236 thousand and \$270 thousand, respectively.

CAPITAL ASSETS – Capital assets are stated at cost less accumulated depreciation. Depreciation on capital assets is computed using the straight line method over the estimated useful lives of the assets, which is three to seven years for most assets. Leasehold improvements are amortized over their expected useful lives or the lease term, whichever is shorter. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation is removed from the accounts, and any resulting gain or loss is reflected in the results from operations in the period of disposal. The TEL's general threshold for capitalization is assets valued at \$500 or greater.

DEFERRED REVENUE – Funds collected from retailers for online game tickets sold in advance of the game drawings are recorded as deferred revenue and recognized as revenue once the related drawing occurs.

FIDELITY FUND – In accordance with the *Tennessee Code Annotated*, Sections 4-51-118 (a), TEL retailers are assessed a one-time fidelity fund fee of \$50. Fidelity fund proceeds are held in a demand deposit account at Citizens Bank and are classified as restricted fidelity fund cash on the Statement of Net Assets. These funds may be used to cover losses incurred as a result of the non-feasance, malfeasance, or misfeasance of TEL retailers. During the years ended June 30, 2012 and June 30, 2011, \$36 thousand and \$50 thousand were respectively used to cover losses incurred as a result of uncollected accounts of TEL retailers.

At the end of each fiscal year, fidelity funds exceeding \$500,000 may be treated as net proceeds from the TEL subject to deposit to the Lottery for Education Account. As of the years ended June 30, 2012 and 2011, there were no fidelity funds available for deposit as net proceeds.

RETAILER COMMISSIONS AND BONUSES – Retailers receive a commission of 6.5% on all instant tickets settled and online tickets sold. In addition, retailers cashing Cash 3 and Cash 4 tickets receive an additional 1% for amounts cashed. Where commission has been paid to retailers for deferred revenue ticket sales, this fee is recorded as a prepaid expense until the related revenue is recognized.

The TEL will pay a bonus of \$25,000 to a retailer who sells a single jackpot winning ticket for Powerball or Mega Millions; however, if there are multiple winning Powerball or Mega Millions jackpot winning tickets sold in Tennessee in a single drawing, the \$25,000 selling bonus will be divided proportionately (based on the number of winning tickets sold by each retailer) between or among the respective retailers.

Notes to the Financial Statements (As of and for the Years Ended June 30, 2012 and June 30, 2011)

The TEL will pay a selling bonus of \$5,000 to a retailer who sells a winning Powerball Power Play or Mega Millions Megaplier ticket if the prize is equal to or greater than one million dollars (\$1,000,000).

The TEL will pay a selling bonus of \$5,000 to a retailer who sells an online game winning ticket other than Powerball and Mega Millions if the prize is equal to or greater than one million dollars (\$1,000,000).

Bonuses were earned as follows during the years ended June 30:

ONLINE GAME	2012	2011
Powerball	\$ 15,000	\$ 30,000
Mega Millions	-	10,000
Tennessee Cash	-	10,000
Total Retailer Bonuses	\$ 15,000	\$ 50,000

CONTRACTOR FEES – The TEL has contracted with two vendors, GTECH Corporation (“GTECH”) and Scientific Games, Inc. (“SGI”), for the majority of the gaming systems and supplies.

GTECH operates the gaming network that consists of approximately 5,000 instant and online retailer ticket terminals and associated software. Effective March 3, 2009, the TEL renegotiated its contract with GTECH to extend through April 9, 2015. Terms of this contract include the continuation of the contractor service fee rate of 1.24%, on the selling price of online tickets sold and on instant ticket activations net of free tickets available as prizes. Accordingly, during fiscal years 2012 and 2011, GTECH was compensated at the rate of 1.24% for all online and instant ticket game sales. Additionally, contractual terms include GTECH’s agreement to provide, install and maintain up to eight hundred (800) instant ticket vending machines (ITVMs) for the TEL.

SGI prints, warehouses, and distributes the instant ticket games to retailers. Effective April 1, 2009, the TEL renegotiated its contract with SGI to extend through April 9, 2015. In accordance with this contract, SGI receives the negotiated fee of 1.07% on the selling price of all instant ticket activations. During the years ended June 30, 2012 and 2011, SGI was compensated at this rate for all instant ticket activations.

PRIZES – In accordance with the Act, as nearly as practical, at least 50% of ticket proceeds must be made available as prize money. Gross prize expense for instant ticket sales is recognized based on a predetermined prize structure for each game in accordance with the approved game working papers when tickets are activated for sale. Gross prize expense for Cash 3, Cash 4, Pick 5, and Tennessee Cash is recognized based on historical payout experience when the related drawings occur.

Powerball and Mega Millions prizes are shared based on contributions made to the prize pool by all member lotteries of the Powerball Group and the Mega Millions Group of the Multi-State Lottery Association (“MUSL”). All Powerball and Mega Millions grand prizes won by players who purchase tickets in Tennessee are funded from pooled contributions by all participating lottery states. The contributions are held by MUSL in trust for the TEL and are paid, at the option of the prize winner, in either a lump-sum, or thirty (30) annual installments for Powerball or twenty-six (26) annual payments for Mega Millions. Lump-sum payments are discounted to present value, as calculated by MUSL for the Powerball game, and the Mega Millions Consortium Group for the Mega Millions game. As of the years ended June 30, 2012 and June 30, 2011, there were no grand prize winners in Tennessee.

UNCLAIMED PRIZES – Prizes not claimed within 90 days of the game-end date for instant games, and within 180 days of a game draw date for online games, are forfeited as unclaimed prizes.

Notes to the Financial Statements (As of and for the Years Ended June 30, 2012 and June 30, 2011)

BUDGET – Pursuant with the Act, annually by June 30th, the TEL is required to submit a proposed operating budget for the next fiscal year to the Tennessee Department of Finance and Administration, Office of Legislative Budget Analysis, and Comptroller of the Treasury. Additionally, by September 1, the TEL is required to submit a proposed operating budget for the succeeding fiscal year to the Tennessee Department of Finance and Administration for informational purposes.

CONTINGENCIES – The TEL is subject to various claims and contingencies related to litigation, fines and penalties, assessments and other matters arising out of the normal course of business. Liabilities related to contingencies are recognized when a loss is probable and can be reasonably estimated. As of the years ended June 30, 2012 and 2011, the TEL has not incurred, nor was it aware of any related liabilities.

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 certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Estimates and assumptions are reviewed periodically and the effects of revisions are reflected in the financial statements in the period they are determined.

ADVERTISING – In accordance with AICPA Statement of Position 93-7, *Reporting on Advertising Costs*, with the exception of outdoor billboards advertising leases which are expensed in accordance with FASB 13 (Note 5), advertising costs are expensed when the related advertising takes place.

NON-OPERATING REVENUES AND EXPENSES – Revenues and expenses resulting from activities not directly associated with the sale of lottery tickets are reflected as non-operating revenues and expenses.

COMPENSATED ABSENCES – Effective November 29, 2004, the TEL implemented an attendance and leave policy allowing employees to earn vacation and sick leave during their employment. The corporation recognizes expense for accrued but unused vacation leave for all employees who have completed one year of service. No such expense exists for accrued but unused sick leave (Note 9).

EMPLOYMENT SEPARATION – Corporate officers earn separation pay for each year of employment with the TEL. Such expense is accrued in the period it is earned (Note 9).

(2) CASH

A significant portion of TEL's deposits are in a financial institution that participates in the bank collateral pool administered by the State Treasurer. The securities pledged to protect these accounts are pledged in the aggregate rather than against each individual account. The members of the pool may be required by agreement to pay an assessment to cover any deficiency. Under this additional assessment agreement, public fund accounts covered by the pool are considered to be insured for purposes of credit risk disclosure. At June 30, 2012 and 2011, bank balances of approximately \$1.829 million and \$1.477 million, respectively, were insured by the bank collateral pool.

Additionally, for both the years ended June 30, 2012 and 2011, the bank balances for the fidelity fund account were \$22,000 and maintained in a demand deposit account that was insured by the Federal Deposit Insurance Corporation for up to a maximum of \$250,000.

The TEL also has deposits in the Local Government Investment Pool (LGIP) administered by the State Treasurer. The TEL's deposits with the LGIP were approximately \$70.7 million and \$65.3 million at June 30, 2012 and 2011, respectively. The LGIP is part of the State Pooled Investment Fund. The fund is not rated by a nationally recognized statistical rating organization. The fund's investment policy and required risk disclosures are presented in the *State of Tennessee Treasurer's Report*. That report is available on the state's website at <http://www.tn.gov/treasury/> or by calling (615) 741-2956.

Notes to the Financial Statements (As of and for the Years Ended June 30, 2012 and June 30, 2011)

(3) PRIZE ANNUITY INVESTMENTS

TEL has games where the prize structure allows for specific prizes to be paid in a cash value or annuity option. Prize annuity investments represent investments TEL has made to pay the winners entitled to multi-year payments.

The prize structure of the *Win for Life* instant ticket game included three grand prizes in the form of lifetime annuities. These grand prizes guarantee the winner will receive \$52,000 a year for the remainder of his/her life, with a minimum of 20 annual payments totaling \$1,040,000. As of June 30, 2006, all of the grand prizes have been claimed by and awarded to winners.

In fiscal year 2007, the TEL purchased one (1) single premium, sum certain lifetime annuity contract for approximately \$739,000, in its name from Aviva Life, and appointed the respective *Win for Life* prize winner as the beneficiary.

In fiscal year 2006, the TEL purchased two (2) single premium, sum certain lifetime annuity contracts for approximately \$904,000 and \$848,000, in its name from Metropolitan Life (Met Life), and appointed the respective *Win for Life* prize winners as the beneficiaries.

The prize structure of the *Millionaire Jumbo Bucks* instant ticket game includes eleven top prizes of \$1 million. Winners have the option to choose the annuity or take cash option when the prize is claimed. The annuity option guarantees the winner would receive annual payments of \$40,000 for 25 years. As of June 30, 2012, one top prize winner elected the annuity option. The TEL purchased one (1) single premium, sum certain annuity contract for approximately \$634,000 in its name from Metropolitan Life (Met Life), and appointed the respective winner as the beneficiary.

In accordance with its investment policy, the TEL may enter into insurance annuity contracts in order to fund annuity prizes. All life insurance annuity contracts must be issued by companies which are financially rated "A" or better by a nationally recognized rating agency and duly licensed, admitted and authorized to transact business in the State of Tennessee.

Credit risk. This is the risk that a counterparty will fail to fulfill its obligation. The TEL mitigates this risk through its investment policy, which limits purchase of investments to those financially rated "A" or better by a nationally recognized rating agency. Consistent with this policy, the annuities purchased from Met Life were rated A+ superior by A.M. Best as of June 30, 2012 and June 30, 2011. The annuity purchased from Aviva was rated A (Excellent) by A.M. Best as of June 30, 2012 and June 30, 2011.

Concentration of credit risk. This risk relates to an investor's failure to adequately diversify its investments and is specifically defined as investments of 5 percent or more in the securities of a single issuer. Though the TEL does not have a policy specific to this risk, as a condition of the purchase, and for the duration of the contract, Met Life and Aviva are required to maintain insurance sufficient to reimburse the TEL for any losses resulting from its failure or inability to meet related obligations.

Custodial credit risk. For an investment, this is the risk that in the event of the failure of the counterparty to a transaction, the investor will not be able to recover the value of its investments that are in the possession of an outside party. Investments are subject to custodial credit risk only if they are evidenced by securities that exist in physical or book entry form. Given that annuity contracts do not meet this condition, no related custodial credit risk exists as of the years ended June 30, 2012 and June 30, 2011.

The TEL records all investments purchased to fund annuity prizes at fair value. Liabilities for annuity prizes are recorded at their discounted present value as prize annuities payable.

In relation to both the prize annuity investments and prize annuities payables, payments due from insurance companies and due to prize winners within the next fiscal year are classified as current, whereas the remaining portion is classified as non-current on the Statement of Net Assets.

Changes in the fair market value of the prize annuity investments are deferred as non-current prize annuities payable. As of the years ended June 30, 2012 and 2011, the fair market value of the prize annuity investments respectively increased by \$141 thousand and \$225 thousand, respectively.

Notes to the Financial Statements (As of and for the Years Ended June 30, 2012 and June 30, 2011)

(4) CAPITAL ASSETS

Capital assets consisted of the following as of June 30, 2012:

	BEGINNING BALANCE	INCREASES	DECREASES	ENDING BALANCE
Furniture and fixtures	\$ 893,000	\$ 2,000	\$ -	\$ 895,000
Computer equipment	406,000	93,000	(25,000)	474,000
Vehicles	225,000	35,000	-	260,000
High mileage vehicles—vans	1,055,000	390,000	(270,000)	1,175,000
Leasehold improvements	400,000	2,000	-	402,000
Communication equipment	904,000	15,000	-	919,000
Software	713,000	17,000	(2,000)	728,000
Gaming equipment	573,000	32,000	(1,000)	604,000
Total capital assets	5,169,000	586,000	(298,000)	5,457,000
Less accumulated depreciation	(4,149,000)	(495,000)	288,000	(4,356,000)
Total capital assets, net	\$ 1,020,000	\$ 91,000	\$ (10,000)	\$ 1,101,000

Capital assets consisted of the following as of June 30, 2011:

	BEGINNING BALANCE	INCREASES	DECREASES	ENDING BALANCE
Furniture and fixtures	\$ 903,000	\$ 2,000	\$ (12,000)	\$ 893,000
Computer equipment	436,000	8,000	(38,000)	406,000
Vehicles	261,000	37,000	(73,000)	225,000
High mileage vehicles—vans	1,016,000	281,000	(242,000)	1,055,000
Leasehold improvements	401,000	31,000	(32,000)	400,000
Communication equipment	891,000	13,000	-	904,000
Software	686,000	27,000	-	713,000
Gaming equipment	567,000	6,000	-	573,000
Total capital assets	5,161,000	405,000	(397,000)	5,169,000
Less accumulated depreciation	(3,802,000)	(740,000)	393,000	(4,149,000)
Total capital assets, net	\$ 1,359,000	\$ (335,000)	\$ (4,000)	\$ 1,020,000

(5) LEASING ARRANGEMENTS

The TEL's leasing arrangements consist of non-cancelable operating leases for office space, outdoor advertising billboards, and related equipment that expire at various dates through 2018. Certain of these leases contain provisions for scheduled rental increases and are renewable at the option of the TEL. No options were exercised during the years ended June 30, 2012 and June 30, 2011. The TEL also subleases office space under operating leases expiring through 2015 to its major vendors.

Notes to the Financial Statements (As of and for the Years Ended June 30, 2012 and June 30, 2011)

The following is a schedule by years of future minimum rental payments required of TEL under all non-cancelable operating leases with original terms of one year:

YEAR ENDING JUNE 30:	2012	2011
2012	\$ -	\$ 2,562,000
2013	2,640,000	2,099,000
2014	1,586,000	1,372,000
2015	418,000	323,000
2016	129,000	129,000
2017	132,000	383,000
2018 and thereafter	251,000	-
Total minimum rental payments	\$ 5,156,000	\$ 6,868,000

Minimum rental payments at June 30, 2012 and 2011, have not been reduced by minimum sublease rentals of \$334 thousand and \$531 thousand, respectively, due in future years under non-cancelable subleases.

The following is a schedule by years of future minimum sublease rental payments due to TEL under all non-cancelable operating leases with original terms of one year or more as of June 30:

YEAR ENDING JUNE 30:	2012	2011
2012	\$ -	\$ 203,000
2013	197,000	197,000
2014	131,000	131,000
Total minimum sublease payments	\$ 328,000	\$ 531,000

The following schedule shows the composition of total rental expense, net of deferred rent expense and income, for all operating leases for the years ended June 30:

	2012	2011
MINIMUM RENTALS:		
Property	\$ 1,480,000	\$ 1,427,000
Billboards	1,274,000	1,248,000
Less: Sublease rentals	(203,000)	(203,000)
Total minimum rentals	\$ 2,551,000	\$ 2,472,000

Notes to the Financial Statements (As of and for the Years Ended June 30, 2012 and June 30, 2011)

(6) DEFERRED RENT

As an incentive for entering into certain lease agreements, the TEL received rent abatements approximating \$667,000 from landlords. In accordance with Financial Accounting Standards 13 (FAS 13), *Accounting for Leases*, and Governmental Accounting Standards Board Statement No. 13, *Accounting for Operating Leases with Scheduled Rent Increases*, the TEL defers rent incentives over the entire lease term on a straight-line basis. Additionally, where lease agreements stipulate escalation of rental payments over the term of the lease, the TEL recognizes related rental expense on a straight-line basis over the entire term of the lease.

At June 30, 2012, total deferred rent of \$ \$263,000 consisted of \$102,000 related to rent abatements and \$161,000 to the straight-lining of rental expense over the life of the related lease terms.

At June 30, 2011, total deferred rent of \$420,000 consisted of \$162,000 related to rent abatements and \$258,000 to the straight-lining of rental expense over the life of the related lease terms.

Notes to the Financial Statements (As of and for the Years Ended June 30, 2012 and June 30, 2011)

(7) DUE TO LOTTERY FOR EDUCATION ACCOUNT

In accordance with the Act, all net proceeds of the TEL are due to the Lottery for Education Account. "Net proceeds" is defined under the Act as "all revenue derived from the sale of lottery tickets or shares and all other monies derived from lottery games less operating expenses." "Operating expenses" are defined under the Act as "all costs of doing business, including, but not limited to, prizes, commissions, and other compensation paid to lottery retailers, advertising and marketing costs, rental fees, personnel costs, capital costs, depreciation of property and equipment, amounts held in or paid from a fidelity fund, and all other operating costs." All other expenses are considered non-operating.

Net proceeds and operating expenses for the years ended June 30, 2012 and June 30, 2011, are summarized as follows:

	2012	2011
OPERATING REVENUES		
Ticket sales (Net)	\$1,310,205,000	\$1,186,318,000
Less instant tickets provided as prizes	(94,350,000)	(83,978,000)
Net ticket sales	1,215,855,000	1,102,340,000
Fees and other revenue	4,654,000	3,990,000
Total lottery proceeds	1,220,509,000	1,106,330,000
OPERATING EXPENSES, AS DEFINED		
Gaming	894,011,000	809,134,000
Operating	16,217,000	15,460,000
Total operating expenses, as defined	910,228,000	824,594,000
Net proceeds before distribution of unrestricted net assets	310,281,000	281,736,000
NON-OPERATING REVENUE AND EXPENSES		
Interest income	68,000	110,000
Total non-operating revenue and expenses	68,000	110,000
Net Proceeds	\$ 310,349,000	\$ 281,846,000
Amount due to Lottery for Education Account for year	310,349,000	281,846,000
Amount paid during year	(233,999,000)	(211,565,000)
Amount due to Lottery for Education Account, end of year	\$ 76,350,000	\$ 70,281,000

All amounts due at the end of each fiscal year were deposited to the Lottery for Education Account in July of the subsequent fiscal year.

Notes to the Financial Statements (As of and for the Years Ended June 30, 2012 and June 30, 2011)

(8) DUE TO AFTER-SCHOOL PROGRAMS ACCOUNT

In accordance with the Act, at the end of each fiscal year, one hundred percent of any unclaimed prize money shall be deposited in the After-School Programs special account.

The amounts due to the After-School Programs special account are derived from unclaimed prizes for instant games that have been officially closed and online draws that have exceeded the 180-day claim period.

Unclaimed prizes for instant games are estimated based upon historical percentages of actual unclaimed dollars at the time of game close and reconciliation at the end of the 90 day redemption period.

For online games, the actual unclaimed amounts are determined after the expiration of the related claim period for the draw.

For instant games, prizes not claimed within 90 days of the announced game-end date are forfeited as unclaimed prizes. For online games, prizes not claimed within 180 days of a game draw date are forfeited as unclaimed prizes.

For fiscal year 2012, unclaimed prizes were \$13,089,000, which was current and payable to the After-School Programs special account at June 30, 2012.

For fiscal year 2011, unclaimed prizes were \$11,644,000, which was current and payable to the After-School Programs special account at June 30, 2011.

All amounts due at the end of each fiscal year were deposited to the After-School Programs special account by August 1 of the subsequent fiscal year.

(9) EMPLOYEE BENEFITS

A. *Deferred Compensation*

Effective September 22, 2003, the TEL provided its employees with a deferred compensation plan created in accordance with Internal Revenue Code Section 457 (the "457 Plan"). The 457 Plan is available to all eligible employees at their option and permits participants to defer a portion of their salary until future years. The deferred compensation is not available to participants until termination, retirement, death, or unforeseeable emergency. During the years ended June 30, 2012 and 2011, employees contributed approximately \$444,000 and \$416,000, respectively to the 457 Plan.

The aggregate fair value of the plan's assets was approximately \$3,187,000 and \$2,758,000, net of administrative fees, as of June 30, 2012 and 2011, respectively.

B. *Defined Contribution Plan*

Effective September 22, 2003, the TEL Board of Directors established a defined contribution plan in accordance with Internal Revenue Code Section 401(a) (the "401(a) Plan"). Under the 401(a) Plan all eligible employees receive compensation from the TEL in the form of non-voluntary deferrals to their individual 401(a) accounts as follows:

1. Contribution of five percent (5%) of employee's compensation, and
2. Matching contribution of seventy-five percent (75%) of the participant's contributions to the 457 Plan up to the first five (5) percent of the participant's compensation.

These contributions vest over a 4-year period at a rate of twenty-five percent (25%) per year and are not available to participants until termination, retirement, death, or unforeseeable emergency. The TEL contributed approximately \$674,000 and \$634,000

Notes to the Financial Statements (As of and for the Years Ended June 30, 2012 and June 30, 2011)

to the 401(a) Plan on behalf of its employees in the years ended June 30, 2012 and 2011, respectively. Of these contributions, approximately \$16,000 and \$29,000 were forfeited by separated employees as of June 30, 2012 and June 30, 2011, respectively.

In accordance with the 401(a) Plan, forfeitures of employer contributions may be used to offset plan administrative expenses and/or reduce future contribution costs. As of the years ended June 30, 2012 and 2011, forfeited amounts of approximately \$15,000 and \$37,000, respectively, were used to offset employer contributions and plan administrative expenses.

Section 1448 of the Small Business Job Protection Act of 1996 added Subsection (g) to Section 457 of the Internal Revenue Code to provide that all assets and income under a Section 457(b) plan that are maintained by a state or local government employer must be held in trust for the exclusive benefit of plan participants and their beneficiaries. The 457 Plan and 401(a) Plan assets are held in aggregate by John Hancock Financial, the plans' custodian.

The aggregate fair value of the plan's assets was approximately \$4,672,000 and \$4,158,000, net of forfeitures and administrative fees, as of June 30, 2012 and 2011, respectively.

C. Compensated Absences

Vacation leave can be earned at various rates depending on the employee's position and years of service. Carryover of vacation leave is limited to the number of hours earned in the prior year. Employees must complete 12 months of service from the date of hire before they receive termination payment for any unused vacation hours. The current portion of the compensated absence liability, expected to be due within one year of the statement date, June 30, 2012, is estimated using historical trends. At June 30, 2012 and 2011, the estimated current portion of the compensated absences liability was \$535 thousand and \$383 thousand, respectively.

Sick leave is earned at the end of each month at the rate of eight hours per month for all employees. Sick leave may be carried over from year to year, but all such accrued sick leave is forfeited upon separation of employment.

D. Employment Separation

Corporate officers accrue forty hours of separation pay for every year of employment with TEL. The TEL had \$347 thousand and \$295 thousand accrued for employment separation obligations for each of the years ending June 30, 2012 and 2011, respectively.

Notes to the Financial Statements (As of and for the Years Ended June 30, 2012 and June 30, 2011)

(10) NON-CURRENT LIABILITIES

Non-current liabilities consisted of the following as of June 30, 2012:

	BEGINNING BALANCE	INCREASES	DECREASES	ENDING BALANCE	DUE WITHIN ONE YEAR
Prize Annuities Payable	\$ 2,414,000	\$ 775,000	\$ (156,000)	\$ 3,033,000	\$ 144,000
Compensated Absences	565,000	535,000	(565,000)	535,000	535,000
Deferred Rent	420,000	-	(158,000)	262,000	61,000
Total non-current liabilities	\$ 3,399,000	\$ 1,310,000	\$ (879,000)	\$ 3,830,000	\$ 740,000

Non-current liabilities consisted of the following as of June 30, 2011:

	BEGINNING BALANCE	INCREASES	DECREASES	ENDING BALANCE	DUE WITHIN ONE YEAR
Prize Annuities Payable	\$ 2,345,000	\$ 225,000	\$ (156,000)	\$ 2,414,000	\$ 104,000
Compensated Absences	533,000	629,000	(597,000)	565,000	383,000
Deferred Rent	578,000	-	(158,000)	420,000	61,000
Total non-current liabilities	\$ 3,456,000	\$ 854,000	\$ (911,000)	\$ 3,399,000	\$ 548,000

Compensated absences presented within the noted schedules are included in accrued liabilities presented on the Statement of Net Assets.

RISK MANAGEMENT – Effective July 31, 2005, the TEL became a member of the Risk Management Fund, an internal service fund of the State of Tennessee. The Risk Management Fund allocates the cost of providing claims servicing and claims payment by charging a premium to the TEL based on a percentage of the TEL's expected loss costs which includes both experience and exposures. This Risk Management Fund provides general and automobile liability up to \$300,000 per person and \$1,000,000 per occurrence. For property, the deductible is the first \$25,000 of losses for a member.

Additionally, in order to minimize financial losses resulting from the occurrence of theft; employee dishonesty; legal judgments; work-related employee injury and accidents; and catastrophic events, the TEL maintains insurance from various other providers. At June 30, 2012, additional insurance coverage was provided at the following maximum amounts:

COVERAGE	2012
Employee Fidelity	\$ 500,000
Automobile/Property	1,000,000
Workers' Compensation	1,000,000
Employment Practices	5,000,000
General Liability/Umbrella	5,000,000

Over the past three fiscal years, in the ordinary course of business, the TEL has filed insurance claims with both the risk pool and the commercial insurers. None of the related settlements exceeded the provided insurance coverage.

(11) COMMITMENTS AND CONTINGENCIES

Legal – The TEL is subject to litigation in the ordinary course of its business. In the opinion of management and legal counsel, the outcome of such litigation will not have a material impact on the financial position or cash flows of the TEL. Furthermore, as of the year ended June 30, 2012, management is not aware of any related liabilities.



Tennessee Education Lottery Corporation

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