

**NEW MEXICO LOTTERY
AUTHORITY**

FINANCIAL STATEMENTS

June 30, 2006

New Mexico Lottery Authority

OFFICIAL ROSTER

June 30, 2006

BOARD OF DIRECTORS

Reta Jones, CPA	Chairman
Cody K. Kelley	Vice-Chairman
Nino Trujillo	Secretary
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OFFICIALS OF THE NEW MEXICO LOTTERY AUTHORITY

Tom Romero	Interim Chief Executive Officer*
Tom Romero	Executive Vice President of Security*
Victor Leon	Vice President of Management Information Systems
Vacant	Vice President of Sales
Sylvia Ann Jaramillo, CPA	Director of Finance
Evelyn McKnight	Director of Human Resources
Adriana Binns	Director of Marketing/ Communications
Vince Torrez	Director of Security
Mary Kranz, CPA	Internal Auditor

* - effective August 1, 2006 Tom Romero was appointed Chief Executive Officer by the Board of Directors and vacated the position of Executive Vice President of Security.

ORGANIZATIONAL DIVISIONS OF THE NEW MEXICO LOTTERY AUTHORITY

The Executive Division, under the direction of the Chief Executive Officer, provides leadership for all activities of the New Mexico Lottery Authority (the Lottery) to carry out its objectives and overall statutory mission to maximize net revenues for the Lottery's beneficiaries. The Division establishes and directs the organization's day-to-day operating strategy and plan. In addition, the Division performs as a liaison between the Board, the Governor, the Legislature, governmental entities, external providers of goods and services, retailers, the public and Lottery Departments and employees.

The Finance Department, under the direction of the Director of Finance, performs all the activities associated with the financial and accounting functions of the Lottery, including the general ledger; cash management; retailer accounts receivable and debt collection; fixed asset accounting; game accounting; payroll and benefit accounting, payment, and review; and tax reporting and payment. In addition, the department provides financial reporting, disclosure, and compliance with generally accepted accounting practices and budget compilation, including the quarterly and annual financial reporting of revenues, expenses, and net revenues to the state; the financial audit and related compilation of financial statements, related notes, and the Management Discussion and Analysis (MDA) for the fiscal year; the statutorily required annual proposed operating budget for the Lottery for the succeeding fiscal year and the final proposed budget for Board of Directors' approval. Furthermore, the department is responsible for the procurement of materials and services; claims center payment of prizes and sales of tickets; and accounts payable.

The Human Resources Department, under the direction of the Director of Human Resources, oversees the development and implementation of human resources policies, programs and services, including recruitment, selection, retention, legal compliance, employee benefits, payroll processing, employee insurance reconciliation, employee relations, employment practices and procedures, employee communications and employee events.

The Internal Audit Department, under the direction of the Internal Auditor, conducts and coordinates comprehensive audits for all aspects of the lottery as spelled out in the New Mexico Lottery Act. Audits are carried out pursuant to an annual audit plan that is approved by the Board of Directors.

The Marketing and Communications Department, under the direction of the Director of Marketing and Communications, is responsible for implementing, managing and administering the activities associated with marketing the Lottery and its products, including advertising, communications, television drawings, promotions and special events. This entails creating and producing multi-media advertising campaigns, in-store point of sale materials and player and retailer publications; as well as negotiating and overseeing the Lottery's participation in a number of statewide promotions and special events. The department is also responsible for all aspects of corporate communications including creating news releases and annual reports and responding to requests for information by the public and the media.

ORGANIZATIONAL DIVISIONS OF THE NEW MEXICO LOTTERY AUTHORITY - CONTINUED

The MIS Division, under the direction of the Vice President of MIS, performs all the activities associated with the systems and data processing functions of the Lottery, including instant ticket transaction processing, back office functionality, order and distribution systems, financial applications, retailer network support, and game management.

The Sales Division, under the direction of the Vice President of Sales, is responsible for developing and implementing all sales activities and programs for the Lottery, including retailer visits, customer relations, ticket sales, point of sales material distribution, retailer installations, promotional and event participation and preparation, as well as maximizing sales initiatives.

The Security Division, under the direction of the Executive Vice President of Security, statutorily as a law enforcement agency is responsible for administering, enforcing and ensuring compliance with the security provisions of the New Mexico Lottery Act. The Division conducts backgrounds of all prospective employees, lottery retailers, lottery vendors and lottery contractors. It also supervises ticket verification and Lottery drawings and conducts drawings when the prize amount is more than \$5,000. The Division functions as liaison between the Attorney General's Office, District Attorney Offices and Law Enforcement agencies in general. It is also responsible for building and employee security and safety. The warehouse component of the Security Division is responsible for the packing and shipment of the Lottery's instant scratcher tickets and for the maintenance and shipping of Lottery premium and point of sale items. The Division is responsible for the management of building and grounds maintenance.

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MOSS ADAMS LLP

Independent Auditors' Report

Board of Directors
New Mexico Lottery Authority
and
Mr. Domingo Martinez, CGFM
New Mexico State Auditor

We have audited the accompanying basic financial statements of the State of New Mexico Lottery Authority (Lottery) and its fiduciary fund, a component unit of the State of New Mexico, as of and for the year ended June 30, 2006, as listed in the table of contents. We have also audited the budgetary to actual statement presented as supplementary information. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audit. The basic financial statements of the State of New Mexico Lottery Authority for the year ended June 30, 2005, were audited by Neff + Ricci LLP, who combined with Moss Adams LLP as of January 1, 2006 and whose report dated September 9, 2005 expressed unqualified opinions on those statements.

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

In our opinion, the basic financial statements and its fiduciary fund referred to above present fairly, in all material respects, the financial position of the Lottery and its fiduciary fund as of June 30, 2006, and the changes in its financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the budgetary to actual statement referred to above presents fairly, in all material respects, the budgetary comparison for the year ended June 30, 2006 in conformity with accounting principles generally accepted in the United States of America.

Board of Directors
New Mexico Lottery Authority
and
Mr. Domingo Martinez, CGFM
New Mexico State Auditor

In accordance with *Government Auditing Standards*, we have also issued a report dated September 1, 2006 on our consideration of the Lottery's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. 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 assessing the results of our audit.

The accompanying management's discussion and analysis is not a required part of the basic financial statements but is supplementary information required by the Government 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.

Mess Adams LLP

Albuquerque, New Mexico
September 1, 2006

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

This Management's Discussion and Analysis of the New Mexico Lottery Authority (the Lottery), offers readers of the Lottery's financial statements a narrative overview and analysis of the financial activities of the Lottery for the fiscal years ended June 30, 2006 and 2005 with comparative numbers for fiscal year 2004. Please read it in conjunction with the financial statements, which begin on page 18.

FINANCIAL HIGHLIGHTS

- In fiscal year 2006 the Lottery's total current assets increased by 17.6% or \$1,180,400 in comparison to fiscal year 2005 and decreased by \$883,563 (11.6%) in fiscal year 2005 from the previous year.
- The Lottery's total current liabilities increased by 17.2% or \$1,248,835 at the end of fiscal year 2006 and decreased by \$989,160 (12.0%) at the end of fiscal year 2005.
- In fiscal year 2006 total revenues were \$150,042,400, an increase of 11.6%, \$15,573,238, compared to fiscal year 2005. In fiscal year 2005 total revenues were \$134,469,162, a reduction of \$7,848,003 (5.5%) in comparison to the previous fiscal year.
- From the previous fiscal year, total game expenses increased by \$11,258,293 or 11.6% in fiscal year 2006, whereas, in fiscal year 2005, total game expenses decreased by \$4,407,834 (4.3%).
- In fiscal year 2006 total operating expenses decreased by \$49,628 (0.9%) compared to the previous fiscal year, while in fiscal year 2005 total operating expenses increased by 4.9% or \$259,383 from the previous fiscal year.
- Total non-operating income improved by \$260,466 or 95.1% in fiscal year 2006. Fiscal year 2005 had a small decrease in total non-operating income of \$6,326 (2.3%) in comparison to fiscal year 2004.
- Net Income was \$36,855,556 in fiscal year 2006. This was an increase of \$4,625,039, 14.3%, in comparison to net income of \$32,230,517 in fiscal year 2005, a decrease of \$3,705,878 (10.3%) from the previous fiscal year.
- Including the final transfer of fiscal year 2006 net revenues on July 28, 2006, the Lottery has transferred \$286,058,908 to the State of New Mexico since the commencement of sales in April 1996.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

OVERVIEW OF THE FINANCIAL STATEMENTS

The Lottery was established in 1995 as a public body, politic and corporate, separate and apart from the State of New Mexico and constituting a governmental instrumentality and therefore, is accounted for as such, reporting all of the Lottery's assets and liabilities using the accrual basis of accounting much like any private-sector business entity.

This report consists of three parts—Management's Discussion and Analysis (this section), the basic financial statements, including the notes to financial statements, and required supplementary information, the Budget to Actual Comparison Statements.

Financial Statements. The Statements of Net Assets on Page 18 and the Statements of Revenues, Expenses, and Changes in Net Assets on page 19 report the Lottery's assets, liabilities, revenues and expenses in comparative format for fiscal year 2006 and fiscal year 2005. The Statements of Cash Flows on pages 20 and 21 report the sources and uses of cash for fiscal years 2006 and 2005. The Statements of Fiduciary Net Assets on page 22 and Statements of Changes in Fiduciary Net Assets on page 23 report the balances and activity of the Lottery's Retirement Plan for fiscal years 2006 and 2005.

Notes to Financial Statements. The Notes to Financial Statements on pages 24 to 37 provide additional information that is essential for a full understanding of the financial statements and provide more detailed data.

Budget to Actual Comparison Statements. The Budget to Actual Comparison Statements on page 38 shows the variances between the budgets and actual Lottery performance.

To assess the Lottery's financial position and financial health, the reader of these statements should pay particular attention to changes in the components of assets and liabilities as set forth in the Statements of Net Assets; in changes in total revenues, game expenses, operating expenses, non-operating income and net income as set forth in the Statements of Revenues, Expenses, and Changes in Net Assets; and in the sources and uses of cash as set forth in the Statements of Cash Flows.

FINANCIAL ANALYSIS

Total Net Assets

The assets of the Lottery exceeded its liabilities at the close of fiscal year 2006 and 2005 by \$50,000 (net assets), which is the amount of the 2% reserve fund that may be retained by the Lottery in accordance with the New Mexico Lottery Act. (Chapter 6, Article 24 NMSA 1978)

In fiscal years 2006 and 2005, the Lottery set aside and expended \$1,071,934 and \$767,634, respectively, in the 2% reserve fund. In the two fiscal years, respectively, \$766,491 and \$563,725 were set aside and expended for bonuses and incentives for retailers, \$122,054 and \$122,789 for responsible gaming advertising, \$81,120 each year for a responsible gaming hotline, \$63,262 and \$0 for special promotions, \$38,984 and \$0 for integrity, and \$23 and \$0 for clerk incentives, all in accordance to the specified purposes per the Act, and leaving a balance of \$50,000 in the 2% reserve fund.

New Mexico Lottery Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) – CONTINUED

OVERVIEW OF THE FINANCIAL STATEMENTS - CONTINUED

Assets

Table 1

Assets

	2006	2005	2004	Increase (Decrease) \$ Change 2005 to 2006	Increase (Decrease) % Change 2005 to 2006	Increase (Decrease) \$ Change 2004 to 2005	Increase (Decrease) % Change 2004 to 2005
Cash	\$ 4,574,650	\$ 3,520,285	\$ 3,049,084	\$ 1,054,365	30.0%	\$ 471,201	15.5%
Accounts receivable, net	837,420	763,744	1,751,903	73,676	9.6	(988,159)	(56.4)
Reserves on deposit	2,339,765	2,281,913	2,667,769	57,852	2.5	(385,856)	(14.5)
Inventory	15,932	16,135	17,377	(203)	(1.3)	(1,242)	(7.1)
Prepaid expenses	<u>120,082</u>	<u>125,372</u>	<u>104,879</u>	<u>(5,290)</u>	(4.2)	<u>20,493</u>	19.5
Total current assets	7,887,849	6,707,449	7,591,012	1,180,400	17.6	(883,563)	(11.6)
Capital assets, net	<u>658,169</u>	<u>695,825</u>	<u>942,876</u>	<u>(37,656)</u>	(5.4)	<u>(247,051)</u>	(26.2)
Total assets	<u>\$ 8,546,018</u>	<u>\$ 7,403,274</u>	<u>\$ 8,533,888</u>	<u>\$ 1,142,744</u>	15.4	<u>\$ (1,130,614)</u>	(13.2)

The Lottery's cash balance at the end of fiscal year 2006 was \$1,054,365 or 30% more than at the end of fiscal year 2005. This increase related to an increase of over \$1,000,000 in prizes accrued for the Lottery's games at the end of fiscal year 2006.

Accounts receivable from the Lottery's retailers are collected weekly through electronic bank transfers. Receivables are equal to sales by retailers net of any prizes paid by the retailers and any commissions earned. The change in accounts receivable between fiscal year 2006 and 2005 was not significant, less than \$75,000. Accounts receivable decreased by almost \$1,000,000 between fiscal year 2005 and the previous year. In fiscal year 2005 the amount due from retailers for the previous week was collected on the final day of the year increasing the cash balance at year-end and, therefore, leaving only a few days of receivables on June 30, 2005.

The Lottery has reserves on deposit with the Multi-State Lottery Association (MUSL) as required by the Powerball game rules. The change in these reserve amounts in fiscal year 2006 was less than \$60,000 and mainly due to the interest earned on these deposits less the cost of membership in MUSL and in the Powerball game. In fiscal year 2005 the reserve decreased by almost \$400,000, due to MUSL reallocating the reserve accounts

New Mexico Lottery Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Assets - Continued

Under a contract signed by the Lottery with its ticket printer in March 2003 instant tickets are owned by the vendor with the Lottery having an obligation to pay for the tickets when the tickets are sold. Thus, during the last few years the inventory has declined as the tickets owned by the Lottery were sold and replaced by tickets printed under this contract. In fiscal years 2006 and 2005 only one game owned by the Lottery remains in inventory.

As part of the contract with the ticket printer, the Lottery implemented a customer relationship management (CRM) system in June 2004. This CRM system has assisted the Lottery in more effectively managing its ticket inventory at retailer locations. The cost of this system was reflected in capital assets in fiscal year 2006 and 2005. The related liability for the CRM system was included in current portion of capital lease obligation (\$106,091 in fiscal year 2006 and \$141,454 in fiscal year 2005) and in non-current portion of capital lease obligation at June 30, 2005 (\$106,091). There was no non-current amount due in fiscal year 2006. There were no significant changes in capital assets in fiscal year 2006.

Liabilities

Table 2
Liabilities

	2006	2005	2004	Increase (Decrease) \$ Change 2005 to 2006	Increase (Decrease) % Change 2005 to 2006	(Decrease) \$ Change 2004 to 2005	(Decrease) % Change 2004 to 2005
Accounts pay- able and other current liabilities	\$ 2,225,990	\$ 1,945,181	\$ 2,304,373	\$ 280,809	14.4%	\$ (359,192)	(15.6%)
Current portion of capital lease Obligation	106,091	141,454	141,454	(35,363)	(25.0)	-	-
Prizes payable	3,495,708	2,468,569	3,057,302	1,027,139	41.6	(588,733)	(19.3)
Due to lottery tuition fund	<u>2,668,229</u>	<u>2,691,979</u>	<u>2,733,214</u>	<u>(23,750)</u>	(0.9)	<u>(41,235)</u>	(1.5)
Total current Liabilities	8,496,018	7,247,183	8,236,343	1,248,835	17.2	(989,160)	(12.0)
Noncurrent por- tion of capital lease obligation	<u>-</u>	<u>106,091</u>	<u>247,545</u>	<u>(106,091)</u>	(100.0)	<u>(141,454)</u>	(57.1)
Total liabilities	<u>\$ 8,496,018</u>	<u>\$ 7,353,274</u>	<u>\$ 8,483,888</u>	<u>\$ 1,142,744</u>	15.5	<u>\$ (1,130,614)</u>	(13.3)

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Liabilities - Continued

Accounts payable and other current liabilities were \$280,809 higher in fiscal year 2006 than in fiscal year 2005. This difference between the two years was mainly attributable to the amount owed to MUSL for the Lottery's share of Powerball prizes at the end of fiscal year 2006 compared to fiscal year 2005. This was due to sales being higher for Powerball for the last few weeks of fiscal year 2006 than for the same time period in fiscal year 2005. In fiscal year 2005 accounts payable decreased by over \$359,000 from the previous year. This change also was mainly attributable to owing MUSL more in fiscal year 2004 than fiscal year 2005.

Prizes payable is mainly comprised of amounts accrued based on the Lottery's game designs and prize structures for on-line and instant game prizes, the related unremitted federal and state taxes withheld on prizes claimed, and any unclaimed prizes in the prize fund. At the end of fiscal year 2006 prizes payable increased by over one million dollars. This difference relates to about one million dollars more of unclaimed prizes (\$1,243,493) being carried over for planned use in the game design and prize structures of Lottery games in fiscal year 2007. In fiscal year 2005 prizes payable was less than in the previous fiscal year by nearly \$600,000. The change in fiscal year 2005 was related to a decrease in the amount of unclaimed prizes remaining in the prize fund at the end of fiscal year 2005 compared to the amount at the end of fiscal year 2004 netted against an increase in prizes payable on instant tickets at the end of fiscal year 2005 compared to the end of the previous year.

At the end of fiscal years 2006 and 2005, \$2,668,229 and \$2,691,979, respectively, of net revenues for the month of June were due to the Lottery Tuition Fund. These funds were transferred to the New Mexico State Treasurer on July 28, 2006 and July 29, 2005, respectively.

New Mexico Lottery Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS – CONTINUED

Sales and Prize Expense

Table 3
Sales and Prize Expense

	2006		
	Sales	Prize Expense	Gross Margin
Instant ticket	\$ 89,367,670	\$ 51,253,084	\$ 38,114,586
Powerball	54,113,990	27,093,452	27,020,538
Roadrunner Cash	8,347,282	4,669,830	3,677,452
Pick 3	2,009,560	1,159,915	849,645
4 This Way!	769,985	450,175	319,810
Total	<u>\$ 154,608,487</u>	<u>\$ 84,626,456</u>	<u>\$ 69,982,031</u>
	2005		
	Sales	Prize Expense	Gross Margin
Instant ticket	\$ 90,840,412	\$ 51,178,563	\$ 39,661,849
Powerball	36,259,131	18,129,565	18,129,566
Roadrunner Cash	9,183,278	5,108,760	4,074,518
Pick 3	2,063,825	1,241,345	822,480
4 This Way!	892,155	515,630	376,525
Total	<u>\$ 139,238,801</u>	<u>\$ 76,173,863</u>	<u>\$ 63,064,938</u>
	2004		
	Sales	Prize Expense	Gross Margin
Instant ticket	\$ 87,019,208	\$ 47,573,559	\$ 39,445,649
Powerball	51,473,388	25,678,962	25,794,426
Roadrunner Cash	8,067,945	4,374,916	3,693,029
Pick 3	2,091,054	1,248,125	842,929
Total	<u>\$ 148,651,595</u>	<u>\$ 78,875,562</u>	<u>\$ 69,776,033</u>
\$ Increase from FY 2005 to FY 2006	<u>\$ 15,369,686</u>	<u>\$ 8,452,593</u>	<u>\$ 6,917,093</u>
% Increase from FY 2005 to FY 2006	<u>11.0%</u>	<u>11.1%</u>	<u>11.0%</u>
\$ Decrease from FY 2004 to FY 2005	<u>\$ (9,412,794)</u>	<u>\$ (2,701,699)</u>	<u>\$ (6,711,095)</u>
% Decrease from FY 2004 to FY 2005	<u>(6.3%)</u>	<u>(3.4%)</u>	<u>(9.6%)</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS – CONTINUED

Sales and Prize Expense – Continued

Table 3 compares sales, prize expense and gross margin (sales minus prize expense) for each lottery game for fiscal year 2006 and fiscal year 2005. Sales, prize expense and gross margin increased for Powerball in fiscal year 2006, but decreased for Roadrunner Cash, and 4 This Way. Sales and gross margin decreased for instant tickets, but prize expense went up in fiscal year 2006. Sales and prize expense also decreased for Pick 3, but gross margin increased in fiscal year 2006. Sales, prize expense and gross margin increased in fiscal year 2005 for Instant tickets and Roadrunner Cash and decreased for Powerball and Pick 3. The new game, 4 This Way!, added almost \$770,000 and \$900,000 to sales in fiscal years 2006 and 2005, respectively.

Sales

In both fiscal years 2006 and 2005 the Lottery used the new customer relationship management (CRM) system for placing instant tickets at retailer locations. The Lottery's customer service representatives placed calls to each retailer location, reviewed the inventory at each location with the retailer, and placed orders continually as needed based on the inventory turnover at that location. In fiscal year 2006 fifty-four instant ticket games were launched—20-\$1, 16-\$2, 8-\$3, 7-\$5, and 3-\$10 games—one less \$1 game, three more \$2, one more \$3, one more \$5 and one less \$20 games than in fiscal year 2005. In fiscal year 2005 the Lottery launched one more \$5 ticket game, one more \$10 ticket game and for the first time a \$20 ticket game compared to the previous fiscal year. In fiscal year 2006 the Lottery launched 25 games with prize tickets and 29 games without prize tickets, while in fiscal year 2005 the Lottery launched 27 games with prize tickets and 24 games without prize tickets. Sales for each of the first five months of fiscal year 2006 were more than in the previous year, but during each of the last seven months of the year, sales were less than in the previous fiscal year.

Powerball sales are generally driven by the advertised jackpot. In fiscal year 2006 there were two jackpots over 300 million dollars. The first jackpot run-up ended in October 2005 at 340 million dollars and the second jackpot run-up went to 365 million dollars in February 2006. There was also a jackpot that rose to 224.2 million dollars in April and three other jackpot run-ups in the year that went over \$100 million each. These jackpot run-ups contributed to Powerball sales being almost eighteen million dollars more than in fiscal year 2005. In fiscal year 2005 there were only 3 jackpots that increased to more than 100 million dollars. Therefore, sales in fiscal year 2005 did not reach the level of sales in the prior fiscal year where there were two jackpots that exceeded 200 million dollars and one that climbed to almost 191 million dollars.

Similar to Powerball, Roadrunner Cash sales are driven by the top prize amount. In fiscal year 2006 the top prize went to more than \$150,000 eight times climbing only once to \$390,000 in December 2005 and twice to over \$200,000 in August 2005 and March 2006. In fiscal year 2005 the top prize went over \$150,000 nine times climbing to \$340,000 in October 2004, to \$400,000 in March 2005 and to \$303,000 in April 2005. At the beginning of fiscal year 2004 the top prize started at \$15,000, increasing each drawing based on sales until the top prize was won. In October 2003 the top prize was changed to start at \$20,000 rather than

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Sales and Prize Expense - Continued

Sales – Continued

\$15,000. In fiscal year 2004 the top prize exceeded \$150,000 five times, climbing once to \$325,000 in February 2004 and once to \$362,000 in March 2004. Because of these differences in the top prizes during these fiscal years, sales were higher in fiscal year 2005 than in either fiscal year 2006 or 2004.

Pick 3 sales decreased by over \$54,000 and \$27,000 in fiscal years 2006 and 2005, respectively. Some of the decrease can be attributable to adding 4 This Way! in fiscal year 2005. 4 This Way!, contributed almost \$770,000 and \$900,000, respectively, in incremental sales in fiscal years 2006 and 2005.

Prize Expense

Prize expense for on-line games with a rolling jackpot or a top prize is based on the overall prize payout per the game design, while prize expense for the other two on-line games is determined by the prizes won for each drawing. The prizes included in each instant game printed determine prize expense for instant games. In general, prize expense increases or decreases from year-to-year relative to the increases or decreases in sales for each Lottery product. In fiscal year 2006, prize expense increased as a result of the increase in sales, while in fiscal year 2005, prize expense decreased as a result of the decline in sales. The overall prize percentage for prize expense, though, was just about .03% and 1.65% more in fiscal years 2006 and 2005, respectively, than in the previous fiscal years.

At the end of the claim period for each game, unclaimed prizes for the Lottery's instant games and on-line games are paid into the "Prize Fund," in accordance with the New Mexico Lottery Act. These unclaimed prizes from the Lottery's prize fund are used to supplement the prizes in instant and on-line games and for second chance drawings and, therefore, reduce the prize expense for Lottery products.

Prize Tickets

In fiscal years 2006 and 2005, prize tickets decreased in instant games by \$208,522 (4.4%) and \$1,550,374 (24.64%), respectively. Prize tickets are placed in the prize structure of the game in lieu of the breakeven prizes. Prize tickets give a player a prize of another instant game ticket of the same price as the instant ticket purchased. In the last few years the Lottery has been studying the market to determine the optimum quantity of prize tickets to place each fiscal year in its instant ticket games.

New Mexico Lottery Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS – CONTINUED

Game Expenses

Table 4
Game Expenses

	2006	2005	2004	Increase (Decrease) \$ Change 2005 to 2006	Increase (Decrease) % Change 2005 to 2006	Increase (Decrease) \$ Change 2004 to 2005	Increase (Decrease) % Change 2004 to 2005
Prize expense	\$ 84,626,456	\$ 76,173,863	\$ 78,875,562	\$ 8,452,593	11.1%	\$ (2,701,699)	(3.4%)
Retailer							
commissions	9,859,881	8,938,622	10,131,112	921,259	10.3	(1,192,490)	(11.8)
On-line vendor							
fees	7,414,912	5,875,866	6,997,562	1,539,046	26.2	(1,121,696)	(16.0)
Advertising	2,816,695	2,566,777	2,494,471	249,918	9.7	72,306	2.9
Ticket vendor							
fees	1,282,575	1,351,089	1,236,725	(68,514)	(5.1)	114,364	9.2
Other game							
expenses	<u>2,208,110</u>	<u>2,044,119</u>	<u>1,622,738</u>	<u>163,991</u>	8.0	<u>421,381</u>	26.0
Total game							
expenses	<u>\$ 108,208,629</u>	<u>\$ 96,950,336</u>	<u>\$ 101,358,170</u>	<u>11,258,293</u>	11.6	<u>\$ (4,407,834)</u>	(4.3)

Retailer commissions are paid to the Lottery's retailers for selling Lottery tickets and cashing Lottery prizes. In addition, retailers are paid quarterly incentives for meeting pre-determined sales goals and marketing the Lottery's products with point of sale advertising and display. In fiscal years 2006 and 2005, the Lottery budgeted these quarterly incentives in the 2% Reserve line item instead of as part of retailer commissions as in previous fiscal years. The New Mexico Lottery Act allows the Lottery to set aside, as a reserve fund, up to two percent of the gross annual revenues for incentive plans for lottery retailers. Thus in fiscal years 2006 and 2005, these quarterly incentives are shown in the other game expenses above. The changes in retailer commissions for fiscal years 2006 and 2005 are consistent with the changes in gross ticket sales for the two years.

On-line vendor fees are made up of two fees that are paid to the provider of the Lottery's on-line gaming system. One fee is paid as a percentage of on-line sales. The other fee is a weekly communication fee paid for each retailer's sales terminal. Normally, the on-line fee increases or decreases as on-line sales increase or decrease and the communication fee increases or decreases depending on the number of sales terminals located at the Lottery's retailer locations. The changes in the on-line vendor fees for the two fiscal years are consistent with the changes in sales in 2006 and 2005.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS – CONTINUED

Game Expenses – Continued

Advertising is expended to market the lottery and its products to the public and to inform the public about the games available, the jackpot and top prize amounts on the on-line games, and to keep the lottery products fresh in the public's minds, all in order to promote sales. Advertising cost to operating revenues in fiscal year 2006 and 2005 are consistent with each other at about 1.88% and 1.91%, respectively.

In fiscal year 2003 the Lottery signed a new contract with its ticket printer effective in March 2003. Under this new contract the instant tickets are owned by the vendor with the Lottery paying for the tickets as a percentage of sales when the tickets are sold. The cost for the tickets under this new contract also included a cost for the CRM system and in fiscal year 2006 the allocated cost for maintenance on the system. The ticket vendor fees for fiscal years 2006 and 2005, thus, are consistent with each other based on the contract prices less the amounts allocated to the CRM system and related maintenance.

Included in other game expenses are the 2% reserve fund expense, promotions, shipping and postage, instant ticket vending machine lease, drawing game and game membership expenses. The expenses primarily contributing to the increase of other game expenses in fiscal year 2006 and 2005 was the change of the quarterly retailer incentives to the 2% reserve fund during these two years, as explained earlier in this report, plus additional sales in fiscal year 2006 earning retailers higher incentives during the year netted against the decreases in the cost of the instant ticket vending machine lease and miscellaneous changes in the other expense line items. (See page 4, Total Net Assets, for an explanation of the expenditures of amounts set aside in the 2% reserve fund.)

New Mexico Lottery Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Operating Expenses

Table 5
Operating Expenses

	2006	2005	2004	Increase (Decrease) \$ Change 2005 to 2006	Increase (Decrease) % Change 2005 to 2006	Increase \$ Change 2004 to 2005	Increase % Change 2004 to 2005
Salaries, wages, and benefits	\$ 3,644,557	\$ 3,640,793	\$ 3,581,334	\$ 3,764	0.1%	\$ 59,459	1.7%
Leases and insurance	636,560	616,968	599,606	19,592	3.2	17,362	2.9
Other operating expenses	<u>1,231,389</u>	<u>1,304,373</u>	<u>1,121,811</u>	<u>(72,984)</u>	(5.6)	<u>182,562</u>	16.3
Total operating expenses	<u>\$ 5,512,506</u>	<u>\$ 5,562,134</u>	<u>\$ 5,302,751</u>	<u>\$ (49,628)</u>	(0.9)	<u>\$ 259,383</u>	4.9

The operating expenses between the fiscal years above are comparable to each other. Other operating expenses include depreciation and amortization, utilities and maintenance, professional fees, materials and supplies, travel, and other expenses. In fiscal year 2006 utilities and maintenance was greater than in the previous fiscal year because \$17,000 more was expended on vehicle gas and maintenance costs and about \$35,000 was allocated to the cost of maintenance on the CRM system from the contract for the printing of tickets and related services. During fiscal year 2006 more than \$118,000 of savings were achieved in professional fees, materials and supplies, travel, and other expenses in comparison to fiscal year 2005. The increase in other operating expenses for fiscal year 2005 in comparison to fiscal year 2004 are related to the amortization of the CRM system implemented in June 2004 and to the additional expenses in professional fees for a SAS 70 audit on the on-line vendor's data processing center and for management information systems consulting fees.

Non-Operating Income

Non-operating income increased by over 95% or over \$260,000 in fiscal year 2006, but decreased by \$6,326 (2.3%) in fiscal year 2005. The increase in fiscal year 2006 related mainly to interest income earned. In fiscal year 2006 the earnings were better because of negotiation for higher rates between the Lottery and its new bank.

New Mexico Lottery Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Net Income

	<u>Total Revenues</u>	<u>Net Income</u>
Fiscal Year 2006	<u>\$ 150,042,400</u>	<u>\$ 36,855,556</u>
Fiscal Year 2005	<u>134,469,162</u>	<u>32,230,517</u>
Fiscal Year 2004	<u>142,317,165</u>	<u>35,936,395</u>
Increase from FY 2005 to FY 2006	<u>\$ 15,573,238</u>	<u>\$ 4,625,039</u>
% Increase from FY 2005 to FY 2006	<u>11.6%</u>	<u>14.3%</u>
Decrease from FY 2004 to FY 2005	<u>\$ (7,848,003)</u>	<u>\$ (3,705,878)</u>
% Decrease from FY 2004 to FY 2005	(5.5%)	(10.3%)

The changes in net income for fiscal years 2006 and 2005 were mainly related to the changes in sales for the Lottery's games during the two years netted against cost savings in select game expense line items and operating expense line items during the two fiscal years.

New Mexico Lottery Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Budgetary Comparison

	2006				
	Original Budget	Final Budget	Actual	Variance with Final Budget	% Variance with Final Budget
Total revenues	\$ 146,150,000	\$ 147,428,000	\$ 150,042,400	\$ 2,614,400	1.8%
Total game expenses	106,139,000	106,888,000	108,208,629	1,320,629	1.2
Total operating expenses	6,333,000	5,854,000	5,512,506	(341,494)	(5.8)
Operating income	33,678,000	34,686,000	36,321,265	1,635,265	4.7
Total non-operating income	226,000	442,000	534,291	92,291	20.9
Net income before transfers to					
Lottery Tuition Fund	\$ 33,904,000	\$ 35,128,000	\$ 36,855,556	\$ 1,727,556	4.9

	2005				
	Original Budget	Final Budget	Actual	Variance with Final Budget	% Variance with Final Budget
Total revenues	\$ 143,851,000	\$ 134,976,000	\$ 134,469,162	\$ (506,838)	(0.4%)
Total game expenses	103,031,000	97,117,000	96,950,336	(166,664)	(0.2)
Total operating expenses	6,285,000	5,880,000	5,562,134	(317,866)	(5.4)
Operating income	34,535,000	31,979,000	31,956,692	(22,308)	(0.1)
Total non-operating income	228,000	221,000	273,825	52,825	23.9
Net income before transfers to					
Lottery Tuition Fund	\$ 34,763,000	\$ 32,200,000	\$ 32,230,517	\$ 30,517	0.1

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Budgetary Comparison - Continued

In general, total revenues and game expenses for fiscal years 2006 were higher than the final budget due to Powerball sales achieving more than 108% of its budget, while in fiscal year 2005 total revenues and game expenses were under budget mainly due to Powerball sales for the year achieving only 90% of its final budget amount. In fiscal year 2006 Instant ticket, Roadrunner Cash and 4 This Way! achieved slightly less than 100% of the budget, while Pick 3 went slightly over budget. In fiscal year 2005 Instant ticket, Roadrunner Cash and Pick 3 sales all were over 100% of their budgets. 4 This Way! added incremental sales in fiscal year 2005. Total operating revenue in fiscal year 2006 was slightly over the final budget at 101.8% with game expenses ending the year at 101.2% of its final budget. In fiscal year 2005 operating revenue achieved over 99.6% of its final budget for the year with game expenses also ending the year at about 99.8% of its budget.

In April 2006 the lottery revised its annual budget. At this time the Lottery increased its sales by about 1.3 million dollars and increased its net income by over 1.2 million dollars. The revision of the budget was made to reflect additional sales for the Lottery's games, adjust the related costs for these sales, decrease the budgeted costs on twelve expense line items and increase the cost on two line items, and adjust interest income for added amounts earned.

In April 2005 the Lottery revised its annual budget. At this time the Lottery decreased the budget for Powerball by 11.6 million dollars, but increased the budget for Instant tickets, Roadrunner Cash and Pick 3 by over 2 million dollars. Nine expense items in game expenses were also reduced along with seven expense items in operating expenses.

In fiscal year 2006 instant ticket sales exceeded the monthly budgeted sales for eight out of the twelve months of the year. Powerball and Roadrunner cash topped their monthly budgets during 6 months of the year, while Pick 3 surpassed its monthly budgets for 8 months of the year. 4 This Way! added incremental sales and only achieved the budget during one month of the year.

In fiscal year 2005 instant ticket sales exceeded the monthly budgeted sales for seven out of the twelve months of the year. Powerball and 4 This Way! sales topped their monthly budgets during only one month of the year. Roadrunner Cash and Pick 3 sales surpassed their budgets in eight out of the twelve months.

Game expenses, such as prize expense, retailer commissions, on-line vendor fees, and ticket printing, are directly affected by increases or decreases in sales and went up or down accordingly during the two fiscal years. Final operating expense amounts for the two years were less than budgeted amounts. Continual monitoring of divisional and departmental budgets kept operating expenses to about 94% of the final budgeted amounts for the two years, respectively. Non-operating income concluded the fiscal year at 120.9% and 123.9% of its final budget amounts for 2006 and 2005, respectively.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Subsequent Event

Effective August 1, 2006 the Lottery Board of Directors approved Tom Romero as CEO. Tom Romero has been the Executive Vice President of Security at the Lottery since February 1996. Upon his appointment as CEO, Mr. Romero vacated the position of Executive Vice President of Security. Mr. Romero had been appointed Interim CEO in November 2005 upon the resignation of Tom Shaheen.

In November 2006 the Lottery will launch a new MUSL on-line game called Hot Lotto. Each ticket will sell for \$1. Jackpots for Hot Lotto start at one million dollars and increase by a minimum of \$50,000. The jackpot can be taken as a 24-year (25 payments) annuity or as a lump sum cash payment. The matrix is 5/39 + 1/19 with odds of winning the jackpot at 1:10,939,383 and overall odds of winning at 1:16. Drawings are held on Wednesdays and Saturdays. Jackpots have averaged \$3.7 million since the game's introduction in April 2002.

Requests for Additional Financial Information

This financial report is designed to provide the executive and legislative branches of the State of New Mexico, the public, the Lottery's retailers, vendors, creditors, and other interested parties with a general overview of the financial position as of June 30, 2006 and 2005, and results of its operations, cash flows, and variances from budgets for the years then ended for the New Mexico Lottery Authority and to demonstrate the Lottery's accountability for the revenues it receives.

If you have any questions about this report or need additional financial information, contact the Director of Finance at the New Mexico Lottery Authority, P.O. Box 93130, Albuquerque, New Mexico 87199-3130.

New Mexico Lottery Authority

STATEMENTS OF NET ASSETS

June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
CURRENT ASSETS		
Cash	\$ 4,574,650	\$ 3,520,285
Accounts receivable (net of allowance for doubtful accounts)	837,420	763,744
Reserves on deposit	2,339,765	2,281,913
Inventory	15,932	16,135
Prepaid expenses	<u>120,082</u>	<u>125,372</u>
 Total current assets	 7,887,849	 6,707,449
 CAPITAL ASSETS, NET	 <u>658,169</u>	 <u>695,825</u>
 Total assets	 <u>\$ 8,546,018</u>	 <u>\$ 7,403,274</u>
 CURRENT LIABILITIES		
Accounts payable and other current liabilities	\$ 2,225,990	\$ 1,945,181
Current portion of capital lease obligation	106,091	141,454
Prizes payable	3,495,708	2,468,569
Due to lottery tuition fund	<u>2,668,229</u>	<u>2,691,979</u>
 Total current liabilities	 8,496,018	 7,247,183
 LONG-TERM LIABILITIES		
Noncurrent portion of capital lease obligation	<u>-</u>	<u>106,091</u>
 Total liabilities	 <u>\$ 8,496,018</u>	 <u>\$ 7,353,274</u>
 NET ASSETS		
Invested in capital assets, net of related debt	\$ 552,078	\$ 448,280
Net assets – restricted	50,000	50,000
Unrestricted net assets	<u>(552,078)</u>	<u>(448,280)</u>
 Total net assets	 <u>\$ 50,000</u>	 <u>\$ 50,000</u>

The accompanying notes are an integral part of these financial statements.

New Mexico Lottery Authority

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

Years ended June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
REVENUES		
Instant ticket sales	\$ 89,367,670	\$ 90,840,412
Powerball sales	54,113,990	36,259,131
Roadrunner Cash sales	8,347,282	9,183,278
Pick 3 sales	2,009,560	2,063,825
4 This Way! Sales	769,985	892,155
Retailer fees	47,180	42,618
Prize tickets	(4,533,193)	(4,741,715)
Spoiled, stolen, and promotional tickets	(80,074)	(70,542)
Total revenues	<u>150,042,400</u>	<u>134,469,162</u>
GAME EXPENSES		
Prize expense	84,626,456	76,173,863
Retailer commissions	9,859,881	8,938,622
On-line vendor fees	7,414,912	5,875,866
Advertising	2,816,695	2,566,777
Ticket vendor fees	1,282,575	1,351,089
Reserve Fund expense	1,071,934	767,634
Shipping and postage	370,751	359,250
Promotions	335,137	387,391
Instant ticket vending machine lease	275,940	331,750
Drawing game	94,264	124,994
Game membership	60,084	73,100
Total game expenses	<u>108,208,629</u>	<u>96,950,336</u>
OPERATING EXPENSES		
Salaries, wages, and benefits	3,644,557	3,640,793
Leases and insurance	636,560	616,968
Utilities and maintenance	440,678	380,152
Depreciation and amortization	409,138	424,025
Professional fees	191,021	240,687
Materials and supplies	68,397	85,835
Other	67,308	87,821
Travel	54,847	85,853
Total operating expenses	<u>5,512,506</u>	<u>5,562,134</u>
OPERATING INCOME	<u>36,321,265</u>	<u>31,956,692</u>
NON-OPERATING INCOME		
Interest income	394,225	133,058
Other income	140,066	140,767
Total non-operating income	<u>534,291</u>	<u>273,825</u>
Net income before transfers	36,855,556	32,230,517
Transfers to Lottery Tuition Fund	<u>(36,855,556)</u>	<u>(32,230,517)</u>
Change in net assets	-	-
Net assets at beginning of year	<u>50,000</u>	<u>50,000</u>
Net assets at end of year	<u>\$ 50,000</u>	<u>\$ 50,000</u>

The accompanying notes are an integral part of these financial statements.

New Mexico Lottery Authority

STATEMENTS OF CASH FLOWS

Years ended June 30, 2006 and 2005

Increase (Decrease) in Cash

	<u>2006</u>	<u>2005</u>
Cash flows from operating activities		
Cash received:		
From retailers-sales net of commissions, incentives, and prize, spoiled, and stolen ticket credits	\$ 140,108,843	\$ 126,518,699
Cash payments:		
To prize winners and related taxes	(71,482,341)	(65,935,366)
To suppliers of goods or services	(15,284,239)	(14,286,079)
To employees for services and related taxes	(3,100,369)	(3,031,448)
To MUSL	<u>(12,116,976)</u>	<u>(10,827,230)</u>
Net cash provided by operating activities	<u>38,124,918</u>	<u>32,438,576</u>
Cash flows from investing activities		
(Additions) deletions to MUSL Reserve Accounts	(22,648)	459,876
Receipts of interest	239,832	58,731
Receipts of rent	121,704	118,004
Other	<u>21,923</u>	<u>28,606</u>
Net cash provided by investing activities	<u>360,811</u>	<u>665,217</u>
Cash flows from noncapital financing activities		
Transfers to Lottery Tuition Fund	<u>(36,879,306)</u>	<u>(32,271,752)</u>
Cash flows from capital and related financing activities		
Purchases of capital assets	(410,604)	(219,386)
Principal payments under capital lease	<u>(141,454)</u>	<u>(141,454)</u>
Net cash used by related financing activities	<u>(552,058)</u>	<u>(360,840)</u>
NET INCREASE IN CASH	1,054,365	471,201
Cash at beginning of year	<u>3,520,285</u>	<u>3,049,084</u>
Cash at end of year	<u>\$ 4,574,650</u>	<u>\$ 3,520,285</u>

The accompanying notes are an integral part of these financial statements.

New Mexico Lottery Authority

STATEMENTS OF CASH FLOWS – CONTINUED

Years ended June 30, 2006 and 2005

	Increase (Decrease) in Cash	
	<u>2006</u>	<u>2005</u>
Reconciliation of operating income to net cash provided by operating activities		
Operating Income	\$ 36,321,265	\$ 31,956,692
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	409,138	424,025
Additional contributions (deletions) to MUSL Reserve Accounts	22,648	(459,876)
Interest on MUSL Unreserved Account	154,393	74,327
Vendor's non-cash transactions	(3,561)	(5,843)
Net changes in assets and liabilities:		
Accounts receivable	(73,676)	988,159
Reserves on deposit	(57,852)	385,856
Inventory	203	1,242
Prepaid expenses	5,290	(20,493)
Accounts payable and other liabilities	280,809	(359,192)
Accrued capital purchases	39,122	42,412
Prizes payable	<u>1,027,139</u>	<u>(588,733)</u>
Net cash provided by operating activities	<u>\$ 38,124,918</u>	<u>\$ 32,438,576</u>

The accompanying notes are an integral part of these financial statements.

New Mexico Lottery Authority

STATEMENTS OF FIDUCIARY NET ASSETS

June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
ASSETS		
Cash and equivalents	\$ 156,095	\$ 153,818
Marketable securities and other investments	2,553,177	2,125,894
Contribution receivable	<u>798</u>	<u>6,048</u>
Total assets	<u>\$ 2,710,070</u>	<u>\$ 2,285,760</u>
NET ASSETS		
Pension Plan participants' benefits	<u>\$ 2,710,070</u>	<u>\$ 2,285,760</u>

The accompanying notes are an integral part of these financial statements.

New Mexico Lottery Authority

STATEMENTS OF CHANGES IN FIDUCIARY NET ASSETS

Years ended June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
ADDITIONS		
Investment earnings	\$ 200,294	\$ 123,373
Employer contributions	348,742	335,483
Total additions	<u>549,036</u>	<u>458,856</u>
DEDUCTIONS		
Distributions to participants	124,712	146,428
Fees	14	-
Total deductions	<u>124,726</u>	<u>146,428</u>
Change in net assets	424,310	312,428
Net assets - beginning	<u>2,285,760</u>	<u>1,973,332</u>
Net assets - ending	<u><u>\$ 2,710,070</u></u>	<u><u>\$ 2,285,760</u></u>

The accompanying notes are an integral part of these financial statements.

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS

June 30, 2006 and 2005

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Reporting Entity

The financial reporting entity as defined by Governmental Accounting Standards Board (GASB) Statement 14, consists of the primary government, organizations for which the primary government is financially accountable, and other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete. This definition of the reporting entity is based primarily on the notion of financial accountability as the "cornerstone of all financial reporting in government".

With the enactment of the New Mexico Lottery Act (the Act) on July 1, 1995, the New Mexico Lottery Authority (the Lottery) was created as a public body, politic and corporate, separate and apart from the State of New Mexico and constituting a governmental instrumentality of the state. The Lottery was created and organized for the purpose of establishing and conducting the Lottery to provide revenues for the public purposes designated by the Act. The New Mexico Lottery was organized as an independent business enterprise separate from state government, self-sustaining and self-funded, without need for state revenues or resources and subject to oversight, audit, and accountability by public officials and agencies. However, since there is a financial benefit to the State's institutions of higher education, which are part of the State, the Lottery is considered a component unit of the State of New Mexico. The Lottery has no component units.

The Lottery commenced sales of instant tickets on April 27, 1996, and sales of on-line tickets on October 20, 1996.

2. Basis of Presentation

The financial statements are prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America.

In accordance with Governmental Accounting Standards Board (GASB) Statement Number 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Lottery has elected to follow all GASB pronouncements, and all Statements and Interpretations of the Financial Accounting Standards Board, Opinions of the Accounting Principles Board, Accounting Research Bulletins, and authoritative pronouncements of the American Institute of Certified Public Accountants, issued on or before November 30, 1989 (collectively representing the generally accepted private-sector accounting hierarchy in the United States of America). In instances where GASB guidance conflicts with private sector principles, the Lottery conforms to GASB.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2006 and 2005

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

2. Basis of Presentation - Continued

A Fiduciary Fund is used to account for assets held in a trustee capacity for Lottery employees. The Lottery's only fiduciary fund is a pension trust fund.

The pension trust fund (Note D) reflects the activities of the New Mexico Lottery Authority Retirement Plan (Plan) pursuant to a trust agreement with a national bank. The bank holds, invests and distributes the assets of the Plan for the benefit of the Plan participants, subject to the overall direction of the Lottery in its capacity as plan administrator.

The Lottery distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing goods and services in connection with the Lottery's principal ongoing operations. The principal operating revenues of the Lottery are sales of instant and on-line tickets. The Lottery also recognizes retailer fees for connecting new retailers to the system and collected for the use of digital signage used by the retailers at their stores as operating revenues. Operating expenses include the costs related to sales, administrative expenses required to manage and operate the Lottery and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

When an expense is incurred that can be paid using either restricted or unrestricted resources, the Lottery's policy is to first apply the expense toward unrestricted resources and then toward restricted resources.

3. Budgets and Budgetary Accounting.

Each year Lottery management prepares a budget in conformity to GAAP for the succeeding fiscal year. The Lottery's budget is not legally binding. The budget is presented by management to the Lottery's board of directors for review, amendment, and approval prior to the beginning of the next fiscal year. Any revisions to this budget during the fiscal year are approved by the Lottery's board of directors. The Lottery's financial statements are reviewed at each regular board of directors' meeting. Performance in relation to the budget is presented and discussed during these meetings.

4. Cash

For the purposes of the Statement of Cash Flows, the Lottery considers cash and cash equivalents to be cash on hand, demand deposits, and repurchase agreements.

5. Accounts Receivable

Accounts receivable represent the unremitted receipts on ticket sales, net of retailer commissions and prizes paid by the retailers. Receipts are transferred weekly from retailer bank accounts to the Lottery. Credit losses relating to contracted retailers have been within management expectations. Generally, collateral is not required on

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2006 and 2005

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

5. Accounts Receivable - Continued

receivables. At June 30, 2006 and 2005, an allowance for doubtful accounts of \$99,987 and \$89,363, respectively, has been provided to recognize future uncollectible billings.

In fiscal years 2006 and 2005, ten customers (427 and 421 retailer locations) represented 46% and 45% of sales for each year and 46% and 38%, respectively for each year, of accounts receivable.

6. Reserves on Deposit

The Lottery is a member of the Multi-State Lottery Association (MUSL), which operates games on behalf of participating lotteries. MUSL currently operates the POWERBALL® (Powerball) game and also operated the Powerball Instant Millionaire TV Game Show for the Lottery until September 24, 2004. Each MUSL member sells Powerball game tickets through its retailers and makes weekly wire transfers to MUSL in an amount equivalent to the member lottery's share of the estimated grand prize liability. Lesser prizes are paid directly to the winners by each member lottery. The prize pool for Powerball is 50% of each drawing period's sales. MUSL has included 2% of each drawing period's sales as part of each MUSL member's prize liability in prize reserve funds. MUSL has placed a \$100,000,000 cap on the prize reserve funds and once the prize reserve funds exceed this designated cap, the excess becomes part of the prize pool. The prize reserve funds serve as a contingency reserve to protect MUSL from unforeseen prize liabilities and the money in this reserve fund is to be used at the discretion of the MUSL Board of Directors. The prize reserve fund monies are refundable to MUSL members if MUSL disbands or if a member leaves MUSL. Members leaving MUSL must wait one year before receiving their remaining share, if any, of the prize reserve funds. The Lottery also has an unreserved fund with MUSL. Interest earned on the MUSL funds and any unclaimed grand prizes may be deposited into this account and game membership fees and other MUSL costs may be paid from this fund. At June 30, 2006 and 2005, the Lottery's share of the Powerball prize reserve was \$2,009,543 and \$2,046,000, respectively, and the Lottery's share of the Powerball unreserved fund was \$330,222 and \$235,913, respectively.

A winner of a Powerball grand prize may select that the prize be paid at the cash value of the prize or as an annuity. A grand prize annuity is paid out in 30 installments.

Government securities at the discounted value of grand prize annuity are purchased by MUSL to fund all future installments and are held in trust. Maturities are staggered in order to provide adequate cash flow for each annual installment. These assets and related liabilities are reflected in MUSL's financial statements and therefore are not reflected in the Lottery's financial statements. MUSL is responsible for transferring the cash or the annuity installment amounts to the member lottery prior to the payment to

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2006 and 2005

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

6. Reserves on Deposit - Continued

the grand prize winner. The Lottery currently is not paying any prize winner any annuity prize payments.

7. Inventory

Since the inception of the Lottery, inventory, which has mainly consisted of lottery instant tickets for future use, has been carried at the lower of cost or market using the specific identification method. In March 2003, the Lottery entered into an agreement with its instant ticket printer whereby the vendor retains title to the instant ticket inventory until the instant tickets are sold. At that time, the Lottery pays the vendor a fee based on a fixed percentage of the instant tickets sold. In fiscal year 2004 the Lottery commenced distributing games printed under this new agreement and through June 30, 2006 has substantially depleted any instant ticket inventory owned by the Lottery.

8. Capital Assets

Capital assets, which include data processing software and hardware, tenant improvements, vehicles, furniture and fixtures, and equipment are stated at cost net of accumulated depreciation. The Lottery capitalizes all assets that have a cost greater than \$1,000 and an expected useful life of more than one year. The legislature of the State of New Mexico amended Section 12-6-10, NMSA 1978 which allowed for the capitalization threshold for capital assets to increase from \$1,000 to \$5,000 effective July 1, 2005. During fiscal year 2006, the Lottery continued to capitalize capital assets greater than \$1,000. Effective October 19, 2006, the Lottery increased its capital asset threshold to \$5,000. Depreciation is computed using the straight-line method over the estimated useful lives of 2 to 5 years, except for leasehold improvements, which are amortized over their expected useful lives or the lease term, whichever is shorter. When assets are retired or otherwise disposed of, the cost 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.

9. Revenue and Accounts Receivable Recognition

Lottery games are sold to the public by contracted retailers and directly by the Lottery. Revenue and accounts receivable for instant tickets are recognized when packs are settled and retailers are billed for the tickets. Revenues and accounts receivable for on-line games are recognized when drawings are held. Accounts receivable are stated at their net realizable value and their past due status is based upon contractual terms.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2006 and 2005

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

10. Prizes

Prize expense for instant ticket and on-line games is recorded based on an estimate of the predetermined prize structure for each game.

11. Commissions

Retailers receive a commission of 6% on gross ticket sales and a 1% cashing commission on winning ticket validations for prizes up to \$600.

12. Advertising Costs

Advertising costs are expensed as incurred.

13. Income Taxes

The Lottery is exempt from Federal and New Mexico income taxes. Accordingly, no provision for income taxes has been made.

14. Cash and Concentrations of Credit Risk

At June 30, 2006 the Lottery maintained its cash balances in one financial institution, while at June 30, 2005, the cash balances were maintained at two financial institutions. The balances for demand deposits were insured by the Federal Deposit Insurance Corporation up to \$100,000 at these financial institutions.

Custodial credit risk – Cash. In the case of deposits, this is the risk that in the event of a bank failure, the Lottery’s deposits may not be returned to it. The Lottery does not have a deposit policy for custodial credit risk.

Custodial credit risk – Investments. For an investment, custodial credit risk is the risk that in the event of the failure of the counterparty, the Lottery will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. Mutual funds, external investment pools, and securities underlying reverse repurchase agreements are not exposed to custodial credit risk. The Lottery does not have an investment policy for custodial credit risk.

The Lottery limits its custodial risk for its cash and requires collateral in an amount greater than or equal to 50% of the deposit not insured by Federal Insuring Agencies. A greater amount of collateral is required when the Lottery determines it is prudent. Collateral must meet State of New Mexico “Security of Public Money” standards and be held in the third party safekeeping.

The Lottery’s custodial risk is in accordance with Article 10, NMSA, 1978 Compilation. The Lottery’s investments are made in repurchase agreements. Investments are made through a local financial institution and are held in safekeeping in its trust departments. Repurchase agreements are collateralized by the Federal National Mortgage Association Securities with a market value of at least 102% of the principal and are used for overnight investment only. As of June 30, 2006 and 2005, the Lottery’s bank balances of \$4,744,933 and \$3,697,751, respectively, were exposed to custodial credit risk because the collateral was held in the name of the agent, although the balances were insured and collateralized with securities pledged to the Lottery.

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2006 and 2005

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

<u>Description</u>	<u>Bank</u>	<u>Balance</u> <u>per Bank</u>
Operating account-repurchase	First Community Bank	\$ 4,744,606
Operating – checking	First Community Bank	327
Payables account-checking	First Community Bank	-
Receiving account-checking	First Community Bank	-
Payroll account-checking	First Community Bank	-
Prize account-checking	First Community Bank	-
Total amount deposited in bank		<u>4,744,933</u>
Less: FDIC coverage		<u>(327)</u>
**Total uninsured funds - repurchase agreement		<u>\$ 4,744,606</u>
102% collateral requirement for repurchase agreement		\$ 4,839,498
*Pledged security		<u>(4,839,545)</u>
Amount under (over) requirement at June 30, 2006		<u>\$ (47)</u>
*Security is held in safekeeping at the Federal Home Loan Bank in Dallas, Texas. Presented at fair value, CUSIP Number 31371LAE9 and 31371LE70, mature June 1, 2013 and October 1, 2013, respectively.		
**The repurchase agreement is collateralized with securities held in the name of their agent.		
Cash per bank at June 30, 2006		\$ 4,744,933
Less reconciling items – outstanding checks		<u>(172,783)</u>
Reconciled cash in bank at June 30, 2006		4,572,150
Cash in vault		<u>2,500</u>
Total cash per statements of net assets		<u>\$ 4,574,650</u>

16. Risk Management

The Lottery 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 Lottery purchases commercial insurance to cover these risks. The amount of coverage has not been exceeded by claims in the last three years.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2006 and 2005

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

17. Reserve Fund

The Act (see note A1) requires that “an amount up to 2% of the gross annual revenues shall be set aside as a Reserve Fund to cover bonuses and incentive plans for Lottery retailers, special promotions for retailers, purchasing special promotional giveaways, sponsoring special promotional events, compulsive gambling rehabilitation and other purposes as the Board deems necessary to maintain the integrity and meet the revenue goals of the Lottery.” Accordingly, the Board of Directors has elected to set aside up to 2% of gross revenues into the reserve account. At June 30, 2006 and 2005, the amounts that had been set aside and expended were \$1,071,934 and \$767,634, respectively.

In the fiscal years 2006 and 2005, respectively, \$766,491 and \$563,725 were set aside and expended for bonuses and incentives for retailers, \$122,054 and \$122,789 for responsible gaming advertising, \$81,120 each year for a responsible gaming hotline, \$63,262 and \$0 for special promotions, \$38,984 and \$0 for integrity, and \$23 and \$0 for clerk incentives, all in accordance to the specified purposes per the Act, and leaving a balance of \$50,000 at the end of each fiscal year.

18. Net Assets – Restricted

Any Reserve Fund amounts not expended by fiscal year end for the defined purposes (see note 17) are to be transferred to the Lottery Tuition Fund, except for unexpended amounts up to \$50,000, which can be retained by the Lottery for future defined expenditures.

19. Unclaimed Prizes

The Act requires that prizes not claimed within the time period established by the Lottery are forfeited and shall be paid into the prize fund (unclaimed prize liability accounts). Unclaimed prizes are applied against prize expense to supplement prizes in the Lottery’s games.

20. Use of Estimates in Preparation of Financial Statements

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 amount of assets and liabilities and 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.

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2006 and 2005

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

21. Shipping and Handling Costs

Shipping and handling costs associated with inventory distribution are expensed as incurred and included in game expenses.

22. Compensated Absences Payable

Paid time off is accrued at rates specified by the Lottery's Paid Time Off Policy. Employees are limited on the total accumulated hours they may keep in their respective Reserve Bank. Employees with time in service less than or equal to 5 years may accumulate a maximum of 320 hours and employees with time in service greater than 5 years may accumulate a maximum of 360 hours, any excess is forfeited at the end of the calendar year. During the years ended June 30, 2006 and 2005, the following changes occurred in the compensated absences liabilities:

<u>Balance</u> <u>July 1, 2005</u>	<u>Increase</u>	<u>Decrease</u>	<u>Balance</u> <u>June 30, 2006</u>
\$ 360,026	\$ 53,830	\$ (89,876)	\$ 323,980

<u>Balance</u> <u>July 1, 2004</u>	<u>Increase</u>	<u>Decrease</u>	<u>Balance</u> <u>June 30, 2005</u>
\$ 302,696	\$ 76,105	\$ (18,775)	\$ 360,026

The balances of compensated absences payable are reported on the balance sheet in accounts payable and other current liabilities. The portion of compensated absences due after one year is not material, and therefore, is not presented separately.

23. Long-term Liabilities - Capital Lease Obligations

During the years ended June 30, 2006 and 2005 the following changes occurred in the capital lease obligations:

<u>Balance</u> <u>July 1, 2005</u>	<u>Increase</u>	<u>Decrease</u>	<u>Balance</u> <u>June 30, 2006</u>	<u>Amounts</u> <u>Due Within</u> <u>One Year</u>
\$ 247,545	\$ -	\$ (141,454)	\$ 106,091	\$ 106,091

<u>Balance</u> <u>July 1, 2004</u>	<u>Increase</u>	<u>Decrease</u>	<u>Balance</u> <u>June 30, 2005</u>	<u>Amounts</u> <u>Due Within</u> <u>One Year</u>
\$ 388,999	\$ -	\$ (141,454)	\$ 247,545	\$ 141,454

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2006 and 2005

NOTE B – CAPITAL ASSETS

Capital assets at June 30, 2006 consisted of:

	Beginning Balance	Increases	Decreases	Ending Balance
Data Processing software	\$ 2,120,209	\$ 1,701	\$ -	\$ 2,121,910
Data processing equipment	1,902,993	32,366	-	1,935,359
Tenant improvements	720,611	59,015	-	779,626
Vehicles	493,081	165,156	(175,094)	483,143
Equipment - communications	299,538	55,223	-	354,761
Furniture and fixtures	285,046	5,880	-	290,926
Equipment - drawing	168,494	45,750	-	214,244
Equipment - warehouse	153,125	3,573	-	156,698
Equipment - office	81,171	2,818	-	83,989
Capital assets	<u>6,224,268</u>	<u>371,482</u>	<u>(175,094)</u>	<u>6,420,656</u>
Data Processing software	(1,920,653)	(106,173)	-	(2,026,826)
Data processing equipment	(1,697,427)	(120,171)	-	(1,817,598)
Tenant improvements	(625,255)	(39,642)	-	(664,897)
Vehicles	(434,215)	(65,215)	175,094	(324,336)
Equipment - communications	(264,999)	(32,640)	-	(297,639)
Furniture and fixtures	(282,836)	(1,294)	-	(284,130)
Equipment - drawing	(118,180)	(26,355)	-	(144,535)
Equipment - warehouse	(151,259)	(771)	-	(152,030)
Equipment - office	(33,619)	(16,877)	-	(50,496)
Accumulated depreciation	<u>(5,528,443)</u>	<u>(409,138)</u>	<u>175,094</u>	<u>(5,762,487)</u>
Capital assets, net	<u>\$ 695,825</u>	<u>\$ (37,656)</u>	<u>\$ -</u>	<u>\$ 658,169</u>

Included in data processing software and data processing equipment are \$400,786 in assets under a capital lease at June 30, 2006 and 2005. There was \$141,454, respectively for each fiscal year, in related amortization on these assets.

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2006 and 2005

NOTE B – CAPITAL ASSETS - CONTINUED

Capital assets at June 30, 2005 consisted of:

	Beginning Balance	Increases	Decreases	Ending Balance
Data Processing software	\$ 2,106,566	\$ 13,643	\$ -	\$ 2,120,209
Data processing equipment	1,814,095	98,180	(9,282)	1,902,993
Tenant improvements	697,981	22,630	-	720,611
Vehicles	493,081	-	-	493,081
Equipment - communications	299,538	-	-	299,538
Furniture and fixtures	285,046	-	-	285,046
Equipment - drawing	261,088	1,745	(94,339)	168,494
Equipment - warehouse	153,125	-	-	153,125
Equipment - office	45,895	40,776	(5,500)	81,171
Capital assets	<u>6,156,415</u>	<u>176,974</u>	<u>(109,121)</u>	<u>6,224,268</u>
Data Processing software	(1,807,606)	(113,047)	-	(1,920,653)
Data processing equipment	(1,593,900)	(112,809)	9,282	(1,697,427)
Tenant improvements	(587,657)	(37,598)	-	(625,255)
Vehicles	(329,418)	(104,797)	-	(434,215)
Equipment - communications	(246,164)	(18,835)	-	(264,999)
Furniture and fixtures	(282,032)	(804)	-	(282,836)
Equipment - drawing	(184,959)	(27,560)	94,339	(118,180)
Equipment - warehouse	(150,637)	(622)	-	(151,259)
Equipment – office	(31,166)	(7,953)	5,500	(33,619)
Accumulated depreciation	<u>(5,213,539)</u>	<u>(424,025)</u>	<u>109,121</u>	<u>(5,528,443)</u>
Capital assets, net	<u>\$ 942,876</u>	<u>\$ (247,051)</u>	<u>\$ -</u>	<u>\$ 695,825</u>

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2006 and 2005

NOTE C - ALLOCATION OF NET INCOME/TRANSFERS TO LOTTERY TUITION FUND

	Net Income	Due to Lottery Tuition Fund	Reserve Fund	Net Assets
Balance at June 30,				
2005	\$ 2,741,979	\$ 2,691,979	\$ -	\$ 50,000
Current year net				
income	36,855,556	36,855,556	-	-
Current year				
transfers	<u>(36,879,306)</u>	<u>(36,879,306)</u>	<u>-</u>	<u>-</u>
Balance at June 30,				
2006	<u>\$ 2,718,229</u>	<u>\$ 2,668,229</u>	<u>\$ -</u>	<u>\$ 50,000</u>

In accordance with the Act, the Lottery shall transmit all net revenues monthly to the New Mexico State Treasurer, who shall deposit the net revenues into state agency number 950, the Lottery Tuition Fund, CAS fund number 637. As of August 1, 2006 and 2005, the Lottery has transferred \$36,855,556 and \$32,230,517, respectively, for the periods ended June 30, 2006 and 2005 to the New Mexico State Treasurer.

NOTE D - RETIREMENT PLAN

Plan Description

All of the Lottery's eligible employees participate in a plan provided by the Lottery pursuant to the New Mexico Lottery Act (Chapter 6, Article 24 NMSA 1978). The Lottery is the administrator of the Plan, which is a defined contribution money purchase pension plan. The New Mexico Lottery Authority Retirement Plan provides for retirement benefits to plan members and their beneficiaries. The balances and activity of the Plan as of and for the years ended June 30, 2006 and 2005 are presented in the Statements of Fiduciary Net Assets and Statements of Changes in Fiduciary Net Assets.

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2006 and 2005

NOTE D - RETIREMENT PLAN - CONTINUED

Funding Policy

The Lottery contributes 13.25% of compensation for eligible employees to the Plan. Lottery contributions are 100% vested when deposited monthly. For the periods ended June 30, 2006 and 2005, the Lottery recognized \$348,742 and \$335,483 of pension expense for the Plan on eligible compensation of \$2,632,015 and \$2,531,947, respectively. The entire pension expense amounts had been paid to the Plan by June 30, 2006 and June 30, 2005, respectively.

NOTE E – CREDIT AGREEMENT

In July 2005 the Lottery entered an agreement with First Community Bank (formerly First State Bank) effective May 15, 2005 for an automatic unsecured overdraft line of credit sweep in the amount of \$1,000,000 with a fixed interest rate at the Wall Street Journal interest rate less .500 percentage points (7.5% and 5.75%, respectively, at June 30, 2006 and June 30, 2005). The line matured in May 2006 and was extended through May 14, 2008. For the periods ended June 30, 2006 and 2005, the Lottery had no outstanding borrowings against the lines.

NOTE F - LEASES

The Lottery has entered into operating leases for the rental of office and warehouse space, and vending machines. Rent expense was \$749,788 and \$791,047 for the years ending June 30, 2006 and 2005, respectively. In August 2002, the Lottery renegotiated its leases for office and warehouse space. These leases were extended for an additional seven years at the same lease amounts that will be paid for the final year of the original lease in 2006. Future minimum rental payments on non-cancelable leases with original terms of one year or more are scheduled as follows:

<u>Year</u>	<u>Amount</u>
2007	\$ 559,071
2008	309,485
2009	378,886
2010	431,485
2011	431,485
2012-2013	755,100
	<u>\$ 2,865,512</u>

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2006 and 2005

NOTE F – LEASES - CONTINUED

Future minimum sublease income from non-cancelable leases with original terms of one year or more are scheduled as follows:

<u>Year</u>	<u>Amount</u>
2007	\$ 117,200
2008	122,000
2009	<u>52,600</u>
	<u>\$ 291,800</u>

Following is a schedule of the composition of net rental expense for all long-term operating leases for the years ended June 30:

	<u>2006</u>	<u>2005</u>
Minimum rentals	\$ 708,071	\$ 768,841
Less: Sublease rentals	<u>(112,500)</u>	<u>(108,800)</u>
	<u>\$ 595,571</u>	<u>\$ 660,041</u>

As part of the agreement with Scientific Games International, Inc. for the procurement of instant lottery ticket printing/related services and customer relationship management system (CRM), the Lottery installed and implemented a CRM system in fiscal year 2004. The CRM system cost is included in the fixed fee paid to the vendor as a percentage of instant tickets sold that have been printed under this contract. The Lottery has accounted for this transaction as a capital lease. The CRM system cost was projected over the life of the contract remaining at the time of installation and has been capitalized on the books of the Lottery at the present value of this cost, as determined with a discount rate of 4%.

Years ending June 30:

2007	\$ 140,769
Less the amount representing interest	<u>(34,678)</u>
Present value of net minimum payments	<u>\$ 106,091</u>

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2006 and 2005

NOTE G - COMMITMENT

The Lottery has an agreement for the On-line Gaming System (the GTECH Agreement) with GTECH Corporation (GTECH) until November 20, 2008. The GTECH Agreement calls for GTECH to provide on-line gaming systems and services, and entitles the Lottery to certain liquidated damages upon the occurrence of defined incidences.

NOTE H - OTHER EXPENSES

Other expenses at June 30, consisted of:

	<u>2006</u>	<u>2005</u>
Registrations and memberships	\$ 24,487	\$ 23,521
Training	21,591	33,405
Other	16,456	27,412
Publications and subscriptions	<u>4,774</u>	<u>3,483</u>
	<u>\$ 67,308</u>	<u>\$ 87,821</u>

New Mexico Lottery Authority

BUDGET TO ACTUAL COMPARISON STATEMENTS

Years ended June 30, 2006 and 2005

	2006				2005			
	Original Budget	Final Budget	Actual	Variance with Final Budget	Original Budget	Final Budget	Actual	Variance with Final Budget
Revenues								
Instant ticket sales	\$ 90,000,000	\$ 91,000,000	\$ 89,367,670	\$(1,632,330)	\$ 87,475,000	\$ 88,500,000	\$ 90,840,412	\$ 2,340,412
Powerball sales	50,000,000	50,000,000	54,113,990	4,113,990	51,600,000	40,000,000	36,259,131	(3,740,869)
Roadrunner Cash sales	8,000,000	8,500,000	8,347,282	(152,718)	7,500,000	8,500,000	9,183,278	683,278
Pick 3 sales	2,000,000	2,000,000	2,009,560	9,560	2,025,000	2,050,000	2,063,825	13,825
4 This Way! Sales	1,000,000	800,000	769,985	(30,015)	1,375,000	1,000,000	892,155	(107,845)
Retailer fees	30,000	44,000	47,180	3,180	32,000	40,000	42,618	2,618
Prize tickets	(4,750,000)	(4,800,000)	(4,533,193)	266,807	(6,000,000)	(5,000,000)	(4,741,715)	258,285
Spoiled, stolen, and promotional tickets	(106,000)	(92,000)	(80,074)	11,926	(132,000)	(90,000)	(70,542)	19,458
Bad debts	(24,000)	(24,000)	-	24,000	(24,000)	(24,000)	-	24,000
Total revenues	146,150,000	147,428,000	150,042,400	2,614,400	143,851,000	134,976,000	134,469,162	(506,838)
Total game expenses	106,139,000	106,888,000	108,208,629	1,320,629	103,031,000	97,117,000	96,950,336	(166,664)
Total operating expenses	6,333,000	5,854,000	5,512,506	(341,494)	6,285,000	5,880,000	5,562,134	(317,866)
Operating income	33,678,000	34,686,000	36,321,265	1,635,265	34,535,000	31,979,000	31,956,692	(22,308)
Total non-operating income	226,000	442,000	534,291	92,291	228,000	221,000	273,825	52,825
Net income before transfers to Lottery Tuition Fund	\$ 33,904,000	\$ 35,128,000	\$ 36,855,556	\$ 1,727,556	\$ 34,763,000	\$ 32,200,000	\$ 32,230,517	\$ 30,517

The accompanying notes are an integral part of these financial statements.

MOSS ADAMS LLP

CERTIFIED PUBLIC ACCOUNTANTS
6100 UPTOWN BLVD NE SUITE 400
ALBUQUERQUE, NM 87110

Report On Internal Control Over Financial Reporting And On Compliance And Other Matters Based On An Audit Of Financial Statements Performed In Accordance With *Government Auditing Standards*

Board of Directors
New Mexico Lottery Authority
and
Mr. Domingo Martinez, CGFM
New Mexico State Auditor

We have audited the basic financial statements of the New Mexico Lottery Authority (the Lottery) and its fiduciary fund as of and for the year ended June 30, 2006, including the budgetary to actual statement presented as supplemental information and have issued our report thereon dated September 1, 2006. 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.

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 an opinion 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 reportable 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 caused by error or fraud 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.

Board of Directors
New Mexico Lottery Authority
and
Mr. Domingo Martinez, CGFM
New Mexico State Auditor

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Lottery's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations and contracts and grant agreements, 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 or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information of the Lottery's management, Board of Directors and the State Auditor's Office, and is not intended to be and should not be used by anyone other than these specified parties.

Mess Adams LLP

Albuquerque, New Mexico
September 1, 2006

New Mexico Lottery Authority

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

Year Ended June 30, 2006

04-01	Capital Asset Inventories	Resolved
04-02	Business Continuity Plan	Resolved

SCHEDULE OF CURRENT YEAR AUDIT FINDINGS

None

New Mexico Lottery Authority

EXIT CONFERENCE

For the year ended June 30, 2006

An exit conference was held at the New Mexico Lottery Authority on October 18, 2006. The following individuals participated:

<u>Name</u>	<u>Title</u>
<i>New Mexico Lottery Authority Audit Committee</i>	
Reta Jones, CPA	Chairman of the Board
Clifford Stroud	Board Member
<i>New Mexico Lottery Authority Employees</i>	
Tom Romero	Chief Executive Officer
Sylvia A. Jaramillo, CPA	Director of Finance
Mary Kranz, CPA	Internal Auditor
<i>Moss Adams LLP</i>	
Scott Eliason, CPA	Audit Partner
Wayne Brown, CPA	Audit Partner

Financial Statement Preparation

The accompanying financial statements have been substantially prepared by the Lottery with assistance from Moss Adams LLP.