

RHODE ISLAND LOTTERY

A COMPONENT UNIT OF THE STATE OF RHODE ISLAND
AND PROVIDENCE PLANTATIONS



COMPREHENSIVE ANNUAL FINANCIAL REPORT
FOR THE FISCAL YEAR ENDED JUNE 30, 1999

COMPREHENSIVE ANNUAL FINANCIAL REPORT

RHODE ISLAND LOTTERY
A COMPONENT UNIT OF THE STATE OF RHODE ISLAND
AND PROVIDENCE PLANTATIONS

FOR THE FISCAL YEAR ENDED JUNE 30, 1999

PREPARED BY THE FINANCE DEPARTMENT



Rhode Island Lottery
Comprehensive Annual Financial Report
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Introductory Section



Gerald S. Aubin
Executive Director

THE RHODE ISLAND LOTTERY

Gerald S. Aubin
Executive Director

Commission Members

Senator Maryellen Goodwin
Chairwoman
Representative Robert E. Flaherty
Vice Chairman
Representative William San Bento, Jr.
Secretary
Senator David E. Bates
Senator Michael J. Damiani
Representative Joseph H. Scott
Robert A. Mancini
William A. White
Lynne A. Urbani

September 29, 1999

The Honorable Lincoln C. Almond, Governor
Senator Maryellen Goodwin, Chairwoman

We are pleased to present to you the **COMPREHENSIVE ANNUAL FINANCIAL REPORT** of the Rhode Island Lottery (Lottery) for the Fiscal Year ended June 30, 1999. This report has been prepared by the Finance Department of the Lottery. The Lottery is responsible for the accuracy of the financial data and the completeness and fairness of the presentation, including all disclosures.

The Lottery is a component unit of the State of Rhode Island, and its financial statements are included in the State's Comprehensive Annual Financial Report. This report presents Lottery activity in a single enterprise fund. Only the activity of the Lottery, and no other data or information related to any other State agency or fund, is included in this report.

This report is presented in four sections - **Introductory, Financial, Statistical, and Compliance**. The Introductory Section, which is unaudited, includes the transmittal letter, a list of principal officials, and the Lottery's organizational chart. The Financial Section contains the Independent Auditor's Report, financial statements, notes to the financial statements, and supplementary information. The Statistical Section, which is also unaudited, contains selected financial, economic, and demographic data, including current and trend data specific to the national lottery industry. The Compliance Section contains the Independent Auditor's Report on Compliance and on Internal Control over Financial Reporting.

The Lottery was created by Constitutional Amendment passed on November 6, 1973. The legislation to create the Lottery was passed in March of 1974, and the Lottery began in May of 1974. The Lottery is operated as a business within the framework of State laws and regulations. Like any business, the Lottery's goal is to maximize income. As a State agency, however, the challenge lies in accomplishing this while maintaining the trust and best interest of the citizens of Rhode Island. It is our goal to achieve both.

THE LOT

History of the Lottery Industry

State run lotteries have long represented to governments an attractive alternative to other taxation methods, since their profits were returned to the public through community works, cultural activities, or financing of various projects. Two examples are the Vatican Museums and the Rialto Bridge in Venice.

To fully understand the history of lotteries in America, one must recognize the fact that the American colonies, at the time of their founding, lacked the capital, both in the public and private sector, needed to start the process of economic and cultural development.

As the English settled in America, they were motivated by the model of development that stressed private rather than public investment. Royalty in England were simply unwilling to spend their own money or tax their subjects to subsidize the development of the colonies, and lotteries became an important method of raising capital for both the public and private initiatives. In fact, the "Great Standing Lottery" held in London in 1612, was staged to help bail the Virginian Company, the corporation in charge of the settlement of Virginia, out of debt.

Perhaps one of the most poignant lottery stories is that of the abortive attempts to bail Thomas Jefferson out of debt by holding a lottery on his behalf on the 50th anniversary of the adoption of the Declaration of Independence, an anniversary that coincided with the precise day of his death.

The period from 1740 to 1820 witnessed an explosion of public works construction, such as roads, bridges, and canals, much of which was financed by lottery proceeds.

Many of America's elite, private universities, Yale, Princeton, Harvard, University of Pennsylvania, and Columbia, have buildings funded through the proceeds of lotteries. The fact of the matter was, that lacking the endowments built up over centuries by places like Oxford and Cambridge, American higher education had no choice but to resort to lotteries.

Many of the principal religious denominations of America (ironically, many of those which would, in the middle part of the 19th century, lead the fight against lotteries) actually depended heavily on lotteries to get their start.

While very few people in America would have denied there was a need to raise money to build colleges, bridges, roads, or churches, then as now, America differed over whether lotteries were the appropriate way to raise those funds. The arguments for and against lotteries have not changed significantly over the course of the 200 years, from the 17th century Puritan and Quaker denunciations of all games of chance, to those similarly voiced by fundamentalist Protestant religious groups in the 19th and 20th centuries.

The concern about gambling, however, was often overwhelmed by the recognition that the lottery was a means that enabled the accomplishment of useful public projects. William Ames, a Cambridge teacher of many of the leaders of the Massachusetts Bay colony, denounced that playing of the lottery solely for the purpose of gain, but defended lotteries as long as they were intended for some pious end. The settlers of New England would find many pious purposes toward which to direct lottery proceeds. During the colonial period, the New England colonies authorized more lotteries than any other region

of the country, which benefited colleges, churches, and every other manner of public works construction one could think of.

By the time of the Revolution, most every American colony joined the New England colonies in using lotteries as a primary method for financing both public works and private economic development. This reliance on lotteries was the result of the coming together of two powerful forces, a desperate need for capital to fight the war against Great Britain and the reluctance to impose taxes. It is during this time in history that some of America's most respected statesmen publicly campaigned for lotteries as a means of raising revenues. The two most well known for this were Thomas Jefferson and Alexander Hamilton.

Thomas Jefferson described a lottery as a "salutary instrument . . . where men run small risks for the chance of obtaining a high prize." It was, he said, a "tax laid only on the willing," and was therefore more accepted than any other form of direct taxation. Alexander Hamilton described lotteries as a means by which an ordinary man could "hazard a trifling sum for the chance of considerable gain." Hamilton offered advice, which has been relevant to every lottery organizer since that time. He said there were two cardinal rules for a successful lottery: keep it simple, so that everyone understands the rules, and keep the tickets cheap, so that everyone could afford to participate.

The period of time from 1800 to the Civil War was the most active time for lotteries. There was an incredible number of lotteries in America during this period, some held for public purposes, some for a mixture of public and private purposes, and some for private purposes as entrepreneurs attempted to raise money for their own projects. It was at this time in history that charges of fraud and deception, which coincided with a resurgence of religious opposition to lotteries as being sinful, began.

By the 1820s, there was a vast array of lotteries being conducted, sometimes at the same time on the same day, and although the lottery ticket sellers became more clever in their efforts (P.T. Barnum was a lottery agent), the market was overwhelmed. Because of that, there were many instances where the proceeds from the lottery were not sufficient to pay the prizes, a problem which often resulted in lottery organizers leaving town with the money in hand before the drawing could be held.

Charges of fraud and deception surrounded lotteries of the 19th century, and the two most commonly believed reasons for these were dishonest lottery promoters and increasing religious opposition. There were, however, many other factors, including the growth of the banking institution, which offered an alternative means for entrepreneurs to raise money; an economic boom in the 19th century which created sources of excess capital that could be used for investment in public works; and lastly, the willingness of state governments to step in and raise taxes to finance worthwhile public projects.

The full history of the decline of the lottery in America lasted from the Civil War until the resumption of the lottery in 1964 when New Hampshire established a state-run lottery for the purpose of raising money for education. New York followed New Hampshire into the lottery business in 1967. In 1971, the State of New Jersey started their lottery and introduced a computer-based weekly game, which offered inexpensive tickets (50 cents), convenience of sale, and a weekly prize of \$50,000. In its first year of operation, the New Jersey Lottery grossed \$142.5 million and set the trend for the lottery industry. New York and New Hampshire revamped their systems, and other states introduced lotteries utilizing New Jersey's operation as a model.

Lotteries, through the years, have become more diversified. The vast array of lottery games in existence today caters to a variety of consumer tastes. These changes are largely attributable to the

work of marketing experts. With greater selections, come increased sales. Considerable changes and new possibilities were introduced in lotteries through major technological innovations such as centralized on-line computer systems (1971) and magnetic strip tickets (1992).

By developing and tailoring products to the needs of clientele, the lottery has established itself as an everyday element in today's society.

History of the Rhode Island Lottery

In 1744, Rhode Island's first lottery raised money for a bridge at Weybosset Street in Providence. Tickets cost about \$12 each and raised approximately \$6,500 for the bridge. Several other lotteries were conducted throughout the 1700s including a lottery used to partially finance the building of a brick Colony House, which became Rhode Island's first State House following the Declaration of Independence. One of the most successful lotteries in Rhode Island was the one authorized to build Thames Street in Newport. It paid over \$1 million in prizes and was so popular that the people of Newport were able to build, pave and extend streets throughout the city.

On November 6, 1973, a Constitutional Amendment was passed in Rhode Island by more than a three to one margin to create a lottery. The amendment mandated that the General Assembly proscribes and regulates all future lotteries in Rhode Island. Legislation was passed to start the Lottery in March 1974, and it began in May of 1974. The original purpose of the Rhode Island Lottery was to make up for the revenue lost from allowing the value of a trade-in automobile toward the sales tax liability on a new automobile.

The Lottery's first drawing was held at the State House on May 30, 1974. This weekly 50-cent game had a top prize of \$50,000. The Numbers Game began on February 13, 1976 and continues today. The first instant ticket game, *Play Ball*, was introduced on May 11, 1976. There have been 172 instant ticket games since 1976. On-line games started in February of 1978, and Lottery sales doubled with this new addition. Rhode Island was the first state to televise a live lottery drawing in January of 1975, at no expense to the Lottery, which is still the case today. That same year Rhode Island became the first state to have a weekly lottery television program. The *4/40 Game* began in the spring of 1981, with variations to that game being made throughout the years culminating with the *Rhody Cash* game in January of 1995. The Multi-State Lottery Association (MUSL) was formed in 1988 for the purpose of affording small states the opportunity to offer games with a higher jackpot than their population alone would generate. The first such game was called *Lotto-America*, which was replaced with *PowerBall* on April 22, 1992. In February of 1998 Rhode Island introduced its own lotto game called *Roll Down* which replaced the Multi-State *Daily Millions Game*. *Keno* was introduced in the State on September 13, 1992, becoming the second U.S. Lottery (Oregon was first) to do so. Around this same time, *Video Lottery Terminals (VLTs)* went on-line at the State's two pari-mutuel facilities.

History of Lottery Games

Lotto Games

The Germans were the first to bring the modern lotto game to the market. Norwest Lotto in northwestern Germany launched the first game on October 9, 1955. Players simply marked 6 figures

out of a total of 49 on their coupon. The idea quickly took off, and many other countries soon followed the Germans' lead.

Today, the 6/49 formula is the most widespread, with approximately 32% of lotteries worldwide utilizing this format. This is followed by the 6/48, 6/45, 6/44, 6/42 and 5/40. More than 30 formulas are available, and some lotteries run several different formulas at the same time.

More than half of the lotteries offering lotto games has drawings twice a week. Approximately 36% have one weekly drawing. In the vast majority of cases, the top prize rolls over if a drawing does not produce a jackpot winner.

With the "quick pick" feature, players can have the computer generate their numbers at random. About 71% of lotteries offer this option.

Alexandre Fichet (1799-1862), who designed a system to replace manual draws using balls, developed technology for lotto drawings in France. He invented a way to carry out lottery drawings using wheels with numbers from 1 to 9 around the rim. At the end of the wheel's rotation, the winning number was clearly shown through a window.

Instant Tickets

The first instant lottery ticket was marketed in 1974 in the Commonwealth of Massachusetts, which became the first state lottery to develop and sell an instant game. Today, all state lotteries offer instant tickets, and this type of lottery game is recognized as one of the most popular lottery offerings in North America.

Video Lottery

Although the invention of the "slot" machine dates back to 1890, it was only in 1976 that the first black and white video technology was developed. Color video terminals were launched on the market several months later.

Initially, video lottery machines were only associated with casinos; however, in 1985, the State of Nebraska changed its legislation and allowed the Nebraska Lottery to test a video lottery that was not connected to a central system. The experiment was terminated that same year.

Several years later, when the South Dakota Lottery was searching for new sources of revenue, it took up the idea of video lottery. In March of 1989, legislation allowing the establishment of the first server-connected video lottery was approved. In the fall of 1990, South Dakota offered the first operational video lottery in all of the United States. By 1992, Oregon, Rhode Island, and Louisiana had video lottery terminals up and running in their respective states.

Keno

Keno originated in China more than 3,000 years ago. Legend has it that this game financed the Great Wall of China. The original Chinese game was played with characters from the ancient poem of luck by Confucius, the "Thousand Character Classic." Keno subsequently spread far beyond the borders of China and was well established in both Europe and the United States by the turn of the 20th Century.

Today, Keno is a very popular lottery offering because of its flexibility in the number of spots that can be played, which in effect means there are actually several games going on at the same time all with different odds of winning a prize. Daily Keno drawings have proven more successful than those held two or three times a week. Rhode Island is one of only a handful of lotteries offering a new Keno draw every 5 minutes.

Rhode Island Lottery Product Offerings

The Rhode Island Lottery provides the opportunity to participate in the following games:

Instant Tickets

Instant (or scratch) tickets are played by scratching the latex covering off the play area on the ticket. In order to win, the player must match two or three of a kind, get like symbols or wild features. Instant ticket offerings in Rhode Island include card games, as well as whimsical, sports, money, and local landmark themes. A new instant game is introduced every 11 working days. Sales for Fiscal Year 1999 were \$51,372,959, an increase of \$11,049,667 over Fiscal Year 1998.

Daily Numbers

The Daily Numbers game has been very popular in Rhode Island since its inception in 1976. Players can wager on 2, 3, or 4 digits. Wagers on 3 and 4 digits can be played in exact or any order. Players can select their own numbers or utilize the computer "quick pick." The Daily Numbers drawing is televised live Monday through Saturday at 7:00 p.m. and at 6:30 p.m. on Sunday. Sales for Fiscal Year 1999 were \$28,221,328 compared to \$29,257,141 for Fiscal Year 1998.

Keno

Keno was introduced in September of 1992 and quickly proved to be a very popular game. Rhode Island Keno has a 10 of 20 of 80 matrix, with a \$100,000 top prize. Players can wager on 1 to 10 numbers (spots) utilizing their own number selection or a computer "quick pick." A Keno drawing occurs every 5 minutes from 6:00 a.m. to 12:45 a.m., Monday through Saturday and 7:00 a.m. to 12:45 a.m. on Sunday. Keno sales for Fiscal Year 1999 were \$57,637,832, an increase of \$6,020,695 over Fiscal Year 1998.

PowerBall

PowerBall is a Multi-State Lottery game offered in 20 states (including Rhode Island), plus the District of Columbia. Players select "5 out of 49" numbers and a PowerBall "1 out of 42." Players can select their own numbers or utilize a computer "quick pick." Jackpots start at \$10 million and grow by a minimum of \$2 million for each drawing not producing a jackpot winner. Televised drawings are shown on Wednesday and Saturday at 10:59 p.m. In July of 1998, PowerBall reached a record jackpot of \$295 million. PowerBall sales were \$52,582,676 in Fiscal Year 1999 compared to \$43,345,345 in Fiscal Year 1998.

Daily Millions

Daily Millions, another Multi-State Lottery game offered in 13 states (including Rhode Island) and the District of Columbia, was replaced in February of 1998 by Rhode Island's own lotto game called Roll Down.

Roll Down

Roll Down, which replaced the Multi-State Lottery Daily Millions Game in February 1998, is an online game with cash prizes offered to players matching 4, 3, or 2 numbers drawn out of 50. Players select 4 numbers out of 50 or utilize the computer "quick pick." The jackpot is paid to the person or divided equally among the persons who match all four numbers drawn. In the event that there are no four number matches, the jackpot is "Rolled Down" and divided equally to those matching three out of the four numbers drawn. Sales for Fiscal Year 1999 were \$5,880,700 compared to Fiscal Year 1998 sales totaling \$3,300,928.

Video Lottery

Video Lottery debuted in Rhode Island in September of 1992. There are a total of 1,628 terminals located in the State's two pari-mutuel facilities, Lincoln Greyhound Park and Newport Grand Jai Alai. Various card and reel games are offered on the video lottery terminals (VLTs). The VLTs afford Rhode Island a chance to compete with Native American casinos in a neighboring state. Fiscal Year 1999 VLT sales were \$545,474,154, a \$81,405,479 increase over Fiscal Year 1998.

Pull Tabs

Rhode Island General Laws mandate that pull tab tickets be sold only by non-profit organizations. The Rhode Island Lottery oversees the sale of pull tab tickets to these groups. Pull tab net sales for Fiscal Year 1999 were \$214,300 compared to net sales of \$196,280 for Fiscal Year 1998.

Rhode Island Economic Outlook

The Rhode Island economy continued to expand in 1998 with an increase of 1.5 percent. Job growth was concentrated in two sectors - services (3,200 jobs) and finance, insurance, and real estate (1,700 jobs).

Rhode Island, since implementing financial service tax incentives, has been able to persuade Fidelity Investments and Fleet Bank to either establish new facilities in the State or expand existing ones, creating many new jobs over the past year. In April 1998, Fidelity opened new offices in the State adding over 1,000 jobs to the growing financial services industry.

Continued construction of the Providence Place Mall fueled construction employment growth of 6.8 percent. Once completed, the mall itself will boost retail trade employment.

Personal income in Rhode Island rose 3.9 percent, with per capita personal income slightly above the national average.

Total merchandise exports expanded 5.6 percent, with the State's three largest export industries, electric equipment, industrial machinery, and scrap and waste, experiencing substantial increases in the dollar value of exports - 20.4 percent, 13.9 percent, and 21.7 percent, respectively. Exports to Canada, Rhode Island's largest market, expanded 14.5 percent. Exports to the United Kingdom declined 59.0 percent, while exports to Japan grew by 7.0 percent.

Single-unit housing permits in Rhode Island expanded by 7.9 percent between fourth quarter 1997 and fourth quarter 1998, while sales of existing homes rose 18.8 percent over the same period, slightly above the previous year's gain of 17.0 percent. Home prices rose 3.2 percent.

Overall, the economic picture for Rhode Island is positive.

Lottery Industry Economic Outlook

The United States Lottery Industry experienced yet another upswing during Fiscal Year 1999. Sales increased from \$35.771 billion in Fiscal Year 1998 to \$36.285 billion in Fiscal Year 1999. The Rhode Island Lottery witnessed a 16.9% increase in sales during Fiscal Year 1999.

Highlights of Fiscal Year 1999

The Rhode Island Lottery's total sales for Fiscal Year 1999 totaled \$741,169,719, a 16.89% increase compared to Fiscal Year 1998 sales of \$634,074,644. A record amount of \$133,475,047 was transferred to the State General Fund in Fiscal Year 1999.

After extensive renovations, Lottery employees are enjoying a more efficient work environment. Renovations are in the final stages and will be completed in the Fall of 1999. The project, coordinated by Lottery staff, is expected to cost thousands of dollars below budget.

The Rhode Island Lottery is celebrating its 25th Anniversary during 1999. The yearlong celebration was highlighted by the Lottery sponsoring a rock concert in the capital city and a party for original Lottery retailers and employees.

In September of 1998, the Lottery implemented an automated instant ticket distribution system called "Tel Sel." This program has been an integral factor for increasing instant ticket sales by allowing our retailers to merchandise, promote, and manage the inventory stock more efficiently.

GFOA Certificate of Achievement

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate for Excellence in Financial Reporting to the Rhode Island Lottery for its Comprehensive Annual Financial Report (CAFR) for the last two consecutive Fiscal Years (1997 and 1998). The Certificate of Achievement is the highest form of recognition in the area of governmental accounting and financial reporting.

In order to be awarded a Certificate of Achievement, a governmental unit must publish an easily readable and efficiently organized comprehensive annual financial report, whose contents conform to

program standards. The CAFR must satisfy both generally accepted accounting principles and legal requirements.

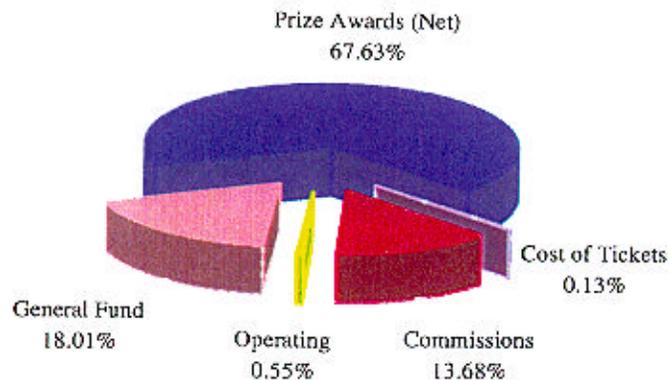
A Certificate of Achievement is valid for a period of one year only. The Rhode Island Lottery received a certificate on its first attempt, in May of 1998. We believe our current report will conform to the Certificate of Achievement program requirements, and we are submitting it to the GFOA.

Rhode Island Lottery Financial Information

The Lottery conducts its operations as an enterprise fund within the State of Rhode Island and is included in the State's Comprehensive Annual Financial Report. Enterprise activities include the sale of lottery tickets to the general public and related supporting functions of personnel, security/legal, planning/research, marketing, finance, and management services. No general government functions or judiciary operations are managed by the Lottery nor are any included in this report.

Total sales for Fiscal Year 1999 surpassed \$741.1 million. This represents an increase of \$107.1 million over the previous record of \$634.1 million in Fiscal Year 1998. The increase in sales is attributed primarily to higher video sales and increased PowerBall sales due to a record jackpot of \$295 million in July of 1998.

Of the total sales reported in Fiscal Year 1999, video lottery sales comprised \$545.5 million or 73.6% of total sales. However, most importantly, the Lottery transferred to the General Fund a record \$133.5 million, which represents an increase of \$18.4 million or 16.0% over the prior Fiscal Year. Distribution of the year's revenue was as follows:



Accounting Systems and Procedures

The Rhode Island Lottery operates the Lottery Fund, an enterprise fund which, like a private business, utilizes the accrual basis of accounting in accordance with generally accepted accounting principles. Under the accrual basis of accounting, revenues are recognized when earned, and expenses are recognized at the time the related liabilities are incurred.

Budgetary Controls

The operating budget of the Rhode Island Lottery is submitted to the Lottery Commission for approval on an annual basis. The Lottery also participates in semi-annual state revenue estimating conferences.

Internal Control Environment

Management of the Lottery is responsible for establishing and maintaining an internal control structure designed to ensure that assets are protected from loss, theft, or misuse and to ensure that the accounting system allows compilation of accurate and timely financial information. The structure is designed to provide reasonable assurance that these objectives are met.

Since the Lottery manages a valuable ticket inventory and controls the disbursement of prizes, the following steps are taken to ensure the operations remain honest and secure:

- Hiring specialized security staff.
- Maintaining secure lottery facilities and limiting access to them.
- Performing background checks on retailers, vendors, and employees.
- Printing lottery tickets with special inks, dyes, and security codes.
- Hiring an independent CPA firm to witness the recording of MUSL drawing results.
- Providing a variety of access and other controls in the computer system.
- Implementing a Video Lottery System Monitoring Plan to ensure the integrity of video lottery games and to ensure that control procedures are operating as designed.
- Performing unannounced video lottery inspections at each retailer to ensure compliance with operating procedures.
- Monitoring video lottery terminals on a daily and weekly basis and reconciling to a cash management system.
- Processing daily transaction data of all vendor activity by Lottery personnel using the Lottery's internal control system programs and reconciling transactions to reports generated by the on-line system.
- The Lottery currently has 55 employees, all of whom are located at the headquarters in Cranston, Rhode Island. The drawing studio is located at the broadcast facilities of the television station, which produces the nightly drawing.

Debt Administration

The Lottery's long-term liabilities are payments owed to lotto jackpot winners. The payments due winners are fully funded by investments in United States Treasury zero coupon bonds. Jackpot prizes awarded under PowerBall are satisfied through investments purchased by the Multi-State Lottery Association. MUSL purchases United States government obligations, which are held in irrevocable trusts established by MUSL for the benefit of participating state lotteries. Accordingly, the Lottery does not record an obligation for PowerBall jackpot awards which are payable in installments from funds provided by MUSL.

Cash Management

The Lottery collects cash due for instant and on-line sales from its 1,200 retailers, through electronic transfer, on a weekly basis. Cash collected from VLTs is deposited in designated banks and is electronically swept Monday through Friday. The Office of the General Treasurer invests the Lottery's excess cash in United States Treasury securities and repurchase agreements.

Risk Management

The Lottery's risk management and insurance program is independent of the State of Rhode Island. Lottery staff administers the program. Insurance with private carriers is maintained to prevent economic loss from uncontrollable risk.

Future Projects

In September of 1999, the Lottery entered into a new contract for Instant Ticket Vending Machines. The new vending machines will have 16-bins for dispensing tickets and will replace the 8-bin units that are currently installed at local retailers. The new vending machines are more appealing and provide a tremendous opportunity for the Lottery to increase revenues. Installation is expected to begin in October of 1999.

The Lottery is planning to be the first Lottery to draw national publicity to a new instant game. The "Imus in the Morning" instant ticket will cost \$5 and is expected to go on sale in November of 1999. Don Imus, the nationally publicized talk show host, will be broadcasting live from Rhode Island at the time of the ticket launch.

Plans are underway to install new video monitors in all of our Keno retailer locations. The network of video monitors called "Next Vision" has the ability to deliver full-motion video, dynamic text messaging, sophisticated graphics, and targeted network capabilities. This new product will strengthen the Lottery's promotional and marketing campaigns and allow for more opportunities in new game development.

A millennium promotion is in the planning stages and is expected to be launched before year end. The new game will offer bonuses up to \$2,000.

Independent Audit

The Rhode Island General Laws require semi-annual audits to be performed by the State Auditor General. The Fiscal Year 1999 audit of the financial statements has been completed in accordance with generally accepted auditing standards and *Government Auditing Standards*. The independent auditor's opinion on the Lottery's financial statements is included in the financial section of this report.

Acknowledgements

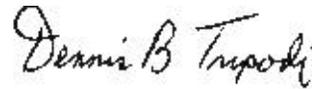
Preparation of this report could not have been accomplished without the efforts of Susan Allaire, Joe DeOrsey, Terri Kiernan, Sandra Reynolds, and Peg Rose.

This Comprehensive Annual Financial Report reflects our commitment to maintain the Rhode Island Lottery's financial statements and record keeping systems in compliance with the highest standards of accountability. Due credit should be given to Lottery Commission Chair Maryellen Goodwin and the Members of the Lottery Commission for their commitment to operating the Lottery in a responsible and progressive manner.

Respectfully submitted,



Gerald S. Aubin
Executive Director



Dennis B. Tripodi
Finance Administrator

Certificate of Achievement for Excellence in Financial Reporting

Presented to

The Rhode Island Lottery

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 1998

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



Carol Brueckner
President

Jeffrey L. Essler
Executive Director

Rhode Island Lottery Commission Structure

The Rhode Island Lottery Commission consists of nine Members, all of whom are citizens and residents of the State of Rhode Island. Three Members from the State Senate are appointed by the Senate Majority Leader, and three Members from the House of Representatives are appointed by the Speaker of the House. Not more than two of the three Members appointed by either the Senate Majority Leader or the Speaker of the House can be from the same political party. The Governor appoints three Members who are representatives of the general public.

The Commission Members are appointed for three-year terms and can be reappointed. Any vacancy on the Commission, occurring for any reason prior to the expiration of the term, including but not limited to termination of active Members in the General Assembly, is filled for the unexpired term by the appointing authority in the same manner as the original appointment.

Commission Members receive no salaries but are allowed reasonable expenses in the performance of their official duties.

The duties of the Commission include meeting at least once a month for the purpose of promulgating and reviewing rules and regulations relating to the Lottery, recommending and setting policy for the Lottery, approving or rejecting actions of the Executive Director, and transacting any other business that may be properly brought before the Commission.

The Lottery is under the immediate supervision and direction of the Executive Director. The Executive Director is appointed by the Governor, with the majority approval of the Commission, and serves at the pleasure of the Commission. Any vacancy occurring in the Office of the Executive Director shall be filled in the same manner as the original appointment. The Executive Director is required to devote his/her entire time and attention to the duties of his/her office and cannot engage in any other profession or occupation. The Executive Director's salary is set by the Commission.

COMMISSION MEMBERS SERVING DURING FISCAL YEAR 1999

SENATOR MARYELLEN GOODWIN
SENATOR MICHAEL DAMIANI
SENATOR DAVID BATES
REPRESENTATIVE JOSEPH SCOTT
REPRESENTATIVE FRANK MONTANARO*
REPRESENTATIVE ROBERT FLAHERTY
MR. WILLIAM WHITE
MR. DONALD WYATT **
MR. ROBERT MANCINI

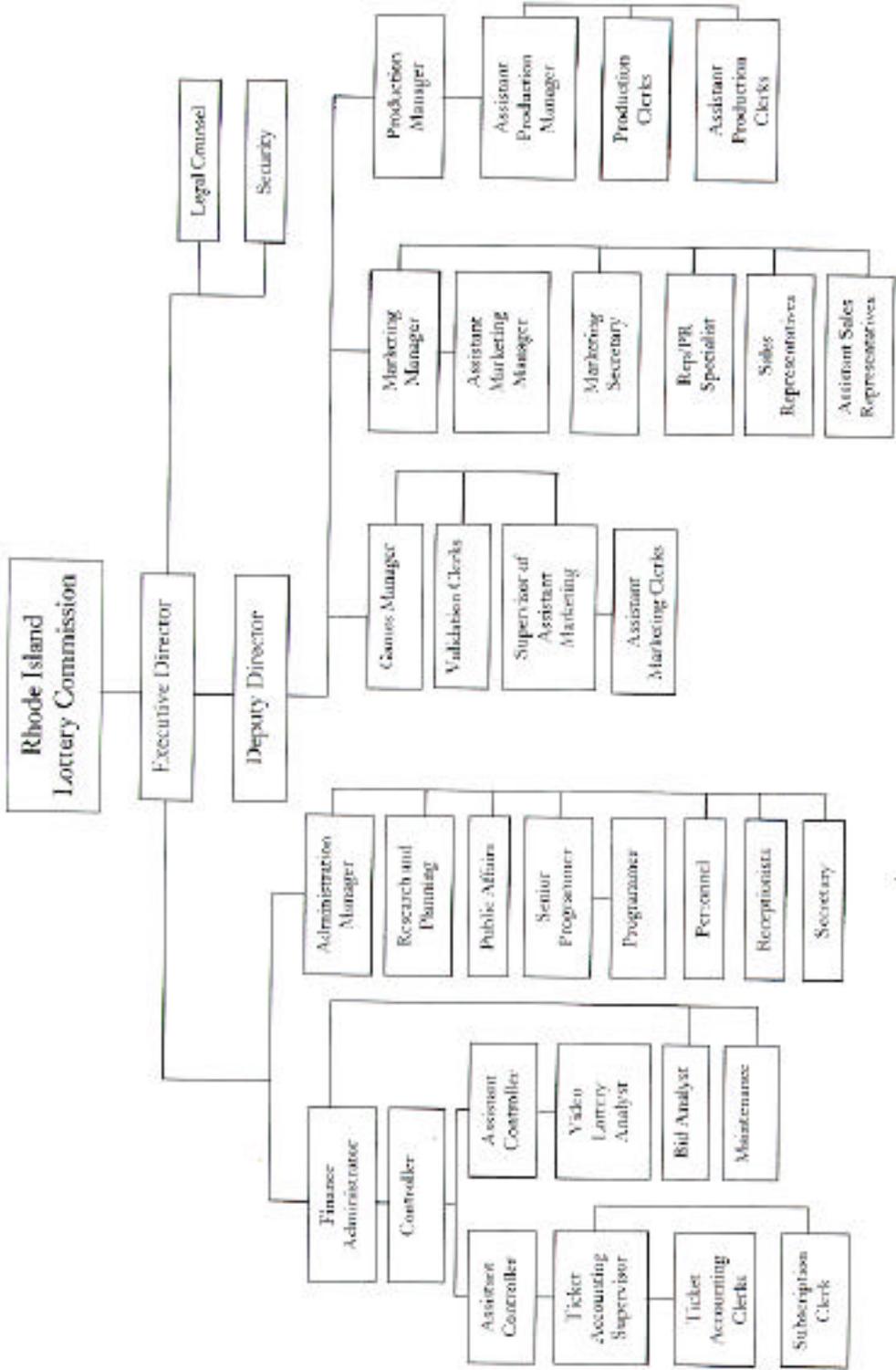
*** REPLACED BY THE FOLLOWING REPRESENTATIVE IN DECEMBER OF 1998**

REPRESENTATIVE WILLIAM SAN BENTO, JR.

**** REPLACED BY THE FOLLOWING IN FEBRUARY OF 1999**

MS. LYNNE URBANI

Rhode Island Lottery Organizational Chart



PRINCIPAL OFFICIALS

**GERALD S. AUBIN
EXECUTIVE DIRECTOR**

**RAYMOND E. GRIMES
DEPUTY DIRECTOR**

**DENNIS B. TRIPODI
FINANCE ADMINISTRATOR**

**MARGARET D. ROSE
ADMINISTRATION MANAGER**

**ROBERT E. MATTESON
MARKETING MANAGER**

**WILLIAM J. DIMUCCIO
GAMES MANAGER**

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Financial Section



ERNEST A. ALMONTE, CPA, CFE
Auditor General

State of Rhode Island and Providence Plantations

GENERAL ASSEMBLY

Office of the Auditor General

1145 Main Street
Pawtucket, Rhode Island 02860-4807

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(401) 222-2111

INDEPENDENT AUDITOR'S REPORT

Joint Committee on Legislative Services, General Assembly,
State of Rhode Island and Providence Plantations:
and
Members of the Rhode Island Lottery Commission:

We have audited the accompanying financial statements of the Rhode Island Lottery (Lottery), a component unit of the State of Rhode Island and Providence Plantations, as of and for the years ended June 30, 1999 and 1998, as listed in the Table of Contents. 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.

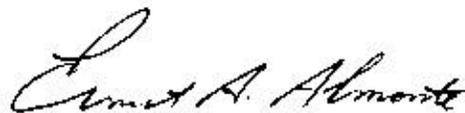
We conducted our audits in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Lottery as of June 30, 1999 and 1998, and the results of its operations and cash flows for the years then ended in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 9, 1999 on our consideration of the Lottery's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts.

Our audits were performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The year 2000 supplementary information on page 34 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and do not express an opinion on it. In addition, we do not provide assurance the Lottery is or will become year 2000 compliant, that the Lottery's year 2000 remediation efforts will be successful in whole or in part, or that parties with which the Lottery does business are or will become year 2000 compliant. The supplementary information included in Schedule 1 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

The statistical section of this report is not a required part of the financial statements, and we did not audit or apply limited procedures to such information and, accordingly, express no opinion on it.



Ernest A. Almonte, CPA, CFE
Auditor General

September 9, 1999

RHODE ISLAND LOTTERY

Balance Sheets

June 30, 1999 and 1998

<u>Assets</u>	<u>1999</u>	<u>1998</u>
Current assets:		
Cash and cash equivalents (note 3)	\$ 1,429,486	\$ 3,477,957
Investments for jackpot awards (note 3)	1,453,000	1,807,000
Accounts receivable-less allowance for doubtful accounts of \$220,333 in 1999 and \$221,953 in 1998	10,697,388	7,022,433
Ticket inventory	570,436	712,913
Deposits with Multi-State Lottery Association (MUSL) (note 1)	696,749	425,507
Deferred charges	<u>147,954</u>	<u>1,442</u>
Total current assets	14,995,013	13,447,252
Investments for jackpot awards (note 3)	2,705,875	3,900,905
Property, plant and equipment, net (note 4)	<u>600,219</u>	<u>618,690</u>
Total assets	<u>\$ 18,301,107</u>	<u>\$ 17,966,847</u>
<u>Liabilities and Retained Earnings</u>		
Current liabilities:		
Due to State's General Fund (note 5)	\$ 975,047	\$ 1,171,622
Current obligation for unpaid prize awards	7,712,587	6,050,639
Accounts payable	5,511,566	5,573,317
Accrued expenses	248,397	221,139
Deferred revenue	<u>896,897</u>	<u>726,592</u>
Total current liabilities	15,344,494	13,743,309
Long-term obligation for unpaid prize awards (note 3)	<u>2,705,875</u>	<u>3,900,905</u>
Total liabilities	<u>18,050,369</u>	<u>17,644,214</u>
Retained earnings:		
Reserved for building (note 9)	<u>250,738</u>	<u>322,633</u>
Total liabilities and retained earnings	<u>\$ 18,301,107</u>	<u>\$ 17,966,847</u>

See accompanying notes to financial statements.

RHODE ISLAND LOTTERY

Statements of Revenue, Expenses and Retained Earnings

Years Ended June 30, 1999 and 1998

	1999	1998
Sales (schedule 1):		
On-line games	\$ 144,322,606	\$ 129,682,677
Instant games	51,372,959	40,323,292
Video lottery	<u>545,474,154</u>	<u>464,068,675</u>
Total sales	<u>741,169,719</u>	<u>634,074,644</u>
Cost of sales:		
Commissions	101,373,221	86,302,679
Prize awards	503,522,789	429,277,957
Unclaimed prize recovery	(2,299,067)	(1,849,978)
Cost of tickets	<u>985,173</u>	<u>1,102,638</u>
Total cost of sales	<u>603,582,116</u>	<u>514,833,296</u>
Gross profit	<u>137,587,603</u>	<u>119,241,348</u>
Operating expenses:		
Personal services	2,792,014	2,687,572
Advertising and promotion	1,242,550	1,384,429
Contract services	71,152	164,067
Equipment leasing (note 14)	325,802	331,819
Depreciation	191,481	172,439
Other	<u>474,162</u>	<u>450,359</u>
Total operating expenses	<u>5,097,161</u>	<u>5,190,685</u>
Operating income	<u>132,490,442</u>	<u>114,050,663</u>
Nonoperating income:		
Pull-tab ticket sales (note 7)	214,300	196,280
Investment earnings	528,425	488,379
Other	169,985	264,405
Total nonoperating income	<u>912,710</u>	<u>949,064</u>
Income before transfer to the State's General Fund	<u>133,403,152</u>	<u>114,999,727</u>
Transfer to the State's General Fund (note 5)	<u>133,475,047</u>	<u>115,071,622</u>
Net loss (note 9)	(71,895)	(71,895)
Retained earnings, beginning of year	<u>322,633</u>	<u>394,528</u>
Retained earnings, end of year	<u>\$ 250,738</u>	<u>\$ 322,633</u>

See accompanying notes to financial statements.

RHODE ISLAND LOTTERY

Statements of Cash Flows

Years Ended June 30, 1999 and 1998

	1999	1998
Cash flows from operating activities:		
Cash received from sales	\$ 737,396,996	\$ 632,957,669
Cash received from MUSL for grand prize winners	20,584,610	6,245,000
Cash received from sale of other tickets	297,594	286,767
Cash received from other sources	168,435	262,565
Cash paid for prizes other than MUSL grand prize winners	(501,016,896)	(428,999,959)
Cash paid to MUSL grand prize winners	(20,584,610)	(6,245,000)
Cash paid for commissions - retailers	(14,105,401)	(12,383,005)
Cash paid for commissions - video lottery	(80,609,682)	(65,646,618)
Cash paid for commissions - on-line games contractor	(6,944,908)	(6,023,266)
Cash paid to suppliers for goods and services	(2,962,769)	(4,053,131)
Cash paid to employees for services	(2,764,756)	(2,596,707)
Net cash provided by operating activities	129,458,613	113,804,315
Cash flows from noncapital financing activities:		
Transfer to State's General Fund	(133,671,622)	(114,444,452)
Net cash used for noncapital financing activities	(133,671,622)	(114,444,452)
Cash flows from capital and related financing activities:		
Purchase of fixed assets	(173,009)	(150,816)
Proceeds from sale of fixed assets	-	12,500
Net cash used for capital and related financing activities	(173,009)	(138,316)
Cash flows from investing activities:		
Proceeds from maturity of investments for jackpot awards	1,809,122	2,387,259
Interest income	528,425	488,379
Net cash provided by investing activities	2,337,547	2,875,638
Net increase (decrease) in cash and cash equivalents	(2,048,471)	2,097,185
Cash and cash equivalents, beginning of year	3,477,957	1,380,772
Cash and cash equivalents, end of year	\$ 1,429,486	\$ 3,477,957

RHODE ISLAND LOTTERY

Statements of Cash Flows

Years Ended June 30, 1999 and 1998

	1999	1998
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 132,490,442	\$ 114,050,663
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	191,481	172,439
Installment payments for jackpot awards	(1,809,122)	(2,387,259)
Other receipts classified as operating activities	215,849	198,120
Rental income and other receipts	168,435	262,565
Provision for doubtful accounts	(1,620)	15,251
(Increase) decrease in assets:		
Investment for jackpot awards	1,549,030	1,931,119
Accounts receivable	(3,673,335)	(1,245,611)
Inventory	142,477	(263,921)
Deposits with MUSL	(271,242)	(143,003)
Deferred charges	(146,512)	7,672
Increase (decrease) in liabilities:		
Obligation for unpaid prize awards	466,918	(1,115,840)
Accounts payable	(61,751)	1,965,764
Accrued expenses	27,258	86,558
Deferred revenue	170,305	269,798
Total adjustments	(3,031,829)	(246,348)
Net cash provided by operating activities	\$ 129,458,613	\$ 113,804,315
Noncash activities:		
Increase in fair value of investments for jackpot awards which also increased obligation for unpaid prize awards	\$ 385,231	\$ 582,142
Increase in deposits with MUSL and deferred revenue	271,242	143,003
	\$ 656,473	\$ 725,145

See accompanying notes to financial statements.

RHODE ISLAND LOTTERY

Notes to Financial Statements

(1) Organization

The Rhode Island Lottery (Lottery) was created in 1974 under the General Laws of the State of Rhode Island to establish and operate lottery games for the purpose of generating resources for the State's General Fund. It is governed by the nine-member Rhode Island Lottery Commission (Commission).

The Lottery offers various on-line games which include: a daily numbers game, Keno, Roll Down, and PowerBall, which is operated by the Multi-State Lottery Association (MUSL). The Lottery also sells instant lottery tickets, which do not involve prize drawings. All tickets are sold through licensed lottery retailers. In addition, the Lottery conducts video lottery games at two licensed facilities.

Prize payout percentages and amounts required to be transferred to the State's general fund as stipulated in the Rhode Island General Laws are summarized below for the various games operated by the Lottery.

<u>Game</u>	<u>Prize Payout</u>	<u>State's General Fund Share</u>
Daily Numbers Instant Ticket Games Roll Down (1) MUSL – PowerBall MUSL – Daily Millions (2)	No less than 45% nor more than 55% of sales	Not less than 30% of ticket sales
Keno	No less than 45% nor more than 65% of sales	Not less than 20% of ticket sales
Video Lottery	Price payout not established by law	46% of net terminal income (video lottery credits purchased less credits redeemed or redeemable) less pro rata share of Lottery's operating expenses

(1) The Roll Down game began February 24, 1998

(2) The Daily Millions game ended February 21, 1998.

RHODE ISLAND LOTTERY

Notes to Financial Statements

Chapter 42-61.2 of the Rhode Island General Laws authorizes the Commission to conduct and control video lottery games. This chapter stipulates the allocation of video lottery net terminal income (video lottery credits purchased less credits redeemed or redeemable). The Commission's share for deposit in the Lottery fund shall be no less than 46% of net terminal income. The remaining net terminal income is divided among licensed video lottery retailers, the technology providers (video lottery terminal providers), the central communications system provider, the city or town in which the video retailer is licensed, and the owners of dog kennels under contract with a licensed video lottery retailer.

The Lottery sells PowerBall tickets, collects all revenues, and remits prize funds to MUSL net of low-tier prize awards. Jackpot prizes, payable in installments, are satisfied through investments purchased by MUSL. MUSL purchases U.S. government obligations, which are held in irrevocable trusts established by MUSL for the benefit of participating state lotteries. Accordingly, the Lottery does not record an obligation for jackpot awards which are payable in installments from funds provided by MUSL.

The prize pool for PowerBall is 50% of each drawing period's ticket sales. MUSL has placed 2% of each drawing period's ticket sales for PowerBall, included, as part of each member's prize liability, in prize reserve funds. As of January 13, 1998, the MUSL Board of Directors decreased the maximum balance on the prize reserve funds for PowerBall to \$77,000,000. Once the prize reserve funds exceed this designated cap, the excess becomes part of the prize pool. The prize reserve funds serve as a contingency reserve to protect MUSL from unforeseen prize liabilities and these reserve funds are to be used at the discretion of the MUSL Board of Directors. The prize reserve funds are refundable to MUSL members if the MUSL disbands or if a member leaves MUSL. Members leaving MUSL must wait one year before receiving their remaining share, if any, of prize reserve funds. At June 30, 1999 and 1998, the prize reserve funds for the PowerBall game had a balance of \$77,000,000 and \$76,506,708, respectively, of which the Lottery's share was \$2,126,422 for both years. The Lottery has charged amounts placed into the prize reserve funds to prize awards expense as the related sales have occurred.

All investment earnings relating to the prize reserve funds are credited to an unreserved account for each member state. This account can be utilized to offset operating costs or for the promotion of any MUSL game as approved by the MUSL Board of Directors. The Lottery's unreserved account is reported on the balance sheets as "Deposits with MUSL". The Lottery is assessed its pro rata share of MUSL's annual operating expenses. MUSL reduced the Lottery's unreserved account by \$71,736 and \$114,324 for operating expenses for the Fiscal Years ended June 30, 1999 and 1998, respectively.

RHODE ISLAND LOTTERY

Notes to Financial Statements

(2) Summary of Significant Accounting Policies

(a) Basis of Accounting

The financial records of the Lottery, a proprietary fund, are accounted for using the economic resources measurement focus and are maintained on the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recognized at the time the related liabilities are incurred. The Governmental Accounting Standards Board (GASB) has the responsibility for establishing generally accepted accounting principles for governmental proprietary fund type activities. In accordance with GASB Statement No. 20, in the absence of specific guidance from a GASB pronouncement, pronouncements of the Financial Accounting Standards Board issued on or before November 30, 1989 have been followed.

(b) Reporting Entity

The Lottery is a component unit of the State of Rhode Island and Providence Plantations (State) for financial reporting purposes. Accordingly, its annual financial statements are included in the State's Comprehensive Annual Financial Report (CAFR).

(c) Revenues and Expenses

Revenue from the sale of lottery tickets and video lottery, and expenses for prizes and commissions are recognized as follows:

1. On-line lottery games with specific drawing dates - when the related drawings are held.
2. Instant ticket lottery games - when ticket packets are charged to retailers. Prize expense is recognized in proportion to the number of tickets sold based on the stated prize structure for a specific instant ticket game.
3. Video lottery games - when game credits are purchased and when game credits are redeemable. Video lottery revenue and prize expenses are recorded at the amount of credits purchased and the amount of credits redeemable. These amounts are net of credits won and played.

The Lottery accrues for the maximum prizes payable. Prize obligations, other than those relating to prizes payable in installments, which remain unclaimed one year after the drawing date, are reported as a reduction to the cost of sales.

RHODE ISLAND LOTTERY

Notes to Financial Statements

(d) *Depreciation*

Property, plant, and equipment are stated at historical cost. Depreciation is computed using the straight-line method based on the estimated useful lives of the assets.

(e) *Cash Equivalents*

Cash equivalents consist of highly liquid investments with a maturity of three months or less at the time of purchase and are stated at cost which approximates market.

(f) *Investments for Jackpot Awards and Obligations for Unpaid Prize Awards*

Prior to November 15, 1983, annuity contracts were purchased in the name of, and paid directly to, the jackpot winner. Accordingly, the Lottery has not recorded an obligation for prize awards satisfied through annuity contracts purchased in the name of the winner. During Fiscal Year 1998, the Lottery returned to this practice of satisfying prize obligations relating to their Win for Life instant ticket game.

Jackpot awards for the Lot-O-Bucks game, which is no longer active, are paid in annual installments. The Lottery satisfied these obligations by purchasing investments with maturities corresponding to the jackpot award annual installments. Investments for jackpot awards purchased since November 15, 1983 are in the name of the Lottery. Accordingly, the Lottery has a direct obligation to make future installment payments to the jackpot winner. These investments and related obligations are recorded at fair value. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. The fair value of investments for jackpot awards are generally based on published market prices and quotations from national security exchanges and securities pricing services.

(g) *Ticket Inventory*

Inventory consists of the cost of tickets for the instant games, which is expensed as a percentage of sales from instant ticket games.

(h) *Deferred Charges*

Advertising, promotion, and design costs relating to new lottery games are deferred until the game is available to the public at which time they are expensed.

RHODE ISLAND LOTTERY

Notes to Financial Statements

(i) *Deferred Revenue*

Tickets can be purchased in advance of scheduled drawing dates. Revenue from advance ticket sales is recognized during the period in which the related drawing is held. Sales pertaining to drawings to be held after the balance sheet date are reported as deferred revenue.

Additionally, as described in Note 1, the balance of the Lottery's unreserved account maintained by MUSL is recorded as an asset (deposits with MUSL) with a corresponding liability (deferred revenue). Miscellaneous revenue is recognized as related expenses are incurred.

(j) *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 disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual amounts could differ from those amounts.

(3) *Deposits and Investment Risk*

(a) *Deposits*

The Lottery's book balance at June 30, 1999 was \$1,429,486 and the bank balance was \$505,575. One account with a bank balance of \$5,951 is held in the Lottery's name and is fully insured by Federal Depository Insurance. Remaining deposits totaling \$499,624 are held by the State General Treasurer. All General Treasurer accounts at a single institution are aggregated for purposes of determining Federal Depository Insurance coverage.

(b) *Investments*

The Lottery's investments are categorized below to provide an indication of the level of market and credit risk assumed by the Lottery at June 30, 1999 and 1998. Investments for jackpot awards were made by the Lottery in accordance with guidelines established by the Commission. All other investments, principally cash equivalent type investments, are made by the State General Treasurer in accordance with guidelines established by the State Investment Commission, which is responsible for the investment of all State funds. Pursuant to Chapter 35-10 of the R.I. General Laws, the State Investment Commission may, in general, "invest in

RHODE ISLAND LOTTERY

Notes to Financial Statements

securities as would be acquired by prudent persons of discretion and intelligence in these matters who are seeking a reasonable income and the preservation of their capital.”

- Category 1 includes investments that are insured or registered, or are held by the Lottery or its agent in the Lottery’s name.
- Category 2 includes investments that are uninsured and unregistered for which the securities are held by the counterparty’s trust department or agent in the Lottery’s name.
- Category 3 includes investments that are uninsured and unregistered, and are held by the counterparty, or by its trust department or agent but not in the Lottery’s name.

All of the Lottery’s investments are Category I investments, which are summarized below.

	<u>Fair Value 1999</u>	<u>Fair Value 1998</u>
Zero coupon U.S. Treasury bonds	\$ 4,158,875	\$ 5,707,905
Repurchase agreements	<u>-</u>	<u>2,000,000</u>
Total investments	4,158,875	7,707,905
Less amounts classified as cash equivalents	<u>-</u>	<u>2,000,000</u>
Total investments for jackpot awards	4,158,875	5,707,905
Less short-term investments for jackpot awards	1,453,000	1,807,000
Long-term investments for jackpot awards	<u>\$ 2,705,875</u>	<u>\$ 3,900,905</u>

RHODE ISLAND LOTTERY

Notes to Financial Statements

(c) *Cash and Cash Equivalents*

Cash and cash equivalents on the balance sheets consist of the following:

	1999	1998
Cash balance per books	\$ 1,429,486	\$ 1,477,957
Investments reclassified as cash equivalents	-	2,000,000
Cash and cash equivalents	\$ 1,429,486	\$ 3,477,957

(4) *Property, Plant and Equipment*

A summary of property, plant and equipment follows:

	Estimated Useful Life	1999	1998
Buildings	20	\$ 1,437,912	\$ 1,437,912
Building improvements	10	232,287	134,370
Ticket production and computer equipment	10	19,612	17,806
Office equipment	10	124,017	116,757
Furniture and fixtures	10	46,803	46,349
Lottery drawing equipment	3	68,861	68,861
Automobiles	3	136,300	136,300
Computer equipment	3	271,516	205,942
Trucks	3	22,445	22,445
		2,359,753	2,186,742
Less: Accumulated depreciation		1,759,534	1,568,052
Property, plant and equipment (net)		\$ 600,219	\$ 618,690

Lottery headquarters are situated on land owned by the State of Rhode Island. The State has assigned custody, control and supervision of the land to the Lottery at no cost. However, since title to such land remains vested in the State, it is not recorded in the balance sheets.

RHODE ISLAND LOTTERY

Notes to Financial Statements

(5) Due to State's General Fund

Due to State's General Fund represents the balance of net income for the period (after adjustment for depreciation expense on the Lottery's headquarters - see note 9) that is to be transferred to the State's General Fund. The amounts transferred and amounts due to State's General Fund are summarized below:

	<u>1999</u>	<u>1998</u>
Transfer to State's General Fund	\$ 133,475,047	\$ 115,071,622
Cash transferred during fiscal year	(133,671,622)	(114,444,452)
Amount due to State's General Fund, beginning of year	1,171,622	544,452
Due to State's General Fund	<u>\$ 975,047</u>	<u>\$ 1,171,622</u>

(6) Commissions

The Lottery pays commissions to sales retailers and its on-line games contractor based on a percentage of gross ticket sales. Video lottery commissions, as specified in the General Laws, are paid to the facility operators, technology providers (video terminal providers), the central communications provider and others based on various percentages of net terminal income (video lottery credits purchased less credits redeemed or redeemable).

The General Laws provide for reductions of certain video lottery commissions. The amount reduced is to be credited to the State's Distressed Communities Relief Fund which is part of the State's General Fund. The Lottery has reflected the actual video commissions paid as an expense.

The amount to be credited to the Distressed Communities Relief Fund is included in the transfer to the State's General Fund.

(7) Pull-Tab Ticket Sales

Tickets designed exclusively for use by nonprofit agencies (pull-tab tickets) are sold by the Lottery. The Lottery incurs no prize expense liability for these ticket sales. These sales are reported net of cost as follows:

	<u>1999</u>	<u>1998</u>
Pull-tab ticket sales	\$ 297,594	\$ 286,767
Cost of tickets	(83,294)	(90,487)
Net pull-tab ticket sales	<u>\$ 214,300</u>	<u>\$ 196,280</u>

RHODE ISLAND LOTTERY

Notes to Financial Statements

(8) Compensated Absences

The Lottery accrues an estimated liability for vested benefits relating to future compensated absences. This includes an expected obligation in connection with vacation credits and accumulated vested sick pay for those employees eligible for retirement. As of June 30, 1999 and 1998, the estimated liability was \$165,583 and \$153,454, respectively. The liability is calculated using the current hourly rates of pay.

(9) Retained Earnings

The Lottery retained \$1,458,275 of its earnings during the years 1980 to 1983 to finance construction of a new office headquarters and accounted for this as a reservation of retained earnings. It adopted the policy of reducing reserved retained earnings by the annual building depreciation expense of \$71,895.

(10) Retirement Plan

Plan Description:

All Lottery employees must participate in a cost-sharing multiple-employer defined benefit pension plan administered by the State of Rhode Island Employees' Retirement System (ERS). The plan provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. The level of benefits provided to state employees is established by Chapter 36-10 of the General Laws which is subject to amendment by the general assembly. The ERS issues a publicly available financial report that includes financial statements and required supplementary information for plans administered by the system. The report may be obtained by writing to the Employees' Retirement System, 40 Fountain Street, Providence, RI 02903.

Funding Policy:

The funding policy, as set forth in Rhode Island General Laws, Section 36-10-2, provides for actuarially determined periodic contributions to the plan. However, the actuarially determined contribution rates can be statutorily changed by the legislature. Lottery employees are required to contribute 8.75% of their annual covered salary. The Lottery is required to contribute at an actuarially determined rate; the current rate is 8.570% of annual covered payroll. The Lottery contributed \$192,085, \$198,081, and \$164,663 for the years ended June 30, 1999, 1998 and 1997, respectively, equal to the required contributions for each year.

RHODE ISLAND LOTTERY

Notes to Financial Statements

(11) Postemployment Benefits

In accordance with the General Laws, postemployment healthcare benefits are provided to all state employees who retire on or after July 1, 1989. The benefits in general cover medical and hospitalization costs for pre-Medicare eligible retirees and a Medicare supplement for Medicare eligible retirees. The retiree is required to pay a portion of the monthly premium. This payment varies with years of service and ranges from 50% for retirees with 10-15 years of service to 0% for retirees with 35 years of service. The Lottery contributed .86% and .66%, respectively, of covered payroll for the years ended June 30, 1999 and 1998 to fund the cost of these benefits.

(12) Deferred Compensation

Employees of the Lottery may participate in a deferred compensation plan offered by the State. Accordingly, required disclosures are reported in the State's CAFR.

(13) Commitments

The Lottery has contracted with a vendor to furnish computer hardware and software together with the related services necessary for the operation of the Lottery's computerized games. Commissions range from 4% to 4.8% of sales from the on-line games. The Lottery leases a portion of its headquarters to the vendor to house computer hardware necessary for the on-line games. The term of the lease coincides with the vendor contract and provides for a rent of \$41,520 per annum. This contract is effective through October 31, 2002 and allows the Lottery the option of extending the agreement for five one-year terms.

The Lottery has also contracted with this vendor to install, operate and maintain a central communications system for the operation of its video lottery games. This contract is effective through August 27, 2002. Commissions, equal to 3% of net terminal income from video lottery sales, are paid from the technology provider's share of net terminal income.

The Lottery is in the process of renovating its headquarters. The Lottery has estimated the remaining cost of these renovations at \$120,000, which includes a \$25,000 contingency.

RHODE ISLAND LOTTERY

Notes to Financial Statements

(14) Equipment Leasing

Leases that do not meet the criteria for capitalization are classified as operating leases with related rentals charged to operations as incurred. The following is a schedule, by year, of future minimum lease payments under operating leases as of June 30, 1999, that have initial or remaining lease terms in excess of one year.

<u>Fiscal Year Ending June 30</u>	<u>Lease Payments</u>
2000	\$ 76,186
Total future minimum lease payments	<u>\$ 76,186</u>

(15) Contingencies

Litigation

A suit was filed by a former Lottery employee against the members of the Commission in their official capacity, the Governor and the Director of Administration. The litigation concerns the former employee's claim that his termination on March 25, 1996 was unlawful. Management believes the likelihood of an unfavorable outcome and any potential damages is impossible to estimate at this time.

Required Supplementary Information

RHODE ISLAND LOTTERY

Required Supplementary Information

Year 2000

The year 2000 issue is the result of shortcomings in many electronic data processing systems and other electronic equipment that may adversely affect the Lottery's operations

The Lottery completed an inventory of its computer systems and has determined that certain software (general ledger and telephone system) and personal computers must be upgraded to be Year 2000 compliant. The Lottery has completed most required remediation by purchasing new, Year 2000 compliant versions of the software and personal computers. The Lottery plans to complete its remaining remediation efforts with a hardware and software update of the winning numbers telephone system. The Lottery estimates remaining costs to approximate \$15,000.

The Lottery uses external organizations (on-line games contractor, central communications provider, and video lottery technology providers) to operate its lottery games. The external organizations are responsible for any required remediation to these systems. The external organizations have indicated that they are now implementing and testing all required remediation. Any costs associated with remediation and testing of these systems will be borne by the external organizations.

The Lottery also uses certain statewide accounting systems (receipts, disbursements, and payroll). The State is responsible for remediating these systems and is also responsible for any related costs. These statewide accounting systems are considered to be Year 2000 compliant.

Because of the unprecedented nature of the Year 2000 issue, its effect and the success of related remediation efforts will not be determinable until the year 2000 and thereafter. Management cannot assure the Lottery will be Year 2000 ready, that the Lottery's remediation efforts will be successful in whole or in part, or that the parties with whom the Lottery does business; will be year 2000 ready.

Supplementary Information

RHODE ISLAND LOTTERY
Sales, Commissions and Prize Awards Expense
Years Ended June 30, 1999 and 1998

Year Ended June 30, 1999

	<u>Sales</u>	<u>Commissions</u>	<u>Prize Awards Expense</u>	<u>Unclaimed Prize Recovery</u>	<u>Cost of Tickets</u>	<u>Gross Profit</u>
Lottery games:						
On-line games						
Keno,	\$ 57,637,832	\$ 7,109,820	\$ 37,802,840	\$ (352,003)	\$ -	\$ 13,077,175
PowerBall	52,582,676	6,486,250	26,291,338	(1,247,608)	-	21,052,696
Daily Numbers	28,221,328	3,481,196	13,779,082	(230,918)	-	11,191,968
Roll Down	<u>5,880,770</u>	<u>725,413</u>	<u>2,943,752</u>	<u>(128,793)</u>	-	<u>2,340,398</u>
	144,322,606	17,802,679	80,817,012	(1,959,322)	-	47,662,237
Instant Tickets	51,372,959	3,416,598	32,573,096	(308,128)	985,173	14,706,220
Video Lottery	<u>545,474,154</u>	<u>80,153,944</u>	<u>390,132,681</u>	<u>(31,617)</u>	-	<u>75,219,146</u>
Totals	<u>\$741,169,719</u>	<u>\$101,373,221</u>	<u>\$503,522,789</u>	<u>\$ (2,299,067)</u>	<u>\$ 985,173</u>	<u>\$137,587,603</u>

Video Commissions – Detail

Facilities	\$ 47,003,082
Technology Providers	19,565,973
Central Communications Provider	4,660,236
Dog Kennel Owners	7,371,240
City/Town	<u>1,553,413</u>
Total	<u>\$ 80,153,944</u>

Year Ended June 30, 1998

	<u>Sales</u>	<u>Commissions</u>	<u>Prize Awards Expense</u>	<u>Unclaimed Prize Recovery</u>	<u>Cost of Tickets</u>	<u>Gross Profit</u>
Lottery games:						
On-line games						
Keno,	\$ 51,617,137	\$ 6,370,298	\$ 33,846,585	\$ (254,516)	\$ -	\$ 11,654,770
PowerBall	43,345,345	5,349,439	21,671,239	(737,303)	-	17,061,970
Daily Numbers	29,257,141	3,610,752	14,527,973	(210,094)	-	11,328,510
Daily Millions	2,162,126	266,837	750,666	(191,390)	-	1,336,013
Roll Down	<u>3,300,928</u>	<u>407,382</u>	<u>1,654,017</u>	<u>-</u>	-	<u>1,239,529</u>
	129,682,677	16,004,708	72,450,480	(1,393,303)	-	42,620,792
Instant Tickets	40,323,292	2,438,008	24,923,500	(429,199)	1,102,638	12,288,345
Video Lottery	<u>464,068,675</u>	<u>67,859,963</u>	<u>331,903,977</u>	<u>(27,476)</u>	-	<u>64,332,211</u>
Totals	<u>\$634,074,644</u>	<u>\$ 86,302,679</u>	<u>\$429,277,957</u>	<u>\$ (1,849,978)</u>	<u>\$ 1,102,638</u>	<u>\$119,241,348</u>

Video Commissions – Detail

Facilities	\$ 39,818,373
Technology Providers	16,552,669
Central Communications Provider	3,964,941
Dog Kennel Owners	6,202,334
City/Town	<u>1,321,646</u>
Total	<u>\$ 67,859,963</u>

See independent auditor's report

Statistical Section

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Rhode Island Statistics



Rhode Island Lottery Revenues Fiscal Years 1990 through 1999

SALES	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Instant Tickets										
Instant Tickets	\$ 12,267,731	\$ 11,972,343	\$ 11,146,312	\$ 30,822,026	\$ 11,308,376	\$ 30,840,247	\$ 23,339,726	\$ 27,354,236	\$ 40,323,332	\$ 51,370,859
MAG										
VLT	-	-	-	32,323,383	35,694,821	192,018,304	314,882,426	409,301,530	464,068,075	515,679,156
On-Line										
Lotto America	11,677,265	10,823,145	3,091,819	-	-	-	-	-	-	-
Grand Lot	134,488	594,282	93,480	21,307	-	-	-	-	-	-
Lot O'Books	8,187,608	9,774,793	1,663,039	1,709,042	6,039,790	5,874,253	-	-	-	-
Daily Numbers	33,378,868	33,816,228	34,311,343	33,271,075	32,323,382	31,861,071	30,900,024	28,408,178	29,253,141	28,221,378
PowerBall	-	-	2,648,066	31,631,441	40,982,752	57,474,711	47,623,022	33,581,093	45,345,345	52,582,874
Keno	-	-	-	38,704,180	38,399,917	24,937,298	31,003,601	41,881,433	51,413,337	57,637,872
Rosely-Cash	-	-	-	-	-	4,115,994	6,844,221	1,132,036	-	-
Daily Millions	-	-	-	-	-	-	-	5,083,443	-	-
Roll Down	-	-	-	-	-	-	-	-	3,398,938	3,880,178
Total On-Line	35,576,851	53,779,186	35,462,647	64,408,628	107,627,857	171,647,524	177,075,676	115,351,668	129,882,677	144,322,654
TOTAL SALES	65,844,632	65,751,529	64,608,959	138,693,669	139,922,890	234,546,871	452,207,581	546,715,844	634,874,644	740,109,719
Other Revenues										
Investment Earnings	547,637	416,032	307,178	344,434	357,711	321,399	438,920	421,223	488,379	528,425
Net Pkg/Tel Sales	243,935	222,744	231,345	256,238	189,454	185,499	162,788	363,867	196,200	214,300
Miscellaneous	23,026	31,483	29,319	23,237	24,475	183,147	119,147	169,343	264,605	169,852
TOTAL OTHER REVENUES	814,600	670,260	667,842	623,909	600,640	689,695	720,855	954,433	949,184	912,578
TOTAL SALES & REVENUES	\$ 66,659,232	\$ 66,421,789	\$ 65,276,801	\$ 139,317,578	\$ 140,523,530	\$ 235,236,566	\$ 456,028,436	\$ 546,460,277	\$ 635,023,798	\$ 741,022,297

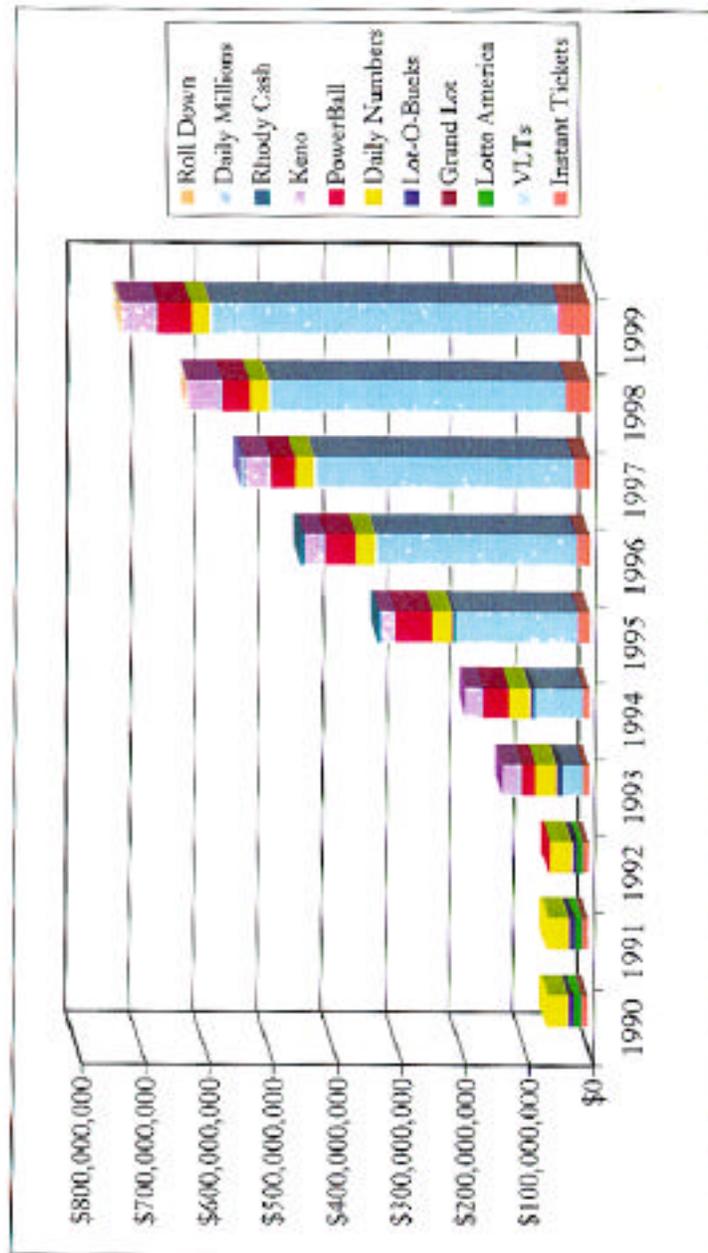
Source: Rhode Island Lottery



Rhode Island Lottery

Sales by Product

Fiscal Years 1990 through 1999



Source: Rhode Island Lottery



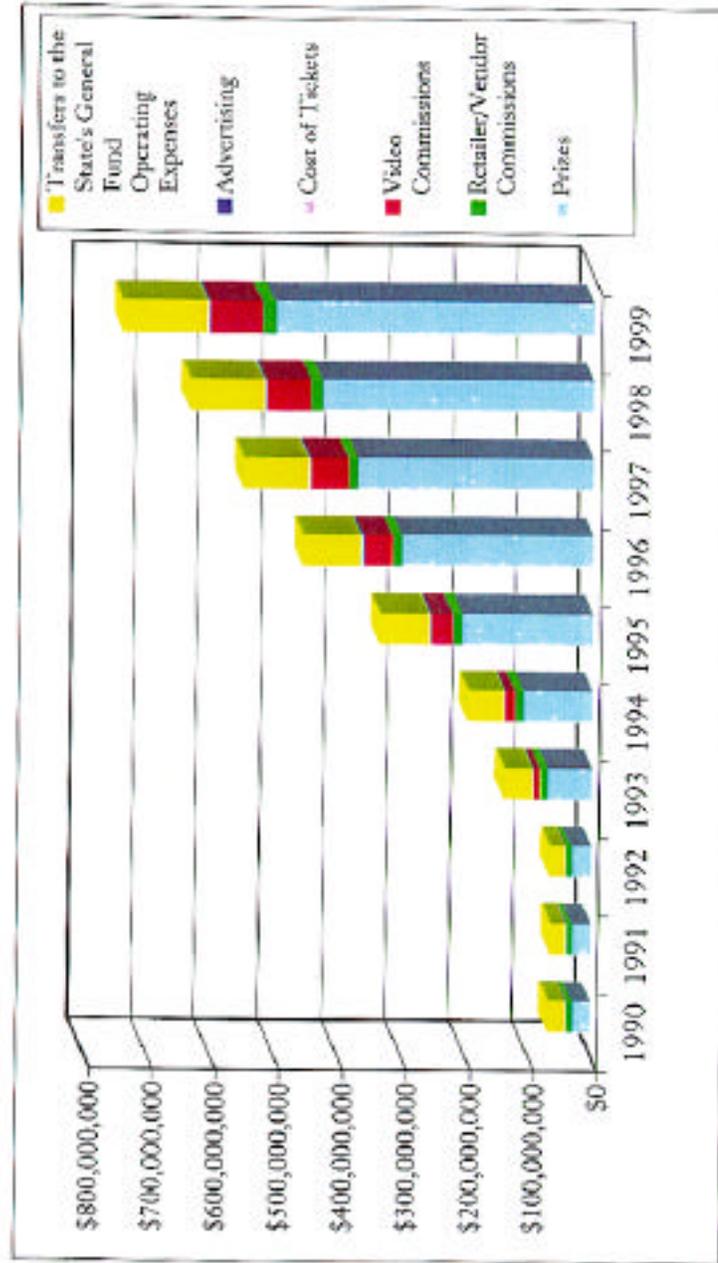
Rhode Island Lottery Expenses and Transfers to the State's General Fund Fiscal Years 1990 through 1999

EXPENSES	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Prize	\$ 30,006,521	\$ 30,996,299	\$ 32,345,255	\$ 79,979,039	\$ 109,800,116	\$ 301,427,166	\$ 202,491,899	\$ 379,856,150	\$ 436,277,851	\$ 292,222,729
Retailer/Vendor Commissions	3,265,657	7,332,421	7,347,280	12,803,268	33,487,754	14,096,163	15,079,373	15,715,267	16,482,718	21,219,277
Video Commissions	-	-	-	8,313,973	14,436,084	31,381,395	43,860,000	57,444,182	67,459,863	69,151,944
Cost of Tickets	427,110	398,206	407,495	417,583	379,253	567,290	619,222	843,618	1,102,658	984,375
Unclaimed Prize Recovery	(766,265)	(666,673)	(719,776)	(998,233)	(1,237,854)	(1,684,010)	(2,110,340)	(2,080,535)	(2,949,978)	(2,293,067)
Advertising	393,314	417,964	558,488	771,343	647,821	1,158,716	1,263,290	1,102,233	1,384,439	1,245,392
Operating Expenses	1,834,078	1,934,311	3,495,136	1,905,940	3,143,891	3,878,081	3,046,370	3,427,727	3,838,216	3,854,651
TOTAL EXPENSES	\$ 29,218,975	\$ 49,457,706	\$ 47,501,296	\$ 93,977,129	\$ 149,137,994	\$ 259,713,352	\$ 345,778,115	\$ 449,509,854	\$ 529,033,981	\$ 688,679,277
TRANSFER TO THE STATE'S GENERAL FUND	\$ 17,214,927	\$ 23,879,798	\$ 23,879,798	\$ 46,878,444	\$ 66,366,521	\$ 76,394,639	\$ 91,379,486	\$ 109,535,238	\$ 115,697,651	\$ 133,472,847

Source: Rhode Island Lottery



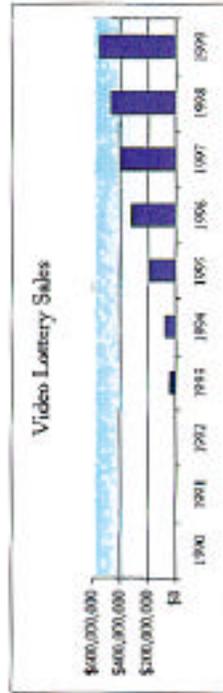
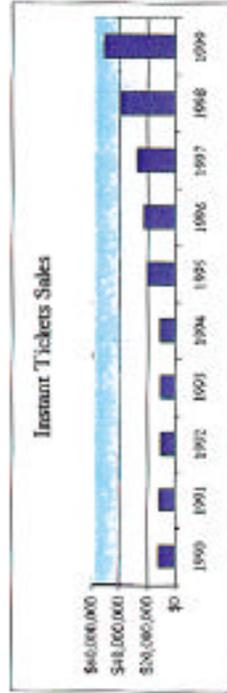
Rhode Island Lottery Expenses and Transfers to the State's General Fund Fiscal Years 1990 through 1999



Source: Rhode Island Lottery



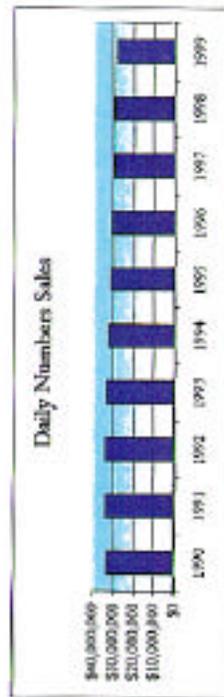
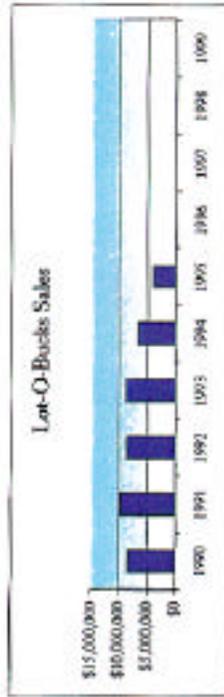
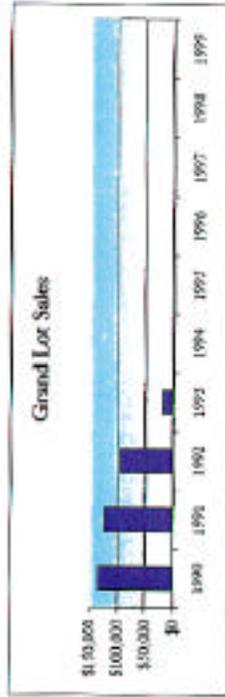
Rhode Island Lottery Sales by Game Fiscal Years 1990 through 1999



Source: Rhode Island Lottery



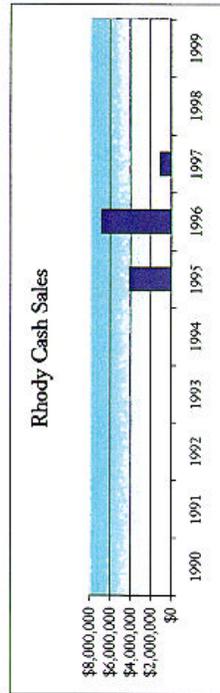
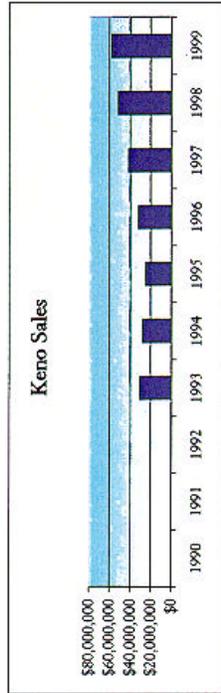
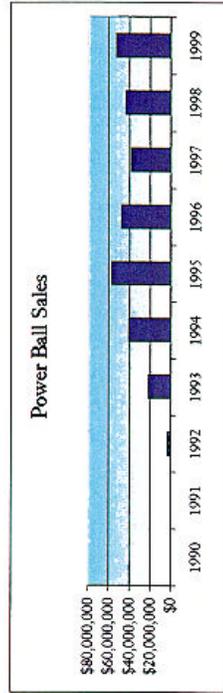
Rhode Island Lottery Sales by Game Fiscal Years 1990 through 1999



Source: Rhode Island Lottery



Rhode Island Lottery
Sales by Game
Fiscal Years 1990 through 1999



Source: Rhode Island Lottery



Rhode Island Lottery

Sales by Game

Fiscal Years 1990 through 1999



Note: Not all games were active during this 10-year period.

- Video Lottery began in Fiscal Year 1993
- Lotto America ended in Fiscal Year 1992
- Grand Lot ended in Fiscal Year 1993
- Lot-O-Bucks ended in Fiscal Year 1994
- PowerBall began in Fiscal Year 1992
- Keno began in Fiscal Year 1993
- Rhody Cash began in Fiscal Year 1997 and ended in Fiscal Year 1997
- Daily Millions began in Fiscal Year 1997 and ended in Fiscal Year 1998
- Roll Down began in Fiscal Year 1998

Source: Rhode Island Lottery

National Statistics

**U.S. LOTTERIES SALES, PRIZES, AND PROFITS
FISCAL YEAR 1999 (UNAUDITED)**

U.S. LOTTERIES SALES, PRIZES, AND PROFITS
FISCAL YEAR 1999 (UNAUDITED)

LOTTERY	TOTAL SALES (\$M)	PRIZES (\$M)	GOVERNMENT PROFITS (\$M)	PRIZES AS % OF REVENUES	GOV'T. PROFITS AS % OF REVENUES
Arizona	268.27	144.01	70.77	54%	26%
California	2,525.06	1,311.60	900.83	32%	36%
Colorado	368.40	224.94	84.68	61%	23%
Connecticut	871.00	517.67	271.31	59%	31%
Delaware (2)	527.44	168.00	78.49	32%	15%
D.C. (1)	205.00	100.00	65.00	49%	32%
Florida	2,178.59	1,089.30	827.86	50%	38%
Georgia	2,034.31	1,059.59	646.71	52%	32%
Idaho	90.45	52.32	20.60	58%	23%
Illinois	1,524.44	807.71	540.01	53%	35%
Indiana	681.43	383.58	204.65	56%	30%
Iowa	184.07	101.98	45.83	55%	25%
Kansas	202.79	107.06	60.97	53%	30%
Kentucky	575.70	340.67	159.59	59%	28%
Louisiana	296.23	148.94	105.66	50%	36%
Maine	144.54	80.62	41.37	56%	29%
Maryland	1,084.06	581.65	401.72	54%	37%
Massachusetts	3,381.62	2,315.95	809.14	68%	24%
Michigan (1)	1,774.53	973.47	623.38	55%	35%
Minnesota	390.01	234.83	85.39	60%	22%
Missouri	513.33	282.33	159.13	55%	31%
Montana	29.99	15.05	6.78	50%	23%
Nebraska	72.36	55.40	17.50	77%	24%
New Hampshire	199.03	113.10	64.15	57%	32%
New Jersey	1,658.20	949.14	643.41	57%	39%
New Mexico	89.23	42.79	19.62	48%	22%
New York	3,697.63	1,871.97	1,413.33	51%	38%
Ohio	2,144.93	1,250.00	696.30	58%	32%
Oregon (3)	1,277.90	756.00	310.76	59%	24%
Pennsylvania	1,649.28	851.04	648.98	52%	39%
<i>RHODE ISLAND (3)</i>	<i>741.38</i>	<i>503.51</i>	<i>133.50</i>	68%	18%
South Dakota (3)	554.64	359.76	96.85	65%	17%
Texas (1)	2,580.00	1,332.00	903.00	52%	35%
Vermont	70.39	43.50	19.05	62%	27%
Virginia	934.52	506.90	321.87	54%	34%
Washington	473.40	295.36	120.53	62%	25%
West Virginia (2)	943.64	664.32	119.25	70%	13%
Wisconsin	428.20	237.20	190.99	55%	45%
TOTAL	37,365.99	20,873.29	11,928.95		

(1) Estimated fiscal 1999 sales

(2) Does not include VLT prizes

(3) Includes cash in VLT sales and cash out (prizes)

Source: La Fleur's Lottery World 1999 Fast Facts

**U.S. LOTTERIES PER CAPITA SALES, PRIZES, AND PROFITS
FISCAL YEAR 1999 (UNAUDITED)**

U.S. LOTTERIES PER CAPITA SALES, PRIZES, AND PROFITS
FISCAL YEAR 1999 (UNAUDITED)

LOTTERY	POPULATION (M)	PER CAPITA SALES	PER CAPITA PRIZES	PER CAPITA GOVERNMENT PROFITS
Arizona	4.6	\$59	\$31	\$16
California	32.3	\$78	\$43	\$28
Colorado	3.9	\$97	\$58	\$22
Connecticut	3.3	\$266	\$157	\$83
Delaware (2)	0.7	\$721	\$240	\$107
D.C. (4)	0.5	\$388	\$100	\$113
Florida	14.7	\$149	\$74	\$55
Georgia	7.3	\$272	\$141	\$86
Idaho	1.2	\$75	\$44	\$17
Illinois	11.9	\$328	\$68	\$45
Indiana	5.9	\$116	\$67	\$35
Iowa	2.9	\$63	\$33	\$16
Kansas	2.6	\$78	\$41	\$23
Kentucky	3.9	\$147	\$87	\$41
Louisiana	4.4	\$68	\$34	\$24
Maine	1.2	\$116	\$47	\$33
Maryland	5.1	\$213	\$114	\$79
Massachusetts	6.1	\$353	\$180	\$112
Michigan (1)	9.8	\$182	\$99	\$64
Minnesota	4.7	\$83	\$50	\$18
Missouri	3.4	\$95	\$52	\$29
Montana	0.9	\$34	\$17	\$8
Nebraska	1.7	\$44	\$33	\$11
New Hampshire	1.2	\$170	\$94	\$57
New Jersey	8.1	\$206	\$117	\$80
New Mexico	1.7	\$32	\$27	\$11
New York	18.1	\$204	\$103	\$78
Ohio	11.2	\$192	\$112	\$62
Oregon (3)	3.2	\$194	\$116	\$96
Pennsylvania	12.0	\$137	\$71	\$54
RHODE ISLAND (3)	1.0	\$747	\$204	\$134
South Dakota (3)	0.7	\$752	\$214	\$138
Texas (1)	19.4	\$133	\$69	\$47
Vermont	0.6	\$120	\$73	\$32
Virginia	6.7	\$139	\$76	\$48
Washington	3.6	\$84	\$53	\$22
West Virginia (2)	1.8	\$520	\$162	\$66
Wisconsin	5.2	\$83	\$46	\$17
TOTAL	211.5	\$161	\$90	\$52

(1) Estimated fiscal 1999 sales

(2) Does not include VLT prizes

(3) Includes cash in VLT sales and cash out (prizes)

Source: La Fleur's Lottery World 1999 Fast Facts

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Compliance Section



ERNEST A. ALMONTE, CPA, CFE
Auditor General

State of Rhode Island and Providence Plantations

GENERAL ASSEMBLY

Office of the Auditor General

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Pawtucket, Rhode Island 02860-4807

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INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Joint Committee on Legislative Services, General Assembly
State of Rhode Island and Providence Plantations:
and
Members of the Rhode Island Lottery Commission:

We have audited the financial statements of the Rhode Island Lottery (Lottery), a component unit of the State of Rhode Island and Providence Plantations, as of and for the year ended June 30, 1999 and have issued our report thereon dated September 9, 1999. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Lottery's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

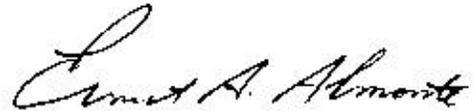
In planning and performing our audit, we considered the Lottery's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted a matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Lottery's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

Reportable Condition

Logical access security to the computer systems used to operate the Lottery's games should be improved by (1) fully utilizing certain designed functions of the systems, (2) strengthening other system security aspects, and (3) implementing a comprehensive security plan for these computer systems that includes delegating certain aspects of security to the Lottery and monitoring by the Lottery of the overall system security function. Certain security features are operational within the Lottery's gaming computer systems; however, the Lottery should implement a formal comprehensive security plan in conjunction with its on-line and video lottery games contractor.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we do not believe that the reportable condition described above is a material weakness. We also noted other matters involving compliance and the internal control over financial reporting which we will report to management of the Lottery in a separate communication.

This report is intended solely for the information and use of the Joint Committee on Legislative Services, the Rhode Island Lottery Commission and Lottery management, and is not intended to be and should not be used by anyone other than these specified parties.



Ernest A. Almonte, CPA, CFE
Auditor General

September 9, 1999