



NEW YORK STATE LOTTERY

Financial Statements

Years Ended March 31, 2001 and 2000

(With Independent Auditors' Report Thereon)

NEW YORK STATE LOTTERY

Financial Statements

Years ended March 31, 2001 and 2000

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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 ("Lottery") as of March 31, 2001 and 2000, and the related statements of revenue and expenses, and cash flows for the years 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 audits.

We conducted our audits 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 audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the New York State Lottery and are intended to present the financial position and results of operations and the cash flows of only that portion of the financial reporting entity of the State that is attributable to the transactions of the Lottery. They 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, 2001 and 2000, and its revenue, expenses, and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

KPMG LLP

May 25, 2001



KPMG LLP/KPMG LLP a US limited liability partnership, is a member of KPMG network, a Swiss association.

NEW YORK STATE LOTTERY

Statements of Assets and Liabilities

March 31, 2001 and 2000

(In Thousands)

Assets	2001	2000
	<u> </u>	<u> </u>
Current assets:		
Cash and cash equivalents (Note 2)	\$ 182,873	154,426
Accounts receivable, net	211,859	163,031
Investments (Note 3)	213,394	207,298
Instant game ticket inventory	5,089	4,275
Total current assets	<u>613,215</u>	<u>529,030</u>
 Long-term investments (Note 3)	 1,502,833	 1,472,361
 Equipment and leasehold improvements, net of accumulated depreciation and amortization (Note 4)	 <u>230</u>	 <u>689</u>
 Total assets	 <u><u>\$ 2,116,278</u></u>	 <u><u>2,002,080</u></u>
 Liabilities		
Current liabilities:		
Prizes payable (Note 5)	\$ 212,445	208,929
Unclaimed and future prizes	383,930	301,204
Due to education (Note 6)	115,582	61,680
Due to administration	11,656	8,559
Deferred revenue	8,193	10,309
Other payables and liabilities	27,969	14,905
Total current liabilities	<u>759,775</u>	<u>605,586</u>
 Long-term prizes payable (Note 5)	 1,356,503	 1,396,494
 Commitments and contingencies (Note 11)	 <u> </u>	 <u> </u>
 Total liabilities	 <u><u>\$ 2,116,278</u></u>	 <u><u>2,002,080</u></u>

See accompanying notes to financial statements.

NEW YORK STATE LOTTERY

Statements of Revenue and Expenses

Years ended March 31, 2001 and 2000

(In Thousands)

	<u>2001</u>	<u>2000</u>
Income from operations:		
Ticket sales	S 4,185,330	3,629,258
Prize expenses	(2,273,582)	(1,848,929)
Retailer commissions	(250,157)	(217,429)
Contractor fees	(104,810)	(89,834)
Instant ticket printing expense	(12,373)	(9,215)
Gross profit on ticket sales	<u>1,544,408</u>	<u>1,463,851</u>
Administrative expenses	(98,598)	(99,946)
Income from operations	<u>1,445,810</u>	<u>1,363,905</u>
Non-Operating Income:		
Investment income	219,081	44,057
Other revenue, net	1,089	1,238
Investment expense	(209,363)	(33,470)
Indirect prize expense	(9,718)	(10,587)
Total non-operating income	<u>1,089</u>	<u>1,238</u>
Net income and required allocation to education (Note 6)	S <u><u>1,446,899</u></u>	<u><u>1,365,143</u></u>

See accompanying notes to financial statements.

NEW YORK STATE LOTTERY

Statements of Cash Flows

Years ended March 31, 2001 and 2000

(In Thousands)

	2001	2000
Cash flows from operating activities:		
Cash received from ticket sales	\$ 4,133,634	3,596,795
Cash payments for prizes	(2,444,831)	(2,041,611)
Cash payments for commissions and fees	(354,568)	(307,803)
Cash payments for ticket printing	(10,403)	(11,517)
Cash payments for administrative expenses	(85,914)	(103,502)
Net cash provided by operating activities	1,237,918	1,132,362
Cash flows from investing activities:		
Proceeds from investment maturities	213,777	210,549
Purchases of investments	(40,575)	(46,369)
Interest on cash and cash equivalents	8,691	10,208
Net proceeds from swaps of investment securities	620	—
Other cash receipts, net	1,089	1,257
Net cash provided by investing activities	183,602	175,645
Cash flows from noncapital financing activities:		
Cash transfer to education	(1,392,997)	(1,345,015)
Cash flows from capital financing activities:		
Disposal of equipment	34	—
Cash payments for equipment and leasehold improvements	(110)	(112)
Principal payments on capital leases	—	(14)
Net cash used by capital financing activities	(76)	(126)
Net increase (decrease) in cash and cash equivalents	28,447	(37,134)
Cash and cash equivalents, beginning of year	154,426	191,560
Cash and cash equivalents, end of year	\$ 182,873	154,426

(Continued)

NEW YORK STATE LOTTERY

Statements of Cash Flows

Years ended March 31, 2001 and 2000

(In Thousands)

	<u>2001</u>	<u>2000</u>
Reconciliation of net income and required allocation to education to net cash provided by operating activities:		
Net income and required allocation to education	\$ 1,446,899	1,365,143
Adjustments to reconcile net income and required allocation to education to net cash provided by operating activities:		
Investment income	(219,081)	(44,057)
Other income	(1,089)	(1,238)
Depreciation and amortization	535	670
Amortization of discount on prizes payable	120,455	124,831
Change in operating assets and liabilities:		
Increase in accounts receivable, net	(48,828)	(40,846)
(Increase) decrease in ticket inventory	(814)	1,120
Decrease in prizes payable	(156,930)	(177,516)
Increase (decrease) in unclaimed and future prizes	82,726	(96,595)
Increase (decrease) in due to administration	3,097	(6,207)
Increase (decrease) in deferred revenue	(2,116)	7,743
(Decrease) increase in other payables and liabilities	13,064	(686)
Net cash provided by operating activities	\$ <u>1,237,918</u>	<u>1,132,362</u>

See accompanying notes to financial statements.

NEW YORK STATE LOTTERY

Notes to Financial Statements

March 31, 2001 and 2000

(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 accounting principles generally accepted in the United States of America, 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 Millennium Millions promotional game was recognized consistent with online 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 11). Accounts receivable represents primarily the amount due from the on-line game vendor net of commissions and fees.

NEW YORK STATE LOTTERY

Notes to Financial Statements

March 31, 2001 and 2000

(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 20% 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 Millennium Millions promotional game, and 25% for Quick Draw.
- Allocations of ticket sales revenue for the payment of lottery prizes not to exceed 65% 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 Millennium Millions promotional game, and 60% for Quick Draw.
- Allocations of ticket sales revenue from all games for the payment of Lottery administrative expenses (including agent commissions and contractor fees) not to exceed 15%. Any excess of the maximum allocation over administrative expenses is allocated to education. Such allocations amounted to approximately \$161,861,000 and \$127,966,000 for fiscal years 2001 and 2000, respectively. Administrative 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 Commissioner of Taxation and Finance and the 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. Investment income represents amortized discount, realized gains and losses, and change in net unrealized gains on investments.

(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, unused inventory is included in printing expense.

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Notes to Financial Statements

March 31, 2001 and 2000

(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 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 investment 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, 2001 and 2000 were \$148,916,000 and \$112,993,000, respectively. Prizes unclaimed for one year after the drawing date (lapsed) are forfeited by the ticket holder. Total prizes lapsed amounted to approximately \$36,085,000 and \$48,845,000 for fiscal years 2001 and 2000, respectively.

Under the Tax Law, the Lottery retains forfeited prizes for supplemental prizes in subsequent Lottery games. During the fiscal years 2000 and 2001, these supplemental prizes were used for Lotto and Millennium Millions, a limited promotional game.

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 net unrealized gain on investments. These funds must be available for the payment of installment prizes in future periods, of approximately \$182 million and \$93 million at March 31, 2001 and 2000 respectively.

NEW YORK STATE LOTTERY

Notes to Financial Statements

March 31, 2001 and 2000

(j) Indirect Prize Expense

Prize expense not directly related to game sales is shown as indirect prize expense. This category includes interest earnings on the Lottery Prize account, gains on investment exchanges through the securities swaps program, and investment gain on maturities in excess of required prize payments due to rounded buys, which are to be used as future prizes.

(k) Reclassification

Certain amounts in the 2000 financial statements have been reclassified to conform to the 2001 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 Commissioner of Taxation and Finance and the 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 \$186,656,000 and \$154,059,000 at March 31, 2001 and 2000, 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, 2001 and 2000 the amount of accounts included in cash and cash equivalents related to the sole custody accounts were \$(3,783,000) and \$367,000, 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.

NEW YORK STATE LOTTERY

Notes to Financial Statements

March 31, 2001 and 2000

(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 2001 and 2000, approximately \$120,861,000 and \$125,237,000, respectively, of amortized discount was included in investment income.

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

	2001	2000
Maturity value	\$ 2,438,094	2,565,648
Less: unamortized discount	903,993	979,206
Total carrying value	1,534,101	1,586,442
Less: investments, maturing within one year, at amortized cost	208,797	205,829
Long-term investments, at amortized cost	\$ 1,325,304	1,380,613
 Total fair value of investments	 \$ 1,716,227	 1,679,659

Maturities of the investments in each of the five fiscal years following March 31, 2001, and the total thereafter, are as follows (in thousands):

2002	\$ 217,006
2003	217,654
2004	218,268
2005	204,016
2006	188,969
Thereafter	1,392,181
	\$ 2,438,094

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 2001, the face value of the securities swapped amounted to \$228,135,000 resulting in a gain of approximately \$617,000. This gain is included in investment income in the statement of revenue and expenses. During fiscal year 2000, 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.

NEW YORK STATE LOTTERY

Notes to Financial Statements

March 31, 2001 and 2000

(4) Equipment and Leasehold Improvements

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

	<u>2001</u>	<u>2000</u>
Equipment	\$ 2,412	2,473
Leasehold improvements	<u>4,526</u>	<u>4,526</u>
	6,938	6,999
Less: accumulated depreciation and amortization	<u>6,708</u>	<u>6,310</u>
Equipment and leasehold improvements, net	<u>\$ 230</u>	<u>689</u>

(5) Prizes Payable

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

	<u>2001</u>	<u>2000</u>
Total obligation	\$ 2,519,179	2,589,433
Unamortized discount	<u>(950,231)</u>	<u>(984,010)</u>
Total carrying amount	1,568,948	1,605,423
Less: prizes payable within one year	<u>212,445</u>	<u>208,929</u>
Long-term prizes payable	<u>\$ 1,356,503</u>	<u>1,396,494</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 investment expense in the statements of revenue and expenses and amounted to \$120,455,000 and \$124,831,000 for fiscal years 2001 and 2000, respectively.

The aggregate amount of prizes payable due in each of the five fiscal years following March 31, 2001, and the total thereafter, is as follows (in thousands):

2002	\$ 217,590
2003	218,191
2004	218,741
2005	210,030
2006	190,690
Thereafter	<u>1,463,937</u>
	<u>\$ 2,519,179</u>

NEW YORK STATE LOTTERY

Notes to Financial Statements

March 31, 2001 and 2000

(6) Education Revenue

Net income and required allocation to education during the fiscal years ended March 31, 2001 and 2000, are as follows (in thousands):

	<u>2001</u>	<u>2000</u>
Revenue transferred to education	\$ 1,392,997	1,345,015
Prior year payable	<u>(61,680)</u>	<u>(41,552)</u>
Amount transferred from current year revenue	1,331,317	1,303,463
Current year payable	<u>115,582</u>	<u>61,680</u>
Net income and required allocation to education	<u>\$ 1,446,899</u>	<u>1,365,143</u>

(7) Pension Benefits

Substantially all employees of the Lottery are members of the New York State and Local Employees' Retirement Systems (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 Systems, 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 for their first ten years of employment; the Lottery contributes the balance payable to the System for these employees.

The Lottery paid to the New York State Comptroller's Office \$584,000 for 2001, \$577,000 for 2000, and \$709,000 for 1999, to cover required employer contributions for retirement benefits. These payments made represent 4.00%, 4.22% and 5.37% of covered payroll for each of the years, respectively.

NEW YORK STATE LOTTERY

Notes to Financial Statements

March 31, 2001 and 2000

(8) Segment Information

Segment information for fiscal 2001 and 2000 by type of lottery game is as follows (in thousands):

		<u>2001</u>					
		<u>Expenses</u>					
	<u>Revenue</u>	<u>Prizes</u>	<u>Commissions</u>	<u>Fees</u>	<u>Ticket Printing</u>	<u>Net</u>	
Millennium	\$ 121,014	(48,406)	(7,261)	(1,846)	-	63,501	
Lotto	558,483	(223,393)	(32,547)	(8,252)	-	294,291	
Take Five	388,283	(194,141)	(23,297)	(5,921)	-	164,924	
Pick 10	41,575	(20,788)	(2,494)	(634)	-	17,659	
New York Numbers	709,126	(354,563)	(42,547)	(10,814)	-	301,202	
Win-4	472,354	(236,177)	(28,341)	(7,203)	-	200,633	
Instant Cash Games	1,386,117	(891,087)	(83,167)	(55,491)	(12,373)	343,999	
Quick Draw	<u>508,378</u>	<u>(305,027)</u>	<u>(30,503)</u>	<u>(14,649)</u>	-	<u>158,199</u>	
	\$ <u>4,185,330</u>	<u>(2,273,582)</u>	<u>(250,157)</u>	<u>(104,810)</u>	<u>(12,373)</u>	<u>1,544,408</u>	
Investment income						219,081	
Other income						1,089	
Administrative expenses						(98,598)	
Investment expense						(209,363)	
Indirect prize expense						<u>(9,718)</u>	
Net income and required allocation to education						\$ <u>1,446,899</u>	
		<u>2000</u>					
		<u>Expenses</u>					
	<u>Revenue</u>	<u>Prizes</u>	<u>Commissions</u>	<u>Fees</u>	<u>Ticket Printing</u>	<u>Net</u>	
Millennium	\$ 62,451	(24,980)	(3,747)	(953)	-	32,771	
Lotto	686,263	(274,505)	(40,855)	(10,270)	-	360,633	
Take Five	330,978	(165,489)	(19,853)	(5,046)	-	140,590	
Pick 10	43,287	(21,643)	(2,597)	(660)	-	18,387	
New York Numbers	709,477	(354,739)	(42,569)	(10,820)	-	301,349	
Win-4	458,922	(229,461)	(27,535)	(6,999)	-	194,927	
Instant Cash Games	1,005,792	(578,859)	(60,348)	(43,290)	(9,215)	314,080	
Quick Draw	<u>332,088</u>	<u>(199,253)</u>	<u>(19,925)</u>	<u>(11,796)</u>	-	<u>101,114</u>	
	\$ <u>3,629,258</u>	<u>(1,848,929)</u>	<u>(217,429)</u>	<u>(89,834)</u>	<u>(9,215)</u>	<u>1,463,851</u>	
Investment income						44,057	
Other income						1,238	
Administrative expenses						(99,946)	
Investment expense						(33,470)	
Indirect prize expense						<u>(10,587)</u>	
Net income and required allocation to education						\$ <u>1,365,143</u>	

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Notes to Financial Statements

March 31, 2001 and 2000

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

(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 14,000 on-line locations where all games are sold and over 1,600 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, 2002. Instant cash game sales are supported by the services of four contractors:

- (1) Under a contract expiring February 28, 2002, Scientific Games, Inc. is responsible for maintaining validating devices installed at each sales location.
- (2) Under a contract expiring July 18, 2001, Scientific Games, Inc. is responsible for production of instant cash tickets.
- (3) Under a contract expiring February 28, 2002, Scientific Games is responsible for various services related to the warehousing, sales, distribution of, and accounting for, instant cash tickets.

NEW YORK STATE LOTTERY

Notes to Financial Statements

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- (4) Instant cash tickets are also sold through vending machines at approximately 4,400 locations. Contracts with On-Point Technology and Interlott, Inc., which expire on March 30, 2003 and March 31, 2003, respectively, provide for maintenance of the vending machines.

(b) Operating Leases

The Lottery has entered into operating leases for equipment and building space. Rental expense was \$4,155,000 and \$5,707,000 in 2001 and 2000, 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, 2001:

2002	\$	4,358,000
2003		4,294,000
2004		3,077,000
2005		2,540,000
2006		1,661,000
Thereafter		<u>2,710,000</u>
Total minimum lease payments	\$	<u>18,640,000</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 \$20,000,000 at March 31, 2001, which have a fair value that approximates \$18,000,000. 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, 2001.

NEW YORK STATE LOTTERY

Notes to Financial Statements

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(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.