



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

Financial Statements and Management's Discussion and Analysis

September 30, 2003 and 2002

(With Independent Auditors' Report Thereon)

**GOVERNMENT OF THE DISTRICT OF COLUMBIA
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KPMG LLP
2001 M Street, NW
Washington, DC 20036

Independent Auditors' Report

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

We have audited the accompanying financial statements of the District of Columbia Lottery and Charitable Games Control Board, an enterprise fund of the Government of the District of Columbia, as of and for the years ended September 30, 2003 and 2002, as listed in the Table of Contents. These financial statements are the responsibility of the District of Columbia Lottery and Charitable Games Control Board management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in note 2, the financial statements only present the District of Columbia Lottery and Charitable Games Control Board and do not purport to, and do not, present fairly the financial position of the Government of the District of Columbia as of September 30, 2003 and 2002, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the District of Columbia Lottery and Charitable Games Control Board, as of September 30, 2003 and 2002, and the changes in its financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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

In accordance with *Government Auditing Standards*, we have also issued a report dated December 19, 2003 on our consideration of District of Columbia Lottery and Charitable Games Control Board's internal control over financial reporting and on our tests of its compliance with certain provisions of laws,





regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

KPMG LLP

December 19, 2003

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This discussion and analysis of the D.C. Lottery and Charitable Games Control Board's (the Lottery) financial performance provides an overview of its financial activities for the fiscal years ended September 30, 2003 and 2002. This discussion and analysis should be read in conjunction with the accompanying financial statements.

Background and Other Significant Information

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

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

Financial Highlights

- Gross revenue from lottery gaming activities increased by \$26,739 or 12.66% over prior year amounts;
- Aggregate ticket sales for all games, excluding Powerball, increased by 5.17% for the year;
- Total operating expenses increased \$17,514 or 11.78% as a result of increased ticket sales; and
- Transfers to the District's General Fund increased \$9,050 or 14.37% over the prior year's total.

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

Using this Financial Report

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

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

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

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

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

Financial Analysis

The Lottery's net assets increased by \$77 and \$110 for the years ended September 30, 2003 and 2002, respectively. The following tables present a summary of the Lottery's financial information as of and for the years ended September 30, 2003, 2002, and 2001.

Table 1: Summary of Net Assets

	September 30		
	2003	2002	2001
Assets:			
Current unrestricted assets	\$ 14,497	13,574	13,877
Capital assets (net of accumulated depreciation)	1,354	1,495	1,328
Restricted investments	73,537	78,789	79,795
Total assets	89,388	93,858	95,000
Liabilities:			
Accounts payable and accrued expenses	3,704	4,084	3,876
Deferred revenues	271	131	113
Accrued prizes and commissions	8,314	7,369	7,841
Obligations for unpaid prizes	73,537	78,789	79,795
Total liabilities	85,826	90,373	91,625
Net assets:			
Invested in capital assets	1,354	1,495	1,328
Unrestricted	2,208	1,990	2,047
Total net assets	\$ 3,562	3,485	3,375

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**Table 2: Summary of Revenues, Expenses,
 and Changes in Net Assets**

	Years ended September 30		
	2003	2002	2001
Operating revenues:			
Gaming revenues	\$ 237,890	211,151	224,885
Operating expenses:			
Prizes	123,564	110,741	105,594
Other	42,621	37,930	36,670
Total operating expenses	166,185	148,671	142,264
Operating income	71,705	62,480	82,621
Nonoperating revenues – interest and dividends	422	630	1,479
Income before transfers	72,127	63,110	84,100
Transfers to the District's General Fund	(72,050)	(63,000)	(84,000)
Change in net assets	\$ 77	110	100

Unrestricted net assets were \$2,208, \$1,990, and \$2,047 at September 30, 2003, 2002, and 2001, respectively, which represents an increase of \$218 in 2003 and a decrease of \$57 in 2002. Current assets increased by \$923 in 2003 and decreased by \$303 in 2002. Total liabilities decreased by \$4,547, or 5.03% for the year ended September 30, 2003 and \$1,252 or 1.37% for the year ended September 30, 2002 primarily due to the decrease in the Lottery's obligations for unpaid prizes.

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The Multi-State Lottery Association (MUSL) purchases U.S. government securities in the name of the Lottery for Lotto America and Powerball jackpot winners from the District of Columbia. Jackpot winners have the option of accepting the cash value of the jackpot amount or annuity payments for 25 years. The restricted investments balance of \$73,537, \$78,789, and \$79,795 in 2003, 2002, and 2001, respectively, represents the net present value of securities totaling \$88,794, \$97,425, and \$106,056 in 2003, 2002, and 2001, respectively, to fund future annuity installment payments. The account decreased \$5,252 and \$1,006 in value during 2003 and 2002, respectively, as the result of payments of \$8,631 net of unrealized losses of \$732 and \$3,215 in 2003 and 2002, respectively, and accretion of investments totaling \$4,111 and \$4,410 in 2003 and 2002, respectively. Corresponding amounts are recorded as obligations for unpaid prizes.

Table 3: Gaming revenues, Prizes, Commissions, and Transfers

		2003									
		Lucky Numbers	D.C. Four	Powerball	Quick Cash	Hot Five	Lucky Numbers Extra	D.C. Four-Extra	Keno	Instant Games	Others
Gaming revenues	\$	70,268	71,894	44,360	4,217	4,841	360	600	3,791	36,904	655
Prizes		(35,848)	(35,413)	(21,415)	(755)	(2,473)	(226)	(380)	(2,312)	(24,742)	—
Agent's commissions		(4,597)	(4,082)	(2,400)	(212)	(300)	(25)	(41)	(254)	(2,781)	—
Gross margin	\$	29,823	32,399	20,545	3,250	2,068	109	179	1,225	9,381	655
Transfers	\$	22,325	24,535	16,238	2,810	1,385	—	125	585	4,047	—
		2002									
		Lucky Numbers	D.C. Four	Powerball	Quick Cash	Hot Five	Lucky Numbers Extra	D.C. Four-Extra	Instant Games	Others	Total
Gaming revenues	\$	72,194	68,453	27,723	4,200	5,067	234	328	32,924	28	211,151
Prizes		(34,692)	(36,146)	(12,039)	(3,215)	(2,635)	(151)	(211)	(21,652)	—	(110,741)
Agent's commissions		(4,491)	(3,822)	(1,519)	(243)	(309)	(16)	(22)	(2,385)	—	(12,807)
Gross margin	\$	33,011	28,485	14,165	742	2,123	67	95	8,887	28	87,603
Transfers	\$	25,475	21,075	10,225	235	1,515	—	—	4,475	—	63,000
		2001									
		Lucky Numbers	D.C. Four	Powerball	Quick Cash	Cash for Life	Hot Five	Instant Games	Others	Total	
Gaming revenues	\$	70,583	65,505	45,854	4,160	—	5,300	32,462	1,021	224,885	
Prizes		(31,837)	(27,353)	(21,689)	(973)	29	(2,519)	(21,252)	—	(105,594)	
Agent's commissions		(3,798)	(3,234)	(2,029)	(196)	1	(282)	(2,099)	—	(11,637)	
Gross margin	\$	34,948	34,918	22,136	2,991	30	2,499	9,111	1,021	107,654	
Transfers	\$	29,600	27,965	17,565	2,490	30	1,875	4,475	—	84,000	

Table 3 provides a comparison of sales, prizes, agent commissions, gross margin, and transfers to the District's General Fund generated by each lottery product offered in fiscal years 2003, 2002, and 2001. Overall gaming revenue sales totaled \$237,890, \$211,151, and \$224,885 in fiscal years 2003, 2002, and 2001, respectively. Prize expenses increased by \$12,823 and \$5,147 in 2003 and 2002, respectively. Total prize payouts as a percentage of sales decreased to 51.94% in 2003 for the year in comparison to 52.45% in 2002. Agent commissions increased by \$1,885 and \$1,170 in 2003 and 2002, respectively, due to the related increase in ticket sales and prize payouts.

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Lucky Numbers

Lucky Numbers is a daily three-digit game in which players may wager 50 cents or one dollar with nine ways to win prizes ranging from 25 to 500 dollars. Sales totaled \$70,268 in 2003 for a \$1,926 or 2.67% decrease over the prior year's sales level of \$72,194.

Prizes increased to \$35,848 in 2003, an increase of \$1,156 or 3.33% from the \$34,692 expensed in 2002. Agents/retailers commissions increased \$106 primarily due to the increase in prize payouts. Net proceeds to the District's General Fund totaled \$22,325, a \$3,150 decrease from the \$25,475 generated in 2002. The reduction in transfer amount can be primarily attributed to the decrease in sales and increase in prize payouts and commissions.

In 2002 sales totaled \$72,194 for a \$1,611 or 2.28% increase over 2001 sales level of \$70,583. The increase represented a reversal of a declining sales trend for several years. The Lucky Numbers game accounted for 34.19% of total gaming revenue and 37.68% of the overall gross margin.

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

D.C. Four

D.C. Four is a daily four-digit game with a fixed payout. Players may wager 50 cents or one dollar for a chance to win seven different ways. Sales totaled \$71,894 in 2003 for a \$3,441 or 5.03% increase over the \$68,453 in the prior year.

Prizes totaled \$35,413 in 2003, a decrease of \$733 or 2.03% over the \$36,146 in prizes reported in 2002. Other operating costs, less prizes and commissions, increased by \$636 over the prior year's amount primarily due to contractual and advertising expenses. The increase in sales, offset by related prizes and commissions resulted in a \$3,914 increase in the gross margin when compared to the prior year. Net proceeds to the District's General Fund totaled \$24,535, an increase of \$3,460 or 16.42% from the \$21,075 transferred in 2002. The D.C. Four game accounted for 30.22% of total gaming revenue and 32.52% of the overall gross margin.

In 2002 sales totaled \$68,453 in 2002 for a \$2,948 or 4.50% increase over the \$65,505 in the prior year. Prizes totaled \$36,146 in 2002, an increase of \$8,793 or 32.15% over the \$27,353 in prizes reported in 2001. Other operating costs increased by \$282 over the prior year's amount. The increase in sales, related prizes and commissions resulted in a \$6,433 decrease in the gross margin when compared to the prior year. Net proceeds to the District's General Fund totaled \$21,075, a reduction of \$6,890 or 24.6% from the \$27,965 transferred in 2001. The reduction in transfer amount was primarily attributed to an increase in prize payouts, commissions, and other expenses.

Powerball

The Powerball game is a five out of fifty-three plus one out of forty-two online lottery game that pays a grand prize on an annuitized pari-mutuel basis and all other prizes on a fixed basis. The Powerball game is sponsored

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by the Multi-State Lottery Association (MUSL), a conglomerate of twenty-six states and the District of Columbia, that combines resources and sales to offer larger jackpots. Party lotteries pool their sales and other resources, but otherwise account for operations separately. Powerball sales of \$44,360 in 2003 represented a \$16,637 or 60.01% increase from the \$27,723 generated in 2002. There were four jackpots in 2003 ranging from \$101 million to \$315 million that accounted for the increase in sales during 2003.

Prizes amounted to \$21,415 for the year representing an increase of \$9,376 or a 77.88% in relation to the \$12,039 expensed in 2002. Powerball prizes are expensed at the rate of 50.0% of sales intake offset by lapsed prizes. Other expenses, less prizes and commissions, increased by \$955 in relation to the higher sales level. The increase in sales partially offset by the related increase in expenses account for the \$6,013 or a 58.81% increase in net proceeds and transfers to the General Fund of \$16,238 from the \$10,225 transferred in 2002.

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

Prizes amounted to \$12,039 for the year representing a decrease of \$9,650 or 44.50% decline in relation to the \$21,689 expensed in 2001. Powerball prizes are expensed at the rate of 50.0% of sales intake offset by lapsed prizes. Other expenses decreased \$842 in relation to the lower sales level. The decline in sales partially offset by related decrease in expenses account for the \$7,971 or a 36.01% decrease in net proceeds and transfers to the District's General Fund of \$10,225 from the \$17,565 transferred in 2001.

Quick Cash

The Quick Cash game is a six out of thirty-nine numbers daily online lotto type game that pays fixed prize payouts ranging from 10 dollars to 250,000 dollars. Players receive three boards (set of six numbers) for one dollar. Quick Cash sales amounted to \$4,217 in fiscal year 2003 and reflected a marginal increase over the \$4,200 sold in 2002.

Prizes in 2003 totaled \$755. This amount represented a \$2,460 or 76.52% decrease over prize payments of \$3,215 in 2002. The decline was a result of the payout of nine prizes of \$250 that occurred in 2002. Net proceeds and transfers to the District's General Fund reflected an increase from \$235 in 2002 to \$2,810 in 2003 due to the decrease in prize payouts.

Quick Cash sales amounted to \$4,200 in fiscal year 2002 and reflected a marginal increase over the \$4,160 sold in 2001. Prizes in 2002 totaled \$3.21 million as the result of the payout of nine top prizes of \$250. This amount represented a \$2,242 or 230.42% increase over prizes payments of \$973 in 2001. Net proceeds and transfer to the District's General Fund reflected a decrease from \$2,490 in 2001 to \$235 in 2002 due to increased prize payouts.

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Hot Five

The Hot Five game is a five out of thirty-three numbers online lotto type game that pays fixed prize payouts ranging from one dollar to 25,000 dollars. Players receive one wager (set of five numbers) for the sum of one dollar. Hot five sales decreased by \$226 or 4.46% from a total of \$5,067 in 2002 to \$4,841 in 2003. Overall operating expenses decreased by \$83 from prior year levels. The decline in sales primarily account for the reduced 2003 transfer amount of \$1,385 in comparison to \$1,515 transferred in 2002.

Hot five sales decreased \$233 from a total of \$5,300 in 2001 to \$5,067 in 2002. Overall expenses increased \$116 from prior year levels. The decline in sales and increase in expenses account for the reduced 2002 transfer amount of \$1,515 in comparison to \$1,875 transferred in 2001.

Lucky Numbers Extra and D.C. Four Extra

The Lucky Numbers and D.C. Four Extra games were launched on August 12, 2002. The games, introduced as online instant games, must be played in conjunction with the Lucky Numbers (three-digit) and D.C. Four (four-digit) games. For one dollar, a player can purchase a chance to win 3 to 500 dollars instantly on a three or four digit ticket prior to the midday or nightly drawing. The player requests an extra ticket when purchasing a three or four-digit ticket. The three or four-digit ticket is printed with an extra number for the extra game. If numerical digits of the extra ticket correspond diagonally to the Lucky Numbers or D.C. Four digits, the player is an instant winner for the sum displayed. Ticket sales for the two games totaled \$960 in 2003 compared to a total of \$562 in 2002. This represents a \$398 or 70.82% increase over prior years. Ticket sales for the two games totaled \$562 in 2002 for approximately two months of operations. Prizes, commissions, start-up costs, and other expenses amounted to \$893 resulting in a net operating loss of \$331 for the year.

Prizes in 2003 totaled \$606. This amount represented a \$244 or a 67.40% increase over prize payments of \$362 in 2002. Net proceeds to the District's General Fund reflected a \$125 increase in transfers from zero transfers in 2002.

Keno

Keno was launched on May 5, 2003. Keno is a 10/20/80 game with fixed prizes. Players choose to play from 1 to 10 spots, with each spot having a different prize structure. Players select twenty numbers from a field of 80 numbers. Draws are held every four minutes during valid game times. Payouts range from five dollars to 100,000 dollars. Ticket sales for approximately 5 months of operations totaled \$3,791. Prizes, commissions, start-up costs, and other expenses amounted to \$3,162 resulting in net operating income of \$45.

Instant Games

Instant or scratch games are designed to allow a player the opportunity to determine if he/she is a winner at the time of purchase. The price of tickets and prize structure are determined before the production of tickets. Instant ticket sales of \$36,904 in 2003 were \$3,980 or 12.09% greater than sales in 2002 of \$32,924.

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Prizes in 2003 totaled \$24,742 and resulted in a prize expense increase of \$3,090 or 14.27% over \$21,652 in 2002. Other operating costs, less prizes and commissions, increased by \$873 over the prior year's amount primarily due to contractual and administrative expenses. Transfers to the General Fund of \$4,047 represent a decrease of \$428 over the transfers reported in 2002.

Instant ticket sales of \$32,924 in 2002 were \$462 greater than 2001 sales of \$32,462. First quarter sales in 2002 were lower than anticipated; however, the Lottery was able to stimulate sales in the last three quarters through games designed with higher prize payouts and the introduction of games with price points of 10 dollars. The average prize payout rate in 2002 was virtually the same as the prior year and resulted in a prize expense increase of \$400. Transfers to the District's General Fund of \$4,475 were exactly the same for 2001 and 2002.

Interest and Dividends

All idle cash of the Lottery is invested through the District's General Fund Pooled Investments Account. Powerball receipts transferred to MUSL to fund major jackpots are invested in securities prior to related jackpots being hit, and earnings are allocated quarterly to party lotteries. Interest and dividend income shown separately in the financial statements decreased by \$208 and \$849 in 2003 and 2002, respectively due to lower interest rates and the slow down in the economy.

Charitable Gaming Activities

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

Contacting the Lottery

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

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Statements of Net Assets

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Assets	<u>2003</u>	<u>2002</u>
Current assets:		
Cash and cash equivalents	\$ 10,617	8,309
Accounts receivable, net	3,221	4,577
Inventory	647	683
Prepaid expenses and other	12	5
Restricted investments	8,631	8,631
Total current assets	<u>23,128</u>	<u>22,205</u>
Noncurrent assets:		
Capital assets, net	1,354	1,495
Restricted investments	64,906	70,158
Total noncurrent assets	<u>66,260</u>	<u>71,653</u>
Total assets	<u>89,388</u>	<u>93,858</u>
Liabilities		
Current liabilities:		
Accounts payable	2,752	2,935
Compensation liabilities	517	726
Deferred revenue	271	131
Accrued prizes and commissions	8,314	7,369
Other accrued liabilities	435	423
Obligations for unpaid prizes – current portion	8,631	8,631
Total current liabilities	<u>20,920</u>	<u>20,215</u>
Obligations for unpaid prizes – noncurrent portion	<u>64,906</u>	<u>70,158</u>
Total liabilities	<u>85,826</u>	<u>90,373</u>
Net Assets		
Invested in capital assets, net of related debt	1,354	1,495
Unrestricted	2,208	1,990
Total net assets	<u>\$ 3,562</u>	<u>3,485</u>

See accompanying notes to financial statements.

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Statements of Revenues, Expenses, and Changes in Net Assets

Years ended September 30, 2003 and 2002

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	<u>2003</u>	<u>2002</u>
Operating revenue:		
Gaming revenue	\$ 237,890	211,151
Operating expenses:		
Prizes	123,564	110,741
Agent's commissions	14,692	12,807
Contractor fees	12,676	11,310
Advertising	4,878	4,592
Administration	10,003	9,030
Amortization and depreciation	372	191
Total operating expenses	<u>166,185</u>	<u>148,671</u>
Operating income	71,705	62,480
Nonoperating revenues – interest income	422	630
Income before transfers	72,127	63,110
Transfers to District General Fund	<u>(72,050)</u>	<u>(63,000)</u>
Change in net assets	77	110
Net assets, beginning of year	<u>3,485</u>	<u>3,375</u>
Net assets, end of year	<u>\$ 3,562</u>	<u>3,485</u>

See accompanying notes to financial statements.

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Statements of Cash Flows

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	2003	2002
Operating activities:		
Cash receipts from customers	\$ 238,731	210,495
Cash receipts from others	655	28
Cash payments to vendors	(21,355)	(19,209)
Cash payments to employees	(6,553)	(5,642)
Cash payments for prizes and commissions	(137,311)	(124,020)
Net cash provided by operating activities	74,167	61,652
Capital and related financing activities:		
Acquisition of fixed assets	(231)	(358)
Noncapital financing activities:		
Transfers to District General Fund	(72,050)	(63,000)
Investing activities:		
Interest income received	422	630
Net increase (decrease) in cash	2,308	(1,076)
Cash and cash equivalents – beginning of year	8,309	9,385
Cash and cash equivalents – end of year	\$ 10,617	8,309
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 71,705	62,480
Amortization and depreciation	372	191
Decrease (increase) in assets:		
Receivables	1,356	(647)
Inventory	36	(126)
Prepaid expenses	(7)	—
Increase (decrease) in liabilities:		
Accounts payable	(183)	119
Compensation liabilities	(209)	86
Deferred revenue	140	18
Accrued prizes	945	(472)
Other current liabilities	12	3
Net cash provided by operating activities	\$ 74,167	61,652

See accompanying notes to financial statements.

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LOTTERY AND CHARITABLE GAMES CONTROL BOARD**

Notes to Financial Statements

September 30, 2003 and 2002

(Dollar amounts in thousands)

(1) Organization

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

(2) Summary of Significant Accounting Policies

(a) Basis of Presentation

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

(b) Basis of Accounting

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

(c) Cash and Cash Equivalents

The Lottery participates in the District's pooled cash program whereby cash that is not needed for immediate disbursement is pooled with that of the District and used to purchase current investments. In accordance with the law, the District may invest the pooled cash directly in, or through repurchase agreements, obligations of the United States or its agencies, which are fully guaranteed by the federal government, and in certificates of deposit, which are issued by federally insured banks. In accordance with District policies, substantially all deposits in the pooled cash program were insured or collateralized with securities held by the District or its agent in the District's name. Interest income from the investment of pooled cash is allocated to the Lottery based on the amount the Lottery invests in the pool. The Lottery considers the pooled cash to be cash equivalents for the purpose of cash flows because the pool may not hold the securities for more than 91 days. Cash and cash equivalents at September 30, 2003 and 2002, respectively, were \$10,617 and \$8,309.

(d) Inventory

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

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

Notes to Financial Statements

September 30, 2003 and 2002

(Dollar amounts in thousands)

(e) Capital Assets

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

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

Category	Estimated useful life
Machinery and equipment	5-8 years
Office furniture and fixtures	5-8 years
Leasehold improvements	5-15 years

(f) Gaming Revenue

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

(g) Prize Expense

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

(h) Compensated Absences

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

There is not a maximum limitation on the amount of unused sick pay benefits that employees may accumulate. The Lottery does not accrue for nonvesting accumulating rights to receive sick pay benefits. At the time of retirement, unused sick pay benefits are converted to additional months of service and are added to the retirees' years of service in computing retirement benefits.

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

Notes to Financial Statements

September 30, 2003 and 2002

(Dollar amounts in thousands)

(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, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(3) Accounts Receivable

The components of accounts receivable as of September 30, 2003 and 2002 are as follows:

<u>Description</u>	<u>2003</u>	<u>2002</u>
Due from agents:		
Online games	\$ 485	1,924
Instant games	3,157	3,037
Total due from agents	3,642	4,961
Other	35	72
Total accounts receivable	3,677	5,033
Less allowance for doubtful accounts	(456)	(456)
Total accounts receivable, net	\$ 3,221	4,577

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

Notes to Financial Statements

September 30, 2003 and 2002

(Dollar amounts in thousands)

(4) Capital Assets

A summary of capital assets as of September 30, 2003 and 2002 is as follows:

	Balance as of October 1, 2002	Additions	Reductions	Balance as of September 30, 2003
Cost:				
Machinery and equipment	\$ 2,630	231	—	2,861
Office furniture and fixtures	321	—	—	321
Leasehold improvements	774	—	—	774
Total cost	<u>3,725</u>	<u>231</u>	<u>—</u>	<u>3,956</u>
Less – accumulated depreciation:				
Machinery and equipment	1,480	372	—	1,852
Office furniture and fixtures	308	—	—	308
Leasehold improvements	442	—	—	442
Total accumulated amortization and depreciation	<u>2,230</u>	<u>372</u>	<u>—</u>	<u>2,602</u>
Capital assets – net	<u>\$ 1,495</u>			<u>1,354</u>
	October 1, 2001	Additions	Reductions	Balance as of September 30, 2002
Cost:				
Machinery and equipment	\$ 2,533	342	245	2,630
Office furniture and fixtures	321	—	—	321
Leasehold improvements	758	16	—	774
Total cost	<u>3,612</u>	<u>358</u>	<u>245</u>	<u>3,725</u>
Less – accumulated depreciation:				
Machinery and equipment	1,577	261	358	1,480
Office furniture and fixtures	304	4	—	308
Leasehold improvements	403	58	19	442
Total accumulated amortization and depreciation	<u>2,284</u>	<u>323</u>	<u>377</u>	<u>2,230</u>
Capital assets – net	<u>\$ 1,328</u>			<u>1,495</u>

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

Notes to Financial Statements

September 30, 2003 and 2002

(Dollar amounts in thousands)

(5) Multi-State Lottery Association

(a) Background

The Lottery is a member of the Multi-State Lottery Association (MUSL). MUSL has 26 members and administers a multi-state lottery game. Powerball, the current game, was initiated on April 20, 1992 and is a semiweekly pari-mutuel drawing with a minimum grand prize of \$10. MUSL previously administered the Lotto-America game which was terminated on April 18, 1992. All MUSL members remit a portion of their Powerball revenue to MUSL for the prize payments and administrative expenses of Powerball.

(b) Restricted Investments and Obligations for Unpaid Prizes

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

As of September 30, 2003 and 2002, the cost of U.S. Government and Agency securities purchased by MUSL for the Lottery aggregated \$88,794 and \$97,425, respectively to fund future installment payments for the Lottery's Lotto-America and Powerball winners.

The market value of these securities was \$73,537 and \$78,789 as of September 30, 2003 and 2002, respectively. The investments provide the Lottery cash payments corresponding to the Lottery's obligations to send the annual installments to the prize winners. The Lottery has reflected the market value of the securities as restricted investments and as corresponding obligations for unpaid prizes on the statements of net assets. All restricted investments are insured and registered or are held by the Lottery or its agent in the Lottery's name.

As of September 30, 2003, the Lottery had the following investments and maturities:

Investment type	Fair value	Investment maturities (in years)			
		Less than 1	1 - 5	6 - 10	More than 10
U.S. Government and Agency Securities	\$ 72,481	8,598	38,703	21,767	3,413
Pooled government cash management fund	1,056	1,056	—	—	—
	<u>\$ 73,537</u>	<u>9,654</u>	<u>38,703</u>	<u>21,767</u>	<u>3,413</u>

These investments are obligations explicitly guaranteed by the U.S. government and are held for prize annuities based on quoted market prices. The fair value of the liabilities are based on current interest rates of the related U.S. government security held to fund annuity obligations. MUSL's investment policy limits its exposure to credit risk by investing only in securities that are backed by the full faith and credit of the U.S. government or its agencies.

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

Notes to Financial Statements

September 30, 2003 and 2002

(Dollar amounts in thousands)

As of September 30, 2003, the Lottery's interest in the SEC 2a7 pooled government cash management fund of \$1,056, shown above, was not rated.

(c) MUSL Prize Reserves

The prize pool for Powerball consists of 50% of each drawing period's sales. 2% of the prize pool is placed in a MUSL prize reserve fund and a MUSL set prize reserve fund. These reserve funds serve as contingency funds to protect MUSL from unforeseen liabilities. As of September 30, 2003 and 2002, the total MUSL prize reserve fund was approximately \$69,000 and \$53,000, respectively, of which the Lottery's share was approximately \$2,200 and \$1,887, respectively. In addition, the total MUSL set prize reserve fund as of September 30, 2003 and 2002, was approximately \$25,000 and \$27,000, respectively, of which the Lottery's share was approximately \$531 and \$839, respectively.

The balance remaining in the reserve funds are refundable to MUSL members if a member leaves or if MUSL disbands. If a member leaves, the member must wait one year before its portion of the prize reserve funds is returned. The balance in the reserve funds may be used at the discretion of MUSL's board of directors. Accordingly, the Lottery's share of the reserve funds is not reflected in the accompanying financial statements.

(6) Obligations for Unpaid Prizes

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

The Lottery's obligations for unpaid prizes are as follows:

	September 30	
	2003	2002
	Jackpot	Jackpot
Jackpot prizes payable:		
Due within one year	\$ 8,631	8,631
Due in subsequent years	64,906	70,158
Total (present value)	73,537	78,789
Add interest to maturity	15,257	18,636
Jackpot prizes payable at maturity	\$ 88,794	97,425

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

Notes to Financial Statements

September 30, 2003 and 2002

(Dollar amounts in thousands)

The following schedule presents the changes in prizes payable:

Balance as of October 1, 2001	\$ 79,795
Increases	7,625
Decreases	<u>(8,631)</u>
Balance as of September 30, 2002	78,789
Increases	3,379
Decreases	<u>(8,631)</u>
Balance as of September 30, 2003	<u>\$ 73,537</u>

(7) Gaming Revenue and Expenses

Gaming revenue and expenses for the fiscal years ended September 30, 2003 and 2002 were as follows:

	2003										
	Lucky Numbers	D.C. Four	Powerball	Quick Cash	Hot Five	Lucky Numbers Extra	D.C. Four- Extra	Keno	Instant Games	Others	Total
	Gaming revenue	\$ 70,268	71,894	44,360	4,217	4,841	360	600	3,791	36,904	655
Prizes	(35,848)	(35,413)	(21,415)	(755)	(2,473)	(226)	(380)	(2,312)	(24,742)	—	(123,564)
Agent's commissions	(4,597)	(4,082)	(2,400)	(212)	(300)	(25)	(41)	(254)	(2,781)	—	(14,692)
Gross margin	<u>\$ 29,823</u>	<u>32,399</u>	<u>20,545</u>	<u>3,250</u>	<u>2,068</u>	<u>109</u>	<u>179</u>	<u>1,225</u>	<u>9,381</u>	<u>655</u>	<u>99,634</u>
	2002										
	Lucky Numbers	D.C. Four	Powerball	Quick Cash	Hot Five	Lucky Numbers Extra	D.C. Four- Extra	Instant Games	Others	Total	
	Gaming revenue	\$ 72,194	68,453	27,723	4,200	5,067	234	328	32,924	28	211,151
Prizes	(34,692)	(36,146)	(12,039)	(3,215)	(2,635)	(151)	(211)	(21,652)	—	(110,741)	
Agent's commissions	(4,491)	(3,822)	(1,519)	(243)	(309)	(16)	(22)	(2,385)	—	(12,807)	
Gross margin	<u>\$ 33,011</u>	<u>28,485</u>	<u>14,165</u>	<u>742</u>	<u>2,123</u>	<u>67</u>	<u>95</u>	<u>8,887</u>	<u>28</u>	<u>87,603</u>	

(8) Transfers to the General Fund of the District

The District Budget Act (PL 4-162) (the Act) of 1983 requires the Lottery to transfer its revenues less expenses and less a reserve not to exceed 2% of annual prize payments to the General Fund of the District. The Mayor may approve a change in the reserve limit, as necessary, upon the request of the Lottery. During the fiscal years ended September 30, 2003 and 2002, the Lottery's net transfers to the General Fund of the District were \$72,050 and \$63,000, respectively. The Lottery was in compliance with the Act for the fiscal years ended September 30, 2003 and 2002.

(9) Retirement Programs

(a) Defined Benefit Pension Plan

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

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

Notes to Financial Statements

September 30, 2003 and 2002

(Dollar amounts in thousands)

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

In accordance with the Balance Budget Act of 1997 (Public Law 105-33), the Lottery contributes 8.51% and employees contribute 7.25% of employees' covered compensation to the Federal Civil Service Retirement System. The Lottery's contribution decreased to 7.50% in October 2002 and to 7.00% in January 2003. Contributions by the Lottery amounted to \$127 and \$201 for the years ended September 30, 2003 and 2002, respectively.

(b) Defined Contribution Plan

All full-time employees hired after September 30, 1987 are covered by the District-sponsored defined contribution plan. Employees do not contribute to this plan and are eligible to participate after one year of service. The Lottery contributes 5% of an eligible employee's base salary, which amounted to \$67 and \$140 for the fiscal years ended September 30, 2003 and 2002, respectively.

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

(c) Deferred Compensation Plan

Lottery employees are eligible to participate in the District-sponsored deferred compensation plan (D.C. Code 47-3601) created in accordance with Internal Revenue Code Section 457. Employees may defer up to 25% of their compensation, not to exceed \$8. Compensation deferred and income earned are taxable when paid or made available to the participant or beneficiary upon retirement, death, termination, or unforeseeable emergency. Contributions are not assets of the Lottery or District, neither of which have any further liability to the plan.

(10) Commitments and Contingencies

(a) Operating Leases

The Lottery leases certain facilities under long-term, noncancelable, and operating leases. The total future minimum rental commitments as of September 30, 2003 are as follows:

Year ending September 30:		
2004	\$	1,240
2005		1,241
2006		1,241
2007		413
	\$	<u>4,135</u>

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

Notes to Financial Statements

September 30, 2003 and 2002

(Dollar amounts in thousands)

The Lottery's future minimum rental commitments for the fiscal year ended September 30, 2003 is effective through February 5, 2007.

Rent expense for the fiscal years ended September 30, 2003 and 2002 was as follows:

	2003	2002
Gross rental expense	\$ 1,266	1,249
Less income from subleases	(170)	(170)
Net rent expense	\$ 1,096	1,079

(b) Risk of Loss

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

(c) Annuity Contracts

Prizes awarded for the Lucky Lotto game, which ended effective May 1, 1989, are payable to the winners in annual installments over 10 or 20 years. The first installment payments were made by the Lottery at the time of the drawing. The Lottery had entered into agreements with insurance companies under which the Lottery purchased annuities contracts that provide the annual installment payments to the Lucky Lotto prize winners. As the insurance companies are responsible for the annual installment payments, neither the present value of the annuities nor the present value of the related future payments is reflected in the accompanying financial statements. The Lottery would be liable for such future installment payments if the insurance companies were to default on their payments. As of September 30, 2003 and 2002, future installment payments due to Lucky Lotto winners were approximately \$5,233 and \$7,303, respectively. As of September 30, 2003 and 2002, future installment payments due to instant lottery winners were approximately \$52 and \$405, respectively.

During 1991, Executive Life Insurance Company (ELIC), with whom the Lottery holds two annuities, was placed into conservancy with the Los Angeles, California Superior Court (Superior Court). In 1993, the Superior Court approved the terms of a rehabilitation plan and the purchase of ELIC by the Aurora National Life Insurance Company. As a result, the Lottery is required to fund a percentage of the annual installment payments for these annuities. The Lottery's accrued prize liability as of September 30, 2003 and 2002 was zero and \$98, respectively, for the Lottery's percentage of the annual installment payments to these Lucky Lotto winners.

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

Notes to Financial Statements

September 30, 2003 and 2002

(Dollar amounts in thousands)

(11) Related Party Transactions

The Lottery had related party transactions with the Office of Cable Television (OCT), another District of Columbia Government agency, during the fiscal years ended September 30, 2003 and 2002. OCT is responsible for the production of daily draws for the various lottery games. The annual contractual cost for the related services rendered amounted to \$480 and was negotiated at arms length.

During fiscal year 2003, the Lottery had related party transactions with the Office of the Chief Financial Officer (OCFO) to provide financial and managerial oversight. These services included, but were not limited to, internal audit and internal security, legal services, financial management, and executive management oversight. The annual contractual cost was \$110 and was negotiated at arms length.

Other services provided by District Government entities to the Lottery include central processing of payroll, accounting, computer technology services, and the handling of intra-district transactions for rent, telephone, security guard services, etc. Personnel costs for these services are budgeted and accounted for as part of the respective entity's regular operations.



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

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

We have audited the financial statements of the Lottery and Charitable Games Control Board (the Lottery), an enterprise fund of the Government of the District of Columbia (District), as of and for the year ended September 30, 2003, and have issued our report thereon dated December 19, 2003. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

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

Internal Control over Financial Reporting

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





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

KPMG LLP

December 19, 2003