

KPMG

NEW YORK STATE LOTTERY
Financial Statements
and Other Financial Information
Years Ended March 31, 1996 and 1995
(With Independent Auditors' Report Thereon)

NEW YORK STATE LOTTERY

Financial Statements
and Other Financial Information

Years Ended March 31, 1996 and 1995

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Independent Auditors' Report

New York State Lottery

We have audited the accompanying statements of assets and liabilities of the New York State Lottery as of March 31, 1996 and 1995, and the related statements of revenue and expenses, and cash flows for the years then ended. These financial statements are the responsibility of the New York State Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the New York State Lottery as of March 31, 1996 and 1995, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.



May 31, 1996

NEW YORK STATE LOTTERY

Statements of Assets and Liabilities

March 31, 1996 and 1995

(In Thousands)

<u>Assets</u>	<u>1996</u>	<u>1995</u>
Current assets:		
Cash and cash equivalents (Note 2)	\$ 137,134	157,657
Accounts receivable	115,813	102,422
Investments, at amortized cost (Note 3)	189,314	173,749
Instant game ticket inventory	<u>5,674</u>	<u>4,565</u>
Total current assets	447,935	438,393
Long-term investments, at amortized cost (Note 3)	1,433,240	1,320,572
Equipment and leasehold improvements, net of accumulated depreciation and amortization (Note 4)	<u>4,169</u>	<u>4,847</u>
Total assets	\$ <u><u>1,885,344</u></u>	<u><u>1,763,812</u></u>
<u>Liabilities</u>		
Current liabilities:		
Prizes payable (Note 5)	\$ 189,661	173,231
Unclaimed and future prizes	154,064	110,128
Due to education (Note 7)	66,146	107,882
Due to administration	5,657	7,108
Deferred revenue	9,422	10,709
Other payables	<u>9,493</u>	<u>18,053</u>
Total current liabilities	434,443	427,111
Long-term prizes payable (Note 5)	1,450,901	1,336,701
Commitments and contingencies (Note 11)	<u> </u>	<u> </u>
Total liabilities	\$ <u><u>1,885,344</u></u>	<u><u>1,763,812</u></u>

See accompanying notes to financial statements.

NEW YORK STATE LOTTERY
 Statements of Revenue and Expenses
 Years Ended March 31, 1996 and 1995
 (In Thousands)

	<u>1996</u>	<u>1995</u>
Ticket sales	\$ 3,610,638	3,028,585
Less:		
Prizes	(1,826,657)	(1,470,635)
Agent commissions	(216,638)	(181,725)
Contractor fees	(86,136)	(64,948)
Instant game ticket printing expense	<u>(12,609)</u>	<u>(7,915)</u>
Gross profit on ticket sales	1,468,598	1,303,362
General and administrative expenses	<u>(82,797)</u>	<u>(68,198)</u>
Income from operations	1,385,801	1,235,164
Nonoperating revenue (expenses):		
Interest income	134,980	121,877
Interest expense - amortization of discount on prizes payable	(127,578)	(117,314)
Other	<u>6,378</u>	<u>4,090</u>
Total nonoperating revenue	<u>13,780</u>	<u>8,653</u>
Income earned and required allocation to education, net (Note 7)	<u>\$ 1,399,581</u>	<u>1,243,817</u>
Components of income earned and required allocation to education, net:		
New York State	\$ 1,399,581	1,243,815
New York City (Note 1)	<u>—</u>	<u>2</u>
	<u>\$ 1,399,581</u>	<u>1,243,817</u>

See accompanying notes to financial statements.

NEW YORK STATE LOTTERY
 Statements of Cash Flows
 Years Ended March 31, 1996 and 1995
 (In Thousands)

	<u>1996</u>	<u>1995</u>
Cash flows from operating activities:		
Cash received from ticket sales	\$ 3,595,994	2,963,875
Cash payments for prizes	(1,779,079)	(1,413,235)
Cash payments for commissions and fees	(302,622)	(246,788)
Cash payments for ticket printing	(15,021)	(10,613)
Cash payments for general and administrative expenses	<u>(83,406)</u>	<u>(63,209)</u>
Net cash provided by operating activities	1,415,866	1,230,030
Cash flows from investing activities:		
Proceeds from investment maturities	180,805	162,822
Proceeds from sale of investments	4,918	-
Purchases of investments	(191,731)	(174,643)
Interest on cash and cash equivalents	6,875	4,202
Net proceeds from swaps of investment securities	3,843	2,513
Other cash payments and receipts, net	<u>2,226</u>	<u>1,374</u>
Net cash provided (used) by investing activities	6,936	(3,732)
Cash flows from noncapital financing activities:		
Cash transfer to education	(1,441,317)	(1,161,849)
Cash flows from capital financing activities:		
Cash payments for equipment and leasehold improvements	(806)	(31)
Principal payments on capital leases	<u>(1,202)</u>	<u>(1,126)</u>
Net cash used by capital financing activities	<u>(2,008)</u>	<u>(1,157)</u>
Net increase (decrease) in cash and cash equivalents	(20,523)	63,292
Cash and cash equivalents, beginning of year	<u>157,657</u>	<u>94,365</u>
Cash and cash equivalents, end of year	<u>\$ 137,134</u>	<u>157,657</u>
Reconciliation of income from operations to net cash provided by operating activities:		
Income from operations	1,385,801	1,235,164
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation and amortization	1,484	1,688
Amortization of discount on prizes payable	(127,578)	(117,314)
Change in operating assets and liabilities:		
Increase in accounts receivable	(13,292)	(65,505)
Increase in ticket inventory	(1,109)	(4,565)
Increase in prizes payable	130,630	137,732
Increase in unclaimed and future prizes	43,936	37,252
Increase (decrease) in due to administration	(1,451)	283
Increase (decrease) in deferred revenue	(1,287)	775
Increase (decrease) in other payables	<u>(1,268)</u>	<u>4,520</u>
Net cash provided by operating activities	<u>\$ 1,415,866</u>	<u>1,230,030</u>

See accompanying notes to financial statements.

NEW YORK STATE LOTTERY

Notes to Financial Statements

March 31, 1996 and 1995

(1) Summary of Significant Accounting Policies

The New York State Lottery (the "Lottery") was established in 1967. The Lottery is currently administered by the Division of the Lottery, an independent unit of the Department of Taxation and Finance, which was created in 1976 and operates in accordance with the provisions of the New York State Lottery for Education Law (Tax Law Article 34). The purpose of the Lottery is to raise revenue for education in the State of New York ("State") through the administration of lottery games.

The Lottery is included within the financial reporting entity of the State of New York. Within the General Purpose Financial Statements of the State of New York, the Lottery is accounted for within two funds. The revenue and expenses for administration, aid to education, and prizes are reported in a Special Revenue Fund. Monies for prizes are transferred to a Lottery Agency Fund for payment of prizes as claims are filed. The accompanying financial statements include the accounts of both funds and are presented as an enterprise fund. The accounting policies of the Lottery conform in all material respects to generally accepted accounting principles whereby revenue is recognized when earned and expenses are recognized when incurred.

During fiscal year 1992, Chapter 6 of the Laws of 1991 created a special anti-crime instant cash game (the City games) for sale only within the City of New York. The purpose was to generate revenue for educational purposes, including security at educational facilities, within New York City. The City games began in September 1991 and are authorized by the legislation to continue through June 1996. The New York State Lottery administers the City games and is reimbursed for administrative costs (including agent commissions and contractors' fees) of the games up to a maximum of 15% of game sales. The law also has a hold harmless provision which requires the City games to reimburse the Lottery for shortfalls in net revenue, as defined, resulting from other instant cash games administered by the Lottery in the City of New York not increasing at an annual rate of 5%. There were no shortfalls in fiscal years 1996 and 1995.

(a) Revenue Recognition

(i) On-line Games

Revenue from ticket sales for Lotto, Quick Draw, Take Five, Pick 10, New York Numbers and Win-4 games (on-line games) is recognized when the related drawing takes place. Receipts from subscription sales and other ticket sales for future drawings are recorded as deferred revenue and recognized when the related drawings take place.

(ii) Instant Cash Games

Revenue from instant cash games is recognized based on the dollar value of the total number of tickets available for sale. Tickets are available for sale upon being activated on the Lottery Validation System at the agent locations.

NEW YORK STATE LOTTERY

Notes to Financial Statements (continued)

(b) Commissions and Fees

Agents receive a commission of 6% based on the total tickets sold. The on-line game contractor receives a fee equal to a contractual percentage of the revenue generated through the respective network maintained by the contractor. All other gaming contractors are paid fees based on the units of service provided (see note 11).

(c) Allocation of Revenue from Ticket Sales

The allocation of ticket sales is made in accordance with the provisions of the New York State Lottery for Education Law which requires:

- Allocations of ticket sales revenue to New York State for educational purposes to be at least 30% for the New York State Lottery instant cash games, 35% for Take Five, New York Numbers, Win-4 and Pick 10, 45% for Lotto, and 25% for Quick Draw.
- Allocations of ticket sales revenue to New York City for educational purposes to be at least 25% for the New York City instant cash games, less any reimbursement to the Lottery for shortfalls in net revenue, as defined.
- Allocations of ticket sales revenue for the payment of lottery prizes not to exceed 55% for the New York State Lottery instant cash games, 50% for the Take Five, New York Numbers, Win-4, Pick 10, and New York City instant cash games, 40% for Lotto and 60% for Quick Draw.
- Allocations of ticket sales revenue from all games for the payment of Lottery administration expenses (including agent commissions and contractor fees) not to exceed 15%. Any excess of the maximum allocation over administration expenses is allocated to education as is any related interest or other income. Such allocations amounted to approximately \$145,603,000 and \$133,182,000 for fiscal years 1996 and 1995, respectively. Administration expenses incurred by the Lottery represent telecommunications, advertising, salary and other operating costs and include an accrual for expenses to be paid after the fiscal year-end.

(d) Cash Equivalents

For purposes of the statements of cash flows, the Lottery considers cash equivalents to be amounts held with banks and amounts held under the joint custody of the Lottery and the Office of the State Comptroller of the State of New York through the Short-Term Investment Pool, which is used for the temporary investment of funds not required for immediate payments.

(e) Investments

Investments, consisting of U.S. Government-backed obligations (zero coupon bonds and stripped Government securities), are carried at amortized cost. The periodic amortization of discount is recorded as interest income in these financial statements.

(f) Inventory

Instant cash game tickets are purchased from printers. Tickets not activated for sale are held in inventory and are valued at cost by game. Tickets are charged to printing expense under the first-in, first-out (FIFO) accounting method when activated for sale by the agents. At the conclusion of an instant cash ticket game unsold inventory is charged as a nonoperating expense.

NEW YORK STATE LOTTERY

Notes to Financial Statements (continued)

(g) Equipment and Leasehold Improvements

Equipment and leasehold improvements are carried at cost. Depreciation of equipment is computed using the straight-line method over five years, the estimated useful lives of the assets. Amortization of leasehold improvements and equipment acquired under capital leases are amortized using the straight-line method over ten and five years, respectively, which is the lesser of their useful lives or the term of the leases.

When assets are retired or otherwise disposed of, the cost and related accumulated depreciation or amortization are removed from the accounts and any resulting gain or loss is reflected in nonoperating revenue (expenses) in the period of disposal.

(h) Prizes Payable

Prizes payable represents the liability for those prizes which are payable in annual installments. Such prize payments are funded by the Lottery's investment in U.S. Government-backed securities. The periodic amortization of discount is recorded as interest expense in these financial statements. Any excess of investment maturities over prize payments is made available for prizes.

(i) Unclaimed and Future Prizes

Prizes unclaimed for one year after the drawing date are forfeited by the ticket holder. Total prizes forfeited amounted to approximately \$38,822,000 and \$27,916,000 for fiscal years 1996 and 1995, respectively.

Legislation passed in June 1991, allows the Lottery to retain forfeited prizes and to use such amounts for payment of supplemental prizes in subsequent Lottery games. During fiscal year 1996, such supplemental prizes were used for Lotto, during fiscal year 1995, such supplemental prizes were paid for Lotto, New York Numbers, and Win-4.

Future prizes represent the difference between the statutory allocation to prizes and the amount allocated to the winning pools of Lottery games. Such amounts are disbursed, as determined by management, for the sole benefit of Lottery game winners.

(j) Reclassification

Certain amounts for 1995 have been reclassified to conform to the 1996 presentation.

(2) Cash and Cash Equivalents

Lottery deposits and investments are made in accordance with New York State statutes.

Lottery sales receipts are allocated and deposited in investment fund accounts for prizes, education and administration under the joint custody of the Lottery and the Office of the State Comptroller of the State of New York. The account for prizes earns interest through participation in a short-term investment pool administered by the State Comptroller. The account for administration earned such interest until June 1994 when the criteria for earning interest was changed by new legislation. The carrying and market value of the accounts included in cash and cash equivalents were \$137,862,000 and \$158,104,000 at March 31, 1996 and 1995, respectively. Interest income earned in each investment account is used for the specific purpose and benefit of that account.

The Lottery also maintains sole custody accounts which are used for daily cash management purposes. The Lottery manages the investment of its cash balances to minimize its uninvested funds. At March 31, 1996 and 1995 the amount of outstanding checks in excess of bank balances included in cash and cash equivalents related to the sole custody accounts were (\$728,000) and (\$447,000), respectively.

NEW YORK STATE LOTTERY

Notes to Financial Statements (continued)

The Lottery's deposits are collateralized under a program administered by the Office of the State Comptroller of the State of New York. The State requires that its depository banks pledge collateral based on available bank balances. All securities pledged as collateral are held by the State's fiscal agent in the name of the State. The Lottery's deposits with financial institutions were fully collateralized at fiscal year-end.

(3) Investments

The Lottery is authorized to invest in U.S. Government-backed obligations (zero coupon bonds), which will provide for the payment of prizes payable (see note 5). During fiscal years 1996 and 1995, approximately \$127,976,000 and \$117,696,000, respectively, of amortized discount was included in interest income.

These investments consisted of the following at March 31 (in thousands):

	<u>1996</u>	<u>1995</u>
Maturity value	\$ 2,784,153	2,622,184
Less: unamortized discount	<u>1,161,599</u>	<u>1,127,863</u>
Total carrying value	1,622,554	1,494,321
Less: investments, maturing within one year	<u>189,314</u>	<u>173,749</u>
Long-term investments	<u>\$ 1,433,240</u>	<u>1,320,572</u>
Total market value	<u>\$ 1,781,053</u>	<u>1,594,142</u>

Maturities of the investments in each of the five fiscal years following March 31, 1996, and the total thereafter, are as follows (in thousands):

1997	\$ 196,455
1998	196,643
1999	196,322
2000	196,447
2001	196,480
Thereafter	<u>1,801,806</u>
	<u>\$ 2,784,153</u>

The Lottery periodically enters into certain swap transactions whereby stripped government securities are swapped for other stripped government securities with substantially identical terms and characteristics. During fiscal years 1996 and 1995, the face value of the securities swapped amounted to \$469,968,000 and \$859,881,000 resulting in a gain of approximately \$3,843,000 and \$2,513,000, respectively. This gain is included in nonoperating revenue in the caption "other."

The Lottery's investments are categorized to give an indication of the level of risk assumed by the Lottery at year-end. All of the Lottery's investments are included in category "A", the lowest risk, as defined by the Governmental Accounting Standards Board to include investments that are "insured or registered or securities held by the Lottery or its agent in the Lottery's name."

Disclosures relating to risk and type of investments as described above are indicative of activity and positions held during the year.

NEW YORK STATE LOTTERY

Notes to Financial Statements (continued)

(4) Equipment and Leasehold Improvements

Equipment and leasehold improvements as of March 31, are as follows (in thousands):

	<u>1996</u>	<u>1995</u>
Equipment (principally capital leases)	\$ 7,333	6,527
Leasehold improvements	4,526	4,526
	<u>11,859</u>	<u>11,053</u>
Less: accumulated depreciation and amortization	7,690	6,206
Equipment and leasehold improvements, net	<u>\$ 4,169</u>	<u>4,847</u>

The Lottery has entered into certain capital leases for computer equipment approximating \$5,378,000 at March 31, 1996 and 1995. Accumulated amortization for the capital leases approximated \$4,654,000 and \$3,889,000 for fiscal years 1996 and 1995, respectively.

(5) Prizes Payable

Prizes payable consisted of the following at March 31 (in thousands):

	<u>1996</u>	<u>1995</u>
Total obligation	\$ 2,810,818	2,635,786
Less: unamortized discount	<u>1,170,256</u>	<u>1,125,854</u>
Total carrying amount	1,640,562	1,509,932
Less: prizes payable within one year	<u>189,661</u>	<u>173,231</u>
Long-term prizes payable	<u>\$ 1,450,901</u>	<u>1,336,701</u>

The amortized discount on the prizes payable is based on interest rates which range from 3.01% to 13.55% and reflect the interest rates earned by the investments held to fund the related liabilities. The amortization of discount is recorded as interest expense in the statements of revenue and expenses and amounted to \$127,578,000 and \$117,314,000 for fiscal years 1996 and 1995, respectively.

The aggregate amount of prizes payable due in each of the five fiscal years following March 31, 1996, and the total thereafter, is as follows (in thousands):

1997	\$ 196,328
1998	196,345
1999	197,213
2000	197,242
2001	197,394
Thereafter	<u>1,826,296</u>
	<u>\$ 2,810,818</u>

NEW YORK STATE LOTTERY

Notes to Financial Statements (continued)

(6) Operating Segment Information

Operating segment information for fiscal 1996 and 1995 by type of lottery game is as follows (in thousands):

1996						
	Ticket Sales	Prizes	Agent Commissions	Contractor Fees	Instant Cash Game Ticket Expense	Gross Profit on Ticket Sales
Lotto	\$ 755,801	(308,372)	(45,348)	(11,265)	-	390,816
Take Five	325,936	(163,600)	(19,556)	(4,970)	-	137,810
Pick 10	71,368	(35,823)	(4,282)	(1,088)	-	30,175
New York						
Numbers	676,905	(339,765)	(40,614)	(10,323)	-	286,203
Win-4	416,173	(208,894)	(24,970)	(6,347)	-	175,962
Instant Cash						
Games	1,022,345	(564,272)	(61,341)	(44,779)	(12,609)	339,344
Quick Draw	342,110	(205,929)	(20,527)	(7,364)	-	108,290
City Games	-	(2)	-	-	-	(2)
	<u>\$ 3,610,638</u>	<u>(1,826,657)</u>	<u>(216,638)</u>	<u>(86,136)</u>	<u>(12,609)</u>	<u>1,468,598</u>
General and administrative expenses						(82,797)
Nonoperating revenue						<u>13,780</u>
Income earned and required allocation to education, net						<u>\$ 1,399,581</u>

1995						
	Ticket Sales	Prizes	Agent Commissions	Contractor Fees	Instant Cash Game Ticket Expense	Gross Profit on Ticket Sales
Lotto	\$ 839,375	(339,777)	(50,372)	(12,543)	-	436,683
Take Five	334,232	(167,565)	(20,054)	(5,097)	-	141,516
Pick 10	83,608	(41,917)	(5,017)	(1,275)	-	35,399
New York						
Numbers	689,374	(345,614)	(41,362)	(10,513)	-	291,885
Win-4	415,847	(208,482)	(24,951)	(6,342)	-	176,072
Instant Cash						
Games	666,145	(367,275)	(39,969)	(29,178)	(7,915)	221,808
City Games	4	(5)	-	-	-	(1)
	<u>\$ 3,028,585</u>	<u>(1,470,635)</u>	<u>(181,725)</u>	<u>(64,948)</u>	<u>(7,915)</u>	<u>1,303,362</u>
General and administrative expenses						(68,198)
Nonoperating revenue						<u>8,653</u>
Income earned and required allocation to education, net						<u>\$ 1,243,817</u>

NEW YORK STATE LOTTERY

Notes to Financial Statements (continued)

(7) Education

Income earned and required allocation to education during the fiscal years ended March 31, 1996 and 1995, are as follows (in thousands):

	<u>1996</u>	<u>1995</u>
Revenue transferred to education	\$ 1,441,317	1,161,849
Prior year payable	<u>(107,882)</u>	<u>(25,914)</u>
Amount transferred from current year revenue	1,333,435	1,135,935
Current year payable	66,146	107,882
Income earned and required allocation to education, net	<u>\$ 1,399,581</u>	<u>1,243,817</u>

(8) Pension Benefits

Substantially all employees of the Lottery are members of the New York State and Local Employees' Retirement System (System), a cost-sharing, multiple employer public employee retirement system. The State Comptroller is sole trustee and administrative head of the System. The System issues a publicly available financial report that includes financial statements and required supplementary information which may be obtained by writing to New York State and Local Employees' Retirement System, Alfred E. Smith Office Building, Albany, New York 12244.

The System provides retirement benefits as well as death and disability benefits. All benefits vest after ten years of accredited service. Retirement benefits are established by the New York State Retirement and Social Security Law. Retirement benefits and contributory requirements depend upon the point in time at which an employee last joined the System. Most members of the System who joined before July 27, 1976 are enrolled in a noncontributory plan; the Lottery contributes the entire amount determined to be payable to the System. Personnel who joined the System after July 27, 1976 are required by law to contribute three percent of their gross salary; the Lottery contributes the balance payable to the System for these employees.

Effective April 1, 1990, the State Legislature amended the Retirement and Social Security Law and mandated a change in the actuarial funding method from the aggregate cost funding method to a modified projected unit credit funding method. This new method utilized a rolling amortization period for differences between actuarial assets and actuarial accrued liabilities, of which approximately 17% of such differences were recognized as credits each year in determining the funding amount. The legislated change was later found by the State Court of Appeals to be unconstitutional. Consequently, the System returned to the aggregate method on April 1, 1994 using a four-year phase-in.

The Lottery paid to the New York State Comptroller's Office \$637,000 for 1996, \$376,000 for 1995 and \$261,000 for 1994 to cover required employer contributions for retirement benefits. These payments made represent 6.09%, 4.1% and 3.1% of covered payroll for each of the years, respectively.

(9) Deferred Compensation

New York State offers its employees, including Lottery employees, a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all employees, permits them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death or unforeseeable emergency.

NEW YORK STATE LOTTERY

Notes to Financial Statements (continued)

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 (until paid or made available to the employee or other beneficiary) solely the property and rights of the State (without being restricted to the provisions of benefits under the plan), subject only to the claims of the State's general creditors. Participants' rights under the plan are equal to those of general creditors of the State in the amount equal to the fair market value of the deferred account for each participant. The assets and liabilities related to this plan are recorded in the State's financial statements.

(10) Postretirement Benefits

In addition to the pension benefits described in Note 8, the State provides health insurance coverage and survivor benefits for retired employees and their survivors. Substantially all of the State's employees may become eligible for these benefits if they reach normal retirement age while working for the State. Health care benefits are provided through an insurance company whose premiums are based on the benefits paid during the year. The State recognizes the cost of providing health insurance by recording its share of insurance premiums as an expenditure in the general fund in the year paid. Additionally, the survivor's benefit program provides for a death benefit to be paid by the State to a retiree's designated beneficiary. The Lottery is not directly charged for these benefits to its former employees.

(11) Commitments and Contingencies

(a) Contractual Arrangements

The Lottery maintains a gaming network of over 10,600 on-line locations where all games are sold and over 3,000 off-line locations which sell only instant cash game tickets. GTECH Corporation (GTECH) is responsible for operating the on-line games under a contract expiring on February 28, 1999. Instant cash game sales are supported by the services of four contractors:

- (1) Under a contract expiring January 31, 1997, Scientific Games, Inc. is responsible for maintaining validating devices installed at each sales location.
- (2) Under a contract expiring July 14, 1996, Dittler Brothers, Inc. is responsible for production of instant cash tickets.
- (3) Under a contract expiring January 13, 1997, GTECH is responsible for various services related to the warehousing, sales, distribution of, and accounting for, instant cash tickets.
- (4) Instant cash tickets are also sold through vending machines at approximately 2,600 locations. A contract with Lottery Enterprises, Inc., expiring on July 14, 1996, provides for maintenance of the vending machines.

NEW YORK STATE LOTTERY

Notes to Financial Statements (continued)

(b) Capital and Operating Leases

The Lottery has entered into certain capital lease obligations with the State of New York which are included in other payables. The leases require semi-annual payments approximating \$638,000 through March 1996 and \$65,000 thereafter, including interest of 6.60% and 5.11% (imputed interest remaining under these leases is approximately \$23,000 and \$97,000 at March 31, 1996 and 1995, respectively). The leases expire in March 1996 and August 1998.

In addition the Lottery has entered into operating leases for equipment and building space. Rental expense was \$5,238,000 and \$3,973,000 in 1996 and 1995, respectively.

The following is a schedule of future minimum lease payments under noncancellable operating leases having initial or remaining terms in excess of one year as of March 31, 1996:

<u>Fiscal Year</u>	<u>Operating Leases</u>
1997	\$ 6,238,000
1998	5,843,000
1999	5,830,000
2000	3,914,000
2001	2,296,000
Thereafter	80,000
Total minimum lease payments	<u>\$ 24,201,000</u>

(c) Insurance Contracts

Prior to 1983, the Lottery had entered into agreements with New York insurance companies under which the Lottery purchased contracts that provide payments corresponding to the Lottery's obligation to the prize winners. The types of contracts entered into include agreements that pay installments for a specific term (investment contracts) as well as agreements to make installment payments to prize winners over the winners' lifetime. Because it is the intent of the Lottery that the insurance companies make future installment payments directly to each prize winner, the present value of the future payments under these contracts are not reflected in the accompanying financial statements. The Lottery may be liable for such future payments if the insurance companies were to default on their payments. Unpaid amounts under the investment contracts approximated \$63,000,000 at March 31, 1996, which have a fair value that approximates \$50,000,000. For contracts other than investment contracts, the insurance companies are making annual payments to approximately 65 individuals totaling approximately \$1,200,000 as of March 31, 1996.

(d) Litigation:

The Lottery has been named as a defendant in several lawsuits. While the ultimate outcome of these lawsuits cannot be predicted at this time, it is the opinion of management and in-house counsel that the disposition of any litigation in which the Lottery is involved will not have a material adverse effect on the financial position of the Lottery.

Other Financial Information

Independent Auditors' Report
on Other Financial Information

New York State Lottery

We have audited and reported separately herein on the financial statements of the New York State Lottery as of and for the year ended March 31, 1996.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements of the New York State Lottery taken as a whole. The following combining schedule of assets and liabilities and combining schedule of revenue and expenses is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

KPMG Peat Marwick LLP

May 31, 1996

NEW YORK STATE LOTTERY

Combining Schedule of Assets and Liabilities

March 31, 1996
(In Thousands)

<u>Assets</u>	<u>All Other Games</u>	<u>City Games</u>	<u>Eliminations</u>	<u>Combined Total</u>
Current assets:				
Cash and cash equivalents	\$ 137,095	39	-	137,134
Accounts receivable	122,139	-	(6,326)	115,813
Investments, at amortized cost	189,314	-	-	189,314
Instant game ticket inventory	<u>5,674</u>	<u>-</u>	<u>-</u>	<u>5,674</u>
Total current assets	454,222	39	(6,326)	447,935
Long-term investments, at amortized cost	1,433,240	-	-	1,433,240
Equipment and leasehold improvements, net of accumulated depreciation and amortization	<u>4,169</u>	<u>-</u>	<u>-</u>	<u>4,169</u>
Total assets	<u>\$1,891,631</u>	<u>39</u>	<u>(6,326)</u>	<u>1,885,344</u>
<u>Liabilities</u>				
Current liabilities:				
Prizes payable	\$ 189,661	-	-	189,661
Unclaimed and future prizes	154,025	39	-	154,064
Due to education	72,530	(6,384)	-	66,146
Due to administration	5,657	-	-	5,657
Deferred revenue	9,422	-	-	9,422
Hold harmless payable	-	6,326	(6,326)	-
Other payables	<u>9,435</u>	<u>58</u>	<u>-</u>	<u>9,493</u>
Total current liabilities	440,730	39	(6,326)	434,443
Long-term prizes payable	<u>1,450,901</u>	<u>-</u>	<u>-</u>	<u>1,450,901</u>
Total liabilities	<u>\$ 1,891,631</u>	<u>39</u>	<u>(6,326)</u>	<u>1,885,344</u>

Note: The hold harmless payable represents the cumulative uncollected balance of the statutory shortfall in net revenue, as defined (see Note 1), based on the annual hold harmless calculation made on the last day of February. The shortfall for fiscal year 1996 was \$0. The remaining \$6,326,000 represents uncollected short fall of prior years. Under the City games legislation, the shortfall can only be recovered from future revenue of City games.

NEW YORK STATE LOTTERY

Combining Schedule of Revenue and Expenses

March 31, 1996
(In Thousands)

	<u>All Other Games</u>	<u>City Games</u>	<u>Combined Total</u>
Ticket sales	\$ 3,610,638	-	3,610,638
Less:			
Prizes	(1,826,655)	(2)	(1,826,657)
Agent commissions	(216,638)	-	(216,638)
Contractor fees	(86,136)	-	(86,136)
Instant game ticket printing expense	<u>(12,609)</u>	<u>-</u>	<u>(12,609)</u>
Gross profit on ticket sales	1,468,600	(2)	1,468,598
General and administrative expenses	<u>(82,797)</u>	<u>-</u>	<u>(82,797)</u>
Income (loss) from operations	<u>1,385,803</u>	<u>(2)</u>	<u>1,385,801</u>
Nonoperating revenue (expenses):			
Interest income	134,978	2	134,980
Interest expense - amortization of discount on prizes payable	(127,578)	-	(127,578)
Hold harmless, City games	-	-	-
Other	<u>6,378</u>	<u>-</u>	<u>6,378</u>
Total nonoperating revenue	<u>13,778</u>	<u>2</u>	<u>13,780</u>
Income earned and required allocation to education, net	<u>\$ 1,399,581</u>	<u>-</u>	<u>1,399,581</u>

Note: Hold harmless, City games represents the statutory shortfall in net revenue, as defined (see Note 1), based on the hold harmless calculation for the twelve-month period ended February 29, 1996.