Creating thrilling experiences for people all across Tennessee.

Tennessee Education Lottery

Annual Report 2008

Table of Contents

Letter from the Chairman and the President and CEO

TEL Board of Directors 2007–08: Front Row (L to R) Claire Tucker, Secretary/Treasurer; Dennis Bottorff, Chair; Lowell Perry Jr.; Back Row (L–R) Jim Hill, Vice-Chair; Marvell Mitchell, Garry McNabb, Jim Ripley

It is a pleasure to present an overview of the 2007–08 fiscal year of the Tennessee Education Lottery Corporation—a year in which increased sales pushed total proceeds for education to over $1 billion. The fiscal year alone generated record sales of more than $1 billion, resulting in a return of $286.1 million to education programs in Tennessee.

These dollars benefited more than 100,000 individuals during the past year through a variety of lottery-funded programs, which include college scholarships, pre-kindergarten and after-school programs. With the ongoing success of the Lottery, the General Assembly continued to expand lottery-funded programs and passed several new initiatives during its 2008 session.

In addition to helping students, the Tennessee Lottery benefited countless other Tennesseans in a variety of ways during fiscal year 2007–08. Players won $627.1 million in prizes, which brings the total paid since inception to more than $2.5 billion. Retailers who sell Lottery products were paid $69.6 million in commissions, for a total of $286.3 million since inception. And, the Lottery's Equal Business Opportunity Program continued to surpass statutory and contractual goals as part of our commitment to diversity and minority business participation.

On behalf of the Board of Directors and the entire staff of the Tennessee Lottery, we invite you to review this report, which includes the Lottery's audited financial statements and highlights from an incredible year. We would also like to share our pledge to remain committed to success, and to thank those who contribute in so many ways. Working together, we will continue to provide Tennesseans with entertainment, prizes, economic benefits—and most of all, a brighter future for education.

Rebecca Hargrove

Rebecca Hargrove, President and CEO

Dennis C Bottorff

Dennis C. Bottorff, Chairman

Education Programs

As the Lottery continues to evolve, so do the education programs that are funded through the sale of lottery tickets. With the passing of each fiscal year, the General Assembly continues to review and enhance lottery-funded education programs. During the past year, for example, legislators created an Energy Efficient grant/loan program to encourage "green" schools and a Helping Heroes grant to assist veterans of the Iraq and Afghanistan wars. They also expanded the opportunities for non-traditional students and created a pilot program to provide laptops to HOPE dual enrollment high school students.

According to the Tennessee Student Assistance Corporation, the state agency responsible for distributing Lottery–funded awards, approximately $225.7 million was awarded during fiscal year 2007–08, helping more than 76,000 students attend higher education institutions throughout the state. Details about these recipients include:

Board of Regents System	20,903
University of Tennessee System	16,898
State Technical/Community Colleges	16,495
Technology Centers	11,434
Independent Four-Year Programs	11,281
Independent Two-Year Programs	223
Private/Business Trade	92
TOTALS	**76,323***

Lottery funds were also used during 2007–08 to fund 257 pre-kindergarten classes and 126 after-school programs. Combined with those who benefited from the scholarship and grant programs, the Lottery assisted more than 100,000 individuals during the past year.

**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.*
SOURCE: Tennessee Student Assistance Corporation

Games

One of the keys to the Lottery's success is offering innovative, exciting games. By gaining feedback from focus groups of players and retailers, networking with other jurisdictions and staying abreast of the latest industry trends, the Lottery continues to offer games that appeal to a variety of players.

Ticket sales remained strong during fiscal year 2007–08, which generated over $1 billion in sales, bringing the total since inception to more than $4.3 billion.

Instant ticket games remained the most popular choice among players, accounting for $795.8 million of overall sales in the fiscal year. In addition to cash prizes, licensed instant games, such as "Indiana Jones" and "Deal or No Deal" gave players a chance to win prize packs and all-expenses-paid trips to Hollywood to vie for the opportunity to play the real "Deal or No Deal" game.

The Lottery introduced "Lotto Plus," giving Tennessee its own lotto-style game with jackpots starting at $1 million. The Lottery also added a new prize level—and a new name—to Lotto 5, now known as Pick 5. Drawing-style games such as these accounted for $268.7 million of overall sales.

Details of all games sales during fiscal year 2007–08 include:

Instant Tickets	$ 795.8 million
Powerball	$ 149.5 million
Cash 3	$ 59.3 million
Lotto 5/Pick 5	$ 22.9 million
Cash 4	$ 23.3 million
Hot Trax Champions	$ 2.3 million
Million $ Madness	$ 3.8 million
Lotto Plus	$ 8.1 million

In addition to instant and drawing-style games, the Lottery held three **Play it Again!** drawings, awarding more than $921,000 in cash prizes in fiscal year 2007–08. **Play it Again!** gives instant-ticket players a second chance to win, while helping the environment. By combining **Play it Again!** with other promotions associated with games such as "Deal or No Deal" and "Indiana Jones," every non-winning instant ticket from the Tennessee Lottery offers a second chance to win.

Players and Winners

Not only is the Tennessee Lottery a win for education, but it's also a win for thousands of players each day. In fact, players won an average of more than $1.7 million each day in prizes during fiscal year 2007–08, for a total of $627.1 million. Since inception, the Lottery has paid more than $2.5 billion in prizes, which includes more than 900 winners of $50,000 or more.

Linda Climer won $250,000 by entering a non-winning instant ticket in "Play it Again!"

Although million-dollar winners usually attract the spotlight, there are countless stories about the excitement a smaller win can create—and how much it can help. Just one example is Tammy Gillespie, who was living in Murfreesboro after her family was forced to leave their home in New Orleans following Hurricane Katrina. Tammy cried tears of joy after learning she won $20,000 in the April 2008 Play it Again! drawing. Linda Climer of Brownsville won $250,000 in that same drawing and said she couldn't wait to pay her bills. "Thank you! Thank you! I just don't know what to say!" she told President and CEO Rebecca Hargrove.

Of course, Greeneville's Candy Carr garnered a great deal of attention after her $1 million win. Not only was she the first jackpot winner of Lotto Plus, but she won the prize after the very first drawing held for the new game, launched on March 9. "This couldn't have come at a better time," Candy said. "It will help out so much."

Candy Carr and her family celebrate their $1 million win.

As people play and have fun, the organization also reminds those who purchase tickets to "Play Responsibly" by sharing this message on printed materials, tickets and by offering resource information at *www.tnlottery.com*.

Retailers

Although the Lottery has an official staff of more than 160 employees, it has thousands of additional team members throughout the state. These partners are the Lottery's retailer network of more than 4,700 locations—a diverse, dedicated group that earned over $69.6 million in commissions during the past fiscal year, for a total of $286.3 million since inception.

From independently owned convenience stores to corporate-owned shopping locations, it is convenient for people to learn about the Lottery and purchase tickets from Memphis to Mountain City.

Retailer partners have earned $286.3 million since inception.

The Tennessee Lottery nurtures its relationship with each retailer by providing a variety of tools to help increase sales of Lottery products, which can also generate additional sales of other items. A team of TEL sales representatives is on the go each day, visiting retailers to offer assistance with marketing and working with customers, and to provide details about new games and other developments. The Lottery also offers a toll-free helpline, publishes a retailer newsletter, maintains a retailer website and seeks input from members of the Retailer Advisory Board.

Equal Business Opportunity Program

Not only does the Tennessee Education Lottery generate hundreds of millions for education, the organization is committed to diversity and minority business participation through a variety of programs.

As in past years, the Lottery and its major procurement vendors exceeded statutory and contractual goals set for its Equal Business Opportunity program. During fiscal year 2007–08, 28 percent of the dollars spent by the Lottery on non-major procurement items were spent with minority businesses.

The Lottery's three major procurement vendors closed the fiscal year by paying the following percentages of their revenue earned from the TEL to minority business:

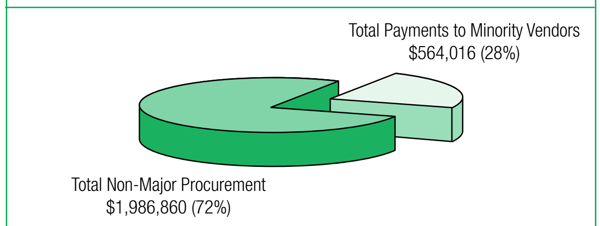
- GTECH: 25 percent
- Scientific Games: 18 percent
- Gish, Sherwood and Friends: 19 percent

As in previous years, all three vendors surpassed their contractual agreements.

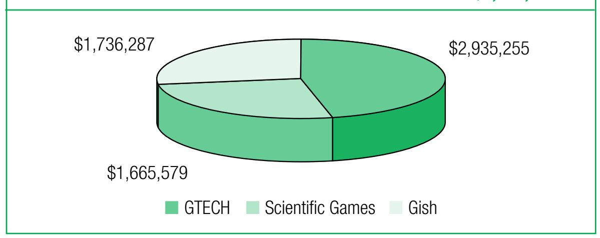
The Lottery continues to gain insight by working with its Advisory Council on Minority Business Participation, a group of nine Tennesseans dedicated to helping create strategies to further educational and economic development opportunities for minority-owned businesses throughout the state.

Members of the 2007–08 Council were Gwendolyn Davis, Mark Deathridge, Sherrie Gilchrist, Leroy Hanna, Willie Martin, Marvell Mitchell, Lowell Perry, A. Gregory Ramos, Esquire, and James Ripley, Esquire.

TEL NON-MAJOR PROCUREMENT
MINORITY BUSINESS PARTICIPATION FISCAL YEAR 2008



MAJOR PROCUREMENT VENDORS
2008 MINORITY BUSINESS PARTICIPATION TOTALED $6,337,121



During the summer of 2008, college students gained professional experience through the Lottery's Summer Internship Program.

The Lottery also participated in community events by partnering with minority business organizations and offered a summer Internship Program to students attending historically black colleges and universities in the state. During fiscal year 2007–08, the intern program, funded by the Lottery's three major procurement vendors, provided the opportunity for 14 college students to gain professional business experience and basic career development skills.

And finally, the Lottery continues its strong record of reflecting the diversity of Tennessee through its workforce. At the close of fiscal year 2007–08, 46 percent of the Lottery's 163 Lottery employees were minority,* and 55 percent of the total were women.

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

Management/Organization

Responsible leadership and a talented staff are crucial to the success of any organization. A seven-member Board of Directors oversees the Tennessee Education Lottery, providing guidance and oversight, while a team of dedicated professionals are charged with meeting the objectives designed to maximize dollars for education.

EXECUTIVE DIVISION: REBECCA HARGROVE, *PRESIDENT AND CEO*

In addition to overseeing the daily operations of the Tennessee Lottery, 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
- Communications, including player services, media and public relations
- Legislative affairs
- Corporate services

LEGAL DIVISION: WANDA YOUNG WILSON, *EXECUTIVE VICE PRESIDENT AND GENERAL COUNSEL*

The Legal Division includes:

- Human Resources—Manages personnel functions
- Legal Services—Provides legal advice and assistance to management and the Board of Directors, serves as the corporate records keeper, oversees litigation, and manages contract compliance
- Security—Responsible for physical and intellectual property security
- Retailer Contract Administration—Manages all functions of retailer applications and contracts

SALES AND MARKETING DIVISION: SIDNEY CHAMBERS, *EXECUTIVE VICE PRESIDENT*

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

- Marketing
- Retailer sales and services
- Corporate accounts
- Promotions and special events
- Warehouse management and distribution

FINANCE AND INFORMATION SYSTEMS: ANDY DAVIS, *CHIEF FINANCIAL AND INFORMATION SYSTEMS OFFICER*

Finance and Information Systems is responsible for the following:

- Financial and retail accounting
- Prize validation, statutory and financial reporting
- Cash management, budgeting, collections and procurement
- Purchasing, facilities management and risk services
- Game drawings, including online and second chance instant games and drawings activities
- Gaming systems and operations oversight
- Computer systems, technology infrastructure and telecommunications systems

Financials

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500
JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-1402
PHONE (615) 401-7897
FAX (615) 532-2765

Independent Auditor's Report

November 20, 2008

The Honorable Phil Bredesen, 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, TN 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, 2008, and June 30, 2007, 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 significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our 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, 2008, and June 30, 2007, 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.

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

In accordance with generally accepted government auditing standards, we have also issued our report dated November 20, 2008, 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, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the 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 read in conjunction with this report in considering the results of our audit.

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes, Jr., CPA
Director

AAH/dgv

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, 2008 and 2007, with comparative information presented for the fiscal year ended June 30, 2006. The overview should be considered in conjunction with the independent auditor's report, the accompanying audited financial statements and notes to 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, 2008 and 2007.
- 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, 2008 and 2007.
- 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, 2008 and 2007.

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

The TEL's primary business purpose is to generate revenues to fund college scholarships for residential Tennessee students and to provide funding for Pre-Kindergarten programs. Accordingly, the main focus of the financial statements is determining funds available for payment to the Lottery for Education Account. In addition to funding the Lottery for Education Account, the TEL's unclaimed prize funds are transferred to the After-School Programs special account benefiting after-school programs in the state of Tennessee. It is important to note that most financial statement balances have a direct or indirect relationship to revenue. Generally, as lottery sales increase, the amount paid to the Lottery for Education Account also increases. Similarly, increases in revenue generally result in direct increases to cost of sales – including, but not limited to, prize expense, commission expense and gaming contractor fees.

FISCAL YEAR 2008 FINANCIAL HIGHLIGHTS

The Tennessee Education Lottery closed out the fiscal year 2008 with a record total return for education of $286.1 million— generating $272.4 million for the Lottery for Education Account and $13.7 million for the After-School Programs special account.

Consistent with that of fiscal year 2007, the TEL achieved gross sales of over $1 billion for the fiscal year ended June 30, 2008. This sustained success is attributed to the TEL's introduction of Lotto Plus, which provided over $8 million in sales, and our instant ticket marketing strategy, which included the launching of several higher price point games, such as TEL's $20 "Sizzling Cash" and $10 "$50 Million Spectacular" instant games, representing a $24.7 million (3%) increase in gross sales.

Cash 3 and Cash 4 sales decreased by 10%. Cash 3 and Cash 4 sales are directly impacted by prizes won by players. The prizes won by players were 15% lower in fiscal year 2008 compared to fiscal year 2007. TEL management believes this had a direct effect on the sales for our Cash 3 and Cash 4 games in 2008.

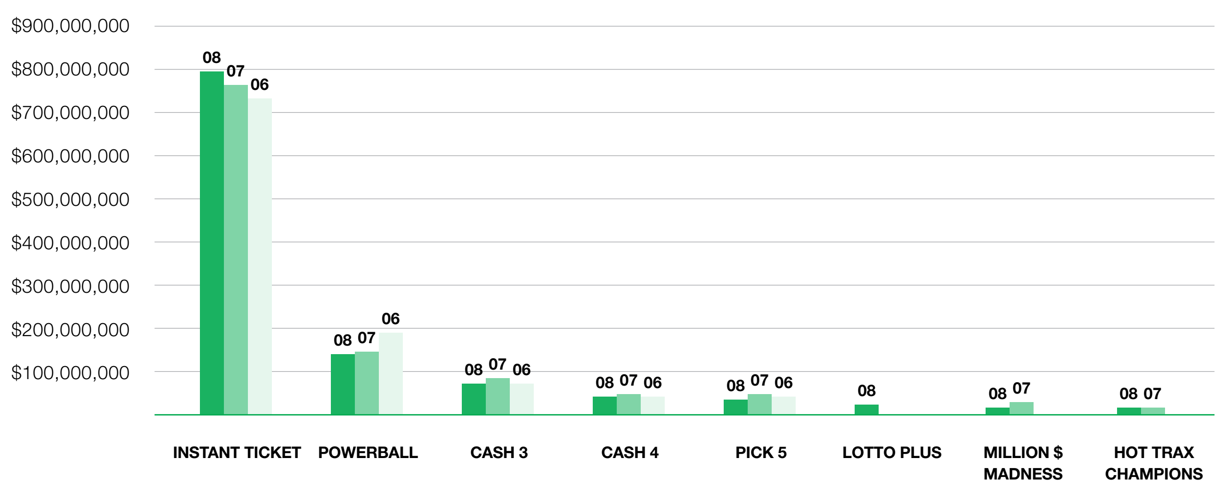
Management's Discussion and Analysis

Pick 5, formerly Lotto 5, is a jackpot driven game. Due to smaller jackpot prizes and the launch of our new in-state jackpot game, Lotto Plus, Pick 5 sales declined by 18% in fiscal year 2008. This decline was expected to occur as player interest in Lotto Plus grew. Nevertheless, the success of the launch of Lotto Plus diminished the lost sales of our Pick 5 game. Accordingly, when comparing the combined 2008 sales for Lotto Plus and Pick 5 to the Pick 5 sales for fiscal year 2007, a 10% increase is noted.

Our fiscal year 2008 Million $ Madness game did not achieve the same level of sales as was experienced in fiscal year 2007. Sales in fiscal year 2008 were approximately 50% lower than the prior year. Management attributes this decline primarily to the game's 2008 sales period (November–January) which was during the holiday season when players are more focused on other lottery products.

POWERBALL sales decreased by 5% in fiscal year 2008. The drop is attributed to declining sales per jackpot runs in fiscal year 2008 when compared to similar jackpot runs in fiscal year 2007. TEL experienced significantly high jackpot occurrences in fiscal year 2006, resulting in higher sales than the two most recent fiscal periods.

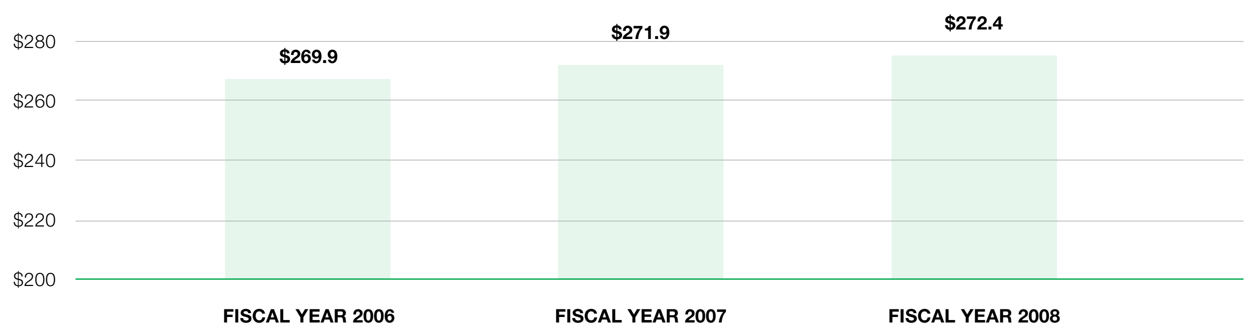
TENNESSEE EDUCATION LOTTERY GROSS TICKET REVENUES
FISCAL YEAR 2008 COMPARISON TO 2007 AND 2006



Management's Discussion and Analysis

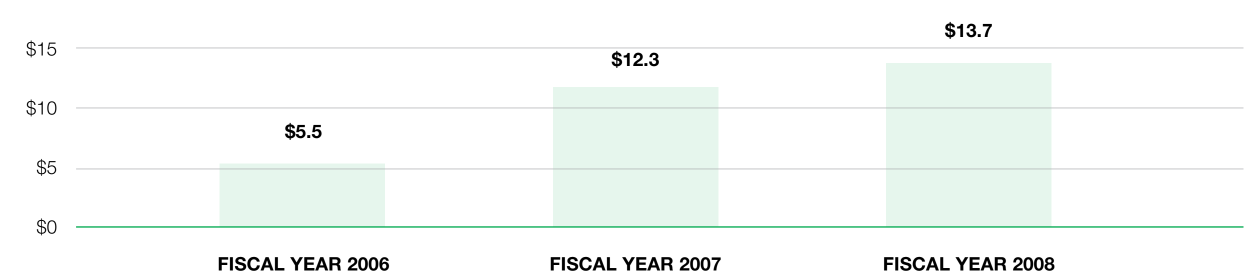
The TEL transferred $272.4 million to the Lottery for Education Account in fiscal year 2008, compared to $271.9 million in fiscal year 2007 and $269.9 in fiscal year 2006.

TENNESSEE EDUCATION LOTTERY
RETURN TO THE LOTTERY FOR EDUCATION ACCOUNT
(IN MILLIONS)



The amounts available for transfer to the After-School Programs special account are derived from unclaimed prizes for instant games officially closed after the 90-day claim period and online draws that have exceeded the 180-day claim period. In fiscal year 2008, the TEL generated $13.7 million for the After-School Programs special account as compared to $12.3 million in fiscal year 2007, and $5.5 million in fiscal year 2006. These amounts represented 100% of realized unclaimed prizes in fiscal years 2008 and 2007. In fiscal year 2006, the amount represented 50% of recognized unclaimed prizes.

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



CONDENSED STATEMENT OF NET ASSETS

ASSETS	JUNE 30, 2008	INCREASE (DECREASE)	JUNE 30, 2007	INCREASE (DECREASE)	JUNE 30, 2006
CURRENT ASSETS					
Cash	$ 68,538,000	$ 5,718,000	$ 62,820,000	$ 4,758,000	$ 58,062,000
Retailer accounts receivable, net	47,857,000	3,555,000	44,302,000	5,865,000	38,437,000
Other	6,759,000	(382,000)	7,141,000	1,492,000	5,649,000
Total current assets	**123,154,000**	**8,891,000**	**114,263,000**	**12,115,000**	**102,148,000**
NON-CURRENT ASSETS					
Other	2,536,000	(41,000)	2,577,000	791,000	1,786,000
Capital assets, net	2,088,000	260,000	1,828,000	(455,000)	2,283,000
Total non-current assets	4,624,000	219,000	4,405,000	336,000	4,069,000
Total assets	**127,778,000**	**9,110,000**	**118,668,000**	**12,451,000**	**106,217,000**
LIABILITIES					
CURRENT LIABILITIES					
Due to Lottery for Education Account	66,969,000	760,000	66,209,000	3,736,000	62,473,000
Due to After School Programs Account	13,724,000	3,288,000	10,436,000	4,918,000	5,518,000
Prizes payable	39,091,000	4,477,000	34,614,000	15,188,000	19,426,000
Accounts payable and accrued liabilities	3,413,000	345,000	3,068,000	(1,443,000)	4,511,000
Deferred liabilities	1,143,000	357,000	786,000	(379,000)	1,165,000
Total current liabilities	**124,340,000**	**9,227,000**	**115,113,000**	**22,020,000**	**93,093,000**
NON-CURRENT LIABILITIES					
Non-current portion of Due to After School Programs Account	-	-	-	(9,265,000)	9,265,000
Non-current portion of other liabilities	3,341,000	(83,000)	3,424,000	(104,000)	3,528,000
Total non-current liabilities	3,341,000	(83,000)	3,424,000	(9,369,000)	12,793,000
Total liabilities	**127,681,000**	**9,144,000**	**118,537,000**	**12,651,000**	**105,886,000**
NET ASSETS					
Investment in capital assets	2,088,000	260,000	1,828,000	(455,000)	2,283,000
Unrestricted assets	(2,088,000)	(260,000)	(1,828,000)	455,000	(2,283,000)
Restricted assets	97,000	(34,000)	131,000	(200,000)	331,000
Total net assets	**$ 97,000**	**$ (34,000)**	**$ 131,000**	**$ (200,000)**	**$ 331,000**

OVERVIEW OF FINANCIAL POSITION

ASSETS: The TEL's financial position remained strong during fiscal 2008. The $9.11 million increase in total assets primarily resulted from increased sales from our Instant Ticket products and the introduction of our Lotto Plus game in fiscal year 2008. The impact of the sales increase is reflected in increased Cash and Retailer Accounts Receivable.

As of the year ended June 30, 2007, the $12.45 million increase in total assets primarily resulted from increased sales from our Instant Ticket, Cash 3, Pick 5 (formerly Lotto 5), and Million $ Madness products. The impact of the sales increase is reflected in increased Cash and Retailer Accounts Receivable. Other factors included, but were not limited to, the purchase of one prize annuity investment to fund a Win for Life grand prize and the increase in the TEL's POWERBALL prize reserve account balances held by the Multi-State Lottery Association ("MUSL").

Management's Discussion and Analysis

LIABILITIES: The $9.14 million increase in total liabilities at June 30, 2008, from the prior year, relates primarily to increased sales, resulting in higher net proceeds payable to the Lottery for Education Account, and more prizes payable to players. In addition, the total amount of unclaimed prizes payable to the After-School Programs Account increased in fiscal year 2008 as several instant games with multi-year sales periods were closed as part of our instant ticket marketing strategy.

The $12.65 million increase in total liabilities at June 30, 2007, from the prior year, relates primarily to increased sales, resulting in higher net proceeds payable to the Lottery for Education Account, and more prizes payable to players.

CONDENSED STATEMENT OF REVENUES & EXPENSES

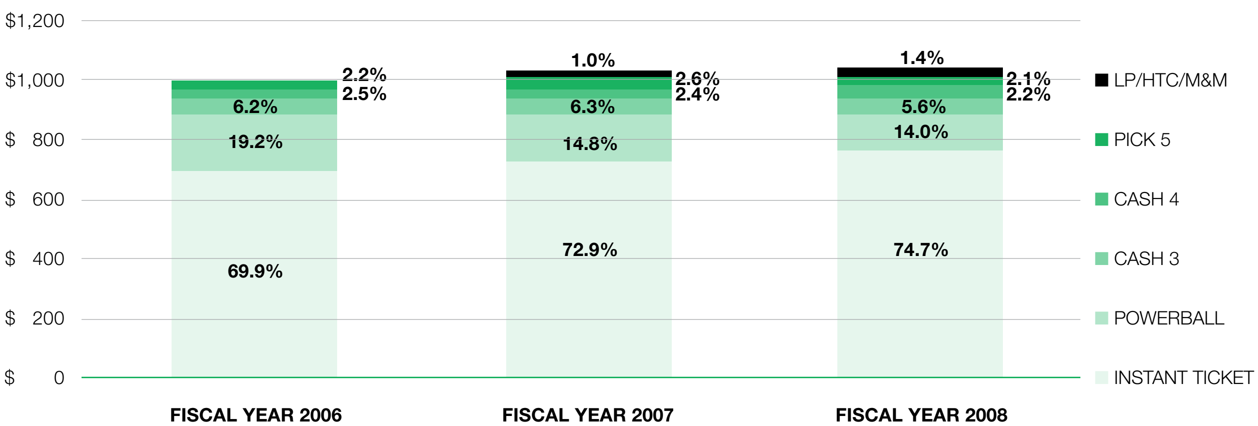
	JUNE 30, 2008	INCREASE/ (DECREASE)	JUNE 30, 2007	INCREASE/ (DECREASE)	JUNE 30, 2006
REVENUES:					
Instant games	$ 795,794,000	$ 24,669,000	$ 771,125,000	$ 74,909,000	$ 696,216,000
Online games	269,165,000	(17,842,000)	287,007,000	(13,045,000)	300,052,000
Less instant tickets provided as prizes	(74,378,000)	(904,000)	(73,474,000)	(5,211,000)	(68,263,000)
Games revenue, net	**990,581,000**	**5,923,000**	**984,658,000**	**56,653,000**	**928,005,000**
Bad debt recoveries/(expense), net	(205,000)	(428,000)	223,000	646,000	(423,000)
Retailer service fees	3,209,000	(58,000)	3,267,000	101,000	3,166,000
Interest income	2,329,000	234,000	2,095,000	99,000	1,996,000
Other revenue	493,000	(571,000)	1,064,000	749,000	315,000
Total revenues	**996,407,000**	**5,100,000**	**991,307,000**	**58,248,000**	**933,059,000**
EXPENSES:					
Cost of sales	695,814,000	3,596,000	692,218,000	52,083,000	640,135,000
General, administrative and other operating expenses	14,413,000	(336,000)	14,749,000	(360,000)	15,109,000
Other expenses	74,000	(187,000)	261,000	261,000	-
Total expenses	**710,301,000**	**3,073,000**	**707,228,000**	**51,984,000**	**655,244,000**
TRANSFERS:					
Proceeds to After-School Program Account					
Current	13,724,000	1,414,000	12,310,000	6,792,000	5,518,000
Deferred	-	-	-	(9,265,000)	9,265,000
Proceeds to Lottery for Education Account	272,416,000	447,000	271,969,000	2,107,000	269,862,000
Total transfers	**286,140,000**	**1,861,000**	**284,279,000**	**(366,000)**	**284,645,000**
Change in net assets	(34,000)	166,000	(200,000)	6,630,000	(6,830,000)
Total net assets, beginning of year	131,000	(200,000)	331,000	(6,830,000)	7,161,000
Total net assets, end of year	**$ 97,000**	**$ (34,000)**	**$ 131,000**	**$ (200,000)**	**$ 331,000**

Management's Discussion and Analysis

REVENUES

Total gross lottery ticket sales for the fiscal years ended June 30, 2008, 2007, and 2006 were $1.065 billion, $1.058 billion, and $996.27 million, respectively. The following chart depicts the distribution of sales by product for the three fiscal years ended June 30:

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



GROSS INSTANT TICKET sales for 2008 grew to $795.79 million, which represents a 3% increase over 2007 instant ticket sales of $771.13 million. Gross instant ticket sales for 2007 of $771.13 million represented an 11% increase over 2006 instant sales of $696.22 million. Instant tickets represent approximately 75% of total gross sales in fiscal year 2008, approximately 73% in 2007 and approximately 70% in 2006. 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 2008 were Jumbo Bucks, Giant Jumbo Bucks, Big Money Maker, Junior Jumbo Bucks and Sizzling Cash.

POWERBALL sales for the fiscal years 2008, 2007, and 2006 were $149.49 million, $156.85 million, and $190.95 million, respectively. These amounts represent approximately 14%, 15%, and 19% of gross ticket sales, respectively for each fiscal year. The significant increase in the 2006 POWERBALL sales as compared to 2008 and 2007 sales can be attributed to the occurrence of two large jackpots exceeding $300 million in fiscal year 2006.

POWERBALL is a multi-jurisdictional lottery game operated in the following jurisdictions, in addition to Tennessee; Arizona, Colorado, Connecticut, Delaware, District of Columbia, Idaho, Iowa, Indiana, Kansas, Kentucky, Louisiana, Maine, Minnesota, Missouri, Montana, North Dakota, Nebraska, New Hampshire, New Mexico, North Carolina, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, South Dakota, US Virgin Islands, Vermont, Wisconsin, and West Virginia.

CASH 3 sales for 2008 and 2007 were $59.26 million and $66.29 million or 6% of gross sales in both years. Average weekly sales for Cash 3 were approximately $1.1 million in 2008, compared to $1.3 million in 2007. The year over year decrease of $7.03 million in 2008 is attributed to the lower prize payout experienced in 2008. The Cash 3 prize payout decreased by 14% in fiscal year 2008 compared to fiscal year 2007.

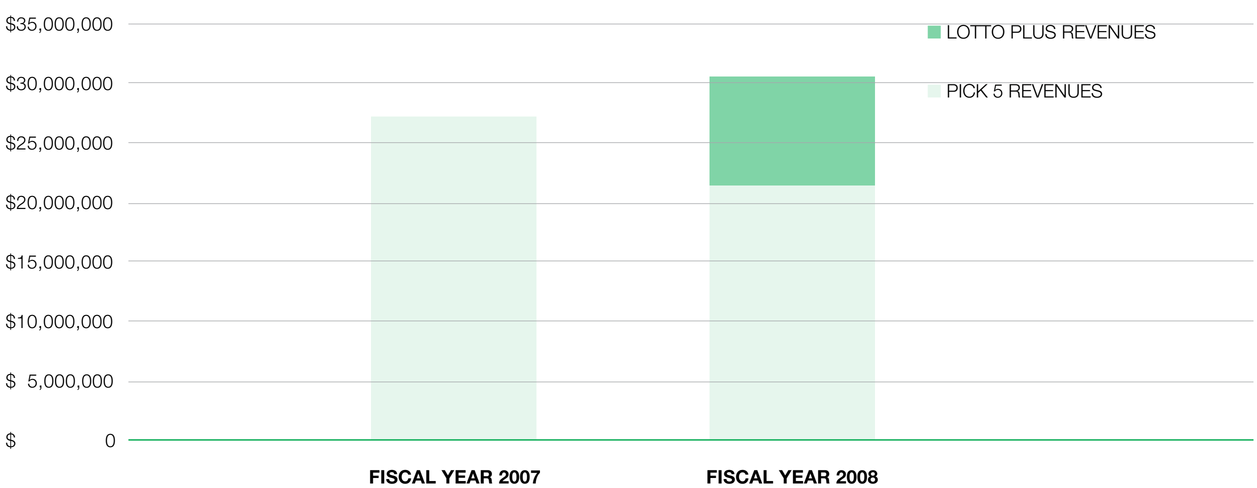
CASH 3 sales for 2006 were $61.42 million or 6% of gross sales. The increase in 2007 Cash 3 sales over 2006 sales is related to the availability of sales for the midday drawing. Specifically, the midday drawing for this game was launched and on sale for 7 months in 2006, as compared to 12 months in 2007.

CASH 4 sales were $23.3 million, $25.3 million, and $25.5 million in the years 2008, 2007, and 2006, respectively. Average weekly sales for Cash 4 were approximately $449 thousand and $486 thousand in 2008 and 2007, respectively. The slight year over year decrease of $2.0 million in 2008 Cash 4 sales is also attributed to the slightly lower prize payout experienced in 2008 as compared to prize payouts in fiscal year 2007.

PICK 5 (formerly Lotto 5) sales were $22.9 million, $27.8 million and $22.2 million in the years 2008, 2007, and 2006, respectively. Fiscal year 2008 sales decreased to approximately 2% of total gross sales from 3% in the prior fiscal year largely as a result of the launch of our in-state lotto game, Lotto Plus, and lower jackpots in fiscal year 2008. The $5.6 million increase in 2007 sales as compared to 2006, were primarily due to the existence of higher jackpots. Average weekly sales for Pick 5 were approximately $440 thousand, $535 thousand, and $425 thousand in 2008, 2007, and 2006, respectively.

LOTTO PLUS, an online game, was introduced in March 2008. Sales were $8.1 million in 2008. Average weekly sales for Lotto Plus were approximately $509 thousand in 2008.

TENNESSEE EDUCATION LOTTERY
COMBINED REVENUES FOR PICK 5 AND LOTTO PLUS
FISCAL YEAR 2008 COMPARED TO
FISCAL YEAR 2007 (PICK 5 ONLY)



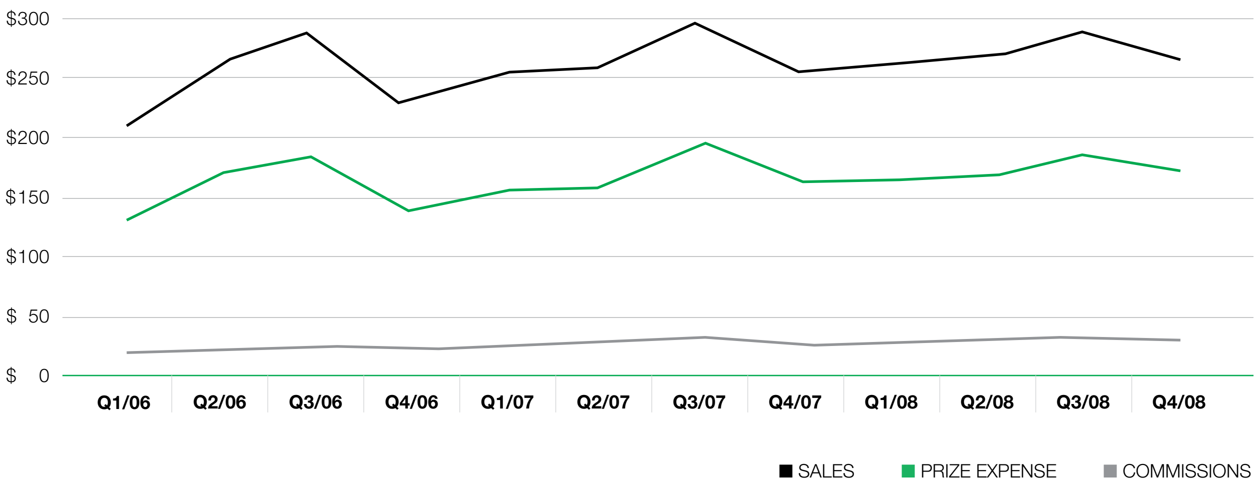
HOTTRAX CHAMPIONS (introduced in November 2006) sales were $2.3 million in 2008 and $2.7 million in 2007. Average weekly sales for Hottrax Champions were approximately $44 thousand in 2008 and $52 thousand in 2007.

MILLION $ MADNESS, a raffle-style online game, was introduced and fully executed in fiscal years 2008 and 2007. Sales from this game were $3.8 million in 2008 and $8.0 million in 2007. This game did not meet sales expectations in fiscal year 2008 as it did in fiscal year 2007.

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 2008, 2007 AND 2006 BY QUARTER
SALES AND SIGNIFICANT COSTS OF SALES
(IN MILLIONS)



Gross prize expense was $602.28 million, $597.23 million and $552.53 million in the years 2008, 2007 and 2006, respectively. Increases of $5.05 million in 2008 and $44.7 million in 2007 are reflective of the increases in overall ticket sales realized in the noted 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.

Gross prize expense for online 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, with the exception of Million $ Madness. Gross prize expense for Million $ Madness is recognized in an amount equal to the total value of all prizes available for this online game. As tickets were sold by retailers, gross prize expense was recognized for each ticket sold in an amount equal to the proportionate share of the total value of available prizes.

The TEL compensates its retailers through a set commission percentage of 6.5% on all instant tickets settled and online tickets sold. There is a 1% cashing bonus earned by retailers for cashing Cash 3 and Cash 4 prizes below $600. In addition, retailers can receive a $25,000 bonus for selling a winning POWERBALL jackpot ticket; no such bonuses were paid in 2008, 2007, or 2006. A $5,000 bonus is awarded to retailers selling a POWERBALL PowerPlay ticket if the prize is equal to or greater than one million dollars; one bonus totaling $5,000 was awarded in 2008; whereas none were awarded in 2007 and 2006. Also, the TEL will pay a $5,000 selling bonus to retailers selling winning online game tickets, other than Powerball, if the prize is equal to or greater than one million dollars. In 2008, five such bonuses were awarded, one for the Lotto Plus jackpot winner, and four related to the Million $ Madness grand prize winners. In 2007, four bonuses totalling $20,000 were awarded for selling the Million $ Madness grand prize winners.

Retailer commissions were $69.57 million, $69.16 million, and $64.95 million for the years ended June 30, 2008, 2007, and 2006, respectively. Consistent with the cost driver relationship of ticket sales to retailer commissions, the increases of $410 thousand in 2008 and $4.21 million in 2007 are reflective of the increases in overall ticket sales realized in the noted period.

The TEL has retained two contractors for the operation of its online gaming network and the manufacturing, warehousing and distribution of its instant ticket games. The online gaming contractor is compensated at a rate of 1.24% of the selling price of all online tickets sold, .6% of the selling price of Hottrax Champions online tickets sold, and 1.24% of instant ticket activations, net of free tickets available as prizes; whereas the instant games contractor receives a fee of 1.139% of the selling price of instant ticket activations by retailers. Contractor fees were $21.35 million for fiscal year 2008, $20.97 million for fiscal year 2007, and $19.41 million for the fiscal year 2006.

Advertising costs were $11.69 million, $12.83 million, and $14.11 million for the fiscal years 2008, 2007, and 2006, respectively. The $1.1 million decrease in 2008 and the $1.3 million decrease in 2007, resulted primarily from a change in marketing strategy between print, radio and television advertising.

GENERAL, ADMINISTRATIVE AND OTHER OPERATING EXPENSES

These expenses do not change in direct proportion with revenues. In accordance with budget directives, TEL's management team worked diligently to control expenses in order to remain, relatively, consistent year over year. As a result, TEL experienced a slight decline year over year in fiscal years 2008 and 2007 for general, administrative and other operating expenses. General, administrative, and other operating expenses were $14.49 million, $15.01 million, and $15.10 million for the years 2008, 2007, and 2006, respectively. The five (5) major expense components were telecommunications, depreciation, personnel, professional fees, and property expenses.

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 financial 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 instant game product offerings, including seasonal themed games, as well as consider the expansion of our licensed property games, which are gaining nationwide popularity.
- The TEL will review the prize payout percentages for its instant game products to determine if an increase in prize payouts will result in higher actual net proceeds.
- The TEL plans to use special promotions and new game features to increase sales of its online games, with special focus on Cash 3, Cash 4 and Powerball in 2009.

Management's Discussion and Analysis

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
JUNE 30, 2008 AND 2007

ASSETS	JUNE 30, 2008	JUNE 30, 2007
CURRENT ASSETS		
Cash (Note 2)	$ 68,441,000	$ 62,689,000
Restricted fidelity fund cash	97,000	131,000
Retailer accounts receivable, net	47,857,000	44,302,000
Prepaid expenses and other assets	6,655,000	7,037,000
Prize annuity investments (Note 3)	104,000	104,000
Total current assets	123,154,000	114,263,000
NON-CURRENT ASSETS		
Prepaid expenses and other assets	99,000	120,000
Prize annuity investments (Note 3)	2,437,000	2,457,000
Capital assets, net of depreciation of $2,605,000 and $2,378,000 (Note 4)	2,088,000	1,828,000
TOTAL ASSETS	127,778,000	118,668,000
LIABILITIES		
CURRENT LIABILITIES		
Due to Lottery for Education Account (Note 7)	66,969,000	66,209,000
Due to After-School Programs Account (Note 8)	13,724,000	10,436,000
Prizes payable	38,987,000	34,510,000
Accounts payable	756,000	34,000
Prize annuities payable (Note 3)	104,000	104,000
Accrued liabilities	2,657,000	3,034,000
Deferred rent (Note 6)	67,000	68,000
Deferred revenue	1,076,000	718,000
Total current liabilities	124,340,000	115,113,000
NON-CURRENT LIABILITIES		
Prize annuities payable (Note 3)	2,437,000	2,457,000
Accrued liabilities (Note 10)	141,000	145,000
Deferred rent (Note 6)	763,000	822,000
Total non-current liabilities	3,341,000	3,424,000
TOTAL LIABILITIES	127,681,000	118,537,000
NET ASSETS		
Investment in capital assets	2,088,000	1,828,000
Unrestricted assets:		
Capital assets	(2,088,000)	(1,828,000)
Restricted assets:		
Restricted for uncollectible retailer receivables	97,000	131,000
TOTAL NET ASSETS	$ 97,000	$ 131,000

See notes to financial statements.

TENNESSEE EDUCATION LOTTERY CORPORATION
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2008 AND 2007

	2008	2007
OPERATING REVENUES		
Ticket sales, net	$ 1,064,754,000	$ 1,058,355,000
Less instant tickets provided as prizes	(74,378,000)	(73,474,000)
Net ticket sales	990,376,000	984,881,000
Retailer service fees	3,209,000	3,267,000
Other	453,000	1,003,000
Net operating revenues	994,038,000	989,151,000
OPERATING EXPENSES		
Available prizes	602,284,000	597,231,000
Current year actual unclaimed prizes (Note 8)	(13,724,000)	(12,310,000)
Net prizes	588,560,000	584,921,000
Retailer commissions and bonuses	69,568,000	69,159,000
Contractor fees	21,352,000	20,971,000
Advertising	11,681,000	12,828,000
Salaries and benefits	10,427,000	10,946,000
Retailer merchandising and marketing	4,653,000	4,339,000
Rent, utilities, and maintenance	1,826,000	1,809,000
Depeciation	668,000	706,000
Professional fees	536,000	401,000
General administrative and other operating	956,000	887,000
Total operating expenses	710,227,000	706,967,000
Operating income	283,811,000	282,184,000
NONOPERATING REVENUES (EXPENSES)		
Interest revenue	2,329,000	2,095,000
Retailer fees for future uncollectible retailer receivables	40,000	61,000
Fidelity fund retailer non-feasance recoupments (Note 1)	(74,000)	(261,000)
Proceeds to After-School Programs Account (Note 8)	(13,724,000)	(12,310,000)
Proceeds to Lottery for Education Account (Note 8)	(272,416,000)	(271,969,000)
Total nonoperating revenues (expenses)	(283,845,000)	(282,384,000)
Change in net assets	(34,000)	(200,000)
NET ASSETS, beginning of year	131,000	331,000
NET ASSETS, end of year	$ 97,000	$ 131,000

See notes to financial statements.

TENNESSEE EDUCATION LOTTERY CORPORATION
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2008 AND 2007

	2008	2007
OPERATING ACTIVITIES		
Cash received from customers	$ 987,182,000	$ 978,636,000
Other operating cash received	3,534,000	4,252,000
Cash paid for prizes	(583,930,000)	(580,422,000)
Cash paid to/on behalf of gaming vendors	(20,681,000)	(21,371,000)
Cash paid to retailers	(69,581,000)	(69,132,000)
Cash paid for advertising	(11,565,000)	(13,423,000)
Cash paid to/on behalf of contractors and employees	(11,050,000)	(11,380,000)
Other operating payments	(7,593,000)	(7,703,000)
Net cash provided by operating activities	286,316,000	279,457,000
NONCAPITAL FINANCING ACTIVITIES		
Payments to Lottery for Education Account	(271,656,000)	(268,233,000)
Payments to After-School Programs Account	(10,436,000)	(7,392,000)
Fidelity fund cash received from retailers	50,000	69,000
Fidelity fun cash refunded to retailers	(10,000)	(8,000)
Fidelity fund cash non-feasance recoupments	(74,000)	(261,000)
Net cash used in noncapital financing activities	(282,126,000)	(275,825,000)
CAPITAL AND RELATED FINANCING ACTIVITIES		
Purchase of property and equipment	(952,000)	(266,000)
Proceeds from disposal of capital assets	151,000	36,000
Net cash provided used in capital and related financing activities	(801,000)	(230,000)
INVESTING ACTIVITIES		
Interest Income	2,329,000	2,095,000
Purchase of prize annuity investments	-	(739,000)
Net cash provided by investing activities	2,329,000	1,356,000
NET CASH PROVIDED BY ALL ACTIVITIES	5,718,000	4,758,000
CASH at beginning of year	62,820,000	58,062,000
CASH at end of year	68,538,000	62,820,000
Reconciliation of cash on the statement of net assets		
Cash	$ 68,441,000	$ 62,689,000
Restricted fidelity fund cash	97,000	131,000
Cash at end of year	$ 68,538,000	$ 62,820,000

See notes to financial statements.

TENNESSEE EDUCATION LOTTERY CORPORATION
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2008 AND 2007

RECONCILIATION OF NET OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES

	2008	2007
Operating income	$ 283,811,000	$ 282,184,000
Adjustments to reconcile operating income to net cash provided by operating activities:		
Bad debt expense	280,000	43,000
Depreciation	668,000	706,000
Gain on disposal of capital assets	(127,000)	(22,000)
Changes in assets and liabilities:		
Retailer accounts receivable	(3,835,000)	(5,907,000)
Prepaids and other assets	403,000	(1,504,000)
Accounts payable and accrued liabilites	341,000	(1,526,000)
Prizes payable	4,477,000	15,240,000
Deferred due to After-School Programs Account	-	(9,265,000)
Prize annuities payable	-	(52,000)
Deferred rent	(60,000)	(61,000)
Deferred revenue	358,000	(379,000)
Net cash provided by operating activities	$ 286,316,000	$ 279,457,000
NONCASH INVESTING ACTIVITIES		
Increase in fair value of prize annuity investments	$ 136,000	$ 195,000

See notes to financial statements.

Notes to the Financial Statements (As of and for the Years Ended June 30, 2008 and 2007)

(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 §§ 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 transfer 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. As of June 30, 2008, the TEL's lottery sales include a variety of instant ticket games and six terminal-based online ticket games: Cash 3, Cash 4, Pick 5, Lotto Plus, Powerball and Hottrax Champions. Also, during the year ended June 30, 2008, the TEL offered Million $ Madness, a raffle style, terminal-based online game.

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 that 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. Certain instant games include free tickets, which entitle the holder to exchange one instant ticket for another of equal value. The selling price of free tickets reduces instant ticket revenue when the ticket is claimed by a player.

Revenue is recognized for online games, with the exception of Million $ Madness, when tickets are sold to players and the related draw occurs. Revenue for Million $ Madness sales is recognized as tickets are sold by retailers.

Revenues are presented net of Bad Debt Expense.

NET ASSETS – Net assets represent cumulative revenues less expenses and required transfers 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 are considered doubtful. At June 30, 2008 and 2007, the Allowance for Doubtful Accounts was $187 thousand and $164 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 3 to 7 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, with the exception of Million $ Madness.

FIDELITY FUND – In accordance with the Tennessee Code Annotated §§ 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 nonfeasance, malfeasance, or misfeasance of TEL retailers. During the years ended June 30, 2008 and June 30, 2007, $74 thousand and $261 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 transfer to the Lottery for Education Account. As of the years ended June 30, 2008 and 2007, there were no fidelity funds available for transfer 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 selling bonus to a retailer who sells a winning Powerball jackpot ticket. The current bonus amount is $25,000. The TEL will also pay a selling bonus to a retailer who sells a winning Powerball PowerPlay ticket if the prize is equal to or greater than one million dollars. The current bonus amount is $5,000. The TEL will pay a selling bonus to a retailer who sells an online game ticket, other than Powerball, if the prize is equal to or greater than one million dollars. The current bonus amount is $5,000.

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

ONLINE GAME	2008	2007
Powerball	$ 5,000	$ -
Lotto Plus	5,000	-
Million $ Madness	20,000	20,000
Total Retailer Bonuses	**$ 30,000**	**$ 20,000**

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 4,750 instant and online retailer ticket terminals and associated software. GTECH receives a fee of 1.24% of the selling price of online tickets sold, and of net instant ticket activations, net of free tickets available as prizes. GTECH also receives an additional .6% of the selling price of Hottrax Champions tickets sold.

SGI prints, warehouses, and distributes the instant game tickets to retailers. SGI receives a fee of 1.139% of the selling price of instant ticket activations by retailers.

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, Lotto Plus, and Hottrax Champions is recognized based on industry average or historical payout experience when tickets are actually sold. Gross prize expense for Million $ Madness is based on a predetermined prize structure based on the total value of all prizes available for the online game. As sold by retailers, gross prize expense is recognized for each ticket sold in an amount equal to the proportionate share of the total value of available prizes.

Powerball prizes are shared based on contributions made to the prize pool by all member lotteries of the Powerball Group of the Multi-State Lottery Association (“MUSL”). All Powerball grand prizes won by players who purchase tickets in Tennessee are funded from pooled contributions by MUSL. 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 29 annual installments. Lump-sum payments are discounted to present value, as calculated by MUSL. As of the years ended June 30, 2008 and June 30, 2007, 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.

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 reasonably estimable. As of the years ended June 30, 2008 and 2007, 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.

INSURANCE – Effective July 31, 2005, the TEL became a member of the Risk Management Fund, an internal service fund of the State of Tennessee. This self-insurance risk pool provides general, property and automobile liability up to $300,000 per person and $1,000,000 per occurrence. 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, 2008, additional insurance coverage was provided at the following maximum amounts:

COVERAGE	**2008**
Employee Fidelity	$ 500,000
Automobile/Property	1,000,000
Workers' Compensation	1,000,000
Employers' Liability	1,000,000
General Liability/Umbrella	5,000,000

Over the past three fiscal years, in the ordinary course of business, the TEL has filed automobile and workers' compensation claims with the commercial insurers. None of these claims exceeded the provided insurance coverage.

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).

PRIOR PERIOD CORRECTIONS TO STATEMENT OF CASH FLOW – Certain amounts presented in the prior period's cash flow statement have been restated to correct computation errors discovered subsequent to issuance of the fiscal year 2007 financial statements. These corrections have no effect on previously reported net assets or operating income and are noted as follows:

- The bad debt expense adjustment has been restated as an increase adjustment of $43,000. The previously reported amount improperly included amounts written off in the prior fiscal year.
- The change in the retailer accounts receivable asset has been restated as a decrease change of $5,907,000 compared to the previously reported decrease change of $5,867,000. The previously reported amount was improperly calculated net of amounts written off during the fiscal year 2007.
- The change in the prize annuities payable has been restated as a decrease change of $52,000. The previously stated change incorrectly reported prize payments made, net of the change in the fair market value of the annuity investments held by the TEL.

(2) CASH

The TEL has implemented Governmental Accounting Standards Board Statement No. 40, *Deposit and Investment Risk Disclosure*, which established and modified the disclosure requirements for deposits and investments.

The TEL's deposits are in financial institutions that participate 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, 2008 and 2007, TEL's bank balances of approximately $1.341 million and $1.228 million, respectively, were insured by the bank collateral pool.

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 $67.6 million and $62.1 million at June 30, 2008 and 2007, respectively. The LGIP is part of the Pooled Investment Fund. The Pooled Investment Fund is authorized by statute to invest funds in accordance with policy guidelines approved by the State Funding Board. The State Treasurer's Pooled Investment Fund is not rated by a nationally recognized statistical rating organization. The Pooled Investment Fund's investment policy and required risk disclosures are presented in the *Tennessee Comprehensive Annual Financial Report*. That report may be obtained by contacting the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor, William R. Snodgrass Tennessee Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243-0298 or by calling (615) 741-2140.

(3) PRIZE ANNUITY INVESTMENTS

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.

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, 2008 and June 30, 2007. The annuity purchased from Aviva was rated A+ superior by A.M. Best as of June 30, 2008 and June 30, 2007.

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, 2008 and June 30, 2007.

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 noncurrent on the Statement of Net Assets.

Changes in the fair market value of the prize annuity investments are deferred as noncurrent prize annuities payable. As of the years ended June 30, 2008 and 2007, the TEL respectively deferred $136 thousand and $195 thousand increases in the fair market value of the prize annuity investments.

(4) CAPITAL ASSETS

Capital assets consisted of the following as of June 30, 2008:

	BEGINNING BALANCE	INCREASES	DECREASES	ENDING BALANCE
Furniture and fixtures	$ 881,000	$ 22,000	$ (3,000)	$ 900,000
Computer equipment	387,000	29,000	(6,000)	410,000
Vehicles	200,000	-	-	200,000
High Mileage Vehicles—Vans	1,101,000	317,000	(456,000)	962,000
Leasehold improvements	307,000	40,000	-	347,000
Communication equipment	879,000	-	-	879,000
Software	259,000	220,000	-	479,000
Gaming equipment	192,000	324,000	-	516,000
Total capital assets	4,206,000	952,000	(465,000)	4,693,000
Less accumulated depreciation	(2,378,000)	(668,000)	441,000	(2,605,000)
Total capital assets, net	**$ 1,828,000**	**$ 284,000**	**$ (24,000)**	**$ 2,088,000**

Capital assets consisted of the following as of June 30, 2007:

	BEGINNING BALANCE	INCREASES	DECREASES	ENDING BALANCE
Furniture and fixtures	$ 873,000	$ 8,000	$ -	$ 881,000
Computer equipment	375,000	12,000	-	387,000
Vehicles	200,000	-	-	200,000
High Mileage Vehicles—Vans	945,000	239,000	(83,000)	1,101,000
Leasehold improvements	307,000	-	-	307,000
Communication equipment	877,000	2,000	-	879,000
Software	259,000	-	-	259,000
Gaming equipment	189,000	5,000	(2,000)	192,000
Total capital assets	4,025,000	266,000	(85,000)	4,206,000
Less accumulated depreciation	(1,742,000)	(706,000)	70,000	(2,378,000)
Total capital assets, net	**$ 2,283,000**	**$ (440,000)**	**$ (15,000)**	**$ 1,828,000**

(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 2014. Certain of these leases contain provisions for scheduled rental increases and are renewable at the option of the TEL. No lease renewal options were exercised as of the years ended June 30, 2008 and June 30, 2007.

In addition, the TEL subleases office space to two of its vendors, GTECH and SGI under operating leases expiring through 2014. These subleases contain provisions for scheduled rental increases and are subordinate to the related lease agreement held by TEL. TEL's sublease with Gish, Sherwood and Friends was terminated effective June 30, 2008. The TEL will enter into a new sublease with its vendor, The Buntin Group, for the space previously occupied by Gish, Sherwood and Friends.

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 or more as of June 30:

YEAR ENDING JUNE 30:	2008	2007
2008	$ -	$ 2,450,000
2009	2,046,000	2,083,000
2010	1,506,000	1,479,000
2011	1,200,000	1,179,000
2012	1,188,000	1,178,000
2013	1,178,000	1,178,000
2014	785,000	784,000
Total minimum rental payments	**$ 7,903,000**	**$ 10,331,000**

Minimum rental payments at June 30, 2008 and 2007 have not been reduced by minimum sublease rentals of $1.10 million and $1.34 million, 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:	2008	2007
2008	$ -	$ 188,000
2009	185,000	194,000
2010	197,000	206,000
2011	197,000	206,000
2012	197,000	206,000
2013	197,000	206,000
2014	131,000	137,000
Total minimum sublease payments	**$ 1,104,000**	**$ 1,343,000**

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:

	2008	2007
MINIMUM RENTALS:		
Property	$ 1,371,000	$ 1,358,000
Billboards	1,213,000	1,264,000
Less: Sublease rentals	(195,000)	(188,000)
Total minimum rentals	**$ 2,389,000**	**$ 2,434,000**

(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, 2008, total deferred rent of $830,000 consisted of $351,000 related to rent abatements and $479,000 to the straight-lining of rental expense over the life of the related lease terms.

At June 30, 2007, total deferred rent of $890,000 consisted of $419,000 related to rent abatements and $471,000 to the straight-lining of rental expense over the life of the related lease terms.

(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, 2008 and June 30, 2007, are summarized as follows:

	2008	2007
OPERATING REVENUES:		
Ticket sales (Net)	$ 1,064,754,000	$ 1,058,355,000
Less instant tickets provided as prizes	(74,378,000)	(73,474,000)
Net ticket sales	990,376,000	984,881,000
Service fees and other revenue	3,662,000	4,270,000
Total lottery proceeds	**994,038,000**	**989,151,000**
OPERATING EXPENSES, AS DEFINED:		
Gaming	709,538,000	704,528,000
Operating	14,413,000	14,749,000
Total operating expenses, as defined	**723,951,000**	**719,277,000**
Net proceeds before distribution of unrestricted net assets	270,087,000	269,874,000
NON-OPERATING REVENUE AND EXPENSES		
Interest income	2,329,000	2,095,000
Total non-operating revenue and expenses	**2,329,000**	**2,095,000**
Net proceeds subject to transfer	**$272,416,000**	**$271,969,000**
Amount due to Lottery for Education Account for year	272,416,000	271,969,000
Amount paid during year	(205,447,000)	(205,760,000)
Amount due to Lottery for Education Account, end of year	$ 66,969,000	$ 66,209,000

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

(8) DUE TO AFTER-SCHOOL PROGRAMS ACCOUNT

The TEL realizes unclaimed prizes for each instant game at the time the game is closed and reconciled. For online games, the realized unclaimed amounts are determined after the expiration of the related claim period for each online drawing.

For instant games, players have 90 days after the announced game-end date to claim a prize. For online games, players have 180 days after the related draw has occurred to claim a prize.

For fiscal year 2008, unclaimed prizes were $13,724,000, which was current and payable to the After-School Programs Account at June 30, 2008.

For fiscal year 2007, unclaimed prizes were $12,310,000, of which $10,436,000 was current and payable to the After-School Programs Account at June 30, 2007.

All amounts due at the end of each fiscal year were transferred to the After-School Programs Special Account in July 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, 2008 and 2007, employees contributed approximately $432,000 and $412,000, respectively to the 457 Plan.

The aggregate fair value of the plan’s assets was approximately $1,717,000 and $1,691,000, net of forfeitures and administrative fees, as of June 30, 2008 and 2007, 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 $622,000 and $626,000 to the 401(a) Plan on behalf of its employees in the years ended June 30, 2008 and 2007, respectively. Of these contributions, approximately $88,000 and $76,000 were forfeited by separated employees as of June 30, 2008 and June 30, 2007, 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, 2008 and 2007, forfeited amounts of approximately $53,000 and $76,000, 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 $2,413,000 and $2,224,000, net of forfeitures and administrative fees, as of June 30, 2008 and 2007, 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 twelve 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, 2008, is estimated using historical trends. At June 30, 2008 and 2007, the estimated current portion of the compensated absences liability was $263 thousand and $253 thousand, respectively.

Sick leave is earned at the end of each month at the rate of four 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 severance pay for every year of employment with TEL. The TEL accrued $140 thousand and $109 thousand for employment separation obligations for each of the years ending June 30, 2008 and 2007, respectively.

(10) LONG-TERM LIABILITIES

Long-term liabilities consisted of the following as of June 30, 2008:

	BEGINNING BALANCE	INCREASES	DECREASES	ENDING BALANCE	DUE WITHIN ONE YEAR
Prize Annuities Payable	$ 2,561,000	$ 136,000	$ (156,000)	$ 2,541,000	$ 104,000
Compensated Absences	398,000	321,000	(315,000)	404,000	263,000
Deferred Rent	890,000	8,000	(68,000)	830,000	67,000
Total long-term liabilities	**$ 3,849,000**	**$ 465,000**	**$ (539,000)**	**$ 3,775,000**	**$ 434,000**

Long-term liabilities consisted of the following as of June 30, 2007:

	BEGINNING BALANCE	INCREASES	DECREASES	ENDING BALANCE	DUE WITHIN ONE YEAR
Prize Annuities Payable	$ 2,573,000	$ 196,000	$ (208,000)	$ 2,561,000	$ 104,000
Compensated Absences	400,000	372,000	(374,000)	398,000	253,000
Deferred Rent	951,000	7,000	(68,000)	890,000	68,000
Total long-term liabilities	**$ 3,924,000**	**$ 575,000**	**$ (650,000)**	**$ 3,849,000**	**$ 425,000**

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

(11) COMMITMENTS AND CONTINGENCIES

PLAY-IT-AGAIN! DRAWINGS – During the fiscal year ended June 30, 2007, the TEL launched its Play-It-Again! program designed to reduce instant ticket litter throughout the state of Tennessee. In connection with this program, each fiscal year the TEL plans to conduct a series of second-chance drawings awarding various prizes to players.

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, 2008, management is not aware of any related liabilities.

(12) SUBSEQUENT EVENTS

On September 9, 2008, the TEL conducted a Play-It-Again! drawing awarding a total of $702,000 to eighteen players.

In October 2008, the TEL initiated legal action against Smartplay International, Inc. and Gaming Laboratories International, Inc. alleging these vendors breached their contracts and committed various tortious acts. The ultimate outcome of the litigation cannot be determined, and no dollar amount has been recognized for payment or settlement of these claims.

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