

A N N U A L R E P O R T

Fiscal Year End June 30, 2003

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FROM THE GOVERNOR



Dear Friends:

As the Florida Lottery celebrates its 16 year anniversary, it has remained an industry leader, steadfast in its commitment to making significant contributions to education through the transfer of Lottery proceeds to Florida's Educational Enhancement Trust Fund. Once again, I am pleased to report the Lottery's contributions, and present this Annual Report for the fiscal year ending June 30, 2003.

The Florida Lottery's fiscal year was highlighted with many important milestones. My appointment of Rebecca Dirden Mattingly as the fifth Florida Lottery Secretary was an integral component to the success of the Lottery this year. Under the skillful leadership and guidance of Secretary Mattingly and former Secretary David Griffin, our goal to transfer \$1 billion to the Educational Enhancement Trust Fund during a single fiscal year was achieved. This was an important achievement, and I am proud of the Lottery's commitment to reaching this goal for education in our state.

**Since 1986,
More Than
\$13 Billion
to Education**



In 1999, our administration charged the Lottery with fulfilling sales objectives and contributions to improve education while adhering to a policy of slow, sustained and responsible sales growth. Since then, the Florida Lottery has transferred more than \$3.7 billion to the Educational Enhancement Trust Fund, bringing the Lottery's overall total contribution to education to more than \$13 billion.

I applaud the Florida Lottery's valuable contributions and commitment to education in our great state this past fiscal year. I look forward to the Lottery's successes as it continues to raise additional funds for Florida's students.

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

Jeb Bush
Governor

FROM THE SECRETARY



Dear Friends and Colleagues:

Fiscal year 2002/2003 marked an important anniversary for the Florida Lottery, as we celebrated our 16th year of operation. We are proud to report another record-breaking year in sales and, most significantly, a record-breaking contribution of additional revenues to education.

The Lottery's fiscal year 2002/2003 successes were driven by increased Lottery sales and operating efficiencies. Higher than in any previous year, Lottery sales provided the largest single-year transfer ever to the Educational Enhancement Trust Fund. **The fiscal year transfer of \$1.035 billion increased the Lottery's total contribution to education to more than \$13 billion since its inception.** The Lottery's commitment to education has provided the opportunity for higher education to more than 179,000 Bright Futures Scholars and enhanced public schools for students in all Florida's 67 counties.

**Remember, when
you play, we all
win!**

The Florida Lottery takes great pride in our support of public education. We remain steadfast in our pledge to provide the people of our state with the best lottery games available in the industry, and to maximize revenues for education while doing so.

I would like to express my appreciation to all who have contributed to the Lottery's success. Our success gives Florida students opportunities to attain their educational goals. Thanks to our players and retailers, the Lottery has created opportunities for each of them and their families. Remember, when you play, we all win.

Sincerely,

A handwritten signature in black ink that reads "Rebecca Dirden Mattingly". The signature is fluid and cursive.

Rebecca Dirden Mattingly
Secretary

A Florida Lottery live drawing created excitement and drew crowds in Fort Lauderdale.



16 Years of Contributions to Education – Adding up dollars for Florida students

In 1986, Florida voters overwhelmingly passed a constitutional amendment authorizing the creation of the Florida Lottery. Following the will of the people, the Florida Legislature, in Subsection 24.102 (1), Florida Statutes, established the purpose and intent of the Florida Lottery to allow the people of this state to benefit from significant additional money for education, while enabling the people of the state to play the best lottery games available. This mission continues to resonate today.

The Florida Lottery of 2002/2003 is a multi-billion dollar state revenue resource where customer value, public trust and an unwavering commitment to the enhancement of public education are cultivated and celebrated with honesty, creativity and diversity. For 16 years, this vision has driven the Lottery in fulfilling its mission.



With the launch of the Lottery's first Scratch-Off ticket, MILLIONAIRE, on January 12, 1988, and the Lottery's first On-line tickets, FLORIDA LOTTO™ and CASH 3™, on April 29, 1988, Floridians were given an opportunity to contribute to the education of their children, while playing games that rivaled Lottery industry best. Since then, FANTASY 5®, PLAY 4™, MEGA MONEY™ and a variety of new Scratch-Off games, have been added to give players more entertainment value.

During fiscal year 2002/2003, the Florida Lottery proudly surpassed the \$13 billion mark in contributions to the Educational Enhancement Trust Fund.

The Lottery also fulfilled another important goal of contributing more than \$1 billion during a single fiscal year. This record-breaking achievement is the Lottery's largest single-year contribution to date. While this amount is significant, the Lottery's financial contribution to education each year continues to account for less than 10 percent of Education's annual budget.

The Florida Lottery's investment in education enhancement continues to reap returns for every level of the Florida education system. Since 1999, contributions from the Florida Lottery enabled school districts to fully or partially fund over 400 school construction or renovation projects through the Classrooms First Program. Since start-up, school districts have received \$6.29 billion of district discretionary funds for students in K-12 throughout the state. Community colleges and public universities have received more than \$3.66 billion in

Lottery funding. More than 179,000 Florida students have had the opportunity to further their education through Bright Futures Scholarships. Since inception, the Lottery has provided funding, in the form of other student financial aid in the amount of \$60 million. For Lottery contributions specific to each county, visit the Florida Lottery Web Site at www.flalottery.com.

The Florida Lottery's contribution to education does not stop with generating funds for education. Our commitment also includes employee participation in the Governor's

**Contributing
more than \$1
billion to the
EETF during a
single fiscal year.**



Deane Bozeman Learning Center PreK-9 in Panama City is one of many school construction projects utilizing funding through the Classrooms First Program.

"My Bright Futures Scholarship gave me the opportunity to work less hours and focus more on my education."

**Louis Okonkwo
Miami-Dade County
Bright Futures scholar**



Mentoring Initiative which has a goal of recruiting 200,000 Floridians to serve as mentors. The Florida Lottery has consistently been recognized for outstanding leadership and exceeding the Governor's Mentoring Initiative goal of 10 percent for employee participation. In addition, the Lottery has made significant contributions to "Just Read, Florida!". Some of the educational activities in support of this program include reading to children, promoting statewide book drives and sponsoring Just Read, Florida! Education Training Conferences for educators.



As the Florida Lottery looks forward to celebrating another year of record breaking contributions to Florida's schools, it will remain focused on its mission to maximize revenues for education.

The Florida Lottery has consistently been recognized for outstanding leadership and employee participation in the Governor's Mentoring Initiative.



COMPARATIVE STATEMENT

State of Florida
Department of the Lottery
Comparative Statement of Income, Expenses and Transfers
For the Five Years Ended June 30, 2003
(In Thousands)

	1999	2000	2001	2002	2003
REVENUES:					
Ticket Sales:					
Scratch-Off	\$ 593,691	\$ 568,352	\$ 639,209	\$ 662,566	\$ 1,073,861
CASH 3	339,273	318,972	326,471	329,830	330,001
PLAY 4	169,415	158,620	163,157	170,708	182,716
FANTASY 5	241,799	216,303	191,614	262,923	259,999
LOTTO	737,687	864,983	845,433	806,023	925,474
MEGA MONEY	14,861	121,266	108,842	98,315	95,930
Total Ticket Sales	2,096,726	2,248,496	2,274,726	2,330,365	2,867,981
Interest and Miscellaneous	16,240	18,047	23,143	16,445	15,508
TOTAL REVENUES	2,112,966	2,266,543	2,297,869	2,346,810	2,883,489
PRIZES & ADMINISTRATIVE EXPENSES:					
PRIZES	1,056,810	1,107,018	1,140,548	1,165,843	1,555,848
Administrative Expenses:					
Retailer Commission	118,919	125,066	126,581	132,351	160,850
Vendor Commission	46,035	47,079	47,034	49,031	61,663
Operating Expenses	85,423	79,793	76,770	72,929	70,211
Total Administrative Expenses	250,377	251,938	250,385	254,311	292,724
TOTAL PRIZES AND ADMINISTRATIVE EXPENSES	1,307,187	1,358,956	1,390,933	1,420,154	1,848,572
INCOME AVAILABLE FOR TRANSFER*	\$ 805,779	\$ 907,587	\$ 906,936	\$ 926,656	\$ 1,034,917
Increase (Decrease) In Income Available for Transfer	\$ 5,066	\$ 101,808	\$ (651)	\$ 19,720	\$ 108,261
TRANSFERS TO EETF** (Net Income)	\$ 807,227	\$ 908,353	\$ 907,157	\$ 926,488	\$ 1,035,178

**Income Available For Transfer represents net income adjusted for the following noncash amounts: Net appreciation in fair value of investments and Amortization of grand prizes payable.*

***Transfers to EETF also include annual changes in the Net Capital Assets not presented in this schedule.*

Scratch-Off Games Pay Off For Education

The performance of the Lottery's Scratch-Off games played an important part of augmenting revenues for education in fiscal year 2002/2003. The Florida Lottery saw a \$411 million increase in Scratch-Off sales from the previous

Scratch-Off sales accounted for 37 percent of combined Lottery sales for the fiscal year

year, directly impacting the largest transfer to date to the Educational Enhancement Trust Fund. Florida Lottery Scratch-Off games ranked fifth in total sales among all domestic lotteries and ranked first in Scratch-Off ticket sales increase from the previous year.

The growth in Scratch-Off sales benefited greatly from legislative change implemented in July 2002. Florida law was amended to allow the Lottery to increase the prizes paid to players. This enabled the Lottery to maximize sales and contributions to Education. This new strategy helped boost Scratch-Off ticket sales 62 percent over the previous year. Scratch-Off sales accounted for 37 percent of combined Lottery sales for the fiscal year and ultimately assisted in the record transfer of lottery funds to the Educational Enhancement Trust Fund.

Throughout this exciting year for Scratch-Off games, the Lottery continued to diversify its product mix, including the launch of the first \$10 Scratch-Off game, CASH BONANZA™. Cash Bonanza was an instant hit with retailers and players as retailers earned a \$0.50 commission on each ticket sold and players were attracted to the game through an improved prize structure that featured the highest payout ever offered on a Scratch-Off game,



CASH BONANZA and \$1,000,000 CASH SPECTACULAR, the state's first \$10 Scratch-Off Games, generated much player excitement.

including a \$250,000 top prize. The combination of retailer and player support resulted in record sales of approximately \$193 million by the end of the fiscal year and set the stage for a successful pricing strategy that would continue well beyond Cash Bonanza.

In addition to Cash Bonanza, the Lottery launched another successful \$10 Scratch-Off game, \$1,000,000 CASH SPECTACULAR™, where top prize winners became instant millionaires. The popularity of this game was overwhelming, producing 10 millionaires and over \$91 million in gross sales by the end of fiscal year.



The tremendous success of CASH BONANZA, \$1,000,000 CASH SPECTACULAR and the other popular Scratch-Off games assured higher sales figures for the fiscal year. Ultimately, this translated into increased contributions to education from the sale of Scratch-Off games by \$27 million over the previous year.

Annual net sales for Scratch-Off tickets were more than \$1 Billion in FY 2002/2003.

Since the Florida Lottery launched its first Scratch-Off game in 1988, annual net sales for this product line have increased from \$533 million to more than \$1 billion in fiscal year 2002/2003. The Florida Lottery continues to create innovative, attractive and marketable Scratch-Off products tailored to a wide spectrum of players. This variety will continue to provide players many entertaining alternatives that will result in increased sales, translating into even greater revenue transfers for education.



Florida Lottery retailer Rosa Payan and her cousin, Homero Surinach, who works with her at the Cypress Petroleum Corporation's Chevron in Fort Lauderdale.

On-line Game Sales Provide Dividends For Florida Students

The Florida Lottery's On-line games set a new sales record in 2003, as the combined sales for FLORIDA LOTTO, FANTASY 5, MEGA MONEY, PLAY 4 and CASH 3 games reached \$1.794 billion for the fiscal year. This sales success, highest since the Florida Lottery's inception, helped ensure that revenue transfers to the Education Enhancement Trust Fund were truly maximized.

The peak performance was fueled by the Florida Lottery's flagship game, FLORIDA LOTTO, which saw sales reach \$925 million during the fiscal year. This sales figure was the highest level the game has reached in more than 10 years and accounted for more than 51 percent of total On-line ticket sales. This great success is attributable in part to high jackpots throughout the year, including two of the top five record FLORIDA LOTTO jackpots. Also contributing was the Lottery's use of business strategies and practices that helped On-line sales climb \$126 million over previous year sales. Highlighting the Lottery's marketing efforts were the retailer incentive and bonus programs, product and retailer focus groups, advertising campaigns, winner awareness campaigns and special events and promotions.

Draw hostess
Bridgid Odgers
conducts the
nightly Florida
Lottery drawing.



On December 14, 2002, the FLORIDA LOTTO jackpot reached \$104.8 million, the second largest jackpot in the history of the Florida Lottery. Four lucky players hit the jackpot that day to become instant multi-millionaires. This jackpot helped the Florida Lottery transfer \$68.4 million to education, the largest single LOTTO contribution to date.

The CASH 3 game continued to play a vital role in the Lottery's On-line product mix, and produced more than \$330 million in sales during fiscal year 2002/2003. This daily game, originally launched in 1988,



has consistently performed well, and contributes an average of 20 percent to the Lottery's On-line ticket sale totals each year.

Following the successful product re-launch of the **FANTASY 5** game in July 2001, ticket sales reached \$260 million for the fiscal year, more than 35 percent higher than before game changes were made.

PLAY 4, another popular daily game, contributed \$182 million to On-line sales during fiscal year 2002/2003. This seven percent sales increase set yet another record for PLAY 4, reaching its highest level since the game launched in 1991.

MEGA MONEY contributed more than \$95 million to the Lottery's On-line ticket sales in fiscal year 2002/2003. In an effort to improve the performance of this game, the Florida Lottery began preparations to enhance the game after receiving input from frequent

MEGA MONEY players. The launch will take place in January 2004.

Throughout the fiscal year, the Lottery conducted rounds of consumer research and business analysis to prepare for game enhancements. Through a strategically planned re-design of the game that would benefit the players

and ultimately education, the Lottery will see this game through a successful fiscal year 2003/2004.

The Florida Lottery's On-line games continued to be the backbone of the Lottery's total product mix. This is reflected in the highest On-line ticket sales in the 16-year history of the Lottery and ultimately translated into more contributions to public education.



In FY 2002/03, 41 players became FLORIDA LOTTO jackpot winners!

Highest On-line ticket sales in the 16-year history of the Lottery



In January 2003, the Florida Lottery issued a request for proposal for a new On-line gaming system vendor. With a current fiscal year value in excess of \$30 million, the contract for On-line gaming services of LOTTO, FANTASY 5, CASH 3, PLAY 4 and MEGA MONEY is one of the largest goods and services procurement contracts awarded by a state agency. Responses were received March 2003 and subsequently evaluated. Selection of an On-line gaming system vendor should occur in August 2003.



Independent auditors monitor the Lottery's daily drawings to insure the Lottery's integrity and accountability.

During fiscal year 2002/2003, the Florida Lottery continued to leverage its investment in a Business Intelligence system that provided the Lottery's data warehouse the ability to construct and deploy a retailer incentive program to help drive sales upward. The Business Intelligence toolset enabled a cross-functional team to design and deliver a package that would provide sales goals to retailers coupled with progress reports that in turn translated into increased sales through earned retailer incentives. This facility was used to build a comprehensive sales overview report for Lottery sales representatives to use in the field when making retailer sales calls.

Additionally, the Florida Lottery enhanced its e-Business infrastructure with best-in-class middleware, security access tools and automated systems management tools. These advances in technology prepare the Lottery to interface optimally with external entities requiring connection to Lottery systems including the much anticipated new gaming system targeted for implementation in fiscal year 2004/2005.

Operations implemented a number of efficiencies, most notably a project involving the Security Division which was recognized as a 2003 Davis Productivity Awards recipient for significant annual savings utilizing the Florida Lottery's existing network to transmit physical security monitoring information from Lottery field offices.

As required by subsection 24.105(4), Florida Statutes, the following information reflects the organizational structure of the Lottery on June 30, 2003.

OFFICE OF THE SECRETARY

The Deputy Secretary assists the Secretary in the development and implementation of business strategies and provides direction, oversight and evaluation of daily business functions related to Games Administration, Information Technology/Operations, Business Development and Product Development.

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

The 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, legislative staff and the Office of the Governor.

The General Counsel provides consultation, direction and representation in all legal matters affecting the Lottery.

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

Human Resource Management administers a comprehensive human resources program including classification, recruitment, selection, attendance and leave.

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.

ASSISTANT SECRETARY FOR PUBLIC AFFAIRS

Communications manages public awareness and player relations by providing current and historical information to players, retailers, news media and the general public through the following units:

- **Media Relations** coordinates all Lottery activities with the news media, including spokesperson interviews, public records requests, news conferences, press releases and maintains the Lottery's web site in both English and Spanish, and produces official Lottery publications.
- **Public Information** manages customer correspondence and e-mail, serves as a clearinghouse for Lottery records, provides in-house Spanish-language translations, provides archive services to the Lottery and the public.
- **Player Information Line** serves as the Lottery's direct liaison to players, responding to inquiries regarding Lottery games and various other facets of Lottery operations.

Educational Affairs promotes awareness and understanding of the state's use of Lottery moneys to provide enhancements to public Education in Florida. Educational Affairs achieves its mission through participation in Education conferences, the development and dissemination of Lottery Education materials, maintaining current information on the Lottery/Education Web Pages as well as through partnerships with the Governor's Office, the Department of Education and other Education entities.

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

ASSISTANT SECRETARY FOR OPERATIONS

Operations is the Lottery's internal services group that provides strategic and automated solutions to fulfill the Lottery's business needs, to provide excellence in customer service, to optimize the sale of Lottery tickets and to ultimately enhance contributions to Education. Operations consists of the following work units:

- **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

maintains the Lottery's Continuity of Operations Plans.

- **Software Quality Assurance** is responsible for researching gaming system functional requirements and performing formal User Acceptance Testing on all gaming system software prior to implementation.
- **Software and Data Services** automates and improves the Lottery's business processes by building information applications that enable and optimize the development of new lottery products, payment of winners, electronic payment by retailers, retailer incentive programs and other mission critical initiatives.
- **Systems and Operations Services (SOS)** maintains a secure, power-redundant data center environment, provides telecommunications systems and services, desktop computing and technology infrastructure services for the Lottery. SOS also maintains the Lottery's Information Technology Disaster Recovery Plan.

ASSISTANT SECRETARY FOR ADMINISTRATION AND FINANCE

Finance and Budget 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. This unit manages and collects funds from retailers who are delinquent in their payments. Financial Reporting prepares financial statements and reports to convey the results of Lottery operations.
- **Disbursements** is responsible for cash management, vendor disbursements and the player disbursement functions of the Lottery including processing prize payments to winners.

Purchasing executes all purchasing and contracting for the Lottery, 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 record management.

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

ADA Compliance ensures that the Lottery and its retailers comply with the Americans with Disabilities Act of 1990.

Retailer Contracting evaluates and approves retailer applications and enters into contracts with retailers that will best serve the public interest and provide adequate and convenient availability of lottery tickets. The unit directly supports the Lottery's efforts in the recruitment and retention of retailers. Through its application and contract renewal processes, Retailer Contracting ensures the integrity, reputation and financial responsibility of all Lottery retailers.

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.

Advertising works directly with our advertising vendors, to develop informative advertising campaigns for our customers (consumers, retailers and the general public), introducing new programs and products the Lottery is offering. Some of our advertising efforts are focused on educating the public regarding the contributions the Lottery makes to the Educational Enhancement Trust Fund.

Statewide Sales consists of eleven 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 work with the Lottery's corporate retail partners.

Research and Policy Analysis initiates and oversees consumer market studies primarily contracted through the Lottery's research vendor of record. This unit's projects center on consumer, retailer, retail environment and advertising campaign analysis. The Research and Policy Analysis unit also provides valuable data used to determine products to be developed, revenue forecasting and overall program effectiveness.

Special Events and Promotions increases the awareness of Lottery products through special sales promotions, promotional merchandise and participation in special events held in communities throughout Florida. These units' responsibilities also include On-line game drawings held at public venues throughout the state, retailer promotions, and Lottery ShowVan bookings.

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DECEMBER 2003

REPORT NO. 2004-061



WILLIAM O. MONROE, CPA
AUDITOR GENERAL

AUDITOR GENERAL STATE OF FLORIDA

G74 Claude Pepper Building
111 West Madison Street
Tallahassee, Florida 32399-1450



850/488-5534/SC 278-5534
Fax: 488-6975/SC 278-6975

The President of the Senate, the Speaker of the
House of Representatives, and the
Legislative Auditing Committee

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

We have audited the accompanying financial statements of the Department of the Lottery (the Lottery), an enterprise fund of the State of Florida, as of and for the year ended June 30, 2003. 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. The Lottery's financial statements as of June 30, 2002, were audited by other auditors whose report, dated October 14, 2002, expressed an unqualified opinion on those statements.

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 1, 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, 2003, and 2002, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

INDEPENDENT AUDITOR'S REPORT

DECEMBER 2003

REPORT NO. 2004-061

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, 2003, and the 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 2, 2003, 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, and contracts. 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 accompanying management's discussion and analysis, presented on pages 3 through 11, is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Respectfully submitted,



William O. Monroe, CPA
December 2, 2003

**STATE OF FLORIDA
DEPARTMENT OF THE LOTTERY****MANAGEMENT'S DISCUSSION AND ANALYSIS****YEARS ENDED JUNE 30, 2003, AND JUNE 30, 2002**

The Florida Lottery has as its mission the maximization of revenues for the benefit of education in a manner consistent with the dignity of the state and the welfare of its citizens.

The Florida Lottery is considered a mature lottery with a full complement of both scratch-off and on-line products. The Department has maintained lottery sales in excess of \$2 billion for fourteen consecutive fiscal years and has transferred over \$800 million annually to the Educational Enhancement Trust Fund during this same period, with the fiscal year 2003 transfer exceeding \$1 billion.

The Lottery is accounted for as an enterprise fund. Enterprise funds are used to account for activities that are financed and operated in a manner similar to private business enterprises: (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.

This discussion and analysis is designed to focus on the fiscal year ended June 30, 2003, activities and comparative financial data from the prior years, 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, 2003:

- Florida Lottery's ticket sales increased 23.1% over the prior fiscal year from approximately \$2,330,365,000 to \$2,867,981,000, reflecting an increase in scratch-off ticket sales of 62.1% or \$411 million and an increase in FLORIDA LOTTO sales of 14.9% or \$119 million.
- During the year there were three large FLORIDA LOTTO jackpots impacting total ticket sales: \$85 million in September 2002, \$100 million in December 2002, and \$50 million in March 2003.
- Florida Lottery's total operating revenue increased by \$537,703,000 (or 23.1%), and income from operations increased 12% from approximately \$915,278,000 to \$1,024,563,000.
- Florida Lottery's restricted net assets increased by \$118,313,000 (or 50.4%), representing an increase in market value of restricted investments held to pay prize winners, and a small net decrease in investment in capital assets.
- Transfers to the Educational Enhancement Trust Fund increased from approximately \$926,488,000 to approximately \$1,035,178,000, or 11.7%, over the prior fiscal year.

SUMMARY OF NET ASSETS

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

Table 1
Summary of Net Assets
As of June 30, 2003 and 2002
(In Thousands)

	<u>2003</u>	<u>2002</u>	<u>Change</u>
Assets			
Current Assets	\$ 176,117	\$ 145,560	\$ 30,557
Restricted Assets			
Cash and Cash Equivalents	99	0	99
Pending Investments Sales Receivable	10,781	0	10,781
Securities Lending Income Receivable	1,305	5,303	(3,998)
Investments, Grand Prize	2,023,765	1,992,100	31,665
Investments, Other	2,060,889	1,902,146	158,743
Capital Assets, Net of Depreciation	<u>2,623</u>	<u>2,884</u>	<u>(261)</u>
Total Assets	<u>\$ 4,275,579</u>	<u>\$ 4,047,993</u>	<u>\$ 227,586</u>
Liabilities			
Current Liabilities	\$ 170,460	\$ 142,241	\$ 28,219
Current Liabilities Payable from Restricted Assets			
Pending Purchases Payable	40,364	0	40,364
Securities Lending Fees Payable	744	995	(251)
Obligations Under Securities Lending	2,030,338	1,907,163	123,175
Grand Prizes Payable	<u>232,601</u>	<u>230,449</u>	<u>2,152</u>
Total Current Liabilities from Restricted Assets	<u>2,304,047</u>	<u>2,138,607</u>	<u>165,440</u>
Noncurrent Liabilities			
Grand Prizes Payable	1,444,742	1,529,113	(84,371)
Compensated Absences Payable	<u>3,267</u>	<u>3,282</u>	<u>(15)</u>
Total Noncurrent Liabilities	<u>1,448,009</u>	<u>1,532,395</u>	<u>(84,386)</u>
Total Liabilities	<u>3,922,516</u>	<u>3,813,243</u>	<u>109,273</u>
Net Assets			
Net Investment in Capital Assets	2,623	2,884	(261)
Restricted Net Assets	<u>350,440</u>	<u>231,866</u>	<u>118,574</u>
Total Net Assets	<u>353,063</u>	<u>234,750</u>	<u>118,313</u>
Total Liabilities and Net Assets	<u>\$ 4,275,579</u>	<u>\$ 4,047,993</u>	<u>\$ 227,586</u>

Table 2
Summary of Revenues, Expenses and Changes in Net Assets
Years Ended June 30, 2003, and 2002
(In Thousands)

	<u>2003</u>	<u>2002</u>
Operating Revenues		
Ticket Sales	\$ 2,867,981	\$ 2,330,365
On-Line Fees and Miscellaneous	4,953	4,877
Retailer Fees	201	190
Total Operating Revenues	<u>2,873,135</u>	<u>2,335,432</u>
Operating Expenses		
Prizes	1,555,848	1,165,843
Retailer Commissions	160,850	132,351
Scratch-Off Tickets	25,665	16,812
On-line Games	35,998	32,219
Advertising	31,181	32,536
Personal Services	24,311	24,489
Other Contractual Services	9,700	7,819
Materials and Supplies	3,298	6,860
Bad Debts	620	191
Depreciation	1,101	1,034
Total Operating Expenses	<u>1,848,572</u>	<u>1,420,154</u>
Income from Operations	<u>1,024,563</u>	<u>915,278</u>
Nonoperating Revenue (Expense)		
Interest	5,157	5,803
Securities Lending Income	34,552	52,548
Securities Lending Fees	(29,355)	(46,973)
Net Appreciation in Fair Value of Investments	241,732	174,801
Amortization of Grand Prizes Payable	(123,158)	(129,266)
Total Nonoperating Revenue		
(Expenses), Net	<u>128,928</u>	<u>56,913</u>
Income Before Operating Transfers	<u>1,153,491</u>	<u>972,191</u>
Transfers to Educational Enhancement Trust Fund	<u>(1,035,178)</u>	<u>(926,488)</u>
Change in Net Assets	<u>118,313</u>	<u>45,703</u>
Net Assets, Beginning of Year	<u>234,750</u>	<u>189,047</u>
Net Assets, End of Year	<u>\$ 353,063</u>	<u>\$ 234,750</u>

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 net assets.

Current Year Impacts to the Statement of Net Assets

For the fiscal year ended June 30, 2003:

- Total assets increased by \$227,586,000. This can be attributed to increases in market value in investments held for grand prize winners and in investments related to securities lending activities.
- Total liabilities increased by \$109,273,060. This can primarily be attributed to net increases in obligation under security lending of \$123,175,000 and transfers due to the Educational Enhancement Trust Fund of \$17,295,000, a pending investment purchase of \$40,364,000 and a net decrease of \$73,563,000 in prizes payable to winners.
- Net assets increased by \$118,313,000 primarily due to the increase in market value of restricted investments held to pay prize winners and investments purchased with cash collateral for security lending.

SUMMARY OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

The most important relationship demonstrated with the Lottery's financial statements is the transfer of all net income to the Educational Enhancement Trust Fund. Accordingly, the primary focus of these financial statements is determining net income available for transfer, rather than the change in net assets of the Lottery which reflects the increase in fair value of restricted investments. The explanation of the changes in net assets has lesser importance in measuring the overall financial condition of the Florida Lottery. Analysis of current year results of operations is important in understanding the Florida Lottery's financial operations for the past fiscal year.

Table 2 is a brief summary of these results.

Normal Impacts That Primarily Affect the Statement of Revenues and Expenses

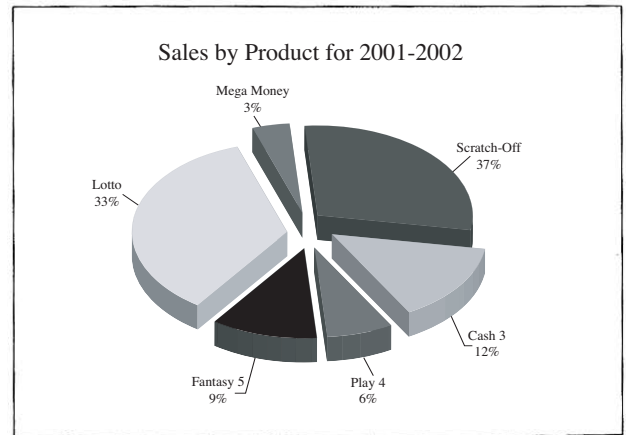
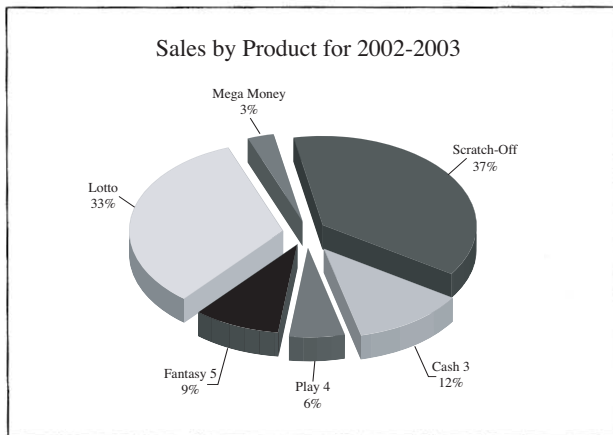
- **Economic Conditions** – Economic factors such as income growth, level of tourism and employment rates impact ticket sales and bad debts.
- **Financial Market Conditions** - Interest rates and bond market conditions affect interest, securities lending income and fees, net appreciation in fair value 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 of the Statement of Revenues and Expenses

Revenue

For the fiscal year ended June 30, 2003, ticket sales increased by \$537,616,000 primarily due to growth in the scratch-off ticket market, and increases in Lotto sales. The \$2,867,981,000 sales figure represents the highest sales in the history of the Florida Lottery.

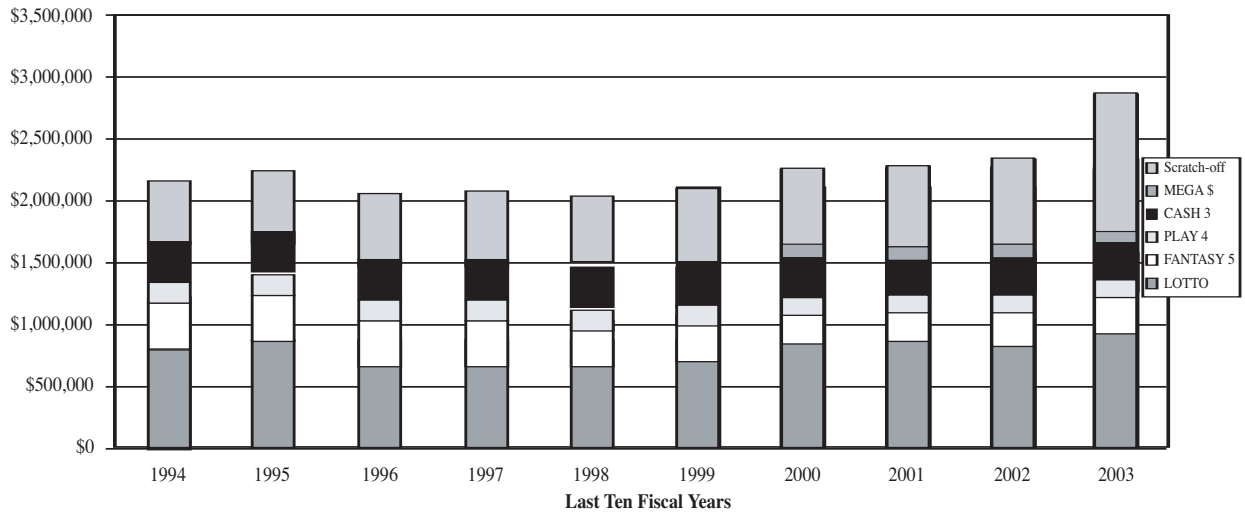
The following chart shows sales by product for the various Lottery games during the 2002-2003 and 2001-2002 fiscal years:



Sales of scratch-off tickets for the fiscal year ending June 30, 2003, were \$1,073,861,000 or 37% of combined sales. Effective July 1, 2002, the Department was authorized pursuant to Section 24.121(1), Florida Statutes, to return a variable percentage of scratch-off game revenues as prizes to maximize revenues transferred to the Educational Enhancement Trust Fund. The Department implemented this strategy in September 2002. As a

result of this strategy, scratch-off sales increased 62%. In addition, for the fiscal year ended June 30, 2003, on-line fees, miscellaneous revenue, and retailer fees increased by \$87,000.

Historical Lottery Sales by Game - (In Thousands)



Department of the Lottery
Historical Lottery Sales By Game
Last Ten Fiscal Years
(In Thousands)

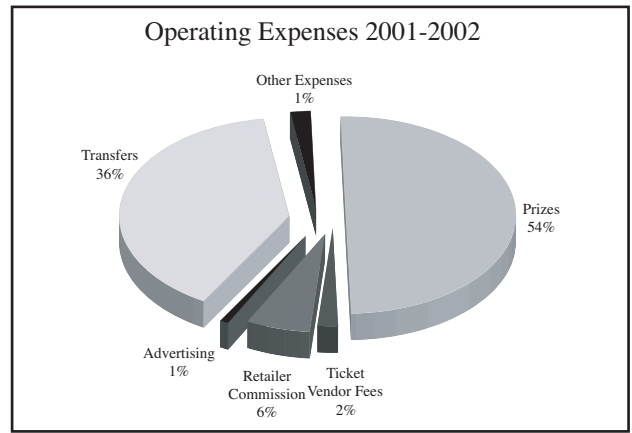
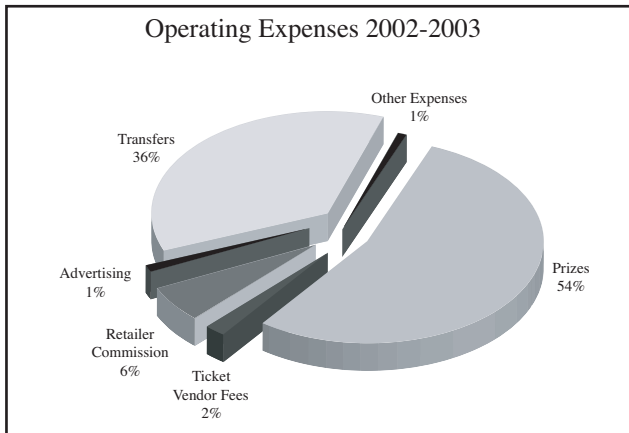
Fiscal Year Ended June 30	FLORIDA LOTTO	FANTASY 5	PLAY 4	CASH 3	MEGA \$ MONEY	Scratch-off Tickets	Combined Sales
1994	\$781,478	\$420,725	\$140,006	\$296,540	-	\$513,775	\$2,152,524
1995	911,564	346,699	145,245	307,006	-	527,625	2,238,139
1996	738,910	296,693	154,852	319,507	-	551,522	2,061,484
1997	721,070	272,289	151,094	309,376	-	616,229	2,070,058
1998	711,326	245,725	159,649	313,930	\$35,968	583,439	2,050,037
1999	737,687	241,799	169,415	339,273	14,861	593,691	2,096,726
2000	864,983	216,303	158,620	318,972	121,266	568,352	2,248,496
2001	845,433	191,614	163,157	326,471	108,842	639,209	2,274,726
2002	806,023	262,923	170,708	329,830	98,315	662,566	2,330,365
2003	925,474	259,999	182,716	330,001	95,930	1,073,861	2,867,981

Total sales have been increasing primarily due to the changes in game structure to FLORIDA LOTTO, which occurred in October 1999, changes in game structure to FANTASY 5, which occurred in July 2001, and higher prize payouts for scratch-off tickets, which occurred in September 2002.

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% of sales revenue being available for Lottery operating and administrative expenses, including retailer commissions, on-line games expense, and scratch-off ticket expense.

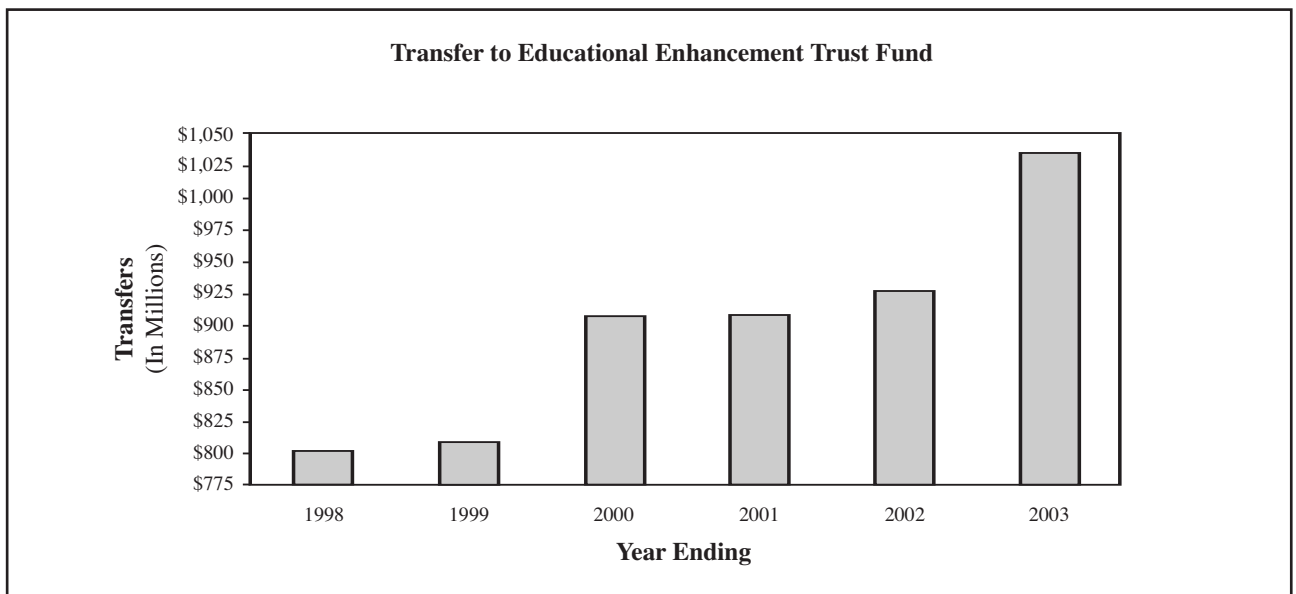
The following chart shows the major components of Lottery operating expenses and transfers as a percentage of ticket sales for the 2002-2003 and 2001-2002 fiscal years:



Transfers

Total transfers to the Educational Enhancement Trust Fund increased by \$108,690,000 during the 2002-2003 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 six fiscal years:



CAPITAL ASSETS

Table 3 summarizes the Lottery's capital assets.

Table 3
Capital Assets
As of June 30, 2003, and 2002
(In Thousands)

	<u>2003</u>	<u>2002</u>
Data processing equipment	\$ 8,769	\$ 9,251
Office equipment and fixtures	6,379	6,400
Vehicles and other equipment	3,372	3,562
	<u>18,520</u>	<u>19,213</u>
Less accumulated depreciation	<u>(15,897)</u>	<u>(16,329)</u>
Total capital assets	<u>\$ 2,623</u>	<u>\$ 2,884</u>

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

Table 4
Change in Capital Assets
For the Years Ending June 30, 2003, and 2002
(In Thousands)

	<u>2003</u>	<u>2002</u>
Beginning Balance	\$ 2,884	\$ 2,716
Additions	878	1,325
Retirements	(1,571)	(826)
Depreciation	432	(331)
Ending Balance	<u>\$ 2,623</u>	<u>\$ 2,884</u>

ECONOMIC FACTORS AND FUTURE IMPACTS

The main economic factors affecting lottery sales are population growth, personal income growth, and employment. Based on the October 24, 2003, Florida Economic Estimating Conference, the population is forecasted to increase 2.18% in 2003-2004 and 1.95% in 2004-2005. During these periods real per capita income is expected to grow 1.1% and 2.0%, respectively. Total nonfarm employment is forecasted to increase by 1.6% and 2.9%, respectively.

Strategies to increase lottery revenues are actively pursued by the Department. The following are some of the functional strategies discussed in the 2004 Strategic Plan:

- **Increase the focus of research and product development for the on-line product segment:** This functional strategy will be accomplished through product extensions, redesign of existing games such as Mega Money, on-line promotions, etc.
- **Improve market penetration through expansion of Lottery retailer network.**

Since July 1, 2002, the Department has been statutorily authorized to return a variable percentage of scratch-off game revenues as prizes to maximize revenues transferred to the Educational Enhancement Trust Fund. It has been the experience of the Department and lotteries of other states that a program that increases the prize payout percentages of scratch-off games leads to higher sales and greater net profits. This strategy has resulted in an increase of 62% in scratch-off ticket sales for Fiscal Year 2003 over the previous year, and an increase of \$27 million in the transfer to the Educational Enhancement Trust Fund from sales of scratch-off tickets during the same period.

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, Capitol Complex, Tallahassee, Florida 32301, (850) 487-7777.

FINANCIAL SECTION

STATE OF FLORIDA DEPARTMENT OF THE LOTTERY

Statement of Net Assets

As of June 30, 2003 and June 30, 2002
(In Thousands)

Assets	<u>June 30, 2003</u>	<u>June 30, 2002</u>
Current Assets:		
Cash and cash equivalents	\$ 115,361	\$ 96,793
Interest receivable	603	383
Accounts receivable, net	56,926	45,495
Inventories	1,306	1,125
Security deposits	1,921	1,764
Total Current Assets	<u>176,117</u>	<u>145,560</u>
Restricted Assets:		
Cash and cash equivalents	99	0
Pending investment sales receivable	10,781	0
Securities lending income receivable	1,305	5,303
Investments, grand prize	2,023,765	1,992,100
Investments, other	2,060,889	1,902,146
Capital assets, net	2,623	2,884
Total Assets	<u>4,275,579</u>	<u>4,047,993</u>
Liabilities		
Current Liabilities:		
Accounts payable and accrued liabilities	10,045	7,934
Prizes payable	70,667	62,011
Due to Educational Enhancement Trust Fund	87,542	70,247
Deposits payable	1,921	1,764
Compensated absences payable	285	285
Total Current Liabilities	<u>170,460</u>	<u>142,241</u>
Current Liabilities Payable from Restricted Assets:		
Pending purchases payable	40,364	0
Securities lending fees payable	744	995
Obligations under securities lending	2,030,338	1,907,163
Grand prizes payable	232,601	230,449
Total Current Liabilities Payable from Restricted Assets	<u>2,304,047</u>	<u>2,138,607</u>
Noncurrent Liabilities:		
Grand prizes payable	1,444,742	1,529,113
Compensated absences payable	3,267	3,282
Total Noncurrent Liabilities	<u>1,448,009</u>	<u>1,532,395</u>
Total Liabilities	<u>3,922,516</u>	<u>3,813,243</u>
Net Assets		
Invested in capital assets	2,623	2,884
Restricted	350,440	231,866
Total Net Assets	<u>\$ 353,063</u>	<u>\$ 234,750</u>

See accompanying notes to financial statements.

NET ASSETS

STATE OF FLORIDA DEPARTMENT OF THE LOTTERY

Statement of Revenues, Expenses and Changes in Net Assets

Years ended June 30, 2003 and June 30, 2002
(In Thousands)

	2003	2002
Operating Revenues:		
Ticket Sales	\$ 2,867,981	\$ 2,330,365
On-Line Fees and Miscellaneous	4,953	4,877
Retailer Fees	201	190
Total Operating Revenues	2,873,135	2,335,432
Operating Expenses:		
Prizes	1,555,848	1,165,843
Retailer Commissions	160,850	132,351
Scratch-Off Tickets	25,665	16,812
On-line Games	35,998	32,219
Advertising	31,181	32,536
Personal Services	24,311	24,489
Other Contractual Services	9,700	7,819
Materials and Supplies	3,298	6,860
Bad Debts	620	191
Depreciation	1,101	1,034
Total Operating Expenses	1,848,572	1,420,154
Operating Income	1,024,563	915,278
Nonoperating Revenue (Expenses):		
Interest	5,157	5,803
Securities Lending Income	34,552	52,548
Securities Lending Fees	(29,355)	(46,973)
Net Appreciation in Fair Value of Investments	241,732	174,801
Amortization of Grand Prizes Payable	(123,158)	(129,266)
Total Nonoperating Revenue (Expenses), Net	128,928	56,913
Income Before Operating Transfers	1,153,491	
Transfers to Educational Enhancement Trust Fund	(1,035,178)	(926,488)
Change in Net Assets	118,313	45,703
Net Assets, Beginning of Year	234,750	189,047
Net Assets, End of Year	\$ 353,063	\$ 234,750

See accompanying notes to financial statements.

STATEMENT OF CASH FLOWS

STATE OF FLORIDA DEPARTMENT OF THE LOTTERY

Statement of Cash Flows

Years ended June 30, 2003 and June 30, 2002
(In Thousands)

	June 30, 2003	June 30, 2002
Operating Activities:		
Ticket sales	\$2,855,896	\$2,330,529
Prizes paid to winners	(1,547,091)	(1,159,232)
Commissions paid and payments to retailers	(160,850)	(132,351)
Paid to vendors for goods and services	(103,952)	(96,184)
Paid to employees	(24,326)	(24,581)
Other operating revenue	5,154	5,067
Net Cash Provided by Operating Activities	<u>1,024,831</u>	<u>923,248</u>
Noncapital Financing Activities:		
Payments to Educational Enhancement Trust Fund	(1,017,883)	(927,500)
Net Cash Used in Noncapital Financing Activities	<u>(1,017,883)</u>	<u>(927,500)</u>
Capital and Related Financing Activities:		
Purchase of capital assets	(839)	(1,326)
Proceeds from sale of capital assets	33	59
Net Cash Used in Capital and Related Financing Activities	<u>(806)</u>	<u>(1,267)</u>
Investing Activities:		
Cash received from maturity of grand prize investments	240,284	237,508
Cash paid to grand prize winners upon maturity of grand prize investments	(240,284)	(237,508)
Interest	12,525	11,937
Net Cash Provided by Investing Activities	<u>12,525</u>	<u>11,937</u>
Net Increase in Cash and Cash Equivalents	<u>18,667</u>	<u>6,418</u>
Cash and Cash Equivalents, Beginning of Year	96,793	90,375
Cash and Cash Equivalents, End of Year	<u>\$115,460</u>	<u>\$96,793</u>
Reconciliation of Income from Operations to Net Cash Provided by Operating Activities:		
Income from operations	\$1,024,563	\$915,278
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation	1,101	1,034
Gain on disposal of capital assets	33	64
Changes in assets and liabilities (Increase) decrease in:		
Accounts receivable	(11,431)	355
Inventories	(181)	53
Increase (decrease) in:		
Accounts payable and accrued liabilities	2,105	(55)
Prizes payable	8,656	6,612
Compensated absences payable	(15)	(93)
Net Cash Provided by Operating Activities	<u>\$1,024,831</u>	<u>\$923,248</u>
Noncash Investing, Capital and Financing Activities:		
Increase in fair value of investments	\$127,159	
See accompanying notes to financial statements.		

NOTES TO FINANCIAL STATEMENTS

STATE OF FLORIDA DEPARTMENT OF THE LOTTERY

Notes to Financial Statements

Years ended June 30, 2003, and June 30, 2002

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. 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 (the 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. Management's analysis has disclosed no component units that should be included in the Lottery's financial statements.

b. Basis of Presentation

The Lottery is accounted for as an enterprise fund. Enterprise funds are used to account for activities that are financed and operated in a manner similar to private business enterprises: (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.

c. 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) Codification Section P80.103, the Lottery has elected not to apply Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989. As also provided by GASB, the Lottery has elected not to adopt any FASB statements issued after November 30, 1989, unless so directed by GASB.

The Lottery's operating revenues and expenses generally result from the sale and marketing of Lottery tickets and the payment of related prizes. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

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.

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. 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, are 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 amended, as nearly as practical, at least 50 percent 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.

Unclaimed prizes for on-line games includes a prior estimate made at the time of the draw adjusted to actual unclaimed prizes, plus a future estimate of on-line prizes that will not be claimed within 180 days. Prior to March 2003, a future estimate of scratch-off prizes that were not expected to be claimed within 60 days after the end of each game was also added to unclaimed prizes. In fiscal year 2001-2002, unclaimed prizes were added to the pool from which future prizes were awarded or used for special prize promotions. Beginning July 2003, unclaimed prizes were used to increase prize payouts of scratch-off games to maximize revenues and to increase the transfer to the Educational Enhancement Trust Fund.

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 an 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, game merchandise, 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. Capital Assets

Capital assets are stated at cost less accumulated depreciation. As required by Chapter 273, Florida Statutes, a capitalization threshold of \$1,000 is employed. 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

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 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 \$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.

k. Compensated Absences

Employees earn the right to be compensated during absences for vacation and illness, and for 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. Net Assets

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

Investments in capital assets of approximately \$2,623,000 and \$2,884,000 at June 30, 2003, and 2002, respectively, are intended to reflect the portion of net assets that 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 in the State Treasury of approximately \$350,440,000 and \$231,866,000 at June 30, 2003, and 2002, respectively.

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

m. 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, balances held by the State Board of Administration (SBA), and pooled investments in the State Treasury.

n. 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, liabilities, revenues, expenses, and disclosures of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates.

o. New Accounting Standards

Effective July 1, 2001, the Lottery adopted the provisions of Governmental Accounting Standards Board (GASB) Statements 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 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, the statement of revenues, expenses and changes in net assets, and the statement of cash flows. These pronouncements also require the presentation of management’s discussion and analysis preceding the financial statements.

2. 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 \$324,000 at June 30, 2003, and \$328,000 at June 30, 2002, were insured by either the State’s collateral for public deposits in accordance with Section 280.04, Florida Statutes, or Federal depository insurance.

Chapter 280, Florida Statutes, generally requires public funds to be deposited in a bank or savings association that is designated by the Chief Financial Officer 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 Chief Financial Officer, 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 Chief Financial Officer as security for public deposits. Collateral may be held by another custodian with approval of the Chief Financial Officer if conditions are met which protect the State’s interest. 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 \$4,134,000 at June 30, 2003, and \$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 \$74,000 and \$78,000 at June 30, 2003, and 2002 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 years ended June 30, 2003, and 2002, were approximately \$1,129,000 and \$30,048,000, respectively.

Surplus cash is maintained in the State Treasury's general pool of investments. The Chief Financial Officer pools funds from all departments. Included in the pool are primarily time deposits, U.S. Government securities, federal agency securities, bankers' acceptances, commercial paper, corporate bonds and notes, repurchase agreements and reverse repurchase agreements. 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 \$111,713,000 and \$96,035,000 at June 30, 2003, and 2002, 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 security lending 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 Office of the Chief Financial Officer.

b. Investments, Grand Prize

The grand prize investments primarily 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 revenues, expenses and changes in net assets. Net appreciation in fair value of investments is reflected as a nonoperating revenue on the statements of revenues, 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

These 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, 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.

Dresdner 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 fair value of the securities loaned is required by the lending agreement. Borrowers must be approved for lending by Dresdner Bank's credit department. Dresdner Bank monitors the fair value of collateral provided and the securities on loan on a daily basis. Additional collateral is required if the fair value of the collateral for any loan is less than 100 percent of the fair value of the securities provided for such loan. The SBA had no credit risk exposure to borrowers at year-end.

The SBA received \$2,030,338,328 of cash collateral for the lending program as of June 30, 2003. At June 30, 2003, 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 66.91 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.

Securities lending activity for the year ended June 30, 2003, and 2002, consisted of (in thousands):

	<u>2003</u>	<u>2002</u>
Securities lending income	\$ 34,552	\$ 52,548
Less broker rebates	(27,776)	(45,115)
Less bank fees	(1,579)	(1,858)
Net securities lending revenue	<u>\$ 5,197</u>	<u>\$ 5,575</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 counter-party'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 counter-party, 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, 2003, is presented below (in thousands):

<u>Investments</u>	<u>Risk Category</u>			<u>Carrying Amount</u>
	<u>1</u>	<u>2</u>	<u>3</u>	
Lottery investments - classified:				
U.S. obligations	\$39,237			\$ 39,237
Commercial paper			\$42,969	42,969
Repurchase agreements		\$567,821		567,821
Bonds and notes			1,450,099	1,450,099
Total classified investments	<u>\$ 39,237</u>	<u>\$ 567,821</u>	<u>\$ 1,493,068</u>	<u>2,100,126</u>
Lottery investments - unclassified:				
Investments held by broker dealers under securities lending agreements:				
U.S. obligations				1,984,528
Pooled investments in State Treasury (included in cash equivalents)				<u>114,638</u>
Total unclassified investments				<u>2,099,166</u>
Total investments				<u>\$ 4,199,292</u>

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

	<u>Investments</u>	<u>Cash at Financial Institutions</u>	<u>Cash at State Treasury</u>	<u>Cash at SBA</u>	<u>Total</u>
Cash and cash equivalents	\$ 114,638	\$ 324	\$ 59	\$ 439	\$ 115,460
Investments, grand prize	2,023,765				2,023,765
Investments, other	<u>2,060,889</u>				<u>2,060,889</u>
Total	<u>\$ 4,199,292</u>	<u>\$ 324</u>	<u>\$ 59</u>	<u>\$ 439</u>	<u>\$ 4,200,114</u>

3. ACCOUNTS RECEIVABLE

Accounts receivable as of June 30, 2003, and 2002, consisted of the following (in thousands):

	<u>June 30, 2003</u>	<u>June 30, 2002</u>
Ticket sales receivable	\$ 58,197	\$ 45,522
Other receivables	<u>16</u>	<u>811</u>
Total receivables	58,213	46,333
Less allowance for doubtful accounts	<u>(1,287)</u>	<u>(838)</u>
Accounts receivable, net	<u>\$ 56,926</u>	<u>\$ 45,495</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 statement of net assets in assets as security deposits and in liabilities as deposits payable.

5. CAPITAL ASSETS

Capital assets at June 30, 2003, and 2002, consisted of (in thousands):

	Balance July 1, 2001	<u>2001 - 2002</u>		Balance June 30, 2002	<u>2002 - 2003</u>		Balance June 30, 2003
		Increase	Decrease		Increase	Decrease	
Data processing equipment	\$ 8,653	\$ 937	\$ (339)	\$ 9,251	\$ 796	\$ (1,278)	\$ 8,769
Office equipment and fixtures	6,367	188	(155)	6,400	37	(58)	6,379
Vehicles and other equipment	3,694	200	(332)	3,562	45	(235)	3,372
	18,714	1,325	(826)	19,213	878	(1,571)	18,520
Less: accumulated depreciation	15,998	1,034	(703)	16,329	1,101	(1,533)	15,897
Total capital assets, net	<u>\$ 2,716</u>	<u>\$ 291</u>	<u>\$ (123)</u>	<u>\$ 2,884</u>	<u>\$ (223)</u>	<u>\$ (38)</u>	<u>\$ 2,623</u>

6. LONG-TERM LIABILITIES

a. Grand Prizes Payable

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

	<u>2003</u>	<u>2002</u>
Lotto grand prizes (face value)	\$2,400,829	\$ 2,572,626
Win For Life grand prizes (face value)	15,206	15,570
Big 10 grand prizes (face value)	370	460
Flamingo Fortune Game Show grand prizes (face value)	1,500	1,600
Monthly Bonus grand prizes (face value)	48	192
Win a Million grand prizes (face value)	750	800
Yearly Dividend grand prizes (face value)	72	96
130K Bonus Game grand prizes (face value)	104	
Less imputed interest	<u>(741,536)</u>	<u>(831,782)</u>
Net present value of grand prizes payable	<u>\$1,677,343</u>	<u>\$ 1,759,562</u>
Current Prizes Payable from restricted assets	\$ 232,601	\$ 230,449
Noncurrent Prizes Payable	1,444,742	1,529,113
	<u>\$1,677,343</u>	<u>\$ 1,759,562</u>

The following depicts by fiscal year the value (in thousands) of the grand prize annuities established to pay prize winners:

<u>Year Ended June 30</u>	<u>Amount</u>
2004	\$ 241,066
2005	241,018
2006	241,018
2007	240,994
2008	239,531
2009-2013	846,261
2014-2018	274,972
2019-2023	36,780
2024-2028	46,589
2029-2033	<u>10,650</u>
Grand prizes (face value)	2,418,879
Less imputed interest	<u>(741,536)</u>
Net present value of grand prizes	\$ <u><u>1,677,343</u></u>

b. Compensated Absences Payable

Compensated absences payable at June 30, consisted of (in thousands):

	<u>2003</u>	<u>2002</u>
Current Compensated Absences	\$ 285	\$ 285
Noncurrent Compensated Absences	<u>3,267</u>	<u>3,282</u>
	<u>\$ 3,552</u>	<u>\$ 3,567</u>

c. Changes in Long-Term Liabilities

Changes in long-term liabilities are summarized as follows (in thousands):

	<u>Balance July 1, 2002</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance June 30, 2003</u>	<u>Amount due within one year</u>
Grand prizes payable	\$1,759,562	\$158,065	(\$240,284)	\$1,677,343	\$232,601
Compensated absences payable	<u>3,567</u>	<u>269</u>	<u>(284)</u>	<u>3,552</u>	<u>285</u>
Total long-term liabilities	<u>\$1,763,129</u>	<u>\$158,334</u>	<u>(\$240,568)</u>	<u>\$1,680,895</u>	<u>\$232,886</u>

7. DUE TO EDUCATIONAL ENHANCEMENT TRUST FUND

In accordance with the Act, as amended, at least 38 percent of on-line and miscellaneous revenue, net of retailer fees, must be transferred to the Educational Enhancement Trust Fund for the benefit of public education. Effective July 1, 2002, the Lottery was authorized, pursuant to Section 24.121(1), Florida Statutes, to increase the percentage of scratch-off game revenues returned as prizes and to transfer a variable percentage to the Educational Enhancement Trust Fund. The Lottery implemented this strategy in September 2002. The amount transferred for the fiscal year ended June 30, 2003, was \$1,035,178,000, 35.9 percent of revenues, and for the fiscal year ended June 30, 2002, the transferred amount was \$926,488,000, 39.5 percent of revenues.

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.

Due to Educational Enhancement Trust Fund consisted of (in thousands):

	<u>June 30, 2003</u>	<u>June 30, 2002</u>
Operating revenue less scratch-off ticket sales	\$ 1,799,274	\$ 1,672,866
Nonoperating revenue (expenses), net	128,928	56,913
Less: retailer fees	(201)	(190)
Net appreciation in fair value of investments	(241,732)	(174,801)
Amortization of grand prizes payable	<u>123,158</u>	<u>129,266</u>
Net revenue less scratch-off ticket sales	1,809,427	1,684,054
Total revenue subject to transfer at 38%	1,809,427	1,684,054
	<u>38%</u>	<u>38%</u>
Statutorily required transfer at 38%	<u>687,582</u>	<u>639,941</u>
Scratch-off ticket sales	1,073,861	662,566
Transfer percentage for scratch-off ticket sales	<u>26%</u>	<u>38%</u>
Direct transfer from scratch-off ticket sales	<u>278,716</u>	<u>251,775</u>
Additional transfer appropriated	15,000	20,000
Supplemental balance transferred	<u>53,880</u>	<u>14,772</u>
Due for the year	<u>\$ 1,035,178</u>	<u>\$ 926,488</u>
Balance due, beginning of year	70,247	71,259
Paid during the year	<u>(1,017,883)</u>	<u>(927,500)</u>
Due to Educational Enhancement Trust Fund, end of year	<u>\$ 87,542</u>	<u>\$ 70,247</u>

8. EMPLOYEE BENEFITS

a. Defined Benefit 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. The 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.

Funding Policy - The Lottery is required to pay all contributions for participating full-time and part-time employees. The contribution rates were as follows (including 1.11 percent health insurance subsidy and .15 percent for administrative costs of the Public Employee Optional Retirement Program) for the fiscal years ended June 30, 2003, and 2002:

	Fiscal Year Ended <u>June 30, 2003</u>	Fiscal Year Ended <u>June 30, 2002</u>
Senior Management	6.06 percent	9.28 percent
Regular Employees	5.76 percent	7.30 percent
Special Risk	16.01 percent	18.44 percent

The Lottery's contributions to the FRS amounted to approximately \$1,059,000 and \$1,376,000 for the years ended June 30, 2003, and 2002, respectively. These contributions represented 5.97 percent and 7.69 percent of covered payroll, for the years ended June 30, 2003, and 2002, respectively. The Lottery contributed 100 percent of the required contributions for the years ended June 30, 2003, and 2002.

b. Senior Management Service Optional Annuity Program (SMSOAP)

Section 121.055, Florida Statutes, created the SMSOAP as an optional retirement program for State members of the Senior Management Service Class. The SMSOAP is a defined contribution plan that provides full and immediate vesting of all contributions paid on behalf of the participants to the participating provider companies to invest as directed to provide retirement and death benefits. Employees in eligible State positions may make an irrevocable election to participate in the SMSOAP in lieu of the Senior Management Service Class. Employers contributed 12.49 percent of covered payroll for July 2002 through June 2003. A participant may contribute by salary reduction an amount not to exceed the percentage contributed by the employer.

c. Defined Contributions Plan

Effective July 1, 2002, the Public Employee Optional Retirement Program (PEORP) was implemented as a defined contribution plan alternative available to all FRS members in lieu of the defined benefit plan. Employer contributions are defined by law, but the ultimate benefit depends in part on the performance of investment funds. The PEORP is funded by employer contributions that are based on salary and membership class (Regular Class, Special Risk Class, etc.). Contributions are directed to individual member accounts, and the individual members allocate contributions and account balances among various approved investment choices. Required employer contributions made to PEORP for the fiscal year ended June 30, 2003, totaled \$14,645.

d. 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.

HIS is funded by required contributions from FRS participating employers. For the years ended June 30, 2003, and 2002, the Lottery contributed 1.11 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.

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

e. 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 (notwithstanding 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 to an ordinary and prudent investor. Pursuant to Section 112.215, Florida Statutes, the Deferred Compensation Trust Fund is created in the State Treasury.

9. OPERATING 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, 2003, are scheduled as follows (in thousands):

<u>Year Ending June 30</u>	<u>Headquarters</u>	<u>Districts</u>	<u>Total</u>
2004	\$ 2,417	\$ 685	\$ 3,102
2005	2,442	355	2,797
2006	2,466	10	2,476
2007	2,491	0	2,491
2008	<u>2,516</u>	<u>0</u>	<u>2,516</u>
	<u>\$ 12,332</u>	<u>\$ 1,050</u>	<u>\$ 13,382</u>

Rental expense under all operating leases totaled approximately \$3,270,000 and \$3,259,000 for the years ended June 30, 2003, and 2002, respectively.

10. OTHER COMMITMENTS

The Lottery has entered into contractual agreements to provide on-line and scratch-off lottery game tickets and related services. The base compensation for the on-line games contract is 1.85 percent of sales, with additional compensation of 1.11 percent of the amount of on-line sales in excess of \$1,580,480,000. However, there is a cap which limits the potential combined compensation rate to 2.08 percent of sales. The contractor's compensation for on-line games for the fiscal years ended June 30, 2003, and 2002, was \$35,998,000, and \$32,219,000, respectively.

For scratch-off lottery game tickets and related services, the contractor was compensated at the rate of 2.4375 percent of net scratch-off ticket sales, with the rate declining to 2.3 percent effective January 1, 2003, and to 2.25 percent effective October 1, 2006, subject to the payment provisions of the agreement.

Compensation under this agreement amounted to \$25,665,000 for the fiscal year ended June 30, 2003, and \$16,153,000 for the fiscal year ended June 30, 2002.

11. LITIGATION

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.

