



NEW YORK STATE LOTTERY

Financial Statements

Years Ended March 31, 1999 and 1998

(With Independent Auditors' Report Thereon)

NEW YORK STATE LOTTERY

Financial Statements

Years ended March 31, 1999 and 1998

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515 Broadway
Albany, NY 12207

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, 1999 and 1998, 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.

As discussed in Note 1, the financial statements present only the New York State Lottery and do not present the financial position of the State of New York and the results of its operations and cash flows.

In our opinion, the financial statements referred to above present fairly, in all material respects, the assets and liabilities of the New York State Lottery as of March 31, 1999 and 1998, and its revenue, expenses, and cash flows for the years then ended in conformity with generally accepted accounting principles.

The year 2000 supplementary information on page 16 is not a required part of the financial statements, but is supplementary information required by the Governmental Accounting Standards Board, and we did not audit and do not express an opinion on such information. Further, we were unable to apply to the information certain procedures prescribed by professional standards because of the nature of the subject matter underlying the disclosure requirements and because sufficiently specific criteria regarding the matters to be disclosed have not been established. In addition, we do not provide assurance that the New York State Lottery is or will become year 2000 compliant, that the New York State Lottery's year 2000 remediation efforts will be successful in whole or in part, or that parties with which the New York State Lottery does business are or will become year 2000 compliant.

KPMG LLP

June 8, 1999



KPMG LLP, KPMG LLP, a U.S. limited liability partnership, is a member of KPMG International, a Swiss association.

NEW YORK STATE LOTTERY

Statements of Assets and Liabilities

March 31, 1999 and 1998

(In Thousands)

Assets	<u>1999</u>	<u>1998</u> (As restated, Note 2)
Current assets:		
Cash and cash equivalents (Note 3)	\$ 191,560	151,078
Accounts receivable, net	122,185	175,904
Investments (Note 4)	205,641	201,201
Instant game ticket inventory	5,395	5,842
Total current assets	<u>524,781</u>	<u>534,025</u>
Long-term investments (Note 4)	1,604,321	1,637,888
Equipment and leasehold improvements, net of accumulated depreciation and amortization (Note 5)	<u>1,247</u>	<u>2,345</u>
Total assets	<u>\$ 2,130,349</u>	<u>2,174,258</u>
 Liabilities		
Current liabilities:		
Prizes payable (Note 6)	\$ 205,405	199,192
Unclaimed and future prizes	397,799	396,027
Due to education (Note 7)	41,552	70,650
Due to administration	14,766	15,669
Deferred revenue	2,566	14,851
Other payables	15,558	11,545
Total current liabilities	<u>677,646</u>	<u>707,934</u>
Long-term prizes payable (Note 6)	1,452,703	1,466,324
Commitments and contingencies (Note 12)	<u>—</u>	<u>—</u>
Total liabilities	<u>\$ 2,130,349</u>	<u>2,174,258</u>

See accompanying notes to financial statements.

NEW YORK STATE LOTTERY

Statements of Revenue and Expenses

Years ended March 31, 1999 and 1998

(In Thousands)

	<u>1999</u>	<u>1998</u> (As restated, Note 2)
Revenue:		
Ticket sales	\$ 3,697,631	3,943,096
Investment income	132,583	241,089
Other income	534	638
Total revenue	<u>3,830,748</u>	<u>4,184,823</u>
Expenses:		
Prizes	1,871,970	2,093,566
Agent commissions	221,840	236,851
Contractor fees	88,969	95,595
Instant game ticket printing	8,516	9,107
General and administrative expenses	97,500	89,631
Interest expense	128,624	131,219
Total expenses	<u>2,417,419</u>	<u>2,655,969</u>
Net income and required allocation to education (Note 7)	<u>\$ 1,413,329</u>	<u>1,528,854</u>

See accompanying notes to financial statements.

NEW YORK STATE LOTTERY

Statements of Cash Flows

Years ended March 31, 1999 and 1998

(In Thousands)

	<u>1999</u>	<u>1998</u>
		(As restated, Note 2)
Cash flows from operating activities:		
Cash received from ticket sales	\$ 3,739,217	3,939,855
Cash payments for prizes	(2,008,009)	(2,120,032)
Cash payments for commissions and fees	(311,732)	(332,303)
Cash payments for ticket printing	(5,449)	(9,695)
Cash payments for general and administrative expenses	(93,605)	(89,937)
Net cash provided by operating activities	<u>1,320,422</u>	<u>1,387,888</u>
Cash flows from investing activities:		
Proceeds from investment maturities	206,621	202,635
Proceeds from sale of investments	3,540	5,799
Purchases of investments	(62,469)	(76,963)
Interest on cash and cash equivalents	9,023	9,546
Net proceeds from swaps of investment securities	4,912	—
Other cash payments and receipts, net	956	1,105
Net cash provided by investing activities	<u>162,583</u>	<u>142,122</u>
Cash flows from noncapital financing activities:		
Cash transfer to education	(1,442,427)	(1,533,924)
Cash flows from capital financing activities:		
Cash payments for equipment and leasehold improvements	—	(47)
Principal payments on capital leases	(96)	(150)
Net cash used by capital financing activities	<u>(96)</u>	<u>(197)</u>
Net increase (decrease) in cash and cash equivalents	40,482	(4,111)
Cash and cash equivalents, beginning of year	<u>151,078</u>	<u>155,189</u>
Cash and cash equivalents, end of year	<u>\$ 191,560</u>	<u>151,078</u>

(Continued)

NEW YORK STATE LOTTERY

Statements of Cash Flows

Years ended March 31, 1999 and 1998

(In Thousands)

	<u>1999</u>	<u>1998</u> (As restated, Note 2)
Reconciliation of net income and required allocation to education to net cash provided by operating activities:		
Net income and required allocation to education	\$ 1,413,329	1,528,854
Adjustments to reconcile net income and required allocation to education to net cash provided by operating activities:		
Investment income	(132,583)	(241,089)
Other income	(534)	(638)
Depreciation and amortization	682	963
Amortization of discount on prizes payable	128,624	131,219
Change in operating assets and liabilities:		
Decrease (increase) in accounts receivable, net	53,846	(6,950)
Decrease (increase) in ticket inventory	447	(2,082)
Decrease in prizes payable	(136,032)	(128,161)
Increase in unclaimed and future prizes	1,772	102,906
(Decrease) increase in due to administration	(958)	2,651
(Decrease) increase in deferred revenue	(12,285)	3,941
Increase (decrease) in other payables	4,114	(3,726)
Net cash provided by operating activities	\$ <u>1,320,422</u>	<u>1,387,888</u>

See accompanying notes to financial statements.

NEW YORK STATE LOTTERY

Notes to Financial Statements

March 31, 1999 and 1998

(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. These financial statements present only the Lottery and do not present the financial position of the State of New York, and the results of its operations and cash flows. 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.

(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. Revenue and receipts for the Lucky Day promotional game that started in February 1997 and ended in October 1997 were recognized consistent with on-line games.

(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.

(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 12).

NEW YORK STATE LOTTERY

Notes to Financial Statements

March 31, 1999 and 1998

(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 Lucky Day promotional game, and 25% for Quick Draw.
- 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 Take Five, New York Numbers, Win-4, and Pick 10, 40% for Lotto and Lucky Day promotional game, 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 \$138,354,000 and \$160,918,000 for fiscal years 1999 and 1998, 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 fair value.

(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 offset against other income.

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Notes to Financial Statements

March 31, 1999 and 1998

(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. 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 other income (expense) in the period of disposal.

(h) *Prizes Payable*

Lotto jackpot players have the option of selecting a lump sum payment in lieu of long term annuity payments. 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*

Unclaimed prizes at March 31, 1999 and 1998 were \$74,272,000 and \$132,048,000, respectively. Prizes unclaimed for one year after the drawing date (lapsed) are forfeited by the ticket holder. Total prizes lapsed amounted to approximately \$68,586,000 and \$62,488,000 for fiscal years 1999 and 1998, respectively.

Under the Tax Law, the Lottery retains forfeited prizes for supplemental prizes in subsequent Lottery games. During fiscal years 1999 and 1998, such supplemental prizes were used primarily for Lotto.

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. Also included in future prizes is an amount equivalent to the unrealized gain on investments. This treatment recognizes that these funds must be available for the payment of installment prizes in future periods.

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Notes to Financial Statements

March 31, 1999 and 1998

(2) Restatement for Adoption of Accounting Pronouncement

In 1999, the Lottery adopted Governmental Accounting Standards Board (GASB) No. 31, "Accounting and Financial Reporting for Certain Investments and for External Investment Pools." The provisions of GASB No. 31 require all governmental entities to report investments at fair value on the balance sheet and to report all investment income, including changes in fair value, consistent with the purpose of the investment in the operating statement.

Changes associated with the implementation of GASB No. 31 have been retroactively applied to April 1, 1997. Investments and unclaimed and future prizes at April 1, 1997 were increased by \$95,791,000. Subsequent changes in the fair value of investments held during 1999 and 1998 are accounted for in the statements of revenue and expenses for the years ended March 31, 1999 and 1998 as investment income and prize expense.

(3) 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 carrying amount of the accounts included in cash and cash equivalents were \$192,899,000 and \$153,602,000 at March 31, 1999 and 1998, respectively. The cost of cash equivalents approximates market value. 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, 1999 and 1998 the amount of outstanding checks in excess of bank balances included in cash and cash equivalents related to the sole custody accounts were (\$1,339,000) and (\$2,524,000), respectively.

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.

(4) 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 6). During fiscal years 1999 and 1998, approximately \$129,030,000 and \$131,624,000, respectively, of amortized discount was included in investment income.

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

	1999	1998
Maturity value	\$ 2,666,677	2,752,005
Less: unamortized discount	1,041,292	1,108,299
Total carrying value	1,625,385	1,643,706
Less: investments, maturing within one year, at amortized cost	202,634	199,177
Long-term investments, at amortized cost	\$ 1,422,751	1,444,529
 Total market value of investments	 \$ 1,809,962	 1,839,089

Maturities of the investments in each of the five fiscal years following March 31, 1999, and the total thereafter, are as follows (in thousands):

2000	\$	210,549
2001		211,022
2002		211,386
2003		211,893
2004		212,364
Thereafter		1,609,463
	\$	2,666,677

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 year 1999, the face value of the securities swapped amounted to \$385,134,000 resulting in a gain of approximately \$4,912,000. This gain is included in investment income. During fiscal year 1998, there were no swap transactions.

The Lottery's investments are categorized to give an indication of the level of custodial 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.

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Notes to Financial Statements

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(5) Equipment and Leasehold Improvements

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

	<u>1999</u>	<u>1998</u>
Equipment	\$ 2,361	7,120
Leasehold improvements	<u>4,526</u>	<u>4,526</u>
	6,887	11,646
Less: accumulated depreciation and amortization	<u>5,640</u>	<u>9,301</u>
Equipment and leasehold improvements, net	\$ <u><u>1,247</u></u>	<u><u>2,345</u></u>

The Lottery has entered into certain capital leases for computer equipment approximating \$563,000 and \$5,378,000 at March 31, 1999 and 1998, respectively. As of March 31, 1999, all capital leases have been fully amortized. Accumulated amortization for the capital leases approximated \$4,879,000 for fiscal year 1998.

(6) Prizes Payable

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

	<u>1999</u>	<u>1998</u>
Total obligation	\$ 2,747,745	2,787,666
Less: unamortized discount	<u>1,089,637</u>	<u>1,122,150</u>
Total carrying amount	1,658,108	1,665,516
Less: prizes payable within one year	<u>205,405</u>	<u>199,192</u>
Long-term prizes payable	\$ <u><u>1,452,703</u></u>	<u><u>1,466,324</u></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 \$128,624,000 and \$131,219,000 for fiscal years 1999 and 1998, respectively.

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March 31, 1999 and 1998

The aggregate amount of prizes payable due in each of the five fiscal years following March 31, 1999, and the total thereafter, is as follows (in thousands):

2000	\$	210,546
2001		210,837
2002		211,111
2003		211,389
2004		211,650
Thereafter		<u>1,692,212</u>
	\$	<u><u>2,747,745</u></u>

(7) Education Revenue

Net income and required allocation to education during the fiscal years ended March 31, 1999 and 1998, are as follows (in thousands):

	<u>1999</u>	<u>1998</u>
Revenue transferred to education	\$ 1,442,427	1,533,924
Prior year payable	<u>(70,650)</u>	<u>(75,720)</u>
Amount transferred from current year revenue	1,371,777	1,458,204
Current year payable	<u>41,552</u>	<u>70,650</u>
Net income and required allocation to education	\$ <u><u>1,413,329</u></u>	<u><u>1,528,854</u></u>

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Notes to Financial Statements

March 31, 1999 and 1998

(8) Segment Information

Segment information for fiscal 1999 and 1998 by type of lottery game is as follows (in thousands):

	1999					
	<u>Revenue</u>	<u>Expenses</u>				<u>Ticket Printing</u>
		<u>Prizes</u>	<u>Commissions</u>	<u>Fees</u>		
Lotto	\$ 749,245	(291,684)	(44,931)	(11,202)	-	401,428
Take Five	360,871	(181,861)	(21,658)	(5,505)	-	151,847
Pick 10	47,770	(24,074)	(2,866)	(729)	-	20,101
New York Numbers	701,126	(353,334)	(42,068)	(10,692)	-	295,032
Win-4	441,651	(222,571)	(26,499)	(6,735)	-	185,846
Instant Cash Games	911,538	(504,886)	(54,692)	(39,925)	(8,516)	303,519
Quick Draw	485,430	(293,560)	(29,126)	(14,181)	-	148,563
	<u>\$ 3,697,631</u>	<u>(1,871,970)</u>	<u>(221,840)</u>	<u>(88,969)</u>	<u>(8,516)</u>	1,506,336
Investment income						132,583
Other income						534
General and administrative						(97,500)
Interest expense						<u>(128,624)</u>
Net income and required allocation to education						<u>\$ 1,413,329</u>

	1998 (As restated)					
	<u>Revenue</u>	<u>Expenses</u>				<u>Ticket Printing</u>
		<u>Prizes</u>	<u>Commissions</u>	<u>Fees</u>		
Lotto	\$ 870,487	(445,697)	(52,213)	(13,038)	-	359,539
Take Five	384,782	(193,388)	(23,087)	(5,859)	-	162,448
Pick 10	49,872	(25,065)	(2,992)	(761)	-	21,054
New York Numbers	698,527	(351,073)	(41,911)	(10,652)	-	294,891
Win-4	434,969	(218,611)	(26,098)	(6,633)	-	183,627
Instant Cash Games	991,688	(552,149)	(59,783)	(43,436)	(9,107)	327,213
Quick Draw	504,444	(304,235)	(30,267)	(15,089)	-	154,853
Lucky Day	8,327	(3,348)	(500)	(127)	-	4,352
	<u>\$ 3,943,096</u>	<u>(2,093,566)</u>	<u>(236,851)</u>	<u>(95,595)</u>	<u>(9,107)</u>	1,507,977
Investment income						241,089
Other income						638
General and administrative						(89,631)
Interest expense						<u>(131,219)</u>
Net income and required allocation to education						<u>\$ 1,528,854</u>

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Notes to Financial Statements

March 31, 1999 and 1998

(9) 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.

The Lottery paid to the New York State Comptroller's Office \$709,000 for 1999, \$902,000 for 1998, and \$819,000 for 1997, to cover required employer contributions for retirement benefits. These payments made represent 5.37%, 7.21% and 6.88% of covered payroll for each of the years, respectively.

(10) 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. All amounts of compensation deferred under the plan, are placed in trust for the participants and their beneficiaries.

(11) Postretirement Benefits

In addition to the pension benefits described in Note 9, 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.

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Notes to Financial Statements

March 31, 1999 and 1998

(12) Commitments and Contingencies

(a) Contractual Arrangements

The Lottery maintains a gaming network of over 14,000 on-line locations where all games are sold and over 2,300 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 29, 2000. Instant cash game sales are supported by the services of four contractors:

- (1) Under a contract expiring January 31, 2000, Scientific Games, Inc. is responsible for maintaining validating devices installed at each sales location.
- (2) Under a contract expiring June 10, 1999, Scientific Games, Inc. is responsible for production of instant cash tickets.
- (3) Under a contract expiring January 13, 2000, 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 3,400 locations. A contract with On-Point Technology (formerly Lottery Enterprises, Inc.), expiring on March 31, 2000, provides for maintenance of the vending machines.

(b) Capital and Operating Lease

The Lottery has entered into operating leases for equipment and building space. Rental expense was \$9,988,000 and \$6,608,000 in 1999 and 1998, 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, 1999:

2000	\$ 4,309,000
2001	3,860,000
2002	3,314,000
2003	2,958,000
2004	2,879,000
Thereafter	<u>3,293,000</u>
Total minimum lease payments	<u>\$ 20,613,000</u>

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(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 \$33,000,000 at March 31, 1999, which have a fair value that approximates \$29,000,000. For contracts other than investment contracts, the insurance companies are making annual payments to approximately 57 individuals totaling approximately \$620,000 as of March 31, 1999.

(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.

(13) Required Supplementary Information – Year 2000 (Unaudited)

The Lottery, along with other New York State agencies, has been addressing the Year 2000 issue for some time. The Lottery reports to the New York State Office of State Operations, which, through the New York State Office for Technology, monitors, coordinates, and facilitates Year 2000 compliance programs for all New York State agencies. The Lottery's Year 2000 team reports to the Director of the Lottery and is represented at the executive level of the agency.

The Lottery has identified and tasked specific individuals with responsibility for Year 2000 support work, and much progress has been made to date. The Lottery's top Year 2000 priority, the vendor audit system, is expected to be Year 2000 compliant as of June 30, 1999. Other high priority systems are expected to be completed September 30, 1999. Testing and contingency planning with data partners, service providers and embedded system vendors is ongoing.

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The Lottery mainframe has been replaced, and Year 2000 compliant operating system software has been tested, and is now being used in production. The Lottery's PC's have been replaced with ones that are hardware compliant, and their operating system software is being upgraded to a compliant version. Major vendors that supply programming and services to the Lottery are making and testing their changes, which will be subject to additional Lottery tests later this year. Lottery programs that are critical to operations have been identified, and are in various stages of compliance.

The Lottery is making all reasonable efforts to provide for Year 2000 readiness, and anticipates that there will be no Year 2000 related interruptions in the operation of Lottery systems.