



Florida Lottery
Annual Report 2004 • 2005

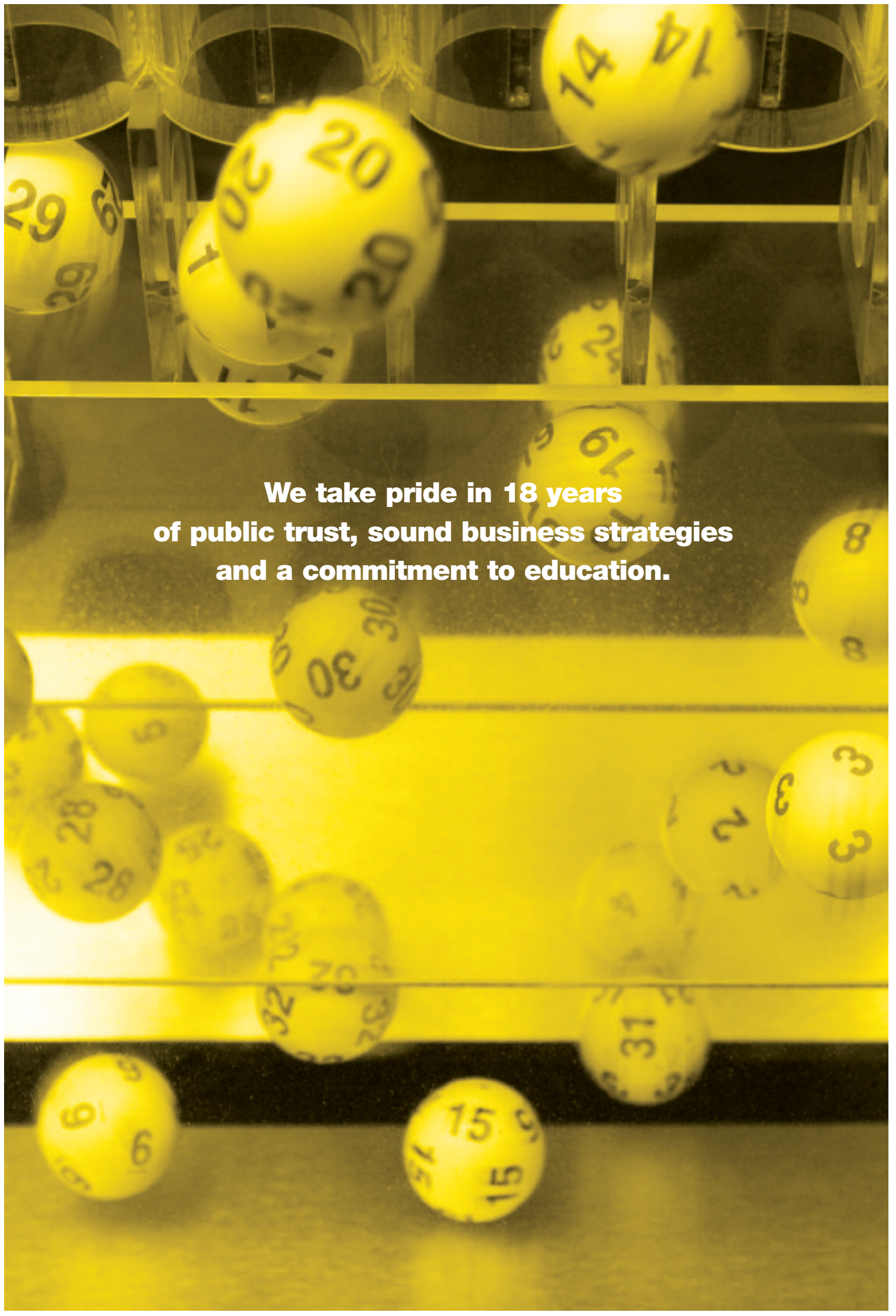
**STATE OF FLORIDA
DEPARTMENT OF THE LOTTERY**

**Comparative Statement of Income and Expenses
For the Five Years Ending June 30
(In Thousands)**

	2001	2002	2003	2004	2005
REVENUES:					
Ticket Sales:					
Scratch-Off™	\$639,209	\$662,566	\$1,073,861	\$1,358,068	\$1,844,619
CASH 3™	326,471	329,830	330,001	349,227	345,598
PLAY 4™	163,157	170,708	182,716	192,581	206,982
FANTASY 5®	191,614	262,923	259,999	259,728	252,467
FLORIDA LOTTO™	845,433	806,023	925,474	785,414	689,820
MEGA MONEY™	108,842	98,315	95,930	125,944	131,248
Total Ticket Sales	2,274,726	2,330,365	2,867,981	3,070,962	3,470,734
Interest and Miscellaneous	23,143	16,445	15,508	15,453	16,739
TOTAL REVENUES	2,297,869	2,346,810	2,883,489	3,086,415	3,487,473
PRIZES AWARDED	1,140,548	1,165,843	1,555,848	1,724,488	2,044,246
ADMINISTRATIVE EXPENSES					
Retailer Commission	126,581	132,351	160,850	174,389	197,781
Vendor Commission	47,034	49,031	61,663	65,544	71,572
Operating Expenses	76,770	72,929	70,211	70,548	71,042
Total Administrative Expenses	250,385	254,311	292,724	310,481	340,395
TOTAL PRIZES AND EXPENSES	1,390,933	1,420,154	1,848,572	2,034,969	2,384,641
INCOME AVAILABLE FOR TRANSFER*	\$906,936	\$926,656	\$1,034,917	\$1,051,446	\$1,102,832
Increase (Decrease) In Income Available for Transfer from Prior Year	\$(651)	\$19,720	\$108,261	\$16,529	\$51,386
TRANSFERS TO EETF (Net Income) **	\$907,157	\$926,488	\$1,035,178	\$1,051,658	\$1,103,633

* 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.



**We take pride in 18 years
of public trust, sound business strategies
and a commitment to education.**



Dear Friends:

I'm proud to inform you that for the sixth consecutive year, the Florida Lottery has remained consistent with my policy of sustained and responsible sales growth of Lottery revenues. During fiscal year 2004-2005 in partnership with retailers throughout the state the Lottery posted net sales of \$3.47 billion, and transferred more than \$1 billion to the Educational Enhancement Trust Fund, bringing the Lottery's overall total contribution to education to more than \$15 billion since 1988.

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Under the outstanding leadership of Secretary Rebecca Dirden Mattingly the Florida Lottery successfully converted more than 11,000 retailers to a new gaming system. The conversion was seamless and an overwhelming success. For these and many other reasons Secretary Mattingly oversees one of the best lotteries in the United States.

Through hard work and a commitment to provide the best Lottery games possible, the agency continues to play a major role in investing in public education in our state. During fiscal year 2004-2005, the Lottery funded 87,000 Bright Futures Scholarships, provided \$103 million in K-12 district discretionary funds and contributed \$210 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 successes as it continues to raise additional funds for Florida's students. Congratulations to every individual and business that has played a role in making this year another success.

Sincerely,

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

Jeb Bush
Governor



Dear Friends and Colleagues:

Fiscal year 2004-2005 was an exciting and record-breaking year for the Florida Lottery. In keeping with Governor Jeb Bush's policy of sustained and responsible sales growth, the Florida Lottery had record sales of \$3.47 billion and transferred more than \$1 billion to the Educational Enhancement Trust Fund (EETF) for the third consecutive year.

In addition to record-breaking sales and contributions to education for Florida's public schools, the Florida Lottery completed its On-line gaming system conversion for: FLORIDA LOTTO™, MEGA MONEY™, FANTASY 5®, PLAY 4™ and CASH 3™. The new system offers many new features, which improve the way we conduct business, provide a better playing experience for our customers and will ultimately generate more funds for education in our state.

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Although the Florida Lottery's contributions account for a small portion of the state's overall investment in education, they are significant. We are very proud of our role in helping students across the state have brighter futures. The fiscal year 2004-2005 transfer of \$1.104 billion to the EETF increased the Florida Lottery's total contribution to education to more than \$15 billion since its inception. The agency's commitment to education has provided the opportunity for higher education to more than 262,000 Bright Futures Scholars, distributed more than \$1.4 billion to school districts for new construction, renovation, remodeling, major repairs or maintenance of education facilities and contributed more than \$4.2 billion to Florida's colleges and universities.

Thanks to our players and retailers, the Florida Lottery continues to be the number one state Lottery in the country, and we remain steadfast in our pledge to provide the people of our state the best lottery games available, in order to maximize revenues for education. I would like to thank the citizens of our state for another year of operation and generating revenue for Florida's public schools. Remember, when you play, we all win!

Sincerely,

A handwritten signature in black ink that reads "Rebecca Dirden Mattingly". The signature is written in a cursive, flowing style.

Rebecca Dirden Mattingly
Secretary

**Florida Lottery profits
have funded more than
600 public school
construction and
renovation projects
throughout the state.**

ALLEY NAVARRE ELEMENTARY SCHOOL

OPENING IN AUGUST 2005

SUPERINTENDENT OF SCHOOLS - JOHN W. ROGERS

SCHOOL BOARD MEMBERS

- DISTRICT 1
- DISTRICT 2
- DISTRICT 3
- DISTRICT 4
- DISTRICT 5



KENNETH E. SMITH
E. HUGH WINKLES
DIANE COLEMAN
JOANN J. SIMPSON
ED GRAY III

ARCHITECT - AMSPACHER and AMSPACHER, P.A.

Making Futures Brighter

Fiscal year 2004-2005 was an exciting year for the Florida Lottery and Florida's students. In keeping with the agency's mission to maximize funds for education, the Florida Lottery provided over \$1 billion to education for the third consecutive year, which brought the agency's total contributions to education to more than \$15 billion since 1988.

The Florida Lottery is proud of its contributions to Florida's Educational Enhancement Trust Fund (EETF), which have reaped returns for every level of Florida's education system. Since its inception, the Florida Lottery has provided \$106 million in student financial aid. Statewide, 600 schools benefited from Lottery generated funds for uses such as new construction, renovation, repairs and maintenance of educational facilities. District discretionary funding supplied \$7.2 billion to K-12 programs throughout the state. Community colleges and public universities have received more than \$4.1 billion in Lottery funding. The Florida Lottery is making futures brighter everyday.

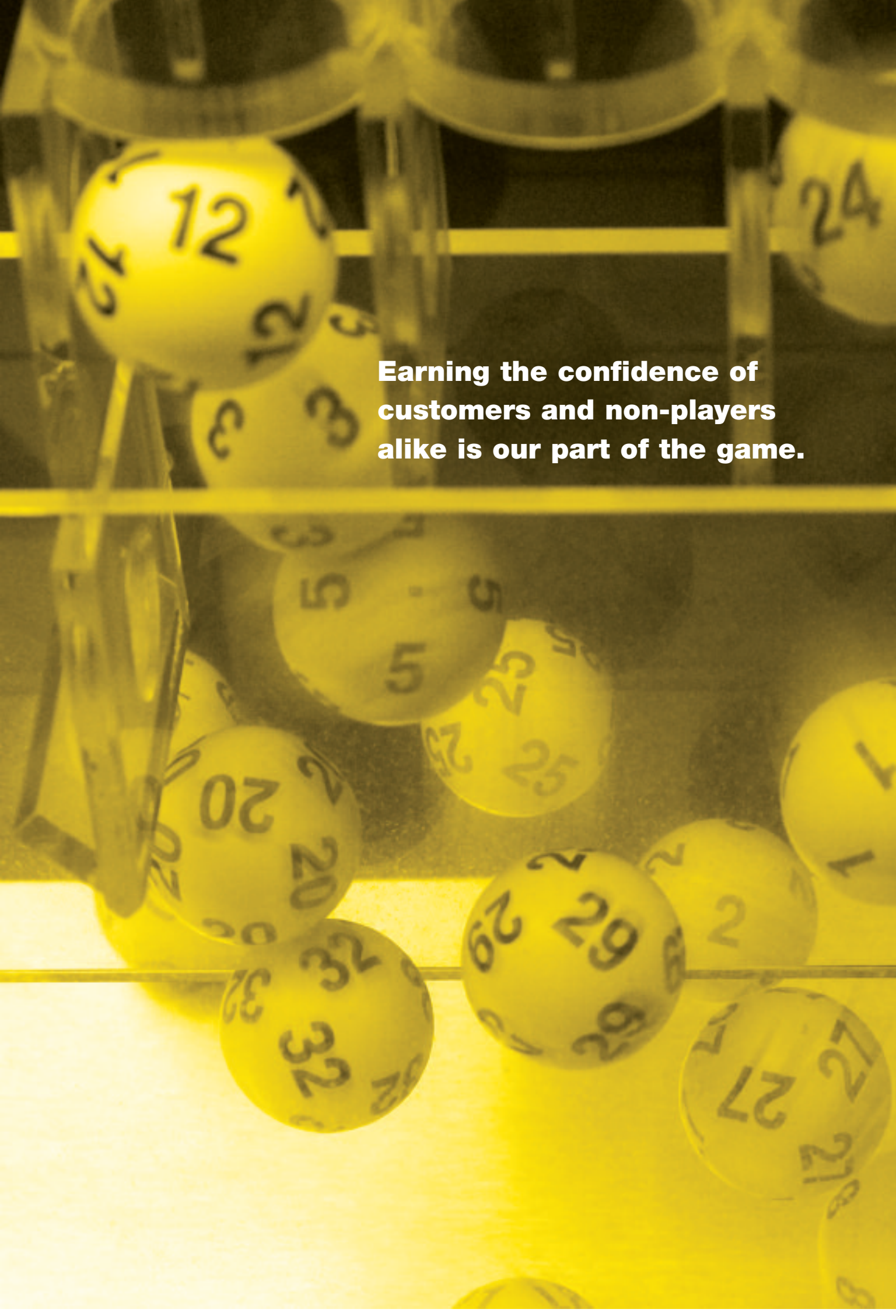
In 1997, the Florida Legislature created the Bright Futures Scholarship Program. This Lottery funded scholarship rewards students for their academic achievements during high school by providing funding for them to attend college. During fiscal year 2004-2005, the Florida Lottery funded more than 87,000 Bright Futures Scholarships in the amount of \$268 million.



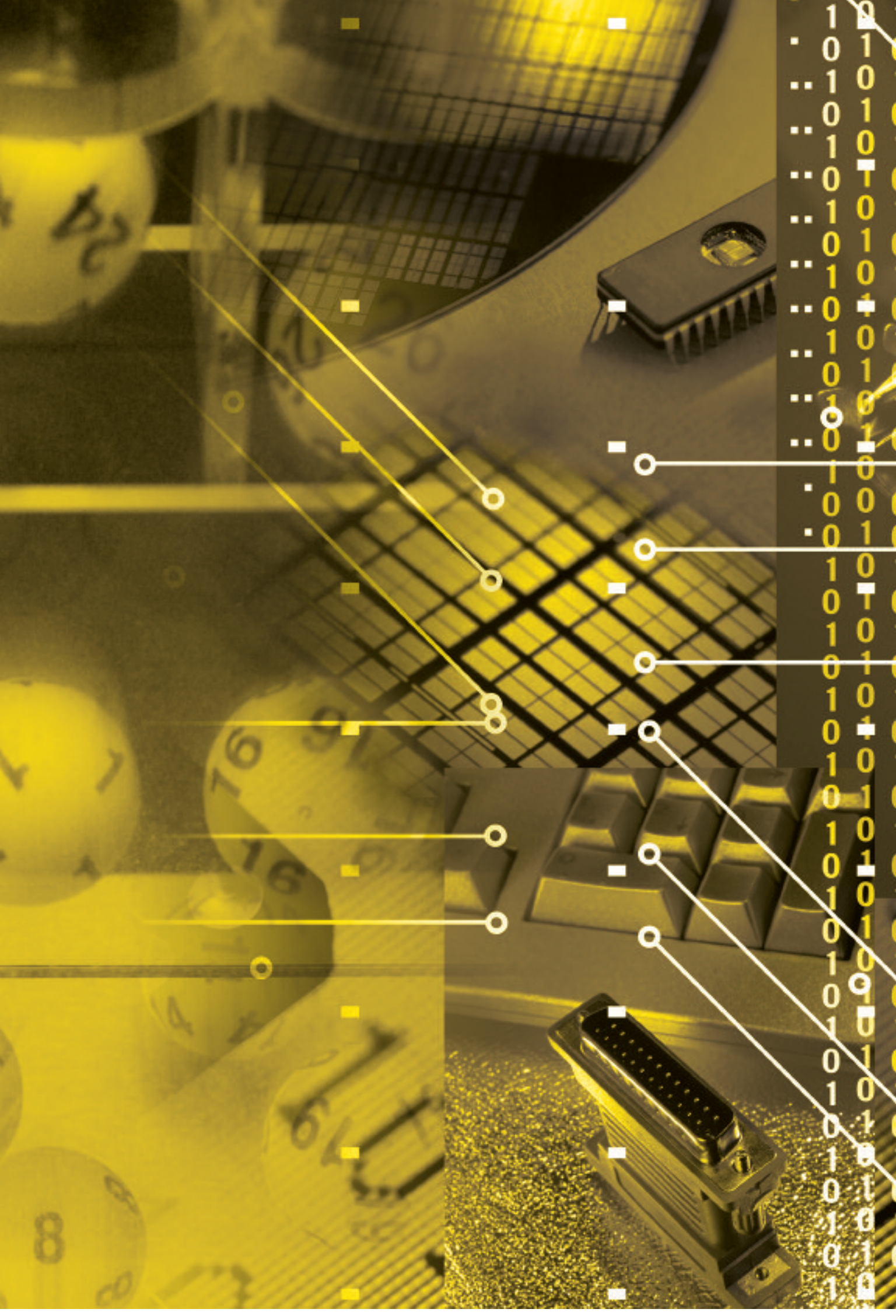
Bright Futures Scholars: Left to Right: Zaraiella Nakamoto, Xavier Durden, Amy Burns, Victoria McCovery, Michael McGuire, Natalie Alvarez

The Florida Lottery's commitment to education does not stop with generating funds for the EETF. The Florida Lottery believes in taking a "hands on" approach to support students, teachers and schools. This includes employee participation in the Governor's Mentoring Initiative, which set a goal of recruiting 200,000 Floridians to serve as mentors. The Florida Lottery has consistently been recognized for outstanding leadership and exceeding the goal of 10 percent mentor participation among the Governor's agencies. In addition, the Florida Lottery has made significant contributions to "Just Read, Florida!" which include educational activities such as reading to children, sponsoring statewide book drives and representing state agencies in reading events throughout Florida. The Florida Lottery also sponsors events such as Florida Teacher of the Year Roundtable, Teen Trendsetters Reading Mentors, the Education Expo and Take Stock in Children.

As the Florida Lottery continues to make futures brighter, it will remain focused on its mission to maximize revenues for education.



**Earning the confidence of
customers and non-players
alike is our part of the game.**



Florida Lottery Operations

During fiscal year 2004-2005, the bulk of the workload for the Florida Lottery's Operations was devoted to the historic conversion to a new gaming system, which went live on January 31, 2005. Some of the tasks included assisting in the review and approval of technical specifications, overseeing the design and development of necessary system interfaces, and implementing and configuring the required infrastructure. Operations also played a fundamental role in the performance of rigorous acceptance testing and development and delivery of extensive user training.

The gaming system conversion improved the way we do business with our retailers. In December 2004, we began recruitment for new retail establishments around the state to house 1,000 of the 2,000 additional terminals provided by the contract between the Florida Lottery and its new vendor, GTECH Corporation. These terminals allowed all retailers in the retailer sales network to sell both Scratch-Off and On-line games. The new gaming system also included a new satellite communications network, state-of-the-art Altura® touch screen terminals, customer display units and in-store electronic point of sale advertising devices.



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The addition of 1,000 keypads for high-volume CASH 3™ and PLAY4™ retailers and 1,000 Express Check units that allow players to check their tickets to see if they are winners helped enhance customer service in our retailer sales network. The Florida Lottery redesigned its On-line tickets and playslips and improved the inventory process for managing retailers' stock.

Operations created a Software Quality Assurance (SQA) unit which was instrumental in coordinating and conducting testing for both the gaming system and applications that were developed in-house, such as the Games Administration Call Tracking System and the Florida Lottery's new Web site. Additionally, SQA tested gaming system enhancements and approved changes as part of a continuous improvement process. Operations also acquired Games Administration, which facilitated the integration of the software development lifecycle from design and coding to testing, quality assurance and ultimately deployment, operations and user support. Games Administration performed draw-related functions of the gaming system and provided extensive customer support to the Florida Lottery's more than 12,000 retailers.



Operations oversees two data centers that operate 24 hours a day: a primary site in Tallahassee and a backup site in Orlando. Several initiatives were undertaken during fiscal year 2004-2005 to improve backup and recovery and to further automate job scheduling. Operations also continued the re-engineering of all legacy applications and systems on aging mainframe systems. This effort is scheduled to be completed in April 2006.



WINNER

Winning Amount
\$5.00

Our new gaming system conversion improved the way we do business with our retailers.

WIN UP TO \$100.00



Our new \$20 Gold Rush ticket rushed to the top with record breaking sales.

Scratch-Off Games have a Golden Year Full of Record Firsts

Fiscal year 2004-2005 generated the highest sales year ever for Scratch-Off games. Players from throughout the state rushed to purchase the Florida Lottery's first \$20 Scratch-Off game, GOLD RUSH. This new and exciting game, which averaged sales of more than \$10 million per week, generated more than \$525 million in sales and set the pace for all Scratch-Off game sales for fiscal year 2004-2005. GOLD RUSH provided an instant rush for players from the minute it hit retailers' shelves.

In addition to GOLD RUSH, the Florida Lottery's marketing strategy for the Monopoly family of games paid big dividends in fiscal year 2004-2005. With price points of \$10, \$5, \$2 and \$1, the Monopoly family of games generated \$264,645,370 in sales in 2004-2005. The Florida Lottery reached another milestone as total Monopoly sales surpassed \$1 billion, making it the most sought after family of Scratch-Off games in Lottery history.

Scratch-Off game sales also set another record with annual net sales of \$1.84 billion, a 35.8 percent increase from fiscal year 2003-2004. Florida ranked fourth in total Scratch-Off sales among the 40 domestic lotteries. Florida ranked number two in growth among domestic lotteries for the third consecutive year with a 13 percent increase in net Scratch-Off sales year over year.



Monopoly sales surpassed \$1 billion, making it the most sought after family of Scratch-Off games in Lottery history.

Pricing strategies and the emergence of higher price point games continue to be the number one driver for top line growth. More than \$900 million—or nearly 50 percent—of total Scratch-Off game sales came from \$10 and \$20 games. Increases in Scratch-Off game sales meant increases in retailer commissions. During fiscal year 2004-2005, Florida Lottery retailers earned more than \$108 million, or an average of \$2.1 million per week, in commissions generated from Scratch-Off games.

The Florida Lottery continuously creates innovative, attractive and marketable Scratch-Off products tailored to a wide spectrum of players. This variety will provide players many entertaining alternatives that will result in increased sales, which means even greater revenues for education.

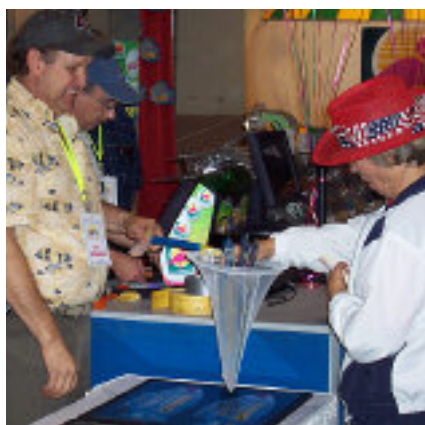


**Our product enhancements
have kept a trend of winning
players and increased sales.**



A New Beginning for On-line Games

Florida Lottery On-line game sales held steady during fiscal year 2004-2005 with the change of the agency's On-line games vendor. With combined sales of \$1.63 billion, FLORIDA LOTTO™, MEGA MONEY™, FANTASY 5®, PLAY 4™ and CASH 3™ sales helped ensure that revenue transfers to the Educational Enhancement Trust Fund (EETF) were over \$1 billion.



Billy DiCorte, owner of Mall News in Port Richey goes fishing for "Grouper" with customers.

With the conversion of the agency's gaming system came many new features. With a new package play called GROUPER™, Lottery players receive one ticket for each of the Florida Lottery's five On-line games plus an additional ticket free, or six tickets for the price of five. The Florida Lottery increased its very popular Advance Playfeature, which allows players to purchase tickets for future drawings. The number of Advance Plays for PLAY 4 and CASH 3 doubled, increasing from seven to 14 days.

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FLORIDA LOTTO

FLORIDA LOTTO gives players millions of reasons to play twice a week. All it takes is a dollar and a dream. Players win the FLORIDA LOTTO jackpot by matching 6-of-6 winning numbers in any order. Players also win cash prizes for matching three, four or five of the winning numbers drawn in the official drawing for the date played. Players can choose to receive their portion of the FLORIDA LOTTO jackpot in a one-time Cash Option payment, or they can receive it in 30 annual payments. In 2004-2005, 41 lucky players won more than \$209 million in jackpot prizes.



MEGA MONEY

MEGA MONEY continued a sales increase for the second consecutive year. Following the game enhancements made in January 2004, MEGA MONEY fiscal year 2004-2005 sales were \$131.2 million. That is a four percent increase over the previous year and a 37 percent increase from before the changes were made to the very popular game.



MEGA MONEY annuity jackpots start at \$500,000 and can roll over to \$2 million. After the MEGA MONEY jackpot reaches \$2 million, the top prize pool rolls down and increases the payouts on all of the lower-tier cash prize levels. Pick four numbers plus one MEGABALL number and players get a chance to win on eight prize levels.

Players win the MEGA MONEY jackpot by matching 4-of-4 winning numbers in any order from 1 to 44 and the MEGABALL number between 1 and 22. There are eight ways to win MEGA MONEY by matching the winning numbers drawn in the official drawing for the date played.

If no MEGA MONEY ticket matches all four winning numbers and the MEGABALL, the top prize pool rolls over to the next draw until it reaches \$2 million. After the MEGA MONEY jackpot reaches \$2 million and there is no top prize winner, the amount in the top prize pool in excess of the funds required for a \$2 million annuity will roll down to increase the prize payouts on all of the lower-tier cash prizes. The rolldown prizes are estimated to be double the normal payouts. Players can choose to receive their portion of the MEGA MONEY jackpot in a one-time Cash Option payment, or they can receive it in 20 annual payments.

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FANTASY 5



With sales of \$252.5 million in fiscal year 2004-2005 FANTASY 5 sales remain strong four years after the last game enhancements were made and current sales are 32 percent higher than before changes to the game were made. FANTASY 5 continues to be well liked by Florida Lottery players, producing more winners than any other On-line game.

FANTASY 5 players can daydream about what they would do with a fantasy prize of around \$200,000. If there is no top prize winner, that amount rolls down to the 4-of-5 prize level. FANTASY 5 has lots of winners.

Players win the FANTASY 5 top prize by matching 5-of-5 winning numbers drawn in any order. Players can win cash prizes or a free Quick Pick ticket for matching two, three or four numbers drawn in the official drawing for the date played. FANTASY 5 is a pari-mutuel game. Actual prize amounts depend on sales and the number of winners in each prize category.

All FANTASY 5 cash prizes are paid in a single cash payment. If there is no top prize winner, the money in the top prize pool rolls down, and is shared equally among winners in the 4-of-5 numbers prize category. When a ticket with 2-of-5 winning numbers is redeemed, the gaming terminal will automatically print a free Quick Pick ticket for the next available draw.



PLAY 4

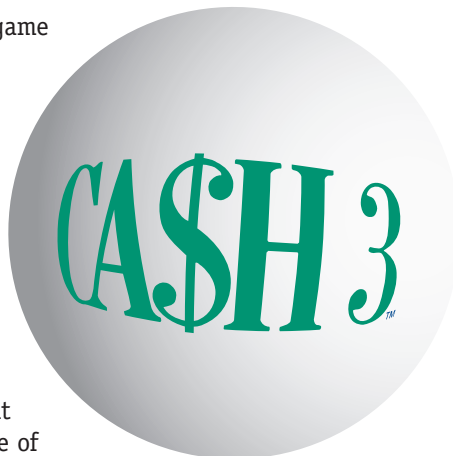
PLAY 4 completed fiscal year 2004-2005 with the highest sales increase of all the Florida Lottery's On-line games because of the product enhancements to the game. PLAY 4 sales of \$206.98 million were \$14.4 million—or 7.5 percent—higher than the previous year.

Players who match all four of the winning numbers drawn in the official drawing for the date played can win up to \$5,000, depending on the type of play purchased and the amount played. For 50¢ or \$1, players can play it their way, any day of the week.

Players can play it Straight for the bigger prizes or boxed to increase their chances of winning smaller prizes. They can also play Straight/Box, Combo and Pairs play. Front Pair, Mid Pair and Back Pair players who match two numbers in exact order can win up to \$50.

CASH 3

The Florida Lottery's popular CASH 3 game continued to play a vital role in the Lottery's On-line product mix, producing \$345.6 million in sales during fiscal year 2004-2005. This daily game, originally launched in 1988, has consistently performed well and contributes an average of 20 percent of the Lottery's total On-line ticket sales each year.



Playing CASH 3 is easy. Players simply select their numbers and play it their way. Players who match all three of the winning numbers drawn in the official drawing for the date played can win up to \$500, depending on the type of play purchased and the amount played. Front Pair or Back Pair players who match two numbers in exact order can win up to \$50. CASH 3 is a game players can play today and get paid today.

Florida Lottery On-line games have generated excitement for players since 1988 and thanks to our monumental gaming system conversion, On-line games will lead the agency into a new era with increased contributions to education.





When you play we all win!



Fiscal Year 2004-2005: A Winning Year for Florida Lottery Players

Since December 12, 1988 the Florida Lottery has given residents and visitors to the state of Florida millions of reasons to believe their dreams can come true. For 43 players their dreams of being a millionaire became a reality during fiscal year 2004-2005 as a result of them playing Florida Lottery games.

The number one producer of millionaires this year was our signature game FLORIDA LOTTO. For 17 years FLORIDA LOTTO players have purchased tickets in the name of fun and entertainment, in hopes of realizing their wildest dreams. During fiscal year 2004-2005, 41 lucky FLORIDA LOTTO players won more than \$209 million in jackpot prizes. FLORIDA LOTTO players weren't the only players whose dreams came true, 49 MEGA MONEY players dreams were way more MEGA as a result of winning more than \$29 million in prizes, and Scratch-Off players instant dreams came true when they won \$39.1 million in prizes and nine very dreamy corvettes too.

The Florida Lottery has provided great dividends to the residents of Florida and promises to continue to do so into the future. Whether they are one of millions of people who have won Lottery prizes or one of the thousands who Lottery dollars help to achieve their dreams by getting a better education – all Florida residents enjoy and benefit from the Florida Lottery!



Above: Tiffany Atkinson, of Lutz, won one of the 10 Corvette convertibles available in the Florida Lottery CORVETTE CASH Scratch-Off game. Her new Corvette is valued at \$79,333.14.





**It pays to be a
Florida Lottery
Retailer.**

Being a Florida Lottery Retailer is More Profitable Than Ever



Since 1988 the Florida Lottery has served as a rewarding source of revenue for businesses throughout the state, which allows those businesses to help contribute funds to education. The Florida Lottery worked with retailers throughout the state to make them as profitable as possible. Benefits of being a Florida Lottery retailer include:

- A \$10,000 bonus for selling single winning FLORIDA LOTTO ticket (multiple winners split the bonus);
- Five percent commission on ticket sales;
- One percent commission on cashing winning tickets;
- Extra cash with Retailer Incentive Programs; and
- Increased customer traffic.

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During fiscal year 2004-2005 Florida Lottery retailers earned more than \$197 million in commissions from Scratch-Off and On-line games. On average, retailers earned over \$3.8 million per week in commissions and bonuses, demonstrating why it pays to be a Florida Lottery retailer.

Organizational Structure.

As required by subsection 24.105(4), Florida Statutes, the following information reflects the organizational structure of the Lottery on June 30, 2005.

OFFICE OF THE SECRETARY

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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.
- **Project Management** is responsible for assisting staff in the effective design, implementation and overall management of large-scale projects and projects that involve multiple Lottery work units.
- **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.

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.

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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.

Labor Relations is responsible for administration of collective bargaining agreements, grievance handling, and employee relations matters.

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 department's 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.

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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.

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.

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• **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.



AUDITOR GENERAL STATE OF FLORIDA

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



WILLIAM O. MONROE, CPA
AUDITOR GENERAL

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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

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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, 2005, and 2004. 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 audits provide 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 operations of the State of Florida as of June 30, 2005, and 2004, 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, 2005, and 2004, and the results of operations 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 21, 2005, on our examination of the effectiveness 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. One purpose of that report is to describe the scope of our testing of internal control over financial reporting and to provide an opinion thereon. With respect to compliance, the purpose of that report is not to provide an opinion on compliance, but rather to describe the scope of our testing of compliance and the results of that testing.

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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 26 through 33, 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

William O. Monroe, CPA
December 21, 2005

**STATE OF FLORIDA
DEPARTMENT OF THE LOTTERY**

MANAGEMENT'S DISCUSSION AND ANALYSIS

YEARS ENDED JUNE 30, 2005, AND JUNE 30, 2004

This discussion of the Florida Lottery's financial statements is meant to provide an overview and analysis of the Lottery's financial results and position for the fiscal years ended June 30, 2005, and June 30, 2004. Please read it in conjunction with the financial statements and notes to the financial statements.

FINANCIAL HIGHLIGHTS

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 sixteen consecutive fiscal years and has transferred a minimum \$800 million annually to the Educational Enhancement Trust Fund (EETF) during this same period, with the fiscal year 2005 transfer exceeding \$1 billion for the third consecutive year.

For the fiscal year ended June 30, 2005:

- Transfers to the EETF increased from approximately \$1,051,658,000 to approximately \$1,103,633,000, or 4.9 percent, over the prior fiscal year.
- Florida Lottery's ticket sales increased 13 percent over the prior fiscal year from approximately \$3,070,962,000 to \$3,470,734,000.
- Florida Lottery's total operating revenue increased by \$400,401,000 (or 13 percent), and shows growth in revenue sources other than ticket sales.
- Nonoperating revenues, net of expenses, increased by \$152 million or approximately 110 percent in 2005 as compared to 2004. This increase is directly attributable to the change in fair value of the grand prize investments held by the Lottery for funding of future grand prize payments.
- Administrative operating expenses, which includes salaries and benefits, rent, utilities and maintenance, professional fees, depreciation, and other administrative expenses, decreased by 1.3 percent from the prior year expenses.

OVERVIEW OF THE FINANCIAL STATEMENTS

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 utilizes the accrual basis of accounting just as most business entities. This discussion and analysis is intended to serve as an introduction to the Lottery's basic financial statements. The statement of net assets on page 34, the statement of revenues, expenses and changes in net assets on page 35, and the statement of cash flows on page 36 report the Lottery's net assets, changes therein, and cash flows. The notes to the financial statements provide additional information that is essential to a reader's understanding of the data provided in the financial statements.

The Lottery transfers its net profits each fiscal year to the EETF. As a result, the Lottery's net assets consist of funds invested in fixed capital assets and restricted assets, which consist of the investments being held by the Lottery to fund deferred prize payouts. The investments do include the cumulative effect of periodic adjustments to recognize the fair value of the grand prize investments despite the fact that Lottery purchased the investments with the intention of holding the investments until maturity in order to meet the future obligations, and therefore, would not realize any gains or losses related to these investments for distribution as net proceeds.

SUMMARY OF NET ASSETS

Table 1 presents the Lottery's Condensed Statement of Net Assets as of the current fiscal year ended June 30, 2005, and the prior fiscal years ended June 30, 2004, and 2003, as derived from the Statements of Net Assets.

Table 1
Condensed Statement of Net Assets
As of June 30, 2005, 2004, and 2003
(In Thousands)

	2005	2004	2003
Assets			
Current Assets	\$ 262,160	\$ 198,377	\$ 176,117
Restricted Assets	3,383,529	3,543,204	4,096,839
Capital Assets, Net of Depreciation	1,481	2,316	2,623
Total Assets	3,647,170	3,743,897	4,275,579
Liabilities			
Current Liabilities	258,090	195,130	170,460
Current Liabilities Payable from Restricted Assets	1,949,327	1,980,899	2,304,047
Noncurrent Liabilities	1,234,236	1,364,182	1,448,009
Total Liabilities	3,441,653	3,540,211	3,922,516
Net Assets			
Net Investment in Capital Assets	1,481	2,316	2,623
Restricted Net Assets	204,036	201,370	350,440
Total Net Assets	\$ 205,517	\$ 203,686	\$ 353,063

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Current Year Impacts to the Statement of Net Assets

For the fiscal year ended June 30, 2005:

- Total assets decreased by \$96,727,000. This is mostly attributable to the decreases in the size of the investment portfolio. The market value of the individual investments increased \$110,029,000, but the size of the total portfolio decreased due to a consistent pattern of jack pot prizewinners selecting the cash option when they have the option of selecting either an annuity or cash. This pattern resulted in a payout of annuities for the current fiscal year of \$244,124,000 and purchases of only \$7,103,000 in new investments.
- Total liabilities decreased by \$98,558,000. This can primarily be attributed to net decreases in obligations under security lending of \$72,605,000 and a decrease of \$130,229,000 in grand prize deferred payments to winners. However, these decreases were offset by an increase in the

current liabilities of \$62,960,000 primarily the increase in the year-end transfer to EETF.

- Net assets increased by \$1,831,000 primarily due to the decrease in the total liability owed to grand prizewinners.

For the fiscal year ended June 30, 2004:

- Total assets decreased by \$531,682,000. This can be attributed to decreases in 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 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 most important relationship demonstrated with the Lottery's financial statements is the transfer of all net income to the EETF. 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.

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Table 2 presents a Condensed Statement of Revenues, Expenses and Changes in Net Assets for the current fiscal year ended June 30, 2005, and the prior fiscal years ended June 30, 2004, and 2003, as derived from the Lottery's Statements of Revenues, Expenses and Changes in Net Assets.

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Table 2

Condensed Statement of Revenues, Expenses and Changes in Net Assets
Years Ended June 30, 2005, 2004, and 2003
(In Thousands)

	2005	2004	2003
Operating Revenues			
Ticket Sales	\$3,470,734	\$3,070,962	\$2,867,981
On-line Fees and Miscellaneous	5,519	4,950	4,953
Retailer Fees	256	196	201
Total Operating Revenues	<u>3,476,509</u>	<u>3,076,108</u>	<u>2,873,135</u>
Operating Expenses			
Prizes	2,044,246	1,724,488	1,555,848
Retailer Commissions	197,781	174,389	160,850
Vendor Commissions	71,572	65,544	61,663
Other Expenses	71,042	70,548	70,211
Total Operating Expenses	<u>2,384,641</u>	<u>2,034,969</u>	<u>1,848,572</u>
Income from Operations	<u>1,091,868</u>	<u>1,041,139</u>	<u>1,024,563</u>
Nonoperating Revenue (Expense)			
Interest and Securities Lending Income, Net of Fees	10,964	10,307	10,354
Net Appreciation in Fair Value of Investments	110,029	(33,038)	241,732
Property Disposal Loss	(45)	(81)	-
Amortization of Grand Prizes Payable	<u>(107,352)</u>	<u>(116,046)</u>	<u>(123,158)</u>
Total Nonoperating Revenue (Expenses), Net	<u>13,596</u>	<u>(138,858)</u>	<u>128,928</u>
Income Before Operating Transfers	<u>1,105,464</u>	<u>902,281</u>	<u>1,153,491</u>
Transfers to Educational Enhancement Trust Fund	<u>(1,103,633)</u>	<u>(1,051,658)</u>	<u>(1,035,178)</u>
Change in Net Assets	1,831	(149,377)	118,313
Net Assets, Beginning of Year	<u>203,686</u>	<u>353,063</u>	<u>234,750</u>
Net Assets, End of Year	<u>\$ 205,517</u>	<u>\$ 203,686</u>	<u>\$ 353,063</u>

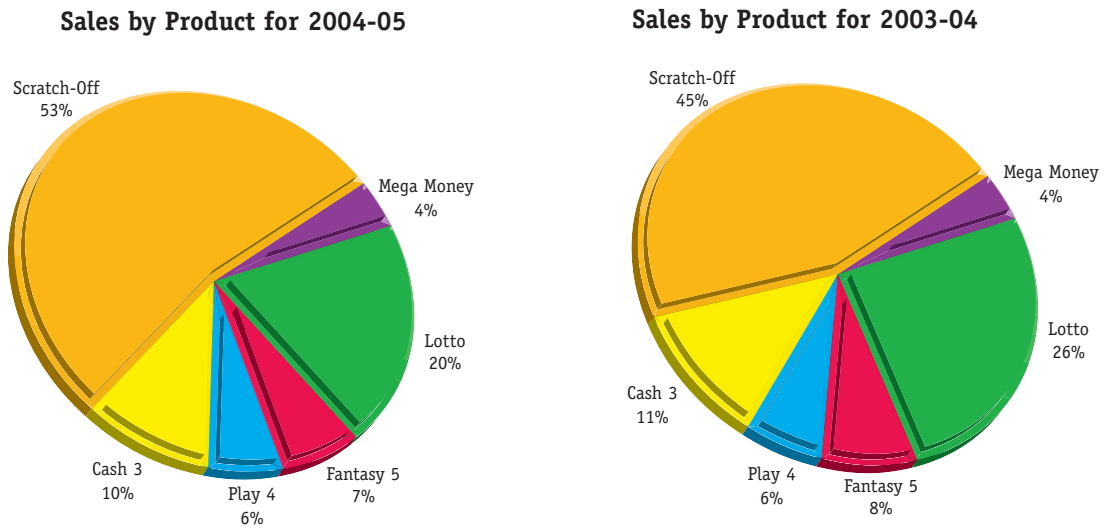
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Current Year Impacts/Analysis of the Statement of Revenues, Expenses and Changes in Net Assets

Revenue

For the fiscal year ended June 30, 2005, ticket sales increased another \$399,772,000 primarily due to growth in the Scratch-Off ticket market. The \$3,470,734,000 sales figure represents the highest sales in the history of the Florida Lottery. Fiscal year 2004-05 is also the second year in which the Lottery reached the \$3 billion sales mark.

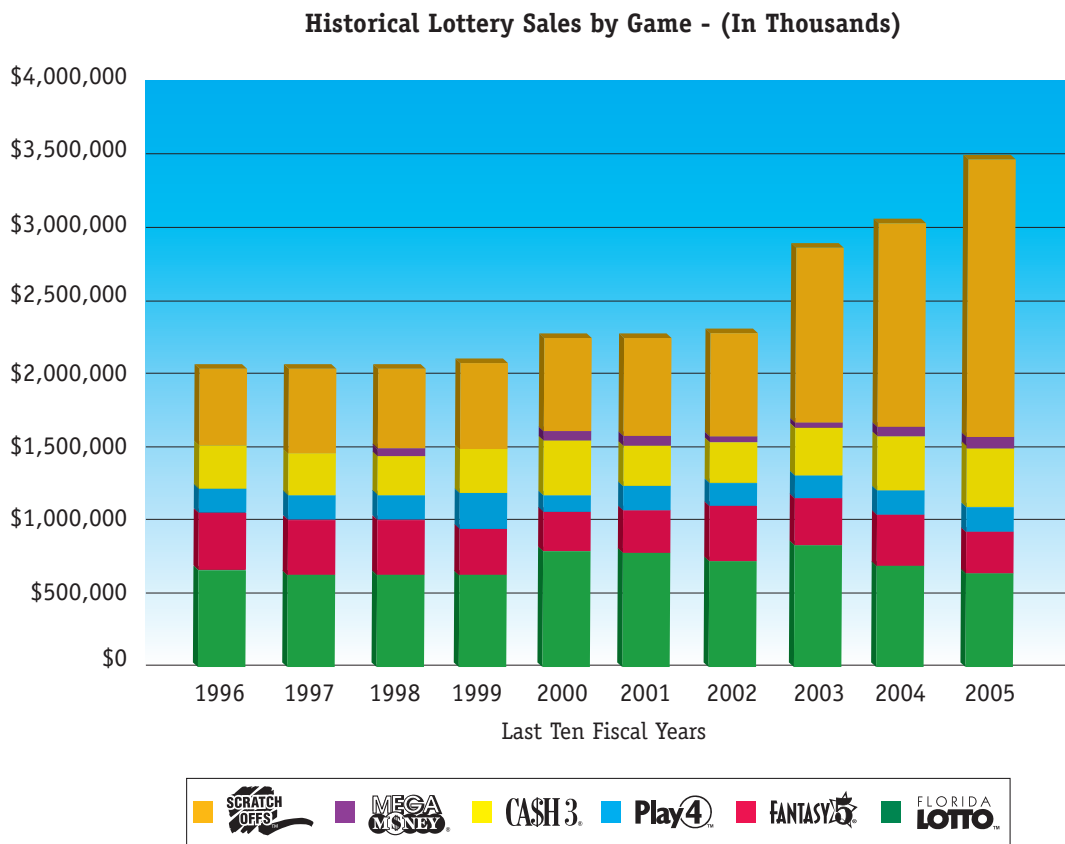
The following chart shows sales by product for the various Lottery games during the June 30, 2005, and 2004 fiscal years:



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Sales of Scratch-Off tickets for the fiscal years ending June 30, 2005, and 2004, were \$1,844,619,000 and \$1,358,068,000, or 53 percent and 45 percent, respectively, of combined sales. The increase in Scratch-Off sales is largely attributable to the introduction of the \$20 prize point Scratch-Off game introduced in July 2004 and the effects of the variable prize payouts, implemented in September 2002.

The following chart and table shows sales by game for the last ten fiscal years:



**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
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
2005	689,820	252,467	206,982	345,598	131,248	1,844,619	3,470,734

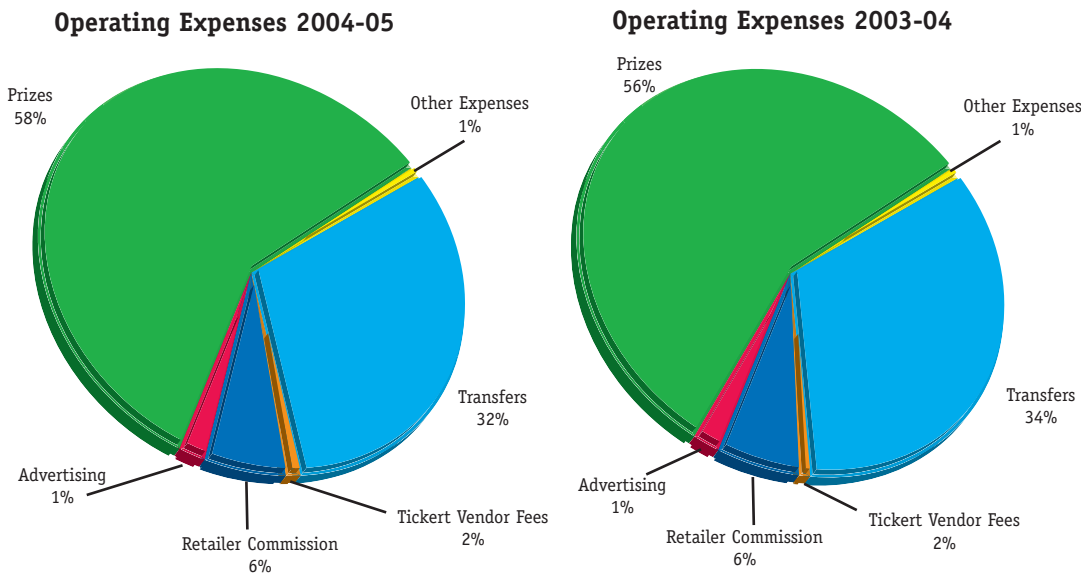
Sales as a whole have been increasing due to the active management of various On-line game structures, active marketing of product lines, and higher prize payouts for Scratch-Off tickets.

Expenses

The percentage of ticket sale revenue available for total expenses of the Florida Lottery is set by Section 24.121, *Florida Statutes*, and results in no more than 12 percent of sales revenue being available for Lottery operating and administrative expenses, including retailer commissions, On-line games expense, and Scratch-Off ticket expense.

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The following chart shows the major components of Lottery operating expenses and transfers as a percentage of ticket sales for the June 30, 2005, and 2004 fiscal years:



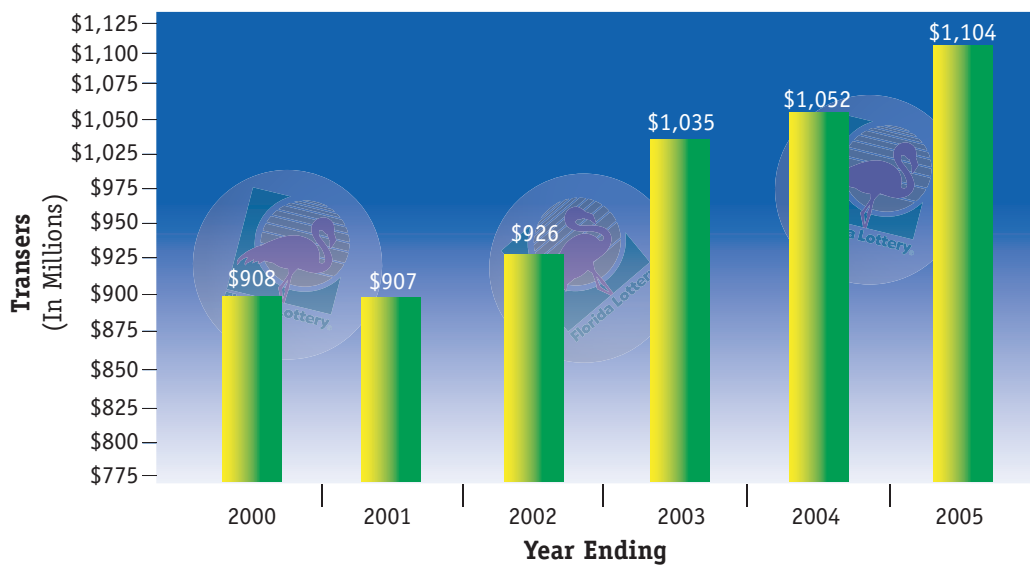
Prizes, commissions, and vendor fees all directly relate to sales. As expected as sales have increased so have these expenses. The other expenses which consist of advertising, salaries and benefits, professional fees, rent, maintenance, bad debt, and depreciation have remained relatively stable. Advertising expense has increased approximately 2.9 percent while administrative expenses have decreased 1.3 percent.

Transfers

The Lottery's contribution to the EETF for the fiscal year ended June 30, 2005, (\$1,103,633,000) was the highest since the Florida Lottery began making transfers in 1988. Fiscal year 2004-05 is the third straight year in which the Lottery's contribution to EETF has been over \$1 billion. Total transfers to the EETF increased by \$51,975,000 from the prior fiscal year. When adjusted for inflation, the Lottery's transfer amount for fiscal year 2004-05, was slightly higher than the prior year. However, overall the Lottery's transfers have not increased at the same rate as inflation over the 18-year period.

The following chart shows the total transfers to the EETF for the past six fiscal years:

Transfer to Educational Enhancement Trust Fund



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CAPITAL ASSETS

At June 30, 2005, and 2004, the Lottery reported capital assets, net of depreciation, of \$1,481,000 and \$2,316,000 respectively. 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. The Lottery must continue to find ways to maintain the annual transfer to EETF of over \$1 billion. The Lottery's strategies revolve around enhancing On-line product sales and increasing retailer penetration in the state. The following are some of the functional strategies:

- **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 On-line games, On-line promotions, etc.

During the 2004 legislative session, the Department was authorized to implement a variable prize payout for On-line similar to the program approved for Scratch-Off games in 2002. 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 36 percent in Scratch-Off ticket sales for fiscal year 2005 over the previous year, and an increase of \$51 million in the transfer to the EETF from sales of Scratch-Off tickets during the same period. The Department does not expect the same rate of return for the On-line games but does expect to see a positive return from applying the variable prize payout strategy. Because the sales are concentrated in higher prize payout games, the transfer to EETF is not projected to increase at a corresponding rate.

- **Improve market penetration through expansion of Lottery retailer network.**

As a result of a new Lottery vendor contract, which went into effect on January 31, 2005, approximately 2,000 retailers that were only selling Scratch-Off tickets now sell all On-line products as well. Given that fact, and other enhancements provided by the new system, ticket sales are expected to increase. The Department has set internal goals for continuing to grow the number of retailers over the next five years by 25 percent.

The positive impacts of the above factors will be partially offset by two negative impacts. Four major hurricanes hit Florida during 2004 and another major hurricane hit Florida in October 2005. Management estimates that the storms resulted in a reduction of approximately \$40 million in Lottery sales in 2004-05, with a corresponding drop in the EETF of about \$12 million. Additionally, 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.

FINANCIAL CONTACT

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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, Chief Financial Officer, 250 Marriott Drive, Capitol Complex, Tallahassee, Florida 32399.

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**STATE OF FLORIDA
DEPARTMENT OF THE LOTTERY**

Statement of Net Assets

As of June 30, 2005, and June 30, 2004
(In Thousands)

	<u>June 30, 2005</u>	<u>June 30, 2004</u>
Assets		
Current Assets:		
Cash and cash equivalents	\$211,245	\$151,801
Interest receivable	1,489	1,347
Accounts receivable, net	46,179	41,952
Inventories	1,006	993
Security deposits	2,241	2,284
Total Current Assets	<u>262,160</u>	<u>198,377</u>
Restricted Assets:		
Securities lending income receivable	4,564	1,301
Investments, grand prize	1,669,744	1,796,659
Investments, other	1,709,221	1,745,244
Capital assets, net	1,481	2,316
Total Assets	<u>3,647,170</u>	<u>3,743,897</u>
Liabilities		
Current Liabilities:		
Accounts payable and accrued liabilities	11,766	9,028
Prizes payable	80,057	60,668
Due to Educational Enhancement Trust Fund	163,227	122,477
Deposits payable	2,241	2,284
Compensated absences payable	799	673
Total Current Liabilities	<u>258,090</u>	<u>195,130</u>
Current Liabilities Payable from Restricted Assets:		
Pending purchases payable	42,188	5,088
Securities lending fees payable	4,216	842
Obligations under securities lending	1,667,092	1,739,697
Grand prizes payable	235,831	235,272
Total Current Liabilities Payable from Restricted Assets	<u>1,949,327</u>	<u>1,980,899</u>
Noncurrent Liabilities:		
Grand prizes payable	1,231,333	1,361,562
Compensated absences payable	2,903	2,620
Total Noncurrent Liabilities	<u>1,234,236</u>	<u>1,364,182</u>
Total Liabilities	<u>3,441,653</u>	<u>3,540,211</u>
Net Assets		
Invested in capital assets	1,481	2,316
Restricted	204,036	201,370
Total Net Assets	<u>\$205,517</u>	<u>\$203,686</u>

See accompanying notes to financial statements.

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**STATE OF FLORIDA
DEPARTMENT OF THE LOTTERY**

Statement of Revenues, Expenses and Changes in Net Assets

Years ended June 30, 2005, and June 30, 2004
(In Thousands)

	<u>June 30, 2005</u>	<u>June 30, 2004</u>
Operating Revenues:		
Ticket sales	\$3,470,734	\$3,070,962
On-line fees and miscellaneous	5,519	4,950
Retailer fees	256	196
Total Operating Revenues	<u>3,476,509</u>	<u>3,076,108</u>
Operating Expenses:		
Prizes	2,044,246	1,724,488
Retailer commissions	197,781	174,389
Scratch-off tickets	43,282	31,916
On-line games	28,290	33,628
Advertising	34,027	33,058
Personal services	24,177	23,236
Other contractual services	7,880	9,782
Materials and supplies	3,660	3,030
Bad debts	293	298
Depreciation	1,005	1,144
Total Operating Expenses	<u>2,384,641</u>	<u>2,034,969</u>
Operating Income	<u>1,091,868</u>	<u>1,041,139</u>
Nonoperating Revenues (Expenses):		
Interest	6,543	4,495
Securities lending income	42,003	25,677
Securities lending fees	(37,582)	(19,865)
Net appreciation in fair value of investments	110,029	(33,038)
Property disposition (loss)	(45)	(81)
Amortization of grand prizes payable	(107,352)	(116,046)
Total Nonoperating Revenues (Expenses), Net	<u>13,596</u>	<u>(138,858)</u>
Income Before Operating Transfers	<u>1,105,464</u>	<u>902,281</u>
Transfers to Educational Enhancement Trust Fund	<u>(1,103,633)</u>	<u>(1,051,658)</u>
Change in Net Assets	1,831	(149,377)
Net Assets, Beginning of Year	<u>203,686</u>	<u>353,063</u>
Net Assets, End of Year	<u>\$205,517</u>	<u>\$203,686</u>

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See accompanying notes to financial statements.

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STATE OF FLORIDA
DEPARTMENT OF THE LOTTERY
Statement of Cash Flows

Years ended June 30, 2005, and June 30, 2004
(In Thousands)

	<u>June 30, 2005</u>	<u>June 30, 2004</u>
Operating Activities:		
Ticket sales	\$3,466,215	\$3,085,638
Prizes paid to winners	(2,024,299)	(1,731,816)
Commissions paid and payments to retailers	(197,781)	(174,389)
Paid to vendors for goods and services	(114,489)	(112,118)
Paid to employees	(23,693)	(23,494)
Other operating revenue	<u>5,775</u>	<u>5,146</u>
Net Cash Provided by Operating Activities	<u>1,111,728</u>	<u>1,048,967</u>
Noncapital Financing Activities:		
Payments to Educational Enhancement Trust Fund	<u>(1,062,883)</u>	<u>(1,016,723)</u>
Net Cash Used in Noncapital Financing Activities	<u>(1,062,883)</u>	<u>(1,016,723)</u>
Capital and Related Financing Activities:		
Purchase of capital assets	<u>(218)</u>	<u>(918)</u>
Net Cash Used in Capital and Related Financing Activities	<u>(218)</u>	<u>(918)</u>
Investing Activities:		
Cash received from maturity of grand prize investments	244,124	241,066
Cash paid to grand prize winners upon maturity of grand prize investments	(244,124)	(241,066)
Interest	<u>10,817</u>	<u>5,015</u>
Net Cash Provided by Investing Activities	<u>10,817</u>	<u>5,015</u>
Net Increase in Cash and Cash Equivalents	59,444	36,341
Cash and Cash Equivalents, Beginning of Year	<u>151,801</u>	<u>115,460</u>
Cash and Cash Equivalents, End of Year	<u>\$211,245</u>	<u>\$151,801</u>
Reconciliation of Income from Operations to Net Cash Provided by Operating Activities:		
Income from operations	\$1,091,868	\$1,041,139
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation	1,005	1,144
Changes in assets and liabilities		
(Increase) decrease in:		
Accounts receivable	(4,227)	14,975
Inventories	(13)	313
Increase (decrease) in:		
Accounts payable and accrued liabilities	2,738	(1,017)
Prizes payable	19,948	(7,328)
Compensated absences payable	<u>409</u>	<u>(259)</u>
Net Cash Provided by Operating Activities	<u>\$1,111,728</u>	<u>\$1,048,967</u>
Noncash Investing, Capital and Financing Activities:		
Increase in fair value of investments	(\$22,008)	(\$153,703)

See accompanying notes to financial statements.

STATE OF FLORIDA
DEPARTMENT OF THE LOTTERY
Notes to Financial Statements

Years ended June 30, 2005, and June 30, 2004

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.

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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.

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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 \$1,481,000 and \$2,316,000 at June 30, 2005, and 2004, 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 \$204,036,000 and \$201,370,000 at June 30, 2005, and 2004, respectively.

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

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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. Any prize that remains unclaimed at the end of a 180 day period following a draw is considered unclaimed. Prior to June 30, 2004, unclaimed prizes for On-line games included 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 2001-02, 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 EETF.

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

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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 \$300,000 at June 30, 2005, and \$315,000 at June 30, 2004, 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.

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

Due to the investing policy of the Lottery, book overdrafts were approximately \$1,763,000 at June 30, 2005, and \$2,431,000 at June 30, 2004, 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 time deposits, 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 \$210,046,000 and \$151,373,000 at June 30, 2005, and 2004, 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 EETF.

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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 \$1,667,092,000 of cash collateral for the lending program as of June 30, 2005, and \$1,739,697,000 as of June 30, 2004. At June 30, 2005, 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 invested in Dresdner Bank's short-term collateral investment pool.

Securities lending activity for the year ended June 30, 2005, and 2004, consisted of (in thousands):

	<u>2005</u>	<u>2004</u>
Securities lending income	\$ 42,003	\$ 25,677
Less broker rebates	(36,478)	(18,413)
Less bank fees	(1,104)	(1,452)
Net securities lending revenue	<u>\$ 4,421</u>	<u>\$ 5,812</u>

d. Investment Credit Risk

Lottery grand prize winner investments have been limited to U.S. Government guaranteed securities in order to comply with Section 24.120(2), Florida Statutes. The security lending short-term collateral investment pool is not rated. The Treasury Investment Pool's current rating by Standard and Poors is AA-f.

e. Investment Interest Rate Risk

The investment policy objective is to match maturities of investments with the maturities of the lottery winner annuities. Therefore, investments are held to maturity after they are purchased thereby eliminating interest rate risk. Listed below are the Lottery's investments in U.S. Treasury Strips at June 30, 2005:

<u>Time to Maturity</u>	<u>Fair Value</u>
< to 1 year	\$ 240,592,281
> 1 to 3 years	454,433,459
> 3 to 5 years	358,274,927
> 5 to 10 years	482,667,928
> 10 to 15 years	81,799,052
> 15 to 20 years	27,429,482
> 20 years	<u>24,546,795</u>
Total	<u>\$ 1,669,743,924</u>

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The Lottery participates in a securities lending program at both the State Board of Administration and the State Treasury.

- 1) The contract between Dresdner Bank and the SBA requires that the maximum weighted average portfolio maturity not exceed 60 days. The pool invests a significant amount of its assets in floating rate securities and limits the maximum reset period for interest rate changes to 6 months. Next reset dates are used in the calculation of weighted average maturity. The weighted average maturity of the short-term investment pool at June 30, 2005, was 26 days.
- 2) The effective duration of the Treasury Investment Pool is 2.22 years at June 30, 2005.

f. Investment Concentration of Credit Risk

Since all long-term investments are in U.S. Government guaranteed securities, the Lottery has not adopted a policy regarding concentration of credit risk.

g. Investment Custodial Credit Risk

Custodial credit risk is defined as the risk that an entity may not recover securities held by another party. At June 30, 2005, all investments held were either insured or registered and held by the Lottery or its agents in the Lottery's name; therefore, the Lottery does not have a formal policy regarding custodial credit risk.

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h. Foreign Currency Risk

The Lottery has no exposure to foreign currency risk as of June 30, 2005.

i. Investment Summary

The following schedule summarizes all investments and investments loaned under security lending agreements (in thousands):

	Carrying Value
U.S. Government Obligations	\$ 30,653
Investments Held by Others Under Security	
Lending Agreements - U.S. Obligations	1,639,091
Pooled Investments with State Treasury	210,882
Money Market and Mutual funds	1,709,221
Total Investments	<u>\$ 3,589,847</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	Total
Cash and cash equivalents	\$ 210,882	\$ 300	\$ 63	\$ 211,245
Investments, grand prize	1,669,744			1,669,744
Investments, other	1,709,221			1,709,221
Total	<u>\$ 3,589,847</u>	<u>\$ 300</u>	<u>\$ 63</u>	<u>\$ 3,590,210</u>

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3. ACCOUNTS RECEIVABLE

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

	<u>2005</u>	<u>2004</u>
Ticket sales receivable	\$ 47,295	\$ 43,310
Other receivables	394	149
Total receivables	47,689	43,459
Less allowance for doubtful accounts	(1,510)	(1,507)
Accounts receivable, net	<u>\$ 46,179</u>	<u>\$ 41,952</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):

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	Balance July 1, 2003	<u>2003-2004</u>		Balance June 30, 2004	<u>2004-2005</u>		Balance June 30, 2005
		Increase	Decrease		Increase	Decrease	
Data processing equipment	\$8,769	\$46	\$(125)	\$8,690	\$80	\$(243)	\$8,527
Office equipment and fixtures	6,379	487	(249)	6,617	14	(35)	6,596
Vehicles and other equipment	3,372	385	(435)	3,322	134	(299)	3,157
	<u>18,520</u>	<u>918</u>	<u>(809)</u>	<u>18,629</u>	<u>228</u>	<u>(577)</u>	<u>18,280</u>
Less: accumulated depreciation	<u>15,897</u>	<u>1,144</u>	<u>(728)</u>	<u>16,313</u>	<u>1,005</u>	<u>(519)</u>	<u>16,799</u>
Total capital assets, net	<u>\$2,623</u>	<u>\$(226)</u>	<u>\$(81)</u>	<u>\$2,316</u>	<u>\$(777)</u>	<u>\$(58)</u>	<u>\$1,481</u>

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6. LONG-TERM LIABILITIES**a. Grand Prizes Payable**

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

	<u>2005</u>	<u>2004</u>
Lotto grand prizes (face value)	\$ 2,011,120	\$ 2,242,013
Mega Money grand prizes (face value)	247	-
Win For Life grand prizes (face value)	14,478	14,842
Big 10 grand prizes (face value)	190	280
Flamingo Fortune Game Show grand prizes (face value)	1,300	1,400
Win a Million grand prizes (face value)	650	700
Yearly Dividend grand prizes (face value)	24	48
Yearly Bonus grand prizes (face value)	400	450
Set for Life grand prize (face value)	2,160	2,280
Cash Spectacular grand prize (face value)	900	950
Less imputed interest	<u>(564,305)</u>	<u>(666,129)</u>
Net present value of grand prizes payable	<u>\$ 1,467,164</u>	<u>\$ 1,596,834</u>
Current Prizes Payable from restricted assets	\$ 235,831	\$ 235,272
Noncurrent Prizes Payable	<u>1,231,333</u>	<u>1,361,562</u>
Total Grand Prizes Payable	<u>\$1,467,164</u>	<u>\$ 1,596,834</u>

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

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Year Ended June 30	<u>Amount</u>
2006	\$ 244,464
2007	244,440
2008	243,003
2009	216,411
2010	196,680
2011-2015	632,659
2016-2020	131,509
2021-2025	58,530
2026-2030	<u>63,773</u>
Grand prizes (face value)	2,031,469
Less imputed interest	<u>(564,305)</u>
Net present value of grand prizes payable	<u>\$ 1,467,164</u>

b. Compensated Absences Payable

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

	<u>2005</u>	<u>2004</u>
Current Compensated Absences	\$ 799	\$ 673
Noncurrent Compensated Absences	<u>2,903</u>	<u>2,620</u>
Total	<u>\$ 3,702</u>	<u>\$ 3,293</u>

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c. Changes in Long-Term Liabilities

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

	Balance July 1, 2004	Additions	Reductions	Balance June 30, 2005	Amount due within one year
Grand prizes payable	\$1,596,834	\$114,454	(\$244,124)	\$1,467,164	\$235,831
Compensated absences payable	3,293	1,080	(671)	3,702	799
Total long-term liabilities	<u>\$1,600,127</u>	<u>\$115,534</u>	<u>(\$244,795)</u>	<u>\$1,470,866</u>	<u>\$236,630</u>

7. DUE TO EDUCATIONAL ENHANCEMENT TRUST FUND

In accordance with the Act, as amended, at least 39 percent of On-line and miscellaneous revenue, net of retailer fees, must be transferred to the EETF 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 EETF. The Lottery implemented this strategy in September 2002. The total amount transferred for the fiscal year ended June 30, 2005, was \$1,103,633,000, 31.7 percent of revenues, and for the fiscal year ended June 30, 2004, the transferred amount was \$1,051,658,000, 34.1 percent of revenues.

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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 EETF.

Due to EETF consisted of (in thousands):

	June 30, 2005	June 30, 2004
Operating revenue less Scratch-Off ticket sales	\$ 1,631,890	\$ 1,718,038
Nonoperating revenue (expenses), net	13,596	(138,858)
Less: Retailer fees	(256)	(196)
Net appreciation in fair value of investments	(110,029)	33,038
Amortization of grand prizes payable	<u>107,352</u>	<u>116,046</u>
Net revenue less Scratch-Off ticket sales	1,642,553	1,728,068
Total revenue subject to transfer at 39%	1,642,553	1,728,068
	<u>39%</u>	<u>39%</u>
Statutorily required transfer	<u>640,614</u>	<u>673,978</u>
Scratch-Off ticket sales	1,844,619	1,358,068
Transfer percentage for Scratch-Off ticket sales	<u>21.031%</u>	<u>21.847%</u>
Direct transfer from Scratch-Off ticket sales	<u>387,944</u>	<u>296,695</u>
Additional transfer appropriated	60,000	20,000
Special one-time transfer of unclaimed jackpot	0	30,148
Supplemental balance transferred	<u>15,075</u>	<u>30,837</u>
Due for the year	<u>\$ 1,103,633</u>	<u>\$ 1,051,658</u>
Balance due, beginning of year	122,477	87,542
Paid during the year	<u>(1,062,883)</u>	<u>(1,016,723)</u>
Due to Educational Enhancement Trust Fund, end of year	<u>\$ 163,227</u>	<u>\$ 122,477</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:

	Fiscal Year Ended June 30, 2005	Fiscal Year Ended June 30, 2004
Senior Management	9.37 percent	9.37 percent
Regular Employees	7.39 percent	7.39 percent
Special Risk	18.53 percent	18.53 percent

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The Lottery's contributions to the FRS amounted to approximately \$1,166,000 and \$1,242,000 for the years ended June 30, 2005, and 2004, respectively. These contributions represented 7.14 percent and 7.51 percent of covered payroll, for the years ended June 30, 2005, and 2004, respectively. The Lottery contributed 100 percent of the required contributions for the years ended June 30, 2005, and 2004.

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 2004 through June 2005. 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, 2005, and 2004, totaled \$89,947 and \$52,122, 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, 2005, and 2004, 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, 2005, are scheduled as follows (in thousands):

<u>Year Ending June 30</u>	<u>Headquarters</u>	<u>Districts</u>	<u>Total</u>
2006	\$ 2,466	\$ 805	\$ 3,271
2007	2,491	616	3,107
2008	2,516	485	3,001
2009	2,615	203	2,818
2010	<u>2,642</u>	<u>116</u>	<u>2,758</u>
	<u>\$ 12,730</u>	<u>\$ 2,225</u>	<u>\$ 14,955</u>

Rental expense under all operating leases totaled approximately \$3,214,000 and \$3,195,000 for the years ended June 30, 2005, and 2004, 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 Lottery entered into a new contract for an On-line gaming system, which took effect on January 31, 2005. The new contractor is compensated at a rate of 1.1499 percent of sales. Prior to January 31, 2005, the base compensation for the On-line games contract was 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 was a cap which limited the potential combined compensation rate to 2.08 percent of sales. The contractors' compensation for On-line games for the fiscal years ended June 30, 2005, and 2004, was \$28,290,000, and \$33,628,000, 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 \$43,282,000 for the fiscal year ended June 30, 2005, and \$31,916,000 for the fiscal year ended June 30, 2004.

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.