

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, 2004

Prepared by the Finance Department





Rhode Island Lottery

Comprehensive Annual Financial Report
For the Fiscal Year Ended June 30, 2004

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Introductory Section



THE RHODE ISLAND LOTTERY

Gerald S. Aubin
Executive Director

Commission Members

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

October 28, 2004

The Honorable Donald L. Carcieri, Governor
Representative Robert E. Flaherty, Chairman

We are pleased to present to you the **COMPREHENSIVE ANNUAL FINANCIAL REPORT** of the Rhode Island Lottery (the Lottery) for the fiscal year ended June 30, 2004. 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, the Lottery's organizational chart and list of principal officials. The Financial Section contains the Independent Auditor's Report, management's discussion and analysis, basic 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 Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*.

Generally Accepted Accounting Principals (GAAP) require that management provide a narrative introduction, overview, and analysis to accompany the basic financial statements in the form of Management's Discussion and Analysis (MD&A). This letter of transmittal is designed to complement MD&A and should be read in conjunction with it. The Rhode Island Lottery's MD&A can be found immediately following the report of the independent auditors.

THE LOT

1425 Pontiac Avenue Cranston, Rhode Island 02920 401-463-6500 www.rilot.com

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.

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, the model of development that stressed private rather than public investment motivated them. 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. A notable outcome for the first drawing of this lottery was that Anglican churches held two of the three winning tickets.

Perhaps one of the most poignant lottery stories is that of the abortive attempts to bail Thomas Jefferson out of an \$80,000 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.

In the 1700s, many other founding fathers also supported American lotteries and used them for projects such as the financing of cannons for the Revolutionary War (Benjamin Franklin), the rebuilding of historic Faneuil Hall in Boston (John Hancock) and the financing of construction on the Mountain Road, which opened westward expansion from Virginia (George Washington).

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 the 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 virtuous 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 were 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 increasingly 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 that 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, which had been the State to pass the first constitutional prohibition of lotteries in the United States in the 1820s, followed New Hampshire's return 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, more than a three to one margin passed a Constitutional Amendment to create a lottery in Rhode Island. 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 two months later in May. 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. 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 Numbers Game began on February 13, 1976 and continues today.

The first instant ticket game, Play Ball, was introduced on May 11, 1976. Since that time an additional 385 instant ticket games have been introduced.

On-line games started in February of 1978, and Lottery sales doubled with this new addition. The 4/40 Game began in the spring of 1981, with variations to that game being made throughout the years.

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. Along with Rhode Island, the initial members were the District of Columbia, Iowa, Oregon, Kansas and West Virginia. The first such game was called Lotto-America, which was replaced with PowerBall on April 22, 1992. In February of 1998, Rhode Island replaced the Multi-State Daily Millions Game with the introduction of its own lotto game called Roll Down. This lotto game was succeeded by Easy Win in March 2000, Money Roll in November 2000 and the current game of Wild Money in January 2002.

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 matrix is the most widespread, followed by the 6/42, 5/35 and 5/39.

Seventy percent of the lotteries offering lotto games have drawings twice a week. Approximately 7% have one weekly drawing and 11% have daily drawings.

With the "quick pick" feature, players can have the computer generate their numbers at random. Most lotteries offer this option, and it represents approximately 70% of the world's on-line lotto purchases.

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.

In 1985, the launch of Tri-State Lotto, the first multi-state lottery, linked Maine, New Hampshire and Vermont state lotteries.

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 linked 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 2,000 years ago. Legend has it that this game financed the Great Wall of China. The original Chinese game was played with characters from the “Thousand Character Classic”, an ancient poem of luck by Confucius. 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 4 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, whimsical, sports, money, and holiday themes.

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 Lottery added an Instant Match feature to the Daily Numbers game in September 2002. Instant Match offers the player the chance to win up to \$500 instantly on a Daily Numbers ticket, for an additional \$1 per wager. The Daily Numbers drawing is televised live Monday through Saturday at 7:00 p.m. and at 6:30 p.m. on Sunday.

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.” In January of 2000, Keno drawings increased from every 5 minutes to every 4 minutes. These Keno drawings occur from 5:00 a.m. to 12:45 a.m., Monday through Saturday and 7:00 a.m. to 12:45 a.m. on Sunday. In April of 2001, Keno Plus was introduced. Players have the option to purchase this feature that could increase their winnings by ten times, thus giving Keno players the potential to win up to \$1,000,000.

PowerBall®

PowerBall is a Multi-State Lottery game offered in 27 states (including Rhode Island), plus the District of Columbia and U.S. Virgin Islands. Players select “5 out of 53” 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. PowerPlay, which is a multiplier for PowerBall winnings, was introduced in March of 2001. Players who choose the PowerPlay option on their PowerBall ticket have the chance to increase their winnings by up to 5 times; however, the multiplier does not apply to a jackpot win.

Wild Money

Wild Money, which replaced Money Roll in January 2002, is an on-line game with a starting jackpot of \$20,000 that continues to grow until a player matches 5 numbers selected out of a field of 35. Its first jackpot of \$315,869 was won on April 13, 2002.

HotTrax®

HotTrax is a monitor game, similar to Keno, in which players wager on an animated auto race to select winning numbers. The race consists of ten cars which travel three laps around the racetrack with races lasting approximately one minute. Players bet on the order in which the cars finish the race and can wager \$1, \$2, \$5 and \$10. Multiple race wagers are allowed on 1, 2, 5, 10, or 15 consecutive races with a maximum wager of \$150 per race. Prizes range from \$2 to \$500 based on a \$1 wager and a Super Progressive Jackpot is awarded if a player’s ten car selection *exactly* matches the order in which they finish. The Super Progressive Jackpot starts at \$5,000 and increases for each race until there is a winner. A new race is run approximately every four minutes. The first HotTrax race was held in May, 2004.

Video Lottery

Video Lottery debuted in Rhode Island in September of 1992. In January 2003, the Lottery Commission approved the request to increase the video lottery terminals (VLTs) from 2,478 to 4,303. A portion of these additional terminals, which operate in the State's two pari-mutuel facilities, Lincoln Greyhound Park and Newport Grand, have been installed; and the remainder will be fully installed when the facilities have made renovations. Various card and reel games are offered on the VLTs. In addition, at the two facilities there are 72 terminals dedicated to a statewide progressive game with jackpots starting at \$30,000. The VLTs afford Rhode Island a chance to compete with Native American casinos in a neighboring state.

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.

Rhode Island Economic Outlook

The Rhode Island economy, which boasts a population of approximately 1,076,164, continued to decline in calendar year 2003. Although the civilian labor force increased by 3.57% and total employment increased 3.36%, total unemployment increased at a higher rate of 7.51% which is .7% below the national average.

The total number of new construction housing permits in 2003 decreased by 11.94% compared to 2002. Total construction cost also decreased by 1.67%, the number of permits issued along with the construction cost is on the decline

Lottery Industry Economic Outlook

The United States Lottery Industry experienced yet another upswing during fiscal year 2004. Based on unaudited figures from the North American Association of State & Provincial Lotteries (NASPL), sales increased from \$42.42 billion in fiscal year 2003 to \$45.29 billion in fiscal year 2004, up 6.7%.

Highlights of Fiscal Year 2004

- In celebration of the Rhode Island Lottery's 30th Anniversary a new \$5 instant ticket "30th Anniversary" was developed. The ticket, which displayed the Lottery's new 30th Anniversary logo, was launched in June and generated approximately \$441,000 in sales in its first four weeks.
- In May 2004 the Lottery launched its newest monitor game called Hot Trax. With Hot Trax, players wager on an animated auto race to select winning numbers. The race consists of ten cars which travel three laps around the racetrack with races lasting approximately one minute. A Super Progressive Jackpot is awarded if a player's ten car selection *exactly* matches the order in which they finish. The Super Progressive Jackpot starts at \$5,000 and increases for each race until there is a winner. Hot Trax was officially launched at a local restaurant on May 28th and through June 2004 has generated approximately \$235,000 in sales.

- The Rhode Island Lottery sponsored its 11th Annual Hat Night at McCoy Stadium, home of the Pawtucket Red Sox. Invited guests included children with special needs, underprivileged children and area little leaguers.
- Sponsorship of Minor League All-Star Game events at McCoy Stadium.
- Funds were raised for various local charitable organizations by donating tickets for sports events, etc to local media outlets to auction-off to raise money. The tickets are received by The Lottery as part of their advertising contracts.

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 seven consecutive fiscal years (1997, 1998, 1999, 2000, 2001, 2002, and 2003). 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, and on each subsequent attempt. We believe our current report will conform to the Certificate of Achievement program requirements, and we are submitting it to the GFOA.

Accounting Systems and Procedures

The Rhode Island Lottery operates the Lottery fund, an enterprise fund that, like a private business, utilizes the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. 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. This is a management tool, and is not a legally adopted budget. 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:

- Addition of an Internal Auditor to staff.
- Employing 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 security features.
- 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 facility 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.
- Development of a comprehensive information security plan for the Lottery's on-line and video lottery systems.

The Lottery currently has 55 employees, all of whom are located at the headquarters in Cranston, Rhode Island. Separated from the headquarters, the drawing studio is located at the broadcast facilities of the television station that produces the nightly drawing.

Cash Management

The Lottery collects cash due for instant and on-line sales from its 1,200 retailers, through electronic transfer, on a bi-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 short-term financial instruments such as 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

A new \$7 instant ticket will be launched in the spring.

A Red Ball Promotion with The Daily Numbers is planned for the spring. If the Red Ball is drawn, the prize payout will increase by approximately 20%.

A new website for The Lottery will be launched in December 2004. The new site will provide users with up to date information about The Lottery, new products that are being released and opportunities available to patrons.

In accordance with the master contract entered into with the gaming systems provider in May 2003, the following projects are anticipated:

- A new state-of-the-art on-line lottery gaming system will replace the current on-line system by January 1, 2007.
- Also to be replaced is the existing video lottery central communications system by January 1, 2010 and the on-line central system hardware by January 1, 2015.

Independent Audit

The Rhode Island General Laws require semi-annual audits to be performed by the State Auditor General. The fiscal year 2004 audit of the financial statements has been completed in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*. The Independent Auditor's Report 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 Gina Grant, Sandra Lee, Josh Almeida 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 Chairman Representative Robert E. Flaherty 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



Michael A. McNamara
Finance Administrator

Certificate of Achievement for Excellence in Financial Reporting

Presented to

Rhode Island Lottery

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2003

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.



A handwritten signature in black ink, appearing to read "Edward Haney".

President

A handwritten signature in black ink, appearing to read "Jeffrey R. Emer".

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. The Senate Majority Leader appoints three Members from the State Senate, and the Speaker of the House appoints three Members from the House of Representatives. 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.

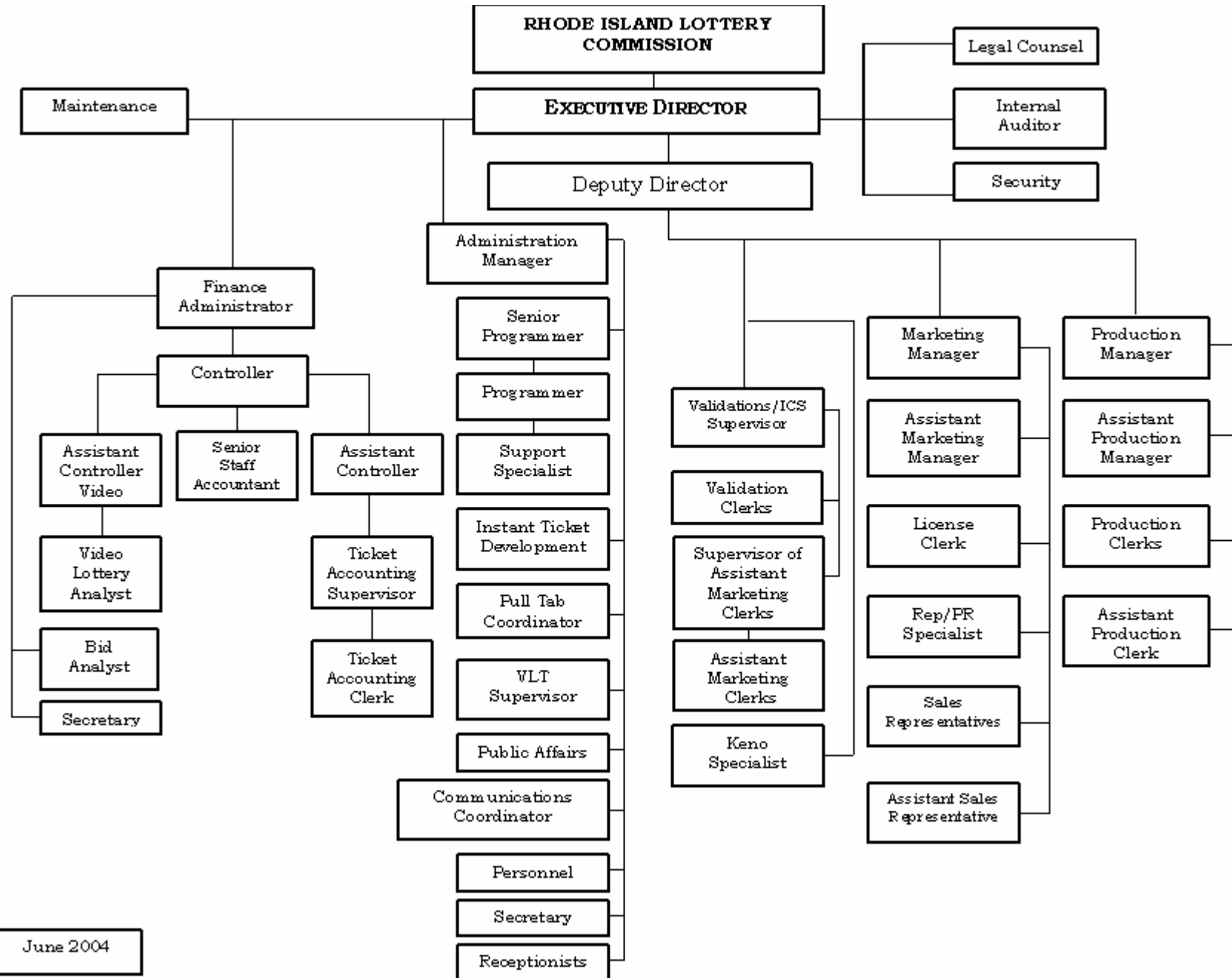
The duties of the Commission include meeting no less than nine times per year for the purpose of promulgating and reviewing rules and regulations relating to the Lottery, recommending and setting policy for the Lottery, approving or rejecting actions of the Executive Director, and transacting any other 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 Commission sets the Executive Director's salary.

COMMISSION MEMBERS SERVING DURING FISCAL YEAR 2004

REPRESENTATIVE ROBERT E. FLAHERTY
SENATOR MARYELLEN GOODWIN
REPRESENTATIVE WILLIAM SAN BENTO, JR.
REPRESENTATIVE JOSEPH SCOTT
SENATOR DAVID BATES
SENATOR MICHAEL DAMIANI
MR. ROBERT MANCINI
MS. LYNNE URBANI
MR. MARK HARRIMAN

Rhode Island Lottery Organizational Chart



PRINCIPAL OFFICIALS

GERALD S. AUBIN
EXECUTIVE DIRECTOR

RAYMOND E. GRIMES
DEPUTY DIRECTOR

MICHAEL A. McNAMARA
FINANCE ADMINISTRATOR

SANDRA LEE
CONTROLLER

MARGARET D. ROSE
ADMINISTRATION MANAGER

ROBERT E. MATTESON
MARKETING MANAGER

Financial Section



ERNEST A. ALMONTE, CPA, CFE
AUDITOR GENERAL
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STATE OF RHODE ISLAND and PROVIDENCE PLANTATIONS

GENERAL ASSEMBLY

OFFICE of the AUDITOR GENERAL

- ♦ INTEGRITY
- ♦ RELIABILITY
- ♦ INDEPENDENCE
- ♦ ACCOUNTABILITY

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 statement of net assets of the Rhode Island Lottery (Lottery), a component unit of the State of Rhode Island and Providence Plantations, as of June 30, 2004, and the related statements of revenues, expenses, and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America 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 audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets of the Lottery as of June 30, 2004, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 26, 2004 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, contracts, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 19 through 25 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 required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Lottery's basic financial statements. 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. Schedule 1 has been subjected to the auditing procedures applied in the audit 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 introductory and statistical sections have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.



Ernest A. Almonte, CPA, CFE
Auditor General

October 26, 2004

RHODE ISLAND LOTTERY

Management's Discussion and Analysis

Management of the Lottery provides this *Management's Discussion and Analysis* of their financial performance for the readers of the Lottery's financial statements. This narrative provides an overview of the Lottery's financial activity for the fiscal year ended June 30, 2004. This analysis is to be considered in conjunction with the financial statements to provide an objective analysis of the Lottery's financial activities based on facts, decisions, and conditions currently facing management.

Understanding the Lottery's Financial Statements

The Lottery, a component unit of the State of Rhode Island and Providence Plantations (State), is accounted for as an enterprise fund that reports all assets and liabilities using the accrual basis of accounting, much like a private business entity. In accordance with accounting principles generally accepted in the United States of America, this report consists of a series of financial statements, along with notes to the financial statements and a supplementary schedule detailing sales, commissions and prize award expense for each lottery game. The financial statements immediately follow this *Management's Discussion and Analysis* and are designed to highlight the Lottery's net assets and changes to those assets resulting from Lottery operations.

The most important relationship demonstrated within the Lottery's financial statements is the requirement that the Lottery transfer all net income to the State's General Fund. Accordingly, the primary focus of these financial statements is determining net income available for payment to the State's General Fund rather than the change in net assets of the Lottery. It is also important to note that most financial statement balances have a direct or indirect relationship to revenue. As lottery sales increase, the amount paid to the State's General Fund also increases. Similarly, increases in revenue for a particular lottery game result in direct increases to the related prize awards and commissions expense.

Most assets included on the Statement of Net Assets represent current amounts such as cash and accounts receivable from lottery retailers. Most liabilities represent current prize awards payable and amounts due to the State's General Fund. Current assets approximate the amounts required to satisfy current liabilities at June 30. Few capital assets are required for Lottery operations.

The deficiency in net assets of \$11.875 million reported at June 30, 2004 relates entirely to the Lottery's sale of its exclusive rights to operate its gaming systems. The Lottery sold this exclusive right to its current gaming systems provider for a 20-year period at a cost of \$12.5 million and immediately paid the proceeds to the State's General Fund. According to the terms of the agreement, if for any reason, this contract is voided prior to its completed term; the Lottery will be required to refund a pro-rata share of the sales price to the gaming system provider. In accordance with generally accepted accounting principles, the Lottery will recognize the revenue related to this transaction over the 20-year life of the contract resulting in the net asset deficiency at June 30, 2004.

Financial Highlights

The Rhode Island Lottery's sales for fiscal year 2004 totaled \$1,480,625,112; a 14.74% increase compared to fiscal year 2003 sales of \$1,290,405,970. A record amount of \$280,940,052 was paid to the State's General Fund in fiscal year 2004.

RHODE ISLAND LOTTERY

Management's Discussion and Analysis

On-Line sales for the fiscal year ended June 30, 2004 increased \$9.7 million or 6% over fiscal year ended June 30, 2003.

Instant sales for the fiscal year ended June 30, 2004 increased \$732,507 over fiscal year ended June 30, 2003.

Gross video lottery sales increased \$180 million with a resulting increase in net terminal income (sales less prize awards) of \$44 million for the fiscal year ended June 30, 2004 as compared with the previous fiscal year.

Due to the increased sales highlighted above, the Lottery increased its payment to the State's General Fund by \$32 million to \$281 million for the fiscal year ended June 30, 2004 as compared to \$249 million for the fiscal year ended June 30, 2003.

Assets and Liabilities

	June 30, 2004	June 30, 2003
Assets:		
Current assets		
Cash and cash equivalents	\$ 7,956,679	\$ 10,416,724
Accounts receivable, net	6,197,195	6,267,885
Other	1,318,891	1,775,662
Total current assets	\$ 15,472,765	\$ 18,460,271
Long-term assets		
Investments for jackpot awards	\$ -	\$ 45,342
Property, plant, and equipment, net	1,707,113	1,838,506
Total assets	\$ 17,179,878	\$ 20,344,119
Liabilities:		
Current liabilities		
Due to State's General Fund	\$ 1,141,647	\$ 940,055
Accounts payable	9,256,883	12,642,986
Prize obligations	6,235,348	6,005,688
Other liabilities	1,171,000	1,335,048
Total current liabilities	\$ 17,804,878	\$ 20,923,777
Long term liabilities		
Obligation for unpaid prize awards	-	45,342
Deferred contract revenue	11,250,000	11,875,000
Total liabilities	\$ 29,054,878	\$ 32,844,119
Net Assets:		
Invested in capital assets	1,707,113	1,838,506
Unrestricted	(13,582,113)	(14,338,506)
Total net assets (deficiency)	\$ (11,875,000)	\$ (12,500,000)

RHODE ISLAND LOTTERY

Management's Discussion and Analysis

The majority of the Lottery's assets consist of cash (including amounts invested in cash equivalent type instruments) and accounts receivable derived from sales of the Lottery's games. At June 30, 2004, the Lottery's assets included \$8.0 million in cash and cash equivalents as compared with \$10.4 million at June 30, 2003. The Lottery's accounts receivable approximated \$6.2 and \$6.3 million, respectively, at June 30, 2004 and 2003.

The Lottery's liabilities included at the balance sheet date are amounts owed for vendor payables, prize obligations, and a residual amount owed to the State's General Fund for June's net operations. The amount owed to the General Fund approximated \$1.1 million at June 30, 2004 as compared with \$940,055 due at June 30, 2003. Vendor payables, made up largely of commissions due to video lottery participants, and prize obligations, attributable mostly to instant ticket games and PowerBall, were \$9.3 million and \$6.2 million, respectively. In comparison, vendor payables and prize obligations at June 30, 2003 were \$12.6 and \$6.0 million, respectively.

The majority of the Lottery's assets represent current resources necessary to pay the current liabilities owed to vendors, prize winners, video lottery participants, and ultimately the State's General Fund.

Investments for jackpot awards relating to the former Lot-O-Bucks game are sufficient to satisfy the outstanding prize liabilities (annual payments) owed to jackpot winners.

The deficiency in net assets reported at June 30, 2004, as previously explained, relates to the Lottery's immediate transfer to the State's General Fund of all proceeds received from the sale of its exclusive rights over the operation of its gaming systems.

Lottery Operations

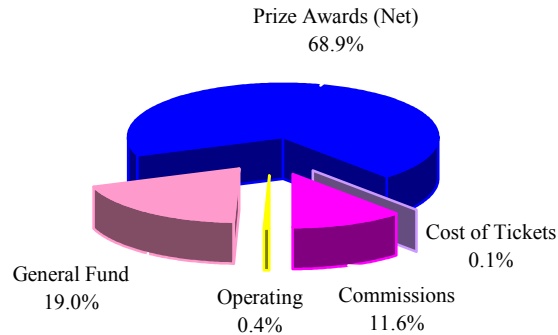
	Year Ended <u>June 30, 2004</u>	Year Ended <u>June 30, 2003</u>
Sales:		
On-line games	\$ 172,877,095	\$ 163,205,060
Instant games	76,521,924	75,789,417
Video lottery	<u>1,231,226,093</u>	<u>1,051,411,493</u>
Total sales	<u>\$ 1,480,625,112</u>	<u>\$ 1,290,405,970</u>
Cost of Sales	(1,193,609,839)	(1,048,569,587)
Operating Expenses	<u>(6,562,950)</u>	<u>(6,278,375)</u>
Total expenses	<u>\$ (1,200,172,789)</u>	<u>\$ (1,054,847,962)</u>
Operating income	<u>\$ 280,452,323</u>	<u>\$ 235,558,008</u>
Non-operating income (expenses):		
Other income	1,314,321	946,994
Payment's to State's General Fund	<u>(281,141,644)</u>	<u>(249,040,055)</u>
Change in net assets	<u>\$ 625,000</u>	<u>\$ (12,535,053)</u>
Total net assets (deficiency), beginning of year	(12,500,000)	35,053
Total net assets (deficiency), end of year	<u><u>\$ (11,875,000)</u></u>	<u><u>\$ (12,500,000)</u></u>

RHODE ISLAND LOTTERY

Management's Discussion and Analysis

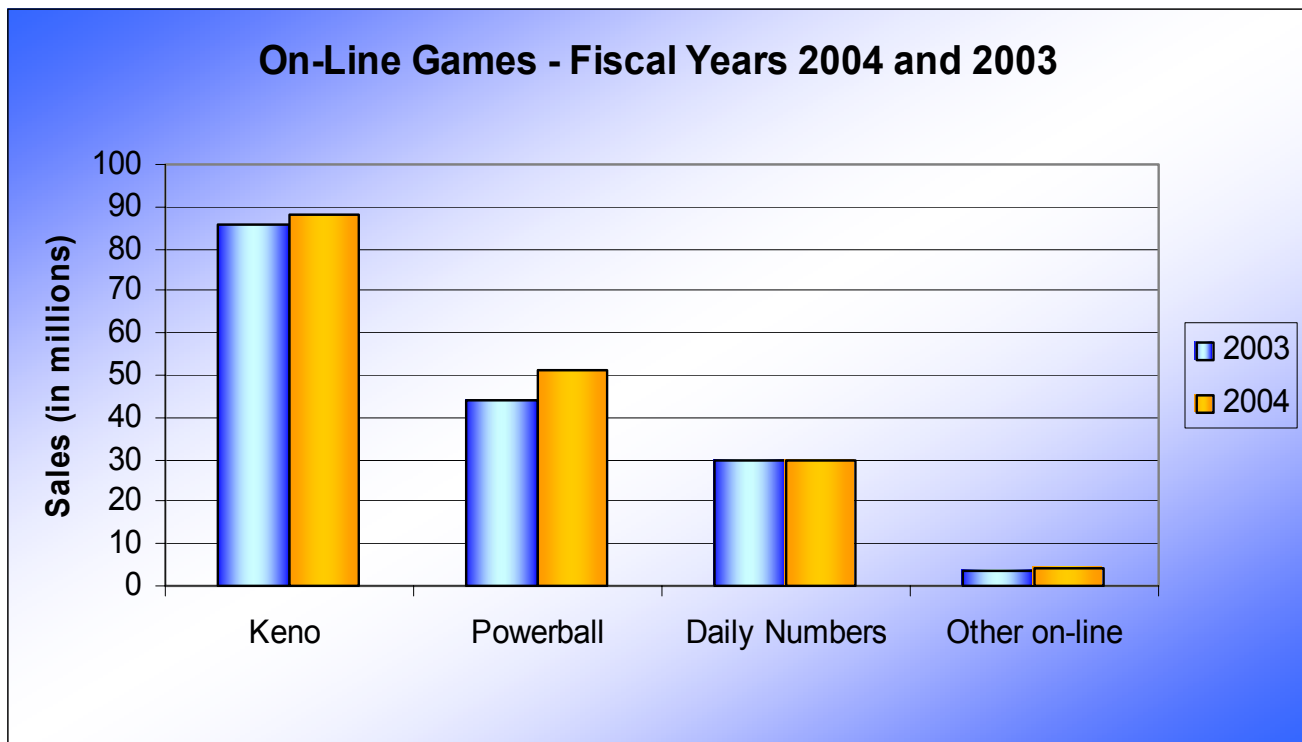
Sales

Distribution of the year's revenue was as follows:



Lottery sales are categorized as on-line, instant and video lottery games. The first category is on-line games, which consisted of PowerBall, Keno, Daily Numbers, Hot Trax and Wild Money at June 30, 2004. In total, on-line sales increased by \$9.7 million, which is mostly attributable to the growth of Powerball sales. Powerball sales for the fiscal year ended June 30, 2004 increased \$6.6 million or 14.9% over the prior fiscal year.

The following graph depicts the Lottery's on-line sales for the fiscal year ended June 30, 2004 and 2003.



Instant tickets or "scratch" tickets are the second type of Lottery game offered to the public. Instant ticket sales for the fiscal year ended June 30, 2004 increased \$732,507 or 1% over the preceding fiscal year.

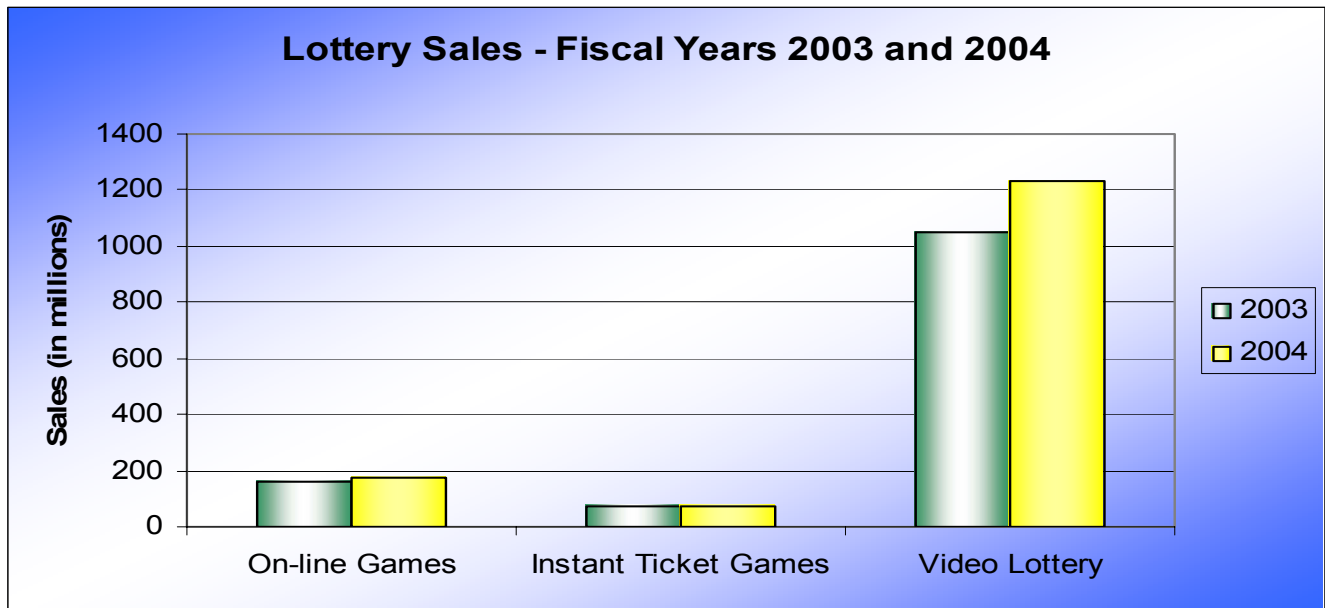
RHODE ISLAND LOTTERY

Management's Discussion and Analysis

The third type of game offered is video lottery. Gross video lottery sales increased \$180 million with a resulting increase in net terminal income (sales minus prize awards) of approximately \$44 million for the fiscal year ended June 30, 2004 as compared with the previous year. Beyond the increasing popularity of video lottery within the State, the Lottery attributes increased sales to the following reasons:

- The installation of an additional 292 video terminals during the year,
- The continued policy of allocating terminals amongst technology providers based on terminal play, and
- The continual renovations being made by the video facilities which provide patrons with a more appealing and comfortable setting in which to enjoy the games.

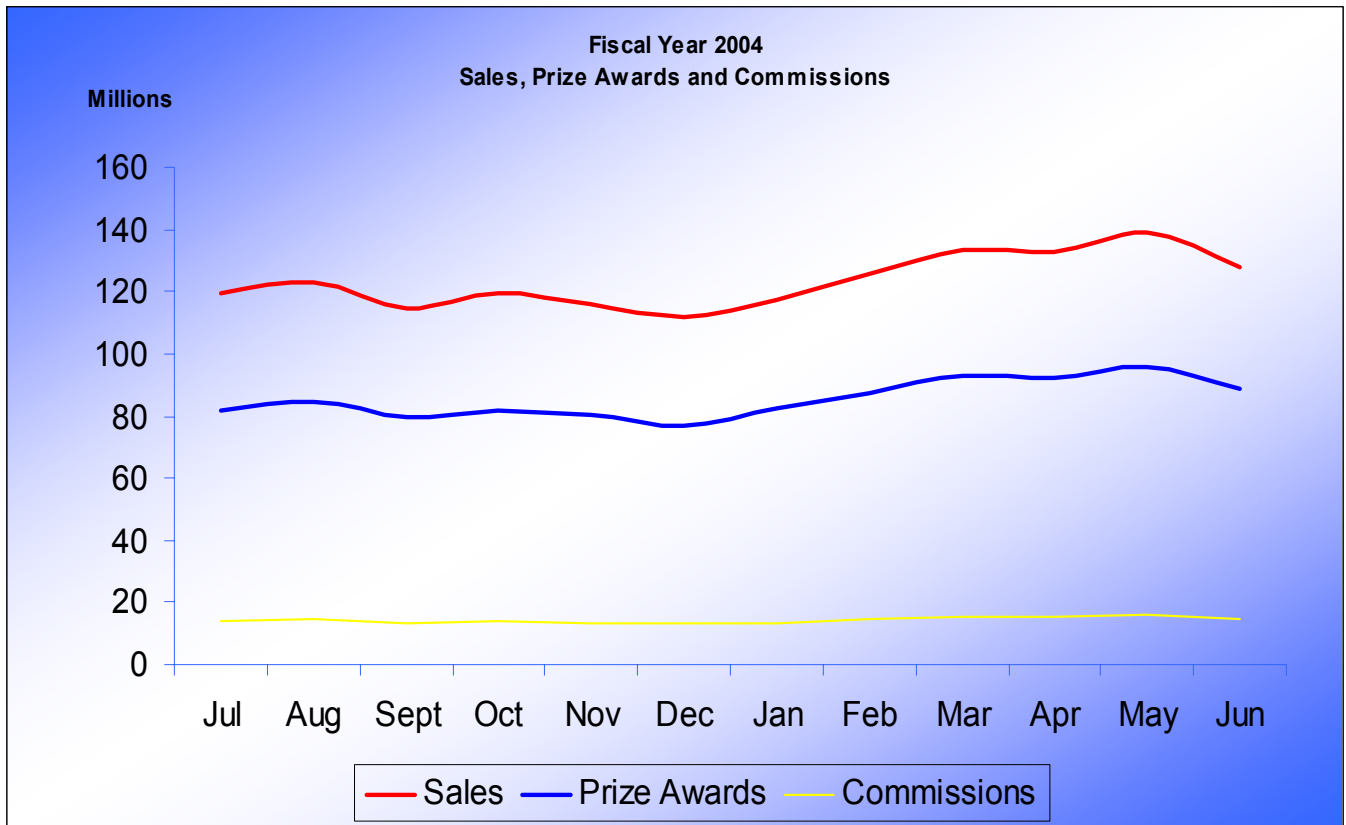
The following graph depicts the Lottery's on-line, instant, and video lottery sales for the fiscal year ended June 30, 2004 in comparison to fiscal year ended June 30, 2003.



As the graph on the following page designates, the Lottery's most significant expenses (commissions and prize awards) are predictable because they have a direct correlation to sales. As lottery sales increase, so do the related prizes and commissions paid by the Lottery. While each Lottery game has a designed prize pay-out structure the overall amount paid as prize award expense is consistent.

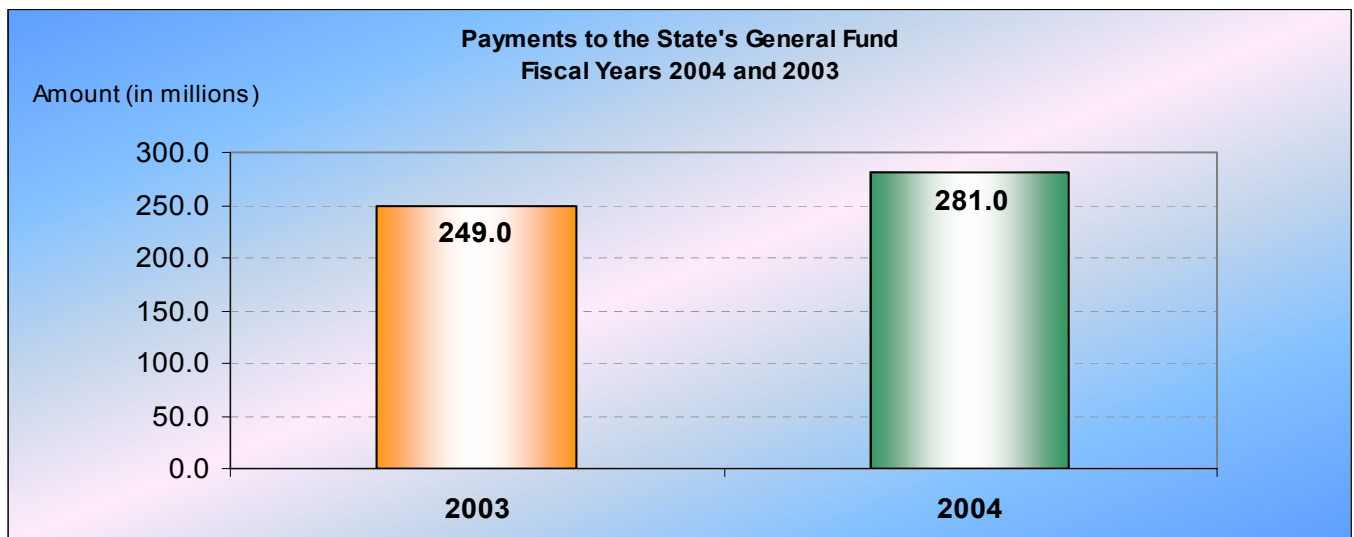
RHODE ISLAND LOTTERY

Management's Discussion and Analysis



Payments to the State's General Fund

The Lottery has continued its overall sales growth during the fiscal year ended June 30, 2004 allowing its payments to the General Fund to increase by \$32 million to a record \$281 million for the period as compared to \$249 million for the fiscal year ended June 30, 2003. Payments to the State's General Fund are estimated to reach \$299 million for the fiscal year ended June 30, 2005.



RHODE ISLAND LOTTERY

Management's Discussion and Analysis

Debt Administration

As of June 30, 2004 the Lottery had one long-term prize obligation owed to a lotto jackpot winner. The payment due the winner is fully funded by investments in United States Treasury zero coupon bonds. Jackpot prizes awarded under PowerBall are satisfied through investments purchased by MUSL. 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.

Potential Factors Impacting Future Operations

The Lottery's mission is to maximize revenues for the purpose of maximizing payments to the State's General Fund. A continuous assessment of the State's financial environment and the Lottery's own product lines and operations are essential to accomplish this mission. The following considerations have been presented to inform those interested in the Lottery's operations about potential factors that could affect future operations:

- ❑ The State of Rhode Island is currently projecting budgetary shortfalls for fiscal year 2005. This caused the State to reevaluate the current commission percentages paid to video lottery participants with the intent of enhancing the Lottery's net income and payments to the State's General Fund. Beginning in fiscal year 2005, commissions to video lottery participants will be changed by the following percentages:
 - Facilities – Lincoln , 1.85% increase
 - Dog Kennel Owners, eliminated
 - Town of Lincoln, .25% increase, effective 1/1/05
- ❑ The Lottery's video lottery operations currently compete with Indian gaming casinos in nearby Connecticut. Proposals are continually made in Rhode Island, as well as neighboring Massachusetts, to seek approval from the voters to allow Indian Gaming Casinos in Rhode Island and Massachusetts. The Lottery's operations may be impacted by competition from other gaming interests that may be developed within Rhode Island or neighboring states.
- ❑ The Lottery Commission has authorized 4,303 terminals at the video lottery facilities. Approximately 82% of these terminals are in operation. Both facilities are currently considering renovations so that 100% of authorized terminals are in operation.

Contacting the Lottery's Financial Management

This financial report is designed to provide a general overview of the Lottery's financial activity for all those interested in the Lottery's operations. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Office of the Finance Administrator, Rhode Island Lottery, 1425 Pontiac Avenue, Cranston, Rhode Island, 02920.

RHODE ISLAND LOTTERY

Statement of Net Assets

June 30, 2004

Assets

Current assets:

Cash and cash equivalents (note 3)	\$ 7,956,679
Investments for jackpot awards (note 3)	46,962
Accounts receivable-less allowance for doubtful accounts of \$355,936	6,197,195
Deposits with Multi-State Lottery Association (MUSL) (note 1)	222,036
Ticket inventory	1,049,391
Deferred charges	502

Total current assets	\$ 15,472,765
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Property, plant and equipment, net (note 4)	1,707,113
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Total assets	\$ 17,179,878
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Liabilities

Current liabilities:

Due to State's General Fund (note 5)	\$ 1,141,647
Current obligation for unpaid prize awards	6,235,348
Accounts payable	9,256,883
Accrued expenses	380,527
Deferred revenue	790,473

Total current liabilities	\$ 17,804,878
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Long-term portion of deferred contract revenue (note 8)	11,250,000
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Total liabilities	\$ 29,054,878
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Net Assets

Invested in capital assets (note 8)	1,707,113
Unrestricted (note 8)	(13,582,113)
Total net assets (deficiency)	\$ (11,875,000)

See accompanying notes to financial statements.

RHODE ISLAND LOTTERY

Statement of Revenue, Expenses and Changes in Net Assets

Year Ended June 30, 2004

Sales (schedule 1):	
On-line games	\$ 172,877,095
Instant games	76,521,924
Video lottery	<u>1,231,226,093</u>
Total sales	<u>\$ 1,480,625,112</u>
Cost of sales:	
Commissions (note 6)	\$ 171,929,740
Prize awards	1,023,688,902
Unclaimed prize recovery	(3,006,492)
Cost of tickets	<u>997,689</u>
Total cost of sales	<u>1,193,609,839</u>
Gross profit	<u>\$ 287,015,273</u>
Operating expenses:	
Personal services	\$ 3,740,101
Advertising	1,606,350
Contract services	86,182
Equipment leasing	51,295
Depreciation	330,088
Other	<u>748,934</u>
Total operating expenses	<u>6,562,950</u>
Operating income	\$ 280,452,323
Non-operating income:	
Other income	1,314,321
Payments to State's General Fund	<u>(281,141,644)</u>
Change in net assets	\$ 625,000
Total net assets (deficiency), beginning of year	<u>(12,500,000)</u>
Total net assets (deficiency), end of year (note 8)	<u><u>\$ (11,875,000)</u></u>

See accompanying notes to financial statements.

RHODE ISLAND LOTTERY

Statement of Cash Flows

Year Ended June 30, 2004

Cash flows from operating activities:	
Cash received from lottery sales	\$ 1,480,468,819
Cash received from MUSL for grand prize winners	6,272,538
Cash received from sale of other tickets	323,595
Cash received from rental income and other receipts	228,469
Cash paid for prizes other than MUSL grand prize winners	(1,020,498,593)
Cash paid to MUSL grand prize winners	(6,272,538)
Cash paid for commissions - retailers	(18,124,635)
Cash paid for commissions - video lottery	(143,889,867)
Cash paid for commissions - on-line games contractor	(12,858,316)
Cash paid to suppliers for goods and services	(3,949,786)
Cash paid to employees for services	(3,582,394)
Net cash provided by operating activities	<u>278,117,292</u>
Cash flows from noncapital financing activities:	
Payments to State's General Fund	<u>(280,940,052)</u>
Net cash used for noncapital financing activities	<u>(280,940,052)</u>
Cash flows from capital and related financing activities:	
Purchase of fixed assets	<u>(183,260)</u>
Net cash used for capital and related financing activities	<u>(183,260)</u>
Cash flows from investing activities:	
Proceeds from maturity of investments for jackpot awards	294,800
Interest income	251,175
Net cash provided by investing activities	<u>545,975</u>
Net decrease in cash and cash equivalents	(2,460,045)
Cash and cash equivalents at July 1, 2003	<u>10,416,724</u>
Cash and cash equivalents at June 30, 2004	<u><u>\$ 7,956,679</u></u>

See accompanying notes to financial statements.

Continued.

RHODE ISLAND LOTTERY

Statement of Cash Flows (continued)

Year Ended June 30, 2004

Reconciliation of operating income to net cash provided by operating activities:	
Operating income	\$ 280,452,323
Adjustments to reconcile operating income to net cash provided by (used for) operating activities:	
Depreciation	330,088
Installment payments for jackpot awards	(294,800)
Miscellaneous receipts classified as operating activities	231,880
Rental income and other receipts	190,830
Provision for doubtful accounts	27,920
(Increase) decrease in assets:	
Accounts receivable	42,771
Inventory	158,955
Deposits with MUSL	37,639
Deferred charges	13,140
Increase (decrease) in liabilities:	
Obligation for unpaid prize awards	476,697
Accounts payable	(3,386,103)
Accrued expenses	46,717
Deferred revenue	(210,765)
Total adjustments	<u>(2,335,031)</u>
Net cash provided by operating activities	<u><u>\$ 278,117,292</u></u>

See accompanying notes to financial statements.

RHODE ISLAND LOTTERY

Notes to Financial Statements

(1) Organization

The Lottery was created in 1974 under the General Laws of the State of Rhode Island (General Laws) 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:

On-Line Games that include: Daily Numbers Game, Keno, Hot Trax, Wild Money and PowerBall, which is operated by the Multi-State Lottery Association (MUSL).

Instant Lottery Tickets, some of which involve top prize drawings, are sold through licensed lottery retailers.

Video Lottery Games which are located at two licensed facilities.

Prize payout percentages and amounts required to be paid to the State's General Fund as stipulated in the 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 HotTrax Instant Ticket Games MUSL – PowerBall Wild Money	Not less than 45% or more than 65% of sales	Not less than 25% of ticket sales
Keno	Not less than 45% or more than 72% of sales	Not less than 15% of ticket sales
Video Lottery	Prize payout not established by law	59% of net terminal income (video lottery credits purchased less credits redeemed or redeemable) less pro rata share of Lottery's operating expenses

Chapter 42-61.2 of the 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 59% of net terminal income. The remaining

RHODE ISLAND LOTTERY

Notes to Financial Statements

(1) Organization - (Continued)

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. Effective July 1, 2004, Chapter 42-61.2 of the General Laws were amended and the owners of dog kennels will not receive a portion of net terminal income.

The Lottery sells PowerBall tickets, collects all revenues, and remits prize funds to MUSL net of low-tier prize awards. Jackpot prizes are payable in either a lump-sum cash distribution or annual installments. Annual 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. The maximum balance on the prize reserve funds for PowerBall is \$100 million. 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, 2004, the prize reserve funds for the PowerBall game reported a balance of \$68.3 million of which the Lottery's share was \$1.9 million. 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. During fiscal year 2004, MUSL reduced the Lottery's unreserved account by \$94,370 for a pro rata share of annual operating expenses. The Lottery has recorded all income and operating expenses related to their unreserved account and have reported the account balance of \$222,036 at June 30, 2004 on the Statement of Net Assets as "Deposits with MUSL".

MUSL issues a publicly available annual financial report that may be obtained by writing to the Multi-State Lottery Association, 4400 NW Urbandale Drive, Urbandale, Iowa 50322.

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 (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*

The Lottery defines all revenues and expenses deriving from on-line, instant ticket and video lottery sales as operating. All other revenues and expenses are defined as non-operating.

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

(2) Summary of Significant Accounting Policies - (Continued)

(d) *Capital Assets*

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. The Lottery's capitalization threshold is \$5,000.

(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 plus accrued interest which approximates fair value.

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

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 is generally based on published market prices and quotations from national security exchanges and securities pricing services.

For certain other games, 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.

(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 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 future drawings are reported as deferred revenue.

The current portion (\$625,000) of deferred revenue related to the sale of the exclusive rights to the operation of its gaming systems is reported in deferred revenue at June 30, 2004.

RHODE ISLAND LOTTERY

Notes to Financial Statements

(2) Summary of Significant Accounting Policies - (Continued)

(i) *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*

A cash balance of \$121,821 existed at June 30, 2004; the bank balance at that date was \$149,941. The primary difference between the book and bank balances was outstanding checks. The State General Treasurer held the entire bank balance at June 30, 2004. All General Treasurer accounts at a single institution are aggregated for purposes of determining Federal Depository Insurance coverage.

(b) *Investments*

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 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."

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, 2004.

- 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.

(3) Deposits and Investment Risk - (Continued)

RHODE ISLAND LOTTERY

Notes to Financial Statements

(b) *Investments*

- 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.

At June 30, 2004, the Lottery's investment balances were as follows:

	<u>Category 1</u>	<u>Fair Value</u>
Repurchase Agreements	\$ 4,000,000	\$4,000,000
Zero coupon U.S. Treasury bonds	<u>46,962</u>	<u>46,962</u>
Total	<u>\$ 4,046,962</u>	4,046,962

Investments not subject to categorization:

Money Market Funds	<u>3,834,858</u>
Total investments	7,881,820
Less amounts classified as cash equivalents	<u>7,834,858</u>
Total investments for jackpot awards	<u>\$ 46,962</u>

Investments for jackpot awards reported at June 30, 2004 represent remaining short-term investments to satisfy final amount owed to Lotto Bucks jackpot winner.

(c) *Cash and Cash Equivalents*

Cash and cash equivalents on the Statement of Net Assets consist of the following:

Cash balance per books	\$ 121,821
Investments reclassified as cash equivalents	<u>7,834,858</u>
Cash and cash equivalents	<u>\$ 7,956,679</u>

(4) Property, Plant and Equipment

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 statement of net assets.

RHODE ISLAND LOTTERY

Notes to Financial Statements

(4) Property, Plant and Equipment – (Continued)

A summary of property, plant and equipment follows:

<u>Cost</u>	<u>Estimated Useful Life</u>	<u>2003 Balance</u>	<u>2004 Additions</u>	<u>2004 Disposals</u>	<u>2004 Balance</u>
Building	20	\$ 1,468,983	\$ -	\$ -	\$ 1,468,983
Building improvements	10	1,749,636	65,024	-	1,814,660
Ticket production equipment	10	19,612	-	-	19,612
Office equipment	10	123,281	-	(933)	122,348
Furniture and fixtures	10	88,868	-	(126)	88,742
Lottery drawing equipment	3	87,778	-	-	87,778
Automobiles	3	308,795	105,863	(80,006)	334,652
Computer equipment	3	401,091	27,808	(20,151)	408,748
Trucks	3	22,445	-	-	22,445
Total		<u>\$ 4,270,489</u>	<u>\$ 198,695</u>	<u>\$ (101,216)</u>	<u>\$ 4,367,968</u>
<u>Accumulated Depreciation</u>					
Building		\$ 1,440,577	\$ 1,557		\$ 1,442,134
Building improvements		226,883	168,989		395,872
Ticket production equipment		14,879	1,163		16,042
Office equipment		76,003	10,868	\$ (762)	86,109
Furniture and fixtures		26,521	6,744		33,265
Lottery drawing equipment		77,357	6,935		84,292
Automobiles		219,793	76,596	\$ (80,169)	216,220
Computer equipment		327,525	57,236	\$ (20,285)	364,476
Trucks		22,445			22,445
Total		<u>\$ 2,431,983</u>	<u>\$ 330,088</u>	<u>\$ (101,216)</u>	<u>\$ 2,660,855</u>
Property, plant & equipment, net		<u>\$ 1,838,506</u>	<u>\$ (131,393)</u>	<u>\$ -</u>	<u>\$ 1,707,113</u>

(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 8) that is to be paid to the State's General Fund. The amounts paid and amounts due to State's General Fund are summarized below:

Due to State's General Fund, Beginning of Year	\$ 940,055
Payments to State's General Fund	281,141,644
Cash Paid During Fiscal Year	<u>(280,940,052)</u>
Due to State's General Fund – End of Year	<u>\$ 1,141,647</u>

RHODE ISLAND LOTTERY

Notes to Financial Statements

(6) Commissions

The Lottery pays commissions to ticket 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 payments to the State's General Fund.

(7) 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, 2004, the estimated liability was \$237,972. The liability is calculated using the current hourly rates of pay.

(8) Net Assets - (Deficiency)

On May 12, 2003, the Lottery entered into a 20-year contract, effective July 1, 2003, with its current gaming system provider. The contract granted the provider the right to be the Lottery's exclusive vendor of hardware and software, together with the related services necessary for the operation of the Lottery's computerized games, through June 30, 2023. In return, the provider made a one-time payment of \$12.5 million to the Lottery as consideration for this exclusive contract right. The Lottery recorded deferred revenue in the amount of \$12.5 million and transferred the cash to the State's General Fund on June 30, 2003. This transfer of unearned revenue resulted in a deficiency in net assets at June 30, 2004 of \$11.875 million. As the contract revenue is recognized over the twenty-year life of the contract, the deficiency in net assets will be reduced by \$625,000 per year.

Net assets reported by The Lottery also include its investment in capital assets, net of accumulated depreciation. The Lottery had no debt related to capital assets at June 30, 2004.

RHODE ISLAND LOTTERY

Notes to Financial Statements

(9) 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 the 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 rate is 9.6% of annual covered payroll for the fiscal year ended June 30, 2004. The Lottery contributed \$234,693, \$186,463, and \$136,845 for the fiscal years ended June 30, 2004, 2003 and 2002, respectively, equal to 100% of the required contributions for each year.

(10) Post employment Benefits

In accordance with the General Laws, post employment 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 1.3% of covered payroll for the fiscal year ended June 30, 2004 to fund the cost of these benefits. This benefit program is administered by the State, therefore all required disclosures are included in the State's CAFR.

(11) Deferred Compensation

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

RHODE ISLAND LOTTERY

Notes to Financial Statements

(12) Commitments

During May 2003, the Lottery entered into a 20-year master contract with its gaming systems provider granting them the right to be the exclusive provider of information technology hardware, software, and related services for all lottery games. This contract is effective from July 1, 2003 through June 30, 2023, and amends all previous agreements between the parties.

As consideration for this exclusive right, the gaming systems provider paid the Lottery \$12.5 million. In the event that the contract term is not fulfilled, the Lottery will be obligated to refund a pro-rata share of this amount to the gaming systems provider.

The contract mandates commission percentages as detailed in the chart below.

Commission Percentages	
On-Line and Instant Tickets	
Total Lottery Sales in the Year	Percent Thereof
\$0 - \$275 Million	5.00%
Over \$275 Million - \$400 Million	1.00%
Over \$400 Million	5.00%
Video Lottery Central System	
Total Net Terminal Income for the Year	Percent Thereof
\$0 - \$500 Million	2.50%
Over \$500 Million - \$1 Billion	1.00%
Over \$1 Billion	2.50%

The Lottery also leases to the vendor a portion of its headquarters to house the computer hardware and office space necessary for the operation of the Lottery's games. The term of the lease is five (5) years, commencing October 19th, 2002 and the square footage leased is 5101 square feet. The annual lease amount for the first year is \$79,065 and the four (4) remaining years will increase by four percent (4%) per annum, effective October 19.

RHODE ISLAND LOTTERY

Notes to Financial Statements

(13) Risk Management

The Lottery is exposed to various types of risk related to its operations. These risks can result in losses incurred from property damage or destruction, inability to operate gaming activities, and worker compensation claims. The Lottery manages these risks through the purchase of commercial insurance. During fiscal year 2004, the Lottery has maintained their amount of purchased insurance coverage. Claims and settlements incurred for fiscal years 2004, 2003 and 2002 have not exceeded the Lottery's insurance coverage.

(14) Contingencies

In September 2003, a federal grand jury issued an indictment against Lincoln Park, a licensed video lottery facility, and two of its executives. The indictment alleges a conspiracy to influence improperly the actions of public officials. This matter has not yet been reached for trial and presently management cannot reasonably predict the outcome of the same.

Supplementary Information

RHODE ISLAND LOTTERY

Sales, Commissions and Prize Awards Expense

Year Ended June 30, 2004

Schedule 1

	Sales	Commissions	Prize Awards Expense	Unclaimed Prize Recovery	Cost of Tickets	Cost of Sales	Gross Profit
Lottery games:							
On-line games							
Keno	\$ 88,327,994	\$ 11,447,114	\$ 57,478,571	\$ (387,338)	\$ -	\$ 68,538,348	\$ 19,789,646
Powerball	50,869,394	6,592,572	25,439,299	(1,121,609)	-	30,910,262	19,959,132
Daily Numbers	29,681,795	3,846,701	15,985,220	(291,331)	-	19,540,590	10,141,205
Hot Trax	235,570	30,529	161,263	-	-	191,792	43,778
Wild Money	3,762,342	487,592	2,085,021	(348,081)	-	2,224,532	1,537,810
	172,877,095	22,404,509	101,149,374	(2,148,358)	-	121,405,525	51,471,570
Instant tickets	76,521,924	8,140,217	50,183,237	(781,245)	997,689	58,539,898	17,982,026
Video Lottery	1,231,226,093	141,385,014	872,356,291	(76,889)	-	1,013,664,416	217,561,677
Totals	<u>\$ 1,480,625,112</u>	<u>\$ 171,929,740</u>	<u>\$ 1,023,688,902</u>	<u>\$ (3,006,492)</u>	<u>\$ 997,689</u>	<u>\$ 1,193,609,839</u>	<u>\$ 287,015,273</u>
<u>Video Commissions - Detail</u>							
Facilities		\$ 94,965,382					
Technology Providers		24,449,595					
Central Communications Provider		8,970,950					
Dog Kennel Owners		9,410,706					
City/Town		3,588,380					
Total		<u>\$ 141,385,014</u>					

See independent auditor's report.

Statistical Section

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Rhode Island Statistics

RHODE ISLAND LOTTERY

Revenues

Fiscal Years 1995 through 2004

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
SALES										
<i>Instant Tickets</i>										
Instant Tickets	\$ 20,840,747	\$ 23,339,726	\$ 27,356,236	\$ 40,323,292	\$ 51,372,959	\$ 61,813,004	\$ 69,394,994	\$ 78,034,555	\$ 75,789,417	\$ 76,521,924
<i>Video</i>										
VLTs	192,018,304	314,882,436	406,108,530	464,068,675	545,474,154	670,764,767	771,019,263	935,208,511	1,051,411,493	1,231,226,093
<i>On-Line</i>										
Lot-O-Bucks	3,974,231	-	-	-	-	-	-	-	-	-
Daily Numbers	31,196,077	30,600,023	29,405,124	29,257,141	28,221,328	28,159,762	28,459,883	28,994,464	29,649,149	29,681,795
PowerBall	57,474,718	47,622,832	37,881,052	43,345,345	52,582,676	37,456,233	36,437,944	46,295,253	44,289,173	50,869,394
Keno	24,927,298	32,003,602	41,801,453	51,617,137	57,637,832	60,801,993	69,190,444	78,837,210	85,589,259	88,327,994
Rhody Cash	4,115,596	6,849,222	1,112,026	-	-	-	-	-	-	-
Daily Millions	-	-	5,051,443	2,162,126	-	-	-	-	-	-
Wild Money	-	-	-	-	-	-	-	2,207,213	3,677,479	3,762,342
Money Roll	-	-	-	-	-	-	1,971,470	1,282,450	-	-
Easy Win	-	-	-	-	-	1,802,708	1,545,704	-	-	-
Hot Trax	-	-	-	-	-	-	-	-	-	235,570
Roll Down	-	-	-	3,300,928	5,880,770	3,293,258	-	-	-	-
Total On-line	121,687,920	117,075,679	115,251,098	129,682,677	144,322,606	131,513,954	137,605,445	157,616,590	163,205,060	172,877,095
TOTAL SALES	334,546,971	455,297,841	548,715,864	634,074,644	741,169,719	864,091,725	978,019,702	1,170,859,656	1,290,405,970	1,480,625,112
<i>Other Revenues</i>										
Investment Earnings	521,709	456,930	421,123	488,379	528,425	766,591	969,516	456,858	285,934	251,175
Net Pull Tab Sales	185,639	162,788	163,067	196,280	214,300	229,991	211,876	238,905	194,302	220,180
Contract Revenue	-	-	-	-	-	-	-	-	-	625,000
Miscellaneous	182,147	105,147	169,343	264,405	169,985	1,072,583	472,068	1,277,365	466,758	217,966
TOTAL OTHER REVENUES	889,495	724,865	753,533	949,064	912,710	2,069,165	1,653,460	1,973,128	946,994	1,314,321
REVENUES	\$ 335,436,466	\$ 456,022,706	\$ 549,469,397	\$ 635,023,708	\$ 742,082,429	\$ 866,160,890	\$ 979,673,162	\$ 1,172,832,784	\$ 1,291,352,964	\$ 1,481,939,433

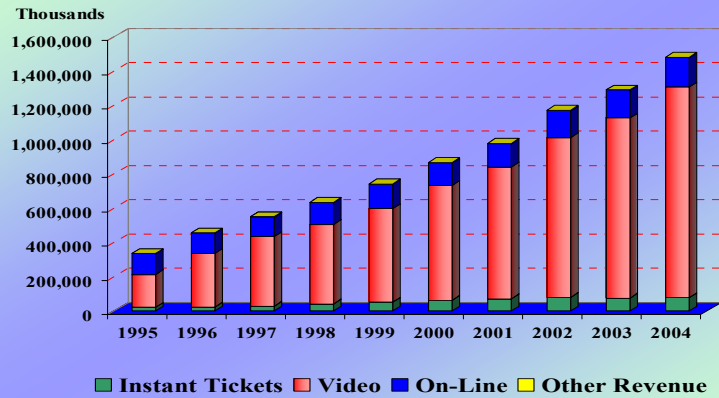
Source: Rhode Island Lottery

RHODE ISLAND LOTTERY

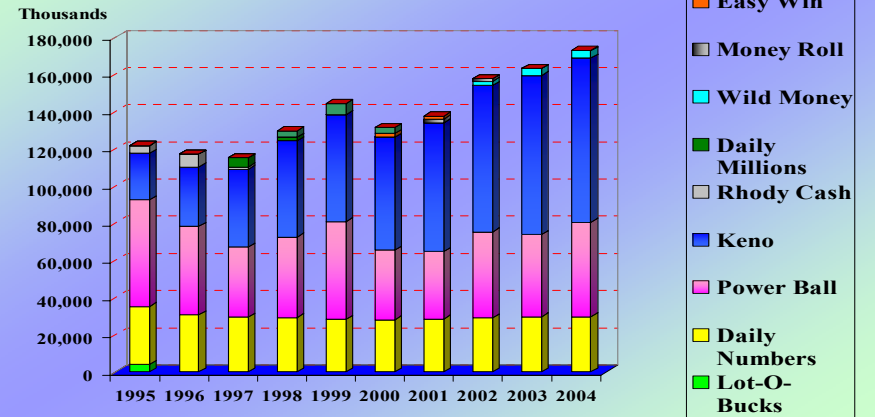
Revenues

Fiscal Years 1995 through 2004

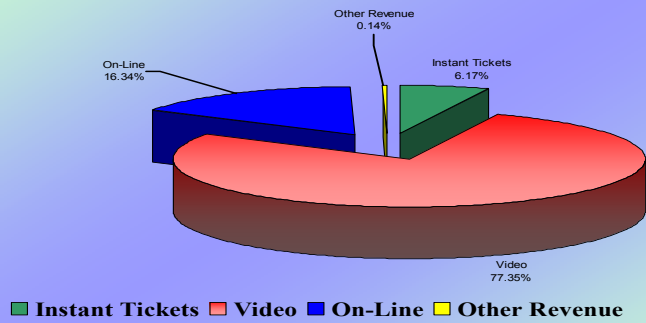
REVENUES
Fiscal Years 1995 ~ 2004



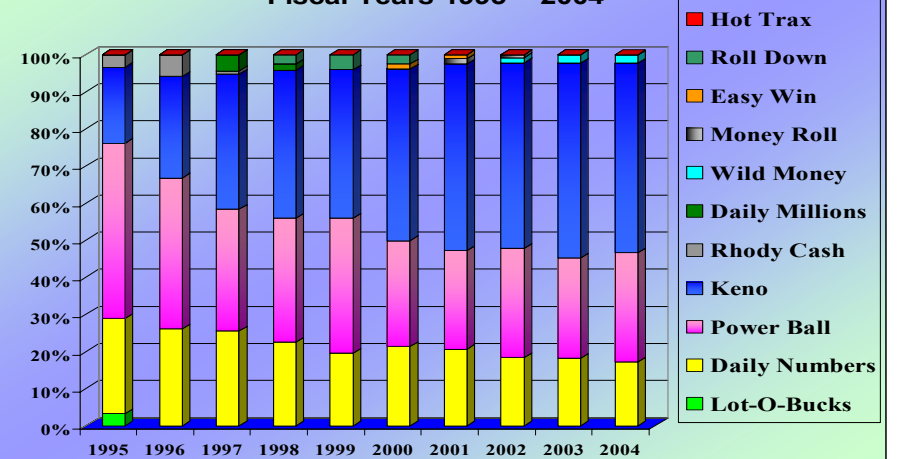
ON-LINE REVENUES
Fiscal Years 1995 ~ 2004



BREAKDOWN OF TOTAL REVENUES
Fiscal Years 1995 ~ 2004

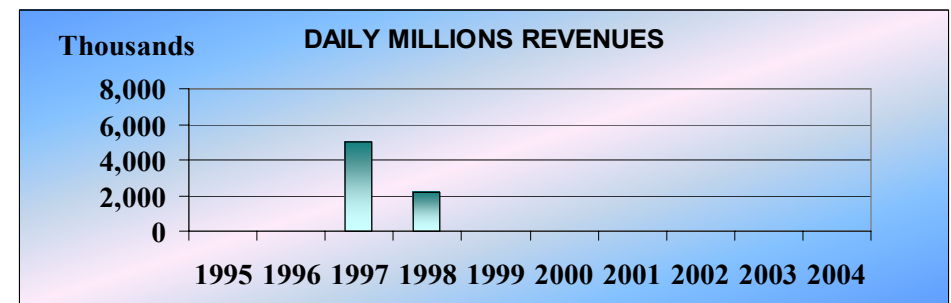
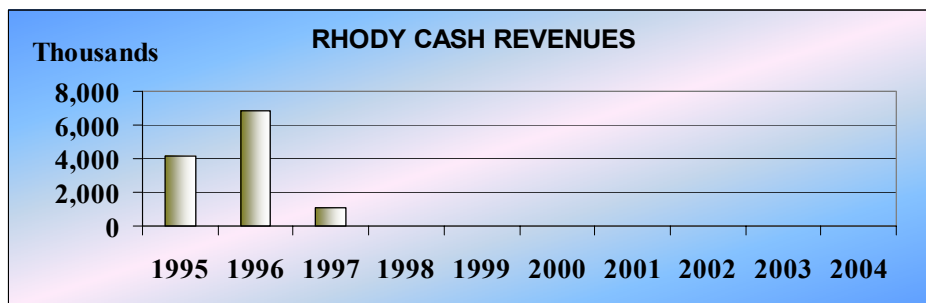
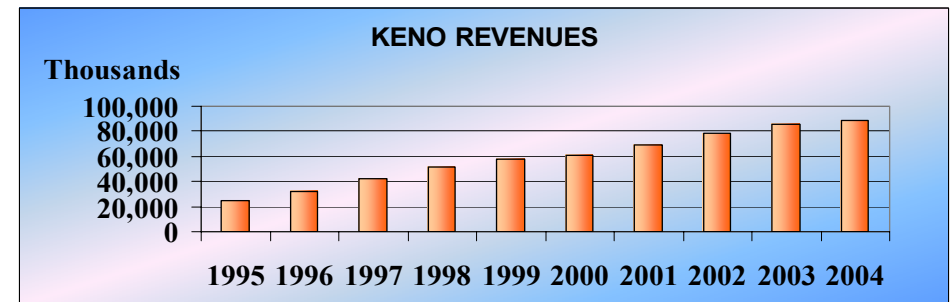
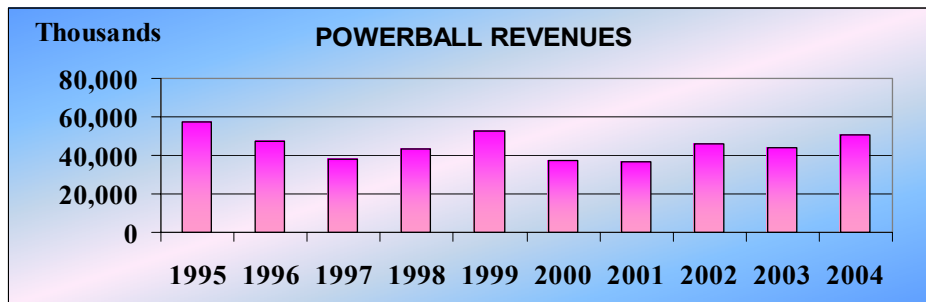
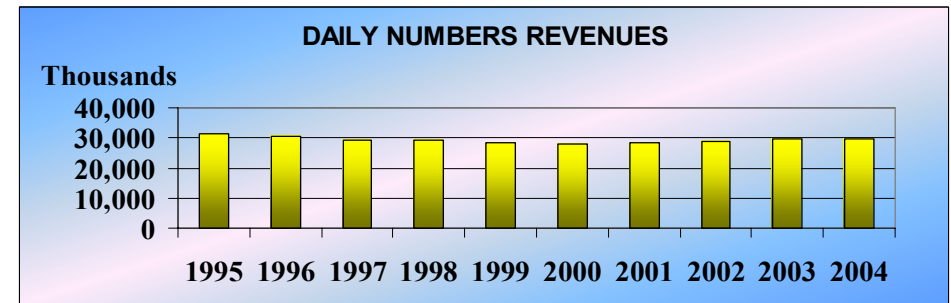
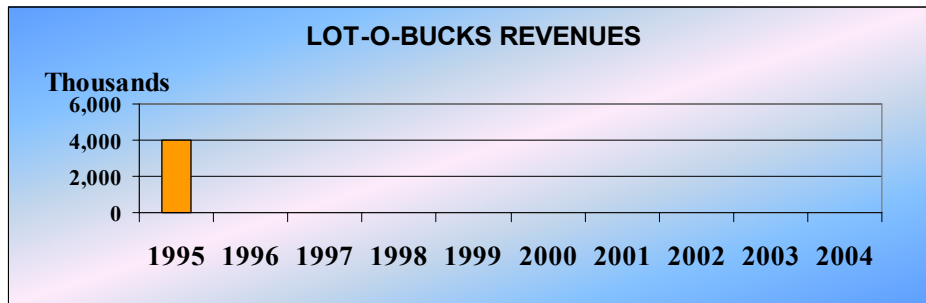
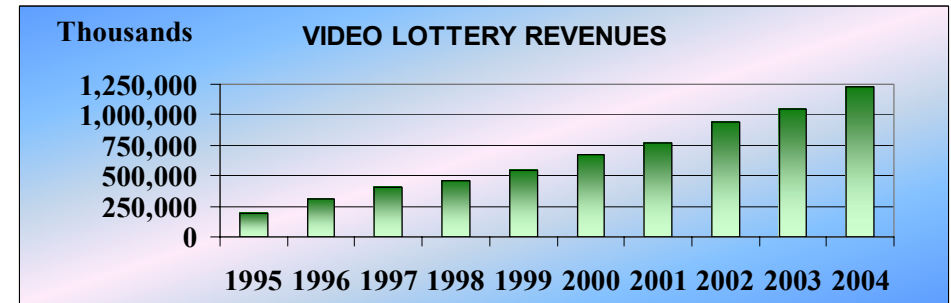
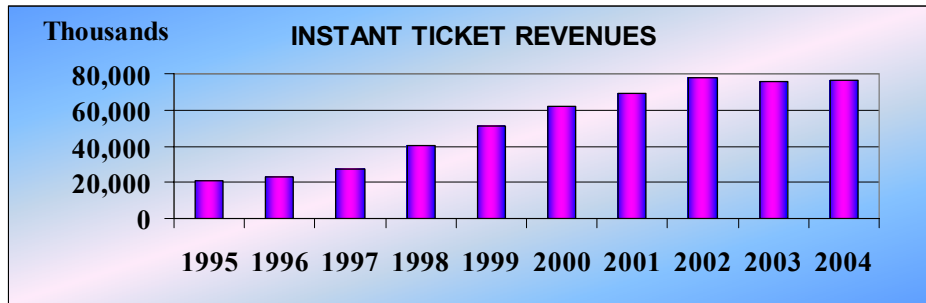


BREAKDOWN OF ON-LINE REVENUES
Fiscal Years 1995 ~ 2004



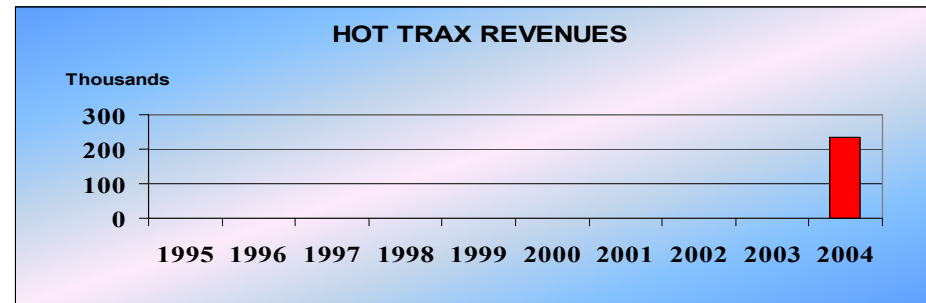
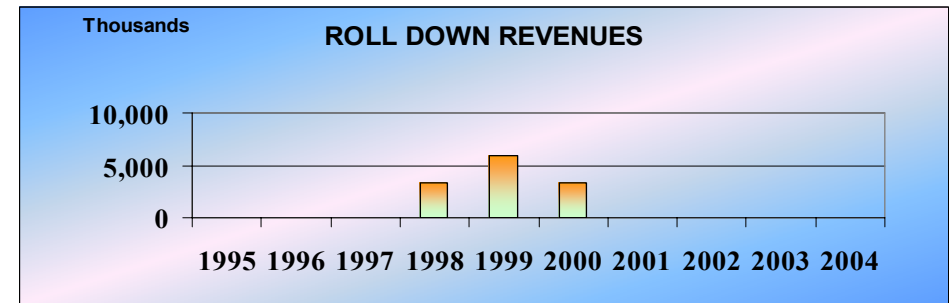
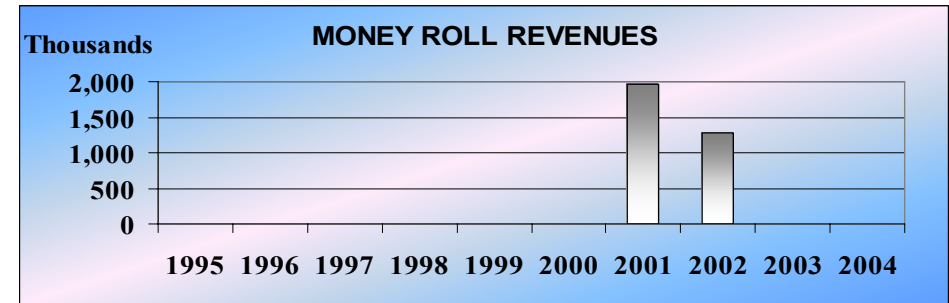
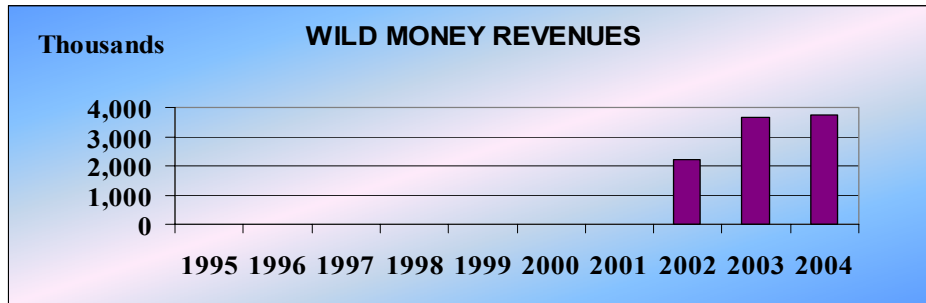
Source: Rhode Island Lottery

Sales by Game



Source: Rhode Island Lottery

Sales by Game



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

Lot-O-Bucks ended in fiscal year 1995

Rhody Cash began in fiscal year 1995 and ended in fiscal year 1997

Daily Millions began in fiscal year 1997 and ended in fiscal year 1998

Wild Money began in fiscal year 2002

Money Roll began in fiscal year 2001 and ended in fiscal year 2002

Easy Win began in fiscal year 2000 and ended in fiscal year 2001

Roll Down began in fiscal year 1998 and ended in fiscal year 2000

Hot Trax began in fiscal year 2004

RHODE ISLAND LOTTERY

Expenses and Payments to the State's General Fund

Fiscal Years 1995 through 2004

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
EXPENSES										
Prizes	\$ 207,427,166	\$ 303,401,899	\$ 373,056,150	\$ 429,277,957	\$ 503,522,789	\$ 590,679,183	\$ 666,947,849	\$ 796,582,302	\$ 880,866,451	\$ 1,023,688,902
Retailer/Vendor Commissions	16,090,163	15,629,373	15,715,397	18,442,716	21,219,277	20,392,735	21,584,246	25,760,434	25,572,841	30,544,726
Video Commissions	32,281,395	43,869,000	57,444,162	67,859,963	80,153,944	100,930,356	107,436,913	132,116,020	145,408,704	141,385,014
Cost of Tickets	567,290	619,223	843,610	1,102,638	985,173	990,209	1,112,469	1,300,380	1,149,999	997,689
Unclaimed Prize Recovery	(1,688,010)	(2,110,340)	(2,080,535)	(1,849,978)	(2,299,067)	(2,778,517)	(3,973,358)	(3,043,175)	(4,428,408)	(3,006,492)
Advertising and Promotion	1,156,710	1,263,390	1,102,533	1,384,429	1,242,550	1,511,749	1,220,577	1,411,592	1,466,628	1,606,350
46 Operating Expenses	<u>2,878,608</u>	<u>3,046,570</u>	<u>3,427,737</u>	<u>3,806,256</u>	<u>3,854,611</u>	<u>4,223,435</u>	<u>4,672,464</u>	<u>4,635,550</u>	<u>4,811,747</u>	<u>4,956,600</u>
TOTAL EXPENSES	<u>\$ 258,713,322</u>	<u>\$ 365,719,115</u>	<u>\$ 449,509,054</u>	<u>\$ 520,023,981</u>	<u>\$ 608,679,277</u>	<u>\$ 715,949,150</u>	<u>\$ 799,001,160</u>	<u>\$ 958,763,103</u>	<u>\$ 1,054,847,962</u>	<u>\$ 1,200,172,789</u>
PAYMENTS TO THE STATE'S GENERAL FUND	<u>\$ 76,795,039</u>	<u>\$ 90,375,486</u>	<u>\$ 100,032,238</u>	<u>\$ 115,071,622</u>	<u>\$ 133,475,047</u>	<u>\$ 150,283,635</u>	<u>\$ 180,743,897</u>	<u>\$ 214,141,576</u>	<u>\$ 249,040,055</u>	<u>\$ 281,141,644</u>

Source: Rhode Island Lottery

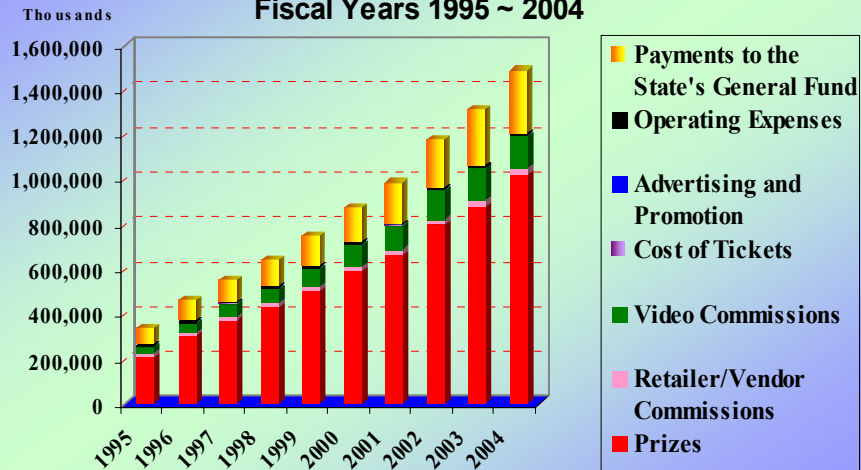
RHODE ISLAND LOTTERY

Expenses and Payments to the State's General Fund

Fiscal Years 1995 through 2004

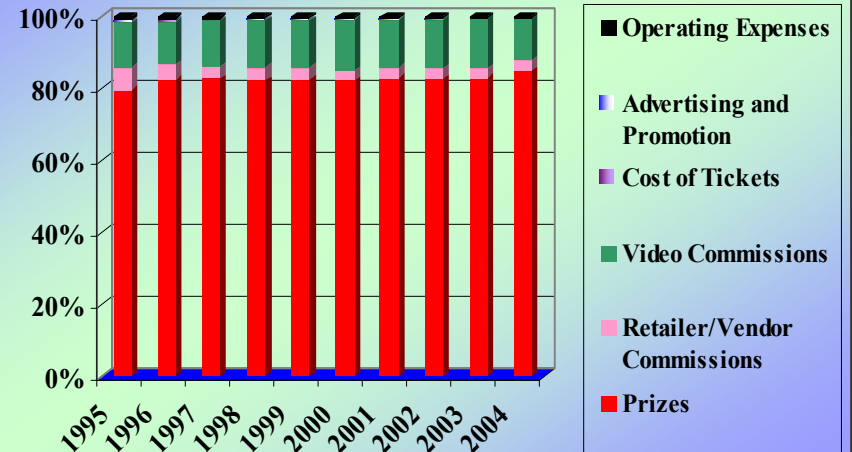
EXPENSES & PAYMENTS TO THE STATE'S GENERAL FUND

Fiscal Years 1995 ~ 2004



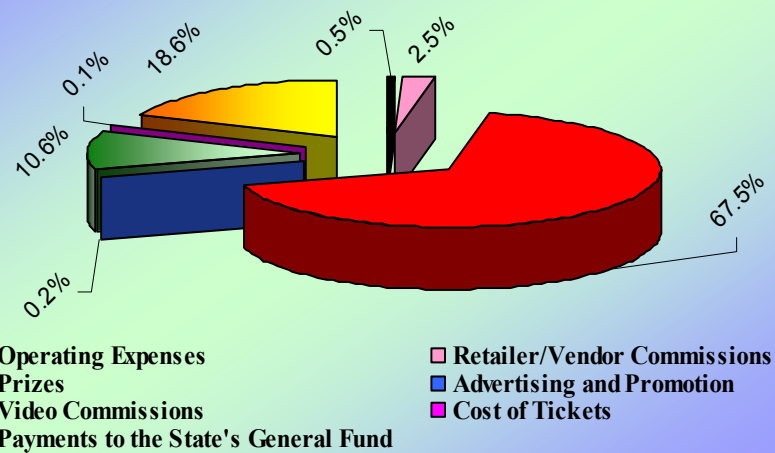
BREAKDOWN OF EXPENSES

Fiscal Years 1995 ~ 2004



BREAKDOWN OF TOTAL EXPENSES & PAYMENTS TO THE STATE'S GENERAL FUND

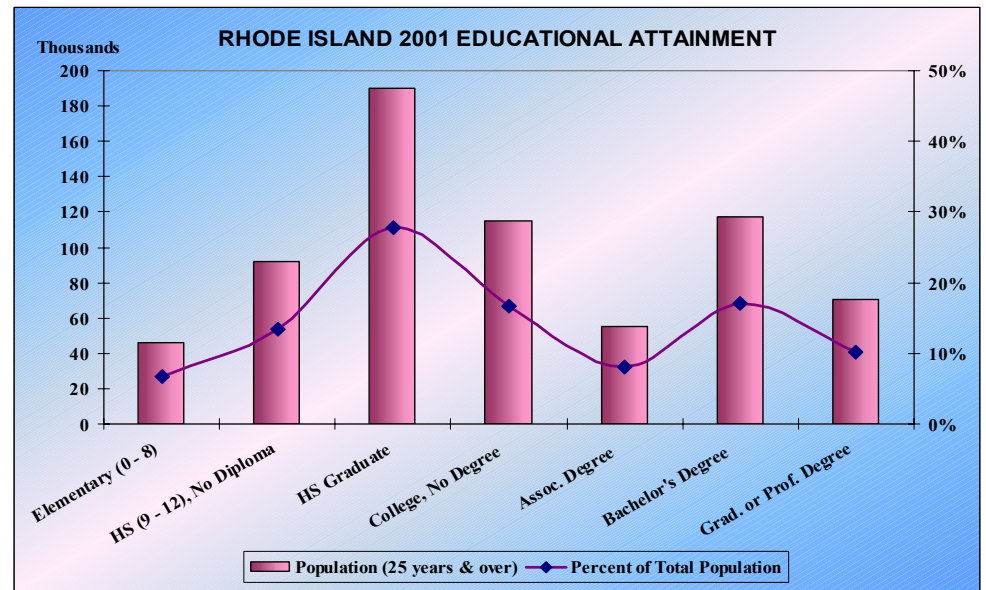
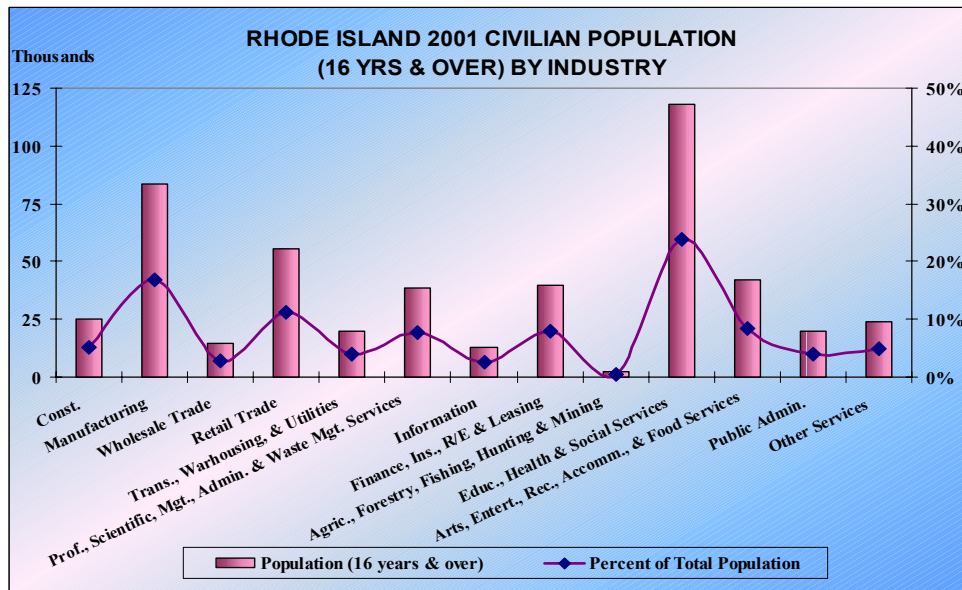
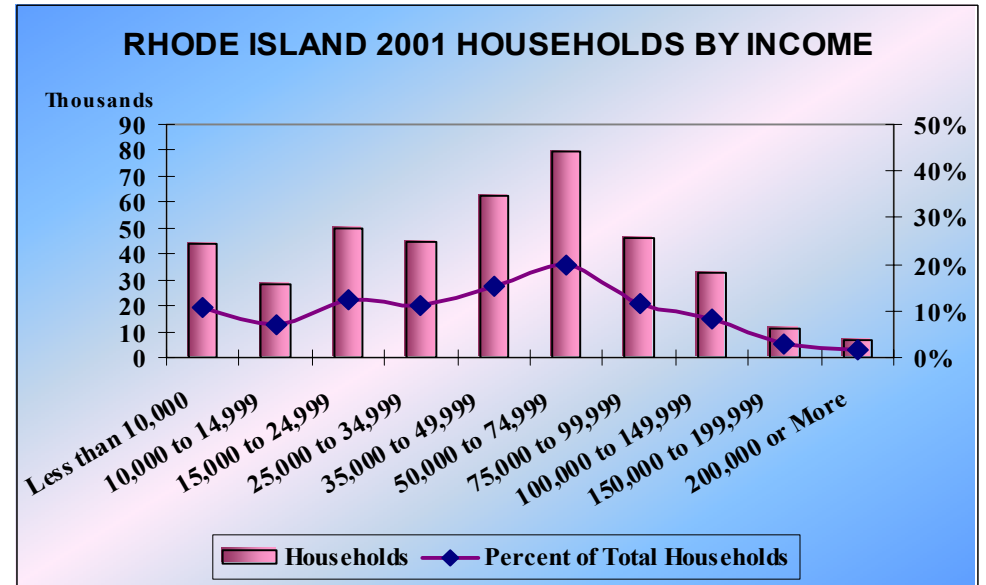
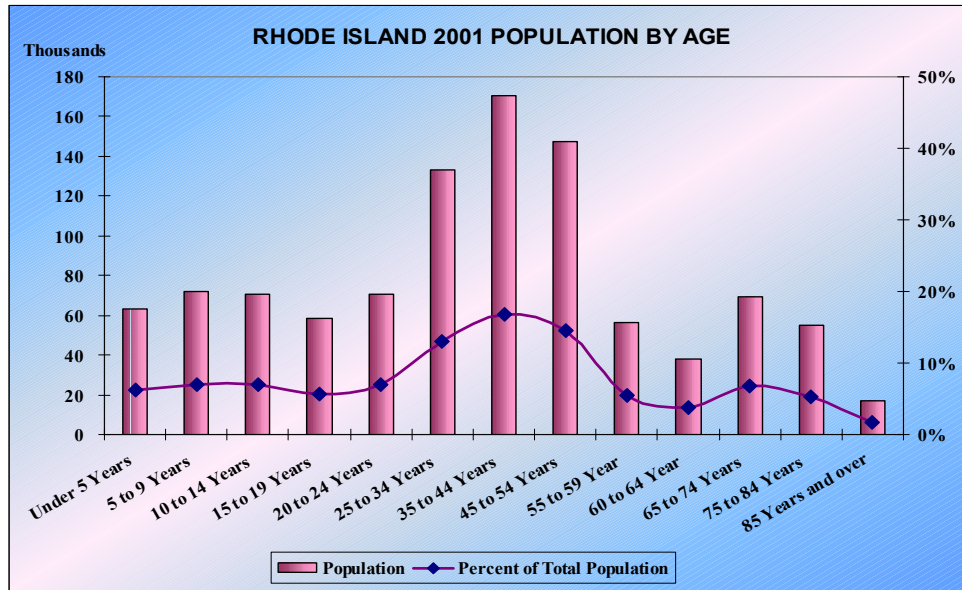
Fiscal Years 1995 ~ 2004



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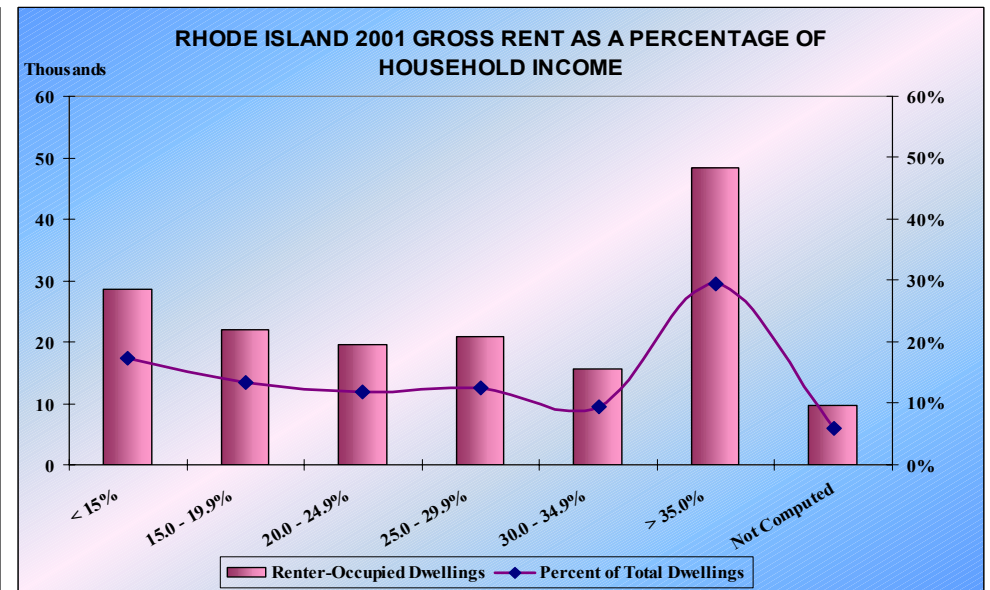
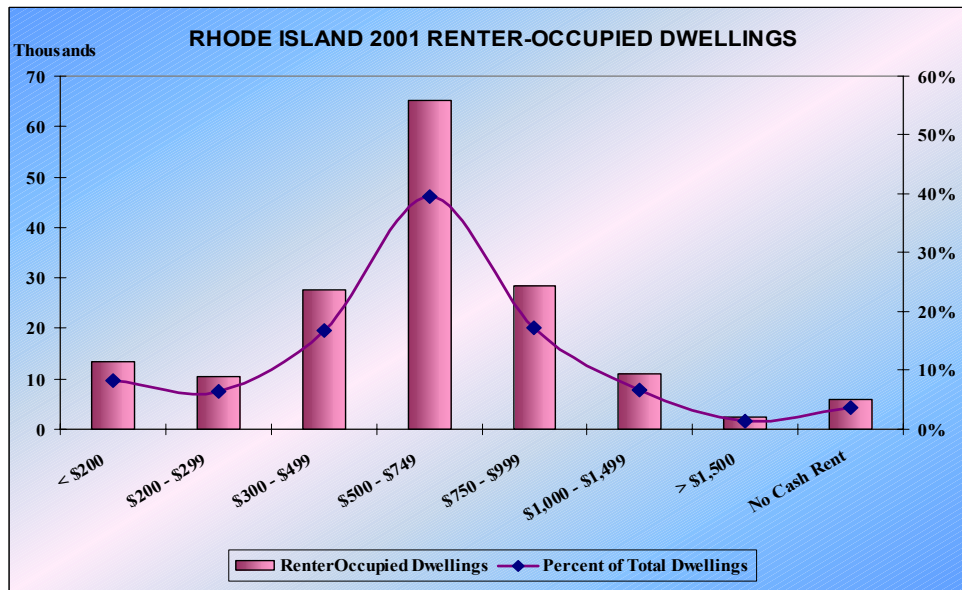
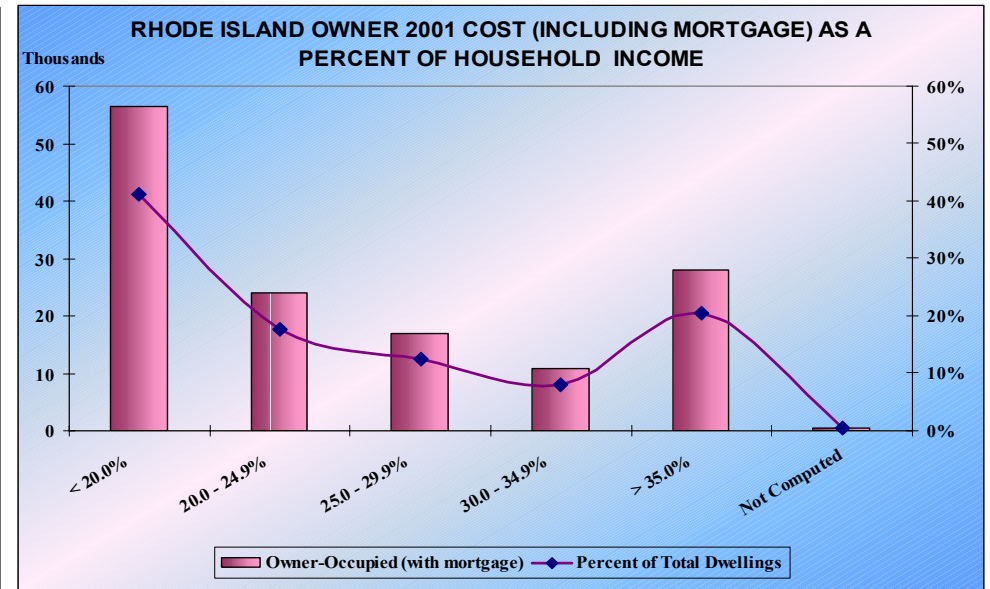
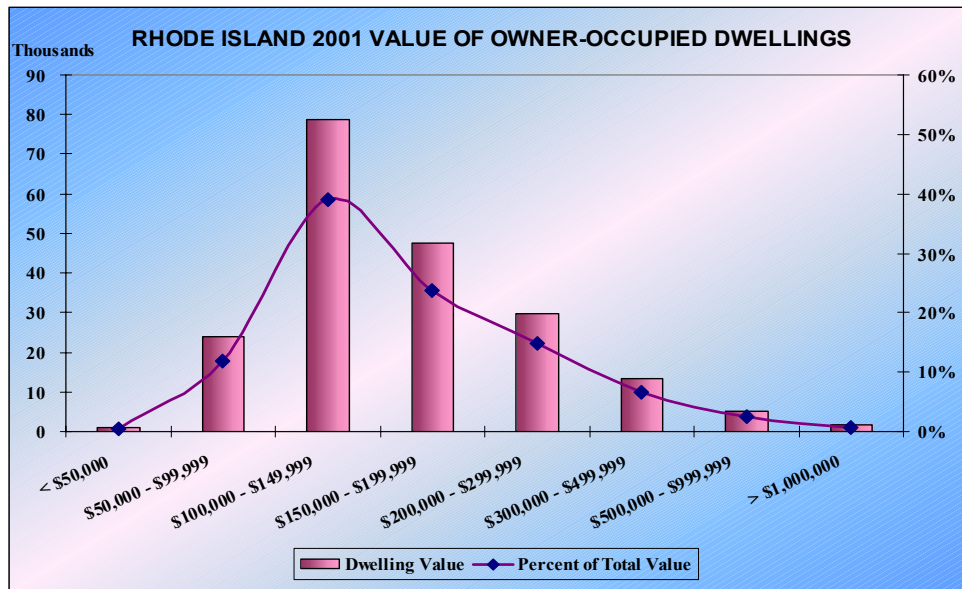
Rhode Island Demographics

Rhode Island Demographics



Source: U.S. Census Bureau, 2001 Supplementary Survey

Rhode Island Demographics



Source: U.S. Census Bureau, 2001 Supplementary Survey

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National Statistics

**U.S. LOTTERIES PER CAPITA SALES
FISCAL YEAR 2003**

LOTTERY	TOTAL SALES (\$M)	POPULATION (M)	PER CAPITA SALES
<i>RHODE ISLAND (2)</i>	<i>1,290.50</i>	<i>1.08</i>	<i>\$1,194.91</i>
South Dakota (2)	646.95	0.76	\$851.25
Delaware (1)	628.06	0.82	\$765.93
Massachusetts	4,197.75	6.43	\$652.84
West Virginia (1)	1,081.91	1.81	\$597.74
District of Columbia ***	237.63	0.56	\$424.34
Georgia	2,604.41	8.68	\$300.05
New York *	5,395.96	19.19	\$281.19
Connecticut	865.29	3.48	\$248.65
New Jersey	2,074.07	8.64	\$240.05
Maryland	1,322.60	5.51	\$240.04
Oregon (1)	853.16	3.56	\$239.65
Ohio	2,078.20	11.44	\$181.66
Michigan ***	1,783.38	10.08	\$176.92
South Carolina	724.31	4.15	\$174.53
Pennsylvania	2,132.98	12.37	\$172.43
New Hampshire	221.23	1.29	\$171.50
Florida	2,867.98	17.02	\$168.51
Kentucky	673.49	4.12	\$163.47
Virginia	1,135.72	7.39	\$153.68
Texas **	3,130.69	22.12	\$141.53
Vermont	79.50	0.62	\$128.23
Maine	164.60	1.31	\$125.65
Illinois	1,585.62	12.65	\$125.35
Missouri	708.57	5.70	\$124.31
Indiana	664.42	6.20	\$107.16
Puerto Rico	338.00	3.88	\$87.11
Colorado	391.53	4.55	\$86.05
Wisconsin	435.05	5.47	\$79.53
California	2,781.57	35.48	\$78.40
Kansas	210.83	2.72	\$77.51
Washington	460.32	6.13	\$75.09
New Mexico	137.33	1.87	\$73.44
Idaho	97.97	1.37	\$71.51
Minnesota	351.82	5.06	\$69.53
Louisiana	311.46	4.50	\$69.21
Iowa	187.83	2.94	\$63.89
Arizona	322.28	5.58	\$57.76
Nebraska	80.92	1.74	\$46.51
Montana	34.68	0.92	\$37.70
TOTAL	45,290.57	259.19	\$174.74

Results are unofficial and unaudited

* FY ends 3/31

** FY ends 8/31

*** FY ends 9/30

(1) Includes net VLT sales (cash in less cash out)

(2) Includes gross VLT sales (cash in)

Source: North American Association of State & Provincial Lotteries

**U.S. LOTTERIES RANKED
BY FISCAL YEAR 2003 SALES**

RANK	LOTTERY	FY '02 SALES (\$M)	FY '03 SALES (\$M)
1	New York *	4,753.62	5,395.96
2	Massachusetts	4,213.22	4,197.75
3	Texas **	2,966.27	3,130.69
4	Florida	2,330.36	2,867.98
5	California	2,917.01	2,781.57
6	Georgia	2,449.36	2,604.41
7	Pennsylvania	1,934.16	2,132.98
8	Ohio	1,983.11	2,078.20
9	New Jersey	2,068.52	2,074.07
10	Michigan ***	1,688.04	1,783.38
11	Illinois	1,590.15	1,585.62
12	Maryland	1,306.55	1,322.60
13	RHODE ISLAND (2)	1,171.10	1,290.50
14	Virginia	1,108.07	1,135.72
15	West Virginia (1)	848.63	1,081.91
16	Connecticut	907.90	865.29
17	Oregon (1)	816.94	853.16
18	South Carolina	319.99	724.31
19	Missouri	585.19	708.57
20	Kentucky	638.72	673.49
21	Indiana	626.30	664.42
22	South Dakota (2)	629.96	646.95
23	Delaware (1)	674.01	628.06
24	Washington	438.61	460.32
25	Wisconsin	427.57	435.05
26	Colorado	407.94	391.53
27	Minnesota	377.13	351.82
28	Puerto Rico	267.40	338.00
29	Arizona	294.82	322.28
30	Louisiana	311.62	311.46
31	District of Columbia ***	211.12	237.63
32	New Hampshire	212.90	221.23
33	Kansas	190.08	210.83
34	Iowa	181.22	187.83
35	Maine	157.90	164.60
36	New Mexico	133.97	137.33
37	Idaho	92.67	97.97
38	Nebraska	73.91	80.92
39	Vermont	81.99	79.50
40	Montana	33.63	34.68
TOTAL		42,421.66	45,290.57

**U.S. LOTTERIES RANKED
BY SALES % CHANGE**

RANK	LOTTERY	% CHANGE
1	South Carolina	126.4%
2	West Virginia (1)	27.5%
3	Puerto Rico	26.4%
4	Florida	23.1%
5	Missouri	21.1%
6	New York *	13.5%
7	District of Columbia ***	12.6%
8	Kansas	10.9%
9	Pennsylvania	10.3%
10	RHODE ISLAND (2)	10.2%
11	Nebraska	9.5%
12	Arizona	9.3%
13	Georgia	6.3%
14	Indiana	6.1%
15	Idaho	5.7%
16	Michigan ***	5.6%
17	Texas **	5.5%
18	Kentucky	5.4%
19	Washington	4.9%
20	Ohio	4.8%
21	Oregon (1)	4.4%
22	Maine	4.2%
23	New Hampshire	3.9%
24	Iowa	3.6%
25	Montana	3.1%
26	South Dakota (2)	2.7%
27	New Mexico	2.5%
28	Virginia	2.5%
29	Wisconsin	1.7%
30	Maryland	1.2%
31	New Jersey	0.3%
32	Louisiana	-0.1%
33	Illinois	-0.3%
34	Massachusetts	-0.4%
35	Vermont	-3.0%
36	Colorado	-4.0%
37	California	-4.6%
38	Connecticut	-4.7%
39	Minnesota	-6.7%
40	Delaware (1)	-6.8%
		6.76%

Results are unofficial and unaudited

* FY ends 3/31

** FY ends 8/31

*** FY ends 9/30

(1) Includes net VLT sales (cash in less cash out)

(2) Includes gross VLT sales (cash in)

Source: North American Association of State & Provincial Lotteries

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Compliance Section



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AUDITOR GENERAL
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STATE OF RHODE ISLAND and PROVIDENCE PLANTATIONS

GENERAL ASSEMBLY

OFFICE of the AUDITOR GENERAL

- ♦ INTEGRITY
- ♦ RELIABILITY
- ♦ INDEPENDENCE
- ♦ ACCOUNTABILITY

**INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

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, 2004 and have issued our report thereon dated October 26, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

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 an opinion 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. As of June 30, 2004, the Lottery has implemented a formal comprehensive security plan, however, material compliance by the Lottery's gaming system provider has not yet been achieved. Material compliance with the

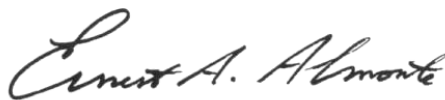
Lottery's comprehensive security plan is vital to ensuring that access to the computer systems used to operate the Lottery's games is appropriately restricted to authorized individuals and any unauthorized access is detected by the Lottery on a timely basis with appropriate follow-up.

A material weakness is a reportable 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 caused by error or fraud 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.

Compliance and Other Matters

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 or other matters that are required to be reported under *Government Auditing Standards*.

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

October 26, 2004