The South Carolina Education Lottery

2006 Annual Financial Report

Chairman of the Board

Thanks a Billion, South Carolina!

2006 Annual Financial Report

Dear Fellow South Carolinians:

Fiscal year 2006 was a billion-dollar year for the South Carolina Education Lottery (SCEL) in more ways than one. Sales exceeded one billion dollars for the first time in our history, totaling $1,144,606,250. We transferred $322,166,426 for educational programs, bringing total contributions to the Education Lottery Account, since our first sale in January 2002, to $1,190,408,384. It is truly appropriate to say: Thanks a billion, South Carolina!

Beyond our extraordinary sales and contributions to funding educational programs, SCEL continues to operate in a prudent manner. Our spending on advertising was limited to 0.8% of sales, well below the statutory ceiling for these costs. Although SCEL has the authority to spend 8% in administrative overhead (excluding retailer commissions), those expenses were successfully limited to 4% of sales. These cost savings result in additional revenue for education.

SCEL continues to enjoy recognition as a leader in the lottery industry, ranking 5th in per capita instant sales among all US lotteries, with high rankings in other sales measures according to the September 2006 issue of *La Fleur's Magazine*. In the per capita transfer of lottery proceeds (the amount we transfer to education divided by our state population), perhaps the most important benchmark of overall performance, SCEL ranks among the best in the nation. Several members of our key management team have received outstanding achievement awards from the North American Association of State and Provisional Lotteries. None of these notable accomplishments would be possible without the collaborative efforts of our dedicated, diligent staff and more than 3,500 licensed lottery retailers.

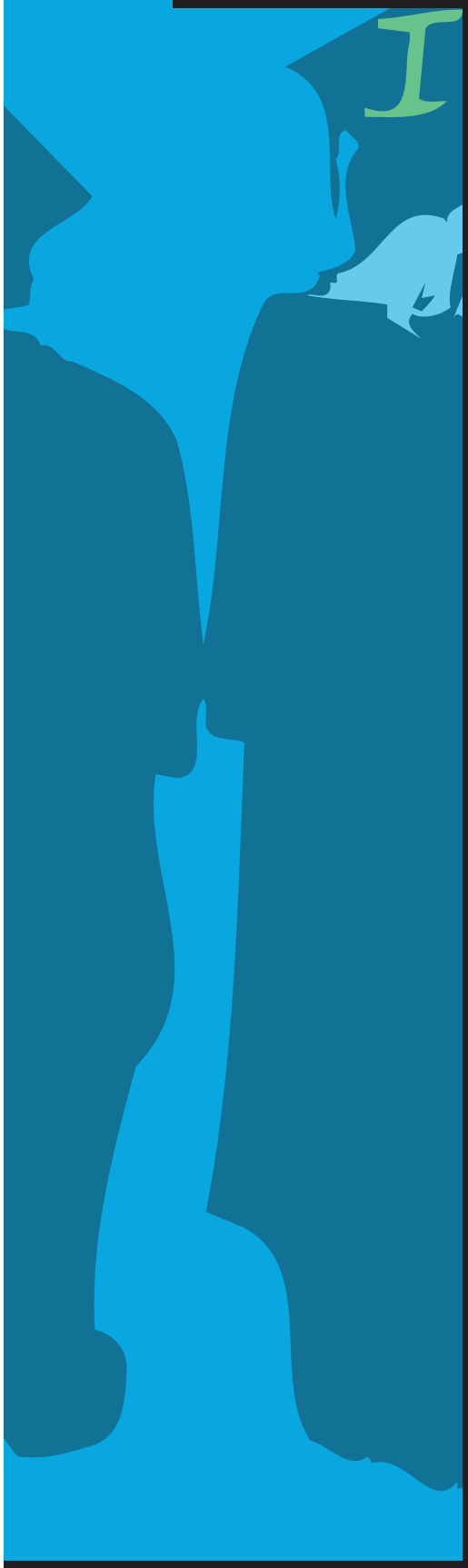
Although SCEL faces new challenges in 2007, we remain focused on our goals of raising funds to support education and marketing our products in a socially responsible manner. We will continue to introduce new, exciting products while maintaining our commitment to operating a lottery with the integrity you expect and rightfully deserve. We will remain true to our mission, and to the legislation which created the South Carolina Education Lottery, to improve educational opportunities for the citizens of South Carolina.

We appreciate your support and welcome your participation in our effort.

Sincerely,

Tim Madden, Chairman
South Carolina Education Lottery Commission

Executive Director



From the Executive Office:

Another record-breaking year is precisely how to describe the amazing story of the South Carolina Education Lottery (SCEL) for the twelve-month period which ended on June 30, 2006. To be quite honest, this is the same headline which we have published for each year since we launched our lottery in January 2002. If you charted revenues from startup in 2002, you would notice that each year surpassed the previous period for lottery ticket sales. So, we are not really breaking new ground when it comes to exceeding expectations. But by any measurement standard, fiscal year 2006 was special and one for the books. In a state with a population of 4.3 million, SCEL sold $1.144 billion worth of lottery tickets! That translates into $269 in per capita sales, ranking South Carolina the number 16 lottery in the world for calendar year 2005 in total per capita sales.

As we all know, revenue figures must relate to net profits for our stakeholders, in our case, education. The South Carolina Legislature has appropriated $1.46 billion to enhance educational opportunities for the people of the Palmetto State though June 2007. Lottery profits have funded everything from college scholarships to kindergarten programs. I invite you to visit our website at www.sceducationlottery.com for a comprehensive analysis of lottery beneficiaries.

Often I am asked about the ingredients for our success. I have a one word reply and that is: our success is attributable to great "people." By that I mean our nine-member Commission, our retail agents, our vendors, our players and, yes, most certainly, our world-class staff. We at SCEL are proud to serve the people of South Carolina. Our goal is to provide state policymakers with the revenue necessary to meet the financial goals placed upon our staff. There are many challenges that lie ahead, but we are equally confident we can meet each one with the same dedication that we have exhibited in the past. After all, records are made to be broken.

Sincerely,

Ernie Passailaigue
Executive Director

SOUTH CAROLINA
EDUCATION LOTTERY COMMISSION

REPORT ON FINANCIAL STATEMENTS

FOR THE YEARS ENDED
JUNE 30, 2006 AND 2005

SOUTH CAROLINA EDUCATION LOTTERY COMMISSION

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State of South Carolina

Office of the State Auditor

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RICHARD H. GILBERT, JR., CPA
DEPUTY STATE AUDITOR

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September 18, 2006

The Honorable Mark Sanford, Governor
and
Members of the South Carolina Education Lottery Commission
Columbia, South Carolina

This report on the audit of the financial statements of the South Carolina Education Lottery Commission for the fiscal year ended June 30, 2006, was issued by Elliott Davis, LLC, Certified Public Accountants, under contract with the South Carolina Office of the State Auditor.

If you have any questions regarding this report, please let us know.

Respectfully submitted,

Richard H. Gilbert, Jr., CPA
Deputy State Auditor

RHGjr/trb

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Richard H. Gilbert, Jr., CPA
Interim State Auditor
State of South Carolina
Columbia, South Carolina

We have audited the accompanying statements of net assets of the South Carolina Education Lottery Commission (the Commission), a discretely presented component unit of the State of South Carolina (the State), as of June 30, 2006 and 2005 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 management of the Commission. 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 *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits 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 Commission as of June 30, 2006 and 2005, and the changes in financial position and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 30, 2006 on our consideration of the Commission's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

The Management's Discussion and Analysis is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. 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.

Our audit was conducted for the purpose of forming an opinion on the financial statements of the Commission. The schedule of business-type activities for the state-wide CAFR is supplementary information required by the South Carolina Office of the Comptroller General and is not a required part of the basic financial statements. It has been subjected to the auditing procedures applied in the audit of the basic financial statements, and in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

Elliott Davis LLC

Elliott Davis, LLC
August 30, 2006

SOUTH CAROLINA EDUCATION LOTTERY COMMISSION
MANAGEMENT'S DISCUSSION AND ANALYSIS

Management of the Commission provides this *Management's Discussion and Analysis* of their financial performance for the readers of the Commission's financial statements. This narrative provides an overview of the Commission's financial activity for the fiscal year ended June 30, 2006. This analysis is to be considered in conjunction with the financial statements to provide an objective analysis of the Commission's financial activities based on facts, decisions, and conditions currently facing management.

Understanding the Commission's Financial Statements

The Commission, an instrumentality of the State of South Carolina, is accounted for as an enterprise fund that reports all assets and liabilities using the accrual basis of accounting, much like a private business entity. In accordance with accounting principles generally accepted in the United States of America, this report consists of a series of financial statements, along with explanatory notes to the financial statements. The financial statements immediately follow this discussion and analysis by management, and are designed to highlight the Commission's net assets and changes to those assets resulting from Commission operations.

The most important relationship demonstrated within the Commission's financial statements is the requirement that the Commission transfer all net proceeds to the State Treasurer for the Education Lottery Account. Accordingly, the primary focus of these financial statements is determining net proceeds available for transfer to the Education Lottery Account, rather than the change in net assets of the Commission.

Financial Highlights

Revenues from lottery games increased by $187.7 million. The Commission returned $702.3 million to winners of lottery games and $81.1 million was paid to retailers for commissions and incentives. Other game related expenses were $20.4 million and operating expenses were $26.3 million. Transfers to and due to the Education Lottery Account were $320.6 million as of and for the year ended June 30, 2006.

Assets and Liabilities (in millions) (See Notes to Financial Statements 4 and 6)

	2006	2005	2004
Capital Assets	$ 5.6	$ 8.7	$12.2
Current and Other Assets	46.1	57.5	72.6
Total Assets	51.7	66.2	84.8
Current Liabilities	45.7	57.3	72.7
Long-term Liabilities	0.8	1.9	2.9
Total Liabilities	46.5	59.2	75.6
Net Assets			
Capital Assets Net of Related Debt	4.7	6.5	8.8
Restricted Assets	0.5	0.5	0.4
Total Net Assets	5.2	7.0	9.2

Commission Operations

	2006	2005	2004
Sales by game and other revenues:			
Revenue - Instant games	696.5	578.8	537.3
Revenue – Online games	226.3	199.2	180.5
Revenue – Powerball®	221.8	178.9	232.2
Other Revenues	3.2	3.2	3.2
Total Revenues	1,147.8	960.1	953.2
Expense by prize and other expenses:			
Retailer Commissions and Incentives	81.1	67.5	67.0
Prize expense - Instant games	482.0	396.7	359.9
Prize expense - Online games	115.5	96.1	87.5
Prize expense – Powerball®	104.9	80.9	104.9
Instant and online direct costs	20.4	18.2	20.4
Operating expenses	26.3	23.7	23.0
Total Expenses	830.2	683.1	662.7
Non-operating income and expense:			
Interest Income	1.2	0.6	0.2
Interest Expense	(0.1)	(0.2)	(0.6)
Total Non-Operating Income (Expense)	1.1	0.4	(0.4)
Transfers to and due to Education Lottery Acct	320.6	279.7	286.8
Change in Net Assets	(1.9)	(2.3)	3.3
Ending Net Assets	5.2	6.9	9.2

All proceeds of the Commission must be transferred to the State Treasurer for the Education Lottery Account with the following exceptions: 1) the cost of capital assets net of depreciation and related debt, and 2) the Restricted Fidelity Fund, derived from the licensing fees of new retailers, which may be retained by the Commission up to $500,000 and used to cover losses the commission may experience due to nonfeasance, misfeasance, or malfeasance of a lottery retailer. Therefore, the net assets of the Commission will never exceed $500,000 related to the Restricted Fidelity Fund plus the cost of capital assets, net of depreciation and related debt. As of July 13, 2006 the Commission had transferred $330.9 million, including $22.9 million in unclaimed prize funds to the State Treasurer for the Education Lottery Account for the fiscal year ended June 30, 2006. Total transfers to the Education Lottery Account are $1.2 billion from inception to June 30, 2006.

Capital Assets and Long Term Debt Activity (in millions)

	Capital Assets	21.1
Less:	Accumulated Depreciation	15.5
Less:	Outstanding principal of related debt	0.9
	Net assets invested in capital assets, net of related debt	4.7

Potential Factors Impacting Future Operations

The Commission is considering membership in a new multi-state game now under development by the Multi-State Lottery Association. This new game is intended to complement Powerball®. Drawings would occur on days other than those of the current Powerball® drawings.

Contacting the Commission's Financial Management

This financial report is designed to provide a general overview of the Commission's financial activity for all those interested in the Commission's operations. Questions concerning any of the information provided in this report, or requests for additional financial information, should be addressed to the Director of Finance, South Carolina Education Lottery, Post Office Box 11949, Columbia, South Carolina 29211-1949.

SOUTH CAROLINA EDUCATION LOTTERY COMMISSION
STATEMENTS OF NET ASSETS

	JUNE 30,	
	2006	**2005**
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 4,997,173	$ 17,680,300
Cash - Restricted fidelity fund	495,230	455,330
Retailer accounts receivable, net of allowance for doubtful accounts of $229,058 and $167,000 for 2006 and 2005, respectively	29,019,114	27,410,349
Accounts receivable - Multi-State Lottery	-	1,509,562
Inventory	3,381,484	2,404,855
Prepaid expenses and other current assets	834,711	262,656
Total current assets	38,727,712	49,723,052
CAPITAL ASSETS, net	5,568,400	8,710,058
DEPOSIT WITH MULTI-STATE LOTTERY	7,425,000	7,753,026
Total assets	51,721,112	66,186,136
LIABILITIES		
CURRENT LIABILITIES		
Due to Education Lottery Account	10,939,754	21,244,269
Prizes payable	28,506,282	23,976,093
Prizes payable - Multi-State Lottery	1,016,738	3,655,771
Accounts payable	2,369,867	5,414,498
Accrued liabilities	1,064,908	877,566
Current portion of accrued compensated absences	40,817	58,456
Current portion of long-term debt	882,359	1,104,166
Deferred revenue	884,928	998,294
Total current liabilities	45,705,653	57,329,113
LONG -TERM DEBT	-	1,113,054
ACCRUED COMPENSATED ABSENCES	834,188	795,801
Total liabilities	46,539,841	59,237,968
NET ASSETS		
Invested in capital assets, net of related debt	4,686,041	6,492,838
Restricted - fidelity funds	495,230	455,330
Total net assets	**$ 5,181,271**	**$ 6,948,168**

See notes to financial statements which are an integral part of these statements.

SOUTH CAROLINA EDUCATION LOTTERY COMMISSION
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

	For the years ended June 30,	
	2006	**2005**
REVENUES		
Instant games	$ 696,459,836	$ 578,838,811
On-line games	226,336,340	199,175,235
Powerball games	221,810,074	178,937,972
Retailer permit fees	505,230	480,600
Retailer telephone fees	2,690,863	2,645,765
Other	49,357	71,079
Total revenue	1,147,851,700	960,149,462
DIRECT COSTS		
Commissions and incentives to retailers	81,065,367	67,534,047
Prize expense		
Instant games	481,989,311	396,667,017
On-line games	115,450,912	96,056,371
Powerball games	104,901,331	80,872,481
Total prize expense	702,341,554	573,595,869
Instant and on-line costs	20,378,890	18,175,707
Total direct costs	803,785,811	659,305,623
Gross profit	344,065,889	300,843,839
OPERATING EXPENSES		
Advertising and promotion	8,682,936	7,746,455
Security checks	216,860	221,295
Salaries, wages and benefits	9,119,334	8,717,883
Contracted and professional services	685,931	392,031
Depreciation	3,647,532	3,592,637
Rent expense	711,261	815,102
Office supplies	160,318	102,800
Bad debt expense	691,200	110,000
Other general and administrative	2,404,460	2,012,467
Total operating expenses	26,319,832	23,710,670
Operating Income	317,746,057	277,133,169
NON-OPERATING INCOME (EXPENSE)		
Interest income	1,233,565	590,010
Gains and Losses	12,549	5,974
Interest expense	(129,139)	(231,441)
Total non-operating expense	1,116,975	364,543
Change in net assets before transfers to and due to Education Lottery Account	318,863,032	277,497,712
TRANSFERS TO AND DUE TO EDUCATION LOTTERY ACCOUNT	320,629,929	279,738,059
Change in net assets	(1,766,897)	(2,240,347)
NET ASSETS,		
BEGINNING OF YEAR	6,948,168	9,188,515
END OF YEAR	**$ 5,181,271**	**$ 6,948,168**

See notes to financial statements which are an integral part of these statements.

SOUTH CAROLINA EDUCATION LOTTERY COMMISSION
STATEMENTS OF CASH FLOWS

	For the years ended June 30,	
	2006	**2005**
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from retailers	$ 1,147,639,131	$ 978,143,880
Cash payments to prize winners	(700,450,398)	(593,461,268)
Cash payments to suppliers for goods and services	(119,221,465)	(96,447,799)
Cash payments to employees for services	(9,280,317)	(8,610,662)
Net cash provided by operating activities	318,686,951	279,624,151
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Reimbursements of (Payments to fund) deposits with Multi-State Lottery	328,026	(2,625,618)
Payments to Education Lottery Account	(330,934,444)	(276,577,163)
Net cash used for noncapital financing activities	(330,606,418)	(279,202,781)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from dispositions of capital assets	45,747	7,871
Interest paid	(129,139)	(231,441)
Purchase of capital assets	(539,072)	(87,499)
Net paid for short-term and long-term debt	(1,334,861)	(1,232,559)
Net cash used for financing activities	(1,957,325)	(1,543,628)
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest received	1,233,565	590,010
Net cash provided by investing activities	1,233,565	590,010
NET DECREASE IN CASH AND CASH EQUIVALENTS	(12,643,227)	(532,248)
CASH AND CASH EQUIVALENTS		
BEGINNING OF YEAR	18,135,630	18,667,878
END OF YEAR	**$ 5,492,403**	**$ 18,135,630**
OPERATING ACTIVITIES		
Operating income	$ 317,746,057	$ 277,133,169
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	3,647,532	3,592,637
Changes in assets and liabilities		
Retailer accounts receivable	(1,608,765)	(4,004,961)
Accounts receivable - Multi-State Lottery	1,509,562	21,767,539
Inventory	(976,629)	(398,967)
Prepaid expenses and other assets	(572,055)	(165,713)
Accounts payable and accrued liabilities	(2,836,541)	1,334,006
Prizes payable	1,891,156	(19,865,399)
Deferred revenue	(113,366)	231,840
Net cash provided by operating activities	**$ 318,686,951**	**$ 279,624,151**

See notes to financial statements which are an integral part of these statements.

NOTE 1 - REPORTING ENTITY

The ***South Carolina Education Lottery Commission*** (the Commission), was established as an instrumentality of the state of South Carolina (the State) with enactment of Act 59 of 2001(the Act). The Commission is responsible for the provision of lotteries on behalf of the State in accordance with the Act. The Act established a board of nine commissioners as an organization legally separate from the State. Three commissioners are appointed by the Governor, three are appointed by the President Pro Tempore of the Senate and three are appointed by the Speaker of the House of Representatives. The Commission exercises powers comparable to those of a governing board of an entrepreneurial organization. The Commission transfers "net proceeds" as defined by the Act to the State. Therefore, the Commission is reported as a discretely presented component unit in the State's Comprehensive Annual Financial Report (CAFR).

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies of the Commission are as follows:

Method of accounting

The Commission is accounted for as an enterprise fund. Enterprise funds are used to account for activities that are financed and operated in a manner similar to private business enterprises where the costs of providing lottery games to the general public on a continuing basis are to be financed through the sale of lottery game tickets. The Act requires that all costs of providing lottery games, including capital costs, be recovered from the sale of lottery game tickets.

The Government Accounting Standards Board (GASB) is the recognized standard setting body for generally accepted accounting principles applicable to governmental proprietary activities in the United States of America. The Commission applies all applicable GASB pronouncements and all applicable Financial Accounting Standards Board (FASB) pronouncements issued on or before November 30, 1989 when not in conflict with GASB pronouncements. In accordance with GASB Statement 20, the Commission has elected not to implement FASB Statements 103 and after.

Basis of accounting

The financial statements are prepared on the accrual basis of accounting 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 they are incurred.

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and 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.

Revenue and accounts receivable recognition

Revenue and accounts receivable for on-line games are recognized when tickets are sold to the public by contracted retailers, except for on-line tickets sold in advance of the draw date for which deferred revenue is recorded.

Revenue and accounts receivable for instant scratch games are recognized upon activation of ticket packs for sale by the retailers. The Commission evaluates its receivables on an ongoing basis for collectability.

(Continued)

Commissions

Retailers receive a commission of 7% on total sales.

Prizes

In accordance with the Act, as nearly as practical, at least 45% of ticket sales must be returned to the public in the form of prizes. Prize expense for instant ticket games is recorded as an estimate at the time the related revenue is recognized based on the predetermined prize structure for each game; periodically, the prize expense is adjusted to reflect amounts actually won. Prize expense for on-line games is recorded at the time the related revenue is recognized based on the known prizes.

Ticket inventories

Inventories are carried at cost (as determined by the specific identification method) and consist of scratch tickets located in the Commission's warehouses or held by retailers. The cost of tickets is charged to operations upon the recognition of revenue under the procedures described above.

Unclaimed prizes

Prizes must be claimed within 90 days after game-end (end of sales) for instant games and within 180 days after the draw date for on-line games. Unclaimed prize money must be deposited in the Education Lottery Account each year.

Net assets

Net assets represent cumulative revenues less expenses in excess of net proceeds transferred or payable to the Education Lottery Account, as defined under the Act.

Net proceeds

Net proceeds, as defined by the Act, consist of all revenue derived from the sale of lottery game tickets or shares and all other monies derived from the lottery games, less operating expenses and prizes.

Operating expenses

Operating expenses, as defined by the Act, in the determination of net proceeds, consist of 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 capital assets and other operating costs.

Cash and cash equivalents

The Commission considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. This includes cash in banks, petty cash and cash on deposit with the South Carolina State Treasurer.

Retailer accounts receivable

Retailer accounts receivable represents lottery proceeds due from retailers for net ticket sales less commissions and prizes paid by the retailers. Lottery proceeds are collected weekly by the Commission from retailer bank accounts.

Capital Assets

Capital assets, which consist of machinery, equipment, vehicles and leasehold improvements, are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of two to five years. 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 costs and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is reflected in the results from operations in the period of disposal. The Commission capitalizes all capital assets purchases of $1,000 or more.

(Continued)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

Restricted fidelity fund

In accordance with the Act, retailers contribute a fee to a fidelity fund upon acceptance as a lottery retailer. The fund is used to cover losses the Commission may incur due to misfeasance, nonfeasance or malfeasance of retailers. At the end of each fiscal year, any amount in the fund in excess of $500,000 is treated as net proceeds from the Commission and is payable to the Education Lottery Account. At June 30, 2006, no amounts were available for transfer as net proceeds. The fidelity fund is held in a separate account and appears on the balance sheet as restricted fidelity fund cash and in net assets as restricted fidelity funds.

Insurance

The Commission is exposed to various risks of loss related to torts; theft of, damage to, and the destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Commission combines coverage provided by the South Carolina Insurance Reserve Fund with the purchase of commercial insurance to substantially cover these risks. The amount of settlements did not exceed insurance coverage in each of the past three years.

Compensated absences

Employees earn the right to be compensated during absences for vacation and compensatory time. Unused leave benefits are paid to employees upon separation from service. The cost of vacation and compensatory time is accrued in the period in which it is earned.

Advertising

Costs incurred for producing and communicating advertising are expensed when incurred, which generally is when the advertising first takes place.

Deposit with Multi-State Lottery (MUSL)

The Commission is required to maintain funds in reserve with MUSL. This reserve serves as a contingent source for prize payouts should MUSL games not generate sufficient funds to pay amounts due to prize winners. MUSL is not a financial institution.

Reclassifications

Certain prior year amounts have been reclassified to conform to current year presentation.

NOTE 3 - DEPOSITS

The Commission's cash and cash equivalents are considered to be cash-on-hand and interest bearing demand deposits held by banks and the State Treasurer.

At June 30, 2006 and 2005, the amounts of the Commission deposits were as follows:

	2006		2005	
	Carrying amount	Bank balances	Carrying amount	Bank balances
Demand deposits	$ 5,123,669	$ 7,217,440	$ 17,584,318	$ 18,087,424
Deposits held by State Treasurer	368,734	368,734	551,312	9,075
	$ 5,492,403	$ 7,586,174	$ 18,135,630	$ 18,096,499

(Continued)

NOTE 3 - DEPOSITS, Continued

Custodial credit risk - deposits

Custodial credit risk is the risk that in the event of a bank failure, the Commission's deposits may not be returned to it. The Commission does not have a deposit policy for custodial credit risk. As of June 30, 2006 and 2005, none of the Commission's bank balances of $7,586,174 and $18,096,499, respectively, were exposed to custodial credit risk.

State law

The Act requires the Commission to transfer to the State Treasurer all net proceeds on a monthly basis. Net proceeds are not available to the Commission for long term investment. State Code Section 11-13-60 requires full collateralization of all deposits held by the State Treasurer.

NOTE 4 - CAPITAL ASSETS

The following is a summary of changes in capital assets and accumulated depreciation during fiscal year 2006:

	Balance June 30, 2005	Additions	Deletions	Balance June 30, 2006
Cost				
Machinery and equipment	$ 19,888,398	$ 480,205	$ (46,522)	$20,322,081
Vehicles	68,826	-	-	68,826
Leasehold improvements	641,349	58,867	-	700,216
	20,598,573	539,072	(46,522)	21,091,123
Accumulated depreciation				
Machinery and equipment	(11,424,731)	(3,514,120)	13,324	(14,925,527)
Vehicles	(65,326)	(3,500)	-	(68,826)
Leasehold Improvements	(398,458)	(129,912)	-	(528,370)
	(11,888,515)	(3,647,532)	13,324	(15,522,723)
Total capital assets, net	$ 8,710,058	$ (3,108,460)	$ (33,198)	$ 5,568,400

The following is a summary of changes in capital assets and accumulated depreciation during fiscal year 2005:

	Balance June 30, 2004	Additions	Deletions	Balance June 30, 2005
Cost				
Machinery and equipment	$ 19,836,623	$ 87,499	$ (35,724)	$ 19,888,398
Vehicles	68,826	-	-	68,826
Leasehold improvements	641,349	-	-	641,349
	20,546,798	87,499	(35,724)	20,598,573
Accumulated depreciation				
Machinery and equipment	(7,991,631)	(3,447,995)	14,895	(11,424,731)
Vehicles	(48,954)	(16,372)	-	(65,326)
Leasehold Improvements	(270,188)	(128,270)	-	(398,458)
	(8,310,773)	(3,592,637)	14,895	(11,888,515)
Total capital assets, net	$ 12,236,025	$ (3,505,138)	$ (20,829)	$ 8,710,058

NOTE 5 - ACCRUED EXPENSES

Accrued liabilities at June 30, 2006 consist of the following:

Accrued payroll and related expenses	$ 658,869
Accrued audit fees	193,507
Accrued SLED costs	112,985
Other	99,547
	$ 1,064,908

Accrued liabilities at June 30, 2005 consist of the following:

Accrued payroll and related expenses	$ 821,775
Other	55,791
	$ 877,566

NOTE 6 - LONG -TERM DEBT AND COMMITMENTS

In October 2001, the Commission entered into a six year contract with a vendor, to provide amongst other things, services and equipment to operate their on-line lottery. The contract required an initial payment of $5,287,938, which has been paid. The contract also calls for monthly administrative fees of $450,000 for the life of the contract. Under the original contract, additional payments, which have been imputed for the purchase of equipment of $140,000 and $122,000 per month, will be made for months three through twenty-six and twenty-seven through sixty-two of the contract, respectively. These additional payments have been imputed to include principal and interest at 8%. A lump sum payment of $5,270,000 was due and paid in March 2004. Title to and risk of loss for this equipment occurred upon installation and acceptance in March 2002.

In January 2005, the contract for the vendor to provide administrative services was extended for an additional ten and a half (10½) months through November 15, 2008. The extension will require ten monthly payments of $450,000 with a final payment of $225,000.

The balance of the long term debt for purchase of equipment to include the imputed principal and interest will be paid in full February 2007 as follows:

	Principal	Interest	Payment
2007	$ 882,359	$ 25,092	$ 907,451

The following is a summary of changes in long-term debt during fiscal year 2006:

	Balance June 30, 2005	Proceeds	Payments	Balance June 30, 2006
Long-term debt	$ 2,217,220	$ -	$ 1,334,861	$ 882,359

The following is a summary of changes in long-term debt during fiscal year 2005:

	Balance June 30, 2004	Proceeds	Payments	Balance June 30, 2005
Long-term debt	$ 3,449,779	$ -	$ 1,232,559	$ 2,217,220

NOTE 7 - ACCRUED COMPENSATED ABSENCES

The following is a summary of changes in accrued compensated absences during fiscal year 2006:

	Balance June 30, 2005	Additions	Deductions	Balance June 30, 2006
Accrued compensated absences	$ 854,257	$ 426,879	$ 406,131	$ 875,005

The following is a summary of changes in accrued compensated absences during fiscal year 2005:

	Balance June 30, 2004	Additions	Deductions	Balance June 30, 2005
Accrued compensated absences	$ 850,163	$ 499,951	$ 495,857	$ 854,257

NOTE 8 - OPERATING LEASES

The Commission has entered into operating leases for the rental of office space for its headquarters and district offices. Certain operating leases contain provisions for scheduled rental increases and are renewable at the option of the Commission.

Future minimum rental payments, to entities outside the State reporting entity, on noncancellable leases with original terms of one year or more are scheduled as follows for the year ending June 30:

	Operating leases
2007	$ 286,796
2008	27,694
2009	23,947
2010	23,773
2011	14,828

Rental expenses under all operating leases including those on month-to-month terms totaled approximately $711,261 and $815,102 for the year ended June 30, 2006, and 2005, respectively. This includes $63,463 and $65,739 of vehicle rental expense to the State Fleet management.

NOTE 9 - DUE TO EDUCATION LOTTERY ACCOUNT

In accordance with the Act, all net proceeds of the Commission are to be transferred to the Education Lottery Account within the State Treasury. In accordance with the Act, net proceeds consist of all revenue derived from the sale of lottery game tickets or shares and all other monies derived from the lottery games less operating expenses and prizes. The following payables resulted from transfers due to the Education Lottery Account at June 30:

	2006	2005
Amount payable to the Education Lottery Account, beginning of year	$ 21,244,269	$ 18,083,373
Change in net assets subject to transfer	318,863,032	277,497,712
	340,107,301	295,581,085
Change in capital assets, net of related debt		
Capital assets, net	3,141,658	3,525,967
Long-term debt	(1,334,861)	(1,232,559)
	1,806,797	2,293,408
Amount collected for fidelity fund	(39,900)	(53,061)
Amount paid during the year	(330,934,444)	(276,577,163)
Amount payable to the Education Lottery Account, end of year	**$ 10,939,754**	**$ 21,244,269**

Transfers related to the above payable were made to the Education Lottery Account in July 2006 and 2005 respectively.

NOTE 10 - EMPLOYEE RETIREMENT SYSTEMS

The Commission contributes to the South Carolina Retirement System (SCRS) cost sharing multiple-employer defined benefit plan administered by the Retirement Division of the State Budget and Control Board.

As established by Title 9-1-480 Code Laws of South Carolina, 1976 (as amended), all eligible persons, except those specifically excluded, shall become members of the retirement system as a condition of their employment. The responsibility of the administration of the system is assigned by law to the State Budget & Control Board.

SCRS offers retirement and disability benefits, cost of living adjustments on an ad-hoc basis, life insurance benefits and survivor benefits. The Plan's provisions are established under Title 9 of the SC Code of Laws.

The following is a recap of the mandated contribution rates for the current fiscal year.

	SCRS
Employee contributions	6.25% of salary
Employer contributions	
Retirement	7.55% of salary
Insurance surcharge	3.25% of salary
Group life insurance	.15% of salary

For the years ending June 30, 2006, 2005, and 2004 the Commission contributions to SCRS were $721,520, $710,153, and $699,039 respectively.

All employer contributions were equal to the required contribution rates for the year. Contributions as a percentage of statewide contributions were not available for June 30, 2006.

(Continued)

NOTE 10 - EMPLOYEE RETIREMENT SYSTEMS, Continued

Commission employees may participate in the 457 and/or 401(k) deferred compensation plans, which are available to state and local governmental employees and administered by a state approved nongovernmental third party. The plans, available to all Commission employees, permit them to defer a portion of their salary until future years. Participation in the plan is optional. The deferred compensation plans are not available to employees until termination, retirement, death or unforeseeable emergency.

Employees eligible for service retirement may participate in the Teacher and Retiree Incentive Program (TERI). TERI participants may retire and begin accumulating retirement benefits on a deferred basis without terminating employment for up to five years. Upon termination of employment or at the end of the TERI period, whichever is earlier, participants will begin receiving monthly service benefits which will include any cost of living adjustments granted during the TERI period. Because participants are considered retired during the TERI period, they do not make SCRS contributions, do not earn service credit, and are ineligible to receive group life insurance benefits or disability retirement benefits.

New employees may elect to participate in the Optional Retirement Program (ORP), which provides retirement and death benefits through the purchase of individual or fixed variable annuity contracts, which are issued to and become the property of the participants. To elect ORP, eligible employees must irrevocably waive SCRS membership within their first ninety days of employment.

A comprehensive annual financial report containing financial statements and required supplementary information for the South Carolina Retirement System is issued and publicly available by writing the South Carolina Retirement System, Post Office Box 11960, Columbia, South Carolina 29211-1960.

NOTE 11 - CONTINGENCIES

The Commission 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 Commission for the year ending June 30, 2006.

NOTE 12 -TRANSACTIONS WITH STATE ENTITIES AND RELATED PARTIES

For the year ended June 30, 2006, the Commission had certain transactions with the State and various other state agencies as follows:

Related Party	Amount	Nature of Transaction
South Carolina Department of Revenue	$ 6,152,393	Transfers of state tax withholding, use taxes and debt setoffs
SLED	277,926	Security services and fees paid for background checks on employees and retailers
South Carolina State Treasurer	330,934,444	Transfers of net proceeds and unclaimed prizes
South Carolina State Treasurer	8,551,465	Transfer of payroll funds for processing
Comptroller General	30,000	Fees for payroll processing
Comptroller General	24,648	Unemployment compensation premium
South Carolina Budget & Control Board	251,828	Insurance, telephone, printing, miscellaneous services
Prison Industries - Department of Corrections	5,679	Recycling services and office furniture
South Carolina Department of Social Services	12,183	Debt setoffs withheld from prize winnings
South Carolina Department of Public Safety	306,181	Security services
SC Legislative Audit Council	116,426	Legislative audit of commission operations
CB Richard Ellis	485,215	Rent for offices used in commission operations, building owned by commission chair

For the year ended June 30, 2005, the Commission had certain transactions with the State and various other state agencies as follows:

Related Party	Amount	Nature of Transaction
South Carolina Department of Revenue	$ 6,598,192	Transfers of state tax withholding, use taxes and debt setoffs
SLED	316,341	Security services and fees paid for background checks on employees and retailers
South Carolina State Treasurer	276,577,163	Transfers of net proceeds and unclaimed prizes
South Carolina State Treasurer	8,316,391	Transfer of payroll funds for processing
Comptroller General	30,000	Fees for payroll processing
Comptroller General	9,258	Unemployment compensation premium
South Carolina Budget & Control Board	357,319	Insurance, telephone, printing, miscellaneous services
Prison Industries - Department of Corrections	6,679	Recycling services and office furniture
South Carolina Department of Social Services	31,525	Debt setoffs withheld from prize winnings
South Carolina Department of Public Safety	241,266	Security services

SOUTH CAROLINA EDUCATION LOTTERY COMMISSION SUPPLEMENTARY SCHEDULE OF BUSINESS-TYPE ACTIVITIES FOR THE STATEWIDE CAFR

	For the years ended June 30,	
	2006	**2005**
Charges for services	$ 1,147,851,700	$ 960,149,462
Operating grants and contributions	1,246,114	595,984
Less expenses	830,234,782	683,247,734
Net program revenue	318,863,032	277,497,712
Transfers out to state agencies/funds	(320,629,929)	(279,738,059)
Change in net assets	(1,766,897)	(2,240,347)
NET ASSETS - BEGINNING	6,948,168	9,188,515
NET ASSETS - ENDING	**$ 5,181,271**	**$ 6,948,168**

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INDEPENDENT AUDITOR'S 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

Richard H. Gilbert, Jr., CPA
Interim State Auditor
State of South Carolina
Columbia, South Carolina

We have audited the financial statements of the ***South Carolina Education Lottery Commission*** (the Commission), a discretely presented component unit of the State of South Carolina (the State), as of and for the years ended June 30, 2006 and 2005, and have issued our report thereon dated August 30, 2006. 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 *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audits, we considered the Commission's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

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

This report is intended solely for the information and use of the audit committee, management of the Commission and the Office of the State Auditor of South Carolina and is not intended to be and should not be used by anyone other than these specified parties.

Elliott Davis LLC

August 30, 2006

SOUTH CAROLINA EDUCATION LOTTERY COMMISSION
SCHEDULE OF FINDINGS
For the years ended June 30, 2006 and 2005

SCHEDULE OF AUDITOR'S RESULTS

We have issued an unqualified opinion, dated August 30, 2006 on the financial statements of the Commission as of and for the year ended June 30, 2006 and 2005.

Our audit disclosed no instances of noncompliance which are material to the Commission's financial statements.

Our audit disclosed no reportable conditions or material weaknesses relating to the audit of the financial statements.

FINDINGS RELATING TO THE FINANCIAL STATEMENTS

Our audit disclosed no findings which are required to be reported in accordance with *Government Auditing Standards*.

Performance Measures

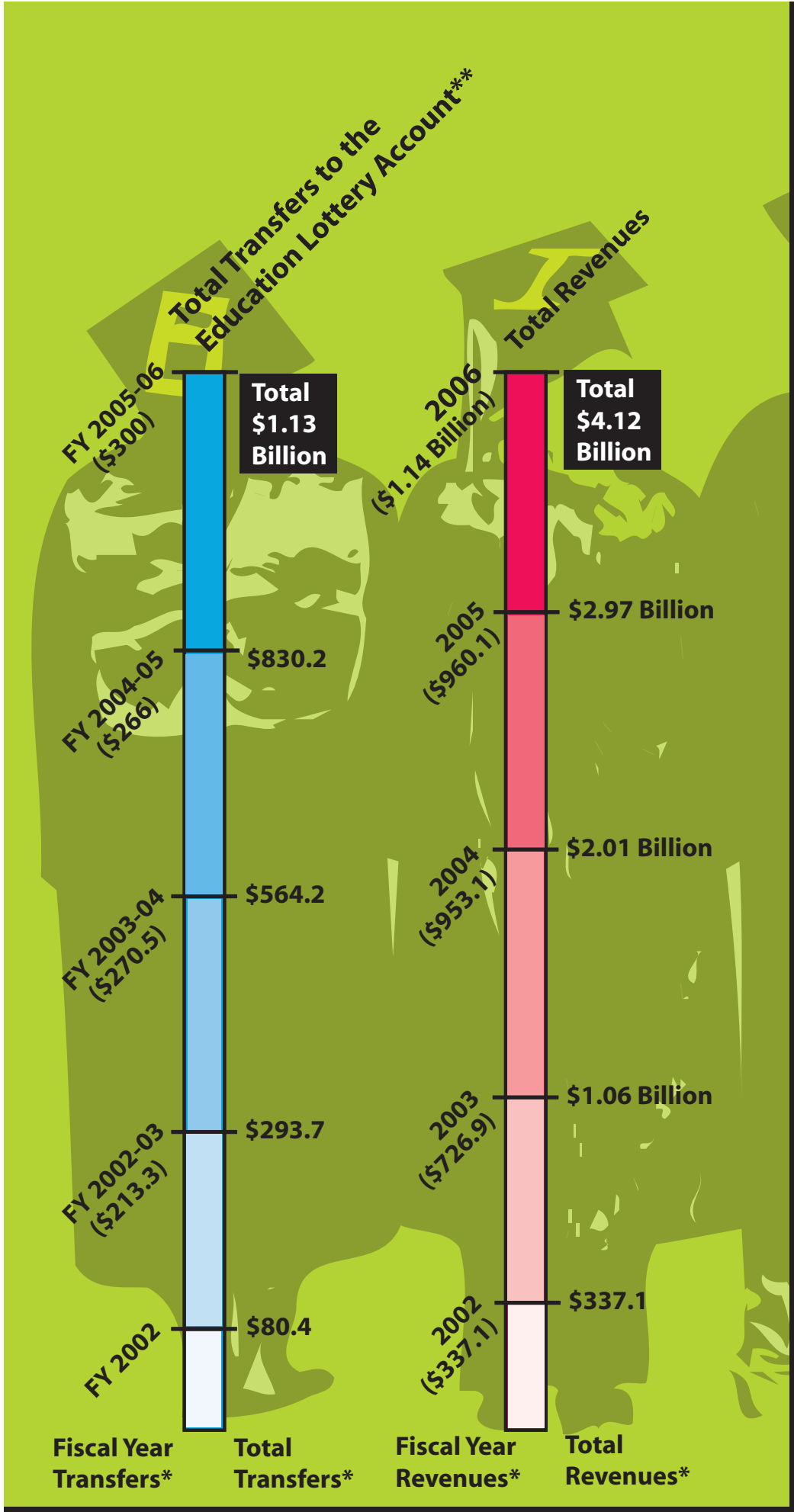
Measuring Success

SCEL's goals and objectives form the basis of the development of priorities for the strategic plan and are a derivative of the Sales and Marketing business plan. Key performance measures communicate the quantitative benchmark used in evaluating the achievement of agency goals. SCEL has additional, detailed internal measures which are utilized in assessing individual job performance.

Again this year, SCEL exemplifies a high level of achievement, as evidenced by record sales and acclaimed human resource management. The South Carolina Chamber of Commerce named SCEL one of the *Top 15 Best Places to Work in South Carolina* and recognized the agency for its *Workplace Diversity*. Five finalists for the lottery industry's prestigious *Edward J. Powers Award* were SCEL employees. Further, in the September 2006 issue of *La Fleur's Magazine*, for fiscal year 2005-06, SCEL ranked 5th in per capita instant ticket sales among U.S. lotteries, achieving an outstanding 20.3% growth rate in this product category from the previous fiscal year. In terms of total sales per capita, SCEL ranked 16th worldwide in calendar year 2005.[1] SCEL closed the fiscal year grossing over $1.14 billion in total sales, which was another record-setting performance.

For details on the South Carolina Education Lottery's performance measures, please review the *Lotto Facts* report on SCEL's website at www.sceducationlottery.com.

[1] "Worldwide 2005 Lottery Sales," La Fleur's Magazine May 2006: 13-22.



On the Cover

The 2005-06 fiscal year was a banner year for the South Carolina Education Lottery (SCEL) in two ways. As a component unit of the State of South Carolina charged with earning funds to be appropriated to support educational programs and opportunities, SCEL reached a landmark when the Lottery transferred the ONE BILLIONTH dollar to the Education Lottery Account on December 15, 2005.

Half a year later, the Lottery passed the BILLIONTH DOLLAR in sales mark on May 9, 2006. While SCEL has exceeded the annual sales goals set by the Board of Economic Advisors every year since startup, this is the first year sales exceeded $1 billion.

Reaching these two milestones was made possible with the support given the Lottery by players and retailers in this state. Thanks a BILLION, South Carolina!

*Dollar figures for transfers to the Education Lottery Account and revenues are in millions unless otherwise indicated.

**Transfer amounts do not include unclaimed prize funds or interest earned on the funds in the Education Lottery Account.

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