

*Georgia Lottery Corporation 2004 Annual Report*



**GEORGIA**  
LOTTERY

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# Letter from the *President & CEO*

For eleven years the Georgia Lottery Corporation (GLC) has delivered on its mission to responsibly raise revenues for educational programs by providing fun and entertaining games for lottery players. Fiscal Year 2004 was a record year at the GLC and more dollars were raised for education than in any previous year.



**The direct impact the  
Lottery's success has had on  
the lives of Georgia families  
is extraordinary.**

Players have won billions playing Georgia Lottery games and over a million Georgia students have benefited from lottery-funded educational programs.

Thanks to our dedicated Board of Directors, determined lottery employees, professional retail partners and our players, the GLC continues to be an industry leader. I am pleased to be a part of this winning team and look forward to building on the many accomplishments this lottery has achieved.

*Margaret R. DeFrancisco*

# Meet the Board of Directors

Our mission remains the same today as it was when the lottery first started – to responsibly raise as many dollars as possible for the educational programs we fund. We are pleased that the Georgia Lottery set a new record this fiscal year for profits, contributing more than \$782 million to lottery-funded educational programs. This represents a more than \$30 million *increase* over the previous year and helps



to ensure the future of the HOPE Scholarship and Pre-K Programs for all Georgians.

The lottery's phenomenal growth is a result of hard work and sound business practices. With the addition of Margaret DeFrancisco as President and CEO of the Georgia Lottery Corporation in 2004, the GLC is looking to reach new heights.

Georgia Lottery proceeds have supplemented existing state appropriations to education, effectively and responsibly. We look forward to building on the high standards of excellence that have always been the hallmark of the Georgia Lottery.

*Barbara M. Dooley, Chair*

*(photos left to right):  
David C. Garrett, III;  
Rayna Casey;  
Roscoe Brown;  
Sylvan M. Byck, Jr.;  
Jim Ivey;  
Matthew Ware.*

# Education

*opening doors to the future*

Our mission is simple – to maximize revenues for the Lottery for Education Account. In fiscal year 2004, record Georgia Lottery sales allowed us to transfer more than \$782 million for educational programs in Georgia – the highest amount in our 11-year history.



Lottery proceeds totaling \$260 million opened the door to education for more than 68,000 four-year-olds in the 2003-2004 school year. Participation in the high-quality Pre-K program helps children develop social and pre-academic skills that will help them succeed in kindergarten and throughout their educational experiences.

Georgia is the largest state in the nation to offer fully funded, universal prekindergarten for every four-year-old. More than half of all four-year-olds in Georgia are enrolled in a lottery-funded Pre-K program this year. Since inception of the Lottery, more than 560,000 four-year-olds have benefited from this remarkable program.

The HOPE Scholarship Program has opened the door to higher educational opportunities for over 750,000 Georgia students since the program's inception in 1993. More than 220,000 lottery-funded HOPE Scholarships were awarded for students to attend colleges and technical colleges in fiscal



**Record Georgia Lottery sales allowed us to transfer more than \$782 million for educational programs in Georgia.**



year 2004. Scholarship funds are awarded based solely on merit and more than \$400 million was distributed last school year.

The nationally acclaimed program continues to extend higher educational opportunities to all Georgians. Additionally, the HOPE Scholarship Program has kept Georgia's best and brightest in state, in turn contributing to a strong workforce.

Since the GLC's inception, close to \$7 billion in proceeds have been transferred to the Lottery for Education Account. These funds directly impact thousands of families in the State of the Georgia.

# Games

*opening doors to fun*

Georgia Lottery games opened the door to fun and excitement throughout fiscal year 2004. The figures were solid for online games Cash 3, Cash 4, Fantasy 5, Lotto South, Mega Millions and Quick Cash Keno. The Change Game took its final bow with a respectable performance.

The Fantasy 5 top prize rolled to its highest ever at \$1.7 million. Mega Millions reached a game-high \$239 million. Adding to the excitement, the record-breaking jackpot drawing was held live in New York's Times Square.



**With sales soaring to over \$2.7 billion, online and instant games were a winning combination.**



Instant games remained a favorite with players. Sales for instant games reached over \$37 million for the week that ended on February 7, 2004, marking the highest sales week in Georgia Lottery history since inception.

The exciting, new instant games Harley-Davidson® and Fast Cash offered second chance drawings and an opportunity for players to win an array of prizes.



**Fiscal Year 2004  
was a record year for  
our retailers, earning  
\$178 million  
for their efforts.**



# *Retailers*

*opening doors to business opportunities*

Retailers are the link between the Georgia Lottery and its consumers. The Georgia Lottery's partnership with its more than 7,700 retailers throughout the state grew even stronger in fiscal year 2004. Retailers played a critical role in the implementation of our new online gaming system. With new terminals and satellite communication, retailers statewide are benefiting from enhanced technology. New, user-friendly terminals enhance customer service and distribution. The new gaming system also allows for continued growth into the future.



# Winners

*opening doors to excitement*

Lucky Georgia Lottery players enjoyed a record year of winning with over \$1.4 billion in prizes awarded during fiscal year 2004.

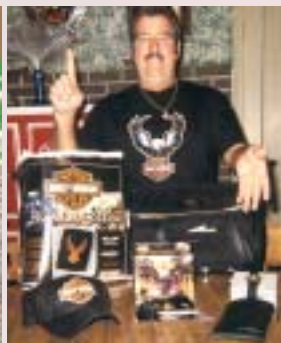
Army Staff Sergeant Stephen Moore received international attention when he became the largest winner in Georgia Lottery history. While on a 30-day leave from South Korea, Staff Sgt. Moore played Mega Millions and won \$150 million, the highest single prize payout in GLC history.



Roswell's Stephen Cooke grabbed headlines when he arrived at Georgia Lottery headquarters expecting to collect \$13.3 million but walked away with \$26.6 million. Mr. Cooke was claiming a Mega Millions jackpot prize and learned that he held two of three jackpot winning tickets.

**Staff Sergeant  
Stephen Moore won  
\$150 million, the highest  
single prize payout  
in GLC history.**

**Fantasy 5 reached a  
record-breaking \$1.7 million,  
and a Marietta man  
became the game's top winner.**



With two children who were HOPE scholars, Sam and Ronnie Deli were already Georgia Lottery winners. The Suwanee couple became even bigger winners when they won \$19 million playing Lotto South.

Walter "Burt" Sheffield of East Dublin won \$1.18 million and became the largest single winner in Fantasy 5 history. Later in the year, Fantasy 5 reached a record-breaking \$1.7 million, and a Marietta man became the game's top winner.

Two lucky Georgia Lottery players won \$25,000 and 400 Harley-Davidson® merchandise prize packages were awarded in a Harley-Davidson® Second Chance Drawing.

# Senior Staff

*opening doors for others*

The Georgia Lottery Corporation currently employs approximately 260 people statewide and has nine district offices (Atlanta East, Atlanta West, Augusta, Columbus, Dalton, Duluth, Macon, Savannah and Thomasville) in addition to the GLC headquarters in downtown Atlanta. The Duluth (formerly Gainesville) and Macon district offices moved into new facilities in fiscal year 2004.

The GLC team is comprised of dedicated and professional men and women committed to the organization's mission to maximize revenues for education.

The GLC is headed by President and Chief Executive Officer Margaret DeFrancisco. The President is responsible for developing long-term marketing strategies and overseeing the day-to-day operations of the corporation.



The **Sales** Division coordinates and oversees all sales and retailer activities, including corporate account management and retailer sales.

The **Corporate Affairs** Division is responsible for internal and external communications including human resources, legislative affairs, public and player information and media relations.

The **Finance and Information Systems** Division provides services related to financial accounting and reporting, cash management, budget, collections, procurement, and maintains state-of-the-art computer systems, technology and telecommunications systems.

The **Legal Affairs** Division provides legal advice and assistance, drafts policies, directs security and investigations, handles internal auditing, and manages contract compliance.

The **Administration** Division incorporates facilities management, prize validation and retailer administration. Additionally, the Senior Vice President of Administration manages the GLC's instant game strategy.

*(photos left to right):*

*Joan Schoubert, Senior Vice President of Administration;*

*Daniel Johnson, Vice President of Systems Development;*

*Mar-D Greer, Vice President of Security;*

*Sharman Lomax, Vice President of Financial Management;*

*Jeff Martin, Vice President of Human Resources;*

*Rosemarie Morse, Vice President of Legal Affairs;*

*Larry Sipes, Vice President of Information Technology.*

# Where the Money Goes



The Georgia Lottery Corporation is committed to opening doors and providing opportunities to all Georgians. Every dollar spent on Georgia Lottery tickets is reinvested into Georgia's economy.

Lottery funds go towards educating Georgia's students and future workforce. Businesses across the state have benefitted from a successful partnership with the GLC and players won close to \$1.5 billion in prizes last year alone.

# Independent Auditors' Report



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## Board of Directors of the Georgia Lottery Corporation:

We have audited the accompanying statements of net assets of the Georgia Lottery Corporation (the "GLC"), a blended component unit of the State of Georgia, as of June 30, 2004 and 2003, and the related statements of revenues, expenses, and changes in net assets and of cash flows for the years then ended. These financial statements are the responsibility of the GLC'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.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the GLC as of June 30, 2004 and 2003, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Management's Discussion and Analysis listed in the Table of Contents is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This information is the responsibility of the GLC's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of supplementary information. However, we did not audit such information, and we do not express an opinion on it.

January 6, 2005

## Management's Discussion and Analysis

As management of the Georgia Lottery Corporation ("GLC"), we offer readers of the GLC's financial statements this narrative overview and analysis of the financial activities for the fiscal year ended June 30, 2004. We encourage readers to consider the information presented here in conjunction with the financial statements, which begin on page 19.

### *Financial Highlights*

The GLC had another record-breaking year in fiscal year 2004. Gross ticket sales surpassed \$2.7 billion, representing the highest sales total in the GLC's eleven-year history. The net proceeds transferred to the Lottery for Education Account were \$782.7 million, also setting a GLC record. The net proceeds transferred represent a growth of \$31.1 million over last year. Other significant financial highlights include the following:

- Gross tickets sales increased by \$106.1 million.
- Prizes expense increased \$91.1 million. This expense increases or decreases in direct proportion to ticket sales and represented approximately 54% percent of gross ticket sales in 2004 and 53% in 2003.
- Direct gaming expenses, which includes retailer commissions and bonuses, contractor fees, advertising and retailer merchandising and marketing, decreased \$26.4 million. These expenses fluctuate in proportion to ticket sales and represented approximately 10% of gross ticket sales in 2004 and 11% in 2003.
- Operating expenses, which includes salaries and benefits, rent, utilities and maintenance, professional fees, depreciation and other expenses increased \$100,000 over the previous fiscal year.
- Nonoperating revenues, net of expenses, decreased \$32.8 million or approximately 190% in 2004 as compared to 2003. This decrease is attributable to the change in the fair value of grand prize investments held by the GLC for funding of future grand prize payments.

### *Overview of the Financial Statements*

The GLC is accounted for as an enterprise fund, reporting transactions using the accrual basis of accounting similar to a business entity. This discussion and analysis is intended to serve as an introduction to the GLC's basic financial statements, along with the notes to the financial statements. The statements of net assets on page 19, the statements of revenues, expenses, and changes in net assets on page 20, and statements of cash flows on pages 21 and 22 report the GLC's net assets and changes therein. The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the financial statements. The notes to the financial statements begin on page 23 of this report.

The GLC transfers its net proceeds each fiscal year to the general fund of the state treasury, for credit to the Lottery for Education Account. As a result, the GLC's net assets consist of funds invested in capital assets and unrestricted net assets. Unrestricted net assets normally result from the inclusion of capital costs in the determination of net proceeds as required by the Georgia Lottery for Education Act, and the cumulative effect of periodic adjustments to recognize the fair value of grand prize investments held to fund grand prizes payable. The GLC expects to hold these investments to maturity to meet our future grand prize winner obligations and, therefore, would not realize any gains or losses related to these investments for distribution as net proceeds. The reader of these financial statements should review the assets and liabilities in the statements of net assets and the operating revenues and expenses, and the transfer to education in the statements of revenues, expenses, and changes in net assets to assess the GLC's financial position as of June 30, 2004 and 2003, and the results of its operations for the years then ended.

## ***Financial Analysis***

### **Assets**

Total assets at the end of fiscal year 2004 were \$465.8 million compared to \$484.8 million at the end of fiscal year 2003, representing a decrease of \$19.0 million.

Current assets decreased from \$262.0 million in 2003 to \$250.7 million in 2004, representing a decrease of \$11.3 million. This decrease is due to a decrease in the funds being held at year end to make the fourth quarter Lottery for Education payment and is the result of lower fourth quarter sales in fiscal year 2004. Additionally, prepaid expenses decreased by \$3.2 million during 2004 due to the GLC entering into a new contract with its two major gaming system vendors which provides for fees to be earned when the corresponding ticket revenue is recognized and thereby eliminates the need for the GLC to record prepaid vendor fees.

Grand prize investments decreased from \$220.6 million in 2003 to \$213.5 million in 2004, a decrease of \$7.4 million. The decrease resulted from net purchases of \$19.0 million, payments to grand prize winners totaling \$21.7 million, interest earned on current year maturities of \$12.0 million, and a \$16.4 million decrease in the fair value of the investments. Capital assets decreased from \$2.1 million in 2003 to \$1.8 million in 2004, a decrease of \$.3 million. The decrease resulted from capital asset purchases of \$.8 million and depreciation expense of \$1.1 million.

### **Liabilities**

Total liabilities at the end of fiscal year 2004 were \$456.8 million compared to \$460.0 million at the end of fiscal year 2003, representing a decrease of \$3.2 million.

Current liabilities decreased from \$262.7 million in 2003 to \$250.1 million in 2004, a decrease of \$12.6 million. The decrease is due to a \$22.3 million decrease in the funds due to the Lottery for Education Account, \$4.4 million decrease on accounts payable and accrued liabilities, and a \$14.0 million increase in prizes payable. The decrease in funds due to the Lottery for Education Account resulted from lower fourth quarter sales in fiscal year 2004 versus 2003. The decrease in accounts payable and accrued liabilities was primarily due to lower year-end accrued payments for vendors, which provide gaming services, products, and systems, and advertising. The increase in prizes payable was primarily due to Georgia's portion of a Mega Millions jackpot continuing to roll as of year-end, June 30, 2004.

Long-term liabilities principally consist of grand prizes payable, which represent the amount to be paid to grand prize winners over future years. Grand prizes payable increased \$9.5 million in 2004. The increase is attributable to two factors. Grand prize payables of \$9.7 million became due and payable in fiscal year 2004 as an annual payment obligation to our grand prize winners, thus reducing the long-term liabilities. The GLC increased its grand prizes payable by \$19.0 million as the result of new annual payment obligations for three Lotto South grand prize winners. The GLC purchased U.S. treasury securities to fund these future payment obligations. During Fiscal 2003, all eligible grand prize winners in our online games elected to receive their prizes in a single cash payment.

## Net Assets and Changes in Net Assets

Net assets decreased to \$9.0 million in fiscal year 2004 from \$24.8 million in fiscal year 2003, representing a \$15.8 million decrease. This decrease primarily resulted from a \$16.8 million unrealized loss in the fair value of grand prize investments held by the GLC for funding of future grand prize payments, and the \$.8 million increase in funds invested in capital assets resulting from inclusion of these capital costs in the determination of net proceeds as required by the Georgia Lottery for Education Act. Accounting principles generally accepted in the United States of America require the GLC to record its grand prize investments at fair value and the change in the fair value is recorded as nonoperating revenue (expense) annually. The GLC classifies the decreases and increases in fair value as unrealized, due to the investments generally being held to maturity to fund future prize obligations.

## Sales

Total lottery ticket sales for fiscal year 2004 were \$2.710 billion, as compared to \$2.604 billion in 2003. This represents an increase of over \$106.1 million. This represents average weekly gross ticket sales for fiscal year 2004 of \$52.1 million versus \$50.1 million in 2003.

Gross instant tickets sales increased significantly, up \$70.2 million over one year ago, from \$1.487 billion in 2003 to \$1.557 billion in 2004. The increase is attributable to several factors, including the administration of a sound marketing strategy, continuous development and introduction of new instant ticket games, and effective management of the instant product mix by providing players the option to choose among a variety of games at different price points; \$1, \$2, \$3, \$5, and \$10. Continued player loyalty to their favorite instant games, including our most popular games such as Jumbo Bucks Classic, Mega Bucks, Junior Jumbo Bucks, and Jumbo Jumbo Bucks helped contribute to the significant sales growth in instant tickets. In addition, the GLC has focused on expanding two core games, Mega Bucks and Lucky 7's, by introducing new games at other price points, including the \$1 Mini Mega Bucks, \$3 Mighty Mega Bucks, and \$2 Double Lucky 7's instant ticket games.

Cash 3 sales decreased \$29.4 million in 2004 to \$596.9 million compared to \$626.3 million in 2003. Cash 3 is a twice-daily game whereby the player chooses a 3-digit number and wins a specified amount if his or her numbers are selected in the draw. The aggregate prize amount per draw varies based on the number of winners and the prize amount. Historically, as the prize amount won for this game increases above or decreases below the industry average of 50 percent of sales, a corresponding increase or decrease in sales will occur. The actual prize payout experience for both fiscal years 2004 and 2003 was 47 percent. Consequently, lower than expected actual prize payouts in fiscal year 2004 resulted in a continued decline in Cash 3 sales.

Mega Millions sales increased \$39.8 million in 2004 to \$186.0 million compared to \$146.2 million in 2003. Mega Millions is a multi-state lottery game operated with ten other states; Illinois, Maryland, Massachusetts, Michigan, New Jersey, New York, Ohio, Texas, Virginia, and Washington. Drawings are held twice weekly on Tuesdays and Fridays. During fiscal year 2004, Mega Millions added the Texas Lottery, which significantly increased the potential player base. As anticipated, the larger player base contributed to larger jackpots and faster jackpot growth. Mega Millions had its largest jackpot in 2004, a record setting \$239 million winning jackpot in February 2004. In comparison, the second largest Mega Millions jackpot, \$183 million was generated during the previous fiscal year, in June 2003.

Cash 4 sales increased \$33.1 million, from \$138.8 million in 2003 to \$171.9 million in 2004. Actual prize payouts in fiscal year 2004 were 58%, exceeding the industry average of 50%. Historically, as the prize amounts won for this game increase above the industry average, a corresponding increase in sales will



occur. In fiscal year 2003, actual prize payouts exceeded 52 percent. Consequently, the six percent increase in actual prize payouts in 2004 over 2003, resulted in increased fiscal year 2004 sales.

Lotto South sales increased \$2.2 million in 2004 to \$76.1 million compared to \$73.9 million in 2003. Lotto South is a multi-state pari-mutuel lottery game operated with two other states; Kentucky and Virginia. Drawings are held twice weekly on Wednesdays and Saturdays. Lotto South produced only one jackpot over \$20 million in both fiscal years 2003 and 2004. During fiscal year 2004, Lotto South had ten winning jackpots as compared to thirteen winning jackpots in fiscal year 2003. The decreased frequency of winning jackpots in fiscal year 2004 resulted in an average jackpot of \$11 million versus an average jackpot of \$9 million in 2003. Historically, higher advertised jackpots generate increased incremental draw sales.

Fantasy 5 sales increased \$5.1 million in 2004 to \$74.7 million compared to \$69.6 million in 2003. During fiscal year 2004, Fantasy 5 had three jackpots over \$1 million, including its highest jackpot since the game's introduction, a jackpot over \$1.7 million. There were two jackpots over \$1 million in fiscal year 2003. Historically, large jackpots result in higher draw sales. These jackpots, over \$1 million, contributed \$10.7 million to total Fantasy 5 sales in fiscal year 2004 versus \$5.6 million in fiscal year 2003.

Sales for our Quick Cash Keno game decreased \$9.5 million from \$56.7 million in 2003 to \$47.2 million in 2004. Management is beginning to develop a marketing plan to increase sales.

The Change Game sales declined \$5.8 million, from \$6.8 million in fiscal year 2003 to \$1.0 million in fiscal year 2004. On June 30, 2004, GLC ended The Change Game.

### **Other Operating Revenue**

Other operating revenue includes online fees and other miscellaneous revenue. For fiscal year 2004, other operating revenue was \$4.7 million versus \$5.1 million in the prior year. This represents a decrease of \$.4 million.

### **Prize Expense**

Gross prize expense for instant games increased to \$934.3 million in fiscal year 2004 from \$892.4 million in 2003, an increase of \$41.9 million. Instant games prize expense is managed through the number of tickets printed for each game and value of prizes as determined prior to ticket production. Prize expense is recognized based on an established prize structure and related percentage of sales for each game introduced, and is recognized when products are made available for sale to the public.

Instant game prize expense is reduced through the use of unclaimed prizes recognized during the fiscal year. For fiscal year 2004, prize expense net of unclaimed prizes for instant games totaled \$896.8 million as compared to \$856.4 million in 2003. Gross instant prize expense was reduced by \$37.5 million and \$36.0 million using unclaimed prizes in 2004 and 2003, respectively.

Prize expense for online games generally increases or decreases each year in direct proportion to ticket sales of the related game. For pari-mutuel online games (Lotto South, Fantasy 5, and The Change Game), actual prize expense is recognized as a percentage of ticket sales; 50 percent, 50 percent, and 45 percent, respectively. For nonpari-mutuel games (Cash 3, Cash 4, Mega Millions, and Quick Cash Keno), actual prize expense is impacted by the number of and the prize value of winning tickets. To recognize prize expense on a consistent basis for these games, the GLC recognizes prize expense based on the estimated

payout experience over the life of the game or based on industry averages. The GLC has established prize liability limits, per draw, for nonpari-mutuel games.

Total online prize expense increased \$50.7 million in 2004 to \$583.5 compared to \$532.8 in 2003. The net increase is comprised of the following increases and decreases by game as follows:

- Prize expense for Cash 3 increased \$6.9 million in fiscal year 2004 as compared to 2003
- Prize expense for Mega Millions increased \$27.2 million in 2004 as compared to 2003
- Prize expense for Cash 4 increased \$20.5 million over 2003
- Prize expense for Lotto South increased \$1.1 million in 2004 as compared to 2003
- Prize expense for Fantasy 5 increased \$2.5 million in 2004 versus 2003
- Prize expense for Quick Cash Keno decreased \$5.0 million in 2004 above 2003
- Prize expense for The Change Game decreased \$2.6 million in 2004.

### **Direct Gaming and Operating Expenses**

Direct gaming expenses usually change in proportion with changes in ticket sales. For fiscal year 2004, increased ticket sales resulted in a corresponding increase in the largest component of direct gaming expenses, retailer commissions and bonuses. Contractor (vendor) fees decreased, while advertising expense remained unchanged in fiscal year 2004 versus 2003.

Retailer commissions and bonuses for fiscal year 2004 were \$178.0 million compared to \$172.9 million in 2003. This represents a \$5.1 million increase from the previous year. The GLC compensates its retailers through three commission/incentive plans. These are:

- a set commission percentage for selling tickets
- a ticket cashing bonus for validating and paying winning prizes up to \$599
- winning jackpot ticket incentives.

Contractor (vendor) fees represent payments made to our two major suppliers of the gaming products, systems, and services. The payments are determined based on a percentage of sales formula. On September 7, 2003, the GLC began operating under its new seven-year vendor contracts for Online Gaming Systems and Services and Instant Ticket Printing and Associated Services. In fiscal year 2004, contractor (vendor) fees were \$63.1 million as compared to \$93.8 million in 2003, representing a decrease of \$30.7 million, attributable to the reduction of .86% in online and 1.15% in instant contracted vendor fees.

Advertising expense for fiscal years 2004 and 2003 was \$19.9 million.

Retailer merchandising and marketing expenses decreased slightly to \$5.9 million in 2004 from \$6.7 million in 2003. This decrease is primarily the result of lower marketing expenses in fiscal year 2004 than 2003. In fiscal year 2003, the GLC launched a new online game, The Change Game with significant marketing support.

Operating expenses increased \$100,000 to \$24.5 million in 2004 from \$24.4 million in 2003.

## **Nonoperating Revenues (net of Expenses)**

Nonoperating revenues, net of expenses consists primarily of interest revenue and the change in the fair value of grand prize investments held by the GLC for funding of future grand prize payments. Nonoperating revenues, net of expenses, decreased \$32.8 million from \$17.3 million in nonoperating revenue in 2003 to \$15.6 million in nonoperating expense in 2004. This decrease is attributable primarily to the \$32.4 million change in the fair value of grand prize investments held by the GLC for funding of future grand prize payments. The increases or decreases in the fair value of grand prize investments are impacted by market fluctuations. The \$16.8 million decrease in the fair value of grand prize investments as of June 30, 2004 and the cumulative effect of the increase in fair value as of June 30, 2003 resulted in a net decrease of \$32.4 million.

Interest income decreased \$.3 million due to lower earnings realized from funds held in a pooled short-term investment fund managed by the State of Georgia Office of Treasury and Fiscal Services. This fund is a combined state general fund and local government investment pool and is used by the GLC for funds not needed in the short-term for operating purposes. These funds generally represent net proceeds held, pending quarterly transfer to the education account.

## **Significant Factors Impacting Next Year**

In January 2004 the State of Tennessee began lottery operations. The GLC could see some effect on its fiscal year 2005 sales as a result of Tennessee lottery operations.

## **Contacting the GLC's Financial Management**

This financial report is designed to provide the state of Georgia, the public, and other interested parties with an overview of the financial results of the GLC's activities, and to show the GLC's accountability for conducting business in a fiscally responsible manner. If you have questions about this report or require additional financial information, contact the GLC's Corporate Affairs Division at the Georgia Lottery Corporation, 250 Williams Street, Inforum, Suite 3000, Atlanta, Georgia, 30303.

# GEORGIA LOTTERY CORPORATION

## STATEMENTS OF NET ASSETS

JUNE 30, 2004 AND 2003

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<b>ASSETS</b>	<b>2004</b>	<b>2003</b>
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 164,865,000	\$ 157,693,000
Restricted fidelity fund cash	120,000	16,000
Retailer accounts receivable—net	84,573,000	99,845,000
Prepaid expenses and other assets	<u>1,216,000</u>	<u>4,446,000</u>
Total current assets	250,774,000	262,000,000
<b>GRAND PRIZE INVESTMENTS</b>	213,168,000	220,617,000
<b>CAPITAL ASSETS—Net</b>	<u>1,821,000</u>	<u>2,136,000</u>
<b>TOTAL ASSETS</b>	<u>\$ 465,763,000</u>	<u>\$ 484,753,000</u>
<b>LIABILITIES AND NET ASSETS</b>		
<b>CURRENT LIABILITIES:</b>		
Due to Lottery for Education Account	\$ 193,600,000	\$ 215,904,000
Prizes payable	47,643,000	33,597,000
Accounts payable and accrued liabilities	8,745,000	13,163,000
Restricted fidelity fund	<u>120,000</u>	<u>16,000</u>
Total current liabilities	250,108,000	262,680,000
<b>LONG-TERM LIABILITIES:</b>		
Grand Prizes Payable	204,960,000	195,432,000
Noncurrent portion of other long-term liabilities	<u>1,722,000</u>	<u>1,876,000</u>
Total liabilities	456,790,000	459,988,000
<b>NET ASSETS:</b>		
Invested in capital assets	1,821,000	2,136,000
Unrestricted	<u>7,152,000</u>	<u>22,629,000</u>
Total net assets	<u>8,973,000</u>	<u>24,765,000</u>
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<u>\$ 465,763,000</u>	<u>\$ 484,753,000</u>

See notes to financial statements.

# GEORGIA LOTTERY CORPORATION

## STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS YEARS ENDED JUNE 30, 2004 AND 2003

	2004	2003
<b>OPERATING REVENUES:</b>		
Ticket sales	\$ 2,710,459,000	\$ 2,604,423,000
Less instant tickets provided as prizes	<u>(160,922,000)</u>	<u>(152,613,000)</u>
Net ticket sales	2,549,537,000	2,451,810,000
Online fees	4,591,000	4,312,000
Other	<u>133,000</u>	<u>837,000</u>
Net operating revenues	2,554,261,000	2,456,959,000
<b>OPERATING EXPENSES:</b>		
Prizes	1,480,303,000	1,389,222,000
Retailer commissions and bonuses	177,990,000	172,856,000
Contractor fees	63,109,000	93,789,000
Advertising	19,860,000	19,930,000
Salaries and benefits	18,193,000	18,025,000
Retailer merchandising and marketing	5,967,000	6,758,000
Rent, utilities, and maintenance	3,271,000	2,755,000
Depreciation	1,134,000	1,326,000
Professional fees	795,000	651,000
Other	<u>1,201,000</u>	<u>1,720,000</u>
Total operating expenses	<u>1,771,823,000</u>	<u>1,707,032,000</u>
Operating income	782,438,000	749,927,000
<b>NONOPERATING REVENUES (EXPENSES):</b>		
Interest revenue and other	1,305,000	1,630,000
Net (decrease) increase in fair value of grand prize investments	<u>(16,811,000)</u>	<u>15,626,000</u>
Total nonoperating revenues (expenses)	<u>(15,506,000)</u>	<u>17,256,000</u>
Income before transfers	<u>766,932,000</u>	<u>767,183,000</u>
<b>TRANSFERS:</b>		
Transfers to and due to Lottery for Education Account	<u>(782,724,000)</u>	<u>(751,557,000)</u>
Total transfers out	<u>(782,724,000)</u>	<u>(751,557,000)</u>
Change in net assets	(15,792,000)	15,626,000
NET ASSETS—Beginning of year	<u>24,765,000</u>	<u>9,139,000</u>
NET ASSETS—End of year	<u>\$ 8,973,000</u>	<u>\$ 24,765,000</u>

See notes to financial statements.

# GEORGIA LOTTERY CORPORATION

## STATEMENTS OF CASH FLOWS YEARS ENDED JUNE 30, 2004 AND 2003

	2004	2003
<b>OPERATING ACTIVITIES:</b>		
Cash received from customers	\$ 2,564,808,000	\$ 2,434,030,000
Other operational cash received	4,724,000	5,149,000
Cash paid to prize winners	(1,468,531,000)	(1,437,183,000)
Cash paid to retailers	(177,990,000)	(172,856,000)
Cash paid to contractors and employees	(104,449,000)	(136,131,000)
Other operating payments	<u>(8,837,000)</u>	<u>(7,740,000)</u>
Net cash provided by operating activities	<u>809,725,000</u>	<u>685,269,000</u>
<b>NONCAPITAL FINANCING ACTIVITIES:</b>		
Payments to Lottery for Education Account	(805,028,000)	(735,996,000)
Payments to Department of Human Resources	<u>(200,000)</u>	<u>(200,000)</u>
Net cash used in noncapital financing activities	<u>(805,228,000)</u>	<u>(736,196,000)</u>
<b>CAPITAL AND RELATED FINANCING ACTIVITIES:</b>		
Purchase of property and equipment	(819,000)	(820,000)
Proceeds from disposals of property and equipment	<u>29,000</u>	<u>93,000</u>
Net cash used in capital and related financing activities	<u>(790,000)</u>	<u>(727,000)</u>
<b>INVESTING ACTIVITIES:</b>		
Interest received	926,000	1,630,000
Purchase of grand prize investments	(106,319,000)	(9,853,000)
Investments sold	87,285,000	6,602,000
Maturities of grand prize investments	<u>21,677,000</u>	<u>21,469,000</u>
Net cash provided by investing activities	<u>3,569,000</u>	<u>19,848,000</u>
<b>NET CASH, CASH EQUIVALENTS, AND RESTRICTED CASH PROVIDED BY (USED IN)</b>	<b>7,276,000</b>	<b>(31,806,000)</b>
<b>CASH, CASH EQUIVALENTS, AND RESTRICTED CASH—Beginning of year</b>	<b><u>157,709,000</u></b>	<b><u>189,515,000</u></b>
<b>CASH, CASH EQUIVALENTS, AND RESTRICTED CASH—End of year</b>	<b><u>\$ 164,985,000</u></b>	<b><u>\$ 157,709,000</u></b>

(Continued)

# GEORGIA LOTTERY CORPORATION

## STATEMENTS OF CASH FLOWS YEARS ENDED JUNE 30, 2004 AND 2003

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	2004	2003
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating income	\$ 782,438,000	\$ 749,927,000
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	1,134,000	1,326,000
Provision for doubtful retailer accounts	213,000	935,000
(Gains) losses on disposals of property and equipment	(29,000)	(79,000)
Changes in assets and liabilities:		
Retailer accounts receivable	15,059,000	(18,715,000)
Prepaid expenses and other assets	3,609,000	(465,000)
Accounts payable and accrued liabilities	(4,418,000)	482,000
Prizes payable	14,246,000	(29,743,000)
Grand prizes payable	(2,477,000)	(18,219,000)
Restricted fidelity fund	104,000	(484,000)
Other liabilities	<u>(154,000)</u>	<u>304,000</u>
Net cash provided by operating activities	<u>\$ 809,725,000</u>	<u>\$ 685,269,000</u>
SCHEDULE OF NONCASH INVESTING, CAPITAL, AND RELATED FINANCING ACTIVITIES:		
Increase (decrease) in fair value of investments	\$ (16,811,000)	\$ 15,626,000
Common stock received	<u>379,000</u>	<u>-</u>
	<u>\$ (16,432,000)</u>	<u>\$ 15,626,000</u>

(Concluded)

See notes to financial statements.

# GEORGIA LOTTERY CORPORATION

## NOTES TO THE FINANCIAL STATEMENTS YEARS ENDED JUNE 30, 2004 AND 2003

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### 1. REPORTING ENTITY

The Georgia Lottery Corporation (the “GLC”) was established as an instrumentality of the state with the enactment of the Georgia Lottery for Education Act (the “Act”) on November 2, 1992. The GLC is responsible for the provision of lotteries on behalf of the State of Georgia in accordance with the Act and is a blended component unit of the State of Georgia.

The GLC’s ticket sales include instant ticket sales and online ticket sales for Cash 3, Cash 4, Lotto South, Fantasy Five, Quick Cash Keno, Mega Millions, and The Change Game. On June 30, 2004, the GLC ended The Change Game.

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Basis of Presentation**—The GLC is accounted for as an enterprise fund. Enterprise funds are used to account for activities that are financed and operated in a manner similar to private business enterprises: (1) where the costs of providing goods and services to the general public on a continuing basis are to be financed through user charges or (2) where the periodic determination of net income is considered appropriate.

**Basis of Accounting**—The financial statements are prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America (“generally accepted accounting principles”). Under this method, revenues are recognized when earned and expenses are recognized when incurred. In accordance with Statement of Governmental Accounting Standards (“SGAS”) No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the GLC is required to follow all applicable Governmental Accounting Standards Board (“GASB”) pronouncements.

**Use of Estimates**—The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Revenue Recognition**—Lottery games are sold to the public by contracted retailers. Revenue is recognized for online games when tickets are sold to players and the related draw has occurred. Revenue is recognized for instant games when the product is made available for sale to the public, which is based on ticket activations by the retailers. Certain instant games include free tickets, which entitle the holder to exchange one instant ticket for another of equal value. The selling price of free tickets reduces instant ticket revenue when the ticket is claimed by a player.

**Commissions and Bonuses**—Retailers receive a commission of 5 percent on ticket sales, except for Cash 3 and The Change Game sales, on which retailers receive a commission of 7 percent and 10 percent, respectively, and a 2 percent cashing bonus on all ticket validations at their location. In addition, retailers receive bonuses for selling winning jackpot tickets for Lotto South, Fantasy Five,



Mega Millions, and certain instant ticket games. During 2004 and 2003, at least four instant ticket games were introduced with a retailer sales commission of 10 percent.

**Contractor Fees**—The GLC has contracted with two vendors for the majority of the gaming systems and supplies.

The GLC entered into a new seven-year vendor contract with an effective date of September 7, 2003 with GTECH Corporation (“GTECH”) for the operation of the gaming network that consists of over 7,700 instant and online retailer ticket terminals and associated software. Under the new contract, GTECH receives a fee of 1.28% of net ticket revenue. Under the previous amended contract, GTECH received a fee of 2.315% of net ticket revenue.

The GLC entered into a new seven-year vendor contract with an effective date of September 7, 2003 with Scientific Games, Inc. for the printing and distribution of instant game tickets. Scientific Games, Inc. receives a fee of 1.2875% of net instant game tickets distributed to retailers. Under the previous contract, Scientific Games received a fee of 2.4375% of net instant ticket revenue.

**Prizes**—In accordance with the Act, as nearly as practical, at least 45 percent of ticket sales must be returned to the public in the form of prizes. Prize expense for instant games is recognized based on the predetermined prize structure for each game. Generally, prize expense for Cash 3, Cash 4, Mega Millions, and Quick Cash Keno is recognized based on the estimated payout experience over the life of the games or the industry averages. Prize expense for Lotto South, Fantasy Five, and The Change Game is recorded on a pari-mutuel basis according to the game structure based on a percentage of revenue recognized.

Mega Millions and Lotto South are multi-state lottery games operated by member lotteries. The Mega Millions and Lotto South prizes are shared based on contributions to the prize pools by the member lotteries. Grand prize investments for jackpot winners who purchased tickets in Georgia are held by the GLC.

The Powerball grand prize is a shared prize from contributions to the prize pool by all member lotteries of the Multi-State Lottery Association (“MUSL”). All Powerball grand prizes won by players who purchased tickets in Georgia are funded by investments purchased by MUSL. The investments are held by MUSL in trust for the GLC and are paid in 20 annual installments. Investments of \$10,567,000 and \$11,900,000 included in the GLC’s grand prize investments in the statements of net assets at June 30, 2004 and 2003, respectively, were held by MUSL in trust. The GLC withdrew from MUSL on August 31, 1996.

**Unclaimed Prizes**—Prizes must be claimed no later than 90 days after game-end for instant games and within 180 days after the draw date for online games. An estimate of the unclaimed prizes is based upon the historical experience rate as a percentage of ticket sales. In accordance with the Act, \$200,000 of unclaimed prizes must be transferred to the Department of Human Resources for the treatment of compulsive gambling and related educational programs. Transfers for this purpose for each fiscal year have been \$200,000. The remainder of unclaimed prizes is used to fund future prizes or special prize promotions, as defined by the statute.

**Net Assets**—Net assets represent cumulative revenues less expenses in excess of net proceeds transferred to the Lottery for Education Account, as defined under the Act (see Note 7). Net assets include funds invested in capital assets and unrestricted net assets. Unrestricted net assets normally result from the inclusion of capital costs in the determination of net proceeds as required by the Act and the cumulative effect of periodic adjustments to recognize the fair value of grand prize

investments held to fund grand prizes payable. Grand prize investments are purchased to finance future payments to Lotto South, Mega Millions, and certain instant game grand prize winners. Any increases or decreases in the fair value of these investments are determined to be unrealized and will not affect (i) the future ability to hold these investments or (ii) the amount of funds available for distribution to the Lottery for Education Account. Unrealized gains on grand prize investments at June 30, 2004 and 2003 were \$7,954,000 and \$24,765,000, respectively.

**Cash and Cash Equivalents**—The GLC considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. This includes cash in banks, petty cash, and balances on account in Georgia Fund 1.

**Retailer Accounts Receivable**—Retailer accounts receivable represents lottery proceeds due from retailers for net ticket sales less commissions, cashing bonuses, and prizes paid by the retailers. Lottery proceeds are collected weekly from retailer bank accounts held in trust for the GLC. At June 30, 2004 and 2003, the allowance for uncollectible retailer receivables was \$1,896,000 and \$1,987,000, respectively.

**Capital Assets**—Capital assets are stated at cost less accumulated depreciation. Depreciation on capital assets is computed using the straight-line method over the estimated useful lives of three to ten years. Leasehold improvements are amortized over their expected useful lives or the lease term, whichever is shorter. When assets are retired or otherwise disposed of, the costs and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is reflected in the results from operations in the period of disposal.

**Fidelity Fund**—In accordance with the Act, retailers contribute a fee to a fidelity fund upon acceptance as a GLC retailer. The GLC is reimbursed from available funds for any losses incurred as a result of the misfeasance or malfeasance of GLC retailers. At the end of each year, any amount in the fund in excess of \$500,000 is treated as net proceeds from the GLC subject to transfer to the Lottery for Education Account. There were no fidelity funds available for transfer as net proceeds for the years ended June 30, 2004 and June 30, 2003. The fidelity fund proceeds are held in a separate account and is presented in the statements of net assets as restricted fidelity fund cash and in liabilities as restricted fidelity funds.

Bank balances of approximately \$120,000 and \$16,000 at June 30, 2004 and 2003, respectively, were either insured by federal depository insurance or collateralized by the GLC's custodial bank in the GLC's name.

**Compensated Absences**—Employees earn the right to be compensated during absences for vacation and illness. Unused leave benefits are paid to employees upon separation from service. The cost of vacation and vested sick leave benefits is accrued in the period in which it was earned.

**Budget**—Georgia Statute requires the GLC to submit to the Office of Planning and Budget (“OPB”) and the State Auditor, annually by June 30, a proposed operating budget for the next fiscal year. Additionally, the GLC is required to submit to the OPB annually, on September 1, a proposed operating budget for the GLC and an estimate of net proceeds for the succeeding fiscal year.

**New Accounting Pronouncements** – In March 2003, GASB issued SGAS No. 40, *Deposit and Investment Risk Disclosures*, which amends SGAS No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*, and addresses additional risks to which governments are exposed. Under SGAS No. 40, state and local governments are required to disclose information covering four principal areas:

- Investment credit risk disclosures, including credit quality information issued by rating agencies;
- Interest rate disclosures that include investment maturity information, such as weighted average maturities or specific identification of the securities;
- Interest rate sensitivity for investments that are highly sensitive to changes in interest rates (example, inverse floaters, enhanced variable-rate investments, and certain asset-back securities); and
- Foreign exchange exposures that would indicate the foreign investment's denomination.

SGAS No. 40 provisions are effective for financial statements for periods beginning after June 15, 2004. The GLC management has not yet determined the impact that implementation of SGAS No. 40 will have on the GLC's financial statements.

In November 2003, GASB issued SGAS No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and Insurance Recoveries* and establishes accounting and financial reporting standards for impairment of capital assets. In accordance with this statement a capital asset will be considered impaired when its service utility has declined significantly and unexpectedly and such impairment will be required to be reported in the financial statements when such impairment has occurred and not as part of ongoing depreciation or upon disposal of the capital asset. This statement also enhances comparability of financial statements between governments by requiring all governmental entities to account for insurance recoveries in the same manner. SGAS No. 42 provisions are effective for financial statements for periods beginning after December 15, 2004. GLC management has not yet determined the impact that implementation of SGAS No. 42 will have on the GLC's financial statements.

In August 2004, GASB issued SGAS No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* and establishes accounting and financial reporting standards for employer costs and obligations related to postemployment healthcare and other nonpension benefits ("OPEB"). This statement generally requires that state and local governmental employers account for and report the annual cost of OPEB and the outstanding obligations and commitments related to OPEB in essentially the same manner as they currently do for pensions. Annual OPEB cost for most employers will be based on actuarially determined amounts that, if paid on an ongoing basis, generally would provide sufficient resources to pay benefits as they come due. The provisions of Statement 45 may be applied prospectively and do not require governments to fund their OPEB plans. An employer may establish its OPEB liability at zero as of the beginning of the initial year of implementation; however, the unfunded actuarial liability is required to be amortized over future periods. This statement also establishes disclosure requirements for information about the plans in which an employer participates, the funding policy followed, the actuarial valuation process and assumptions, and, for certain employers, the extent to which the plan has been funded over time. The earliest that SGAS No. 45 provisions will be effective is for financial statements periods beginning after December 15, 2006. GLC management has not yet determined the impact that implementation of SGAS No. 45 will have on the GLC's financial statements.

**Reclassifications**—Certain reclassifications have been made in the 2003 financial statements to conform with the 2004 presentation.

### 3. CASH, CASH EQUIVALENTS, AND GRAND PRIZE INVESTMENTS

**Cash**—Cash is held in demand deposits at various financial institutions. The bank balance of these deposits of approximately \$2,444,000 and \$2,134,000 at June 30, 2004 and 2003, respectively, were insured by either the state’s collateral for public deposits in accordance with Georgia Statutes, Chapter 280.04, or federal depository insurance. These deposits are collateralized with U.S. Government securities held in a custody account at the Federal Reserve Bank for the benefit of the GLC. The fair value of the underlying securities must be at least equal to the amount of funds held by the financial institution on behalf of the GLC.

**Cash Equivalents**—Cash equivalents represent surplus cash invested in Georgia Fund 1 administered by the State of Georgia’s Office of Treasury and Fiscal Services. The voluntary fund is a short-term investment vehicle that is available for use by state entities and local governments. Georgia Fund 1 invests its assets in U.S. Treasury bills, U.S. Treasury notes, securities issued by federal agencies and instrumentalities, banker’s acceptances, and repurchase agreements.

As of June 30, 2004, Georgia Fund 1 net assets totaled \$6,292,865,000 and were invested in the following:

Repurchase agreements	29%
Federal agencies/instrumentality securities	66%
Banker’s acceptances	5%

The GLC’s investment in Georgia Fund 1 was approximately \$164,134,000 and \$156,441,000 at June 30, 2004 and 2003, respectively. No allocation will be made as to the GLC’s share of the types of investments or Georgia Fund 1’s risk categories. Interest earned on the GLC’s investments was approximately \$926,000 and \$1,630,000 for the years ended June 30, 2004 and 2003, respectively.

The GLC’s share of the assets and liabilities arising from the above investments will not be carried on the statements of net assets since the Georgia Fund 1 is operated on a pooled basis. To do so may give the misleading impression that the GLC has some controlling authority over the investment vehicles.

**Grand Prize Investments**—All grand prize investments represent funds held to pay grand prize winners who have selected multi-year payments. Grand prize investments are recorded at their fair values. Increases or decreases in the fair value of these investments is recorded as nonoperating revenue (expense).

Grand prize investments at June 30, 2004 and 2003 consist of the following:

	Fair Value	
	2004	2003
U.S. Treasury securities	\$ 203,000,000	\$ 210,392,000
Government agencies	<u>10,168,000</u>	<u>10,225,000</u>
	<u>\$ 213,168,000</u>	<u>\$ 220,617,000</u>

Grand prize investments are not presented as current assets, as they are not part of the GLC’s current operations.

Changes in grand prize investments for the years ended June 30, 2004 and 2003 consisted of:

Fair value—June 30, 2002	\$ 210,774,000
Purchases	9,853,000
Payments to grand prize winners	(21,469,000)
Investments sold	(6,602,000)
Interest earned on current year maturities	12,435,000
Change in fair value	<u>15,626,000</u>
Fair value—June 30, 2003	<u>220,617,000</u>
Purchases	106,319,000
Payments to grand prize winners	(21,677,000)
Investments sold	(87,285,000)
Interest earned on current year maturities	12,005,000
Change in fair value	<u>(16,811,000)</u>
Fair value—June 30, 2004	<u>\$ 213,168,000</u>

GASB Statement No. 3 provides for the classification of investments to give an indication of the level of credit risk assumed by the GLC. Category 1 includes investments for which the securities are held by the GLC or its agent in the GLC's name. Category 2 includes investments for which the securities are held by the counterparty's trust department or agent in the GLC's name. Category 3 includes investments for which the securities are held by the counterparty's safekeeping department in the GLC's name. At June 30, 2004, grand prize investments of \$151,720,000 and \$61,448,000 were classified as Category 1 and Category 3, respectively. At June 30, 2003, grand prize investments of \$168,990,000 and \$51,627,000 were classified as Category 1 and Category 3, respectively.

#### 4. CAPITAL ASSETS

Capital assets at June 30 consisted of:

	Balance at June 30, 2003	Increases	Decreases	Balance at June 30, 2004
Capital assets:				
Furniture and fixtures	\$ 2,486,000	\$ 1,000	\$ -	\$ 2,487,000
Computer and communications equipment	7,870,000	358,000	(952,000)	7,276,000
Vehicles	2,211,000	211,000	(227,000)	2,195,000
Leasehold improvements	2,135,000	230,000	-	2,365,000
Software	429,000	13,000	(50,000)	392,000
Other assets	1,362,000	6,000	-	1,368,000
Total capital assets at historical cost	<u>16,493,000</u>	<u>819,000</u>	<u>(1,229,000)</u>	<u>16,083,000</u>
Less accumulated depreciation	<u>(14,357,000)</u>	<u>(1,134,000)</u>	<u>1,229,000</u>	<u>(14,262,000)</u>
Capital assets—net	<u>\$ 2,136,000</u>	<u>\$ (315,000)</u>	<u>\$ -</u>	<u>\$ 1,821,000</u>

	Balance at June 30, 2002	Increases	Decreases	Balance at June 30, 2003
Capital assets:				
Furniture and fixtures	\$ 2,486,000	\$ -	\$ -	\$ 2,486,000
Computer and communications equipment	7,893,000	163,000	(186,000)	7,870,000
Vehicles	2,384,000	396,000	(569,000)	2,211,000
Leasehold improvements	2,130,000	5,000	-	2,135,000
Software	188,000	241,000	-	429,000
Other assets	<u>1,347,000</u>	<u>15,000</u>	<u>-</u>	<u>1,362,000</u>
Total capital assets at historical cost	<u>16,428,000</u>	<u>820,000</u>	<u>(755,000)</u>	<u>16,493,000</u>
Less accumulated depreciation	<u>(13,772,000)</u>	<u>(1,326,000)</u>	<u>741,000</u>	<u>(14,357,000)</u>
Capital assets—net	<u>\$ 2,656,000</u>	<u>\$ (506,000)</u>	<u>\$ (14,000)</u>	<u>\$ 2,136,000</u>

## 5. GRAND PRIZES PAYABLE

Grand prizes payable is recorded at the net present value of the U.S. Treasury securities purchased for each jackpot winner. Grand prizes payable was accreted by approximately \$12,005,000 and \$12,435,000 for the years ended June 30, 2004 and 2003, respectively. Grand prizes payable are not presented as current liabilities, as they are not part of the GLC's current operations.

Future payments of grand prizes payable at June 30, 2004 are scheduled as follows:

2005	\$ 22,702,000
2006	22,701,000
2007	22,682,000
2008	22,632,000
2009	22,631,000
2010-2014	111,984,000
2015-2019	33,633,000
2020-2024	10,835,000
2025-2029	10,671,000
2030-2034	8,357,000
2035-2039	<u>1,132,000</u>
	289,960,000
Less imputed interest	<u>(85,000,000)</u>
Net present value of grand prizes payable	<u>\$ 204,960,000</u>

The Omnibus Consolidated and Emergency Supplemental Appropriations Act, 1999 (the "Omnibus Act") was enacted into federal law on October 21, 1998. Included in this Omnibus Act is a Special Rule for Cash Options for Receipt of Qualified Prizes ("Special Rule"). Pursuant to the Special Rule, the GLC may extend to recipients of "qualified prizes" the opportunity, within a certain period after the drawing, to select a lump-sum payment equivalent to the cash value of an annuitized prize. Qualified prizes, as defined in the Omnibus Act, include multiple-year payments of a minimum of ten years.

Claimants of qualified prizes, as defined in the GLC Rules and Regulations, on or after the date of enactment of the Omnibus Act, can make an irrevocable election to receive a lump-sum cash

payment equivalent of the annuitized prize within 60 days of the claim date. Grand prizes payable at June 30, 2004 consist of no qualified prizes under this provision of the Special Rule.

## 6. OPERATING LEASES

The GLC has entered into operating leases for the rental of office space for its headquarters and district offices. Certain operating leases contain provisions for scheduled rental increases and are renewable at the option of the GLC. During the year ended June 30, 2003, all of the district office leases were re-negotiated with varying lease terms.

Future minimum rental payments on noncancelable leases with original terms of one year or more are scheduled as follows:

<b>Year Ending June 30,</b>	<b>Operating Leases</b>
2005	\$ 1,946,000
2006	1,948,000
2007	1,948,000
2008	2,231,000
2009	2,231,000
2010-2014	<u>11,155,000</u>
	21,459,000
Less sublease revenues	<u>(2,541,000)</u>
Total	<u>\$ 18,918,000</u>

Rental expense under all operating leases totaled approximately \$2,103,000 and \$1,601,000 for the years ended June 30, 2004 and 2003, respectively.

## 7. DUE TO LOTTERY FOR EDUCATION ACCOUNT

In accordance with the Act, all net proceeds of the GLC are due to the Lottery for Education Account within the state of Georgia Treasury. Net proceeds is defined under the Act as “all revenue derived from the sale of lottery tickets or shares and all other monies derived from the GLC less operating expenses.” Any unrealized gain or loss resulting from changes in fair value of grand prize investments does not represent funds received from GLC operations and is excluded from determination of “net proceeds.”

“Operating expenses” are defined under the Act as “all costs of doing business, including, but not limited to, prizes, commissions, and other compensation paid to retailers, advertising and marketing costs, personnel costs, capital costs, depreciation of property and equipment, funds for compulsive gambling education and treatment, amounts held in or paid from a fidelity fund, and other operating costs.”

Net proceeds and operating expenses for the years ended June 30, 2004 and 2003 are summarized as follows:

	2004	2003
Operating revenues:		
Ticket sales	\$ 2,710,459,000	\$ 2,604,423,000
Less instant tickets provided as prizes	(160,922,000)	(152,613,000)
Net ticket sales	2,549,537,000	2,451,810,000
Online fees and other revenues	4,724,000	5,149,000
Interest revenue and other	<u>1,305,000</u>	<u>1,630,000</u>
GLC proceeds	<u>2,555,566,000</u>	<u>2,458,589,000</u>
Operating expenses—as defined:		
Gaming	1,747,229,000	1,682,555,000
Operating	24,594,000	24,477,000
Other	1,019,000	1,020,000
Total operating expenses—as defined	<u>1,772,842,000</u>	<u>1,708,052,000</u>
Net proceeds before distribution of unrestricted net assets	<u>782,724,000</u>	<u>750,537,000</u>
Other:		
Funds resulting from current year capital purchases	-	820,000
Funds for compulsive gambling education and treatment	<u>-</u>	<u>200,000</u>
Total other	<u>-</u>	<u>1,020,000</u>
Net proceeds subject to transfer	<u>\$ 782,724,000</u>	<u>\$ 751,557,000</u>
Amount due to Lottery for Education Account for year	\$ 782,724,000	\$ 751,557,000
Amount paid during year	<u>(589,124,000)</u>	<u>(535,653,000)</u>
Amount due to Lottery for Education Account—end of year	<u>\$ 193,600,000</u>	<u>\$ 215,904,000</u>

Subsequent to June 30, 2004, all amounts due at the end of fiscal year 2004 were transferred to the Lottery for Education Account.

## 8. EMPLOYEE BENEFITS

**401(k) Defined Contribution Plan**—Effective July 1, 1998, House Bill 441 was enacted into law, allowing the Georgia Lottery Corporation to participate in the Deferred Compensation Plan offered by the state of Georgia for public employees pursuant to Section 401(k) of the Internal Revenue Code.

There were 250 GLC employees participating in the 401(k) plan at June 30, 2004. For the years ended June 30, 2004 and 2003, GLC contributed \$812,000 and \$627,000, respectively, to the plan, and for the years ended June 30, 2004 and 2003 paid \$3,000 of plan administrative fees, on behalf of GLC employees. Contributions by plan participants during fiscal years ended June 30, 2004 and 2003 were \$516,000 and \$507,000, respectively.

**457 Deferred Compensation Plan**—Beginning in December 1994, the GLC offered its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all full-time employees at their option, permits participants to defer a portion of their salary until future years. The deferred compensation is not available to participants until termination, retirement, death, or unforeseeable emergency.



Section 1448 of the Small Business Job Protection Act of 1996 added Subsection (g) to Section 457 of the Internal Revenue Service Code to provide that all assets and income under a Section 457(b) plan that are maintained by a state or local government employer must be held in trust for the exclusive benefit of plan participants and their beneficiaries. Nationwide Retirement Solutions is the custodian of the plan's assets. As of June 30, 2004 and 2003, the fair value of the plan's assets was \$1,259,000 and \$987,000, respectively. Contributions by participants during the years ended June 30, 2004 and 2003 were \$141,000 and \$166,000, respectively.

**Compensated Absences**—Employees are compensated for earned vacation and sick leave hours upon separation from service. As of July 1, 2003, the beginning balance for compensated absence liability was \$1,910,000. At June 30, 2004, the year-end compensated absence liability balance was \$1,705,000. Increases to the compensated absences balance represent vacation and sick leave hours earned by employees and decreases represent their usage of leave. During the year ended June 30, 2004, employees earned and used leave totaling \$1,221,000 and \$1,426,000, respectively. The current portion of the compensated absence liability, expected to be due within one year of the statement date, June 30, 2004, is estimated using historical trends. At June 30, 2004 and 2003, the estimated current portion of the compensated absences liability was \$230,000 and \$34,000, respectively.

## 9. CONTINGENCIES

The GLC is subject to litigation in the ordinary course of its business. In the opinion of management and legal counsel, the outcome of such litigation will not have a material impact on the financial position or cash flows of the GLC.

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