

SOUTH CAROLINA EDUCATION LOTTERY

REPORT ON FINANCIAL STATEMENTS

**FOR THE YEAR ENDED
JUNE 30, 2003**

State of South Carolina



Office of the State Auditor

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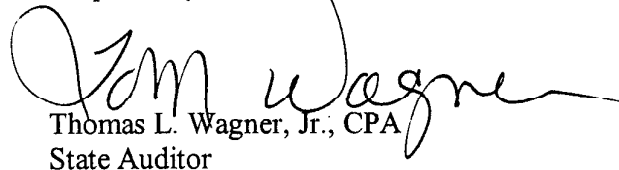
September 30, 2003

The Honorable Mark Sanford, Governor
and
Members of the South Carolina Education Lottery Commission
Columbia, South Carolina

This report on the audit of the financial statements of the South Carolina Education Lottery for the fiscal year ended June 30, 2003, was issued by Elliott Davis, LLC, Certified Public Accountants, under contract with the South Carolina Office of the State Auditor.

If you have any questions regarding this report, please let us know.

Respectfully submitted,


Thomas L. Wagner, Jr., CPA
State Auditor

TLWjr/cwc

SOUTH CAROLINA EDUCATION LOTTERY

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

The Commission
South Carolina Education Lottery
Columbia, South Carolina

We have audited the accompanying statement of net assets of the ***South Carolina Education Lottery*** (the SCEL), a component unit of the State of South Carolina, as of June 30, 2003 and the related statements of revenues, expenses, and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the management of the SCEL. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the ***South Carolina Education Lottery*** as of June 30, 2003, and the changes in financial position and cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 22, 2003 on our consideration of the SCEL's internal control over financial reporting and 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.

The Management's Discussion and Analysis is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the financial statements of the SCEL. The schedule of business-type activities for the state-wide CAFR is supplementary information required by the South Carolina Office of the Comptroller General. It has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and, accordingly, we express no opinion on it.

Elliott Davis LLC

August 22, 2003

SOUTH CAROLINA EDUCATION LOTTERY MANAGEMENT'S DISCUSSION AND ANALYSIS

Management of the Lottery provides this *Management's Discussion and Analysis* of their financial performance for the readers of the Lottery's financial statements. This narrative provides an overview of the Lottery's financial activity for the fiscal year ended June 30, 2003. This analysis is to be considered in conjunction with the financial statements to provide an objective analysis of the Lottery's financial activities based on facts, decisions, and conditions currently facing management.

Understanding the Lottery's Financial Statements

The Lottery, an instrumentality of the State of South Carolina, is accounted for as an enterprise fund that reports all assets and liabilities using the accrual basis of accounting, much like a private business entity. In accordance with generally accepted accounting principles, this report consists of a series of financial statements, along with explanatory notes to the financial statements. The financial statements immediately follow this discussion and analysis by management and are designed to highlight the Lottery's net assets and changes to those assets resulting from Lottery operations.

The most important relationship demonstrated within the Lottery's financial statements is the requirement that the Lottery transfer all net proceeds to the State Treasurer for the Education Lottery Account. Accordingly, the primary focus of these financial statements is determining net proceeds available for transfer to the Education Lottery Account rather than the change in net assets of the Lottery. It is also important to note that most financial statement balances have a direct or indirect relationship to revenue. As lottery sales increase, the amount transferred to the Education Lottery Account also increases. Similarly, increases in revenue for a particular lottery game result in direct increases to the related prize awards and commissions expense.

Most assets included on the Statements of Net Assets represent current amounts such as cash and accounts receivable from lottery retailers. Most liabilities represent current prize awards payable and amounts due to the Education Lottery Account.

The fiscal year ended June 30, 2002 included only six months of sales and related expenses, therefore, no comparisons are made with the prior year.

Financial Highlights

Lottery operations generated \$724.3 million in sales of lottery products and \$2.8 million in other revenues. We incurred \$415.7 million in prize expense for winners, \$51.1 million was paid to retailers in commissions and incentives, and other expenses amounted to \$40.9 million.

Assets and Liabilities

Capital Assets

The Lottery acquired additional Capital Assets of \$1.7 million in the fiscal year. The most significant item in this category was the purchase of additional retailer terminals.

Debt

The debt is related to the original purchase of the retailer terminals. The on-line vendor agreed to a deferred payment for \$5.3 million for the retailer terminals until March, 2004. The Lottery reduced the principle of this debt by \$0.8 million during the fiscal year.

Lottery Operations

- Total sales of instant tickets for the year were \$426.3 million. The prize expense related to these sales was \$274.3 million or 64.3%.
- The Lottery sales of Pick 3 (a three number game with a daily draw) were \$99.0 million with a related prize expense of \$49.4 million or 49.9%.
- The Lottery began sales of its second daily game (Pick 4), a five number game with a daily draw, on January 27, 2003. Total sales for the period were \$19.4 million with a related prize expense of \$8.7 million or 44.8%.
- The Lottery began a second draw on Tuesdays to complement the Saturday draw for the Carolina 5 game. Sales for this game were \$25.6 million with a related prize expense of \$10.3 million or 40.2%.
- The Lottery joined the Multi-State Lottery Association (MUSL), the sponsoring organization for Powerball. The SC Lottery began Powerball sales on October 5, 2002 with the first draw being on October 9. Total Powerball sales were \$153.8 with a related prize expense of \$72.9 or 47.4%.
- All proceeds of the Lottery must be transferred to the State Treasurer for the Education Lottery Account with the following exceptions: 1) the cost of property and equipment net of depreciation and related debt, and 2) the Restricted Fidelity Fund which may be retained by the Lottery up to \$500,000 and used to cover losses the commission may experience due to nonfeasance, misfeasance, or malfeasance of a lottery retailer. Therefore the net assets of the Lottery will never exceed \$500,000 related to the Restricted Fidelity Fund plus the cost of property and equipment net of depreciation and related debt. As of July 14, 2003, the Lottery had transferred \$213.3 million resulting from operations and \$7.3 million in unclaimed prize funds to the State Treasurer for the Education Lottery Account for the fiscal year ended June 30, 2003.

Potential Factors Impacting Future Operations

Management added a mid-day draw (six days per week) to the Pick 3 and Pick 4 games effective July 1, 2003.

Contacting the Lottery's Financial Management

This financial report is designed to provide a general overview of the Lottery's financial activity for all those interested in the Lottery's operations. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Director of Finance, South Carolina Education Lottery, Post Office Box 11949, Columbia, South Carolina 29211-1949.

***SOUTH CAROLINA EDUCATION LOTTERY
STATEMENT OF NET ASSETS
JUNE 30, 2003***

ASSETS

CURRENT ASSETS

Cash and cash equivalents	\$ 13,942,944
Cash - Restricted fidelity fund	361,733
Retailer accounts receivable	32,146,558
Inventory	2,282,333
Prepaid expenses and other current assets	<u>264,777</u>

Total current assets	48,998,345
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CAPITAL ASSETS, net

15,171,651

Deposit with Multi-State Lottery

2,290,309

Total assets

66,460,305

LIABILITIES

CURRENT LIABILITIES

Due to Education Lottery Account	17,818,473
Prizes payable	23,610,910
Accounts payable	5,963,787
Accrued liabilities	880,906
Accrued compensated absences	270,000
Current portion of long-term debt	6,275,056
Deferred revenue	<u>1,869,482</u>

Total current liabilities	56,688,614
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LONG -TERM DEBT

3,449,775

ACCRUED COMPENSATED ABSENCES

513,363

Total liabilities

60,651,752

NET ASSETS

Invested in capital assets, net of related debt	5,446,820
Restricted - fidelity funds	<u>361,733</u>

Total net assets

\$ 5,808,553

See notes to financial statements which are an integral part of this statement.

SOUTH CAROLINA EDUCATION LOTTERY
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
For the year ended June 30, 2003

REVENUES

Instant games	\$ 426,311,967
On-line games	298,001,308
Retailer permit fees	327,813
Retailer telephone fees	2,044,924
Other	<u>223,518</u>
Total revenue	<u>726,909,530</u>

DIRECT COSTS

Commissions and incentives to retailers	<u>51,136,250</u>
Prize expense	
Instant games	274,301,493
On-line games	<u>141,415,762</u>
Total prize expense	<u>415,717,255</u>
Instant and on-line costs	<u>19,253,048</u>
Total direct costs	<u>486,106,553</u>
Gross profit	<u>240,802,977</u>

OPERATING EXPENSES

Advertising and promotion	6,405,304
Security checks	117,950
Salaries, wages and benefits	7,871,294
Contracted and professional services	450,097
Depreciation	3,322,198
Rent expense	798,651
Office supplies	158,581
Other general and administrative	<u>1,797,326</u>
Total operating expenses	<u>20,921,401</u>
Operating Income	<u>219,881,576</u>

NON-OPERATING INCOME (EXPENSE)

Interest income	223,287
Interest expense	<u>(815,892)</u>
Total non-operating expense	<u>(592,605)</u>

Change in net assets before transfers to and due to Education Lottery Account	219,288,971
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TRANSFERS TO AND DUE TO EDUCATION LOTTERY ACCOUNT 220,056,527

Change in net assets	(767,556)
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NET ASSETS,

BEGINNING OF YEAR	<u>6,576,109</u>
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END OF YEAR	<u>\$ 5,808,553</u>
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See notes to financial statements which are an integral part of this statement.

***SOUTH CAROLINA EDUCATION LOTTERY
STATEMENT OF CASH FLOWS
For the year ended June 30, 2003***

CASH FLOWS FROM OPERATING ACTIVITIES

Cash received from retailers	\$ 716,284,432
Cash payments to prize winners	(404,389,058)
Cash payments to suppliers for goods and services	(79,469,411)
Cash payments to employees for services	<u>(7,360,383)</u>
Net cash provided by operating activities	<u>225,065,580</u>

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

Payments to fund deposit with Multi-State Lottery	(2,290,309)
Payments to Education Lottery Account	<u>(213,133,348)</u>
Net cash used for noncapital financing activities	<u>(215,423,657)</u>

CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES

Interest paid	(886,945)
Net paid for short-term and long-term debt	<u>(864,108)</u>
Net cash used for financing activities	<u>(1,751,053)</u>

CASH FLOWS FROM INVESTING ACTIVITIES

Interest received	226,039
Purchase of capital assets	<u>(1,650,926)</u>
Net cash used for investing activities	<u>(1,424,887)</u>

NET INCREASE IN CASH AND CASH EQUIVALENTS

6,465,983

CASH AND CASH EQUIVALENTS

BEGINNING OF YEAR

7,838,694

END OF YEAR

\$ 14,304,677

OPERATING ACTIVITIES

Operating income	\$ 219,881,576
Adjustments to reconcile operating income to net cash provided by operating activities	
Depreciation	3,322,198
Changes in assets and liabilities	
Retailer accounts receivable	(12,273,297)
Inventory	(385,855)
Prepaid expenses and other assets	(30,164)
Accounts payable and accrued liabilities	1,574,726
Prizes payable	11,328,197
Deferred revenue	<u>1,648,199</u>
Net cash provided by operating activities	<u>\$ 225,065,580</u>

See notes to financial statements which are an integral part of this statement

SOUTH CAROLINA EDUCATION LOTTERY NOTES TO FINANCIAL STATEMENTS

NOTE 1 - REPORTING ENTITY

The *South Carolina Education Lottery* (the SCEL), a component unit of the State of South Carolina, was established as an instrumentality of the state with the enactment of the South Carolina Lottery for Education Act (the Act) on June 29, 2001 and began development operations upon enactment. The SCEL is responsible for the provision of lotteries on behalf of the State of South Carolina in accordance with the Act.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies of the SCEL are as follows:

Method of accounting

The SCEL 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 where the costs of providing lottery games to the general public on a continuing basis are to be financed through the sale of lottery game tickets. The Act requires that all costs of providing lottery games, including capital costs, be recovered from the sale of lottery game tickets. The SCEL is reported as a discretely presented component unit within the State of South Carolina's Comprehensive Annual Financial Report (CAFR) due to the fact that the State appoints members of the SCEL's Commission.

The Government Accounting Standards Board (GASB) is the recognized standard setting body for accounting principles generally accepted applicable to governmental proprietary activities in the United States of America. The SCEL applies all applicable GASB pronouncements and all applicable Financial Accounting Standards (FASB) pronouncements issued on or before November 30, 1989 when not in conflict with GASB pronouncements. In accordance with GASB Statement 20, the SCEL has elected not to implement FASB Statements 103 and after.

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. Under this method, revenues are recognized when they are earned and expenses are recognized when they are incurred.

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and 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 and accounts receivable recognition

Revenue and accounts receivable for on-line games are recognized when tickets are sold to the public by contracted retailers, except for tickets sold in advance of the draw date for which deferred revenue is recorded.

Revenue and accounts receivable for instant scratch games are recognized upon activation of ticket packs for sale by the retailers. The SCEL evaluates its receivables on an ongoing basis for collectability. As of June 30, 2003, management determined that no allowance for doubtful accounts was necessary.

(Continued)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

Commissions

Retailers receive a commission of 7% on total sales.

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 ticket games is recorded as an estimate at the time the related revenue is recognized based on the predetermined prize structure for each game; periodically, the prize expense is adjusted to reflect amounts actually won. Prize expense for on-line games is recorded at the time the related revenue is recognized based on the known prizes.

Ticket inventories

Inventories are carried at cost (as determined by the specific identification method) and consist of scratch tickets located in the SCEL's warehouses or held by retailers. The cost of tickets is charged to operations upon the recognition of revenue under the procedures described above.

Unclaimed prizes

Prizes must be claimed within 90 days after game-end (end of sales) for instant games and within 180 days after the draw date for on-line games. Unclaimed prize money must be deposited in the Education Lottery Account each year.

Net assets

Net assets represent cumulative revenues less expenses in excess of net proceeds transferred or payable to the Education Lottery Account, as defined under the Act.

Net proceeds

Net proceeds, as defined by the Act, consist of all revenue derived from the sale of lottery game tickets or shares and all other monies derived from the lottery games, less operating expenses and prizes.

Operating expenses

Operating expenses, as defined by the Act, in the determination of net proceeds, consist of all costs of doing business including, but not limited to, prizes, commissions and other compensation paid to lottery retailers, advertising and marketing costs, rental fees, personnel costs, capital costs, depreciation of property and equipment and other operating costs.

Cash and cash equivalents

The SCEL 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 cash on deposit with the South Carolina State Treasurer.

Retailer accounts receivable

Retailer accounts receivable represents lottery proceeds due from retailers for net ticket sales less commissions and prizes paid by the retailers. Lottery proceeds are collected weekly by the SCEL from retailer bank accounts.

Capital Assets

Capital assets which consist of machinery, equipment, vehicles, and leasehold improvements, are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of two 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. The SCEL capitalizes all property and equipment purchases of \$1,000 or more.

(Continued)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

Restricted fidelity fund

In accordance with the Act, retailers contribute a fee to a fidelity fund upon acceptance as a SCEL retailer. The fund is used to cover losses the SCEL may incur due to misfeasance, nonfeasance or malfeasance of retailers. At the end of each fiscal year, any amount in the fund in excess of \$500,000 is treated as net proceeds from the SCEL and is payable to the Education Lottery Account. At June 30, 2003, no amounts were available for transfer as net proceeds. The fidelity fund is held in a separate account and appears on the balance sheet as restricted fidelity fund cash and in net assets as restricted fidelity funds.

Insurance

The SCEL is exposed to various risks of loss related to torts; theft of, damage to, and the destruction of assets; errors and omissions; injuries to employees; and natural disasters. The SCEL combines coverage provided by the South Carolina Insurance Reserve Fund with the purchase of commercial insurance to substantially cover these risks.

Compensated absences

Employees earn the right to be compensated during absences for vacation and compensatory time. Unused leave benefits are paid to employees upon separation from service. The cost of vacation and compensatory time is accrued in the period in which it is earned.

Advertising

Costs incurred for producing and communicating advertising are expensed when incurred, which generally is when the advertising first takes place.

Deposit with Multi-State Lottery (MUSL)

The SCEL is required to maintain funds in reserve with MUSL. This reserve serves as a contingent source for prize payouts should MUSL games not generate sufficient funds to pay amounts due to prize winners. MUSL is not a financial institution.

NOTE 3 - CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of interest bearing demand deposits. The deposits are categorized to indicate the level of risk assumed by the SCEL at year end. Category A includes deposits insured or collateralized with securities held by the SCEL or its agent in the SCEL's name. Category B includes deposits that are collateralized with securities held by the pledging financial institution's trust department or agency in the SCEL's name. Category C includes uncollateralized deposits, including any bank balance that is collateralized with securities held by the pledging financial institution, or by its trust department or agent, but not in the SCEL's name.

At June 30, 2003 cash and cash equivalents were as follows:

	<u>A</u>	<u>B</u>	<u>C</u>	<u>Bank Balance</u>	<u>Carrying Value</u>
Demand deposits	<u>\$ 15,682,390</u>	<u>\$</u>	<u>\$</u>	\$ 15,682,390	\$ 13,983,215
Deposits held by State Treasurer				<u>321,462</u>	<u>321,462</u>
Total cash and cash equivalents				<u>\$ 16,003,852</u>	<u>\$ 14,304,677</u>

NOTE 4 - CAPITAL ASSETS

The following is a summary of changes in capital assets and accumulated depreciation during the fiscal year:

	<u>Balance</u> <u>June 30, 2002</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u> <u>June 30, 2003</u>
Property and equipment				
Machinery and equipment	\$ 17,685,875	\$ 1,585,544	\$ -	\$ 19,271,419
Vehicles	47,826	21,000	-	68,826
Leasehold improvements	<u>579,136</u>	<u>44,382</u>	<u>-</u>	<u>623,518</u>
	<u>18,312,837</u>	<u>1,650,926</u>	<u>-</u>	<u>19,963,763</u>
Accumulated depreciation				
Machinery and equipment	(1,445,559)	(3,178,424)	-	(4,623,983)
Vehicles	(6,570)	(19,442)	-	(26,012)
Leasehold Improvements	<u>(17,785)</u>	<u>(124,332)</u>	<u>-</u>	<u>(142,117)</u>
	<u>(1,469,914)</u>	<u>(3,322,198)</u>	<u>-</u>	<u>(4,792,112)</u>
Total property and equipment, net	<u>\$ 16,842,923</u>	<u>\$ (1,671,272)</u>	<u>\$ -</u>	<u>\$ 15,171,651</u>

NOTE 5 - ACCRUED EXPENSES

Accrued liabilities at June 30, 2003 consists of the following:

Accrued payroll and related expenses	\$ 722,712
Other	<u>158,194</u>
	<u>\$ 880,906</u>

NOTE 6 - LONG-TERM DEBT AND COMMITMENTS

In October 2001, the SCEL entered into a six year contract with a vendor, to provide amongst other things, services and equipment to operate their on-line lottery. The contract required an initial payment of \$5,287,938, which has been paid. The contract also calls for monthly administrative fees of \$450,000 for the life of the contract. Additional payments, which have been imputed for the purchase of equipment of \$140,000 and \$122,000 per month will be made for months three through twenty-six and twenty-seven through sixty-two of the contract, respectively, with a lump sum payment of \$5,270,000 due March 2004. These additional payments have been imputed to include principal and interest at 8%. Title to and risk of loss for this equipment occurred upon installation and acceptance in March 2002.

At June 30, 2003, the future maturities of the imputed principal and interest payments on the equipment are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Payment</u>
2004	\$ 6,275,056	\$ 602,944	\$ 6,878,000
2005	1,232,563	231,438	1,464,001
2006	1,334,864	129,136	1,464,000
2007	<u>882,348</u>	<u>25,092</u>	<u>907,440</u>
	<u>\$ 9,724,831</u>	<u>\$ 988,610</u>	<u>\$ 10,713,441</u>

(Continued)

NOTE 6 - LONG-TERM DEBT AND COMMITMENTS, Continued

The following is a summary of changes in long-term debt during the fiscal year:

	<u>Balance</u> <u>June 30, 2002</u>	<u>Proceeds</u>	<u>Payments</u>	<u>Balance</u> <u>June 30, 2003</u>
Long-term debt	<u>\$ 10,588,939</u>	<u>\$ -</u>	<u>\$ 864,108</u>	<u>\$ 9,724,831</u>

NOTE 7 - ACCRUED COMPENSATED ABSENCES

The following is a summary of changes in accrued compensated absences during the fiscal year:

	<u>Balance</u> <u>June 30, 2002</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance</u> <u>June 30, 2003</u>
Accrued compensated absences	<u>\$ 333,940</u>	<u>\$ 829,710</u>	<u>\$ 380,287</u>	<u>\$ 783,363</u>

NOTE 8 - OPERATING LEASES

The SCEL 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 SCEL.

Future minimum rental payments, to entities outside the State of South Carolina reporting entity, on noncancellable leases with original terms of one year or more are scheduled as follows for the year ending June 30:

	<u>Operating</u> <u>leases</u>
2004	\$ 618,521
2005	577,925
2006	269,795
2007	48,502
2008	4,042

Rental expenses under all operating leases including those on month-to-month terms, totaled approximately \$798,651 for the year ended June 30, 2003. This includes \$76,577 of vehicle rental expense to the State of South Carolina Fleet management.

NOTE 9 - DUE TO EDUCATION LOTTERY ACCOUNT

In accordance with the Act, all net proceeds of the SCEL are to be transferred to the Education Lottery Account within the South Carolina State Treasury. In accordance with the Act, net proceeds consist of all revenue derived from the sale of lottery game tickets or shares and all other monies derived from the lottery games less operating expenses and prizes. At June 30, 2003 a payable resulted from transfers due to the Education Lottery Account as follows:

Amount payable to the Education Lottery Account at June 30, 2002	\$ 10,895,294
Change in net assets subject to transfer	<u>219,288,971</u>
	<u>230,184,265</u>
Change in capital assets, net of related debt	
Property and equipment, net	1,671,272
Long-term debt	<u>(864,108)</u>
	<u>807,164</u>
Amount collected for fidelity fund	<u>(39,608)</u>
Amount paid during the year	<u>(213,133,348)</u>
Amount payable to the Education Lottery Account at June 30, 2003	<u>\$ 17,818,473</u>

Transfers related to the above payable of \$17,569,475 and \$248,998 were made to the Education Lottery Account in July 2003 and August 2003, respectively.

NOTE 10 - EMPLOYEE RETIREMENT SYSTEMS

The SCEL contributes to the South Carolina Retirement System (SCRS) cost sharing multiple-employer defined benefit plan administered by the Retirement Division of the State Budget and Control Board.

As established by Title 9-1-480 Code Laws of South Carolina, 1976 (as amended), all eligible persons, except those specifically excluded, shall become members of the retirement system as a condition of their employment. The responsibility of the administration of the system is assigned by law to the State Budget & Control Board.

SCRS offers retirement and disability benefits, cost of living adjustments on an ad-hoc basis, life insurance benefits and survivor benefits. The Plan's provisions are established under Title 9 of the SC Code of Laws.

The following is a recap of the mandated contribution rates for the current fiscal year.

	<u>SCRS</u>
Employee contributions	6% of salary
Employer contributions	7.55% of salary

For the years ending June 30, 2003 and 2002 the SCEL contributions to SCRS were \$605,768 and \$359,533, respectively.

All employer contributions were equal to the required contribution rates for the year. Contributions as a percentage of statewide contributions were not available for June 30, 2003.

(Continued)

NOTE 10 - EMPLOYEE RETIREMENT SYSTEMS, Continued

A comprehensive annual financial report containing financial statements and required supplementary information for the South Carolina Retirement System is issued and publicly available by writing the South Carolina Retirement System, Post Office Box 11960, Columbia, South Carolina 29211-1960.

NOTE 11 - CONTINGENCIES

The SCEL 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 SCEL for the year ending June 30, 2003.

***SOUTH CAROLINA EDUCATION LOTTERY
SUPPLEMENTARY SCHEDULE OF BUSINESS-TYPE
ACTIVITIES FOR THE STATEWIDE CAFR
For the year ended June 30,***

	<u>2003</u>	<u>2002</u>
Charges for services	\$ 726,909,530	\$ 337,149,060
Operating grants and contributions	223,287	60,592
Less expenses	<u>507,843,846</u>	<u>249,488,249</u>
Net program revenue	219,288,971	87,721,403
Transfers out to state agencies/funds	<u>(220,056,527)</u>	<u>(81,145,294)</u>
Change in net assets	(767,556)	6,576,109
NET ASSETS - BEGINNING	<u>6,576,109</u>	<u>-</u>
NET ASSETS - ENDING	<u>\$ 5,808,553</u>	<u>\$ 6,576,109</u>



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**INDEPENDENT AUDITOR'S 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 Commission
of the *South Carolina Education Lottery*

We have audited the financial statements of the *South Carolina Education Lottery* (the SCEL), a component unit of the State of South Carolina, as of and for the year ended June 30, 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 SCEL's financial statements are free of material misstatement, we performed tests of 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 SCEL's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. 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 audit committee, management of the SCEL and the State Auditor of Public Accounts of South Carolina and is not intended to be and should not be used by anyone other than these specified parties.

Elliott Davis LLC

August 22, 2003

SOUTH CAROLINA EDUCATION LOTTERY
SCHEDULE OF FINDINGS
For the year ended June 30, 2003

SCHEDULE OF AUDITOR'S RESULTS

We have issued an unqualified opinion, dated August 22, 2003 on the financial statements of the South Carolina Education Lottery as of and for the year ended June 30, 2003.

Our audit disclosed no instances of noncompliance which are material to the South Carolina Education Lottery's financial statements.

Our audit disclosed no reportable conditions or material weaknesses relating to the audit of the financial statements.

FINDINGS RELATING TO THE FINANCIAL STATEMENTS

Our audit disclosed no findings which are required to be reported in accordance with *Government Auditing Standards*.