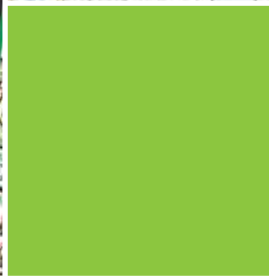
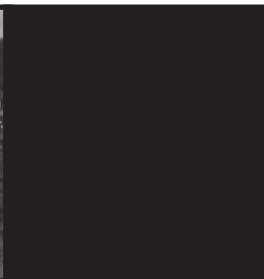


Florida Lottery  
**2006-2007 Annual Report**



# 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.



# Executive Summary

It's been almost 20 years since Florida voters approved a constitutional amendment authorizing the creation of a state lottery. Since then, Florida Lottery games have generated more than \$18 billion for public education statewide.

But the Lottery's benefit to Florida does not end with the education revenue it provides.

The Florida Lottery has had a multibillion-dollar impact on Florida's overall economy. This impact is evident not only in increased profits returned to the state's education system each year as a direct result of the Lottery's revenue-generating success, but also in the added revenue the Lottery's 13,000 retailers enjoy through commissions, bonuses and increased sales, and in the billions of dollars awarded to players from all across the state.

From inception through fiscal year 2006-07, close to \$48 billion in Lottery tickets were sold, and players won more than \$25 billion in prizes. What's more, retailers statewide netted in excess of \$2.68 billion in commissions and cashing bonuses.

When you look at the big picture, the Lottery is a win-win for the state. Florida's public education, residents, visitors, businesses and lottery winners all are beneficiaries of the Lottery's success.



## Lottery Games and Promotions

Once again the Florida Lottery has delivered on its promise to provide players with what they want most – more prizes and bigger payouts. In fiscal year 2006-07, the Lottery introduced three limited-time promotional games and 49 new Scratch-Off games that, combined with lottery promotions and core games such as FLORIDA LOTTO™, MEGA MONEY™, FANTASY 5®, PLAY 4™ and CASH 3™, paid out more than \$828 million to more than 48 million winners statewide.

Summer 2006 offered players the Race for Cash promotion, which had Lottery fans racing to purchase \$5 or more in FLORIDA LOTTO, MEGA MONEY and FANTASY 5 tickets. With a variety of cash prizes and the chance to win an Ultimate Race-of-a-Lifetime Experience prize pack to a NASCAR Nextel Cup Series race, this promotion was a delight for race fans throughout the state.

In November, the Florida Lottery launched *Holiday* MILLIONAIRE RAFFLE™, an old-fashioned raffle game that produced the largest number of millionaires in one night in Florida Lottery history. The game truly lived up to its tagline, “So Much Money, So Little Time” by selling out 1.25 million tickets in just 11 days! On New Year’s Day, 10 lucky players won \$1 million, while 20 players won \$100,000 and 100 players won \$10,000.

Another limited-time promotional game, CARS & CASH™, launched in March 2007 offering players six weekly drawings for a chance to win a choice of three Ford vehicles or \$250,000. A total of 42 Ford vehicles and six prizes of \$250,000 were awarded. A first for the Florida Lottery, the Ford Escape Hybrid was offered as one of the vehicle prizes. More than 111,000 instant-win prizes of \$50 were awarded through this game.

Fiscal year 2006-07 proved to be another record-breaking year for Scratch-Off games with an annual growth of \$2.3 billion in sales. Kicking off the year was the GOLD family of Scratch-Off games, which offered players four levels of play: \$1 LUCKY GOLD, \$2 SUPER GOLD, \$5 JUMBO GOLD and \$10 MEGA GOLD. These games were followed in September by DEAL OR NO DEAL, which coincided with the season premier of the television game show.

With colorful new holographic and foil designs, holiday-themed Scratch-Off tickets once again served as great gifts and stocking stuffers for family and friends. A total of seven games were offered with prizes ranging from \$1,000 to \$150,000.

## A Year in Review 2006-2007

July	August	September	October	November	December
Race for Cash offers players NEXTEL Cup Series Race weekends and one Ultimate Race-of-a-Lifetime prize package.	GOLD Family of Scratch-Off games launches: \$1 LUCKY GOLD, \$2 SUPER GOLD, \$5 JUMBO GOLD and \$10 MEGA GOLD.	DEAL OR NO DEAL Scratch-Off game launch coincides with the season premier of the “Deal or No Deal” TV game show.	Seven holiday holographic and foil Scratch-Off tickets go on sale.	First-ever <i>Holiday</i> MILLIONAIRE RAFFLE game sells out all 1.25 million tickets in just 11 days.	CASH 3 produces a triplet number win: 7-7-7, resulting in 18,542 winners sharing more than \$4.55 million.

Completing the family of successful MONOPOLY Scratch-Off games, the \$20 MILLION DOLLAR MONOPOLY game went on sale in late January, and featured top prizes of \$1 million. Last, but not least, the Florida Lottery launched the \$100,000 HOLD 'EM POKER Scratch-Off game, which featured more than \$25 million in prizes, including a top prize of \$100,000 plus World Poker Tour merchandise prize packs.

## Education

Over the past four years, the Florida Lottery has experienced tremendous success resulting in increased contributions to education. Fiscal year 2006-07 was no different, producing record-breaking sales revenue and contributions to Florida's public education system. For the first time since its inception, the Lottery's annual net sales exceeded \$4 billion, resulting in more than \$1.26 billion for the Educational Enhancement Trust Fund (EETF).

Though Florida Lottery contributions make up approximately five percent of the state's total education budget, the Lottery continues to make a difference in every facet of Florida's public education system. In 2006-2007, \$330.90 million was allocated to K-12 programs statewide, \$345.15 million was allocated to Bright Futures scholarships, \$21.45 million was allocated to other student financial aid, and \$268.20 million was allocated to the Classrooms for Kids Program for school construction and renovation. Florida's community colleges and state universities received a combined total of \$472.18 million from the EETF.\*

Perhaps one of the Florida Lottery's greatest accomplishments is fully-funding the Bright Futures Scholarship Program. Since the program's inception in 1997, nearly \$2 billion in scholarships has been awarded to more than 350,000 Florida students to attain a postsecondary education.

A quality public education can and should be readily available to every Florida student. To date, the Florida Lottery has brought our state \$18 billion closer to achieving that goal.

\* 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.

January	February	March	April	May	June
\$20 MILLION DOLLAR MONOPOLY game goes on sale.	FANTASY 5 with EZmatch's limited-time increase on instant prizes produces 836,968 winners collecting \$2,861.	CARS & CASH promotional game offers six \$250,000 cash prizes and 42 Ford vehicles.	The \$100,000 HOLD 'EM POKER Scratch-Off game is a success, selling more than \$19 million in tickets.	<i>Firecracker</i> MILLIONAIRE RAFFLE™ offers 12 prizes of \$1 million.	Governor Crist signs S. B. 1376, granting the Florida Lottery authority to apply for and hold patents for games, play styles, methods and systems.

## 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, 2007.

**The Office of the Secretary** directs the operations of the Florida Lottery, and is responsible for the effective management of the Lottery in accordance with directives identified in statute and corresponding rules, regulations, policies and procedures.

**The Office of 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 the Governor's legislative objectives by the legislature.
- **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 department'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 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 section provides maintenance and hardware support for the Integrated Security System and manages the agency'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 Deputy Secretary** assists the Secretary in the development and implementation of business strategies, and provides direction, oversight and evaluation of daily business functions related to Research, Product Development and Business Development – with the primary focus of managing programs aimed at increasing Lottery sales and transfers to the Educational Enhancement Trust Fund.

- **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** works to expand the channels or venues through which Lottery products are sold and seeks new ways to generate sales and income from Lottery products and programs. This office also oversees the retailer contracting and renewal process.
- **Retailer Contracting** evaluates and approves retailer applications and enters into contracts with retailers that will best serve the public interest and provide adequate and convenient availability of Lottery tickets. The unit directly supports the Lottery's efforts in the recruitment and retention of retailers. Through its application and contract renewal process, this unit ensures the integrity, reputation and financial responsibility of all Lottery retailers.
- **ADA Office** ensures that all policies and directives relating to the Americans with Disabilities Act (ADA), as they pertain to Lottery retailers, are implemented and upheld. Through geographically located coordinators, this unit ensures compliance with the ADA for all Lottery retail locations.

**The Office of Public Affairs** assists the Secretary in the development and implementation of public relations strategies, and provides direction, oversight and evaluation of daily business functions related to Communications, Customer Service, and Education Information. Public Affairs 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:

- **Communications** coordinates all Lottery activities with the news media, including spokesperson interviews, public records requests, news conferences and press releases. Communications also oversees the Lottery's Web site in both English and Spanish, and produces official Lottery publications.
- **Customer Service** serves as the Lottery's direct liaison to players, responding to inquiries regarding games and various other facets of 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.

**The Office of the Chief Information Officer** provides strategic and automated solutions to fulfill the Lottery's business needs through the efficient and effective development and deployment of the Lottery's information technology resources, 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. This unit 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 online gaming system and setting the games to pay winners. Games Administration serves as the system coordinator and liaison to all Lottery retailers.

**The Office of the Inspector General** assists the Secretary with internal control systems necessary to ensure the fiscal accountability and integrity of the Lottery. The division is responsible for performing financial, compliance and performance audits of the Lottery, and preparing audit reports of said findings and investigations.

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

**The Office of Administration** assists the Secretary with strategic leadership relative to employee relations, procurement, contract administration and management, and general support services. The division oversees labor relations matters including collective bargaining agreements, the handling of grievances and disciplinary actions.

- **Employee Relations** administers comprehensive employer services in the following program areas: Compensation and Payroll, Benefits (retirement), Attendance and Leave (sick leave transfer program, Family Medical Leave Act), employee records, worker's compensation, unemployment compensation, service awards, dual/secondary employment and some collective bargaining issues.
- **Employee Development** administers comprehensive employer services in the following program areas: recruitment and selection, policy coordination, classification (e.g., organization restructure, class studies, position descriptions, salary analysis), professional development, performance excellence and management report generation.
- **General Services** manages and administers the contract management process as well as provides resources in the monitoring of contract deliverables. Provides direction to ensure the minority business community participates in the Lottery's procurement and contracting processes.
- **Purchasing Office** provides strategic resources in the acquisition of commodities and contractual services necessary in the operation of the Florida Lottery. Additional responsibilities include administering general and routine activities that result in the issuance of purchase orders and execution of contracts.
- **Support Services** provides the day-to-day operational services including facilities management, fleet management, property/inventory control, warehousing operations, records management and mail operations. The unit oversees janitorial and other contracted services.

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

- The **Budget** unit prepares the annual legislative budget request and any necessary budget amendments for the Lottery, monitors expenditures to ensure budgetary compliance, and coordinates the development of the Lottery's long-range plan.
- **Claims Processing** processes the prize payments of tickets submitted to Lottery headquarters and assists the district offices with the payment of tickets presented at those offices.
- **Vendor Disbursements** is responsible for making payments to vendors supplying goods and services to the Lottery.
- **General Accounting** administers and oversees the accounting data systems, and coordinates duties of the Financial Reporting and Accounts Receivable and Cash Management units.
  - The **Financial Reporting** unit prepares financial statements and reports the results of Lottery operations. This unit also oversees the reconciliation of all accounting data systems.
  - The **Accounts Receivable and Cash Management** unit is responsible for coordinating all cash activities. This includes collecting funds from retailers, tracking delinquencies, coordinating financial reviews, covering required disbursements, coordinating all banking activities and managing all investments.

**The Office of Marketing** assists the Secretary with all areas relating to the promotion and sale of Lottery products, including Strategic Alliance Marketing, special events and promotions, graphics, and advertising. The division 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.

- **Strategic Alliance Marketing** drives the growth of the Lottery beyond its core business, and initiates and manages key promotional business and marketing 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 and contributions to education 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 scheduling.
- **Graphics** provides overall art design and direction for the Lottery, including quality control for Scratch-Off ticket design, publications, promotional items and graphic presentations.

**The Office of Statewide and Corporate Sales** assists the Secretary by increasing Lottery sales statewide through the implementation of a strong sales and marketing plan. The division plans effective sales strategies and training in advance of all new product launches, in addition to overseeing the activities and disseminating policies and procedures to the nine statewide district offices.

- **Corporate Sales** is responsible for the growth and development of the Lottery's corporate business. The unit serves as a liaison between the Lottery and main corporate offices of retailers statewide.
- **The nine District Offices** 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.



DAVID W. MARTIN, CPA  
AUDITOR GENERAL

# 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, 2007, and 2006. 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, 2007, and 2006, 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, 2007, and 2006, 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 January 25, 2008, 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 3 through 12, 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,

A handwritten signature in cursive script, reading "David W. Martin". The signature is written in dark ink and is positioned above the typed name and date.

David W. Martin, CPA  
January 25, 2008

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**STATE OF FLORIDA  
DEPARTMENT OF THE LOTTERY**

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**MANAGEMENT'S DISCUSSION AND ANALYSIS**

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**YEARS ENDED JUNE 30, 2007, AND JUNE 30, 2006**

As management of the Florida Lottery, we offer readers of the Florida Lottery's financial statements this overview and analysis of the Lottery's financial results and position for the fiscal years ended June 30, 2007, and 2006. We encourage readers to consider the information presented here in conjunction with the financial statements and notes to the financial statements, which begin on page 13.

**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 ticket sales in excess of \$2 billion for eighteen 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 2007 transfer exceeding \$1 billion for the fifth consecutive year.

For the fiscal year ended June 30, 2007:

- Transfers to the EETF increased from approximately \$1.22 billion to approximately \$1.26 billion or 3.2%, over the prior fiscal year.
- Florida Lottery's ticket sales increased 4.9% over the prior fiscal year from approximately \$3.9 billion to \$4.1 billion.
- Prize expense increased \$143.7 million (6.1%) during fiscal year 2007. The Lottery has the authority to vary the prize expense in order to maximize transfers. This expense typically increases or decreases in direct proportion to ticket sales and represented approximately 60.3% of net ticket sales.
- The gaming vendors' fees and retailer commissions are based on sales and therefore fluctuate in direct correlation with sales revenue. Fiscal year 2007 expenses for these items increased over the prior year expenses by 4.3%.
- Administrative operating expenses, which includes advertising, salaries and benefits, rent, utilities and maintenance, professional fees, depreciation and other administrative expenses, increased slightly by 1.70%. Administrative operating expenses for fiscal years 2007 and 2006 were \$73.2 million and \$71.9 million, respectively. However, when expressed as a percentage of sales the expenses actually decreased from 1.83% of sales in fiscal year 2006 to 1.78% of sales in fiscal year 2007.

**OVERVIEW OF THE FINANCIAL STATEMENTS**

The Lottery is accounted for as an enterprise fund, reporting transactions using the accrual basis of accounting similar to a business entity. 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 13, the Statement of Revenues, Expenses and Changes in Net Assets on page 14, and the Statement of Cash Flows on page 15 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. The restricted assets consist of the twenty percent for unclaimed prizes designated for future prizes and 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, 2007, and the prior fiscal years ended June 30, 2006, and 2005, as derived from the Statement of Net Assets.

**Table 1**  
**Condensed Statement of Net Assets**  
**As of June 30, 2007, 2006, and 2005**  
**(In Thousands)**

	<u>2007</u>	<u>2006</u>	<u>2005</u>
<b>Assets</b>			
Current Assets	\$ 223,108	\$ 178,017	\$ 262,160
Restricted Assets	2,553,972	2,879,757	3,383,529
Capital Assets, Net of Depreciation	1,908	1,244	1,481
<b>Total Assets</b>	<u>2,778,988</u>	<u>3,059,018</u>	<u>3,647,170</u>
<b>Liabilities</b>			
Current Liabilities	218,842	175,955	258,090
Current Liabilities Payable from Restricted Assets	1,488,254	1,665,130	1,949,327
Noncurrent Liabilities	979,115	1,118,217	1,234,236
<b>Total Liabilities</b>	<u>2,686,211</u>	<u>2,959,302</u>	<u>3,441,653</u>
<b>Net Assets</b>			
Net Investment in Capital Assets	1,908	1,244	1,481
Restricted Net Assets	90,869	98,472	204,036
<b>Total Net Assets</b>	<u>\$ 92,777</u>	<u>\$ 99,716</u>	<u>\$ 205,517</u>

**Assets**

Total assets at the end of fiscal year 2007 decreased by \$280 million from \$3.1 billion at June 30, 2006, to \$2.8 billion at June 30, 2007. At the end of fiscal year 2006, total assets were \$588.1 million less than the \$3.6 billion at the end of fiscal year 2005.

Current assets increased from \$178 million in 2006 to \$223.1 million in 2007, representing an increase of \$45.1 million. This increase is primarily due to an increase of \$36.5 million in cash and cash equivalents and a \$10.1 million increase in retailer accounts receivable due to the timing of billing and collections from our retailers at year-end cutoff. In fiscal year 2006, current assets had decreased \$84.1 million from \$262.1 million at June 30, 2005. That decrease was primarily due to the decrease of \$64.6 million in cash and cash equivalents and a \$21.5 million decrease in retailer accounts receivable due to discontinuing the estimation of a receivable for unrecorded Scratch-Off ticket sales.

Restricted assets decreased \$325.7 million from \$2.8 billion in 2006 to \$2.5 billion in 2007. This decrease is mostly attributable to the decreases in size of the investment portfolio. The net appreciation in fair value of the grand prize investments increased \$76.5 million. However, the size of the total portfolio continues to decrease 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 \$246.5 million and purchases of only \$19.5 million in new investments. In fiscal year 2006, payouts of annuities were \$244.5 million and purchases of new investments consisted of \$31.8 million. 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 years. At June 30, 2007, the Lottery held \$1.2 billion in collateral versus \$1.4 billion at June 30, 2006, and \$1.7 billion at June 30, 2005.

### **Liabilities**

Total liabilities at June 30, 2007, were \$2.6 billion, which is \$273 million lower than the total liabilities of \$2.9 billion at June 30, 2006. The total liabilities at June 30, 2006, were \$482.3 million lower than the June 30, 2005, amount of \$3.4 billion.

Current liabilities increased from \$175.9 million on June 30, 2006, to \$218.8 million on June 30, 2007. The increase of \$42.8 million is divided between an increase in the year-end payable to EETF of \$23.5 million and the increased prizes payable of \$17.6 million. The increase to EETF resulted from higher sales in the fourth quarter of 2007 versus 2006 while the increase in the prizes payable account represents the higher liability for various games at the end of fiscal year 2007 versus 2006. The June 30, 2006, current liabilities of \$175.9 million were lower than the June 30, 2005, amounts of \$258 million. The primary reason for the \$82.1 million reduction was the change in transfers to EETF. The formula used for calculating the monthly transfers to EETF was changed at the beginning of fiscal year 2005-2006 resulting in a \$69.3 million reduction in the year-end liability.

Current liabilities from restricted assets decreased \$176.8 million from \$1.6 billion at June 30, 2006, to \$1.4 billion at June 30, 2007. This can be primarily attributed to a net decrease in obligations under security lending of \$177.2 million. The June 30, 2006, balance of \$1.6 billion was \$284.1 million less than the June 30, 2005, balance of \$1.9 billion. Again, this decrease can be primarily attributed to a net decrease in obligations under security lending of \$241.9 million.

Noncurrent liabilities principally consist of grand prizes payable, which represent the amount to be paid to grand prizewinners over future years. Grand prizes payable experienced a decrease of \$139 million from year-end 2006 to 2007 and a decrease of \$116 million from year-end 2005 to 2006.

### **Net Assets and Changes in Net Assets**

Net assets decreased by \$6.9 million from June 30, 2006, to June 30, 2007. Net assets at June 30, 2007, 2006, and 2005 were \$92.7 million, \$99.7 million, and \$205.5 million, respectively. The fiscal year 2007 decrease is primarily due to the decrease in both total liabilities and total assets as described above. The fiscal year 2006 decrease of \$105.8 million was primarily due to the decrease in the total liability owed to grand prizewinners 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 changes 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, 2007, and the prior fiscal years ended June 30, 2006, and June 30, 2005, as derived from the Lottery's Statement of Revenues, Expenses and Changes in Net Assets.

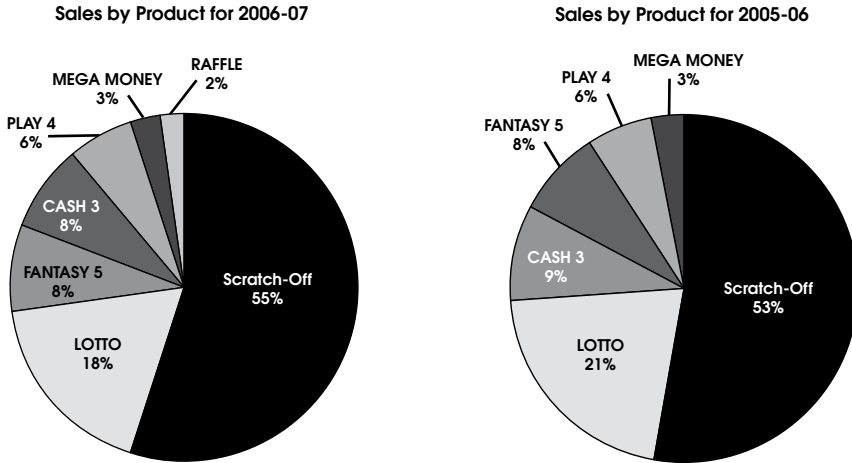
**Table 2**  
**Condensed Statement of Revenues, Expenses and Changes in Net Assets**  
**As of June 30, 2007, 2006, and 2005**  
**(In Thousands)**

	2007	2006	2005
Operating Revenues			
Ticket Sales	\$4,122,116	\$3,929,030	\$3,470,734
On-Line & Retailer Fees and Miscellaneous	7,438	7,291	5,775
Total Operating Revenues	4,129,554	3,936,321	3,476,509
Operating Expenses			
Prizes	2,484,519	2,340,859	2,044,246
Retailer Commissions	234,292	224,570	197,781
Vendor Commissions	78,089	75,047	71,572
Other Expenses	73,219	71,994	71,042
Total Operating Income	2,870,119	2,712,470	2,384,641
Income from Operations	1,259,435	1,223,851	1,091,868
Nonoperating Revenue, net of expenses	(3,102)	(105,001)	13,596
<b>Income Before Operating Transfers</b>	1,256,333	1,118,850	1,105,464
Transfers to EETF from Revenue	(1,224,524)	(1,182,763)	(1,103,633)
Transfers to EETF from Unclaimed Prizes	(38,748)	(41,888)	0
Total Transfers to EETF	(1,263,272)	(1,224,651)	(1,103,633)
<b>Change in Net Assets</b>	(6,939)	(105,801)	1,831
Net Assets, Beginning of Year	99,716	205,517	203,686
Net Assets, End of Year	\$ 92,777	\$ 99,716	\$ 205,517

**Sales**

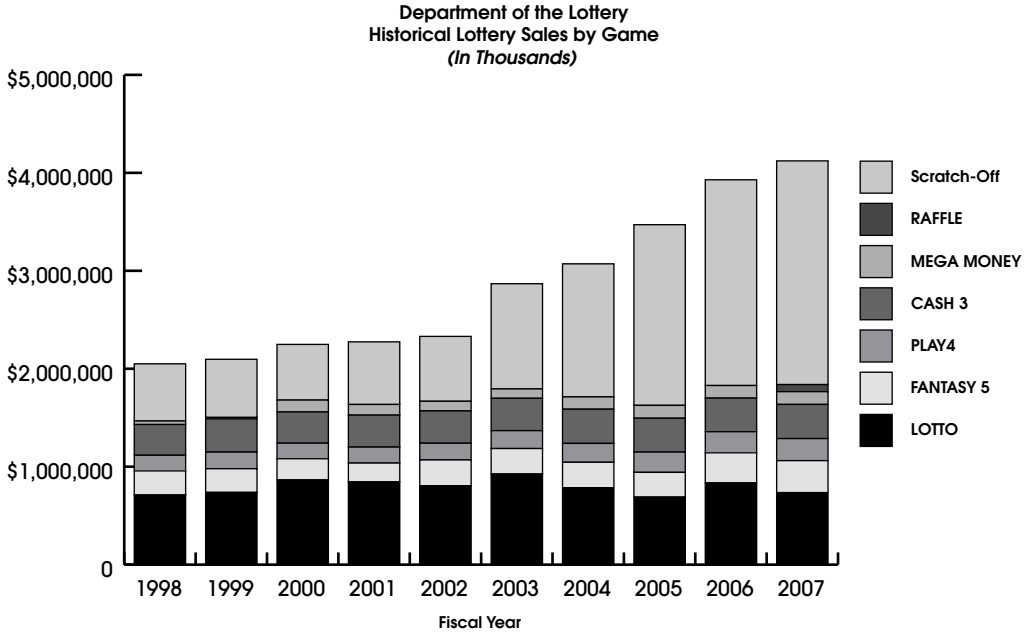
For the fiscal year ended June 30, 2007, ticket sales increased another \$193 million due most to growth in the Scratch-Off market and slight increases in the On-line market. The \$4.1 billion sales figure represents the highest sales in the history of the Florida Lottery. Fiscal year 2006-07 is the first year in which the Lottery reached the \$4 billion sales threshold. Fiscal year 2005-2006 was also a record breaking year with sales of \$3.9 billion, both Scratch-Off and On-line experienced double digit growth resulting in an increase of \$458 million in net sales.

The following chart shows sales by product for the various Lottery games during the June 30, 2007, and 2006 fiscal years:



Sales of Scratch-Off tickets for the fiscal years ending June 30, 2007, and 2006, were \$2.3 billion or 55% and \$2.1 billion or 53% of combined sales in each of the two years. The increase in Scratch-Off sales is largely attributable to the introduction of the second and third \$20 price-point Scratch-Off game introduced in January 2006 and again in January 2007, record sales of holiday-themed games, utilization of central-themed games across price points 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™	MILLIONAIRE RAFFLE™	Scratch-Off Tickets	Combined Sales
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
2007	735,585	326,241	225,285	348,694	130,142	\$72,549	2,283,620	4,122,116

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

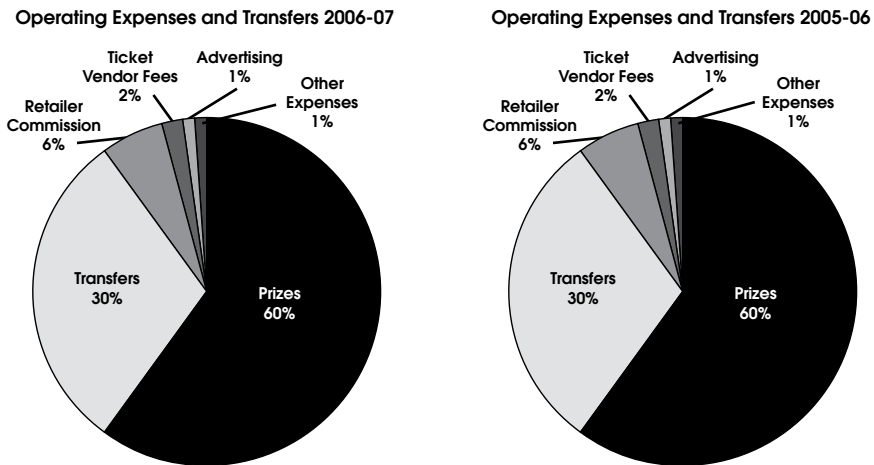
On-line sales during fiscal year 2006 grew by \$202.7 million to \$1.8 billion. Fiscal year 2005 On-line sales were \$1.6 billion. A special promotion that utilized new options available from the new gaming system, coupons and vouchers, was successfully executed during the 2005 holiday season. The Cash for the Holidays promotion increased On-line sales by \$17.7 million. EZ Match™, a new game feature that adds an instant win possibility to an On-line ticket, was added to Fantasy 5 in March 2006. These two elements plus the extra sales generated from four LOTTO rollover jackpots where the final jackpot exceeded \$40 million are the reason for double-digit growth (12.4%) in fiscal year 2006.

The first quarter of fiscal year 2007 started off with another special promotion that ended with a drawing held on Labor Day 2006. The 2006 holiday season launched the Lottery's latest game "Millionaire Raffle." The first raffle generated \$25 million in sales and sold out in only 11 days. The Millionaire Raffle was used again in the early spring when the Lottery partnered with Ford Motor Company and gave away cars and generated \$18.1 million in sales. Sales for the third raffle kicked off on May 18th and ended with a drawing on July 4, 2007. The On-line sales for fiscal year 2007 benefited from \$29.3 million in sales from the Firecracker Millionaire Raffle. Fiscal year 2007 contained only two LOTTO rollover jackpots over \$40 million. The low number of high-dollar jackpots offset some of the gains made by the promotions and games but the year still resulted in a net gain of \$9.5 million for On-line sales.

**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, 2007, and 2006 fiscal years:



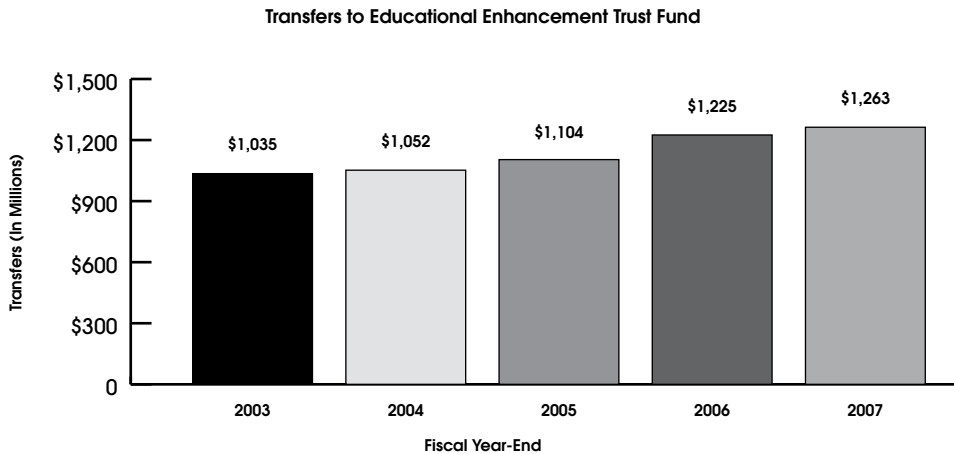
Prizes, commissions and vendor fees all directly relate to sales. As expected, as sales have increased so have these expenses. In fiscal year 2007, prizes, commissions and vendor fees increased to \$2.8 billion from \$2.6 billion in fiscal year 2006. The other expenses, which consist of advertising, salary and benefits, professional fees, rent, maintenance, bad debt, and depreciation, have remained relatively stable. Fiscal year 2007 and 2006 administrative expenses were \$73.2 million and \$71.9 million, respectively.

**Transfers**

The Lottery's contribution to the EETF for the fiscal year ended June 30, 2007, \$1.26 billion, was the highest since the Florida Lottery began making transfers in 1988. Fiscal year 2007 is the fifth straight year in which the Lottery's contribution to EETF has been over \$1 billion. Total transfers to the EETF increased by \$38.6 million from the prior fiscal year. When adjusted for inflation, the Lottery's transfer amount for fiscal year 2007 was slightly lower than the prior year adjusted-for-inflation transfer amount. However, overall the Lottery's transfer rates have increased slightly over the rate of inflation during the 20-year period.



The following chart shows the total transfers to the EETF for the past five 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 currently being explored by management:

- 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 24.121, Florida Statutes, authorizes the Lottery to utilize variable prize payout for both On-line games and Scratch-Off games. It has been the experience of the Lottery and other lotteries that a program that increases the prize payout percentages of Scratch-Off games leads to higher sales and greater net profits. Since 2002, this strategy has resulted in an increase of 244% in Scratch-Off ticket sales, and an increase of \$236 million in the annual transfer to the EETF from sales of Scratch-Off tickets during the same period. The Lottery began utilizing higher prize payouts for On-line games in fiscal year 2005 but did not expect the same rate of return for the On-line games but has experienced a positive return from applying the variable prize payout strategy. During fiscal year 2006-07, the Lottery utilized the higher payout authority to support the EZ Match add-on product and the three raffle games. The raffle games alone resulted in \$72.5 million in sales and a net EETF contribution of \$28 million.

- 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. As of the end of fiscal year 2007, the retailer base had grown to approximately 13,000 retailers. The Department has set internal goals for continuing to grow the number of retailers over the next two and a half years by 7.6%.

## 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, 2007, and June 30, 2006  
(In Thousands)**

<b>Assets</b>	June 30, 2007	June 30, 2006
<b>Current Assets</b>		
Cash and cash equivalents	\$183,031	\$146,578
Interest receivable	1,312	2,800
Accounts receivable, net	34,700	24,650
Inventories	967	1,437
Security deposits	3,098	2,552
<b>Total Current Assets</b>	<b>223,108</b>	<b>178,017</b>
<b>Restricted Assets:</b>		
Cash and cash equivalents	18,429	11,187
Securities lending income receivable	3,343	1,856
Investments, grand prize	1,287,954	1,438,466
Investments, other	1,244,246	1,428,248
<b>Total Restricted Assets</b>	<b>2,553,972</b>	<b>2,879,757</b>
Capital assets, net	1,908	1,244
<b>Total Assets</b>	<b>2,778,988</b>	<b>3,059,018</b>
<b>Liabilities</b>		
<b>Current Liabilities:</b>		
Accounts payable and accrued liabilities	11,868	10,690
Prizes payable	85,576	67,903
Due to Educational Enhancement Trust Fund	117,433	93,923
Deposits payable	3,098	2,552
Compensated absences payable	867	887
<b>Total Current Liabilities</b>	<b>218,842</b>	<b>175,955</b>
<b>Current Liabilities Payable from Restricted Assets:</b>		
Pending purchases payable	0	1,181
Securities lending fees payable	2,994	1,528
Obligations under securities lending	1,247,931	1,425,162
Grand prizes payable	237,329	237,259
<b>Total Current Liabilities Payable from Restricted Assets</b>	<b>1,488,254</b>	<b>1,665,130</b>
<b>Noncurrent Liabilities:</b>		
Grand prizes payable	976,090	1,115,234
Compensated absences payable	3,025	2,983
<b>Total Noncurrent Liabilities</b>	<b>979,115</b>	<b>1,118,217</b>
<b>Total Liabilities</b>	<b>2,686,211</b>	<b>2,959,302</b>
<b>Net Assets</b>		
Invested in capital assets	1,908	1,244
Restricted net assets for undistributed appreciation on restricted investments	72,440	88,462
Restricted net assets for future prizes or special prize promotions	18,429	10,010
<b>Total Net Assets</b>	<b>\$92,777</b>	<b>\$99,716</b>

See accompanying notes to financial statements.

STATE OF FLORIDA  
DEPARTMENT OF THE LOTTERY

Statement of Revenues, Expenses and Changes in Net Assets

Years ended June 30, 2007, and June 30, 2006  
(In Thousands)

	June 30, 2007	June 30, 2006
Operating Revenues:		
Ticket sales	\$4,122,116	\$3,929,030
On-line fees and miscellaneous	7,196	7,047
Retailer fees	242	244
<b>Total Operating Revenues</b>	<b>4,129,554</b>	<b>3,936,321</b>
Operating Expenses:		
Prizes	2,484,519	2,340,859
Retailer commissions	234,291	224,570
Scratch-Off tickets	53,298	48,792
On-line games	24,792	26,255
Advertising	34,575	34,194
Personal services	26,147	25,207
Other contractual services	7,615	8,360
Materials and supplies	3,071	3,409
Bad debts	1,085	219
Depreciation	726	605
<b>Total Operating Expenses</b>	<b>2,870,119</b>	<b>2,712,470</b>
<b>Operating Income</b>	<b>1,259,435</b>	<b>1,223,851</b>
Nonoperating Revenues (Expenses):		
Interest	10,138	6,898
Securities lending income	74,549	68,122
Securities lending fees	(71,374)	(64,335)
Investment management fees	(297)	(88)
Net appreciation (depreciation) in fair value of investments	71,930	(17,545)
Property disposition (loss)	(97)	(23)
Amortization of grand prizes payable	(87,951)	(98,030)
<b>Total Nonoperating Revenues (Expenses), Net</b>	<b>(3,102)</b>	<b>(105,001)</b>
<b>Income Before Operating Transfers</b>	<b>1,256,333</b>	<b>1,118,850</b>
Transfers to Educational Enhancement Trust Fund		
Transfers from revenue	(1,224,524)	(1,182,763)
Transfers from unclaimed prizes	(38,748)	(41,888)
<b>Total Transfers to Educational Enhancement Trust Fund</b>	<b>(1,263,272)</b>	<b>(1,224,651)</b>
<b>Change in Net Assets</b>	<b>(6,939)</b>	<b>(105,801)</b>
Net Assets, Beginning of Year	99,716	205,517
Net Assets, End of Year	<b>\$92,777</b>	<b>\$99,716</b>

See accompanying notes to financial statements.

STATE OF FLORIDA  
DEPARTMENT OF THE LOTTERY

Statement of Cash Flows

Years ended June 30, 2007, and June 30, 2006  
(In Thousands)

	June 30, 2007	June 30, 2006
Operating Activities:		
Ticket sales	\$4,110,980	\$3,950,339
Prizes paid to winners	(2,466,776)	(2,351,585)
Commissions paid and payments to retailers	(234,291)	(224,570)
Paid to vendors for goods and services	(121,703)	(122,517)
Paid to employees	(26,125)	(25,039)
Other operating revenue	7,439	7,291
<b>Net Cash Provided by Operating Activities</b>	<b>1,269,524</b>	<b>1,233,919</b>
Noncapital Financing Activities:		
Payments to Educational Enhancement Trust Fund	(1,239,762)	(1,293,955)
<b>Net Cash Used in Noncapital Financing Activities</b>	<b>(1,239,762)</b>	<b>(1,293,955)</b>
Capital and Related Financing Activities:		
Purchase of capital assets	(1,488)	(391)
<b>Net Cash Used in Capital and Related Financing Activities</b>	<b>(1,488)</b>	<b>(391)</b>
Investing Activities:		
Cash received from maturity of grand prize investments	246,500	244,516
Cash paid to grand prize winners upon maturity of grand prize investments	(246,500)	(244,516)
Other investment activity	15,422	6,946
<b>Net Cash Provided by Investing Activities</b>	<b>15,422</b>	<b>6,946</b>
<b>Net Increase in Cash and Cash Equivalents</b>	<b>43,696</b>	<b>(53,481)</b>
Cash and Cash Equivalents, Beginning of Year	157,764	211,245
Cash and Cash Equivalents, End of Year	\$201,460	\$157,764
Reconciliation of Income from Operations to Net Cash Provided by Operating Activities:		
Income from operations	\$1,259,435	\$1,223,851
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation	726	605
Changes in assets and liabilities		
(Increase) decrease in:		
Accounts receivable	(10,051)	21,528
Inventories	470	(431)
Increase (decrease) in:		
Accounts payable and accrued liabilities	1,178	(1,075)
Prizes payable	17,744	(10,726)
Compensated absences payable	22	167
<b>Net Cash Provided by Operating Activities</b>	<b>\$1,269,524</b>	<b>\$1,233,919</b>
Noncash Investing, Capital and Financing Activities:		
Increase/(decrease) in fair value of investments	(\$75,543)	(\$157,508)

See accompanying notes to financial statements.

**STATE OF FLORIDA  
DEPARTMENT OF THE LOTTERY**

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**Notes to Financial Statements**

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Years ended June 30, 2007, and June 30, 2006  
(In Thousands)

**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 game merchandise 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.

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 \$3,269,000 at June 30, 2007, and \$386,000 at June 30, 2006, were insured by either the State's collateral for public deposits in accordance with Section 280.04, Florida Statutes, or Federal depository insurance.

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

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

Due to the investing policy of the Lottery, book overdrafts were approximately \$4,415,000 at June 30, 2007, and \$2,184,000 at June 30, 2006, 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 \$198,120,000 and \$157,140,000 at June 30, 2007, and 2006, 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 borrowers 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. The contract with the lending agent requires it 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 \$1,247,931,000 of cash collateral for the lending program as of June 30, 2007, and \$1,425,162,000 as of June 30, 2006. At June 30, 2007, 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, 2007, and 2006, consisted of (in thousands):

	2007	2006
Securities lending income	\$ 74,549	\$ 68,122
Less broker rebates	(70,582)	(63,390)
Less bank fees	(792)	(945)
<b>Net securities lending revenue</b>	<b>\$ 3,175</b>	<b>\$ 3,787</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, 2007 (in thousands):

<u>Time to Maturity</u>	<u>Fair Value</u>
< 1 year	\$ 240,677
> 1 year to 3 years	382,341
> 3 years to 5 years	274,069
> 5 years to 10 years	298,513
> 10 years to 15 years	40,300
> 15 years to 20 years	32,528
> 20 years to 25 years	18,765
> 25 years	761
Total	<u>\$ 1,287,954</u>

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 collateral investment pool at June 30, 2007, was approximately 31 days.

The effective duration of the Treasury Investment Pool is approximately 3.21 years at June 30, 2007.

**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, 2007, and 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, 2007, and June 30, 2006.

**i. Investment Summary**

The following schedule summarizes all investments and investments loaned under security lending agreements at June 30 (in thousands):

	<b>June 30, 2007 Carrying Value</b>	<b>June 30, 2006 Carrying Value</b>
U.S. Government Obligations	\$ 56,452	\$ 40,596
Investments Held by Others Under Security Lending Agreements - U.S. Obligations	1,231,502	1,397,870
Pooled Investments with State Treasury	198,120	157,140
Money Market and Mutual Funds	1,244,246	1,428,248
<b>Total Investments</b>	<b>\$ 2,730,320</b>	<b>\$ 3,023,854</b>

The following schedule reconciles cash and investments to the statement of net assets at June 30 (in thousands):

	<b>June 30, 2007</b>			
	<b>Investments</b>	<b>Cash at Financial Institutions</b>	<b>Cash at State Treasury</b>	<b>Total</b>
Cash and cash equivalents	\$ 179,691	\$ 3,269	\$ 71	\$ 183,031
Restricted cash and cash equivalents	18,429			18,429
Investments, grand prize	1,287,954			1,287,954
Investments, other	1,244,246			1,244,246
<b>Total</b>	<b>\$ 2,730,320</b>	<b>\$ 3,269</b>	<b>\$ 71</b>	<b>\$ 2,733,660</b>

	<b>June 30, 2006</b>			
	<b>Investments</b>	<b>Cash at Financial Institutions</b>	<b>Cash at State Treasury</b>	<b>Total</b>
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**

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

	2007	2006
Ticket sales receivable	\$ 37,237	\$ 26,361
Other receivables	253	18
Total receivables	37,490	26,379
Less allowance for doubtful accounts	(2,790)	(1,729)
Accounts receivable, net	<u>\$ 34,700</u>	<u>\$ 24,650</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):

	2005-06			2006-07			Balance June 30, 2007
	Balance June 30, 2005	Increase	Decrease	Balance June 30, 2006	Increase	Decrease	
Data processing equipment	\$8,527	\$102	\$(97)	\$8,532	\$1,283	\$(421)	\$9,394
Office equipment and fixtures	6,596	42	(75)	6,563	5	(608)	5,960
Vehicles and other equipment	3,157	247	(107)	3,297	200	(325)	3,172
	<u>18,280</u>	<u>391</u>	<u>(279)</u>	<u>18,392</u>	<u>1,488</u>	<u>(1,354)</u>	<u>18,526</u>
Less: accumulated depreciation	16,799	605	(256)	17,148	726	(1,256)	16,618
Total capital assets, net	<u>\$1,481</u>	<u>\$(214)</u>	<u>\$(23)</u>	<u>\$1,244</u>	<u>\$ 762</u>	<u>\$( 98)</u>	<u>\$1,908</u>

## 6. LONG-TERM LIABILITIES

### a. Grand Prizes Payable

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

	2007	2006
Lotto grand prizes (face value)	\$ 1,596,403	\$ 1,813,250
Mega Money grand prizes (face value)	5,594	3,963
Win for Life grand prizes (face value)	13,750	14,114
Big 10 grand prizes (face value)	10	100
Flamingo Fortune Game Show grand prizes (face value)	1,100	1,200
Monthly Grand game prizes (face value)	60	84
Win a Million grand prizes (face value)	550	600
Yearly Bonus grand prizes (face value)	300	350
Lucky for Life grand prizes (face value)	12,700	6,400
Set for Life grand prize (face value)	3,000	3,180
Cash Spectacular grand prize (face value)	800	850
Less imputed interest	(420,848)	(491,598)
Net present value of grand prizes payable	<u>\$ 1,213,419</u>	<u>\$ 1,352,493</u>
Current Prizes Payable from restricted assets	\$ 237,329	\$ 237,259
Noncurrent Prizes Payable	976,090	1,115,234
Total Grand Prizes Payable	<u>\$ 1,213,419</u>	<u>\$ 1,352,493</u>

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

Year Ended June 30	Amount
2008	\$ 246,337
2009	219,745
2010	200,002
2011	176,742
2012	152,791
2013-2017	419,566
2018-2022	76,345
2023-2027	81,690
2028-2031	58,073
2032-2036	2,976
Grand Prizes (face value)	<u>1,634,267</u>
Less imputed interest	(420,848)
Net present value of grand prizes payable	<u>\$ 1,213,419</u>

**b. Compensated Absences Payable**

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

	2007	2006
Current Compensated Absences	\$ 867	\$ 887
Noncurrent Compensated Absences	3,025	2,983
Total	<u>\$ 3,892</u>	<u>\$ 3,870</u>

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

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

	Balance July 1, 2006	Additions	Reductions	Balance June 30, 2007	Amount Due Within One Year
Grand prizes payable	\$1,352,493	\$107,426	(\$246,500)	\$1,213,419	\$237,329
Compensated absences payable	3,870	22	0	3,892	867
Total long-term liabilities	<u>\$1,356,363</u>	<u>\$107,448</u>	<u>(\$246,500)</u>	<u>\$1,217,311</u>	<u>\$238,196</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, 2007, was \$1,263,272,000, (30.6 percent of revenues) and for the fiscal year ended June 30, 2006, the transferred amount was \$1,224,651,000 (31.2 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.

Effective July 1, 2005, provisions of the Act relating to the allocation of revenues for public education were revised. 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, 2007, and June 30, 2006, was as follows (in thousands):

	June 30, 2007	June 30, 2006
On-line ticket sales	\$ 1,838,496	\$ 1,828,912
Average percent transferred	39%	39%
Transfer of On-line ticket sales	717,013	716,541
Unclaimed On-line ticket prizes	32,969	41,963
Percent transferred	80%	80%
Transfer of unclaimed On-line ticket prizes	26,375	33,570
Scratch-Off ticket sales	2,283,620	2,100,118
Average percent transferred	21%	21%
Transfer of Scratch-Off ticket sales	487,396	448,601
Unclaimed Scratch-Off ticket prizes	15,466	10,397
Percent transferred	80%	80%
Transfer of Scratch-Off ticket prizes	12,373	8,318
Nonoperating expenses, net	(3,102)	(105,001)
Add:		
Net (appreciation) depreciation in fair value of investments	(71,930)	17,545
Amortization of grand prizes payable	87,951	98,030
Total Nonoperating revenue, net	12,919	10,574
On-line fees and miscellaneous revenue	7,196	7,047
Due for the year	\$ 1,263,272	\$ 1,224,651
Balance due, beginning of year	93,923	163,227
Paid during the year	(1,239,762)	(1,293,955)
Due to Educational Enhancement Trust Fund, June 30	\$ 117,433	\$ 93,923

## 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 financial statements and other supplementary information for the FRS are included in the Comprehensive Annual Financial Report of the State of Florida which may be obtained from the Florida Department of Financial Services. The FRS also issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by contacting the State of Florida, Department of Management Services, Division of Retirement.

*Funding Policy* - The Lottery is required to pay all contributions for participating full-time and part-time employees. The contribution rates were as follows:

	Fiscal Year Ended June 30, 2007	Fiscal Year Ended June 30, 2006
Senior Management	13.12 percent	10.45 percent
Regular Employees	9.85 percent	7.83 percent
Special Risk	20.92 percent	18.53 percent

The Lottery's contributions to the FRS amounted to approximately \$1,605,000 and \$1,283,000 for the years ended June 30, 2007, and 2006, respectively. These contributions represented 9.0 percent and 7.4 percent of covered payroll, for the years ended June 30, 2007, and 2006, respectively. The Lottery contributed 100 percent of the required contributions for the years ended June 30, 2007, and 2006.

**b. Other Defined Benefit Plan**

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. The HIS is a cost-sharing multiple-employer defined benefit pension plan. For the fiscal years ended June 30, 2007, and 2006, 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.

The HIS is funded by required contributions from FRS participating employers. For the years ended June 30, 2007, and 2006, 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.

The State of Florida's implementation of GASB Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, resulted in a reevaluation of the HIS classification as a "postemployment benefit other than a pension" and its reclassification as a "pension benefit." The accounting and financial reporting for the HIS is now governed by GASB Statement No. 27, *Accounting for Pensions by State and Local Government Employers*, which was implemented for the fiscal year ending June 30, 2007, the transition year. Further disclosures and other supplementary information for the HIS are included in the Comprehensive Annual Financial Report of the State of Florida which may be obtained from the Florida Department of Financial Services.

**c. Group Health Insurance**

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.

**d. 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.

**e. 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, 2007, and 2006, totaled \$218,759 and \$144,947, respectively.

**f. Deferred Compensation Plan**

The Lottery, through the State of Florida, offers its employees a deferred compensation plan created in accordance with Section 457 of the Internal Revenue Code. The plan (refer to Section 112.215, Florida Statutes), available to all regular payroll State employees, permits them to defer a portion of their salaries until future years. The deferred compensation is not available to employees until termination, retirement, death or an unforeseen emergency.

All amounts of compensation deferred under the plan, all property and rights purchased with those amounts, and all income attributable to those amounts, property, or rights are (not- withstanding the mandates of 26 U.S.C.s.457(b)(6), all of assets specified in subparagraph 1) held in trust for the exclusive benefit of participants and their beneficiaries as mandated by 26 U.S.C.s.457(g)(1).

The Lottery does not contribute to the plan. Participation under the plan is solely at the discretion of the employee.

The State has no liability for losses under the plan but does have the duty of due care that would be required 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. As of June 30, 2007, the Lottery was unable to calculate the lease payments for Headquarters, District 3, District 6, and District 10 beyond fiscal year 2008. The Lottery’s lease for Headquarters’ office space expires on July 14, 2008. The three district offices leases expire during fiscal year 2008. The Lottery expects to have lease payments for Headquarters and all district offices in FY 2009 and beyond.

Future minimum rental payments as of June 30, 2007, are scheduled as follows (in thousands):

Year Ending June 30	Headquarters	Districts	Total
2008	\$ 2,516	\$ 671	\$ 3,187
2009	0	355	355
2010	0	316	316
2011	0	209	209
2012	0	70	70
	<u>\$ 2,516</u>	<u>\$ 1,621</u>	<u>\$ 4,137</u>

Rental expense under all operating leases totaled approximately \$3,323,000 and \$3,274,000 for the years ended June 30, 2007, and 2006, respectively.

**10. OTHER COMMITMENTS**

The Lottery has entered into contractual agreements under which On-line and Scratch-Off lottery game vendors provide gaming systems, 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. The contractor’s compensation for On-line games for the fiscal years ended June 30, 2007, and 2006, was \$24,791,000, and \$26,255,000, respectively.

For Scratch-Off lottery game tickets and related services, the contractor was compensated at the rate of 2.3 percent of net Scratch-Off ticket sales to September 30, 2006, with the rate declining to 2.25 percent effective October 1, 2006, subject to the payment provisions of the agreement. Compensation under this agreement amounted to \$53,298,000 for the fiscal year ended June 30, 2007, and \$48,792,000 for the fiscal year ended June 30, 2006.

**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.

# Contact

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