AUDIT REPORT

Tennessee Education Lottery Corporation

For the Year Ended
June 30, 2009

STATE OF TENNESSEE

COMPTROLLER OF THE TREASURY

Department of Audit

Division of State Audit

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STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
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December 3, 2009

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, Tennessee 37228

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Tennessee Education Lottery Corporation for the year ended June 30, 2009. You will note from the independent auditor's report that an unqualified opinion was given on the fairness of the presentation of the financial statements.

Consideration of internal control over financial reporting and tests of compliance resulted in no audit findings.

Sincerely,

Arthur A. Hayes, Jr., CPA
Director

AAH/ajm
09/070

State of Tennessee

Audit Highlights

Comptroller of the Treasury — Division of State Audit

Financial and Compliance Audit
Tennessee Education Lottery Corporation
For the Year Ended June 30, 2009

AUDIT OBJECTIVES

The objectives of the audit were to consider the corporation's internal control over financial reporting; to determine compliance with certain provisions of laws, regulations, and contracts; to determine the fairness of the presentation of the financial statements; and to recommend appropriate actions to correct any deficiencies.

AUDIT FINDINGS

The audit report contains no findings.

OPINION ON THE FINANCIAL STATEMENTS

The opinion on the financial statements is unqualified.

Audit Report
Tennessee Education Lottery Corporation
For the Year Ended June 30, 2009

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Tennessee Education Lottery Corporation
For the Year Ended June 30, 2009

INTRODUCTION

POST-AUDIT AUTHORITY

This is a report on the financial and compliance audit of the Tennessee Education Lottery Corporation. The audit was conducted pursuant to Section 4-51-129, *Tennessee Code Annotated*, which states that the corporation shall "be subject to audits by the Comptroller of the Treasury in accordance with Section 8-4-109."

Section 8-4-109, *Tennessee Code Annotated*, authorizes the Comptroller of the Treasury to audit any books and records of any governmental entity that handles public funds when the Comptroller considers an audit to be necessary or appropriate.

BACKGROUND

The Tennessee Education Lottery Corporation (TEL) was created on June 11, 2003, by the Tennessee General Assembly through the Tennessee Education Lottery Implementation Law. Pursuant with the law, TEL was incorporated as a body, politic and corporate, and a quasi-public instrumentality. TEL is responsible for the operation of a state lottery and is deemed to be acting in all respects for the benefit of the people of the State of Tennessee. TEL is governed by a seven-member board of directors. The board of directors is appointed by the Governor and confirmed by a joint resolution of each house of the General Assembly.

The Tennessee Education Lottery Corporation's lottery games include instant ticket games and online games. At June 30, 2009, TEL had launched a total of 212 instant ticket games and 7 online games: Cash 3, Cash 4, Pick 5, Lotto Plus, Hottrax Champions, Million $ Madness, and Powerball. TEL is required to pay its operating expenses from lottery proceeds and, as nearly as possible, make 50% of the money from actual sales of lottery tickets available as prize money. TEL is required by statute to make quarterly payments of an amount representing net lottery proceeds of the immediately preceding quarter to the state treasury for credit to the "lottery for education account." State law also requires TEL to pay 100% of monies constituting unclaimed prizes to the state treasury to be deposited in the "after school programs account" at the end of each fiscal year.

ORGANIZATION

The Tennessee Education Lottery Corporation is organized into four major divisions: Executive, Legal, Sales and Marketing, and Finance and Information Systems.

The Executive Division oversees the daily operations of the corporation and is responsible for developing a broad vision for the corporation and ensuring that strategies to achieve all corporate objectives are implemented. The division is also responsible for

- advertising strategy;
- communications, including player services, media, and public relations; and
- legislative affairs.

The Legal Division includes the departments of Human Resources, Legal Services, Security, and Retailer Contract Administration. The Human Resources Department manages all personnel functions. The Legal Services Department provides legal advice and assistance to management and the board of directors, serves as the corporate records keeper, oversees litigation, and manages contract compliance. The Security Department is responsible for physical and intellectual property security. The Retailer Contract Administration Department manages all functions of retailer applications and contracts.

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, and
- warehouse management and distribution.

The Division of 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;
- fleet management services;
- game drawings, including online and second-chance instant games;

- gaming systems and operations oversight; and
- computer systems, technology infrastructure, and telecommunications systems.

An organization chart for the Tennessee Education Lottery Corporation is on the following page.

AUDIT SCOPE

The audit was limited to the period July 1, 2008, through June 30, 2009, and was conducted 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. Financial statements are presented for the year ended June 30, 2009, and for comparative purposes, the year ended June 30, 2008. The Tennessee Education Lottery Corporation has been included as a component unit in the *Tennessee Comprehensive Annual Financial Report*.

OBJECTIVES OF THE AUDIT

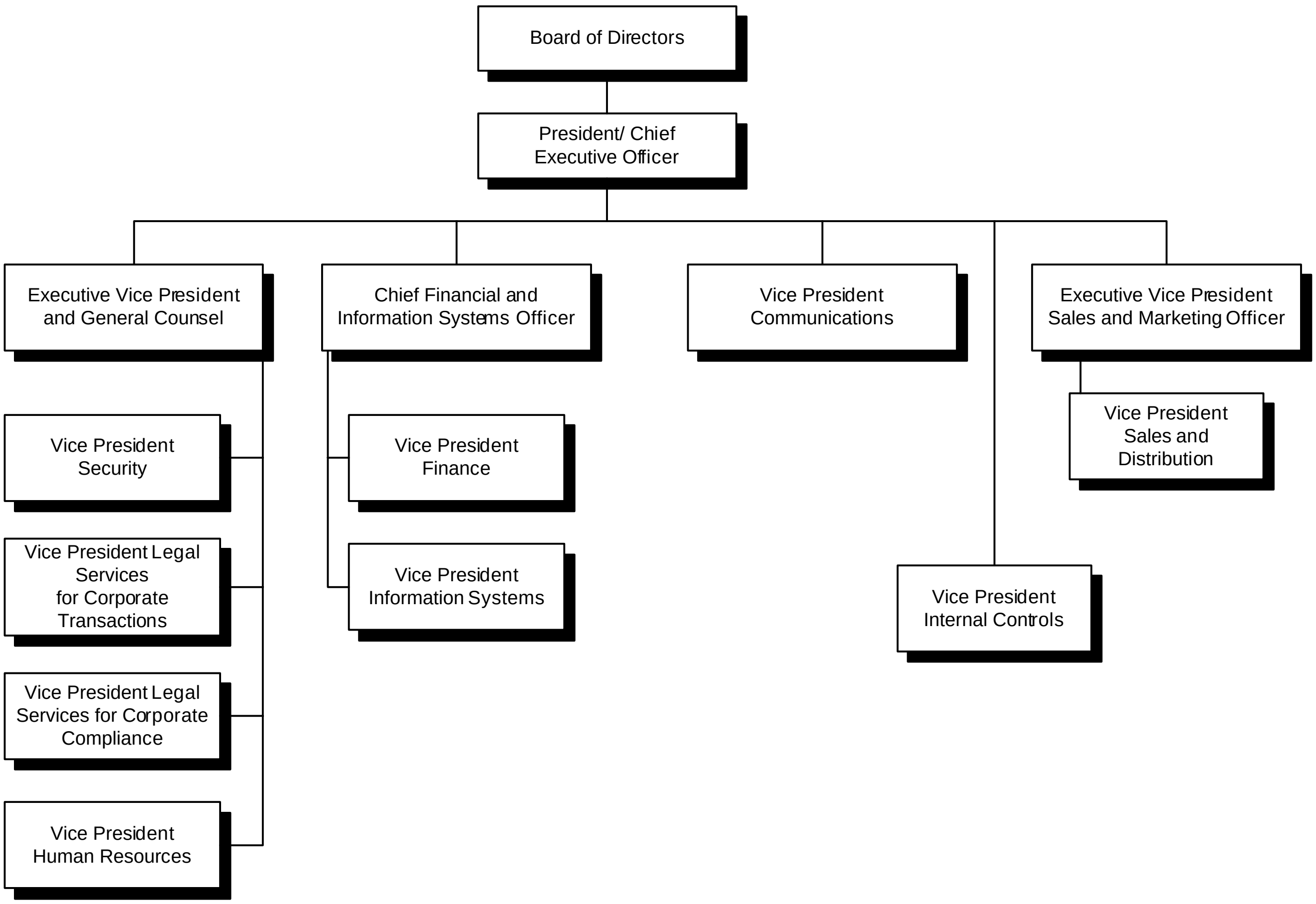
The objectives of the audit were

1. to consider the corporation's internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements;
2. to determine compliance with certain provisions of laws, regulations, and contracts;
3. to determine the fairness of the presentation of the financial statements; and
4. to recommend appropriate actions to correct any deficiencies.

PRIOR AUDIT FINDINGS

There were no findings in the prior audit report.

Tennessee Education Lottery Corporation
Organization Chart



OBSERVATIONS AND COMMENTS

MANAGEMENT'S RESPONSIBILITY FOR RISK ASSESSMENT

Auditors and management are required to assess the risk of fraud in the operations of the entity. The risk assessment is based on a critical review of operations considering what frauds could be perpetrated in the absence of adequate controls. The auditors' risk assessment is limited to the period during which the audit is conducted and is limited to the transactions that the auditors are able to test during that period. The risk assessment by management is the primary method by which the entity is protected from fraud, waste, and abuse. Since new programs may be established at any time by management or older programs may be discontinued, that assessment is ongoing as part of the daily operations of the entity.

Risks of fraud, waste, and abuse are mitigated by effective internal controls. It is management's responsibility to design, implement, and monitor effective controls in the entity. Although internal and external auditors may include testing of controls as part of their audit procedures, these procedures are not a substitute for the ongoing monitoring required of management. After all, the auditor testing is limited and is usually targeted to test the effectiveness of particular controls. Even if controls appear to be operating effectively during the time of the auditor testing, they may be rendered ineffective the next day by management override or by other circumventions that, if left up to the auditor to detect, will not be noted until the next audit engagement and then only if the auditor tests the same transactions and controls. Furthermore, since staff may be seeking to avoid auditor criticisms, they may comply with the controls during the period that the auditors are on site and revert to ignoring or disregarding the control after the auditors have left the field.

The risk assessments and the actions of management in designing, implementing, and monitoring the controls should be adequately documented to provide an audit trail both for auditors and for management, in the event that there is a change in management or staff, and to maintain a record of areas that are particularly problematic. The assessment and the controls should be reviewed and approved by the head of the entity.

FRAUD CONSIDERATIONS

Statement on Auditing Standards No. 99, *Consideration of Fraud in a Financial Statement Audit,* promulgated by the American Institute of Certified Public Accountants requires auditors to specifically assess the risk of material misstatement of an audited entity's financial statements due to fraud. The standard also restates the obvious premise that management, not the auditors, is primarily responsible for preventing and detecting fraud in its own entity. Management's responsibility is fulfilled in part when it takes appropriate steps to assess the risk of fraud within the entity and to implement adequate internal controls to address the results of those risk assessments.

During our audit, we discussed these responsibilities with management and how management might approach meeting them. We also increased the breadth and depth of our inquiries of management and others in the entity as we deemed appropriate. We obtained formal assurances from top management that management had reviewed the entity's policies and procedures to ensure that they are properly designed to prevent and detect fraud and that management had made changes to the policies and procedures where appropriate. Top management further assured us that all staff had been advised to promptly alert management of all allegations of fraud, suspected fraud, or detected fraud and to be totally candid in all communications with the auditors. All levels of management assured us there were no known instances or allegations of fraud that were not disclosed to us.

RESULTS OF THE AUDIT

AUDIT CONCLUSIONS

Internal Control

As part of the audit of the Tennessee Education Lottery Corporation's financial statements for the year ended June 30, 2009, we considered internal control over financial reporting as a basis for designing auditing procedures for the purpose of expressing an opinion on the financial statements, as required by auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in generally accepted government auditing standards. Consideration of internal control over financial reporting disclosed no material weaknesses.

Compliance and Other Matters

The results of our audit tests disclosed no instances of noncompliance or other matters that are required to be reported under generally accepted government auditing standards.

Fairness of Financial Statement Presentation

The Division of State Audit has rendered an unqualified opinion on the corporation's financial statements.

STATE OF TENNESSEE
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DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
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Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

November 4, 2009

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 financial statements of the Tennessee Education Lottery Corporation, a component unit of the State of Tennessee, as of and for the year ended June 30, 2009, and have issued our report thereon dated November 4, 2009. 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 generally accepted government auditing standards.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the corporation's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the corporation's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the corporation's internal control over financial reporting.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with accounting principles generally accepted in the United States of America such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the corporation's financial statements are free of material misstatement, we performed tests of the corporation's compliance with certain provisions of laws, regulations, and contracts, 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 generally accepted government auditing standards.

This report is intended solely for the information and use of the General Assembly of the State of Tennessee, the board of directors, management, and others within the entity, and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record.

Sincerely,

Arthur A. Hayes, Jr., CPA
Director

AAH/ajm
09/070

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
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Independent Auditor's Report

November 4, 2009

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, 2009, and June 30, 2008, 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, 2009, and June 30, 2008, 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 on pages 11 through 24 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 4, 2009, 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 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/ajm

TENNESSEE EDUCATION LOTTERY CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEARS ENDED JUNE 30, 2009, AND JUNE 30, 2008

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, 2009 and 2008, with comparative information presented for the fiscal year ended June 30, 2007. 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, 2009 and 2008.
- 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, 2009 and 2008.
- 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, 2009 and 2008.

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 deposited to the After-School Programs special account benefiting after-school programs in the State of Tennessee.

Fiscal Year 2009 Financial Highlights

The Tennessee Education Lottery closed out the fiscal year 2009 with a total return for education of $280.2 million, generating $265.5 million for the Lottery for Education Account and $14.7 million for the After-School Programs special account.

For the third straight year, the TEL achieved gross sales of over $1 billion. Additionally, in comparison to fiscal year 2008, gross sales increased by $22.9 million. Management attributes this upward trend to the following factors:

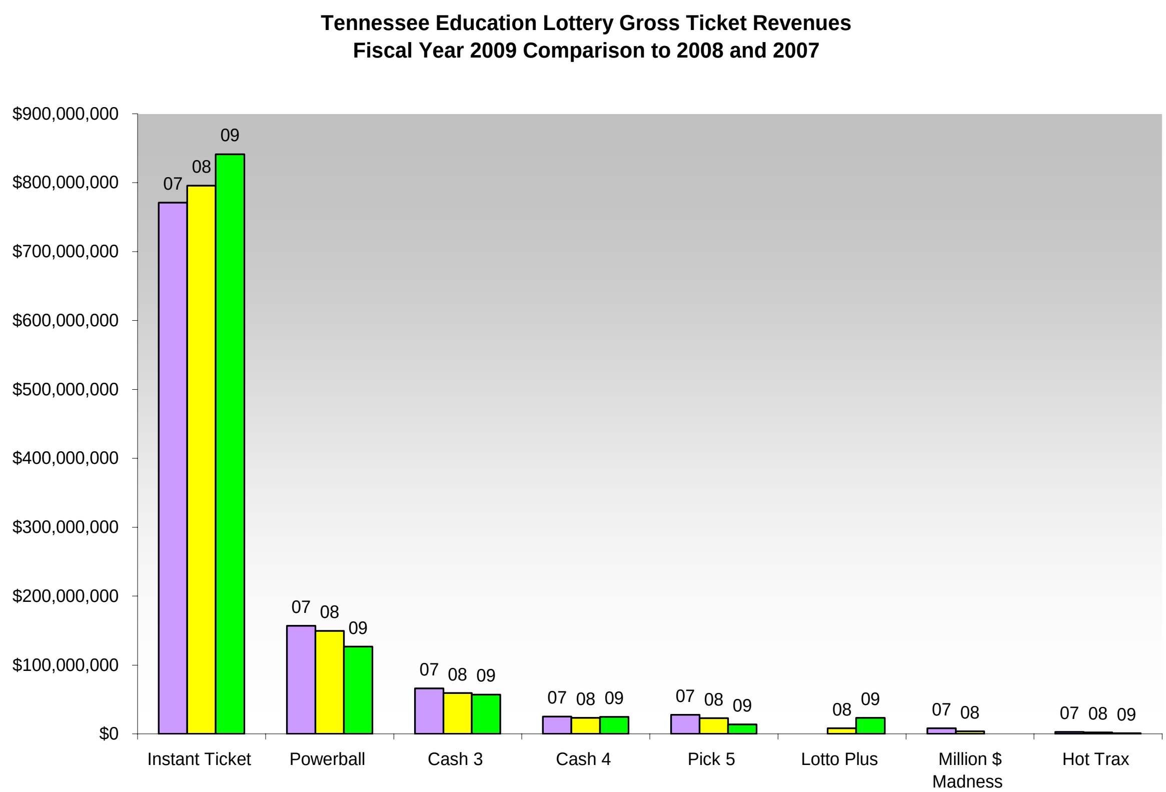
- Ongoing success of our instant ticket marketing strategy which continued to include launches of spotlight games (i.e., *Tennessee Millionaires' Club and 5th Anniversary Celebration*) that helped to boost instant ticket game sales by $45.6 million (6%);
- TEL's *Play It Again* second chance program continues to extend the sales period of our instant products, allowing our products to remain in the marketplace longer; and
- Experience of a full fiscal year's sales activity for our in-state, online jackpot game, Lotto Plus — as compared to only four (4) months of sales activity in fiscal year 2008 — which resulted in a $15.3 million increase in gross sales.

Fiscal year 2009 Cash 3 and Cash 4 sales remained relatively consistent with those of fiscal year 2008, experiencing a slight, combined decrease of 1%. Fostering this continuity was the implementation of two sales promotions, More Money and Lucky Sum, during fiscal year 2009. Overall, management believes these marketing strategies were effective in their aims of increasing prize availability and maintaining prize payouts, the primary drivers of Cash 3 and Cash 4 sales.

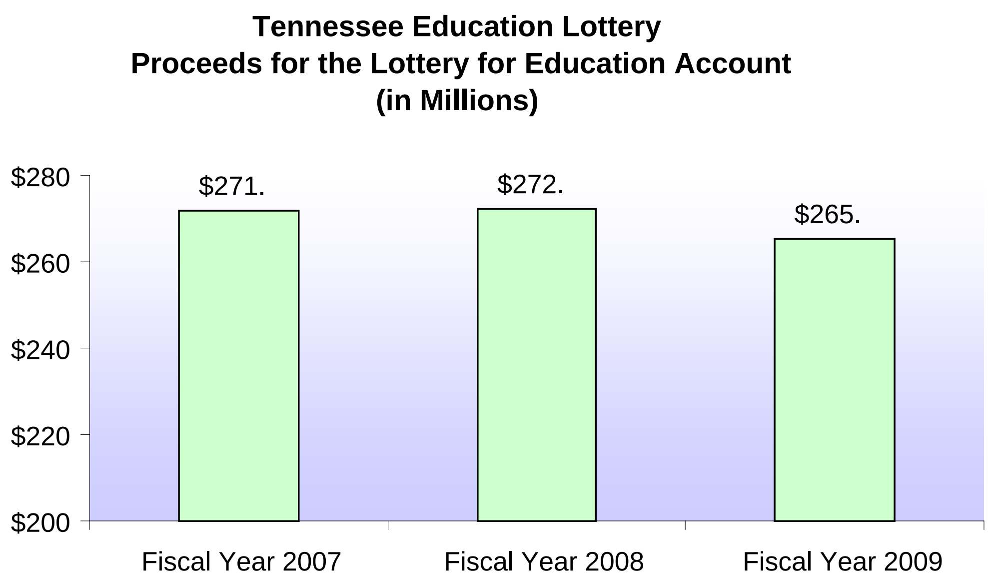
Pick 5, another jackpot driven game, saw ticket sales decline by 39% in fiscal year 2009. Management believes this decline reflects the residual impact of the fiscal year 2008 Lotto Plus launch on Pick 5 sales. More specifically, as player familiarity with Lotto Plus continued to grow, it was expected that many players would shift interest from Pick 5 to Lotto Plus (as it generally maintains a larger jackpot) and a corresponding sales decrease would occur. Nevertheless, consistent with fiscal year 2008, the success of Lotto Plus continued to diminish the lost sales of our Pick 5 game. Accordingly, when comparing the combined 2009 Pick 5 and Lotto Plus sales to combined 2008 Pick 5 and Lotto Plus, an increase of 21% was realized.

POWERBALL sales decreased by 15% in fiscal year 2009. POWERBALL sales are impacted by the size of the jackpots. In fiscal year 2009 we experienced two jackpot cycles of $200 million and $220 million, compared to two jackpots of $279 million and $300 million in fiscal year 2008.

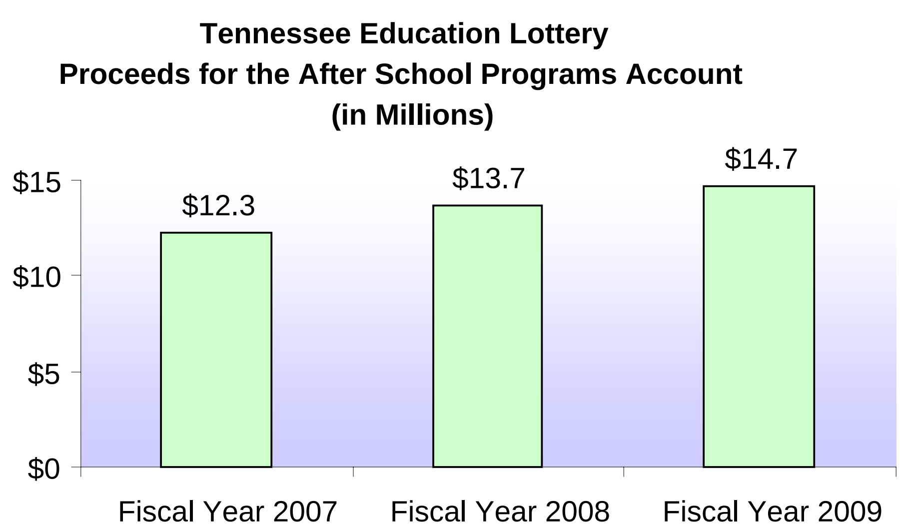
The Hottrax Champions game was discontinued in December 2008, due to declining sales and limited retailer support.



The TEL generated $265.5 million for the Lottery for Education Account in fiscal year 2009, compared to $272.4 million in fiscal year 2008 and $271.9 million in fiscal year 2007.



The amounts deposited 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 2009, the TEL generated $14.7 million for the After-School Programs special account as compared to $13.7 million in fiscal year 2008, and $12.3 million in fiscal year 2007. These amounts represented 100% of realized unclaimed prizes.



Condensed Statement of Net Assets

	June 30, 2009	Increase/ (Decrease)	June 30, 2008	Increase/ (Decrease)	June 30, 2007
Assets:					
Current assets					
Cash	$ 67,671,000	$ (867,000)	$ 68,538,000	$ 5,718,000	$ 62,820,000
Retailer accounts receivable, net	42,707,000	(5,150,000)	47,857,000	3,555,000	44,302,000
Other	6,496,000	(263,000)	6,759,000	(382,000)	7,141,000
Total current assets	116,874,000	(6,280,000)	123,154,000	8,891,000	114,263,000
Non-current assets					
Other	2,504,000	(32,000)	2,536,000	(41,000)	2,577,000
Capital assets, net	1,722,000	(366,000)	2,088,000	260,000	1,828,000
Total non-current assets	4,226,000	(398,000)	4,624,000	219,000	4,405,000
Total assets	**121,100,000**	**(6,678,000)**	**127,778,000**	**9,110,000**	**118,668,000**
Liabilities:					
Current liabilities					
Due to Lottery for Education Account	67,664,000	695,000	66,969,000	760,000	66,209,000
Due to After School Programs Account	14,666,000	942,000	13,724,000	3,288,000	10,436,000
Prizes payable	31,947,000	(7,144,000)	39,091,000	4,477,000	34,614,000
Accounts payable and accrued liabilities	2,504,000	(909,000)	3,413,000	345,000	3,068,000
Deferred liabilities	1,111,000	(32,000)	1,143,000	357,000	786,000
Total current liabilities	**117,892,000**	**(6,448,000)**	**124,340,000**	**9,227,000**	**115,113,000**
Non-current liabilities					
Non-current portion of other liabilities	3,208,000	(133,000)	3,341,000	(83,000)	3,424,000
Total non-current liabilities	3,208,000	(133,000)	3,341,000	(83,000)	3,424,000
Total liabilities	**121,100,000**	**(6,581,000)**	**127,681,000**	**9,144,000**	**118,537,000**
Net Assets					
Investment in capital assets	1,722,000	(366,000)	2,088,000	260,000	1,828,000
Unrestricted assets	(1,722,000)	366,000	(2,088,000)	(260,000)	(1,828,000)
Restricted assets	-	(97,000)	97,000	(34,000)	131,000
Total net assets	**$ -**	**$ (97,000)**	**$ 97,000**	**$ (34,000)**	**$ 131,000**

Overview of Financial Position

Assets

The $6.68 million decrease in total assets at June 30, 2009, primarily resulted from a decrease in Retailer Accounts Receivable due to the timing of collection of related balances.

As of the year ended June 30, 2008, the $9.11 million increase in total assets over fiscal year 2007 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.

Liabilities

The $6.58 million decrease in total liabilities at June 30, 2009, relates primarily to decreased prizes payable due to the timing of the receipt and payout of winning prize claims experienced during fiscal year 2009 as compared to fiscal year 2008.

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.

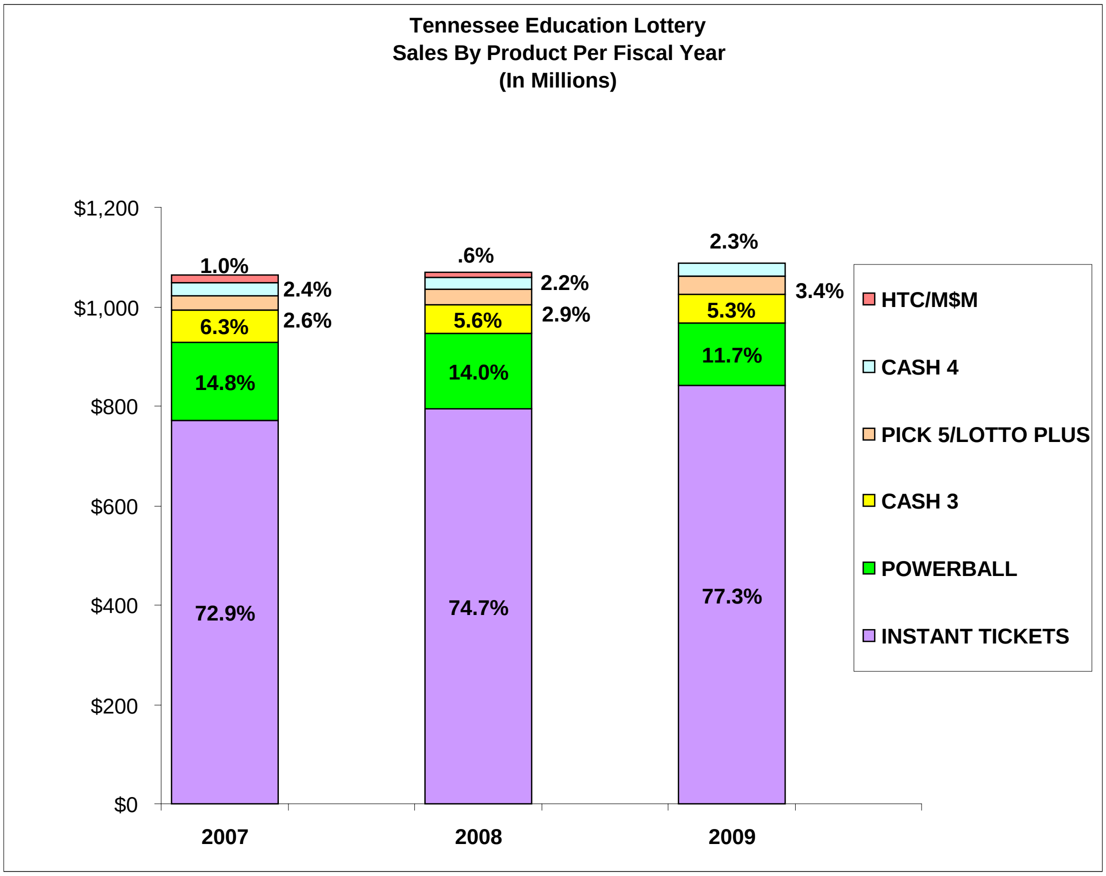
Condensed Statement of Revenues & Expenses

	June 30, 2009	Increase/ (Decrease)	June 30, 2008	Increase/ (Decrease)	June 30, 2007
Revenues:					
Instant games	$ 841,372,000	$ 45,578,000	$ 795,794,000	$ 24,669,000	$ 771,125,000
Online games	246,513,000	(22,652,000)	269,165,000	(17,842,000)	287,007,000
Less instant tickets provided as prizes	(72,453,000)	1,925,000	(74,378,000)	(904,000)	(73,474,000)
Games revenue, net	**1,015,432,000**	**24,851,000**	**990,581,000**	**5,923,000**	**984,658,000**
Bad debt recoveries/(expense), net	(496,000)	(291,000)	(205,000)	(428,000)	223,000
Retailer service fees	3,267,000	58,000	3,209,000	(58,000)	3,267,000
Interest income	1,263,000	(1,066,000)	2,329,000	234,000	2,095,000
Other revenue	642,000	149,000	493,000	(571,000)	1,064,000
Total revenues	**1,020,108,000**	**23,701,000**	**996,407,000**	**5,100,000**	**991,307,000**

Expenses:					
Cost of sales	724,822,000	29,008,000	695,814,000	3,596,000	692,218,000
General, administrative and other operating expenses	15,101,000	688,000	14,413,000	(336,000)	14,749,000
Other expenses	130,000	56,000	74,000	(187,000)	261,000
Proceeds to After School Program Account	14,666,000	942,000	13,724,000	1,414,000	12,310,000
Proceeds to Lottery for Education Account	265,486,000	(6,930,000)	272,416,000	447,000	271,969,000
Total expenses	**1,020,205,000**	**23,764,000**	**996,441,000**	**4,934,000**	**991,507,000**
Change in net assets	(97,000)	(63,000)	(34,000)	166,000	(200,000)
Total net assets, beginning of year	97,000	(34,000)	131,000	(200,000)	331,000
Total net assets, end of year	**$ -**	**$ (97,000)**	**$ 97,000**	**$ (34,000)**	**$ 131,000**

Revenues

Total gross lottery ticket sales for the fiscal years ended June 30, 2009, 2008, and 2007 were $1.088 billion, $1.065 billion, and $1.058 billion, respectively. The following chart depicts the distribution of sales by product for the three fiscal years ended June 30:



Gross instant ticket sales for 2009 grew to $841.37 million, which represents a 6% increase over 2008 instant ticket sales of $795.79 million. Gross instant ticket sales for 2008 of $795.79 million represented a 3% increase over 2007 instant sales of $771.13 million. Instant tickets represent approximately 77% of total gross sales in fiscal year 2009, approximately 75% in 2008 and approximately 73% in 2007. The year-over-year increase in gross instant ticket sales is attributed to the instant ticket marketing strategy which involves ongoing introduction of multiple spotlight games, including special themed games, and higher price point games with higher prize payouts. The games most popular with the players in 2009 were Jumbo Bucks, Giant Jumbo Bucks, Tennessee Millionaire's Club, Junior Jumbo Bucks, and $50 Million Cash Spectacular.

POWERBALL sales for the fiscal years 2009, 2008, and 2007 were $126.74 million, $149.49 million, and $156.85 million, respectively. These amounts represent approximately 12%, 14%, and 15% of gross ticket sales, respectively, for each fiscal year.

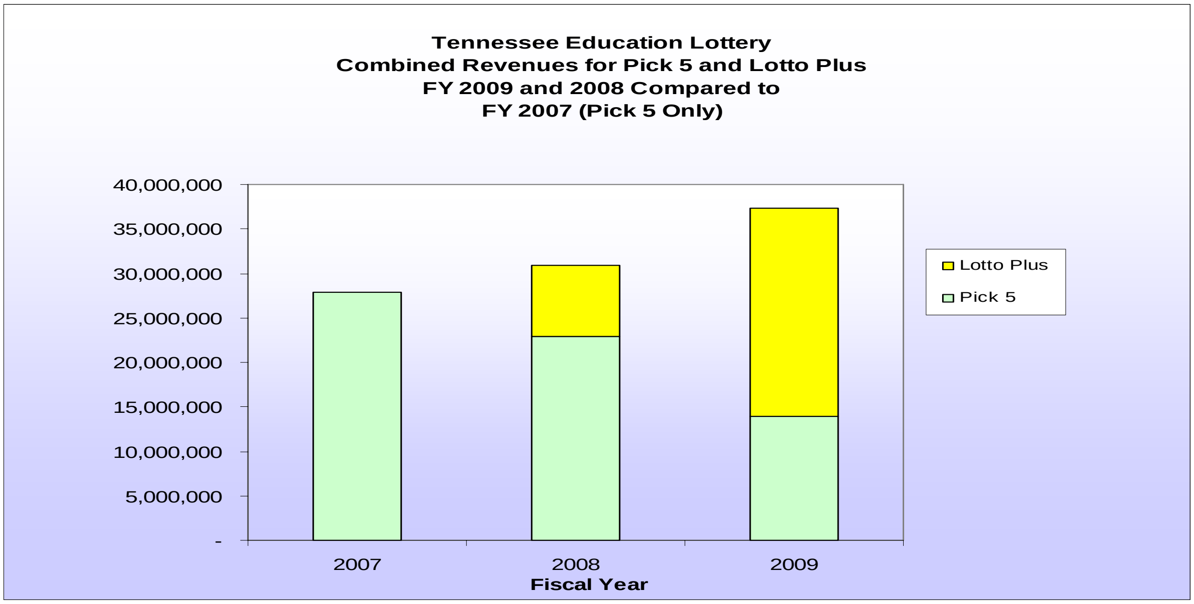
POWERBALL is a multi-jurisdictional lottery game operated in the following jurisdictions in addition to Tennessee: Arizona, Colorado, Connecticut, Delaware, District of Columbia, Florida, Idaho, Iowa, Indiana, Kansas, Kentucky, Louisiana, Maine, Minnesota, Missouri, Montana, Nebraska, New Hampshire,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

Cash 3 sales for fiscal years 2009, 2008, and 2007 were $57.19 million, $59.26 million, and $66.29 million. These amounts represent approximately 5%, 6%, and 6% of gross ticket sales, respectively, for each year. Average weekly sales for Cash 3 were approximately $1.1 million in 2009 and 2008, compared to $1.3 million in 2007.

Cash 4 sales were $24.5 million, $23.3 million, and $25.3 million in the years 2009, 2008, and 2007, respectively. Average weekly sales for Cash 4 were approximately $471 thousand, $449 thousand, and $486 thousand in 2009, 2008, and 2007, respectively.

Pick 5 sales were $13.9 million, $22.9 million and $27.8 million in the years 2009, 2008, and 2007, respectively. Average weekly sales for Pick 5 were approximately $267 thousand, $440 thousand, and $535 thousand in 2009, 2008, and 2007, respectively. The significant decrease in 2009 compared to 2008 was attributable to full-year sales of Lotto Plus and smaller jackpots in fiscal year 2009.

Lotto Plus, an online game, was introduced in March 2008. Sales were $23.4 million in 2009 and $8.1 million in 2008. Average weekly sales for Lotto Plus were approximately $450 thousand in 2009 and $509 thousand in 2008. The significant increase in 2009 compared to 2008 was primarily attributable to a full 12 months of sales in 2009.

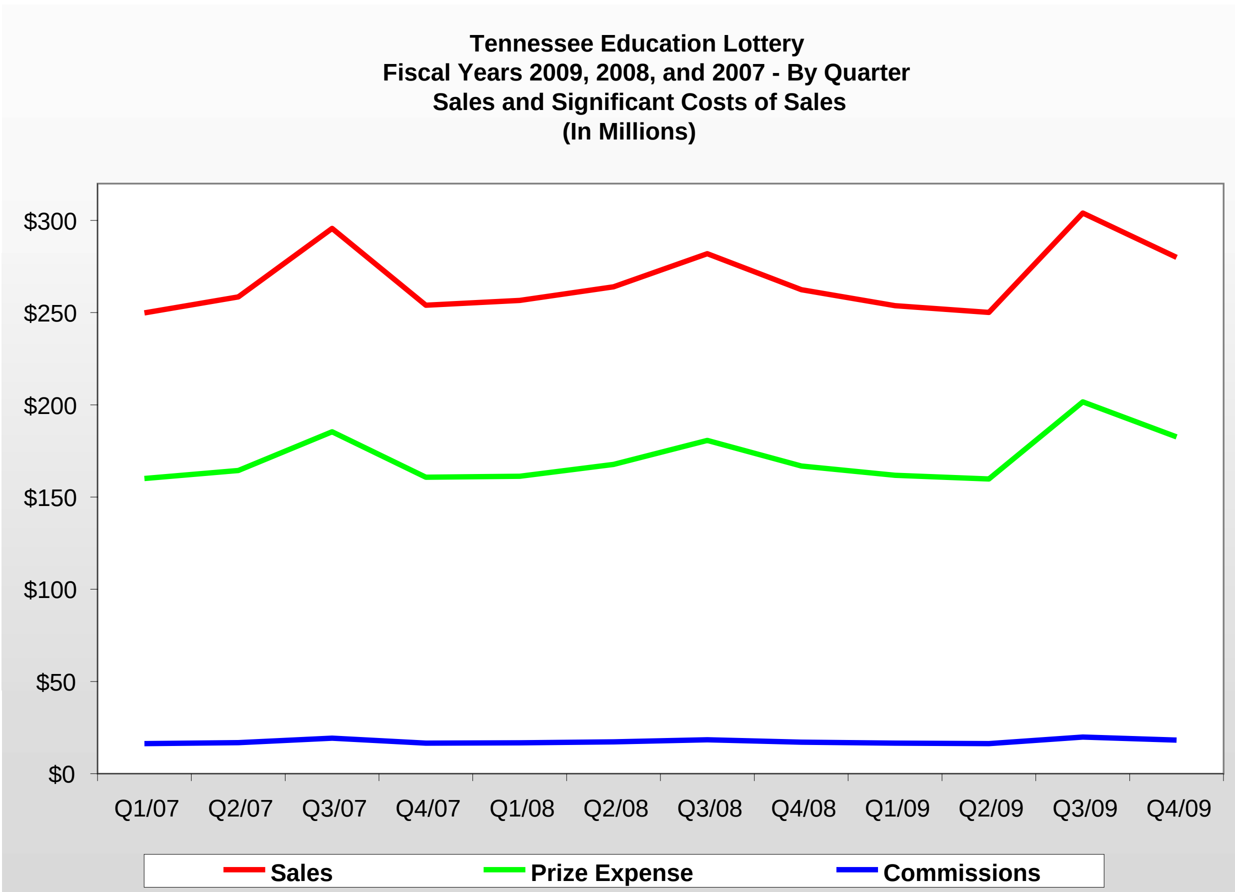


Hottrax Champions sales were $793 thousand in 2009, $2.3 million in 2008, and $2.7 million in 2007. This game was discontinued on December 31, 2008, due to declining sales and limited retailer support.

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. This game was not reopened in fiscal year 2009.

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:



Gross prize expense was $633.33 million, $602.28 million, and $597.23 million in the years 2009, 2008, and 2007, respectively. Increases of $31.05 million in 2009, and $5.05 million in 2008 are reflective of the increases in overall ticket sales realized in the related period.

Instant games prize expense is managed through the number of tickets printed for each game and value of prizes as determined prior to ticket production. Prize expense is recorded based on an established prize structure and related percentage of sales for each game introduced, and is recognized when products are made available for sale to the public. The aggregated prize payout for all instant games was 66% of instant game sales, net of free tickets for 2009 and 65% of instant game sales, net of free tickets for 2008 and 2007.

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 was recognized as tickets were sold by retailers in an amount equal to the proportionate share of the total value of available prizes. Upon completion of the game, gross prize expense was recorded as the amount equal to the total value of all prizes available for this online game.

Retailer commissions were $71.03 million, $69.57 million, and $69.16 million for the years ended June 30, 2009, 2008, and 2007, respectively. Consistent with the cost-driver relationship of ticket sales to retailer commissions, the increases of $1.46 million in 2009 and $410 thousand in 2008 are reflective of the increases in overall ticket sales realized in the related period.

Retailers are compensated a set commission percentage of 6.5% on all instant tickets settled and online tickets sold. They also receive an additional 1% bonus for cashing Cash 3 and Cash 4 ticket prizes below $600. Additionally, the TEL pays a $25,000 bonus to retailers selling a winning POWERBALL jackpot ticket and a $5,000 bonus to retailers selling any online game ticket where the prize won is equal to or greater than $1 million dollars. No POWERBALL jackpot ticket selling bonuses were paid during the last three fiscal years. Online game ticket selling bonuses equaling $45,000 were awarded for fiscal year 2009, whereas a total of $30,000 was earned in both fiscal years 2008 and 2007.

Contractor fees for fiscal years 2009, 2008, and 2007 were, respectively, $22.00 million, $21.35 million, and $20.97 million. 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. As compensation, the instant ticket vendor receives a contractually negotiated fee on the selling price of all instant ticket activations, whereas the online gaming vendor receives a contractually negotiated fee on the selling price of online tickets sold, and on instant ticket activations net of free instant tickets available as prizes.

Effective April 1, 2009, the instant ticket gaming contract was renegotiated to extend through April 9, 2015, and also to include a reduction of the contractor service fee from 1.139% to 1.07%. For fiscal year 2009, the related contractor was compensated at the rate of 1.139% for the fiscal period July 1, 2008, through March 31, 2009; and 1.07% for the fiscal period April 1, 2009, to June 30, 2009. The fee received for fiscal years 2008 and 2007 was 1.139%.

For fiscal years 2009, 2008, and 2007, the online gaming contractor was compensated at the rate of 1.24% of ticket sales, with an additional .6% received for Hottrax Champions ticket sales. Additionally, effective March 3, 2009, this contract was renegotiated to extend through April 9, 2015. Terms of this contract include the continuation of the contractor fee at 1.24%, as well as this vendor's agreement to provide, install, and maintain up to eight hundred (800) instant ticket vending machines (ITVMs) for the TEL.

Advertising costs incurred by the TEL were $10.48 million, $11.69 million, and $12.83 million for the fiscal years 2009, 2008, and 2007, respectively. These costs are significantly influenced by budget directives and constraints. On a continuous basis, management strives to achieve an optimal balance between these costs and obtained benefits. During fiscal year 2009, the TEL's $1.2 million decrease from the prior year resulted from implementation of several corporate-wide cost-saving initiatives. The 2008 $1.1 million decrease resulted primarily from a change in marketing strategy between print, radio, and television advertising.

General, Administrative and Other Operating Expenses

General, administrative, and other operating expenses were $15.23 million, $14.49 million, and $15.01 million for the years 2009, 2008, and 2007, respectively. For each of these years, the five (5) major expense components were personnel, property expenses, depreciation, telecommunications, and professional fees. These expenses do not change in direct proportion with revenues, but are instead significantly influenced by budget directives and constraints, and current business and economic conditions. In view of these factors, moderate variances in these expenses are expected to occur over fiscal periods. Nevertheless, to the most reasonable extent possible, TEL's management team works diligently to control these expenses to relatively consistent year-over-year amounts.

Potential Factors Impacting Future Results

The TEL's mission is to maximize revenues for the purpose of maximizing payments to the Lottery for Education Account. A continuous assessment of Tennessee's economic environment and the TEL's own product lines and operations is 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 implement promotional offerings to improve brand awareness and increase player participation in our online games.
- The TEL will continue to introduce new instant and online game product offerings, as well as consider the expansion of our licensed property games that are gaining nationwide popularity.
- The TEL will review the prize payout percentages for its instant game products to determine if revisions in the prize payout structures will result in higher actual net proceeds.

Contacting the TEL's Financial Management

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

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

TENNESSEE EDUCATION LOTTERY CORPORATION
STATEMENTS OF NET ASSETS
AS OF JUNE 30, 2009, AND JUNE 30, 2008

	June 30, 2009	June 30, 2008
ASSETS:		
CURRENT ASSETS:		
Cash (Note 2)	$ 67,671,000	$ 68,441,000
Restricted fidelity fund cash	-	97,000
Retailer accounts receivable, net	42,707,000	47,857,000
Prepaid expenses and other assets	6,392,000	6,655,000
Prize annuity investments (Note 3)	104,000	104,000
Total current assets	116,874,000	123,154,000
NONCURRENT ASSETS:		
Prepaid expenses and other assets	76,000	99,000
Prize annuity investments (Note 3)	2,428,000	2,437,000
Capital assets, net of depreciation of $3,167,000 and $2,605,000 (Note 4)	1,722,000	2,088,000
TOTAL ASSETS	121,100,000	127,778,000
LIABILITIES:		
CURRENT LIABILITIES:		
Due to Lottery for Education Account (Note 7)	67,664,000	66,969,000
Due to After School Programs Account (Note 8)	14,666,000	13,724,000
Prizes payable	31,843,000	38,987,000
Accounts payable	77,000	756,000
Prize annuities payable (Note 3)	104,000	104,000
Accrued liabilities	2,427,000	2,657,000
Deferred rent (Note 6)	61,000	67,000
Deferred revenue	1,050,000	1,076,000
Total current liabilities	117,892,000	124,340,000
NONCURRENT LIABILITIES		
Prize annuities payable (Note 3)	2,428,000	2,437,000
Accrued liabilities (Note 10)	105,000	141,000
Deferred rent (Note 6)	675,000	763,000
Total noncurrent liabilities	3,208,000	3,341,000
TOTAL LIABILITIES	121,100,000	127,681,000
NET ASSETS:		
Investment in capital assets	1,722,000	2,088,000
Unrestricted assets:		
Capital assets	(1,722,000)	(2,088,000)
Restricted assets:		
Restricted for uncollectible retailer receivables	-	97,000
TOTAL NET ASSETS	$ -	$ 97,000

See notes to financial statements.

TENNESSEE EDUCATION LOTTERY CORPORATION
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2009, AND JUNE 30, 2008

	June 30, 2009	June 30, 2008
OPERATING REVENUES:		
Ticket sales, net	$ 1,087,389,000	$ 1,064,754,000
Less instant/promotional tickets provided as prizes	(72,453,000)	(74,378,000)
Net ticket sales	1,014,936,000	990,376,000
Retailer service fees	3,267,000	3,209,000
Other	609,000	453,000
Net operating revenues	1,018,812,000	994,038,000
OPERATING EXPENSES:		
Available prizes	633,328,000	602,284,000
Current year actual unclaimed prizes (Note 8)	(14,666,000)	(13,724,000)
Net prizes	618,662,000	588,560,000
Retailer commissions and bonuses	71,032,000	69,568,000
Contractor fees	21,999,000	21,352,000
Advertising	10,483,000	11,681,000
Salaries and benefits	11,215,000	10,427,000
Retailer merchandising and marketing	2,646,000	4,653,000
Rent, utilities, and maintenance	1,842,000	1,826,000
Depreciation	786,000	668,000
Professional fees	364,000	536,000
General administrative and other operating	894,000	956,000
Total operating expenses	739,923,000	710,227,000
Operating income	278,889,000	283,811,000
NONOPERATING REVENUES (EXPENSES):		
Interest revenue	1,263,000	2,329,000
Retailer fees for future uncollectible retailer receivables	33,000	40,000
Fidelity fund retailer non-feasance recoupments (Note 1)	(130,000)	(74,000)
Proceeds to After School Programs Account (Note 8)	(14,666,000)	(13,724,000)
Proceeds to Lottery for Education Account (Note 7)	(265,486,000)	(272,416,000)
Total nonoperating revenues(expenses)	(278,986,000)	(283,845,000)
Change in Net Assets	(97,000)	(34,000)
NET ASSETS, beginning of year	97,000	131,000
NET ASSETS, end of year	$ -	$ 97,000

See notes to financial statements.

TENNESSEE EDUCATION LOTTERY CORPORATION
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2009, AND JUNE 30, 2008

	June 30, 2009	June 30, 2008
OPERATING ACTIVITIES:		
Cash received from customers	$ 1,020,071,000	$ 987,182,000
Other operating cash received	3,841,000	3,534,000
Cash paid for prizes	(625,688,000)	(583,930,000)
Cash paid to/on behalf of gaming vendors	(22,349,000)	(20,681,000)
Cash paid to retailers	(71,042,000)	(69,581,000)
Cash paid for advertising	(11,123,000)	(11,565,000)
Cash paid to/on behalf of employees	(11,056,000)	(11,050,000)
Other operating payments	(5,908,000)	(7,593,000)
Net cash provided by operating activities	276,746,000	286,316,000
NONCAPITAL FINANCING ACTIVITIES:		
Payments to Lottery for Education Account	(264,791,000)	(271,656,000)
Payments to After School Programs Account	(13,724,000)	(10,436,000)
Fidelity fund cash received from retailers	43,000	50,000
Fidelity fund cash refunded to retailers	(10,000)	(10,000)
Fidelity fund cash non-feasance recoupments	(130,000)	(74,000)
Net cash used in noncapital financing activities	(278,612,000)	(282,126,000)
CAPITAL AND RELATED FINANCING ACTIVITIES:		
Purchase of property and equipment	(300,000)	(952,000)
Proceeds from disposal of capital assets	36,000	151,000
Net cash used in capital and related financing activities	(264,000)	(801,000)
INVESTING ACTIVITIES:		
Interest income	1,263,000	2,329,000
Net cash provided by investing activities	1,263,000	2,329,000
NET CASH (USED IN)/PROVIDED BY ALL ACTIVITIES	(867,000)	5,718,000
CASH at beginning of year	68,538,000	62,820,000
CASH at end of year	$ 67,671,000	$ 68,538,000

Reconciliation of cash on the statement of net assets

	June 30, 2009	June 30, 2008
Cash	$ 67,671,000	$ 68,441,000
Restricted fidelity fund cash	-	97,000
Cash at end of year	$ 67,671,000	$ 68,538,000

See notes to financial statements.

TENNESSEE EDUCATION LOTTERY CORPORATION
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2009, AND JUNE 30, 2008

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

	June 30, 2009	June 30, 2008
Operating income	$ 278,889,000	$ 283,811,000
Adjustments to reconcile operating income to net cash provided by operating activities:		
Bad debt expense	496,000	280,000
Depreciation	786,000	668,000
Gain on disposal of capital assets	(36,000)	(127,000)
Changes in assets and liabilities:		
Retailer accounts receivable	4,653,000	(3,835,000)
Prepaids and other assets	286,000	403,000
Accounts payable and accrued liabilities	(1,064,000)	341,000
Prizes payable	(7,144,000)	4,477,000
Deferred rent	(94,000)	(60,000)
Deferred revenue	(26,000)	358,000
Net cash provided by operating activities	$ 276,746,000	$ 286,316,000

NONCASH INVESTING ACTIVITIES:

	June 30, 2009	June 30, 2008
Increase in fair value of prize annuity investments	$ 147,000	$ 136,000

See notes to financial statements.

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Description of Reporting Entity – Effective June 11, 2003, the Tennessee Education Lottery Implementation Law (the "Act"), Section 4-51-101 et seq., *Tennessee Code Annotated*, was signed into law, creating the Tennessee Education Lottery Corporation (the "TEL"). Pursuant with the Act, the TEL was incorporated in the State of Tennessee as a body, politic and corporate, and a quasi-public instrumentality.

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

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

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

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

On January 20, 2004, the TEL began lottery ticket sales. During the years ended June 30, 2009 and 2008, the TEL's lottery sales included a variety of instant ticket games and seven terminal-based online ticket games: Cash 3, Cash 4, Pick 5, Lotto Plus, Powerball, Hottrax Champions, and Million Dollar Madness. Hottrax Champions was officially closed during the year ended June 30, 2009. Also, Million Dollar Madness, a raffle style game, was offered and concluded in fiscal year 2008.

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 was recognized as tickets were sold by retailers. Online games may include a promotional period that provides one free ticket with the sale of a specified online game. The selling price of the free promotional online ticket reduces the respective games' gross revenues when the qualifying ticket is sold to the player.

Revenues are presented net of Bad Debt Expense.

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

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

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

Lottery proceeds are collected weekly from retailer bank accounts established in trust for the TEL. Amounts not collected upon the established collection date are deemed delinquent. Delinquent accounts are reviewed periodically by TEL management. Accounts outstanding more than 180 days from the most recent date of delinquency or date of last payment are considered doubtful. At June 30, 2009 and 2008, the Allowance for Doubtful Accounts was $430 thousand and $187 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.

Fidelity Fund – In accordance with Section 4-51-118 (a), *Tennessee Code Annotated*, 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, 2009, and June 30, 2008, $130 thousand and $74 thousand, respectively, were used to cover losses incurred as a result of uncollected accounts of TEL retailers.

At the end of each fiscal year, fidelity funds exceeding $500,000 may be treated as net proceeds from the TEL subject to deposit to the Lottery for Education Account. As of the years ended June 30, 2009 and 2008, there were no fidelity funds available for deposit as net proceeds.

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

The TEL will pay a 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 $1 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 $1 million dollars. The current bonus amount is $5,000.

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

On-Line Game	2009	2008
Powerball	$ 25,000	$ 5,000
Lotto Plus	20,000	5,000
Million $ Madness	-	20,000
Total Retailer Bonuses	**$ 45,000**	**$ 30,000**

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 4,780 instant and online retailer ticket terminals and associated software. In accordance with its contract, GTECH receives the negotiated fee on the selling price of online tickets sold, and on instant ticket activations net of free tickets available as prizes. During fiscal years 2009 and 2008, GTECH was compensated at the rate of 1.24% for all online and instant ticket game sales, with an additional .6% license fee paid on Hottrax Champions tickets sold.

Effective March 3, 2009, the TEL renegotiated its contract with GTECH to extend through April 9, 2015. Terms of this contract include the continuation of the contractor service fee rate of 1.24%, as well as GTECH's agreement to provide, install, and maintain up to eight hundred (800) instant ticket vending machines (ITVMs) for the TEL.

SGI prints, warehouses, and distributes the instant game tickets to retailers. In accordance with its contract, SGI receives the negotiated fee on the selling price of all instant ticket activations. Effective April 1, 2009, the TEL renegotiated its contract with SGI to extend through April 9, 2015, and also to include a reduction of the contractor service fee from 1.139% to 1.07%. For the fiscal year ended June 30, 2009, SGI was compensated at the rate of 1.139% for the fiscal period through March 31, 2009, and 1.07% for the fiscal period April 1, 2009, to June 30, 2009. The fee received for the year ended June 30, 2008, was 1.139%.

Prizes – In accordance with the Act, as nearly as practical, at least 50% of ticket proceeds must be made available as prize money. Gross prize expense for instant ticket sales is recognized based on a predetermined prize structure for each game in accordance with the approved game working papers when tickets are activated for sale. Gross prize expense for Cash 3, Cash 4, Pick 5, and Lotto Plus is recognized based on industry average or historical payout experience when tickets are actually sold. Additionally, gross prize expense was similarly recognized for Hottrax Champions during the years ended June 30, 2009 and 2008.

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, 2009, and June 30, 2008, there were no grand prize winners in Tennessee.

Gross prize expense for Million $ Madness was recognized as the total value of all prizes available for the online game. As of the year ended June 30, 2008, gross prize expense for Million $ Madness was recognized in the amount of $4,163,300.

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, 2009 and 2008, 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, 2009, additional insurance coverage was provided at the following maximum amounts:

Coverage	**2009**
Employee Fidelity	$ 500,000
Automobile/Property	1,000,000
Workers' Compensation	1,000,000
Employment Practices	5,000,000
General Liability/Umbrella	5,000,000

Over the past three fiscal years, in the ordinary course of business, the TEL has filed 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).

(2) CASH

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, 2009 and 2008, TEL's bank balances of approximately $1.131 million and $1.341 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 $67.0 million and $67.6 million at June 30, 2009 and 2008, respectively. The LGIP is part of the State Pooled Investment Fund. The fund is not rated by a nationally recognized statistical rating organization. The fund's investment policy and required risk disclosures are presented in the *State of Tennessee Treasurer's Report*. That report is available on the state's website at http://www.tn.gov/treasury/ or by calling (615) 741-2956.

(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, 2009, and June 30, 2008. The annuity purchased from Aviva was, respectively, rated A excellent and A+ superior by A.M. Best as of June 30, 2009, and June 30, 2008.

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, 2009, and June 30, 2008.

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, 2009 and 2008, the TEL respectively deferred $147 thousand and $136 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, 2009:

	Beginning Balance	Increases	Decreases	Ending Balance
Furniture and fixtures	$ 900,000	$ 1,000	$ -	$ 901,000
Computer equipment	410,000	34,000	(37,000)	407,000
Vehicles	200,000	-	-	200,000
High Mileage Vehicles - Vans	962,000	182,000	(184,000)	960,000
Leasehold improvements	347,000	-	(3,000)	344,000
Communication equipment	879,000	-	-	879,000
Software	479,000	152,000	-	631,000
Gaming equipment	516,000	51,000	-	567,000
Total capital assets	4,693,000	420,000	(224,000)	4,889,000
Less accumulated depreciation	(2,605,000)	(786,000)	224,000	(3,167,000)
Total capital assets, net	**$ 2,088,000**	**$ (366,000)**	**$ -**	**$ 1,722,000**

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**

(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 2017. 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, 2009, and June 30, 2008.

In addition, the TEL subleases office space under operating leases expiring through 2011 to The Buntin Group, and through 2014 to GTECH and SGI.

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:	2009	2008
2009	$ -	$ 2,046,000
2010	2,246,000	1,506,000
2011	1,627,000	1,200,000
2012	1,584,000	1,188,000
2013	1,490,000	1,178,000
2014	1,056,000	785,000
2015 and thereafter	219,000	-
Total minimum rental payments	**$ 8,222,000**	**$ 7,903,000**

Minimum rental payments at June 30, 2009 and 2008 have not been reduced by minimum sublease rentals of $941 thousand and $1.1 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:	2009	2008
2009	$ -	$ 185,000
2010	208,000	197,000
2011	208,000	197,000
2012	197,000	197,000
2013	197,000	197,000
2014	131,000	131,000
Total minimum sublease payments	**$ 941,000**	**$ 1,104,000**

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:

	2009	2008
Minimum rentals:		
Property	$ 1,431,000	$ 1,371,000
Billboards	995,000	1,213,000
Less: Sublease rentals	(196,000)	(195,000)
Total minimum rentals	**$ 2,230,000**	**$ 2,389,000**

(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, 2009, total deferred rent of $736,000 consisted of $285,000 related to rent abatements and $451,000 to the straight-lining of rental expense over the life of the related lease terms.

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.

(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, 2009, and June 30, 2008, are summarized as follows:

	2009	2008
Operating revenues:		
Ticket sales (Net)	$1,087,389,000	$1,064,754,000
Less instant tickets provided as prizes	(72,453,000)	(74,378,000)
Net ticket sales	1,014,936,000	990,376,000
Service fees and other revenue	3,876,000	3,662,000
Total lottery proceeds	1,018,812,000	994,038,000
Operating expenses, as defined:		
Gaming	739,488,000	709,538,000
Operating	15,101,000	14,413,000
Total operating expenses, as defined	754,589,000	723,951,000
Net proceeds before distribution of unrestricted net assets	264,223,000	270,087,000
Non-operating revenue and expenses		
Interest income	1,263,000	2,329,000
Total non-operating revenue and expenses	1,263,000	2,329,000
Net proceeds	$265,486,000	$272,416,000
Amount due to Lottery for Education Account for year	265,486,000	272,416,000
Amount paid during year	(197,822,000)	(205,447,000)
Amount due to Lottery for Education Account, end of year	$67,664,000	$66,969,000

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

(8) DUE TO AFTER SCHOOL PROGRAMS ACCOUNT

In accordance with the Act, at the end of each fiscal year, one hundred percent of any unclaimed prize money shall be deposited in the After School Program 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 2009, unclaimed prizes were $14,666,000, which was current and payable to the After School Programs Account at June 30, 2009.

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.

All amounts due at the end of each fiscal year were deposited 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, 2009 and 2008, employees contributed approximately $403,000 and $432,000, respectively to the 457 Plan.

The aggregate fair value of the plan's assets was approximately $1,667,000 and $1,717,000, net of administrative fees, as of June 30, 2009 and 2008, 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 $630,000 and $622,000 to the 401(a) Plan on behalf of its employees in the years ended June 30, 2009 and 2008, respectively. Of these contributions, approximately $27,000 and $88,000 were forfeited by separated employees as of June 30, 2009, and June 30, 2008, 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, 2009 and 2008, forfeited amounts of approximately $58,000 and $53,000, 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 $2,375,000 and $2,413,000, net of forfeitures and administrative fees, as of June 30, 2009 and 2008, 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, 2009, is estimated using historical trends. At June 30, 2009 and 2008, the estimated current portion of the compensated absences liability was $365 thousand and $263 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 40 hours of separation pay for every year of employment with TEL. The TEL accrued $191 thousand and $140 thousand for employment separation obligations for each of the years ending June 30, 2009 and 2008, respectively.

(10) LONG-TERM LIABILITIES

Long-term liabilities consisted of the following as of June 30, 2009:

	Beginning Balance	**Increases**	**Decreases**	**Ending Balance**	**Due within one year**
Prize Annuities Payable	$2,541,000	$147,000	$(156,000)	$2,532,000	$104,000
Compensated Absences	404,000	536,000	(470,000)	470,000	365,000
Deferred Rent	830,000	5,000	(99,000)	736,000	61,000
Total long-term liabilities	$3,775,000	$688,000	$(725,000)	$3,738,000	$530,000

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

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

(11) COMMITMENTS AND CONTINGENCIES

Legal – The TEL is subject to litigation in the ordinary course of its business. In the opinion of management and legal counsel, the outcome of such litigation will not have a material impact on the financial position or cash flows of the TEL. Furthermore, as of the year ended June 30, 2009, management is not aware of any related liabilities.