



**GOVERNMENT OF THE DISTRICT OF COLUMBIA  
LOTTERY AND CHARITABLE GAMES CONTROL BOARD**

**Financial Statements and Management's Discussion and Analysis**

**September 30, 2002 and 2001**

**(With Independent Auditors' Report Thereon)**

**GOVERNMENT OF THE DISTRICT OF COLUMBIA  
LOTTERY AND CHARITABLE GAMES CONTROL BOARD**

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2001 M Street NW  
Washington, DC 20036

## Independent Auditors' Report

To the Mayor and Members of  
The Council of the Government of the District of Columbia, and  
The Lottery and Charitable Games Control Board  
Washington, D.C.

We have audited the accompanying financial statements of the District of Columbia Lottery and Charitable Games Control Board, an enterprise fund of the Government of the District of Columbia, as of and for the years ended September 30, 2002 and 2001, as listed in the table of contents. These financial statements are the responsibility of the District of Columbia Lottery and Charitable Games Control Board's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America 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 audits 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 the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in note 2, these financial statements present only the District of Columbia Lottery and Charitable Games Control Board and do not purport to, and do not present fairly the financial position of the Government of the District of Columbia as of September 30, 2002 and 2001, and the changes in its financial position and its cash flows, where applicable, for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the District of Columbia Lottery and Charitable Games Control Board, as of September 30, 2002 and 2001, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As described in note 2, the District of Columbia Lottery and Charitable Games Board has implemented a new financial reporting model and related disclosures, as of October 1, 2001, as required by the following Governmental Accounting Standards Board (GASB) Pronouncements:

- GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*
- GASB Statement No. 37, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus*
- GASB Statement No. 38, *Certain Financial Statement Note Disclosures*





The Management's Discussion and Analysis on pages 3 to 9 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued a report dated January 7, 2003 on our consideration of District of Columbia Lottery and Charitable Games Control Board's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

KPMG LLP

January 7, 2003

**GOVERNMENT OF THE DISTRICT OF COLUMBIA  
LOTTERY AND CHARITABLE GAMES CONTROL BOARD**

Management's Discussion and Analysis

September 30, 2002

(Dollar amounts in thousands)

The discussion and analysis of the D.C. Lottery and Charitable Games Control Board's (the Lottery Board) financial performance provides an overview of its financial activities for the fiscal year ended September 30, 2002. This discussion and analysis should be read in conjunction with the attached financial statements.

**Background and Other Significant Information**

The Lottery Board was established by Public Law 3-172 as an independent agency of the Government of the District of Columbia (District). In accordance with law, the Lottery Board is responsible for generating revenues through the sales of lottery products and required to remit monthly gaming revenues less prizes, operating expenses and a reserve not to exceed 2% of annual prize payments to the General Fund of the District.

The Lottery Board's financial transactions are accounted for as an enterprise fund in the District's basic financial statements.

**Financial Highlights**

- Gross revenue from lottery gaming activities decreased by \$13,734 or 6.11% from prior year amounts;
- Aggregate ticket sales for all games, excluding Powerball, increased 3.03% for the year;
- Total operating expenses increased \$6,407 or 4.50% despite decreases in related lottery ticket sales;
- The quick cash game's top prize of \$250 was won nine times during the fiscal year;
- Transfers to the District's General Fund decreased \$21,000, equivalent to 25.0% of the prior year's total.

To effectively understand the Lottery Board's operations and to assess its financial activities, the reader must pay attention to individual game sales, related prize expenses and payout percentages, and the resulting impact on change in net assets or amounts transferred to the District's General Fund. Prize payouts and Powerball sales have the most dramatic effect on transfer levels but are beyond the control of management.

**Using This Financial Report**

This financial report consists of a series of financial statements, prepared in accordance with GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*. These statements focus on the financial condition, the results of operations, and cash flows of the Lottery Board as a whole.

One of the most important questions asked about the Lottery Board's finances is whether or not they have improved as a result of the year's activities. The key to understanding this core question is the Statement of Net Assets; the Statement of Revenues, Expenses and Changes in Net Assets; and the Statement of Cash Flows. These statements present financial information in a form that is similar to that used by commercial activities.

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The Lottery Board's net assets (the difference between assets and liabilities) are one indicator of the improvement or erosion of financial health. The Statement of Net Assets includes all assets and liabilities. It is prepared under economic resources measurement focus and the accrual basis of accounting, whereby revenues are recognized when earned and expenses are recognized when the related liability is incurred.

The Statement of Revenues, Expenses and Changes in Net Assets presents the revenues earned and the expenses incurred during the year. Activities are reported as either or nonoperating.

Another important factor to consider when evaluating financial viability is the Lottery Board's ability to meet financial obligations as they come due. The Statement of Cash Flows presents information related to cash inflows and outflows summarized by operating, capital and noncapital financing and investing activities.

**Condensed Financial Information**

The Lottery Board's net assets increased by \$110 for the year ended September 30, 2002. Following is condensed financial information as of and for the years ended September 30, 2002 and 2001.

**Table 1: Condensed Balance Sheet Information  
 (In Thousands)**

	September 30	
	2002	2001
<b>Assets:</b>		
Current and other assets	\$ 13,574	13,877
Capital assets (net of accumulated depreciation)	1,495	1,328
Restricted investments	78,789	79,795
Total assets	\$ 93,858	95,000
<b>Liabilities:</b>		
Accounts payable and accrued expenses	\$ 4,084	3,876
Deferred revenues	131	113
Accrued prizes and commissions	7,369	7,841
Obligations for unpaid prizes	78,789	79,795
Total liabilities	90,373	91,625
<b>Net assets:</b>		
Invested in capital assets	1,495	1,328
Unrestricted	1,990	2,047
Total net assets	\$ 3,485	3,375

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**Table 2: Condensed of Revenues, Expenses,  
 and Changes in Net Assets Information  
 (In Thousands)**

	<b>Years ended September 30</b>	
	<b>2002</b>	<b>2001</b>
Operating revenues:		
Gaming Revenue	\$ 211,151	224,885
Operating expenses:		
Prizes	110,741	105,594
Other	37,930	36,670
Total operating expenses	<u>148,671</u>	<u>142,264</u>
Operating income	62,480	82,621
Nonoperating revenues – interest and dividends	630	1,479
Income before transfers	63,110	84,100
Transfers out	<u>(63,000)</u>	<u>(84,000)</u>
Change in net assets	<u>\$ 110</u>	<u>100</u>

Unrestricted net assets were \$1,990, at September 30, 2002, which represents a decrease of \$57 from the prior year. Overall current assets decreased by \$303 in comparison to the prior year balances. Total liabilities decreased by \$1,252, or 1.36% for the year ended September 30, 2002 due to lower Powerball game accrued prizes and commissions and the decrease in the Lottery Board's obligations for unpaid prizes.

The Multi-State Lottery Association (MUSL) purchases U.S. government securities in the name of the Lottery Board for Lotto America and Powerball jackpot winners from the District of Columbia. Jackpot winners have the option of accepting the cash value of the jackpot amount or annuity payments for 25 years. The restricted investments balance of \$78,789 represents the net present value of securities totaling \$97,390 to fund future annuity installment payments. The account decreased \$1,006 in value during the year as the result of payments of \$8,631 net of unrealized gains of \$3,215 and accretion of investments totaling \$4,410. Corresponding amounts are recorded as obligations for unpaid prizes.

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Table 3: Ticket Sales, Prizes, Commissions and Transfers

2002 (In Thousands)										
	Lucky Numbers	D.C. Four	Powerball	Quick Cash	Hot Five	Lucky Numbers Extra	D.C. Four-Extra	Instant Games	Others	Total
Gaming Revenue	\$ 72,194	68,453	27,723	4,200	5,067	234	328	32,924	28	211,151
Prizes	(34,692)	(36,146)	(12,039)	(3,215)	(2,635)	(151)	(211)	(21,652)	—	(110,741)
Agent commissions	(4,491)	(3,822)	(1,519)	(243)	(309)	(16)	(22)	(2,385)	—	(12,807)
Gross margin	<u>\$ 33,011</u>	<u>28,485</u>	<u>14,165</u>	<u>742</u>	<u>2,123</u>	<u>67</u>	<u>95</u>	<u>8,887</u>	<u>28</u>	<u>87,603</u>
Transfers	<u>\$ 25,475</u>	<u>21,075</u>	<u>10,225</u>	<u>235</u>	<u>1,515</u>	<u>—</u>	<u>—</u>	<u>4,475</u>	<u>—</u>	<u>63,000</u>

  

2001 (In Thousands)										
	Lucky Numbers	D.C. Four	Powerball	Quick Cash	Cash for Life	Hot Five	Instant Games	Others	Total	
Gaming Revenue	\$ 70,583	65,505	45,854	4,160	—	5,300	32,462	1,021	224,885	
Prizes	(31,837)	(27,353)	(21,689)	(973)	29	(2,519)	(21,252)	—	(105,594)	
Agent commissions	(3,798)	(3,234)	(2,029)	(196)	1	(282)	(2,099)	—	(11,637)	
Gross margin	<u>\$ 34,948</u>	<u>34,918</u>	<u>22,136</u>	<u>2,991</u>	<u>30</u>	<u>2,499</u>	<u>9,111</u>	<u>1,021</u>	<u>107,654</u>	
Transfers	<u>\$ 29,600</u>	<u>27,965</u>	<u>17,565</u>	<u>2,490</u>	<u>30</u>	<u>1,875</u>	<u>4,475</u>	<u>—</u>	<u>84,000</u>	

Table 3 provides a comparison of sales, prizes, agent commissions, gross margin, and transfers to the District's General Fund generated by each lottery product offered in fiscal years 2002 and 2001. Overall gaming revenue sales totaled \$211,151 in fiscal year 2002 and represented a \$13,734 or 6.11% decrease from the prior year's level of \$224,885. Despite local and national events such as September 11th, and a slowdown of the economy, sales increases were logged in all games, with the exception of Hot Five and Powerball. Prize expenses increased by \$5,147 or 4.88%. Total prize payouts as a percentage of sales increased to 52.45% for the year in comparison to 46.95% in 2001. Agent commissions increased by \$1,170, due to the related increase in the sales commissions rate from 4.00% to 5.00%, which became effective January 2, 2002.



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**Lucky Numbers**

Lucky Numbers is a daily three-digit game in which players may wager 50 cents or one dollar with nine ways to win prizes ranging from 25 to 500 dollars. Sales totaled \$72,194 for a \$1,611 or 2.28% increase over the prior year's sales level of \$70,583. The increase represents a reversal of a declining sales trend for several years. The Lucky Numbers game accounted for 34.19% of total gaming revenue and 37.68% of the overall gross margin.

Prizes increased to \$34,692 in 2002, an increase of \$2,855 or 8.97% from the \$31,837 in 2001. Agents/retailers commissions increased \$693 primarily as the result of the rate increase. Other operating costs accounted for an additional \$319 increase in expenses. The increase in sales and related expenses translated into net proceeds to the District's General Fund of \$25,475, a \$4,125 decrease from the \$29,600 generated in 2001.

**D.C. Four**

D.C. Four is a daily four-digit game with a fixed payout. Players may wager 50 cents or one dollar for a chance to win seven different ways. Sales totaled \$68,453 in 2002 for a \$2,948 or 4.50% increase over the \$65,505 in the prior year.

Prizes totaled \$36,146 in 2002, an increase of \$8,793 or 32.15% over the \$27,353 in prizes reported in 2001. Other operating costs increased by \$282 over the prior year's amount. The increase in sales, related prizes and commissions resulted in a \$6,433 decrease in the gross margin when compared to the prior year. Net proceeds to the general fund totaled \$21,075, a reduction of \$6,890 or 24.6% from the \$27,965 transferred in 2001. The reduction in transfer amount can be primarily attributed to an increase in prize payouts, commissions, and other expenses.

**Powerball**

The Powerball game is a five out of fifty-three plus one out of forty-two online lottery game that pays a grand prize on an annuitized pari-mutuel basis and all other prizes on a fixed basis. The Powerball game is sponsored by the Multi-State Lottery Association (MUSL), a conglomerate of twenty-three states and the District of Columbia, that combines resources and sales to offer larger jackpots. Party lotteries pool their sales and other resources, but otherwise account for operations separately.

Powerball sales of \$27,723 in 2002 represented an \$18,131 or 39.54% decrease from the \$45,854 generated in 2001. Powerball game sales are jackpot driven and the lack of medium to high jackpots in 2002 severely hampered sales. There were no jackpots that eclipsed the \$100 million mark during the year. This was in comparison to one jackpot of \$295 million and two others over \$100 million in 2001 that essentially accounts for the dramatic decrease in 2002 sales. Another factor contributing to the decline in sales was the downturn in the economy, which impacted interest rates causing jackpots to increase at a slower pace.

Prizes amounted to \$12,039 for the year representing a decrease of \$9,650 or a 44.50% in relation to the \$21,689 expensed in 2001. Powerball prizes are expensed at the rate of 50.0% of sales intake offset by

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lapsed prizes. Other expenses decreased \$842 in relation to the lower sales level. The decline in sales partially offset by related decrease in expenses account for the \$7,971 or a 36.01% decrease in net proceeds and transfers to the General Fund of \$10,225 from the \$17,565 transferred in 2001.

**Quick Cash**

Quick Cash game is a six out of thirty-nine numbers daily online lotto type game that pays fixed prize payouts ranging from 10 dollars to 250,000 dollars. Players receive three boards (set of six numbers) for one dollar. Quick Cash sales amounted to \$4,200 in fiscal year 2002 and reflected a marginal increase over the \$4,160 sold in 2001. Prizes in 2002 totaled \$3.21 million as the result of the payout of nine top prizes of \$250. This amount represented a \$2,242 or 230.42% increase over prizes payments of \$973 in 2001. Net proceeds and transfer to the General Fund reflected a decrease from \$2,490 in 2001 to \$235 in 2002 due to increased prior payouts.

**Hot Five**

The Hot Five game is a five out of thirty-three numbers online lotto type game that pays fixed prize payouts ranging from one dollar to 25,000 dollars. Player receives one wager (set of five numbers) for the sum of one dollar. Hot five sales decreased \$233 from a total of \$5,300 in 2001 to \$5,067 in 2002. Overall expenses increased \$116 from prior year levels. The decline in sales and increase in expenses account for the reduced 2002 transfer amount of \$1,515 in comparison to \$1,875 transferred in 2001.

**Lucky Numbers Extra and D.C. Four Extra**

The Lucky Numbers and D.C. Four Extra games were launched August 12, 2002. The games, introduced as online instant games, must be played in conjunction with the Lucky Numbers (three-digit) and D.C. Four (four-digit) games. For one dollar, a player can purchase a chance to win 3 to 500 dollars instantly on a three or four digit ticket prior to the midday or nightly drawing. The player requests an extra ticket when purchasing a three or four-digit ticket. The three or four-digit ticket is printed with an extra number for the extra game. If numerical digits of the extra ticket correspond diagonally to the Lucky Numbers or D.C. Four digits, the player is an instant winner for the sum displayed. Ticket sales for the two games totaled \$562 for approximately two months of operation. Prizes, commissions, start-up costs, and other expenses amounted to \$893 and resulted in a net operating loss of \$331.

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**Instant Tickets**

Instant or scratch games are designed to allow the player to determine if he/she is a winner at the time of purchase. The price of tickets and prize structure are determined before the production of tickets. Instant ticket sales of \$32,924 in 2002 were \$462 greater than 2001 sales of \$32,462. First quarter sales were lower than anticipated; however, the Lottery was able to stimulate sales in the last three quarters through games designed with higher prize payouts and the introduction of games with price points of 10 dollars. The average prize payout rate in 2002 was virtually the same as the prior year and resulted in a prize expense increase of \$400. Transfers to the General Fund of \$4,475 were exactly the same for 2001 and 2002.

**Interest and Dividends**

All idle cash of the Lottery Board is invested through the District's General Fund Pooled Investments Account. Powerball receipts transferred to MUSL to fund major jackpots are invested in securities prior to related jackpots being hit, and earnings are allocated quarterly to party lotteries. Interest and dividend income shown separately in the financial statements decreased by \$849 or 57.40% to \$630 in 2002 due to lower interest rates and the slow down in the economy.

**Charitable Gaming Activities**

The Lottery Board also oversees charitable gaming activities to include the licensing and regulation of charitable and other not-for-profit organizations conducting bingo, raffles, and other fund-raising activities within the District of Columbia. The mission of the Lottery Board with respect to charitable gaming is to insure that only qualified organizations are licensed to conduct fund-raising activities and that they are carried out in accordance with existing laws, rules and regulations. Revenues generated through the issuance of licenses, processing fess, etc. are not intended to cover costs associated with overseeing program activities.

**Contacting the Lottery Board**

Interested parties can contact the D.C. Lottery Board at D.C. Lottery and Charitable Games Control Board, 2101 Martin Luther King Jr. Avenue, S.E. Washington, D.C. 20020.

**GOVERNMENT OF THE DISTRICT OF COLUMBIA  
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Statements of Net Assets

September 30, 2002 and 2001

(Dollar amounts in thousands)

<b>Assets</b>	<b>2002</b>	<b>2001</b>
<b>Current assets:</b>		
Cash and cash equivalents	\$ 8,309	9,385
Accounts receivable, net	4,577	3,930
Inventory	683	557
Prepaid expenses and other	5	5
Restricted investments	8,631	8,631
Total current assets	22,205	22,508
<b>Noncurrent assets:</b>		
Capital assets, net	1,495	1,328
Restricted investments	70,158	71,164
Total noncurrent assets	71,653	72,492
Total assets	\$ 93,858	95,000
<b>Liabilities</b>		
<b>Current liabilities:</b>		
Accounts payable	\$ 2,935	2,816
Compensation liabilities	726	640
Deferred revenues	131	113
Accrued prizes and commissions	7,369	7,841
Other accrued liabilities	423	420
Obligations for unpaid prizes – current portion	8,631	8,631
Total current liabilities	20,215	20,461
Obligations for unpaid prizes – noncurrent portion	70,158	71,164
Total liabilities	90,373	91,625
<b>Net Assets</b>		
Investment in capital assets	1,495	1,328
Unrestricted net assets	1,990	2,047
Total net assets	\$ 3,485	3,375

The accompanying notes are an integral part of these financial statements.

**GOVERNMENT OF THE DISTRICT OF COLUMBIA  
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Statements of Revenues, Expenses, and Changes in Net Assets

Years ended September 30, 2002 and 2001

(Dollar amounts in thousands)

	<u>2002</u>	<u>2001</u>
Operating revenues:		
Gaming revenues	\$ 211,151	224,885
Operating expenses:		
Prizes	110,741	105,594
Agents commissions	12,807	11,637
Contractor fees	11,310	11,962
Advertising	4,592	3,836
Administration	9,030	9,008
Amortization and depreciation	191	227
Total operating expenses	<u>148,671</u>	<u>142,264</u>
Operating income	62,480	82,621
Nonoperating revenues – interest and dividends	<u>630</u>	<u>1,479</u>
Income before transfers	63,110	84,100
Transfers to District General Fund	<u>(63,000)</u>	<u>(84,000)</u>
Change in net assets	110	100
Net assets, beginning of year	<u>3,375</u>	<u>3,275</u>
Net assets, end of year	<u>\$ 3,485</u>	<u>3,375</u>

The accompanying notes are an integral part of these financial statements.

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Statements of Cash Flows

Years ended September 30, 2002 and 2001

(Dollar amounts in thousands)

	2002	2001
Operating activities:		
Cash receipts from customers	\$ 210,495	223,865
Cash receipts from others	28	1,020
Cash payments to vendors	(19,209)	(17,999)
Cash payments to employees	(5,642)	(5,631)
Cash payments for prizes and commissions	(124,020)	(117,120)
Net cash provided by operating activities	61,652	84,135
Capital and related financing activities – acquisition of fixed assets	(358)	(1,075)
Non-capital financing activities – transfers out	(63,000)	(84,000)
Investing activities – interest and dividends	630	1,479
Net (decrease) increase in cash	(1,076)	539
Cash and cash equivalents – beginning of year	9,385	8,846
Cash and cash equivalents – end of year	\$ 8,309	9,385
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 62,480	82,621
Amortization and depreciation	191	227
Decrease (increase) in assets:		
Receivables	(647)	21
Inventory	(126)	(1)
Prepaid expenses	—	1
Increase (decrease) in liabilities:		
Accounts payable	119	1,053
Compensation liabilities	86	27
Deferred revenue	18	(20)
Accrued prizes	(472)	111
Other current liabilities	3	95
Net cash provided by operating activities	\$ 61,652	84,135

The accompanying notes are an integral part of these financial statements.

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Notes to Financial Statements

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(Dollar amounts in thousands)

**(1) Organization**

The Lottery and Charitable Games Control Board (Lottery) was established by Public Law 3-172 as an independent agency of the Government of the District of Columbia (District). In accordance with the law, the Lottery must remit its monthly gaming revenues, less prizes, operating expenses and a reserve not to exceed 2% of projected annual prize payments to the General Fund of the District.

**(2) Summary of Significant Accounting Policies**

**(a) Basis of Presentation**

The Lottery's financial transactions are accounted for as an enterprise fund in the District's financial statements. The accompanying financial statements are only those of the Lottery and are not intended to present the financial position, changes in financial position, and cash flows of the District taken as a whole. The District provides certain legal, central accounting, and other services to the Lottery. The costs and revenue associated with these services are not reflected in these financial statements.

**(b) Basis of Accounting**

The accompanying financial statements are prepared on the accrual basis of accounting. Under this method, revenues are reported when earned and expenses are reported at the time the related liabilities are incurred. In accordance with Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and other Governmental Entities that use Proprietary Fund Accounting*, the Lottery has elected not to follow the Financial Accounting Standards Board (FASB) Statements and Interpretations, APB Opinions, and Accounting Research Bulletins issued after November 30, 1989.

**(c) Adoption of New Accounting Standards**

During fiscal year 2002, the Lottery adopted GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*; Statement No. 37, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus*; and Statement No. 38, *Certain Financial Statement Note Disclosures*.

The only impact on the Lottery was on the presentation of net assets, certain revisions to the notes to the financial statements, and the inclusion of management's discussion and analysis.

**(d) Cash and Cash Equivalents**

The Lottery participates in the District's pooled cash program whereby cash that is not needed for immediate disbursement is pooled with that of the District and used to purchase current investments. In accordance with the law, the District may invest the pooled cash directly in, or through repurchase agreements, obligations of the United States or its agencies, which are fully guaranteed by the federal government, and in certificates of deposit, which are issued by federally insured banks. In accordance with District policies, substantially all deposits in the

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pooled cash program were insured or collateralized with securities held by the District or its agent in the District's name. Interest income from the investment of pooled cash is allocated to the Lottery based on the amount the Lottery invests in the pool. The Lottery considers the pooled cash to be cash equivalents for the purpose of cash flows because the pool may not hold the securities for more than 91 days.

**(e) Inventory**

Inventory, consisting of instant lottery tickets, is valued at cost using the specific identification basis. The costs of the instant lottery tickets are recorded as an expense when the tickets are sold.

**(f) Capital Assets**

Capital assets are recorded at cost. The cost of major remodeling, betterments, and improvements of \$5 and greater are capitalized. Repairs and maintenance costs are expensed as incurred. When capital assets are retired or sold, the cost and related accumulated depreciation are removed from the appropriate property and equipment accounts, and resulting gains or losses are recorded.

Amortization and depreciation expense are calculated using the straight-line method over the following estimated useful lives:

<u>Category</u>	<u>Estimated Useful Life</u>
Machinery and equipment	5-8 years
Office furniture and fixtures	5-8 years
Leasehold improvements	5-15 years

**(g) Gaming Revenue**

Revenue from online tickets is recorded as gaming revenue when the drawings are held. Online tickets sold in advance are recorded as deferred revenue until the drawings are held. Revenue from instant tickets is recorded as gaming revenue when the tickets are activated.

**(h) Prize Expense**

Instant tickets prize expense is based on the prize payout percentage for each instant lottery game and is accrued as the related gaming revenue is earned. Prize expenses for online games, excluding Powerball, are accrued based on the draw liability associated with drawings for the specific games. Powerball prize expense is recorded at the rate of 50% of ticket sales. The accrued prize liability represents a payable for prize amounts that have not been claimed as of each fiscal year-end.



**GOVERNMENT OF THE DISTRICT OF COLUMBIA  
 LOTTERY AND CHARITABLE GAMES CONTROL BOARD**

Notes to Financial Statements

September 30, 2002 and 2001

(Dollar amounts in thousands)

**(i) *Compensated Absences***

The Lottery permits employees to accumulate earned but unused vacation and sick pay benefits depending on the employee's length of service. Employees may not accumulate more than 240 hours of vacation benefits. The Lottery accrues for accumulated vacation as the benefits are earned by employees.

There is not a maximum limitation on the amount of unused sick pay benefits that employees may accumulate. The Lottery does not accrue for nonvesting accumulating rights to receive sick pay benefits. At the time of retirement, unused sick pay benefits are credited at the rate of 30 days for each month of service and are added to the retirees' years of service in the retirement programs.

**(j) *Use of Estimates***

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

**(k) *Comparative 2001 Financial Data***

Certain 2001 account balances have been reclassified to conform with the presentation used in 2002.

**(3) *Accounts Receivable***

The components of accounts receivable as of September 30, 2002 and 2001 are as follows:

<b>Description</b>	<b>2002</b>	<b>2001</b>
	<hr/>	<hr/>
Due from agents:		
Online games	\$ 1,924	1,931
Instant games	3,037	2,369
	<hr/>	<hr/>
Total due from agents	4,961	4,300
Other	72	86
	<hr/>	<hr/>
Total accounts receivable	5,033	4,386
Less allowance for doubtful accounts	(456)	(456)
	<hr/>	<hr/>
Total accounts receivable, net	\$ 4,577	3,930
	<hr/> <hr/>	<hr/> <hr/>

**GOVERNMENT OF THE DISTRICT OF COLUMBIA  
 LOTTERY AND CHARITABLE GAMES CONTROL BOARD**

Notes to Financial Statements  
 September 30, 2002 and 2001  
 (Dollar amounts in thousands)

**(4) Capital Assets**

A summary of capital assets as of September 30, 2002 and 2001 is as follows:

	<u>Balance as of October 1, 2001</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance as of September 30, 2002</u>
Cost:				
Machinery and equipment	\$ 2,533	342	245	2,630
Office furniture and fixtures	321	—	—	321
Lease hold improvements	758	16	—	774
Total cost	<u>3,612</u>	<u>358</u>	<u>245</u>	<u>3,725</u>
Less – accumulated depreciation				
Machinery and equipment	1,577	261	358	1,480
Office furniture and fixtures	304	4	—	308
Lease hold improvements	403	58	19	442
Total accumulated depreciation	<u>2,284</u>	<u>323</u>	<u>377</u>	<u>2,230</u>
Capital assets – net	<u>\$ 1,328</u>			<u>1,495</u>
	<u>Balance as of October 1, 2000</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance as of September 30, 2001</u>
Cost:				
Machinery and equipment	\$ 2,203	912	582	2,533
Office furniture and fixtures	321	—	—	321
Lease hold improvements	605	163	10	758
Total cost	<u>3,129</u>	<u>1,075</u>	<u>592</u>	<u>3,612</u>
Less – accumulated depreciation				
Machinery and equipment	1,980	181	582	1,579
Office furniture and fixtures	301	4	—	305
Lease hold improvements	368	42	10	400
Total accumulated depreciation	<u>2,649</u>	<u>227</u>	<u>592</u>	<u>2,284</u>
Capital assets – net	<u>\$ 480</u>			<u>1,328</u>

The Lottery changed its depreciation method from the half-year convention to the monthly cost allocation method to conform to the District's accounting policy guidelines upon installation of a new fixed assets system. Under the new accounting method, depreciation expense for capital assets

**GOVERNMENT OF THE DISTRICT OF COLUMBIA  
LOTTERY AND CHARITABLE GAMES CONTROL BOARD**

Notes to Financial Statements

September 30, 2002 and 2001

(Dollar amounts in thousands)

capitalized prior to October 1, 2001 and the current year amounted to \$302 and \$20, respectively. Current year depreciation of \$191 has been reduced by \$132 to adjust related accumulated depreciation balances at September 30, 2002.

**(5) Multi-State Lottery Association**

**(a) Background**

The Lottery is a member of the Multi-State Lottery Association (MUSL). MUSL has 22 members and administers a multi-state lottery game. Powerball, the current game, was initiated on April 20, 1992 and is a semiweekly pari-mutuel drawing with a minimum grand prize of \$10. MUSL previously administered the Lotto-America game which was terminated on April 18, 1992. All MUSL members remit a portion of their Powerball revenue to MUSL for the prize payments and administrative expenses of Powerball.

**(b) Restricted Investments and Obligations for Unpaid Prizes**

Lotto-America and Powerball prizes of \$250 or greater are payable to the winner in annual installments over 25 years. The Lottery is responsible for sending the annual payments to Lotto-America and Powerball winners who purchased their winning tickets from the Lottery. MUSL is responsible for providing the Lottery cash to fund these installment payments.

As of September 30, 2002 and 2001, MUSL had purchased for the Lottery, U.S. government securities aggregating \$97,389 and \$106,056, respectively to fund future installment payments for the Lottery's Lotto-America and Powerball winners.

The market value of these securities was \$78,789 and \$79,795 as of September 30, 2002 and 2001, respectively. The investments provide the Lottery cash payments corresponding to the Lottery's obligations to send the annual installments to the prize winners. The Lottery has reflected the market value of the securities as restricted investments and as corresponding obligations for unpaid prizes on the statements of net assets. All restricted investments are insured and registered or are held by the Lottery or its agent in the Lottery's name.

**(c) MUSL Prize Reserves**

The prize pool for Powerball consists of 50% of each drawing period's sales, including tax. Two percent of the prize pool is placed in a MUSL prize reserve fund and a MUSL set prize reserve fund. These reserve funds serve as contingency funds to protect MUSL from unforeseen liabilities. As of September 30, 2002 and 2001, the total MUSL prize reserve fund was approximately \$53,000, of which the Lottery's share was approximately \$1,887. In addition, the total MUSL set prize reserve fund as of September 30, 2002 and 2001, was approximately \$27,000, of which the Lottery's share is approximately \$839.

The balance remaining in the reserve funds are refundable to MUSL members if a member leaves or if MUSL disbands. If a member leaves, the member must wait one year before their portion of the prize reserve funds is returned. The balance in the reserve funds may be used at

**GOVERNMENT OF THE DISTRICT OF COLUMBIA  
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Notes to Financial Statements  
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the discretion of MUSL's board of directors. Accordingly, the Lottery's share of the reserve funds is not reflected in the accompanying financial statements.

**(6) Obligations for Unpaid Prizes**

Jackpot prizes are paid in 20 or 25 installments. The first installment is paid approximately two weeks after the prize is claimed. The subsequent annual payments are funded with U.S. Treasury STRIPS purchased by MUSL for the Lottery. Jackpot prizes payable represent the future annual prize payments valued at cost plus accrued interest (present value of securities held to maturity) of the investment securities funding the payments.

	<b>Year ended September 30, 2002 Jackpot</b>	<b>Year ended September 30, 2001 Jackpot</b>
Jackpot prizes payable:		
Due within one year	\$ 8,631	8,631
Due in subsequent years	70,158	71,164
Total (present value)	78,789	79,795
Add: Interest to maturity	18,600	26,261
Jackpot prizes payable at maturity	\$ 97,389	106,056

The following schedule presents the changes in prizes payable:

Balance as of October 1, 2000	\$	76,878
Increases		11,548
Decreases		(8,631)
Balance as of September 30, 2001		79,795
Increases		7,625
Decreases		(8,631)
Balance as of September 30, 2002	\$	78,789

**GOVERNMENT OF THE DISTRICT OF COLUMBIA  
LOTTERY AND CHARITABLE GAMES CONTROL BOARD**

Notes to Financial Statements

September 30, 2002 and 2001

(Dollar amounts in thousands)

**(7) Gaming Revenues and Expenses**

Gaming revenues and expenses for the fiscal years ended September 30, 2002 and 2001 are as follows:

**Ticket Sales, Prizes, and Commissions  
2002**

	Lucky Numbers	D.C. Four	Powerball	Quick Cash	Hot Five	Lucky Numbers Extra	D.C. Four- Extra	Instant Games	Others	Total
Ticket revenue	\$ 72,194	68,453	27,723	4,200	5,067	234	328	32,924	28	211,151
Prizes	(34,692)	(36,146)	(12,039)	(3,215)	(2,635)	(151)	(211)	(21,652)	—	(110,741)
Agent commissions	(4,491)	(3,822)	(1,519)	(243)	(309)	(16)	(22)	(2,385)	—	(12,807)
Gross margin	\$ 33,011	28,485	14,165	742	2,123	67	95	8,887	28	87,603

**2001**

	Lucky Numbers	D.C. Four	Powerball	Quick Cash	Cash for Life	Hot Five	Instant Games	Others	Total
Ticket revenue	\$ 70,583	65,505	45,854	4,160	—	5,300	32,462	1,021	224,885
Prizes	(31,837)	(27,353)	(21,689)	(973)	29	(2,519)	(21,252)	—	(105,594)
Agent commissions	(3,798)	(3,234)	(2,029)	(196)	1	(282)	(2,099)	—	(11,637)
Gross margin	\$ 34,948	34,918	22,136	2,991	30	2,499	9,111	1,021	107,654

**(8) Transfers to the General Fund of the District**

The District Budget Act (PL 4-162) (the Act) of 1983 requires the Lottery to transfer its revenues less expenses and less a reserve not to exceed 2% of projected annual prize payments, to the General Fund of the District. The Mayor may approve a change in the reserve limit, as necessary, upon the request of the Lottery. During the fiscal years ended September 30, 2002 and 2001, the Lottery's net transfers to the General Fund of the District were \$63,000 and \$84,000 respectively. The Lottery was in compliance with the Act for the fiscal years ended September 30, 2002 and 2001.

**(9) Retirement Programs**

**(a) Defined Benefit Pension Plan**

The majority of the full-time Lottery employees hired before October 1, 1987 are covered by the Federal Civil Service Retirement System (5 U.S.C. 833 1). The Federal Civil Service Retirement System is a cost-sharing multiple employer pension plan.

**GOVERNMENT OF THE DISTRICT OF COLUMBIA  
LOTTERY AND CHARITABLE GAMES CONTROL BOARD**

Notes to Financial Statements

September 30, 2002 and 2001

(Dollar amounts in thousands)

The U.S. Office of Personnel Management is responsible for administering the Federal Civil Service Retirement System, including collecting the contributions and disbursing the benefits.

In accordance with the Balance Budget Act of 1997 (Public Law 105-33), the Lottery contributes 8.51% and employees contribute 7.25% of employees' covered compensation to the Federal Civil Service Retirement System. The Lottery's contribution will decrease to 7.50% in October 2002 and to 7.00% in January 2003. Contributions by the Lottery amounted to \$201, \$295 and \$274 for the years ended September 30, 2002, 2001 and 2000, respectively. The number of Lottery employees covered under the Federal Civil Service Retirement System is 44.

**(b) *Defined Contribution Plan***

All full-time employees hired after September 30, 1987 are covered by the District-sponsored defined contribution plan. Employees do not contribute to this plan and are eligible to participate after one year of service. The Lottery contributes 5% of an eligible employee's base salary, which amounted to \$140 and \$127 for the fiscal years ended September 30, 2002 and 2001, respectively.

Contributions and earnings vest fully after four years of service following a one-year waiting period. Contributions and earnings are forfeited if separation occurs before five years of credited service. These contributions are not considered assets of the Lottery or the District, which have no further liability to this plan.

**(c) *Deferred Compensation Plan***

Lottery employees are eligible to participate in the District-sponsored deferred compensation plan (D.C. Code 47-3601) created in accordance with Internal Revenue Code Section 457. Employees may defer up to 25% of their compensation, not to exceed \$8. Compensation deferred and income earned are taxable when paid or made available to the participant or beneficiary upon retirement, death, termination, or unforeseeable emergency. Contributions are not assets of the Lottery or District, which have no further liability to the plan.

**GOVERNMENT OF THE DISTRICT OF COLUMBIA  
 LOTTERY AND CHARITABLE GAMES CONTROL BOARD**

Notes to Financial Statements

September 30, 2002 and 2001

(Dollar amounts in thousands)

**(10) Commitments and Contingencies**

**(a) Operating Leases**

The Lottery leases certain facilities under long-term, noncancelable, and operating leases. The total future minimum rental commitments for the fiscal years ending September 30, 2003 and beyond are as follows:

<b>Year ending September 30,</b>	
2003	\$ 1,241
2004	1,240
2005	1,241
2006	1,241
2007	413
	<u>5,376</u>
	<u>\$ 5,376</u>

Rent expense for the fiscal years ended September 30, 2002 and 2001 is as follows:

	<u>2002</u>	<u>2001</u>
Gross rental expense	\$ 1,249	1,219
Less income from subleases	(170)	(170)
Net rent expense	<u>\$ 1,079</u>	<u>1,049</u>

**(b) Risk of Loss**

The Lottery is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Lottery or District covers all of the Lottery's claim settlements and judgments out of the Lottery revenues or the District's General Fund resources.

**(c) Annuity Contracts**

Prizes awarded for the Lucky Lotto game, which ended effective May 1, 1989, are payable to the winners in annual installments over 10 or 20 years. The first installment payments were made by the Lottery at the time of the drawing. The Lottery had entered into agreements with insurance companies under which the Lottery purchased annuities contracts that provide the annual installment payments to the Lucky Lotto prize winners. As the insurance companies are responsible for the annual installments payments, neither the present value of the annuities nor the present value of the related future payments is reflected in the accompanying financial statements. The Lottery would be liable for such future installment payments if the insurance companies were to default on their payments. As of September 30, 2002 and 2001, future installment payments due to Lucky Lotto winners were approximately \$7,303 and \$9,323

**GOVERNMENT OF THE DISTRICT OF COLUMBIA  
LOTTERY AND CHARITABLE GAMES CONTROL BOARD**

Notes to Financial Statements

September 30, 2002 and 2001

(Dollar amounts in thousands)

respectively. As of September 30, 2002 and 2001, future installment payments due to instant lottery winners were approximately \$405 and \$759, respectively.

During 1991, Executive Life Insurance Company (ELIC), with whom the Lottery holds two annuities, was placed into conservancy with the Los Angeles, California Superior Court (Superior Court). In 1993, the Superior Court approved the terms of a rehabilitation plan and the purchase of ELIC by the Aurora National Life Insurance Company. As a result, the Lottery is required to fund a percentage of the annual installment payments for these annuities. The Lottery's accrued prize liability as of September 30, 2002 and 2001 includes \$98 and \$236, respectively, for the Lottery's percentage of the annual installment payments to these Lucky Lotto winners.

**(11) Related Party Transactions**

The Lottery had related party transactions with the Office of Cable Television (OCT), another District of Columbia Government agency, during the fiscal year ended September 30, 2002. OCT is responsible for the production of daily draws for the various lottery games. The annual contractual cost for the related services rendered amounted to \$480 and was negotiated at arms length. Other services provided by District Government entities to the Lottery include central processing of payroll, accounting, computer technology services, and the handling of intradistrict transactions for rent, telephone, security guard services, etc. Personnel costs for these services are budgeted and accounted for as part of the respective entity's regular operations.





2001 M Street NW  
Washington, DC 20036

**Independent Auditors' Report on Compliance and on Internal Control Over  
Financial Reporting Based on an Audit of Financial Statements Performed  
in Accordance with *Government Auditing Standards***

To the Mayor and Members of  
The Council of the Government of District of Columbia, and  
The Lottery and Charitable Games Control Board  
Washington, D.C.

We have audited the basic financial statements of the Lottery and Charitable Games Control Board (the Lottery), an enterprise fund of the Government of the District of Columbia (District), as of and for the year ended September 30, 2002, and have issued our report thereon dated January 7, 2003. 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.

**Compliance**

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

**Internal Control over Financial Reporting**

In planning and performing our audit, we considered the Lottery's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the basic financial statements and not to provide assurance on internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.





This report is intended solely for the information and use of the Mayor, Council, the Inspector General of the Government of the District of Columbia and management of the Lottery, and should not be used by anyone other than these specified parties.

KPMG LLP

January 7, 2003