

NORTH CAROLINA EDUCATION LOTTERY

Financial Statements

June 30, 2013

(With Report of Independent Auditor Thereon)

Financial Statement Audit Report of the
North Carolina Education Lottery
For the Period Ended June 30, 2013

Performed under contract with the
North Carolina Office of the State Auditor
Beth A. Wood, CPA

NORTH CAROLINA EDUCATION LOTTERY

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Report of Independent Auditor

To the Commissioners
North Carolina Education Lottery
Raleigh, North Carolina

Report on the Financial Statements

We have audited the accompanying statements of net position of the North Carolina Education Lottery (“NCEL”), a major enterprise fund of the state of North Carolina, as of and for the years ended June 30, 2013 and 2012, and the related statements of revenues, expenses and changes in net position and cash flows, and notes to the financial statements which collectively comprise the NCEL’s basic financial statements as listed in the table of contents.

Management’s Responsibility for the Financial Statements

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

Auditor’s Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the entity’s internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall financial statement presentation of the financial statements.

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

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the NCEL as of June 30, 2013 and 2012, and the respective changes in financial position and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 2, the financial statements present only the NCEL and do not purport to and do not present fairly the financial position of the state of North Carolina as of and for the years ended June 30, 2013 and 2012, and the changes in its financial position and its cash flows thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis as listed in the table of contents be presented to supplement the basic financial statements. Such information, although not a required 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 our 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.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated September 27, 2013, on our consideration the NCEL's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants agreements, and other matters. The purpose of the report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the NCEL's internal control over financial reporting and compliance.

A handwritten signature in cursive script that reads "Cherry Bekant LLP".

Raleigh, North Carolina
September 27, 2013

NORTH CAROLINA EDUCATION LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2013 and 2012

The following is a discussion and analysis of the financial performance of the North Carolina Lottery Commission [aka, North Carolina Education Lottery (NCEL)] for the fiscal years ended June 30, 2013, 2012 and 2011 and should be read in conjunction with the financial statements, including the footnotes. This report consists of three parts: management's discussion and analysis, the basic financial statements and the notes to the financial statements. Included below and on the following pages are the financial highlights, summary of contributions to the state, and summary results of operations for the fiscal years ended June 30, 2013, 2012 and 2011.

Financial Highlights

For fiscal year 2013, gross ticket sales totaled \$1.69 billion representing a \$93.1 million increase over fiscal year 2012. Total operating income was \$480 million, which represented an increase of \$19.2 million over fiscal year 2012. Other significant financial highlights included the following:

- North Carolina General Statute Section 18C-164 (a) requires the NCEL to transfer net proceeds from operations and any prior year surplus to the State of North Carolina at least four times a year. In fiscal year 2013, the sum total of these cash transfers was \$461.4 million, the largest annual total for cash transfers in NCEL's history. Total cash transfers for fiscal years 2012 and 2011 were \$456.8 million and \$446.9 million, respectively.
- Awarded \$1 million or more to an NCEL player for the 129th time.
- Increased the number of retailers to 6,839, representing a 1% increase over the prior year, and provided service to our retailers on a regular basis.
- Released 49 new instant scratch-off games into the marketplace generating gross instant ticket sales of \$1.01 billion.

Overview of the Financial Statements

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

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

Included in this report are the Statements of Net Position as of June 30, 2013 and 2012, the Statements of Revenues, Expenses, and Changes in Net Position for the periods ended June 30, 2013 and 2012, and the Statements of Cash Flows for the periods ended June 30, 2013 and 2012.

NORTH CAROLINA EDUCATION LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2013 and 2012

The NCEL transfers its net revenues to the Office of State Budget and Management (OSBM) for credit to the Education Lottery Fund. Education Lottery funds are distributed by OSBM based on the budgeted distribution of lottery net revenue as recommended by the General Assembly.

Total Assets

Total assets at the end of fiscal year 2013 were \$111 million compared to \$96 million at the end of fiscal year 2012, representing an increase of \$15 million.

Current assets increased from \$48 million in 2012 to \$60 million in 2013, representing an increase of \$12 million. This growth resulted from an increase in Pooled Cash due to fiscal year 2013 and 2012 surplus earnings held to be dispersed in the subsequent fiscal year. In addition, there was an increase in the State Treasurer's Securities Lending Collateral. More detailed information can be found in Note 2D in the financial statements. The increase was also partially caused by an increase in accounts receivable in 2013 from 2012. This primarily represents amounts due from retailers for ticket sales less commissions and prizes paid by the retailers. The increase is essentially due to the timing of the end of the accounting week for billing and collections from our retailers at fiscal year end. Electronic Funds Transfer is used to collect receivables weekly from retailer bank accounts that are set up in trust for the NCEL.

Current assets were also affected by a \$404 thousand increase in investments in annuity contracts.

The Short Term Investment portfolio has the general characteristics of a demand deposit account in that participants may deposit additional cash at any time and may withdraw cash at any time without prior notice or penalty. All deposits are combined with other State agencies and invested by the State Treasurer until needed to cover disbursements. Investments are limited to those authorized for the State's General Fund, pursuant to NC General Statute 147-69.1. Interest earned of \$417 thousand on these balances is recorded as non-operating revenue. Earnings on the accounts are credited on a monthly basis. The allocable share of the revenues arising from State Treasurer's Securities Lending Collateral program transactions are also included as non-operating revenue.

The NCEL's investment in capital assets, net of accumulated depreciation in 2013 was \$897 thousand which is approximately \$225 thousand higher than 2012. The investment in capital assets includes game equipment, data processing equipment, telephone equipment, software and fixtures. The capitalization of all items including equipment, computers, and furniture follows the Office of the State Controller's (OSC) policy. The NCEL defines capital assets as assets with an initial unit cost of \$5,000 or greater and an estimated useful life of two or more years. Capital assets are carried at cost less accumulated depreciation.

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

NORTH CAROLINA EDUCATION LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2013 and 2012

The activity for capital assets for the year ended June 30, 2013 was (in thousands):

<u>Category</u>	<u>Balance July 1, 2012</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2013</u>
Capital assets, depreciable				
Furniture	\$ 29	\$ 17	\$ -	\$ 46
Equipment	3,076	553	-	3,629
Motorized equipment	67	-	-	67
Total capital assets, depreciable	<u>3,172</u>	<u>570</u>	<u>-</u>	<u>3,742</u>
Less accumulated depreciation for:				
Furniture	29	2	-	31
Equipment	2,403	343	-	2,746
Motorized equipment	68	-	-	68
Total accumulated depreciation	<u>2,500</u>	<u>345</u>	<u>-</u>	<u>2,845</u>
Total capital assets, depreciable, net	<u>672</u>	<u>225</u>	<u>-</u>	<u>897</u>
Capital assets, net	<u>\$ 672</u>	<u>\$ 225</u>	<u>\$ -</u>	<u>\$ 897</u>

Total Liabilities

Total current liabilities for the NCEL were \$61 million in 2013 increasing by \$12 million from 2012. The growth in current liabilities mainly resulted from increases in due to other funds and the obligations under State Treasurer's security lending collateral agreements. The increase in due to other funds can be attributed to the timing of transactions encountered in the normal course of business. The increase in the obligations under State Treasurer's security lending collateral is directly related to the NCEL having more cash on hand at year-end. Current liabilities also consist of prize awards payable, and other payables.

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

<u>Beginning</u>	<u>Earned</u>	<u>Used</u>	<u>Ending</u>	<u>Current Liability</u>	<u>Long Term Portion</u>
<u>\$ 1,228</u>	<u>\$ 1,666</u>	<u>\$ 1,546</u>	<u>\$ 1,348</u>	<u>\$ 291</u>	<u>\$ 1,057</u>

Noncurrent liabilities also includes the present value of the annuity contracts that fund the long term installment prizes that are due to NCEL annuity prize winners that will be paid after June 30, 2014.

NORTH CAROLINA EDUCATION LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2013 and 2012

Net Position and Changes in Net Position

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

Condensed Statement of Net Position (in thousands)

	<u>2013</u>	<u>2012</u>	<u>2011</u>
ASSETS			
Total Current Assets	\$ 59,643	\$ 48,484	\$ 30,345
Noncurrent Assets	51,605	47,337	36,586
Total Assets	<u>111,248</u>	<u>95,821</u>	<u>66,931</u>
LIABILITIES			
Total Current Liabilities	60,525	49,338	30,217
Noncurrent Liabilities	50,723	46,483	36,714
Total Liabilities	<u>111,248</u>	<u>95,821</u>	<u>66,931</u>
NET POSITION			
Net Investment in Capital Assets	897	672	819
Unrestricted	<u>(897)</u>	<u>(672)</u>	<u>(819)</u>
Total Net Position	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

Current liabilities consist of "Due to Other Funds" in the amount of \$27.317 million. Of this amount, \$27.253 million represents the remaining amount of the "Net Revenues" and "50% of Unclaimed Prizes" for Fiscal Year 2013 not yet transferred to the State of North Carolina as of June 30, 2013. These funds will be transferred to the state during Fiscal Year 2014. The remainder is due to other state agencies for services provided to the NCEL. Additional information on "Due to Other Funds" is found in Note 6D to the financial statements.

Revenues

Operating revenues consist of gross sales, fees and licenses net of prize tickets.

NORTH CAROLINA EDUCATION LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2013 and 2012

Sales

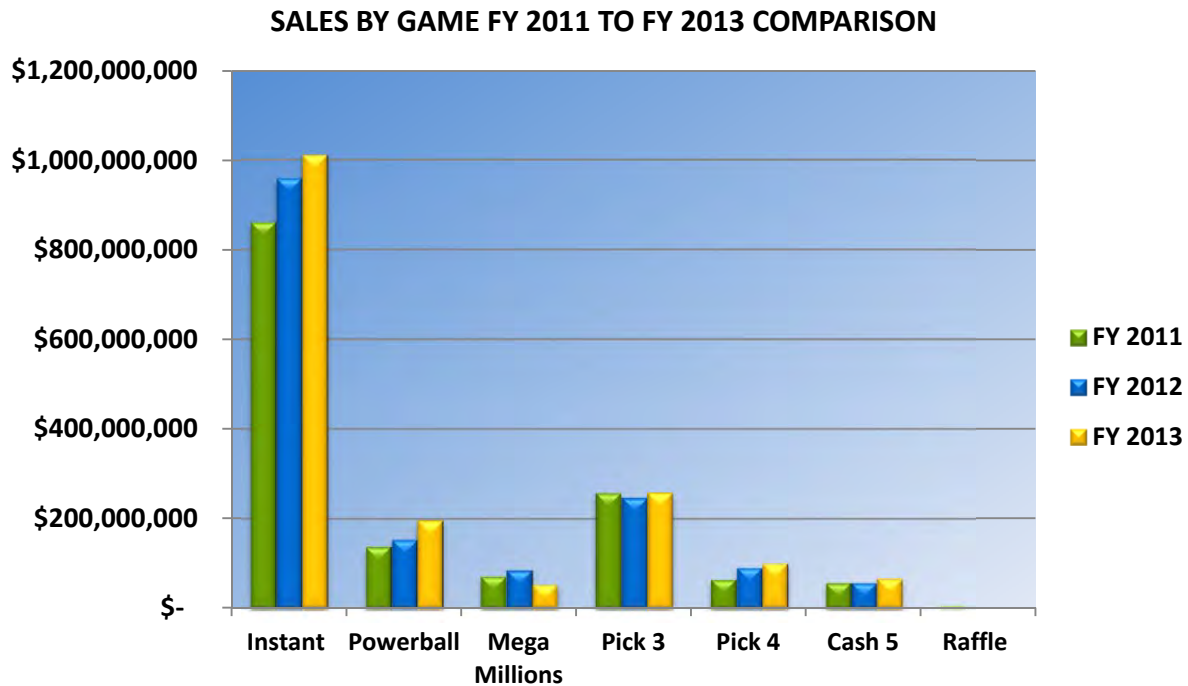
The gross lottery ticket sales for fiscal year 2013 totaled \$1.69 billion as compared to \$1.597 billion for fiscal year 2012 and \$1.461 billion in fiscal year 2011. This represents an increase of \$93 million from 2012 and \$229 million from 2011.

Gross instant ticket sales were \$1.01 billion for fiscal year 2013 compared with \$960 million for fiscal year 2012 and \$862 million in fiscal year 2011, an increase of approximately \$50 million from fiscal year 2012 and approximately \$148 million from fiscal year 2011. The increase realized during fiscal year 2013 is attributable to several factors. The NCEL continued with its third \$20 instant scratch-off mega game, \$4 Million Cash Blowout, with a prize payout of 75%, which generated over \$63 million in sales during fiscal year 2013. In addition the NCEL launched its fourth \$20 instant scratch-off mega game, \$4 Million Gold Bullion, which generated over \$54 million in sales. The NCEL also launched its "A Week for Life" family of tickets, with games available at four price points from \$10 and below, which combined generated sales of over \$121 million. The NCEL released several very successful licensed games during the year. The Star Trek Instant Scratch-Off was introduced and provided players the chance to win a grand prize trip package, including VIP access to the Star Trek convention in Las Vegas. The NCEL launched its suite of Instant Monopoly Scratch-Off licensed games, with Monopoly games at four price points under \$10 resulting in over \$40 million in sales. In addition, other licensed instant games released such as "Bejeweled Money Multiplier" also proved to be very popular.

Draw game sales were \$678 million for fiscal year 2013 compared to \$637 million for fiscal year 2012 and \$599 for fiscal year 2011, representing a \$41 million increase from fiscal year 2012 and a \$79 million increase from fiscal year 2011. Draw game sales benefited from high jackpots in the multi-state game Powerball. The Powerball jackpot reached over \$500 million twice during the fiscal year, which helped increase Powerball sales to \$197 million, from \$153 million the previous year. The Carolina Cash 5 top prize exceeded half a million dollars eight times during the fiscal year and reached over \$1 million once, resulting in increased draw sales. The Carolina Pick 4 game also had increased sales from the previous year. Carolina Pick 4 sales were over \$103.9 million compared to \$91.5 million the previous year.

NORTH CAROLINA EDUCATION LOTTERY
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 June 30, 2013 and 2012

The following chart depicts the distribution of sales by product for the fiscal years ended June 30, 2013, 2012 and 2011.



Non-operating Revenues mainly consist of investment earnings on Short Term Investment Fund (STIF) accounts and security lending transactions, and Multi-State Lottery Association (MUSL) dividends received.

Expenses

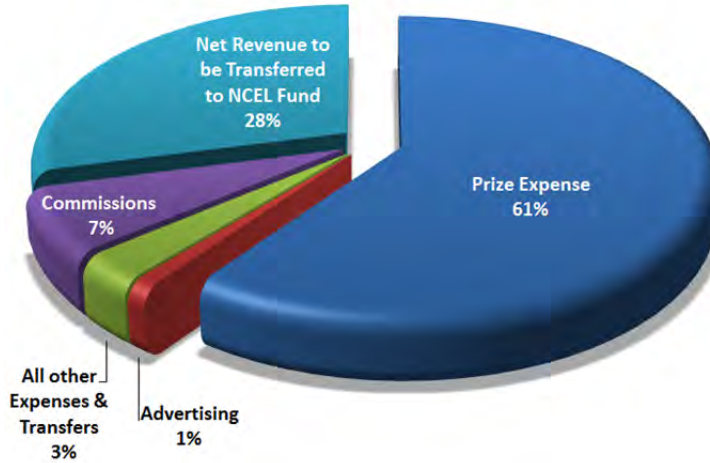
Section 18C-162, NC General Statute stipulates that no more than 8% of the total annual revenues shall be allocated for payment of expenses of the Lottery. Advertising expenses shall not exceed 1% of the total annual revenues.

NORTH CAROLINA EDUCATION LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS

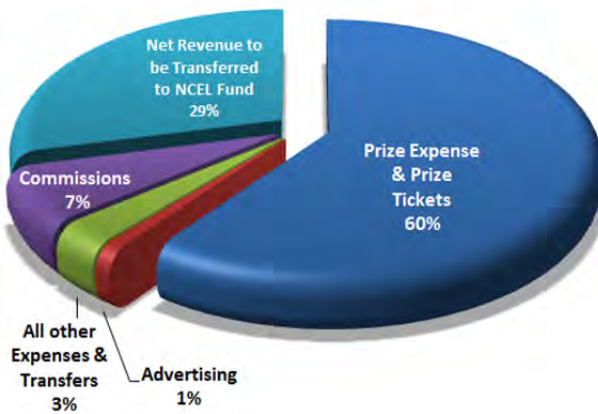
June 30, 2013 and 2012

The following charts show the major components of NCEL operating expenses and transfers as a percentage of total revenues for the fiscal years ended June 30, 2013, 2012 and 2011.

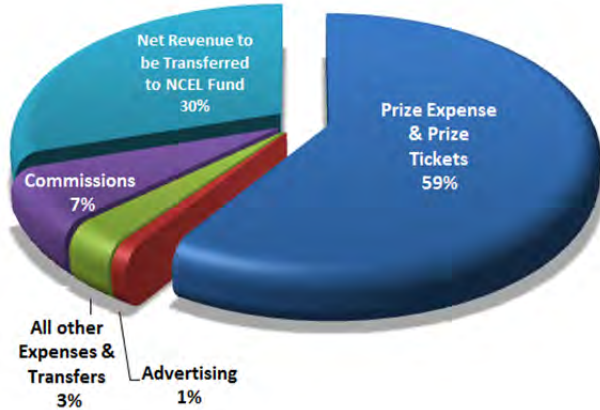
DISTRIBUTION OF REVENUE FY 2013



DISTRIBUTION OF REVENUE FY 2012



DISTRIBUTION OF REVENUE FY 2011



Prizes, commissions and gaming vendor charges all directly relate to sales. As expected, as sales have increased so have these expenses. In fiscal year 2013 total gaming expenses which consist of prizes, retailer commissions and gaming vendor charges (gaming system services), totaled \$1,170 million as compared to \$1,099 million and \$989 million for fiscal years 2012 and 2011, respectively. Other operating expenses, which consist of advertising and marketing, salary and benefits, professional fees, rent, maintenance, depreciation and general administrative expenses increased to \$46.1 million in fiscal year 2013, as compared with \$42.7 million and \$39.9 million for fiscal years 2012 and 2011, respectively. Other operating expenses represented 2.7%, 2.6% and 2.7% of total operating revenues in fiscal years 2013, 2012 and 2011, respectively.

NORTH CAROLINA EDUCATION LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2013 and 2012

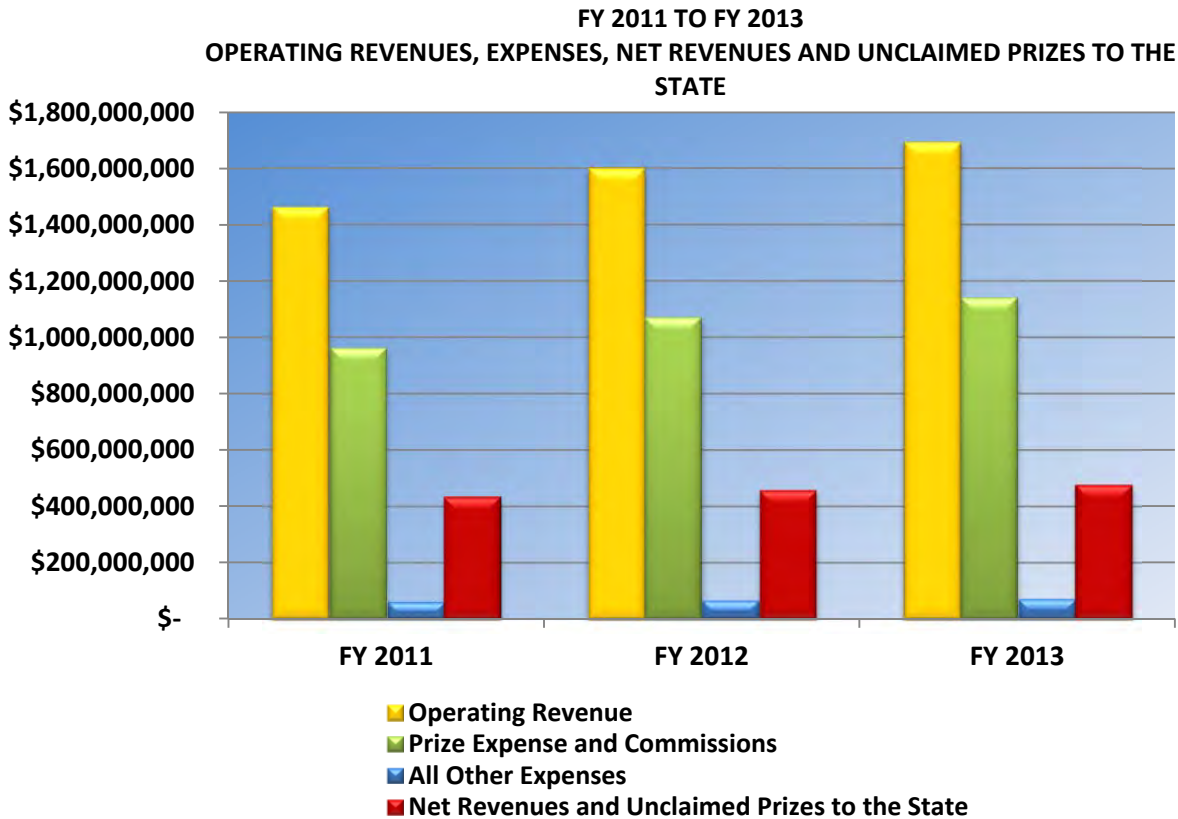
Condensed Statement of Revenues, Expenses and Changes in Net Position (in thousands)

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Operating Revenues:			
Gross Sales:	\$ 1,689,803	\$ 1,596,693	\$ 1,461,106
Less: Prize Tickets	-	(181)	(1,375)
Less: Sales/Service Bad Debt	(90)	(55)	(152)
Fees and Licenses	5,296	5,381	5,061
Total Operating Revenues	<u>1,695,009</u>	<u>1,601,838</u>	<u>1,464,640</u>
Operating Expenses:			
Gaming Expenses:			
Lottery Prizes	1,024,437	961,556	862,996
Retailer Commissions	118,148	111,624	102,127
Gaming Systems Services	27,262	26,031	23,482
Total Gaming Expenses	<u>1,169,847</u>	<u>1,099,211</u>	<u>988,605</u>
Other Operating Expenses	<u>46,078</u>	<u>42,700</u>	<u>39,905</u>
Total Operating Expenses	<u>1,215,925</u>	<u>1,141,911</u>	<u>1,028,510</u>
Operating Income	<u>479,084</u>	<u>459,927</u>	<u>436,130</u>
Nonoperating Revenues (Expenses):			
Investment Earnings, Nonoperating Revenue (Expense) and Compulsive Gambling Contribution	(576)	(458)	111
Net Revenues and Unclaimed prizes to the State	(478,508)	(459,469)	(436,241)
Total Nonoperating Revenue (Expenses)	<u>(479,084)</u>	<u>(459,927)</u>	<u>(436,130)</u>
Change in Net Position	<u>-</u>	<u>-</u>	<u>-</u>
Net Position Beginning July 1	<u>-</u>	<u>-</u>	<u>-</u>
Net Position Ending June 30	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

NORTH CAROLINA EDUCATION LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2013 and 2012

From fiscal year 2011 to fiscal year 2013, the NCEL has achieved annual increases in revenues and transfers to the State. The following graph depicts these trends.



Budget and Economic Outlook

On June 4, 2013, the NCEL Commission approved the Fiscal Year 2014 budget for the NCEL to provide a projected \$462 million to the State's Education Lottery Fund. This projected budget is a 4.5% increase over the fiscal year 2013 budget that reflected a \$442 million transfer to the State's Education Lottery Fund. The NCEL will continue to monitor the current economic conditions in the State, and its impact upon lottery ticket sales. As per the General Assembly Fiscal Research Division: "Since the economic slowdown last spring, the State's economy has steadily been gaining strength. While we do not anticipate the pace of economic growth to significantly quicken, we do expect it to stay on a steady upward trend." Also "The economy is on solid footing on most fronts, and improvements in the State's employment growth means the recovery will move along a sturdier track." Therefore, the NCEL has constructed an increasing but conservative budget and sales forecast for the upcoming fiscal year.

A focus of the NCEL Commission is to ensure sound operations. The existence of this focus is apparent in the opinions issued by external audit firms. For the seventh consecutive year, the State Auditor contracted with an outside CPA firm to conduct the fiscal year financial audit, which resulted in an unmodified opinion.

NORTH CAROLINA EDUCATION LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS
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Requests for Information

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

NORTH CAROLINA EDUCATION LOTTERY

Statements of Net Position (in thousands)
June 30, 2013 and 2012

	2013	2012
ASSETS		
Current Assets:		
Cash and Cash Equivalents:		
Cash	\$ 99	\$ 119
Pooled Cash	32,386	26,381
Receivables:		
Accounts Receivable	17,774	14,797
Interest Receivable	18	39
Investment in Annuity Contracts	4,154	3,750
Inventory	-	4
Prepaid Items	381	335
State Treasurer's Security Lending Collateral	4,831	3,059
Total Current Assets	59,643	48,484
Noncurrent Assets:		
Investment in Annuity Contracts	49,666	45,417
Prepaid Items	1,042	1,248
Capital Assets, Depreciable (Net):		
Furniture and Equipment	3,742	3,172
Accumulated Depreciation	(2,845)	(2,500)
Total Capital Assets, Depreciable (Net)	897	672
Total Assets	111,248	95,821
LIABILITIES		
Current Liabilities:		
Accounts Payable	23,572	31,611
Accrued Payroll	431	412
Other Liabilities	-	263
Annuity Prize Award Payable - Current	4,154	3,750
Accrued Paid Time Off - Current	291	162
Due to Other Funds	27,317	10,175
Obligations Under State Treasurer's Security Lending Agreements	4,760	2,965
Total Current Liabilities	60,525	49,338
Noncurrent Liabilities:		
Annuity Prize Award Payable	49,666	45,417
Accrued Paid Time Off	1,057	1,066
Total Liabilities	111,248	95,821
NET POSITION		
Net Investment in Capital Assets	897	672
Unrestricted	(897)	(672)
Total Net Position	\$ -	\$ -

See Notes to the Financial Statements.

NORTH CAROLINA EDUCATION LOTTERY

Statements of Revenues, Expenses and Changes in Net Position (in thousands)
Years Ended June 30, 2013 and 2012

	2013	2012
Operating Revenues:		
Gross Sales:	\$ 1,689,803	\$ 1,596,693
Less: Prize Tickets	-	(181)
Less: Sales/Service Bad Debt	(90)	(55)
Fees and Licenses	5,296	5,381
Total Operating Revenues	1,695,009	1,601,838
Operating Expenses:		
Salaries, Wages, and Benefits	17,540	16,639
Lottery Prizes	1,024,437	961,556
Retailer Commissions	118,148	111,624
Retailer Incentive	781	609
Gaming Systems Services	27,262	26,031
Advertising	15,278	14,696
Marketing	3,540	2,512
Other Services	4,802	4,634
Furniture, Fixtures, and Equipment	1,307	762
Depreciation	346	457
Other General and Administrative Expenses	2,484	2,391
Total Operating Expenses	1,215,925	1,141,911
Operating Income	479,084	459,927
Nonoperating Revenues (Expenses):		
Investment Earnings	417	523
Compulsive Gambling Contribution	(1,000)	(1,000)
Unclaimed Prizes to NC Education Lottery Fund	(11,381)	(11,083)
Net Revenues to the State of NC	(467,127)	(448,386)
Miscellaneous Nonoperating Revenues (Expenses)	7	19
Total Nonoperating Revenues (Expenses)	(479,084)	(459,927)
Change in Net Position	-	-
Net Position Beginning, July 1	-	-
Net Position Ending, June 30	\$ -	\$ -

See Notes to the Financial Statements.

NORTH CAROLINA EDUCATION LOTTERY

Statements of Cash Flows (in thousands)
Years Ended June 30, 2013 and 2012

	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from Customers	\$ 1,573,884	\$ 1,485,286
Payments to Employees and Fringe Benefits	(17,401)	(16,827)
Payments for Prizes, Benefits and Claims	(1,032,548)	(948,310)
Payments to Vendors and Suppliers	(55,480)	(51,955)
Other Receipts/Payments	25	-
	468,480	468,194
Net Cash Flows Provided from Operating Activities		
CASH USED FOR NONCAPITAL FINANCING ACTIVITIES		
Transfers to State	(461,367)	(456,765)
Transfers to Other State Agencies	(1,000)	(1,000)
	(462,367)	(457,765)
Total Cash Used for Noncapital Financing Activities		
CASH USED FOR CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisition and Construction of Capital Assets	(570)	(311)
	(570)	(311)
Total Cash Used for Capital and Related Financing Activities		
CASH PROVIDED FROM INVESTING ACTIVITIES		
Investment Earnings	442	605
	442	605
Total Cash Provided from Investing Activities		
Net Increase/(Decrease) in Cash and Cash Equivalents	5,985	10,723
Cash and Cash Equivalents at Beginning of Year	26,500	15,777
Cash and Cash Equivalents at End of Year	\$ 32,485	\$ 26,500
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating Income	\$ 479,084	\$ 459,927
Adjustments to Reconcile Operating Income to Cash Provided by Operating Activities:		
Depreciation Expense	345	457
Other Nonoperating Income	26	3
(Increase) Decrease in Assets:		
Accounts Receivable	(2,977)	(4,900)
Inventories	4	12
Prepaid Items	160	(1,404)
Increase (Decrease) in Liabilities:		
Accounts Payable	(8,039)	14,052
Accrued Payroll and Related Liabilities	19	(254)
Other Liabilities	(142)	301
	(8,039)	14,052
Total Cash Provided by Operating Activities	\$ 468,480	\$ 468,194
NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES		
Assets Acquired through the Assumption of a Liability	\$ 6,425	\$ 12,013
Change in Fair Value of Investments	22	72

See Notes to the Financial Statements.

NORTH CAROLINA EDUCATION LOTTERY
NOTES TO FINANCIAL STATEMENTS (in thousands)
June 30, 2013 and 2012

NOTE 1 - ORGANIZATION

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

- Carolina Pick 3 on October 6, 2006
- Carolina Cash 5 on October 27, 2006
- Carolina Pick 3 second daily draw (Monday through Saturday) on March 31, 2008
- Carolina Pick 4 on April 17, 2009
- Mega Millions on January 31, 2010
- Carolina Pick 4 second daily draw and Carolina Pick 3 second Sunday draw on February 27, 2011

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

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity:

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

B. Basis of Presentation:

The financial statements are prepared on the accrual basis of accounting in a manner similar to a private enterprise. The NCEL elected to apply all applicable Governmental Accounting Standards Board (GASB) pronouncements as well as Accounting Principles Board (APB) opinions. GASB Statement No. 62 incorporates into the GASB's authoritative literature the applicable guidance previously presented in the following pronouncements issued before November 30, 1989: 1) Financial Accounting Standards Board (FASB) Statements and Interpretations, 2) Accounting Principles Board Opinions, and 3) Accounting Research Bulletins of the American Institute of Certified Public Accountants' (AICPA) Committee on Accounting Procedure. The guidance generally has been taken "as-is" from the original FASB and AICPA pronouncements, except a few provisions that have been modified where necessary to relate specifically to the governmental environment.

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

NORTH CAROLINA EDUCATION LOTTERY
NOTES TO FINANCIAL STATEMENTS (in thousands)
June 30, 2013 and 2012

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

C. Cash and Cash Equivalents:

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

D. State Treasurer's Securities Lending Collateral:

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

Based on the authority provided in General Statute 147-69.3(e), the State Treasurer lends securities from its investment pool to brokers-dealers and other entities (borrowers) for collateral that will be returned for the same securities in the future. The Treasurer's securities custodian manages the securities lending program. The Treasurer's custodian lent U.S. government and agency securities, FNMA's, corporate bonds and notes for collateral. The Treasurer's custodian is permitted to receive cash, U.S. government and agency securities, or irrevocable letters of credit as collateral for the securities lent.

The collateral is initially pledged at 102 percent of the market value of the securities lent, and additional collateral is required if its value falls to less than 100 percent of the market value of the securities lent. There are no restrictions on the amount of loans that can be made. Substantially all security loans can be terminated on demand by either the State Treasurer or the borrower.

Additional details on the State Treasurer's securities lending program are included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.osc.nc.gov/> and clicking on "Financial Reports," or by calling the State Controller's Financial Reporting Section at (919) 707-0500.

E. Allowance for Doubtful Accounts:

An allowance for doubtful accounts has not been established because there are no indications of significant delinquencies from the collection of retailer accounts as of June 30, 2013 and 2012.

NORTH CAROLINA EDUCATION LOTTERY
NOTES TO FINANCIAL STATEMENTS (in thousands)
June 30, 2013 and 2012

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

F. Capital Assets:

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

<u>Category</u>	<u>Years</u>
Equipment	5-7
Furniture	5
Computers and Software	3-5

G. Game Revenue Recognition:

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

H. Lottery Prize Expense Recognition:

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

I. Use of Estimates:

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

NOTE 3 – REVENUE

A. Operating Revenue:

1. Game Revenue:

Instant packs are settled using the following methodology:

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

NORTH CAROLINA EDUCATION LOTTERY
NOTES TO FINANCIAL STATEMENTS (in thousands)
June 30, 2013 and 2012

NOTE 3 – REVENUE (continued)

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

Game Revenue	2013	2012
Instant	\$ 1,011,943	\$ 959,955
Prize tickets	-	(181)
Draw	677,860	636,738
Bad debt write off	(83)	(51)
Damaged tickets, sales services	(7)	(4)
Total	\$ 1,689,713	\$ 1,596,457

2. Fees and Licenses:

The majority of Fees and Licenses represent a weekly retailer communication fee charged to active retailers for terminal satellite communications and an application fee for new retailers and changes in ownership. Total Fees and Licenses for fiscal year 2013 and 2012 were \$5,296 and \$5,381, respectively.

B. Non-operating Revenue:

The cash accounts of the NCEL are Short Term Investment Fund (STIF) Accounts which are interest bearing accounts held with the NC State Treasurer. Investments are limited to those authorized for the State's General Fund, pursuant to NC General Statute 147-69.1. The investment earnings earned on these accounts and the related security lending collateral transactions is \$417 and \$523 for the years ended June 30, 2013 and 2012, respectively.

The NCEL also has miscellaneous non-operating revenue related to dividends received from MUSL which were \$26 and \$50 for the years ended June 30, 2013 and 2012, respectively. The remaining miscellaneous non-operating revenue consists of sales and marketing materials to other lotteries and other miscellaneous items.

NOTE 4 – EXPENSES

A. Operating Expenses:

1. Lottery Prize Expense:

Prize Expense	2013	2012
Instant	\$ 685,202	\$ 642,075
Draw	327,854	308,398
50% of unclaimed prizes	11,381	11,083
Total	\$ 1,024,437	\$ 961,556

NORTH CAROLINA EDUCATION LOTTERY
NOTES TO FINANCIAL STATEMENTS (in thousands)
June 30, 2013 and 2012

NOTE 4 – EXPENSES (continued)

2. Retailer Commissions:

Commissions	2013	2012
Instant	\$ 70,735	\$ 67,092
Draw	47,413	44,532
Total	\$ 118,148	\$ 111,624

3. Retailer Incentives:

In fiscal year 2010, the State Lottery Commission approved a retailer incentive program where retailers would receive compensation for selling a top/second tier prize in the Multi-State games POWERBALL and Mega Millions and a top tier prize in Carolina Cash 5. As of December 2011, the retailer incentive program was expanded to include instant ticket prizes of over \$1 million as well. The total payments issued for the retailer incentive program for fiscal years 2013 and 2012 were \$781 and \$609, respectively.

4. Other Services:

The principal expenses included are: security services, background checks, communications, legal services, travel, financial audit services, network support, and costs for temporary employees. The Other category under Other Services also includes payments issued to Alcohol and Law Enforcement (ALE) in the amount of \$948 in fiscal year 2013 and \$933 in fiscal year 2012.

	2013	2012
Security services	\$ 12	\$ 11
Background checks	1,016	977
Communications, including wiring	1,201	1,250
Legal services	158	94
Travel	149	133
Other	2,266	2,169
Total	\$ 4,802	\$ 4,634

5. Furniture, Fixtures, and Equipment:

To operate a lottery, numerous items of equipment, furniture, and ticket dispensers are required. Most of these items were one time purchases to be replaced as needed at various points in the future. These items were also below our threshold for capitalization (See Note 5E) and therefore expensed. The total expenses for fiscal years 2013 and 2012 were \$1,307 and \$762, respectively.

NORTH CAROLINA EDUCATION LOTTERY
NOTES TO FINANCIAL STATEMENTS (in thousands)
June 30, 2013 and 2012

NOTE 4 – EXPENSES (continued)

6. Leases – Buildings, Offices and Other Equipment:

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

Projected lease payments for these facilities are:

<u>Year Ending</u>	<u>Amount</u>
2014	\$ 1,145
2015	1,161
2016	1,150
2017	272
2018	227
2019-2023	429
<u>Total</u>	<u>\$ 4,384</u>

The total space rental costs for the fiscal years 2013 and 2012 were \$1,096 and \$1,091, respectively. The NCEL also has several contracts for various equipment leases including instant ticket vending machines (ITVM's).

B. Non-operating Expenses:

The allocable share of the expenses arising from State Treasurer's Securities Lending Collateral program transactions, totaling \$18 and \$31 for the years ended June 30, 2013 and 2012, respectively, are included as non-operating expense. For the years ended June 30, 2013 and 2012, the remaining non-operating expenses consist of other miscellaneous non-operating items.

C. Transfers Out:

There were three significant transfers from the NCEL. One million dollars was transferred to the NC Department of Health and Human Services for a gambling addiction education and treatment program as stipulated in the North Carolina State Lottery Act for the years ended June 30, 2013 and 2012 (See Note 7D).

The second transfer was \$11,381 and \$11,083 for the years ended June 30, 2013 and 2012, respectively, from unclaimed prizes during the year. The North Carolina State Lottery Act requires the NCEL to transfer "Fifty percent (50%)" of unclaimed prizes to the NC Education Lottery Fund each year (See Note 7C).

The third transfer was in compliance with the North Carolina State Lottery Act. This Act requires all "Net Revenues" of the NCEL to be transferred to the NC Education Lottery Fund for the educational purposes set forth in the legislation. "Net Revenues" were \$467,127 for fiscal year 2013 compared with \$448,386 for fiscal year 2012 (see Note 12). However, \$439,875 was transferred to the NC Education Lottery Fund for fiscal year 2013 compared with \$438,283 for fiscal year 2012. The balances remaining (\$27,253 and \$10,103 for fiscal years 2013 and 2012) were recorded as a payable to the State for both fiscal years and were transferred subsequent to fiscal year end. NC General Statute 18C-162 states: "The funds remaining in the North Carolina State Lottery Fund after receipt of all revenues to the Lottery Fund and after accrual of all obligations of the Commission for prizes and expenses shall be considered to be the net revenues of the North Carolina State Lottery Fund."

NORTH CAROLINA EDUCATION LOTTERY
NOTES TO FINANCIAL STATEMENTS (in thousands)
June 30, 2013 and 2012

NOTE 5 – ASSETS

A. Cash:

The cash and cash equivalents balances at June 30, 2013 and 2012 include no undeposited receipts on hand.

Unless specifically exempt, the NCEL is required by North Carolina General Statute 147-77 to deposit moneys received with the State Treasurer or with a depository institution in the name of the State Treasurer. Except as noted above, all NCEL funds are deposited with the State Treasurer. The NCEL has no deposit policy concerning credit risk, as all deposits are held by the State Treasurer.

At June 30, 2013 and 2012, respectively, \$32,386 and \$26,381 of the amounts shown on the Statement of Net Position as cash and cash equivalents represents the NCEL's equity position in the State Treasurer's Short Term Investment Fund. The Short Term Investment Fund (a portfolio within the State Treasurer's Investment Pool, an external investment pool that is not registered with the Securities and Exchange Commission and does not have a credit rating) had a weighted average maturity of 1.6 and 1.5 years, as of June 30, 2013 and 2012, respectively. Assets and shares of the Short Term Investment Fund are valued at amortized cost, which approximates fair value.

Deposit and investment risks associated with the State Treasurer's Investment Pool (which includes the State Treasurer's Short Term Investment Fund) are included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.osc.nc.gov> and clicking on "Financial Reports" or by calling the State Controller's Financial Reporting Section at (919) 707-0500.

B. Accounts Receivable:

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

C. Inventory:

Inventory for the NCEL consists of all merchandise prizes that are paid for before distribution. Inventory is reduced as prizes are fulfilled. Inventory as of June 30, 2013 and 2012 was \$0 and \$4, respectively.

D. Investments in Annuity Contracts:

Investments in Annuity Contracts represent the present value of the contracts that fund the long term installment prizes contracted through insurance company annuities (See Note 7B). The current and long term balances are \$4,154 and \$49,666 for fiscal year 2013 and \$3,750 and \$45,417 for fiscal year 2012, respectively.

The policies of the NCEL only allow for direct purchase of annuity contracts from which the proceeds are used to fund long term installment prizes. As the NCEL is not pursuing other forms of investments, they are not currently anticipated under the policy. As a means of limiting exposure to interest rate risk, the policy only allows for direct purchase of annuity contracts which future value payments are pre-negotiated with the providers of the contracts. These contracts are not subject to foreign currency risk because the provider is required by contract to pay the full annuities. Accordingly, the NCEL does not have a policy regarding foreign currency risk since investments in products subject to this risk are not applicable to the NCEL.

The policy of the NCEL restricts direct purchase of annuity contracts to those with companies that hold minimum ratings as follows: AA by Fitch, Aa by Moody's or AA by Standard & Poor's. As of June 30, 2013, all annuities carried a rating of Aa/AA.

NORTH CAROLINA EDUCATION LOTTERY
NOTES TO FINANCIAL STATEMENTS (in thousands)
June 30, 2013 and 2012

NOTE 5 – ASSETS (continued)

Maturities for investments in annuity contracts are as follows:

<u>Maturities</u>	<u>2013</u>	<u>2012</u>
Less than 1 year	\$ 4,154	\$ 3,750
1 to 5 years	20,640	18,750
6 to 10 years	20,640	18,750
More than 10 years	8,386	7,917
Total	\$ 53,820	\$ 49,167

E. Capital Assets:

The activity for capital assets for the year ended June 30, 2013 was:

<u>Category</u>	<u>Balance July 1, 2012</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2013</u>
Capital assets, depreciable				
Furniture	\$ 29	\$ 17	\$ -	\$ 46
Equipment	3,076	553	-	3,629
Motorized equipment	67	-	-	67
Total capital assets, depreciable	3,172	570	-	3,742
Less accumulated depreciation for:				
Furniture	29	2	-	31
Equipment	2,403	343	-	2,746
Motorized equipment	68	-	-	68
Total accumulated depreciation	2,500	345	-	2,845
Total capital assets, depreciable, net	672	225	-	897
Capital assets, net	\$ 672	\$ 225	\$ -	\$ 897

The activity for capital assets for the year ended June 30, 2012 was:

<u>Category</u>	<u>Balance July 1, 2011</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2012</u>
Capital assets, depreciable				
Furniture	\$ 29	\$ -	\$ -	\$ 29
Equipment	2,804	310	(38)	3,076
Motorized equipment	67	-	-	67
Total capital assets, depreciable	2,900	310	(38)	3,172
Less accumulated depreciation for:				
Furniture	27	2	-	29
Equipment	1,991	450	(38)	2,403
Motorized equipment	63	5	-	68
Total accumulated depreciation	2,081	457	(38)	2,500
Total capital assets, depreciable, net	819	(147)	-	672
Capital assets, net	\$ 819	\$ (147)	\$ -	\$ 672

NORTH CAROLINA EDUCATION LOTTERY
NOTES TO FINANCIAL STATEMENTS (in thousands)
June 30, 2013 and 2012

NOTE 5 – ASSETS (continued)

Equipment expenditures for 2013 and 2012 included replacements of aged instant ticket dispensers and computer server equipment.

NOTE 6 – LIABILITIES

A. Accounts Payable:

This primarily represents trade payables to vendors, prize liabilities, and multi-state game low-tier liability. At year end, June 30, 2013 and 2012, the balances were:

<u>Account Type</u>	<u>2013</u>	<u>2012</u>
Trade payables to vendors and other	\$ 4,074	\$ 3,926
Instant prize liability	8,518	8,889
Prize liability – unused unclaimed prizes	7,976	11,223
Multi state games low-tier liability	2,843	4,438
Prize liability – breakage	161	3,135
Total Accounts Payable	<u>\$ 23,572</u>	<u>\$ 31,611</u>

B. Other Liabilities:

Other liabilities of \$0 and \$263 for the years ended June 30, 2013 and 2012, respectively, primarily consist of federal and state withholding on prize payments, various clearing accounts, and deferred revenue.

C. Annuity Prize Awards Payable:

Annuity prize awards payable represents the present value of the contracts that fund the long term installment prizes that are due to NCEL annuity prize winners (See Note 7B). The current and long term balances are \$4,154 and \$49,666 for fiscal year 2013 and \$3,750 and \$45,417 for fiscal year 2012, respectively.

Annuity activity for both short and long term accounts during fiscal year 2013 are as follows:

	<u>Beginning Balance</u>	<u>Purchases</u>	<u>Annuity Appreciation</u>	<u>Annuity Disbursements</u>	<u>Reclass to Short Term</u>	<u>Ending Balance</u>
Short Term	\$ 3,750	\$ -	\$ -	\$ (3,750)	\$ 4,154	\$ 4,154
Long Term	45,417	7,188	1,215	-	(4,154)	49,666
Total	<u>\$ 49,167</u>	<u>\$ 7,188</u>	<u>\$ 1,215</u>	<u>\$ (3,750)</u>	<u>\$ -</u>	<u>\$ 53,820</u>

Annual activity for both short and long term accounts during fiscal year 2012 are as follows:

	<u>Beginning Balance</u>	<u>Purchases</u>	<u>Annuity Appreciation</u>	<u>Annuity Disbursements</u>	<u>Reclass to Short Term</u>	<u>Ending Balance</u>
Short Term	\$ 3,000	\$ -	\$ -	\$ (2,700)	\$ 3,450	\$ 3,750
Long Term	35,620	11,484	1,763	-	(3,450)	45,417
Total	<u>\$ 38,620</u>	<u>\$ 11,484</u>	<u>\$ 1,763</u>	<u>\$ (2,700)</u>	<u>\$ -</u>	<u>\$ 49,167</u>

NORTH CAROLINA EDUCATION LOTTERY
NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2013 and 2012

NOTE 6 – LIABILITIES (continued)

D. Due to Other Funds:

As explained in Note 4C, \$27,253 and \$10,103 for the years ended June 30, 2013 and 2012, respectively, represent the amounts of the "Net Revenues" for the year not yet transferred to the State as of June 30, but will be transferred to the State subsequent to fiscal year-end. The remainder is due to other state agencies for services provided to the NCEL.

E. Accrued Paid Time Off:

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

Activity for the year ended June 30, 2013:

<u>Beginning</u>	<u>Earned</u>	<u>Used</u>	<u>Ending</u>	<u>Current Liability</u>	<u>Long Term Portion</u>
\$ 1,228	\$ 1,666	\$ 1,546	\$ 1,348	\$ 291	\$ 1,057

Activity for the year ended June 30, 2012:

<u>Beginning</u>	<u>Earned</u>	<u>Used</u>	<u>Ending</u>	<u>Current Liability</u>	<u>Long Term Portion</u>
\$ 1,162	\$ 1,323	\$ 1,257	\$ 1,228	\$ 162	\$ 1,066

NOTE 7 – OTHER IMPORTANT ITEMS

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

MUSL is a voluntary association created for the purpose of administering joint, multi-jurisdictional lottery games, such as POWERBALL and Mega Millions. As of June 30, 2013, MUSL included 33 state lotteries, the District of Columbia and the U.S. Virgin Islands. The chief executive officer of each member lottery serves on the MUSL board of directors.

As a member of MUSL, the NCEL is required to contribute to various prize reserve funds maintained by MUSL. These contributions are included in the 50% prize expense calculated on POWERBALL and Mega Millions sales. The net amount of the 50% prize expense less the amount required to pay low-tier prizes within the State is paid to MUSL. This payment is to cover the NCEL's share of current jackpot prizes based on the NCEL's percent of sales for each drawing and the NCEL's share of the prize reserve fund. The prize reserve fund serves as a contingency reserve to protect all MUSL members including the NCEL from unforeseen prize liabilities. All prize reserve funds remitted, and the related interest earnings, will be returned to the NCEL upon leaving MUSL, less any portion of unanticipated prize claims which may have been paid from the fund. As of June 30, 2013 and 2012 the NCEL had been credited with \$9,992 and \$10,094, respectively, in the MUSL prize reserve funds.

NORTH CAROLINA EDUCATION LOTTERY
NOTES TO FINANCIAL STATEMENTS (in thousands)
June 30, 2013 and 2012

NOTE 7 – OTHER IMPORTANT ITEMS (continued)

B. Annuity Installment Prizes:

The NCEL funds long term installment prizes through the purchase of insurance company annuities. The contract holders will fund the future value of the installment prize awards over the life of the prize awarded to the player. The NCEL currently holds contracts with Met Life Insurance Company and Prudential Life Insurance Company to provide these future prize installment payments. The future value of the annuity prizes awarded as of June 30, 2013 and 2012 were \$67,982 and \$64,550, respectively.

C. Unclaimed Prizes:

As of June 30, 2013 and 2012, the NCEL had unclaimed prizes from both online and instant games. The first POWERBALL draw after the NCEL started selling tickets was on May 31, 2006, and therefore, the NCEL began recognizing unclaimed prizes on November 27, 2006 (180 days after the first draw). The first Carolina Pick 3 unclaimed prizes were recorded on April 4, 2007 and the first unclaimed prizes for Carolina Cash 5 were recorded on April 25, 2007. Unclaimed prizes for Carolina Pick 4 were recorded on November 14, 2009. Unclaimed prizes for Mega Millions were recorded on August 1, 2010. The NCEL closed forty-nine instant games during fiscal year 2013 resulting in \$11,435 in unclaimed prizes. In 2012, the NCEL closed forty-six instant games resulting in \$10,226 in unclaimed prizes.

<u>Game Type</u>	2013	2012
Instant	\$ 11,435	\$ 10,226
Powerball	5,025	5,998
Mega Millions	1,723	1,314
Carolina Cash 5	1,434	1,418
Carolina Pick 4	1,410	1,452
Carolina Pick 3	1,735	1,758
Total unclaimed prizes	<u>\$ 22,762</u>	<u>\$ 22,166</u>

D. Compulsive Gambling Contribution:

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

E. Limitations on Operating and Advertising Expenses:

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

NORTH CAROLINA EDUCATION LOTTERY
NOTES TO FINANCIAL STATEMENTS (in thousands)
June 30, 2013 and 2012

NOTE 8 – RISK MANAGEMENT

The NCEL is exposed to various risks of loss related to torts; theft of, damage to, and the destruction of assets; errors and omissions; injuries to employees; and natural disasters. The NCEL participates in the State’s Risk Management Program for property, liability, crime and automobile coverage, and pays an annual premium for this coverage. The Lottery has not experienced any losses during the year ended June 30, 2013.

The types of coverage, limits, and deductibles, as of June 30, 2013, are described below (the following chart is not shown in thousands).

Coverage Type	Limits (\$)	Deductible (\$)	Comments
Public officers and employee liability	1,000,000 /10,000,000	The first 150,000 /1,000,000 per person are paid by the Commission.	State is self-insured up to \$1,000,000; excess up to \$10,000,000 is with a private insurer.
All risk – property contents	4,697,880	5,000	
Auto – liability	1,000,000 per person/10,000,000 per accident		
Auto – comp/collision	29,470	50 100	Comp. deductible Collision deductible
Theft, disappearance, destruction	250,000	2,500	Inside premises
Theft, disappearance, destruction	50,000	2,500	Outside premises
Computer fraud	5,000,000	75,000	+10% over \$75,000
Employee dishonesty	5,000,000	75,000	+10% over \$75,000
Forgery and alteration	100,000	2,500	
Robbery and safe burglary – money/securities	500,000	1,000	

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

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

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

Additional details on State-administered risk management programs are disclosed in the State of North Carolina’s *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller’s Internet home page <http://www.osc.nc.gov/> and clicking on “Financial Reports” or by calling the State Controller’s Financial Reporting Section at (919) 707-0500.

NORTH CAROLINA EDUCATION LOTTERY
NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2013 and 2012

NOTE 9 – PENSION AND DEFERRED COMPENSATION PLANS

A. Retirement Plan:

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

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

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

For the years ending June 30, 2013, 2012 and 2011, respectively, the NCEL had a total payroll of \$13,139, \$12,839, and \$12,018, of which \$13,139, \$12,839 and \$12,018 was covered under the Teachers' and State Employees' Retirement System. Total employer and employee contributions for pension benefits for the years ended June 30, 2013, 2012 and 2011, were \$1,883, \$1,725 and \$1,314, respectively. Required employer contribution rates for the years ended June 30, 2013, 2012 and 2011, were 8.33%, 7.44% and 4.93%, respectively, while employee contributions were 6% each year. The NCEL made 100% of its annual required contributions as mandated by Senate Bill 58. The contribution amounts for the years ended June 30, 2013, 2012, and 2011, were \$1,094, \$955 and \$592, respectively.

The Teachers' and State Employees' Retirement System's financial information is included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.osc.nc.gov/> and clicking on "Financial Reports", or by calling the State Controller's Financial Reporting Section at (919) 707-0500.

B. Supplemental Retirement Income Plan:

IRC Section 401(k) Plan – All full-time employees are eligible to enroll in the Supplemental Retirement Income Plan, a defined contribution plan, created under Internal Revenue Code Section 401(k). All costs of administering the plan are the responsibility of the plan participants. The Plan is provided by Prudential Retirement, administered by the NC Department of the State Treasurer and sponsored by the State of North Carolina. The effective date of participation was January 30, 2006. The voluntary contributions by employees amounted to \$138, \$170 and \$197 for the years ended June 30, 2013, 2012 and 2011, respectively.

C. Deferred Compensation Plan:

IRC Section 457 Plan – The State of North Carolina offers its permanent employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457 through the North Carolina Public Employee Deferred Compensation Plan (the Plan). The Plan permits each participating employee to defer a portion of his or her salary until future years. The deferred compensation is available to employees upon separation from service, death, disability, retirement or financial hardships if approved by the Plan's Board of Trustees. The Board, a part of the North Carolina Department of State Treasurer, maintains a separate fund for the exclusive benefit of the participating employees and their beneficiaries, *the North Carolina Public Employee Deferred Compensation Trust Fund*. The Board also contracts with an external third party to perform certain administrative requirements and to manage the trust fund's assets. All costs of administering and funding the Plan are the responsibility of the Plan participants. The effective date of participation was January 30, 2006. The voluntary contributions by employees amounted to \$58, \$85 and \$109, for the years ended June 30, 2013, 2012 and 2011, respectively.

NORTH CAROLINA EDUCATION LOTTERY
NOTES TO FINANCIAL STATEMENTS (in thousands)
June 30, 2013 and 2012

NOTE 10 – OTHER POSTEMPLOYMENT BENEFITS

A. Health Care for Long Term Disability Beneficiaries and Retirees:

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

The Plan's benefit and contribution provisions are established by the State Treasurer and the Board of Trustees of the State Health Plan for Teachers and State Employees as authorized by Chapter 135, Article 3B, of the General Statutes. The Plan does not provide for automatic post-retirement benefit increases.

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

For the current fiscal year 2013, the NCEL contributed 5.3% of the covered payroll under the Teachers' and State Employees' Retirement System. Required contribution rates for the years ended June 30, 2012 and 2011, were 5.0% and 4.9%, respectively. The NCEL made 100% of its annual required contributions to the Plan for the years ended June 30, 2013, 2012, and 2011, which were \$696, \$642, and \$589, respectively.

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

Additional detailed information about these programs can be located in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.osc.nc.gov/> and clicking on "Financial Reports", or by calling the State Controller's Financial Reporting Section at (919) 707-0500.

B. Long Term Disability:

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

Disability income benefits are funded by actuarially determined employer contributions that are established in the Appropriations Bill by the General Assembly. For the fiscal year ended June 30, 2013, the NCEL made a statutory contribution of .44% of covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program to the DIPNC. Required contribution rates for the years ended June 30, 2013, 2012 and 2011, were .44%, .52% and .52%, respectively. The NCEL made 100% of its annual required contributions to the DIPNC for the years ended June 30, 2013, 2012, and 2011, which were \$58, \$66, and \$62, respectively. The NCEL assumes no liability for long term disability benefits under the Plan other than its contribution.

NORTH CAROLINA EDUCATION LOTTERY
NOTES TO FINANCIAL STATEMENTS (in thousands)
June 30, 2013 and 2012

NOTE 10 – OTHER POSTEMPLOYMENT BENEFITS (continued)

Additional detailed information about the DIPNC is disclosed in the State of North Carolina’s *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller’s Internet home page <http://www.osc.nc.gov/> and clicking on “Financial Reports”, or by calling the State Controller’s Financial Reporting Section at (919) 707-0500.

NOTE 11 – LITIGATION

As of June 30, 2013, the NCEL is not, nor anticipates being, a party to any litigation.

NOTE 12 - ALLOCATION OF TOTAL ANNUAL REVENUES/TRANSFERS TO NC EDUCATION LOTTERY FUND

	<u>2013</u>	
Lottery Ticket Sales	\$ 1,689,713	
Fees and Licenses	5,296	
Investment Earnings and Other Revenues	424	
Total Annual Revenue	<u>1,695,453</u>	
Less Prize Tickets	<u>-</u>	0% Of Total Annual Revenue
Total Net Revenue	<u>1,695,453</u>	
Prize Expense	(1,024,437)	61% Of Total Annual Revenue
Advertising	(15,278)	1% Of Total Annual Revenue
All Other Expenses and Transfers	<u>(59,062)</u>	
Total Section 18C-162.a.3	<u>(74,360)</u>	4% Of Total Annual Revenue
Commissions (per 18C-142)	(118,148)	7% Of Lottery Ticket Sales
Unclaimed Prizes to The State of North Carolina	11,381	
Net Revenues to The State of North Carolina	<u>467,127</u>	
Total Revenues to The State of North Carolina	<u>\$ 478,508</u>	28% Of Total Annual Revenue

NORTH CAROLINA EDUCATION LOTTERY
NOTES TO FINANCIAL STATEMENTS (in thousands)
June 30, 2013 and 2012

NOTE 12 - ALLOCATION OF TOTAL ANNUAL REVENUES/TRANSFERS TO NC EDUCATION LOTTERY FUND (continued)

	<u>2012</u>		
Lottery Ticket Sales	\$ 1,596,638		
Fees and Licenses	5,381		
Investment Earnings and Other Revenues	<u>523</u>		
Total Annual Revenue	1,602,542		
Less Prize Tickets	<u>(181)</u>	0%	Of Total Annual Revenue
Total Net Revenue	<u>1,602,361</u>		
Prize Expense	(961,556)	60%	Of Total Annual Revenue
Advertising	(14,696)	1%	Of Total Annual Revenue
All Other Expenses and Transfers	<u>(55,016)</u>		
Total Section 18C-162.a.3	<u>(69,712)</u>	4%	Of Total Annual Revenue
Commissions (per 18C-142)	(111,624)	7%	Of Lottery Ticket Sales
Unclaimed Prizes to The State of North Carolina	11,083		
Net Revenues to The State of North Carolina	<u>448,386</u>		
Total Revenues to The State of North Carolina	<u>\$ 459,469</u>	29%	Of Total Annual Revenue

In accordance with Section § 18C-162 of the North Carolina State Lottery Act: Allocation of revenues.

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

NORTH CAROLINA EDUCATION LOTTERY
NOTES TO FINANCIAL STATEMENTS (in thousands)
June 30, 2013 and 2012

NOTE 12 - ALLOCATION OF TOTAL ANNUAL REVENUES/TRANSFERS TO NC EDUCATION LOTTERY FUND (continued)

Additionally, in accordance with Section § 18C-142 of the North Carolina State Lottery Act, Compensation for lottery game retailers, "The amount of compensation paid to lottery game retailers for their sales of lottery tickets or shares shall be seven percent (7%) of the retail price of the tickets or shares sold for each lottery game."

§ 18C-161. Types of income to the North Carolina State Lottery Fund.

- (1) All proceeds from the sale of lottery tickets or shares.
- (2) The funds for initial start-up costs provided by the State.
- (3) All other funds credited or appropriated to the Commission from any sources.
- (4) Interest earned by the North Carolina Lottery Fund.

The NCEL transferred \$461.4 million to the NC Education Lottery Fund for fiscal year 2013 compared with \$456.8 million for fiscal year 2012. As explained in Note 4C, \$27.3 million and \$10.1 million for fiscal years ended June 30, 2013 and 2012, respectively, were the amounts of the "Net Revenues" and "50% of Unclaimed Prizes" that were transferred to the State subsequent to the end of the respective fiscal year.

NOTE 13 – CHANGES IN FINANCIAL ACCOUNTING AND REPORTING

For the fiscal year ended June 30, 2013, the NCEL implemented the following pronouncement issued by the Governmental Accounting Standards Board (GASB):

GASB Statement No. 63, Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position.

Statement No. 63 provides a new statement of net position format to report all assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position (which is the net residual amount of the other elements). The Statement requires that deferred outflows of resources and deferred inflows of resources be reported separately from assets and liabilities. Statement No. 63 also amends certain provisions of Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, and related pronouncements to reflect the residual measure in the statement of financial position as net position, rather than net assets.

NOTE 14 – SUBSEQUENT EVENTS

The Commission of the NCEL has evaluated all subsequent events for potential recognition and disclosure through September 27, 2013, the date these financial statements will be available.

Report of Independent Auditor on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

To the Commissioners
North Carolina Education Lottery
Raleigh, North Carolina

We have audited in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the North Carolina Education Lottery (“NCEL”), a major enterprise fund of the State of North Carolina, as of and for the years ended June 30, 2013 and 2012, which collectively comprise the NCEL’s basic financial statements as listed in the table of contents, and have issued our report thereon dated September 27, 2013.

The financial statements present only the NCEL and do not purport to and do not present fairly the financial position of the State of North Carolina, as of and for the years ended June 30, 2013 and 2012, and the changes in their financial position and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Internal Control over Financial Reporting

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

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

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

Compliance and Other Matters

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

Purpose of this Report

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

A handwritten signature in black ink that reads "Cheryl Bekant LLP". The signature is written in a cursive style.

Raleigh, North Carolina
September 27, 2013

This audit required 359 audit hours at a cost of \$50,456.