

A Lot to Celebrate!



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Florida Lottery
Annual Report 2003-2004

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Governor's Letter



Dear Friends:

The residents of Florida can take pride, once again, in the Florida Lottery's performance during fiscal year 2003-2004. Consistent with my policy of sustained and responsible growth of Lottery revenues, total net sales increased by more than \$202 million. Since 1999, the Florida Lottery has transferred more than \$5.2 billion to the Educational Enhancement Trust Fund, bringing the Lottery's overall total contribution to education to more than \$14 billion.

Under the skillful leadership of Secretary Rebecca Dirden Mattingly, the Florida Lottery has continued to achieve the highest marks for its management and business expertise. This impressive evaluation was reemphasized by the Legislature's Office of Program Policy Analysis and Government Accountability, which again called the Florida Lottery the number one state Lottery in the country.

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 fiscal year 2003-2004, the Lottery funded 120,890 Bright Future Scholarships, provided \$263 million in K-12 district discretionary funds and contributed \$287 million to Florida's community colleges and state universities.

I applaud the Florida Lottery's valuable contributions and commitment to education in our great state. I look forward to the Lottery's future successes as it continues to raise additional funds for Florida's students to achieve their dreams.

Sincerely,

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

Jeb Bush
Governor

Secretary's Message



Dear Friends and Colleagues:

The Florida Lottery's continued, solid performance is an accomplishment in which we can all take pride. For the fifth consecutive fiscal year, the Lottery has generated record sales and has provided more than \$1 billion in non-tax revenue to support improvements to public education in Florida for the second consecutive year. In pursuing the Governor's policy of sustained and responsible sales growth, the Lottery posted net sales of \$3.07 billion, an increase of \$202 million over fiscal year 2002-2003. For these reasons and many more, the Florida Lottery has "A Lot to Celebrate."

While the Lottery provides only a portion of Florida's overall investment in public education, today's Lottery supplies money for programs that invest directly in students, among them the Bright Futures Scholarship Program. In fiscal year 2003-2004, Lottery money provided \$235 million in Bright Futures Scholarships, opening our universities' doors to 120,890 students, many of whom might not otherwise have had the resources to further their education.

During fiscal year 2003-2004, the Florida Lottery contributed hundreds of millions of dollars in funding for public schools. Our K-12 public schools in all 67 counties received a combined total of more than \$263 million in discretionary Lottery money. Our community colleges and state universities received a combined total of more than \$287 million.

The Florida Lottery is very proud of our support of public education in the state. We are determined to keep our pledge to provide the people of our state with the best Lottery games available in the industry and to maximize revenues for education in a manner that is in keeping with the values of our state.

I would like to express my deep appreciation to the many people who have contributed to the Lottery's many achievements this year. Most of all, I must thank our players, retailers, vendors and employees, whose dedication has created the Lottery's success. They have supported the Florida Lottery in enhancing the educational opportunities for Florida's students, helping them reach their educational goals and enhancing the lives of all our citizens. Remember, when you play, we all win!

Sincerely,

Rebecca Dirden Mattingly
Secretary



A Lot to Celebrate

Contributing More Funds to Education in Our State

Since the Lottery sold its first ticket on January 12, 1988, Florida students have had A Lot to Celebrate. The celebration continues everyday when Florida students are awarded Bright Futures Scholarships and are given the opportunity to live their educational dreams. In fiscal year 2003-2004, the Lottery celebrated sales of more than \$3 billion, which allowed it to contribute more than \$1 billion to education for the second consecutive fiscal year.

During fiscal year 2003-2004, the Florida Lottery proudly surpassed the \$14 billion mark in contributions to the Educational Enhancement Trust Fund. Although this is a substantial amount of money, it's important to remember that the Lottery's financial contribution to education each year continues to account for less than 10 percent of Florida's annual education budget.

In 1999, the Lottery was charged with fulfilling sales objectives and contributions to improve education. Since then, the Lottery has had record-breaking sales each year. The Florida Lottery is the first lottery in the nation to generate more than \$10 billion for education within its first 12 years.

With contributions from the Florida Lottery, Florida school districts have been able to fully or partially fund more than 400 school construction or renovation projects through the Classrooms First Program. Since start-up, school districts have received \$6.7 billion of district discretionary funding for students in K-12 throughout the state.

Community colleges and public universities have received more than \$3.9 billion in Lottery funding. Since 1997, more than 220,000 Florida students have earned Bright Futures Scholarships, which are fully funded by the Florida Lottery. Last year alone, the Florida Lottery funded 120,890 Bright Future Scholarships in the amount of \$235 million. The Lottery has provided more than \$81 million in funding in the form of other student financial aid.

The Lottery continues to be 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. It allows 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 thrive today. Each year, the Lottery adds new Scratch-Off games to give players more entertainment value. Floridians are given an opportunity to contribute to the education of their children, while playing games that allow them the chance to win lots of money and prizes.

The Florida Lottery's financial contributions are substantial, but it is not the only way that it contributes to education in the state. The Lottery's Mentoring Program continues to excel under the leadership of Secretary Rebecca Mattingly and exceeded the Governor's Mentoring Initiative participation goals in fiscal year 2003-2004. The Lottery remains committed to employee participation in the Governor's Mentoring Initiative. It has more than 90 employees statewide who provide mentoring to students in local, school-based activities and the number of participants continues to increase steadily.

The Lottery maintains its support of the "Just Read, Florida!" program by reading to children, promoting statewide book drives and sponsoring the "Just Read, Florida!" Education Training Conference for educators. Although the Lottery has a lot to celebrate, its work is not finished. It continues to remain focused on its mission to maximize revenues for education and provide the people of this state with the best lottery games available in the industry.



Comparative Statement on Income and Expenses

State of Florida
Department of the Lottery
Comparative Statement of Income and Expenses

For the Five Years Ending June 30
(In Thousands)

	2000	2001	2002	2003	2004
REVENUES:					
Ticket Sales:					
Scratch-Off	\$ 568,352	\$ 639,209	\$ 662,566	\$ 1,073,861	\$ 1,358,068
CASH 3	318,972	326,471	329,830	330,001	349,227
PLAY 4	158,620	163,157	170,708	182,716	192,581
FANTASY 5	216,303	191,614	262,923	259,999	259,728
LOTTO	864,983	845,433	806,023	925,474	785,414
MEGA MONEY	121,266	108,842	98,315	95,930	125,944
Total Ticket Sales	2,248,496	2,274,726	2,330,365	2,867,981	3,070,962
Interest and Miscellaneous	18,047	23,143	16,445	15,508	15,453
TOTAL REVENUES	2,266,543	2,297,869	2,346,810	2,883,489	3,086,415
PRIZES AWARDED	1,107,018	1,140,548	1,165,843	1,555,848	1,724,488
ADMINISTRATIVE EXPENSES					
Retailer Commission	125,066	126,581	132,351	160,850	174,389
Vendor Commission	47,079	47,034	49,031	61,663	65,544
Operating Expenses	79,793	76,770	72,929	70,211	70,548
Total Administrative Expenses	251,938	250,385	254,311	292,724	310,481
TOTAL PRIZES AND EXPENSES	1,358,956	1,390,933	1,420,154	1,848,572	2,034,969
INCOME AVAILABLE FOR TRANSFER*	\$907,587	\$906,936	\$926,656	\$1,034,917	\$1,051,446
Increase (Decrease) In Income Available for Transfer from Prior Year	\$101,808	\$(651)	\$19,720	\$108,261	\$16,529
TRANSFERS TO EETF ** (Net Income)	\$908,353	\$907,157	\$926,488	\$1,035,178	\$1,051,658

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

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

Scratch-Off Games

Sales for Scratch-Off Games Continue to Roll

When referring to the term “roll” in traditional Lottery talk, it usually refers to the On-line jackpot games. In this case, it refers to the tremendous sales growth generated from Scratch-Off games over the last couple of years and the important role these games play in raising revenues for education.

In 2003-2004, Scratch-Off game sales exceeded the record breaking sales from 2002-2003 by \$284 million. This increase in Scratch-Off game sales directly contributed to another record-setting year of Lottery transfers to the Educational Enhancement Trust Fund, and marked the second consecutive year where the Lottery transferred more than \$1 billion to education.

Florida Lottery Scratch-Off games ranked fifth in total sales among all domestic Lotteries and ranked first for the second consecutive year in Scratch-Off ticket sales increase from the previous year.

The growth in Scratch-Off games continued to benefit greatly from the legislative change implemented in July 2002. Florida law was amended to allow the Lottery to set prize payouts for Scratch-Off games at levels that would maximize sales and contributions to education. This new strategy helped boost Scratch-Off ticket sales by 26 percent over the previous year. Scratch-Off sales accounted for 44 percent of combined Lottery sales, up from 37 percent in the previous fiscal year.

Pricing strategies for Scratch-Off games helped drive sales in 2003-2004. Revenue for \$5 and \$10 products increased from \$536 million to \$795 million, representing a 48 percent increase over the previous year. Mega Monopoly, a \$10 game, was strategically launched in July to offset what is traditionally a slow sales period. The strategy worked, as Mega Monopoly quickly became one of the top selling products, generating more than \$154 million in sales in 2003-2004. Mega Monopoly set the pace for a tremendous year, as our Monopoly family of Scratch-Off games increased from \$125.7 million in 2002-2003 to more than \$301 million in 2003-2004.

Merchandising strategies, such as increasing product facings at Lottery retail locations, also played a significant role in sustaining growth in Scratch-Off sales in 2003-2004. The average retailer went from carrying 17 games to 19 games. In addition, on-counter product displays improved the merchandising of Scratch-Off games and made them more visible to consumers. The combined effect of having more games available, along with better product positioning, paved the way for continued success. Retailers enjoyed the higher commissions earned from increased product sales and players enjoyed the greater selection of games.

The Florida Lottery launched its first Scratch-Off game January 12, 1988. Since fiscal year 1988-1989, the first full year of sales, annual net sales for this product line have more than tripled, from \$365 million to \$1.3 billion in fiscal year 2003-2004. 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 with many entertaining alternatives that will result in increased sales, translating into even greater revenue transfers to education.



On-line Games

On-line Game Sales Provide Steady Revenue For Florida Students to Celebrate

The Florida Lottery's On-line games remained strong in fiscal year 2003-2004. The combined sales for FLORIDA LOTTO™, FANTASY 5®, MEGA MONEY™, PLAY 4™ and CASH 3™ were \$1.713 billion for fiscal year 2003-2004. Sales for all On-line games, except FLORIDA LOTTO, increased or remained stable.

This year's **FLORIDA LOTTO** winners celebrated with a higher-than-average number of jackpots won. There were 33 winning jackpots, creating 39 new FLORIDA LOTTO millionaires in fiscal year 2003-2004. Following FLORIDA LOTTO's \$106 million jackpot and highest sales level in 10 years in fiscal year 2002-2003, sales of \$785 million in fiscal year 2003-2004 were 15 percent lower due to the lack of rollovers and only two jackpots greater than \$60 million. FLORIDA LOTTO continues to be the Lottery's most popular On-line game and represented a 25 percent product share of all Lottery games.

Continuing the Lottery's strategy of constantly improving our On-line games, the focus of the year was on enhancements to the **MEGA MONEY** game in January 2004. The unique game features of the new MEGA MONEY game were the result of player input and extensive business analysis. Following the successful product launch supported with advertising promotions and retailer incentives, MEGA MONEY sales increased by \$30 million. Mega Money sales were \$125.9 million in fiscal year 2004.

CASH 3, the most popular daily game, continued a five-year growth trend. With no dedicated advertising or promotional effort, CASH 3 achieved the highest sales level in its 17-year history. CASH 3 sales of \$349 million were six percent higher in fiscal year 2003-2004 than the prior fiscal year.

PLAY 4, another successful daily game, contributed \$192.6 million to On-line sales during fiscal year 2003-2004. Continuing a five-year-sales-growth trend, this five percent sales increase set yet another record year for PLAY 4, reaching its highest level since the game launched in 1991.

FANTASY 5 ticket sales of \$259.7 million for fiscal year 2003-2004 continued to remain stable after the successful product re-launch of the FANTASY 5 game in July 2001. After three years, FANTASY 5 sales were still more than 35 percent higher than before game changes were made.

After an extensive formal competitive procurement process for a new Lottery On-line gaming system, an agreement was signed with the successful bidder, GTECH Corporation, on November 26, 2003. The gaming system conversion date was set for January 31, 2005. Offering the latest in state-of-the-art gaming technology, the agreement with our new On-line vendor provides for a statewide satellite communications network, new gaming system, terminals and peripherals, and related services. GTECH Corporation also offers marketing support and an arsenal of new product ideas.

The state will receive a new gaming system that is technologically superior to the previous one at a reduced cost to the state. This system was chosen to provide state-of-the-art retailer and player convenience, and to expand Lottery distribution channels.



Operations

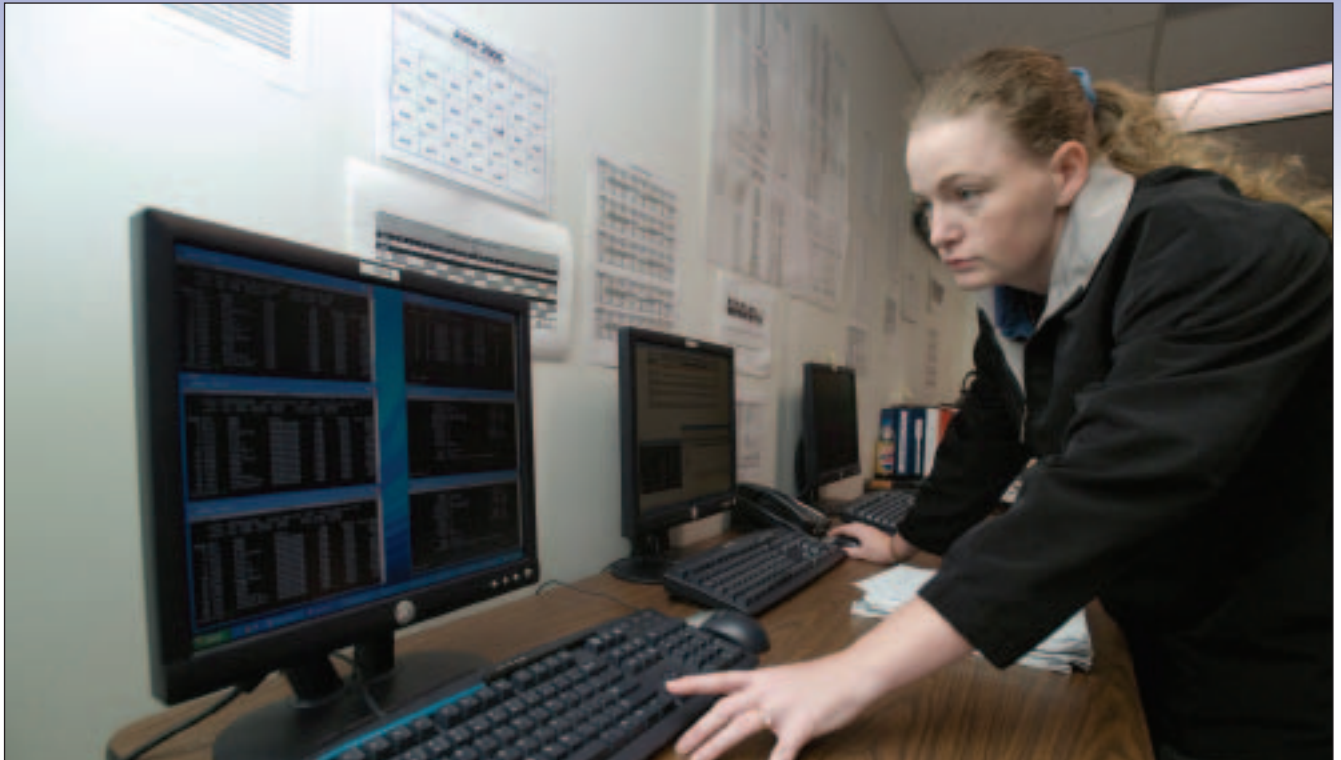


photo credit: Ray Stanyard

In January 2003, the Florida Lottery issued a request for proposal for a new On-line gaming system vendor. The contract was awarded to GTECH Corporation in August 2003 and the contract was executed in November 2003. All functional areas of the Lottery were subsequently involved in the design and implementation of this new gaming system, one of the largest goods and services procurement contracts awarded by a state agency. Operations had the largest involvement in this implementation, including system specification development, system interface and integration design, technical infrastructure design and implementation, and customer acceptance testing.

The majority of Operation's workload for fiscal year 2003-2004 was devoted to implementing this new gaming system. However, Operations completed several other projects during fiscal year 2003-2004. The Wide Area Network, or "WAN", connecting Headquarters to the district sales offices and the Orlando backup data center, was upgraded from the State's Frame Relay network to the State's Router Transport Service (RTS) network. This increased overall bandwidth to each site, providing greatly improved connectivity to each site while reducing recurring costs. This provided the network infrastructure to support the continued expansion of the Lottery's business intelligence system, and an improved backup and restore facility to support the agency's Continuity of Operations Plan (COOP) and Information Technology Disaster Recovery Plan (ITDRP). The Lottery also significantly upgraded its backup data center UNIX capacity in support of the COOP and the ITDRP.

Finally, Operations continued to re-engineer remaining legacy applications and systems in order to retire two aging large-scale platforms: IBM OS/390 and DEC Alpha/VMS. The gaming vendor, GTECH, will assume some of the legacy applications, while others will be ported to AIX or Windows servers. This re-engineering project is scheduled for completion by December 31, 2005.

Organizational Structure

As required by subsection 24.105(4), Florida Statutes, the following information reflects the organizational structure of the Lottery on June 30, 2004.

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, Operations and Business Development.

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

- **Legislative Affairs** is responsible for promoting and securing the passage of the Secretary's and Governor's legislative objectives by the Legislature.

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 and press releases. Media Relations also maintains the Lottery's Web site, in both English and Spanish, and produces official Lottery publications.
- **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. It also manages customer correspondence and e-mail, serves as a clearinghouse for Lottery records, provides in-house Spanish-language translations, and provides archiving services to the public.

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

- **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 process, Retailer Contracting ensures the integrity, reputation and financial responsibility of all Lottery retailers.

Educational Affairs promotes awareness and understanding of the state's use of Lottery moneys to provide enhancements to public education in Florida.

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

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.

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

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.

Organizational Structure

(Continued)

CHIEF INFORMATION OFFICER

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 units:

- **Games Administration** manages all retailer accounting issues and systems related to game transactions, including inventory. This unit coordinates all On-line gaming functions, for CASH 3™, PLAY 4™, FANTASY 5®, MEGA MONEY™ and FLORIDA LOTTO™, including closing 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.
- **Information Security Management (ISM)** develops and coordinates the information security infrastructure and program to provide protection and ensure integrity for the departments computers, data and networks. Information Security Management maintains the Lottery's Continuity of Operations Plans (COOP).
- **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. System and Operation Services also maintains the Lottery's Information Technology Disaster Recovery Plan.

CHIEF FINANCIAL OFFICER

Finance and Budget is responsible for the financial operation of the Department of the Lottery. Finance and Budget consist of the following units.

- **Budget** prepares legislative budget requests for the Lottery, monitors expenditures to ensure budgetary compliance, and coordinates development of the Lottery's long-range program plan.
- **Disbursements** encompass the retailer disbursements/collections and player disbursements sections. Retailer disbursements/collections manages and collects funds from retailers who are delinquent in their payments as well as disburses funds to retailers as appropriate. Player disbursements processes the prize payment of tickets submitted to Lottery headquarters and assists the district offices with the payment of tickets presented at those offices.
- **General Accounting** encompasses the Financial Reporting, Cash Management and Vendor Disbursements sections. Financial Reporting prepares financial statements and reports to convey the results of Lottery operations. Cash management is responsible for coordinating all cash activities, ensuring all payroll entries are posted correctly, and overseeing the prize payment accounting process for grand-prize-winners. Vendor Disbursements is responsible for making payments to vendors supplying goods and services to the Lottery.
- **Purchasing** executes all purchasing and contracting for the Lottery and acts as liaison with the Department of Management Service and 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, central receiving operations, facilities management, maintenance, mail center operations, and record management.

Organizational Structure

(Continued)

CHIEF MARKETING OFFICER

Marketing encompasses all areas relating to the sale of Lottery products, including statewide sales, research and policy analysis, advertising, 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 improve public education.
- **Statewide Sales** consists of nine 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 promotions, promotional merchandise and participation in special events held in communities throughout Florida. Responsibilities also include On-line game live drawings held at public venues throughout the state, retailer promotions and Lottery Show-Van bookings.
- **Graphics** provides overall art design and direction for the Lottery, including quality control for Scratch-Off ticket design, publications, promotional items and graphic presentations.

Fiscal Year Ended June 30, 2004

Financial Section

STATE OF FLORIDA DEPARTMENT OF THE LOTTERY

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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 years ended June 30, 2004, and 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.

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, 2004, and 2003, 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.

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, 2004, and 2003, and the changes in financial position and cash flows thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 13, 2004, on our consideration of the Lottery's internal control over financial reporting and on our tests of the Lottery's compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of that report is to describe the scope of our testing of compliance and the results of that testing, and not to provide an opinion on compliance. The report also describes the scope of our testing of internal control over financial reporting and provides an opinion thereon. The report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The accompanying management's discussion and analysis, presented on pages 14 through 21, 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 13, 2004

**STATE OF FLORIDA
DEPARTMENT OF THE LOTTERY**

**MANAGEMENT'S DISCUSSION AND ANALYSIS
YEARS ENDED JUNE 30, 2004, AND JUNE 30, 2003**

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

Management's Discussion and Analysis (MD&A), a component of required supplementary information, introduces the Lottery's financial statements and provides an analytical overview of the Lottery's basic financial activities. 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 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 fifteen consecutive fiscal years and exceeded the \$3 billion mark for the first time during fiscal year 2004. Life-to-date, the Lottery has transferred over \$14 billion to the Educational Enhancement Trust Fund, with the fiscal year 2004 transfer exceeding \$1 billion for the second consecutive year.

The information presented here should be read in conjunction with the accompanying financial statements.

FINANCIAL HIGHLIGHTS AND SUMMARY

For the fiscal year ended June 30, 2004:

- Florida Lottery's ticket sales increased 7.1 percent over the prior fiscal year from approximately \$2,867,981,000 to \$3,070,962,000, reflecting an increase in scratch-off ticket sales of 26.5 percent or \$284 million and a decrease in On-line ticket sales of 4.5 percent or \$81 million.
- Florida Lottery's total operating revenue increased by \$202,973,000 (or 7.1 percent), and income from operations increased 1.6 percent from approximately \$1,024,563,000 to \$1,041,139,000.
- Transfers to the Educational Enhancement Trust Fund increased from approximately \$1,035,178,000 to approximately \$1,051,658,000, or 1.6 percent, over the prior fiscal year.

For the fiscal year ended June 30, 2003:

- Florida Lottery's ticket sales increased 23.1 percent 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 percent or \$411 million and an increase in FLORIDA LOTTO sales of 14.9 percent 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 percent), and income from operations increased 12 percent from approximately \$915,278,000 to \$1,024,563,000.
- Florida Lottery's restricted net assets increased by \$118,313,000 (or 50.4 percent), representing an increase in the fair 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 percent, over the prior fiscal year.

SUMMARY OF NET ASSETS

Table 1 presents the Lottery's condensed Statement of Net Assets as of the current fiscal year ended June 30, 2004, and the prior fiscal years ended June 30, 2003, and June 30, 2002, as derived from the Statement of Net Assets.

Table 1
Condensed Statement of Net Assets
As of June 30, 2004, 2003, and 2002
(In Thousands)

	2004	2003	2002
Assets			
Current Assets	\$ 198,377	\$ 176,117	\$ 145,560
Restricted Assets	3,543,204	4,096,839	3,899,549
Capital Assets, Net of Depreciation	2,316	2,623	2,884
Total Assets	3,743,897	4,275,579	4,047,993
Liabilities			
Current Liabilities	195,130	170,460	142,241
Current Liabilities Payable from Restricted Assets	1,980,899	2,304,047	2,138,607
Noncurrent Liabilities	1,364,182	1,448,009	1,532,395
Total Liabilities	3,540,211	3,922,516	3,813,243
Net Assets			
Net Investment in Capital Assets	2,316	2,623	2,884
Restricted Net Assets	201,370	350,440	231,866
Total Net Assets	\$ 203,686	\$ 353,063	\$ 234,750

Current Year Impacts to the Statement of Net Assets

For the fiscal year ended June 30, 2004:

- Total assets decreased by \$531,682,000. This can be attributed to decreases in the fair value in investments held for grand prize winners and in investments related to securities lending activities.
- Total liabilities decreased by \$382,305,000. This can primarily be attributed to net decreases in obligations under security lending of \$290,641,000 and a net decrease of \$90,508,000 in prizes payable to winners.
- Net assets decreased by \$149,377,000 primarily due to the decrease in the fair value of restricted investments held to pay prize winners and investments purchased with cash collateral for security lending.

For the fiscal year ended June 30, 2003:

- Total assets increased by \$227,586,000. This can be attributed to increases in the fair 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 obligations 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 the fair 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 Florida Lottery was created to be a self-supporting, revenue-producing, department of state government whose purpose is to generate significant additional monies to support improvements to Florida's public education system. 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 change in fair value of restricted investments.

Table 2 presents a condensed Summary of Revenues, Expenses and Changes in Net Assets for the current fiscal year ended June 30, 2004, and the prior fiscal years ended June 30, 2003, and June 30, 2002, as derived from the Lottery's Statement of Revenues, Expenses and Changes in Net Assets.

Table 2
Condensed Statement of Revenues, Expenses and Changes in Net Assets
For the Fiscal Years Ended June 30, 2004, 2003, and 2002
(In Thousands)

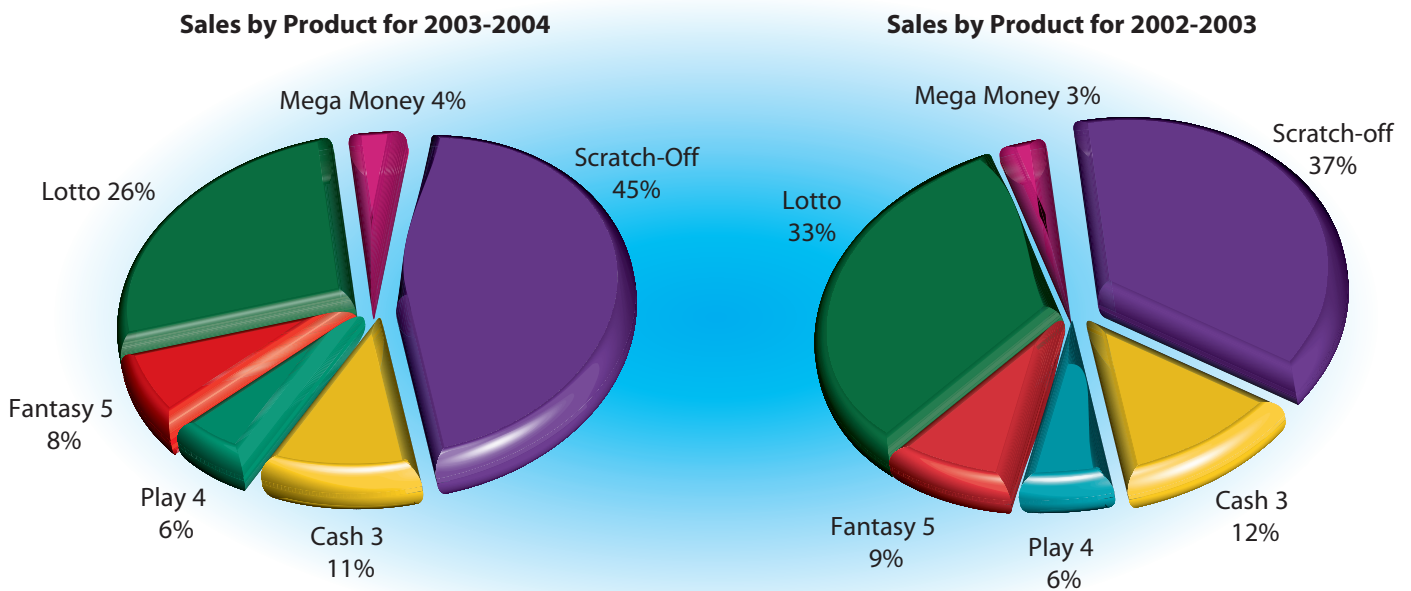
	2004	2003	2002
Operating Revenues			
Ticket Sales	\$3,070,962	\$2,867,981	\$2,330,365
On-Line Fees and Miscellaneous	4,950	4,953	4,877
Retailer Fees	196	201	190
Total Operating Revenues	3,076,108	2,873,135	2,335,432
Operating Expenses			
Prizes	1,724,488	1,555,848	1,165,843
Retailer Commissions	174,389	160,850	132,351
Vendor Commissions	65,544	61,663	49,031
Other Expenses	70,548	70,211	72,929
Total Operating Expenses	2,034,969	1,848,572	1,420,154
Income from Operations	1,041,139	1,024,563	915,278
Nonoperating Revenues (Expenses)			
Interest and Securities Lending Income, Net of Fees	10,307	10,354	11,378
Net Appreciation in Fair Value of Investments	(33,038)	241,732	174,801
Property Disposal Loss	(81)	-	-
Amortization of Grand Prizes Payable	(116,046)	(123,158)	(129,266)
Total Nonoperating Revenues (Expenses), Net	(138,858)	128,928	56,913
Income Before Operating Transfers	902,281	1,153,491	972,191
Transfers to Educational Enhancement Trust Fund	(1,051,658)	(1,035,178)	(926,488)
Change in Net Assets	(149,377)	118,313	45,703
Net Assets, Beginning of Year	353,063	234,750	189,047
Net Assets, End of Year	\$ 203,686	\$ 353,063	\$ 234,750

Current Year Impacts/Analysis of the Statement of Revenues, Expenses and Changes in Net Assets

Revenue

For the fiscal years ended June 30, 2004, and June 30, 2003, ticket sales increased by \$202,981,000 and \$537,616,000, respectively, primarily due to growth in the scratch-off ticket market. The \$3,070,962,000 sales figure for the fiscal year ended June 30, 2004, represents the highest sales in the history of the Florida Lottery.

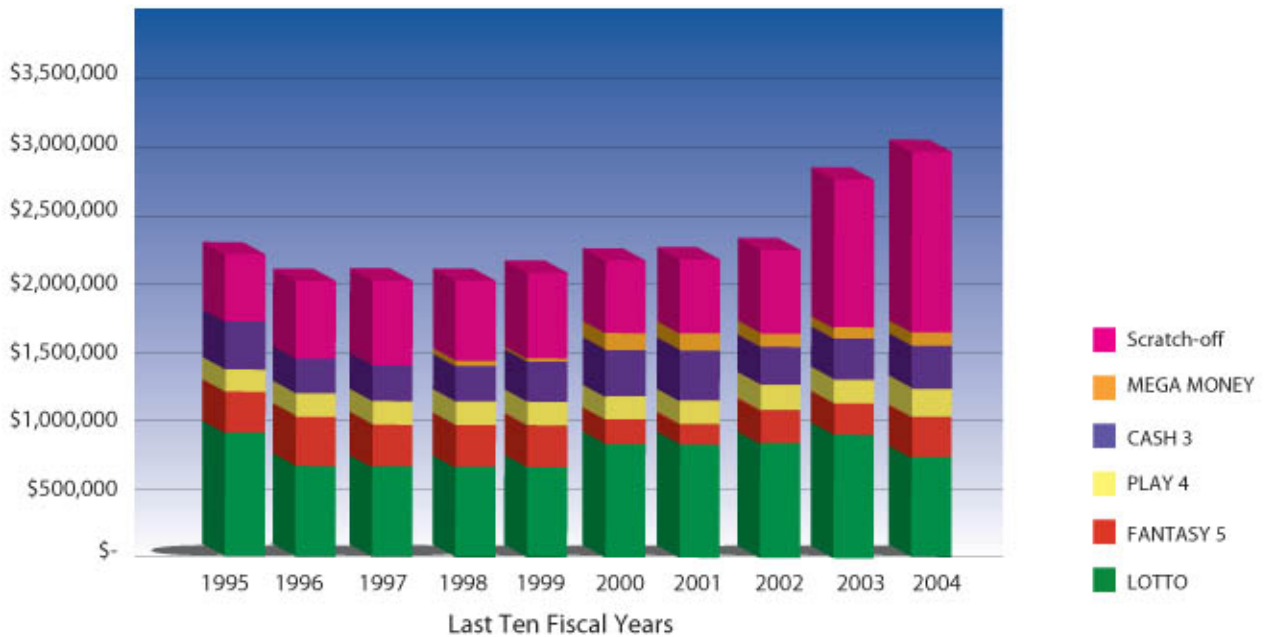
The following chart shows sales by product for the various Lottery games during the fiscal years ended June 30, 2004, and 2003:



Sales of scratch-off tickets for the fiscal years ended June 30, 2004, and 2003, were \$1,358,068,000 and \$1,073,861,000 or 45 percent and 37 percent, respectively, 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 26 percent and 62 percent for the fiscal years ended June 30, 2004, and 2003, respectively.

The following show sales by game for the last ten fiscal years:

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
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
2004	785,415	259,728	192,580	349,227	125,944	1,358,068	3,070,962

Total sales have been increasing primarily due to the changes in game structure to MEGA MONEY, which occurred in January 2004, and higher prize payouts for scratch-off tickets, which occurred in September 2002.

Expenses

One of the Lottery’s performance measures, as incorporated by reference in the General Appropriations Act, is “Operating expense as a percent of total revenue.” For the fiscal year ended June 30, 2004, this performance measure, was set at 10.59 percent of total revenue, with applicable operating expenses to include retailer commissions, on-line games expense, scratch-off ticket expense, and other operating and administrative expenses. For the fiscal year ended June 30, 2004, operating expense as a percent of total revenue was 10.1 percent.

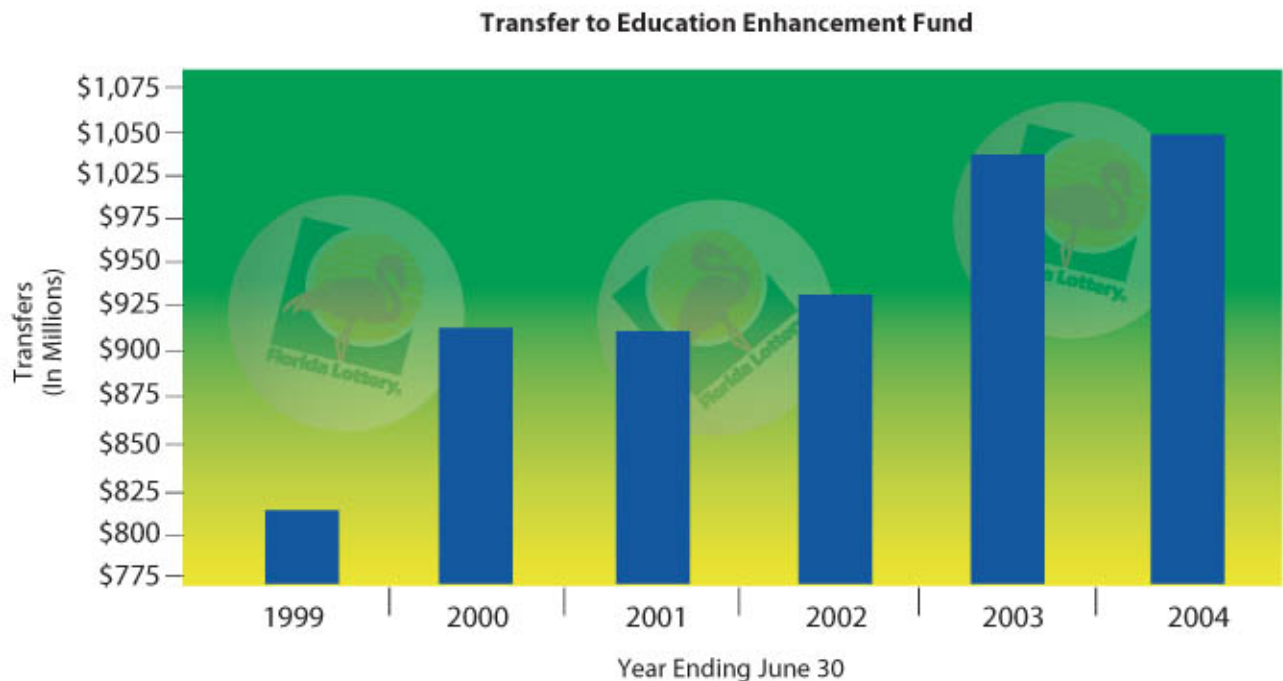
The following chart shows the major components of Lottery operating expenses and transfers as a percentage of total revenue for the fiscal years ended June 30, 2004, and 2003:



Transfers

The Lottery’s contribution to the Educational Enhancement Trust Fund for the fiscal year ended June 30, 2004, (\$1,051,658,000) was the highest since the Florida Lottery began operations in 1988. Total transfers to the Educational Enhancement Trust Fund increased by \$16,480,000 for the fiscal year ended June 30, 2004, primarily due to the increases in scratch-off ticket sales and MEGA MONEY sales, as well as an unclaimed prize approximating \$30 million. Total transfers to the Educational Enhancement Trust Fund increased by \$108,690,000 for the fiscal year ended June 30, 2003, primarily due to the increase in ticket sales.

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



CAPITAL ASSETS

At June 30, 2004, and 2003, the Lottery reported capital assets, net of depreciation, of \$2,316,000 and \$2,623,000, respectively. At June 30, 2002, the Lottery reported capital assets, net of depreciation, of \$2,884,000. Refer to Notes 1 and 5 to the financial statements for additional information on capital assets.

ECONOMIC FACTORS AND FUTURE IMPACTS

The main economic factors affecting lottery sales are population growth, personal income growth, and employment. Based on the October 2004 Florida Economic Estimating Conference, the population is forecasted to increase 2.55 percent and 2.20 percent for the fiscal years ending June 30, 2004, and 2005, respectively. During these periods, real per capita income is expected to grow 0.4 percent and 2.3 percent, respectively. Total non-farm employment is forecasted to increase by 1.9 percent and 2.6 percent, respectively.

The following are some of the strategies to increase lottery revenues that will be actively pursued by the Department:

Increase the prize payout percentage for on-line games.

In 2002, the Legislature passed HB 2011 which granted the Lottery the flexibility to vary the prize payout percentage on its scratch-off games. This eliminated the statutory requirement to transfer a set percentage of Lottery revenues from the sale of scratch-off tickets to the Educational Enhancement Trust Fund, thereby enabling the Lottery to further maximize revenue to support education.

Research indicates that if the Lottery were given the same flexibility to vary the prize payout percentage on its on-line games, it would be able to do two things:

- Increase revenues for education based on a projected increase in on-line ticket sales due to higher prize payouts; and
- Free up 80 percent of the unclaimed prize money that could then go directly to education.

Providing the Lottery the same flexibility to vary the prize payout percentage for its on-line games as it has for its scratch-off games will allow both scratch-off and on-line games to operate at or near the levels necessary to maximize revenues for education.

Improve market penetration through expansion of the Lottery's retailer network.

With the conversion to the new gaming system on January 31, 2005, the Lottery, for the first time, will have 12,000 full-service terminals. The Lottery Revenue Estimating Conference has projected an annualized \$92 million increase in net sales, with an additional \$33 million going to the Educational Enhancement Trust Fund, as a result of this conversion. Over the longer term, the Lottery hopes to recruit 3,000 new full-service retailers (net) statewide, bringing our retailer-to-population ratio down to approximately 1:1,200 (based on population estimates through fiscal year 2007.) Consistent with shifts that have occurred in the retail industry, the primary focus of this effort will be to recruit new "chain store" retailers. If successful, the Lottery will be able to achieve and sustain a competitive level of market penetration.

Increase the focus of research and product development for the on-line product segment.

Over the past five years, on-line sales have grown by only 1.9 percent while scratch-off sales have increased by 139 percent. Steady growth in the scratch-off product segment has also occurred across the domestic lottery market during the past five years without any corresponding growth in domestic on-line sales.

The Lottery's net margin for its on-line product segment is approximately 39 percent. The Lottery's net margin in the scratch-off product segment for the year ended June 30, 2004, was approximately 21.8 percent. Given the recent trend in sales, the need to increase on-line sales is required to maintain efficient net margins and increase total Educational Enhancement Trust Fund transfers over the long-term.

This functional strategy will be accomplished through product extensions, redesign of existing games, on-line game promotions, and the exploration of new on-line game concepts that follow conservative and traditional on-line game play styles. Expanding the Lottery's network of full-service retailers will also boost total on-line game sales.

Professional Development

Life-long learning is the hallmark of almost every successful company that has achieved a competitive advantage in an ever-changing trade environment. As the Florida Lottery continues to be challenged to "do more with less," ongoing staff development will become a strategic imperative. Training and development efforts will focus on business fundamentals, time management and organizational skills, leadership and customer service.

The positive impacts of the above factors will be partially offset by three negative impacts. Four major hurricanes hit Florida during August and September 2004. Management anticipates the storms will result in a reduction of approximately \$40 million in Lottery sales in fiscal year 2004-2005, with a corresponding drop in the transfers to the Educational Enhancement Trust Fund of about \$12 million. Secondly, LOTTO sales have been running considerably below forecast levels due to the lack of rollovers, along with lower interest rates, both of which result in lower jackpots. Lastly, Florida voters recently passed a constitutional amendment authorizing Miami-Dade and Broward Counties to hold a referendum to authorize slot machines. It is expected to pass in both counties. The fiscal impact to the Lottery has not yet been fully determined.

FINANCIAL CONTACT

The Florida Lottery's Financial Statements and this Management's Discussion and 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 32399.

**STATE OF FLORIDA
DEPARTMENT OF THE LOTTERY**

Statement of Net Assets

As of June 30, 2004, and June 30, 2003
(In Thousands)

Assets	<u>June 30, 2004</u>	<u>June 30, 2003</u>
Current Assets:		
Cash and cash equivalents	\$151,801	\$115,361
Interest receivable	1,347	603
Accounts receivable, net	41,952	56,926
Inventories	993	1,306
Security deposits	2,284	1,921
Total Current Assets	<u>198,377</u>	<u>176,117</u>
Restricted Assets:		
Cash and cash equivalents	0	99
Pending investment sales receivable	0	10,781
Securities lending income receivable	1,301	1,305
Investments, grand prize	1,796,659	2,023,765
Investments, other	1,745,244	2,060,889
Capital assets, net	2,316	2,623
Total Assets	<u>3,743,897</u>	<u>4,275,579</u>
Liabilities		
Current Liabilities:		
Accounts payable and accrued liabilities	9,028	10,045
Prizes payable	60,668	70,667
Due to Educational Enhancement Trust Fund	122,477	87,542
Deposits payable	2,284	1,921
Compensated absences payable	673	285
Total Current Liabilities	<u>195,130</u>	<u>170,460</u>
Current Liabilities Payable from Restricted Assets:		
Pending purchases payable	5,088	40,364
Securities lending fees payable	842	744
Obligations under securities lending	1,739,697	2,030,338
Grand prizes payable	235,272	232,601
Total Current Liabilities Payable from Restricted Assets	<u>1,980,899</u>	<u>2,304,047</u>
Noncurrent Liabilities:		
Grand prizes payable	1,361,562	1,444,742
Compensated absences payable	2,620	3,267
Total Noncurrent Liabilities	<u>1,364,182</u>	<u>1,448,009</u>
Total Liabilities	<u>3,540,211</u>	<u>3,922,516</u>
Net Assets		
Invested in capital assets	2,316	2,623
Restricted	201,370	350,440
Total Net Assets	<u>\$203,686</u>	<u>\$353,063</u>

See accompanying notes to financial statements.

**STATE OF FLORIDA
DEPARTMENT OF THE LOTTERY**

Statement of Revenues, Expenses and Changes in Net Assets

Years ended June 30, 2004, and June 30, 2003

(In Thousands)

	<u>June 30, 2004</u>	<u>June 30, 2003</u>
Operating Revenues:		
Ticket sales	\$3,070,962	\$2,867,981
On-line fees and miscellaneous	4,950	4,953
Retailer fees	196	201
Total Operating Revenues	<u>3,076,108</u>	<u>2,873,135</u>
Operating Expenses:		
Prizes	1,724,488	1,555,848
Retailer commissions	174,389	160,850
Scratch-off tickets	31,916	25,665
On-line games	33,628	35,998
Advertising	33,058	31,181
Personal services	23,236	24,311
Other contractual services	9,782	9,700
Materials and supplies	3,030	3,298
Bad debts	298	620
Depreciation	1,144	1,101
Total Operating Expenses	<u>2,034,969</u>	<u>1,848,572</u>
Operating Income	<u>1,041,139</u>	<u>1,024,563</u>
Nonoperating Revenues (Expenses):		
Interest	4,495	5,157
Securities lending income	25,677	34,552
Securities lending fees	(19,865)	(29,355)
Net appreciation in fair value of investments	(33,038)	241,732
Property disposition (loss)	(81)	
Amortization of grand prizes payable	(116,046)	(123,158)
Total Nonoperating Revenues (Expenses), Net	<u>(138,858)</u>	<u>128,928</u>
Income Before Operating Transfers	<u>902,281</u>	<u>1,153,491</u>
Transfers to Educational Enhancement Trust Fund	(1,051,658)	(1,035,178)
Change in Net Assets	<u>(149,377)</u>	<u>118,313</u>
Net Assets, Beginning of Year	<u>353,063</u>	<u>234,750</u>
Net Assets, End of Year	<u>\$203,686</u>	<u>\$353,063</u>

See accompanying notes to financial statements.

**STATE OF FLORIDA
DEPARTMENT OF THE LOTTERY**

Statement of Cash Flows

Years ended June 30, 2004, and June 30, 2003
(In Thousands)

	June 30, 2004	June 30, 2003
Operating Activities:		
Ticket sales	\$3,085,638	\$2,855,896
Prizes paid to winners	(1,731,816)	(1,547,091)
Commissions paid and payments to retailers	(174,389)	(160,850)
Paid to vendors for goods and services	(112,118)	(103,952)
Paid to employees	(23,494)	(24,326)
Other operating revenue	5,146	5,154
Net Cash Provided by Operating Activities	<u>1,048,967</u>	<u>1,024,831</u>
Noncapital Financing Activities:		
Payments to Educational Enhancement Trust Fund	(1,016,723)	(1,017,883)
Net Cash Used in Noncapital Financing Activities	<u>(1,016,723)</u>	<u>(1,017,883)</u>
Capital and Related Financing Activities:		
Purchase of capital assets	(918)	(839)
Proceeds from sale of capital assets	0	33
Net Cash Used in Capital and Related Financing Activities	<u>(918)</u>	<u>(806)</u>
Investing Activities:		
Cash received from maturity of grand prize investments	241,066	240,284
Cash paid to grand prize winners upon maturity of grand prize investments	(241,066)	(240,284)
Interest	5,015	12,525
Net Cash Provided by Investing Activities	<u>5,015</u>	<u>12,525</u>
Net Increase in Cash and Cash Equivalents	<u>36,341</u>	<u>18,667</u>
Cash and Cash Equivalents, Beginning of Year	115,460	96,793
Cash and Cash Equivalents, End of Year	<u>\$151,801</u>	<u>\$115,460</u>
Reconciliation of Income from Operations to Net Cash Provided by Operating Activities:		
Income from operations	\$1,041,139	\$1,024,563
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation	1,144	1,101
Disposal of capital assets		33
Changes in assets and liabilities		
(Increase) decrease in:		
Accounts receivable	14,975	(11,431)
Inventories	313	(181)
Increase (decrease) in:		
Accounts payable and accrued liabilities	(1,017)	2,105
Prizes payable	(7,328)	8,656
Compensated absences payable	(259)	(15)
Net Cash Provided by Operating Activities	<u>\$1,048,967</u>	<u>\$1,024,831</u>
Noncash Investing, Capital and Financing Activities:		
Increase in fair value of investments	(\$153,703)	\$127,159

See accompanying notes to financial statements.

**STATE OF FLORIDA
DEPARTMENT OF THE LOTTERY**

Notes to Financial Statements

Years ended June 30, 2004, and June 30, 2003

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."

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 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.

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 position, and cash flows. All fund assets and liabilities, current and noncurrent, are accounted for on the statement of net assets. Under Governmental Accounting Standards Board (GASB) Statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting, proprietary funds have the option to elect to apply all pronouncements of the Financial Accounting Standards Board (FASB) issued after November 30, 1989. 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.

d. Cash and Cash Equivalents

The Lottery considers all highly liquid investments with an original maturity of three months or less when purchased, 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.

e. Investments

Florida Statutes authorize the Lottery to invest in certain instruments. The Lottery reports investments at fair value. Details of investments are included in Note 2.

f. 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.

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. Capital Assets

Capital assets are stated at cost less accumulated depreciation. As required by Chapter 273, Florida Statutes, a capitalization threshold of \$1,000 and useful life extending beyond one year 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 Statement of Revenues, Expenses and Changes in Net Assets, in the period of disposal.

i. Net Assets

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

Investments in capital assets of approximately \$2,316,000 and \$2,623,000 at June 30, 2004, and 2003, 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 \$201,370,000 and \$350,440,000 at June 30, 2004, and 2003, respectively.

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

j. 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.

k. 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).

l. 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 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 after the drawing. As of July 1, 2004, the Lottery discontinued the practice of estimating the future unclaimed on-line prizes.

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

m. 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 year-end salary rates and include employer social security and pension contributions at current rates.

n. 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.

o. 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, and expenses and disclosures of contingent assets and liabilities. Actual results could differ from those estimates.

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 \$315,000 at June 30, 2004, and \$324,000 at June 30, 2003, 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 \$2,431,000 at June 30, 2004, and \$4,134,000 at June 30, 2003, 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, up to \$75 million.

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 certificates of deposit, U.S. Government securities, federal agency securities, bankers' acceptances, commercial paper, corporate bonds and notes, repurchase agreements and reverse repurchase agreements. Approximately 67 percent of these classifiable 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 \$151,373,000 and \$111,713,000 at June 30, 2004, and 2003, 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 \$1,739,697,000 of cash collateral for the lending program as of June 30, 2004, and \$2,030,338,000 as of June 30, 2003. At June 30, 2004, 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 86.33 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, 2004, and 2003, consisted of (in thousands):

	2004	2003
Securities lending income	\$ 25,677	\$ 34,552
Less broker rebates	(18,413)	(27,776)
Less bank fees	(1,452)	(1,579)
Net securities lending revenue	\$ 5,812	\$ 5,197

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, 2004, is presented below (in thousands):

Investments	Risk Category			Carrying Amount
	1	2	3	
Lottery investments - classified:				
Certificates of Deposit	\$	\$	\$ 128,840	\$ 128,840
U.S. obligations	85,645			85,645
Commercial paper			87,055	87,055
Repurchase agreements		201,813		201,813
Bonds and notes			1,141,897	1,141,897
Total classified investments	\$ <u>85,645</u>	\$ <u>201,813</u>	\$ <u>1,357,792</u>	<u>1,645,250</u>
Lottery investments - unclassified:				
Investments held by broker dealers under securities lending agreements:				
U.S. obligations				1,711,015
Investment agreement				163,761
Money market and mutual funds				21,877
Pooled investments in State Treasury (included in cash equivalents)				<u>151,433</u>
Total unclassified investments				<u>2,048,086</u>
Total investments				<u>\$ 3,693,336</u>

The following schedule reconciles cash and investments to the statement of net assets (in thousands):

	Investments	Cash at Financial Institutions	Cash at State Treasury	Cash at SBA	Total
Cash and cash equivalents	\$ 151,433	\$ 315	\$ 53	\$	\$ 151,801
Investments, grand prize	1,796,659				1,796,659
Investments, other	<u>1,745,244</u>				<u>1,745,244</u>
Total	<u>\$ 3,693,336</u>	<u>\$ 315</u>	<u>\$ 53</u>	<u>\$</u>	<u>\$ 3,693,704</u>

3. ACCOUNTS RECEIVABLE

Accounts receivable as of June 30 consisted of the following (in thousands):

	2004	2003
Ticket sales receivable	\$ 43,310	\$58,197
Other receivables	149	16
Total receivables	43,459	58,213
Less allowance for doubtful accounts	(1,507)	(1,287)
Accounts receivable, net	<u>\$ 41,952</u>	<u>\$ 56,926</u>

4. SECURITY DEPOSITS AND DEPOSITS PAYABLE

The Lottery receives certificates of deposit and cashier checks from certain vendors and retailers 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 consisted of (in thousands):

	<u>2002 - 2003</u>			<u>2003 - 2004</u>			
	Balance June 30,2002	Increase	Decrease	Balance June 30,2003	Increase	Decrease	
Data processing equipment	\$ 9,251	\$ 796	\$ (1,278)	\$ 8,769	\$ 46	\$ (125)	\$ 8,690
Office equipment and fixtures	6,400	37	(58)	6,379	487	(249)	6,617
Vehicles and other equipment	3,562	45	(235)	3,372	385	(435)	3,322
	<u>19,213</u>	<u>878</u>	<u>(1,571)</u>	<u>18,520</u>	<u>918</u>	<u>(809)</u>	<u>18,629</u>
Less: accumulated depreciation	16,329	1,101	(1,533)	15,897	1,144	(728)	16,313
Total capital assets, net	<u>\$ 2,884</u>	<u>\$ (223)</u>	<u>\$ (38)</u>	<u>\$ 2,623</u>	<u>\$ (226)</u>	<u>\$ (81)</u>	<u>\$ 2,316</u>

6. LONG-TERM LIABILITIES

a. Grand Prizes Payable

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

	<u>2004</u>	<u>2003</u>
Lotto grand prizes (face value)	\$ 2,242,013	\$ 2,400,829
Win For Life grand prizes (face value)	14,842	15,206
Big 10 grand prizes (face value)	280	370
Flamingo Fortune Game Show grand prizes (face value)	1,400	1,500
Monthly Bonus grand prizes (face value)	-	48
Win a Million grand prizes (face value)	700	750
Yearly Dividend grand prizes (face value)	48	72
Yearly Bonus grand prizes (face value)	450	-
130K Bonus Game grand prizes (face value)	-	104
Set for Life grand prize (face value)	2,280	-
Cash Spectacular grand prize (face value)	950	-
Less imputed interest	(666,129)	(741,536)
Net present value of grand prizes payable	<u>\$ 1,596,834</u>	<u>\$ 1,677,343</u>
Current Prizes Payable from restricted assets	\$ 235,272	\$ 232,601
Noncurrent Prizes Payable	<u>1,361,562</u>	<u>1,444,742</u>
	<u>\$ 1,596,834</u>	<u>\$ 1,677,343</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>
2005	\$	244,024
2006		244,024
2007		244,000
2008		242,563
2009		215,971
2010-2014		749,818
2015-2019		195,852
2020-2024		55,820
2025-2029		57,087
2030-2034		<u>13,804</u>
Grand prizes (face value)		2,262,963
Less imputed interest		<u>(666,129)</u>
Net present value of grand prizes	\$	<u>1,596,834</u>

b. Compensated Absences Payable

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

	<u>2004</u>	<u>2003</u>
Current Compensated Absences	\$ 673	\$ 285
Noncurrent Compensated Absences	<u>2,620</u>	<u>3,267</u>
	<u>\$ 3,293</u>	<u>\$ 3,552</u>

c. Changes in Long-Term Liabilities

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

	Balance July 1, 2003	Additions	Reductions	Balance June 30, 2004	Amount due within one year
Grand prizes payable	\$1,677,343	\$160,557	(\$241,066)	\$1,596,834	\$235,272
Compensated absences payable	3,552	243	(502)	3,293	673
Total long-term liabilities	<u>\$1,680,895</u>	<u>\$160,800</u>	<u>(\$241,568)</u>	<u>\$1,600,127</u>	<u>\$235,945</u>

7. DUE TO EDUCATIONAL ENHANCEMENT TRUST FUND

In accordance with the Act, as amended, at least 39 percent (38 percent for the year ended June 30, 2003) 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, 2004, was \$1,051,658,000, 34.1 percent of revenues, and for the fiscal year ended June 30, 2003, the transferred amount was \$1,035,178,000, 35.9 percent of revenues.

Because the net appreciation in fair value of investments and amortization of grand prizes payable, included in non-operating 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):

	June 30, 2004	June 30, 2003
Operating revenue less scratch-off ticket sales	\$ 1,718,038	\$ 1,799,274
Nonoperating revenue (expenses), net	(138,858)	128,928
Less: Retailer fees	(196)	(201)
Net appreciation in fair value of investments	33,038	(241,732)
Amortization of grand prizes payable	116,046	123,158
Net revenue less Scratch-Off ticket sales	1,728,068	1,809,427
Total revenue subject to transfer at 39% and 38%	1,728,068	1,809,427
	39%	38%
Statutorily required transfer at 39% and 38%	<u>673,978</u>	<u>687,582</u>
Scratch-off ticket sales	1,358,068	1,073,861
Transfer percentage for scratch-off ticket sales	21.847%	26%
Direct transfer from scratch-off ticket sales	<u>296,695</u>	<u>278,716</u>
Additional transfer appropriated	20,000	15,000
Special one-time transfer of unclaimed jackpot	30,148	
Supplemental balance transferred	<u>30,837</u>	<u>53,880</u>
Due for the year	\$ <u>1,051,658</u>	\$ <u>1,035,178</u>
Balance due, beginning of year	87,542	70,247
Paid during the year	<u>(1,016,723)</u>	<u>(1,017,883)</u>
Due to Educational Enhancement Trust Fund, end of year	\$ <u><u>122,477</u></u>	\$ <u><u>87,542</u></u>

*\$16,688,000 special appropriation for the increase in transfer rate from 38% to 39% is included in the \$673,978,000 statutorily required transfer.

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:

	Fiscal Year Ended June 30, 2004	Fiscal Year Ended June 30, 2003
Senior Management	9.37 percent	6.06 percent
Regular Employees	7.39 percent	5.76 percent
Special Risk	18.53 percent	16.01 percent

The Lottery’s contributions to the FRS amounted to approximately \$1,242,000 and \$1,047,000 for the years ended June 30, 2004, and 2003, respectively. These contributions represented 7.51 percent and 5.88 percent of covered payroll, for the years ended June 30, 2004, and 2003, respectively. The Lottery contributed 100 percent of the required contributions for the years ended June 30, 2004, and 2003.

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 2003 through June 2004. 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 years ended June 30, 2004, and 2003, totaled \$52,122 and \$14,645, respectively.

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. For the fiscal year ended June 30, 2004, eligible retirees or beneficiaries received a monthly retiree health insurance subsidy payment equal to the number of years of creditable service completed at the time of retirement multiplied by \$5. The payments to individual retirees or beneficiaries were at least \$30 but not more than \$150 per month, pursuant to

Section 112.363, Florida Statutes. 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, 2004, and 2003, 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 computer equipment. Certain leases are renewable at the option of the Lottery.

Future minimum rental payments as of June 30, 2004, are scheduled as follows (in thousands):

<u>Year Ending June 30</u>	<u>Headquarters</u>	<u>Districts</u>	<u>Total</u>
2005	\$ 2,442	\$ 590	\$ 3,032
2006	2,466	456	2,922
2007	2,491	358	2,849
2008	2,516	282	2,798
2009	<u>2,615</u>	<u>51</u>	<u>2,666</u>
	<u>\$ 12,530</u>	<u>\$ 1,737</u>	<u>\$ 14,267</u>

Rental expense under all operating leases totaled approximately \$3,195,000 and \$3,270,000 for the years ended June 30, 2004, and 2003, 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, 2004, and 2003, was \$33,628,000, and \$35,998,000, respectively.

The Lottery has entered into a new contract for an on-line gaming system, which will be in effect January 31, 2005. The contractor will be compensated at a rate of 1.1499 percent of sales.

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 \$31,916,000 for the fiscal year ended June 30, 2004, and \$25,665,000 for the fiscal year ended June 30, 2003.

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.

12. SUBSEQUENT EVENTS

Four major hurricanes hit Florida during August and September 2004. Lottery management anticipates the storms will result in a reduction of approximately \$40 million in Lottery sales for the fiscal year ended June 30, 2005, with a corresponding drop in the transfers to the Educational Enhancement Trust Fund of about \$12 million.