

THE GEORGIA LOTTERY CORPORATION



2002 ANNUAL REPORT

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GEORGIA
L O T T E R Y

APRIL 18, 2002

Pay to
the order of

GEORGIA STUDENTS

\$ 5,090,872,000⁰⁰

5 BILLION 90 MILLION 872 THOUSAND DOLLARS

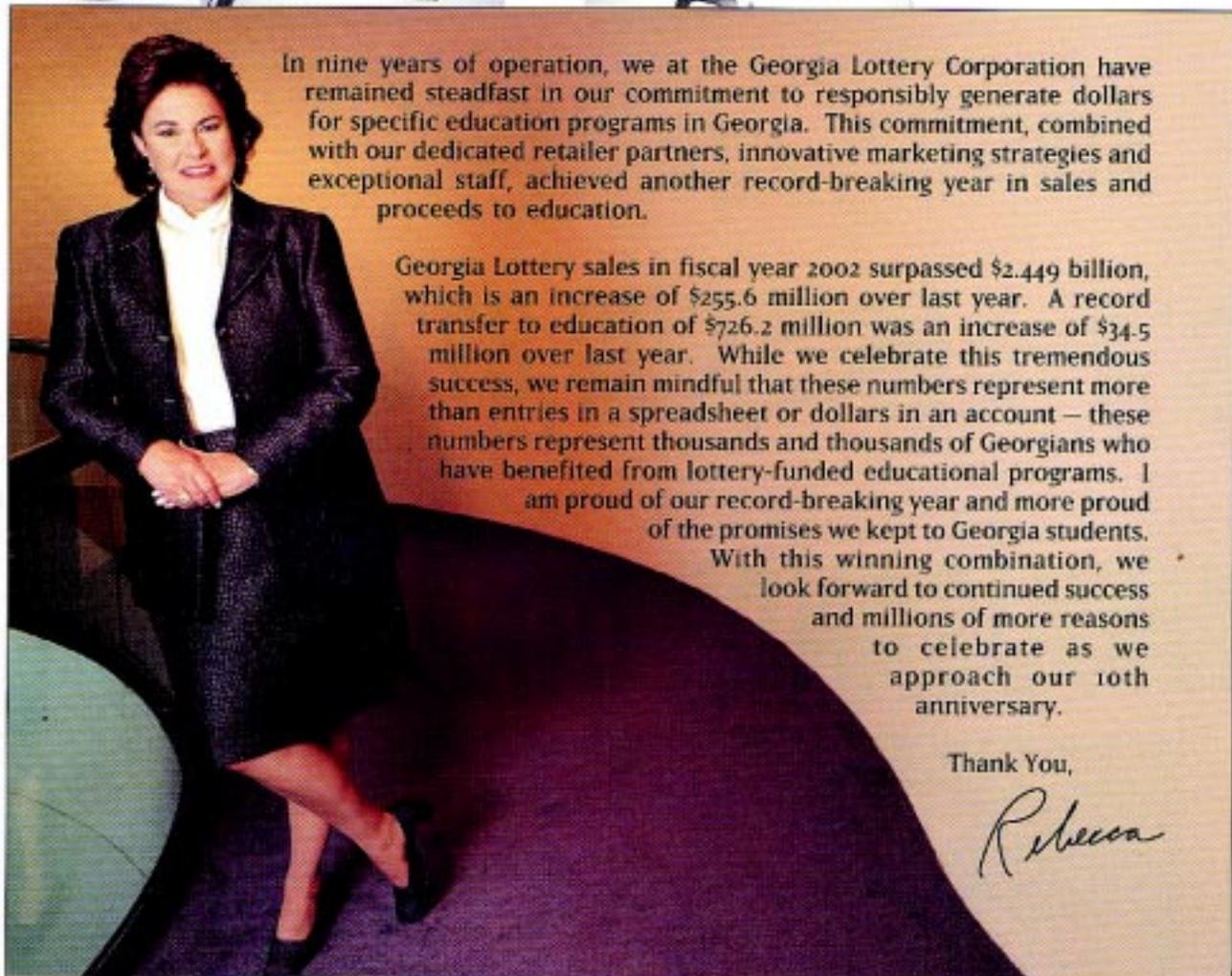
For:

**ABC's to
College Degrees**

Rebecca Graham Paul

NON-NEGOTIABLE

Fiscal Year 2002 was a record year for the Georgia Lottery Corporation, our retailer partners, our players and winners, and most importantly, our beneficiaries – Georgia students.



In nine years of operation, we at the Georgia Lottery Corporation have remained steadfast in our commitment to responsibly generate dollars for specific education programs in Georgia. This commitment, combined with our dedicated retailer partners, innovative marketing strategies and exceptional staff, achieved another record-breaking year in sales and proceeds to education.

Georgia Lottery sales in fiscal year 2002 surpassed \$2.449 billion, which is an increase of \$255.6 million over last year. A record transfer to education of \$726.2 million was an increase of \$34.5 million over last year. While we celebrate this tremendous success, we remain mindful that these numbers represent more than entries in a spreadsheet or dollars in an account – these numbers represent thousands and thousands of Georgians who have benefited from lottery-funded educational programs. I am proud of our record-breaking year and more proud of the promises we kept to Georgia students. With this winning combination, we look forward to continued success and millions of more reasons to celebrate as we approach our 10th anniversary.

Thank You,

Rebecca

"WE LOOK FORWARD TO CONTINUED SUCCESS AND MILLIONS OF MORE REASONS TO CELEBRATE AS WE APPROACH OUR 10TH ANNIVERSARY."



During my seven-year tenure on this distinguished Board, I have constantly been amazed at the tremendous success that comes each year with the Georgia Lottery Corporation. It should be no surprise to me or anyone else that this year is no exception. With great success comes great expectation. The Georgia Lottery exceeded all of our expectations again in fiscal year 2002 with record-breaking sales of \$2.449 billion and \$726 million transferred to Georgia students.

With record sales and returns to education for nine consistent years, it is no wonder that this Georgia Lottery team is recognized as one of the best in the country and the world. In fact, if the Georgia Lottery were a private company, it would rank on the Fortune 500 list as the number one most profitable company, with 32.9% profit as a percentage of revenue and as number six in revenues per employee, at over \$8.4 million.



J. Veronica Biggins, Chairwoman

From a business perspective these numbers are impressive for many reasons. To create such success, the Georgia Lottery operates from a strong foundation guided by sound business practices. More importantly, the Georgia Lottery maintains the highest level of integrity and public trust as a public corporation accountable to all Georgians. It is this commitment from the staff and Board to responsibly maximize revenues that directly results in profits for HOPE Scholarships, Pre-K programs for all four-year-olds and technology enhancements for all public schools.

As Chairwoman and on behalf of the members of the Board of Directors of the Georgia Lottery Corporation, I am pleased to report that the close of fiscal year 2002 completes another successful chapter in the history of the Georgia Lottery.

A handwritten signature in cursive script that reads "Veronica".

THE GEORGIA LOTTERY BOARD MEMBERS

J. VERONICA BIGGINS, CHAIRWOMAN

ROSCOE BROWN
MATTHEW WARE
DOROTHY YATES KIRKLEY

SYLVAN M. BYCK, JR.
BARBARA M. DOOLEY
CECIL M. PHILLIPS

THE LOTTERY IS ENHANCING EDUCATION



Kolade Apata,
Emory University
HOPE Scholar



Lisa Bailey,
Gwinnett Technical College
HOPE Scholar

On April 17, 2002, the Georgia Lottery celebrated an important milestone in its nine-year history. That week, the GLC transferred its FIVE-BILLIONTH DOLLAR to the Lottery for Education Account. Five billion dollars since inception translates into more than 600,000 students who have attended Georgia colleges on HOPE Scholarships, more than 430,000 four-year-olds who received an early start to their education in a high quality Pre-K program, and more than \$1.7 billion that has been used to improve Georgia's school facilities and the technology they use. Record Georgia Lottery sales in fiscal year 2002 allowed us to make a record return to education - \$726 million for education in fiscal year 2002 alone.

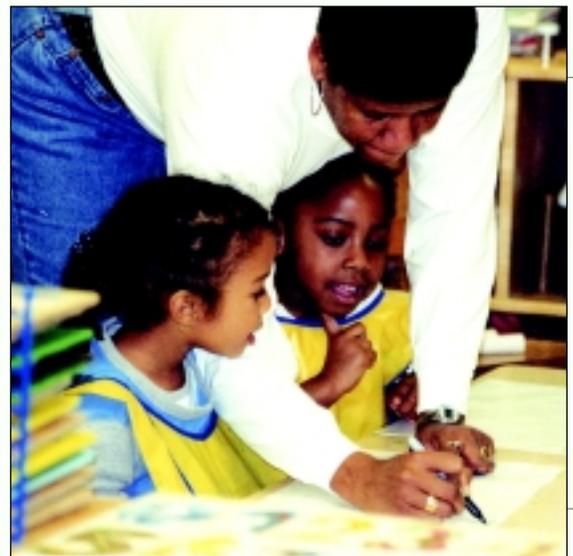
Each dollar raised by the Georgia Lottery for educational programs in Georgia means more lives positively changed in the state. Three current HOPE Scholarship recipients were able to commemorate the GLC's milestone transfer with us in April. One student in particular, Lisa Bailey, is part of a HOPE family. She has returned to school full-time at Gwinnett Technical College to attain a new career that will enable her to touch the lives of others. Her husband, Ted, also earned his degree by taking advantage of the HOPE Scholarship. The couple has two children who are on track to receive HOPE upon high school graduation. This HOPE family is able to put their resources directly into the state economy, rather than worrying about student loan payments.



The HOPE Family, Lisa and Ted Bailey, daughter Ashley and son JB

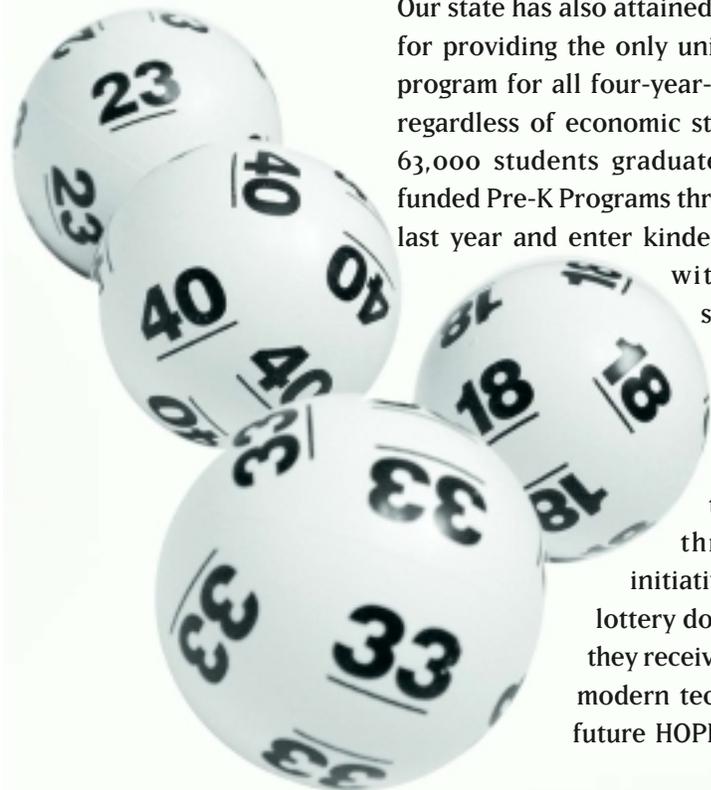
Lisa is one of almost 200,000 HOPE Scholarship recipients who furthered their education in the 2001-2002 school year. Because of the phenomenal success of the HOPE Scholarship Program, Georgia has ranked number one in the nation for the past five consecutive years for providing financial aid to students seeking education beyond high school.

Our state has also attained national acclaim for providing the only universal preschool program for all four-year-olds in the state, regardless of economic status. More than 63,000 students graduated from lottery-funded Pre-K Programs throughout the state last year and enter kindergarten this year with the tools to succeed. In grade school these students will have access to state-of-the-art technology through funding initiatives paid for with



Four-year-olds benefiting from lottery-funded program at "Sheltering Arms"

lottery dollars. The valuable educational experience they receive starting at age four, and enhanced through modern technology in school, will enable them to be future HOPE recipients!



GEORGIA LOTTERY GAMES SOARED TO RECORD HEIGHTS



The Georgia Lottery Corporation continued its tradition of providing fun and entertaining games for players in 2002. Through changes and enhancements to some existing games, record jackpot prizes, and the introduction of 60 new instant ticket games, Georgia Lottery products soared to record heights in 2002.

After listening to player requests for larger, faster-growing jackpots, the Big Game was super-sized into Mega Millions in May of 2002. The game quickly delivered on its promise with jackpots starting at \$10 million! Sales for the Big Game/Mega Millions soared to \$187,693,000. After an eight-year stretch Lotto Georgia was retired to make room for Lotto South, a new multi-jurisdictional game offered in Georgia, Kentucky and Virginia. With drawings held twice weekly, Lotto South swiftly became a new favorite. The combined sales of Lotto Georgia and Lotto South totaled \$84,820,000 in fiscal year 2002. A record \$26 million Lotto South jackpot was awarded to a Georgia winner in January 2002.

Fantasy 5 top prizes reached their highest levels ever in fiscal year 2002, leading to a boost in sales totaling \$86,828,000. The leftover Lotto Georgia jackpot prize money from the final drawing on September 8, 2001, was added to the Fantasy 5 top prize on New Year's Eve - resulting in a jackpot of more than \$1.2 million split by two winners. Four months later the Fantasy 5 top prize passed the \$1 million mark again, generating the largest single top prize awarded in the game's history.

It was a record year for instant tickets in 2002. With the introduction of 60 new games throughout the year, players had a wide variety of fresh and entertaining games from which to choose. Led by instant favorite Jumbo Bucks Classic and sparked by the addition of Giant Jumbo Bucks, instant ticket sales topped the \$1 billion mark for the first time ever with sales of \$1,225,868,000 in 2002.

Our other products made solid contributions to the bottom line with Cash 3 sales leading the way at \$688,178,000, Cash 4 sales totaling \$131,962,000 and Quick Cash Keno sales peaking at \$44,014,000. Overall, the Georgia Lottery's blend of instant ticket and on-line products proved to be a winning combination again in 2002. Ultimately, it is the success of these products that results in profits for the education programs funded with lottery dollars.

**FANTASY 5
TOP PRIZES
REACHED THEIR
HIGHEST LEVELS
EVER IN 2002**



GEORGIA LOTTERY WINNERS



Sandra and Dwight Hefner of Dalton claiming \$26 million Lotto South jackpot



Erika Greene of Dacula with big check from record \$331 million Big Game jackpot

With over \$1.3 billion awarded in prizes during fiscal year 2002, thousands of lucky Georgia Lottery players enjoyed a record year of winning with instant and on-line games. Players of instant games won a whopping \$694 million, surpassing the previous year's record by more than \$153 million.

With mega jackpots this year, the Big Game and Mega Millions created big excitement for winners. Erika Greene appeared in headlines around the world as one of three winners in a \$331 million Big Game jackpot drawing. When the jackpot soared as the second largest in U.S. history, Erika purchased a lottery ticket for the first time ever. A little beginner's luck went a long way, and the warehouse worker walked away with the cash option of \$58.9 million before taxes.



James Hollis Jr. of Milledgeville wins the largest single top prize in the history of Fantasy 5, a record \$1,056,754.

Lotto Georgia players won more than \$7 million before the game ended a few months into the fiscal year, and Lotto South emerged, awarding over \$35 million. Instead of New Year's resolutions, Sandra Hefner created a wish list for 2002. Just a few days later, the wish list became a shopping list when Sandra and her husband, Dwight, won a \$26 million Lotto South jackpot. The Hefners became the biggest winners in Lotto South history, but with three children benefiting from HOPE Scholarships, they already considered themselves Georgia Lottery winners.

Over \$43 million was awarded to Fantasy 5 players. James E. Hollis Jr. won a Fantasy 5 top prize of \$1,056,754 to become the largest single winner in the game's history. When Fantasy 5 reached \$1,247,708, two lucky winners split the record top prize.

Georgia Lottery players also won big with Cash 3, Cash 4 and Quick Cash Keno. More than \$344 million was awarded to Cash 3 players, while Cash 4 players won more than \$63 million. Quick Cash Keno players received over \$24 million.



LOTTERY RETAILERS WORKING FOR GEORGIA STUDENTS

The Georgia Lottery shares a positive partnership with its more than 7,000 retailers across the state. Retailers continue to play a vital role as the connection between the lottery and its players, demonstrating an unparalleled level of commitment and hard work. Fiscal year 2002 was a milestone year across-the-board as retailers earned a record \$163 million for their efforts.



RETAILERS CONTINUE TO PLAY
A VITAL ROLE BETWEEN THE
LOTTERY AND ITS PLAYERS.



Senior Staff (left to right): Rosemarie Morse, Vice President of Legal Affairs; Larry Sipes, Vice President of Information Technology; Sharman Lomax, Vice President of Financial Management; Mar-D Greer, Vice President of Security; Sidney Chambers, Senior Vice President of Sales; Wanda Wilson, Senior Vice President and General Counsel; Daniel Johnson, Vice President of Systems Development; Rebecca Paul, President and CEO; Jeff Martin, Vice President of Human Resources; Andy Davis, Senior Vice President of Finance and Information Systems; Jeannie Lin, Vice President of Advertising; Cathy Walls, Senior Vice President of Corporate Affairs; Joan Schoubert, Senior Vice President of Administration.

The Georgia Lottery Corporation currently employs approximately 250 people statewide and has nine district offices (Atlanta East, Atlanta West, Augusta, Columbus, Dalton, Gainesville, Macon, Savannah and Thomasville) in addition to the GLC headquarters in downtown Atlanta.

The GLC is headed by President and Chief Executive Officer Rebecca Paul. The President is responsible for developing long-term marketing strategies and overseeing the day-to-day operations of the corporation.

The Sales Division is responsible for coordinating and overseeing all sales and retailer activities.

The Corporate Affairs Division provides internal and external communications including human resources, legislative affairs, public and player information and media relations.

The Finance and Information Systems Division provides services related to financial accounting and reporting, cash management, the budget, collections, procurement, and maintains state-of-the-art computer systems, technology and telecommunications systems.

The Legal Affairs Division provides legal advice and assistance, drafts policies, directs security and investigations, handles internal auditing, and manages contract compliance.

The Administration Division incorporates facilities management, prize validation and retailer administration.

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Atlanta, Georgia 30303-1924

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INDEPENDENT AUDITORS' REPORT

Board of Directors
Georgia Lottery Corporation:

We have audited the accompanying statements of net assets of the Georgia Lottery Corporation (the "GLC"), a blended component unit of the State of Georgia, as of June 30, 2002 and 2001, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the GLC'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. 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, such financial statements present fairly, in all material respects, the financial position of the GLC as of June 30, 2002 and 2001, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Management's Discussion and Analysis listed in the Table of Contents is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This information is the responsibility of the GLC's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of supplementary information. However, we did not audit such information, and we do not express an opinion on it.

Deloitte & Touche LLP

September 12, 2002

Deloitte
Touche
Tohmatsu

Management's Discussion and Analysis

As management of the Georgia Lottery Corporation ("GLC"), we offer readers of the GLC's financial statements this narrative overview and analysis of the financial activities for the fiscal year ended June 30, 2002. We encourage readers to consider the information presented here in conjunction with the financial statements, which begin on page 20.

Financial Highlights

The Georgia Lottery Corporation had another record-breaking year in fiscal year 2002. Gross ticket sales surpassed \$2.449 billion, representing the highest sales total in the GLC's nine-year history. The net proceeds transferred to the Lottery for Education Account were \$726.2 million, also setting a GLC record. The net proceeds represent a growth of \$34.5 million over last year. Other significant financial highlights include the following:

- Gross tickets sales increased by \$255.6 million.
- Prize expense increased \$166.8 million. This expense increases or decreases in direct proportion to ticket sales and represented approximately 53% of gross ticket sales in 2002 and 52% of gross ticket sales in 2001.
- Direct gaming expenses (not including prize expense) increased \$29.3 million. These expenses also increase or decrease in proportion to ticket sales and represented approximately 11% of gross ticket sales in 2002 and 2001.
- Operating expenses decreased \$.3 million.
- Nonoperating revenues, net of expenses, decreased \$6.2 million.

Overview of the Financial Statements

The Georgia Lottery Corporation is accounted for as an enterprise fund, reporting transactions using the accrual basis of accounting similar to a business entity. This discussion and analysis are intended to serve as an introduction to the GLC's basic financial statements, along with the notes to the financial statements. The statements of net assets on page 20, the statements of revenues, expenses, and changes in net assets on page 21, and statements of cash flows on page 22 report the GLC's net assets and changes therein. The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the financial statements. The notes to the financial statements begin on page 24 of this report.

The GLC transfers its net proceeds each fiscal year to the general fund of the state treasury, for credit to the Lottery for Education Account. As a result, the GLC's net assets consist of funds invested in capital assets and unrestricted net assets. Unrestricted net assets normally result from the inclusion of capital costs in the determination of net proceeds as required by the Georgia Lottery for Education Act, and the cumulative effect of periodic adjustments to recognize the fair value of grand prize investments held to fund grand prizes payable. The GLC expects to hold these investments to maturity to meet our future grand prize winner obligations and, therefore, would not realize any gains or losses related to these investments for distribution as net proceeds. The reader of these financial statements should review the assets and liabilities in the statements of net assets and the operating revenues and expenses, and the transfer to education in the statements of revenues, expenses, and changes in net assets to assess the GLC's financial position as of June 30, 2002 and 2001, and the results of its operations for the years then ended.

Financial Analysis

Assets

Total assets in 2002 were \$489.0 million as compared to \$472.4 million in 2001, an increase of \$16.6 million over the previous fiscal year. Total assets consist of current assets, grand prize investments, and capital assets. Current assets increased from \$260.4 million in 2001 to \$275.6 million in 2002, an increase of \$15.2 million. This increase is primarily due to a \$26.9 million increase in cash attributable to higher fourth quarter sales in 2002 versus 2001, and a \$12.1 million decrease in retailer accounts receivable due to the timing of collections from our customers. Grand prize investments increased to \$210.8 million in 2002 from \$209.2 million in 2001, an increase of \$1.6 million. The increase resulted from net purchases of \$3.9 million, payments to grand prize winners totaling \$21.4 million, interest earned on current year maturities of \$13.0 million, and a \$6.1 million increase in the fair value of the investments. Capital assets decreased from \$2.9 million in 2001 to \$2.7 million in 2002, a decrease of \$.2 million. The decrease resulted from capital asset purchases of \$1.0 million and depreciation expense of \$1.2 million.

Liabilities

Total liabilities in 2002 were \$479.9 million as compared to \$468.1 million in 2001, an increase of \$11.8 million over the previous fiscal year.

Current liabilities increased from \$260.9 million in 2001 to \$277.0 million in 2002, an increase of \$16.1 million. The increase is primarily due to an \$8.0 million increase in the funds due to the Lottery for Education Account for fiscal year 2002 over fiscal year 2001 and a \$8.0 million increase in prizes payable. The increase in funds due to the Lottery for Education Account resulted from higher fourth quarter sales in fiscal year 2002 versus 2001. The prizes payable increase resulted primarily from a June 2002 jackpot prize for Lotto South not claimed as of June 30, 2002.

Long-term liabilities principally consist of grand prizes payable, which represent the amount to be paid to grand prize winners over future years. Grand prizes payable decreased \$4.5 million in 2002. The decrease is attributable to two factors. Grand prize payables of \$8.4 million became due and payable in fiscal year 2002 as an annual payment obligation to our grand prize winners, thus reducing the long-term liabilities. The GLC increased its grand prizes payable by \$4 million resulting from new annual payment obligations for grand prize winners for an instant game, Win-for-Life. The GLC purchased U.S. treasury securities to fund these future payment obligations. During fiscal year 2002, all eligible jackpot winners in our online games elected to receive their prizes in a single cash payment.

Net Assets and Changes in Net Assets

Generally, the GLC's net assets are comprised of two components: net assets invested in capital assets and unrestricted net assets due to the inclusion of capital costs in the determination of net proceeds and the cumulative effect of periodic adjustments to recognize the fair value of grand prize investments, as stated in the previous section.

Net assets increased to \$9.1 million in fiscal year 2002 from \$4.3 million in fiscal year 2001, resulting in a \$4.8 million increase. This increase resulted primarily from a \$6.1 million unrealized gain in the fair value of grand prize investments held by the GLC for funding of future grand prize payments, less the transfer of prior year funds resulting from capital purchases of \$1.3 million. Accounting principles generally accepted in the United States of America require the GLC to record its grand prize investments at fair value and the change in the fair value is recorded as nonoperating revenue (expense) annually. The

GLC classifies the decreases and increases in fair value as unrealized, due to the investments generally being held to maturity to fund future prize obligations. The \$1.3 million was authorized for transfer to the Lottery for Education Account in fiscal year 2002 by the GLC's Board of Directors.

Sales

Total lottery ticket sales for fiscal year 2002 were \$2.449 billion, as compared to \$2.194 billion in 2001. This represents an increase of over \$255.6 million. This represents average weekly gross ticket sales for fiscal year 2002 of \$47.1 million versus \$42.2 million in 2001.

Gross instant tickets sales increased substantially, up \$227.9 million over one year ago, from \$997.9 million in 2001 to \$1.226 billion in 2002. The increase is attributable to several factors, including the administration of a sound marketing strategy, continuous development and introduction of new instant ticket games, and effective management of the instant product mix by providing players the option to choose among a variety of games at different price points; \$1, \$2, \$3, \$5, and \$10. In addition, continued player loyalty to their favorite instant games, including our most popular games such as Jumbo Bucks Classic, Win-for-Life, Junior Jumbo Bucks, and Lucky 7's, helped contribute to the significant sales growth in instant tickets.

Cash 3 sales declined to \$688.2 million in 2002 from \$729.6 million in 2001. Cash 3 is a twice-daily game whereby the player chooses a 3-digit number, and wins a specified amount if his or her numbers are selected in the draw. The aggregate prize amount per draw varies based on the number of winners and the prize amount. Historically, as the prize amount won for this game increases above or decreases below the industry average of 50% of sales, a corresponding increase or decrease in sales the next quarter will occur, resulting in a trailing effect. During fiscal year 2001, three of the four quarters of sales were preceded by quarters with prize percentages averaging 52%. In fiscal year 2002, three of the four quarters of sales were preceded with prize percentages averaging 44%. Consequently, fiscal year 2001 sales were higher than 2002 due to the higher frequency of above-normal prize payouts.

Mega Millions and The Big Game sales increased \$47.2 million in fiscal year 2002 to \$187.7 million compared to The Big Game sales of \$140.5 million in 2001. The Big Game, a multi-state lottery game operated in seven participating states (Georgia, Illinois, Maryland, Massachusetts, Michigan, New Jersey, and Virginia) had its second largest jackpot in fiscal year 2002 since the game's introduction, \$331 million, contributing to the sales increase. In May 2002, The Big Game multi-state consortium agreed to end The Big Game and replace it with Mega Millions. The new game included the addition of two additional state lotteries, the New York Lottery and the Ohio Lottery. The addition of these two states significantly increased the potential player base. Other changes introduced in conjunction with the new game were the increase in the game matrix resulting in an increase in the overall odds for winning, increase of the prize amounts for six of the eight fixed prize levels, and raising the starting minimum jackpots from \$5 million to \$10 million. With these changes, and the larger player base, the GLC anticipates larger jackpots and faster jackpot growth.

Cash 4 sales improved from \$111.2 million in 2001 to \$132.0 million in 2002, representing a \$20.8 million increase. This increase is attributable to the implementation of a second mid-day draw starting February 2001, and an increase in prizes in 2002 over 2001.

The combined sales of \$84.8 million for Lotto Georgia and Lotto South in 2002 added \$4.3 million in sales as compared to Lotto Georgia sales of \$80.6 million in 2001. In September 2001, the GLC ended its in-state lotto game, Lotto Georgia. As historically proven throughout the industry, as this type of game matures, sales begin to become flat and growth can stagnate. In its continuing effort to provide players

with exciting games, the GLC decided to launch a new multi-state pari-mutuel lottery game in September 2001, Lotto South, with two other states, Kentucky and Virginia, to replace the Lotto Georgia game. Drawings are held twice weekly on Wednesdays and Saturdays. Management anticipated larger jackpots and faster jackpot growth with the additional player base. Lotto South was well-received by players and has met management's expectations of generating larger jackpots. There were three Lotto South jackpots of \$20 million or more during fiscal year 2002.

Sales for our Fantasy 5 game increased \$2.0 million from \$84.9 million in 2001 to \$86.8 million in 2002. The GLC had its largest Fantasy 5 jackpot prize awarded to a single winner of just over \$1 million during April 2002.

Quick Cash Keno sales were \$49.2 million and \$44.0 million in fiscal years 2001 and 2002, respectively. No specific factors have occurred supporting the \$5.2 million decrease in sales during 2002. However, as the game has matured, it has experienced a decline in sales due to the limited number of retailer locations and no major game changes occurring since the game's introduction in 1995.

Prize Expense

Prize expense for instant games increased to \$727.5 million in fiscal year 2002 from \$579.0 million in 2001, an increase of \$148.5 million. Instant games prize expense is managed through the number of tickets printed for each game and value of prizes as determined prior to ticket production. Prize expense is recognized based on an established prize structure and related percentage of sales for each game introduced and is recognized when products are made available for sale to the public.

Instant game prize expense is reduced through the use of unclaimed prizes recognized during the fiscal year. For fiscal year 2002, prize expense net of unclaimed prizes for instant games totaled \$694.6 million as compared to \$541.4 million in 2001. Gross instant prize expense was reduced by \$32.9 million and \$37.6 million using unclaimed prizes in 2002 and 2001, respectively.

Prize expense for online games generally increases or decreases each year in direct proportion to ticket sales of the related game. For pari-mutuel online games (Lotto South/Lotto Georgia and Fantasy 5), actual prize expense is recognized at 50% of ticket sales. For nonpari-mutuel games (Cash 3, Cash 4, TBG/Mega Millions, and Quick Cash Keno), actual prize expense is impacted by the number of and the prize value of winning tickets. To recognize prize expense on a consistent basis for these games, the GLC recognizes prize expense based on the estimated payout experience over the life of the game or based on industry averages. The GLC has established prize liability limits, per draw, for nonpari-mutuel games.

- Prize expense for Cash 3 decreased \$20.7 million in fiscal year 2002 as compared to 2001.
- Prize expense for The Big Game/Mega Millions increased \$24.1 million in 2002 as compared to 2001.
- Prize expense for Cash 4 increased \$10.0 million versus 2001.
- Prize expense for Lotto Georgia/Lotto South increased \$2.1 million in 2002 as compared to 2001.
- Prize expense for Fantasy 5 increased \$1.0 million in 2002 over 2001.
- Prize expense for Quick Cash decreased \$2.9 million in 2002 versus 2001.

Direct Gaming and Operating Expenses

Direct gaming expenses change in proportion with changes in ticket sales. The increase in ticket sales for fiscal year 2002 were accompanied by corresponding increases in direct gaming expenses as compared to fiscal year 2001.

Retailer commissions and bonuses for fiscal year 2002 were \$163.6 million compared to \$148.6 million in 2001. This represents a \$15 million increase from the previous year. The GLC compensates its retailers through three commission/incentive plans. These are:

- a set commission percentage for selling tickets
- a ticket cashing bonus for validating and paying winning prizes up to \$599
- winning jackpot ticket incentives.

In 2002, vendor (contractor) fees were \$84.7 million as compared to \$72.7 million in 2001. This represents an increase of \$12.0 million. Vendor fees represent payments made to our two major suppliers of the gaming products, systems, and services. The payments are determined based on a percentage of sales formula.

Advertising expense increased \$.8 million to \$18.5 million in 2002 from \$17.7 million in 2001. This increase is mostly attributable to the implementation of Mega Millions in May 2002.

Retailer merchandising and marketing expenses increased to \$6.1 million in 2002 from \$4.8 million in 2001. This increase is attributable to the marketing of new instant games and the relaunch of our multi-state game, Mega Millions.

Operating expenses decreased slightly to \$22.7 million in 2002 from \$23.1 million in 2001, a reduction of \$.3 million. This reduction resulted primarily from the net of cost savings realized in our telecommunications expenses due to a new long distance services contract and an increase in personnel services.

Other Revenue

Other revenue decreased \$6.2 million, from \$13.6 million in 2001 to \$7.2 million in 2002. Interest income decreased \$4.8 million due to lower earnings realized from funds held in a pooled short-term investment fund managed by the Office of Treasury and Fiscal Services. This fund is a combined state general fund and local government investment pool and is used by the GLC for funds not needed in the short-term for operating purposes. These funds generally represent net proceeds held, pending quarterly transfer to the education account. The remaining \$1.7 million reduction in fiscal year 2002 resulted from one-time operating revenues recognized in fiscal year 2001.

Significant Factors Impacting Next Year

On July 28, 2002, the GLC launched a new online game, The Change Game. The GLC is the first lottery in the world to launch The Change Game. Management anticipates success in attracting new players with minimal cannibalization of other daily online games. Players purchase a randomly chosen six-character alphanumeric play combination through an online quick pick selection with change of \$.25 to \$.99 received from other purchases in a retail location. Drawings are held daily, and guarantees three winners for each draw. The game concept is new, thereby making it impossible at this time to estimate the sales

of this game and impact on our other daily games, or the related impact on net proceeds in fiscal year 2003.

The multi-state Mega Millions consortium expanded with the addition of the Washington State Lottery in September 2002. This is the first lottery state west of the Mississippi River to join Mega Millions. This should result in a broader player base for the game when larger jackpots occur and will also expose the game to a more nationwide audience. This will increase the number of states participating in the multi-state game to ten. A reliable estimate of the impact of an additional state joining the game cannot be made at this time.

The GLC issued two Requests for Proposals (“RFPs”) in August 2002, one for Online Gaming Systems and Services and the other for Instant Ticket Printing and Associated Services. The successful vendors will be responsible for all related products, systems, and services beginning on September 10, 2003 for a seven-year period. The GLC anticipates the selection of successful vendors by December 2002. The GLC does not anticipate any impact on current operations during the evaluation, selection, and implementation processes related to these RFPs, which is scheduled to occur in fiscal year 2003.

The GLC borders five states, four of which have never had lotteries prior to January 2002. The state of South Carolina started a lottery in January 2002. The GLC could see some effect on sales as that lottery matures and adds new games. In addition, Tennessee will have a lottery referendum on its ballot in November 2002. If it passes, Tennessee could begin ticket sales during our fiscal year 2003. There is also the potential of North Carolina having a similar issue on their ballot in November 2002. The growth of the South Carolina lottery, along with the potential lotteries in Tennessee and North Carolina, could have some effect on the GLC sales, especially in the border areas.

Contacting the GLC’s Financial Management

This financial report is designed to provide the state of Georgia, the public, and other interested parties with an overview of the financial results of the GLC’s activities, and to show the GLC’s accountability for conducting business in a fiscally responsible manner. If you have questions about this report or require additional financial information, contact the GLC’s Corporate Affairs Division at the Georgia Lottery Corporation, 250 Williams Street, Inforum, Suite 3000, Atlanta, Georgia, 30303.

GEORGIA LOTTERY CORPORATION

STATEMENTS OF NET ASSETS JUNE 30, 2002 AND 2001

ASSETS	2002	2001
CURRENT ASSETS:		
Cash and cash equivalents (Note 3)	\$ 210,451,000	\$ 183,548,000
Restricted fidelity fund cash	500,000	500,000
Retailer accounts receivable, net	60,629,000	72,752,000
Prepaid expenses and other assets	<u>3,981,000</u>	<u>3,560,000</u>
Total current assets	275,561,000	260,360,000
GRAND PRIZE INVESTMENTS (Note 3)	210,774,000	209,177,000
CAPITAL ASSETS, net (Note 4)	<u>2,656,000</u>	<u>2,898,000</u>
TOTAL ASSETS	<u>\$ 488,991,000</u>	<u>\$ 472,435,000</u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES:		
Due to Lottery for Education Account (Note 7)	\$ 200,343,000	\$ 192,333,000
Prizes payable	63,540,000	55,535,000
Accounts payable and accrued liabilities	12,681,000	12,607,000
Restricted fidelity fund	500,000	500,000
Other liabilities	<u>8,000</u>	<u>8,000</u>
Total current liabilities	277,072,000	260,983,000
LONG-TERM LIABILITIES:		
Grand Prizes Payable (Note 5)	201,216,000	205,674,000
Noncurrent portion of other long-term liabilities	<u>1,564,000</u>	<u>1,439,000</u>
Total liabilities	479,852,000	468,096,000
NET ASSETS:		
Investment in capital assets	2,656,000	2,898,000
Unrestricted	<u>6,483,000</u>	<u>1,441,000</u>
Total net assets (Note 2)	<u>9,139,000</u>	<u>4,339,000</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 488,991,000</u>	<u>\$ 472,435,000</u>

See notes to financial statements.

GEORGIA LOTTERY CORPORATION

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS FOR THE YEARS ENDED JUNE 30, 2002 AND 2001

	2002	2001
OPERATING REVENUES:		
Ticket sales	\$ 2,449,363,000	\$ 2,193,807,000
Less instant tickets provided as prizes	<u>(127,413,000)</u>	<u>(106,038,000)</u>
Net ticket sales	2,321,950,000	2,087,769,000
Online fees	4,387,000	4,313,000
Other	<u>106,000</u>	<u>1,822,000</u>
Net operating revenues	2,326,443,000	2,093,904,000
OPERATING EXPENSES:		
Prizes	1,308,235,000	1,141,483,000
Retailer commissions and bonuses	163,626,000	148,598,000
Contractor fees	84,694,000	72,663,000
Advertising	18,528,000	17,700,000
Salaries and benefits	16,692,000	15,116,000
Retailer merchandising and marketing	6,122,000	4,756,000
Rent, utilities, and maintenance	2,889,000	4,980,000
Depreciation	1,248,000	1,317,000
Professional fees	643,000	490,000
Other	<u>1,579,000</u>	<u>1,456,000</u>
Total operating expenses	<u>1,604,256,000</u>	<u>1,408,559,000</u>
Operating income	722,187,000	685,345,000
NONOPERATING REVENUES (EXPENSES):		
Interest revenue	2,702,000	7,495,000
Net increase in fair value of grand prize investments	6,055,000	7,421,000
Fidelity funds subject to transfer (Note 2)	<u>58,000</u>	<u>87,000</u>
Total nonoperating revenues (expenses)	<u>8,815,000</u>	<u>15,003,000</u>
Income before transfers	<u>731,002,000</u>	<u>700,348,000</u>
TRANSFERS:		
Transfers to and due to Lottery for Education Account	<u>(726,202,000)</u>	<u>(691,672,000)</u>
Total transfers out	<u>(726,202,000)</u>	<u>(691,672,000)</u>
Change in net assets	4,800,000	8,676,000
NET ASSETS, beginning of year	<u>4,339,000</u>	<u>(4,337,000)</u>
NET ASSETS, end of year	<u>\$ 9,139,000</u>	<u>\$ 4,339,000</u>

See notes to financial statements.

GEORGIA LOTTERY CORPORATION

STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED JUNE 30, 2002 AND 2001

	2002	2001
OPERATING ACTIVITIES:		
Cash received from customers	\$ 2,334,073,000	\$ 2,076,864,000
Other operational cash received	4,550,000	6,222,000
Cash paid to prize winners	(1,317,503,000)	(1,166,905,000)
Cash paid to retailers	(163,626,000)	(148,598,000)
Cash paid to contractors and employees	(123,546,000)	(107,716,000)
Other operating payments	<u>(7,808,000)</u>	<u>(7,805,000)</u>
Net cash provided by operating activities	726,140,000	652,062,000
NONCAPITAL FINANCING ACTIVITIES:		
Payments to Lottery for Education Account	(718,192,000)	(722,334,000)
Payments to Department of Human Resources	<u>(200,000)</u>	<u>(200,000)</u>
Net cash used in noncapital financing activities	(718,392,000)	(722,534,000)
CAPITAL AND RELATED FINANCING ACTIVITIES:		
Purchase of property and equipment	(1,042,000)	(1,055,000)
Proceeds from disposals of property and equipment	<u>23,000</u>	<u>93,000</u>
Net cash used in capital and related financing activities	(1,019,000)	(962,000)
INVESTING ACTIVITIES:		
Interest received	2,702,000	7,495,000
Purchase of grand prize investments	(30,142,000)	(9,631,000)
Investments sold	26,177,000	23,007,000
Maturities of grand prize investments	<u>21,437,000</u>	<u>21,516,000</u>
Net cash provided by investing activities	<u>20,174,000</u>	<u>42,387,000</u>
NET CASH, CASH EQUIVALENTS, AND RESTRICTED		
CASH PROVIDED BY (USED IN) - ALL ACTIVITIES	26,903,000	(29,047,000)
CASH, CASH EQUIVALENTS, AND RESTRICTED		
CASH, at beginning of year	<u>184,048,000</u>	<u>213,095,000</u>
CASH, CASH EQUIVALENTS, AND RESTRICTED		
CASH, at end of year	<u>\$ 210,951,000</u>	<u>\$ 184,048,000</u>

(Continued)

GEORGIA LOTTERY CORPORATION

STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED JUNE 30, 2002 AND 2001

	2002	2001
RECONCILIATION OF NET OPERATING REVENUE TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating income	\$ 722,187,000	\$ 685,345,000
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	1,248,000	1,317,000
Provision for doubtful accounts	328,000	240,000
Gain (loss) on disposals of property and equipment	13,000	(93,000)
Changes in assets and liabilities:		
Retailer accounts receivable	11,795,000	(11,145,000)
Prepaid expenses and other assets	(421,000)	(930,000)
Accounts payable and accrued liabilities	74,000	1,505,000
Prizes payable	8,204,000	9,758,000
Grand prizes payable	(17,472,000)	(35,180,000)
Restricted fidelity fund	58,000	87,000
Other liabilities	126,000	1,158,000
Net cash provided by operating activities	<u>\$ 726,140,000</u>	<u>\$ 652,062,000</u>
SCHEDULE OF NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES:		
Increase in fair value of investments	\$ 9,139,000	\$ 3,084,000
Gain (loss) on disposal of capital assets	<u>(13,000)</u>	<u>93,000</u>
Total noncash investing, capital, and financing activities	<u>\$ 9,126,000</u>	<u>\$ 3,177,000</u>

(Concluded)

See notes to financial statements.

GEORGIA LOTTERY CORPORATION

NOTES TO THE FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2002 AND 2001

1. REPORTING ENTITY

The Georgia Lottery Corporation (the “GLC”) was established as an instrumentality of the state with the enactment of the Georgia Lottery for Education Act (the “Act”) on November 2, 1992. The GLC is responsible for the provision of lotteries on behalf of the State of Georgia in accordance with the Act and is a blended component unit of the State of Georgia.

The GLC’s ticket sales include instant ticket sales and online ticket sales for Cash 3, Cash 4, Lotto Georgia, Lotto South, Fantasy Five, Quick Cash Keno, The Big Game, and Mega Millions. In September 2001, the GLC ended ticket sales of Lotto Georgia and began ticket sales for a new game, Lotto South. Additionally, during May 2002 ticket sales began for Mega Millions, which replaced The Big Game when two additional state lotteries joined the multi-state game.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation - The GLC is accounted for as an enterprise fund. Enterprise funds are used to account for activities that are financed and operated in a manner similar to private business enterprises: (1) where the costs of providing goods and services to the general public on a continuing basis are to be financed through user charges or (2) where the periodic determination of net income is considered appropriate.

Basis of Accounting - The financial statements are prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America (“generally accepted accounting principles”). Under this method, revenues are recognized when earned and expenses are recognized when incurred. In accordance with Statement of Governmental Accounting Standards (“SGAS”) No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the GLC is required to follow all applicable Governmental Accounting Standards Board (“GASB”) pronouncements.

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

Revenue Recognition - Lottery games are sold to the public by contracted retailers. Revenue is recognized for online games when tickets are sold to players. Revenue is recognized for instant games when the product is made available for sale to the public, which is based on ticket activations by the retailers. Certain instant games include free tickets which entitle the holder to exchange one instant ticket for another of equal value. The selling price of free tickets reduces instant ticket revenue when the ticket is claimed by a player.

Commissions and Bonuses - Retailers receive a commission of 5% on ticket sales, except for Cash 3 sales, on which retailers receive a commission of 7%, and a 2% cashing bonus on all ticket validations. In addition, retailers receive bonuses for selling winning jackpot tickets for Lotto South, Lotto Georgia, Fantasy Five, Mega Millions, The Big Game, and certain instant ticket games. During 2002 and 2001, at least four instant ticket games were introduced with a retailer sales commission of 10%.

Contractor Fees - The GLC has contracted with two vendors for the majority of the gaming systems and supplies.

The GLC contracts with GTECH Corporation (“GTECH”) for the operation of the gaming network that consists of over 7,900 instant and online retailer ticket terminals and associated software. GTECH receives a fee of 2.315% of net ticket revenue. The portion of the fee associated with instant game tickets confirmed as received by retailers but not yet activated is accounted for by the GLC as a prepaid expense. The current contract extension period expires on September 10, 2003.

The GLC contracts with Scientific Games, Inc. for the printing and distribution of instant game tickets. Scientific Games, Inc. receives a fee of 2.4375% of net instant game tickets distributed to retailers. The portion of the fee associated with instant game tickets distributed to retailers but not yet activated is accounted for by the GLC as a prepaid expense. The current contract extension period expires on September 10, 2003.

Prizes - In accordance with the Act, as nearly as practical, at least 45% of ticket sales must be returned to the public in the form of prizes. Prize expense for instant games is recognized based on the predetermined prize structure for each game. Generally, prize expense for Cash 3, Cash 4, Mega Millions, The Big Game, and Quick Cash Keno is recognized based on the estimated payout experience over the life of the games or the industry averages. Prize expense for Lotto South, Lotto Georgia, and Fantasy Five is recorded on a pari-mutuel basis according to the game structure based on a percentage of revenue recognized.

The Mega Millions, The Big Game, and Lotto South are multi-state lottery games operated by member lotteries. The Mega Millions and Lotto South grand prizes are shared prizes from contributions to the prize pools by the member lotteries. Grand prize investments for jackpot winners who purchased tickets in Georgia are held by the GLC.

The Powerball grand prize is a shared prize from contributions to the prize pool by all member lotteries of the Multi-State Lottery Association (“MUSL”). All Powerball grand prizes won by players who purchased tickets in Georgia are funded by investments purchased by MUSL. The investments are held by MUSL in trust for the GLC and are paid in 20 annual installments. Investments of \$11,594,000 and \$11,696,000 included in the GLC’s grand prize investments in the statements of net assets at June 30, 2002 and 2001, respectively, were held by MUSL in trust. The GLC withdrew from MUSL on August 31, 1996.

Unclaimed Prizes - Prizes must be claimed no later than 90 days after game-end for instant games and within 180 days after the draw date for online games. An estimate of the unclaimed prizes is recognized as a percentage of ticket sales based upon the historical experience rate. In accordance with the Act, \$200,000 of unclaimed prizes must be transferred to the Department of Human Resources for the treatment of compulsive gambling and related educational programs. Transfers for this purpose for each fiscal year have been \$200,000. The remainder of unclaimed prizes is used to fund future prizes or special prize promotions, as defined by the statute.

Net Assets - Net assets represent cumulative revenues less expenses in excess of net proceeds transferred to the Lottery for Education Account, as defined under the Act (see Note 7). Net assets include funds invested in capital assets and unrestricted net assets. Unrestricted net assets normally result from the inclusion of capital costs in the determination of net proceeds as required by the Act and the cumulative effect of periodic adjustments to recognize the fair value of grand prize investments held to fund grand prizes payable. Grand prize investments are purchased to finance future payments to Lotto Georgia, Lotto South, The Big Game, Mega Millions, and certain instant game grand prize winners. Any increases or decreases in the fair value of these investments are determined to be unrealized and will not affect (i) the future ability to hold these investments or (ii) the amount of funds available for distribution to the Lottery for Education Account. Unrealized gains on grand prize investments at June 30, 2002 and 2001 were \$9,139,000 and \$3,084,000, respectively.

Cash and Cash Equivalents - The GLC considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. This includes cash in banks, petty cash, and balances on account in Georgia Fund 1.

Retailer Accounts Receivable - Retailer accounts receivable represents lottery proceeds due from retailers for net ticket sales less commissions, cashing bonuses, and prizes paid by the retailers. Lottery proceeds are collected weekly from retailer bank accounts held in trust for the GLC. At June 30, 2002 and 2001, the allowance for uncollectible retailer receivables was \$1,735,000 and \$1,561,000, respectively.

Capital Assets - Capital assets are stated at cost less accumulated depreciation. Depreciation on capital assets is computed using the straight-line method over the estimated useful lives of three to five years. Leasehold improvements are amortized over their expected useful lives or the lease term, whichever is shorter. When assets are retired or otherwise disposed of, the costs and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is reflected in the results from operations in the period of disposal.

Fidelity Fund - In accordance with the Act, retailers contribute a fee to a fidelity fund upon acceptance as a GLC retailer. The GLC is reimbursed from the fund for any losses incurred as a result of the misfeasance or malfeasance of GLC retailers. At the end of each year, any amount in the fund in excess of \$500,000 is treated as net proceeds from the GLC subject to transfer to the Lottery for Education Account. Fidelity funds available for transfer as net proceeds were \$58,000 and \$87,000 for the years ended June 30, 2002 and 2001, respectively. The fidelity fund proceeds are held in a separate account and appear on the balance sheet as restricted fidelity fund cash and in liabilities as restricted fidelity funds.

The bank balance of approximately \$500,000 at June 30, 2002 and 2001 was either insured by federal depository insurance or collateralized by the GLC's custodial bank in the GLC's name.

Insurance - The GLC participates in the various insurance programs established and administered by the state of Georgia for property, general liability, automobile liability, workers' compensation, and federal civil rights actions. Property is insured for actual cash value to an aggregate of \$7 million per loss event; liability coverage is provided up to \$1 million per person and \$1 million per occurrence; and workers' compensation is provided to comply with the applicable law.

Compensated Absences - Employees earn the right to be compensated during absences for vacation and illness. Unused leave benefits are paid to employees upon separation from service. The cost of vacation and vested sick leave benefits is accrued in the period in which it was earned.

Budget - Georgia Statute requires the GLC to submit to the Office of Planning and Budget (“OPB”) and the State Auditor, annually by June 30, a proposed operating budget for the next fiscal year. Additionally, the GLC is required to submit to the OPB annually, on September 1, a proposed operating budget for the GLC and an estimate of net proceeds for the succeeding fiscal year.

New Accounting Pronouncements - The GASB issued SGAS No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, as amended by SGAS No. 36, *Recipient Reporting for Certain Shared Nonexchange Revenues – an Amendment of GASB Statement No. 33*. SGAS No. 33, as amended, was adopted effective July 1, 2000 and did not have a material impact on the financial statements of the GLC.

The GASB issued SGAS No. 34, *Basic Financial Statements - and Management’s Discussion and Analysis - for State and Local Governments*, as amended by SGAS No. 37, *Basic Financial Statements - and Management’s Discussion and Analysis - State and Local Governments: Omnibus – an amendment of GASB Statements No. 21 and No. 34*, and SGAS No. 38, *Certain Financial Statement Note Disclosures*. The GLC adopted these statements on July 1, 2001. In general, these statements required the GLC to present a Management’s Discussion and Analysis (“MD&A”), to present the statements of cash flows under the direct method and required the GLC to change certain captions within the financial statements. The MD&A is considered to be required supplemental information and precedes the financial statements. In adopting this statement certain reclassification have been made to the 2001 amounts to conform to the 2002 presentation.

3. CASH, CASH EQUIVALENTS, AND GRAND PRIZE INVESTMENTS

Cash - Cash is held in demand deposits at various financial institutions. The bank balance of these deposits of approximately \$3,028,000 at June 30, 2002 and \$2,845,000 at June 30, 2001 was insured by either the state’s collateral for public deposits in accordance with Georgia Statutes, Chapter 280.04, or federal depository insurance. These deposits are collateralized with U.S. Government securities held in a custody account at the Federal Reserve Bank for the benefit of the GLC. The fair value of the underlying securities must be at least equal to the amount of funds held by the financial institution on behalf of the GLC.

Cash Equivalents - Cash equivalents represent surplus cash invested in Georgia Fund 1 administered by the Office of Treasury and Fiscal Services. The voluntary fund is a short-term investment vehicle that is available for use by state entities and local governments. Georgia Fund 1 invests its assets in U.S. Treasury bills, U.S. Treasury notes, securities issued by federal agencies and instrumentalities, banker’s acceptances, and repurchase agreements.

As of June 30, 2002, Georgia Fund 1 net assets totaled \$8,236,339,000 and were invested in the following:

Repurchase agreements	15%
Federal agencies/instrumentality securities	76%
Banker’s acceptances	9%

The GLC’s investment in Georgia Fund 1 was approximately \$188,511,000 at June 30, 2002 and \$181,934,000 at June 30, 2001. No allocation will be made as to the GLC’s share of the types of investments or Georgia Fund 1’s risk categories. Interest earned on the GLC’s investments was approximately \$2,702,000 and \$7,495,000 for the years ended June 30, 2002 and 2001, respectively.

The GLC's share of the assets and liabilities arising from the above investments will not be carried on the balance sheet since the Georgia Fund 1 is operated on a pooled basis. To do so may give the misleading impression that the GLC has some controlling authority over the investment vehicles.

Grand Prize Investments - All grand prize investments represent funds held to pay grand prize winners who have selected multi-year payments. Grand prize investments are recorded at their fair values. Increases or decreases in the fair value of these investments are determined to be unrealized as of June 30, 2002 and 2001.

Grand prize investments at June 30, 2002 and 2001 consist of the following:

	<u>Fair Value</u>	
	<u>2002</u>	<u>2001</u>
U.S. Treasury securities	\$ 201,736,000	\$ 200,818,000
Government agencies	<u>9,038,000</u>	<u>8,359,000</u>
	<u>\$ 210,774,000</u>	<u>\$ 209,177,000</u>

Grand prize investments are not presented as current assets, as they are not part of the GLC's current operations.

Changes in grand prize investments for the years ended June 30, 2002 and 2001 consisted of:

Fair value, June 30, 2000	\$ 222,250,000
Purchases	9,631,000
Payments to grand prize winners	(21,516,000)
Investments sold	(23,007,000)
Interest earned on current year maturities	14,398,000
Change in fair value	<u>7,421,000</u>
Fair value, June 30, 2001	209,177,000
Purchases	30,142,000
Payments to grand prize winners	(21,437,000)
Investments sold	(26,177,000)
Interest earned on current year maturities	13,014,000
Change in fair value	<u>6,055,000</u>
Fair value, June 30, 2002	<u>\$ 210,774,000</u>

GASB Statement No. 3 provides for the classification of investments to give an indication of the level of credit risk assumed by the GLC. Category 1 includes investments for which the securities are held by the GLC or its agent in the GLC's name. Category 2 includes investments for which the securities are held by the counterparty's trust department or agent in the GLC's name. Category 3 includes investments for which the securities are held by the counterparty's safekeeping department in the GLC's name. At June 30, 2002, grand prize investments of \$155,764,000 and \$55,010,000 were classified as Category 1 and Category 3, respectively. At June 30, 2001, grand prize investments of \$157,110,000 and \$52,067,000 were classified as Category 1 and Category 3, respectively.

4. CAPITAL ASSETS

Capital assets at June 30, 2002 consisted of:

	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets:				
Furniture and fixtures	\$ 2,389,000	\$ 106,000	\$ (9,000)	\$ 2,486,000
Computer and communications equipment	7,402,000	606,000	(115,000)	7,893,000
Vehicles	2,153,000	231,000	-	2,384,000
Leasehold improvements	2,095,000	35,000	-	2,130,000
Software	162,000	26,000	-	188,000
Other assets	<u>1,348,000</u>	<u>38,000</u>	<u>(39,000)</u>	<u>1,347,000</u>
Total capital assets at historical cost	<u>15,549,000</u>	<u>1,042,000</u>	<u>(163,000)</u>	<u>16,428,000</u>
Less accumulated depreciation	<u>(12,651,000)</u>	<u>(1,248,000)</u>	<u>127,000</u>	<u>(13,772,000)</u>
Capital assets, net	<u>\$ 2,898,000</u>	<u>\$ (206,000)</u>	<u>\$ (36,000)</u>	<u>\$ 2,656,000</u>

Capital assets at June 30, 2001 consisted of:

	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets:				
Furniture and fixtures	\$ 2,304,000	\$ 85,000	\$ -	\$ 2,389,000
Computer and communications equipment	7,282,000	390,000	(270,000)	7,402,000
Vehicles	2,084,000	402,000	(333,000)	2,153,000
Leasehold improvements	2,042,000	55,000	(2,000)	2,095,000
Software	156,000	6,000	-	162,000
Other assets	<u>1,231,000</u>	<u>117,000</u>	<u>-</u>	<u>1,348,000</u>
Total capital assets at historical cost	<u>15,099,000</u>	<u>1,055,000</u>	<u>(605,000)</u>	<u>15,549,000</u>
Less accumulated depreciation	<u>(11,938,000)</u>	<u>(1,317,000)</u>	<u>604,000</u>	<u>(12,651,000)</u>
Capital assets, net	<u>\$ 3,161,000</u>	<u>\$ (262,000)</u>	<u>\$ (1,000)</u>	<u>\$ 2,898,000</u>

5. GRAND PRIZES PAYABLE

Grand prizes payable is recorded at the net present value of the U.S. Treasury securities purchased for each jackpot winner. Grand prizes payable was accreted by approximately \$13,014,000 and \$14,398,000 for the years ended June 30, 2002 and 2001, respectively. Grand prizes payable are not presented as current liabilities, as they are not part of the GLC's current operations.

Future payments of grand prizes payable at June 30, 2002 are scheduled as follows:

2003	\$ 21,470,000
2004	21,303,000
2005	21,254,000
2006	21,254,000
2007	21,235,000
2008-2012	105,923,000
2013-2017	65,666,000
2018-2022	4,088,000
2023-2027	3,593,000
2028-2032	3,042,000
2033-2037	<u>2,066,000</u>
	290,894,000
Less imputed interest	<u>(89,678,000)</u>
Net present value of grand prizes payable	<u>\$ 201,216,000</u>

The Omnibus Consolidated and Emergency Supplemental Appropriations Act, 1999 (the “Omnibus Act”) was enacted into federal law on October 21, 1998. Included in this Omnibus Act is a “Special Rule for Cash Options for Receipt of Qualified Prizes” (“Special Rule”). Pursuant to the Special Rule, the GLC may extend to recipients of “qualified prizes” the opportunity, within a certain period after the drawing, to select a lump-sum payment equivalent to the cash value of an annuitized prize. Qualified prizes, as defined in the Omnibus Act, include multiple-year payments of a minimum of ten years.

Claimants of qualified prizes, as defined in the GLC Rules and Regulations, on or after the date of enactment of the Omnibus Act, can make an irrevocable election to receive a lump-sum cash payment equivalent of the annuitized prize within 60 days of the claim date. Grand prizes payable at June 30, 2002 consist of no qualified prizes under this provision of the Special Rule.

6. OPERATING LEASES

The GLC has entered into operating leases for the rental of office space for its headquarters and district offices. Certain operating leases contain provisions for scheduled rental increases and are renewable at the option of the GLC. The GLC currently leases its headquarters office from Cousins Properties, Inc., and the lease was scheduled to expire on June 30, 2003. On February 8, 2002, the GLC’s Board of Directors approved a ten-year extension of this lease expiring on June 30, 2013.

Future minimum rental payments on noncancelable leases with original terms of one year or more are scheduled as follows:

Year Ending June 30,	Operating Leases
2003	\$ 1,963,000
2004	1,670,000
2005	1,656,000
2006	1,656,000
2007	1,656,000
2008-2012	9,960,000
2013	<u>2,206,000</u>
	20,767,000
Less sublease revenues	<u>(508,000)</u>
Total	<u>\$ 20,259,000</u>

Rental expense under all operating leases totaled approximately \$1,705,000 and \$1,661,000 for the years ended June 30, 2002 and 2001, respectively.

7. DUE TO LOTTERY FOR EDUCATION ACCOUNT

In accordance with the Act, all net proceeds of the GLC are due to the Lottery for Education Account within the state of Georgia Treasury. "Net proceeds" is defined under the Act as "all revenue derived from the sale of lottery tickets or shares and all other monies derived from the GLC less operating expenses." Any unrealized gain or loss resulting from changes in fair value of grand prize investments does not represent funds received from GLC operations and is excluded from determination of "net proceeds."

"Operating expenses" are defined under the Act as "all costs of doing business, including, but not limited to, prizes, commissions, and other compensation paid to retailers, advertising and marketing costs, personnel costs, capital costs, depreciation of property and equipment, funds for compulsive gambling education and treatment, amounts held in or paid from a fidelity fund, and other operating costs."

Net proceeds and operating expenses for the years ended June 30, 2002 and 2001 are summarized as follows:

	2002	2001
Operating revenues:		
Ticket sales	\$ 2,449,363,000	\$ 2,193,807,000
Less instant tickets provided as prizes	<u>(127,413,000)</u>	<u>(106,038,000)</u>
Net ticket sales	2,321,950,000	2,087,769,000
Online fees and other revenues	4,493,000	6,135,000
Interest income	<u>2,702,000</u>	<u>7,495,000</u>
GLC proceeds	<u>2,329,145,000</u>	<u>2,101,399,000</u>
Operating expenses, as defined:		
Gaming	1,581,527,000	1,385,498,000
Operating	22,729,000	23,061,000
Other	<u>1,242,000</u>	<u>1,255,000</u>
Total operating expenses, as defined	<u>1,605,498,000</u>	<u>1,409,814,000</u>
Net proceeds before distribution of unrestricted net assets	<u>723,647,000</u>	<u>691,585,000</u>
Other:		
Funds resulting from prior year capital purchases	1,255,000	-
Funds resulting from current year capital purchases	1,242,000	-
Fidelity funds subject to transfer (Note 2)	<u>58,000</u>	<u>87,000</u>
Total other	<u>2,555,000</u>	<u>87,000</u>
Net proceeds subject to transfer	<u>\$ 726,202,000</u>	<u>\$ 691,672,000</u>
Amount due to Lottery for Education Account for year	\$ 726,202,000	\$ 691,672,000
Amount paid during year	<u>(525,859,000)</u>	<u>(499,339,000)</u>
Amount due to Lottery for Education Account, end of year	<u>\$ 200,343,000</u>	<u>\$ 192,333,000</u>

On July 15, 2002, all amounts due at June 30, 2002 were transferred to the Lottery for Education Account.

8. EMPLOYEE BENEFITS

401(k) Defined Contribution Plan - Effective July 1, 1998, House Bill 441 was enacted into law, allowing the Georgia Lottery Corporation to participate in the Deferred Compensation Plan offered by the state of Georgia for public employees pursuant to Section 401(k) of the Internal Revenue Code.

There were 253 GLC employees participating in the 401(k) plan at June 30, 2002. For fiscal years ended June 30, 2002 and 2001, GLC contributed \$485,000 and \$705,000, respectively, to the plan, and paid \$3,000 and \$4,000, respectively, of plan administrative fees, on behalf of GLC employees. Contributions by plan participants during fiscal years ended June 30, 2002 and 2001 were \$505,000 and \$408,000, respectively.

457 Deferred Compensation Plan - Beginning in December 1994, the GLC offered its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all full-time employees at their option, permits participants to defer a portion of their salary until future years. The deferred compensation is not available to participants until termination, retirement, death, or unforeseeable emergency.

Section 1448 of the Small Business Job Protection Act of 1996 added Subsection (g) to Section 457 of the Internal Revenue Service Code to provide that all assets and income under a Section 457(b) plan that are maintained by a state or local government employer must be held in trust for the exclusive benefit of plan participants and their beneficiaries. Nationwide Retirement Solutions is the custodian of the plan's assets. As of June 30, 2002 and 2001, the fair value of the plan's assets was \$891,000 and \$1,002,000, respectively. Contributions by participants during the years ended June 30, 2002 and 2001 were \$112,000 and \$92,000, respectively.

Compensated Absences - Employees are compensated for earned vacation and sick leave hours upon separation from service. As of July 1, 2001, the beginning balance for compensated absence liability was \$1,380,000. At June 30, 2002, the year-end compensated absence liability balance was \$1,580,000. Increases to the compensated absences balance represent vacation and sick leave hours earned by employees and decreases represent their usage of leave. During fiscal year 2002, employees earned and used leave totaling \$884,000 and \$684,000, respectively. The current portion of the compensated absence liability, expected to be due within one year of the statement date, June 30, 2002, is estimated using historical trends. As of June 30, 2002, the estimated current portion of the compensated absences liability was \$95,000.

9. CONTINGENCIES

The GLC is subject to litigation in the ordinary course of its business. In the opinion of management and legal counsel, the outcome of such litigation will not have a material impact on the financial position or cash flows of the GLC.

10. SUBSEQUENT EVENTS

On July 28, 2002, the GLC began ticket sales for the Change Game. The Change Game is an online game operated by the GLC. Prize expense for the Change Game is recorded on a pari-mutuel basis according to the game structure based on a percentage of revenue recognized.

On September 4, 2002, the Washington State Lottery joined Mega Millions, bringing the total to ten states participating in the multi-state lottery game.