

**NEW MEXICO
LOTTERY AUTHORITY**

Financial Statements

June 30, 2007

New Mexico Lottery Authority

OFFICIAL ROSTER

June 30, 2007

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OFFICIALS OF THE NEW MEXICO LOTTERY AUTHORITY

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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 Information Technology and Product Development Department, under the direction of the Senior Vice President, 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 Product Development area manages and monitors the instant and online products, including such areas as game launches, game endings, inventory management, customer relationship management, and performance analysis using several key performance indicators.

The Sales Department, under the direction of the Director 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 Department, 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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Independent Auditors' Report

Board of Directors
New Mexico Lottery Authority
and
Mr. Hector H. Balderas
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 years ended June 30, 2007 and 2006, as listed in the table of contents. We have also audited the budgetary to actual statements presented as supplementary information. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express opinions on these financial statements based on our audits.

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

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the Lottery and its fiduciary fund as of June 30, 2007 and 2006, and the changes in its financial position and, where applicable, 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 statements referred to above presents fairly, in all material respects, the budgetary comparison for the years ended June 30, 2007 and 2006 in conformity with accounting principles generally accepted in the United States of America.

Board of Directors
New Mexico Lottery Authority
and
Mr. Hector H. Balderas
New Mexico State Auditor

In accordance with *Government Auditing Standards*, we have also issued a report dated October 22, 2007 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 grant agreements 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 considered in assessing the results of our audit.

The management's discussion and analysis, on pages 3 through 18, is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Albuquerque, New Mexico
October 22, 2007

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, 2007 and 2006 with comparative numbers for fiscal year 2005. Please read it in conjunction with the financial statements, which begins on page 19.

FINANCIAL HIGHLIGHTS

- At the end of fiscal year 2007 the Lottery's total current assets increased by 38.6% or \$3,040,987 in comparison to fiscal year 2006 and increased by 17.6% or \$1,180,400 in fiscal year 2006 in comparison to the end of the previous year.
- The Lottery's total current liabilities increased by 32.9% or \$2,792,054 at the end of fiscal year 2007 and increased 17.2% or \$1,248,835 at the end of fiscal year 2006 in comparison to the previous fiscal year.
- In fiscal year 2007 total revenues were \$148,080,254, a decrease of \$1,962,146 or 1.3%, compared to the previous fiscal year. In fiscal year 2006 total revenues were \$150,042,400, an increase of 11.6% or \$15,573,238 higher than fiscal year 2005.
- From the previous fiscal years, total game expenses decreased by \$27,531, (0.03%), in fiscal year 2007, whereas, in fiscal year 2006, total game expenses increased by \$11,258,293 or 11.6%.
- In fiscal year 2007 operating expenses increased by \$269,322 or 4.9% compared to the previous fiscal year, while in fiscal year 2006 total operating expenses decreased by \$49,628 (0.9%) from the previous fiscal year.
- Total non-operating income improved from the previous fiscal years by \$178,517, 33.41%, and \$260,466 or 95.1% in fiscal years 2007 and 2006, respectively.
- Net Income in fiscal year 2007 was \$34,830,136 a decrease of \$2,025,420 (5.5%), from the previous fiscal year's Net Income of \$36,855,556. Fiscal year 2007's Net Income was an increase of \$4,625,039, 14.3%, in comparison to the net income in fiscal year 2005.
- Including the final transfer on July 31, 2007 of June 2007 net revenues, the Lottery has transferred \$320,939,044 to the State of New Mexico since the commencement of sales in April 1996.

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.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

Financial Statements. The Statements of Net Assets on Page 19 and the Statements of Revenues, Expenses, and Changes in Net Assets on page 20 report the Lottery's assets, liabilities, revenues and expenses in comparative format for fiscal year 2007 and fiscal year 2006. The Statements of Cash Flows on pages 21 and 22 report the sources and uses of cash for fiscal years 2007 and 2006. The Statements of Fiduciary Net Assets on page 23 and Statements of Changes in Fiduciary Net Assets on page 24 report the balances and activity of the Lottery's Retirement Plan for fiscal years 2007 and 2006.

Notes to Financial Statements. The Notes to Financial Statements on pages 25 to 40 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 41 show 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

At the end of fiscal year 2007, the Lottery's total assets and total liabilities were equal with total net assets reduced to zero. The \$50,000 balance in the reserve account since fiscal year 1996 was recorded as a liability to the Lottery Tuition Fund at the close of fiscal year 2007. As of July 1, 2007, the provision for a 2% Reserve Fund was removed from the New Mexico Lottery Act. Therefore, the \$50,000 balance in the 2% Reserve Fund was transferred with the final transfer of net revenues to the Lottery Tuition Fund.

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

In fiscal years 2007 and 2006, the Lottery set aside and expended \$911,933 and \$1,071,934, respectively, in the 2% reserve fund. In the fiscal years 2007 and 2006, respectively, \$723,509 and \$766,491 were set aside and expended for bonuses and incentives for retailers, \$65,424 and \$122,054 for responsible gaming advertising, \$81,120 each year for a responsible gaming hotline, \$0 and \$63,262 for special promotions, \$41,880 and \$38,984 for integrity, and \$0 and \$23 for clerk incentives, all in accordance to the specified purposes per the Act, and leaving a balance in the 2% reserve fund of \$0 and 50,000 at the end of fiscal year 2007 and 2006, respectively.

New Mexico Lottery Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) – CONTINUED

OVERVIEW OF THE FINANCIAL STATEMENTS - CONTINUED

Assets

Table 1

Assets

	2007	2006	2005	Increase (Decrease) \$ Change 2006 to 2007	Increase (Decrease) % Change 2006 to 2007	Increase (Decrease) \$ Change 2005 to 2006	Increase (Decrease) % Change 2005 to 2006
Cash and cash equivalents	\$ 6,828,460	\$ 4,574,650	\$ 3,520,285	\$ 2,253,810	49.3%	\$ 1,054,365	30.0%
Accounts receivable, net	1,650,965	837,420	763,744	813,545	97.1	73,676	9.6
Reserves on deposit	2,338,018	2,339,765	2,281,913	(1,747)	(0.1)	57,852	2.5
Inventory	15,790	15,932	16,135	(142)	(0.9)	(203)	(1.3)
Prepaid expenses	95,603	120,082	125,372	(24,479)	(20.4)	(5,290)	(4.2)
Total current assets	10,928,836	7,887,849	6,707,449	3,040,987	38.6	1,180,400	17.6
Capital assets, net	359,236	658,169	695,825	(298,933)	(45.4)	(37,656)	(5.4)
Total assets	\$ 11,288,072	\$ 8,546,018	\$ 7,403,274	\$ 2,742,054	32.1%	\$ 1,142,744	15.4%

The Lottery's cash and cash equivalent balances at the end of fiscal years 2007 and 2006 were \$2,253,810 or 49.3% and \$1,054,365 or 30% in excess of the previous years, respectively. The increases in cash in both years related mainly to increases in prizes accrued for the Lottery's games at the end of the two fiscal years.

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 and any miscellaneous receivables from any other source. Accounts Receivable increased by \$813,545 between fiscal year 2007 and 2006. This change was mostly due to higher sales for the last week of fiscal year 2007 in comparison to fiscal year 2006 and also included \$158,533 due from the Multi-State Lottery Association (MUSL) for interest earned in fiscal year 2007 on the deposits with MUSL. The change in accounts receivable between fiscal year 2006 and 2005 was not significant, less than \$75,000.

The Lottery has reserves on deposit with MUSL as required by the Powerball® (Powerball) and Hot Lotto® (Hot Lotto) game rules. The change in these reserve amounts in both fiscal years 2007 and 2006 was insignificant.

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 2007 and 2006 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 2007 and 2006. The related liability for the CRM system was fully amortized in fiscal year 2007 and was included in the current portion of capital lease obligation (\$106,091) in fiscal year 2006. There were no significant changes in capital assets in fiscal years 2007 and 2006 other than depreciation expense.

Liabilities

Table 2
Liabilities

	2007	2006	2005	Increase (Decrease) \$ Change 2006 to 2007	Increase (Decrease) % Change 2006 to 2007	Increase (Decrease) \$ Change 2005 to 2006	Increase (Decrease) % Change 2005 to 2006
Accounts pay- able and other current liabilities	\$ 2,550,728	\$ 2,225,990	\$ 1,945,181	\$ 324,738	14.6%	\$ 280,809	14.4%
Current portion of capital lease obligation	-	106,091	141,454	(106,091)	(100.0)	(35,363)	(25.0)
Prizes payable	5,576,596	3,495,708	2,468,569	2,080,888	59.5	1,027,139	41.6
Due to lottery tuition fund	3,160,748	2,668,229	2,691,979	492,519	18.5	(23,750)	(0.9)
Total current liabilities	11,288,072	8,496,018	7,247,183	2,792,054	32.9	1,248,835	17.2
Noncurrent por- tion of capital lease obligation	-	-	106,091	-	-	(106,091)	(100.0)
Total liabilities	<u>\$ 11,288,072</u>	<u>\$ 8,496,018</u>	<u>\$ 7,353,274</u>	<u>\$ 2,792,054</u>	32.9	<u>\$ 1,142,744</u>	15.5%

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Liabilities - Continued

Accounts payable and other current liabilities were \$324,738 and \$280,809 higher in fiscal years 2007 and 2006 than in the previous fiscal years. In fiscal year 2007 this was primarily due to amounts owed to four vendors of the Lottery for advertising, on-line and instant ticket fees and amounts payable to MUSL for the Powerball and Hot Lotto games' share of prizes. Sales at the end of fiscal year 2007 were higher than at the end of fiscal year 2006, thus, resulting in higher amounts due to the vendors as a percentage of sales. In fiscal year 2006 the 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 because sales were higher for Powerball for the last few weeks of fiscal year 2006 in comparison to the same time period in fiscal year 2005.

Prizes payable is essentially 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 2007 prize payable increased by over two million dollars and at the end of fiscal year 2006 prizes payable increased by over one million dollars. These differences relate to the change of prizes payable on the Lottery games between the years, but also to about 1.5 million and one million dollars more of unclaimed prizes being carried over for planned use in the game design and prize structures of Lottery games in fiscal years 2008 and 2007.

At the end of fiscal years 2007 and 2006, \$3,160,748 and \$2,668,229, 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 31, 2007 and July 28, 2006, 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

	2007		
	Sales	Prize Expense	Gross Margin
Instant ticket, net of prize, stolen, and promotional tickets	\$ 91,366,360	\$ 56,153,065	\$ 35,213,295
Powerball, net of spoiled and promotional tickets	42,578,490	21,312,734	21,265,756
Roadrunner Cash, net of spoiled and promotional tickets	7,905,584	4,448,375	3,457,209
Hot Lotto, net of spoiled and promotional tickets	3,474,154	1,657,403	1,816,751
Pick 3, net of spoiled and promotional tickets	2,056,965	1,192,340	864,625
4 This Way!, net of spoiled and promotional tickets	652,910	355,838	297,072
Total	<u>\$ 148,034,463</u>	<u>\$ 85,119,755</u>	<u>\$ 62,914,708</u>
	2006		
	Sales	Prize Expense	Gross Margin
Instant ticket, net of prize, stolen, and promotional tickets	\$ 84,814,849	\$ 51,253,084	\$ 33,561,765
Powerball, net of spoiled and promotional tickets	54,064,465	27,093,452	26,971,013
Roadrunner Cash, net of spoiled and promotional tickets	8,339,340	4,669,830	3,669,510
Pick 3, net of spoiled and promotional tickets	2,007,574	1,159,915	847,659
4 This Way!, net of spoiled and promotional tickets	768,992	450,175	318,817
Total	<u>\$ 149,995,220</u>	<u>\$ 84,626,456</u>	<u>\$ 65,368,764</u>
	2005		
	Sales	Prize Expense	Gross Margin
Instant ticket, net of prize, stolen, and promotional tickets	\$ 86,089,660	\$ 51,178,563	\$ 34,911,097
Powerball, net of spoiled and promotional tickets	36,208,061	18,129,565	18,078,496
Roadrunner Cash, net of spoiled and promotional tickets	9,176,098	5,108,760	4,067,338
Pick 3, net of spoiled and promotional tickets	2,061,886	1,241,345	820,541
4 This Way!, net of spoiled and promotional tickets	890,839	515,630	375,209
Total	<u>\$ 134,426,544</u>	<u>\$ 76,173,863</u>	<u>\$ 58,252,681</u>
\$ Increase (decrease) from FY 2006 to FY 2007	<u>\$ (1,960,757)</u>	<u>\$ 493,299</u>	<u>\$ (2,454,056)</u>
% Increase (decrease) from FY 2006 to FY 2007	<u>(1.3%)</u>	<u>0.6%</u>	<u>-3.8%</u>
\$ Decrease from FY 2005 to FY 2006	<u>\$ 15,568,676</u>	<u>\$ 8,452,593</u>	<u>\$ 7,116,083</u>
% Decrease from FY 2005 to FY 2006	<u>11.6%</u>	<u>11.1%</u>	<u>12.2%</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS – CONTINUED

Sales and Prize Expense – Continued

Table 3 compares net sales, prize expense and gross margin (net sales minus prize expense) for each lottery game for fiscal year 2007, 2006, and 2005. In fiscal year 2007 sales, prize expense, and gross margin increased for both Instant tickets and Pick 3, but decreased for Powerball, Roadrunner Cash, and 4 This Way!. The Lottery's new game, Hot Lotto, produced \$1.8 million in gross margin in fiscal year 2007. 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

In both fiscal years 2007 and 2006, the Lottery continued to use the 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 2007, sales on sixty-one instant ticket games were launched--20-\$1, 18-\$2, 10-\$3, 10-\$5, 2-\$10 games and 1-\$20—two more \$2, two more \$3, three more \$5, one less \$10 and one more \$20 game than in the previous fiscal year. 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 2007, the Lottery launched 23 games with prize tickets and 38 games without prize tickets, while in fiscal year 2006 the Lottery launched 25 games with prize tickets and 29 games without prize tickets. Instant ticket sales for eleven months in fiscal year 2007 were higher than in fiscal year 2006. Instant ticket 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 2007, there were three jackpots that were more than \$200 million, the largest going to \$254 million. There were also two jackpots that rose to \$106 and \$182 million each. In fiscal year 2006, there were two jackpots over 300 million dollars each—to \$340 million and to \$365 million. There was also a jackpot that rose to \$224.2 million and three other jackpot run-ups in the year that went over \$100 million each. The difference in the jackpots amounts in the two fiscal years produced a drop in Powerball sales in fiscal year 2007 by almost \$11.5 million. In fiscal year 2006 the jackpot run-ups contributed to Powerball sales being almost eighteen million dollars more than in fiscal year 2005.

Similar to Powerball, Roadrunner Cash sales are driven by the top prize amount. In fiscal year 2007, the top prize rose to more than \$150,000 on seven occasions, climbing to \$687,000 in November 2006 and to \$200,000 in April 2007. In fiscal year 2006, the top prize was more than \$150,000 eight times climbing once to \$390,000 and twice to over \$200,000. 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. Because of these differences in the top prizes

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Sales and Prize Expense - Continued

Sales – Continued

during these fiscal years, sales were higher in fiscal year 2005 than in either fiscal year 2007 or 2006. In fiscal year 2007, the new game, Hot Lotto, was also introduced. Sales for the MUSL game, Hot Lotto started on November 12, 2006 with the first drawing on November 15, 2006. Hot Lotto sales for the seven and one-half months in fiscal year were almost \$3.5 million and more than met the expectations for sales for this new game during fiscal year 2007.

Pick 3 sales in fiscal years 2007 and 2006 are comparable, contributing over \$2,000,000 to on-line sales in each year. 4 This Way! sales having been decreasing during the last few fiscal years, thus, the game will be ended in October 2007.

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 and the prize structure of the games. In fiscal year 2007, prize expense increased in relation to the decrease in sales in comparison to fiscal year 2006. This was mainly due to an increase of about 1% in the instant ticket prize expense in fiscal year 2007. This increase in prizes for instant games produced an increase in gross margin of over \$1.65 million or a 4.9% increase. In fiscal year 2006, prize expense increased as a result of the increase in sales.

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 and help the Lottery to maximize its sales.

Prize Tickets

In fiscal years 2007 and 2006, prize tickets decreased in instant games by \$197,376 (4.4%) and \$208,522 (4.4%), 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 point 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

	2007	2006	2005	Increase (Decrease) \$ Change 2006 to 2007	Increase (Decrease) % Change 2006 to 2007	Increase (Decrease) \$ Change 2005 to 2006	Increase (Decrease) % Change 2005 to 2006
Prize expense	\$ 85,119,755	\$ 84,626,456	\$ 76,173,863	\$ 493,299	0.6%	\$ 8,452,593	11.1%
Retailer							
commissions	9,754,742	9,859,881	8,938,622	(105,139)	(1.1)	921,259	10.3
On-line vendor							
fees	6,597,580	7,414,912	5,875,866	(817,332)	(11.0)	1,539,046	26.2
Advertising	2,913,129	2,816,695	2,566,777	96,434	3.4	249,918	9.7
Ticket vendor							
fees	1,444,683	1,282,575	1,351,089	162,108	12.6	(68,514)	(5.1)
Other game							
expenses	<u>2,351,209</u>	<u>2,208,110</u>	<u>2,044,119</u>	<u>143,099</u>	6.5	<u>163,991</u>	8.0
Total game							
expenses	<u>\$ 108,181,098</u>	<u>\$ 108,208,629</u>	<u>\$ 96,950,336</u>	<u>\$ (27,531)</u>	(0.03)%	<u>\$11,258,293</u>	11.6%

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 2007, 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 2007, 2006, and 2005, these quarterly incentives are shown in the other game expenses above. The changes in retailer commissions for fiscal years 2007 and 2006 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 on-line sales in 2007 and 2006.

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 2007 and 2006 are consistent with each other at about 1.97% and 1.88%, 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 2007 and 2006 the allocated cost for maintenance on the system. The ticket vendor fees for fiscal years 2007 and 2006, 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. In fiscal year 2007, the expense primarily contributing to the increase in other game expenses was the purchase of electronic signs to display the jackpot and top prizes at retailer locations for on-line games for the next drawing. These signs will be used in lieu of a number of outdoor board signs that have been eliminated to save costs. 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

	2007	2006	2005	Increase (Decrease) \$ Change 2006 to 2007	Increase (Decrease) % Change 2006 to 2007	Increase (Decrease) \$ Change 2005 to 2006	Increase (Decrease) % Change 2005 to 2006
Salaries, wages, and benefits	\$ 3,685,704	\$ 3,644,557	\$ 3,640,793	\$ 41,147	1.1%	\$ 3,764	0.1%
Leases and insurance	632,380	636,560	616,968	(4,180)	(0.7)	19,592	3.2
Other operating expenses	<u>1,463,744</u>	<u>1,231,389</u>	<u>1,304,373</u>	<u>232,355</u>	18.9	<u>(72,984)</u>	(5.6)
Total operating expenses	<u>\$ 5,781,828</u>	<u>\$ 5,512,506</u>	<u>\$ 5,562,134</u>	<u>\$ 269,322</u>	4.9%	<u>\$ (49,628)</u>	(0.9)%

Other operating expenses include depreciation and amortization, utilities and maintenance, professional fees, materials and supplies, travel, and other expenses. Operating expenses in fiscal year 2007 were more than in the previous year essentially because of professional fees and materials and supplies expense being higher. In fiscal year 2007, the Lottery's professional fees were more because of higher legal fees due to litigation, the issuance of a major RFP for on-line and related services, and other legal costs; and the procurement of a performance audit during the year. In addition, in fiscal year 2007, the Lottery's capitalization threshold was changed from \$1,000 to \$5,000 in accordance to the Audit Act and, therefore, items purchased that previously would have been capitalized were expensed into non-capitalized items that are included in materials and supplies. This change also resulted in a decrease in depreciation expense in fiscal year 2007. 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.

Non-Operating Income

Non-operating income increased in both fiscal years 2007 and 2006 by over 33.41% or over \$178,500 and 95.1% or over \$260,000, respectively. The increase in both fiscal years related mainly to interest income earned on the Lottery's cash balances in the bank and in the MUSL reserve accounts.

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 2007	<u>\$ 148,080,254</u>	<u>\$ 34,830,136</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>
Decrease from FY 2006 to FY 2007	<u>\$ (1,962,146)</u>	<u>\$ (2,025,420)</u>
% Decrease from FY 2006 to FY 2007	<u>(1.3%)</u>	<u>(5.5%)</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>

The changes in net income for fiscal years 2007 and 2006 were mainly related to the changes in sales for the Lottery's games during the two years netted against the cost of the product and operating expenses during the two fiscal years.

New Mexico Lottery Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Budgetary Comparison

	2007				
	Original Budget	Final Budget	Actual	Variance with Final Budget	% Variance with Final Budget
Total revenues	\$ 150,402,000	\$ 147,500,000	\$ 148,080,254	\$ 580,254	0.4%
Total game expenses	109,621,000	107,001,000	108,181,098	1,180,098	1.1
Total operating expenses	<u>6,680,000</u>	<u>6,183,000</u>	<u>5,781,828</u>	<u>(401,172)</u>	(6.5)
Operating income	34,101,000	34,316,000	34,117,328	(198,672)	(0.6)
Total non-operating income	<u>386,000</u>	<u>456,000</u>	<u>712,808</u>	<u>256,808</u>	56.3
Net income before transfers to					
Lottery Tuition Fund	<u>\$ 34,487,000</u>	<u>\$ 34,772,000</u>	<u>\$ 34,830,136</u>	<u>\$ 58,136</u>	0.2%

	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	<u>6,333,000</u>	<u>5,854,000</u>	<u>5,512,506</u>	<u>(341,494)</u>	(5.8)
Operating income	33,678,000	34,686,000	36,321,265	1,635,265	4.7
Total non-operating income	<u>226,000</u>	<u>442,000</u>	<u>534,291</u>	<u>92,291</u>	20.9
Net income before transfers to					
Lottery Tuition Fund	<u>\$ 33,904,000</u>	<u>\$ 35,128,000</u>	<u>\$ 36,855,556</u>	<u>\$ 1,727,556</u>	4.9 %

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Budgetary Comparison - Continued

Overall, total revenues and game expenses in fiscal year 2007 were in excess of the final budget primarily due to instant ticket, Hot Lotto, and Pick 3 sales, which ended the year at more than the revised budget amounts at 102%, 116%, and 103%, respectively. Powerball and Roadrunner Cash sales did not meet their final sales budget amounts mainly because of the maximum jackpot and top prize amounts that occurred during the fiscal year. Net income for the fiscal year was just over 100% of the final budget.

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. 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. 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 March 2007, the Lottery revised its fiscal year 2007 annual budget to increase instant sales by \$2,000,000, decrease Powerball sales by \$5,000,000, increase Hot Lotto sales by \$500,000, and decrease 4 This Way! sales by \$200,000. Roadrunner Cash and Pick 3 sales were left at the original budget amounts. Because sales were decreased by \$2.7 million, the related game expenses of prize expense, retailer commissions and on-line vendor fees were also reduced. Since instant ticket sales were increased, the related ticket vendor fees and shipping and postage were increased to compensate for the related sales. Eleven other budget line items were also reduced for cost savings expected, two budget line items were increased for legal fees anticipated and for additional materials and supplies expense due to the change in the capitalization threshold to \$5,000. The budget for interest income was increased by \$70,000. Although sales were reduced by \$2.7 million, net income was increased by \$285,000 or .82%.

In April 2006, the Lottery revised its fiscal year 2006 annual budget. At this time the Lottery increased its sales by about \$1.3 million and increased its net income by over \$1.2 million. 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 fiscal year 2007, instant ticket sales exceeded the monthly budgeted sales for nine out of the twelve months in the year, while Powerball topped its sales budget four times, Pick 3 surpassed its budget in 8 months, and Roadrunner Cash and 4 This Way! exceeded their budgets only two and three months, respectively, out of the twelve months. The new game, Hot Lotto, had sales surpass its budget in five out of the seven and one-half months of sales in the year.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Budgetary Comparison - Continued

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.

Game expenses, such as prize expense, retailer commissions, on-line vendor fees, ticket printing, shipping and postage 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. Non-operating income concluded the fiscal year at 156.3% and 120.9% of its final budget amounts for 2007 and 2006, respectively.

Subsequent Event

Effective July 1, 2007, Senate Bill 364 changed the New Mexico Lottery Act, Chapter 6, Article 24 NMSA 1978, to require the Lottery to transmit no later than the last business day of each month at least twenty-seven percent of the gross revenue of the previous month until December 31, 2008 and at least thirty percent of the gross revenue of the previous month thereafter to the State Treasurer, who shall deposit it into the lottery tuition fund. In addition, the 2% reserve fund was discontinued. Previously, the Act had required 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." Because of the removal of the 2% fund encompassing compulsive gambling rehabilitation, the legislation added back language to the Act under the Board of Directors duties "to support problem gambling initiatives and provide information to players about where to obtain problem gambling assistance in New Mexico". The change per the legislation also included that all procurement be conducted "in accordance with the Procurement Code" where previously the Act had stated that the Authority shall conduct all major procurement in keeping with the general principles of the Procurement Code.

In October 2007, the Lottery will end the on-line game, 4 This Way! and commence a New Mexico raffle game. The first raffle game tickets will go on sale on Sunday, October 28, 2007 and will cost \$10.00 each. A limited number of tickets, 125,000 tickets, will be available for purchase for the first raffle game. Each ticket will have a unique raffle number and will be printed sequentially by the system. The drawing for the first raffle game will take place on December 31, 2007. 106 raffle numbers will be drawn for prizes ranging from 100 prizes of \$500 to 4 top prizes of \$125,000 each. The Lottery has two raffle games planned for fiscal year 2008.

New Mexico Lottery Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

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, 2007 and 2006, 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, 2007 and 2006

	<u>2007</u>	<u>2006</u>
CURRENT ASSETS		
Cash and cash equivalents	\$ 6,828,460	\$ 4,574,650
Accounts receivable (net of allowance for doubtful accounts)	1,650,965	837,420
Reserves on deposit	2,338,018	2,339,765
Inventory	15,790	15,932
Prepaid expenses	<u>95,603</u>	<u>120,082</u>
 Total current assets	 10,928,836	 7,887,849
 CAPITAL ASSETS, NET	 <u>359,236</u>	 <u>658,169</u>
 Total assets	 <u><u>\$ 11,288,072</u></u>	 <u><u>\$ 8,546,018</u></u>
 CURRENT LIABILITIES		
Accounts payable and other current liabilities	\$ 2,550,728	\$ 2,225,990
Current portion of capital lease obligation	-	106,091
Prizes payable	5,576,596	3,495,708
Due to lottery tuition fund	<u>3,160,748</u>	<u>2,668,229</u>
 Total liabilities	 <u><u>\$ 11,288,072</u></u>	 <u><u>\$ 8,496,018</u></u>
 NET ASSETS		
Invested in capital assets, net of related debt	\$ 359,236	\$ 552,078
Restricted net assets	-	50,000
Unrestricted net assets (deficit)	<u>(359,236)</u>	<u>(552,078)</u>
 Total net assets	 <u><u>\$ -</u></u>	 <u><u>\$ 50,000</u></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, 2007 and 2006

	<u>2007</u>	<u>2006</u>
REVENUES		
Instant ticket sales	\$ 95,729,489	\$ 89,367,670
Powerball sales	42,625,468	54,113,990
Roadrunner Cash sales	7,934,309	8,347,282
Hot Lotto sales	3,476,503	-
Pick 3 sales	2,058,844	2,009,560
4 This Way! sales	653,662	769,985
Retailer fees	45,791	47,180
Prize tickets	(4,335,817)	(4,533,193)
Spoiled, stolen, and promotional tickets	<u>(107,995)</u>	<u>(80,074)</u>
Total revenues	<u>148,080,254</u>	<u>150,042,400</u>
GAME EXPENSES		
Prize expense	85,119,755	84,626,456
Retailer commissions	9,754,742	9,859,881
On-line vendor fees	6,597,580	7,414,912
Advertising	2,913,129	2,816,695
Ticket vendor fees	1,444,683	1,282,575
Reserve Fund expense	911,933	1,071,934
Promotions	650,133	335,137
Shipping and postage	415,265	370,751
Instant ticket vending machine lease	253,932	275,940
Drawing game	109,704	94,264
Game membership	<u>10,242</u>	<u>60,084</u>
Total game expenses	<u>108,181,098</u>	<u>108,208,629</u>
OPERATING EXPENSES		
Salaries, wages, and benefits	3,685,704	3,644,557
Leases and insurance	632,380	636,560
Utilities and maintenance	415,924	440,678
Depreciation and amortization	391,824	409,138
Professional fees	320,784	191,021
Materials and supplies	203,024	68,397
Travel	66,340	54,847
Other	<u>65,848</u>	<u>67,308</u>
Total operating expenses	<u>5,781,828</u>	<u>5,512,506</u>
OPERATING INCOME	<u>34,117,328</u>	<u>36,321,265</u>
NON-OPERATING INCOME		
Interest income	582,916	394,225
Other income	<u>129,892</u>	<u>140,066</u>
Total non-operating income	<u>712,808</u>	<u>534,291</u>
Net income before transfers	34,830,136	36,855,556
Transfers to Lottery Tuition Fund	<u>(34,880,136)</u>	<u>(36,855,556)</u>
Change in net assets	(50,000)	-
Net assets at beginning of year	<u>50,000</u>	<u>50,000</u>
Net assets at end of year	<u>\$ -</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, 2007 and 2006

Increase (Decrease) in Cash and Cash Equivalents

	<u>2007</u>	<u>2006</u>
Cash flows from operating activities		
Cash received:		
From retailers-sales net of commissions, incentives, and prize, spoiled, and stolen ticket credits	\$ 137,670,500	\$ 140,108,843
From MUSL - Powerball Jackpot	29,450,223	-
Cash payments:		
To prize winners and related taxes	(100,723,950)	(71,482,341)
To suppliers of goods or services	(15,163,549)	(15,284,239)
To employees for services and related taxes	(3,124,154)	(3,100,369)
To MUSL	<u>(11,765,140)</u>	<u>(12,116,976)</u>
Net cash provided by operating activities	<u>36,343,930</u>	<u>38,124,918</u>
Cash flows from investing activities		
Additions (deletions) to MUSL Reserve Accounts	6,225	(22,648)
Receipts of interest	369,496	239,832
Receipts of rent	126,404	121,704
Other	<u>234</u>	<u>21,923</u>
Net cash provided by investing activities	<u>502,359</u>	<u>360,811</u>
Cash flows from noncapital financing activities		
Transfers to Lottery Tuition Fund	<u>(34,387,617)</u>	<u>(36,879,306)</u>
Cash flows from capital and related financing activities		
Purchases of capital assets	(98,771)	(410,604)
Principal payments under capital lease	<u>(106,091)</u>	<u>(141,454)</u>
Net cash used by related financing activities	<u>(204,862)</u>	<u>(552,058)</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	2,253,810	1,054,365
Cash and cash equivalents at beginning of year	<u>4,574,650</u>	<u>3,520,285</u>
Cash and cash equivalents at end of year	<u>\$ 6,828,460</u>	<u>\$ 4,574,650</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, 2007 and 2006

Increase (Decrease) in Cash and Cash Equivalents

	<u>2007</u>	<u>2006</u>
Reconciliation of operating income to net cash provided by operating activities		
Operating Income	\$ 34,117,328	\$ 36,321,265
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	391,824	409,138
Additional contributions (deletions) to MUSL Reserve Accounts	(6,225)	22,648
Interest on MUSL Unreserved Account	24,478	154,393
Vendor's non-cash transactions	(3,250)	(3,561)
Net changes in assets and liabilities:		
Accounts receivable	(655,012)	(73,676)
Reserves on Deposit	1,747	(57,852)
Inventory	142	203
Prepaid expenses	24,479	5,290
Accounts payable and other liabilities	324,738	280,809
Accrued purchases	42,793	39,122
Prizes payable	<u>2,080,888</u>	<u>1,027,139</u>
Net cash provided by operating activities	<u>\$ 36,343,930</u>	<u>\$ 38,124,918</u>

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

New Mexico Lottery Authority

STATEMENTS OF FIDUCIARY NET ASSETS

June 30, 2007 and 2006

	<u>2007</u>	<u>2006</u>
ASSETS		
Cash and Cash Equivalents	\$ 193,339	\$ 156,095
Marketable securities and other investments	3,160,686	2,553,177
Contribution receivable	<u>15,625</u>	<u>798</u>
Total assets	<u>\$ 3,369,650</u>	<u>\$ 2,710,070</u>
NET ASSETS		
Pension plan participants' benefits	<u>\$ 3,369,650</u>	<u>\$ 2,710,070</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, 2007 and 2006

	<u>2007</u>	<u>2006</u>
ADDITIONS		
Investment earnings	\$ 491,186	\$ 200,294
Employer contributions	<u>365,686</u>	<u>348,742</u>
Total additions	856,872	549,036
DEDUCTIONS		
Distributions to participants	197,292	124,712
Fees	<u>-</u>	<u>14</u>
Total deductions	197,292	124,726
Change in net assets	659,580	424,310
Net assets - beginning	<u>2,710,070</u>	<u>2,285,760</u>
Net assets - ending	<u><u>\$ 3,369,650</u></u>	<u><u>\$ 2,710,070</u></u>

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

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS

June 30, 2007 and 2006

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 economic resources measurement focus and 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.

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2007 and 2006

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 for the use of digital signage 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 and Cash Equivalents

For the purposes of the Statement of Cash Flows, the Lottery considers cash and cash equivalents to be cash on hand, demand deposits, time deposits with an original maturity of ninety days or less, and overnight 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, 2007 and 2006

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

5. Accounts Receivable - Continued

receivables. At June 30, 2007 and 2006, an allowance for doubtful accounts of \$94,251 and \$99,987, respectively, has been provided to recognize future uncollectible billings.

In fiscal years 2007 and 2006, ten customers (460 and 427 retailer locations) represented 50% and 46% of sales and accounts receivable for each year, respectively.

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) and Hot Lotto® (Hot Lotto) games for the Lottery. Each MUSL member sells Powerball and Hot Lotto 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 for each game. Lesser prizes are paid directly to the winners by each member lottery. The prize pools for both Powerball and Hot Lotto are 50% of each game's drawing period's sales after the prize reserve accounts are funded to the amounts set by the MUSL product group. MUSL included 2% of the Lottery's Powerball drawing period's sales in two prize reserve accounts until the Lottery's share of the prize reserve accounts reached the amounts designated by the MUSL product group. Both the Lottery's Powerball Prize Reserve Account (PRA) and the Set Prize Reserve Account are fully funded. MUSL includes from 1% to 3% of the Lottery's Hot Lotto drawing period's sales, depending on the annuitized value of the Grand Prize, into a prize reserve account until the Lottery's share of the prize reserve account reaches the amount designated by the MUSL product group. At June 30, 2007, the Lottery's remaining Hot Lotto prize reserve buy-in amount was \$551,679. MUSL has placed a \$100,000,000 cap on the two Powerball prize reserve funds and a \$9,000,000 cap on the Hot Lotto prize reserve fund. Once the prize reserve funds exceed these designated caps, the excess becomes part of the grand prize pool. The prize reserve funds serve as contingency reserves to protect MUSL from unforeseen prize liabilities and the money in these reserve funds are to be used at the discretion of the MUSL Board of Directors. The prize reserve funds are refundable to MUSL members if MUSL disbands, a member leaves MUSL, or a game is discontinued. In these instances, members 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 the unreserved fund and game membership fees and other MUSL costs may be paid from this fund. At June 30, 2007 and 2006, the Lottery's share of the Powerball prize reserve funds was \$1,906,630 and \$2,009,543, respectively; the Lottery's share of the Hot Lotto prize reserve funds was \$193,251 and \$0, respectively; and the Lottery's share of the unreserved fund was \$238,137 and \$330,222, respectively.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2007 and 2006

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

6. Reserves on Deposit - Continued

A winner of a Powerball grand prize or a Hot Lotto grand prize may select that the prize be paid at the cash value of the prize or as an annuity. A Powerball grand prize annuity is paid out in 30 installments and a Hot Lotto grand prize annuity is paid out in 25 installments. Government securities at the discounted value of the 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 any grand prize winner. Currently, the Lottery 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, 2007 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. In fiscal year 2006, the Lottery capitalized 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 that allowed for the capitalization threshold for capital assets to increase from \$1,000 to \$5,000 effective July 1, 2005. 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.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2007 and 2006

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

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.

10. Prizes

Prize expense for instant ticket, Powerball, and Hot Lotto games is recorded based on an estimate of the predetermined prize structure for each game. Prize expense for Roadrunner Cash, Pick 3, and 4 This Way! games is recorded based on the actual prizes won for each game's drawings.

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. Custodial Credit Risk and Interest Rate Risk

At June 30, 2007 and 2006, the Lottery maintained its cash balances in one financial institution. The balances for demand deposits and time deposits were insured by the Federal Deposit Insurance Corporation up to \$100,000, each respectively, at this financial institution.

Custodial credit risk – Deposits. 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. The Lottery limits its custodial risk for its cash and requires collateral in an amount greater than or equal to 50% of any 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.

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.

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2007 and 2006

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

14. Custodial Credit Risk and Interest Rate Risk (Continued)

The Lottery's custodial risk for investments is in accordance with Article 10, NMSA, 1978 Compilation. The Lottery's investments are made in certificates of deposit and overnight 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. Collateral must meet State of New Mexico "Security of Public Money" standards and be held in third party safekeeping.

As of June 30, 2007 and 2006, \$8,620,910 and \$4,744,606 of the Lottery's bank balance of \$8,720,910 and \$4,744,933, respectively, was exposed to custodial credit risk as follows:

	<u>2007</u>	<u>2006</u>
Uninsured and uncollateralized	\$ 667,907	\$ -
Collateral held by the pledging bank's trust department not in the Lottery's name	<u>7,953,003</u>	<u>4,744,606</u>
	<u>\$ 8,620,910</u>	<u>\$ 4,744,606</u>

Interest Rate Risk – Investments. Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Lottery does not have a specific policy to limit its exposure to interest rate risk.

At June 30, 2007 and 2006, the Lottery had an overnight yield repurchase agreement with a one-day maturity. At June 30, 2007, the Lottery also had an investment in a certificate of deposit with a seven-day maturity.

15. Bank Accounts

<u>Description</u>	<u>Bank</u>	<u>Balance per Bank</u>
Operating account - overnight repurchase Agreement	First Community Bank	\$ 6,922,742
Operating account - certificate of deposit	First Community Bank	1,798,698
Operating account – checking	First Community Bank	(530)
Total amount deposited in bank		8,720,910
Less: FDIC coverage		<u>(100,000)</u>
**Total uninsured funds – deposits and overnight repurchase agreement		<u>\$ 8,620,910</u>

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2007 and 2006

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

50% pledged collateral requirement per statute for	
Deposits	\$ 849,084
* Total pledged security	<u>(891,720)</u>
Amount under (over) requirement	
at June 30, 2007	<u>\$ (42,636)</u>

102% pledged collateral requirement per statute for	
repurchase agreement	\$ 7,061,197
** Total pledged security	<u>(7,061,283)</u>

Amount under (over) requirement	
at June 30, 2007	<u>\$ (86)</u>

* Securities are held in safekeeping at the Federal Home Loan Bank in Dallas, Texas. Presented at fair value, CUSIP Numbers 3133XA7G6, matures January 15, 2008,

** Securities are held in safekeeping at the Federal Home Loan Bank in Dallas, Texas. Presented at fair value, CUSIP Numbers 3133XE5K1, matures January 18, 2008.

***The deposits and overnight repurchase agreement are collateralized with securities held in the name of their agent.

Cash and cash equivalents per bank at June 30, 2007	\$ 8,720,910
Less reconciling items--outstanding checks	<u>(1,893,450)</u>
Reconciled cash in bank at June 30, 2007	6,827,460
Cash in vault	<u>1,000</u>
Total cash and cash equivalents per statements of net assets	<u>\$ 6,828,460</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, 2007 and 2006

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, 2007 and 2006, the amounts that had been set aside and expended were \$911,933 and \$1,071,934, respectively.

In the fiscal years 2007 and 2006, respectively, \$723,509 and \$766,491 were set aside and expended for bonuses and incentives for retailers, \$65,424 and \$122,054 for responsible gaming advertising, \$81,120 each year for a responsible gaming hotline, \$0 and \$63,262 for special promotions, \$41,880 and \$38,984 for integrity, and \$0 and \$23 for clerk incentives, all in accordance to the specified purposes per the Act, and leaving a balance of \$0 and 50,000 at the end of fiscal year 2007 and 2006, respectively.

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 until July 1, 2007 could be retained by the Lottery for future defined expenditures. As of July 1, 2007, the provision for a 2% Reserve Fund was removed from the New Mexico Lottery Act. Therefore, the \$50,000 balance in the 2% Reserve Fund was transferred to the Lottery Tuition Fund.

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, 2007 and 2006

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

As of January 1, 2007 the Lottery replaced the paid time off leave with annual and sick leave. Prior to that time, paid time off was accrued at rates specified by the Lottery's Paid Time Off Policy. Employees were limited on the total accumulated hours they could keep in their respective Reserve Bank. Employees with time in service less than or equal to 5 years could accumulate a maximum of 320 hours and employees with time in service greater than 5 years could accumulate a maximum of 360 hours, any excess was forfeited at the end of the calendar year. The new annual leave and sick leave are accrued at rates specified by the Lottery's Leave Policy. Annual leave is awarded based on the employee's years of service, leave status, and employment status (full-time or part-time) and sick leave is awarded at 3.7 hours biweekly for full-time employees. The maximum number of annual leave full-time employees may carry over and retain in their annual leave bank varies from 80 hours for an employee with less than 5 years of service up to a maximum of 320 hours for an employee with fifteen or more years of service. The maximum number of sick leave hours that a full-time employee may carry over from year-to-year is 480 hours. Part-time employees receive leave and carry-over and retain leave in their leave banks based on their percentage of employment. Upon separation from service, employees with one year of service or more will be compensated for their annual leave balance, not to exceed the maximum annual leave bank based on their years of service. Accrued sick leave hours will not be paid out to an employee upon separation from service.

During the years ended June 30, 2007 and 2006, the following changes occurred in the compensated absences liabilities:

<u>Balance</u> <u>July 1, 2006</u>	<u>Increase</u>	<u>Decrease</u>	<u>Balance</u> <u>June 30, 2007</u>
\$ 323,980	\$ 9,198	\$ (155,286)	\$ 177,892
 <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

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2007 and 2006

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES -CONTINUED

22. Compensated Absences Payable - Continued

The balances of compensated absences payable are reported on the statements of net assets 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, 2007 and 2006 the following changes occurred in the capital lease obligations:

<u>Balance July 1, 2006</u>	<u>Increase</u>	<u>Decrease</u>	<u>Balance June 30, 2007</u>	<u>Amounts Due Within One Year</u>
\$ 106,091	\$ -	\$ (106,091)	\$ -	\$ -

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

24. Accounts payable and other current liabilities

Accounts payable and other current liabilities are comprised of the following at June 30:

	<u>2007</u>	<u>2006</u>
Accounts payable	\$ 1,917,479	\$ 1,357,412
Accrued liabilities, vendors*	118,647	253,744
Accrued liabilities, retailers*	146,971	150,574
Accrued payroll, and payroll taxes and benefits	189,739	140,280
Compensated absences	<u>177,892</u>	<u>323,980</u>
	<u>\$ 2,550,728</u>	<u>\$ 2,225,990</u>

* The Lottery has accrued an estimated amount of services delivered by its vendors and retailers for the months of June 2007 and 2006, respectively.

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2007 and 2006

NOTE B – CAPITAL ASSETS

Capital assets at June 30, 2007 consisted of:

	<u>Beginning Balance</u>	<u>Reclassification</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
Data Processing software	\$ 2,121,910	\$ (13,641)	\$ 7,611	\$ (40,678)	\$ 2,075,202
Data processing equipment	1,935,359	(155,390)	62,990	(27,857)	1,815,102
Tenant improvements	779,626	-	17,976	-	797,602
Vehicles	483,143	-	-	-	483,143
Furniture and fixtures	290,926	(21,337)	-	(24,541)	245,048
Equipment - warehouse	156,698	-	-	-	156,698
Equipment - drawing	214,244	(61,122)	2,500	-	155,622
Equipment - communications	354,761	(243,035)	4,534	-	116,260
Equipment - office	83,989	(4,490)	-	(4,449)	75,050
Obsolete capital assets	-	499,015	-	-	499,015
	<u>6,420,656</u>	<u>-</u>	<u>95,611</u>	<u>(97,525)</u>	<u>6,418,742</u>
Capital assets					
Data Processing software	(2,026,826)	13,641	(97,287)	40,678	(2,069,794)
Data processing equipment	(1,817,598)	155,390	(91,326)	25,137	(1,728,397)
Tenant improvements	(664,897)	-	(49,537)	-	(714,434)
Vehicles	(324,336)	-	(61,972)	-	(386,308)
Furniture and fixtures	(284,130)	21,337	(1,980)	24,541	(240,232)
Equipment - warehouse	(152,030)	-	(1,515)	-	(153,545)
Equipment - drawing	(144,535)	61,122	(40,959)	-	(124,372)
Equipment - communications	(297,639)	243,035	(35,246)	-	(89,850)
Equipment - office	(50,496)	4,490	(12,002)	4,449	(53,559)
Obsolete capital assets	-	(499,015)	-	-	(499,015)
	<u>(5,762,487)</u>	<u>-</u>	<u>(391,824)</u>	<u>94,805</u>	<u>(6,059,506)</u>
Accumulated depreciation					
Capital assets, net	<u>\$ 658,169</u>	<u>\$ -</u>	<u>\$ (296,213)</u>	<u>\$ (2,720)</u>	<u>\$ 359,236</u>

Included in data processing software and date processing equipment are \$400,786 in assets under a capital lease at June 30, 2007 and 2006. There was \$106,091 and \$141,454, respectively for each fiscal year, in related amortization on these assets.

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2007 and 2006

NOTE B – CAPITAL ASSETS - CONTINUED

Capital assets at June 30, 2006 consisted of:

	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
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
Furniture and fixtures	285,046	5,880	-	290,926
Equipment - warehouse	153,125	3,573	-	156,698
Equipment - drawing	168,494	45,750	-	214,244
Equipment - communications	299,538	55,223	-	354,761
Equipment - office	<u>81,171</u>	<u>2,818</u>	<u>-</u>	<u>83,989</u>
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)
Furniture and fixtures	(282,836)	(1,294)	-	(284,130)
Equipment - warehouse	(151,259)	(771)	-	(152,030)
Equipment - drawing	(118,180)	(26,355)	-	(144,535)
Equipment - communications	(264,999)	(32,640)	-	(297,639)
Equipment - office	<u>(33,619)</u>	<u>(16,877)</u>	<u>-</u>	<u>(50,496)</u>
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>

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2007 and 2006

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, 2006	\$ 2,718,229	\$ 2,668,229	\$ -	\$ 50,000
Current year net income	34,830,136	34,830,136	-	-
Current year transfers	(34,387,617)	(34,387,617)	50,000	(50,000)
Balance at June 30, 2007	\$ 3,160,748	\$ 3,110,748	\$ 50,000	\$ -

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 July 31, 2007 and 2006, the Lottery has transferred \$34,830,136 and \$36,855,556, respectively, for the periods ended June 30, 2007 and 2006 to the New Mexico State Treasurer. In addition, the \$50,000 balance in the 2% Reserve Fund was transferred to the New Mexico State Treasurer, for deposit in the Lottery Tuition Fund, on July 31, 2007.

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, 2007 and 2006 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, 2007 and 2006

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, 2007 and 2006, the Lottery recognized \$365,686 and \$348,742 of pension expense for the Plan on eligible compensation of \$2,759,894 and \$2,632,015, respectively. The entire pension amounts have been paid to the Plan by June 30, 2007 and 2006, respectively, for all compensation paid during the respective fiscal years.

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% at June 30, 2007 and 2006). The line matured in May 2006 and was extended through May 14, 2008. For the periods ended June 30, 2007 and 2006, the Lottery had no outstanding borrowings against the line.

NOTE F - LEASES

The Lottery has entered into operating leases for the rental of office and warehouse space, and vending machines. Rent expense was \$727,842 and \$749,788 for the years ending June 30, 2007 and 2006, 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 were 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>
2008	\$ 309,485
2009	378,886
2010	431,485
2011	431,485
2012	431,485
2013	<u>323,615</u>
	<u>\$ 2,306,441</u>

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2007 and 2006

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>
2008	\$ 122,000
2009	<u>52,600</u>
	<u>\$ 174,600</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>2007</u>	<u>2006</u>
Minimum rentals	\$ 685,417	\$ 708,071
Less: Sublease rentals	<u>(117,200)</u>	<u>(112,500)</u>
	<u>\$ 568,217</u>	<u>\$ 595,571</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%. As of June 30, 2007, the cost of the CRM system has been fully amortized.

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.

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2007 and 2006

NOTE H - OTHER EXPENSES

Other expenses at June 30, consisted of:

	2007	2006
Registrations and memberships	\$ 29,048	\$ 24,487
Other	24,877	16,456
Training	8,734	21,591
Publications and subscriptions	3,189	4,774
	\$ 65,848	\$ 67,308

NOTE I - SUBSEQUENT EVENTS

Effective July 1, 2007, Senate Bill 364 changed the New Mexico Lottery Act, Chapter 6, Article 24 NMSA 1978, to require the Lottery to transmit no later than the last business day of each month at least twenty-seven percent of the gross revenue of the previous month until December 31, 2008 and at least thirty percent of the gross revenue of the previous month thereafter to the state treasurer, who shall deposit it into the lottery tuition fund. In addition, the 2% reserve fund was discontinued. Previously, the Act had required 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.” Because of the removal of the 2% fund encompassing compulsive gambling rehabilitation, the legislation added back language to the Act under the Board of Directors duties “to support problem gambling initiatives and provide information to players about where to obtain problem gambling assistance in New Mexico”. The change per the legislation also included that all procurement be conducted “in accordance with the Procurement Code” where previously the Act had stated that the Authority shall conduct all major procurement in keeping with the general principles of the Procurement Code.

In October 2007, the Lottery will end the on-line game, 4 This Way! and commence a New Mexico raffle game. The first raffle game tickets will go on sale on Sunday, October 28, 2007 and will cost \$10.00 each . A limited number of tickets, 125,000 tickets, will be available for purchase for the first raffle game. Each ticket will have a unique raffle number and will be printed sequentially by the system. The drawing for the first raffle game will take place on December 31, 2007. 106 raffle numbers will be drawn for prizes ranging from 100 prizes of \$500 to 4 top prizes of \$125,000 each. The Lottery has two raffle games planned for fiscal year 2008

New Mexico Lottery Authority

BUDGET TO ACTUAL COMPARISON STATEMENTS

Years ended June 30, 2007 and 2006

	2007				2006			
	Original Budget	Final Budget	Actual	Variance with Final Budget	Original Budget	Final Budget	Actual	Variance with Final Budget
Revenues								
Instant ticket sales	\$ 91,500,000	\$ 93,500,000	\$ 95,729,489	\$ 2,229,489	\$ 90,000,000	\$ 91,000,000	\$ 89,367,670	\$(1,632,330)
Powerball sales	50,000,000	45,000,000	42,625,468	(2,374,532)	50,000,000	50,000,000	54,113,990	4,113,990
Roadrunner Cash sales	8,500,000	8,500,000	7,934,309	(565,691)	8,000,000	8,500,000	8,347,282	(152,718)
Hot Lotto	2,500,000	3,000,000	3,476,503	476,503	-	-	-	-
Pick 3 sales	2,000,000	2,000,000	2,058,844	58,844	2,000,000	2,000,000	2,009,560	9,560
4 This Way! Sales	800,000	600,000	653,662	53,662	1,000,000	800,000	769,985	(30,015)
Retailer fees	44,000	43,000	45,791	2,791	30,000	44,000	47,180	3,180
Prize tickets	(4,800,000)	(5,000,000)	(4,335,817)	664,183	(4,750,000)	(4,800,000)	(4,533,193)	266,807
Spoiled, stolen, and promotional tickets	(118,000)	(131,000)	(107,995)	23,005	(106,000)	(92,000)	(80,074)	11,926
Bad debts	(24,000)	(12,000)	-	12,000	(24,000)	(24,000)	-	24,000
Total revenues	<u>150,402,000</u>	<u>147,500,000</u>	<u>148,080,254</u>	<u>580,254</u>	<u>146,150,000</u>	<u>147,428,000</u>	<u>150,042,400</u>	<u>2,614,400</u>
Total game expenses	109,621,000	107,001,000	108,181,098	1,180,098	106,139,000	106,888,000	108,208,629	1,320,629
Total operating expenses	<u>6,680,000</u>	<u>6,183,000</u>	<u>5,781,828</u>	<u>(401,172)</u>	<u>6,333,000</u>	<u>5,854,000</u>	<u>5,512,506</u>	<u>(341,494)</u>
Operating income	34,101,000	34,316,000	34,117,328	(198,672)	33,678,000	34,686,000	36,321,265	1,635,265
Total non-operating income	<u>386,000</u>	<u>456,000</u>	<u>712,808</u>	<u>256,808</u>	<u>226,000</u>	<u>442,000</u>	<u>534,291</u>	<u>92,291</u>
Net income before transfers to Lottery Tuition Fund	<u>\$ 34,487,000</u>	<u>\$ 34,772,000</u>	<u>\$ 34,830,136</u>	<u>\$ 58,136</u>	<u>\$ 33,904,000</u>	<u>\$ 35,128,000</u>	<u>\$ 36,855,556</u>	<u>\$ 1,727,556</u>

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

**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. Hector H. Balderas
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, 2007, including the budgetary to actual statement presented as supplemental information and have issued our report thereon dated October 22, 2007. 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 opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Lottery's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Lottery's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Lottery's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Lottery's financial statements that is more than inconsequential will not be prevented or detected by the Lottery's internal control.

Board of Directors
New Mexico Lottery Authority
and
Mr. Hector H. Balderas
New Mexico State Auditor

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Lottery's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

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, 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 one instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards* and which is described in the accompanying schedule of current year findings as item 2007-01.

The Lottery's response to the finding identified in our audit is described in the accompanying schedule of current year findings. We did not audit the Lottery's response and, accordingly, we express no opinion on it.

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.

Albuquerque, New Mexico
October 22, 2007

New Mexico Lottery Authority

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

Year Ended June 30, 2007

None

SCHEDULE OF CURRENT YEAR AUDIT FINDINGS AND RESPONSES

Other Findings, as Required by State Statute, Section 12-6-5, NMSA 1978

2007-01 – Professional Services Contracts

CONDITION

The Lottery entered into professional services contracts with a local accounting firm for “drawing services” without the approval of the State Auditor, during the years June 30, 2007 and June 30, 2006. The amounts of the contracts were \$108,405 for the year ended June 30, 2007 and \$92,689 for the year ended June 30, 2006.

CRITERIA

Section 2.2.2.8.H.(3) (Fiscal Year 2007) and Section 2.2.2.8.I.(3) (Fiscal year 2006) of the New Mexico Administrative Code (NMAC), *Requirements for Contracting and Conducting Audits of Agencies*, requires that “the agency and IPA shall not enter into any financial, special audit or any other nonaudit service contract without the prior written approval of the State Auditor.”

CAUSE

The Lottery Authority and staff who approved and signed these professional service contracts were unaware of the State Auditor requirements for contracting with Accounting Firms.

EFFECT

The Lottery is in violation of Sections 2.2.2.8.H.(3) (Fiscal Year 2007) and 2.2.2.8.H.(3) (Fiscal Year 2006) of NMAC.

RECOMMENDATION

We recommend that the Lottery provide additional training to those preparing and presenting contracts to ensure that proper approval is obtained for all professional services contracts in the future.

LOTTERY RESPONSE

Management concurs with the recommendation. An internal inquiry was conducted by the Security Division to ascertain why this approval from the Office of the State Auditor was not obtained. Since then, this responsibility has been removed from the sole domain of the Internal Audit Department and has been allocated as a responsibility of several departments at the Lottery in order to ensure that this approval is received on any future contracts between the Lottery and Independent Public Accountants prior to a contract being approved and signed by the Lottery Authority and staff.

New Mexico Lottery Authority

EXIT CONFERENCE

For the year ended June 30, 2007

An exit conference was held at the New Mexico Lottery Authority on October 17, 2007. The following individuals participated:

<u>Name</u>	<u>Title</u>
<i>New Mexico Lottery Authority Audit Committee</i>	
Reta Jones, CPA, CVA	Chairman of the Board
Clifford Stroud, Treasurer	Board Member
Herman Tabet	Board Member
<i>New Mexico Lottery Authority Employees</i>	
Tom Romero	Chief Executive Officer
Sylvia A. Jaramillo, CPA	Director of Finance
<i>Moss Adams LLP</i>	
Scott Eliason, CPA	Audit Partner
Amy Myer, CPA	Manager

Financial Statement Preparation

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