



Benefitting New Mexico's Future

2005

NEW MEXICO LOTTERY AUTHORITY ANNUAL REPORT FY 2005



A Message From the Board of Directors

Serving the Lottery in Fiscal Year 2005

This was another productive year for the New Mexico Lottery Authority (NMLA) and its seven member Board of Directors. Board members are, statutorily, unpaid citizen volunteers appointed by the Governor and confirmed by the State Senate. By law, our private sector perspectives and professional backgrounds help guide a large entrepreneurial organization. We also have the responsibility to exercise sound and prudent business judgment in the management and promotion of the Lottery.

The board's mission is to maintain a Lottery that demonstrates the highest level of integrity, and one that players truly enjoy, while simultaneously and responsibly maximizing additional revenue for public education, as designated by the New Mexico Lottery Act. Our board and the NMLA staff have again accomplished those goals.

By statute, the NMLA board membership must include accounting, business, law enforcement and legal professionals. There were no new appointments made during FY '05. Membership included former Governor David Cargo of Albuquerque, an Albuquerque attorney; Claydean Claiborne, Mayor of Jal; Rudy Garcia, a Gallup business executive; Dan Girand of Roswell, a law enforcement veteran; Jill Gutierrez, a Las Cruces bank president; Reta D. Jones, an Albuquerque CPA; and, Cody Kelley, an Albuquerque attorney. At the beginning of the fiscal year, Ms. Claiborne was re-elected to chair the board, and Mr. Kelley was re-elected vice-chair. Several terms expired at the end of the fiscal year. Subsequent appointments and re-appointments will be addressed in the next annual report.

The board's statutory responsibilities include, but are not limited to: the adoption of rules, policies and procedures; maximizing net revenue for Lottery beneficiaries; appointment of the Lottery's CEO; setting and oversight of the corporation's annual budget; conducting on-going studies of this and other lotteries to continually improve efficiency, profitability and security; and the preparation of reports for the Legislature and the people of New Mexico. The board is also instructed to "pursue any and all other matters necessary, desirable or convenient for the efficient and effective operation of Lottery games, the continued entertainment and convenience of the public and the integrity of the Lottery."

The following annual report to the people of New Mexico highlights the Lottery Authority's goals, challenges and successes for fiscal year 2005, including intensifying the commitment to educate the college students of this State.

Respectfully submitted,
The New Mexico Lottery Authority
Board of Directors
for Fiscal Year 2005

Claydean Claiborne, Chairman
Cody K. Kelley, Vice-Chairman
Jill Gutierrez, Secretary
Dan Girand, Treasurer
Reta D. Jones, CPA, Assistant Secretary-Treasurer
Gov. David Cargo, Member
Rudy Garcia, Member

*From left to right:
David Cargo, Jill Gutierrez,
Reta Jones, Claydean Claiborne,
Cody Kelley, Dan Girand
and Rudy Garcia*



A Year of Challenges and Opportunities

A Letter from the CEO

On behalf of the New Mexico Lottery Authority, I am pleased to submit this annual report to the citizens of New Mexico for the fiscal year that ended June 30, 2005.

The New Mexico Lottery closed the 2005 fiscal year with \$139.2 million in gross sales, our second-best year ever. Cumulative gross sales also surpassed \$1 billion. The Lottery posted a \$32.2 million profit, the third consecutive year with net proceeds exceeding \$30 million. All profits were earmarked by the State for the Lottery Success Scholarship program, which experienced record enrollment and record financial transfers to colleges.

A variety of challenges and opportunities impacted the Lottery. Lottery management continued to look for efficiencies in daily operations, thereby achieving cost reductions. Profits are based not only on strong sales but innovative ways of doing business, including always exploring new methods to hold down costs. When appropriate, fresh games are launched to help raise additional revenue. Such was the case with the launch of *4 This Way!*, a unique four-digit game unveiled during the fall of 2004.

The higher the Lottery's profit, the more money there is for Lottery Success Scholarships. And by the end of fiscal year 2005, the Lottery's return to New Mexico education since inception approached \$250 million. By the close of the school year, more than 35,000 students had received Lottery Success Scholarships since the Lottery began operations.

Sales are driven by a strong mix of products: *Powerball* and its massive multi-state jackpots; New Mexico's own *Roadrunner Cash* with a rolling top prize; the new *4 This Way!* with a fixed \$4,000 top prize; *Pick 3* with a top prize of \$500; and over 50 instant (Scratcher) games that change constantly and are available any time throughout the year. Sales are also bolstered by public awareness of prizes won by players, which in FY 2005 ranged from prize tickets and \$1 prizes to a \$400,000 *Roadrunner Cash* top prize, a record for the game.

Despite record Scratcher and *Roadrunner Cash* sales, *Powerball* sales dipped from previous years. The largest *Powerball* jackpot during the fiscal year was \$220.3 million, with only two jackpots over \$200 million and three over \$170 million. Players seemed to want even larger jackpots, such as the \$300 million+ prizes in earlier and subsequent fiscal years. This points to the importance of offering a balanced product line.



Tom Romero, Interim CEO
and Executive Vice President of Security

Even with a drop in *Powerball* sales, overall Lottery sales remained strong. Students from every community, economic bracket and ethnic demographic benefited from what the State Legislature designed and the people of New Mexico wanted: a program offering an in-state and tuition-free college education to any eligible New Mexico high school graduate or GED recipient, regardless of economics. The Lottery Success Scholarship is also an incentive for students to remain in high school, knowing that an affordable college or trade education is within reach.

Sincerely,

A handwritten signature in black ink that reads "Tom Romero". The signature is fluid and cursive, written over a white background.

Thomas E. Romero
Interim CEO

Fiscal Year 2005

The Year in Review

Strong sales of in-state games helped drive the New Mexico Lottery to its second-best year of sales during fiscal year 2005. Gross sales of all games exceeded \$139.2 million. Net revenues (profits) earmarked for the Lottery Success Scholarship program were \$32.2 million, topping \$30 million for the third straight year.

Four New Mexico-specific Lottery products – instant tickets (Scratchers), *Roadrunner Cash*, *4 This Way!* and *Pick 3* – combined to set records. *Powerball*, the traditional lotto game sold here and 28 other lotteries during fiscal year 2005, had a slump in many states, including New Mexico. Jackpots did not reach record or near-record levels, and some player interest waned. While *Powerball* may be the most visible Lottery game, it is just one component in a successful mix of games and products.

Instant ticket gross sales surpassed \$90 million in one year for the first time. *Roadrunner Cash* sales exceeded \$9 million, also for the first time, in part because of record top prizes. Newly-introduced *4 This Way!* combined with *Pick 3* to exceed fiscal year 2004's *Pick 3* sales by 41 percent for a total of just under \$3 million.

Historically, New Mexicans have cited not just the chance of winning a prize as a reason to buy Lottery tickets but also their support of the Lottery's educational beneficiaries. The continued popularity of the Lottery Success Scholarship program adds to the Lottery's success.

From the previous fiscal years, total game expenses decreased by \$4.4 million (4.3 percent) in fiscal year 2005 after increasing by almost \$6.1 million (6.4 percent) in fiscal year 2004. These changes in game expenses were mainly related to the changes in on-line sales volume during the fiscal year.

There were again more than 1,100 New Mexico businesses licensed as authorized Lottery retailers. These independent and chain businesses provide information about various Lottery products. They are often the first points of contact for information as diverse as Lottery Success Scholarship eligibility, Amber Alerts for missing children (relayed through Lottery ticket terminals), scams and problem gambling assistance. These professionals sold creative and entertaining games that generated \$76.2 million in prizes and offered informational resources for the Lottery Success Scholarship.



MEASURING SUCCESS IN DEGREES

Scratchers

Instant ticket sales reached two milestones during fiscal year 2005. For the first time, Scratcher gross sales topped \$90 million during one fiscal year. The increase was \$3.8 million and 4.4 percent over the previous fiscal year. Because of a decline in on-line sales, instant ticket revenues constituted their strongest share of overall sales, 65.2 percent.

Scratcher games often have loyal but varied player bases. As a result, the Lottery offers different play styles, themes, prices and ticket prizes. Some games are created locally, while others are generated by the instant ticket vendor.

There were 51 Scratchers launched during the fiscal year, and ticket price points ranged from \$1 to New Mexico's first \$20 game. Prizes offered ranged from prize (free) tickets and \$1 to \$500,000 (also a first for a New Mexico instant ticket). Players claimed more than \$57.9 million in instant ticket prizes.

Strong instant ticket sales were due, in part, to an improved distribution management system. It was the first full fiscal year of the Lottery's customer relationship management (CRM) computer system, part of the previously-announced instant ticket vending contract with Scientific Games International. One of the CRM system's abilities is to better manage, monitor and track the instant ticket inventory for each retailer based upon history and sales patterns.

The same Scientific Games contract also includes marketing services, allowing the Lottery to conduct statewide focus groups for retailers and lottery players. This provided additional information for the Lottery to create successful games while being able to avoid games that would not do well in New Mexico.

Under the terms of the multi-year contract, in effect since March 2003, Scientific Games is paid 1.65 percent of New Mexico Lottery gross instant ticket sales, less returns. This minimizes the Lottery's risk for printed but unsold tickets.



WHEEL OF FORTUNE



Violet Henke of Alamogordo won an expense-paid trip to Hollywood and an audition for the "Wheel of Fortune" game show from the New Mexico Lottery's "Wheel of Fortune" Scratcher second chance drawing.

The top five Scratchers during the fiscal year were *Ruby Red 7s* (\$5), *Winter Green* (\$10), *\$100,000 Big Bucks* (\$10), *Wheel of Fortune*® (\$3) and *New Mexico Crossword* (\$3). Film screen icon *Betty Boop*™ made her third

appearance as a New Mexico Lottery character with six different ticket scenes and was the top-selling \$2 ticket during the fiscal year. This Scratcher mix included number-themed games, higher price points and extended play. For example, bingo and crossword-themed games are popular because they take a little longer to play.

On-line Games

Drawing games using numbers chosen by players or computer "quick picks" represented a mix of growth and decline. The growth occurred among in-state games. The decline centered on *Powerball*, the nation's biggest jackpot game. The \$48.4 million in on-line sales during fiscal year 2005 represents 34.8 percent of gross sales. That is more than a \$13.2 million and 27.3 percent decrease over fiscal year 2004.

Although all on-line games cost \$1 per play, each offer different play styles, prizes and odds. *Powerball*, *Roadrunner Cash* and *Pick 3* have been the mainstays of New Mexico Lottery on-line games for some time.

A new on-line game was added during the first quarter of the fiscal year. *4 This Way!* was uniquely designed by and for the New Mexico Lottery. Players select four numbers that must be matched in order from first to last. That way, players still have a chance of winning a prize on the final number drawn. It was designed to complement the more established *Roadrunner Cash* and *Pick 3* games.

Drawing results for all three in-state games continued to be televised Mondays through Saturdays on New Mexico's three CBS affiliates, KRQE (Albuquerque), KBIM (Roswell) and KREZ

BENEFITTING NEW MEXICO'S FUTURE

(Durango/Farmington). Univision affiliate KLUZ (Albuquerque) also broadcasts the drawing results in Spanish. Numerous stations televised *Powerball* results immediately after the twice-weekly drawings.

During the fourth quarter of the fiscal year, proposals were submitted for a televised drawing services contract. It was awarded to KOB, Albuquerque's NBC affiliate, and its two satellite stations, KOBR (Roswell) and KOBF (Farmington). KOB's bid included restoring live broadcasts of *Powerball* drawings and producing biannual Lottery and Lottery Success Scholarship-related public affairs programs. The change in drawing stations was made after fiscal year 2005. KLUZ's Spanish language broadcasts were not affected.

Powerball®

Powerball is New Mexico's traditional lotto-style game. It was sold during the fiscal year in 27 states, the District of Columbia and the U.S. Virgin Islands. The large population base allows smaller lotteries such as New Mexico's to offer multi-million dollar jackpots that grow quickly. *Powerball* offers nine basic prize levels, from the multi-million dollar jackpot won by matching all six numbers to a prize for matching just the Powerball. During the fiscal year players selected five numbers from 1 to 53, and one red Powerball from 1 to 42.

As the number of lotteries participating in *Powerball* grew, so did its population base. Because the jackpot was won 16 times during fiscal year 2005, jackpots did not reach extremely high levels that attracted strong player interest. Only two *Powerball* jackpots surpassed \$200 million. There were no *Powerball* jackpots won in New Mexico. With the majority of *Powerball* jackpots won

during the fiscal year under \$100 million, some players experienced what the industry refers to as "jackpot fatigue." Even though the starting jackpot of \$10 million is a substantial amount of money, many players don't buy *Powerball* tickets until jackpots reach the \$100 million mark or higher.

New Mexico benefited from extensive national publicity in March 2005,

when three *Powerball* winners statewide matched all five white balls for a \$100,000 second prize. It was part of a national trend that night when a record 110 winners nationwide won a second prize... most using fortune cookie numbers. Winning \$100,000 tickets that night were sold in Clovis, Las Vegas and Rio Rancho.

In the fourth quarter of the fiscal year, governing members of the Multi-State Lottery Association, the organization that operates *Powerball*, voted to add two more white balls to the game. The changes, which went into effect in fiscal year 2006, were designed to create larger and faster-growing jackpots. The starting jackpot was increased to \$15 million from \$10 million, while second and third prizes were doubled. However, these pending changes had no financial impact during fiscal year 2005.

The largest *Powerball* prizes won included 15 second prizes. Most were \$100,000, but one player also chose the optional Power Play® multiplier and quadrupled his prize to \$400,000. There were also 72 *Powerball* third prizes of \$5,000 to \$25,000, depending upon whether the Power Play® multiplier was purchased. Overall, New Mexico Lottery players claimed more than \$6.3 million in *Powerball* prizes.

Powerball sales accounted for 26 percent of Lottery sales, down significantly from 34.6 percent in the previous fiscal year.

Roadrunner Cash

New Mexico's in-state five digit game, *Roadrunner Cash*, had yet another year of sales increases, the strongest among all four on-line products. Sales jumped more than \$1.1 million to almost \$9.2 million, a 13 percent increase over fiscal year 2004.

The biggest boost to *Roadrunner Cash* resulted from an earlier change creating a "rolling" top prize. Like a traditional lotto-style jackpot, the *Roadrunner Cash* top prize rolls and grows until it is won, but on a smaller scale with better odds. In March 2005, the



Norma Hastings of Las Vegas, NV purchased her winning \$100,000 "Powerball" ticket in Clovis — she used her lucky fortune cookie numbers



Janet Brooker of Hobbs won \$100,000 playing Powerball

MEASURING SUCCESS IN DEGREES



Albert Pino of Raton won \$200,000 playing Roadrunner Cash



Mike Kezele of Gallup won \$4,000 playing our newest online game, 4 This Way!



4 This Way! was promoted at Monster Jam 2005 just after the game debuted

Roadrunner Cash top prize reached a record \$400,000, creating much player and media attention.

Coupled with expanded marketing and promotion of the game, *Roadrunner Cash* was clearly New Mexico's own cash five number game. Top prizes of \$20,000 to \$400,000 were won 33 times during the fiscal year. Sales represented nearly 6.6 percent of overall Lottery sales. *Roadrunner Cash* players claimed more than \$4.8 million in prizes.

Pick 3

Sales dipped slightly for *Pick 3*, in part because of interest in *4 This Way!* (see below). *Pick 3*'s player base appears to have stabilized. Only three numbers are chosen for each drawing. There are nine different ways to win eight different prize levels, from \$5 to a fixed \$500.

Pick 3 sales totaled just under \$2.1 million for fiscal year 2005, statistically unchanged from the previous year. It accounted for slightly less than 1.5 percent of Lottery gross sales, a slight increase over the previous year. There were 832 top prize winning tickets of \$500, a substantial increase over the previous year. Some of those players were repeat winners. New Mexico Lottery players claimed nearly \$1.2 million in *Pick 3* prizes.

4 This Way!

The New Mexico Lottery's newest on-line game is *4 This Way!* It launched just prior to the second quarter of fiscal year 2005. Players select four numbers that must be matched in exact order from first to last. That way, players still have a chance of winning a prize on the final number drawn.

Players who match four numbers in the order drawn win \$4,000. Players who miss the first number but match the last three win \$40. The prize for missing the first two numbers but matching the last two is \$4. Matching the fourth and final number pays \$1.

4 This Way! was originally estimated to generate about \$1.3 million in sales during its first nine months. It fell below expectations, generating just over \$892,000 sales, slightly less than 0.7 percent of overall gross Lottery sales. However, coupled with the somewhat-similar *Pick 3* game, *4 This Way!* helped create additional sales for in-state games.

There were 93 winners of the \$4,000 *4 This Way!* top prize, including several repeat winners. Players claimed \$483,000 in *4 This Way!* prizes.

\$9.5 Million

In Commissions and Incentives Paid to New Mexico Lottery Retailers

There were 1,129 authorized New Mexico Lottery retailers at the beginning of fiscal year 2005. During the year there were 75 new retailers added and 98 retailers removed, for a net loss of 23 retailers. These changes are due primarily to non-Lottery related matters, including store closures, mergers, consolidations or ownership changes. Each ownership change is registered as one closed retailer and one new retailer. The NMLA closed fiscal year 2005 with 1,106 authorized retailers.

Lottery retailers play a crucial role. As front-line representatives, they handle tens of millions of transactions every year, ranging from ticket sales to prize redemptions of up to \$600. They dispense brochures and information as diverse as the Lottery Success Scholarship, scams, responsible gaming or simply how certain games are played.

Once again, the Lottery held regional informational forums for retailers. These are opportunities to share the latest developments with store owners, managers or personnel from specific areas, as well as listening to their concerns and looking for positive ways to implement change.

Through sales and cashing commissions, plus winning ticket and promotional incentives, NMLA retailers earned \$9.5 million in compensation during the fiscal year. That was \$629,000 lower than the previous year, due to the decline in *Powerball* sales.

With *Powerball* sales down, there were fewer top retailers along the New Mexico/Texas border than in previous years.

Based on FY 2005 overall sales New Mexico's top retailer locations were:

- | | |
|-----------------------------------|--------------|
| 1. Howdy's Food Mart #10 | Santa Teresa |
| 2. Bien Muir Indian Market Center | Albuquerque |
| 3. Circle K #00379 (*) | Albuquerque |
| 4. Peppers Supermarket | Deming |
| 5. Food Jet #1 | Carlsbad |
| 6. Chevron Xpress | Las Vegas |
| 7. Circle K #01481 | Roswell |
| 8. Lowe's Supermarket #55 | Alamogordo |
| 9. Stires Mini-Mart | Chaparral |
| 10. DNN Petroleum Services | Magdalena |

(*) Previously sold *Powerball* jackpot winning ticket

The ten largest chains representing overall sales rankings are:

1. Allsup's Convenience Stores
2. Giant Industries
3. Circle K Corporation
4. Diamond Shamrock
5. Brewer Oil
6. Town & Country Stores
7. Phillips 66
8. Southwest Convenience Stores (7-Eleven Franchise)
9. Chevron Redi-Mart (Ever-Ready Oil Company)
10. Albertson's Food and Drug



Janet Tucker, Administrative Assistant to Vice President of Sales, prepares to greet arriving retailers for the Retailer Luncheon in Hobbs on March 31, 2005



Retailers stand in line with goodie bags and learn more about the Lottery at the Retailer Luncheon in Roswell on May 24, 2005



Amigo Mart #837 employees take a quick break to pose during their Classic Bingo promotion on May 20, 2005

Other Developments

During the New Mexico Lottery's Ninth Year of Operations

- ▶ Under a 2003 instant ticket contract described in last year's annual report, vendor Scientific Games International owns the instant tickets. The Lottery pays for the tickets based on a percentage of sales when the tickets are sold. The cost for the tickets under this contract included the cost of a customer relationship management (CRM) system, described elsewhere in the 2004 and 2005 annual reports. Because the CRM system was not implemented until June 2004, the Lottery paid a lesser price per ticket sold until that time than originally negotiated. The price paid in fiscal year 2005, therefore, was slightly higher than the previous fiscal year.
- ▶ Nightly on-line drawings for in-state games changed from traditional ball machines to state-of-the-art digital draw systems. Previously announced during fiscal year 2004, the new process was launched by the Security Division during fiscal year 2005.
- ▶ Fiscal support continued for the New Mexico Council on Problem Gambling and its toll-free help line accessible from anywhere in New Mexico 24 hours per day. The Lottery's current annual contract was signed in fiscal year 2004 and includes up to three one-year extensions.
- ▶ The Lottery renegotiated its contract with Interlott, now a wholly-owned subsidiary of on-line vendor GTECH, for instant ticket vending machines (ITVMs). The changes resulted in lower costs.
- ▶ Several Lottery divisions, including Security, Management Information Systems and Internal Audit, analyzed ways to further protect and improve the organization's strategic operations. Improvements were recommended and implemented.
- ▶ Bids were solicited for the Lottery's banking and related services. The bid was awarded during the fourth quarter of the fiscal year to First State Bank (now First Community Bank).

(Portions of this summary are included in the Management's Discussion and Analysis section of the Lottery's official audit report; the complete MD&A is available upon request.)



Wilma Atencio, Executive Security Operations Administrator, works on the new digital draw station



Using the keypad security system to gain access to the new digital draw system area



Wilma Atencio and Mary Kranz, Internal Auditor, test the new digital drawing system

The New Mexico Lottery in the Community

Events, Sponsorships and Special Programs

It is important for the New Mexico Lottery to have a presence in the community. Constitutional limitations restrict the types of sponsorships in which the Lottery may participate. However, a variety of special events and promotions across the state help inform the general public about not only Lottery products but also Lottery beneficiaries.

Summer activities helped kick off fiscal year activities, followed shortly by promotions helping launch the Lottery's newest on-line game, *4 This Way!* Intercollegiate sports sponsorships again helped connect localized Lottery exposure and the educational benefits from Lottery profits.

Promotional and sponsorship activities during FY 2005 included:

- Albuquerque Isotopes Baseball
- CD 104 Chili Cook Off – Carlsbad
- Commencement Ceremonies for new Lottery Success Scholarship advertising campaigns (Eastern New Mexico University – Portales, New Mexico State University – Las Cruces, University of New Mexico – Albuquerque)
- Eastern New Mexico University Athletics – Portales
- Fire and Ice Bike Rally – Grants
- Great American Duck Race – Deming
- Journal Pavilion Concerts – Albuquerque
- Lea County Fair – Lovington
- New Mexico College Awareness Coalition – Statewide
- New Mexico State University Athletics – Las Cruces
- Numerous radio remotes promoting Lottery games and the Lottery Success Scholarship
- Pork & Brew – Rio Rancho
- Saturday Night at the Fights (boxing, car show, basketball) – Las Cruces
- Speedway of Southern New Mexico – Las Cruces
- Summerfest Concerts – Albuquerque
- University of New Mexico Athletics – Albuquerque
- Western New Mexico University Athletics – Silver City
- Whole Enchilada Fiesta – Las Cruces



The "Lottery Trolley" travels across the state for special events. It's pictured here during the Fire & Ice Bike Rally in Grants, July 16-18, 2004



Bobby Box from Big Oldies 98.5 FM hands out Scratchers at a Classic Bingo radio promotion, June 1, 2005



The Lottery's sponsorship of "Howl Towel" night received national exposure during an ESPN telecast of a UNM basketball game, February 14, 2005

MEASURING SUCCESS IN DEGREES

\$139.2 Million

In Gross Ticket Sales for the New Mexico Lottery

Fiscal Year 2005: A Financial Overview

The New Mexico Lottery's tenth year of sales began in April 2005. Sales and net income fell slightly below projections. *Powerball* sales were more than \$15 million less than in fiscal year 2004, while the Lottery's four other products gained over \$5.8 million from the previous fiscal year.

Gross revenues totaled approximately \$139.2 million. Net revenues were approximately \$32.2 million. All net proceeds were

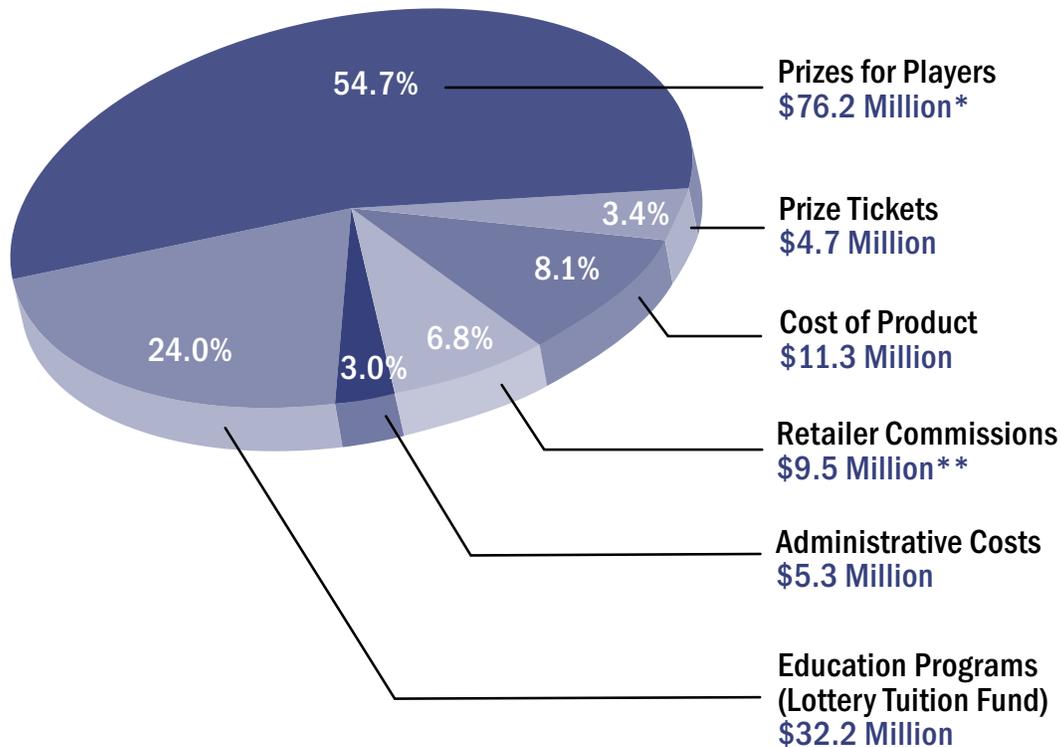
again statutorily earmarked for the Lottery Tuition Fund, which finances the Lottery Success Scholarship program for in-state college tuition.

Gross sales revenues were approximately \$9.4 million less than the previous fiscal year, and net income for the Lottery Success Scholarship was \$3.7 million less than the previous year.

The NMLA's audited financial statements are found at the end of this report.

Where \$139.2 Million in Ticket Sales Go

(rounded)



(*) Includes jackpot prize payments to Multi-State Lottery Association for Powerball

(**) Includes \$564,000 for FY 2005 which in the audited financial statements is charged to Reserve Fund expense

Historical Review

A History of New Mexico Lottery Performance

The following is a history of New Mexico Lottery gross sales and net revenues (profits) since inception. Fiscal year 1996 sales were only about nine weeks long; all other fiscal years run July 1 – June 30.

Of the total amount of money transferred for New Mexico education, almost \$66.6 million was used for school construction and repairs from fiscal 1997 through fiscal 2001.

All annualized figures are rounded.

	Gross Sales (**)	Net Profits for New Mexico Public Education
FY '96(*)	\$28.4 Million	\$6.3 Million
FY '97	\$82.1 Million ↑	\$21.9 Million ↑
FY '98	\$84.9 Million ↑	\$20.1 Million ↓
FY '99	\$89.5 Million ↑	\$19.6 Million ↓
FY '00	\$110.7 Million ↑	\$24.5 Million ↑
FY '01	\$115.7 Million ↑	\$25.9 Million ↑
FY '02	\$134.0 Million ↑	\$29.6 Million ↑
FY '03	\$137.0 Million ↑	\$33.1 Million ↑
FY '04	\$148.7 Million ↑	\$35.9 Million ↑
FY '05	\$139.2 Million ↑	\$32.2 Million ↓
TOTALS:	\$1.1 Billion	\$249.2 Million (***)

Lottery Success Scholarship/Lottery Tuition Fund:	\$182,649,502 (1996 to FY '05)
Public School Capital Outlay Fund:	\$ 66,553,850 (1996 to 2001)
Cumulative Total Through Fiscal Year 2005:	\$249,203,352

(*) Represents partial fiscal year, April 27 – June 30, 1996

(**) Historical data have been revised to better reflect prize ticket and spoiled, stolen and promotional ticket credits

(***) Rounded to reflect cumulative total

MEASURING SUCCESS IN DEGREES

13,497

Spring Semester Lottery Success Scholarships

Spring 2005 Semester

Name of School	Students	Total LSS Awards (Fall '97 – Spring '05)
FOUR YEAR UNIVERSITIES		
Eastern New Mexico University – Portales (Main Campus)	754 ▲	\$ 6,815,271
New Mexico Highlands University – Las Vegas ⁽¹⁾	229	\$ 2,148,152
New Mexico Institute of Mining and Technology – Socorro	335 ▲	\$ 3,512,863
New Mexico State University – Las Cruces (Main Campus)	3,688 ▲	\$ 41,399,863
University of New Mexico – Albuquerque (Main Campus)	5,828 ▲	\$ 70,449,959
Western New Mexico University – Silver City	161 ▲	\$ 1,240,410
TWO-YEAR BRANCH COLLEGES		
Eastern New Mexico University – Roswell	165	\$ 598,628
Eastern New Mexico University – Ruidoso	14	\$ 63,918
New Mexico State University – Alamogordo	124	\$ 566,477
New Mexico State University – Carlsbad	94	\$ 508,248
New Mexico State University – Doña Ana	307 ▲	\$ 1,007,582
New Mexico State University – Grants	44	\$ 224,638
University of New Mexico – Gallup	81 ▲	\$ 319,733
University of New Mexico – Los Alamos	60	\$ 309,703
University of New Mexico – Taos	41	\$ 141,003
University of New Mexico – Valencia (Los Lunas)	132	\$ 648,176
INDEPENDENT COMMUNITY/JUNIOR COLLEGES		
Albuquerque Technical Vocational Institute	697 ▲	\$ 1,589,770
Clovis Community College	121 ▲	\$ 312,988
Luna Community College – Las Vegas ⁽¹⁾⁽²⁾	0	\$ 27,150
Mesalands Community College – Tucumcari ⁽³⁾	28	\$ 138,622
New Mexico Junior College – Hobbs	94	\$ 289,298
New Mexico Military Institute – Roswell	9	\$ 96,167
Northern New Mexico College – Española & El Rito ⁽⁴⁾	77	\$ 353,444
San Juan College – Farmington	252	\$ 573,600
Santa Fe Community College	162	\$ 521,745
TOTAL CAMPUSES – 25⁽¹⁾		
TOTAL STUDENTS SPRING 2005 SEMESTER⁽⁵⁾⁽⁶⁾	13,497	
TOTAL USED SINCE INCEPTION THROUGH SPRING 2005⁽⁵⁾⁽⁶⁾		\$ 133,857,408

- (1) Some satellite campuses are reflected in main campus information
- (2) LCC was formerly known as Luna Vocational Technical Institute
- (3) MCC was formerly known as Mesa Technical College
- (4) NNMC was formerly known as Northern New Mexico Community College; it now offers both two- and four-year programs
- (5) Lottery Success Scholarship (LSS) debits and student count may be adjusted by New Mexico Higher Education Department (NMHED) in subsequent semesters, pending reviews, audits and/or appeals; these may also reflect minor financial differences due to overall decimal point rounding, and are statistically insignificant
- (6) LSS transfer, draw and usage figures will always differ slightly in different categories because of official reconciliation and adjustments between NMHED and the various institutions
- ▲ Reflects record LSS enrollment for the Spring '05 semester

Source: New Mexico Higher Education Department, (800) 279-9777 / www.hed.state.nm.us

Appropriated by New Mexico Higher Education Department and its predecessor, the Commission on Higher Education, for the Lottery Success Scholarship program through FY 2005⁽⁵⁾

Fall '97	\$ 1,398,445	(2,192 students)	Fall '01	\$ 8,369,094	(8,181 students)
Spring '98	\$ 3,024,521	(5,087 students)	Spring '02	\$ 10,605,208	(11,001 students)
Fall '98	\$ 2,809,491	(4,139 students)	Fall '02	\$ 9,532,303	(8,875 students)
Spring '99	\$ 5,230,796	(7,802 students)	Spring '03	\$ 11,735,843	(11,352 students)
Fall '99	\$ 5,001,758	(6,406 students)	Fall '03	\$ 10,833,452	(9,608 students)
Spring '00	\$ 7,686,597	(10,014 students)	Spring '04	\$ 13,089,784	(12,288 students)
Fall '00	\$ 6,773,604	(7,593 students)	Fall '04	\$ 12,711,544	(10,219 students)
Spring '01	\$ 8,849,942	(10,429 students)	Spring '05	\$ 16,205,026	(13,497 students)
			TOTAL	\$133,857,408⁽⁵⁾⁽⁶⁾	

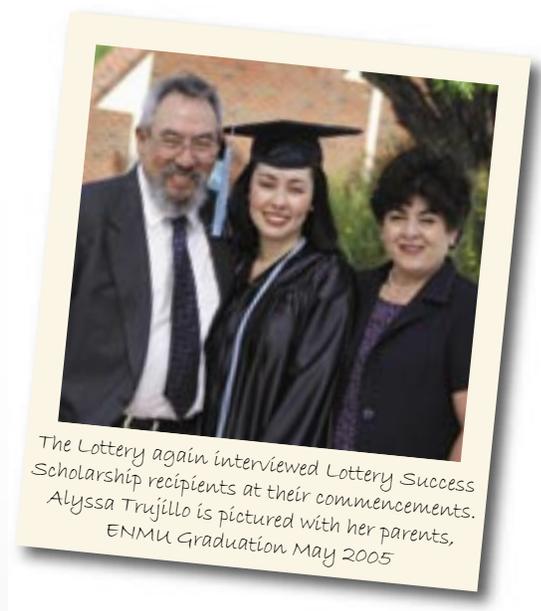
BENEFITTING NEW MEXICO'S FUTURE

37,701

High School Graduates and GED Recipients Have Received Lottery Success Scholarships Since Inception

Lottery Success Scholarship Program Student Count By County
Fall 1997 – Spring 2005

County	Attended College ⁽¹⁾	Total Awards	Total Grads So Far
Bernalillo	11,298	\$ 48,488,838	3,463
Catron	58	\$ 237,784	24
Chaves	1,327	\$ 3,552,559	355
Cibola	480	\$ 1,433,514	191
Colfax	232	\$ 847,339	77
Curry	1,043	\$ 2,504,075	316
De Baca	67	\$ 211,508	23
Doña Ana	3,919	\$ 15,073,300	1,322
Eddy	1,288	\$ 3,778,006	427
Grant	681	\$ 2,410,536	240
Guadalupe	85	\$ 245,450	27
Harding	46	\$ 170,030	22
Hidalgo	107	\$ 451,572	47
Lea	985	\$ 1,607,767	332
Lincoln	368	\$ 1,172,035	131
Los Alamos	671	\$ 2,786,773	219
Luna	318	\$ 1,013,204	93
McKinley	1,007	\$ 2,753,121	275
Mora	120	\$ 445,605	36
Otero	1,256	\$ 4,211,012	486
Quay	257	\$ 732,286	73
Rio Arriba	1,107	\$ 3,287,425	404
Roosevelt	552	\$ 1,578,466	163
San Juan	2,046	\$ 4,949,538	716
San Miguel	693	\$ 2,352,266	225
Sandoval	1,730	\$ 6,720,639	407
Santa Fe	2,554	\$ 8,763,361	713
Sierra	149	\$ 570,279	47
Socorro	264	\$ 952,085	95
Taos	574	\$ 1,814,226	154
Torrance	281	\$ 1,029,841	73
Union	100	\$ 316,736	31
Valencia	1,557	\$ 4,980,495	483
Other	481	\$ 1,416,892	158
TOTAL:	37,701	\$ 132,858,563	11,848

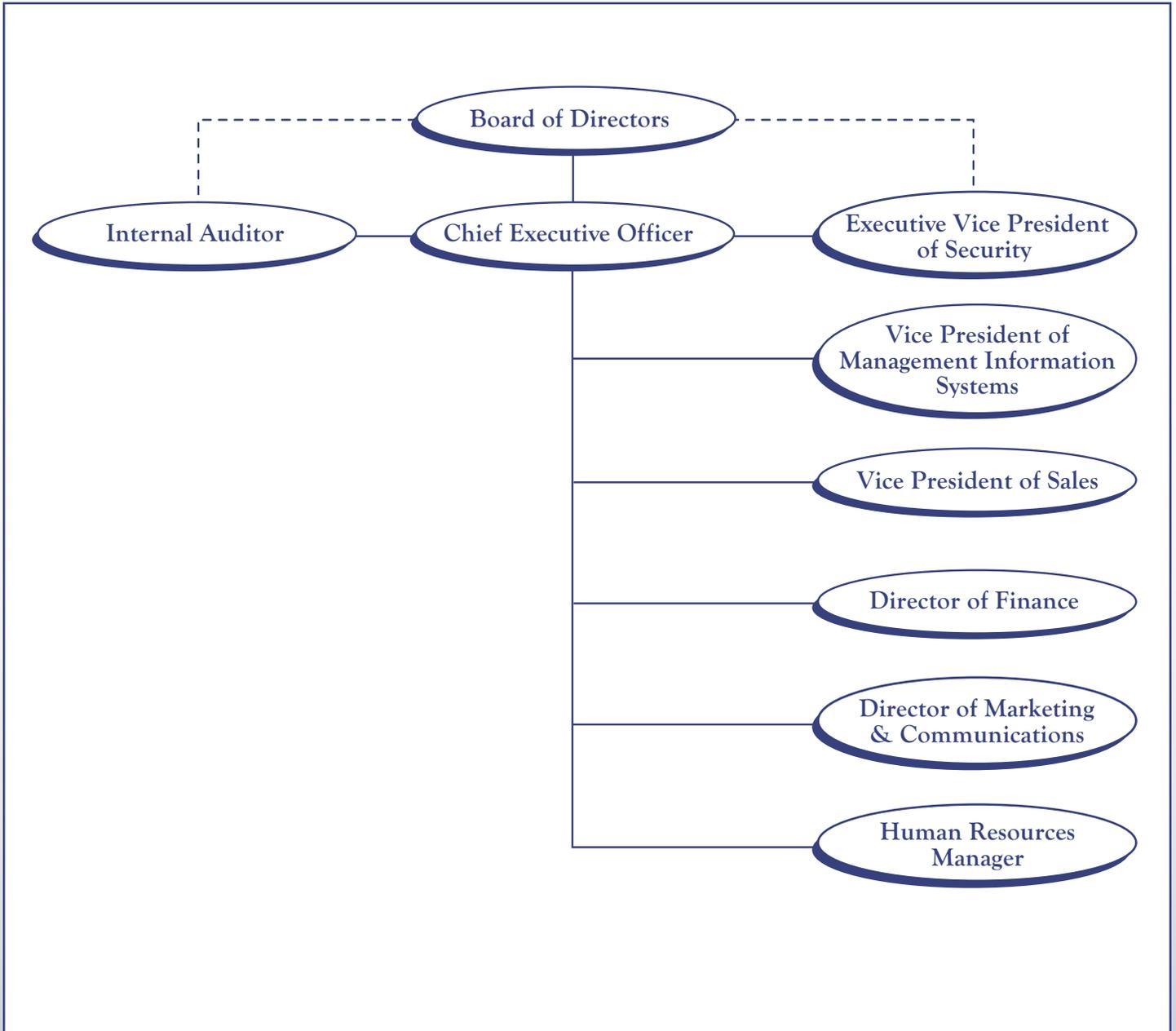


- Source: New Mexico Higher Education Department (NMHED), (800) 279-9777 / www.hed.state.nm.us; represents Lottery Success Scholarship draws through Spring '05
- These figures will always differ slightly in different categories because of official reconciliation and adjustments between NMHED and the various institutions
- The Lottery previously provided \$66,553,850 to the Public School Capital Outlay Fund for State-awarded school construction and repair grants. Following action by the New Mexico Legislature, the Lottery's contribution to this fund ended in fiscal year 2001 and the last grants made with Lottery revenues occurred in fiscal year 2002
- This report was prepared using the institution-supplied student and student financial aid files
- Rio Rancho High School's first graduating class was in FY 1999; some student data may be split between Bernalillo and Sandoval Counties
- "Other" includes New Mexico students who graduated from a Texas or Arizona high school under a reciprocal agreement with the State Department of Education and Arizona residents on the Navajo Reservation who qualify for Lottery Success Scholarships
- Student count is cumulative and includes all students that were awarded a Lottery Success Scholarship at any time; a majority of these students are still enrolled
- Graduates and degrees may include duplicates if a student attained more than one degree – i.e., a student received an Associates degree and continued for a Bachelors degree; degrees include bachelors, associate, certificate and professional; several graduate students are also included, because their Lottery scholarships applied to undergraduate tuition that was part of their simultaneous graduate programs
- Based on data submitted by institutions
- Graduates so far; non-graduates may still be enrolled, may no longer be on LSS, or may have left the institution
- Some students may be counted more than once because of transfers or other factors, according to HED

(* Includes students currently enrolled and those previously enrolled)

Organizational Chart

New Mexico Lottery Authority (Direct Reports)



INDEPENDENT AUDITORS' REPORT

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

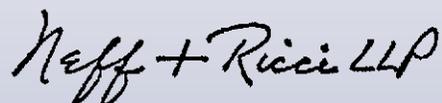
We have audited the accompanying basic financial statements of the State of New Mexico Lottery Authority (Lottery), a component unit of the State of New Mexico, as of and for the year ended June 30, 2005 and 2004, as listed in the table of contents. We have also audited the budgetary to actual statement 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 audits.

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 referred to above present fairly, in all material respects, the financial position of the Lottery as of June 30, 2005 and 2004, and the changes in its financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the budgetary to actual statement referred to above presents fairly, in all material respects, the budgetary comparison for the years ended June 30, 2005 and 2004 in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated September 9, 2005 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 considering the results of our audit.

For the year ended June 30, 2005, the Lottery has not presented the Management's Discussion and Analysis that the Governmental Accounting Standards Board has determined is necessary to supplement, although not required to be part of, the basic financial statements.



Albuquerque, New Mexico
September 9, 2005

STATEMENTS OF NET ASSETS

June 30, 2005 and 2004

	2005	2004
CURRENT ASSETS		
Cash	\$ 3,520,285	\$ 3,049,084
Accounts receivable (net of allowance for doubtful accounts)	763,744	1,751,903
Reserves on deposit	2,281,913	2,667,769
Inventory	16,135	17,377
Prepaid expenses	125,372	104,879
Total current assets	6,707,449	7,591,012
CAPITAL ASSETS, NET		
Total assets	\$ 7,403,274	\$ 8,533,888
CURRENT LIABILITIES		
Accounts payable and other current liabilities	\$ 1,945,181	\$ 2,304,373
Current portion of capital lease obligation	141,454	141,454
Prizes payable	2,468,569	3,057,302
Due to lottery tuition fund	2,691,979	2,733,214
Total current liabilities	7,247,183	8,236,343
LONG-TERM LIABILITIES		
Noncurrent portion of capital lease obligation	106,091	247,545
Total liabilities	\$ 7,353,274	\$ 8,483,888
NET ASSETS		
Invested in capital assets, net of related debt	\$ 448,280	\$ 553,877
Net assets – Restricted	50,000	50,000
Unrestricted net assets	(448,280)	(553,877)
Total net assets	\$ 50,000	\$ 50,000

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

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

Years ended June 30, 2005 and 2004

	2005	2004
REVENUES		
Instant ticket sales	\$ 90,840,412	\$ 87,019,208
Powerball sales	36,259,131	51,473,388
Roadrunner Cash sales	9,183,278	8,067,945
Pick 3 sales	2,063,825	2,091,054
4 This Way! sales	892,155	-
Retailer fees	42,618	31,523
Prize tickets	(4,741,715)	(6,292,089)
Spoiled, stolen, and promotional tickets	(70,542)	(73,864)
Total revenues	<u>134,469,162</u>	<u>142,317,165</u>
GAME EXPENSES		
Prize expense	76,173,863	78,875,562
Retailer commissions	8,938,622	10,131,112
On-line vendor fees	5,875,866	6,997,562
Advertising	2,566,777	2,494,471
Ticket vendor fees	1,351,089	1,236,725
Reserve Fund expense	767,634	91,027
Promotions	387,391	379,011
Shipping and postage	359,250	415,019
Instant ticket vending machine lease	331,750	394,200
Drawing game	124,994	134,997
Game membership	73,100	208,484
Total game expenses	<u>96,950,336</u>	<u>101,358,170</u>
OPERATING EXPENSES		
Salaries, wages, and benefits	3,640,793	3,581,334
Leases and insurance	616,968	599,606
Depreciation and amortization	424,025	332,085
Utilities and maintenance	380,152	368,217
Professional fees	240,687	176,633
Other	87,821	90,979
Travel	85,853	76,282
Materials and supplies	85,835	77,615
Total operating expenses	<u>5,562,134</u>	<u>5,302,751</u>
OPERATING INCOME	<u>31,956,692</u>	<u>35,656,244</u>
NON-OPERATING INCOME		
Other income	140,767	180,199
Interest income	133,058	99,952
Total non-operating income	<u>273,825</u>	<u>280,151</u>
Net income before transfers	32,230,517	35,936,395
Transfers to Lottery Tuition Fund	<u>(32,230,517)</u>	<u>(35,936,395)</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.

STATEMENT OF CASH FLOWS

Years ended June 30, 2005 and 2004

	Increase (Decrease) in Cash	
	<u>2005</u>	<u>2004</u>
Cash flows from operating activities		
Cash received:		
From retailers-sales net of commissions, incentives, and prize, spoiled, and stolen ticket credits	\$126,518,699	\$133,008,789
Cash payments:		
To prize winners and related taxes	(65,935,366)	(63,044,549)
To suppliers of goods or services	(14,286,079)	(14,307,927)
To employees for services and related taxes	(3,031,448)	(2,920,821)
To MUSL	(10,827,230)	(16,996,244)
Net cash provided by operating activities	<u>32,438,576</u>	<u>35,739,248</u>
Cash flows from investing activities		
Deletions to MUSL Reserve Accounts	459,876	819,224
Receipts of interest	58,731	29,372
Receipts of rent	118,004	113,304
Other	28,606	78,290
Net cash provided in investing activities	<u>665,217</u>	<u>1,040,190</u>
Cash flows from noncapital financing activities		
Transfers to Lottery Tuition Fund	(32,271,752)	(36,220,085)
Cash flows from capital and related financing activities		
Purchases of capital assets	(219,386)	(350,699)
Principal payments under capital lease	(141,454)	(11,787)
Net cash used by related financing activities	<u>(360,840)</u>	<u>(362,486)</u>
NET INCREASE IN CASH	471,201	196,867
Cash at beginning of year	<u>3,049,084</u>	<u>2,852,217</u>
Cash at end of year	<u>\$ 3,520,285</u>	<u>\$ 3,049,084</u>

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

STATEMENT OF CASH FLOWS – *continued*

Years ended June 30, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Reconciliation of operating income to net cash provided by operating activities		
Operating income	\$ 31,956,692	\$ 35,656,244
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	424,025	332,085
Additional contributions (deletions) to MUSL Reserve Accounts	(459,876)	57,732
Interest on MUSL Unreserved Account	74,327	70,580
Vendors' non-cash transactions	(5,843)	(11,395)
Net changes in assets and liabilities:		
Accounts receivable	988,159	822,736
Reserves on deposit	385,856	30,951
Inventory	1,242	223,884
Prepaid expenses	(20,493)	(9,010)
Accounts payable and other liabilities	(359,192)	(223,722)
Accrued capital purchases	42,412	(45,606)
Prizes payable	(588,733)	(1,165,231)
Net cash provided by operating activities	<u>\$ 32,438,576</u>	<u>\$ 35,739,248</u>

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

NOTES TO FINANCIAL STATEMENTS

June 30, 2005 and 2004

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

2. Basis of Presentation – continued

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.

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 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. Operating expenses include administrative expenses required to manage and operate the Lottery. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

3. Budgets and Budgetary Accounting

Every year Lottery management submits a budget prepared 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 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 and demand deposits.

5. Restricted Cash

The Lottery was required by the terms of its initial main office building lease agreement to deposit an amount equal to five

Note A – Summary of Significant Accounting Policies – *continued*

5. Restricted Cash – *continued*

months of rent in an interest-bearing escrow account. The restricted cash was held in an escrow account at an interest rate of less than 1%. Accrued interest on the security deposit was paid monthly to the Lottery. The initial amount of the security deposit was reduced every six months, beginning six months from the occupancy date, by an amount equal to one month's rent until the security deposit equaled the amount of one month's rent. This remained the required security deposit for the balance of the term until April 29, 2005 when the lessor released the Lottery from the requirement for this security deposit and allowed the Lottery to withdraw the deposit from the escrow account. Therefore, at June 30, 2005 and June 30, 2004, the restricted cash balances were zero and \$22,086, respectively.

6. 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 receivables. At June 30, 2005 and 2004, an allowance for doubtful accounts of \$89,363 and \$118,931, respectively, has been provided to recognize future uncollectible billings.

In fiscal years 2005 and 2004, ten customers (421 and 420 retailer locations) represented 44% of sales for each year and 41% and 43%, respectively for each year, of accounts receivable.

7. 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,

7. Reserves on Deposit – *continued*

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, 2005 and 2004, the Lottery's share of the Powerball prize reserve was \$2,046,000 and \$2,601,102, respectively, and the Lottery's share of the Powerball unreserved fund was \$235,913 and \$66,667, 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 the grand prize winner. The Lottery currently is not paying any prize winner any annuity prize payments.

8. 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, 2005 has substantially depleted any instant ticket inventory owned by the Lottery.

9. Capital Assets

Capital assets, which include data processing software and hardware, tenant improvements, vehicles, and equipment are

NOTES TO FINANCIAL STATEMENTS – *continued*

June 30, 2005 and 2004

Note A – Summary of Significant Accounting Policies – *continued*

9. Capital Assets – *continued*

stated at cost net of accumulated depreciation. The Lottery capitalizes all capital assets that have a cost greater than \$1,000 and an expected useful life of more than one year. 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.

10. 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.

11. Prizes

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

12. 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.

13. Advertising Costs

Advertising costs are expensed as incurred.

14. Income Taxes

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

15. Cash and Concentrations of Credit Risk

At June 30, 2005 the Lottery maintained its cash balances in two financial institutions. The balances for demand deposits were insured by the Federal Deposit Insurance Corporation up to \$100,000 for each of 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 short-term investments 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 local financial institutions and are held in safekeeping in their trust departments. Repurchase agreements are collateralized by the Federal Home Loan Bank Securities with a market value of at least 102% of the principal and are used for overnight investment only. As of June 30, 2005 the Lottery's bank balances of \$3,697,751 were not exposed to custodial credit risk because they were insured and collateralized with securities pledged to the NM Lottery Authority.

NOTES TO FINANCIAL STATEMENTS – *continued*

June 30, 2005 and 2004

Note A – Summary of Significant Accounting Policies – *continued*

16. Bank Accounts

Description	Bank	Balance per Bank
Operating account – checking	Bank of America	\$ 92,441
Payables account – checking	Bank of America	-
Receiving account – checking	Bank of America	-
Payroll account – checking	Bank of America	-
Prize account – checking	Bank of America	-
Operating account – repurchase	First State Bank	3,605,310
Payables account – checking	First State Bank	-
Receiving account – checking	First State Bank	-
Payroll account – checking	First State Bank	-
Prize account – checking	First State Bank	-
Total amount deposited in bank		3,697,751
Less: FDIC coverage		<u>(92,441)</u>
Total uninsured funds – repurchase agreement		<u>\$ 3,605,310</u>
102% collateral requirement for repurchase agreement		\$ 3,677,416
*Pledged security		<u>(4,300,000)</u>
Amount under (over) requirement at June 30, 2005		<u>\$ (622,584)</u>

*Security is held in safekeeping at the Federal Home Loan Bank in Dallas, Texas. Federal Home Loan Bank, presented at fair value, CUSIP Number 3133X2BZ7, matures November 14, 2008.

**The repurchase agreement is collateralized with securities held in the name of their agent.

Cash per bank at June 30, 2005	\$ 3,697,751
Less reconciling items – outstanding checks	<u>(179,966)</u>
Reconciled cash in bank at June 30, 2005	3,517,785
Cash in vault	<u>2,500</u>
Total cash per statements of net assets	<u>\$ 3,520,285</u>

17. Insurance

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

18. 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, 2005 and 2004, the amounts that had been set aside and expended were \$767,634 and \$91,027, respectively.

19. Net Assets – Restricted

Any Reserve Fund amounts not expended by fiscal year end for the defined purposes (see note 18) 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.

20. 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.

21. 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.

22. Shipping and Handling Costs

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

NOTES TO FINANCIAL STATEMENTS – *continued*

June 30, 2005 and 2004

Note A – Summary of Significant Accounting Policies – *continued*

23. 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. During the years ended June 30, 2005 and 2004, the following changes occurred in the compensated absences liabilities:

<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

<u>Balance</u> <u>July 1, 2003</u>	<u>Increase</u>	<u>Decrease</u>	<u>Balance</u> <u>June 30, 2004</u>
\$ 296,236	\$ 46,991	\$ (40,531)	\$ 302,696

The portion of compensated absences due after one year is not material, and therefore, is not presented separately.

24. Long-term Liabilities – Capital Lease Obligations

During the years ended June 30, 2005 and 2004 the following changes occurred in the capital lease obligations:

<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

<u>Balance</u> <u>July 1, 2003</u>	<u>Increase</u>	<u>Decrease</u>	<u>Balance</u> <u>June 30, 2004</u>	<u>Amounts</u> <u>Due Within</u> <u>One Year</u>
\$ -	\$ 400,786	\$ (11,787)	\$ 388,999	\$ 141,454

NOTES TO FINANCIAL STATEMENTS – *continued*

June 30, 2005 and 2004

Note B – Capital Assets

Capital assets at June 30, 2005 consisted of:

	Beginning Balance	Additions	Deletions	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	6,156,415	176,974	(109,121)	6,224,268
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	(5,213,539)	(424,025)	109,121	(5,528,443)
Capital assets, net	\$ 942,876	\$ (247,051)	\$ -	\$ 695,825

Included in data processing software and data processing equipment are \$400,786 in assets under a capital lease at June 30, 2005 and 2004. There was \$141,454 and \$11,787 in related amortization on these assets in fiscal years 2005 and 2004, respectively.

Capital assets at June 30, 2004 consisted of:

	Beginning Balance	Additions	Deletions	Ending Balance
Data Processing software	\$ 1,797,002	\$ 309,564	\$ -	\$ 2,106,566
Data processing equipment	1,641,833	172,262	-	1,814,095
Tenant improvements	680,813	17,168	-	697,981
Vehicles	470,436	22,645	-	493,081
Equipment - communications	243,035	56,503	-	299,538
Furniture and fixtures	285,046	-	-	285,046
Equipment - drawing	242,002	73,508	(54,422)	261,088
Equipment - warehouse	150,638	2,487	-	153,125
Equipment - office	44,395	1,500	-	45,895
Capital assets	5,555,200	655,637	(54,422)	6,156,415
Data Processing software	(1,780,345)	(27,261)	-	(1,807,606)
Data processing equipment	(1,483,826)	(110,074)	-	(1,593,900)
Tenant improvements	(553,157)	(34,500)	-	(587,657)
Vehicles	(191,564)	(137,854)	-	(329,418)
Equipment - communications	(243,035)	(3,129)	-	(246,164)
Furniture and fixtures	(281,228)	(804)	-	(282,032)
Equipment - drawing	(227,592)	(11,789)	54,422	(184,959)
Equipment - warehouse	(150,381)	(256)	-	(150,637)
Equipment - office	(24,748)	(6,418)	-	(31,166)
Accumulated depreciation	(4,935,876)	(332,085)	54,422	(5,213,539)
Capital assets, net	\$ 619,324	\$ 323,552	\$ -	\$ 942,876

NOTES TO FINANCIAL STATEMENTS – continued

June 30, 2005 and 2004

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, 2004	\$ 2,783,214	\$ 2,733,214	\$ -	\$ 50,000
Current year net income	32,230,517	32,230,517	-	-
Current year transfers	<u>(32,271,752)</u>	<u>(32,271,752)</u>	<u>-</u>	<u>-</u>
Balance at June 30, 2005	<u>\$ 2,741,979</u>	<u>\$ 2,691,979</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, 2005 and 2004, the Lottery has transferred \$32,230,517 and \$35,936,395, respectively, for the periods ended June 30, 2005 and 2004 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.

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, 2005 and 2004, the Lottery recognized \$335,483 and \$341,145 of pension expense for the Plan on eligible compensation of \$2,531,947 and \$2,574,679, respectively. Except for the June 2004 contribution, the entire pension expense amounts had been paid

Note D – Retirement Plan – continued

Funding Policy – continued

to the Plan by June 30, 2005 and June 30, 2004, respectively. The June 2004 pension contribution was made in July 2004.

Presented below are the June 30, 2005 and 2004 Statements of Fiduciary Net Assets and Statements of Change in Net Assets:

	2005	2004
ASSETS		
Cash and equivalents	\$ 153,818	\$ 171,460
Marketable securities and other investments	2,125,894	1,763,656
Contribution receivable	<u>6,048</u>	<u>38,216</u>
Total assets	<u>\$ 2,285,760</u>	<u>\$ 1,973,332</u>
NET ASSETS		
Pension plan participants' benefits	<u>\$ 2,285,760</u>	<u>\$ 1,973,332</u>
ADDITIONS		
Investment earnings	\$ 123,373	\$ 225,973
Employer contributions	<u>335,483</u>	<u>341,145</u>
Total additions	458,856	567,118
DEDUCTIONS		
Distributions to participants	<u>146,428</u>	<u>61,413</u>
Change in net assets	312,428	505,705
Net assets – beginning	<u>1,973,332</u>	<u>1,467,627</u>
Net assets – ending	<u>\$ 2,285,760</u>	<u>\$ 1,973,332</u>

Note E – Credit Agreement

In May 2001, the Lottery entered into an unsecured credit agreement with Bank of America. The agreement provided an overdraft protection facility for the Lottery's operating bank account in the amount of \$1,000,000, with an interest rate at the Bank of America's Prime Rate of 4.00% at June 30, 2004. This credit agreement matured in May 2005. In July 2005 the Lottery entered a new agreement with 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 the first year (5.75% at June 30, 2005). The line matures in May 2006. For the periods ended June 30, 2005 and 2004, the Lottery had no outstanding borrowings against the lines.

NOTES TO FINANCIAL STATEMENTS – *continued*

June 30, 2005 and 2004

Note F – Leases

The Lottery has entered into operating leases for the rental of office and warehouse space, and vending machines. Rent expense was \$791,047 and \$837,472 for the years ending June 30, 2005 and 2004, respectively. Certain leases contain provisions for scheduled rental increases for inflationary purposes and are renewable at the option of the Lottery. 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:

Year	Amount
2006	\$ 594,926
2007	559,071
2008	309,485
2009	378,886
2010	431,485
2011-2013	1,186,585
	\$ 3,460,438

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

Year	Amount
2006	\$ 112,500
2007	117,200
2008	122,000
2009	52,600
	\$ 404,300

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

	2005	2004
Minimum rentals	\$ 768,841	\$ 815,043
Less: Sublease rentals	(108,800)	(104,100)
	\$ 660,041	\$ 710,943

Note F – Leases – *continued*

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:	
2006	\$ 136,076
2007	140,769
Total minimum payments	276,845
Less the amount representing interest	(29,300)
Present value of net minimum payments	\$ 247,545

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 at a rate of 8.5236% of on-line sales less than \$60 million. 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:

	2005	2004
Training	\$ 33,405	\$ 31,218
Other	27,412	28,584
Registrations and memberships	23,521	28,102
Publications and subscriptions	3,483	3,075
	\$ 87,821	\$ 90,979

BUDGET TO ACTUAL COMPARISON STATEMENTS

Years ended June 30, 2005 and 2004

	2005				2004			
	Original Budget	Revised Budget	Actual	Variance with Revised Budget	Original Budget	Revised Budget	Actual	Variance with Revised Budget
Revenues								
Instant ticket sales	\$ 87,475,000	\$ 88,500,000	\$ 90,840,412	\$ 2,340,412	\$ 81,000,000	\$ 84,200,000	\$ 87,019,208	\$ 2,819,208
Powerball sales	51,600,000	40,000,000	36,259,131	(3,740,869)	45,000,000	51,000,000	51,473,388	473,388
Roadrunner Cash sales	7,500,000	8,500,000	9,183,278	683,278	7,800,000	7,300,000	8,067,945	767,945
Pick 3 sales	2,025,000	2,050,000	2,063,825	13,825	2,000,000	2,000,000	2,091,054	91,054
4 This Way! sales	1,375,000	1,000,000	892,155	(107,845)	-	-	-	-
Retailer fees	32,000	40,000	42,618	2,618	24,000	32,000	31,523	(477)
Prize tickets	(6,000,000)	(5,000,000)	(4,741,715)	258,285	(5,000,000)	(6,500,000)	(6,292,089)	207,911
Spoiled, stolen, and promotional tickets	(132,000)	(90,000)	(70,542)	19,458	(174,000)	(132,000)	(73,864)	58,136
Bad debts	(24,000)	(24,000)	-	24,000	(24,000)	(24,000)	-	24,000
Total revenues	143,851,000	134,976,000	134,469,162	(506,838)	130,626,000	137,876,000	142,317,165	4,441,165
Total game expenses	103,031,000	97,117,000	96,950,336	(166,664)	95,469,000	98,831,000	101,358,170	2,527,170
Total operating expenses	6,285,000	5,880,000	5,562,134	(317,866)	6,244,000	5,739,000	5,302,751	(436,249)
Operating income	34,535,000	31,979,000	31,956,692	(22,308)	28,913,000	33,306,000	35,656,244	2,350,244
Total non-operating income	228,000	221,000	273,825	52,825	256,000	286,000	280,151	(5,849)
Net income before transfers to Lottery Tuition Fund	\$ 34,763,000	\$ 32,200,000	\$ 32,230,517	\$ 30,517	\$ 29,169,000	\$ 33,592,000	\$ 35,936,395	\$ 2,344,395

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

Credits

Writer

Lance Ross

Layout and Design

Jessica Quintana

Contributing Photographers

Wendy Creel, Nadine Guillén, Jessica Quintana, Pat Ratledge, Lance Ross

Financial Statements and Notes to Financial Statements

Sylvia A. Jaramillo, CPA

Additional Research

Adriana Binns, Gina Borrego, Nadine Guillén,
Carolyn Hall, Jim Howard, Mary Kranz, CPA,
Linda McLaughlin, Philippe Menzies,
Pat Shodean, Karla Wilkinson

Additional Assistance

Paul Landrum, Ofelia Morales, Laura Mulry
New Mexico Higher Education Department

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PO Box 93130
Albuquerque, NM 87199-3130
(505) 342-7600
www.nmlottery.com