



**NEW YORK STATE LOTTERY**

Basic Financial Statements

March 31, 2003 and 2002

(With Independent Auditors' Report Thereon)

**NEW YORK STATE LOTTERY**

**Basic Financial Statements**

**March 31, 2003 and 2002**

**Table of Contents**

	<b>Page</b>
<b>Independent Auditors' Report</b>	<b>1</b>
<b>Management's Discussion and Analysis</b>	<b>2</b>
<b>Statements of Net Assets</b>	<b>8</b>
<b>Statements of Revenue, Expenses, and Changes in Net Assets</b>	<b>9</b>
<b>Statements of Cash Flows</b>	<b>10</b>
<b>Notes to Financial Statements</b>	<b>11</b>



515 Broadway  
Albany, NY 12207

## Independent Auditors' Report

### New York State Lottery:

We have audited the accompanying financial statements of the New York State Lottery (Lottery) as of March 31, 2003 and 2002, and the related statements of revenues, expenses, and changes in net assets, 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 of the New York State Lottery are intended to present the financial position, and changes in financial position and cash flows, of only that portion of the financial reporting entity of the State of New York that is attributable to the transactions of the Lottery. They do not purport to, and do not, present fairly the financial position of the State of New York as of March 31, 2003, and the changes in financial position and its cash flows, where applicable, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the New York State Lottery as of March 31, 2003 and 2002, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in note 1, the Lottery adopted Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements - Management's Discussion and Analysis - for State and Local Governments*, as amended by GASB Statement No. 37, *Basic Financial Statements - Management's Discussion and Analysis - for State and Local Governments: Omnibus*; and GASB Statement No. 38 *Certain Financial Statement Note Disclosures*, as of April 1, 2001.

The Management's Discussion and Analysis on pages 2 through 7 is not a required part of the basic financial statements but is supplementary information required by accounting standards generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

June 27, 2003



KPMG LLP, PwC LLP & US Limited Liability Partnership, is a member of KPMG network, a Swiss American firm.

**NEW YORK STATE LOTTERY**  
Management's Discussion and Analysis  
March 31, 2003

The following discussion and analysis is of the New York State Lottery's (Lottery) financial position and activities for the fiscal year ended March 31, 2003. This document has been prepared by management and should be read in conjunction with the financial statements and footnotes attached hereto. The Lottery's financial statements for the year ended March 31, 2003 are, for the first time, prepared in accordance with the requirements of Governmental Accounting Standards Board Statement 34. Comparative results with 2002 are presented in the basic financial statements and this management discussion and analysis.

**Financial Highlights**

New York Lottery ticket sales totaled more than \$5.395 billion, the highest total ever for the Lottery, while net proceeds transferred to the Lottery Aid to Education exceeded \$1.78 billion for fiscal year 2003. This amount surpassed fiscal year 2002 by more than \$190.6 million or 12.0%. Some additional highlights of the fiscal year were:

- Ticket sales increase by \$642.3 million, or 13.5%.
- Prize expense increased by \$420.6 million, a 15.9% increase. Prize expense increases directly with increased sales. As instant tickets become a higher percentage of total sales the prize expense growth outpaces sales growth since instant tickets pay out the highest percentage in prizes.
- Operating income increased by \$174.9 million, or 10.8%.
- Nonoperating income increased by \$172.6 million. This was primarily due to a \$119.0 million increase in the fair value of the securities used to pay annuity prize winners.
- Working capital (current assets less current liabilities) increased by \$9.0 million to \$121.1 million during the fiscal year.

**Overview of the Financial Statements**

The New York Lottery presents its financial statements on an accrual basis of accounting as an enterprise fund of the State of New York, similar to a nongovernment business entity. The three financial statements presented are:

- Statement of Net Assets, on page 8 – this statement presents information reflecting the Lottery's assets, liabilities, and net assets. Net assets present the amount of total assets less liabilities and is one way to measure the Lottery's financial position. Increases or decreases can be an indicator of financial improvement or deterioration.
- Statement of Revenues, Expenses, and Changes in Net Assets, on page 9 – this statement reflects the operating revenues and expenses and non-operating revenues and expenses of the Lottery for the year. Income before transfers out is similar to net profit or loss for a business.
- Statement of Cash Flows, on page 10 – the statement of cash flows is presented on the direct method of reporting which reflects cash flows from operating, noncapital financing, capital and related financing, and investing activities. Cash collections and payments are reflected in this statement to arrive at the net increase or decrease in cash for the year.

The financial statements provide information about the Lottery's overall financial condition.

**NEW YORK STATE LOTTERY**  
**Management's Discussion and Analysis**  
**March 31, 2003**

This management discussion and analysis is meant to be an introduction to the financial statements and to assist readers in understanding the results of the operation and the financial standing of the New York Lottery. The notes to the financial statements include substantial additional data and explanations which should be used in concert with the financial statements.

The New York Lottery deposits its net proceeds into three accounts held in joint custody with the New York Office of the State Comptroller. These three accounts and the purpose of the funds in each account are: the Lottery Education account which accumulates the required deposits for Aid to Education, the Prize Pending account which consists of prizes that are not yet paid, and the Administration account which is utilized to pay the administrative costs of the Lottery.

Unrestricted net assets listed on the statement of net assets are largely the result of increased fair market value of United States guaranteed marketable securities held by the Lottery to pay prize winners on an annuity basis. The New York Lottery's policy and practice is to hold these investments to maturity to meet these prize payment obligations. As such, the Lottery will not realize any fair value gain on these investments. Investments consist of United States Government-backed obligations of zero coupon bonds and stripped securities that equal the face amount of the bond or security upon maturity.

Restricted Net Assets for Future Prizes consist of prize funds that are in excess of prizes actually claimed at the fiscal year end, but which are necessary to ensure future prize payments. For example, prize funds from past sales which are to be utilized to pay a Lotto or Mega Millions jackpot which has not yet been won is one example of the restricted net assets.

**Financial Analysis**

**Summary of Net Assets**

The comparative statement of net assets represents the Lottery's financial position as of the fiscal years ended for 2003 and 2002. The Lottery's assets, liabilities and net assets are summarized as follows (in millions):

	<u>FY 2003</u>	<u>FY 2002</u>	<u>Dollar change</u>	<u>Percent change</u>
Current assets	\$ 688	692	(4)	(0.6)%
Noncurrent assets	1,460	1,389	71	5.1%
Total assets	<u>\$ 2,148</u>	<u>2,081</u>	<u>67</u>	<u>3.2%</u>
Current liabilities	\$ 567	580	(13)	(2.2)%
Noncurrent liabilities	1,248	1,298	(50)	(3.9)%
Total liabilities	<u>\$ 1,815</u>	<u>1,878</u>	<u>(63)</u>	<u>(3.4)%</u>
Restricted net assets	\$ 91	80	11	13.8%
Unrestricted net assets	242	123	119	96.7%
Total net assets	<u>\$ 333</u>	<u>203</u>	<u>130</u>	<u>64.0%</u>

**NEW YORK STATE LOTTERY**  
Management's Discussion and Analysis  
March 31, 2003

***Current Assets***

Current assets consist of cash and cash equivalents, accounts receivable, instant ticket inventory and the current portion of annuity investments. The total current assets did not change significantly during the fiscal year. Accounts receivable increased by \$40 million during the fiscal year due to increased sales of instant cash games. Cash and cash equivalents fell by \$50.0 million due to an increase in the funds paid by the Lottery to Aid to Education.

***Non-Current Assets***

The Lottery funds installment prizes for games like Win for Life, Lotto and Mega Millions through investment in United States Treasury Securities. The total market value of these securities was \$1.68 billion at March 31, 2003 (an increase of \$77.0 million). The 4.8% increase in the fair value of investments was primarily due to the continued decline in the yield on United State Treasury Securities in the market. The amount at March 31, 2003 of \$1.46 billion was invested in securities that are for prizes that are payable beyond fiscal year 2004. The remaining value of securities is related to prizes that are due during fiscal year 2004 and that value is part of current assets.

***Current Liabilities***

Current liabilities consist of the current portion of long term prizes payable, prizes that have been awarded but not yet claimed, amounts due to Education on an accrual basis, accrued expenses, accounts payable, and the sales value of tickets purchased by players for which a drawing has not yet been held. In total, these accounts fell by \$13 million during the fiscal year. This decrease is the result of amounts Due to Education being \$46 million less this year due to timing of payments to the State, offset by an increase in Unclaimed Prizes of \$33 million. Unclaimed Prizes is higher due to an increase in instant ticket sales and new sales from the multi-state Mega Million game started in fiscal year 2003. Amounts due to prize winners are the majority (76.6%) of the current liabilities.

***Noncurrent Liabilities***

Noncurrent liabilities consist of installment prizes due in fiscal years 2005 and beyond as well as the total amount due to employees for unused vacation and sick leave. During the fiscal year, long-term prizes payable fell by over \$50 million as a result of payments made to past winners and only a few new jackpot winners selecting payment by installments.

***Net Assets***

Net assets represent the excess of the Lottery's assets over its liabilities. Restricted net assets for prizes include forfeited prizes and other prize assets that are to be used for future prize expenses. Unrestricted net assets are primarily the cumulative difference between the market value of the Lottery's United States Treasury Securities and the book value of prize liabilities that the securities are funding. Since the Lottery's policy and practice is to purchase and hold securities to maturity and then pay the associated installment prize, this cumulative fair value gain will not ultimately be realized but essentially fluctuates daily based on the securities market.

**NEW YORK STATE LOTTERY**  
**Management's Discussion and Analysis**  
**March 31, 2003**

**Summary of Revenues, Expenses, and Changes in Net Assets**

The results of the Lottery's operations are presented in the Statement of Revenues, Expenses and Changes in Net Assets which is summarized as follows (in millions):

	<u>FY 2003</u>	<u>FY 2002</u>	<u>Dollar Change</u>	<u>Percent Change</u>
Operating revenue:				
Ticket sales	\$ 5,396	4,754	642	13.5%
Operating expenses:				
Direct expenses	(3,502)	(3,039)	(463)	15.2%
Indirect expenses	(107)	(103)	(4)	3.9%
Total operating expenses	(3,609)	(3,142)	(467)	14.8%
Operating income	1,787	1,612	175	10.8%
Non-Operating Income (Expenses)	123	(49)	172	351.1%
Income before transfers out	1,910	1,563	347	22.2%
Transfers out - contribution for aid to education	(1,780)	(1,590)	(190)	11.9%
Change in net assets	\$ 130	(27)	157	581.5%

**Revenues**

The New York Lottery provides Aid to Education in New York by selling Lottery tickets throughout the state at over 15,000 locations. During fiscal year end 2003 the Lottery surpassed over \$3.01 billion in on-line sales and achieved \$2.39 billion in Instant sales for a new record sales year of \$5.40 billion. During fiscal year 2002 these sales totaled \$4.75 billion. Based on total sales, fiscal year 2003 saw a \$642.0 million (13.5%) sales increase. The majority of the increase in total sales was from Instants, Mega Millions as well as New York's Numbers and Win 4. A categorization of sales by game and the percentage of total revenues in millions for fiscal year 2003 is as follows:

<u>Game</u>	<u>FY 2003 Sales</u>	<u>Percent of total sales</u>
Mega Millions	\$ 373	6.9%
Lotto	392	7.3%
Take 5	381	7.1%
New York's Numbers	754	14.0%
Win 4	579	10.7%
Quick Draw	476	8.8%
Pick 10 and Instant Win	52	0.9%
Instants	2,389	44.3%
Total sales revenues	\$ 5,396	100.0%

**NEW YORK STATE LOTTERY**  
Management's Discussion and Analysis  
March 31, 2003

***Direct Expenses***

Direct expenses consist of prize expense, commissions to Lottery retailers, fees to gaming contractors, expenses of providing instant tickets to players, and telecommunications. The largest of all categories of Lottery expenses is prizes. This expense, during FY 2003, increased by \$421 million to \$3.062 billion and, along with retailer commissions, which increased by \$39 million to \$325 million, account for nearly all of the increase in direct expenses. These two categories as well as gaming contractor fees rise and fall proportionately to the change in ticket sales. Direct expenses accounted for 65% of sales in 2003 up 1% from 2002.

***Other Operating Expenses***

Other operating expenses include marketing, state agency charges, personal services, fringe benefits and other administrative costs. These costs increased 4.2% during the fiscal year compared to 2002 and the majority of the \$4.4 million increase is in personal service, fringe benefits, state agency charges and on-line games/jackpot marketing incurred to advertise and administer the new multi-state Mega Millions game. Other operating expenses as a percentage of sales fell from 2.2% in fiscal year 2002 to 2.0% in fiscal year 2003, as new ticket sales out paced the additional costs incurred to advertise and administer the games.

***Nonoperating Income (Expense)***

Nonoperating income consists of small amounts of miscellaneous income plus the net growth or decline in the book and fair value of the United States Treasury Securities utilized to fund long term prizes. Investment income (\$230 million in 2003) consists of both the fair value adjustments of investments plus the normal growth of the value of Lottery investments as the securities move closer to maturity. Investment expense is a reflection of the Lottery expending the investment income to increase the valuation of the long term prizes payable to winners. The annual market value adjustment of investments, shown here as income, flows to the unrestricted net assets balance on the statement of net assets. As stated previously, this market value adjustment is unrealized by the Lottery since it holds investments to maturity.

***Income Before Transfers Out***

The revenues and expenses for fiscal year 2003 resulted in income before transfers out of \$1.91 billion. \$1.78 billion of this was transferred to the Due to Aid to Education account and \$130.3 million flowed through to the Statement of Net Assets as the change in net assets. Of the \$130.3 million \$119.0 million was due to the unrealized gain on investments and categorized as an increase in the cumulative unrestricted total. Total net assets at the end of fiscal year 2003 were \$333.3 million.

**Summary and Outlook**

During fiscal year 2003, the Lottery added the multi-state game Mega Millions and through the continued growth in sales of instant ticket games, New York's Numbers and Win 4, reached new sales and income records. For fiscal year 2004, the State legislature approved the Lottery to start a video lottery gaming system at several horse racing venues throughout the state. Also, the Lottery is expanding the number and distribution of retailers in the State to increase overall sales.

**NEW YORK STATE LOTTERY**  
Management's Discussion and Analysis  
March 31, 2003

**Contacting New York Lottery's Financial Management**

This financial report is designed to provide the State of New York, the public, and other interested parties an overview of the financial results of the New York Lottery's activities and to offer an explanation of the financial condition and results of operations of the Lottery. If you have questions about this report or require additional financial information, contact the Press and Community Relations Office at The New York Lottery, One Broadway Center, Post Office Box 7500, Schenectady, NY 12301-7500.

**NEW YORK STATE LOTTERY**

Statements of Net Assets

March 31, 2003 and 2002

(In thousands)

<b>Assets</b>	<b>2003</b>	<b>2002</b>
<b>Current assets:</b>		
Cash and cash equivalents	\$ 130,830	181,325
Accounts receivable	324,770	284,215
Instant Ticket inventory	7,982	7,966
Investments	224,464	218,389
<b>Total current assets</b>	<b>688,046</b>	<b>691,895</b>
Long term investments, net	1,460,099	1,389,151
Other assets	247	165
<b>Total assets</b>	<b>2,148,392</b>	<b>2,081,211</b>
<b>Liabilities</b>		
<b>Current liabilities:</b>		
Prizes payable	221,890	217,550
Unclaimed prizes	212,159	179,260
Due to education	108,562	154,453
Accounts payable and accrued liabilities	14,038	19,835
Deferred ticket sales	10,277	8,697
<b>Total current liabilities</b>	<b>566,926</b>	<b>579,795</b>
Compensated absences	5,049	4,742
Long term prizes payable	1,243,112	1,293,651
<b>Total liabilities</b>	<b>1,815,087</b>	<b>1,878,188</b>
<b>Net Assets</b>		
Restricted for future prizes	91,474	80,235
Unrestricted	241,831	122,788
<b>Total net assets</b>	<b>\$ 333,305</b>	<b>203,023</b>

See accompanying notes to basic financial statements.

**NEW YORK STATE LOTTERY**  
**Statements of Revenues, Expenses, and Changes in Net Assets**  
**Years ended March 31, 2003 and 2002**

	<u>2003</u>	<u>2002</u>
Operating revenue:		
Ticket sales	\$ 5,395,955	4,753,618
Operating Expenses:		
Prize expense	(3,061,744)	(2,641,181)
Retailer commissions	(324,891)	(285,702)
Gaming contractor fees	(55,647)	(63,700)
Instant Ticket direct expenses	(32,259)	(21,981)
Telecommunications	(27,063)	(25,952)
Total direct expenses	<u>(3,501,604)</u>	<u>(3,038,516)</u>
Online games/jackpot marketing	(33,985)	(31,297)
Personal service and fringe benefits	(22,097)	(21,078)
Instant games marketing	(20,722)	(20,504)
All games marketing	(17,277)	(17,528)
Other administrative costs	(9,566)	(9,927)
State agency charges	(3,514)	(2,459)
Total operating expenses	<u>(3,608,765)</u>	<u>(3,141,309)</u>
Operating income	<u>1,787,190</u>	<u>1,612,309</u>
Nonoperating revenue and expenses:		
Investment income	230,381	65,506
Other revenues, net	647	367
Investment expense	(107,581)	(115,043)
Total nonoperating income	<u>123,447</u>	<u>(49,170)</u>
Income before transfers out	1,910,637	1,563,139
Transfers out – contribution for aid to education	<u>(1,780,355)</u>	<u>(1,589,714)</u>
Change in net assets	130,282	(26,575)
Net assets beginning of year	<u>203,023</u>	<u>229,598</u>
Net assets end of year	<u>\$ 333,305</u>	<u>203,023</u>

See accompanying notes to basic financial statements.

**NEW YORK STATE LOTTERY**  
**Statements of Cash Flows**  
**Years ended March 31, 2003 and 2002**  
**(In thousands)**

	<u>2003</u>	<u>2002</u>
<b>Cash flows from operating activities:</b>		
Cash received from ticket sales	\$ 5,358,289	4,681,333
Cash payments for prizes	(3,185,876)	(2,789,556)
Cash payments for commissions	(324,992)	(285,680)
Cash payments for contractor fees	(57,151)	(62,210)
Cash payments for telecommunications	(27,063)	(25,952)
Cash payments for instant ticket direct expenses	(32,043)	(27,666)
Cash payments for other operating expenses	(109,235)	(104,879)
<b>Net cash provided by operating activities</b>	<u>1,621,929</u>	<u>1,385,390</u>
<b>Cash flows from investing activities:</b>		
Proceeds from investment maturities	221,207	217,778
Purchases of investments	(71,199)	(52,979)
Interest on cash and cash equivalents	2,591	3,984
Net proceeds from swaps of investment securities	759	5,409
Other	647	367
<b>Net cash provided by investing activities</b>	<u>154,005</u>	<u>174,559</u>
<b>Cash flows from noncapital financing activities:</b>		
Cash transfer to education	(1,826,246)	(1,561,497)
<b>Cash flows from capital financing activities:</b>		
Cash payments for equipment and leasehold improvements	(183)	—
<b>Net cash used by capital financing activities</b>	<u>(183)</u>	<u>—</u>
<b>Net decrease in cash and cash equivalents</b>	(50,495)	(1,548)
Cash and cash equivalents beginning of year	181,325	182,873
Cash and cash equivalents, end of year	<u>\$ 130,830</u>	<u>181,325</u>
<b>Reconciliation of operating income to cash provided by operating activities:</b>		
Operating income	\$ 1,787,190	1,612,309
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	101	65
<b>Change in operating assets and liabilities:</b>		
Increase in accounts receivable, net	(40,555)	(72,356)
Increase in ticket inventory	(16)	(2,877)
Decrease in prizes payable	(153,780)	(172,791)
Increase in unclaimed prizes	32,899	24,929
Increase in compensated absences	307	444
Decrease in accounts payable and accrued liabilities	(5,797)	(4,837)
Increase in deferred ticket sales	1,580	504
<b>Net cash provided by operating activities</b>	<u>\$ 1,621,929</u>	<u>1,385,390</u>
<b>Noncash investing activities:</b>		
Increase (decrease) in unrealized gains on investments	\$ 119,043	(59,338)
Amortization of investment discount	107,988	115,521

See accompanying notes to basic financial statements.

**NEW YORK STATE LOTTERY**  
Notes to Basic Financial Statements  
March 31, 2003 and 2002

**(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.

Effective April 1, 2001, the Lottery adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 34, Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments, as amended by GASB Statement No. 37, Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments: Omnibus; and GASB Statement No. 38 Certain Financial Statement Note Disclosures. GASB Statement No. 34 establishes financial reporting standards for state and local governments. Based on the provisions of GASB Statement No. 34, the Lottery is now included in the State of New York’s Basic Financial Statements as an enterprise fund. The financial statements present only the Lottery and do not present the financial position of the State of New York, and changes in its financial position and cash flows. Significant changes to the Lottery’s financial statements due to the adoption of GASB No. 34 and related statements are:

- The inclusion of a Management’s Discussion and Analysis section.
- The establishment of net assets and categorization as restricted or unrestricted.

As a result of the adoption, the opening net assets for April 1, 2001 have been restated, in thousands, as follows:

Net assets at April 1, 2001, as previously reported	\$	—
Forfeited prizes, excess statutory prize funds for future prizes and the cumulative fair value gain on investments moved from current liabilities		229,598
Net assets at April 1, 2001, as restated	\$	229,598

## NEW YORK STATE LOTTERY

### Notes to Basic Financial Statements

March 31, 2003 and 2002

The Lottery prepares its financial statements under the economic resources measurement focus whereby all inflows, outflows and balances affecting net assets are reported, and uses the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when incurred. The primary operating revenue of the Lottery is ticket sales from games. Non-operating income consists mostly of investment income and unrealized gains on investments. Operating expenses consist of direct expenses for prizes, commissions to Lottery retailers, fees to gaming contractors, expenses for providing instant tickets to players, and telecommunications. Other operating expenses that are indirect to the results of each game include marketing, state agency charges, personal services, and fringe benefits. Non-operating expense is the amortization of the discount on long term prizes payable. The Lottery applies all applicable GASB pronouncements as well as the following pronouncements issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements: Statements and Interpretations of the Financial Accounting Standards Board (FASB), Accounting Principles Board (APB) Opinions, and Accounting Research Bulletins (ARB's) of the Committee on Accounting Procedure. The Lottery has elected the option, under GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Government Entities that Uses Proprietary Funds*, not to apply all FASB Statements and Interpretations issued after November 30, 1989. The more significant of the Lottery's accounting policies are described below.

**(a) Revenue Recognition**

**(i) On-Line Games**

Revenue from ticket sales for Lotto, Quick Draw, Take Five, Pick 10, Mega Millions, Instant Win, New York's 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.

**(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 sales generated through the respective network maintained by the contractor. The instant game contractor is paid a fee equal to a contractual percentage of instant sales. All other gaming contractors are paid fees based on the units of service provided (see note 10).

**(c) Accounts Receivable**

Accounts receivable represents amounts due from the Lottery game contractor, net of commissions and fees, as well as amounts due from agents for instant cash game tickets which have been activated, but not yet settled. Instant ticket settlements occur not more than 45 days after a book of tickets is activated.

## NEW YORK STATE LOTTERY

### Notes to Basic Financial Statements

March 31, 2003 and 2002

**(d) 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's Numbers, Win-4, Mega Millions and Pick 10, 45% for Lotto and Instant Win, and 25% for Quick Draw. In addition, the Lottery has legislative authority to issue up to three Instant Games per year with at least 10% for educational purposes.
- 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's Numbers, Win-4, Mega Millions, and Pick 10, 40% for Lotto and Instant Win, and 60% for Quick Draw. In addition, the Lottery has legislative authority to issue up to three Instant Games per year with 75% allocated to prizes.
- Allocations of ticket sales revenue from all games for the payment of Lottery administrative expenses (including agent commissions and contractor fees) are not to exceed 15%. Any excess of the maximum allocation over administrative expenses is allocated to education. Such allocations amounted to approximately \$262,372,000 and \$212,915,000 for fiscal years 2003 and 2002, 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.

**(e) Cash and 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.

**(f) 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.

**(g) 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.

## NEW YORK STATE LOTTERY

### Notes to Basic Financial Statements

March 31, 2003 and 2002

**(h) Capital Assets**

Capital assets consists of equipment and leasehold improvements which are carried at cost and are recorded in Other Assets. 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 Revenue, Net in the period of disposal.

**(i) Prizes Payable**

Lotto and Mega Millions 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.

**(j) Unclaimed Prizes**

Unclaimed prizes at March 31, 2003 and 2002 were \$212,159,000 and \$179,260,000 respectively. Prizes unclaimed for one year after the drawing date (lapsed) are forfeited by the ticket holder. Total prizes lapsed amounted to approximately \$52,339,000 and \$65,787,000 for fiscal years 2003 and 2002, respectively. These forfeited prizes are netted against Prize Expense in the Statement of Revenues, Expenses, and Changes in Net Assets.

Under the Tax Law, the Lottery retains forfeited prizes for supplemental prizes in subsequent Lottery games. During the fiscal years 2003 and 2002, these supplemental prizes were used for Lotto, Mega Millions, Instant Win, and various Instant Games.

**(k) Restricted Net Assets**

Restricted net assets for prizes includes forfeited prizes and other prize assets that are restricted under New York State Tax Law Sections 1612 and 1614 for the purpose of meeting future prize expense.

**(l) Reclassification**

Certain amounts in the 2002 financial statements have been reclassified to conform to the 2003 presentation.

# NEW YORK STATE LOTTERY

## Notes to Basic Financial Statements

March 31, 2003 and 2002

### (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 interest is used for future Lottery prizes. The carrying amount of the accounts included in cash and cash equivalents were \$134,155,000 and \$184,898,000 at March 31, 2003 and 2002, respectively. The carrying value of cash equivalents approximates market value.

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, 2003 and 2002 the amount of accounts included in cash and cash equivalents related to the sole custody accounts were \$(3,325,000) and \$(3,573,000), 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.

### (3) Investments

The Lottery is authorized to invest in U.S. Government-backed obligations (zero coupon bonds and treasury strips), which will provide for the payment of prizes payable (see note 4). During fiscal years 2003 and 2002, approximately \$107,988,000 and \$115,451,000, respectively, of amortized discount was included in investment income.

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

	<u>2003</u>	<u>2002</u>
Maturity value	\$ 2,234,327	2,331,403
Less unamortized discount	791,595	846,651
Total at amortized cost	1,442,732	1,484,752
Less investments, maturing within one year, at amortized cost	217,557	213,000
Long-term investments, at amortized cost	\$ 1,225,175	1,271,752
Total fair value of investments reported	\$ 1,684,563	1,607,540

## NEW YORK STATE LOTTERY

### Notes to Basic Financial Statements

March 31, 2003 and 2002

Maturities of the investments in each of the five fiscal years following March 31, 2003, and the total thereafter, are as follows (in thousands):

2004	\$	222,831
2005		208,651
2006		193,638
2007		177,791
2008		165,621
2009-2013		607,798
2014-2018		270,321
2019-2023		177,374
2024-2028		210,302
	\$	2,234,327

The Lottery periodically enters into certain transactions whereby stripped government securities are exchanged for other stripped government securities with substantially identical terms and characteristics. During fiscal year 2003, the face value of the securities swapped amounted to \$92,373,000 resulting in a gain of approximately \$759,000. This gain is included in investment income in the statement of revenue and expenses.

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.

#### (4) Prizes Payable

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

		2003	2002
Total obligation	\$	2,254,423	2,361,787
Unamortized discount		(789,421)	(850,586)
Total carrying amount		1,465,002	1,511,201
Less prizes payable within one year		221,890	217,550
Long-term prizes payable	\$	1,243,112	1,293,651

The amortized discount on the prizes payable is based on interest rates which range from 1.13% 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 Expenses, and Changes in Net Assets and amounted to \$107,581,000 and \$115,045,000 for fiscal years 2003 and 2002, respectively.

**NEW YORK STATE LOTTERY**  
**Notes to Basic Financial Statements**  
**March 31, 2003 and 2002**

The aggregate amount of prizes payable due in each of the five fiscal years following March 31, 2003, and the total thereafter, is as follows (in thousands):

2004	\$	225,973
2005		217,346
2006		198,104
2007		182,588
2008		170,549
2009-2013		630,039
2014-2018		279,998
2019-2023		170,389
2024-2028		179,437
	\$	<u>2,254,423</u>

The Lottery's long-term liabilities, including prizes payable, as of March 31, 2003 and 2002 are comprised of the following, in thousands:

	<u>Compensated Absences</u>	<u>Prizes Payable</u>
Balance at March 31, 2001	\$ 4,298	1,356,503
Liabilities incurred	444	44,110
Amortized discount	—	115,044
Prized becoming current	—	(222,006)
Balance at March 31, 2002	<u>4,742</u>	<u>1,293,651</u>
Liability incurred	307	68,160
Amortized discount	—	107,581
Prizes becoming current	—	(226,280)
Balance at March 31, 2003	<u>\$ 5,049</u>	<u>1,243,112</u>

**(5) Aid to Education**

The required allocation and contribution transferred out for aid to education during the fiscal years ended March 31, 2003 and 2002, are as follows (in thousands):

	<u>2003</u>	<u>2002</u>
Revenue transferred to education	\$ 1,826,246	1,561,497
Prior year payable	<u>(154,453)</u>	<u>(126,236)</u>
Amount transferred from current year revenue	1,671,793	1,435,261
Current year payable	<u>108,562</u>	<u>154,453</u>
Required allocation to education	<u>\$ 1,780,355</u>	<u>1,589,714</u>

# NEW YORK STATE LOTTERY

## Notes to Basic Financial Statements

March 31, 2003 and 2002

### (6) Pension Benefits

Substantially all employees of the Lottery are members of the New York State and Local Employees' Retirement System (ERS) and the Public Employees' Group Term Life Insurance Plan (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, 110 State Street, Albany, New York 12236.

The System provides retirement benefits as well as death and disability benefits. All benefits vest after five 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 3% 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 \$836,000 for 2003, \$553,000 for 2002, and \$584,000 for 2001, to cover required employer contributions for retirement benefits. These payments made represent 5.38%, 3.67%, and 4.00% of covered payroll for each of the years, respectively.

### (7) Operating Income

Composition of operating income for fiscal 2003 and 2002 by type of lottery game is as follows (in thousands):

	2003					Net
	Expenses					
	Revenue	Prizes	Commissions	Fees	Instant direct expense	
Mega Millions	\$ 373,435	(186,422)	(22,656)	(4,673)	—	159,684
Lotto	392,046	(160,868)	(23,221)	(4,540)	—	203,417
Take five	381,277	(185,850)	(22,877)	(4,900)	—	167,650
Pick 10	34,155	(16,276)	(2,049)	(439)	—	15,391
New York's Numbers	754,224	(363,642)	(45,254)	(9,692)	—	335,636
Win 4	579,329	(286,785)	(34,762)	(7,445)	—	250,337
Instant	2,388,729	(1,566,204)	(144,506)	(17,627)	(32,259)	628,133
Instant Win	16,466	(10,704)	(988)	(211)	—	4,563
Quick Draw	476,294	(284,993)	(28,578)	(6,120)	—	156,603
	<u>\$ 5,395,955</u>	<u>(3,061,744)</u>	<u>(324,891)</u>	<u>(55,647)</u>	<u>(32,259)</u>	1,921,414
Telecommunications						(27,063)
Other operating expenses						<u>(107,161)</u>
Total operating income						<u>\$ 1,787,190</u>

**NEW YORK STATE LOTTERY**  
Notes to Basic Financial Statements  
March 31, 2003 and 2002

	2002					Net
	Expenses					
	Revenue	Prizes	Commissions	Fees	Instant direct expense	
Lotto	\$ 565,287	(208,001)	(33,047)	(8,275)		315,964
Take five	434,856	(212,864)	(26,092)	(6,552)		189,348
Pick 10	37,789	(18,020)	(2,267)	(569)		16,933
New York's Numbers	736,534	(390,326)	(44,191)	(11,083)		290,934
Win 4	523,789	(246,913)	(31,425)	(7,879)		237,572
Instants	1,966,521	(1,270,027)	(119,349)	(15,692)	(21,981)	539,472
Quick Draw	488,842	(295,030)	(29,331)	(13,650)		150,831
	<u>\$ 4,753,618</u>	<u>(2,641,181)</u>	<u>(285,702)</u>	<u>(63,700)</u>	<u>(21,981)</u>	1,741,054
Telecommunications						(25,952)
Other operating expenses						<u>(102,793)</u>
Total operating income						<u>\$ 1,612,309</u>

**(8) 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.

**(9) Postretirement Benefits**

In addition to the pension benefits described in note 7, 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 or on behalf of its former employees.

NEW YORK STATE LOTTERY

Notes to Basic Financial Statements

March 31, 2003 and 2002

(10) Commitments and Contingencies

(a) Contractual Arrangements

The Lottery maintains a gaming network of over 15,000 on-line locations where all games are sold and over 100 off-line locations which sell only instant cash game tickets. GTECH Corporation (GTECH) is responsible for operating all Lottery games under a contract expiring on March 1, 2007. Instant cash game sales are also supported by the services of three contractors:

- (1) Under a contract expiring March 25, 2004, Pollard Banknote Limited is responsible for production of instant cash tickets.
- (2) Under a contract expiring October 15, 2004, Scientific Games, Inc. is a back-up ticket supplier.
- (3) Instant cash tickets are also sold through approximately 4,400 vending machines at approximately 2,700 locations. A contract with Interlott, Inc., which expires on April 30, 2007, provides for maintenance of the vending machines.

(b) Operating Leases

The Lottery has entered into operating leases for equipment and building space. Rental expense was \$4,664,000 and \$4,562,000 in 2003 and 2002, respectively.

The following is a schedule of future minimum lease payments under noncancelable operating leases having initial or remaining terms in excess of one year as of March 31, 2003:

2004	\$	3,506,000
2005		2,984,000
2006		2,092,000
2007		871,000
2008		738,000
2009-2013		<u>1,319,000</u>
Total minimum lease payments	\$	<u>11,510,000</u>

## NEW YORK STATE LOTTERY

### Notes to Basic Financial Statements

March 31, 2003 and 2002

**(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 prizewinners. 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 prizewinners 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 \$4,473,000 at March 31, 2003, which have a fair value that approximates \$4,421,000. For contracts other than investment contracts, the insurance companies are making annual payments to approximately 69 individuals totaling approximately \$1,245,000 as of March 31 2003.

**(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.