



# Reflections

Reflections

Florida Lottery **Annual Report 2001•2002**

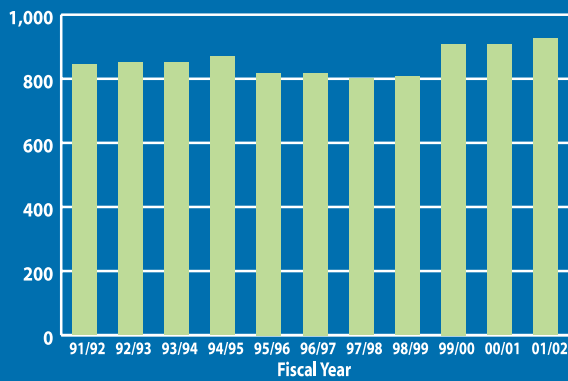


**Mission:**

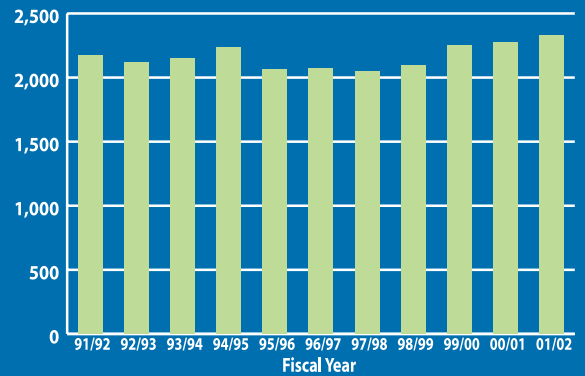
To operate the state lottery  
as authorized by Section 15,  
Article X of the State Constitution  
and maximize revenues  
in a manner consonant with  
the dignity of the state and  
the welfare of its citizens.

# At a Glance

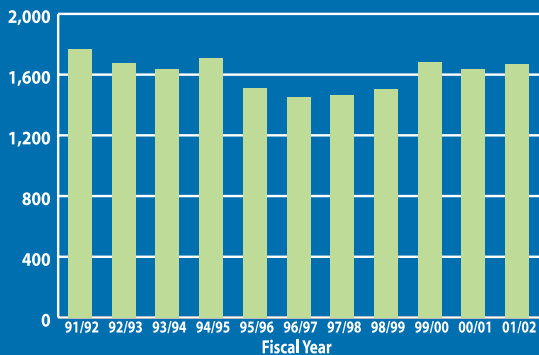
**Net Transfers to Educational Enhancement Trust Fund (EETF)**  
(in millions)



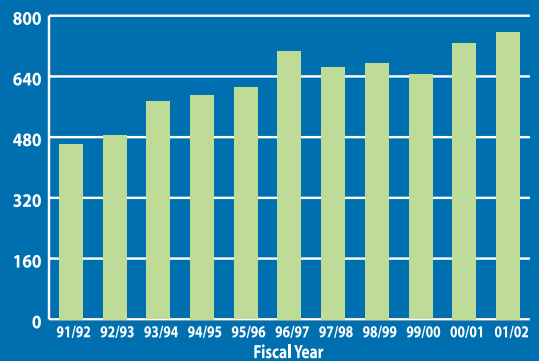
**Total Net Sales**  
(in millions)



**Total On-line Sales**  
(in millions)



**Gross Scratch-Off Sales**  
(in millions)





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## From the Governor

Dear Friends:

The residents of Florida can take pride, once again, in the Florida Lottery's performance during the 2001/2002 fiscal year. Consistent with my policy of sustained and responsible growth of Lottery revenues, total net sales increased by more than \$55 million.

This record sales year allowed the Florida Lottery to contribute more than \$926 million in non-tax revenue to the Educational Enhancement Trust Fund. The total contribution to education has been more than \$12 billion since the Lottery's first year of operation in 1988.

Although the Lottery plays only a small role in the state's overall investment in public education, the Lottery plays a major role in investing in the state's most valuable resources, our children, the leaders of tomorrow. During the fiscal year 2001/2002, the Lottery funded 98,294 Bright Futures Scholarships, \$396.4 million in district discretionary funds, and \$197.2 million in support of Florida's community colleges and state universities.

The Lottery has flourished under Secretary David Griffin's direction and leadership, and I am confident that Floridians will continue to benefit from the Lottery's ongoing success. Congratulations to all who have played a role in the Florida Lottery's achievements.

Sincerely,

A handwritten signature in black ink that reads "Jeb Bush".

Jeb Bush  
Governor



## From the Secretary

Dear Friends and Colleagues:

I am pleased to report that during fiscal year 2001/2002, the Florida Lottery achieved higher sales than ever before, enabling us to post the largest single year transfer to the Educational Enhancement Trust Fund.

The transfer of more than \$926 million resulted from the efficient, businesslike lottery operation we built during the last three years. The Lottery continues to be mindful of Governor Bush's policy for responsible growth in its mission to provide additional revenue for the state's overall system of public education.

My goal, to transfer \$1 billion to the Educational Enhancement Trust Fund during a single fiscal year, is steadfast. The Lottery continues to make improvements in executing its core competencies. These improvements, coupled with new legislation allowing increased instant game payouts, have left the Lottery positioned to achieve this goal.

I wish to extend my appreciation to all our customers. Whether a player, retailer, employee, or business, I thank everyone who has helped the Florida Lottery emerge as a leader in the lottery industry.

Sincerely,

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

David Griffin  
Secretary

# Change

to On-line games

proves successful

# Change

## Product Development

### On-line Games

Three years ago, the Florida Lottery began a series of successful enhancements to the Lottery's On-line products, including a restructuring of LOTTO and FANTASY 5. Today, as a result of these enhancements, On-line product sales average a combined net increase of more than \$164 million since fiscal year 1998/1999.

LOTTO was the first On-line product to change, with an increase in the matrix from 49 numbers to 53 numbers and the addition of a mid-week draw. These changes increased the number of rollovers and boosted the average jackpot size. LOTTO sales annually are averaging \$101 million more than before the game enhancements were made. Fiscal year 2001/2002 produced three record LOTTO jackpots, \$87.63 million on January 19, 2002;

\$56.37 million on September 5, 2001; and \$36.34 million on May 15, 2002.

The Lottery also launched a new FANTASY 5 game on July 16, 2001. This new game provided average jackpots of \$100,000 with a new "rolldown" feature and larger lower-tier prizes. These enhancements, along with better overall odds and a free FANTASY 5 ticket for a 2-of-5 match, created a 37 percent sales increase by the end of fiscal year 2001/2002, an increase of \$71 million over the previous fiscal year.

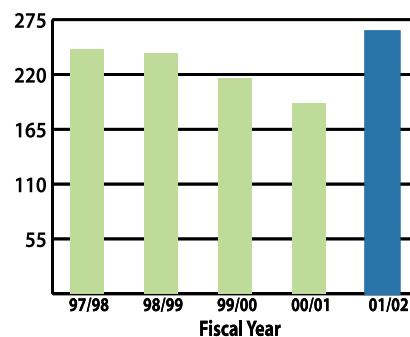
Although MEGA MONEY sales showed a marginal decline, sales increases in CASH 3 and PLAY 4 offset the decrease in MEGA MONEY sales. The combined sales of CASH 3, Play 4 and MEGA MONEY, for fiscal year 2001/2002, generated more than \$598 million in sales.

During fiscal year 2001/2002, the Florida Lottery added requested

player convenience features to the Lottery's On-line games. The On-line ticket cancellation period was extended from 20 minutes to two hours, and LOTTO Advance Play was extended from 26 draws to 52 draws. The new combined HOW TO PLAY brochure was also introduced in the marketplace to provide the players with detailed information about all Florida Lottery games in a single, convenient source.

### FANTASY 5 Sales

(in millions)



During fiscal year 2001/2002, the Florida Lottery added requested



# Innovation

in Scratch-Off games

establishes

new precedent



# Innovation

## Scratch-Off Games

Fiscal year 2001/2002 was a true success story for the Florida Lottery's Scratch-Off game product line. Scratch-Off games reached record-breaking net sales of more than \$662 million. This new record reflected an increase of more than \$23 million from the record set during previous fiscal year 2000/2001, and was the result of prudent market research, innovative product development and the implementation of a diversified product line, along with the following:

- An increase in the number of game launches.
- An increase in the number of \$5 games.
- A decrease in the product life cycle.
- An increase in the number of mid-tier prizes.
- An emphasis on product advertisement.

The selling season began earlier than usual for the holiday Scratch-Off games during the 2001/2002 fiscal year. The strategy of giving the holiday Scratch-Off games an extended product life, along with the introduction of more holiday games such as JINGLE BUCKS, HOLIDAY CASH, MERRY MONEY and FAST NEW YEAR'S CASH, resulted in another new record in holiday Scratch-Off game sales.

Expanding the line of \$5 Scratch-Off games, along with the line of a player favorite Monopoly®, also resulted in revenue growth for the 2001/2002 fiscal year.

The events of September 11, 2001 had a pervasive effect on virtually every aspect of American life, and Florida's tourism industry was hard hit. Partnering with Visit Florida, the Lottery created an innovative marketing concept to promote Florida tourism: the Play FLA USA Scratch-Off game. Through partnership with Carnival Cruise Lines®, Northwest Florida's Emerald Coast, Kennedy

Space Center, Miami Seaquarium®, SeaWorld®, Universal Orlando®, and scores of Florida businesses and attractions, the Lottery was able to leverage the buying power of its customer base in an extremely successful promotion that benefited not only education, but also players and the tourism industry. The Play FLA USA Scratch-Off game concept encouraged the Lottery's customer base to frequent Florida's many businesses and tourist attractions, and generated excitement about the magnificent places to visit within the state.

# Unity

benefits

marketing

research



## Marketing Research

Marketing research activities are a critical element of any entrepreneurial business, and it's no different for the Florida Lottery. Prior to fiscal year 2001/2002, the many marketing research activities had been conducted through various vendors hired by the Lottery's Scratch-Off game and advertising vendors. This year, the Lottery consolidated each marketing research activity into a competitively bid "Invitation to Negotiate." This consolidation of research services enabled the Lottery to rely on one vendor for all research and data collection services, such as monthly tracking surveys and focus group testing of new game concepts.

**This new arrangement provided several benefits to the Lottery:**

- Strengthened objectivity of marketing research.
 

The marketing research company that won the contract through the competitive bid process, Ipsos-Reid, answers directly to the Florida Lottery, rather than to a vendor hired by the Lottery.
- Significant improvement in the overall quality of research.
 

Ipsos-Reid is perhaps the leading lottery research firm in North America and, as such, has brought the ability to benchmark Florida marketing and product results against those of other state and provincial lotteries.
- The realization of significant annual cost savings.

The consolidation of services is expected to save \$60,000 in recurring costs annually.

information technology

enhancements

**Strengthen**

operations

# Strengthen

## Operations

During fiscal year 2001/2002, the Florida Lottery continued to strengthen its presence in the marketplace through further advances in information technology that support marketing and sales initiatives. Major initiatives for the fiscal year included the implementation of a "Business Intelligence" system that will provide executive management and the sales force with valuable information-analysis capabilities for formulating action-oriented sales plans and driving business decisions. The Business Intelligence process provides the Lottery staff with tools including:

- An interactive set of tools to query an information data warehouse.
- Sales trend identification and tracking.
- The infrastructure to support database redesign and software

reengineering projects.

- The infrastructure to support the Lottery's continued advancement in the information technology arena.

Information technology also allowed the Florida Lottery to improve service to our multi-location retail partners through the introduction of a more efficient electronic funds transfer system. Network and firewall infrastructure also received significant upgrades to improve service and security, while containing or reducing costs.

A joint initiative with the State Technology Office allowed the Lottery to boost its Web presence through prime positioning on the front page of the MyFlorida.com Web site. Now, visitors to the state of Florida Web portal can link directly to information about all Florida Lottery products on the official Florida Lottery Web site, located at [www.flalottery.com](http://www.flalottery.com).

Lottery's contribution

to education

illustrates

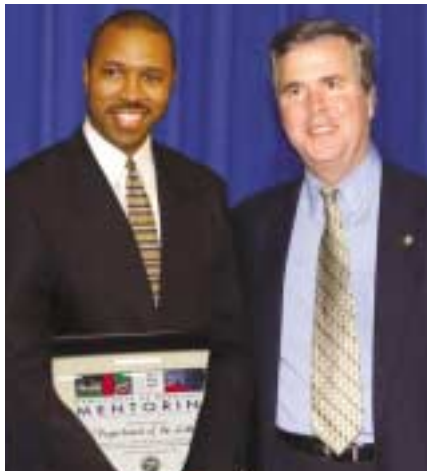
**Commitment**

# Commitment

## Lottery Contributions to Education

During the 2001/2002 school year, more than 98,000 Florida students received a Bright Futures Scholarship. These scholarships amounted to more than \$174.9 million in Lottery funding. Based on local need, the 67 school districts throughout the state, received more than \$396.4 million in Lottery funding during the 2001/2002 fiscal year. \$180 million in School Construction Funds were designated for debt service and direct project funding for public school renovation and new-school construction. Florida's State University System and Community Colleges each received more than \$98.6 million.

The Lottery's commitment to education is further illustrated through employee participation in the Governor's Mentoring Initiative.



This year, Governor Jeb Bush appointed Lottery Secretary David Griffin as the Mentoring Chair for all state agencies. The Lottery's Mentoring Program excelled under the leadership of Secretary Griffin and exceeded the Governor's Mentoring Initiative participation goals in the program for fiscal year 2001/2002. The Lottery and Secretary Griffin received an award from Governor Bush for exceeding participation goals and was also recognized as one of the top two state agencies participating in the Mentoring Program.



# Continuity

provides clear

path for our

ultimate goal



# Continuity

## Continuity of Operations Plan

The tragedy that occurred on September 11, 2001 has underscored the importance of disaster recovery plans.

On April 16, 2002, Gov. Jeb Bush signed into law House Bill 0727, relating to disaster preparedness. This bill amended Section 252.365, Florida Statutes, The Emergency Management Act, by revising the process for coordination and approval of disaster preparedness plans. The new plan addresses a full range of potential emergencies and is referred to as a Continuity of Operations Plan, which all state agencies must have completed by July 1, 2003.

The Florida Lottery has always had a comprehensive and effective disaster recovery plan to ensure continuity of mission-critical functions under any and all circumstances. The Lottery continues to evaluate and update our Continuity of Operations Plan.

## Looking to the Future

### Approaching 15 Years

January 12, 2003 will mark 15 years since the sale of the Florida Lottery's first MILLIONAIRE Scratch-Off ticket. The Lottery now offers a product line including five On-line games and more than 40 Scratch-Off and Bingo games at any given time. Proceeds from the sale of these products have resulted in contributions of nearly \$12 billion to the Educational Enhancement Trust Fund through fiscal year 2001/2002.

### New Legislation for Prize Payouts

During the 2002 legislative session, new policy was created regarding the prize payouts for the Lottery's Scratch-Off games. This legislation, which becomes effective July 1, 2002, amends section 24.121, Florida Statutes. This amendment will allow the Lottery to determine variable

percentages of the gross revenue from the sale of Scratch-Off games and return them to the public in the form of prizes.

With this new legislation, the Lottery is looking forward to an even stronger future for Scratch-Off games. The ability to increase prize payouts will help to maximize Scratch-Off game sales, and will further the Lottery's ultimate goal: maximizing contributions to the Educational Enhancement Trust Fund.

organization and

# Structure

are key components

of a strong lottery



# Structure

## Organizational Structure

As required by subsection 24.105(5), Florida Statutes, the following information reflects the organizational structure of the Lottery as of June 30, 2002.

### 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.

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

**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.

**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 Lottery. Duties include performing financial, compliance and performance audits of the Lottery, and preparing audit reports of the findings.

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

**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 and administers employee insurance programs, worker's compensation and retirement.

**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 Lottery and its retailers comply 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 Lottery, monitors expenditures to ensure budgetary compliance, coordinates development of the Lottery's long-range program plan and maintains the performance-based program budget.

**General Accounting** encompasses the Accounts Receivable and Financial Reporting sections. Accounts Receivable manages the collection of funds from retailers who are delinquent in their payments. Financial Reporting prepares financial statements and reports to convey the results of Lottery operations.

**Disbursements** manage the Cash Management, Vendor Disbursements and Player Disbursements units. Cash Management coordinates the management of Lottery funds. Vendor Disbursements disburses all vendor payments. Player Disbursements processes prize payments to winners, including those made to FLORIDA LOTTO jackpot winners, and receives "Entry" tickets for special mail-in game promotions.

**Purchasing** executes all purchasing and contracting for the Lottery, and maintains ongoing with the Department of

Management Services and the Office of Supplier Diversity.

**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.

## Assistant Secretary for Marketing

Marketing encompasses all areas relating to the sale of Lottery products, including Statewide Sales, Research and Policy Analysis, 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 11,500 Lottery retailers. In addition to the office management staff, each district office employs a staff of Sales Representatives who assist in the promotion and sale of Lottery products at the retail level, and Sales Executives who interface with the Lottery's corporate retail partners at their headquarters level. The Sales Executives present Lottery product sales and promotional programs to be implemented chain-wide throughout the state.

**Research and Policy Analysis** initiates and oversees consumer market studies contracted by the Lottery's research vendor of record. This section's projects include consumer, retailer, retail environment and advertising campaign analysis. The Research and Policy Analysis section provides valuable data used to determine products to be

developed, revenue forecasting and overall program effectiveness.

**Advertising** works directly with our General and Spanish market advertising agencies of record to develop advertising campaigns that inform our customers (consumers, retailers and the general public) about the new programs and products the Lottery has to offer. Some of our advertising efforts are also focused on educating the public regarding the contributions the Lottery makes to the Educational Enhancement Trust Fund.



**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. Special Events and Promotions 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, provides library services to the Lottery and produces the Lottery's official publications.

**Graphics** provides overall art direction for the Lottery, including quality control for Scratch-Off ticket design, publications, promotional items, presentation graphics, Web site 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.

## Assistant Secretary of Operations

**Operations** consists of the business areas that collectively provide technology solutions and services to support the Lottery'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 through a team of Software Quality Assurance professionals.

**Office of Information Security Management (ISM)** develops and coordinates the information security infrastructure and program to provide protection and ensure the integrity for Lottery 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, works with the Lottery's external auditors, and coordinates the preparation of security risk analyses pertaining to the Lottery'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. Business Recovery also coordinates regular testing of mission critical systems at the remote backup data center and tracks severe weather for business continuity preparation.

**Division of Information Resources (IR)** designs and implements automated systems necessary for the optimal functioning of the Lottery in a secure, power-redundant data center environment. IR also provides a comprehensive telecommunications system, services and office automation system. IR consists of the following work units:

**IR Computer Systems Operations** ensures the smooth operation of the Lottery's automated systems, providing 24/7 staffing of the Lottery's primary and remote back-up data centers, verification and balancing of transactions from the gaming vendor, production control, and backup and system recovery services.

**IR Systems Design and Development** provides application programming, systems analysis and functional requirements for critical business systems, including the Internal Control System, Scratch-Off ticket accounting, the Distributed Check Writer and all in-house administrative systems.

**IR Systems and Network Support** installs, configures and maintains the Lottery's statewide and local-area non-gaming networks, including all in-house administrative computer systems, hardware, operating systems software and voice systems.

**IR Client Services** manages the end-user computing environment through the installation and maintenance of all desktop computing hardware and software. Client Services also 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 Lottery business applications.

# Financials

State of Florida • Department of the Lottery  
June 30, 2002

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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 financial statements of State of Florida, Department of the Lottery (the Lottery) (an enterprise fund) as of and for the year ended June 30, 2002. 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 General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit 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.

As discussed in Note 2, the financial statements present only the Lottery and do not purport to, and do not, present fairly the financial position of the State of Florida as of June 30, 2002, and the changes in its financial position and its cash flows, where applicable, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

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, 2002, and the respective changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 to the basic financial statements, in fiscal year 2002, the Lottery adopted Governmental Accounting Standards Board (GASB) Statement No. 34, Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments, GASB Statement No. 37, Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments: Omnibus, and GASB Statement No. 38, Certain Financial Statement Note Disclosures.

In accordance with Government Auditing Standards, we have also issued a report dated October 14, 2002 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.

The management discussion and analysis on pages 21 through 27 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

October 14, 2002

**KPMG LLP**





# Accounting

## Management's Discussion and Analysis

The purpose of this discussion and analysis of the State of Florida, Department of the Lottery (Florida Lottery) is to (1) assist the reader in focusing on important financial matters; (2) provide a broad overview of the Florida Lottery's Financial Statements for the fiscal year ended June 30, 2002; and (3) discuss comparative financial data from the prior year.

This discussion and analysis is designed to focus on the current year's activities, resulting changes and currently known facts. The information presented here should be read in conjunction with the accompanying financial statements. These statements are presented in conformance with Governmental Accounting Standards Board Statement Number 34, Basic Financial Statements and Management's Discussion and Analysis – for State and Local Governments (GASB 34).

### Financial Highlights and Summary

For the fiscal year ended  
June 30, 2002:

- Florida Lottery's net assets increased by \$45,703,000 (or 24.18%).
- Florida Lottery's total operating revenue increased by \$50,924,000 (or 2.2%), and income from operations increased by \$21,703,000 (or 2.4%).
- Transfers to the Educational Enhancement Trust Fund increased by \$19,331,000 (or 2.1%).

Table 1 reflects the condensed Summary of Net Assets compared to the prior year.

**Table 1**

**Summary of Net Assets**

As of June 30, 2002 and 2001  
(in thousands)

|                               | <u>2002</u>              | <u>2001</u>              |
|-------------------------------|--------------------------|--------------------------|
| Current assets                | \$ 145,560               | \$ 139,315               |
| Securities lending receivable | 5,303                    | 7,435                    |
| Investments                   | 3,894,246                | 4,083,397                |
| Capital assets                | <u>2,884</u>             | <u>2,716</u>             |
| <b>Total assets</b>           | <b><u>4,047,993</u></b>  | <b><u>4,232,863</u></b>  |
| Current liabilities           | 142,241                  | 136,045                  |
| Securities lending payables   | 1,908,158                | 2,057,844                |
| Grand prizes payable          | 1,759,562                | 1,846,267                |
| Compensated absences payable  | <u>3,282</u>             | <u>3,660</u>             |
| <b>Total liabilities</b>      | <b><u>3,813,243</u></b>  | <b><u>4,043,816</u></b>  |
| Net assets:                   |                          |                          |
| Investment in capital assets  | 2,884                    | 2,716                    |
| Restricted                    | <u>231,866</u>           | <u>186,331</u>           |
| <b>Total net assets</b>       | <b><u>\$ 234,750</u></b> | <b><u>\$ 189,047</u></b> |

**Normal Impacts that Primarily Affect the Statement of Net Assets**

- **Net Results of Activities** – This will increase or decrease current assets and current liabilities.
- **Prize Payments and Investments of Prize Winnings for Players**–This will increase or decrease current assets, investments, current liabilities and grand prizes payable.
- **Changes in Interest Rates**– This will increase or decrease investments and will increase or decrease the restriction for undistributed appreciation on investments in net assets.
- **Securities Lending of Grand Prize Investments** – This will increase or decrease securities lending receivable, investments and securities lending payables.
- **Purchase, Retirement, and Depreciation of Capital Assets**– This will increase or decrease the capital assets account and the corresponding restriction for capital assets in net assets.

**Current Year Impacts to the Statement of Net Assets**

For the fiscal year ended June 30, 2002:

- Total assets decreased by \$184,870,000. This can be attributed to decreases in investments held for grand prize winners and in investments related to securities lending activities.
- Total liabilities decreased by \$230,573,000. This can primarily be attributed to a net decrease of \$80,093,000 in prizes payable to winners and a \$143,052,000 decrease in securities lending obligations.
- Net assets increased by \$45,703,000 (or 24.18%) primarily due to the above factors.

The explanation of the changes in net assets is important in measuring the overall financial condition of the Florida Lottery. Additionally, analysis of current year results of operations is important in determining the Florida Lottery's financial condition for the past fiscal year. Table 2 is a brief summary of these results.

Table 2 summarizes revenue and expenses on a comparative basis for current and prior fiscal years.

**Table 2**  
**Summary of Revenue, Expenses and Changes in Net Assets**

As of June 30, 2002 and 2001  
(in thousands)

|   | <u>2002</u>       | <u>2001</u>       |
|---|-------------------|-------------------|
| Operating revenue                               |                   |                   |
| Ticket sales                                    | \$ 2,330,365      | \$ 2,274,726      |
| On-line fees and miscellaneous                  | 4,877             | 9,603             |
| Retailer fees                                   | <u>190</u>        | <u>179</u>        |
| Total operating revenue                         | <u>2,335,432</u>  | <u>2,284,508</u>  |
| Operating expenses                              |                   |                   |
| Prizes  | 1,165,843         | 1,140,548         |
| Retailer commissions                            | 132,351           | 126,581           |
| Scratch-Off tickets                             | 16,812            | 15,988            |
| On-line games                                   | 32,219            | 31,046            |
| Advertising                                     | 32,536            | 33,708            |
| Personal services                               | 24,489            | 23,916            |
| Other contractual services                      | 7,819             | 10,198            |
| Materials and supplies                          | 6,860             | 7,519             |
| Bad debts                                       | 191               | 196               |
| Depreciation                                    | <u>1,034</u>      | <u>1,233</u>      |
| Total operating expenses                        | <u>1,420,154</u>  | <u>1,390,933</u>  |
| Income from operations                          | <u>915,278</u>    | <u>893,575</u>    |
| Nonoperating revenue (expense)                  |                   |                   |
| Interest  | 5,803             | 7,929             |
| Securities lending income                       | 52,548            | 113,749           |
| Securities lending fees                         | (46,973)          | (108,317)         |
| Net appreciation in fair value of investments   | 174,801           | 210,288           |
| Amortization of grand prizes payable            | <u>(129,266)</u>  | <u>(135,437)</u>  |
| Total nonoperating revenue<br>(expenses), net   | 56,913            | 88,212            |
| Income before operating transfers               | <u>972,191</u>    | <u>981,787</u>    |
| Transfers to Educational Enhancement Trust Fund | <u>(926,488)</u>  | <u>(907,157)</u>  |
| Change in net assets                            | 45,703            | 74,630            |
| Net assets, beginning of year                   | <u>189,047</u>    | <u>114,417</u>    |
| Net assets, end of year                         | <u>\$ 234,750</u> | <u>\$ 189,047</u> |

### Normal Impacts that Primarily Affect the Statement of Revenue and Expenses

- **Economic Conditions** – Economic factors such as income growth, level of tourism and employment rates impact ticket sales and bad debts.
- **Financial Market Conditions** - Interest rates and bond market conditions affect interest, securities lending income and fees, net appreciation in fair value of investments and amortization of grand prizes payable.
- **Lottery Product Changes and Size of Jackpots**– Modifications to the structure of existing games and the introduction of new games affect ticket sales. The size of the FLORIDA LOTTO jackpot, which is impacted mostly by the number of jackpot rollovers and the current interest rates, also affects ticket sales.
- **Level of Lottery Ticket Sales** – Prizes, retailer commissions, Scratch-Off ticket expense, On-line games expense and transfers to the Educational Enhancement Trust Fund directly fluctuate with the value of On-line and Scratch-Off ticket sales.
- **Normal Operating Activities** – Advertising, personal services, other contractual services, materials and supplies and depreciation are all impacted by the normal operating transactions required to run the Florida Lottery.

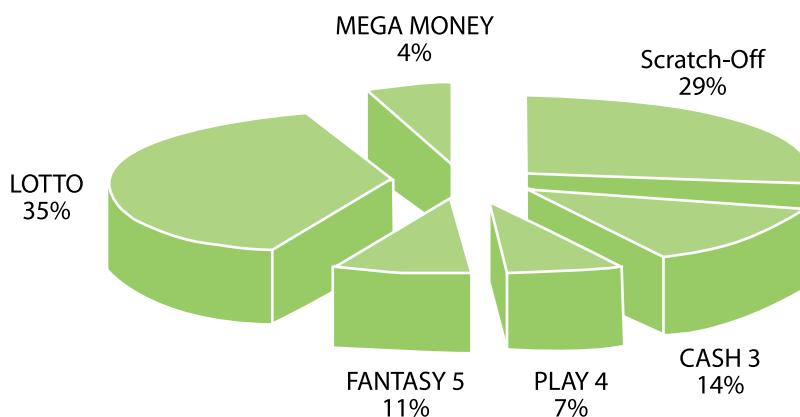
### Current Year Impacts / Analysis on the Statement of Revenue and Expenses

#### Revenue

For the fiscal year ended June 30, 2002, ticket sales increased by \$55,639,000 primarily due to changes introduced July 2001 in the FANTASY 5 On-line game, and growth in the Scratch-Off ticket market. The \$2,330,365,000 sales figure represents the highest sales in the history of the Florida Lottery.

The following chart shows sales by product for the various Lottery games during the 2001-2002 fiscal year:

#### Sales by Product

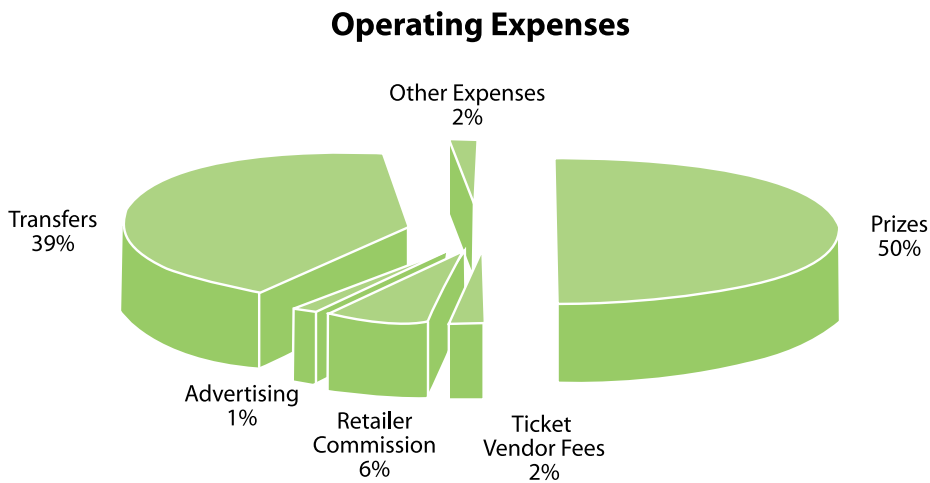


In addition, for the fiscal year ended June 30, 2002, On-line fees and miscellaneous revenue decreased by \$4,726,000 primarily because the balance in the previous fiscal year included a one-time contract liquidated damages paid to the Florida Lottery.

**Expenses**

The percentage of ticket sale revenue available for total expenses of the Florida Lottery is set by Section 24.121, Florida Statutes, and results in no more than 12 percent of sales revenue being available for lottery operating and administrative expenses including retailer commissions, On-line games expense, and Scratch-Off ticket expense. Prize expense has been approximately 50 percent of lottery sales. For the fiscal year ended June 30, 2002, transfers to the Educational Enhancement Trust Fund are required to be at least 38 percent of the gross revenue from the sale of lottery tickets and other earned revenue, excluding retailer application processing fees, and any unencumbered balance remaining at the end of the fiscal year.

The following chart shows the major components of Lottery operating expenses as a percentage of ticket sales for the 2001-2002 fiscal year:

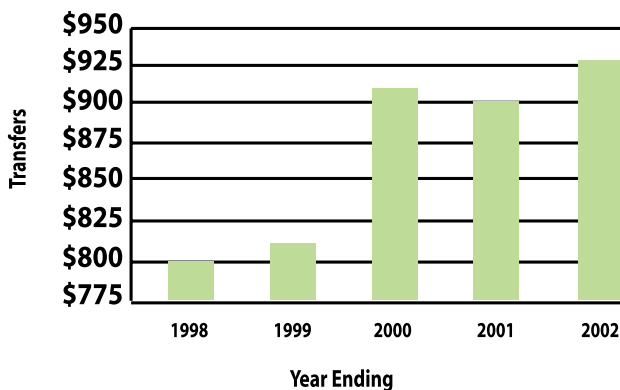


During the 2001-2002 fiscal year other contractual services decreased by \$2,379,000 primarily due to the termination of the instant ticket vending machine contract that had been in operation during the previous fiscal year.

Total transfers to the Educational Enhancement Trust Fund increased by \$19,331,000 during the 2001-2002 fiscal year primarily due to the increase in ticket sales. This transfer is the highest since the Florida Lottery began operations in 1988.

The following chart shows the total transfers to the Educational Enhancement Trust Fund for the past five fiscal years:

**Transfer to Educational Enhancement Trust Fund**



## Capital Assets

Table 3 Summarizes capital assets.

**Table 3**

### Capital Assets

As of June 30, 2002 and 2001  
(in thousands)

|                               | <u>2002</u>            | <u>2001</u>            |
|-------------------------------|------------------------|------------------------|
| Data processing equipment     | \$ 9,251               | \$ 8,653               |
| Office equipment and fixtures | 6,400                  | 6,367                  |
| Vehicles and other equipment  | <u>3,562</u>           | <u>3,694</u>           |
|                               | 19,213                 | 18,714                 |
| Less accumulated depreciation | <u>16,329</u>          | <u>15,998</u>          |
| Total capital assets          | \$ <u><u>2,884</u></u> | \$ <u><u>2,716</u></u> |

The following reconciliation, Table 4, summarizes the change in capital assets.

### For year ending June 30, 2002

(in thousands)

|                   |                        |
|-------------------|------------------------|
| Beginning Balance | \$ 2,716               |
| Additions         | 1,325                  |
| Retirements       | (826)                  |
| Depreciation      | <u>(331)</u>           |
| Ending Balance    | \$ <u><u>2,884</u></u> |

The increase in capital assets was due to current year capital expenditures. The major addition was \$865,000 in data processing equipment.

## Economic Factors and Future Impacts

The main economic factors affecting lottery sales are population growth, personal income growth and employment. Based on the September 2002 Florida Economic Estimating Conference, the population is forecasted to increase 1.80 percent in 2002-2003 and 1.61 percent in 2003-2004. During these periods real per capita income is expected to grow 0.9 percent and 1.1 percent, respectively. Total non-farm employment is forecasted to increase by 1.1 percent and 2.8 percent, respectively.

As the result of a statutory change, during the 2002-2003 fiscal year the Lottery will be able to return a variable percentage of Scratch-Off game revenue as prizes to maximize revenue transferred to the Education Enhancement Trust Fund.

## Financial Contact

The Florida Lottery's Financial Statements and this analysis are designed to give a general overview to all interested parties. If you have any questions regarding this report or require additional information, please contact the State of Florida, Department of the Lottery, Finance and Budget Department, 250 Marriott Drive, Tallahassee, Florida 32301, (850) 487-7777.

**Statement of Net Assets**

June 30, 2002

(In Thousands)

**Assets**

## Current assets:

|  |              |
|--|--------------|
| Cash and cash equivalents  | \$ 96,793    |
| Interest receivable  | 383          |
| Accounts receivable, net of allowance for doubtful accounts of \$838 | 45,495       |
| Inventories  | 1,125        |
| Securities deposits  | <u>1,764</u> |

|                      |                |
|----------------------|----------------|
| Total current assets | <u>145,560</u> |
|----------------------|----------------|

## Restricted assets:

|                                      |              |
|--------------------------------------|--------------|
| Securities lending income receivable | 5,303        |
| Investments, grand prize             | 1,992,100    |
| Investments, other                   | 1,902,146    |
| Capital assets, net                  | <u>2,884</u> |

|              |                  |
|--------------|------------------|
| Total assets | <u>4,047,993</u> |
|--------------|------------------|

**Liabilities**

## Current liabilities:

|   |            |
|---|------------|
| Accounts payable and accrued liabilities  | 7,934      |
| Prizes payable                            | 62,011     |
| Due to Educational Enhancement Trust Fund | 70,247     |
| Deposits payable                          | 1,764      |
| Compensated absences payable              | <u>285</u> |

|                           |                |
|---------------------------|----------------|
| Total current liabilities | <u>142,241</u> |
|---------------------------|----------------|

## Current liabilities payable from restricted assets:

|                                      |                |
|--------------------------------------|----------------|
| Securities lending fees payable      | 995            |
| Obligations under securities lending | 1,907,163      |
| Grand prizes payable                 | <u>230,449</u> |

|  |                  |
|--|------------------|
| Total current liabilities payable from restricted assets | <u>2,138,607</u> |
|--|------------------|

## Noncurrent liabilities:

|                              |              |
|------------------------------|--------------|
| Grand prizes payable         | 1,529,113    |
| Compensated absences payable | <u>3,282</u> |

|                              |                  |
|------------------------------|------------------|
| Total noncurrent liabilities | <u>1,532,395</u> |
|------------------------------|------------------|

|                   |                  |
|-------------------|------------------|
| Total liabilities | <u>3,813,243</u> |
|-------------------|------------------|

**Net Assets**

|                            |                |
|----------------------------|----------------|
| Invested in capital assets | 2,884          |
| Restricted                 | <u>231,866</u> |

|                  |                   |
|------------------|-------------------|
| Total net assets | <u>\$ 234,750</u> |
|------------------|-------------------|

See accompanying notes to financial statements.

**Statement of Revenue, Expenses and Changes in Net Assets**

Year ended June 30, 2002

(In Thousands)

|   |    |                       |
|---|----|-----------------------|
| Operating revenue:                              |    |                       |
| Ticket sales                                    | \$ | 2,330,365             |
| On-line fees and miscellaneous                  |    | 4,877                 |
| Retailer fees                                   |    | <u>190</u>            |
| Total operating revenue                         |    | <u>2,335,432</u>      |
| Operating expenses:                             |    |                       |
| Prizes  |    | 1,165,843             |
| Retailer commissions                            |    | 132,351               |
| Scratch-Off tickets                             |    | 16,812                |
| On-line games                                   |    | 32,219                |
| Advertising                                     |    | 32,536                |
| Personal services                               |    | 24,489                |
| Other contractual services                      |    | 7,819                 |
| Materials and supplies                          |    | 6,860                 |
| Bad debts                                       |    | 191                   |
| Depreciation                                    |    | <u>1,034</u>          |
| Total operating expenses                        |    | <u>1,420,154</u>      |
| Operating income                                |    | <u>915,278</u>        |
| Nonoperating revenue (expenses):                |    |                       |
| Interest  |    | 5,803                 |
| Securities lending income                       |    | 52,548                |
| Securities lending fees                         |    | (46,973)              |
| Net appreciation in fair value of investments   |    | 174,801               |
| Amortization of grand prizes payable            |    | <u>(129,266)</u>      |
| Total nonoperating revenue (expenses), net      |    | <u>56,913</u>         |
| Income before operating transfers               |    | 972,191               |
| Transfers to Educational Enhancement Trust Fund |    | <u>(926,488)</u>      |
| Change in net assets                            |    | 45,703                |
| Net assets, beginning of year                   |    | <u>189,047</u>        |
| Net assets, end of year                         | \$ | <u><u>234,750</u></u> |

*See accompanying notes to financial statements.*



**Statement of Cash Flows**

Year ended June 30, 2002

(In Thousands)

|   |    |                       |
|---|----|-----------------------|
| Operating activities:   |    |                       |
| Ticket sales  | \$ | 2,330,529             |
| Prizes paid to winners  |    | (1,159,232)           |
| Commissions paid and payments to retailers  |    | (132,351)             |
| Paid to vendors for goods and services  |    | (96,184)              |
| Paid to employees   |    | (24,581)              |
| Other operating revenue   |    | <u>5,067</u>          |
| Net cash provided by operating activities   |    | <u>923,248</u>        |
| Noncapital financing activities:  |    |                       |
| Payments to Educational Enhancement Trust Fund  |    | <u>(927,500)</u>      |
| Net cash used in noncapital financing activities  |    | <u>(927,500)</u>      |
| Capital and related financing activities:   |    |                       |
| Purchase of capital assets  |    | (1,326)               |
| Proceeds from sale of capital assets  |    | <u>59</u>             |
| Net cash used in capital and related financing activities                                     |    | <u>(1,267)</u>        |
| Investing activities:   |    |                       |
| Cash received from maturity of grand prize investments  |    | 237,508               |
| Cash paid to grand prize winners upon maturity of grand prize investments                     |    | (237,508)             |
| Interest  |    | <u>11,937</u>         |
| Net cash provided by investing activities   |    | <u>11,937</u>         |
| Net increase in cash and cash equivalents   |    | 6,418                 |
| Cash and cash equivalents, beginning of year  |    | <u>90,375</u>         |
| Cash and cash equivalents, end of year  | \$ | <u><u>96,793</u></u>  |
| Reconciliation of income from operations to net cash provided by operating activities:        |    |                       |
| Income from operations  | \$ | 915,278               |
| Adjustments to reconcile income from operations to net cash provided by operating activities: |    |                       |
| Depreciation  |    | 1,034                 |
| Gain on disposal of capital assets  |    | 64                    |
| Changes in assets and liabilities   |    |                       |
| Decrease in:  |    |                       |
| Accounts receivable   |    | 355                   |
| Inventories   |    | 53                    |
| Increase (decrease) in:   |    |                       |
| Accounts payable and accrued liabilities  |    | (55)                  |
| Prizes payable  |    | 6,612                 |
| Compensated absences payable  |    | <u>(93)</u>           |
| Net cash provided by operating activities   | \$ | <u><u>923,248</u></u> |

See accompanying notes to financial statements.

# Notes to Financial Statements

June 30, 2002

## (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.

In evaluating the Lottery as a reporting entity, management has addressed all potential component units for which the Lottery may be financially accountable and, as such, be includable in the Lottery’s financial statements. The Lottery is financially accountable if it appoints a voting majority of the organization’s governing board and (1) it is able to impose its will on the organization or (2) there is a potential for the organization to provide specific financial benefit to or impose specific financial burden on the Lottery. Additionally, the primary government is required to consider other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity’s financial statements to be misleading or incomplete.

## (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 revenue 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.

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 statement of net assets. 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.

When both restricted and unrestricted resources are available for use, it is the Lottery’s policy to use restricted resources first, then unrestricted resources as they are needed.

**Notes to Financial Statements June 30, 2002 (continued)****(c) 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. 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.

**(d) 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).

**(e) Prizes**

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

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.

**(f) 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.

**(g) 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.

**(h) Capital Assets**

Capital assets are stated at cost less accumulated depreciation. Depreciation on capital assets is computed using the straight-line method over the following estimated useful lives:

|                               |               |
|-------------------------------|---------------|
| Data processing equipment     | 3 to 5 years  |
| Office furniture and fixtures | 3 to 15 years |
| Vehicles and other equipment  | 3 to 20 years |

**Notes to Financial Statements June 30, 2002 (continued)**

When capital 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.

**(i) 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 \$100 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.

**(j) 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.

**(k) Net Assets**

Net assets are categorized as invested in capital assets, restricted and unrestricted.

Invested in capital assets of approximately \$2,884,000 is intended to reflect the portion of net assets which are associated with non-liquid, capital assets.

Restricted net assets are undistributed appreciation on restricted investments held for grand prize winners, securities lending cash collateral, and pooled investments with the State Treasurer of approximately \$231,866,000.

Unrestricted assets consist of all other net assets not included in the previous categories. The Lottery has no unrestricted net assets.

**(l) 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.

**(m) 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 revenue and expenses during the reporting period. Actual results could differ from those estimates.

**(n) New Accounting Standards**

Effective July 1, 2001, the Lottery adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 34, Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments as amended by GASB Statement No. 37, Basic Financial Statements—and Management's Discussion and Analysis- for State and Local Governments: Omnibus and GASB Statement No. 38, Certain Financial Statement

**Notes to Financial Statements June 30, 2002 (continued)**

Disclosures. GASB Statement No. 34 establishes financial reporting standards for state and local governments.

These pronouncements create new basic financial statements for reporting on the Lottery's financial activities. These financial statements are the statement of net assets and statement of revenue, expenses and changes in net assets. These pronouncements also require the presentation of management's discussion and analysis preceding the financial statements.

**(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 \$328,000 at June 30, 2002, 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% of the average monthly balance of public deposits or 125% 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% 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 \$1,513,000 at June 30, 2002, representing outstanding prize payment checks, and retailer payment checks. These outstanding checks are included as a component of prizes payable, and accounts payable. The Lottery has an agreement with a financial institution to honor prize payments and retailer 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 \$78,000 at June 30, 2002. 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% collateralized by the securities purchased. The largest amounts invested in repurchase agreements during the year ended June 30, 2002 were approximately \$30,048,000. For the year ended June 30, 2002, the largest amount in overnight investments was on September 12, 2001, as a result of September 11, 2001. The State Treasurer's bank was closed on September 12, 2001, so the Lottery was unable to send funds to the Treasurer.

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% 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 \$96,035,000 at June 30, 2002. 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 statement of net assets 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.

## Notes to Financial Statements June 30, 2002 (continued)

**(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.

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 restriction for undistributed appreciation on investments in net assets. 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 statement of net assets, and as a nonoperating expense on the statements of revenue, expenses and changes in net assets. Net appreciation in fair value of investments is reflected as a nonoperating revenue on the statements of revenue, expenses and changes in net assets, 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%, or other securities at 102%, 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% 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 \$1,907,163,000 of cash collateral for the lending program as of June 30, 2002. At June 30, 2002, 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 65.28% 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.

Securities lending activity for the year ended June 30, 2002 consisted of (in thousands):

|                                |    |              |
|--------------------------------|----|--------------|
| Securities lending income      | \$ | 52,548       |
| Less broker rebates            |    | (45,115)     |
| Less bank fees                 |    | (1,858)      |
|                                |    | <hr/>        |
| Net securities lending revenue | \$ | <u>5,575</u> |

## Notes to Financial Statements June 30, 2002 (continued)

## (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.

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, 2002 is presented below.

| <u>Investments</u>  | <u>Risk Category<br/>1</u> | <u>Risk Category<br/>2</u> | <u>Risk Category<br/>3</u> | <u>Carrying<br/>Amount</u> |
|---|----------------------------|----------------------------|----------------------------|----------------------------|
|   | (in thousands)             |                            |                            |                            |
| Lottery investments—classified:   |                            |                            |                            |                            |
| Certificates of deposit, negotiable   | \$ --                      | \$ --                      | \$ 442,465                 | \$ 442,465                 |
| U.S. obligations  | 120,817                    | 6,719                      | --                         | 127,536                    |
| Commercial paper  | --                         | --                         | 177,827                    | 177,827                    |
| Time deposits   | --                         | --                         | 12,097                     | 12,097                     |
| Repurchase agreements   | --                         | --                         | 328,063                    | 328,063                    |
| Bonds and notes   | --                         | --                         | 899,119                    | 899,119                    |
| <br>Total classified investments  | <br><u>\$ 120,817</u>      | <br><u>\$ 6,719</u>        | <br><u>\$ 1,859,571</u>    | <br><u>1,987,107</u>       |
| Lottery investments—unclassified:   |                            |                            |                            |                            |
| Investments held by broker dealers<br>under securities lending agreements:    |                            |                            |                            |                            |
| U.S. obligations  |                            |                            |                            | 1,864,565                  |
| Investment agreements   |                            |                            |                            | 14,516                     |
| Money market and mutual funds   |                            |                            |                            | <u>28,058</u>              |
| <br>Pooled investments with State Treasurer<br>(included in cash equivalents) |                            |                            |                            | <br><u>96,035</u>          |
| <br>Total unclassified investments  |                            |                            |                            | <br><u>2,003,174</u>       |
| <br>Total investments   |                            |                            |                            | <br><u>\$ 3,990,281</u>    |

The following schedule reconciles cash and investments to the balance sheet presentation (in thousands):

|                           | <u>Investments</u>      | <u>Cash at<br/>financial<br/>institutions</u> | <u>Cash at State<br/>Treasurer</u> | <u>Total</u>            |
|---------------------------|-------------------------|---|------------------------------------|-------------------------|
| Cash and cash equivalents | \$ 96,035               | \$ 328  | \$ 430                             | \$ 96,793               |
| Investments, grand prize  | 1,992,100               | --  | --                                 | 1,992,100               |
| Investments, other        | 1,902,146               | --  | --                                 | 1,902,146               |
| <br>Total                 | <br><u>\$ 3,990,281</u> | <br><u>\$ 328</u>                             | <br><u>\$ 430</u>                  | <br><u>\$ 3,991,039</u> |

## Notes to Financial Statements June 30, 2002 (continued)

**(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 statement of net assets in assets as securities deposits and in liabilities as deposits payable.

**(5) Capital Assets**

Capital assets at June 30, 2002 consisted of (in thousands):

|                                | <u>Beginning balance</u> | <u>Increase</u> | <u>Decrease</u> | <u>Ending balance</u> |
|--------------------------------|--------------------------|-----------------|-----------------|-----------------------|
| Data processing equipment      | \$ 8,653                 | \$ 937          | \$ (339)        | \$ 9,251              |
| Office equipment and fixtures  | 6,367                    | 188             | (155)           | 6,400                 |
| Vehicles and other equipment   | <u>3,694</u>             | <u>200</u>      | <u>(332)</u>    | <u>3,562</u>          |
|                                | 18,714                   | 1,325           | (826)           | 19,213                |
| Less: accumulated depreciation | <u>15,998</u>            | <u>1,034</u>    | <u>703</u>      | <u>16,329</u>         |
| <br>                           |                          |                 |                 |                       |
| Total                          | <u>\$ 2,716</u>          | <u>\$ 291</u>   | <u>\$ (123)</u> | <u>\$ 2,884</u>       |

**(6) Long-term Obligations***Grand Prizes Payable*

Grand prizes payable at June 30, 2002 consisted of (in thousands):

|   |                     |
|---|---------------------|
| LOTTO grand prizes (face value)                     | \$ 2,572,626        |
| WIN FOR LIFE grand prizes (face value)              | 15,570              |
| BIG 10 grand prizes (face value)                    | 460                 |
| FLAMINGO FORTUNE GAME SHOW grand prize (face value) | 1,600               |
| MONTHLY BONUS grand prizes (face value)             | 192                 |
| WIN A MILLION grand prizes (face value)             | 800                 |
| YEARLY DIVIDEND grand prizes (face value)           | 96                  |
| Less imputed interest                               | <u>(831,782)</u>    |
| <br>  |                     |
| Net present value of grand prizes payable           | <u>\$ 1,759,562</u> |

|                              | <u>Beginnng<br/>balance</u> | <u>Additions</u>  | <u>Reduction</u>    | <u>Ending<br/>balance</u> | <u>Amount<br/>due within<br/>one year</u> |
|------------------------------|-----------------------------|-------------------|---------------------|---------------------------|---|
| Grand prizes payable         | \$ 1,846,267                | \$ 150,803        | \$ (237,508)        | \$ 1,759,562              | \$ 230,449                                |
| Compensated absences payable | <u>3,660</u>                | <u>—</u>          | <u>(93)</u>         | <u>3,567</u>              | <u>285</u>                                |
|                              | <u>\$ 1,849,927</u>         | <u>\$ 150,803</u> | <u>\$ (237,601)</u> | <u>\$ 1,763,129</u>       | <u>\$ 230,734</u>                         |

**(7) Due to Educational Enhancement Trust Fund**

In accordance with the Act, at least 38% of revenue, net of retailer application fees, for the year ended June 30, 2002, 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 nonoperating revenue 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 Financial Statements June 30, 2002 (continued)**

Due to Educational Enhancement Trust Fund at June 30, 2002 consisted of (in thousands):

|  |                  |
|--|------------------|
| Operating revenue                                      | \$ 2,335,432     |
| Non-operating revenue (expenses), net                  | 56,913           |
| Less: Retailer application fees                        | (190)            |
| Net appreciation in fair value of investments          | (174,801)        |
| Amortization of grand prizes payable                   | <u>129,266</u>   |
| Net revenue  | 2,346,620        |
|  | <u>x 38%</u>     |
| Statutorily required transfer                          | 891,715          |
| Additional transfer appropriated                       | 20,000           |
| Unencumbered balance to be transferred                 | <u>14,773</u>    |
| Due for year   | 926,488          |
| Balance, beginning of year                             | 71,259           |
| Paid during year                                       | <u>(927,500)</u> |
| Due to Educational Enhancement Trust Fund, end of year | <u>\$ 70,247</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.

*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 1.11% health insurance subsidy for the fiscal year ended June 30, 2002):

|                   |       |
|-------------------|-------|
| Senior management | 9.28% |
| Regular employees | 7.30% |

The Lottery's contributions to the FRS amounted to approximately \$1,376,000 for the year ended June 30, 2002. These contributions represented 7.69% of covered payroll, for the year ended June 30, 2002. The Lottery contributed 100% of the required contributions for each of the year ended June 30, 2002.

**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 January 1, 1999, through June 30, 2001, 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. Beginning July 1, 2001, the payments to individual retirees or beneficiaries were at least \$30 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.

**Notes to Financial Statements June 30, 2002 (continued)**

HIS is funded by required contributions from FRS participating employers. For the year ended June 30, 2002 the Lottery contributed 1.11% 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.

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.

Future minimum rental payments as of June 30, 2002 are scheduled as follows (in thousands):

| Year ending<br>June 30 | Headquarters     | Districts       | Total            |
|------------------------|------------------|-----------------|------------------|
| 2003                   | \$ 2,393         | \$ 847          | \$ 3,240         |
| 2004                   | 2,417            | 534             | 2,951            |
| 2005                   | 2,442            | 254             | 2,696            |
| 2006                   | 2,466            | 10              | 2,476            |
| 2007                   | 2,491            | —               | 2,491            |
| 2008                   | 2,516            | —               | 2,516            |
|                        | \$ <u>14,725</u> | \$ <u>1,645</u> | \$ <u>16,370</u> |

Rental expense under all leases totaled approximately \$3,259,000 for the years ended June 30, 2002.

**Notes to Financial Statements June 30, 2002 (continued)****(10) Litigation**

*On-line Services* – The Department has contracted with IGT OnLine Entertainment Systems, Inc. (IGT), formerly Automated Wagering International, Inc., for On-line services since 1988. These services include the provision of computer hardware, software and telecommunications, along with maintenance and other services. Since 1995, when the Department rebid the contract and again chose IGT as its On-line service provider, the status of the contract has been subject to legal proceedings by an unsuccessful bidder. As a result of the recent court decisions, the Department will be rebidding the contract in the near future.

The term of the current contract began on September 30, 1999 and runs through December 31, 2004; it provides that IGT 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 and as of May 2001 all phases of the new gaming system had been completed. The base compensation to IGT 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 \$32,219,000 for the year ended June 30, 2002.

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. The original contract was effective through September 30, 2002, and has been extended through September 30, 2008. The contractor is currently compensated at the rate of 2.4375% of net Scratch-Off ticket sales, with the rate declining to 2.3% effective January 1, 2003, and to 2.25% effective October 1, 2006, subject to the payment provisions of the agreement. This compensation amounted to \$16,153,000 for the year ended June 30, 2002.

*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.



This publication is a product of Florida Lottery's Division of Communications.

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