

# Reaching for the Sky

Florida Lottery 2000-2001 Annual Report





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## From the Governor



Dear Friends:

The Florida Lottery's continued solid performance is an accomplishment in which we all can take pride. For the second consecutive fiscal year, the Lottery has generated record sales and has provided more than **\$900 million** in non-tax revenue to support improvements to Florida's public schools. In pursuing my policy of sustained and responsible sales growth, the Lottery posted net sales of **\$2.274 billion**, an increase of **\$26.2 million** over fiscal year 2000.



While the Lottery provides only a portion of Florida's overall investment in public education, today's Lottery supplies money for programs that invest directly in students, among them the Bright Futures Scholarship Program. In fiscal year 2000-2001, Lottery money provided **\$164.8 million** in Bright Futures Scholarships, opening our universities' doors to **92,202** students, many of whom might not otherwise have had the resources to further their educations. The Lottery also contributed **\$106.9 million** for statewide preschool projects designed to help Florida's most valuable, and needy, residents.

During fiscal year 2001, the Florida Lottery earned hundreds of millions of dollars in funding for public schools themselves. Our K-12 public schools in all 67 counties received a combined total of more than **\$267.4 million** in discretionary Lottery money. Our community colleges and state universities received a combined total of more than **\$204.2 million**.

The Lottery's contributions to education have exceeded **\$11 billion** since the first ticket was sold in 1988. Under the proven leadership of Secretary David Griffin, I am confident our Lottery will continue to make meaningful contributions to our children and to the future of our great state. Congratulations to every individual and business that has played a part in making our Lottery a success.

Sincerely,

A handwritten signature in cursive script that reads "Jeb Bush".

Jeb Bush

## From the Secretary



Dear Friends and Colleagues:

In 1999, we drafted the blueprint that would help us to build record sales and record proceeds for education. Now, a smarter, more businesslike Lottery has taken shape. Never has there been a leaner, more efficient or more profitable Florida Lottery. Two years of record sales, coupled with our efforts to reduce costs and operate more efficiently, have generated more than **\$1.8 billion** in non-tax profits for education, profits that provide funding for Bright Futures scholarships, plus support for K-12 schools, community colleges, state universities, and much more.

In fiscal year 2001, we focused on elevating the Scratch-Off games to world-class status, completed the implementation of a new gaming system, and improved the Lottery customer experience. These efforts resulted in a record year for both Scratch-Off game sales *and* for total ticket sales. Our strong performance in the marketplace, along with efficient management of our business and contracts, resulted in transfers to the Educational Enhancement Trust Fund of more than **\$900 million** for the second straight fiscal year.

A net sales increase of **1.1 percent** during fiscal year 2001 underscores not only our commitment to Florida's schoolchildren, but also our determination to follow through on Gov. Bush's plan for responsible growth of Lottery revenue while holding the line on new forms of gaming in Florida. I am confident that adherence to sound marketing and business principles will continue to move us toward the goal of contributing **\$1 billion** annually to education.

Our goals may be lofty, but Florida deserves a Lottery that rises to big challenges. To every player, retailer and business who contributed to our success in fiscal year 2001, thank you. To all who will share in our successes in the years to come, welcome.

Sincerely,

A handwritten signature in black ink that reads "David Griffin". The signature is written in a cursive, flowing style.

David Griffin



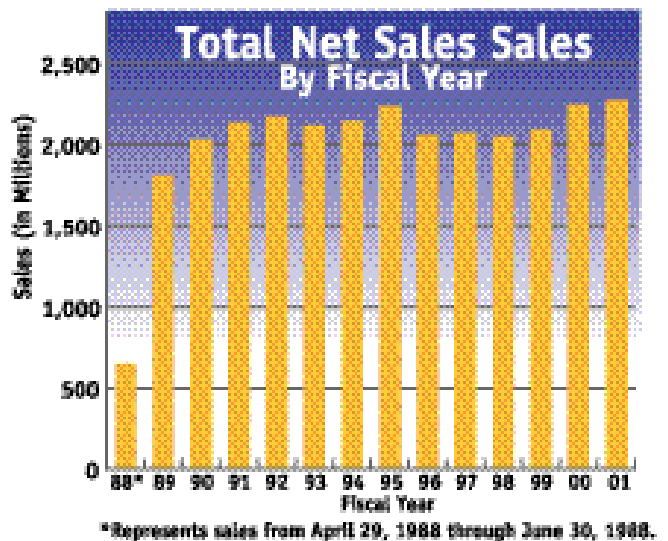
# Reaching for the Sky



Eleanor and Herbert Grotkopf, of St. Petersburg, claimed an estimated \$3 million FLORIDA LOTTO jackpot from the April 4, 2001 drawing. The couple elected to receive their jackpot prize in a one-time cash payment of \$1,503,398!

In 1999, when we began the process of building a new Florida Lottery, we envisioned a monument to efficiency and productivity. Our retooled product lines and leaner operations would become a new foundation upon which to build a landmark business enterprise for Florida. That foundation, based upon sound business principles, has supported two consecutive record sales years, and two years of transfers to the Educational Enhancement Trust Fund totaling more than **\$1.8 billion** combined!

Our goals are to stand head and shoulders above expectations, to reach for the sky while keeping our feet firmly planted, to take our rightful place in Florida's financial landscape. We are proud of the progress we have made, and of our new stature as a growing business in a time when lottery sales are declining sharply nationwide. How could we have known that the results of fiscal year 2001 would raise the bar even further on our definition of success?





# Scratch-Off Ticket Sales Soar to New Heights

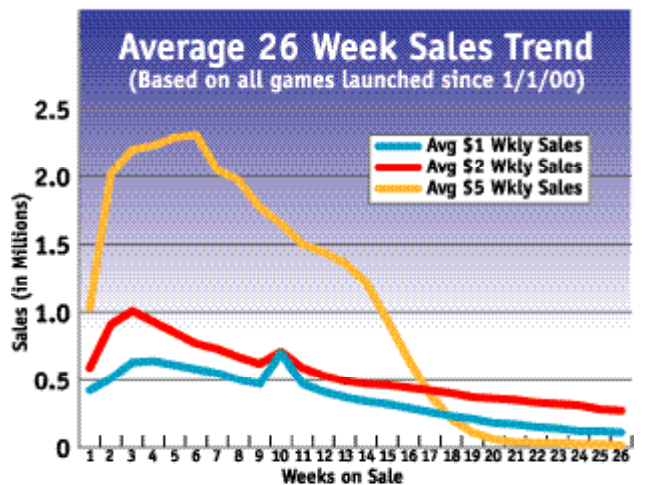
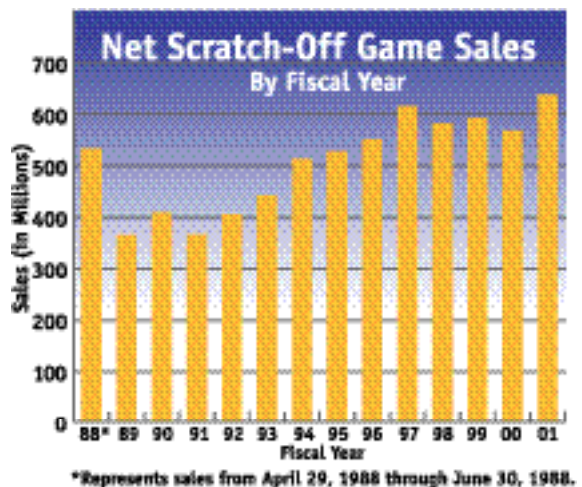


The re-engineering of our Scratch-Off game marketing program that began in fiscal year 2000 became the cornerstone for a record year in fiscal 2001. Net sales for Scratch-Off tickets reached an all-time high of **\$639.2 million**, increasing more than **\$70 million** over the previous year and eclipsing the previous record, set in fiscal year 1997, by more than **\$22.9 million**!

Record sales performances don't happen by accident. The framework for our Scratch-Off ticket boom was the product of careful planning, thorough research, and a determination to apply the results of that research to product marketing. The building blocks of our success included:

## The introduction of more Scratch-Off games with fewer tickets

Our research shows the first four weeks after a game hits the marketplace are the most important to sales. The Lottery introduced **38 percent** more Scratch-Off games during fiscal 2001, games with shorter life cycles designed to take full advantage of those critical weeks immediately following launch.



Half of 6 months' sales achieved:  
 In first 7 weeks for \$5 games  
 In first 9 weeks for both \$1 and \$2 games



## Regularly scheduled game launches

We imposed discipline on the introduction of new Scratch-Off games during fiscal 2001, with new games launching at regularly scheduled intervals. The constant flow of new product kept players interested, and kept Scratch-Off sales on an upward slope.

## The launch of more \$5 games

The Lottery introduced four games at the \$5 price point during fiscal 2001. The most popular \$5 game was COWBOY CASH, which sold more than **\$34 million** in tickets. STOCKING STUFFER (\$19 million in sales), CASINO ACTION (\$21 million in sales), and MEGA BUCKS (\$23 million in sales) topped off the year's \$5 Scratch-Off game offerings. The \$5 games' bigger payouts, better overall odds of winning, and bigger top prizes generated renewed player enthusiasm for the Scratch-Off games.



The Florida Lottery's \$5 Scratch-Off games helped to secure a record year, not only for the Scratch-Off product line, but also for total Lottery sales. Our \$5 tickets sold a combined total of more than \$97 million during fiscal year 2001.

## Co-promotion of Scratch-Off tickets with other recognized brands

Partnerships with marketing behemoths like Harley-Davidson®, Carnival Cruise Lines®, Universal Orlando® theme parks, and Top-Flite® also generated soaring interest in Scratch-Off tickets. Added value and brand familiarity attracted new players and brought lapsed players back to the Scratch-Off games. The success of the \$2 HARLEY-DAVIDSON Scratch-Off game is the best example of the power of Lottery co-promotions in 2001. Within 12 weeks of the game's launch, Lottery players had purchased nearly all of the 7.5 million HARLEY-DAVIDSON tickets printed. That's twice as fast as expected!

## An emphasis on mid-tier prizes and higher overall payouts

Industry research shows lottery games with higher overall payouts create more “winning experiences” for players, and sell better. The Florida Lottery increased the overall payout percentage for Scratch-Off games during fiscal 2001, and placed a greater emphasis on prizes in the popular \$25 to \$100 category.

All of these factors combined to forge a year like no other for the Scratch-Off product line. In all, the Lottery introduced 50 new Scratch-Off games during the fiscal year, and increased overall Scratch-Off game sales by more than **12 percent** over the previous year!



Within 12 weeks of launch, the Florida Lottery's \$2 HARLEY-DAVIDSON Scratch-Off game was nearly sold out. That's twice as fast as expected! Pictured is Harley-Davidson winner Raymond Wetzel (seated), a part-time resident of Boca Raton.

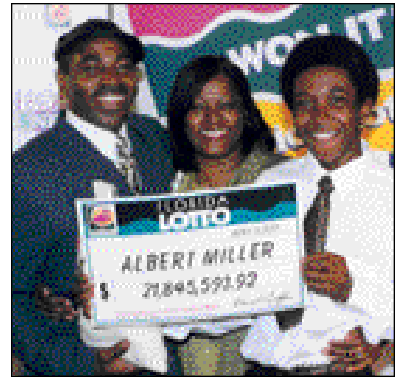


## On-line Games Maintain Altitude

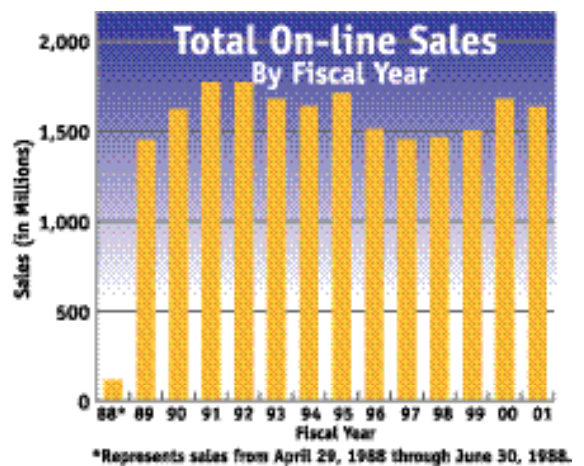
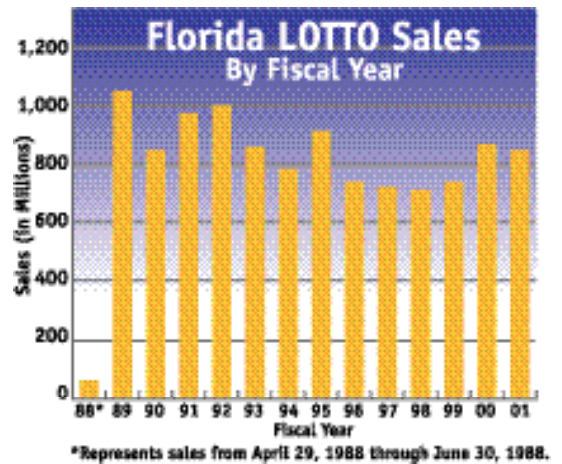
Sky-high sales continued for the Florida Lottery's On-line games during fiscal 2001. Combined On-line game sales for FLORIDA LOTTO, MEGA MONEY, FANTASY 5, PLAY 4 and CASH 3 remained essentially unchanged at **\$1.635 billion**, a marginal **0.2 percent** decline overall from fiscal 2000. The On-line games' continued high performance was largely a result of the previous year's FLORIDA LOTTO renovation. Despite an unprecedented LOTTO winning streak (and the corresponding lack of jackpot rollovers), our big-jackpot game maintained fiscal year sales in excess of **\$845 million** for the second year in a row!

Increases in CASH 3 and PLAY 4 sales, up **2 percent** and **2.8 percent** respectively, also helped to secure a second straight year of On-line game sales elevated to levels not seen since 1995. Players benefited from the daily games' strength as well, enjoying a record **\$5 million** CASH 3 payout on the numbers 3-3-3, drawn May 3, 2001.

While Scratch-Off games were the focus of our efforts in fiscal year 2001, preparations were being made behind the scenes to build upon our On-line game sales with the proposed launch of a new FANTASY 5 game. The new game will respond to players' requests for bigger jackpots, and will offer innovative, exciting new game features. New FANTASY 5 is due in the summer of 2001.



Albert Miller (left), of Winter Haven, only plays FLORIDA LOTTO when he has a few extra dollars to spare. On April 9, 2001, he claimed a jackpot worth an estimated at \$40 million. Albert and his family chose to receive their winnings in a one-time cash payment of \$21,845,593!

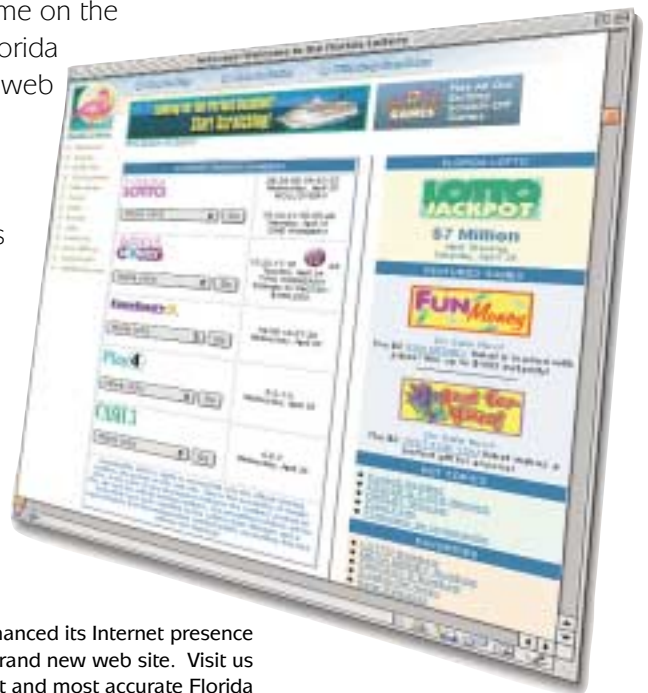




## Technology Improvements Reinforce Climbing Sales

The Florida Lottery completed one of the most significant infrastructure projects in its history during fiscal 2001. On May 14, the Lottery and its gaming system vendor, Automated Wagering International, completed the implementation of a new On-line gaming system. The wrap-up of this long-term infrastructure project included the completion of new-terminal rollout in all Lottery retail locations statewide, and the activation of new security and efficiency features related to ticket stock.

In February 2001, the Lottery, in cooperation with MyFlorida.com, opened a new window to the World Wide Web with a new web site, located at [www.flalottery.com](http://www.flalottery.com). The overhaul of our web presence was a customer-driven process, based upon player e-mail, usage patterns and other web-related feedback. The Florida Lottery's home on the Internet offers more, and more detailed, Florida Lottery information than ever before. Our web site, now hosted on servers at the state of Florida's Shared Resource Center in Tallahassee, has improved the web experience for Lottery web site enthusiasts through increased speed, greater capacity and a drastic reduction in down time.



The Florida Lottery dramatically enhanced its Internet presence with the February 2001 launch of a brand new web site. Visit us at [www.flalottery.com](http://www.flalottery.com) for the latest and most accurate Florida Lottery information available anywhere on the web.



## On the Horizon

Our determination to create a world-class Lottery illustrates our desire to help take Florida education to a higher plane. For fiscal year 2001, Florida college students received **\$164.8 million** in Bright Futures Scholarships, up from **\$131.8 million** in fiscal year 2000. On June 20, lifetime transfers to



Florida's Educational Enhancement Trust Fund reached a milestone **\$11 billion!**

While the Florida Lottery has reached a level not seen before, we realize that many of the world's greatest landmarks are those not yet completed. For us, the heavy lifting continues into 2002 as we continue working to improve our stature among state lotteries. We thank everyone who has contributed to the Lottery's accomplishments, and invite you to join us in our mission to reach ever higher on behalf of Florida's students and schools.





# Organizational Structure

As required by Chapter 24.105(5), Florida Statutes, the following information reflects the organizational structure of the Lottery at June 30, 2001.

## **Office of the Secretary**

**Chief of Staff** assists the Secretary in providing overall organizational direction and coordination, both in day-to-day activities and in long-range planning.

- **Legislative Affairs** serves as the Lottery's primary point of contact with legislators and legislative staff.

**General Counsel** staff provides overall direction, consultation and representation in legal matters affecting the Lottery.

**Inspector General** staff reviews and evaluates internal control systems necessary to ensure the fiscal accountability of the Department. Duties include performing financial, compliance and performance audits of the Department, and preparing audit reports of the findings.

**Division of Security and Administration** provides security services for the Department, including protection of buildings and facilities, investigative activities, game drawing security, and background investigations for vendors, retailers and employees.

- **Purchasing** executes all purchasing and contracting for the Department, and maintains liaison with the Department of Management Services and the Minority Business Advocacy and Assistance Office.
- **Support Services** provides operational support functions to Lottery offices throughout Florida, including vehicle fleet operation, property management, stock room and central receiving operations, facilities management and maintenance, mail center operations, central copy operations, and records management.

**Division of Human Resources Management** develops, implements, and administers a comprehensive human resources program.

- **Classification, Recruitment and Selection** advertises vacant positions, screens applicants to determine eligibility, audits selection packages for compliance with Departmental regulations, and maintains the position classification system.
- **Attendance and Leave** processes payroll, audits timesheet records, administers employee insurance programs, workman's compensation, retirement, and processes payroll deductions.
- **The Training and Development Office** provides a comprehensive general training program for employees, which includes management and supervisory training

**Product Development** provides direction and oversight in the creation, design and management of both On-line and Scratch-Off Lottery products.

**Games Administration and Compliance** manages all retailer-accounting issues and systems related to game transactions, including inventory and banking. Games Administration and Compliance also coordinates On-line Game functions for CASH 3, PLAY 4, FANTASY 5, MEGA MONEY and FLORIDA LOTTO, including closing games for draws, entering winning numbers into the On-line gaming system, and setting the games to pay. Games Administration and Compliance serves as the system coordinator for, and liaison to, Lottery retailers.

- **Office of Contract Compliance** manages Retailer Contracting and, through its Americans With Disabilities Act (ADA) Compliance unit, ensures that the Department and its retailers are in compliance with the Americans with Disabilities Act of 1990. Contract Compliance also provides oversight to contract management, helping to ensure optimum performance and compliance with the terms and conditions of major contracts.

## **Finance and Budget**

**The Budget Office** prepares legislative budget requests for the Department, monitors expenditures to ensure budgetary compliance, coordinates development of the Department's long-range program plan, and maintains the performance-based program budget.

**General Accounting** encompasses the Cash Management, Accounts Receivable and Financial Reporting sections. Cash Management coordinates the management of Lottery funds. Accounts Receivable manages the receipt of funds from retailers who sell Lottery products. Financial Reporting prepares financial statements and reports to convey the results of Lottery operations.

**Disbursements** manages the Accounts Payable and Player Accounting Services units. Accounts Payable disburses all vendor payments. Player Accounting Services processes prize payments to winners, including those made to FLORIDA LOTTO jackpot winners, and receives "Entry" tickets for special mail-in game promotions.

## **Assistant Secretary for Marketing**

**Marketing** encompasses all areas relating to the sale of Lottery products, including Statewide Sales, Research and Planning, Advertising, and Special Events and Promotions.

**Division of Sales** consists of 11 district sales offices, which manage the sale, promotion and redemption of Lottery products through a statewide network of more than 11,000 Lottery retailers. Each district office employs a staff of Lottery Sales Representatives who assist in the promotion and sale of Lottery products at the retail level. Five Sales Executives provide liaison to multi-location corporate retailers to ensure that the sales and promotional support of Lottery products meet the corporations' needs. Corporate Sales coordinates cooperative promotions, and plays a vital role in corporate retailer recruitment.

**Research and Planning** coordinates market research performed by the Lottery's contracted service providers for Scratch-Off games and Advertising. This area also is responsible for providing timely data and analyses of sales, player preferences and program effectiveness useful in product development planning, revenue forecasting, decision-making and communication.

**Division of Advertising** coordinates with the Lottery's contracted advertising agencies in the development and production of advertising materials that support the Lottery's marketing objectives.

**Special Events and Promotions** increases awareness of Lottery products through special sales promotions, promotional merchandise, and participation in special events held in communities throughout Florida. Promotions and events include game launches, On-line game drawings held at public venues throughout Florida, retailer promotions, and Lottery Showvan bookings.

## **Assistant Secretary for Public Affairs**

**Division of Communications** manages relations with and all written and electronic communication provided to players, retailers, news media and the general public.

- **Media Relations** coordinates all Lottery activities with the news media, including spokesperson interviews, news conferences, media kits and the Lottery's web site.
- **Public Information** manages customer correspondence and e-mail, serves as a clearinghouse for Lottery records, provides in-house Spanish-language translations, and provides library services to the Department. Public Information also produces the Department's official publications, including "Florida Lottery Update," a newsletter for retailers, and the Department's annual report.
- **Graphics** provides overall art direction for the Department, including quality control for Scratch-Off ticket design, publications, promotional items, presentation graphics, and photographic services.
- **Player Information Line** serves as the Lottery's liaison to players, responding to inquiries regarding Lottery games and various other facets of Lottery operations.

**Office of Educational Affairs** promotes awareness and understanding of the State's use of Lottery dollars to provide enhancements to public education in Florida through the development of educational materials, participation in educational conferences, and the formation of partnerships with the Department of Education and other educational organizations.

## **Assistant Secretary for Operations**

**Operations** consists of the following business areas that collectively provide technology solutions and services to support the Department's marketing and business needs. In addition, Operations manages the gaming vendor contract and coordinates cross-functional, formal user acceptance testing for gaming system enhancements.

**Division of Information Resources (IR)** designs and implements computer applications systems necessary for the functioning of the Department in a secure, power-redundant data center environment. IR also provides a comprehensive telecommunications system and office automation system.

- **Computer Operations** ensures the smooth operation of the Department's automated systems, providing 24-hour-per-day, seven-day-per-week staffing of the Lottery's primary and back-up data centers, verification and balancing of transactions from the gaming vendor, production control, and backup and system recovery services.
- **Systems Design and Development** provides application programming and systems analysis for critical business systems, including the Internal Control System, Scratch-Off ticket accounting, the Distributed Check Writer, and all in-house administrative systems
- **Systems and Network Support** installs, configures and maintains the Department's statewide and local-area non-gaming networks, including all in-house administrative computer systems, hardware, operating systems software, and voice systems.
- **Client Services** manages the end-user computing environment through the installation and maintenance of all desktop computing hardware and software. The Information Center within the Client Services unit provides Lottery staff with technical help desk services, internal consulting services, and group training courses relating to office automation, end-user computing tools, and specific business applications.

**Office of Information Security Management (ISM)**

develops and coordinates the information security infrastructure and program to provide protection and ensure integrity for the Department's computers, data and networks. ISM researches and installs firewall systems and virus protection software, administers and monitors systems access, and provides information security awareness and training. The unit also performs internal security audits and coordinates the preparation of security risk analyses pertaining to the Department's information resources.

**Office of Business Recovery** maintains a comprehensive business continuity plan to continue Lottery sales in the event of a natural disaster or other emergency.



# Financial Statements

June 30, 2001 and 2000

State of Florida | Department of the Lottery  
*(With Independent Auditors' Report Thereon)*

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# Independent Auditors' Report

State of Florida | Department of the Lottery

President of the Senate,  
Speaker of the House of Representatives  
and the Joint Legislative Auditing Committee  
Tallahassee, Florida

We have audited the accompanying balance sheets of the State of Florida, Department of the Lottery (the "Lottery") as of June 30, 2001 and 2000 and the related statements of revenue, expenses and changes in retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit 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 audit provides 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 Lottery as of June 30, 2001 and 2000, and the results of its operations and its 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 a report dated October 15, 2001 on our consideration of the Lottery's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

**KPMG LLP**

October 15, 2001

**Balance Sheets**

June 30, 2001 and 2000

(In Thousands)

<b>Assets</b>	<b>2001</b>	<b>2000</b>
Current assets:		
Cash and cash equivalents	\$ 90,375	125,230
Interest receivable	514	659
Accounts receivable, net	45,850	33,270
Inventories	1,178	1,269
Securities deposits	<u>1,398</u>	<u>1,551</u>
Total current assets	139,315	161,979
Securities lending income receivable	7,435	7,495
Investments, grand prize	2,032,149	2,054,143
Investments, other	2,051,248	1,730,614
Property and equipment, net	<u>2,716</u>	<u>2,937</u>
Total assets	<u>\$ 4,232,863</u>	<u>3,957,168</u>
 <b>Liabilities and Retained Earnings</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 7,989	14,326
Prizes payable	55,399	54,504
Due to Educational Enhancement Trust Fund	71,259	89,753
Deposits payable	<u>1,398</u>	<u>1,551</u>
Total current liabilities	136,045	160,134
Securities lending fees payable	7,629	8,725
Obligations under securities lending	2,050,215	1,729,162
Grand prizes payable	1,846,267	1,941,006
Compensated absences payable	<u>3,660</u>	<u>3,724</u>
Total liabilities	<u>4,043,816</u>	<u>3,842,751</u>
Retained earnings:		
Reserved for undistributed appreciation on restricted investments	186,331	111,480
Reserved for net fixed assets	<u>2,716</u>	<u>2,937</u>
Total retained earnings	<u>189,047</u>	<u>114,417</u>
Total liabilities and retained earnings	<u>\$ 4,232,863</u>	<u>3,957,168</u>

See accompanying notes to financial statements.

**Statements of Revenue, Expenses and Changes in Retained Earnings**

Years ended June 30, 2001 and 2000

(In Thousands)

	<u>2001</u>	<u>2000</u>
Operating revenue:		
Ticket sales	\$ 2,274,726	2,248,496
On-line fees and miscellaneous	9,603	7,702
Retailer fees	<u>179</u>	<u>153</u>
Total operating revenue	<u>2,284,508</u>	<u>2,256,351</u>
Operating expenses:		
Prizes	1,140,548	1,107,018
Retailer commissions	126,581	125,066
Scratch-off tickets	15,988	13,855
On-line games	31,046	33,224
Advertising	33,708	31,870
Personal services	23,916	28,108
Other contractual services	10,198	12,261
Materials and supplies	7,519	5,385
Bad debts	196	207
Depreciation	<u>1,233</u>	<u>1,962</u>
Total operating expenses	<u>1,390,933</u>	<u>1,358,956</u>
Income from operations	<u>893,575</u>	<u>897,395</u>
Nonoperating revenue (expenses):		
Interest	7,929	5,310
Securities lending income	113,749	87,793
Securities lending fees	(108,317)	(82,911)
Net appreciation in fair value of investments	210,288	110,758
Amortization of grand prizes payable	<u>(135,437)</u>	<u>(141,229)</u>
Total nonoperating revenue (expenses), net	<u>88,212</u>	<u>(20,279)</u>
Income before operating transfers	981,787	877,116
Transfers to Educational Enhancement Trust Fund	(907,157)	(908,353)
Retained earnings, beginning of year	<u>114,417</u>	<u>145,654</u>
Retained earnings, end of year	<u>\$ 189,047</u>	<u>114,417</u>

See accompanying notes to financial statements.

**Statements of Cash Flows**

Years ended June 30, 2001 and 2000

(In Thousands)

	<u>2001</u>	<u>2000</u>
Operating activities:		
Ticket sales	\$ 2,261,951	2,240,707
Prizes paid to winners	(1,139,653)	(1,098,278)
Commissions paid and payments to retailers	(126,581)	(125,066)
Paid to vendors for goods and services	(104,798)	(93,137)
Paid to employees	(23,981)	(28,727)
Other operating revenue	<u>9,782</u>	<u>7,684</u>
Net cash provided by operating activities	<u>876,720</u>	<u>903,183</u>
Noncapital financing activities:		
Payments to Educational Enhancement Trust Fund	<u>(925,651)</u>	<u>(862,527)</u>
Net cash used in noncapital financing activities	<u>(925,651)</u>	<u>(862,527)</u>
Capital and related financing activities:		
Purchase of property and equipment	(1,225)	(1,240)
Proceeds from sale of property and equipment	<u>306</u>	<u>171</u>
Net cash used in capital and related financing activities	<u>(919)</u>	<u>(1,069)</u>
Investing activities:		
Cash received from maturity of grand prize investments	236,789	235,205
Cash paid to grand prize winners upon maturity of grand prize investments	(236,789)	(235,205)
Interest	<u>14,995</u>	<u>9,466</u>
Net cash provided by investing activities	<u>14,995</u>	<u>9,466</u>
Net (decrease) increase in cash and cash equivalents	(34,855)	49,053
Cash and cash equivalents, beginning of year	<u>125,230</u>	<u>76,177</u>
Cash and cash equivalents, end of year	<u>\$ 90,375</u>	<u>125,230</u>

(Continued)

**Statements of Cash Flows**

Years ended June 30, 2001 and 2000

(In Thousands)

	<u>2001</u>	<u>2000</u>
Reconciliation of income from operations to net cash provided by operating activities:		
Income from operations	\$ 893,575	897,395
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation	1,233	1,962
Loss on disposal of property and equipment	(93)	(127)
Changes in assets and liabilities:		
Decrease (increase) in:		
Accounts receivable	(12,580)	(7,582)
Inventories	91	(9)
Increase (decrease) in:		
Accounts payable and accrued liabilities	(6,337)	3,424
Prizes payable	895	8,740
Compensated absences payable	(64)	(620)
Net cash provided by operating activities	<u>\$ 876,720</u>	<u>903,183</u>

See accompanying notes to financial statements.



## Notes To The Financial Statements

Years ended June 30, 2001 and 2000

### **(1) REPORTING ENTITY**

The State of Florida, Department of the Lottery (the "Lottery") was established as a state agency with the enactment of the Florida Public Education Lottery Act (the "Act") in 1987. The purpose of the Act is "to implement Section 15, Article X of the State Constitution in a manner that enables the people of the State to benefit from significant additional monies for education and also enables the people of the State to play the best lottery games available." The Act originally created the State Lottery Commission composed of five members appointed by the Governor. The purpose of the Commission was to serve as a resource for the Department and to provide private sector perspectives on the operation of a large marketing enterprise. The 2001 Legislature abolished several governmental boards and commissions, including the Commission, effective June 30, 2001.

The Lottery has adopted Governmental Accounting Standards Board ("GASB") Statement No. 14, The "Financial Reporting Entity", for the purposes of evaluating its financial statements. Based on the criteria in Statement No. 14, the Lottery has determined that there are no other units that meet the criteria for inclusion in the Lottery's financial statements. The Florida Comptroller's office prepares the Comprehensive Annual Financial Report for the State of Florida, which includes the Lottery as a part of the primary government.

### **(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

#### *(a) Basis of Presentation*

The Lottery is accounted for as a proprietary type enterprise fund. Enterprise funds are used to account for activities that are financed and operated in a manner similar to private business enterprises: (1) where the costs of providing goods and services to the general public on a continuing basis are to be financed through user charges; or (2) where the periodic determination of net income is considered appropriate. The Lottery is reported as an enterprise fund within the State of Florida's Comprehensive Annual Financial Report.

#### *(b) Basis of Accounting*

Basis of accounting refers to the timing of recognition of revenues and expenses in the accounts and reporting in the financial statements. The financial statements are prepared on the accrual basis of accounting in accordance with generally accepted accounting principles. Under this method, revenues are recognized when they are earned and expenses are recognized when they are incurred.



**Notes To The Financial Statements** | Years ended June 30, 2001 and 2000 *(continued)*

The measurement focus of proprietary fund types is on a flow of economic resource method, which emphasizes the determination of net income, financial positions and cash flows. All fund assets and liabilities, current and noncurrent, are accounted for on the balance sheet. Pursuant to Governmental Accounting Standards Board (GASB) Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting", the Lottery has elected not to apply Financial Accounting Standards Board ("FASB") pronouncements issued after November 30, 1989. As also provided by Statement No. 20, the Lottery has elected not to adopt any FASB statements issued after November 30, 1989 unless so directed by GASB.

*(c) Use of Estimates*

The preparation of financial statements in conformity with generally accepted accounting principles 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.

*(d) Revenue Recognition*

Lottery games are sold to the public by contracted retailers. Revenue is recognized when on-line tickets are sold to players and when books of scratch-off tickets are settled by retailers. Certain games include tickets which entitle the holder to exchange one ticket for another (free tickets). Such tickets are deemed to be replacements and, therefore, not included in ticket sales.

*(e) Commissions*

Retailers receive a commission of five percent on ticket sales. The commission on ticket sales for scratch-off games is based upon total tickets distributed to the players (including free tickets) which, when compared to revenue, causes the percentage to be slightly higher than five percent. Additionally, retailers are paid commissions through a one percent cashing bonus on redemption of tickets (including free tickets).

*(f) Prizes*

In accordance with the Act, as nearly as practicable, at least 50 percent of ticket sales must be returned to the public in the form of prizes.

**Notes To The Financial Statements** | Years ended June 30, 2001 and 2000 *(continued)*

Prize expense for scratch-off games is recorded based on the predetermined prize structure for each game, net of a provision for unclaimed prizes, as revenue is recognized. Prize expense for on-line games is recorded based on prizes won by the players, as revenue is recognized.

An estimate of scratch-off prizes which will not be claimed within 60 days after the end of each game and an estimate of on-line prizes which will not be claimed within 180 days after the drawing are added to the pool from which future prizes are to be awarded or used for special prize promotions.

All prizes are recorded at the actual amount except for the annuity-funded prizes which are paid out on a deferred basis. The actual prize expense for these types of prizes is based on the present value of the annuity using the interest yield on the investments which were acquired to fund the annuity.

In October and November 1998 several changes to the structure of past and future deferred prize payments occurred. In October 1998, Congress passed a law redefining constructive receipt. This change applied to deferred prizes payable over 10 years or more. The Lottery enacted this change for eligible new Lotto winners for draws on and after October 23, 1998, allowing grand prize winners 60 days after entitlement of the prize to decide whether to receive a lump sum cash prize or annual payments. The change was also adopted prospectively for eligible scratch-off game grand prize winners. On November 15, 1998, the Lottery changed the Lotto deferred prize payment period from 20 years to 30 years.

*(g) Inventories*

Supply inventory and promotional items are valued at cost, using the first-in, first-out method. Supply inventory is comprised of office materials and supplies and prepaid postage.

*(h) Allowance for Doubtful Accounts*

The allowance for doubtful accounts is based on an analysis of collectibility of accounts receivable which considers the age of the accounts.

*(i) Property and Equipment*

Property and equipment are stated at cost less accumulated depreciation. Depreciation on property and equipment is computed using the straight-line method over the following estimated useful lives:

**Notes To The Financial Statements** | Years ended June 30, 2001 and 2000 *(continued)*

Data processing equipment	3 to 5 years
Office furniture and fixtures	4 to 15 years
Vehicles and other equipment	3 to 15 years

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. Effective April 1, 2001 the Lottery converted over to the state of Florida property classification system. This conversion resulted in changes to some of the assigned estimated useful lives for existing property and changes to the monthly estimates of depreciation for the remainder of the useful life of this property.

*(j) Self-Insurance*

The Lottery participates in the various self-insurance programs established by the State of Florida for property and casualty losses and employee health insurance. Coverages include property, general liability, automobile liability, workers' compensation, court awarded attorney fees and federal civil rights actions. Property is self-insured for actual cash value to an aggregate of \$2 million per loss event. Property losses in excess of \$2 million are commercially insured up to \$200 million per loss event. Workers' compensation is provided to comply with the applicable law. The employee health insurance program provides for payment of medical claims of employees and covered dependents.

*(k) Compensated Absences*

Employees earn the right to be compensated during absences for vacation, illness, and unused special compensatory leave earned for hours worked on legal holidays. Compensated absences for annual leave are recorded as a liability when the benefits are earned. Compensated absences for sick leave are calculated based on the vesting method. Within the limits established by law or rule, unused leave benefits are paid to employees upon separation from state service. The cost of vacation and calculated sick leave benefits is accrued in the period in which earned. The compensated absences amounts are based on current salary rates and include employer social security and pension contributions at current rates.

*(l) Retained Earnings*

Retained earnings at June 30, 2001 and 2000, is comprised of the net book value of property and equipment of approximately \$2,716,000 and \$2,937,000, respectively, and the reserve for the undistributed appreciation on restricted investments held for grand

**Notes To The Financial Statements** | Years ended June 30, 2001 and 2000 *(continued)*

prize winners, securities lending cash collateral, and pooled investments with the State Treasurer of approximately \$186,331,000 and \$111,480,000, respectively.

*(m) Budget*

The budgetary basis of accounting required by state law differs materially from the basis used to report revenues and expenses in accordance with generally accepted accounting principles. Budgetary basis revenues are essentially on the cash basis. Budgetary basis expenses include disbursements plus current year payables and encumbrances which are certified forward into the next fiscal year and exclude prior year certified forwards. State law authorizes the payment of prior year payables and encumbrances not certified forward from the current year budget.

Certain expenses and other financing uses are not formally budgeted. Among these items are prizes, retailer commissions, bad debts and depreciation (while the cost of acquiring fixed assets and inventories is budgeted). These appear on the statement of revenues, expenses and changes in retained earnings but are not part of the operating budget.

*(n) Cash and Cash Equivalents*

The Lottery considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. This includes cash in banks, repurchase agreements with financial institutions, petty cash and balances in the State Board of Administration and the State Treasury pooled investments.

*(o) New Accounting Standards*

In June 1999, the GASB issued Statement No. 34, "Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments". Generally, this statement establishes financial reporting standards for state and local governments, including states, cities, towns, villages, and special-purpose governments such as school districts and public utilities. It establishes that the basic financial statements and required supplementary information for general purpose governments should consist of: management's discussion and analysis, basic financial statements, and required supplementary information. The requirements of this statement are effective for the Lottery in the year ended June 30, 2002. The State of Florida has elected not to adopt this statement prior to its effective date.

**Notes To The Financial Statements** | Years ended June 30, 2001 and 2000 *(continued)*

**(3) CASH AND INVESTMENTS**

*(a) Cash and Cash Equivalents*

Cash is held in demand deposits at various financial institutions. These deposits, with a book value of approximately \$349,000 at June 30, 2001 and \$329,000 at June 30, 2000, were insured by either the State's collateral for public deposits in accordance with Florida Statutes, Chapter 280.04 or Federal depository insurance.

Chapter 280, F.S., generally requires public funds to be deposited in a bank or savings association that is designated by the State Treasurer as authorized to receive deposits in the State and that meets the collateral requirements. Collateral in the amount of the greater of the average daily balance of public deposits multiplied by the depository's minimum collateral pledging level, established by the State Treasurer, or 25 percent of the average monthly balance of public deposits or 125 percent of the average daily balance of public deposits greater than capital, is required to be deposited with the State Treasurer as security for public deposits. Collateral may be held by another custodian with approval of the Treasurer if conditions are met which protect the State's interests. The amount of collateral may be increased to 125 percent of the average daily balance of public deposits if specified conditions exist. Eligible collateral includes federal, federally-guaranteed, state and local government obligations and corporate bonds.

Statutes provide that if a loss to public depositories is not covered by deposit insurance and the proceeds from the sale of securities pledged by the defaulting depository, the difference will be provided by an assessment levied against other qualified public depositories of the same type as the depository in default.

Due to the investing policy of the Lottery, book overdrafts were approximately \$1,221,000 at June 30, 2001 and \$1,150,000 at June 30, 2000, representing outstanding prize payment checks. These outstanding checks are included as a component of prizes payable. The Lottery has an agreement with a financial institution to honor prize payments, as they are presented to the bank, with investments covered by an overnight repurchase agreement as described below.

Investments, covered by an overnight repurchase agreement, were approximately \$99,000 and \$79,000 at June 30, 2001 and 2000, respectively. The underlying securities for the repurchase agreement are U.S. Government securities. These securities are uninsured and unregistered and are held by the financial institution in the Lottery's name. The repurchase agreement requires that the market value of the underlying securities must equal or exceed the amount held for investment which is 100 percent collateralized by the securities purchased. The largest amounts invested in repurchase agreements during the

**Notes To The Financial Statements** | Years ended June 30, 2001 and 2000 *(continued)*

years ended June 30, 2001 and 2000, were approximately \$2,100,000 and \$3,126,000, respectively.

Surplus cash is maintained in the State's general pool of investments. The State Treasurer pools funds from all departments. Included in the pool are time deposits, U.S. Government securities, bankers' acceptances, commercial paper, corporate notes, repurchase agreements and reverse repurchase agreements through a securities lending program. Approximately 90 percent of these investments are of the lowest credit risk category (insured or registered or held by the State or its agent in the State's name). The Lottery's share of this investment pool was approximately \$89,947,000 and \$124,838,000 at June 30, 2001 and 2000, respectively. No allocation will be made as to the Lottery's share of the types of investments or their risk categories. The Lottery's share of the assets and liabilities arising from the reverse repurchase agreements will likewise not be carried on the balance sheet since the State Treasury operates on a pooled basis and to do so may give the misleading impression that the Lottery itself has entered into such agreements. For further information refer to the State of Florida's Comprehensive Annual Financial Report or publications of the State Treasurer's Office.

*(b) Investments, Grand Prize*

The grand prize investments consist of U.S. Government obligations held on the Lottery's behalf by the State Board of Administration ("SBA"). Grand prize investments and related grand prizes payable are not presented in current assets or liabilities. They are not part of current operations but instead are restricted assets and liabilities that are held by the Lottery for grand prize winnings to be paid on a deferred basis if the cash payment option is not selected.

The Lottery adopted the provisions of GASB Statement No. 31, "Accounting and Financial Reporting for Certain Investments and for External Investment Pools", during the fiscal year beginning July 1, 1997. Generally, this statement establishes fair value standards for various investments, including debt securities and open ended mutual funds. Grand prize investments are shown at fair value, and the related grand prizes payable are adjusted to the net present value using the yield on the investments. The difference between the fair value of the investments and the net present value of the grand prizes payable is reflected as a reserve in retained earnings. This represents the unrealized gains on the investments. Because these investments are held restrictively for grand prize winners, this balance is not available for transfer to the Educational Enhancement Trust Fund.

Interest accreted on grand prize investments during the year is reflected as an increase in the carrying value of grand prizes payable on the balance sheet, and as a nonoperating

**Notes To The Financial Statements** | Years ended June 30, 2001 and 2000 *(continued)*

expense on the statements of revenues, expenses and changes in retained earnings. Net appreciation in fair value of investments is reflected as a nonoperating revenue on the statements of revenues, expenses and changes in retained earnings, and takes into account all changes in fair value that occurred during the year, including purchases, maturities, sales, and interest on maturities.

*(c) Investments, Other*

The other investments consist of the fair value of investments made with cash collateral held by the SBA on the Lottery's behalf as part of a securities lending program.

The SBA, authorized by Section 215.47 of the Florida Statutes, participates in a securities lending program involving grand prize investments. The Lottery, through the SBA, loans various securities to a borrower for collateral with a simultaneous agreement to return collateral for the same securities in the future. Collateral received from borrowers may be cash or U.S. Government securities. The SBA is contractually limited from pledging or selling collateral except in the event of borrower default. Contracts with lending agents require them to indemnify the SBA if the borrowers fail to return the underlying securities or fail to pay income distributions on them. No significant violations of legal or contractual provisions occurred, and no losses resulted from borrower or lending agent defaults.

Deutsche Bank is the agent in lending U.S. Treasury securities to various authorized brokers for cash or U.S. Government securities. Collateral in the form of cash at 100 percent, or other securities at 102 percent, of the market value of the securities loaned is required by the lending agreement. Borrowers must be approved for lending by Deutsche Bank's credit department. Deutsche Bank monitors the market value of collateral provided and the securities on loan on a daily basis. Additional collateral is required if the market value of the collateral for any loan is less than 100 percent of the market value of the securities provided for such loan. The SBA had no credit risk exposure to borrowers at year-end.

The SBA received \$2,050,215,000 of cash collateral for the lending program as of June 30, 2001. At June 30, 2001, the collateral that was held for the securities lending transactions exceeded the fair value of the securities underlying the agreements (including accrued interest). The cash was primarily invested in short-term investments. However, approximately 42 percent of the total cash collateral was invested in investments with maturities of 6 months or more. Maturities of investments made with cash collateral generally do not match maturities of the securities loaned, due to securities loan agreements being open-ended with no fixed expiration date.

**Notes To The Financial Statements** | Years ended June 30, 2001 and 2000 *(continued)*

Securities lending activity for the years ended June 30, 2001 and 2000 consisted of:

	<u>2001</u>	<u>2000</u>
	<i>(in thousands)</i>	
Securities lending income	\$ 113,749	\$ 87,793
Less broker rebates	(106,506)	(81,476)
Less bank fees	<u>(1,811)</u>	<u>(1,435)</u>
Net securities lending revenue	<u>\$ 5,432</u>	<u>\$ 4,882</u>

*(d) Investment Credit Risk*

GASB Statement No. 3 provides for the classification of investments to give an indication of the level of credit risk assumed by the Lottery.

Category 1 credit risk investments include investments that are insured or registered or for which the securities are held by the Lottery or its agent in the Lottery's name. Category 2 includes uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent in the Lottery's name. Category 3 includes uninsured and unregistered investments for which the securities are held by the counterparty, or by its trust department or agent but not in the Lottery's name.



**Notes To The Financial Statements** | Years ended June 30, 2001 and 2000 *(continued)*

All of the Lottery’s investments are carried at fair value. Certain investments cannot be categorized because they are not evidenced by securities that exist in physical or book entry form, such as mutual funds or commingled funds. The schedule of Lottery investments at June 30, 2001 is presented below.

<u>Investments</u>	<u>Risk Category 1</u>	<u>Risk Category 3</u>	<u>Carrying amount</u>
		<i>(in thousands)</i>	
Lottery investments—classified:			
Certificates of deposit, negotiable	\$       --	\$ 167,224	\$ 167,224
U.S. obligations	43,079	—	43,079
Commercial paper	--	494,138	494,138
Time deposits	--	106,305	106,305
Repurchase agreements	--	82,817	82,817
Bonds and notes	--	<u>822,912</u>	<u>822,912</u>
Total classified investments	<u>\$ 43,079</u>	<u>\$ 1,673,396</u>	<u>1,716,475</u>
Lottery investments—unclassified:			
Investments held by broker dealers under securities lending agreements:			
U.S. obligations			1,989,071
Investment agreements			15,528
Money market and mutual funds			362,324
Pooled investments with State Treasurer (included in cash equivalents)			<u>89,947</u>
Total unclassified investments			<u>2,456,870</u>
Total investments			<u>\$ 4,173,345</u>

**(4) SECURITY DEPOSITS AND DEPOSITS PAYABLE**

The Lottery receives from certain vendors and retailers certificates of deposit and cashier checks in order to secure contract performance. These instruments are held in trust by the State with any interest earnings being credited to the vendor or retailer. These deposits are established to reduce the potential financial risk to the Lottery in the event of a breach of contract. These certificates and checks appear on the balance sheet in assets as security deposits and in liabilities as deposits payable.

**Notes To The Financial Statements** | Years ended June 30, 2001 and 2000 *(continued)*

**(5) PROPERTY AND EQUIPMENT**

Property and equipment at June 30 consisted of:

	<u>2001</u>	<u>2000</u>
	<i>(in thousands)</i>	
Data processing equipment	\$ 8,653	\$ 9,646
Office equipment and fixtures	6,367	7,283
Vehicles and other equipment	<u>3,694</u>	<u>3,789</u>
	18,714	20,718
Less accumulated depreciation	<u>(15,998)</u>	<u>(17,781)</u>
Total property and equipment, net	<u>\$ 2,716</u>	<u>\$ 2,937</u>

**(6) GRAND PRIZES PAYABLE**

Grand prizes payable at June 30 consisted of:

	<u>2001</u>	<u>2000</u>
	<i>(in thousands)</i>	
Lotto grand prizes (face value)	\$ 2,765,509	\$ 2,987,775
Win For Life grand prizes (face value)	15,934	16,298
Big 10 grand prizes (face value)	550	640
Flamingo Fortune Game Show Grand Prize (face value)	1,700	1,800
Monthly bonus grand prizes (face value)	336	480
Win a Million grand prizes (face value)	850	900
Less imputed interest	<u>(938,612)</u>	<u>(1,066,887)</u>
Net present value of grand prizes payable	<u>\$ 1,846,267</u>	<u>\$ 1,941,006</u>

**(7) DUE TO EDUCATIONAL ENHANCEMENT TRUST FUND**

In accordance with the Act, at least 38 percent of revenue, net of retailer application fees, for the years ended June 30, 2001 and 2000, must be transferred to the Educational Enhancement Trust Fund for the benefit of public education. Because the net appreciation in fair value of investments and amortization of grand prizes payable, included in non-operating revenues and expenses, relate to valuations of the restricted grand prize investments and grand prizes payable, they are excluded from the determination of transfers to the Educational Enhancement Trust Fund.

**Notes To The Financial Statements** | Years ended June 30, 2001 and 2000 *(continued)*

Due to Educational Enhancement Trust Fund at June 30 consisted of:

	<u>2001</u>	<u>2000</u>
	<i>(in thousands)</i>	
Operating revenue	\$ 2,284,508	\$ 2,256,351
Nonoperating revenue (expenses), net	88,212	(20,279)
Less: Retailer application fees	(179)	(153)
Net appreciation in fair value of investments	(210,288)	(110,758)
Amortization of grand prizes payable	<u>135,437</u>	<u>141,229</u>
Net revenue	2,297,690	2,266,390
	x <u>38%</u>	x <u>38%</u>
Statutorily required transfer	873,122	861,228
Additional transfer appropriated	17,520	6,898
Unencumbered balance to be transferred	<u>16,515</u>	<u>40,227</u>
Due for year	907,157	908,353
Balance, beginning of year	89,853	43,927
Paid during year	<u>(925,751)</u>	<u>(862,527)</u>
Due to Educational Enhancement Trust Fund, end of year	<u>\$ 71,259</u>	<u>\$ 89,753</u>

**(8) EMPLOYEE BENEFITS**

*Retirement Plan*

*Plan Description*—The Lottery participates in the Florida Retirement System (“FRS”), a cost-sharing multiple-employer public employee defined benefit retirement system administered by the State of Florida, Department of Management Services, Division of Retirement, to provide retirement and survivor benefits to participating public employees. Chapter 121, Florida Statutes, establishes the authority for participant eligibility, contribution requirements, vesting eligibility and benefit provisions. FRS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by contacting the State of Florida, Department of Management Services, Division of Retirement, Bureau of Research, Education and Policy, 2639 North Monroe Street, Building C, Tallahassee, Florida 32399-1650.

**Notes To The Financial Statements** | Years ended June 30, 2001 and 2000 *(continued)*

*Funding Policy*—The Lottery is required to pay all contributions for full-time and part-time employees. Generally, employee participation is compulsory. The contribution rates are as follows (including .94 percent health insurance subsidy for the fiscal years ended June 30, 2001 and 2000):

	<b>July 1, 2000 through June 30, 2001</b>	<b>July 1, 1999 through June 30, 2000</b>
Senior management	11.13%	12.13%
Regular employees	9.15%	10.15%

The Lottery’s contributions to the FRS amounted to approximately \$1,632,000 and \$2,166,000 for the years ended June 30, 2001 and 2000, respectively. These contributions represented 9.38 percent and 10.42 percent of covered payroll, for the years ended June 30, 2001 and 2000, respectively. The Lottery contributed 100 percent of the required contributions for each of the years ended June 30, 2001 and 2000.

**OTHER POSTEMPLOYMENT BENEFITS**

In 1987, the Florida Legislature established through Section 112.363, Florida Statutes, the Retiree Health Insurance Subsidy (“HIS”) to assist retirees of all state-administered retirement systems in paying health insurance costs. From July 1, 1997 through December 31, 1998, eligible retirees or beneficiaries received as much as \$3 per month for each year of creditable service completed at the time of retirement; the payments to individual retirees or beneficiaries were at least \$30 but not more than \$90 per month. Beginning January 1, 1999, eligible retirees or beneficiaries received as much as \$5 per month for each year of creditable service completed at the time of retirement; the payments to individual retirees or beneficiaries were at least \$50 but not more than \$150 per month.

To be eligible to receive the HIS, a retiree under any state-administered retirement system must provide proof of health insurance coverage, which can include Medicare.

HIS is funded by required contributions from FRS participating employers. For each of the years ended June 30, 2001 and 2000 the Lottery contributed .94 percent of payroll for all active employees covered by the FRS. This contribution was added to the amount submitted for retirement contributions and was deposited in a separate trust fund from which HIS payments are authorized. If these contributions fail to provide full subsidy benefits to all participants, the subsidy payments may be reduced or canceled.

**Notes To The Financial Statements** | Years ended June 30, 2001 and 2000 *(continued)*

In addition to the HIS, Chapter 110.123, Florida Statutes, provides that retirees may participate in the State's group health insurance programs. Premiums are paid by the retiree.

**DEFERRED COMPENSATION PLAN**

The Lottery, through the State of Florida, offers its employees a deferred compensation plan created in accordance with Section 457 of the Internal Revenue Code. The plan (refer to Section 112.215, Florida Statutes), available to all regular payroll State employees, permits them to defer a portion of their salaries until future years. The deferred compensation is not available to employees until termination, retirement, death or an unforeseen emergency.

All amounts of compensation deferred under the plan, all property and rights purchased with those amounts, and all income attributable to those amounts, property, or rights are (not withstanding the mandates of 26 U.S.C.s.457(b)(6), all of assets specified in subparagraph 1) held in trust for the exclusive benefit of participants and their beneficiaries as mandated by 26 U.S.C.s. 457(g)(1).

The Lottery does not contribute to the plan. Participation under the plan is solely at the discretion of the employee.

The State has no liability for losses under the plan but does have the duty of due care that would be required of an ordinary and prudent investor. During the 1997 fiscal year Chapter 97-8 of the Laws of Florida amended Section 112.215, Florida Statutes, by creating the Deferred Compensation Trust Fund in the State Treasury.

**(9) COMMITMENTS AND CONTINGENCIES**

*Commitments–Leases–* The Lottery has entered into operating leases for the rental of office and warehouse space for the headquarters and district offices as well as the rental of scratch-off ticket vending machines and computer equipment. Certain leases are renewable at the option of the Lottery.

**Notes To The Financial Statements** | Years ended June 30, 2001 and 2000 *(continued)*

Future minimum rental payments as of June 30, 2001 are scheduled as follows (in thousands):

<b>Year Ending June 30</b>	<b>Headquarters</b>	<b>Districts</b>	<b>Total</b>
2002	\$ 2,370	\$ 932	\$ 3,302
2003	2,393	710	3,103
2004	2,417	366	2,783
2005	2,442	120	2,562
2006 and thereafter	<u>7,473</u>	<u>—</u>	<u>7,473</u>
	<u>\$ 17,095</u>	<u>\$ 2,128</u>	<u>\$ 19,223</u>

Rental expense under all leases totaled approximately \$5,432,000 and \$5,791,000 for the years ended June 30, 2001 and 2000, respectively.

**(10) LITIGATION**

*On Line Services* – The Department has contracted with Automated Wagering, Inc. (“AWI”) for on-line services since 1988. These services include the provision of computer hardware, software and telecommunications, along with maintenance and other services. In 1995, the Department rebid the contract and again chose AWI as its on-line service provider. Shortly thereafter, the unsuccessful bidder protested the award of the contract to AWI; however, the award of the contract was upheld by the Florida Supreme Court. In a separate lawsuit filed in 1999, the unsuccessful bidder challenged the validity of the contract that was ultimately awarded to AWI. On January 28, 2000, the Leon County, Florida Circuit Court entered a judgment in favor of the challenger, finding the AWI contract to be null and void and issuing an injunction against proceeding under the contract.

The Department has appealed the decision of the Circuit Court. By operation of law, an automatic stay of the court’s order is in effect pending appellate review. In addition, the Circuit Judge specifically wrote that his Order is not intended to prohibit the Department from continuing to operate on an interim basis, utilizing its emergency powers.

On February 28, 2001, the Florida First District Court of Appeal upheld the Circuit Court’s decision. On March 15, 2001, the Department filed motions seeking a rehearing of the Court of Appeal’s decision, and asking that court to certify the case to the Florida Supreme Court. On July 17, 2001, the Court of Appeal certified two questions regarding the Department’s authority to contract as it did to the Florida Supreme Court, as being questions of great importance.

**Notes To The Financial Statements** | Years ended June 30, 2001 and 2000 *(continued)*

Although AWI is currently providing its services pursuant to the disputed contract, the Department and AWI have entered into an emergency interim contract, containing the same terms, which would become effective if the stay is lifted. This emergency contract would remain in effect until a new contract is executed or if the current contract is determined to be valid by the appellate court. The Department is confident that Lottery operations will continue without interruption until this matter is concluded, and that no adverse operational or financial consequences will ensue as a result of these developments.

The term of the current contract began on September 30, 1999 and runs through December 31, 2004; it provides that AWI will design, install and operate a new statewide gaming system, including 10,000 new, full service terminals and 2,000 new scratch-off only terminals. The new gaming system was implemented on February 7, 2000. The new terminal rollout phase began in May 2000 at the rate of 300-400 terminal installations per week. As of May 2001 all phases of the new gaming system, including terminal rollout, had been completed. The base compensation to AWI is 1.85% of on-line sales. The contract also provides for potential additional compensation, during the initial five-year term only, of 1.11% of the amount of on-line sales in excess of \$1,580,480,000 (10% over the revenue projections for Fiscal Year 1999-2000 as projected by the February 1999 Revenue Estimating Conference). However, there is a cap which limits the potential combined compensation rate to 2.08%. The contractor's compensation was \$31,046,000 and \$33,224,000 for the years ended June 30, 2001 and 2000, respectively.

The Lottery entered into an agreement with Scientific Games Inc. as of April 2, 1997, to provide scratch-off lottery game tickets and related services through September 30, 2002. The contractor's compensation is 2.4375 percent of net scratch-off sales during the term of the agreement, subject to the payment provisions of the agreement. This compensation amounted to \$15,583,000 and \$13,855,000 for the years ended June 30, 2001 and 2000, respectively.

*Other* – The Lottery is involved in litigation and other claims incidental to the ordinary course of its operations. In the opinion of Lottery management, based on the advice of legal counsel, the ultimate disposition of these lawsuits and claims will not have a material adverse effect on the financial position of the Lottery.







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