

*Comprehensive Annual
Financial Report
For the Fiscal Year Ended
June 30, 2001*

TheLot

Your Rhode Island Lottery

A Component Unit of the
State of Rhode Island and
Providence Plantations

COMPREHENSIVE ANNUAL FINANCIAL REPORT

RHODE ISLAND LOTTERY

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

FOR THE FISCAL YEAR ENDED JUNE 30, 2001

PREPARED BY THE FINANCE DEPARTMENT



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THE RHODE ISLAND LOTTERY

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Executive Director

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September 14, 2001

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

We are pleased to present to you the **COMPREHENSIVE ANNUAL FINANCIAL REPORT** of the Rhode Island Lottery (Lottery) for the Fiscal Year ended June 30, 2001. This report has been prepared by the Finance Department of the Lottery. The Lottery is responsible for the accuracy of the financial data and the completeness and fairness of the presentation, including all disclosures.

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

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

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

THE LOT

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History of the Lottery Industry

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

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

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

Perhaps one of the most poignant lottery stories is that of the abortive attempts to bail Thomas Jefferson out of an \$80,000 debt by holding a lottery on his behalf on the 50th anniversary of the adoption of the Declaration of Independence, an anniversary that coincided with the precise day of his death.

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

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

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

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

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

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

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

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

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

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

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

The full history of the decline of the lottery in America lasted from the Civil War until the resumption of the lottery in 1964 when New Hampshire established a state-run lottery for the purpose of raising money for education. New York, which had been the State to pass the first constitutional prohibition of lotteries in the United States in the 1820s, followed New Hampshire's return into the lottery business in 1967. In 1971, the State of New Jersey started their lottery and introduced a computer-

based weekly game, which offered inexpensive tickets (50 cents), convenience of sale, and a weekly prize of \$50,000. In its first year of operation, the New Jersey Lottery grossed \$142.5 million and set the trend for the lottery industry. New York and New Hampshire revamped their systems, and other states introduced lotteries utilizing New Jersey's operation as a model.

Lotteries, through the years, have become more diversified. The vast array of lottery games in existence today caters to a variety of consumer tastes. These changes are largely attributable to the work of marketing experts. With greater selections, come increased sales. Considerable changes and new possibilities were introduced in lotteries through major technological innovations such as centralized on-line computer systems (1971) and magnetic strip tickets (1992).

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

History of the Rhode Island Lottery

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

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

The Lottery's first drawing was held at the State House on May 30, 1974. This weekly 50-cent game had a top prize of \$50,000. The Numbers Game began on February 13, 1976 and continues today.

The first instant ticket game, *Play Ball*, was introduced on May 11, 1976. Since that time an additional 277 instant ticket games have been introduced.

On-line games started in February of 1978, and Lottery sales doubled with this new addition. Rhode Island was the first state to televise a live lottery drawing in January of 1975, at no expense to the Lottery, which is still the case today. That same year Rhode Island became the first state to have a weekly lottery television program. The *4/40 Game* began in the spring of 1981, with variations to that game being made throughout the years culminating with the *Rhody Cash* game in January of 1995.

The Multi-State Lottery Association (MUSL) was formed in 1988 for the purpose of affording small states the opportunity to offer games with a higher jackpot than their population alone would generate. Along with Rhode Island, the initial members were the District of Columbia, Iowa, Oregon, Kansas and West Virginia. The first such game was called *Lotto-America*, which was replaced with *PowerBall* on April 22, 1992. In February of 1998, Rhode Island replaced the Multi-State *Daily*

Millions Game with the introduction of its own lotto game called *Roll Down*, which was in turn replaced in March of 2000 with *Easy Win* and replaced again in November of 2000 with *Money Roll*.

Keno was introduced in the State on September 13, 1992, becoming the second U.S. Lottery (Oregon was first) to do so. Around this same time, *Video Lottery Terminals (VLTs)* went on-line at the State's two pari-mutuel facilities.

History of Lottery Games

Lotto Games

The Germans were the first to bring the modern lotto game to the market. Norwest Lotto in northwestern Germany launched the first game on October 9, 1955. Players simply marked 6 figures out of a total of 49 on their coupon. The idea quickly took off, and many other countries soon followed the Germans' lead.

Today, the 6/49 formula is the most widespread, with approximately 31% of lotteries worldwide utilizing this format. This is followed by the 6/42, 6/45, 6/36, 7/47 and 6/44. More than 20 formulas are available, and some lotteries run several different formulas at the same time.

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

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

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

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

Instant Tickets

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

Video Lottery

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

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

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

Keno

Keno originated in China more than 2,000 years ago. Legend has it that this game financed the Great Wall of China. The original Chinese game was played with characters from the "Thousand Character Classic", an ancient poem of luck by Confucius. Keno subsequently spread far beyond the borders of China and was well established in both Europe and the United States by the turn of the 20th Century. Today, Keno is a very popular lottery offering because of its flexibility in the number of spots that can be played, which in effect means there are actually several games going on at the same time all with different odds of winning a prize. Daily Keno drawings have proven more successful than those held two or three times a week. Rhode Island is one of only a handful of lotteries offering a new Keno draw every 4 minutes.

Rhode Island Lottery Product Offerings

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

Instant Tickets

Instant (or scratch) tickets are played by scratching the latex covering off the play area on the ticket. In order to win, the player must match two or three of a kind, get like symbols or wild features. Instant ticket offerings in Rhode Island include card games, as well as whimsical, sports, money, and local landmark themes. A new instant game is introduced every 11 working days. Sales for Fiscal Year 2001 were \$69,394,994, an increase of \$7,581,990 over Fiscal Year 2000.

Daily Numbers

The Daily Numbers game has been very popular in Rhode Island since its inception in 1976. Players can wager on 2, 3, or 4 digits. Wagers on 3 and 4 digits can be played in exact or any order. Players can select their own numbers or utilize the computer "quick pick." The Daily Numbers drawing is televised live Monday through Saturday at 7:00 p.m. and at 6:30 p.m. on Sunday. Sales for Fiscal Year 2001 were \$28,459,883 compared to \$28,159,762 for Fiscal Year 2000.

Keno

Keno was introduced in September of 1992 and quickly proved to be a very popular game. Rhode Island Keno has a 10 of 20 of 80 matrix, with a \$100,000 top prize. Players can wager on 1 to 10 numbers (spots) utilizing their own number selection or a computer "quick pick." In January of 2000

Keno drawings increased from every 5 minutes to every 4 minutes. These Keno drawings occur from 6:00 a.m. to 12:45 a.m., Monday through Saturday and 7:00 a.m. to 12:45 a.m. on Sunday. In April of 2001, Keno Plus was introduced. Players have the option to purchase this feature that could increase their winnings by ten times, thus giving Keno players the potential to win up to \$1,000,000. Keno sales for Fiscal Year 2001 were \$69,190,444, an increase of \$8,388,451 over Fiscal Year 2000.

PowerBall

PowerBall is a Multi-State Lottery game offered in 20 states (including Rhode Island), plus the District of Columbia. Players select "5 out of 49" numbers and a PowerBall "1 out of 42." Players can select their own numbers or utilize a computer "quick pick." Jackpots start at \$10 million and grow by a minimum of \$2 million for each drawing not producing a jackpot winner. Televised drawings are shown on Wednesday and Saturday at 10:59 p.m. PowerPlay, which is a multiplier for PowerBall winnings, was introduced in March of 2001. Players who choose the PowerPlay option on their PowerBall ticket have the chance to increase their winnings by up to 5 times, however, the multiplier does not apply to a jackpot win. PowerBall sales were \$36,437,944 in Fiscal Year 2001 compared to \$37,456,233 in Fiscal Year 2000. Sales can fluctuate considerably from year to year due to the randomness of jackpot wins, with sales increasing proportionately with the jackpot.

Easy Win

Easy Win, which replaced Roll Down in March of 2000, is an on-line game with cash prizes offered to players matching 4, 3, or 2 numbers in any of the 4 sets drawn out of a field of 50 numbers. Players get 4 sets consisting of 4, 5, 6 and 7 numbers. Players can pick their own numbers in the first four number sequence only, or they can utilize the computer "quick pick", all other numbers are automatically generated by the computer "quick pick". The top prize of \$25,000 is paid to the player who matches 4 out of 4 in the first number sequence. Sales for Fiscal Year 2001 were \$1,545,704 compared to \$1,802,708 for Fiscal Year 2000.

Money Roll

Money Roll, which replaced Easy Win in November of 2000, is an on-line game based on the previously popular on-line game Roll Down; however, Money Roll is designed to produce more winners as well as improved chances of winning top prizes. Players wager on 4 numbers out of 39 by picking their own numbers or by utilizing the computer "quick pick". Cash prizes are offered to players matching 4, 3, or 2 numbers and prizes are paid on a pari-mutual basis with the jackpot being split evenly between the 3 of 4 winners if there are no 4 of 4 winners. Sales for Fiscal Year 2001 were \$1,971,470.

Video Lottery

Video Lottery debuted in Rhode Island in September of 1992. There are a total of 2,478 video lottery terminals operating in the State's two pari-mutuel facilities, Lincoln Greyhound Park and Newport Grand Jai Alai. Various card and reel games are offered on the video lottery terminals (VLTs). The VLTs afford Rhode Island a chance to compete with Native American casinos in a neighboring state. Fiscal Year 2001 VLT sales were \$771,019,263, a \$100,254,496 increase over Fiscal Year 2000.

Pull Tabs

Rhode Island General Laws mandate that pull tab tickets be sold only by non-profit organizations. The Rhode Island Lottery oversees the sale of pull tab tickets to these groups. Pull tab net sales for Fiscal Year 2001 were \$211,876 compared to net sales of \$229,991 for Fiscal Year 2000.

Rhode Island Economic Outlook

The Rhode Island economy continued to expand in 2000 with a slight increase of 682 jobs. Job growth was concentrated in retail trade, services and construction. Projections indicate that by 2008 employment should increase 15.1 percent with the largest gains occurring in the services and retail trade industries.

Personal income in Rhode Island rose 6.9 percent, with per capita personal income slightly above the national average.

With the completion of the Providence Place Mall and the opening of other national retail chains such as Target and Best Buy, retail employment has continued to increase.

While the total number of new construction housing permits declined the permits for multi-family housing rose 6.0 percent.

Overall, the economic outlook for Rhode Island is positive.

Lottery Industry Economic Outlook

The United States Lottery Industry experienced yet another upswing during Fiscal Year 2000. Based on unaudited figures from the North American Association of State & Provincial Lotteries, sales increased from \$36.22 billion in Fiscal Year 1999 to \$37.47 billion in Fiscal Year 2000. The Rhode Island Lottery ranked first in the nation in per capita sales and ranked second with a 16.58% sales increase for Fiscal Year 2000.

Highlights of Fiscal Year 2001

The Rhode Island Lottery's sales for Fiscal Year 2001 totaled \$978,019,702, a 13.19% increase compared to Fiscal Year 2000 sales of \$864,091,725. A record amount of \$180,743,897 was transferred to the State General Fund in Fiscal Year 2001.

On March 4, 2001, the Lottery added a new feature to the PowerBall game called PowerPlay. This new feature allows players to multiply their winnings up to five times the original prize on all non-jackpot prizes. Non-jackpot winners now have the potential to win up to \$500,000.

On April 1, 2001, the Lottery introduced a new addition to its Keno game called Keno Plus. Keno Plus is a multiplier effect on its widely used Keno games. This new addition to the Keno game will enable players to purchase both a regular ticket and an additional multiplier, which will compound winnings in 60% of the drawings. Players can now win up to \$1,000,000 playing Keno Plus.

In April 2001, the Rhode Island Lottery, along with Public Gaming Research Institute, co-sponsored the International Lottery Expo 2001 in Newport, Rhode Island. In attendance were representatives from 35 Lotteries from around the world. This four-day program offered valuable information on how to keep sales strong and growing. It also took a look at the future and what Lotteries can do to keep up with the competition in our fast-paced world of entertainment options.

The Rhode Island Lottery sponsored its 8th Annual Hat Night at McCoy Stadium in Pawtucket, Rhode Island. Invited guests included children with special needs, underprivileged children and area little leaguers.

GFOA Certificate of Achievement

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate for Excellence in Financial Reporting to the Rhode Island Lottery for its Comprehensive Annual Financial Report (CAFR) for the last four consecutive Fiscal Years (1997, 1998, 1999 and 2000). The Certificate of Achievement is the highest form of recognition in the area of governmental accounting and financial reporting.

In order to be awarded a Certificate of Achievement, a governmental unit must publish an easily readable and efficiently organized comprehensive annual financial report, whose contents conform to program standards. The CAFR must satisfy both generally accepted accounting principles and legal requirements.

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

Rhode Island Lottery Financial Information

The Lottery conducts its operations as an enterprise fund within the State of Rhode Island and is included in the State's Comprehensive Annual Financial Report. Enterprise activities include the sale of lottery tickets to the general public and related supporting functions of personnel, security/legal, planning/research, marketing, finance, and management services. Neither general government functions or judiciary operations are managed by the Lottery nor are any included in this report.

Total sales for Fiscal Year 2001 surpassed \$978 million. This represents an increase of \$114 million over the previous record of \$864 million in Fiscal Year 2000. The increase in sales is attributed primarily to higher video lottery sales.

Of the total sales reported in Fiscal Year 2001, video lottery sales comprised \$771.0 million or 78.8% of total sales. However, most importantly, the Lottery transferred to the General Fund a record \$180.7 million, which represents an increase of \$30.4 million or 20.3% over the prior Fiscal Year.

Distribution of the year's revenue was as follows:



Accounting Systems and Procedures

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

Budgetary Controls

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

Internal Control Environment

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

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

- Employing specialized security staff.
- Maintaining secure lottery facilities and limiting access to them.
- Performing background checks on retailers, vendors, and employees.
- Printing lottery tickets with special security features.
- Hiring an independent CPA firm to witness the recording of MUSL drawing results.
- Providing a variety of access and other controls in the computer system.

- Implementing a Video Lottery System Monitoring Plan to ensure the integrity of video lottery games and to ensure that control procedures are operating as designed.
- Performing unannounced video lottery inspections at each retailer to ensure compliance with operating procedures.
- Monitoring video lottery terminals on a daily and weekly basis and reconciling to a cash management system.
- Processing daily transaction data of all vendor activity by Lottery personnel using the Lottery's internal control system programs and reconciling transactions to reports generated by the on-line system.
- Development of a comprehensive information security plan for the Lottery's on-line and video lottery systems.

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

Debt Administration

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

Cash Management

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

Risk Management

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

Future Projects

Beginning July 1, 2001, the Lottery introduced a new retailer incentive program that will allow retailers who achieve a specific sales goal to be awarded with a 25% bonus commission on sales from instant tickets.

In the fall of 2001, the Lottery will be introducing a new on-line game that will replace its current Money Roll Game. The new on-line game will feature rolling jackpots that are expected to grow to over \$200,000. Players will select 5 numbers from a field of 35 and a bonus number will be drawn which will increase players chances of winning. This game is designed to result in higher jackpots. There will be three weekly drawings with pari-mutual jackpots averaging approximately \$85,000 per draw.

The Lottery recognizes that the Internet is a rapidly expanding information source for many customers. To take advantage of this interest in the Internet, the Lottery issued a Request for Proposal (RFP) to redesign its current Web Site in the hope of providing the best possible service to its players. The new Web Site is expected to be implemented some time in the spring of 2002. Players will be allowed to conveniently access the latest winning numbers and game information. The new site will be more market oriented, user friendly and interactive.

In July of 2001, the Lottery issued an RFP for a new Video Lottery Central Computer System Provider (CCSP). The CCSP will operate a Central Control Computer, which must be linked to all Video Lottery Terminals. The contract resulting from the RFP will be for an initial five (5) years with options to extend the contract for an additional five (5) years. The RFP is requiring all new equipment to be installed. It is expected that a new contract will be signed in the fall of 2001.

In November of 2001, the Lottery is planning to introduce its first ten-dollar (\$10) instant ticket. The new game called Rhode Island Holidays will feature instant prizes from \$10 to \$100,000.

Independent Audit

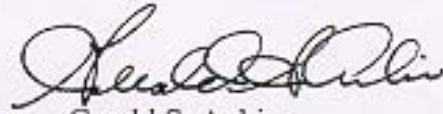
The Rhode Island General Laws require semi-annual audits to be performed by the State Auditor General. The Fiscal Year 2001 audit of the financial statements has been completed in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*. The Independent Auditor's Report on the Lottery's financial statements is included in the financial section of this report.

Acknowledgements

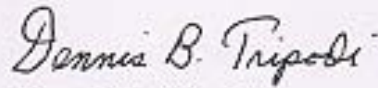
Preparation of this report could not have been accomplished without the efforts of Gina Grant, Anne D'Antuono, Lisa Jackson, Ray Perry, Sandra Reynolds, Peg Rose and Betty Zhang.

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

Respectfully submitted,



Gerald S. Aubin
Executive Director



Dennis B. Tripodi
Finance Administrator

Certificate of Achievement for Excellence in Financial Reporting

Presented to

Rhode Island
Lottery

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2000

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



Anne Spray Kinney
President

Jeffrey L. Esler
Executive Director

Rhode Island Lottery Commission Structure

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

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

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

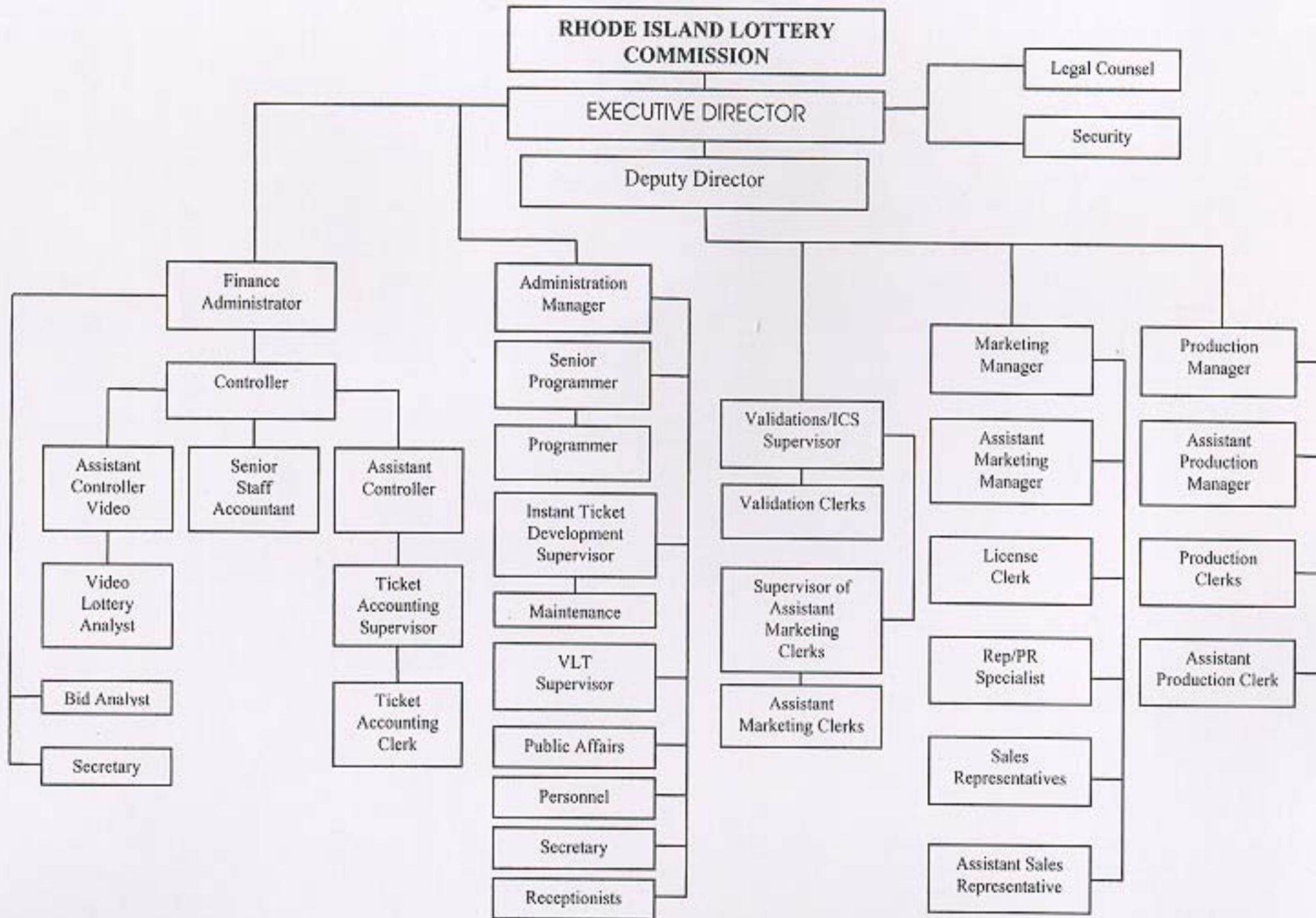
The duties of the Commission include meeting no less than nine times per year for the purpose of promulgating and reviewing rules and regulations relating to the Lottery, recommending and setting policy for the Lottery, approving or rejecting actions of the Executive Director, and transacting any other business that may be properly brought before the Commission.

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

COMMISSION MEMBERS SERVING DURING FISCAL YEAR 2001

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

Rhode Island Lottery Organizational Chart



PRINCIPAL OFFICIALS

GERALD S. AUBIN
EXECUTIVE DIRECTOR

RAYMOND E. GRIMES
DEPUTY DIRECTOR

DENNIS B. TRIPODI
FINANCE ADMINISTRATOR

MARGARET D. ROSE
ADMINISTRATION MANAGER

ROBERT E. MATTESON
MARKETING MANAGER

SANDRA REYNOLDS
CONTROLLER



ERNEST A. ALMONTE, CPA, CFE
AUDITOR GENERAL
EALMONTE@OAG.STATE.RI.US

STATE OF RHODE ISLAND and PROVIDENCE PLANTATIONS
GENERAL ASSEMBLY

OFFICE of the AUDITOR GENERAL

- ◆ INTEGRITY
- ◆ RELIABILITY
- ◆ INDEPENDENCE
- ◆ ACCOUNTABILITY

INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying financial statements of the Rhode Island Lottery (Lottery), a component unit of the State of Rhode Island and Providence Plantations, as of and for the years ended June 30, 2001 and 2000, as listed in the Table of Contents. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audits.

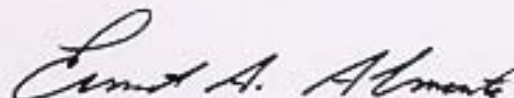
We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan 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 audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Lottery as of June 30, 2001 and 2000, and the results of its operations and cash flows for the years 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 September 4, 2001 on our consideration of the Lottery's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Our audits were performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information included in Schedule 1 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

We did not audit the data included in the statistical section and, accordingly, express no opinion thereon.


Ernest A. Almonte, CPA, CFE
Auditor General

September 4, 2001

RHODE ISLAND LOTTERY

Balance Sheets

June 30, 2001 and 2000

<u>Assets</u>	<u>2001</u>	<u>2000</u>
Current assets:		
Cash and cash equivalents (note 3)	\$ 4,798,950	\$ 19,405,047
Investments for jackpot awards (note 3)	902,000	1,208,000
Accounts receivable-less allowance for doubtful accounts of \$314,593 in 2001 and \$288,998 in 2000	6,004,682	4,850,636
Ticket inventory	735,696	803,801
Deposits with Multi-State Lottery Association (MUSL) (note 1)	354,748	394,553
Deferred charges	72,598	141,151
Total current assets	12,868,674	26,803,188
Investments for jackpot awards (note 3)	937,580	1,665,448
Property, plant and equipment, net (note 4)	513,244	618,752
Total assets	\$ 14,319,498	\$ 29,087,388
<u>Liabilities and Retained Earnings</u>		
Current liabilities:		
Cash overdraft (note 3)	\$ 432,782	\$ -
Due to State's General Fund (note 5)	1,443,897	12,883,635
Current obligation for unpaid prize awards	5,029,304	6,739,201
Accounts payable	5,752,145	7,057,537
Accrued expenses	475,706	307,314
Deferred revenue	141,136	255,410
Total current liabilities	13,274,970	27,243,097
Long-term obligation for unpaid prize awards	937,580	1,665,448
Total liabilities	14,212,550	28,908,545
Retained earnings:		
Reserved for building (note 8)	106,948	178,843
Total liabilities and retained earnings	\$ 14,319,498	\$ 29,087,388

See accompanying notes to financial statements.

RHODE ISLAND LOTTERY

Statements of Revenue, Expenses and Retained Earnings

Years Ended June 30, 2001 and 2000

	2001	2000
Sales (schedule 1):		
On-line games	\$ 137,605,445	\$ 131,513,954
Instant games	69,394,994	61,813,004
Video lottery	771,019,263	670,764,767
Total sales	978,019,702	864,091,725
Cost of sales:		
Commissions	129,021,159	121,323,091
Prize awards	666,947,849	590,679,183
Unclaimed prize recovery	(3,973,358)	(2,778,517)
Cost of tickets	1,112,469	990,209
Total cost of sales	793,108,119	710,213,966
Gross profit	184,911,583	153,877,759
Operating expenses:		
Personnel services	3,146,406	3,016,103
Advertising and promotion	1,220,577	1,511,749
Contract services	309,762	101,236
Equipment leasing (note 13)	259,212	293,822
Depreciation	217,457	218,768
Other	739,627	593,506
Total operating expenses	5,893,041	5,735,184
Operating income	179,018,542	148,142,575
Nonoperating income (expenses):		
Interest and miscellaneous income	1,653,460	2,069,165
Payments to the State's General Fund (note 5)	(180,743,897)	(150,283,635)
Net loss (note 8)	(71,895)	(71,895)
Retained earnings, beginning of year	178,843	250,738
Retained earnings, end of year	\$ 106,948	\$ 178,843

See accompanying notes to financial statements.

RHODE ISLAND LOTTERY

Statements of Cash Flows

Years Ended June 30, 2001 and 2000

	2001	2000
Cash flows from operating activities:		
Cash received from sales	\$ 976,709,169	\$ 869,926,894
Cash received from MUSL for grand prize winners	6,245,000	6,296,897
Cash received from miscellaneous sources	894,822	992,474
Cash paid for prizes other than MUSL grand prize winners	(665,587,967)	(590,091,008)
Cash paid to MUSL grand prize winners	(6,245,000)	(6,296,897)
Cash paid for commissions - retailers	(14,472,546)	(13,635,606)
Cash paid for commissions - video lottery	(108,676,974)	(99,171,862)
Cash paid for commissions - on-line games contractor	(7,035,140)	(6,872,420)
Cash paid to suppliers for goods and services	(3,568,487)	(3,788,918)
Cash paid to employees for services	(3,103,567)	(2,999,553)
Net cash provided by operating activities	175,159,310	154,360,001
Cash flows from noncapital financing activities:		
Payments to State's General Fund	(192,183,635)	(138,375,047)
Negative cash balance implicity financed	432,782	-
Net cash used for noncapital financing activities	(191,750,853)	(138,375,047)
Cash flows from capital and related financing activities:		
Purchase of fixed assets	(193,649)	(237,940)
Net cash used for capital and related financing activities	(193,649)	(237,940)
Cash flows from investing activities:		
Proceeds from maturity of investments for jackpot awards	1,209,579	1,461,956
Interest income	969,516	766,591
Net cash provided by investing activities	2,179,095	2,228,547
Net increase (decrease) in cash and cash equivalents	(14,606,097)	17,975,561
Cash and cash equivalents, beginning of year	19,405,047	1,429,486
Cash and cash equivalents, end of year	\$ 4,798,950	\$ 19,405,047

RHODE ISLAND LOTTERY

Statements of Cash Flows

Years Ended June 30, 2001 and 2000

	2001	2000
Reconciliation of operating income to net cash provided by		
Operating activities:		
Operating income	\$ 179,018,542	\$ 148,142,575
Adjustments to reconcile operating income to net cash		
provided by (used for) operating activities:		
Depreciation	217,457	218,768
Installment payments for jackpot awards	(1,209,579)	(1,461,956)
Miscellaneous receipts classified as operating activities	765,645	1,303,213
Provision for doubtful accounts	43,742	68,665
(Increase) decrease in assets:		
Investment for jackpot awards	1,033,868	1,285,427
Accounts receivable	(1,197,789)	5,778,087
Inventory	68,105	(233,365)
Deposits with MUSL	39,805	302,196
Deferred charges	68,553	6,803
Increase (decrease) in liabilities:		
Obligation for unpaid prize awards	(2,437,765)	(2,013,813)
Accounts payable	(1,305,392)	1,545,971
Accrued expenses	168,392	58,917
Deferred revenue	(114,274)	(641,487)
Total adjustments	(3,859,232)	6,217,426
Net cash provided by operating activities	\$ 175,159,310	\$ 154,360,001

See accompanying notes to financial statements.

RHODE ISLAND LOTTERY

Notes to Financial Statements

(1) Organization

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

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

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

<u>Game</u>	<u>Prize Payout</u>	<u>State's General Fund Share</u>
Daily Numbers Instant Ticket Games MUSL – PowerBall Money Roll (1) Easy Win (2)	Not less than 45% or more than 65% of sales	Not less than 30% of ticket sales
Keno	Not less than 45% or more than 72% of sales	Not less than 20% of ticket sales
Video Lottery	Prize payout not established by law	51% of net terminal income (video lottery credits purchased less credits redeemed or redeemable) less pro rata share of Lottery's operating expenses

(1) The Money Roll game began November 19, 2000.

(2) The Easy Win game ended November 18, 2000.

RHODE ISLAND LOTTERY

Notes to Financial Statements

(1) Organization - (Continued)

Chapter 42-61.2 of the Rhode Island General Laws authorizes the Commission to conduct and control video lottery games. This chapter stipulates the allocation of video lottery net terminal income (video lottery credits purchased less credits redeemed or redeemable). The Commission's share for deposit in the Lottery fund shall be no less than 51% of net terminal income. The remaining net terminal income is divided among licensed video lottery retailers, the technology providers (video lottery terminal providers), the central communications system provider, the city or town in which the video retailer is licensed, and the owners of dog kennels under contract with a licensed video lottery retailer.

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

The prize pool for PowerBall is 50% of each drawing period's ticket sales. MUSL has placed 2% of each drawing period's ticket sales for PowerBall, included as part of each member's prize liability, in prize reserve funds. The maximum balance on the prize reserve funds for PowerBall is \$77,000,000. Once the prize reserve funds exceed this designated cap, the excess becomes part of the prize pool. The prize reserve funds serve as a contingency reserve to protect MUSL from unforeseen prize liabilities and these reserve funds are to be used at the discretion of the MUSL Board of Directors. The prize reserve funds are refundable to MUSL members if the MUSL disbands or if a member leaves MUSL. Members leaving MUSL must wait one year before receiving their remaining share, if any, of prize reserve funds. At June 30, 2001 and 2000, the prize reserve funds for the PowerBall game had reached a maximum balance of \$77,000,000 of which the Lottery's share was \$2,126,422. The Lottery has charged amounts placed into the prize reserve funds to prize awards expense as the related sales have occurred.

All investment earnings relating to the prize reserve funds are credited to an unreserved account for each member state. This account can be utilized to offset operating costs or for the promotion of any MUSL game as approved by the MUSL Board of Directors. The Lottery's unreserved account is reported on the balance sheets as "Deposits with MUSL". The Lottery is assessed its pro rata share of MUSL's annual operating expenses. MUSL reduced the Lottery's unreserved account by \$80,636 and \$74,017 for operating expenses for the fiscal years ended June 30, 2001 and 2000, respectively.

MUSL's independent auditors issue a publicly available annual financial report that may be obtained by writing to the Multi-State Lottery Association, 1701 48th Street, Suite 200, West Des Moines, Iowa 50266-6723.

RHODE ISLAND LOTTERY

Notes to Financial Statements

(2) Summary of Significant Accounting Policies

(a) *Basis of Accounting*

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

(b) *Reporting Entity*

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

(c) *Revenues and Expenses*

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

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

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

RHODE ISLAND LOTTERY

Notes to Financial Statements

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

(d) *Depreciation*

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

(e) *Cash Equivalents*

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

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

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

For certain other games, annuity contracts were purchased in the name of, and paid directly to, the jackpot winner. Accordingly, the Lottery has not recorded an obligation for prize awards satisfied through annuity contracts purchased in the name of the winner.

(g) *Ticket Inventory*

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

(h) *Deferred Revenue*

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

RHODE ISLAND LOTTERY

Notes to Financial Statements

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

(i) *Use of Estimates*

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

(j) *Reclassifications*

Certain prior period amounts have been reclassified to conform with the current period presentation.

(3) Deposits and Investment Risk

(a) *Deposits*

A cash overdraft of \$432,782 existed at June 30, 2001; the bank balance at that date was \$108,146. The primary difference between the book and bank balances was outstanding checks. The entire bank balance at June 30, 2001 is held by the State General Treasurer. All General Treasurer accounts at a single institution are aggregated for purposes of determining Federal Depository Insurance coverage.

The Lottery's book balance at June 30, 2000 was \$12,208,934 and the bank balance was \$12,255,924. The primary difference between the book and bank balances was outstanding checks. The entire bank balance at June 30, 2000 was held by the State General Treasurer.

(b) *Investments*

The Lottery's investments are categorized below to provide an indication of the level of market and credit risk assumed by the Lottery at June 30, 2001 and 2000. Investments for jackpot awards were made by the Lottery in accordance with guidelines established by the Commission. All other investments, principally cash equivalent type investments, are made by the State General Treasurer in accordance with guidelines established by the State Investment Commission, which is responsible for the investment of all State funds. Pursuant to Chapter 35-10 of the R.I. General Laws, the State Investment Commission may, in general, "invest in securities as would be acquired by prudent persons of discretion and intelligence in these matters who are seeking a reasonable income and the preservation of their capital."

RHODE ISLAND LOTTERY

Notes to Financial Statements

(3) Deposits and Investment Risk - (Continued)

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

All of the Lottery's investments are Category 1 investments, which are summarized below.

	<u>Fair Value</u> 2001	<u>Fair Value</u> 2000
Zero coupon U.S. Treasury bonds	\$ 1,839,580	\$ 2,873,448
U.S. Government Agency Notes	<u>4,798,950</u>	<u>7,196,113</u>
Total investments	6,638,530	10,069,561
Less amounts classified as cash equivalents	<u>4,798,950</u>	<u>7,196,113</u>
Total investments for jackpot awards	1,839,580	2,873,448
Less short-term investments for jackpot awards	<u>902,000</u>	<u>1,208,000</u>
Long-term investments for jackpot awards	<u>\$ 937,580</u>	<u>\$ 1,665,448</u>

(c) Cash and Cash Equivalents

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

	<u>2001</u>	<u>2000</u>
Cash balance per books	\$ -	\$ 12,208,934
Investments reclassified as cash equivalents	<u>4,798,950</u>	<u>7,196,113</u>
Cash and cash equivalents	<u>\$ 4,798,950</u>	<u>\$ 19,405,047</u>

RHODE ISLAND LOTTERY

Notes to Financial Statements

(4) Property, Plant and Equipment

A summary of property, plant and equipment follows:

	Estimated Useful Life	<u>2001</u>	<u>2000</u>
Buildings	20	\$ 1,437,912	\$ 1,437,912
Building improvements	10	136,915	280,796
Ticket production and computer equipment	10	19,612	19,612
Office equipment	10	133,184	120,265
Furniture and fixtures	10	25,194	42,311
Lottery drawing equipment	3	68,861	68,861
Automobiles	3	282,582	284,854
Computer equipment	3	298,407	276,383
Trucks	3	<u>22,445</u>	<u>22,445</u>
		2,425,112	2,553,439
Less: Accumulated depreciation		<u>1,911,868</u>	<u>1,934,687</u>
Property, plant and equipment (net)		<u>\$ 513,244</u>	<u>\$ 618,752</u>

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

(5) Due to State's General Fund

Due to State's General Fund represents the balance of net income for the period (after adjustment for depreciation expense on the Lottery's headquarters - see Note 8) that is to be paid to the State's General Fund. The amounts paid and amounts due to State's General Fund are summarized below:

	<u>2001</u>	<u>2000</u>
Payments to State's General Fund	\$ 180,743,897	\$ 150,283,635
Cash paid during fiscal year	(192,183,635)	(138,375,047)
Amount due to State's General Fund, beginning of year	<u>12,883,635</u>	<u>975,047</u>
Due to State's General Fund, end of year	<u>\$ 1,443,897</u>	<u>\$ 12,883,635</u>

RHODE ISLAND LOTTERY

Notes to Financial Statements

(6) Commissions

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

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

(7) Compensated Absences

The Lottery accrues an estimated liability for vested benefits relating to future compensated absences. This includes an expected obligation in connection with vacation credits and accumulated vested sick pay for those employees eligible for retirement. As of June 30, 2001 and 2000, the estimated liability was \$190,342 and \$157,990, respectively. The liability is calculated using the current hourly rates of pay.

(8) Retained Earnings

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

(9) Retirement Plan

Plan Description:

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

RHODE ISLAND LOTTERY

Notes to Financial Statements

(9) Retirement Plan - (Continued)

Funding Policy:

The funding policy, as set forth in Rhode Island General Laws, Section 36-10-2, provides for actuarially determined periodic contributions to the plan. However, the actuarially determined contribution rates can be statutorily changed by the legislature. Lottery employees are required to contribute 8.75% of their annual covered salary. The Lottery is required to contribute at an actuarially determined rate; the rate is 7.99% and 8.57%, respectively, of annual covered payroll for the years ended June 30, 2001 and 2000. The Lottery contributed \$178,730, \$181,386, and \$192,085 for the years ended June 30, 2001, 2000 and 1999, respectively, equal to the required contributions for each year.

(10) Postemployment Benefits

In accordance with the General Laws, postemployment healthcare benefits are provided to all state employees who retire on or after July 1, 1989. The benefits in general cover medical and hospitalization costs for pre-Medicare eligible retirees and a Medicare supplement for Medicare eligible retirees. The retiree is required to pay a portion of the monthly premium. This payment varies with years of service and ranges from 50% for retirees with 10-15 years of service to 0% for retirees with 35 years of service. The Lottery contributed .98% and .66%, respectively, of covered payroll for the years ended June 30, 2001 and 2000 to fund the cost of these benefits. This benefit program is administered by the State, therefore all required disclosures are included in the State's CAFR.

(11) Deferred Compensation

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

(12) Commitments

The Lottery has contracted with a vendor to furnish computer hardware and software together with the related services necessary for the operation of the Lottery's computerized games. Commissions range from 4% to 4.8% of sales from the on-line games. The Lottery leases a portion of its headquarters to the vendor to house computer hardware necessary for the on-line games. The term of the lease coincides with the vendor contract and provides for a rent of \$41,520 per annum. The Lottery recently exercised its option of extending this agreement until October 31, 2007.

The Lottery has also contracted with this vendor to install, operate and maintain a central communications system for the operation of its video lottery games. This contract is effective through August 27, 2002. Commissions, equal to 2.5% of net terminal income

RHODE ISLAND LOTTERY

Notes to Financial Statements

(12) Commitments - (Continued)

from video lottery sales, are paid from the technology provider's share of net terminal income.

(13) Equipment Leasing

Leases that do not meet the criteria for capitalization are classified as operating leases with related rentals charged to operations as incurred. The following is a schedule, by year, of future minimum lease payments under operating leases as of June 30, 2001, that have initial or remaining lease terms in excess of one year.

<u>Fiscal Year Ending June 30</u>	<u>Lease Payments</u>
2002	\$ 132,529
2003	4,316
Total future minimum lease payments	<u>\$ 136,845</u>

(14) Contingencies

Litigation

A suit was filed by a former Lottery employee against the members of the Commission in their official capacity, the Governor and the Director of Administration. The litigation concerns the former employee's claim that his termination on March 25, 1996 was unlawful. In February 2001, a judge decided that the Commission was in violation of the Open Meetings Act at its meeting on March 25, 1996, however, the employee was not reinstated to his former position. The Commission was fined and the plaintiffs were awarded attorney's fees and costs. These amounts have been accrued at June 30, 2001 but continue to be appealed by both parties.

Damage to Lottery Headquarters

On March 6, 2001, due to a severe storm, a significant portion of the roof collapsed at the Lottery headquarters. It is estimated that the cost of repairing the roof and building will be \$850,000. As a result of the roof collapse, the Lottery entered into a sublease agreement for temporary office space located at 1210 Pontiac Avenue, Cranston, Rhode Island. The terms of the arrangement require the Lottery to pay an annual rent of \$103,950. The Lottery is also responsible for its pro rata share of all other amounts required to be paid as additional rent under the master lease agreement. The Lottery expects the building repairs and rent to be covered by insurance proceeds.

RHODE ISLAND LOTTERY
Sales, Commissions and Prize Awards Expense
Years Ended June 30, 2001 and 2000

Year Ended June 30, 2001

	Sales	Commissions	Prize Awards Expense	Unclaimed Prize Recovery	Cost of Tickets	Cost of Sales	Gross Profit
Lottery games:							
On-line games							
Keno	\$ 69,190,444	\$ 8,544,378	\$ 45,109,305	\$ (391,197)	\$ -	\$ 53,262,486	\$ 15,927,958
PowerBall	36,437,944	4,499,748	18,221,098	(1,199,772)	-	21,521,074	14,916,870
Daily Numbers	28,459,883	3,514,532	14,382,925	(276,198)	-	17,621,259	10,838,624
Money Roll	1,971,470	243,458	986,317	-	-	1,229,775	741,695
Easy Win	1,545,704	190,880	693,215	(133,343)	-	750,752	794,952
	<u>137,605,445</u>	<u>16,992,996</u>	<u>79,392,860</u>	<u>(2,000,510)</u>	<u>-</u>	<u>94,385,346</u>	<u>43,220,099</u>
Instant tickets	69,394,994	4,591,250	45,614,019	(1,921,088)	1,112,469	49,396,650	19,998,344
Video Lottery	771,019,263	107,436,913	541,940,970	(51,760)	-	649,326,123	121,693,140
Totals	<u>\$ 978,019,702</u>	<u>\$ 129,021,159</u>	<u>\$ 666,947,849</u>	<u>\$ (3,973,358)</u>	<u>\$ 1,112,469</u>	<u>\$ 793,108,119</u>	<u>\$ 184,911,583</u>

Video Commissions - Detail

Facilities	\$ 69,867,771
Technology Providers	18,844,614
Central Communications Provider	5,727,456
Dog Kennel Owners	10,706,090
City/Town	2,290,982
Total	<u>\$ 107,436,913</u>

Year Ended June 30, 2000

	Sales	Commissions	Prize Awards Expense	Unclaimed Prize Recovery	Cost of Tickets	Cost of Sales	Gross Profit
Lottery games:							
On-line games							
Keno	\$ 60,801,993	\$ 7,526,018	\$ 39,603,546	\$ (361,393)	\$ -	\$ 46,768,171	\$ 14,033,822
PowerBall	37,456,233	4,636,300	18,728,152	(1,688,215)	-	21,676,237	15,779,996
Daily Numbers	28,159,762	3,485,591	13,938,785	(216,530)	-	17,207,846	10,951,916
Easy Win	1,802,708	241,839	787,764	-	-	1,029,603	773,105
Roll Down	3,293,258	407,637	1,644,019	(107,970)	-	1,943,686	1,349,572
	<u>131,513,954</u>	<u>16,297,385</u>	<u>74,702,266</u>	<u>(2,374,108)</u>	<u>-</u>	<u>88,625,543</u>	<u>42,888,411</u>
Instant tickets	61,813,004	4,095,350	39,929,109	(378,550)	990,209	44,636,118	17,176,886
Video Lottery	670,764,767	100,930,356	476,047,808	(25,859)	-	576,952,305	93,812,462
Totals	<u>\$ 864,091,725</u>	<u>\$ 121,323,091</u>	<u>\$ 590,679,183</u>	<u>\$ (2,778,517)</u>	<u>\$ 990,209</u>	<u>\$ 710,213,966</u>	<u>\$ 153,877,759</u>

Video Commissions - Detail

Facilities	\$ 59,203,929
Technology Providers	24,683,194
Central Communications Provider	5,840,962
Dog Kennel Owners	9,255,284
City/Town	1,946,987
Total	<u>\$ 100,930,356</u>

See independent auditor's report.



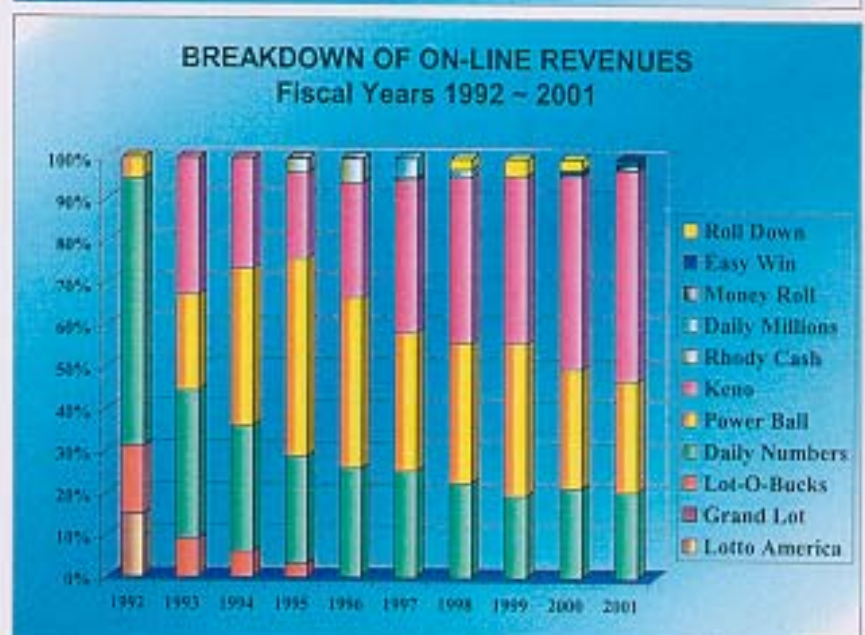
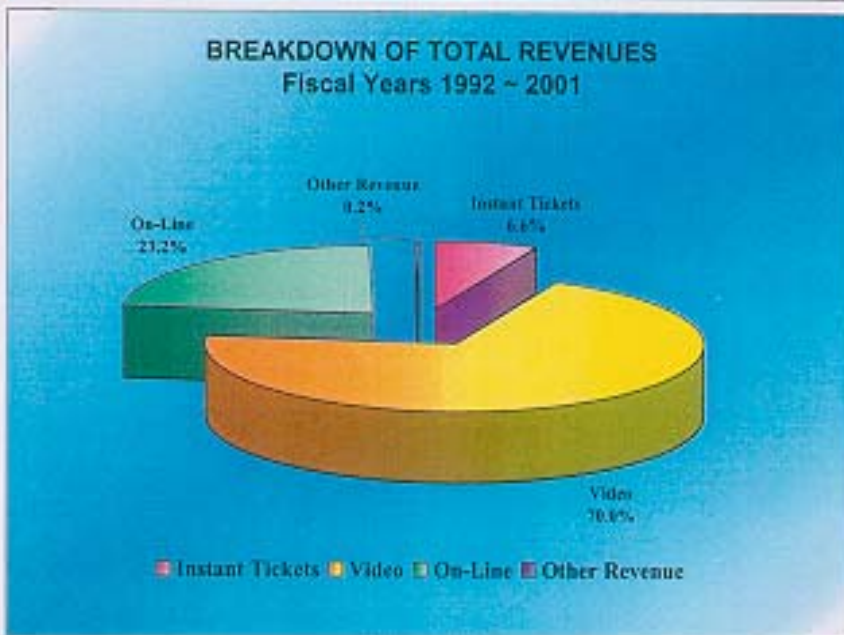
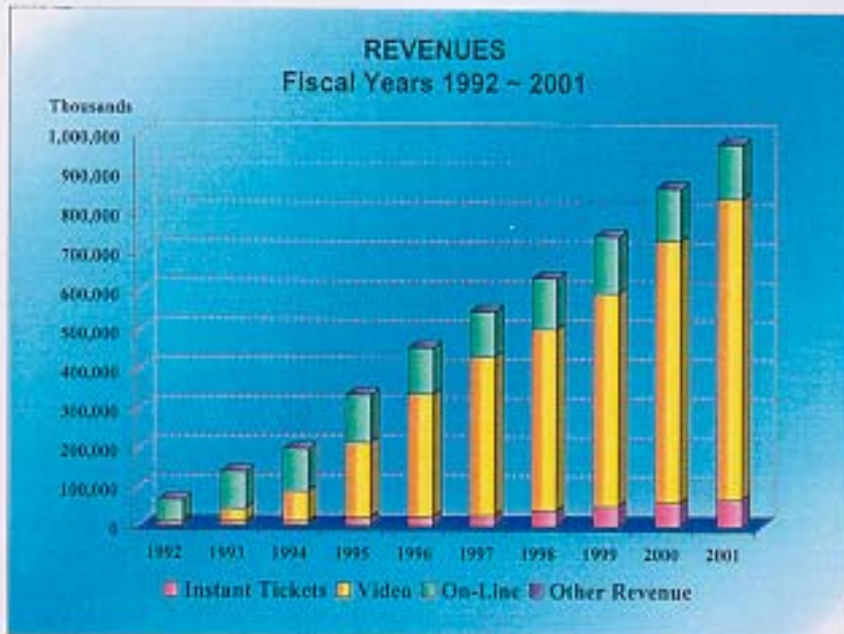
Rhode Island Lottery

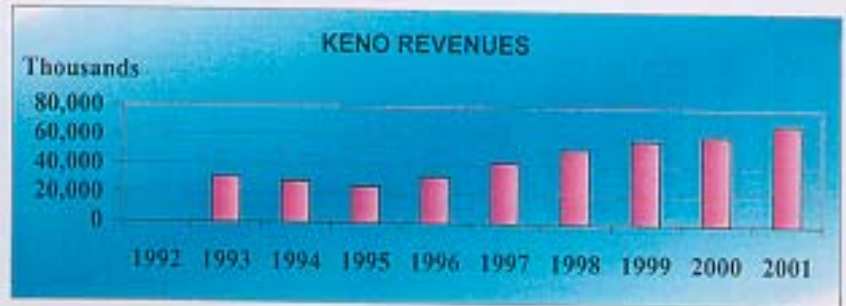
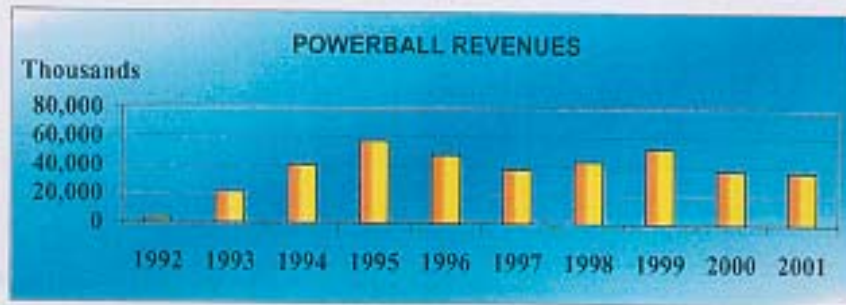
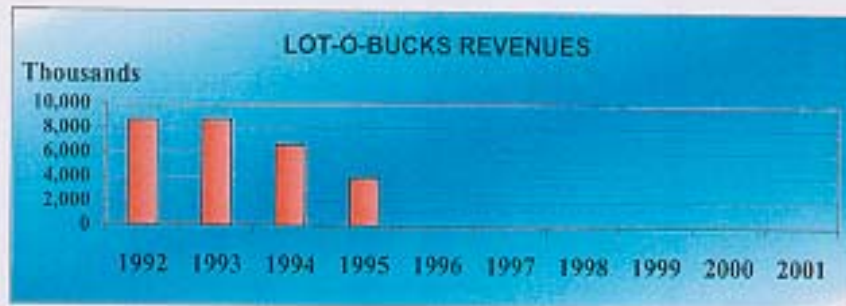
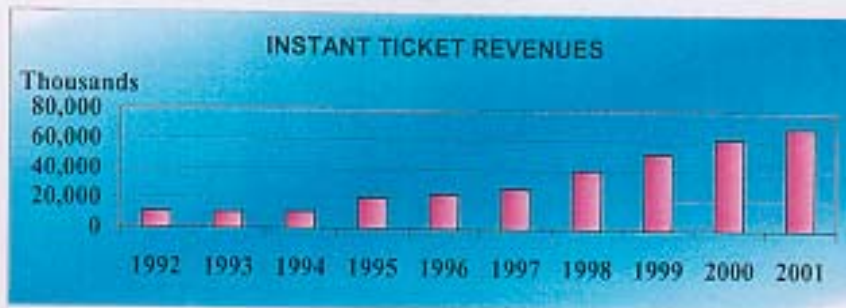
Revenues

Fiscal Years 1992 through 2001

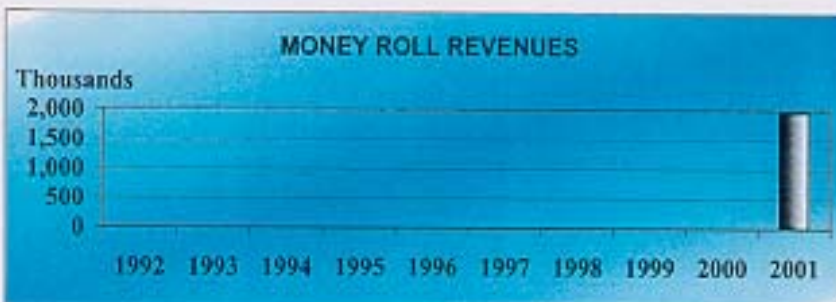
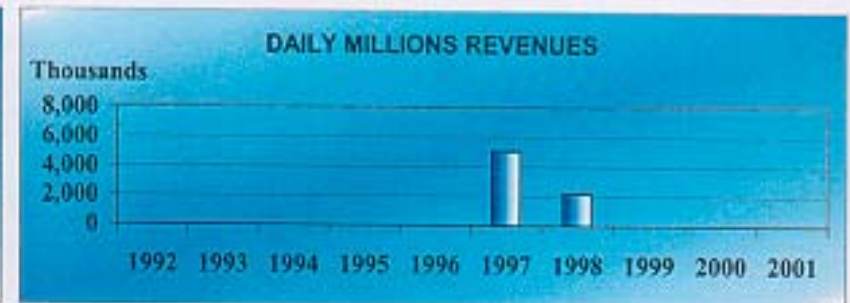
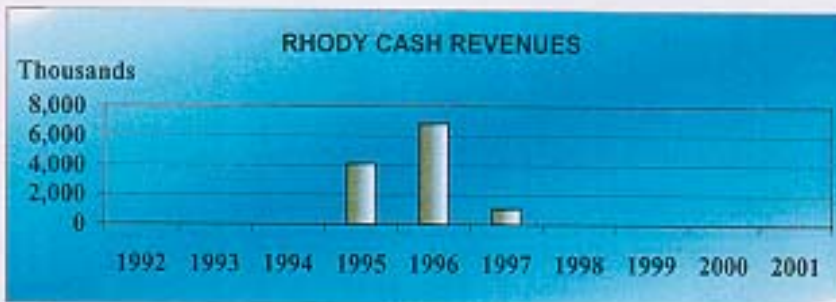
	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
SALES										
<i>Instant Tickets</i>										
Instant Tickets	\$ 11,146,332	\$ 10,922,026	\$ 11,300,376	\$ 20,840,747	\$ 23,339,726	\$ 27,356,236	\$ 40,323,202	\$ 51,372,959	\$ 61,813,004	\$ 69,394,994
<i>Video</i>										
VLTs	-	32,725,369	76,694,627	192,018,304	314,882,436	406,108,530	464,068,675	545,474,154	670,764,767	771,019,263
<i>On-Line</i>										
Lotto America	7,951,839	-	-	-	-	-	-	-	-	-
Grand Lot	95,480	21,367	-	-	-	-	-	-	-	-
Lot-O-Bucks	8,663,939	8,700,942	6,639,796	3,974,231	-	-	-	-	-	-
Daily Numbers	34,111,383	33,271,675	32,325,382	31,196,077	30,600,023	29,405,124	29,257,141	28,221,328	28,159,762	28,459,881
PowerBall	2,640,006	21,612,441	40,562,732	57,474,718	47,622,832	37,881,052	43,345,345	52,582,676	37,456,233	36,437,944
Keno	-	30,794,180	28,399,977	24,927,298	32,003,602	41,801,453	51,617,137	57,637,832	60,801,993	69,190,444
Rhody Cash	-	-	-	4,115,596	6,849,222	1,112,026	-	-	-	-
Daily Millions	-	-	-	-	-	5,051,443	2,162,126	-	-	-
Money Roll	-	-	-	-	-	-	-	-	-	1,971,470
Easy Win	-	-	-	-	-	-	-	-	1,802,708	1,545,704
Roll Down	-	-	-	-	-	-	3,300,928	5,680,770	3,293,258	-
Total On-line	53,462,647	94,409,605	107,927,887	121,687,920	117,075,679	115,251,098	129,682,677	144,322,606	131,513,954	137,605,445
TOTAL SALES	64,608,979	138,057,080	195,922,890	334,546,971	455,297,841	548,715,864	634,074,644	741,169,719	864,091,725	978,019,702
<i>Other Revenues</i>										
Investment Earnings	207,178	194,424	257,711	521,709	456,930	421,123	488,579	528,425	766,591	969,516
Net Pull Tab Sales	221,365	205,278	185,454	185,639	162,788	163,067	196,280	214,300	229,991	211,876
Miscellaneous	29,319	27,207	26,475	182,147	105,147	169,343	264,405	169,985	1,072,583	472,068
TOTAL OTHER REVENUES	457,862	426,909	469,640	889,495	724,865	753,533	949,064	912,710	2,069,165	1,653,460
TOTAL SALES & REVENUES	\$ 65,066,841	\$ 138,483,989	\$ 196,392,530	\$ 335,436,466	\$ 456,022,706	\$ 549,469,397	\$ 635,023,708	\$ 742,082,429	\$ 866,160,890	\$ 979,673,162

Source: Rhode Island Lottery





Source: Rhode Island Lottery



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

Video Lottery began in Fiscal Year 1993

Lotto America ended in Fiscal Year 1992

Grand Lot ended in Fiscal Year 1993

Lot-O-Bucks ended in Fiscal Year 1995

PowerBall began in Fiscal Year 1992

Keno began in Fiscal Year 1993

Rhody Cash began in Fiscal Year 1995 and ended in Fiscal Year 1997

Daily Millions began in Fiscal Year 1997 and ended in Fiscal Year 1998

Money Roll began in Fiscal Year 2001

Easy Win began in Fiscal Year 2000 and ended in Fiscal Year 2001

Roll Down began in Fiscal Year 1998 and ended in Fiscal Year 2000

Source: Rhode Island Lottery

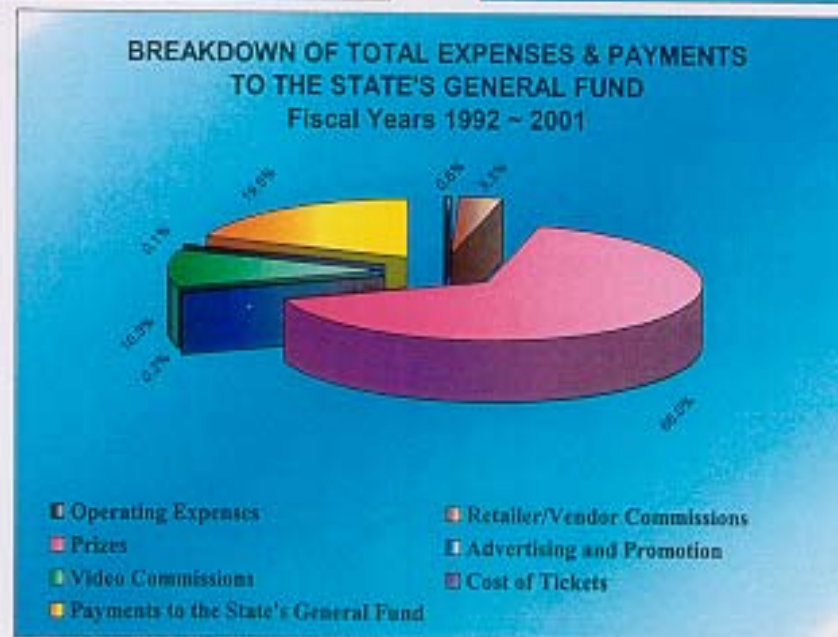
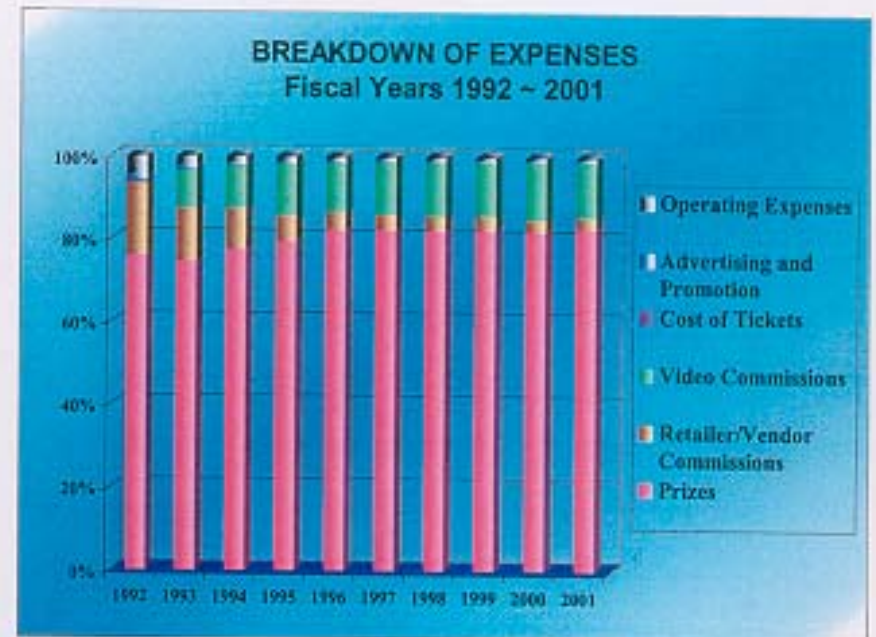
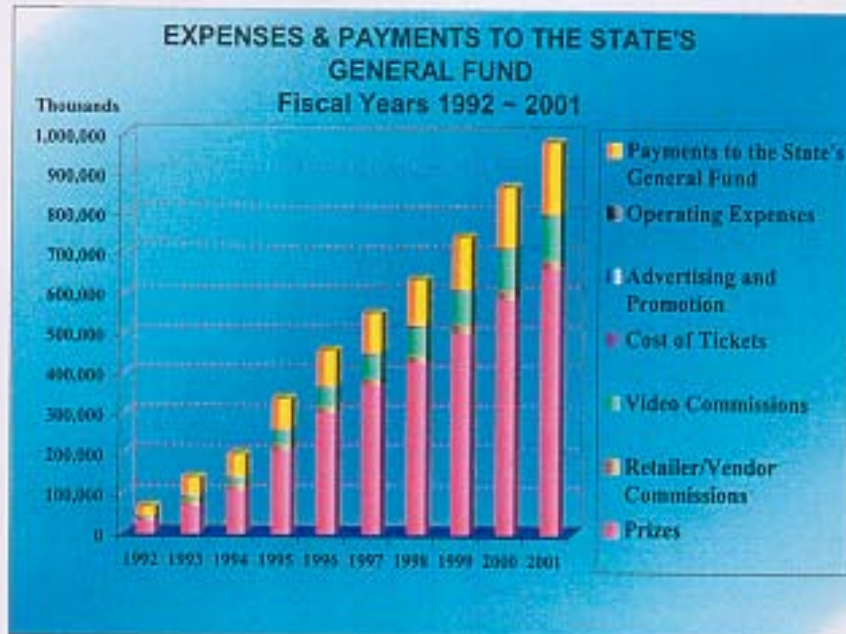


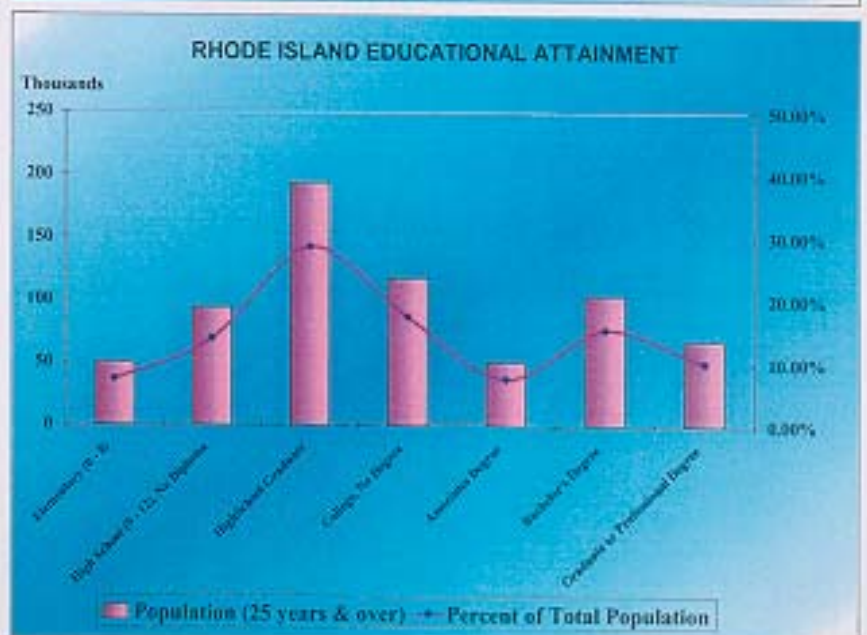
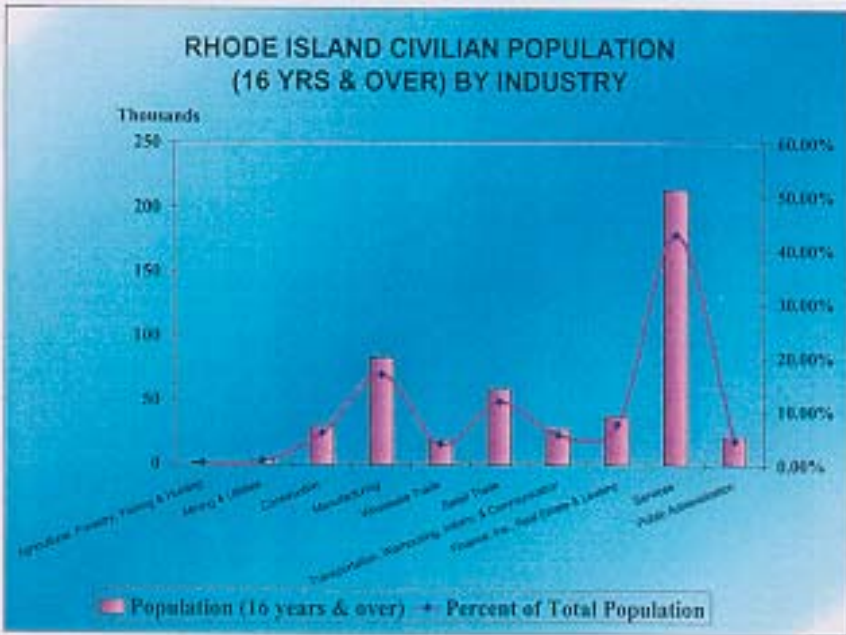
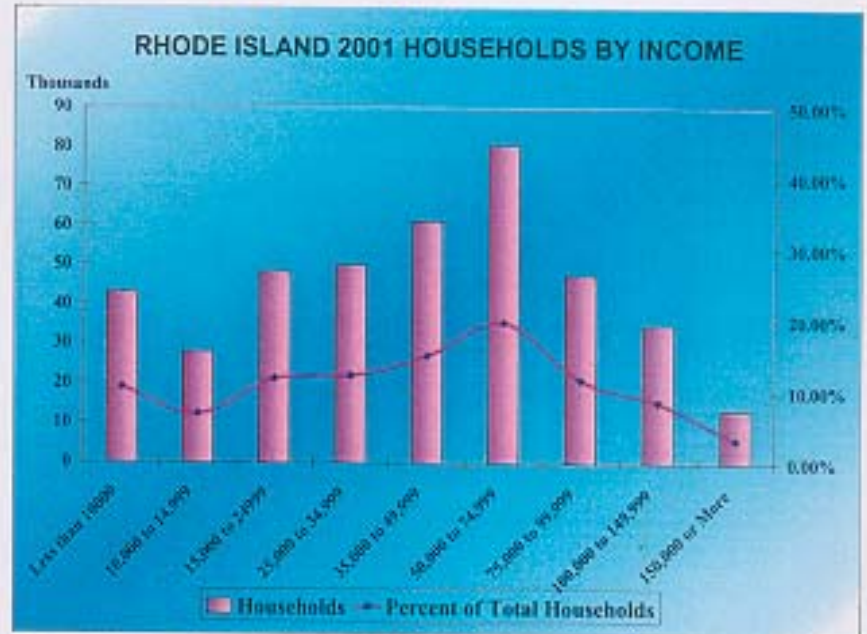
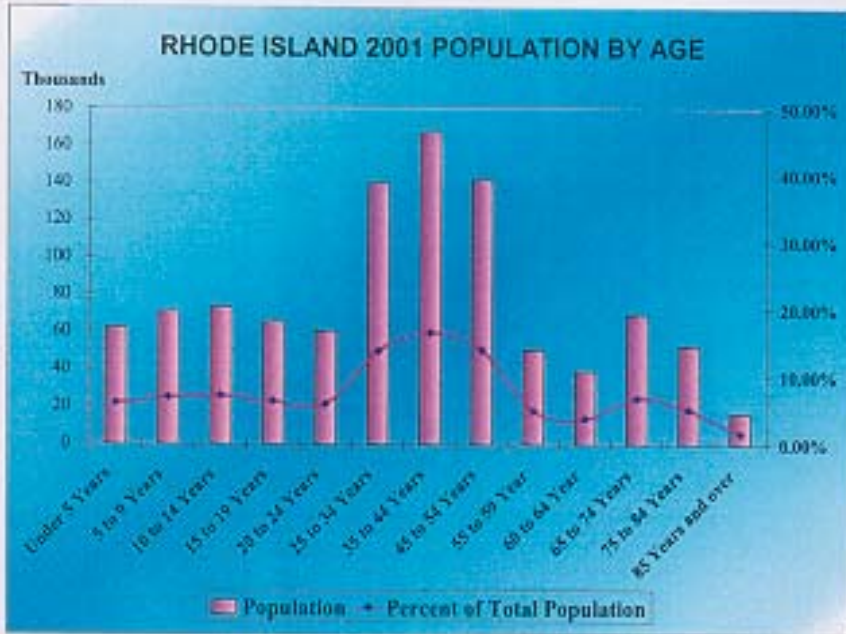
Rhode Island Lottery

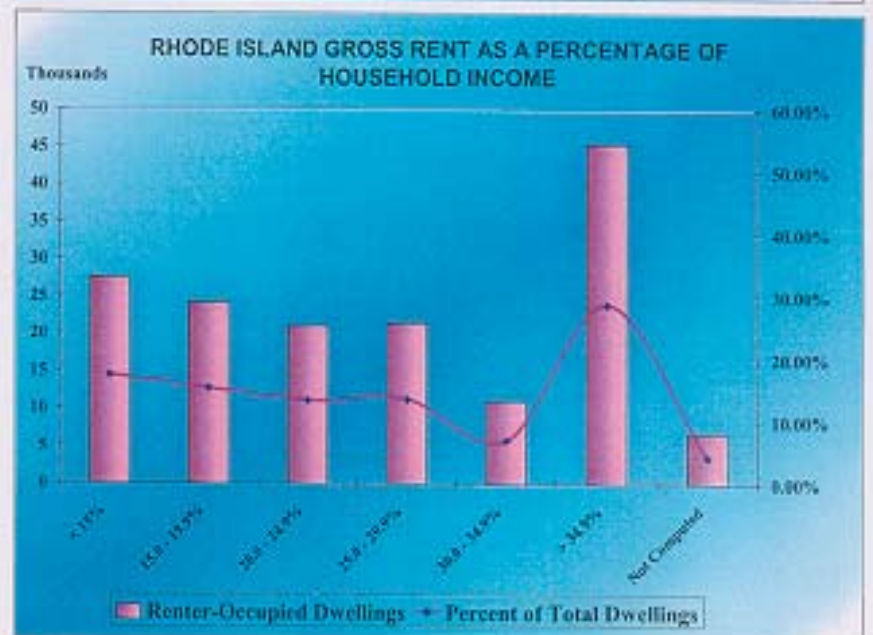
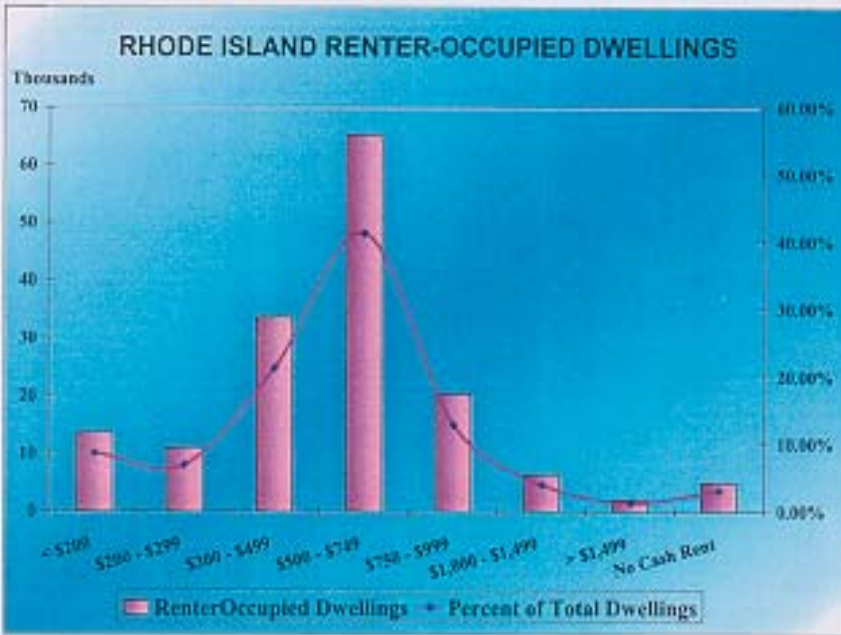
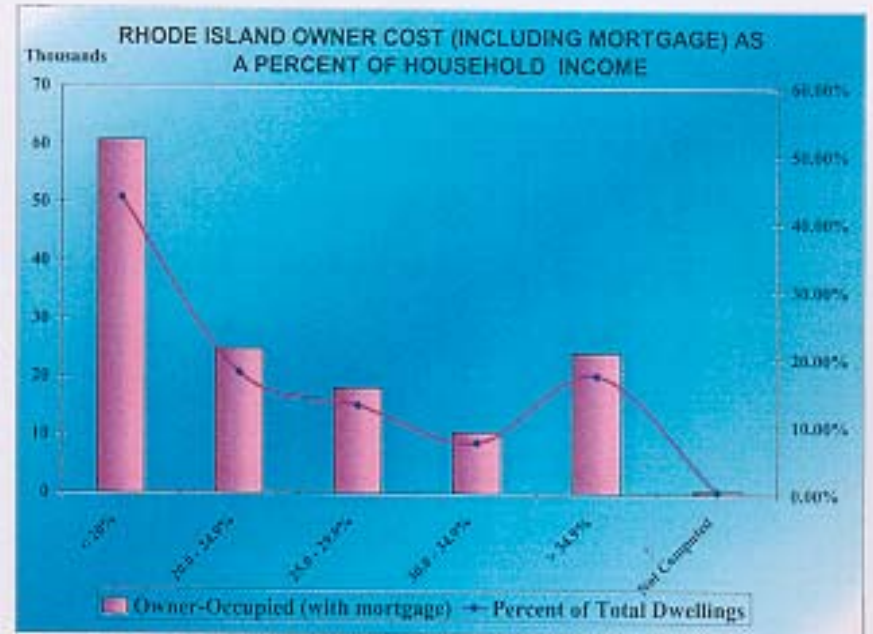
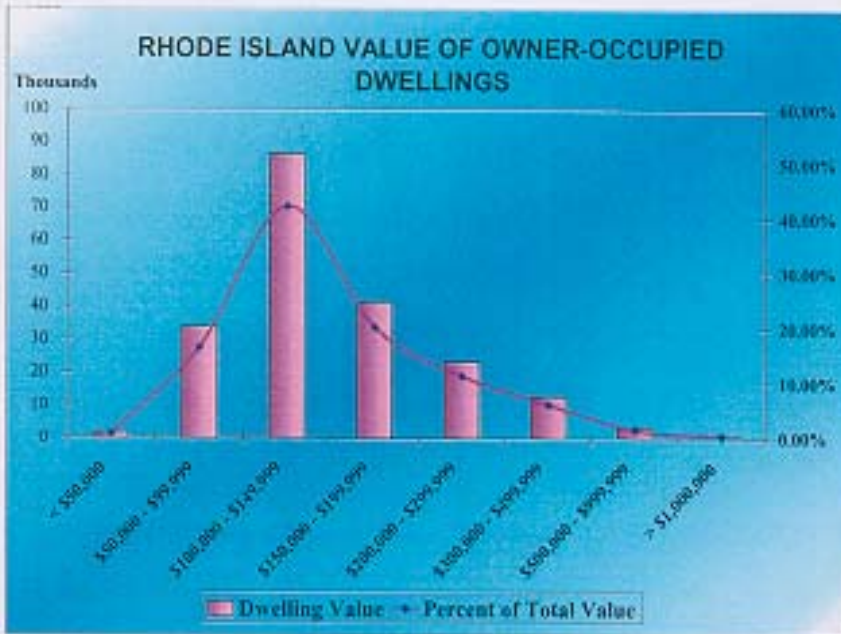
Expenses and Payments to the State's General Fund

Fiscal Years 1992 through 2001

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
EXPENSES										
Prizes	\$ 32,145,535	\$ 70,978,039	\$ 109,803,118	\$ 207,427,166	\$ 303,401,899	\$ 373,056,150	\$ 429,277,957	\$ 503,522,789	\$ 590,679,183	\$ 666,947,849
Retailer/Vendor Commissions	7,347,580	12,075,388	13,987,194	16,090,163	15,629,373	15,715,397	18,442,716	21,219,277	20,392,735	21,584,246
Video Commissions	-	8,741,973	14,436,084	32,281,395	43,869,000	57,444,162	67,859,963	80,153,944	100,950,356	107,436,913
Cost of Tickets	401,691	417,581	379,050	567,290	619,223	843,610	1,102,638	985,173	990,209	1,112,469
Unclaimed Prize Recovery	(719,776)	(996,235)	(1,237,054)	(1,688,010)	(2,110,340)	(2,080,535)	(1,849,978)	(2,299,067)	(2,778,517)	(3,973,358)
Advertising and Promotion	538,488	771,543	647,021	1,156,710	1,263,390	1,102,533	1,384,429	1,242,550	1,511,749	1,220,577
Operating Expenses	1,848,188	1,988,840	2,142,081	2,878,608	3,046,570	3,427,737	3,806,256	3,854,611	4,223,435	4,672,464
TOTAL EXPENSES	<u>\$ 41,561,706</u>	<u>\$ 93,977,129</u>	<u>\$ 140,157,494</u>	<u>\$ 258,713,322</u>	<u>\$ 368,719,115</u>	<u>\$ 449,509,054</u>	<u>\$ 520,023,981</u>	<u>\$ 608,679,177</u>	<u>\$ 715,949,150</u>	<u>\$ 799,001,169</u>
PAYMENTS TO THE STATE'S GENERAL FUND	<u>\$ 23,579,798</u>	<u>\$ 44,578,444</u>	<u>\$ 56,306,931</u>	<u>\$ 76,795,039</u>	<u>\$ 90,375,486</u>	<u>\$ 108,032,238</u>	<u>\$ 115,071,622</u>	<u>\$ 133,475,047</u>	<u>\$ 150,283,635</u>	<u>\$ 180,743,897</u>







**U.S. LOTTERIES PER CAPITA SALES
FISCAL YEAR 2000**

LOTTERY	TOTAL SALES (\$M)	POPULATION (M)	PER CAPITA SALES
RHODE ISLAND (2)	864.32	1.05	\$823.16
South Dakota (2)	581.05	0.75	\$774.73
Delaware (1)	556.45	0.78	\$713.40
Massachusetts	3,697.97	6.35	\$582.36
District of Columbia ***	215.51	0.57	\$378.09
Georgia	2,313.55	8.19	\$282.48
West Virginia (1)	447.97	1.81	\$247.50
Connecticut	837.51	3.41	\$245.60
Oregon (1)	760.01	3.42	\$222.23
Maryland	1,175.14	5.30	\$221.72
New Jersey	1,839.80	8.41	\$218.76
Ohio	2,209.10	11.35	\$194.63
New York *	3,629.26	18.98	\$191.21
Michigan ***	1,694.75	9.94	\$170.50
New Hampshire	190.81	1.24	\$153.88
Florida	2,324.39	15.98	\$145.46
Kentucky	583.68	4.04	\$144.48
Virginia	973.00	7.08	\$137.43
Pennsylvania	1,679.66	12.28	\$136.80
Texas **	2,657.29	20.85	\$127.45
Vermont	75.92	0.61	\$124.46
Illinois	1,503.86	12.42	\$121.08
Maine	147.91	1.27	\$116.46
Indiana	582.63	6.08	\$95.83
Missouri	508.02	5.60	\$90.72
Colorado	370.96	4.30	\$86.27
Minnesota	397.29	4.92	\$80.75
Washington	452.81	5.89	\$76.88
California	2,598.38	33.87	\$76.72
Wisconsin	406.70	5.36	\$75.88
Kansas	192.56	2.69	\$71.58
Idaho	86.51	1.29	\$67.06
Louisiana	276.38	4.47	\$61.83
Iowa	178.21	2.93	\$60.82
New Mexico	110.61	1.82	\$60.77
Arizona	255.55	5.13	\$49.81
Nebraska	68.17	1.71	\$39.87
Montana	29.90	0.90	\$33.22
TOTAL	37,473.79	243.04	\$154.19

* FY ends 3/31

** FY ends 8/31

*** FY ends 9/30

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

(2) Includes gross VLT sales (cash in)

Source: Most recent information reported by the North American Association
of State & Provincial Lotteries

**U.S. LOTTERIES RANKED
BY FISCAL YEAR 2000 SALES**

RANK	LOTTERY	FY '99 SALES (\$M)	FY '00 SALES (\$M)
1	Massachusetts	3,365.16	3,697.97
2	New York *	3,697.63	3,629.26
3	Texas **	2,572.55	2,657.29
4	California	2,501.69	2,598.38
5	Florida	2,178.59	2,324.39
6	Georgia	2,034.31	2,313.55
7	Ohio	2,144.73	2,209.10
8	New Jersey	1,658.20	1,839.80
9	Michigan ***	1,768.70	1,694.75
10	Pennsylvania	1,668.66	1,679.86
11	Illinois	1,524.40	1,503.86
12	Maryland	1,088.15	1,175.14
13	Virginia	934.60	973.00
14	RHODE ISLAND (2)	741.38	864.32
15	Connecticut	871.00	837.51
16	Oregon (1)	728.51	760.01
17	Kentucky	583.15	583.68
18	Indiana	681.43	582.63
19	South Dakota (2)	548.21	581.05
20	Delaware (1)	527.43	556.45
21	Missouri	513.33	508.02
22	Washington	473.40	452.81
23	West Virginia (1)	392.62	447.97
24	Wisconsin	428.20	406.70
25	Minnesota	390.01	397.29
26	Colorado	358.00	370.96
27	Louisiana	289.04	276.38
28	Arizona	268.26	255.55
29	District of Columbia ***	209.26	215.51
30	Kansas	198.92	192.56
31	New Hampshire	199.20	190.81
32	Iowa	184.07	178.21
33	Maine	144.54	147.91
34	New Mexico	89.23	110.61
35	Idaho	90.45	86.51
36	Vermont	70.39	75.92
37	Nebraska	72.36	68.17
38	Montana	30.00	29.90
	TOTAL	36,219.76	37,473.79

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

RANK	LOTTERY	% CHANGE
1	New Mexico	23.96%
2	RHODE ISLAND (2)	16.58%
3	Indiana	14.50%
4	West Virginia (1)	14.10%
5	Georgia	13.73%
6	New Jersey	10.95%
7	Massachusetts	9.89%
8	Maryland	7.99%
9	Vermont	7.86%
10	Florida	6.69%
11	South Dakota (2)	5.99%
12	Delaware (1)	5.50%
13	Oregon (1)	4.32%
14	Virginia	4.11%
15	California	3.86%
16	Colorado	3.62%
17	Texas **	3.29%
18	Ohio	3.00%
19	District of Columbia ***	2.99%
20	Maine	2.33%
21	Minnesota	1.87%
22	Pennsylvania	0.67%
23	Kentucky	0.09%
24	Montana	-0.33%
25	Missouri	-1.03%
26	Illinois	-1.35%
27	New York *	-1.85%
28	Iowa	-3.18%
29	Kansas	-3.20%
30	Connecticut	-3.85%
31	Michigan ***	-4.18%
32	New Hampshire	-4.21%
33	Washington	-4.35%
34	Idaho	-4.36%
35	Louisiana	-4.38%
36	Arizona	-4.74%
37	Wisconsin	-5.02%
38	Nebraska	-5.79%
	TOTAL	3.46%

* FY ends 3/31
 ** FY ends 6/31
 *** FY ends 9/30

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

Source: Most recent information reported by the North American Association
 of State & Provincial Lotteries



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EALMONTE@OAG.STATE.RI.US

STATE OF RHODE ISLAND and PROVIDENCE PLANTATIONS
GENERAL ASSEMBLY

OFFICE of the AUDITOR GENERAL

- ◆ INTEGRITY
- ◆ RELIABILITY
- ◆ INDEPENDENCE
- ◆ ACCOUNTABILITY

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

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

We have audited the financial statements of the Rhode Island Lottery (Lottery), a component unit of the State of Rhode Island and Providence Plantations, as of and for the year ended June 30, 2001 and have issued our report thereon dated September 4, 2001. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

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

Internal Control Over Financial Reporting

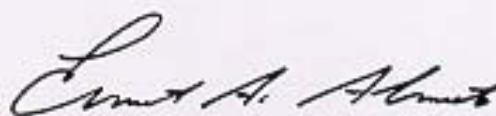
In planning and performing our audit, we considered the Lottery's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting.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

Reportable Condition

Logical access security to the computer systems used to operate the Lottery's games should be improved by (1) fully utilizing certain designed functions of the systems, (2) strengthening other system security aspects, and (3) implementing a comprehensive security plan for these computer systems that includes delegating certain aspects of security to the Lottery and monitoring by the Lottery of the overall system security function. During fiscal year 2001, the Lottery began implementing a formal comprehensive security plan including activation of certain security features originally designed within the Lottery's gaming systems. Complete implementation of this plan is necessary to ensure that access is appropriately restricted to authorized individuals and any unauthorized access is detected by the Lottery on a timely basis with appropriate follow-up.

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

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



Ernest A. Almonte, CPA, CFE
Auditor General

September 4, 2001