

# FLORIDA LOTTERY 2005-2006 ANNUAL REPORT



## MISSION STATEMENT



The Florida Lottery was created to allow the people of the state to benefit from significant additional moneys for education while playing the best lottery games available. Consistent with this, it is the mission of the Florida Lottery to maximize revenues in a manner consonant with the dignity of the state and the welfare of its citizens.

**EDUCATION ... THAT'S THE TICKET!**



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Florida Lottery Annual Report for fiscal year ended June 30, 2006.



## EXECUTIVE SUMMARY

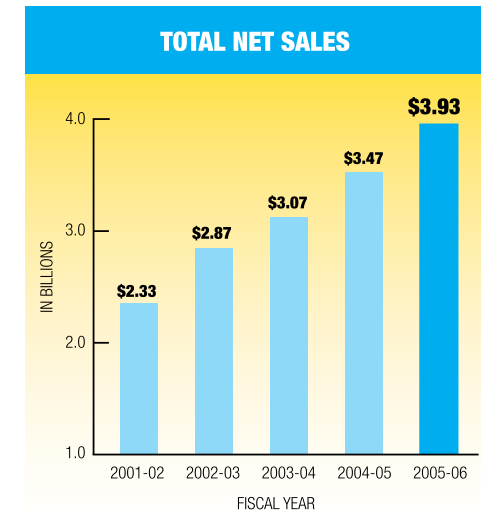
It is with great enthusiasm that the Florida Lottery presents the 2005-2006 Annual Report. In keeping with our mission of maximizing revenues for the enhancement of public education in the state, the Florida Lottery reached another record-breaking year of sales and contributions to education. During fiscal year 2005-2006, the Florida Lottery achieved \$3.93 billion in sales and \$1.22 billion in transfers to the Educational Enhancement Trust Fund – making it the third consecutive year of more than \$3 billion in sales and the fourth consecutive year of more than \$1 billion in contributions to education. As compared to the previous year, Lottery sales increased by more than \$450 million.

Fiscal year 2005-2006 was a very busy time for Florida Lottery retailers, vendors, partners and employees alike. A new On-line gaming system installed the previous year allowed new and innovative opportunities, including the development of the promotion *Cash for the Holidays* and the addition of EZmatch to FANTASY 5® as a play-through feature. Also, Florida Lottery retailers enjoyed extra bonuses which led to an increase in both sales and revenue.



At the Florida Lottery, we take our role of contributing to the educational opportunities of Florida's children and their future very seriously. As of June 30, 2006, Lottery contributions since inception totaled more than \$16 billion. During fiscal year 2005-2006, the Florida Lottery contributed \$1.22 billion to education, an increase of \$121 million over the prior year.

The Florida Lottery is a ticket to the future for Florida's students. With the patronage of our players, the dedication of our retailers and employees, a state-of-the-art gaming system, and the insight of the Florida Legislature and Governor Charlie Crist, the future looks bright for the Florida Lottery, its players and beneficiaries. The Lottery continues helping the students and schools of our great state achieve academic success, as they strive to turn their dreams into reality. Education...That's the ticket!





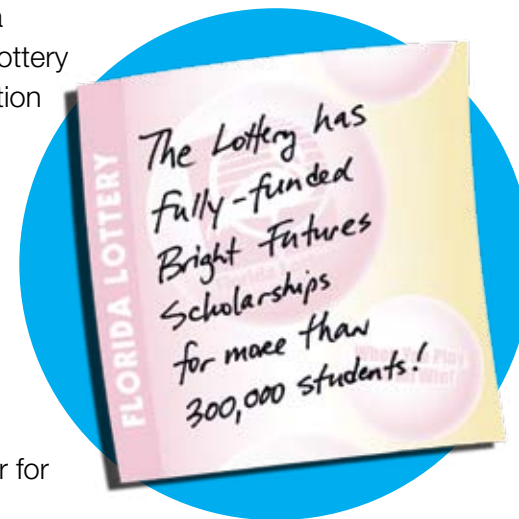
## EDUCATION CONTRIBUTIONS

**T** The Florida Lottery firmly believes that education is the key to success for Florida students. From the first day of pre-kindergarten to the last day of college, students' futures begin to take shape as they work to make their dreams come true; and the Florida Lottery is proud to help make these dreams a reality.

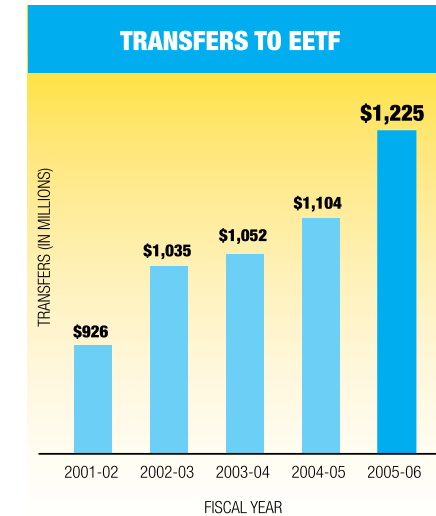
Every Lottery ticket sold contributes to endless opportunities for success for Florida students. As of June 30, 2006, Florida Lottery ticket sales generated more than \$16 billion to education since inception.

Though Lottery contributions make up approximately five percent of the state's total education budget, the Florida Lottery continues to make a difference in every facet of Florida's public education system. Lottery funds contribute to K-12 programs; bonds for school construction and maintenance; state universities and community colleges, including workforce education programs; the Bright Futures Scholarship Program; and other state student financial aid.

For fiscal year 2005-2006, the Florida Legislature appropriated \$1.14 billion\* to Florida's 67 school districts based on projected transfers to the Educational Enhancement Trust Fund (EETF) for that fiscal year. In actuality, the Florida Lottery transferred more than \$1.22 billion to the EETF, providing approximately \$86.45 million in Lottery funds that will carry over for appropriation in 2006-2007.



In 2005-2006, \$343.90 million were allocated to K-12 programs, \$311.77 million to 140,049 Bright Futures scholarships, \$18.13 million to other student financial aid, and \$212.90 million to the Classrooms First and Classrooms for Kids programs for school construction and renovation, and to help Florida school districts meet constitutional class-size reduction requirements. Florida's community colleges and state universities also benefited, receiving a combined total of \$251.50 million.



One of the Lottery's greatest accomplishments is fully-funding the Bright Futures Scholarship program. Since the program's inception in 1997, close to \$1.65 billion in scholarships have been awarded to more than 300,000 Florida students to attain a postsecondary education.

Additionally, Florida Lottery employees show their commitment to Florida students by mentoring through programs such as the Florida Mentoring partnership. In 2005-2006, 23 Lottery employees assisted public school students as mentors or tutors, providing the extra support these students needed. Florida Lottery employees have also contributed their time and effort in other activities, including assisting with spelling bees and speech contests.



\* Florida Lottery appropriations to education are based on the Revenue Estimating Conference's projections for the year. Lottery funds are appropriated by the Florida Legislature and administered by the Florida Department of Education.

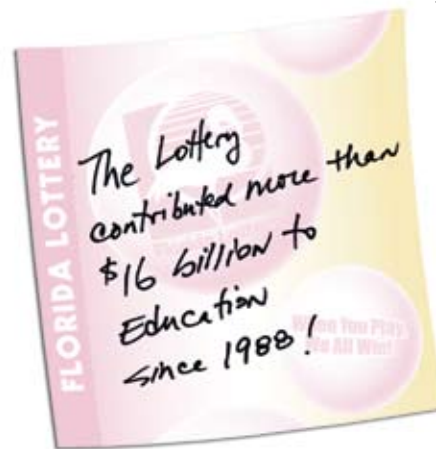
## WINNING TICKETS

**S**ince the Florida Lottery began selling tickets in 1988, each game offered has been designed with our players in mind. Throughout the years, the Florida Lottery has launched five core On-line games, more than 610 Scratch-Off games and 22 limited-time promotional games, offering a variety of games as diverse as Florida's player base.

The Lottery has not only made the dreams of Florida students a reality, but those of Lottery players as well. During fiscal year 2005-2006, Florida Lottery tickets made 48 lucky players new millionaires, allowing each winner to live his or her dream. Throughout the fiscal year, the Florida Lottery awarded more than \$2 billion in prizes.

The Florida Lottery also provided players the opportunity to win \$1 million in the special holiday promotion *Cash for the Holidays*. The drawing was held on New Year's Eve and the winning numbers were revealed at the New Year's Eve celebration at Miami's Bayfront Park. The promotion produced 11 winners, including one millionaire.

For the third consecutive year, the Florida Lottery surpassed the \$3 billion mark in net revenues. Lottery sales totaled \$3.93 billion, an increase of more than \$450 million from the previous year. Record-breaking sales led to \$1.22 billion in contributions to the Educational Enhancement Trust Fund.



### Fiscal Year 2005-06 Winners

| Lottery Game           | Number of Winners* | Amount Won*               |
|------------------------|--------------------|---------------------------|
| CASH 3                 | 1,076,263          | \$161,977,880.00          |
| Play4                  | 247,450            | \$103,548,084.00          |
| FANTASY 5              | 28,379,245         | \$134,842,925.18          |
| FANTASY 5 with ezmatch | 5,265,485          | \$17,691,743.00           |
| MEGA MONEY             | 7,770,888          | \$62,604,739.64           |
| FLORIDA LOTTO          | 9,584,952          | \$393,285,660.09          |
| SCRATCH OFFS           | 152,107,210        | \$1,540,936,067.00        |
| <b>Total</b>           | <b>204,431,493</b> | <b>\$2,414,887,098.91</b> |

\*Data taken from the GTech host gaming system as of June 30, 2006.



# A YEAR IN REVIEW

The Florida Legislature authorizes higher prize payouts for On-line games.



Sparkling Gold, one of the top-selling Scratch-Off tickets of the year, launches.



Cash for the Holidays launches, giving Florida Lottery players a chance to win up to \$1,000 on the spot and entry into a \$1 million drawing.



Lucky for Life, the second \$20 Scratch-Off game offered by the Florida Lottery, goes on sale.



The Florida Lottery introduces EZmatch, an instant play-through option that may be purchased with FANTASY 5 for an additional \$1.



More than 55,000 high school graduates become eligible to receive Bright Futures scholarships.



2005

2006

July August September October November December January February March April May June



The Florida Lottery launches the Jackpot family of Scratch-Off games, which includes a \$10 Mega Jackpot ticket, a \$5 Jumbo Jackpot ticket, a \$2 Super Jackpot ticket and a \$1 Jackpot ticket.



The Florida Lottery's "Education Babies" campaign kicks off with television and radio ads statewide.



The Florida Lottery hosts Cash Bash, featuring a New Year's Eve live drawing and the reveal of the Cash for the Holidays million dollar winner.



Florida Lottery ticket sales push total education contributions to more than \$16 billion.



Two lucky players split the highest FLORIDA LOTTO jackpot, \$82 million, since December 2002.



The Florida Lottery wins three "Lottery Product of the Year" awards, including one for the Jackpot family of instant games, from the Public Gaming Research Institute.

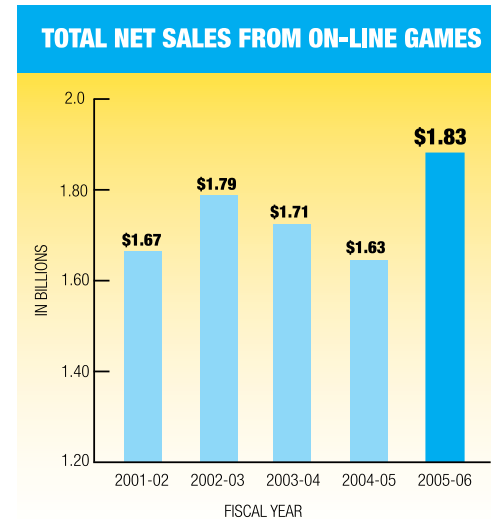
## ON-LINE GAMES

**F**iscal year 2005-2006 was a banner year for the Florida Lottery's On-line games. With five core On-line products and the launch of two promotional games, sales reached an all-time high of \$1.83 billion.

In April 2006, FLORIDA LOTTO™ offered players a chance to win \$82 million, the highest jackpot since December 2002. The \$82 million jackpot and numerous rollovers during the year had a positive effect on FLORIDA LOTTO sales, increasing 21 percent over the previous year. FLORIDA LOTTO sales for fiscal year 2005-2006 totaled \$835.23 million, generating approximately \$334.09 million for the EETF.

The growth in On-line ticket sales was sparked by legislation passed during the Spring 2005 Legislative Session, when Florida lawmakers granted the Florida Lottery the flexibility to vary the prize payout percentage for On-line games. The change ultimately provided the Lottery an opportunity to maximize sales in the On-line product category by offering larger prizes and better odds of winning.

The variable payout authority coupled with the new gaming system implemented in



January 2005, allowed the Lottery more flexibility in its game offerings. In December 2005, the Lottery offered players a chance to win \$1 million in the promotion *Cash for the Holidays*. In March 2006, the Lottery introduced EZmatch, a new game feature that was added to FANTASY 5® as the first variable prize payout game.

*Cash for the Holidays*, which went on sale from November 21 through December 30, 2005, was a special holiday promotion. Players who purchased a FLORIDA LOTTO, MEGA MONEY®, or FANTASY 5 ticket of \$5 or more had the opportunity to “play, listen and win.” When the terminal played a special holiday tune, players instantly won cash prizes ranging from \$25 to \$1,000, free FLORIDA LOTTO tickets or entry vouchers for the Million Dollar New Year’s Eve drawing, where more than \$2 million in prizes were awarded. A total of 900,000 players were entered into the New Year’s Eve drawing to win \$1 million. FLORIDA LOTTO, MEGA MONEY and FANTASY 5 sales increased a total of \$17.74 million (13 percent) during the promotion’s six-week period.

FANTASY 5 with EZmatch gave players the chance to win up to \$500 instantly. Prizes varied from \$2 to \$500, and players had the opportunity to win up to five times on one ticket. FANTASY 5 with EZmatch contributed \$27.52 million in sales, increasing FANTASY 5 sales by more than 24 percent for the remainder of the fiscal year.





## SCRATCH-OFF GAMES

Scratch-Off tickets played a major role in Florida Lottery sales during fiscal year 2005-2006, contributing \$2.10 billion in net sales – a first for Scratch-Off games.

Florida Lottery Scratch-Off games ranked fourth in total sales and seventh in growth among the 42 domestic lotteries. The Florida Lottery, as a whole, remained in the top 10 in growth among the domestic lotteries for a fourth consecutive year.

In 2005-2006, the Florida Lottery launched 53 new Scratch-Off games, including one \$20 game, Lucky for Life, and new additions to the Monopoly family of games. Price points varied with each new launch, making the games appealing to a diverse player base.

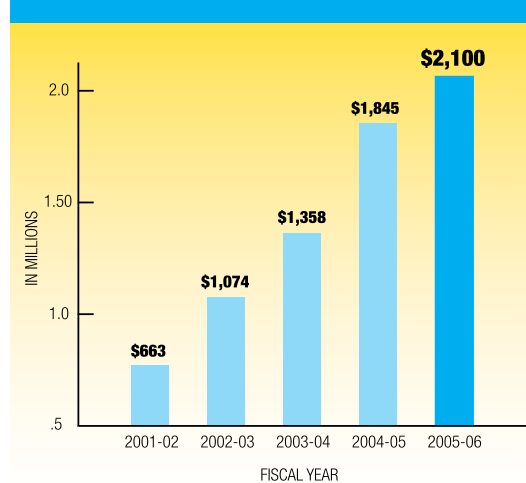
Lucky for Life, the second of the Lottery's \$20 games, offered players more than \$400 million in prizes, including the highest top prize ever offered on a Scratch-Off game - \$100,000 a year for life. The top prize, combined with the strategy

of launching the game during the peak selling period of the year, generated \$222.57 million in sales and accounted for more than 10 percent of total Scratch-Off sales.

The Monopoly family of games, which offered price points of \$10, \$5, \$2 and \$1, continued to be successful, generating \$238.21 million in sales. Monopoly has become a favorite for Florida Lottery players, with more than \$1 billion in sales since 1997.



TOTAL NET SALES FROM SCRATCH-OFF GAMES



Record \$2.10 Billion in Scratch-Off sales.



## ORGANIZATIONAL STRUCTURE

*As required by subsection 24.105(4), Florida Statutes, the following information reflects the organizational structure of the Florida Lottery on June 30, 2006.*

### OFFICE OF THE SECRETARY

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 that involve multiple Lottery units.

The **Deputy Secretary of Planning, Public Affairs and Agency Efficiency** assists the Secretary in the development and implementation of business strategies, and provides direction, oversight and evaluation of daily business functions related to Communications, Education Information, Security and Operations.

- **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** 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, and serves as a clearinghouse for Lottery records.
- **Education Information** promotes awareness and understanding of the state's use of Lottery moneys to provide enhancements to public education in Florida.

- **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. The Division of Security also manages the agency's Safety Awareness Program and the Lottery's Continuity of Operations Plan (COOP).
  - **Investigations and Operations** monitors the physical security of all Lottery facilities and investigates any security breaches. This unit also investigates problem claims and other allegations of potential illegal activity, and is responsible for managing the nightly draw process.
  - **Intelligence and Administrative Support** conducts background investigations on potential vendors, contractors, retailers and employees and provides analytical support for other criminal investigations. This unit provides maintenance and hardware support for the Integrated Security System and manages the division's Loss Prevention Program, which aids retailers in reducing ticket theft and informs the general public of lottery related scams and other fraudulent activity.
  - **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.

The **Chief of Operations** provides strategic and automated solutions to fulfill the Lottery's business needs, including excellence in customer service, optimizing the sale of Lottery tickets and ultimately enhancing contributions to education. Operations consists of the following units:

- **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.
- **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.
- **Systems and Operations Services** maintains a secure, power redundant data center environment, provides telecommunications systems and services, desktop computing and technology



infrastructure services for the Lottery. Systems and Operations Services also maintains the Lottery's Information Technology Disaster Recovery Plan.

- **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.

The **Deputy Secretary of Business Development, Research and Strategy** assists the Secretary in the development and implementation of business strategies, and provides direction, oversight and evaluation of daily business functions related to Research, Product Development and Business Development.

- **Research** 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 unit also provides valuable data used to determine products to be developed, revenue forecasting and overall program effectiveness.
- **Product Development** provides direction and oversight in the creation, design, development and management of both On-line and Scratch-Off Lottery products.
- **Business Development** 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, the unit's Retailer Contracting group ensures the integrity, reputation and financial responsibility of all Lottery retailers.

The **Inspector General** assists the Secretary with 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 and investigations.

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

The **Chief Administrative Officer** assists the Secretary with strategic leadership relative to employee relations, procurement, fleet and facilities issues. The Chief Administrative Officer oversees labor relations matters including administration of collective bargaining agreements, grievance handling and disciplinary actions.

- **Employee Relations and Development** administers a comprehensive human resources program including position classification, payroll, benefits, recruitment, selection, and attendance and leave.
- **General Services** is responsible for purchasing, contract administration, cooperative management, headquarters facility lease management and general operational support for the Lottery. This unit also acts as the liaison with the Department of Management Services and the Office of Supplier Diversity.
- **Support Services** provides operational support functions to Lottery offices throughout Florida, including vehicle fleet management, headquarters facility maintenance, central receiving operations, mail center operations and records management.
- **Purchasing** provides support in procurement activities including vendor selection, procurement method selection and specification development.

The **Chief Financial Officer** assists the Secretary with providing effective leadership for the Lottery to grow responsibly in a profitable and sustainable manner. The CFO is responsible for the development and monitoring of the department's budget, all financial reporting, disbursements and monitoring of cash flows.

- **Finance and Budget** is responsible for the financial operation 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 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, and disburses funds to retailers as appropriate. Player Disbursements processes the prize payments of tickets submitted to Lottery headquarters, and assists the district offices with the payment of tickets presented at those offices.

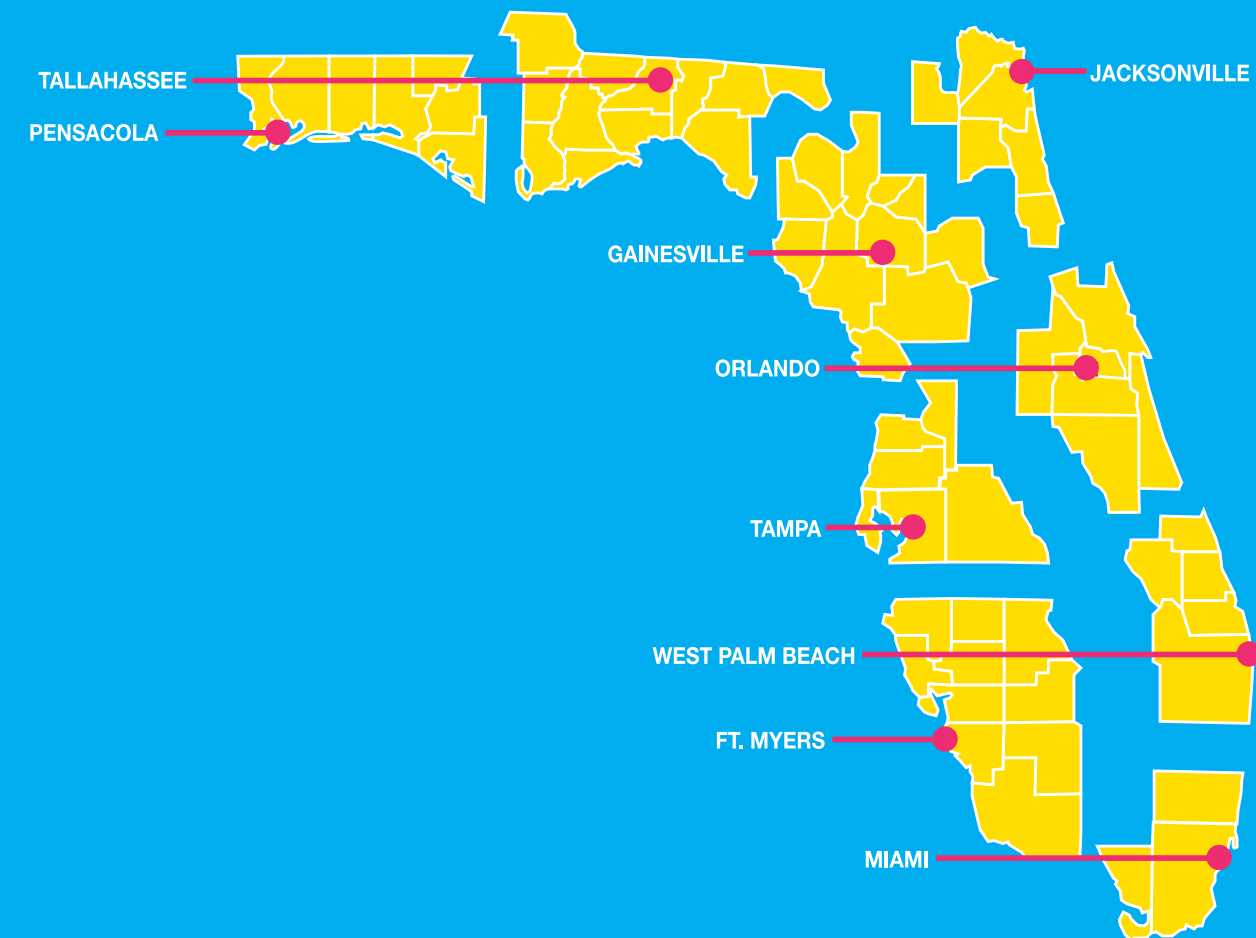
- **General Accounting** encompasses the Financial Reporting, Cash Management and Vendor Disbursements sections. Financial Reporting prepares financial statements and reports to convey the results of Lottery operations. Cash Management is responsible for coordinating all cash activities, ensuring all 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.

The **Chief Marketing Officer** assists the Secretary with all areas relating to the promotion and sale of Lottery products, including Strategic Alliance Marketing, Special Events and Promotions, Graphics, Advertising and Statewide Sales.

- **Strategic Alliance Marketing** drives the growth of the Lottery beyond its core business, and initiates and manages key business marketing promotional initiatives. Responsibilities also include identifying, evaluating, negotiating and implementing new strategic alliances and corporate sponsorships.
- **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.
- **Advertising** works directly with the advertising vendors to develop informative advertising campaigns for customers (consumers, retailers and the general public), introducing them to Lottery programs, products and messages.

- **Statewide Sales** consists of nine district sales offices, which manage the sale, promotion and redemption of Lottery products through a statewide network of close to 13,000 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.

#### District Offices





FINANCIAL STATEMENTS  
JUNE 30, 2006 AND 2005





# AUDITOR GENERAL STATE OF FLORIDA

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

## INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

We have audited the accompanying financial statements of the Department of the Lottery (the Lottery), an enterprise fund of the State of Florida, as of and for the years ended June 30, 2006, and 2005. 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, 2006, and 2005, 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, 2006, and 2005, 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 22, 2006, 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. 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 24 through 31, is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Respectfully submitted,

William O. Monroe, CPA  
December 22, 2006



STATE OF FLORIDA  
DEPARTMENT OF THE LOTTERY

MANAGEMENT'S DISCUSSION AND ANALYSIS

YEARS ENDED JUNE 30, 2006, AND JUNE 30, 2005

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, 2006, and 2005. 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 seventeen consecutive fiscal years and has transferred a minimum of \$800 million annually to the Educational Enhancement Trust Fund (EETF) during this same period, with the fiscal year 2006 transfer exceeding \$1 billion for the fourth consecutive year.

For the fiscal year ended June 30, 2006:

- Transfers to the EETF increased from approximately \$1,103,633,000 to approximately \$1,224,651,000, or 11.1%, over the prior fiscal year.
- Florida Lottery's ticket sales increased 13.2% over the prior fiscal year from approximately \$3,470,734,000 to \$3,929,030,000.
- Florida Lottery's total operating revenue increased by \$459,812,000 (or 13.23%), and shows minor growth in revenue sources other than ticket sales.
- Non-operating revenues, net of expenses, decreased \$118,597,000 million or approximately 872% in 2006 as compared to 2005. This change is mostly attributable to the change in fair value of the grand prize investments held by the Lottery for funding of future grand prize payments.
- The gaming vendors' fees and retailer commissions are based on sales and therefore fluctuate in direct correlation with sales revenue. Fiscal year 2006 expenses for these items increased over the prior year expenses by 11.24%.
- Administrative operating expenses, which includes salaries and benefits, rent, utilities and maintenance, professional fees, depreciation and other administrative expenses, increased slightly by 1.34%. Administrative operating expenses for fiscal years 2006 and 2005 were \$71.9 million and \$71.0 million respectively.

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 as do most business entities. This discussion and analysis is intended to serve as an introduction to the Lottery's basic financial statements, along with the notes to the financial statements. The Statement of Net Assets on page

32, the Statement of Revenues, Expenses and Changes in Net Assets on page 33, and the Statements of Cash Flows on page 34 report the Lottery's net assets and changes therein. 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, 2006, and the prior fiscal years ended June 30, 2005, and 2004, as derived from the Statement of Net Assets.

Table 1  
Condensed Statement of Net Assets  
As of June 30, 2006, 2005, and 2004  
(In Thousands)

|  | 2006             | 2005              | 2004              |
|--|------------------|-------------------|-------------------|
| <b>Assets</b>                                      |                  |                   |                   |
| Current Assets                                     | \$ 178,017       | \$ 262,160        | \$ 198,377        |
| Restricted Assets                                  | 2,879,757        | 3,383,529         | 3,543,204         |
| Capital Assets, Net of Depreciation                | 1,244            | 1,481             | 2,316             |
| <b>Total Assets</b>                                | <b>3,059,018</b> | <b>3,647,170</b>  | <b>3,743,897</b>  |
| <b>Liabilities</b>                                 |                  |                   |                   |
| Current Liabilities                                | 175,955          | 258,090           | 195,130           |
| Current Liabilities Payable from Restricted Assets | 1,665,130        | 1,949,327         | 1,980,899         |
| Noncurrent Liabilities                             | 1,118,217        | 1,234,236         | 1,364,182         |
| <b>Total Liabilities</b>                           | <b>2,959,302</b> | <b>3,441,653</b>  | <b>3,540,211</b>  |
| <b>Net Assets</b>                                  |                  |                   |                   |
| Net Investment in Capital Assets                   | 1,244            | 1,481             | 2,316             |
| Restricted Net Assets                              | 98,472           | 204,036           | 201,370           |
| <b>Total Net Assets</b>                            | <b>\$ 99,716</b> | <b>\$ 205,517</b> | <b>\$ 203,686</b> |

Current Year Impacts to the Statement of Net Assets

For the fiscal year ended June 30, 2006:

- Total assets decreased by \$ 588,152,000. This is mostly attributable to the decreases in size of the investment portfolio. The fair value of the individual investments decreased \$17,545,000. In addition the size of the total portfolio decreased due to a consistent pattern of jackpot 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 \$244,516,000 and purchases of only \$31,816,000 in new investments. As a result of the diminishing size of the investment portfolio, the value of the collateral from the lending of those securities was also less than the prior year. At June 30, 2006, the Lottery held \$1.4 billion in col-

lateral verses \$1.7 billion at June 30, 2005.

- Total liabilities decreased by \$482,351,000. This can be primarily attributed to a net decrease in obligation under security lending of \$ 241,930,000 and a decrease of \$114,671,000 in grand prize deferred payments to winners. In addition, there was a decrease in the year-end liability to EETF of \$69,304,000. This reduction was due to the transferring of more funds during the course of the year rather than making a large transfer at year-end.
- Net assets decreased by \$105,801,000 due to the decrease in both total liabilities and total assets as described above.

For the fiscal year ended June 30, 2005:

- Total assets decreased by \$96,727,000. This is mostly attributable to the decreases in 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 jackpot prizewinners that when they have the option of selecting either an annuity or cash have been selecting the cash option. This pattern resulted in a payout of annuities for the current fiscal year of \$244,124,000 and only purchased \$7,103,000 in new investments.
- Total liabilities decreased by \$98,558,000. This can primarily be attributed to net decreases in obligation 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 prize-winners netted against the financial statement elements.

**SUMMARY OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS**

The most important relationship demonstrated with the Lottery's financial statements is the transfer of 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 decrease in fair value of restricted investments.

Table 2 presents a condensed Summary of Revenues, Expenses and Changes in Net Assets for the current fiscal year ended June 30, 2006, and the prior fiscal years ended June 30, 2005, and June 30, 2004 as derived from the Lottery's Statement of Revenues, Expenses and Changes in Net Assets.

**Table 2**  
**Condensed Statement of Revenues, Expenses and Changes in Net Assets**  
**As of June 30, 2006, 2005 and 2004**  
**(In Thousands)**

|   | <u>2006</u>        | <u>2005</u>        | <u>2004</u>        |
|---|--------------------|--------------------|--------------------|
| Operating Revenues                                    |                    |                    |                    |
| Ticket Sales  | \$3,929,030        | \$3,470,734        | \$3,070,962        |
| On-Line Fees and Miscellaneous                        | 7,047              | 5,519              | 4,950              |
| Retailer Fees   | 244                | 256                | 196                |
| Total Operating Revenues                              | <u>3,936,321</u>   | <u>3,476,509</u>   | <u>3,076,108</u>   |
| Operating Expenses                                    |                    |                    |                    |
| Prizes  | 2,340,859          | 2,044,246          | 1,724,488          |
| Retailer Commissions                                  | 224,570            | 197,781            | 174,389            |
| Vendor Commissions                                    | 75,047             | 71,572             | 65,544             |
| Other Expenses  | 71,994             | 71,042             | 70,548             |
| Total Operating Expenses                              | <u>2,712,470</u>   | <u>2,384,641</u>   | <u>2,034,969</u>   |
| Income from Operations                                | <u>1,223,851</u>   | <u>1,091,868</u>   | <u>1,041,139</u>   |
| Nonoperating Revenue (Expense)                        |                    |                    |                    |
| Interest and Securities Lending Income, Net of Fees   | 10,597             | 10,964             | 10,307             |
| Net Appreciation in Fair Value of Investments         | (17,545)           | 110,029            | (33,038)           |
| Property Disposal Loss                                | (23)               | (45)               | (81)               |
| Amortization of Grand Prizes Payable                  | (98,030)           | (107,352)          | (116,046)          |
| Total Nonoperating Revenue (Expenses), Net            | <u>(105,001)</u>   | <u>13,596</u>      | <u>(138,858)</u>   |
| <b>Income Before Operating Transfers</b>              | <u>1,118,850</u>   | <u>1,105,464</u>   | <u>902,281</u>     |
| Transfers to Educational Enhancement Trust Fund       |                    |                    |                    |
| Transfers from Revenue                                | (1,182,763)        | (1,103,633)        | (1,051,658)        |
| Transfers from Unclaimed Prizes                       | (41,888)           | 0                  | 0                  |
| Total Transfers to Educational Enhancement Trust Fund | <u>(1,224,651)</u> | <u>(1,103,633)</u> | <u>(1,051,658)</u> |
| <b>Change in Net Assets</b>                           | <u>(105,801)</u>   | <u>1,831</u>       | <u>(149,377)</u>   |
| Net Assets, Beginning of Year                         | <u>205,517</u>     | <u>203,686</u>     | <u>353,063</u>     |
| Net Assets, End of Year                               | <u>\$ 99,716</u>   | <u>\$ 205,517</u>  | <u>\$ 203,686</u>  |

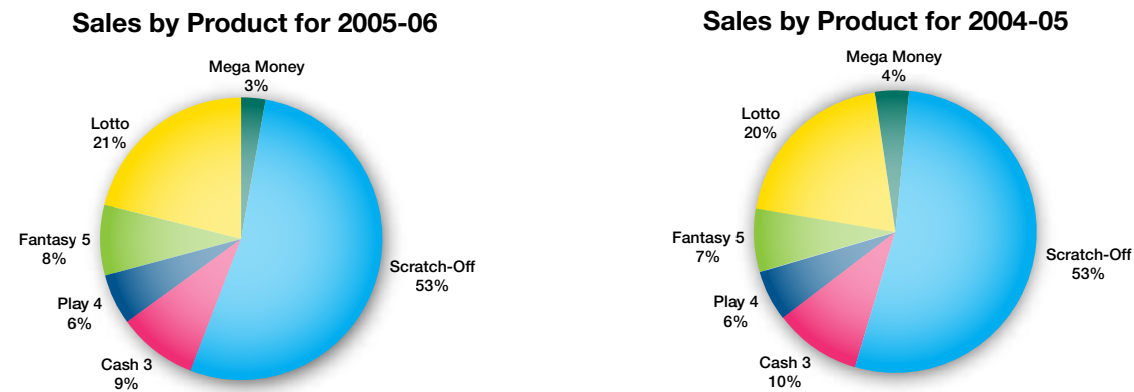


**Current Year Impacts/Analysis of the Statement of Revenues and Expenses and Changes in Net Assets**

**Revenue**

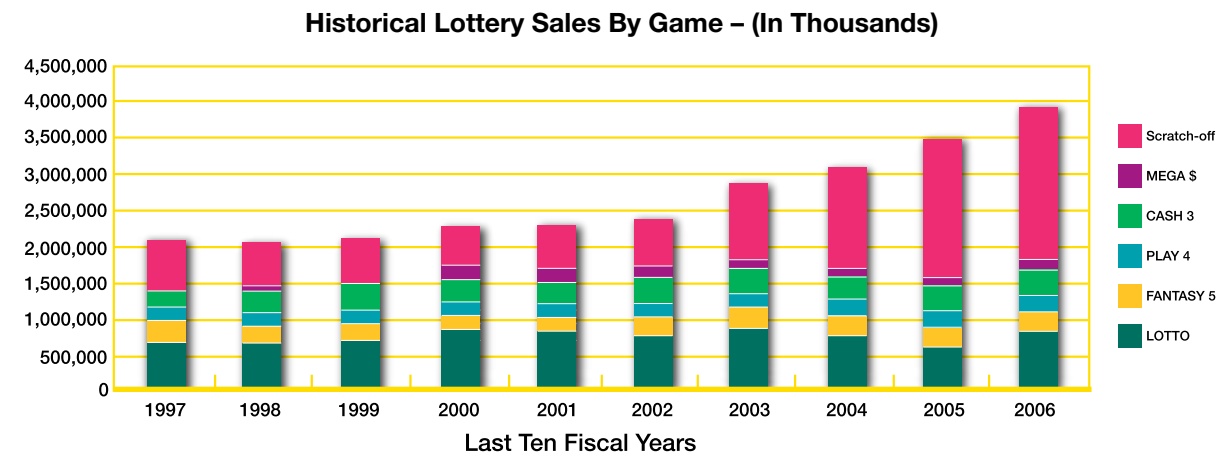
For the fiscal year ended June 30, 2006, ticket sales increased another \$458,296,000 due to growth in both the Scratch-Off and On-line markets. The \$3,929,030,000 sales figure represents the highest sales in the history of the Florida Lottery. Fiscal year 2005-06 is also the third year in which the Lottery reached the \$3 billion sales mark.

The following chart shows sales by product for the various Lottery games during the June 30, 2006, and 2005 fiscal years:



Sales of Scratch-Off tickets for the fiscal years ending June 30, 2006, and 2005 were \$2,100,118,000 and \$1,844,619,000, or 53% of combined sales in each of the two years. The increase in Scratch-Off sales is largely attributable to the introduction of a second \$20 price point Scratch-Off game introduced in January 2006, record sales of holiday-themed games and, more generally, 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)**

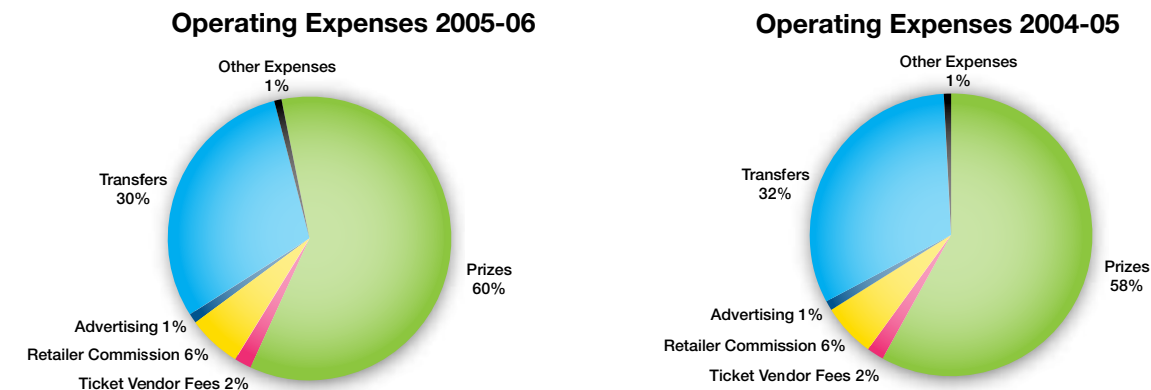
| Fiscal Year Ended June 30 | FLORIDA LOTTO™ | FANTASY 5® | PLAY 4™   | CASH 3™   | MEGA \$ MONEY™ | Scratch-Off Tickets | Combined Sales |
|---------------------------|----------------|------------|-----------|-----------|----------------|---------------------|----------------|
| 1997                      | \$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      |
| 2006                      | 835,028        | 306,679    | 215,529   | 343,174   | 128,502        | 2,100,118           | 3,929,030      |

Sales as a whole have been increasing due to the active management of various game structures, aggressive marketing of both product lines and implementation of variable prize payouts strategies.

**Expenses**

Section 24.121, Florida Statutes, stipulates that after the payment of prizes and transfers to EETF, the remaining funds are to be used for operating and administrative expenses. These expenses include retailer commissions, On-line game expenses, Scratch-Off ticket expenses, Advertising and other expenses required for the day-to-day operations of the Lottery.

The following chart shows the major components of Lottery operating expenses and transfers as a percentage of ticket sales for the June 30, 2006, and 2005 fiscal years:

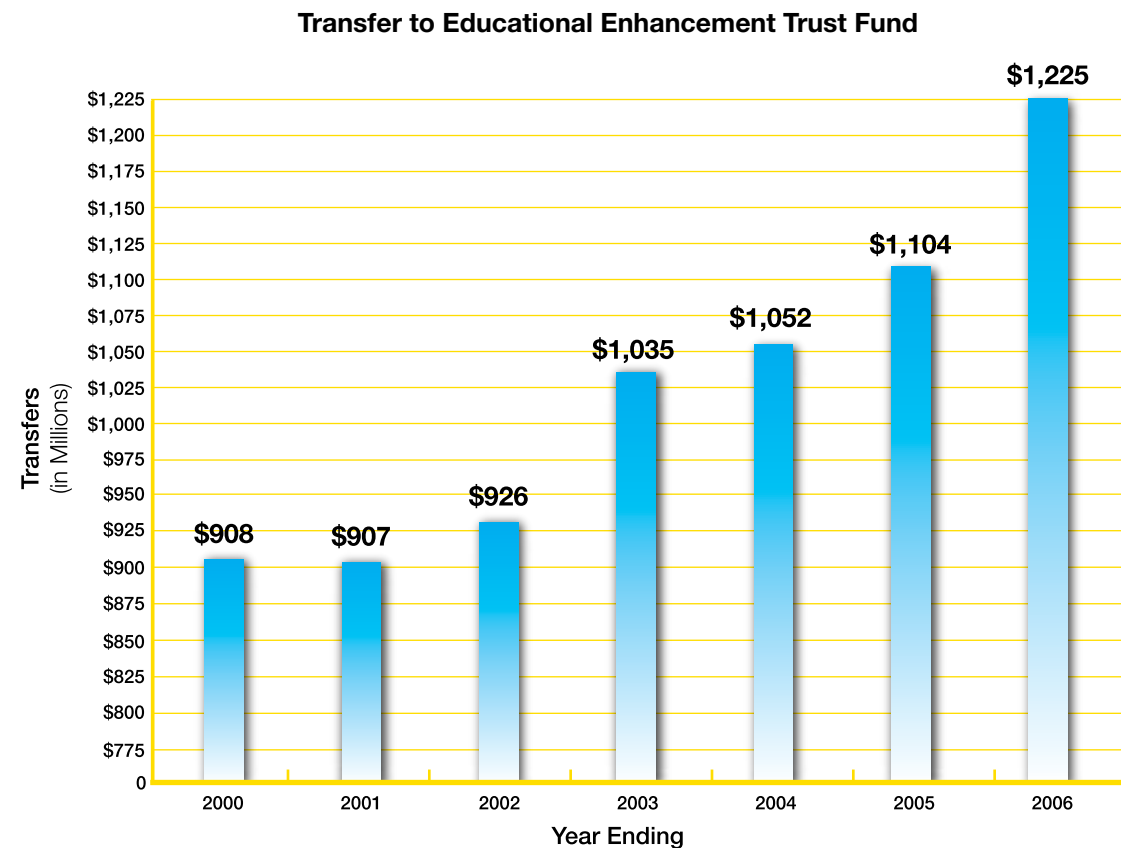


Prizes, commissions and vendor fees all directly relate to sales. As expected, as sales have increased so have these expenses. The other expenses which consist of advertising, salary and benefits, professional fees, rent, maintenance, bad debt, and depreciation have remained relatively stable.

**Transfers**

The Lottery's contribution to the EETF for the fiscal year ended June 30, 2006 (\$1,224,651,000) was the highest since the Florida Lottery began making transfers in 1988. Fiscal year 2005-06 is the fourth straight year in which the Lottery's contribution to EETF has been over \$1 billion. Total transfers to the EETF increased by \$121,018,000 from the prior fiscal year. When adjusted for inflation, the Lottery's transfer amount for fiscal year 2005-06, was 8% higher than the prior year adjusted-for-inflation transfer amount. However, overall the Lottery's transfer rates have increased slightly over the rate of inflation over the 19-year period.

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



**ECONOMIC FACTORS AND FUTURE IMPACTS**

The main economic factors affecting lottery sales are population growth, personal income growth, tourism, and competition for discretionary consumer spending. 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 discussed in the 2004 Strategic Plan:

- Increase the focus of research and product development for the On-line product segment:** This functional strategy will be accomplished through product extensions, redesign of existing On-line games, On-line promotions, etc.

Chapter 2005-84, Laws of Florida, authorized the Lottery to implement a variable prize payout for On-line games 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 217% in Scratch-Off ticket sales since fiscal year 2002, and an increase of \$197 million in the annual 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. During fiscal year 2005-06, the Department utilized one promotion and one product add-on feature to begin implementing the higher prize payout strategy for its On-line games. The holiday promotion resulted in a \$17.7 million sales increase and a net EETF contribution of \$4.7 million. EZmatch, the add on feature for Fantasy 5, increased FY 05-06 sales by 44.1 million which resulted in \$13 million in additional EETF transfers.

- 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 the negative impacts of hurricane related activities. 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 2004-2005, with a corresponding drop in the EETF of about \$12 million. The 2005 hurricane decreased sales by approximately \$22 million and decreased EETF transfers by \$7.5 million.

**FINANCIAL CONTACT**

The Florida Lottery's Financial Statements and this Management's Discussion and Analysis are designed to give a general overview to all interested parties. If you have any questions regarding this report or require additional information, please contact the State of Florida, Department of the Lottery, Chief Financial Officer, 250 Marriott Drive, Capitol Complex, Tallahassee, Florida 32399.

STATE OF FLORIDA  
DEPARTMENT OF THE LOTTERY

Statement of Net Assets

| As of June 30, 2006, and June 30, 2005<br>(In Thousands)                       |                  |                  |
|--|------------------|------------------|
| Assets   | June 30, 2006    | June 30, 2005    |
| Current Assets:  |                  |                  |
| Cash and cash equivalents  | \$146,578        | \$211,245        |
| Interest receivable  | 2,800            | 1,489            |
| Accounts receivable, net   | 24,650           | 46,179           |
| Inventories  | 1,437            | 1,006            |
| Security deposits  | 2,552            | 2,241            |
| <b>Total Current Assets</b>  | <u>178,017</u>   | <u>262,160</u>   |
| Restricted Assets:   |                  |                  |
| Investments with State Treasurer   | 11,187           | 0                |
| Securities lending income receivable   | 1,856            | 4,564            |
| Investments, grand prize   | 1,438,466        | 1,669,744        |
| Investments, other   | 1,428,248        | 1,709,221        |
| Total restricted assets  | <u>2,879,757</u> | <u>3,383,529</u> |
| Capital assets, net  | 1,244            | 1,481            |
| <b>Total Assets</b>  | <u>3,059,018</u> | <u>3,647,170</u> |
| <b>Liabilities</b>   |                  |                  |
| Current Liabilities:   |                  |                  |
| Accounts payable and accrued liabilities                                       | 10,690           | 11,766           |
| Prizes payable   | 67,903           | 80,057           |
| Due to Educational Enhancement Trust Fund                                      | 93,923           | 163,227          |
| Deposits payable   | 2,552            | 2,241            |
| Compensated absences payable   | 887              | 799              |
| <b>Total Current Liabilities</b>   | <u>175,955</u>   | <u>258,090</u>   |
| Current Liabilities Payable from Restricted Assets:                            |                  |                  |
| Pending purchases payable  | 1,181            | 42,188           |
| Securities lending fees payable  | 1,528            | 4,216            |
| Obligations under securities lending   | 1,425,162        | 1,667,092        |
| Grand prizes payable   | 237,259          | 235,831          |
| <b>Total Current Liabilities Payable from Restricted Assets</b>                | <u>1,665,130</u> | <u>1,949,327</u> |
| Noncurrent Liabilities:  |                  |                  |
| Grand prizes payable   | 1,115,234        | 1,231,333        |
| Compensated absences payable   | 2,983            | 2,903            |
| <b>Total Noncurrent Liabilities</b>  | <u>1,118,217</u> | <u>1,234,236</u> |
| <b>Total Liabilities</b>   | <u>2,959,302</u> | <u>3,441,653</u> |
| <b>Net Assets</b>  |                  |                  |
| Invested in capital assets   | 1,244            | 1,481            |
| Restricted net assets for undistributed appreciation on restricted investments | 88,462           | 204,036          |
| Restricted net assets for future prizes or special prize promotions            | 10,010           | 0                |
| <b>Total Net Assets</b>  | <u>\$99,716</u>  | <u>\$205,517</u> |

See accompanying notes to financial statements.

STATE OF FLORIDA  
DEPARTMENT OF THE LOTTERY

Statement of Revenues, Expenses and Changes in Net Assets

| As of June 30, 2006, and June 30, 2005<br>(In Thousands)     |                    |                    |
|--|--------------------|--------------------|
|  | June 30, 2006      | June 30, 2005      |
| Operating Revenues:  |                    |                    |
| Ticket sales   | \$3,929,030        | \$3,470,734        |
| On-line fees and miscellaneous                               | 7,047              | 5,519              |
| Retailer fee   | 244                | 256                |
| <b>Total Operating Revenues</b>                              | <u>3,936,321</u>   | <u>3,476,509</u>   |
| Operating Expenses:  |                    |                    |
| Prizes   | 2,340,859          | 2,044,246          |
| Retailer commissions   | 224,570            | 197,781            |
| Scratch-Off tickets  | 48,792             | 43,282             |
| On-line games  | 26,255             | 28,290             |
| Advertising  | 34,194             | 34,027             |
| Personal services  | 25,207             | 24,177             |
| Other contractual services                                   | 8,360              | 7,880              |
| Materials and supplies                                       | 3,409              | 3,660              |
| Bad debts  | 219                | 293                |
| Depreciation   | 605                | 1,005              |
| <b>Total Operating Expenses</b>                              | <u>2,712,470</u>   | <u>2,384,641</u>   |
| <b>Operating Income</b>                                      | <u>1,223,851</u>   | <u>1,091,868</u>   |
| Nonoperating Revenues (Expenses):                            |                    |                    |
| Interest   | 6,898              | 6,543              |
| Securities lending income                                    | 68,122             | 42,003             |
| Securities lending fees                                      | (64,335)           | (37,582)           |
| Investment management fees                                   | (88)               | 0                  |
| Net appreciation (depreciation) in fair value of investments | (17,545)           | 110,029            |
| Property disposition (loss)                                  | (23)               | (45)               |
| Amortization of grand prizes payable                         | (98,030)           | (107,352)          |
| <b>Total Nonoperating Revenues (Expenses), Net</b>           | <u>(105,001)</u>   | <u>13,596</u>      |
| <b>Income Before Operating Transfers</b>                     | <u>1,118,850</u>   | <u>1,105,464</u>   |
| Transfers to Educational Enhancement Trust Fund              |                    |                    |
| Transfers from revenue                                       | (1,182,763)        | (1,103,633)        |
| Transfers from unclaimed prizes                              | (41,888)           | 0                  |
| <b>Total Transfers to Educational Enhancement Trust Fund</b> | <u>(1,224,651)</u> | <u>(1,103,633)</u> |
| <b>Change in Net Assets</b>                                  | <u>(105,801)</u>   | <u>1,831</u>       |
| Net Assets, Beginning of Year                                | 205,517            | 203,686            |
| Net Assets, End of Year                                      | <u>\$99,716</u>    | <u>\$205,517</u>   |

See accompanying notes to financial statements.



STATE OF FLORIDA  
DEPARTMENT OF THE LOTTERY

Statement of Cash Flows

Years ended June 30, 2006, and June 30, 2005  
(In Thousands)

|   | June 30, 2006      | June 30, 2005      |
|---|--------------------|--------------------|
| Operating Activities:   |                    |                    |
| Ticket sales  | \$3,950,339        | \$3,466,215        |
| Prizes paid to winners  | (2,351,585)        | (2,024,299)        |
| Commissions paid and payments to retailers  | (224,570)          | (197,781)          |
| Paid to vendors for goods and services  | (122,517)          | (114,489)          |
| Paid to employees   | (25,039)           | (23,693)           |
| Other operating revenue   | 7,291              | 5,775              |
| <b>Net Cash Provided by Operating Activities</b>  | <u>1,233,919</u>   | <u>1,111,728</u>   |
| Noncapital Financing Activities:  |                    |                    |
| Payments to Educational Enhancement Trust Fund  | (1,293,955)        | (1,062,883)        |
| <b>Net Cash Used in Noncapital Financing Activities</b>                                       | <u>(1,293,955)</u> | <u>(1,062,883)</u> |
| Capital and Related Financing Activities:   |                    |                    |
| Purchase of capital assets  | (391)              | (218)              |
| <b>Net Cash used in Capital and Related Financing Activities</b>                              | <u>(391)</u>       | <u>(218)</u>       |
| Investing Activities:   |                    |                    |
| Cash received from maturity of grand prize investments  | 244,516            | 244,124            |
| Cash paid to grand prize winners upon maturity of grand prize investments                     | (244,516)          | (244,124)          |
| Investment income, net of fees  | 6,946              | 10,817             |
| <b>Net Cash Provided by Investing Activities</b>  | <u>6,946</u>       | <u>10,817</u>      |
| <b>Net Increase in Cash and Cash Equivalents</b>  | <u>(53,481)</u>    | <u>59,444</u>      |
| Cash and Cash Equivalents, Beginning of Year  | 211,245            | 151,801            |
| Cash and Cash Equivalents, End of Year  | <u>\$157,764</u>   | <u>\$211,245</u>   |
| Reconciliation of Income from Operations to Net Cash Provided by Operating Activities:        |                    |                    |
| Income from operations  | \$1,223,851        | \$1,091,868        |
| Adjustments to reconcile income from operations to net cash provided by operating activities: |                    |                    |
| Depreciation  | 605                | 1,005              |
| Changes in assets and liabilities   |                    |                    |
| (Increase) decrease in:   |                    |                    |
| Accounts receivable   | 21,528             | (4,227)            |
| Inventories   | (431)              | (13)               |
| Increase (decrease) in:   |                    |                    |
| Accounts payable and accrued liabilities  | (1,075)            | 2,738              |
| Prizes payable  | (10,726)           | 19,948             |
| Compensated absences payable  | 167                | 409                |
| <b>Net Cash Provided by Operating Activities</b>  | <u>\$1,233,919</u> | <u>\$1,111,728</u> |
| Noncash Investing, Capital and Financing Activities:  |                    |                    |
| Increase/(decrease) in fair value of investments  | (\$157,508)        | (\$22,008)         |

See accompanying notes to financial statements.

STATE OF FLORIDA  
DEPARTMENT OF THE LOTTERY

Notes to Financial Statements

Years ended June 30, 2006, and June 30, 2005

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 moneys for education and also enables the people of the State to play the best lottery games available."

In evaluating the Lottery as a reporting entity, management has addressed all potential component units for which the Lottery may be financially accountable and, as such, be includable in the Lottery's financial statements. The Lottery is financially accountable if it appoints a voting majority of the organization's governing board and (1) it is able to impose its will on the organization or (2) there is a potential for the organization to provide specific financial benefit to or impose specific financial burden on the Lottery. Additionally, the primary government is required to consider other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete. Management's analysis has disclosed no component units that should be included in the Lottery's financial statements.

b. Basis of Presentation

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

c. Basis of Accounting

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

The measurement focus of proprietary fund types is on a flow of economic resource method, which emphasizes the determination of net income, financial position, and cash flows. All fund assets and liabilities, current and noncurrent, are accounted for on the Statement of Net Assets. Under Governmental Accounting Standards Board (GASB) Statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting, proprietary funds have the option to elect to apply all pronouncements of the Financial Accounting Standards Board (FASB) issued after November 30, 1989. The Lottery has elected not to apply Financial

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

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

**d. Cash and Cash Equivalents**

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

**e. Investments**

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

**f. Allowance for Doubtful Accounts**

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

**g. Inventories**

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

**h. Capital Assets**

Capital assets are stated at cost less accumulated depreciation. As required by Chapter 273, Florida Statutes, a capitalization threshold of \$1,000 and useful life extending beyond one year is employed. Depreciation on capital assets is computed using the straight-line method over the following estimated useful lives:

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

When capital assets are retired or otherwise disposed of, the costs and related accumulated depreciation are removed from the accounts and any resulting gain or loss is reflected in the Statement of Revenues, Expenses and Changes in Net Assets, in the period of disposal.

**i. Net Assets**

Net Assets includes categories for net investments in capital assets, restricted net assets for undistributed appreciation on restricted investments, and restricted net assets for future prizes or special prize promotions.

The net investments in capital assets category represents the investment in capital assets, recorded at cost less accumulated depreciation.

The restricted net assets for undistributed appreciation on restricted investments category represents the undistributed appreciation for all restricted asset accounts.

The restricted net assets for future prizes or special prize promotions category represent the portion of unclaimed prize obligations legally reverted back to the Lottery for the payment of future prize pools or special prize promotions in accordance with Section 24.115(2), Florida Statutes.

**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 variable percentages of the gross revenue from the sale of On-line and Scratch-Off Lottery tickets shall be returned to the public in the form of prizes paid by the Lottery or retailers as authorized. Prior to July 1, 2006, the Act authorized, as nearly as practicable, at least 50% 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, as revenue is recognized. Any prize that remains unclaimed 60 days after a Scratch-Off games is closed is considered unclaimed.

As of July 1, 2005, eighty percent of all unclaimed prize money is deposited in the Educational Enhancement Trust Fund (EETF). The remaining twenty percent of unclaimed prize money is added to the pool from which future prizes are to be awarded or used for special prize promotions and is reported as Restricted net assets for future prizes or special prize promotions.

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

**m. Compensated Absences**

Employees earn the right to be compensated during absences for vacation, illness, and unused special compensatory leave earned for hours worked on legal holidays. Compensated absences for annual leave are recorded as a liability when the benefits are earned. Compensated absences for sick

leave are calculated based on the vesting method. Within the limits established by law or rule, unused leave benefits are paid to employees upon separation from State service. The cost of vacation and calculated sick leave benefits is accrued in the period in which earned. The compensated absences amounts are based on current year-end salary rates and include employer social security and pension contributions at current rates.

**n. Self-Insurance**

The Lottery participates in the various self-insurance programs established by the State of Florida for property and casualty losses and employee health insurance. Coverages include property, general liability, automobile liability, workers' compensation, court-awarded attorney fees, and federal civil rights actions. Property is self-insured for actual cash value to an aggregate of \$2 million per loss event. Property losses in excess of \$2 million are commercially insured up to \$100 million per loss event. Workers' compensation is provided to comply with the applicable law. The employee health insurance program provides for payment of medical claims of employees and covered dependents.

**o. Use of Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, and expenses and disclosures of contingent assets and liabilities. Actual results could differ from those estimates.

**2. CASH AND INVESTMENTS**

**a. Cash and Cash Equivalents**

Cash is held in demand deposits at various financial institutions. These deposits, with a book value of approximately \$386,000 at June 30, 2006, and \$300,000 at June 30, 2005, were insured by either the State's collateral for public deposits in accordance with Section 280.04, Florida Statutes, or Federal depository insurance.

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

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

Due to the investing policy of the Lottery, book overdrafts were approximately \$2,184,000 at June 30, 2006, and \$1,763,000 at June 30, 2005, 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. The Lottery's share of this investment pool was approximately \$157,140,000 and \$210,046,000 at June 30, 2006, and 2005, 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.

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 statement 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 \$1,425,162,000 of cash collateral for the lending program as of June 30, 2006, and \$1,667,092,000 as of June 30, 2005. At June 30, 2006, 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, 2006, and 2005, consisted of (in thousands):

|                                       | 2006            | 2005            |
|---------------------------------------|-----------------|-----------------|
| Securities lending income             | \$68,122        | \$42,003        |
| Less broker rebates                   | (63,390)        | (36,478)        |
| Less bank fees                        | (945)           | (1,104)         |
| <b>Net securities lending revenue</b> | <b>\$ 3,787</b> | <b>\$ 4,421</b> |

**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, 2006:

| Time to Maturity       | Fair Value             |
|------------------------|------------------------|
| < 1 year               | \$ 240,537,000         |
| > 1 year to 3 years    | 420,009,000            |
| > 3 years to 5 years   | 307,626,000            |
| > 5 years to 10 years  | 370,183,000            |
| > 10 years to 15 years | 51,147,000             |
| > 15 years to 20 years | 31,640,000             |
| > 20 years             | 17,324,000             |
| <b>Total</b>           | <b>\$1,438,466,000</b> |

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

- 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, 2006 was 27 days.

- 2) The effective duration of the Treasury Investment Pool is 2.72 years at June 30, 2006.

**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, 2006, 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.

**h. Foreign Currency Risk**

The Lottery has no exposure to foreign currency risk as of June 30, 2006.

**i. Investment Summary**

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

|   | Carrying Value      |
|---|---------------------|
| U.S. Government Obligations   | \$ 40,596           |
| Investments Held by Others Under Security Lending Agreements - U.S. Obligations | 1,397,870           |
| Pooled Investments with State Treasury  | 157,140             |
| Money Market and Mutual Funds   | 1,428,248           |
| <b>Total Investments</b>  | <b>\$ 3,023,854</b> |

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

|                                      | Investments         | Cash at Financial Institutions | Cast at State Treasury | Total               |
|--------------------------------------|---------------------|--------------------------------|------------------------|---------------------|
| Cash and cash equivalents            | \$ 145,953          | \$ 386                         | \$ 239                 | \$ 146,578          |
| Restricted cash and cash equivalents | 11,187              |                                |                        | 11,187              |
| Investments, grand prize             | 1,438,466           |                                |                        | 1,438,466           |
| Investments, other                   | 1,428,248           |                                |                        | 1,428,248           |
| <b>Total</b>                         | <b>\$ 3,023,854</b> | <b>\$ 386</b>                  | <b>\$ 239</b>          | <b>\$ 3,024,479</b> |

**3. ACCOUNTS RECEIVABLE**

The Ticket sales receivable balance for fiscal year 2004-05 included an estimated amount totaling \$28,245,301 for unrecorded Scratch-Off ticket sales prior to fiscal year-end. The practice of including an estimated receivable amount for unrecorded Scratch-Off ticket sales was discontinued beginning with fiscal year 2005-06.

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

|                                      | 2006             | 2005             |
|--------------------------------------|------------------|------------------|
| Ticket sales receivable              | \$26,361         | \$47,295         |
| Other receivables                    | 18               | 394              |
| Total receivables                    | 26,379           | 47,689           |
| Less allowance for doubtful accounts | (1,729)          | (1,510)          |
| Accounts receivable, net             | <u>\$ 24,650</u> | <u>\$ 46,179</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 security deposits, and in liabilities, as deposits payable.

**5. CAPITAL ASSETS**

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

|                                | 2004-05                  |                |               | 2005-06                  |                |               | Balance<br>June 30, 2006 |
|--------------------------------|--------------------------|----------------|---------------|--------------------------|----------------|---------------|--------------------------|
|                                | Balance<br>June 30, 2004 | Increase       | Decrease      | Balance<br>June 30, 2005 | Increase       | Decrease      |                          |
| Data processing equipment      | \$8,690                  | \$80           | \$(243)       | \$8,527                  | \$102          | \$(97)        | \$8,532                  |
| Office equipment and fixtures  | 6,617                    | 14             | (35)          | 6,596                    | 42             | (75)          | 6,563                    |
| Vehicles and other equipment   | 3,322                    | 134            | (299)         | 3,157                    | 247            | (107)         | 3,297                    |
|                                | 18,629                   | 228            | (577)         | 18,280                   | 391            | (279)         | 18,392                   |
| Less: accumulated depreciation | 16,313                   | 1,005          | (519)         | 16,799                   | 605            | (256)         | 17,148                   |
| Total capital assets, net      | <u>\$2,316</u>           | <u>\$(777)</u> | <u>\$(58)</u> | <u>\$1,481</u>           | <u>\$(214)</u> | <u>\$(23)</u> | <u>\$1,244</u>           |

**6. LONG-TERM LIABILITIES**

**a. Grand Prizes Payable**

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

|  | 2006               | 2005               |
|--|--------------------|--------------------|
| Lotto grand prizes (face value)                      | \$1,813,250        | \$2,011,120        |
| Mega Money grand prizes (face value)                 | 3,963              | 247                |
| Win for Life grand prizes (face value)               | 14,114             | 14,478             |
| Big 10 grand prizes (face value)                     | 100                | 190                |
| Flamingo Fortune Game Show grand prizes (face value) | 1,200              | 1,300              |
| Monthly Grand game prizes (face value)               | 84                 | -                  |
| Win a Million grand prizes (face value)              | 600                | 650                |
| Yearly Dividend grand prizes (face value)            | -                  | 24                 |
| Yearly Bonus grand prizes (face value)               | 350                | 400                |
| Lucky for Life grand prizes (face value)             | 6,400              | -                  |
| Set for Life grand prize (face value)                | 3,180              | 2,160              |
| Cash Spectacular grand prize (face value)            | 850                | 900                |
| Less imputed interest                                | (491,598)          | (564,305)          |
| Net present value of grand prizes payable            | <u>\$1,352,493</u> | <u>\$1,467,164</u> |
| Current Prizes Payable from restricted assets        | \$237,259          | \$235,831          |
| Noncurrent Prizes Payable                            | 1,115,234          | 1,231,333          |
| Total Grand Prizes Payable                           | <u>\$1,352,493</u> | <u>\$1,467,164</u> |

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

| Year Ended                                | Amount             |
|---|--------------------|
| June 30                                   |                    |
| 2007                                      | \$ 246,500         |
| 2008                                      | 245,063            |
| 2009                                      | 218,471            |
| 2010                                      | 198,728            |
| 2011                                      | 175,468            |
| 2012-2016                                 | 526,823            |
| 2017-2021                                 | 95,051             |
| 2022-2026                                 | 72,583             |
| 2027-2031                                 | 65,404             |
| Grand prizes (face value)                 | 1,844,091          |
| Less imputed interest                     | (491,598)          |
| Net present value of grand prizes payable | <u>\$1,352,493</u> |

**b. Compensated Absences Payable**

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

|                                  | 2006            | 2005            |
|----------------------------------|-----------------|-----------------|
| Current Compensated Absences     | \$ 887          | \$ 799          |
| Non Current Compensated Absences | 2,983           | 2,903           |
| Total                            | <u>\$ 3,870</u> | <u>\$ 3,702</u> |

**c. Changes in Long-Term Liabilities**

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

|                              | Balance<br>July 1, 2005 | Additions        | Reductions         | Balance<br>June 30, 2006 | Amount<br>due within<br>one year |
|------------------------------|-------------------------|------------------|--------------------|--------------------------|----------------------------------|
| Grand prizes payable         | \$1,467,164             | \$129,845        | (\$244,516)        | \$1,352,493              | \$237,259                        |
| Compensated absences payable | 3,702                   | 466              | (298)              | 3,870                    | 887                              |
| Total long-term liabilities  | <u>\$1,470,866</u>      | <u>\$130,311</u> | <u>(\$244,814)</u> | <u>\$1,356,363</u>       | <u>\$238,146</u>                 |

**7. DUE TO EDUCATIONAL ENHANCEMENT TRUST FUND**

In accordance with the Act, effective July 1, 2005, variable percentages of the gross revenue from the sale of On-line and Scratch-Off lottery tickets as determined by the Lottery, and other earned revenue, excluding application processing fees, shall be deposited in the Educational Enhancement Trust Fund (EETF) as provided in Section 24.121, Florida Statutes, as amended. Previously, the Act required at least 39 percent of On-line and miscellaneous revenue, net of retailer fees, be transferred to the EETF for the benefit of public education. Effective July 1, 2002, the Department was authorized, pursuant to Section 24.121(1), Florida Statutes, to increase the percentage of Scratch-Off game revenues returned as prizes and transfer a variable percentage to the EETF. The Lottery implemented this strategy in September 2002. The amount transferred for the fiscal year ended June 30, 2006, was \$1,244,651,000, (31.2% percent of revenues) and for the fiscal year ended June 30, 2005, the transferred amount was \$1,103,633,000 (31.7 percent of revenues).

Because the net appreciation in fair value of investments and amortization of grand prizes payable, included in non-operating revenue and expenses, relate to valuations of the restricted grand prize investments and grand prizes payable, they are excluded from the determination of transfers to the EETF.

The amount due to EETF at June 30, 2005, was as follows (in thousands):

|  | <b>June 30, 2005</b> |
|--|----------------------|
| Operating revenues less Scratch-Off ticket sales         | \$ 1,631,890         |
| Nonoperating revenue, net                                | 13,596               |
| Less: Retailer fees                                      | (256)                |
| Net appreciation in fair value of investments            | (110,029)            |
| Amortization of grand prizes payable                     | 107,352              |
| Net revenue less Scratch-Off ticket sales                | <u>1,642,553</u>     |
| Total revenue subject to transfer at 39%                 | 1,642,553            |
|  | 39%                  |
| Statutorily required transfer                            | <u>640,614</u>       |
| Scratch-Off ticket sales                                 | 1,844,619            |
| Transfer percentage for Scratch-Off ticket sales         | 21.031%              |
| Direct transfer from Scratch-Off ticket sales            | <u>387,944</u>       |
| Additional transfer appropriated                         | 60,000               |
| Supplemental balance transferred                         | <u>15,075</u>        |
| Due for the year   | <u>\$ 1,103,633</u>  |
| Balance due beginning of the year                        | 122,477              |
| Paid during the year                                     | <u>(1,062,883)</u>   |
| Due to Educational Enhancement Trust Fund, June 30, 2005 | <u>\$ 163,227</u>    |

Effective July 1, 2005, the Act revised the provisions relating to the allocation of revenues for public education. The changes in the provisions were designed to maximize the transfers of moneys to the EETF. These revisions resulted in changes in the methodology used to calculate the transfer based on a business model of revenue minus expenses rather than a percent of revenue.

The amount due to EETF at June 30, 2006, was as follows (in thousands):

|  | <b>June 30, 2006</b> |
|--|----------------------|
| On-line ticket sales                                     | \$ 1,828,912         |
| Average percent transferred                              | 39%                  |
| Transfer of On-line ticket sales                         | <u>716,541</u>       |
| Unclaimed On-line ticket prizes                          | 41,963               |
| Percent transferred                                      | 80%                  |
| Transfer of unclaimed On-line ticket prizes              | <u>33,570</u>        |
| Scratch-Off ticket sales                                 | 2,100,118            |
| Average percent transferred                              | 21%                  |
| Transfer of Scratch-Off ticket sales                     | <u>448,601</u>       |
| Unclaimed Scratch-Off ticket prizes                      | 10,397               |
| Percent transferred                                      | 80%                  |
| Transfer of Scratch-Off ticket prizes                    | <u>8,318</u>         |
| Nonoperating expenses, net                               | (105,001)            |
| Add:   |                      |
| Net depreciation in fair value of investments            | 17,545               |
| Amortization of grand prizes payable                     | 98,030               |
| Total Nonoperating revenue, net                          | <u>10,574</u>        |
| On-line fees and miscellaneous revenue                   | <u>7,047</u>         |
| Due for the year   | <u>\$ 1,224,651</u>  |
| Balance due, beginning of year                           | 163,227              |
| Paid during the year                                     | <u>(1,293,955)</u>   |
| Due to Educational Enhancement Trust Fund, June 30, 2006 | <u>\$ 93,923</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<br>June 30, 2006 | Fiscal Year Ended<br>June 30, 2005 |
|-------------------|------------------------------------|------------------------------------|
| Senior Management | 10.45 percent                      | 9.37 percent                       |
| Regular Employees | 7.83 percent                       | 7.39 percent                       |
| Special Risk      | 18.53 percent                      | 18.53 percent                      |

The Lottery's contributions to the FRS amounted to approximately \$1,283,000 and \$1,166,000 for the years ended June 30, 2006, and 2005, respectively. These contributions represented 7.4 percent and 7.14 percent of covered payroll, for the years ended June 30, 2006, and 2005, respectively. The Lottery contributed 100 percent of the required contributions for the years ended June 30, 2006, and 2005.

**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 2005 through June 2006. 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, 2006, and 2005, totaled \$144,947 and \$89,947, 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, 2006, and 2005, 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, 2006, are scheduled as follows (in thousands):

| Year Ending<br>June 30 | Headquarters    | Districts       | Total           |
|------------------------|-----------------|-----------------|-----------------|
| 2007                   | \$ 2,491        | \$ 796          | \$ 3,287        |
| 2008                   | 2,516           | 471             | 2,987           |
| 2009                   | 2,615           | 260             | 2,875           |
| 2010                   | 210             | 217             | 427             |
| 2011                   | 0               | 106             | 106             |
|                        | <u>\$ 7,832</u> | <u>\$ 1,850</u> | <u>\$ 9,682</u> |

Rental expense under all operating leases totaled approximately \$3,274,000 and \$3,214,000 for the years ended June 30, 2006, and 2005, 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 contractor's compensation for On-line games for the fiscal years ended June 30, 2006, and 2005, was \$26,255,000, and \$28,290,000, 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 \$48,792,000 for the fiscal year ended June 30, 2006, and \$43,282,000 for the fiscal year ended June 30, 2005.

#### **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.





