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RHODE ISLAND LOTTERY  
Component Unit of the State of Rhode Island  
and Providence Plantations  
Financial Statements  
Fiscal Years Ended June 30, 1998 and 1997

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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# RHODE ISLAND LOTTERY

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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, 1998 and 1997, 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.

Except as discussed in the following paragraph, 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.

Government Accounting Standards Board Technical Bulletin 98-1, *Disclosures About Year 2000 Issues*, requires disclosure of certain matters regarding the year 2000 issue. The Lottery has included such disclosures in Note 16. Because of the unprecedented nature of the year 2000 issue, its effects and the success of related remediation efforts will not be fully determinable until the year 2000 and thereafter. Accordingly, insufficient audit evidence exists to support the Lottery's disclosures with respect to the year 2000 issue made in Note 16. Further, we do not provide assurance that the Lottery is or will be year 2000 ready, 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 will be year 2000 ready.

In our opinion, except for the effects of such adjustments on the 1998 financial statements, if any, as might have been determined to be necessary had we been able to examine evidence regarding year 2000 disclosures, the financial statements referred to above present fairly, in all material respects, the financial position of the Lottery as of June 30, 1998 and 1997, 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 December 11, 1998 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 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

December 11, 1998

## RHODE ISLAND LOTTERY

### Balance Sheets

June 30, 1998 and 1997

<u>Assets</u>	<u>1998</u>	<u>1997</u>
Current Assets:		
Cash and cash equivalents (note 3)	\$ 3,477,957	\$ 1,380,772
Investments for jackpot awards (note 3)	1,807,000	2,386,000
Accounts receivable -less allowance for doubtful accounts of \$221,953 in 1998 and \$206,702 in 1997	7,022,433	5,792,073
Ticket inventory	712,913	448,992
Deposits with Multi-State Lottery Association (MUSL) (note 1)	425,507	282,504
Deferred charges	1,442	9,114
Total current assets	13,447,252	10,299,455
Investments for jackpot awards (note 3)	3,900,905	5,215,938
Property, plant and equipment, net (note 4)	618,690	652,814
Total assets	<u>\$ 17,966,847</u>	<u>\$ 16,168,207</u>
<u>Liabilities and Retained Earnings</u>		
Current Liabilities:		
Due to State's General Fund (note 5)	\$ 1,171,622	\$ 544,452
Current obligation for unpaid prize awards	6,050,639	5,814,361
Accounts payable	5,573,317	3,607,553
Accrued expenses	221,139	134,581
Deferred revenue	726,592	456,794
Total current liabilities	13,743,309	10,557,741
Long-term obligation for unpaid prize awards (note 3)	3,900,905	5,215,938
Total liabilities	<u>17,644,214</u>	<u>15,773,679</u>
Retained Earnings:		
Reserved for building (note 9)	322,633	394,528
Total liabilities and retained earnings	<u>\$ 17,966,847</u>	<u>\$ 16,168,207</u>

See accompanying notes to financial statements.

## RHODE ISLAND LOTTERY

### Statements of Revenue, Expenses and Retained Earnings

Years Ended June 30, 1998 and 1997

	1998	1997
Sales (schedule 1):		
On-line games	\$ 129,682,677	\$ 115,251,098
Instant games	40,323,292	27,356,236
Video lottery	464,068,675	406,108,530
Total sales	634,074,644	548,715,864
Cost of sales:		
Commissions	86,302,679	73,159,559
Prize awards	429,277,957	373,056,150
Unclaimed prize recovery	(1,849,978)	(2,080,535)
Cost of tickets	1,102,638	843,610
Total cost of sales	514,833,296	444,978,784
Gross profit	119,241,348	103,737,080
Operating expenses:		
Personal services	2,687,572	2,370,964
Advertising	1,384,429	1,102,533
Contract services	164,067	341,476
Equipment leasing (note 14)	331,819	333,583
Depreciation	172,439	150,689
Other	450,359	231,025
Total operating expenses	5,190,685	4,530,270
Operating income	114,050,663	99,206,810
Nonoperating income:		
Pull-tab ticket sales (note 7)	196,280	163,067
Investment earnings	488,379	421,123
Other	264,405	169,343
Total nonoperating income	949,064	753,533
Income before transfer to the State's General Fund	114,999,727	99,960,343
Transfer to the State's General Fund (note 5)	115,071,622	100,032,238
Net loss (note 9)	(71,895)	(71,895)
Retained earnings, beginning of year	394,528	466,423
Retained earnings, end of year	\$ 322,633	\$ 394,528

See accompanying notes to financial statements.

## RHODE ISLAND LOTTERY

### Statements of Cash Flows

Years Ended June 30, 1998 and 1997

	1998	1997
Cash flows from operating activities:		
Cash received from sales	\$ 632,957,669	\$ 550,444,905
Cash received from MUSL for grand prize winners	6,245,000	6,313,300
Cash received from sale of other tickets	286,767	249,534
Cash received from other sources	262,565	156,691
Cash paid for prizes other than MUSL grand prize winners	(428,999,959)	(374,633,312)
Cash paid to MUSL grand prize winners	(6,245,000)	(6,313,300)
Cash paid for commissions – retailers	(12,383,005)	(10,571,034)
Cash paid for commissions – video lottery	(65,646,618)	(56,141,888)
Cash paid for commissions – on-line games contractor	(6,023,266)	(5,158,422)
Cash paid to suppliers for goods and services	(4,053,131)	(2,625,401)
Cash paid to employees for services	(2,596,707)	(2,352,431)
Net cash provided by operating activities	113,804,315	99,368,642
Cash flows from noncapital financing activities:		
Transfer to State’s General Fund	(114,444,452)	(99,963,271)
Repayment of negative cash balance implicitly financed	-	(1,197,511)
Net cash used for noncapital financing activities	(114,444,452)	(101,160,782)
Cash flows from capital and related financing activities:		
Purchase of fixed assets	(150,816)	(141,534)
Proceeds from sale of fixed assets	12,500	19,800
Net cash used for capital and related financing activities	(138,316)	(121,734)
Cash flows from investing activities:		
Proceeds from maturity of investments for jackpot awards	2,387,259	2,873,523
Interest income	488,379	421,123
Net cash provided by investing activities	2,875,638	3,294,646
Net increase in cash and cash equivalents	2,097,185	1,380,772
Cash and cash equivalents, beginning of year	1,380,772	-
Cash and cash equivalents, end of year	\$ 3,477,957	\$ 1,380,772

## RHODE ISLAND LOTTERY

### Statements of Cash Flows

Years Ended June 30, 1998 and 1997

	1998	1997
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 114,050,663	\$ 99,206,810
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	172,439	150,689
Installment payments for jackpot awards	(2,387,259)	(2,873,523)
Other receipts classified as operating activities	198,120	165,067
Rental income and other receipts	262,565	156,691
Provision for doubtful accounts	15,251	(10,768)
(Increase) decrease in assets:		
Investment for jackpot awards	1,931,119	2,257,959
Accounts receivable	(1,245,611)	1,881,006
Inventory	(263,921)	177,620
Deposits with MUSL	(143,003)	(47,441)
Deferred charges	7,672	27,623
Increase (decrease) in liabilities:		
Obligation for unpaid prize awards	(1,115,840)	(3,042,133)
Accounts payable	1,965,764	1,404,955
Accrued expenses	86,558	20,611
Deferred revenue	269,798	(106,524)
Total adjustments	(246,348)	161,832
Net cash provided by operating activities	\$ 113,804,315	\$ 99,368,642
Noncash investing activities:		
Increase in fair value of investments for jackpot awards which also increased obligation for unpaid prize awards	\$ 582,142	\$ 709,555
Increase in deposits with MUSL and deferred revenue	143,003	47,441
	\$ 725,145	\$ 756,996

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	Prize 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 pools for PowerBall and Daily Millions are 50% of each drawing period's ticket sales. MUSL has placed 2% and 4.856% of each drawing period's ticket sales for PowerBall and Daily Millions, respectively, included as part of each member's prize liability, in prize reserve funds. As of January 13, 1998, the MUSL Board of Directors changed the maximum balance on the prize reserve funds for PowerBall and Daily Millions to \$77,000,000 and \$25,000,000, respectively. 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, 1998 and 1997, the prize reserve fund for the PowerBall game had a balance of \$76,506,708 and \$83,137,269, respectively, of which the Lottery's share was \$2,126,422 and \$2,373,705, respectively. The Lottery has charged amounts placed into the prize reserve funds to prize awards expense as the related sales have occurred.

Due to the Lottery's withdrawal from the Daily Millions game, MUSL will refund the remaining balance in the prize reserve account on April 1, 1999. The related receivable of \$335,900 is reported on the balance sheet as of June 30, 1998.

# RHODE ISLAND LOTTERY

## Notes to Financial Statements

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 \$114,324 and \$128,683 for operating expenses for the Fiscal Years ended June 30, 1998 and 1997, respectively.

### (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 (FASB) 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.

# RHODE ISLAND LOTTERY

## Notes to Financial Statements

3. Video lottery games - when game credits are purchased and when game credits are redeemable. Video lottery revenue and prize expense 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.

(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. In Fiscal Year 1998, the Lottery has 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.

# RHODE ISLAND LOTTERY

## Notes to Financial Statements

(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.

(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) *Reclassifications*

Certain 1997 amounts have been reclassified to conform with the current year presentation.

(k) *Restatements*

The 1997 amounts for investments for jackpot awards and the relating obligation for unpaid prize awards reported on the balance sheet have been restated at fair value to reflect the adoption of GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. Previously, these investments and the related obligation were recorded at cost plus accrued interest thereon, less annual installments paid. Investment for jackpot awards and related obligation for unpaid prize awards were increased by \$90,174 at June 30, 1997.

(l) *Use of Estimates*

# RHODE ISLAND LOTTERY

## Notes to Financial Statements

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, 1998 was \$1,477,957 and the bank balance was \$1,688,895. One account with a bank balance of \$101,685 is held in the Lottery's name; \$100,000 is insured by Federal Depository Insurance and \$1,685 is uninsured and uncollateralized. Remaining deposits totaling \$1,587,210 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, 1998 and 1997. 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 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.

# RHODE ISLAND LOTTERY

## Notes to Financial Statements

- 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 1 investments, which are summarized below.

	<u>Fair Value 1998</u>	<u>Fair Value 1997</u>
Zero coupon U.S. Treasury bonds	\$ 5,707,905	\$ 7,601,938
Repurchase agreements	<u>2,000,000</u>	<u>700,000</u>
Total investments	7,707,905	8,301,938
Less amounts classified as cash equivalents	<u>2,000,000</u>	<u>700,000</u>
Total investments for jackpot awards	5,707,905	7,601,938
Less short-term investments for jackpot awards	<u>1,807,000</u>	<u>2,386,000</u>
Long-term investments for jackpot awards	<u>\$ 3,900,905</u>	<u>\$ 5,215,938</u>

### *(c) Cash and Cash Equivalents*

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

	<u>1998</u>	<u>1997</u>
Cash balance per books	\$ 1,477,957	\$ 680,772
Investments reclassified as cash equivalents	<u>2,000,000</u>	<u>700,000</u>
Cash and cash equivalents	<u>\$ 3,477,957</u>	<u>\$ 1,380,772</u>

# RHODE ISLAND LOTTERY

## Notes to Financial Statements

4) Property, Plant and Equipment

A summary of property, plant and equipment follows:

	Estimated Useful Life	<u>1998</u>	<u>1997</u>
Buildings	20	\$ 1,437,912	\$ 1,437,912
Building improvements	10	134,370	117,741
Ticket production and computer equipment	10	17,806	17,372
Office equipment	10	116,757	115,082
Furniture and fixings	10	46,349	46,880
Lottery drawing equipment	3	68,861	59,410
Automobiles	3	136,300	103,069
Computer equipment	3	205,942	219,553
Trucks	3	<u>22,445</u>	<u>22,445</u>
		2,186,742	2,139,464
Less: Accumulated depreciation		<u>1,568,052</u>	<u>1,486,650</u>
<hr/>			
Property, plant and equipment (net)		<u>\$ 618,690</u>	<u>\$ 652,814</u>

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.

(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>1998</u>	<u>1997</u>
Transfer to State's General Fund	\$ 115,071,622	\$ 100,032,238
Cash transferred during fiscal year	(114,444,452)	(99,963,271)
Amount due to State's General Fund, beginning of fiscal year	<u>544,452</u>	<u>475,485</u>
Due to State's General Fund	<u>\$ 1,171,622</u>	<u>\$ 544,452</u>

# RHODE ISLAND LOTTERY

## Notes to Financial Statements

(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:

	1998	1997
Pull-tab ticket sales	\$ 286,767	\$ 249,534
Cost of tickets	(90,487)	(86,467)
Net pull-tab ticket sales	<u>\$ 196,280</u>	<u>\$ 163,067</u>

(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, 1998 and 1997, the estimated liability was \$153,454 and \$75,792, 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.

# RHODE ISLAND LOTTERY

## Notes to Financial Statements

(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 Fiscal Year 1998 rate is 10.83% of annual covered payroll. The Lottery contributed \$198,081, \$164,663 and \$144,012 for the years ended June 30, 1998, 1997 and 1996, respectively, equal to the required contributions for each year.

(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 .66% of covered payroll for the years ended June 30, 1998 and 1997 to fund the cost of these benefits.

(12) Deferred Compensation

# RHODE ISLAND LOTTERY

## Notes to Financial Statements

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 soliciting bids for building renovations. The Lottery has estimated the cost of these renovations at \$220,000, which includes a \$25,000 contingency in the event any unknown problems arise.

(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, 1998, that have initial or remaining lease terms in excess of one year.

<u>Fiscal Year Ending June 30</u>	<u>Lease Payments</u>
1999	\$ 321,662
2000	<u>32,246</u>
Total future minimum lease payments	<u>\$ 353,908</u>

# RHODE ISLAND LOTTERY

## Notes to Financial Statements

(15) Contingencies

Litigation

A suit was filed by a former Lottery employee against the Rhode Island Lottery Commission, 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.

(16) 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 as early as Fiscal Year 1999.

The Lottery has 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 assessed these systems and plans to accomplish remediation by purchasing new, year 2000 compliant versions of the software and personal computers. The Lottery estimates such costs to approximate \$70,000.

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 assessing and planning any 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 presently in the remediation phase.

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

# **RHODE ISLAND LOTTERY**

## **Notes to Financial Statements**

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.

**RHODE ISLAND LOTTERY**  
Sales, Commissions and Prize Awards Expense  
Years Ended June 30, 1998 and 1997

## Year Ended June 30, 1998

	Sales	Commissions	Prize Awards Expense	Unclaimed Prize Recovery	Cost of Tickets	Cost of Sales	Gross Profit
Lottery games:							
On-line games							
Keno	\$ 51,617,137	\$ 6,370,298	\$ 33,846,585	\$ (254,516)	\$ -	\$ 39,962,367	\$ 11,654,770
PowerBall	43,345,345	5,349,439	21,671,239	(737,303)	-	26,283,375	17,061,970
Daily Numbers	29,257,141	3,610,752	14,527,973	(210,094)	-	17,928,631	11,328,510
Daily Millions	2,162,126	266,837	750,666	(191,390)	-	826,113	1,336,013
Roll Down	3,300,928	407,382	1,654,017	-	-	2,061,399	1,239,529
	129,682,677	16,004,708	72,450,480	(1,393,303)	-	87,061,885	42,620,792
Instant Tickets	40,323,292	2,438,008	24,923,500	(429,199)	1,102,638	28,034,947	12,288,345
Video Lottery	464,068,675	67,859,963	331,903,977	(27,476)	-	399,736,464	64,332,211
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>\$ 514,833,296</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	1,321,646
Total	<u>\$ 67,859,963</u>

**Year Ended June 30, 1997**

	<u>Sales</u>	<u>Commissions</u>	<u>Prize Awards Expense</u>	<u>Unclaimed Prize Recovery</u>	<u>Cost of Tickets</u>	<u>Cost of Sales</u>	<u>Gross Profit</u>
Lottery games:							
On-line games							
Keno	\$ 41,801,453	\$ 5,204,049	\$ 27,264,335	\$ (200,818)	\$ -	\$ 32,267,566	\$ 9,533,887
PowerBall	37,881,052	4,715,980	18,940,526	(979,707)	-	22,676,799	15,204,253
Daily Numbers	29,405,124	3,660,775	14,542,857	(219,093)	-	17,984,539	11,420,585
Daily Millions	5,051,443	628,877	2,525,722	-	-	3,154,599	1,896,844
Rhody Cash	<u>1,112,026</u>	<u>141,363</u>	<u>567,407</u>	<u>(91,785)</u>	<u>-</u>	<u>616,985</u>	<u>495,041</u>
	115,251,098	14,351,044	63,840,847	(1,491,403)	-	76,700,488	38,550,610
Instant Tickets	27,356,236	1,364,353	15,454,746	(540,797)	843,610	17,121,912	10,234,324
Video Lottery	<u>406,108,530</u>	<u>57,444,162</u>	<u>293,760,557</u>	<u>(48,335)</u>	<u>-</u>	<u>351,156,384</u>	<u>54,952,146</u>
Totals	<u>\$ 548,715,864</u>	<u>\$ 73,159,559</u>	<u>\$ 373,056,150</u>	<u>\$ (2,080,535)</u>	<u>\$ 843,610</u>	<u>\$ 444,978,784</u>	<u>\$ 103,737,080</u>

Video Commissions – Detail

Facilities	\$ 33,677,876
Technology Providers	13,978,377
Central Communications Provider	3,370,758
Dog Kennel Owners	5,293,565
City/Town	<u>1,123,586</u>
Total	<u>\$ 57,444,162</u>

See independent auditor's report.



ERNEST A. ALMONTE, CPA, CFE  
Auditor General

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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, 1998 and have issued our report thereon dated December 11, 1998, which was qualified because insufficient audit evidence exists to support the Lottery's disclosures with respect to the year 2000 issue. Except as discussed in the preceding sentence, 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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. 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. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we 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 for the information of the Joint Committee on Legislative Services, the Rhode Island Lottery Commission and Lottery management. However, this report is a matter of public record and its distribution is not limited.



Ernest A. Almonte, CPA, CFE  
Auditor General

December 11, 1998