








**BRIDGING IT TOGETHER**



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Dear Friends,

Every Florida resident can be proud of our Lottery's performance during fiscal year 2000. In keeping with my policy of slow, steady growth of Lottery revenue while holding the line on expansion of gaming in Florida, the Lottery generated net sales of more than \$2.24 billion. This, in combination with our diligent efforts to reduce program costs, resulted in a record year, and a modest sales increase of 7 percent over fiscal year 1999.

Most important, the Lottery earned more than \$908 million in non-tax revenue for Florida's schools. Lottery profits from fiscal year 2000 provided:

- Bright Futures College Scholarships for more than 73,000 high-performing students.
- Pre-kindergarten programs serving more than 30,000 children.
- Financial backing for \$2.7 billion worth of new-school construction.
- \$169.7 million in discretionary funding for K - 12 schools.
- \$201.2 million in funding to Florida's community colleges and state universities.

To the extent possible, we want the Lottery to operate like a business; however, we also recognize the Lottery has a higher responsibility to conduct business in a responsible manner. Fiscal year 2000's strong showing enabled the Lottery to increase its commitment to responsible gaming practices and programs dramatically.

Since 1988, Lottery games have generated more than \$10 billion for public education programs. Under the leadership of Secretary David Griffin, I believe we will see continued responsible increases in sales and profits. Congratulations to everyone who has contributed to this success.

Sincerely,

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

Jeb Bush

## FROM SECRETARY DAVID GRIFFIN

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Dear Friends and Colleagues,

In fiscal year 1999, we implemented a new foundation to support the modernization of our business and a slow, sustained growth of Lottery sales and profits for education. This year, we built upon that foundation, streamlining our operations and earning additional revenue for education.

We revamped FLORIDA LOTTO, our flagship game, for the first time since its April 1988 launch. Customer response was dramatic, as players lined up to play for LOTTO's bigger overall jackpots, mid-week draws and enhanced lower-tier prizes. In concert with our gaming vendor, Automated Wagering International, we began rolling out a brand-new gaming system, complete with new software and new terminals, for the first time since startup in 1988.

During the past fiscal year, the Lottery's executive management team conducted a top-down review of our operations, searching for ways to enhance our productivity while cutting costs. The result: Florida Lottery sales and profits reached an all-time high. The Lottery also achieved an important milestone in fiscal year 2000, reaching a lifetime contribution of \$10 billion to Florida's public education system.

But our work has just begun. We continue to build our business with an eye toward efficiency, and with each step forward, we see additional opportunities for improvement.

I remain optimistic about the future of the state and our Lottery. To every player, retailer, business and employee that contributed to our success in fiscal year 2000, I thank you and ask that you join us in our continuing efforts to construct a better Lottery for every Floridian.

Sincerely,



David Griffin,  
Secretary



## THE NUTS AND BOLTS OF BUILDING A MODERN LOTTERY

Last year was all about the future, about laying the foundation for a better Florida Lottery – a Florida Lottery that operates more efficiently and behaves more like a business. This year was all about building upon that foundation.

In July of 1999, Secretary David Griffin assumed leadership of the Lottery, and began assembling the staff that would construct a new institution, with the goal of providing \$1 billion annually to Florida’s Educational Enhancement Trust Fund by the year 2005.

FLORIDA LOTTO has always been the cornerstone of the Lottery’s past success. During the game’s first 12 years, LOTTO sold \$9.4 billion in tickets, and accounted for roughly 40 percent of all sales. But LOTTO, like overall sales, had stalled. For four consecutive fiscal years, 1996 through 1999, LOTTO had sold fewer than 750 million tickets annually, and sales for all games had reached an annual ceiling of \$2.1 billion to \$2.2 billion per year.

Players were demanding more, so shoring up LOTTO was a top priority. A new FLORIDA LOTTO was unveiled Oct. 24, 1999. Along with a matrix change from 6-of-49 to 6-of-53 numbers, new LOTTO offered the twice-weekly drawings, bigger overall jackpots, and the significantly larger lower-tier prizes for matching three-, four-, and five-of-six winning numbers that players had been asking for.

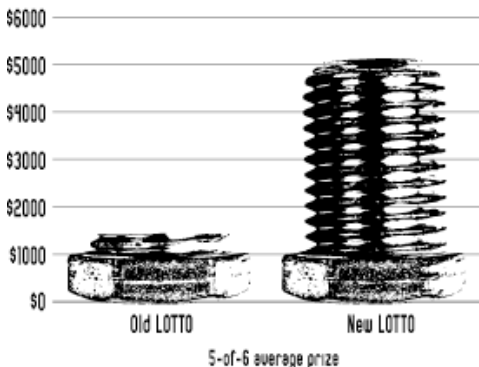
The renovation of LOTTO produced precisely the results the Lottery’s careful research had suggested it would:

- **Higher Overall Jackpots:** The median jackpot for new LOTTO was \$11 million, versus \$8 million for the comparable period under old LOTTO.

- **More Big Jackpots:** Between December 1999 and May 2000, LOTTO generated four rollover series that reached estimated jackpots of \$50 million or more, including a \$77 million jackpot in December 1999 and an \$80 million prize in March 2000. In the 11 years prior, LOTTO had generated only nine jackpots of \$50 million or more.

- **Bigger Lower-tier Prizes:** Lower-tier prizes increased substantially, most dramatically in the five-of-six number category, with median prizes up from \$1,350 to \$5,374.50.

### LOTTO PRIZES: OLD VS. NEW



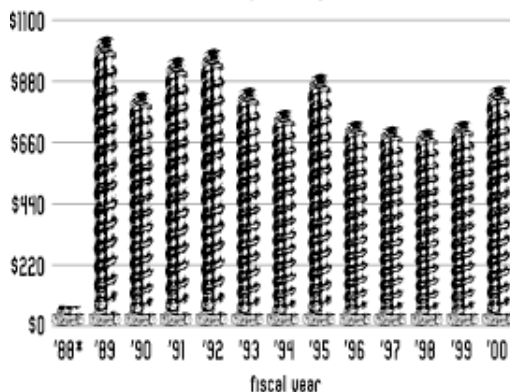
Player response to the new game was phenomenal. From Oct. 24, 1999 through June 30, 2000:

- LOTTO sales increased **\$116.9 million**, or **21.8 percent**, over the same period the previous year.
- LOTTO sales were higher in 28 of the first 37 weeks of new LOTTO, or 76 percent of the time, when compared to the corresponding week the previous year.

The bottom line for Floridians: LOTTO generated an **additional \$44.43 million** in non-tax revenue to support improvements to Florida public education programs.

## FLORIDA LOTTO SALES

[in millions]



\*Includes sales from April 23, 1988 through June 30, 1988.

*Members of the Whispering Pines Lottery Trust, of Holiday, reaped the benefits of New LOTTO, winning the March 29, 2000, \$81.6 million jackpot. They chose to receive their prize in a single cash payment of \$38.7 million!*

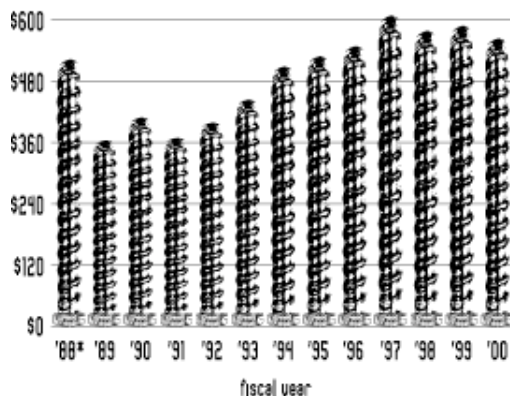


## FRAMING A SCRATCH-OFF STRATEGY

While LOTTO was generating renewed excitement among On-line game players, more heavy lifting was going on behind the scenes as we framed a new strategy for Scratch-Off game marketing. For several years, Scratch-Off games, while selling well, had not been performing up to their potential. Sales in fiscal year 1999 showed no increase from the previous year, and were lagging far behind their fiscal 1997, \$616 million<sup>1</sup> record year.

## NET SCRATCH-OFF TICKET SALES

[in millions]



\*Includes sales from Jan. 12, 1988 through June 30, 1988.

<sup>1</sup>Net Scratch-Off game sales, fiscal year 1997

The building blocks of the Lottery's new Scratch-Off game marketing strategy included:

- An increased overall payout and an increased focus on prizes in the popular \$25 to \$200 range.
- Increased advertising of the Scratch-Off games.
- A renewed emphasis on co-promotions, welding the Florida Lottery's famous Scratch-Off products to the products of other giants such as Universal Studios Orlando®.
- Providing added value to the Scratch-Off game product.

The May 1, 2000 launch of MEN IN BLACK™, Alien Attack™ was proof positive that the Lottery's new approach to Scratch-Off game marketing would lead to greater success.

MEN IN BLACK™ featured a generous prize structure, including cash prizes up to \$10,000, valuable merchandise prizes, and expense-paid, two-day vacation trips to Universal Studios and Islands of Adventure™ theme parks in Orlando. For added value, Florida, Georgia and Alabama residents could redeem non-winning MEN IN BLACK™ tickets for discount admission to Universal Studios Florida theme parks.

The game was a smash hit! Not only did Lottery players purchase more than \$1 million in MEN IN BLACK™ tickets a week, but they also redeemed non-winning tickets at Universal Studios Florida by the thousands.

In all, the Lottery launched 34 Scratch-Off games in fiscal year 2000, including popular games like WIN FOR LIFE, MONOPOLY, and DAYTONA 500, and generated net sales of more than \$568 million.



*The Integra™ On-line Gaming Terminal.*

## A MODERN INFRASTRUCTURE FOR A MODERN LOTTERY

Rebuilding the games was only part of the Lottery's success in fiscal year 2000. While the framework for a world-class marketing program was being constructed, the Lottery also was looking at its business infrastructure, seeking ways to streamline its operations and enhance efficiency.

In late 1999, the Lottery, along with its gaming system vendor, Automated Wagering International Inc., began the process of replacing Florida's 12-year-old gaming software and terminals. When complete, the new state-of-the-art gaming system will allow the Lottery to offer players new games, enhanced play options,



and exciting, innovative promotions.

In keeping with Gov. Bush's philosophy of reducing the size of government and doing more with less, management reorganized and streamlined internal operations during fiscal year 2000. Doing so entailed the necessary task of trimming the Lottery's workforce for the first time since startup in 1988, a reduction of approximately 27 percent of the Department's full-time equivalent positions. While staff reductions are never easy, they were necessary to bring the size of the Lottery's workforce in line with similar lotteries nationwide. In spite of staff reductions, the Lottery still was able to achieve not only a record sales year, but also an unprecedented **\$908 million** in profits for Florida's public schools.

## A WORK IN PROGRESS

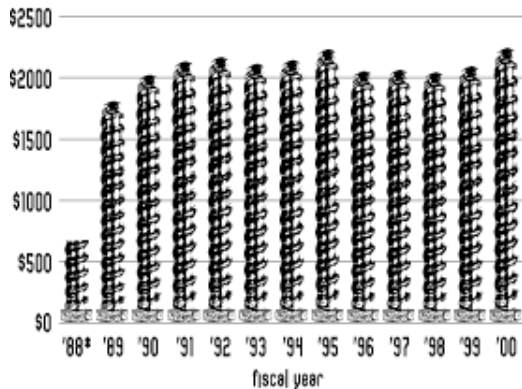
Fiscal year 2000 was supposed to be a building year, not a record year. And yet, each day, with each brick that was laid, a more modern, more exciting and more successful Lottery was taking shape. Net sales for fiscal year 2000 reached an all-time high of **\$2.24 billion!** The Lottery also reached yet another important benchmark in fiscal year 2000: In May, lifetime transfers to education surpassed **\$10 billion!** No other lottery has ever earned so much revenue for its state in just 12 years.

Constructing anything of lasting value requires a long-term commitment. Our commitment to the business of helping Florida raise education to new heights is unending. Florida can be proud of the progress so far, and have confidence that its Lottery crew won't rest until Florida's Lottery, and its education system, reach the pinnacle of success.

*The Florida Lottery supports the Governor's Mentoring Initiative. Lottery Secretary David Griffin mentors Darrius, from Hartsfield Elementary School in Tallahassee. The Florida Lottery has one of the longest-running Mentor/Tutor programs in Florida state government.*

## NET LOTTERY SALES

(in millions)

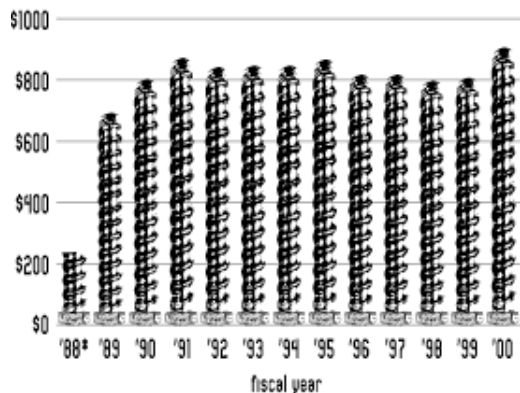


\*Includes sales from Jan. 12, 1988 through June 30, 1988.

## STATE EDUCATIONAL ENHANCEMENT TRUST FUND

### TRANSFERRED TO EETF

(in millions)



\*Profits Jan. 12, 1988 through June 30, 1988.



# ORGANIZATIONAL STRUCTURE

As required by Chapter 24.105(5), Florida Statutes, the following information reflects the organizational structure of the Lottery at June 30, 2000.

## OFFICE OF THE SECRETARY

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

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

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

**Legislative Affairs** serves as the Lottery's primary point of contact with legislators and legislative staff.

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

**Office of Contract Compliance** manages Retailer Contracting and, through its ADA Compliance unit, ensures that the Department and its retailers are in compliance with the Americans with Disabilities Act of 1990. Contract Compliance also provides oversight to contract management, helping to ensure optimum performance and compliance with the terms and conditions of major contracts.

**Division of Security and Administration** provides security services for the Department, including protection of buildings and facilities, investigative activities, game drawing security, and background investigations for vendors, retailers and employees.

**Support Services** provides operational support functions to Lottery offices throughout Florida, including vehicle fleet operation, property management, stock room and central receiving operations, facilities management and maintenance, mail center operations, central copy operations, and records management.

**Office of Educational Affairs** promotes awareness and understanding of the State's use of Lottery dollars to provide enhancements to public education in Florida through the development of educational materials, participation in educational conferences, and the formation of partnerships with the Department of Education and other educational organizations.

**Division of Human Resources Management** develops, implements, and administers a comprehensive human resources program.

8 **Classification, Recruitment and Selection** advertises vacant positions, screens applicants to determine eligibility, audits selection packages for compliance with Departmental regulations, and maintains the position classification system.

**Attendance and Leave** processes payroll, audits timesheet records, administers employee insurance programs, workman's compensation, retirement, and processes payroll deductions.

**Training and Development** provides a comprehensive general training program for employees, which includes management and supervisory training. The unit also manages the Awards Recognition program, which recognizes distinguished service and achievement.

## **ASSISTANT SECRETARY FOR FINANCE AND BUDGET**

**Division of Financial Management** administers and manages General Accounting, Games Accounting, and Disbursements.

**General Accounting** encompasses the Cash Management, Accounts Receivable and Financial Reporting sections. Cash Management coordinates the management of Lottery funds. Accounts Receivable manages the receipt of funds from retailers who sell Lottery products. Financial Reporting prepares financial statements and reports to convey the results of Lottery operations.

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

**Disbursements** manages the Accounts Payable and Player Accounting Services units. Accounts Payable disburses all vendor payments. Player Accounting Services processes prize payments to winners, including those made to FLORIDA LOTTO jackpot winners, and receives "Entry" tickets for special mail-in game promotions.

The **Budget Office** prepares legislative budget requests for the Department, monitors expenditures to ensure budgetary compliance, coordinates development of the Department's strategic plan, and maintains the performance-based program budget.

**Purchasing** executes all purchasing and contracting for the Department, and maintains liaison with the Department of Management Services and the Minority Business Advocacy and Assistance Office.

## **ASSISTANT SECRETARY FOR MARKETING**

**Marketing** encompasses all areas relating to the sale of Lottery products, including Statewide Sales, Corporate Sales, Research and Planning, Advertising, and Special Events and Promotions.

**Division of Statewide Sales** consists of 11 district sales offices, which manage the sale, promotion and redemption of Lottery products through a statewide network of more than 11,000 Lottery retailers. Each district office employs a staff of Lottery Sales Representatives who assist in the promotion and sale of Lottery products at the retail level.

**Division of Corporate Sales** consists of five Sales Executives who provide liaison to multi-location corporate retailers to ensure that the sales and promotional support of Lottery products meets the corporations' needs. Corporate Sales coordinates cooperative promotions, and plays a vital role in corporate retailer recruitment.

**Research and Planning** coordinates market research performed by the Agency's contracted service providers for Scratch-Off games and Advertising. This area also is responsible for providing timely data and analyses of sales, player attitudes and program effectiveness useful in product development planning, revenue forecasting, decision-making and communication.

**Division of Advertising** coordinates with the Lottery's contracted advertising agencies in the development and production of advertising materials that support the Lottery's marketing objectives.

**Special Events and Promotions** increases awareness of Lottery products through special sales promotions, promotional merchandise, and participation in special events held in communities throughout Florida. Promotions and events include game launches, On-line game drawings held at public venues throughout Florida, retailer promotions, and Lottery Showvan bookings.

## **ASSISTANT SECRETARY FOR PUBLIC AFFAIRS**

10 **Division of Communications** manages relations with, and all written and electronic communication provided to, players, retailers, news media and the general public.

**Media Relations** coordinates all Lottery activities with the news media, including spokesperson interviews, news conferences, media kits and the Lottery's web site.

**Public Information** manages customer correspondence and e-mail, serves as a clearinghouse for Lottery records, provides in-house Spanish-language translations, and provides photographic services to the Department. Public Information also produces the Department's official publications, including "Florida Lottery Update," a newsletter for retailers, and the Department's annual report.

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

**Player Information Line** serves as the Lottery's liaison to players, responding to inquiries regarding Lottery games and various other facets of Lottery operations.

## **ASSISTANT SECRETARY FOR OPERATIONS**

**Operations** consists of the following business areas that collectively provide technology solutions and services to support the Department's marketing and business needs. In addition, Operations manages the gaming vendor contract and coordinates cross-functional, formal, user-acceptance testing for gaming-system enhancements.

**Division of Information Resources (IR)** designs and implements computer applications systems necessary for the functioning of the Department in a secure, power-redundant data center environment. IR also provides a comprehensive telecommunications system and office automation system.

**Computer Operations** ensures the smooth operation of the Department's automated systems, providing 24-hour-per-day, seven-day-per-week staffing of the Lottery's primary and backup data centers, verification and balancing of transactions from the gaming vendor, production control, and backup and system recovery services.

**Systems Design and Development** provides application programming and systems analysis for critical business systems, including the Internal Control System, Scratch-Off ticket accounting, the Distributed Check Writer, and all in-house administrative systems.

**Systems and Network Support** installs, configures and maintains the Department's statewide and local-area non-gaming networks, including all in-house administrative computer systems, hardware, operating systems software, and voice systems.

**Client Services** manages the end-user computing environment through the installation and maintenance of all desktop computing hardware and software. The Information Center within the Client Services unit provides Lottery staff with technical help desk services, internal consulting services, and group training courses relating to office automation, end-user computing tools, and specific business applications.

**Office of Information Security Management (ISM)** develops and coordinates the information security infrastructure and program to provide protection and ensure integrity for the Department's computers, data and networks. ISM researches and installs firewall systems, virus protection software, administers and monitors systems access, and provides information security awareness and training. The unit also performs internal security audits and coordinates the preparation of security risk analyses pertaining to the Department's information resources.

**Office of Business Recovery** maintains a comprehensive business continuity plan to continue Lottery sales in the event of a natural disaster or other emergency.

## **THE LOTTERY COMMISSION**

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The purpose of the Lottery Commission, as provided in section 24.106(5), Florida Statutes, is to serve as a resource for the Department, and to provide the Lottery Secretary with private-sector perspectives on the operation of a large marketing enterprise.

**William A. Beckett**

**Orlando, Florida**

Appointment Date: 12/23/1998

Term Expiration: 06/10/2001

**Teresa W. Brady**

**Jacksonville, Florida**

Appointment Date: 07/14/1998

Term Expiration: 06/10/2002

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**Harold M. Knowles**

**Tallahassee, Florida**

Appointment Date: 08/05/1999

Term Expiration: 06/10/2003

**Kaaren Johnson-Street**

**Winter Springs, Florida**

Appointment Date: 08/05/1999

Term Expiration: 06/10/2003

There was one vacancy on the Lottery Commission at June 30, 2000.

# FINANCIALS



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# STATE OF FLORIDA • DEPARTMENT OF THE LOTTERY

## INDEPENDENT AUDITORS' REPORT

Years Ended June 30, 2000 and 1999 [continued]

### Independent Auditors' Report

President of the Senate,  
Speaker of the House of Representatives and  
the Joint Legislative Auditing Committee  
Tallahassee, Florida

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We have audited the accompanying balance sheet of the State of Florida, Department of the Lottery (the "Lottery") as of June 30, 2000 and the related statements of revenue, expenses and changes in retained earnings and cash flows for the year then ended. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audit. The accompanying financial statements of the Lottery as of June 30, 1999 were audited by other auditors whose report thereon dated October 22, 1999, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

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, 2000, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated October 6, 2000 on our consideration of the Lottery's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

KPMG LLP

October 6, 2000

# STATE OF FLORIDA • DEPARTMENT OF THE LOTTERY

## BALANCE SHEETS

Years Ended June 30, 2000 and 1999  
[In Thousands]

<b>ASSETS</b>	<b>2000</b>	<b>1999</b>
<b>Current assets:</b>		
Cash and cash equivalents	\$ 125,230	76,177
Interest receivable	659	222
Accounts receivable, net	33,270	25,688
Inventories	1,269	1,260
Securities deposits	<u>1,551</u>	<u>1,873</u>
Total current assets	161,979	105,220
Securities lending income receivable	7,495	4,441
Investments, grand prize	2,054,143	2,156,604
Investments, other	1,730,614	1,136,953
Property and equipment, net	<u>2,937</u>	<u>3,703</u>
Total assets	<u>\$ 3,957,168</u>	<u>3,406,921</u>
 <b>LIABILITIES AND RETAINED EARNINGS</b>		
<b>Current liabilities:</b>		
Accounts payable and accrued liabilities	\$ 14,326	10,902
Prizes payable	54,504	45,764
Due to Educational Enhancement Trust Fund	89,753	43,927
Deposits payable	<u>1,551</u>	<u>1,873</u>
Total current liabilities	160,134	102,466
Securities lending fees payable	8,725	4,124
Obligations under Securities Lending	1,729,162	1,136,885
Grand prizes payable	1,941,006	2,013,448
Compensated absences payable	<u>3,724</u>	<u>4,344</u>
Total liabilities	<u>3,842,751</u>	<u>3,261,267</u>
<b>Retained earnings:</b>		
Reserved for undistributed appreciation on restricted investments	111,480	141,951
Reserved for net fixed assets	<u>2,937</u>	<u>3,703</u>
Total retained earnings	<u>114,417</u>	<u>145,654</u>
Total liabilities and retained earnings	<u>\$ 3,957,168</u>	<u>3,406,921</u>

# STATE OF FLORIDA • DEPARTMENT OF THE LOTTERY

## STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN RETAINED EARNINGS

Years Ended June 30, 2000 and 1999

(In Thousands)

	2000	1999
Operating revenues:		
Ticket sales	\$ 2,248,496	2,096,726
On-line fees and miscellaneous	7,702	7,331
Retailer fees	<u>153</u>	<u>174</u>
Total operating revenues	<u>2,256,351</u>	<u>2,104,231</u>
Operating expenses:		
Prizes	1,107,018	1,056,810
Retailer commissions	125,066	118,919
Scratch-off tickets	13,855	14,471
On-line games	33,224	31,564
Advertising	31,870	29,299
Personal services	28,108	31,890
Other contractual services	12,261	14,663
Materials and supplies	5,385	6,945
Bad debts	207	146
Depreciation	<u>1,962</u>	<u>2,480</u>
Total operating expenses	<u>1,358,956</u>	<u>1,307,187</u>
Income from operations	<u>897,395</u>	<u>797,044</u>
Nonoperating (expenses) revenues:		
Interest	5,310	4,591
Securities lending income	87,793	58,283
Securities lending fees	(82,911)	(54,139)
Net appreciation in fair value of investments	110,758	64,991
Amortization of grand prizes payable	<u>(141,229)</u>	<u>(145,178)</u>
Total nonoperating revenue (expenses), net	<u>(20,279)</u>	<u>(71,452)</u>
Income before operating transfers	877,116	725,592
Transfers to Educational Enhancement Trust Fund	(908,353)	(807,227)
Retained earnings, beginning of year	<u>145,654</u>	<u>227,289</u>
Retained earnings, end of year	\$ <u><u>114,417</u></u>	<u><u>145,654</u></u>

See accompanying notes to financial statements.

# STATE OF FLORIDA • DEPARTMENT OF THE LOTTERY

## STATEMENTS OF CASH FLOWS

Years Ended June 30, 2000 and 1999  
(In Thousands)

	2000	1999
<b>Operating activities:</b>		
Ticket sales	\$ 2,240,707	2,092,752
Prizes paid to winners	(1,098,278)	(1,056,854)
Commissions paid and payments to retailers	(125,066)	(118,919)
Paid to vendors for goods and services	(93,137)	(93,889)
Paid to employees	(28,727)	(31,692)
Other operating revenues	<u>7,684</u>	<u>7,459</u>
Net cash provided by operating activities	<u>903,183</u>	<u>798,857</u>
<b>Noncapital financing activities:</b>		
Payments to Educational Enhancement Trust Fund	<u>(862,527)</u>	<u>(812,685)</u>
Net cash used in noncapital financing activities	<u>(862,527)</u>	<u>(812,685)</u>
<b>Capital and related financing activities:</b>		
Purchase of property and equipment	(1,240)	(1,108)
Proceeds from sale of property and equipment	<u>171</u>	<u>66</u>
Net cash used in capital and related financing activities	<u>(1,069)</u>	<u>(1,042)</u>
<b>Investing activities:</b>		
Cash received from maturity of other investments	—	9,768
Cash received from maturity of grand prize investments	235,205	228,376
Cash paid to grand prize winners upon maturity of grand prize investments	(235,205)	(228,376)
Interest	<u>9,466</u>	<u>7,047</u>
Net cash provided by investing activities	<u>9,466</u>	<u>16,815</u>
Net increase in cash and cash equivalents	49,053	1,945
Cash and cash equivalents, beginning of year	<u>76,177</u>	<u>74,232</u>
Cash and cash equivalents, end of year	<u>\$ 125,230</u>	<u>76,177</u>

See accompanying notes to financial statements.

# STATE OF FLORIDA • DEPARTMENT OF THE LOTTERY

## STATEMENTS OF CASH FLOWS, CONTINUED

Years Ended June 30, 2000 and 1999

(In Thousands)

	2000	1999
Reconciliation of income from operations to net cash provided by operating activities:		
Income from operations	\$ 897,395	797,044
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation	1,962	2,480
Gain (loss) on disposal of property and equipment	(127)	11
Changes in assets and liabilities:		
Decrease (increase) in:		
Accounts receivable	(7,582)	(3,828)
Inventories	(9)	(339)
Increase (decrease) in:		
Accounts payable and accrued liabilities	3,424	3,335
Prizes payable	8,740	(45)
Compensated absences payable	(620)	199
Net cash provided by operating activities	\$ <u>903,183</u>	<u>798,857</u>

# STATE OF FLORIDA • DEPARTMENT OF THE LOTTERY

## NOTES TO THE FINANCIAL STATEMENTS

Years Ended June 30, 2000 and 1999

### **(1) REPORTING ENTITY**

The State of Florida, Department of the Lottery [the "Lottery"] was established as a state agency with the enactment of the Florida Public Education Lottery Act [the "Act"] in 1987. The purpose of the Act is "to implement Section 15, Article X of the State Constitution in a manner that enables the people of the State to benefit from significant additional monies for education and also enables the people of the State to play the best lottery games available."

The Lottery has adopted Governmental Accounting Standards Board ["GASB"] Statement No. 14, The "Financial Reporting Entity", for the purposes of evaluating its financial statements. Based on the criteria in Statement No. 14, the Lottery has determined that there are no other units that meet the criteria for inclusion in the Lottery's financial statements. The Florida Comptroller's office prepares the Comprehensive Annual Financial Report for the State of Florida, which includes the Lottery as a part of the primary government.

### **(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

#### ***(A) 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.

#### ***(B) BASIS OF ACCOUNTING***

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

The measurement focus of proprietary fund types is on a flow of economic resource method, which emphasizes the determination of net income, financial positions and cash flows. All fund assets and liabilities, current and noncurrent, are accounted for on the balance sheet. Pursuant to Governmental Accounting Standards Board [GASB] Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting", the Lottery has elected not to apply Financial Accounting Standards Board ["FASB"] pronouncements issued after November 30, 1989. As also provided by Statement No. 20, the Lottery has elected not to adopt any FASB statements issued after November 30, 1989 unless so directed by GASB.

# STATE OF FLORIDA • DEPARTMENT OF THE LOTTERY

## NOTES TO THE FINANCIAL STATEMENTS

Years Ended June 30, 2000 and 1999 (continued)

### ***[C] 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 and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### ***[D] REVENUE RECOGNITION***

Lottery games are sold to the public by contracted retailers. Revenue is recognized when on-line tickets are sold to players and when books of scratch-off tickets are settled by retailers. 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, not included in ticket sales.

### ***[E] COMMISSIONS***

Retailers receive a commission of five percent on ticket sales. The commission on ticket sales for scratch-off games is based upon total tickets distributed to the players (including free tickets) which, when compared to revenue, causes the percentage to be slightly higher than five percent. Additionally, retailers are paid commissions through a one percent cashing bonus on redemption of tickets (including free tickets).

### ***[F] PRIZES***

In accordance with the Act, as nearly as practicable, at least 50 percent of ticket sales must be returned to the public in the form of prizes.

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

An estimate of scratch-off prizes which will not be claimed within 60 days after the end of each game and an estimate of on-line prizes which will not be claimed within 180 days after the drawing are added to the pool from which future prizes are to be awarded or used for 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 the annuity using the interest yield on the investments which were acquired to fund the annuity.

# STATE OF FLORIDA • DEPARTMENT OF THE LOTTERY

## NOTES TO THE FINANCIAL STATEMENTS

Years Ended June 30, 2000 and 1999 [continued]

In October and November 1998 several changes to the structure of past and future deferred prize payments occurred. In October 1998, Congress passed a law redefining constructive receipt. This change applied to deferred prizes payable over 10 years or more. The Lottery enacted this change for eligible new Lotto winners for draws on and after October 23, 1998, allowing grand prize winners 60 days after entitlement of the prize to decide whether to receive a lump sum cash prize or annual payments. The change was also adopted prospectively for eligible scratch-off game grand prize winners. On November 15, 1998, the Lottery changed the Lotto deferred prize payment period from 20 years to 30 years.

### ***[G] INVENTORIES***

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

### ***[H] ALLOWANCE FOR DOUBTFUL ACCOUNTS***

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

### ***[I] PROPERTY AND EQUIPMENT***

Property and equipment are stated at cost less accumulated depreciation. Depreciation on property and equipment 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 6 years
Vehicles and other equipment	3 to 5 years

When assets are retired or otherwise disposed of, the costs and related accumulated depreciation are removed from the accounts and any resulting gain or loss is reflected in the results from operations in the period of disposal.

### ***[J] SELF-INSURANCE***

The Lottery participates in the various self-insurance programs established by the State of Florida for property and casualty losses and employee health insurance. Coverages include property, general liability, automobile liability, workers' compensation, court awarded attorney fees and federal civil rights actions. Property is self-insured for actual cash value to an aggregate of \$2 million per loss event. Property losses in excess of \$2 million are commercially insured up to \$200 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.



# STATE OF FLORIDA • DEPARTMENT OF THE LOTTERY

## NOTES TO THE FINANCIAL STATEMENTS

Years Ended June 30, 2000 and 1999 (continued)

### ***[K] 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 salary rates and include employer social security and pension contributions at current rates.

### ***[L] RETAINED EARNINGS***

Retained earnings at June 30, 2000 and 1999, is comprised of the net book value of property and equipment of approximately \$2,937,000 and \$3,703,000, respectively, and the reserve for the undistributed appreciation on restricted investments held for grand prize winners, securities lending cash collateral, and pooled investments with the State Treasurer of approximately \$111,480,000 and \$141,951,000, respectively.

### ***[M] BUDGET***

The budgetary basis of accounting required by state law differs materially from the basis used to report revenues and expenses in accordance with generally accepted accounting principles. Budgetary basis revenues are essentially on the cash basis. Budgetary basis expenses include disbursements plus current year payables and encumbrances which are certified forward into the next fiscal year and exclude prior year certified forwards. State law authorizes the payment of prior year payables and encumbrances not certified forward from the current year budget.

Certain expenses and other financing uses are not formally budgeted. Among these items are prizes, retailer commissions, bad debts and depreciation (while the cost of acquiring fixed assets and inventories is budgeted). These appear on the statement of revenues, expenses and changes in retained earnings but are not part of the operating budget.

### ***[N] CASH AND CASH EQUIVALENTS***

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

### ***[O] NEW ACCOUNTING STANDARDS***

In June 1999, the GASB issued Statement No. 34, "Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments". Generally,

# STATE OF FLORIDA • DEPARTMENT OF THE LOTTERY

## NOTES TO THE FINANCIAL STATEMENTS

Years Ended June 30, 2000 and 1999 [continued]

this statement establishes financial reporting standards for state and local governments, including states, cities, towns, villages, and special-purpose governments such as school districts and public utilities. It establishes that the basic financial statements and required supplementary information for general purpose governments should consist of: management's discussion and analysis, basic financial statements, and required supplementary information. The requirements of this statement are effective for the Lottery in the year ended June 30, 2002. The State of Florida has elected not to adopt this statement prior to its effective date.

### ***[P] RECLASSIFICATIONS OF PRIOR YEAR***

The balance sheet accounts interest receivable, security lending income receivable and security lending fees payable have been reclassified to conform to the current year presentation required under GASB Statement No. 28, "Accounting and Financial Reporting for Securities Lending Transactions".

### **[3] 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 \$329,000 at June 30, 2000 and \$311,000 at June 30, 1999, were insured by either the State's collateral for public deposits in accordance with Florida Statutes, Chapter 280.04 or Federal depository insurance.

Chapter 280, F.S., generally requires public funds to be deposited in a bank or savings association that is designated by the State Treasurer 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 State Treasurer, 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 State Treasurer as security for public deposits. Collateral may be held by another custodian with approval of the Treasurer if conditions are met which protect the State's interests. 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 \$1,150,000 at June 30, 2000 and \$1,712,000 at June 30, 1999, representing outstanding prize payment checks. These outstanding checks are included as a component of

# STATE OF FLORIDA • DEPARTMENT OF THE LOTTERY

## NOTES TO THE FINANCIAL STATEMENTS

Years Ended June 30, 2000 and 1999 (continued)

prizes payable. The Lottery has an agreement with a financial institution to honor prize payments, as they are presented to the bank, with investments covered by an overnight repurchase agreement as described below.

Investments, covered by an overnight repurchase agreement, were approximately \$79,000 and \$61,000 at June 30, 2000 and 1999, respectively. The underlying securities for the repurchase agreement are U.S. Government securities. These securities are uninsured and unregistered and are held by the financial institution in the Lottery's name. The repurchase agreement requires that the market value of the underlying securities must equal or exceed the amount held for investment which is 100 percent collateralized by the securities purchased. The largest amounts invested in repurchase agreements during the years ended June 30, 2000 and 1999, were approximately \$3,126,000 and \$3,794,000, respectively.

Surplus cash is maintained in the State's general pool of investments. The State Treasurer pools funds from all departments. Included in the pool are time deposits, U.S. Government securities, bankers' acceptances, commercial paper, corporate notes, repurchase agreements and reverse repurchase agreements through a securities lending program. Approximately 90 percent of these investments are of the lowest credit risk category (insured or registered or held by the State or its agent in the State's name). The Lottery's share of this investment pool was approximately \$124,838,000 and \$75,265,000 at June 30, 2000 and 1999, 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 reverse repurchase agreements will likewise not be carried on the balance sheet 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 State Treasurer's Office.

### 24 **(B) INVESTMENTS, GRAND PRIZE**

The grand prize investments 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.

The Lottery adopted the provisions of GASB Statement No. 31, "Accounting and Financial Reporting for Certain Investments and for External Investment Pools", during the fiscal year beginning July 1, 1997. Generally, this statement establishes fair value standards for various investments, including debt securities and open ended mutual funds. 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 reserve in retained earnings. This represents the

# STATE OF FLORIDA • DEPARTMENT OF THE LOTTERY

## NOTES TO THE FINANCIAL STATEMENTS

Years Ended June 30, 2000 and 1999 [continued]

unrealized gains on the investments. Because these investments are held restrictively for grand prize winners, this balance is not available for transfer to the Educational Enhancement Trust Fund.

Interest accreted on grand prize investments during the year is reflected as an increase in the carrying value of grand prizes payable on the balance sheet, and as a nonoperating expense on the statements of revenues, expenses and changes in retained earnings. Net appreciation in fair value of investments is reflected as a nonoperating revenue on the statements of revenues, expenses and changes in retained earnings, 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*

The other 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 of the 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.

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

The SBA received \$1,729,162,000 of cash collateral and \$150,000,000 of U.S. Government securities as collateral for the lending program as of June 30, 2000. At June 30, 2000, the collateral that was held for the securities lending transactions exceeded the fair value of the securities underlying the agreements [including accrued interest]. The cash was primarily invested in short-term investments. However, approximately 38 percent of the total cash collateral was invested in investments with maturities of 6 months or more. Maturities of investments made with cash collateral generally do not match maturities of the securities loaned, due to securities loan agreements being open-ended with no fixed expiration date.

# STATE OF FLORIDA • DEPARTMENT OF THE LOTTERY

## NOTES TO THE FINANCIAL STATEMENTS

Years Ended June 30, 2000 and 1999 (continued)

Securities lending activity for the years ended June 30, 2000 and 1999 consisted of:

	2000	1999
	(in thousands)	
Securities lending income	\$ 87,793	\$ 58,283
Less broker rebates	(81,476)	(52,767)
Less bank fees	<u>(1,435)</u>	<u>(1,372)</u>
Net securities lending revenue	\$ <u>4,882</u>	\$ <u>4,144</u>

### ***[D] INVESTMENT CREDIT RISK***

GASB Statement No. 3 provides for the classification of investments to give an indication of the level of credit risk assumed by the Lottery.

Category 1 credit risk investments include investments that are insured or registered or for which the securities are held by the Lottery or its agent in the Lottery's name. Category 2 includes uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent in the Lottery's name. Category 3 includes uninsured and unregistered investments for which the securities are held by the counterparty, or by its trust department or agent but not in the Lottery's name.

# STATE OF FLORIDA • DEPARTMENT OF THE LOTTERY

## NOTES TO THE FINANCIAL STATEMENTS

Years Ended June 30, 2000 and 1999 [continued]

All of the Lottery's investments are carried at fair value. Certain investments cannot be categorized because they are not evidenced by securities that exist in physical or book entry form, such as mutual funds or commingled funds. The schedule of Lottery investments at June 30, 2000 is presented below.

Investments	Risk Category 1	Risk Category 3	Carrying amount
		(in thousands)	
Lottery investments—classified:			
Certificates of deposit, negotiable	\$     —	\$ 141,763	\$ 141,763
U.S. obligations	355,845	—	355,845
Commercial paper	—	504,392	504,392
Time deposits	8,264	417,386	425,650
Repurchase agreements	—	28,923	28,923
Bonds and notes	—	605,095	605,095
Total classified investments	\$ <u>364,109</u>	\$ <u>1,697,559</u>	\$ <u>2,061,668</u>
Lottery investments—unclassified:			
Investments held by broker dealers under securities lending agreements:			
U.S. obligations			1,698,298
Investment agreements			24,791
Pooled investments with State Treasurer [included in cash equivalents]			<u>124,838</u>
Total unclassified investments			<u>1,847,927</u>
Total investments			\$ <u>3,909,595</u>

### [4] SECURITY DEPOSITS AND DEPOSITS PAYABLE

The Lottery receives from certain vendors and retailers certificates of deposit and cashier checks in order to secure contract performance. These instruments are held in trust by the State with any interest earnings being credited to the vendor or retailer. These deposits are established to reduce the potential financial risk to the Lottery in the event of a breach of contract. These certificates and checks appear on the balance sheet in assets as security deposits and in liabilities as deposits payable.

# STATE OF FLORIDA • DEPARTMENT OF THE LOTTERY

## NOTES TO THE FINANCIAL STATEMENTS

Years Ended June 30, 2000 and 1999 (continued)

### [5] PROPERTY AND EQUIPMENT

Property and equipment at June 30 consisted of:

	<u>2000</u>	<u>1999</u>
	(in thousands)	
Data processing equipment	\$ 9,646	\$ 10,801
Office equipment and fixtures	7,283	7,372
Vehicles and other equipment	<u>3,789</u>	<u>3,567</u>
	20,718	21,740
Less accumulated depreciation	<u>(17,781)</u>	<u>(18,037)</u>
Total property and equipment, net	<u>\$ 2,937</u>	<u>\$ 3,703</u>

### [6] GRAND PRIZES PAYABLE

Grand prizes payable at June 30 consisted of:

	<u>2000</u>	<u>1999</u>
	(in thousands)	
Lotto grand prizes (face value)	\$ 2,987,775	\$ 3,174,251
Win For Life grand prizes (face value)	16,298	16,662
Big 10 grand prizes (face value)	640	730
Flamingo Fortune Game Show Grand Prize (face value)	1,800	1,900
Monthly Bonus grand prizes (face value)	480	384
Win a Million grand prizes (face value)	900	950
Less imputed interest	<u>(1,066,887)</u>	<u>(1,181,429)</u>
Net present value of grand prizes payable	<u>\$ 1,941,006</u>	<u>\$ 2,013,448</u>

### [7] DUE TO EDUCATIONAL ENHANCEMENT TRUST FUND

In accordance with the Act, at least 38 percent of revenue, net of retailer application fees, for the years ended June 30, 2000 and 1999, must be transferred to the Educational Enhancement Trust Fund for the benefit of public education. Because the net appreciation in fair value of investments and amortization of grand prizes payable, included in non-operating revenues and expenses, relate to valuations of the restricted grand prize investments and grand prizes payable, they are excluded from the determination of transfers to the Educational Enhancement Trust Fund.

# STATE OF FLORIDA • DEPARTMENT OF THE LOTTERY

## NOTES TO THE FINANCIAL STATEMENTS

Years Ended June 30, 2000 and 1999 [continued]

Due to Educational Enhancement Trust Fund at June 30 consisted of:

	<u>2000</u>	<u>1999</u>
	(in thousands)	
Operating revenues	\$ 2,256,351	\$ 2,104,231
Nonoperating revenues [expenses], net	[20,279]	[71,452]
Less: Retailer application fees	[153]	[174]
Net appreciation in fair value of investments	[110,758]	[64,991]
Amortization of grand prizes payable	<u>141,229</u>	<u>145,178</u>
 Net revenues	 2,266,390	 2,112,792
	x <u>38%</u>	x <u>38%</u>
 Statutorily required transfer	 861,228	 802,861
Additional transfer appropriated	6,898	4,366
Unencumbered balance to be transferred	<u>40,227</u>	<u>—</u>
 Due for year	 908,353	 807,227
Balance, beginning of year	43,927	49,385
Paid during year	<u>[862,527]</u>	<u>[812,685]</u>
 Due to Educational Enhancement Trust Fund, end of year	 <u>\$ 89,753</u>	 <u>\$ 43,927</u>

## [8] EMPLOYEE BENEFITS

### *RETIREMENT 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. 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, Bureau of Research, Education and Policy, 2639 North Monroe Street, Building C, Tallahassee, Florida 32399-1650.



# STATE OF FLORIDA • DEPARTMENT OF THE LOTTERY

## NOTES TO THE FINANCIAL STATEMENTS

Years Ended June 30, 2000 and 1999 (continued)

*Funding Policy*—The Lottery is required to pay all contributions for full-time and part-time employees. Generally, employee participation is compulsory. The contribution rates are as follows (including .94 percent health insurance subsidy for the fiscal years ended June 30, 2000 and 1999):

	July 1, 1999 through June 30, 2000	July 1, 1998 through June 30, 1999
Senior management	12.13%	24.04%
Regular employees	10.15%	16.45%

The Lottery's contributions to the FRS amounted to approximately \$2,166,000 and \$3,631,000 for the years ended June 30, 2000 and 1999, respectively. These contributions represented 10.42 percent and 17.18 percent of covered payroll, for the years ended June 30, 2000 and 1999, respectively. The Lottery contributed 100 percent of the required contributions for each of the years ended June 30, 2000 and 1999.

### ***OTHER POSTEMPLOYMENT BENEFITS***

In 1987, the Florida Legislature established through Section 112.363, Florida Statutes, the Retiree Health Insurance Subsidy ("HIS") to assist retirees of all state-administered retirement systems in paying health insurance costs. From July 1, 1997 through December 31, 1998, eligible retirees or beneficiaries received as much as \$3 per month for each year of creditable service completed at the time of retirement; the payments to individual retirees or beneficiaries were at least \$30 but not more than \$90 per month. Beginning January 1, 1999, eligible retirees or beneficiaries received as much as \$5 per month for each year of creditable service completed at the time of retirement; the payments to individual retirees or beneficiaries were at least \$50 but not more than \$150 per month.

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 each of the years ended June 30, 2000 and 1999 the Lottery contributed .94 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, Chapter 110.123, Florida Statutes, provides that retirees may participate in the State's group health insurance programs. Premiums are paid by the retiree.

# STATE OF FLORIDA • DEPARTMENT OF THE LOTTERY

## NOTES TO THE FINANCIAL STATEMENTS

Years Ended June 30, 2000 and 1999 [continued]

### *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 of an ordinary and prudent investor. During the 1997 fiscal year Chapter 97-8 of the Laws of Florida amended Section 112.215, Florida Statutes, by creating the Deferred Compensation Trust Fund in the State Treasury.

# STATE OF FLORIDA • DEPARTMENT OF THE LOTTERY

## NOTES TO THE FINANCIAL STATEMENTS

Years Ended June 30, 2000 and 1999 (continued)

### [9] COMMITMENTS AND CONTINGENCIES

**Commitments—Leases—** The Lottery has entered into operating leases for the rental of office and warehouse space for the headquarters and district offices as well as the rental of scratch-off ticket vending machines and computer equipment. Certain leases are renewable at the option of the Lottery.

Future minimum rental payments as of June 30, 2000 are scheduled as follows (in thousands):

Year ending June 30	Computer equipment	Scratch-off ticket vending machines	Headquarters	Districts	Total
2001	\$ 183	\$ 1,200	\$ 2,363	\$ 771	\$ 4,517
2002	—	—	2,370	729	3,099
2003	—	—	2,393	476	2,869
2004	—	—	2,417	341	2,758
2005 and thereafter	—	—	4,908	120	5,028
	\$ <u>183</u>	\$ <u>1,200</u>	\$ <u>14,451</u>	\$ <u>2,437</u>	\$ <u>18,271</u>

Rental expense under all leases totaled approximately \$5,791,000 and \$5,642,000 for the years ended June 30, 2000 and 1999, respectively.

**Litigation—On Line Services—** The Department has contracted with Automated Wagering, Inc. ("AWI") for on-line services since 1988. These services include the provision of computer hardware, software and telecommunications, along with maintenance and other services. In 1995, the Department rebid the contract and again chose AWI as its on-line service provider. Shortly thereafter, the unsuccessful bidder protested the award of the contract to AWI; however, the award of the contract was upheld by the Florida Supreme Court. In a separate lawsuit filed in 1999, the unsuccessful bidder challenged the validity of the contract that was ultimately awarded to AWI. On January 28, 2000, the Leon County, Florida Circuit Court entered a judgment in favor of the challenger, finding the AWI contract to be null and void and issuing an injunction against proceeding under the contract.

The Department has appealed the decision of the Circuit Court. By operation of law, an automatic stay of the court's order is in effect pending appellate review. In addition, the Circuit Judge specifically wrote that his Order is not intended to prohibit the Department from continuing to operate on an interim basis, utilizing its emergency powers. Appellate briefs have been filed and the case is pending before the appellate court for a decision.

# STATE OF FLORIDA • DEPARTMENT OF THE LOTTERY

## NOTES TO THE FINANCIAL STATEMENTS

Years Ended June 30, 2000 and 1999 [continued]

Although AWI is currently providing its services pursuant to the disputed contract, the Department and AWI have entered into an emergency interim contract, containing the same terms, which would become effective if the stay is lifted. This emergency contract would remain in effect until a new contract is executed or if the current contract is determined to be valid by the appellate court. The Department is confident that Lottery operations will continue without interruption until this matter is concluded, and that no adverse operational or financial consequences will ensue as a result of these developments.

The term of the current contract began on September 30, 1999 and runs through December 31, 2004; it provides that AWI will design, install and operate a new statewide gaming system, including 10,000 new, full service terminals and 2,000 new scratch-off only terminals. The new gaming system was implemented on February 7, 2000. The new terminal rollout phase will take place from May through December 2000 at the rate of 300-400 terminal installations per week. The base compensation to AWI is 1.85% of on-line sales plus additional compensation subject to cap limitations. The contractor's compensation was \$33,224,000 and \$31,564,000 for the years ended June 30, 2000 and 1999, respectively. The compensation was calculated at a rate of 2.10% until September 30, 1999 when the 1.85% rate became effective.

The Lottery entered into an agreement with Scientific Games Inc. as of April 2, 1997, to provide scratch-off lottery game tickets and related services through September 30, 2002. The contractor's compensation is 2.4375 percent of net scratch-off sales during the term of the agreement, subject to the payment provisions of the agreement.

**Litigation—1-900 Refunds—** Ralph DeLuise, etc., vs. The Florida Department of the Lottery, et al., Leon County Circuit Court, Case No. 99-3999. This case was filed on July 26, 1999 and seeks a refund of amounts paid by callers to the Lottery's 1-900 winning numbers information line, from the date of inception in October 1995, to present. The Lottery is defending the claim in court. If the Lottery is unsuccessful in its actions the potential refund liability could total approximately \$8 million.

**Litigation—Other—** 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.

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