

# Financial Section





## INDEPENDENT AUDITORS' REPORT

To the Texas Lottery Commission:

We have audited the accompanying financial statements of the governmental activities, the business-type activities and each major fund and fiduciary fund information of the Texas Lottery Commission (the "Commission"), an agency of the State of Texas, as of and for the year ended August 31, 2002, which collectively comprise the Commission's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Commission's management. Our responsibility is to express an opinion on these financial statements based on our audit.

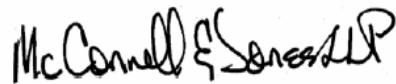
We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and 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 financial position of the governmental activities, the business-type activities, and each major fund and fiduciary fund information of the Commission as of August 31, 2002, and the respective changes in financial position and cash flows, where applicable, thereof 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 November 5, 2002, on our consideration of the Commission's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts.

The Management Discussion and Analysis and budgetary comparison information on pages 5 through 9 and 45, respectively, are not a required part of the basic financial statements but are 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 basic financial statements taken as whole. The combining fiduciary fund financial statement on page 43 is presented for the purpose of additional analyses and is not a required part of the basic financial statements of the Commission. This financial statement is the responsibility of the Commission's management. Such additional information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion is fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

A handwritten signature in black ink, appearing to read "McConnell & Senese LLP". The signature is written in a cursive, somewhat stylized font.

Houston, Texas  
November 5, 2002

**Texas Lottery Commission**  
**Management's Discussion and Analysis**  
**For the Year Ended August 31, 2002**  
(Unaudited)

Management of the Texas Lottery Commission (the "Commission") provides this *Management's Discussion and Analysis* of the financial performance of the Commission's financial statements. Although fiscal year 2002 represents the first year in which the Commission implemented the provisions of Governmental Accounting Standards Board (GASB) Statement No. 34, management has decided to present comparative analysis to provide a more comprehensive perspective of the Commission's financial performance. This narrative provides an overview of the Commission's financial activities for the fiscal years ended August 31, 2002 and 2001. This analysis is to be considered in conjunction with the financial statements to provide an objective analysis of the Commission's financial activities based on facts, decisions, and conditions currently facing management.

*Financial Highlights*

**Government-wide:**

- The assets of the Commission exceeded its liabilities at the close of fiscal year 2002 by \$101.7 million (reported as *net assets*), an increase of \$63 million from the previous fiscal year.

**Fund Level:**

- As of the close of the fiscal year 2002, the Commission's governmental funds reported a combined ending fund balance of \$503,513, with \$499,625 reported as *reserved fund balance*; earmarked for specific purposes such as vendor payables. The unreserved balance at fiscal year end was \$3,888.
- The proprietary funds reported net assets at year-end 2002 of \$101.4 million, an increase of \$63.4 million during the year.

More detailed information regarding these activities and funds begins on page 11.

*Understanding the Commission's Financial Statements*

This discussion and analysis is an introduction to the Commission's basic financial statements which are comprised of three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements.

For the first time, this report includes government-wide financial statements as required by GASB Statement No. 34.

**Government-wide Statements (Reporting the Commission as a whole)**

The Statement of Net Assets and the Statement of Activities are two financial statements that report information about the Commission, as a whole, and about its activities that should help answer this question: Is the Commission more (or less) effective in achieving its defined objective? These statements include all non-fiduciary assets and liabilities using the accrual basis of accounting. The current fiscal year's revenues and expenses are taken into account regardless of when cash is received or paid.

The Statement of Net Assets on page 11 presents all of the Commission's assets and liabilities, with the difference between the two reported as "net assets". Over time, increases and decreases in net assets measure whether the Commission's financial position is improving or deteriorating.

The Statement of Activities on page 12 presents information showing how the Commission's net assets changed during fiscal year 2002. All changes in net assets are reported as soon as the underlying events giving rise to the change occur, regardless of the timing of related cash flows. Therefore, revenues and expenses are reported in these statements for some items that will result in changes in cash flows in future fiscal periods (e.g. earned but unused compensatory leave).

Both statements report two activities:

- *Governmental Activities* – The Commission's Charitable Bingo Operations Division is reported under this category. Intergovernmental revenues are the only source of funding for these services.
- *Business-type Activities* – The Commission's operations are accounted for under this category. Sales of lottery tickets and fees charged to retailers provide funding for the business-type activities. The primary focus of business-type activities is generate net income available for transfer to the State's Foundation School Fund, the Multi-categorical Teaching Hospital and the Tertiary Care Facility Accounts rather than the change in net assets of the Commission.

This report includes two schedules (pages 14 and 16) that reconcile the amounts reported on the governmental fund financial statements (modified accrual accounting) with governmental activities (accrual accounting) on the appropriate government-wide statements. The following summarizes the impact of transitioning from modified accrual to full accrual accounting:

- Capital assets used in governmental activities are not reported on governmental fund statements.
- Unless due and payable, long-term liabilities such as compensated absences only appear as liabilities in the government-wide statements.
- Capital outlay spending results in capital assets on the government-wide statements, but are reported as expenditures on the governmental fund statements.
- Certain other outflows represent either increases or decreases in liabilities on the government-wide statements, but are reported as expenditures on the governmental fund statements.

The Notes to the Basic Financial Statements provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes can be found beginning on page 24 of this report.

### **Fund Financial Statements (Reporting the Commission's Major Funds)**

Because the Commission operates with five funds, management determined that for fair presentation, all except for the fiduciary funds would be considered major. The fund financial statements begin on page 13 and provide detailed information about all the individual funds. A fund is a fiscal and accounting entity with a self-balancing set of accounts that the Commission uses to keep track of specific sources of funding and spending for a particular purpose. The Commission's funds are divided into three categories: governmental, proprietary, and fiduciary; and use different accounting methods.

- *Governmental funds* – The Commission's Charitable Bingo Operations Division and its services are reported in the governmental funds, which focus on how money flows into and out of those funds and the balances left at year-end that are available for future spending. The governmental fund financial statements provide a detailed short-term view of the Commission's Charitable Bingo Division

operations and the basic services it provides. Governmental fund information helps determine whether there are more or fewer financial resources that can be spent in the near future to finance Charitable Bingo programs. These funds are reported using modified accrual accounting, which measures cash and all other financial assets that can readily be converted to cash. Governmental funds include the General Fund and the General Fund Consolidated Account.

- *Proprietary funds* – Proprietary funds utilize accrual accounting; the same method used by private sector businesses. There are two types of proprietary funds: Enterprise funds report activities that provide supplies and services to the general public. Internal service funds report activities that provide supplies and services for the governments other programs and activities. The Commission records all transactions related to the operation of the State Lottery in an Enterprise Fund.
- *Fiduciary funds* – The Commission acts as a trustee or fiduciary for its employee Savings Bond Account and Suspense Fund. The Commission's fiduciary activities are reported in separate Statements of Fiduciary Assets and Liabilities and Changes in Fiduciary Net Assets beginning on page 22. These funds, which include agency funds, are reported using accrual accounting. The government-wide statements exclude fiduciary fund activities and balances because these assets are restricted in purpose and do not represent discretionary assets of the Commission to finance its operations.

#### Additional Required Supplementary Information

Following the basic financial statements is additional Required Supplementary Information that further explains and supports the information in the financial statements. The Required Supplementary Information includes a budgetary comparison schedule reconciling the statutory and generally accepted accounting principles (GAAP) fund balances at fiscal year-end for the General Fund.

### Financial Analysis of the Government as a Whole

#### *Statement of Net Assets*

##### Total Primary Government

(In millions of dollars)

	<u>August 31, 2002</u>
Current and other non-current assets	\$ 1,756.7
Capital Assets	1.3
<b>Total assets</b>	<u>1,758.0</u>
Long-term liabilities	1,364.2
Other liabilities	292.1
<b>Total Liabilities</b>	<u>1,656.3</u>
Net assets:	
Invested in capital assets, net of related debt	1.3
Restricted	9.5
Unrestricted	90.9
<b>Total net assets</b>	<u>\$ 101.7</u>

The largest component (89.3%) of the Commission's net assets is comprised of **unrestricted net assets** of \$90.9 million, which may be used at the Commission's discretion, but often have limitations on use based on State statutes. **Restricted net assets** are the next largest component, comprising 9.3%. These

net assets represent resources that are subject to external restrictions, constitutional provisions, or enabling legislation on how they can be used. The remaining portion represents the amount invested in fixed assets, net of related debt. The Commission uses these capital assets to provide services; consequently, these assets are *not* available for future spending.

The majority of the Commission's assets consist of cash, cash equivalents and investments used to fund future installment payments. At August 31, 2002, the Commission's assets included \$105.4 million in cash and cash equivalents as compared with \$168.8 million at August 31, 2001. The Commission's short and long-term investments approximated \$1,617.7 and \$1,550.7 million, respectively, at August 31, 2002 and 2001.

The Commission's liabilities included at the balance sheet date are amounts owed to the State's Foundation School Fund for unspent administrative funds for fiscal year 2002, vendor payables, and prize obligations. The amount due to the Foundation School Fund approximated \$15.5 million at August 31, 2002 as compared with \$25.9 million at August 31, 2001. Prize obligations, made up largely of instant ticket games and *Lotto Texas* installment payments, were \$1,609.5 million and \$1,632.7 million at August 31, 2002 and 2001, respectively. Vendor payables were \$18.1 million at August 31, 2002 as compared to \$21.5 million at August 31, 2001.

The majority of the Commission's assets represent current resources necessary to pay the current liabilities owed to vendors, prizewinners, and ultimately the State's Foundation School Fund.

***Statement of Activities and Changes in Net Assets***

Total Primary Government

(In millions of dollars)

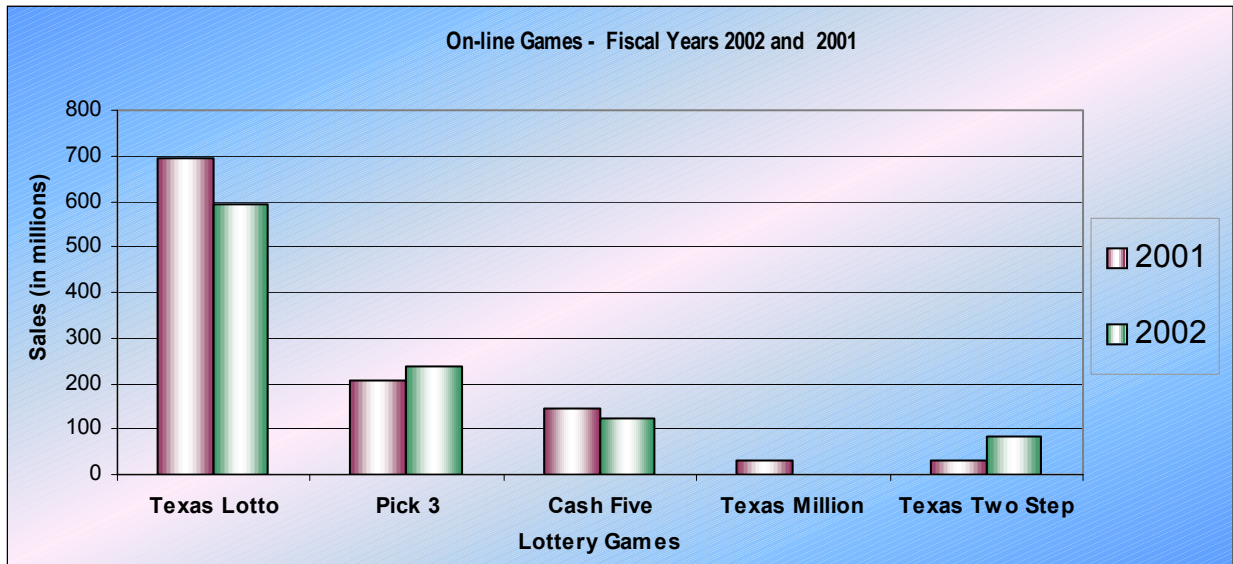
August 31, 2002

Sales	\$ 2,966.3
Intergovernmental Revenue	3.3
Prize Expense	(1,715.4)
Commissions	(148.4)
Operating and other expenses	(183.3)
Operating income	922.5
Other income	70.4
Transfer to State's General Fund	(928.9)
Change in net assets	<u>\$ 64.0</u>

Sales

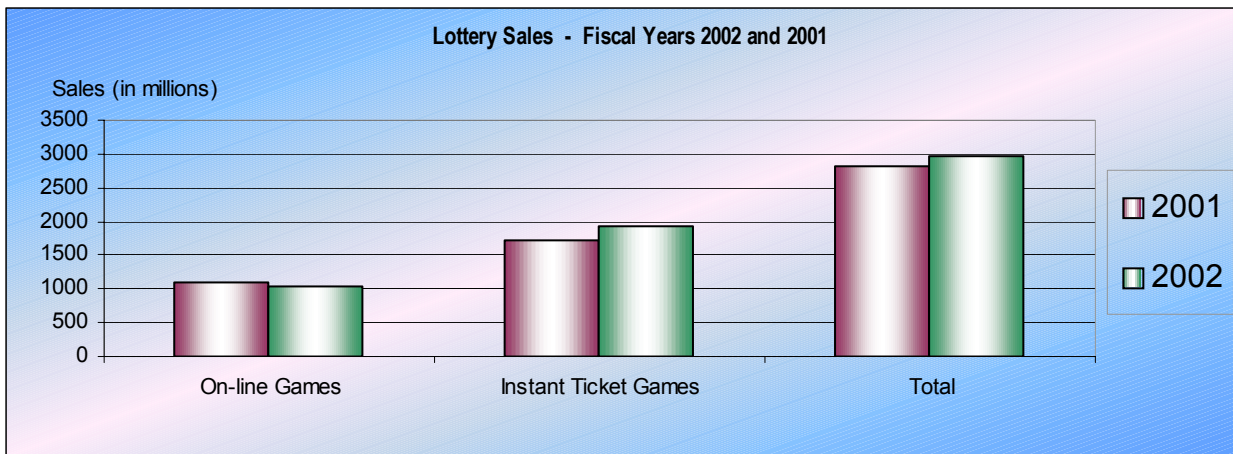
Lottery sales consist of on-line and instant lottery games. The first category is on-line games, which included *Lotto Texas*, *Pick 3*, *Cash Five* and *Texas Two Step* at August 31, 2002. In total, on-line sales declined by \$74.5 million, which is mostly attributable to a decline in *Lotto Texas* sales. Other on-line games such as *Pick 3* and *Texas Two Step* proved to be more successful during Fiscal Year 2002. A change in the matrix for *Pick 3* resulted in the ninth consecutive year of increased sales. Sales for *Pick 3*, at August 31, 2002, totaled \$236.4 million. *Texas Two Step* sales increased by \$50 million during its first full year in existence.

The following graph depicts the Commission’s on-line sales for the fiscal year ended August 31, 2002 and 2001.



Instant tickets or “scratch-off” tickets is the other category of Lottery games offered to the public. Instant ticket sales for the fiscal year ended August 31, 2002 increased by \$215.4 million or 12.6% over the preceding fiscal year’s sales. Implementation of a new instant ticket production plan appears to be the primary reason for the increase in sales. The plan called for fewer tickets per production, but a higher variety of instant games, including offering more popular and higher price point games (\$10 and \$5 tickets) to the public.

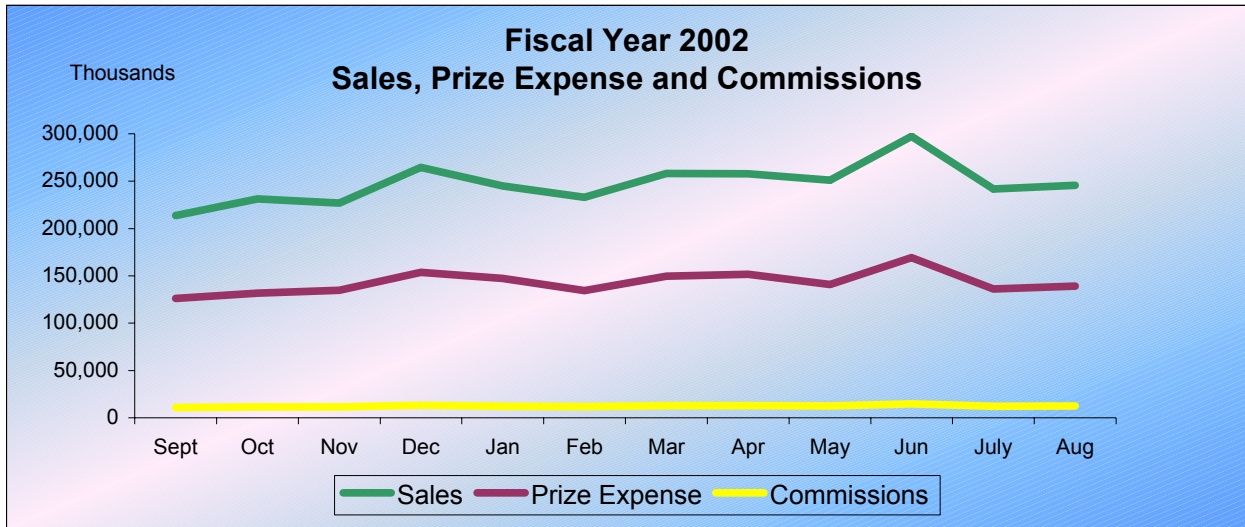
The following graph depicts the Lottery’s on-line, instant and total lottery sales for the fiscal year ended August 31, 2002 in comparison to the fiscal year ended August 31, 2001.



Commissions and Prize Awards Expense

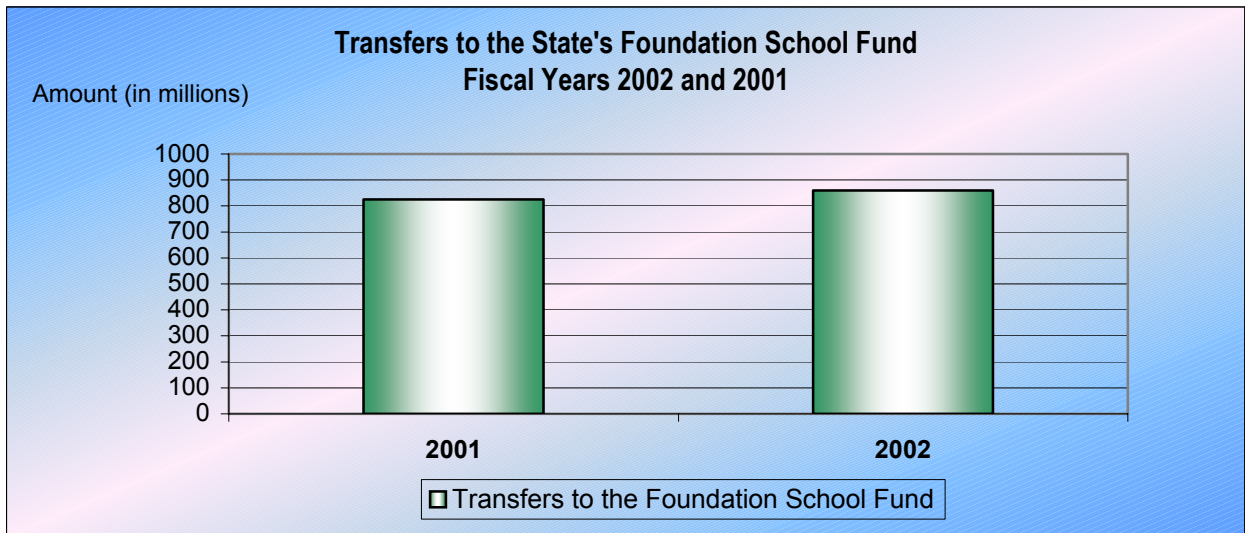
As the following graph depicts, the Commission’s most significant expenses (commissions and prize expense) are predictable because they have a direct correlation to sales. As Lottery sales increase, so do the related prizes and commissions paid by the Commission. While each Lottery game has a predetermined and unique prize payout structure the overall amount paid as prize award expense is consistent.



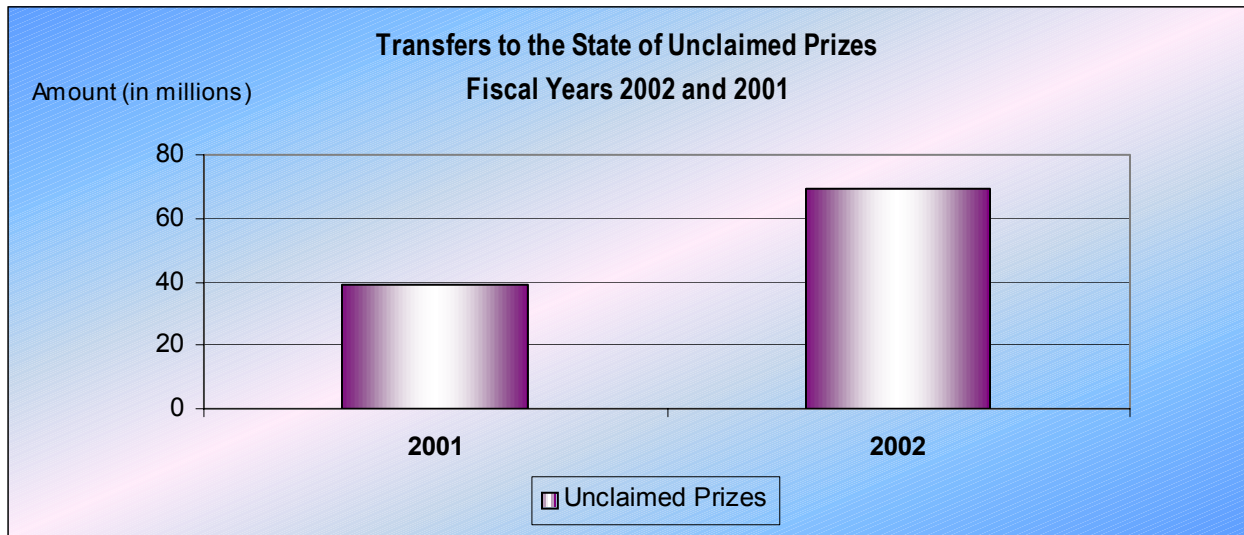


Payments to the State

The Commission recorded its third consecutive year of Lottery sales growth during the fiscal year ended August 31, 2002. Lottery sales for the fiscal year ended August 31, 2002 totaled \$2,966.3 million; an increase of 4.99% over the previous years total of \$2,825.3 million. The increase allowed transfers to the Foundation School Fund to increase by \$34 million to \$859.1 million for the period, as compared to \$825.1 million for the fiscal year ended August 31, 2001.



In addition to the transfers to the Foundation School Fund, the Commission also transfers unclaimed prizes to the State's Multicategorical Teaching Hospital (Hospital) and Tertiary Care Facility. A maximum of \$40 million per biennium is earmarked for the benefit of the Hospital. For the fiscal year ended August 31, 2002, the total unclaimed prizes was \$69.6 million representing an increase of \$30.6 million or 78.8% over the previous year's amount. Of this total amount, the Commission transferred \$40 million to the Hospital bringing the total to the statutory limit for the biennium 2002 and 2003. The remaining \$29.6 million of unclaimed prizes for fiscal year 2002 was then transferred to the Tertiary Care Facility Account.



### Potential Factors Impacting Future Operations

The Commission has two missions: 1) Administer and market state Lottery games in an efficient and secure manner using appropriate marketing tools and innovative technology to generate revenue for the State of Texas while enhancing public confidence in the integrity and fairness of the games 2) Provide authorized organizations the opportunity to raise funds for their charitable purposes by conducting bingo. Determine that all charitable bingo funds are used for a lawful purpose. Promote and maintain the integrity of the charitable bingo industry throughout Texas.

A continuous assessment of the State's financial environment and the Commission's own product lines and operations are essential to accomplish these missions. The following considerations have been presented to inform those interested in the Commission's operations about potential factors that could affect future operations:

- Due to declining sales of the *Lotto Texas* on-line game, management is considering changes to the game's matrix. Changes to the matrix are being considered in an effort to renew player interest and increase revenues.
- The Commission's games currently compete with multi-state lottery games offered in neighboring Louisiana and New Mexico. Indian gaming casinos may also be considered as competition. The Commission's operations may be adversely impacted by competition from other gaming interests that may be developed both within the State of Texas or neighboring states.
- Management has identified a number of policy issues for consideration by the Texas Legislature. These policy issues could allow additional revenue-enhancing opportunities, such as authorizing a multi-jurisdiction lottery game for Texas, video lottery at pari-mutuel tracks and the introduction of a Keno game. A bill authorizing the Texas Lottery Commission to participate in a multi-jurisdiction lottery game has been filed with the Texas Legislature, 78th Regular Session.

### Contacting the Commission's Financial Management

This financial report is designed to provide a general overview of the Commission's financial activity for all those interested in the Commission's operations. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Texas Lottery Commission Attn: Director of Financial Administration, P.O. Box 16630, Austin, Texas 78761-6630.

# **Financial Statements**

**Texas Lottery Commission**  
**Statement of Net Assets**  
**August 31, 2002**

	Primary Government		
	Current Year		
	Governmental Activities	Business-type Activities	Total 2002
<b>ASSETS</b>			
Current Assets:			
Cash and Cash Equivalents:			
Cash in Bank	\$ -	\$ 6,597.64	\$ 6,597.64
Cash in State Treasury	-	105,358,533.84	105,358,533.84
Short Term Investments	-	167,783,613.46	167,783,613.46
Internal Balances	(174,198.61)	174,198.61	-
Restricted:			
Cash and Cash Equivalents:			
Cash in State Treasury	38,369.83	-	38,369.83
Legislative Appropriations	862,133.35	-	862,133.35
Accounts Receivable	-	27,381,154.52	27,381,154.52
Merchandise Inventories	-	5,442,560.87	5,442,560.87
<b>Total Current Assets</b>	<b>726,304.57</b>	<b>306,146,658.94</b>	<b>306,872,963.51</b>
Non-Current Assets:			
Investments	-	1,449,872,948.09	1,449,872,948.09
Capital Assets:			
Furniture and Equipment	213,623.38	5,049,341.90	5,262,965.28
Accumulated Depreciation	(185,768.98)	(3,831,924.75)	(4,017,693.73)
Vehicles, Boats, and Aircraft	-	133,747.72	133,747.72
Accumulated Depreciation	-	(76,732.02)	(76,732.02)
<b>Total Non-Current Assets</b>	<b>27,854.40</b>	<b>1,451,147,380.94</b>	<b>1,451,175,235.34</b>
<b>Total Assets</b>	<b>754,158.97</b>	<b>1,757,294,039.88</b>	<b>1,758,048,198.85</b>
<b>LIABILITIES</b>			
Current Liabilities:			
Payables from:			
Accounts Payable	7,437.64	18,052,717.94	18,060,155.58
Other Intergovernmental	38,369.83	-	38,369.83
Payroll	176,984.10	991,846.67	1,168,830.77
Other	-	10,790,380.60	10,790,380.60
Due to Other Agencies	-	15,453,851.20	15,453,851.20
Employees' Compensable Leave	124,940.59	706,311.96	831,252.55
Payable From Restricted Assets-Current	-	245,785,943.54	245,785,943.54
<b>Total Current Liabilities</b>	<b>347,732.16</b>	<b>291,781,051.91</b>	<b>292,128,784.07</b>
Non-Current Liabilities:			
Employees' Compensable Leave	87,396.32	429,633.72	517,030.04
Payable From Restricted Assets	-	1,363,685,782.55	1,363,685,782.55
<b>Total Non-Current Liabilities</b>	<b>87,396.32</b>	<b>1,364,115,416.27</b>	<b>1,364,202,812.59</b>
<b>Total Liabilities</b>	<b>435,128.48</b>	<b>1,655,896,468.18</b>	<b>1,656,331,596.66</b>
<b>NET ASSETS</b>			
Invested in Capital Assets, Net of Related Debt	27,854.40	1,274,432.85	1,302,287.25
Expendable restricted for:			
Pooled Bond Fund	-	5,000,000.00	5,000,000.00
Prize Reserve Fund	-	4,562,632.52	4,562,632.52
Unrestricted	291,176.09	90,560,506.33	90,851,682.42
<b>Total Net Assets</b>	<b>\$ 319,030.49</b>	<b>\$ 101,397,571.70</b>	<b>\$ 101,716,602.19</b>
<b>Total liabilities and net assets</b>	<b>\$ 754,158.97</b>	<b>\$ 1,757,294,039.88</b>	<b>\$ 1,758,048,198.85</b>

The accompanying notes to the financial statements are an integral part of this statement.

**Texas Lottery Commission**  
**Statement of Activities**  
**August 31, 2002**

Functions/Programs	Program Revenues				Net (Expense) Revenue and Changes in Net Assets		
	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Primary Government		
					Governmental Activities	Business-type Activities	Total
<b>Primary government:</b>							
Governmental Activities:							
Bingo licensing	\$ 10,633,999.08	\$ 30,585.60	\$ -	\$ -	\$ (10,603,413.48)	\$ -	\$ (10,603,413.48)
Bingo law enforcement	1,774,841.89	-	-	-	(1,774,841.89)	-	(1,774,841.89)
Depreciation	16,040.71	-	-	-	(16,040.71)	-	(16,040.71)
Total governmental activities	<u>12,424,881.68</u>	<u>30,585.60</u>	<u>-</u>	<u>-</u>	<u>(12,394,296.08)</u>	<u>-</u>	<u>(12,394,296.08)</u>
Business-type activities:							
Lottery operations	122,009,713.11	729,702.36	-	-	-	(121,280,010.75)	(121,280,010.75)
Marketing, research, and promotion	3,710,708.79	-	-	-	-	(3,710,708.79)	(3,710,708.79)
Advertising	29,745,177.08	-	-	-	-	(29,745,177.08)	(29,745,177.08)
Security	3,419,028.83	133,857.50	-	-	-	(3,285,171.33)	(3,285,171.33)
Central administration	11,268,119.87	155,919.28	-	-	-	(11,112,200.59)	(11,112,200.59)
Lottery prizes and sales	1,715,365,639.61	2,966,262,258.55	-	-	-	1,250,896,618.94	1,250,896,618.94
Retailer commissions	148,359,044.45	-	-	-	-	(148,359,044.45)	(148,359,044.45)
Depreciation	757,034.34	-	-	-	-	(757,034.34)	(757,034.34)
Lottery prize investments	-	-	59,860,020.00	-	-	59,860,020.00	59,860,020.00
Total business-type activities	<u>2,034,634,466.08</u>	<u>2,967,281,737.69</u>	<u>59,860,020.00</u>	<u>-</u>	<u>0.00</u>	<u>992,507,291.61</u>	<u>992,507,291.61</u>
Total primary government	<u>\$ 2,047,059,347.76</u>	<u>\$ 2,967,312,323.29</u>	<u>\$ 59,860,020.00</u>	<u>\$ -</u>	<u>\$ (12,394,296.08)</u>	<u>\$ 992,507,291.61</u>	<u>\$ 980,112,995.53</u>
<b>General Revenues - detailed</b>							
					3,334,634.80	-	3,334,634.80
					9,175,954.82	-	9,175,954.82
					-	(1,455.67)	(1,455.67)
					-	271,528.23	271,528.23
					-	-	-
					-	(928,881,809.01)	(928,881,809.01)
					<u>12,510,589.62</u>	<u>(928,611,736.45)</u>	<u>(916,101,146.83)</u>
					116,293.54	63,895,555.16	64,011,848.70
					250,152.42	37,502,016.54	37,752,168.96
					(47,415.47)	-	(47,415.47)
					<u>\$ 319,030.49</u>	<u>\$ 101,397,571.70</u>	<u>\$ 101,716,602.19</u>

The accompanying notes to the financial statements are an integral part of this statement.

**Texas Lottery Commission  
Balance Sheet – Governmental Funds  
August 31, 2002**

	<u>General Fund</u>	<u>Governmental Funds Total</u>
<b>ASSETS</b>		
Current Assets:		
Restricted:		
Cash and Cash Equivalents:		
Cash in State Treasury	\$ 38,369.83	\$ 38,369.83
Legislative Appropriations	<u>862,133.35</u>	<u>862,133.35</u>
Total Current Assets	<u>900,503.18</u>	<u>900,503.18</u>
Non-Current Assets:	-	-
Total Assets	<u>\$ 900,503.18</u>	<u>\$ 900,503.18</u>
<b>LIABILITIES AND FUND BALANCES</b>		
Liabilities:		
Current Liabilities:		
Payables From:		
Accounts Payable	\$ 7,437.64	\$ 7,437.64
Other Intergovernmental	38,369.83	38,369.83
Payroll Payable	176,984.10	176,984.10
Due To Other Funds	<u>174,198.61</u>	<u>174,198.61</u>
Total Liabilities	<u>396,990.18</u>	<u>396,990.18</u>
<b>FUND BALANCES</b>		
Fund Balances:		
Reserved for:		
Encumbrances	499,625.42	499,625.42
Undesignated	<u>3,887.58</u>	<u>3,887.58</u>
Total Fund Balances	<u>503,513.00</u>	<u>503,513.00</u>
Total Liabilities and Fund Balances	<u>\$ 900,503.18</u>	<u>\$ 900,503.18</u>

The accompanying notes to the financial statements are an integral part of this statement.

**Texas Lottery Commission**  
**Reconciliation of Total Governmental Fund Balance**  
**to Net Assets of Governmental Activities**  
**For the Year Ended August 31, 2002**

**Total Governmental Fund Balance** \$ 503,513.00

Amounts reported for governmental activities in the statement of net assets are different because:

Capital assets used in governmental activities are not financial resources and therefore are not reported in the fund. These assets consist of:

Furniture and equipment	213,623.38	
Accumulated depreciation	(185,768.98)	
Total Capital Assets		27,854.40

Some liabilities are not due and payable in the current period and therefore are not reported in the fund. Those liabilities consist of:

Employee compensated leave	(212,336.91)	
Total long-term liabilities		(212,336.91)

**Net assets of Governmental Activities** \$ 319,030.49

The accompanying notes to the financial statements are an integral part of this statement.

**Texas Lottery Commission**  
**Statement of Revenues, Expenditures, and**  
**Changes in Fund Balances – Governmental Funds**  
**For the Fiscal Year Ended August 31, 2002**

	<b>General Fund</b>	<b>Governmental Funds Total</b>
<b>REVENUES</b>		
Legislative Appropriations:		
Original Appropriations	\$ 2,785,997.00	\$ 2,785,997.00
Additional Appropriations	548,637.80	548,637.80
Licenses, Fees & Permits	9,175,954.82	9,175,954.82
Other	30,785.60	30,785.60
Total Revenues	12,541,375.22	12,541,375.22
<b>EXPENDITURES</b>		
Salaries and Wages	2,040,223.35	2,040,223.35
Payroll Related Costs	444,264.98	444,264.98
Professional Fees and Services	185,774.75	185,774.75
Travel	88,811.20	88,811.20
Materials and Supplies	165,280.49	165,280.49
Communication and Utilities	33,657.13	33,657.13
Repairs and Maintenance	45,109.66	45,109.66
Rentals & Leases	167,958.02	167,958.02
Printing and Reproduction	29,511.10	29,511.10
Intergovernmental Payments	9,175,954.82	9,175,954.82
Other Expenditures	31,308.96	31,308.96
Capital Outlay	22,893.00	22,893.00
Total Expenditures/Expenses	12,430,747.46	12,430,747.46
Excess (Deficiency) of Revenues Over Expenditures	110,627.76	110,627.76
<b>OTHER FINANCING SOURCES (USES)</b>		
Total Other Financing Sources and Uses	-	-
Net Change in Fund Balances/Net Assets	110,627.76	110,627.76
<b>FUND BALANCES</b>		
Fund Balances - Beginning	440,300.71	440,300.71
Appropriations Lapsed	(47,415.47)	(47,415.47)
Fund Balances - Ending	\$ 503,513.00	\$ 503,513.00

The accompanying notes to the financial statements are an integral part of this statement.



**Texas Lottery Commission**  
**Reconciliation of Changes in Fund Balances of Governmental Funds**  
**to Changes in Net Assets of Governmental Activities**  
**For the Year Ended August 31, 2002**

**Net change in Fund Balance Total - Governmental Fund** \$ 110,627.76

Amounts reported for governmental activities in the statement of activities are different because:

Capital outlays are reported as expenditures in governmental funds. However, in the statement of activities, the cost of capital assets is allocated over their estimated useful lives as depreciation expense. In the current period, these amounts are:

Capital outlay	22,893.00	
Depreciation expense	(16,040.71)	
	6,852.29	6,852.29

Some items reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds. These activities consist of:

Increase in compensated leave	(1,186.51)	
Total long-term liabilities		(1,186.51)

**Change in Net assets of Governmental Activities** \$ 116,293.54

The accompanying notes to the financial statements are an integral part of this statement.

**Texas Lottery Commission**  
**Statement of Net Assets**  
**Proprietary Funds**  
**August 31, 2002**

	Enterprise Fund (5025) U/F (1100)	Enterprise Fund (0895) U/F (0895)	Totals 2002
<b>ASSETS</b>			
Current Assets:			
Cash and Cash Equivalents:			
Cash in Bank	\$ 6,597.64	\$ -	\$ 6,597.64
Cash in State Treasury	105,358,533.84	-	105,358,533.84
Short Term Investments:			
Unrestricted	10,089,833.54		10,089,833.54
Restricted		157,693,779.92	157,693,779.92
Receivables from:			
Third Parties	27,381,154.52	-	27,381,154.52
Due From Other Funds	174,198.61	-	174,198.61
Merchandise Inventories	5,442,560.87	-	5,442,560.87
Total Current Assets	<u>148,452,879.02</u>	<u>157,693,779.92</u>	<u>306,146,658.94</u>
Non-Current Assets:			
Restricted:			
Investments	-	1,449,872,948.09	1,449,872,948.09
Capital Assets:			
Depreciable:			
Furniture and Equipment	5,049,341.90	-	5,049,341.90
Accumulated Depreciation	(3,831,924.75)	-	(3,831,924.75)
Vehicles, Boats, and Aircraft	133,747.72	-	133,747.72
Accumulated Depreciation	(76,732.02)	-	(76,732.02)
Total Non-Current Assets	<u>1,274,432.85</u>	<u>1,449,872,948.09</u>	<u>1,451,147,380.94</u>
Total Assets	<u>149,727,311.87</u>	<u>1,607,566,728.01</u>	<u>1,757,294,039.88</u>
<b>LIABILITIES</b>			
Current Liabilities:			
Payables from:			
Accounts Payable	18,052,717.94	-	18,052,717.94
Payroll	991,846.67	-	991,846.67
Other	10,790,380.60	-	10,790,380.60
Due to Other Agencies	15,453,851.20	-	15,453,851.20
Employees' Compensable Leave	706,311.96	-	706,311.96
Prizes Payable	87,022,943.54	-	87,022,943.54
Payable From Restricted Assets	-	158,763,000.00	158,763,000.00
Total Current Liabilities	<u>133,018,051.91</u>	<u>158,763,000.00</u>	<u>291,781,051.91</u>
Non-Current Liabilities: (Note 5)			
Employees' Compensable Leave	429,633.72	-	429,633.72
Payable From Restricted Assets	-	1,363,685,782.55	1,363,685,782.55
Total Non-Current Liabilities	<u>429,633.72</u>	<u>1,363,685,782.55</u>	<u>1,364,115,416.27</u>
Total Liabilities	<u>133,447,685.63</u>	<u>1,522,448,782.55</u>	<u>1,655,896,468.18</u>
<b>NET ASSETS</b>			
Invested in Capital Assets, Net of Debt	1,274,432.85	-	1,274,432.85
Restricted for:			
Expendable:			
Restricted by Other			
Pooled Bond Fund	5,000,000.00	-	5,000,000.00
Prize Reserve Fund	4,562,632.52	-	4,562,632.52
Unrestricted	5,442,560.87	85,117,945.46	90,560,506.33
Total Net Assets	<u>\$ 16,279,626.24</u>	<u>\$ 85,117,945.46</u>	<u>\$ 101,397,571.70</u>
Total Liabilities and Net Assets	<u>\$ 149,727,311.87</u>	<u>\$ 1,607,566,728.01</u>	<u>\$ 1,757,294,039.88</u>

The accompanying notes to the financial statements are an integral part of this statement.

**Texas Lottery Commission**  
**Statement of Revenues, Expenses, and**  
**Changes in Net Assets - Proprietary Funds**  
**For the Fiscal Year Ended August 31, 2002**

	Enterprise Fund (5025) U/F (1100)	Enterprise Fund (0895) U/F (0895)	Total Proprietary Funds 2002
<b>OPERATING REVENUES:</b>			
Sales of Goods and Services:			
Lottery Proceeds			
Ticket Sales	\$ 2,966,262,258.55	\$ -	\$ 2,966,262,258.55
Lottery License Application Fees	227,687.50	-	227,687.50
Lottery Security Proceeds	133,857.50	-	133,857.50
Other Sales	157,900.09	-	157,900.09
Other Operating Revenues	500,034.05	-	500,034.05
Total Operating Revenues	<u>2,967,281,737.69</u>	<u>-</u>	<u>2,967,281,737.69</u>
<b>OPERATING EXPENSES:</b>			
Cost of Goods Sold			-
Salaries and Wages	11,632,271.98	-	11,632,271.98
Payroll Related Costs	2,655,390.42	-	2,655,390.42
Professional Fees and Services	4,428,396.63	-	4,428,396.63
Travel	306,650.93	-	306,650.93
Materials and Supplies	2,333,709.67	-	2,333,709.67
Communication and Utilities	391,055.37	-	391,055.37
Repairs and Maintenance	596,753.44	-	596,753.44
Rentals and Leases	6,196,420.78	-	6,196,420.78
Printing and Reproduction	14,836,395.65	-	14,836,395.65
Depreciation and Amortization	757,034.34	-	757,034.34
Bad Debt Expense	566,073.10	-	566,073.10
Lottery Prizes	1,715,355,957.61	-	1,715,355,957.61
Other Operating Expenses			
Retailer Commissions	148,359,044.45	-	148,359,044.45
Lottery Operator Fees	90,168,388.63	-	90,168,388.63
Advertising	30,140,361.72	-	30,140,361.72
Retailer Bonuses	4,172,483.05	-	4,172,483.05
Other	1,738,078.31	-	1,738,078.31
Total Operating Expenses	<u>2,034,634,466.08</u>	<u>-</u>	<u>2,034,634,466.08</u>
Operating Income	<u>932,647,271.61</u>	<u>-</u>	<u>932,647,271.61</u>
<b>NONOPERATING REVENUES (EXPENSES):</b>			
Investment Income	271,528.23	-	271,528.23
Net Increase in Fair Value of Investments	-	56,892,719.33	56,892,719.33
Settlement of Claims	(1,455.67)	-	(1,455.67)
Amortization of Investments held for Prizes Payable	-	2,967,300.67	2,967,300.67
Total Nonoperating Revenues (Expenses)	<u>270,072.56</u>	<u>59,860,020.00</u>	<u>60,130,092.56</u>
Income before Other Revenues, Expenses, Gains/Losses and Transfers	932,917,344.17	59,860,020.00	992,777,364.17
<b>OTHER REVENUES, EXPENSES, GAINS/LOSSES AND TRANSFERS:</b>			
Transfers-Out	(928,881,809.01)	-	(928,881,809.01)
Total Other Revenue, Expenses, Gain/Losses and and Transfers	<u>(928,881,809.01)</u>	<u>-</u>	<u>(928,881,809.01)</u>
Change in Net Assets	<u>4,035,535.16</u>	<u>59,860,020.00</u>	<u>63,895,555.16</u>
Total Net Assets, September 1, 2001	12,756,646.22	25,257,925.46	38,014,571.68
Restatements (Note 11)	(512,555.14)	-	(512,555.14)
Total Net Assets, September 1, 2001, as Restated	<u>12,244,091.08</u>	<u>25,257,925.46</u>	<u>37,502,016.54</u>
Total Net Assets, August 31, 2002	<u>\$ 16,279,626.24</u>	<u>\$ 85,117,945.46</u>	<u>\$ 101,397,571.70</u>

The accompanying notes to the financial statements are an integral part of this statement.

**Texas Lottery Commission**  
**Statement of Cash Flows**  
**Proprietary Funds**  
**For the Fiscal Year Ended August 31, 2002**

	Enterprise Fund (5025) U/F (1100)	Enterprise Fund (0895) U/F (0895)	Total Proprietary Funds 2002
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Receipts from Customers	\$ 2,958,429,636.41	\$ -	\$ 2,958,429,636.41
Payments to Suppliers for Goods and Services	(304,714,419.60)	-	(304,714,419.60)
Payments to Employees	(14,883,601.04)	-	(14,883,601.04)
Payments for Other Expenses	(1,744,224,454.44)	-	(1,744,224,454.44)
Net Cash Provided by Operating Activities	<u>894,607,161.33</u>	<u>-</u>	<u>894,607,161.33</u>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>			
Proceeds from other Financing	-	(154,303,000.00)	(154,303,000.00)
Payments for Transfers to Other Funds	(956,477,825.28)	-	(956,477,825.28)
Payments for Other Uses	-	58,841,576.00	58,841,576.00
Net Cash Provided by Noncapital Financing Activities	<u>(956,477,825.28)</u>	<u>(95,461,424.00)</u>	<u>(1,051,939,249.28)</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>			
Payments for Additions to Capital Assets	(490,311.10)	-	(490,311.10)
Net Cash Provided by Capital and Related Financing Activities	<u>(490,311.10)</u>	<u>-</u>	<u>(490,311.10)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Proceeds from Sales of Investments	-	154,303,000.00	154,303,000.00
Proceeds from Interest and Investment Income	270,072.56	-	270,072.56
Payments to Acquire Investments	(1,349,649.86)	(58,841,576.00)	(60,191,225.86)
Net Cash Provided by Investing Activities	<u>(1,079,577.30)</u>	<u>95,461,424.00</u>	<u>94,381,846.70</u>
Net (Decrease) in Cash and Cash Equivalents	(63,440,552.35)	-	(63,440,552.35)
Cash and Cash Equivalents--September 1, 2001	<u>168,805,683.83</u>	<u>-</u>	<u>168,805,683.83</u>
Cash and Cash Equivalents--August 31, 2002	<u>\$ 105,365,131.48</u>	<u>\$ -</u>	<u>\$ 105,365,131.48</u>

The accompanying notes to the financial statements are an integral part of this statement.

**Texas Lottery Commission**  
**Statement of Cash Flows**  
**Proprietary Funds**  
**For the Fiscal Year Ended August 31, 2002**  
**(continued)**

	Enterprise Fund (5025) U/F (1100)	Enterprise Fund (0895) U/F (0895)	Total Proprietary Funds 2002
<b>Reconciliation of Operating Income to Net Cash Provided by Operating Activities</b>			
<b>Operating Income (Loss)</b>	\$ 932,647,271.61	\$ -	\$ 932,647,271.61
<b>Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities</b>			
Amortization and Depreciation	757,034.34	-	757,034.34
Bad Debt Expense	566,073.10	-	566,073.10
Operating Income and Cash Flow Categories:			
Changes in Assets and Liabilities:			
(Increase) Decrease in Receivables	(8,852,101.28)	-	(8,852,101.28)
Decrease in Inventories	33,265.36	-	33,265.36
Increase (Decrease) in Payables	(30,544,381.80)	-	(30,544,381.80)
Total Adjustments	<u>(38,040,110.28)</u>	<u>-</u>	<u>(38,040,110.28)</u>
<b>Net Cash Provided by Operating Activities</b>	<u>\$ 894,607,161.33</u>	<u>\$ -</u>	<u>\$ 894,607,161.33</u>

The accompanying notes to the financial statements are an integral part of this statement.

**Texas Lottery Commission  
Statement of Fiduciary Net Assets**

**August 31, 2002**

	<b>Agency Funds</b>	<b>Totals 2002</b>
<b>ASSETS</b>		
Current Assets:		
Cash and Cash Equivalents:		
Cash in State Treasury	<u>\$ 1,726.16</u>	<u>\$ 1,726.16</u>
Total Assets	<u><u>\$ 1,726.16</u></u>	<u><u>\$ 1,726.16</u></u>
<b>LIABILITIES</b>		
Current Liabilities:		
Funds Held for Others	<u>1,726.16</u>	<u>1,726.16</u>
Total Liabilities	<u><u>\$ 1,726.16</u></u>	<u><u>\$ 1,726.16</u></u>

The accompanying notes to the financial statements are an integral part of this statement.

**Texas Lottery Commission**  
**Statement of Changes in Assets and Liabilities**  
**Fiduciary Funds**  
**August 31, 2002**

	<b>Beginning Balance September 1, 2001</b>	<b>Additions</b>	<b>Deductions</b>	<b>Ending Balance August 31, 2002</b>
<b>UNAPPROPRIATED RECEIPTS</b>				
<b>ASSETS</b>				
Current				
Cash in State Treasury	\$ 238,306.32	\$ 53,252.29	\$ 289,832.45	\$ 1,726.16
Total Assets	<u>238,306.32</u>	<u>53,252.29</u>	<u>289,832.45</u>	<u>1,726.16</u>
<b>LIABILITIES</b>				
Current				
Funds Held for Others	238,306.32	53,252.29	289,832.45	1,726.16
Total Liabilities	<u>\$ 238,306.32</u>	<u>\$ 53,252.29</u>	<u>\$ 289,832.45</u>	<u>\$ 1,726.16</u>

The accompanying notes to the financial statements are an integral part of this statement.

# **Notes to the Financial Statements**



# Notes to the Financial Statements

<b>NOTE 1: Summary of Significant Accounting Policies</b>
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## Entity

The Texas Lottery Commission (the “Commission”) is an agency of the State of Texas and its financial records comply with state statutes and regulations. This includes compliance with the Texas Comptroller of Public Accounts’ Reporting Requirements for State Agencies.

The Commission serves the State by operating Lottery games. The Texas Lottery was created on August 12, 1991, with the enactment of House Bill No. 54, as a division of the Office of the Comptroller of Public Accounts. The Texas Lottery was approved by the voters of Texas in a general election on November 7, 1991, and commenced operations on November 20, 1991. The Commission was formed by the State lawmakers during the 1993 legislative session and became effective September 1, 1993. On November 9, 1993, the Governor of the State of Texas announced the appointment of three persons as the initial Commissioners. The commissioners appoint the Executive Director of the Texas Lottery Commission and the Director of Charitable Bingo.

Effective April 1, 1994, House Bill No. 2771 transferred Bingo operations from the Texas Alcoholic Beverage Commission to the Texas Lottery Commission. The Charitable Bingo Division of the Commission collects fees and regulates the operations of charitable bingo in the State of Texas. Fees collected are allocated to cities and counties with the balance being deposited in the General Revenue Fund.

The Commission includes within this report all components as determined by an analysis of their relationship to the Texas Lottery Commission. No component units have been identified as defined by GASB Statement No. 14, which should have been blended or presented by discrete columns into an appropriate fund.

## BASIS OF PRESENTATION

The accompanying financial statements of the Commission have been prepared to conform with Generally Accepted Accounting Principles (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB).

In June 1999, the Governmental Accounting Standards Board (GASB) approved Statement No. 34, *Basic Financial Statements and Management Discussion and Analysis for State and Local Governments*. This statement provides for the most significant change in financial reporting in over twenty years. Statement No. 38, *Certain Financial Statement Note Disclosures* establishes and modifies certain disclosure requirements. The Commission beginning September 1, 2001, implements these statements. The financial statements for fiscal year ending August 31, 2001, have been adjusted and presented as memorandum totals for compliance under the new reporting model.

Financial reporting for the Commission is based on all GASB pronouncements, as well as FASB Statements and Interpretations, APB Opinions, and Accounting Research Bulletins issued on or before November 30, 1989, that do not conflict with or contradict GASB pronouncements. FASB pronouncements issued after November 30, 1989, are not followed in the preparation of the accompanying financial statements.

## **FINANCIAL REPORTING STRUCTURE**

The basic financial statements include both government-wide (based on the Commission as a whole) and fund financial statements. While the previous model emphasized fund types (the total of all funds of a particular type), the new reporting model focuses on the Commission as a whole in the government-wide financial statements and major individual funds in the fund financial statements. Both the government-wide and fund financial statements categorize primary activities as either governmental or business type. Totals on the business-type activities fund statements directly reconcile to the business-type activities column in the government-wide statements.

### **Government-wide Financial Statements**

The government-wide financial statements (Statement of Net Assets and Statement of Activities) display information about the Commission as a whole, except for its fiduciary activities. These statements include separate columns for the governmental and business-type activities of the Commission. Eliminating adjustments have been made in the Statement of Activities so that certain allocated expenses are recorded only once (by the function to which they were allocated).

The focus of the government-wide statements is on the sustainability of the Commission as an entity and the change in aggregate financial position resulting from the activities of the fiscal period.

In the government-wide Statement of Net Assets, both the governmental and business-type activities columns are presented on a consolidated basis by column, and are reflected on a full accrual, economic resource basis, which incorporates long-term assets and receivables as well as long-term debt and obligations.

The government-wide Statement of Activities reflects both the gross and net cost per functional category (Bingo Licensing, Central Administration, etc.) which are otherwise supported by general government revenues (General Appropriations.) The Statement of Activities reduces gross expenses, including depreciation, by related program revenues, operating, and capital grants. The program revenues must be directly associated with the function, or with a business-type activity. The operating grants include operating-specific and discretionary (either operating or capital) grants, while the capital grants column reflects capital-specific grants. The Commission does not use capital grants to finance any of its operations.

Program revenues include charges for services, special assessments, and payments made by third parties outside of the Commission if that money is restricted to a particular program. Internally dedicated resources are reported as general revenues rather than program revenues. Program revenues are netted within program expenses in the statement of activities to present the net cost of each program.

The net costs (program expenses less program revenues) of all activities are normally covered by general revenues. The previous reporting model did not present net cost by function or activity.

Amounts paid to acquire capital assets are capitalized as assets in the government-wide financial statements, rather than reported as expenditures. Proceeds of long-term debt are recorded as liabilities in the government-wide financial statements, rather than as other financing sources. Amounts paid to reduce long-term indebtedness of the reporting government are reported as reductions of the related liabilities, rather than as expenditures.

The Commission's fiduciary funds are presented in the fund financial statements by type (pension, private-purpose, and agency). Since the assets are held for the benefit of others and cannot be used to address activities or obligations of the government, the funds are not incorporated into the government-wide statements.

## **Fund Structure**

The accompanying financial statements are presented on the basis of funds, each of which is considered a separate accounting entity. The Fund Types used to account for the operations of the Commission include the General Fund, two Enterprise Funds, and two Agency Funds.

### ***Governmental Fund Types***

#### General Fund

The general fund is used to account for all financial resources of the state except those required to be accounted for in another fund. The General Fund is used to account for bingo operations. The general fund is also used to account for the City and County portion of the Bingo Prize Fee (5% of prizes paid) collected by the Charitable Bingo Operations Division of the Commission. The funds are allocated to the localities on a quarterly basis. In prior fiscal years, the Bingo Prize Fee was reported in an Agency Fund. Due to the implementation of GASB 34, the presentation and classification was changed in fiscal year 2002.

### ***Proprietary Fund Types***

#### Enterprise Funds

Enterprise funds are used to account for operations financed and operated in a manner similar to a private business. The intent is to recover costs through user charges or to determine periodically if revenues earned, expenses incurred, and/or net income is appropriate for management control, accountability, and other purposes. The Lottery operations and investment activities are accounted for in Enterprise Funds, which account for operations in a manner similar to private business.

Lottery – Enterprise (05) Appd Fund, D23 Fund 1100 (5025) - This fund is used to record all transactions related to the operation of the State Lottery.

Lotto Prize Trust – Enterprise (05) Appd Fund, D23 Fund 0895 (0895) - This fund is used to account for investments purchased by the Commission to meet future installment obligations to prize winners. Before fiscal year 1998, this fund was reported as an Agency Fund. Due to the implementation of GASB 31, the presentation was changed in fiscal year 1998.

### ***Fiduciary Fund Types***

#### Agency Funds

Agency funds are used to account for assets held as an agent for individuals, other government entities, and/or other funds. These funds are custodial in nature and do not involve measurement of results of operations.

Suspense Fund (900) - This fund is used to hold funds prior to the ultimate disposition of the funds to other governmental entities or the General Revenue Fund.

U.S. Savings Bond Fund (901) - This fund is used to accumulate money withheld from the salaries of employees for the purpose of purchasing United States Savings Bonds. Bonds are purchased when an individual has accumulated a sufficient amount.

### ***Fund Financial Statements***

The fund financial statements are similar to the financial statements presented in the previous model. The new emphasis is on the major funds in either the governmental or business-type categories. Due to the number of funds used by the Commission to account for its activities, management has decided to present all funds as major funds. Therefore, non-major funds will not be presented in the fund financial statements.

The major governmental funds in the fund financial statements are presented on a current financial resource and modified accrual basis of accounting. This presentation is deemed most appropriate to demonstrate (a) compliance with legal and covenant requirements; (b) the source and use of financial resources; and (c) how the Commission's actual experience conforms to the budget. Since the governmental fund statements are presented using a different measurement focus and basis of accounting than the government-wide statements' governmental column, a reconciliation is presented which explains the adjustments required to restate the fund-based financial statements to the governmental activities column in the government-wide financial statements. The fund financial statements are presented after the government-wide financial statements.

The Commission uses funds to report its financial position and the results of its operations. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities. A fund is a separate accounting entity with a self-balancing set of accounts.

## **BASIS OF ACCOUNTING, MEASUREMENT FOCUS AND FUND FINANCIAL STATEMENT PRESENTATION**

The basis of accounting determines when revenues and expenditures or expenses are recognized in the accounts reported in the financial statements. The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. The governmental fund types that build the fund financial statements are accounted for using the modified accrual basis of accounting. Under modified accrual, revenues are recognized in the period in which they become both measurable and available to finance operations of the fiscal year or liquidate liabilities existing at fiscal year end. The Commission considers receivables collected within sixty days after year-end to be available and recognizes them as revenues of the current year for Fund Financial Statements prepared on the modified basis of accrual. Expenditures and other uses of financial resources are recognized when their related liability is incurred.

The governmental fund types included in the Statement of Net Assets and Statement of Activities are accounted for using the full accrual basis of accounting. Under full accrual accounting, revenues are recognized when earned and expenses are recognized at the time liabilities are incurred.

The proprietary funds are accounted for on the full accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recognized at the time liabilities are incurred.

Proprietary funds distinguish operating from non-operating items. Operating revenues and expenses result from providing services or producing and delivering goods in connection with the proprietary funds principal ongoing operations. Operating expenses for the enterprise funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. Revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Fiduciary funds are reported using the economic resources measurement focus.

## **Budgets and Budgetary Accounting**

The budget is prepared biennially and represents appropriations authorized by the legislature and approved by the Governor (the General Appropriations Act). Encumbrance accounting is employed for budgetary control purposes only for the General Fund.

Unencumbered appropriations are generally subject to lapse 60 days after the end of the fiscal year for which they were appropriated.

## **Assets, Liabilities, and Fund Balances/Net Assets**

### ***ASSETS***

#### Cash and Cash Equivalents

For purposes of the statement of cash flows, the Commission considers cash and cash equivalents to be cash on hand and demand deposits.

#### Cash and Allocation of Income

Revenues from instant and on-line lottery ticket sales, and fees, net of retailer commissions and direct retailer prize payments are deposited directly into an account in the Enterprise Fund (5025) Fund. From this account, prize payment reimbursements are made to a separate local bank account ("Lottery Prize Payment Account") to provide for prize payments. The Commission retains 12 percent of gross Lottery revenues accruing from the sales of tickets for the payment of costs incurred in the operation and administration of the Lottery operations, including not less than 5 percent for retailer commissions. For fiscal year 2002, the remainder of unspent administrative funds will be transferred to the Foundation School Fund. Net proceeds will continue to be transferred to the Foundation School Fund during fiscal year 2003. Unexpended amounts in the Lottery operations account at August 31, 2002 are included as restricted cash on the Commission's balance sheet, since the use of such funds is necessary to cover the Commission's expenditures and prize payment obligations.

Accrued transfers in the amount of \$15,453,851.20 are recorded as "Due to the Foundation School Fund" as of August 31, 2002.

#### Investments

Investments are stated at fair value in accordance with GASB Statement 31 – Accounting and Financial Reporting for Certain Investments and for External Investment Pools. Investments are purchased to meet future installment payments to prize winners. The investments are

shown at fair value and the related payable is reported at amortized cost. The net unrealized gain (loss) on investment securities, which is the difference between the fair value and the amortized cost, is reflected as Unrestricted-Net Assets in the “Combined Statement of Net Assets-Proprietary Funds”.

#### Restricted Assets

Restricted Assets include monies or other resources restricted by legal or contractual requirements. These assets include proceeds held in a repurchase agreement for payment of lottery prizes, and investments held by a third party to satisfy future lotto prizes.

#### Inventories

Merchandise inventories include instant game tickets on hand at year end and for sale. The inventory is carried at cost, as determined by the weighted average method.

#### Capital Assets

The Commission increased the threshold for recording assets from \$1,000 to \$5,000. The effect of this change is reflected in Note 2. Assets with an initial, individual cost of \$5,000 or higher and an estimated useful life in excess of one year are capitalized. These assets are capitalized at cost or, if not purchased, at appraised fair value as of the date of acquisition. Purchases of assets by governmental funds are reported as expenditures. Depreciation is reported on all “exhaustible” assets. Assets are depreciated over the estimated useful life of the assets using the straight-line method.

All capital assets acquired by proprietary funds are reported at cost or estimated historical cost, if actual historical cost is not available. Donated assets are reported at fair value on the acquisition date. Depreciation is charged to operations over the estimated useful life of each asset, using the straight-line method.

### ***LIABILITIES***

#### Accounts Payable

Accounts Payable represents the liability for the value of assets or services received at the balance sheet date for which payment is pending.

#### Employees' Compensable Leave Balances

Employees' Compensable Leave Balances represent the liability that becomes “due” upon the occurrence of relevant events such as resignations, retirements, and uses of leave balances by covered employees. Liabilities are reported separately as either current or non-current in the statement of net assets.

#### Prizes Payable

*Lotto Texas* jackpot prizes of \$2 million or more are payable in a lump sum or in annual installments. Prior to February 1997, the *Lotto Texas* prizes were paid in twenty installments. Beginning in February 1997, the players were given a choice at the time of purchase of receiving either a lump sum payment or twenty-five annual installments. The first installment is processed on the day the prize is claimed. The subsequent installments are

funded with United States securities purchased by the Texas Treasury Safekeeping Trust Company on the Commission's behalf, as are the installment payments for *Weekly Grand*, *Weekly Bonus*, *Monthly Money*, and *Win for Life* prizes.

The amortization of the discount of investments held for prizes payable is based on yields ranging from 1.20 percent to 5.81 percent and reflects interest rates earned by the investments held to fund the prizes payable.

The aggregate amount of prizes payable due in each of the five fiscal years following August 31, 2002, and the total thereafter is as follows:

Aggregate Amount of Prizes Payables	Governmental Activities		Business-Type Activities	
	Principal	Interest	Principal	Interest
2003 (Future Year 1)			\$158,763,000	
2004 (Future Year 2)			158,763,000	
2005 (Future Year 3)			158,613,000	
2006 (Future Year 4)			158,523,000	
2007 (Future Year 5)			158,523,000	
2008-2012			792,615,000	
2013-2017			394,480,000	
2018-2022			157,544,000	
2023-2025			35,468,000	
<b>Total Prizes Payable</b>			<b>\$2,173,292,000</b>	

#### Unclaimed Prizes

The ticket holders forfeit prizes that remain unclaimed for 180 days after the on-line drawing date or 180 days after the close of an instant game. During fiscal year 2002, the Commission transferred all unclaimed lottery prize winnings on a quarterly basis to the Texas Department of Health's account in General Revenue for credit to the State Owned Multicategorical Teaching Hospital Account in the amount of \$40 million, fulfilling the statutory limit of \$40 million for the biennium 2002 and 2003. The remaining unclaimed lottery prize winnings for fiscal year 2002 were transferred to the Tertiary Care Facility Account in the amount of \$29,618,383.00.

### ***FUND BALANCE/NET ASSETS***

The difference between fund assets and liabilities is "Net Assets" on the government-wide, proprietary and fiduciary fund statements, and the "Fund Balances" is the difference between fund assets and liabilities on the governmental fund statements.

#### Reservation of Fund Balance

Fund balances for governmental funds are classified as either reserved or unreserved in the fund financial statements. Reservations are legally restricted to a specific future use or not available for expenditure.

#### Reserved for Encumbrances

This represents commitments of the value of contracts awarded or assets ordered prior to year-end but not received as of that date. Encumbrances are not included with expenditures or

liabilities. They represent current resources designated for specific expenditures in subsequent operating periods.

#### Invested In Capital Assets, Net of Related Debt

Invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation and reduced by outstanding balances for bond, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets. Net assets invested in capital assets, net of related debt at August 31, 2002 was \$1,302,287.25.

#### Restricted Net Assets

Restricted net assets result when constraints placed on net asset use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provision or enabling legislation.

Restricted Net Assets in the Proprietary Funds consist of the following:

Reserved for Pooled Bond Fund	\$5,000,000.00
Reserved for Future Lotto Prizes	\$4,562,632.52

#### Pooled Bond Fund

The Reserve for Pooled Bond Fund is established in accordance with the Texas Government Code, Chapter 466. Specifically, Texas Government Code, Section 466.156 authorizes the Executive Director of the Commission to establish a pooled bond fund from the collection of cash from each sales agent to be used to reimburse the State for losses to the State from the operation of the Commission's sales. As of August 31, 2002, the balance in the Pooled Bond Fund did not exceed the statutory cap of \$5 million.

#### Future Lotto Prizes

The Reserve for Future Lotto Prizes is 2 percent of the 55 percent prize pool. The Lotto Texas prize reserve fund may be increased or decreased by any amounts allocated to the prize pool and not paid to the winners. The Lotto Texas prize reserve fund may be increased or decreased, for example, by rounding down, paying Lotto Texas prizes, and also rolling-over amounts from the fourth prize. The Lotto Texas prize reserve fund may be used only for the *Lotto Texas* game.

#### Unrestricted Net Assets

Unrestricted net assets consist of net assets which do not meet the definition of the two preceding categories. Unrestricted net assets often have constraints on resources, which are imposed by management, but can be removed or modified. Unrestricted Net Assets in the Proprietary Funds consist of the following:

Future Lotto Prizes	\$85,117,945.46
Unrestricted/Undesignated	\$5,442,560.87



Future Lottery Prizes

The Reserve for Future Lottery Prizes is used to account for the investments in proprietary fund (0895) and the difference between fair value and amortized cost.

Unreserved/Undesignated:

This category represents any unappropriated balances at year-end.

***INTERFUND TRANSACTIONS AND BALANCES***

The agency has the following types of transactions among funds:

- (1) Operating Transfers: Legally required transfers that are reported when incurred as ‘Operating transfers in’ by the recipient fund and as ‘Operating transfers out’ by the disbursing fund.
- (2) Reimbursements: Reimbursements of expenditures made by one fund for another that are recorded as expenditures in the reimbursing fund and as a reduction of expenditures in the reimbursed fund.

The composition of the agency’s interfund receivables and payables at August 31, 2002 is presented in Note 6. Transfers to Foundation School Fund during fiscal year 2002 are as follows:

Cash transfers	\$ 869,700,799.00
Accrued transfers at beginning of fiscal year	<u>(25,891,224.19)</u>
Amount transferred from current year revenue	843,809,574.81
Accrued transfers at end of fiscal year	<u>15,453,851.20</u>
Total Transfers to Foundation School Fund	<u><u>\$ 859,263,426.01</u></u>

Transfers to Multicategorical Teaching Hospital Account for unclaimed prizes during fiscal year 2002 are as follows:

Cash transfers	\$ 40,000,000.00
Accrued transfers at beginning of fiscal year	<u>0.00</u>
Amount transferred from current year unclaimed prizes	40,000,000.00
Accrued transfers at end of fiscal year	<u>0.00</u>
Total Transfers to Multicategorical Teaching Hospital Account	<u><u>\$ 40,000,000.00</u></u>

Transfers to the Tertiary Care Facility Account for unclaimed prizes during fiscal year 2002 are as follows:

Cash transfers	\$ 46,886,590.00
Accrued transfers at beginning of fiscal year	<u>(17,268,207.00)</u>
Amount transferred from current year unclaimed prizes	29,618,383.00
Accrued transfers at end of fiscal year	<u>0.00</u>
Total Transfers to Tertiary Care Facility Account	<u><u>\$ 29,618,383.00</u></u>

## ***REVENUES AND EXPENSES***

### Recognition of Revenue

Lottery revenues are primarily comprised of revenues from instant and on-line lottery ticket sales and retailer fees. Instant ticket sales are recognized as revenue when settled with retailers. Ticket packs are considered settled on the earliest of the date when 50 percent of the low tier prizes in the pack are validated or 45 days after the pack is activated by the retailer. On-line ticket sales are recognized as revenue when tickets are purchased by Lottery players. Revenues from retailer license and application fees are recorded when licenses are granted.

Lottery revenues are used for payments of prizes and to pay costs incurred in the operation and administration of the Lottery, such costs being limited to 12 percent of gross Lottery revenues accruing from the sale of tickets, including not less than 5 percent for retailer commissions.

### Lottery Prizes

Prize expense for instant and on-line games is estimated as a function of sales based on the predetermined prize structure for each game.

### Retailer Commissions

Retailers receive a commission of not less than 5 percent based on total ticket sales.

### Retailer Bonuses

A retailer who sells a *Lotto Texas* jackpot prize is eligible to receive a bonus of one percent of the jackpot ticket the retailer sold, not to exceed \$500,000. A retailer selling a winning top tier instant game ticket for *Weekly Grand* receives a \$10,000 bonus. A one percent bonus, not to exceed \$10,000, is available for a retailer selling a *Texas Two Step* winning jackpot ticket, and a *Cash Five* "5 of 5" prize earns the retailer a one percent bonus. In the event that more than one winning top tier ticket is sold in connection with any of the games referenced within this paragraph, the retailers that sold the tickets will share equally in the bonus.

### Lottery Operator Fees

The Lottery operator received a fee of 3.05 percent for fiscal year 2002 based on the total lottery tickets sold, as defined in Section 7.3 of the RFP for Lottery Operator, dated December 21, 1991. In addition to the operator, the Commission contracts for other goods and services in the ordinary course of business. Payments under such contracts are charged to expense as the goods and services are received.

**NOTE 2: Fixed Assets**

A summary of changes in Capital Assets for the year ended August 31, 2002, is presented below:

PRIMARY GOVERNMENT						
	Balance 9/1/01	Adjustments*	Reclassifications	Additions	Deletions	Balance 8/31/02
<b>Governmental activities:</b>						
Depreciable Assets:						
Buildings and Building Improvements						
Furniture and Equipment	490,525.27	(286,978.70)		22,893.00	(12,816.19)	213,623.38
Total depreciable assets at historical cost	490,525.27	(286,978.70)		22,893.00	(12,816.19)	213,623.38
Less accumulated depreciation for:						
Furniture and Equipment		(182,544.46)		(16,040.71)	12,816.19	(185,768.98)
Total accumulated depreciation	0.00	(182,544.46)	0.00	(16,040.71)	12,816.19	(185,768.98)
Depreciable assets, net	490,525.27	(469,523.16)		6,852.29	0.00	27,854.40
Governmental activities capital assets, net:	\$ 490,525.27	\$ (469,523.16)	\$ 0.00	\$ 6,852.29	\$ 0.00	\$ 27,854.40

\*Adjustment Column Worksheet

	GASB 34/35 Fund Type Changes	Capitalization Threshold Changes	Accumulated Depreciation	Other Adjustments	Total Adjustments
<b>Governmental Activities</b>					
Depreciable Assets:					
Furniture and Equipment		(286,978.70)			(286,978.70)
Total depreciable assets at historical cost		(286,978.70)			(286,978.70)
Less accumulated depreciation for:					
Furniture and Equipment			(182,544.46)		(182,544.46)
Total accumulated depreciation			(182,544.46)		(182,544.46)
Depreciable assets, net		(286,978.70)	(182,544.46)		(469,523.16)
Governmental activities capital assets, net:		\$ (286,978.70)	\$ (182,544.46)	\$ 0.00	\$ (469,523.16)

PRIMARY GOVERNMENT						
	Balance 9/1/01	Adjustments*	Reclassifications	Additions	Deletions	Balance 8/31/02
<b>Business-type activities</b>						
Depreciable Assets:						
Furniture and Equipment	7,006,474.79	(2,420,957.99)		474,131.10	(10,306.00)	5,049,341.90
Vehicles, Boats, & Aircraft	133,747.72					133,747.72
Total depreciable assets at historical cost	7,140,222.51	(2,420,957.99)		474,131.10	(10,306.00)	5,183,089.62
Less accumulated depreciation for:						
Furniture and Equipment	(4,999,399.56)	1,899,645.95		(742,477.14)	10,306.00	(3,831,924.75)
Vehicles, Boats, & Aircraft	(70,931.72)	8,756.90		(14,557.20)		(76,732.02)
Total accumulated depreciation	(5,070,331.28)	1,908,402.85		(757,034.34)	10,306.00	(3,908,656.77)
Depreciable assets, net	2,069,891.23	(512,555.14)		(282,903.24)		1,274,432.85
Business-Type activities capital assets, net:	\$ 2,069,891.23	\$ (512,555.14)		\$ (282,903.24)		\$ 1,274,432.85

\*Adjustment Column Worksheet

	GASB 34/35 Fund Type Changes	Capitalization Threshold Changes	Accumulated Depreciation	Other Adjustments	Total Adjustments
<b>Business-type activities</b>					
Depreciable Assets:					
Furniture and Equipment		(2,420,957.99)			(2,420,957.99)
Total depreciable assets at historical cost	0.00	0.00	(2,420,957.99)	0.00	(2,420,957.99)
Less accumulated depreciation for:					
Furniture and Equipment	0.00	0.00	1,899,645.95	0.00	1,899,645.95
Vehicles, Boats, & Aircraft	0.00	0.00	8,756.90	0.00	8,756.90
Other Capital Assets	0.00	0.00	0.00	0.00	0.00
Total accumulated depreciation	0.00	0.00	1,908,402.85	0.00	1,908,402.85
Depreciable assets, net	0.00	0.00	(512,555.14)	0.00	(512,555.14)
Business-Type activities capital assets, net:	\$ 0.00	\$ 0.00	\$ (512,555.14)	\$ 0.00	\$ (512,555.14)

\* Adjustment column includes GASB 34 fund type changes, capitalization threshold changes, assets that were not previously recorded and accumulated depreciation.

The Fixed Assets of the Texas Lottery Commission are depreciated by using the Modified Straight-Line method. Fixed Assets depreciable lives are established by the State's Property Accounting Division as follows:

Description	Life
Furniture and Equipment	3-10
Vehicles, Boats, & Aircraft	5-7
Leasehold Improvements	Life of the Lease

**NOTE 3: Deposits, Investments, & Repurchase Agreements**

The Commission's deposits are collateralized under a program administered by the Texas Treasury Safekeeping Trust Company. State law requires that all State funds administered by the Texas Treasury Safekeeping Trust Company deposited in financial institutions above the federally insured amounts be fully collateralized by the pledging of eligible securities valued at market excluding accrued interest to the state. All securities pledged to the state must be held by a third-party bank domiciled in Texas, the Federal Reserve Bank of Dallas or one of its branches, or in the vault of the Texas Treasury Safekeeping Trust Company. The deposits in the Lottery prize payment account were fully collateralized at August 31, 2002.

**Deposits of Cash in Bank**

- A. The carrying amount of \$6,597.64 for Cash in Bank (including restricted assets) is presented below.
- B. The bank balance of the Commission has been classified according to the following risk categories:
  - Category 1: Insured or collateralized with securities held by the governmental entity or by its agent in the name of the governmental entity.
  - Category 2: Collateralized with securities held by the pledging financial institution's trust department or agent in the governmental entity's name.
  - Category 3: Uncollateralized (which would include any deposits collateralized with securities held by the pledging financial institutions or by its trust department or agent but not in the governmental entity's name).

Category 1	Category 2	Category 3	Bank Balance	Carrying Amount
\$ 6,557.55	\$	\$	\$ 6,557.55	\$ 6,597.64

Consisting of the following:

Demand Deposits (Exh I)	\$ 6,597.64
Certificates of Deposit	
Securities Lending Cash Collateral	
<b>Total Deposits Carrying Amounts</b>	<b>\$ 6,597.64</b>

**Investments**

The Commission's investments consist of United States Government Securities. These investments have been purchased to provide for the payment of the *Lotto Texas* jackpot prizes that are payable annually to the winners over a nineteen-year or twenty-four year period, as well as, the installment payments for *Weekly Grand*, *Weekly Bonus*, *Monthly Money and Win for Life* prizes, as the investments mature. All investments are held to maturity. Therefore, fluctuations in market price have no effect on the ability of the Commission to meet installment payment obligations as they become due. The Commission's investments, which are held by the Texas Treasury Safekeeping Trust Company, are categorized to give an indication of the level of risk assumed by the Commission at year end. All of the Commission's investments at August 31, 2002, with the exception of reverse repurchase agreements, are included in category 1, the lowest risk, as defined by Governmental Accounting Standards Board Statement 3, and include investments that are insured or registered or securities held by the Texas Treasury Safekeeping Trust Company or its agent in the Texas Treasury Safekeeping Trust Company's name.

The fair values of investments as of the balance sheet date (include both short-term and long-term) are shown below. Investments are categorized to give an indication of the level of risk assumed by the agency at year-end. The three categories are:

- Category 1: Investments that are insured or registered, or for which the agency, or its agent in the agency's name holds the securities.
- Category 2: Uninsured and unregistered investments for which the securities are held by the broker's or dealer's trust department or agent in the agency's name.
- Category 3: Uninsured and unregistered investments for which the securities are held by the broker or dealer, or by its trust department or agent, but not in the agency's name.

Categorized Investments:

Type of Security	Category			Fair Value
	1	2	3	
Govt. Investments	\$1,484,110,372.00			\$1,484,110,372.00
<b>Totals</b>	<b>\$1,484,110,372.00</b>			<b>\$1,484,110,372.00</b>

Uncategorized Investments:

Investments held by broker-dealers under reverse repurchase agreements:	
U.S. Government Securities	133,546,189.55
<b>Total Investments</b>	<b>\$1,617,656,561.55</b>

Consisting of the following:	
Proprietary Funds Current Restricted Short Term Investments	\$ 167,783,613.46
Proprietary Funds Non-Current Restricted Investments	1,449,872,948.09
<b>Total Investments per Financial Statements</b>	<b>\$1,617,656,561.55</b>

## Reverse Repurchase Agreements

At August 31, 2002, certain investments were subject to reverse repurchase agreements entered into by the Texas Treasury Safekeeping Trust Company. Such reverse repurchase agreements, which are permitted by statute, consist of sales of securities with a simultaneous agreement to repurchase them in the future at the same price plus a contract rate of interest. Proceeds are invested in securities that mature at or near the same date as the reverse repurchase agreement and the proceeds from those securities will be used to liquidate the agreement, resulting in a matched position and minimizing market risk because the Texas Treasury Safekeeping Trust Company will hold the securities to maturity and liquidate them at face value. The market value of securities underlying reverse repurchase agreements normally exceeds the cash received, providing a margin against decline in market value. If the repurchaser defaults on the obligation to sell these securities to the Texas Treasury Safekeeping Trust Company or provide securities or cash of equal value, an economic loss could result equal to the difference between the market value plus accrued interest of the underlying securities. Any such loss incurred would be the responsibility of the Texas Treasury Safekeeping Trust Company rather than the Commission. To minimize the risk of such default, all securities backing the reverse repurchase agreements are held by the Federal Reserve Bank in the name of the Texas Treasury Safekeeping Trust Company.

The amount of investments subject to reverse repurchase agreements at August 31, 2002 was approximately \$73,762,879.00, at cost. The fair value of the securities underlying these agreements at August 31, 2002 was approximately \$133,546,189.55.

**NOTE 4: Summary of Long Term Liabilities**

**Changes in Long-Term Liabilities**

During the year ended August 31, 2002, the following changes occurred in long-term liabilities.

Governmental Activities	Balance 09-1-01	Additions	Deductions	Balance 08-31-02	Amounts Due Within One Year
Compensable Leave	\$211,150.40	\$203,584.94	\$202,398.43	\$212,336.91	\$124,940.59
<b>Total Governmental Activities</b>	<b>\$211,150.40</b>	<b>\$203,584.94</b>	<b>\$202,398.43</b>	<b>\$212,336.91</b>	<b>\$124,940.59</b>

Business-Type Activities	Balance 09-1-01	Additions	Deductions	Balance 08-31-02	Amounts Due Within One Year
Compensable Leave	\$1,232,226.07	\$1,737,933.39	\$1,834,213.78	\$1,135,945.68	\$706,311.96
<b>Total Business-Type Activities</b>	<b>\$1,232,226.07</b>	<b>\$1,737,933.39</b>	<b>\$1,834,213.78</b>	<b>\$1,135,945.68</b>	<b>\$706,311.96</b>

**Employees' Compensable Leave**

A state employee is entitled to be paid for all unused vacation time accrued, in the event of the employee's resignation, dismissal, or separation from State employment, provided the employee has had continuous employment with the State for six months. Expenditures for accumulated annual leave balances are recognized in the period paid or taken in governmental fund types. For these fund types, the liability for unpaid benefits is recorded in the Statement of Net Assets. An expense and liability for proprietary fund types are recorded in the proprietary funds as the benefits accrue to employees. No liability is recorded for non-vesting accumulating rights to receive sick pay benefits.

**NOTE 5: Operating Lease Obligations**

The Commission leases its headquarters facility in Austin, Texas, twenty-two claim centers throughout Texas, and five regional offices under the terms of operating leases expiring at various dates through 2010. Rent expense for Charitable Bingo and Lottery operations under these and other leases, including the rental of instant ticket vending machines, amounted to \$5,374,810.46 in fiscal year 2002. These lease agreements generally do not require payment of taxes, insurance and maintenance by the Commission, except for utility costs directly attributable to computer equipment. The Commission also leases office equipment under a month-to-month master-operating lease negotiated by the Comptroller. Generally, management expects that leases will be renewed or replaced by other leases in the normal course of business.

Some of the leases entered into by the Commission include renewal options; escalation and tenant finish allowance clauses. During Fiscal Year 2002, the Commission extended the lease for its headquarters facility through May 7, 2010. Because of this extension, the Lessor provided the Commission with a Tenant Finish Allowance in the amount of \$500,000.00. The allowance is to be used solely for tenant improvements and not to perform Lessor obligations. As of August 31, 2001 and 2002, the Commission had Tenant Finish Allowance balances of \$391,279.10 and \$280,858.60, respectively.

Included in the expenditures or expenses reported in the financial statements are the following amounts of rent paid or due under operating leases:

<b>Fund Type</b>	
General Revenue Fund	\$ 165,417.02
General Revenue - Dedicated	2,150,712.60
<b>Totals - Memorandum Only</b>	<b>\$ 2,316,129.62</b>

Future minimum lease rental payments under non-cancelable operating leases having an initial term of more than one year are as follows:

<b>Year Ended August 31,</b>	
2003	\$ 2,315,875.00
2004	2,232,055.17
2005	2,160,519.34
2006	2,223,381.36
2007	2,370,484.48
2008 through 2010	8,688,177.00
<b>Total Minimum Future Lease Rental Payments</b>	<b>\$19,990,492.35</b>

***NOTE 6: Interfund Balances/Activities***

As explained in Note 1 on Interfund Activities and Balances, there are numerous transactions between funds and agencies. At year-end, amounts to be received or paid are reported as:

- Interfund Receivables or Interfund Payables – (Note 6 presentation required)
- Due From Other Agencies or Due To Other Agencies
- Due From Other Funds or Due To Other Funds
- Transfers In or Transfers Out (Note 6 presentation required)
- Legislative Transfers In or Legislative Transfer Out (Note 6 presentation required)

The agency experienced routine transfers with other state agencies, which were consistent with the activities of the fund making the transfer. Repayment of interfund balances will occur within one year from the date of the financial statement.

The following interfund examples are for note presentation purposes only and do not tie to the Balance Sheet for Governmental Funds.

- Operating Transfers In or Operating Transfers Out
- Legislative Transfers In or Legislative Transfers Out - Not Applicable

Individual balances and activity at August 31, 2002 follows:

<b>Note 6 Presentation:</b>			
	<b>DUE FROM Other Agencies</b>	<b>DUE TO Other Agencies</b>	<b>Source</b>
GENERAL REVENUE (01) Appd Fund 0001, D23 Fund 1100 (Agency 479, D23 Fund 001)	\$	\$	
ENTERPRISE (05) Appd Fund 5025, D23 Fund 1100			
(Agency 701, D23 Fund 0193)		15,453,851.20	Transfer
(Agency 501, D23 Fund 0001)			
(Agency 479, D23 Fund 0001)			
(Agency 902, D23 Fund 0001)			
<b>Total Due From/To Other Agencies (Exh I)</b>		<b>\$ 15,453,851.20</b>	

<b>Note 6 Presentation:</b>			
	<b>DUE FROM Other Funds</b>	<b>DUE TO Other Funds</b>	<b>Source</b>
GENERAL REVENUE (01) Appd Fund 001, D23 Fund 001	\$	\$	
(Agency 362 D23 Fund 001)	0.00	174,198.61	Expenditure
ENTERPRISE (05) Appd Fund 5025, D23 Fund 1100	0.00	0.00	
Agency 362, D23 Fund 0001	174,198.61	0.00	Revenue
<b>Total Due From/To Other Funds</b>	<b>\$ 174,198.61</b>	<b>\$ 174,198.61</b>	

<b>Note 6 Presentation:</b>		
	<b>Operating TRANSFERS IN</b>	<b>Operating TRANSFERS OUT</b>
ENTERPRISE (05) Appd Fund 5025, D23 Fund 1100	\$	\$
Agy 701, D23 Fund 0193		859,263,426.01
Agy 501, D23 Fund 5049		40,000,000.00
Agy 501, D23 Fund 0001		29,618,383.00
<b>Total Legislative Transfers</b>	<b>\$</b>	<b>\$ 928,881,809.01</b>

***NOTE 7: Employees Retirement Plans***

The State has joint contributory retirement plans for substantially all of its employees. The Agency participates in the plans administered by the Employees Retirement System of Texas. Future pension costs are the liabilities of the Retirement System. The System does not account for each State agency separately. Annual financial reports prepared by the System include audited financial statements and actuarial assumptions and conclusions. The audited financial report for the Employees Retirement Plan is available by writing: Employees Retirement System of Texas, P.O. Box 13207, Austin, Texas, 78711.

***NOTE 8: Deferred Compensation***

State employees may elect to defer a portion of their earnings for income tax and investment purposes pursuant to authority granted in the TEX.GOV'T CODE ANN., sec 609.001. Two plans are available for employees to defer compensation. Both plans are administered by the Employees Retirement System. The State also administers another plan; "TexaSaver" created in accordance with Internal Revenue Code Sec. 401(K). The assets of this plan do not belong to the state. The state has no liability related to this plan.



**NOTE 9: Continuance Subject to Review**

The Lottery Division is subject to the Texas Sunset Act. Unless continued in existence as provided by the Sunset Act, the Lottery Division is abolished and Chapter 466, Texas Government Code expires September 1, 2003. Additionally, the Commission is subject to the Texas Sunset Act. Unless continued in existence as provided by the Sunset Act, the Commission is abolished and Chapter 467, Texas Government Code expires September 1, 2003.

**NOTE 10: Segment Information**

The Commission is not required to disclose segment information because information is already provided in the basic financial statements in the form of major individual enterprise funds.

**NOTE 11: Restatement of Fund Balances / Retained Earnings**

(a) Change in method of applying a principle – Proprietary Fund

During 2002, the Commission changed its asset capitalization threshold from \$1,000 to \$5,000 for each item. Accordingly, an adjustment was made to reduce previously reported Proprietary Fund balance by \$512,555.14 as follows:

	<b>Enterprise Fund</b>
Fund Bal/Equity August 31, 2001	\$38,014,571.68
GASB 34/35 Fund Type Changes	
Fund Bal/Equity August 31, 2001	\$38,014,571.68
Restatements:	
a.	\$(512,555.14)
Net Restatements	\$(512,555.14)
<b>Fund Bal/Equity August 31, 2001</b>	<b>\$37,502,016.54</b>

(b) Change in accounting basis and method of applying a principle – Governmental Fund

The implementation of GASB 34 resulted in certain changes in the accounting basis previously applied by the Commission to its Governmental Fund. Those changes included the elimination of the Account Groups and the recognition of depreciation on capital assets. Further, the Commission increased its asset capitalization threshold from \$1,000 to \$5,000 for each item. The effect of these changes was to restate and reduce the previously reported Governmental Fund balance by \$190,148.29 as follows:

	<b>Governmental Funds</b>
	<hr/>
Net Assets – Beginning	\$ 440,300.71
Adjustments:	
FY01 Capital Assets Balance in General Fixed Asset Account Group	490,525.27
Reduction for increase in capitalization threshold for fixed assets	(286,978.70)
Accumulated depreciation from prior year	(182,544.46)
FY01 compensable lease balance in General Long Term Debt Account Group	(211,150.40)
Total adjustment	<hr/> (190,148.29) <hr/>
<b>Net Assets, September 1, 2001, as restated and adjusted</b>	<b><hr/><hr/>\$ 250,152.42</b>

# **Combining Statements**

**Texas Lottery Commission**  
**Combining Statement of Changes in Assets and Liabilities**  
**Agency Funds**  
**August 31, 2002**

	<b>Beginning Balance September 1, 2001</b>	<b>Additions</b>	<b>Deductions</b>	<b>Ending Balance August 31, 2002</b>
<b>UNAPPROPRIATED RECEIPTS</b>				
<b>Employee Savings Bond Account (0901) U/F (0901)</b>				
<b>ASSETS</b>				
Current				
Cash in State Treasury	\$ 1,176.16	\$ 16,426.16	\$ 15,876.16	\$ 1,726.16
Total Assets	<u>\$ 1,176.16</u>	<u>\$ 16,426.16</u>	<u>\$ 15,876.16</u>	<u>\$ 1,726.16</u>
<b>LIABILITIES</b>				
Current				
Funds Held for Others	1,176.16	16,426.16	15,876.16	1,726.16
Total Liabilities	<u>\$ 1,176.16</u>	<u>\$ 16,426.16</u>	<u>\$ 15,876.16</u>	<u>\$ 1,726.16</u>
<b>Suspense Fund (0900) U/F (0900)</b>				
<b>ASSETS</b>				
Current				
Cash in State Treasury	\$ 236,797.19	\$ -	\$ 236,797.19	\$ -
Total Assets	<u>\$ 236,797.19</u>	<u>\$ -</u>	<u>\$ 236,797.19</u>	<u>\$ -</u>
<b>LIABILITIES</b>				
Current				
Funds Held for Others	236,797.19		236,797.19	-
Total Liabilities	<u>\$ 236,797.19</u>	<u>\$ -</u>	<u>\$ 236,797.19</u>	<u>\$ -</u>
<b>Suspense Fund (0900) U/F (9016)</b>				
<b>ASSETS</b>				
Current				
Cash in State Treasury	\$ 332.97	\$ 36,826.13	\$ 37,159.10	\$ -
Total Assets	<u>\$ 332.97</u>	<u>\$ 36,826.13</u>	<u>\$ 37,159.10</u>	<u>\$ -</u>
<b>LIABILITIES</b>				
Current				
Funds Held for Others	332.97	36,826.13	37,159.10	-
Total Liabilities	<u>\$ 332.97</u>	<u>\$ 36,826.13</u>	<u>\$ 37,159.10</u>	<u>\$ -</u>
<b>Totals - All Agency Funds</b>				
<b>ASSETS</b>				
Current				
Cash in State Treasury	\$ 238,306.32	\$ 53,252.29	\$ 289,832.45	\$ 1,726.16
Total Assets	<u>\$ 238,306.32</u>	<u>\$ 53,252.29</u>	<u>\$ 289,832.45</u>	<u>\$ 1,726.16</u>
<b>LIABILITIES</b>				
Current				
Funds Held for Others	238,306.32	53,252.29	289,832.45	1,726.16
Total Liabilities	<u>\$ 238,306.32</u>	<u>\$ 53,252.29</u>	<u>\$ 289,832.45</u>	<u>\$ 1,726.16</u>

# **Required Supplementary Information**

**Texas Lottery Commission  
Budgetary Comparison Schedule  
For the Fiscal Year Ended August 31, 2002  
(Unaudited)**

	<b>GENERAL FUND</b>			
	<b>Budgetary Amounts</b>		<b>Actual Amounts</b>	<b>Variance with</b>
	<b>Budget (Original)</b>	<b>Budget (Final)</b>	<b>(Budgetary Basis)</b>	<b>Budget</b>
<b>REVENUES</b>				
Legislative Appropriations:				
Original Appropriations (GR)	\$ 2,785,997.00	\$ 2,785,997.00	\$ 2,785,997.00	\$ -
Additional Appropriations (GR)	154,148.00	154,148.00	548,637.80	394,489.80
Other (GR)	39,886.00	39,886.00	30,785.60	(9,100.40)
Total Revenues	<u>2,980,031.00</u>	<u>2,980,031.00</u>	<u>3,365,420.40</u>	<u>385,389.40</u>
<b>EXPENDITURES</b>				
Salaries and Wages	2,353,506.00	2,353,957.00	2,040,223.35	313,733.65
Payroll Related Costs	15,360.00	42,058.00	444,264.98	(402,206.98)
Professional Fees and Services	141,518.00	177,518.00	185,774.75	(8,256.75)
Travel	110,800.00	74,800.00	88,811.20	(14,011.20)
Materials and Supplies	22,600.00	22,600.00	165,280.49	(142,680.49)
Communication and Utilities	3,250.00	3,250.00	33,657.13	(30,407.13)
Repairs and Maintenance	390.00	390.00	45,109.66	(44,719.66)
Rentals & Leases	171,120.00	171,120.00	167,958.02	3,161.98
Printing and Reproduction	25,000.00	25,000.00	29,511.10	(4,511.10)
Other Expenditures	12,145.00	49,238.00	31,308.96	17,929.04
Capital Outlay	60,100.00	60,100.00	22,893.00	37,207.00
Total Expenditures/Expenses	<u>2,915,789.00</u>	<u>2,980,031.00</u>	<u>3,254,792.64</u>	<u>(274,761.64)</u>
Excess (Deficiency) of Revenues Over Expenditures	<u>64,242.00</u>	<u>-</u>	<u>110,627.76</u>	<u>110,627.76</u>
<b>OTHER FINANCING SOURCES (USES)</b>				
Total Other Financing Sources and Uses	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
<b>SPECIAL ITEMS</b>				
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
<b>EXTRAORDINARY ITEMS</b>				
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Net Change in Fund Balances/Net Assets	<u>64,242.00</u>	<u>-</u>	<u>110,627.76</u>	<u>110,627.76</u>
<b>FUND FINANCIAL STATEMENT-FUND BALANCES</b>				
Fund Balances, September 1, 2001, as Restated	410,300.71	410,300.71	440,300.71	-
Appropriations Lapsed	-	-	(47,415.47)	-
Fund Balances--August 31, 2002	<u>\$ 474,542.71</u>	<u>\$ 410,300.71</u>	<u>\$ 503,513.00</u>	<u>\$ 110,627.76</u>

**RECONCILIATION OF BUDGETARY ACCOUNTING TO GAAP**

<b>Total Fund Balance - governmental funds (Above)</b>		\$ 503,513.00
Amounts reported for governmental activities in the statement of net assets are different because:		
Capital assets used in governmental activities are not financial resources and therefore are not reported in the fund. These assets consist of:		
Furniture and equipment	27,854.40	
Accumulated depreciation	-	
Total Capital Assets	<u>27,854.40</u>	
Some liabilities are not due and payable in the current period and therefore are not reported in the fund. Those liabilities consist of:		
Employee compensated leave	<u>(212,336.91)</u>	<u>(212,336.91)</u>
Total long-term liabilities		
<b>Net assets of governmental activities</b>		<u>\$ 319,030.49</u>