AUDIT REPORT

Tennessee Education Lottery Corporation

For the Year Ended
June 30, 2011

STATE OF TENNESSEE

COMPTROLLER OF THE TREASURY

Department of Audit

Division of State Audit

TENNESSEE
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STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
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January 30, 2012

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

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Tennessee Education Lottery Corporation for the year ended June 30, 2011. 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/rs
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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, 2011

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, 2011

TABLE OF CONTENTS

TABLE OF CONTENTS (CONT.)

Tennessee Education Lottery Corporation
For the Year Ended June 30, 2011

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 to 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, 2011, TEL had launched a total of 294 instant ticket games and 9 online games: Cash 3, Cash 4, Tennessee Cash, Pick 5, Lotto Plus, Hottrax Champions, Million $ Madness, Powerball, and MegaMillions. 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 moneys 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;
- legislative affairs;
- corporate services; and
- internal controls.

The Legal Division includes

- Human Resources–manages all personnel functions;
- Legal Services–provides legal advice and assistance to management and the board of directors, serves as the corporate record keeper, oversees litigation, and manages contract compliance
- Security–responsible for physical and intellectual property security; and
- Retailer Contract Administration–manages all functions of retailer applications and contracts.

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

- Sales and Marketing–manages all sales activity and field marketing;
- Retailer Sales and Services–provides all facets of customer service for retailer network;
- Corporate Accounts–manages corporate office relationships;
- Promotions and Special Events–promotes the TEL at a variety of functions throughout the state;
- Warehouse Management and Distribution; and
- District Offices–manages the TEL’s four district offices.

The Division of Finance and Information Systems is responsible for the following:

- financial, product, and customer accounting;
- prize validation and statutory and financial reporting;
- cash management, budgeting, accounts receivable, and procurement;
- game drawings, including online and second-chance instant games and drawing activities;
- 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, 2010, through June 30, 2011, 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, 2011, and for comparative purposes, the year ended June 30, 2010. 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

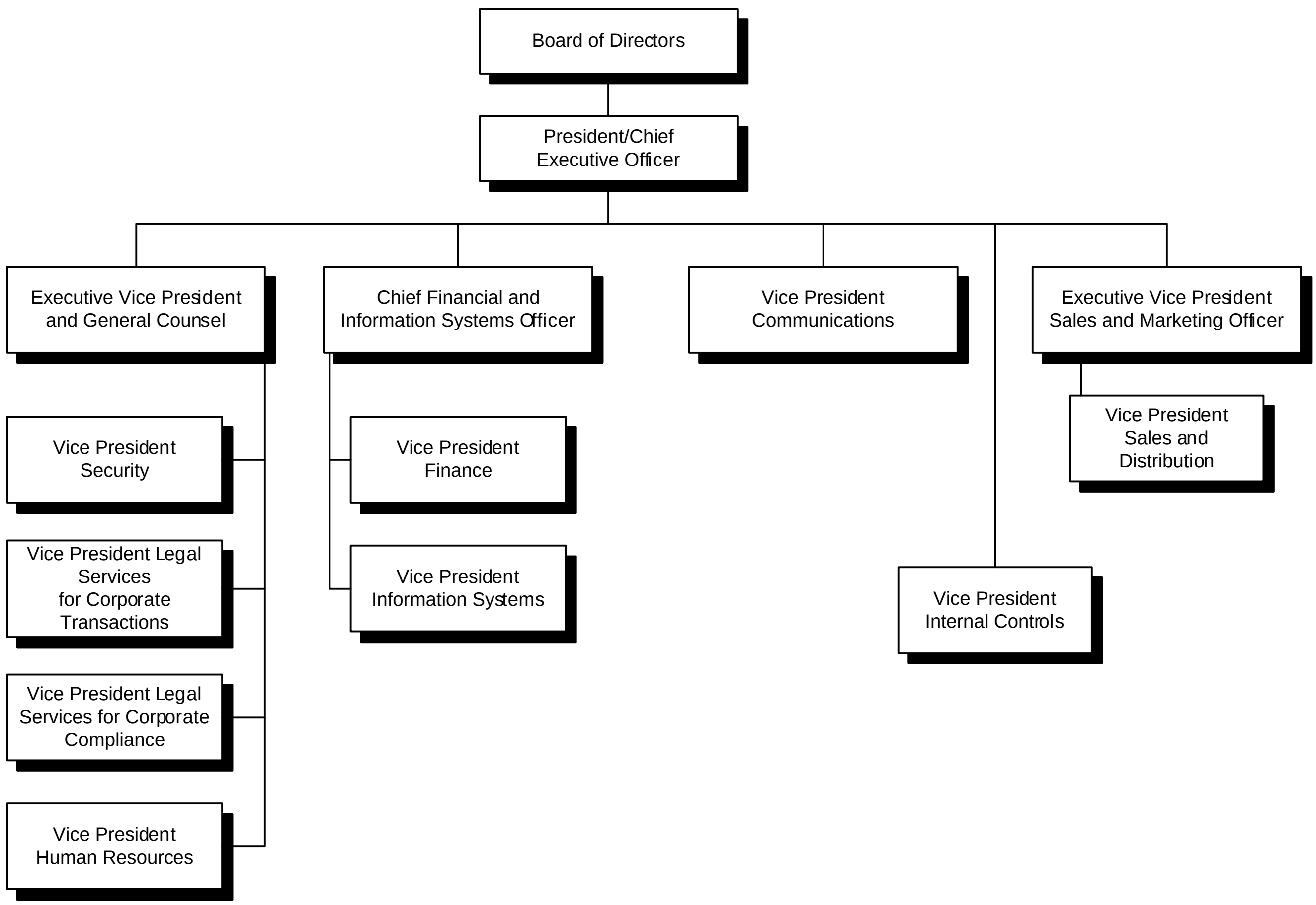
1. to consider the corporation's internal control over financial reporting as a basis for designing auditing procedures for the purpose of expressing an opinion on the financial statements;

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.

Tennessee Education Lottery Corporation
Organization Chart



PRIOR AUDIT FINDINGS

There were no findings in the prior audit report.

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, 2011, 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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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 17, 2011

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

Ladies and Gentlemen:

We have audited the 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, 2011, and have issued our report thereon dated November 17, 2011. 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

Management of the Tennessee Education Lottery Corporation is responsible for establishing and maintaining effective 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 *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 financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, 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 its 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, management, and others within the corporation 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/rs

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500
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Independent Auditor's Report

November 17, 2011

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

Ladies and Gentlemen:

We have audited the accompanying statements of net assets of the Tennessee Education Lottery Corporation, a component unit of the State of Tennessee, as of June 30, 2011, and June 30, 2010, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the corporation's management. Our responsibility is to express an opinion on these financial statements, based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the 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, 2011, and June 30, 2010, 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 23 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 17, 2011, on our consideration of the corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with generally accepted government auditing standards and should be considered in assessing the results of our audit.

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes, Jr., CPA
Director

AAH/rs

The Tennessee Education Lottery Corporation ("TEL") offers the following Management's 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, 2011 and 2010, with comparative information presented for the fiscal year ended June 30, 2009. The overview should be considered in conjunction with the independent auditor's report, the accompanying audited financial statements, and notes to the financial statements.

Understanding the TEL's Financial Statements

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

The financial statements are comprised of three components:

- The Statements of Net Assets – Reflects the TEL's financial position at June 30, 2011, and June 30, 2010.
- 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, 2011, and June 30, 2010.
- 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, 2011, and June 30, 2010.

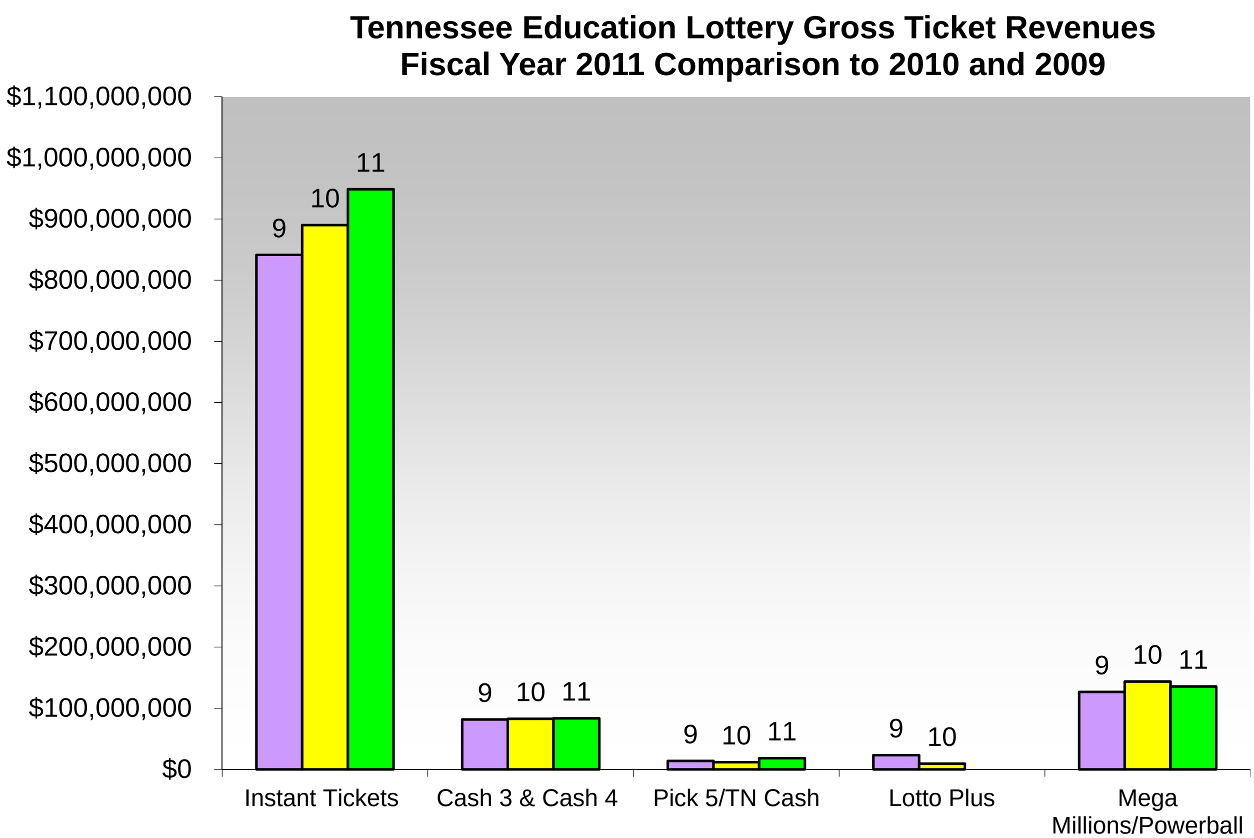
The Notes to the Financial Statements document additional information essential for readers to gain a comprehensive understanding of the data provided in the TEL's financial statements.

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

Fiscal Year 2011 Financial Highlights

Despite the challenges of a sluggish economy, the TEL set a new record for the fiscal year ended June 30, 2011, raising an all-time high of $293.5 million for education programs in the state of Tennessee. An increase of $4.6 million over last year's record transfer, this brings the total generated for education since ticket sales began in January 2004, to $2.07 billion!

Driving this increase in funds transferred to education was another record-setting achievement of nearly $1.2 billion in total gross sales. This marked an impressive $48.3 million (4.2%) increase over the previous fiscal year, not to mention the fifth straight year that the TEL has reached gross sales of over $1 billion. Overall, total gross ticket sales since inception have surpassed a substantial $7.8 billion!



As in recent prior years, upward movement in instant ticket sales was the primary factor fueling our sales growth. Management attributes this to the effectiveness of its instant ticket marketing strategy which emphasizes offering more, as well as a broader spectrum of, games and prizes to lottery players. Accordingly, the TEL continued to launch new instant ticket games at varying price points during each month of fiscal year 2011. As added variety to its traditionally themed games, the TEL also introduced several licensed property games [i.e., *Trucks & Bucks ($5), The Price Is Right ($5), Tennessee Titans ($5),* and *Orange Crush ($2)*] and spotlight games [i.e., *$2 Million Bonanza ($20)* and *Lottery TN Black ($10)*]. In February 2011, the TEL added Lady Jumbo Bucks ($3) to the popular "Jumbo Bucks" family of instant ticket games. Additionally, available prizes, varying among a wide range of cash and non-cash prizes (automobiles, destination trips offering more prize-winning opportunities, season tickets, etc.), increased by $36.1 million (6.7%). Ultimately, under this promotional approach, annual instant ticket sales were up by over $58.4 million (6.6%).

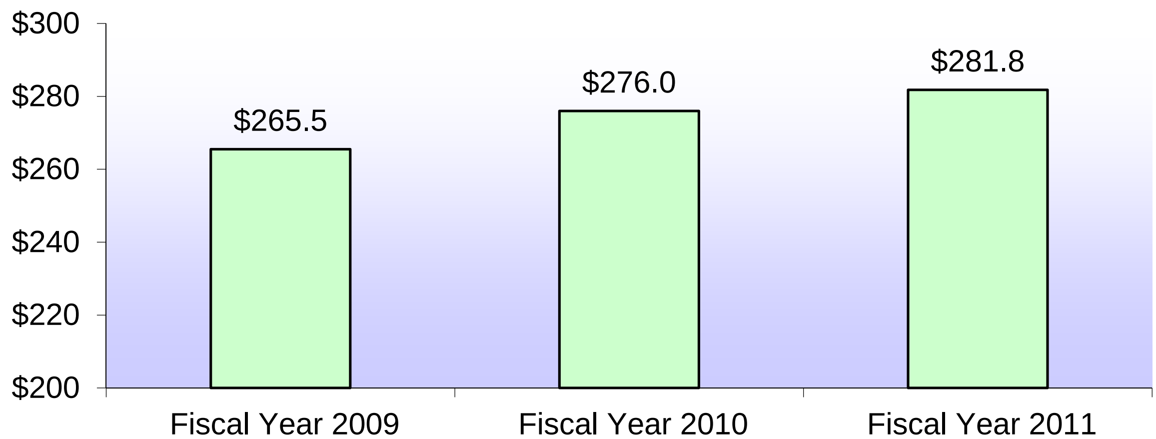
Cash 3 and Cash 4 sales in fiscal year 2011 remained relatively consistent with those of fiscal year 2010.

In October 2010, Pick 5 was discontinued and replaced with the new in-state, cash jackpot game, Tennessee Cash. The Tennessee Cash game gives players an additional opportunity to win prizes as well as offering higher average jackpot payouts than its predecessor. As a result of this change, combined Pick 5 and Tennessee Cash gross ticket sales grew to $18.5 million from the prior year Pick 5 gross ticket sales of $11.9 million – a $6.6 million (55.5%) increase.

In January 2010, the TEL ended the Lotto Plus game in order to shift focus to the January 31st introduction of the multijurisdictional jackpot game, Mega Millions. Along with Powerball, this game gives Tennessee players the opportunity to play large jackpot games four times each week. Both Mega Millions and Powerball sales are driven by the size of jackpots; specifically, as the jackpot increases, ticket sales tend to trend upwards as well. Sales for Powerball declined in 2011 by 30%. This decrease is directly related to lower average jackpots compared to fiscal year 2010. Mega Millions sales were $45.3 million in 2011, and were driven by two jackpot cycles exceeding $300 million.

The TEL generated $281.8 million for the Lottery for Education Account in fiscal year 2011, compared to $276.0 million in fiscal year 2010 and $265.5 million in fiscal year 2009.

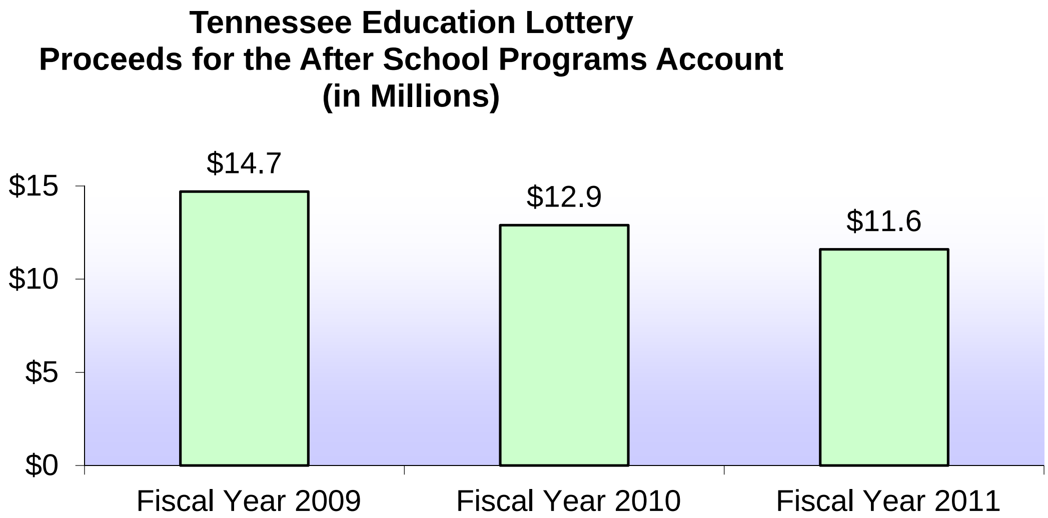
Tennessee Education Lottery
Proceeds for the Lottery for Education Account
(in Millions)



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

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

In fiscal year 2011, the TEL recognized $11.6 million for the After-School Programs special account as compared to $12.9 million in fiscal year 2010, and $14.7 million in fiscal year 2009.



Condensed Statement of Net Assets

Assets:	**June 30, 2011**	**Increase/ (Decrease)**	**June 30, 2010**	**Increase/ (Decrease)**	**June 30, 2009**
Current assets					
Cash	$ 66,414,000	$ (1,908,000)	$ 68,322,000	$ 651,000	$ 67,671,000
Retailer accounts receivable, net	53,510,000	5,804,000	47,706,000	4,999,000	42,707,000
Other	7,008,000	521,000	6,487,000	(9,000)	6,496,000
Total current assets	126,932,000	4,417,000	122,515,000	5,641,000	116,874,000
Noncurrent assets					
Other	2,345,000	48,000	2,297,000	(207,000)	2,504,000
Capital assets, net	1,020,000	(339,000)	1,359,000	(363,000)	1,722,000
Total noncurrent assets	3,365,000	(291,000)	3,656,000	(570,000)	4,226,000
Total assets	**130,297,000**	**4,126,000**	**126,171,000**	**5,071,000**	**121,100,000**
Liabilities:					
Current liabilities					
Due to Lottery for Education Account	70,281,000	(1,385,000)	71,666,000	4,002,000	67,664,000
Due to After-School Programs Account	11,644,000	(1,250,000)	12,894,000	(1,772,000)	14,666,000
Prizes payable	40,897,000	6,595,000	34,302,000	2,355,000	31,947,000
Accounts payable and accrued liabilities	3,632,000	(27,000)	3,659,000	1,155,000	2,504,000
Deferred liabilities	992,000	226,000	766,000	(345,000)	1,111,000
Total current liabilities	127,446,000	4,159,000	123,287,000	5,395,000	117,892,000

Noncurrent liabilities					
Noncurrent portion of other liabilities	2,850,000	(27,000)	2,877,000	(331,000)	3,208,000
Total noncurrent liabilities	2,850,000	(27,000)	2,877,000	(331,000)	3,208,000
Total liabilities	**130,296,000**	**4,132,000**	**126,164,000**	**5,064,000**	**121,100,000**
Net assets:					
Investment in capital assets	1,020,000	(339,000)	1,359,000	(363,000)	1,722,000
Unrestricted assets	(1,020,000)	339,000	(1,359,000)	363,000	(1,722,000)
Restricted assets	1,000	(6,000)	7,000	7,000	-
Total net assets	**$ 1,000**	**$ (6,000)**	**$ 7,000**	**$ 7,000**	**$ -**

Overview of Financial Position

Assets
The $4.13 million increase in total assets at June 30, 2011, and the $5.07 million increase in total assets at June 30, 2010, were primarily due to the noted increase in lottery ticket sales for the related fiscal years and the subsequent timing of collection of the relevant Retailer Accounts Receivable balances.

Liabilities
The $4.13 million increase in total liabilities at June 30, 2011, relates primarily to increased fiscal year sales and thus accordingly, more prizes payable to players.

The $5.06 million increase in total liabilities at June 30, 2010, related primarily to increased fiscal year 2010 ticket sales, resulting in higher net proceeds payable to the Lottery for Education Account, and more prizes payable to players.

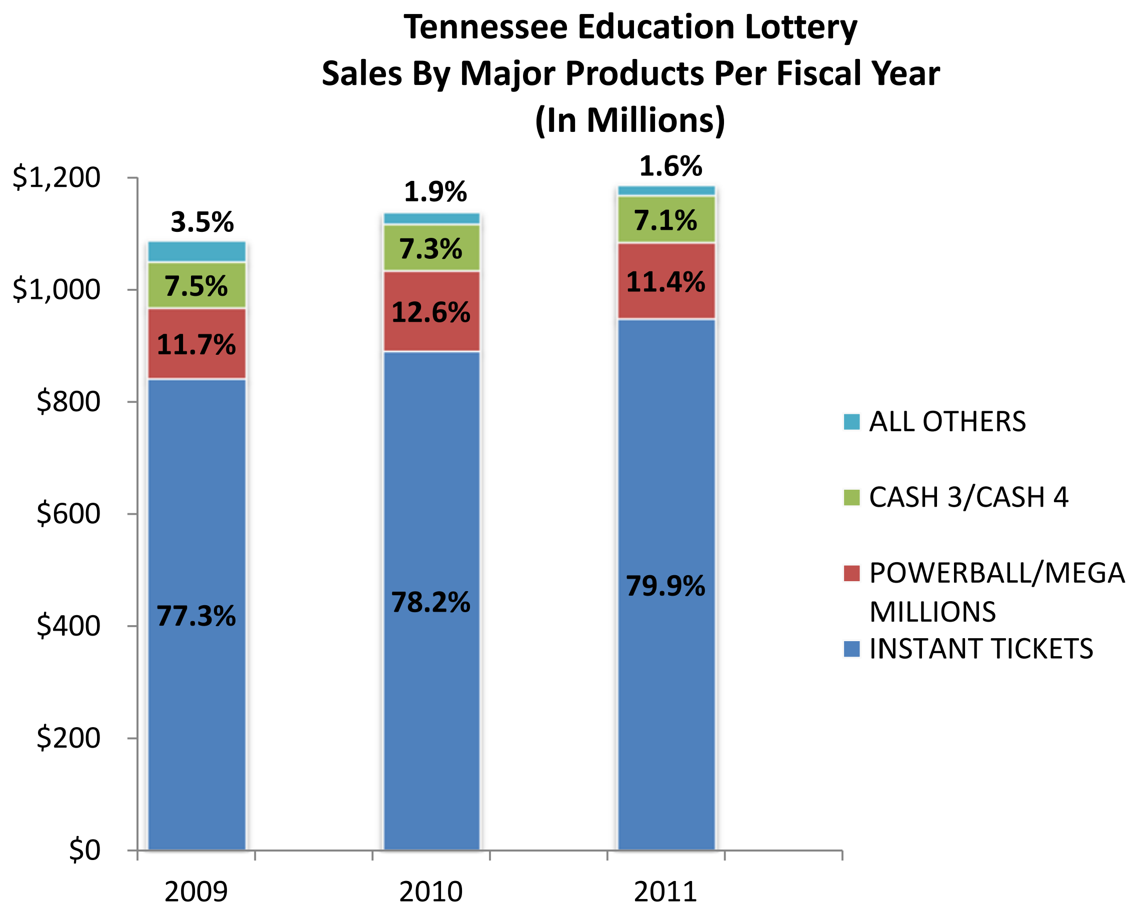
Condensed Statement of Revenues and Expenses

	Year Ended June 30, 2011	Increase/ (Decrease)	Year Ended June 30, 2010	Increase/ (Decrease)	Year Ended June 30, 2009
Revenues:					
Instant games	$ 948,710,000	$ 58,437,000	$ 890,273,000	$ 48,901,000	$ 841,372,000
Online games	237,847,000	(10,270,000)	248,117,000	1,604,000	246,513,000
Less instant/promotional tickets provided as prizes	(83,978,000)	(6,068,000)	(77,910,000)	(5,457,000)	(72,453,000)
Games revenue, net	**1,102,579,000**	**42,099,000**	**1,060,480,000**	**45,048,000**	**1,015,432,000**
Bad debt recoveries/ (expense), net	(239,000)	135,000	(374,000)	122,000	(496,000)
Retailer service fees	3,396,000	(14,000)	3,410,000	143,000	3,267,000

Interest income	110,000	(101,000)	211,000	(1,052,000)	1,263,000
Other revenue	639,000	143,000	496,000	(146,000)	642,000
Total revenues	**1,106,485,000**	**42,262,000**	**1,064,223,000**	**44,115,000**	**1,020,108,000**
Expenses:					
Cost of sales	797,490,000	36,951,000	760,539,000	35,717,000	724,822,000
General, administrative and other operating expenses	15,461,000	695,000	14,766,000	(335,000)	15,101,000
Other expenses	50,000	12,000	38,000	(92,000)	130,000
Proceeds to After-School Programs Account	11,644,000	(1,250,000)	12,894,000	(1,772,000)	14,666,000
Proceeds to Lottery for Education Account	281,846,000	5,867,000	275,979,000	10,493,000	265,486,000
Total expenses	**1,106,491,000**	**42,275,000**	**1,064,216,000**	**44,011,000**	**1,020,205,000**
Change in net assets	(6,000)	(13,000)	7,000	104,000	(97,000)
Total net assets, beginning of year	7,000	7,000	-	(97,000)	97,000
Total net assets, end of year	**$ 1,000**	**$ (6,000)**	**$ 7,000**	**$ 7,000**	**$ -**

Revenues

Gross lottery ticket sales for the fiscal years ended June 30, 2011, 2010, and 2009 were $1.187 billion, $1.138 billion, and $1.088 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 2011 grew to $948.7 million, which represents a 6.6% increase over 2010 instant ticket sales of $890.3 million. Gross instant ticket sales for 2010 of $890.3 million represented a 5.8% increase over 2009 instant sales of $841.4 million. Instant tickets represent approximately 80% of total gross sales in fiscal year 2011, approximately 78% in 2010 and approximately 77% in 2009. The year over year increase in gross instant ticket sales is attributed to the instant ticket marketing strategy which involves ongoing introduction of multiple games, including special themed games, and higher price point games with higher prize payouts. The games most popular with the players in 2011 were Jumbo Bucks, Giant Jumbo Bucks, Junior Jumbo Bucks, Millionaire Jumbo Bucks, Lady Jumbo Bucks, Lucky 7's and Tennessee Millionaire's Club.

Powerball sales for the fiscal years 2011, 2010, and 2009 were $90.4 million, $127.9 million, and $126.7 million, respectively. These amounts represent approximately 8%, 11%, and 12% 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, Arkansas, Colorado, Connecticut, Delaware, District of Columbia, Florida, Idaho, Iowa, Indiana, Kansas, Kentucky, Louisiana, Maine, Minnesota, Missouri, Montana, Nebraska, New Hampshire, New Mexico, North Carolina, North Dakota, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, South Dakota, US Virgin Islands, Vermont, Wisconsin, and West Virginia. On January 31, 2010, Powerball began cross-selling tickets in 10 Mega Millions states. Those states were Georgia, Illinois, Maryland, Massachusetts, Michigan, New Jersey, New York, Texas, Virginia, and Washington.

Mega Millions is a multi-jurisdictional lottery game administered by a lottery consortium group. The group includes the following state lotteries: California, Georgia, Illinois, Maryland, Massachusetts, Michigan, New Jersey, New York, Ohio, Texas, Virginia, and Washington. Tennessee and certain other MUSL lottery members are authorized to sell the Mega Millions game by the consortium as part of a cross-sell agreement. Tennessee began sales for the game in January 2010. Sales for fiscal years 2011 and 2010 were $45.3 million and $15.9 million, respectively. This amount represents 4% and 1% of gross ticket sales, respectively, for each of the fiscal years 2011 and 2010.

Cash 3 sales for fiscal years 2011, 2010, and 2009 were $58.1 million, $57.2 million, and $57.2 million, respectively. These amounts represent approximately 5% of gross ticket sales for each of the noted fiscal years.

Cash 4 sales were $25.5 million, $25.6 million, and $24.5 million in the years 2011, 2010, and 2009, respectively. These amounts represent approximately 2% of gross ticket sales for each of the noted fiscal years.

Tennessee Cash, an online, jackpot driven game, was introduced on October 3, 2010. Ticket sales for 2011 were $16 million.

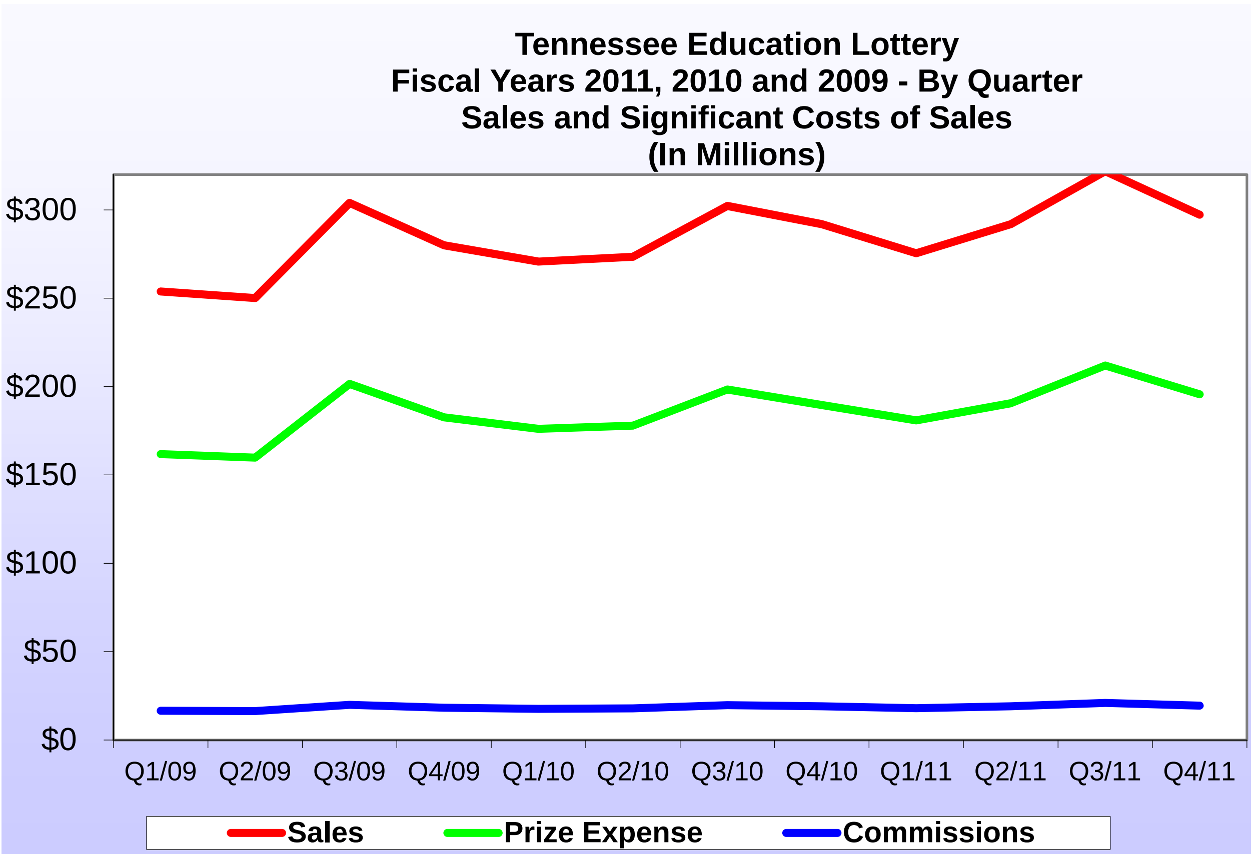
Pick 5 sales were $2.5 million, $11.9 million, and $13.9 million in the years 2011, 2010, and 2009, respectively. The significant decrease in fiscal year 2011 sales is reflective of the discontinuance of the game in October 2010. The $2 million decrease in 2010 sales compared to 2009 sales was attributable to smaller jackpot cycles occurring in fiscal year 2010 as compared to the prior year.

Lotto Plus, a TEL online game, was ended in January 2010, due to the declining profitability and the conflicting draw schedule with Mega Millions. Sales were $9.5 million and $23.4 million in 2010 and 2009, respectively.

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

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 $695.1 million, $664.0 million, and $633.3 million in the years 2011, 2010, and 2009, respectively. Increases of $31.1 million in 2011 and $30.7 million in 2010 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 66.6%, 66.4%, and 66.1% of instant game sales, net of free tickets for 2011, 2010, and 2009, respectively.

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. The aggregated prize payout for all online drawing style games were 50.2%, 50.1%, and 50.6% for 2011, 2010, and 2009, respectively

Retailer commissions were $77.5 million, $74.3 million, and $71.0 million for the years ended June 30, 2011, 2010, and 2009, respectively. Consistent with the cost driver relationship of ticket sales to retailer commissions, the increases of $3.2 million in 2011, and $3.3 million in 2010, 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. Additionally, the TEL will pay a bonus of $25,000 to a retailer who sells a single jackpot winning ticket for Powerball or Mega Millions; however, if there are multiple winning Powerball or Mega Millions jackpot winning tickets sold in Tennessee in a single drawing, the $25,000 selling bonus will be proportionately divided among the respective retailers based on the number of winning tickets sold by the retailer. The TEL will also pay a $5,000 bonus to retailers selling any online game ticket where the prize won is equal to or greater than $1 million. No Powerball or Mega Millions jackpot ticket selling bonuses were paid during the last three fiscal years. Online game ticket selling bonuses equaling $50,000, $60,000, and $45,000 were awarded for fiscal years 2011, 2010, and 2009, respectively.

Contractor fees for fiscal years 2011, 2010, and 2009, were $23.8 million, $22.6 million, and $22.0 million, respectively. 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 years 2011 and 2010, the related contractor was compensated at the rate of 1.07%. The fee received for fiscal year 2009 was 1.139% for the period July 1, 2008, through March 31, 2009, and 1.07% for the period April 1, 2009, through June 30, 2009.

For fiscal years 2011, 2010, and 2009, the online gaming contractor was compensated at the rate of 1.24% of ticket sales. For fiscal year 2009, the contractor also earned an additional .6% on 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 $9.4 million, $9.4 million, and $10.5 million for the fiscal years 2011, 2010, and 2009, respectively. These costs are significantly influenced by budget directives and constraints, as well as correlated to sales revenue. On a continuous basis, management strives to achieve an optimal balance between these costs and obtained benefits while keeping these costs relatively consistent with prior year amounts. As such, 2011 and 2010 amounts reflect continuation of the TEL's cost-saving initiatives implemented subsequent to fiscal year 2009.

General, Administrative, and Other Operating Expenses

General, administrative, and other operating expenses were $15.46 million, $14.80 million, and $15.23 million for the fiscal years 2011, 2010, and 2009, respectively. For each of these years, the five (5) major expense components were depreciation, personnel, professional fees, property and telecommunications expenses. These expenses do not change in direct proportion with revenues, but are instead significantly influenced by budget directives and constraints and current business and economic conditions. In view of these factors, moderate variances in these expenses are expected to occur over fiscal periods. Nevertheless, to the most reasonable extent possible, TEL's management team works diligently to control these expenses to 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 are essential to accomplish this mission. The following considerations have been presented to inform those interested in the TEL's operations about factors that could potentially affect future results:

- The TEL will continue to implement promotional offerings to improve brand awareness and increase player participation in our games.

- The TEL will continue to introduce new and/or enhanced 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 continually review the prize payout percentages for its instant game products to ensure we are receiving the highest actual net proceeds for each game and/or price point category.

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

Exhibit A

TENNESSEE EDUCATION LOTTERY CORPORATION
STATEMENTS OF NET ASSETS
AS OF JUNE 30, 2011, AND JUNE 30, 2010

	June 30, 2011	June 30, 2010
ASSETS		
CURRENT ASSETS:		
Cash (Note 2)	$ 66,413,000	$ 68,315,000
Restricted fidelity fund cash	1,000	7,000
Retailer accounts receivable, net	53,510,000	47,706,000
Prepaid expenses and other assets	6,904,000	6,383,000
Prize annuity investments (Note 3)	104,000	104,000
Total current assets	126,932,000	122,515,000
NONCURRENT ASSETS:		
Prepaid expenses and other assets	35,000	56,000
Prize annuity investments (Note 3)	2,310,000	2,241,000
Capital assets, net of depreciation of $4,149,000 and $3,802,000 (Note 4)	1,020,000	1,359,000
Total noncurrent assets	3,365,000	3,656,000
TOTAL ASSETS	130,297,000	126,171,000
LIABILITIES		
CURRENT LIABILITIES		
Due to Lottery for Education Account (Note 7)	70,281,000	71,666,000
Due to After-School Programs Account (Note 8)	11,644,000	12,894,000
Prizes payable	40,793,000	34,198,000
Accounts payable	173,000	50,000
Prize annuities payable (Note 3)	104,000	104,000
Accrued liabilities (Note 10)	3,459,000	3,609,000
Deferred rent (Note 6)	61,000	61,000
Deferred revenue	931,000	705,000
Total current liabilities	127,446,000	123,287,000
NONCURRENT LIABILITIES:		
Prize annuities payable (Note 3)	2,310,000	2,241,000
Accrued liabilities (Note 10)	181,000	119,000
Deferred rent (Note 6)	359,000	517,000
Total noncurrent liabilities	2,850,000	2,877,000
TOTAL LIABILITIES	130,296,000	126,164,000
NET ASSETS		
Investment in capital assets	1,020,000	1,359,000
Unrestricted assets:		
Capital assets	(1,020,000)	(1,359,000)
Restricted assets:		
Restricted for uncollectible retailer receivables	1,000	7,000
TOTAL NET ASSETS	$ 1,000	$ 7,000

See notes to financial statements.

Exhibit B

TENNESSEE EDUCATION LOTTERY CORPORATION
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2011, AND JUNE 30, 2010

	Year Ended June 30, 2011	Year Ended June 30, 2010
OPERATING REVENUES:		
Ticket sales, net	$ 1,186,318,000	$ 1,138,016,000
Less instant/promotional tickets provided as prizes	(83,978,000)	(77,910,000)
Net ticket sales	1,102,340,000	1,060,106,000
Retailer service fees	3,396,000	3,410,000
Other	594,000	451,000
Net operating revenues	1,106,330,000	1,063,967,000
OPERATING EXPENSES:		
Available prizes	695,149,000	664,042,000
Current year actual unclaimed prizes (Note 8)	(11,644,000)	(12,894,000)
Net prizes	683,505,000	651,148,000
Retailer commissions and bonuses	77,457,000	74,331,000
Contractor fees	23,794,000	22,638,000
Advertising	9,393,000	9,378,000
Salaries and benefits	11,755,000	11,134,000
Retailer merchandising and marketing	3,341,000	3,044,000
Rent, utilities, and maintenance	1,659,000	1,730,000
Depreciation	740,000	769,000
Professional fees	346,000	262,000
General administrative and other operating	961,000	871,000
Total operating expenses	812,951,000	775,305,000
Operating income	293,379,000	288,662,000
NONOPERATING REVENUES (EXPENSES):		
Interest revenue	110,000	211,000
Retailer fees for future uncollectible retailer receivables	45,000	45,000
Fidelity fund retailer non-feasance recoupments (Note 1)	(50,000)	(38,000)
Proceeds to After-School Programs Account (Note 8)	(11,644,000)	(12,894,000)
Proceeds to Lottery for Education Account (Note 7)	(281,846,000)	(275,979,000)
Total nonoperating revenues (expenses)	(293,385,000)	(288,655,000)
Change in net assets	(6,000)	7,000
NET ASSETS, beginning of year	7,000	-
NET ASSETS, end of year	$ 1,000	$ 7,000

See notes to financial statements.

Exhibit C

TENNESSEE EDUCATION LOTTERY CORPORATION
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2011, AND JUNE 30, 2010

	Year Ended June 30, 2011	Year Ended June 30, 2010
OPERATING ACTIVITIES:		
Cash received from customers	$ 1,096,798,000	$ 1,054,805,000
Other operating cash received	3,934,000	3,815,000
Cash paid for prizes	(677,295,000)	(648,850,000)
Cash paid to/on behalf of gaming vendors	(23,701,000)	(22,567,000)
Cash paid to retailers	(77,467,000)	(74,304,000)
Cash paid for advertising	(9,938,000)	(8,554,000)
Cash paid to/on behalf of employees	(11,563,000)	(10,898,000)
Other operating payments	(6,285,000)	(5,992,000)
Net cash provided by operating activities	294,483,000	287,455,000
NONCAPITAL FINANCING ACTIVITIES:		
Payments to Lottery for Education Account	(283,231,000)	(271,977,000)
Payments to After-School Programs Account	(12,894,000)	(14,666,000)
Fidelity fund cash received from retailers	50,000	49,000
Fidelity fund cash refunded to retailers	(6,000)	(4,000)
Fidelity fund cash non-feasance recoupments	(50,000)	(38,000)
Net cash used in noncapital financing activities	(296,131,000)	(286,636,000)
CAPITAL AND RELATED FINANCING ACTIVITIES:		
Purchase of property and equipment	(409,000)	(406,000)
Proceeds from disposal of capital assets	39,000	27,000
Net cash used in capital and related financing activities	(370,000)	(379,000)
INVESTING ACTIVITIES:		
Interest income	110,000	211,000
Net cash provided by investing activities	110,000	211,000
NET CASH PROVIDED/(USED) BY ALL ACTIVITIES	(1,908,000)	651,000
CASH at beginning of year	68,322,000	67,671,000
CASH at end of year	$ 66,414,000	$ 68,322,000

Reconciliation of cash on the statement of net assets

Cash	$ 66,413,000	$ 68,315,000
Restricted fidelity fund cash	1,000	7,000
Cash at end of year	$ 66,414,000	$ 68,322,000

See notes to financial statements.

TENNESSEE EDUCATION LOTTERY CORPORATION
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2011, AND JUNE 30, 2010

	Year Ended June 30, 2011	Year Ended June 30, 2010
RECONCILIATION OF NET OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating income	$ 293,379,000	$ 288,662,000
Adjustments to reconcile operating income to net cash provided by operating activities:		
Bad debt expense	239,000	374,000
Depreciation	740,000	769,000
Gain on disposal of capital assets	(34,000)	(25,000)
Changes in assets and liabilities:		
Retailer accounts receivable	(6,044,000)	(5,372,000)
Prepaids and other assets	(500,000)	29,000
Accounts payable and accrued liabilities	40,000	1,166,000
Prizes payable	6,595,000	2,355,000
Deferred rent	(158,000)	(158,000)
Deferred revenue	226,000	(345,000)
Net cash provided by operating activities	$ 294,483,000	$ 287,455,000
NONCASH INVESTING ACTIVITIES:		
(Decrease) increase in fair value of prize annuity investments	$ 225,000	$ (31,000)

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"), *Tennessee Code Annotated*, Sections 4-51-101, et.seq., was signed into law, creating the Tennessee Education Lottery Corporation (the "TEL"). Pursuant with the Act, the TEL was incorporated in the State of Tennessee as a body, politic and corporate, and a quasi-public instrumentality.

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

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

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

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

On January 20, 2004, the TEL began lottery ticket sales. During the years ended June 30, 2011 and 2010, the TEL's lottery sales included a variety of instant ticket games and online, terminal-based, ticket games: Cash 3, Cash 4, Pick 5, Lotto Plus, Tennessee Cash, Powerball, and Mega Millions. Effective January 31, 2010, Lotto Plus was ended, and Mega Millions, a multi-state jackpot game, was added to the TEL's online game offerings. Also, on October 1, 2010, Pick 5 was discontinued and replaced with the in-state jackpot game, Tennessee Cash.

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

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

Revenue Recognition - Lottery games are sold to the public by contracted retailers. Revenue is recognized for instant games when retailers make them available for sale to the public, as indicated by the retailers' activation of tickets.

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

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

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

Revenues are presented net of bad debt expense.

Net Assets - Net assets represent cumulative revenues less expenses and required beneficiary program payments in accordance with the Act (see Notes 7 and 8). Net assets include funds invested in capital assets, restricted assets, and unrestricted 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, 2011 and 2010, the Allowance for Doubtful Accounts was $270 thousand and $471 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 *Tennessee Code Annotated*, Section 4-51-118 (a), TEL retailers are assessed a one-time fidelity fund fee of $50. Fidelity fund proceeds are held in a demand deposit account at Citizens Bank and are classified as restricted fidelity fund cash on the Statement of Net Assets. These funds may be used to cover losses incurred as a result of the nonfeasance, malfeasance, or misfeasance of TEL retailers. During the years ended June 30, 2011, and June 30, 2010, $50 thousand and $38 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 June 30, 2011 and 2010, there were no fidelity funds available for deposit as net proceeds.

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

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

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

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

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

On-Line Game	2011	2010
Powerball	$ 30,000	$ 40,000
Mega Millions	10,000	5,000
Tennessee Cash	10,000	-
Lotto Plus	-	15,000
Total Retailer Bonuses	**$ 50,000**	**$ 60,000**

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 4,800 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 2011 and 2010, GTECH was compensated at the rate of 1.24% for all online and instant ticket game sales.

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%. During the years ended June 30, 2011 and 2010, SGI was compensated at the rate of 1.07% for all instant ticket activations.

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

Powerball and Mega Millions prizes are shared based on contributions made to the prize pool by all member lotteries of the Powerball Group and the Mega Millions Group of the Multi-State Lottery Association ("MUSL"). All Powerball and Mega Millions grand prizes won by players who purchase tickets in Tennessee are funded from pooled contributions by all participating lottery states. The contributions are held by MUSL in trust for the TEL and are paid, at the option of the prize winner, in either a lump-sum, or thirty (30) annual installments for Powerball and twenty-six (26) annual payments for Mega Millions. Lump-sum payments are discounted to present value, as calculated by MUSL for the Powerball game and the Mega Millions Consortium Group for the Mega Millions game. For the years ended June 30, 2011, and June 30, 2010, there were no grand prize winners in Tennessee.

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

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

Contingencies - The TEL is subject to various claims and contingencies related to litigation, fines and penalties, assessments and other matters arising out of the normal course of business. Liabilities related to contingencies are recognized when a loss is probable and reasonably estimable. As of June 30, 2011 and 2010, 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.

Risk Management - Effective July 31, 2005, the TEL became a member of the Risk Management Fund, an internal service fund of the State of Tennessee. The Risk Management Fund allocates the cost of providing claims servicing and claims payment by charging a premium to the TEL based on a percentage of the TEL's expected loss costs which include both experience and exposures. 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, 2011, additional insurance coverage was provided at the following maximum amounts:

Coverage	2011
Employee Fidelity	$ 500,000
Automobile/Property	$ 1,000,000
Workers' Compensation	$ 1,000,000
Employment Practices	$ 5,000,000
General Liability/Umbrella	$ 5,000,000

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

Nonoperating Revenues and Expenses - Revenues and expenses resulting from activities not directly associated with the sale of lottery tickets are reflected as nonoperating revenues and expenses.

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

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

(2) CASH

A significant portion of TEL's deposits are in a financial institution that participates in the bank collateral pool administered by the State Treasurer. The securities pledged to protect these accounts are pledged in the aggregate rather than against each individual account. The members of the pool may be required by agreement to pay an assessment to cover any deficiency. Under this additional assessment agreement, public fund accounts covered by the pool are considered to be insured for purposes of credit risk disclosure. At June 30, 2011 and 2010, bank balances of approximately $1.477 million and $1.866 million, respectively, were insured by the bank collateral pool.

For the years ended June 30, 2011 and 2010, bank balances of approximately $22,000 were also maintained in a demand deposit account that was insured by the Federal Deposit Insurance Corporation for up to a maximum of $250,000.

The TEL also has deposits in the Local Government Investment Pool (LGIP) administered by the State Treasurer. The TEL's deposits with the LGIP were approximately $65.3 million and $66.7 million at June 30, 2011 and 2010, 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, 2011, and June 30, 2010. The annuity purchased from Aviva was rated A (Excellent) by A.M. Best as of June 30, 2011, and June 30, 2010.

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 June 30, 2011, and June 30, 2010.

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. For the years ended June 30, 2011 and 2010, the fair market value of the prize annuity investments respectively increased by $225 thousand and decreased by $31 thousand.

(4) CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2011, consisted of the following:

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

Capital asset activity for the year ended June 30, 2010, consisted of the following:

	Beginning Balance	Increases	Decreases	Ending Balance
Furniture and fixtures	$ 901,000	$ 2,000	$ -	$ 903,000
Computer equipment	407,000	31,000	(2,000)	436,000
Vehicles	200,000	78,000	(17,000)	261,000
High mileage vehicles - vans	960,000	173,000	(117,000)	1,016,000
Leasehold improvements	344,000	57,000	-	401,000
Communication equipment	879,000	12,000	-	891,000
Software	631,000	55,000	-	686,000
Gaming equipment	567,000	-	-	567,000
Total capital assets	4,889,000	408,000	(136,000)	5,161,000
Less accumulated depreciation	(3,167,000)	(769,000)	134,000	(3,802,000)
Total capital assets, net	**$ 1,722,000**	**$ (361,000)**	**$ (2,000)**	**$ 1,359,000**

(5) LEASING ARRANGEMENTS

The TEL's leasing arrangements consist of non-cancelable operating leases for office space, outdoor advertising billboards, and related equipment that expire at various dates through 2018. Certain of these leases contain provisions for scheduled rental increases and are renewable at the option of the TEL. No options were exercised during the year ended June 30, 2011, and one option was exercised during the year ended June 30, 2010.

In addition, the TEL subleases office space under operating leases expiring through 2014 to its major vendors.

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	2011	2010
2011	$ -	$ 2,259,000
2012	2,562,000	1,932,000
2013	2,099,000	1,755,000
2014	1,372,000	1,079,000
2015	323,000	223,000
2016	129,000	153,000
2017 and thereafter	383,000	-
Total minimum rental payments	**$ 6,868,000**	**$ 7,401,000**

Minimum rental payments at June 30, 2011 and 2010, have not been reduced by minimum sublease rentals of $531 thousand and $728 thousand, respectively, due in future years under non-cancelable subleases.

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

Year Ending June 30	2011	2010
2011	$ -	$ 203,000
2012	203,000	197,000
2013	197,000	197,000
2014	131,000	131,000
Total minimum sublease payments	**$ 531,000**	**$ 728,000**

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:

	2011	2010
Minimum rentals:		
Property	$ 1,427,000	$ 1,429,000
Billboards	1,248,000	1,049,000
Less: Sublease rentals	(203,000)	(206,000)
Total minimum rentals	**$ 2,472,000**	**$ 2,272,000**

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

At June 30, 2010, total deferred rent of $578,000 consisted of $223,000 related to rent abatements and $355,000 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 nonoperating.

Net proceeds and operating expenses for the years ended June 30, 2011, and June 30, 2010, are summarized as follows:

	2011	2010
Operating revenues:		
Ticket sales (net)	$1,186,318,000	$1,138,016,000
Less tickets provided as prizes	(83,978,000)	(77,910,000)
Net ticket sales	1,102,340,000	1,060,106,000
Fees and other revenue	3,990,000	3,861,000
Total lottery proceeds	1,106,330,000	1,063,967,000
Operating expenses, as defined:		
Gaming	809,134,000	773,433,000
Operating	15,460,000	14,766,000
Total operating expenses, as defined	824,594,000	788,199,000
Net proceeds before distribution of unrestricted net assets	281,736,000	275,768,000
Nonoperating revenue and expenses		
Interest income	110,000	211,000
Total nonoperating revenue and expenses	110,000	211,000
Net proceeds	$281,846,000	$275,979,000
Amount due to Lottery for Education Account for year	281,846,000	275,979,000
Amount paid during year	(211,565,000)	(204,313,000)
Amount due to Lottery for Education Account, end of year	$70,281,000	$71,666,000

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 Programs Account.

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

Effective in fiscal year 2010, unclaimed prizes for instant games are estimated based upon historical percentages of actual unclaimed dollars at the time of game close and reconciliation at the end of the 90-day redemption period.

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

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

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

For fiscal year 2010, unclaimed prizes were $12,894,000, which was current and payable to the After-School Programs Account at June 30, 2010.

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, 2011 and 2010, employees contributed approximately $416,000 and $373,000, respectively, to the 457 Plan.

The aggregate fair value of the plan's assets was approximately $2,758,000 and $2,051,000, net of administrative fees, as of June 30, 2011 and 2010, 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 $634,000 and $618,000 to the 401(a) Plan on behalf of its employees in the years ended June 30, 2011 and 2010, respectively. Of these contributions, approximately $29,000 and $14,000 were forfeited by separated employees as of June 30, 2011, and June 30, 2010, 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. For the years ended June 30, 2011 and 2010, forfeited amounts of approximately $37,000 and $6,000, respectively, were used to offset employer contributions and plan administrative expenses.

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

The aggregate fair value of the plan's assets was approximately $4,158,000 and $3,043,000, net of forfeitures and administrative fees, as of June 30, 2011 and 2010, 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, 2011, is estimated using historical trends. At June 30, 2011 and 2010, the estimated current portion of the compensated absences liability was $383 thousand and $414 thousand, respectively.

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

D. Employment Separation

Corporate officers accrue forty hours of separation pay for every year of employment with TEL. The TEL had $295 thousand and $243 thousand accrued for employment separation obligations for the years ended June 30, 2011 and 2010, respectively.

(10) NONCURRENT LIABILITIES

Noncurrent liabilities activity for the year ended June 30, 2011, consisted of the following:

	Beginning Balance	Increases	Decreases	Ending Balance	Due within one year
Prize annuities payable	$ 2,345,000	$ 225,000	$ (156,000)	$ 2,414,000	$ 104,000
Compensated absences	533,000	629,000	(597,000)	565,000	383,000
Deferred rent	578,000	-	(158,000)	420,000	61,000
Total noncurrent liabilities	$ 3,456,000	$ 854,000	$ (911,000)	$ 3,399,000	$ 548,000

Noncurrent liabilities activity for the year ended June 30, 2010, consisted of the following:

	Beginning Balance	Increases	Decreases	Ending Balance	Due within one year
Prize annuities payable	$ 2,532,000	$ -	$ (187,000)	$ 2,345,000	$ 104,000
Compensated absences	470,000	606,000	(543,000)	533,000	414,000
Deferred rent	736,000	-	(158,000)	578,000	61,000
Total noncurrent liabilities	$ 3,738,000	$ 606,000	$ (888,000)	$ 3,456,000	$ 579,000

Compensated absences presented within the schedules above 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 June 30, 2011, management is not aware of any related liabilities.