



NEW MEXICO LOTTERY AUTHORITY

FINANCIAL STATEMENTS

JUNE 30, 2014 and 2013

MOSS ADAMS_{LLP}

Certified Public Accountants | Business Consultants

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New Mexico Lottery Authority

OFFICIAL ROSTER

June 30, 2014

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OFFICIALS OF THE NEW MEXICO LOTTERY AUTHORITY

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J. Vince Torrez	Executive Vice President of Security
Evelyn McKnight	Director of Human Resources
Vacant	Director of Marketing
David Ramirez	Director of MIS
Pam Poteat	Director of Sales

ORGANIZATIONAL DIVISIONS OF THE NEW MEXICO LOTTERY AUTHORITY

As per the New Mexico Lottery Act, Chapter 6, Article 24 NMSA 1978, the New Mexico Lottery Authority (the Lottery) is governed by a seven-member Board of Directors (Board or Directors), who provide the Lottery with the private-sector perspective of a large marketing and sales enterprise in order to maximize revenues for the Legislative Lottery Scholarship.

The Directors are residents of New Mexico appointed by the Governor with the advice and consent of the Senate. The Directors are prominent persons in their businesses or professions and geographically represent the State of New Mexico. No more than four Directors are from any one political party. The Directors receive no compensation for their services, but are reimbursed for approved expenses incurred in the conduct of the Lottery's business. Each Director is subject to a background check and investigation to determine his/her fitness for the office. At least one Director has five years of experience as a law enforcement officer, one Director is an attorney admitted to practice in New Mexico, and one Director is a Certified Public Accountant certified in New Mexico. The Directors serve for a five-year term, but can be reappointed by the Governor. The Board selects a Chairman, a Vice-Chairman, a Secretary/Treasurer, and an Assistant-Secretary/Treasurer each fiscal year. The Chairman also appoints a Chairman and two Directors for each of the three standing committees of the Board, the Finance/Audit Committee, the Security/Operations Committee, and the Personnel Committee. The Directors appoint the Chief Executive Officer (CEO) and prescribe his qualifications, duties and salary, and with the recommendation and assistance of the CEO, employ an Executive Vice President of Security and an Internal Auditor. The Directors meet at least once each quarter, and more often as needed. At their meetings the Directors:

- adopt, amend, or repeal rules, policies and procedures necessary for the operation of the Lottery;
- approve, disapprove, amend, or modify the original budget for the succeeding fiscal year and any revised budget during a fiscal year;
- review and discuss current financial information and the Lottery's performance to the approved budget for the fiscal year;
- approve or disapprove all procurements over seventy-five thousand dollars and the resulting award of contracts;
- approve the financial audit contract after (or pending) Office of the State Auditor (State Auditor) approval, hold an audit exit conference with the independent public accountants (IPA) at an executive session of the Board or in the Finance/Audit Committee, and at an open meeting accept the fiscal year audit following release by the State Auditor and presentation by the IPA;
- listen to and discuss Lottery updates on sales, games, issues, etc.;
- review, discuss, and accept internal audit reports; and
- discuss, and when necessary, approve or disapprove other matters that should properly come before the Directors in their fiduciary duty for the efficient and effective operation, profitability, integrity, and security of the Lottery.

ORGANIZATIONAL DIVISIONS OF THE NEW MEXICO LOTTERY AUTHORITY - CONTINUED

The Executive Division, under the direction of the Chief Executive Officer, provides leadership for all activities of 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 among the Board, the Governor, the Legislature, governmental entities, external providers of goods and services, retailers, the public, and Lottery divisions and employees. Also, within the Executive Division is Product Development, which manages and monitors the instant and on-line products, including such areas as game launches, game endings, and performance analysis using several key performance measures. In addition, within the Executive Division is communications and retailer recruitment. Communications is responsible for all aspects of corporate communications including creating news releases and responding to requests for information by the public and the media.

The Administration Division, under the direction of the Chief of Staff/Director of Administration, 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 division 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 of New Mexico; the financial audit and related compilation of financial statements, related notes, and the Management's 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 by division for Board of Directors' approval. Furthermore, the division is responsible for the procurement of materials and services; claims center payment of prizes and sales of tickets; and accounts payable. The warehouse component of the Administration 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 also responsible for the management of building and grounds maintenance and vehicle fleet operations and maintenance.

The Human Resources Division, 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, 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 and as may be requested by the CEO.

**ORGANIZATIONAL DIVISIONS
OF THE NEW MEXICO LOTTERY AUTHORITY - CONTINUED**

The Marketing Division, under the direction of the Director of Marketing, is responsible for implementing, managing and administering the activities associated with marketing the Lottery and its products, including advertising, 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 Management Information Systems (MIS) Division, under the direction of the Director of MIS, performs all the activities associated with the systems and data processing functions of the Lottery, including instant ticket transaction processing, back office functionality, order and distribution systems, financial applications, retailer network support, game management, monitoring of game activities and draw game vendors, and providing data and analysis to divisions.

The Sales Division, 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 relationship management, ticket sales, inventory management, point of sales material distribution, retailer installations, promotional and event participation and preparation, as well as maximizing sales initiatives.

The Security Division, under the direction of the Executive Vice President of Security, statutorily as a law enforcement agency is responsible for administering, enforcing and ensuring compliance with the security provisions of the New Mexico Lottery Act. The division conducts backgrounds of all prospective employees, lottery retailers, lottery vendors and lottery contractors. It also supervises ticket verification and Lottery drawings and conducts drawings when the prize amount is more than \$5,000. The division functions as liaison among 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.

TABLE OF CONTENTS

NEW MEXICO LOTTERY AUTHORITY

REPORT OF INDEPENDENT AUDITORS	1-3
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)	4-23
BASIC FINANCIAL STATEMENTS	
Statements of Net Position	24
Statements of Revenues, Expenses and Changes in Net Position	25
Statements of Cash Flows	26-27
Statements of Fiduciary Net Position	28
Statements of Changes in Fiduciary Net Position	29
Notes to Financial Statements	30-49
SUPPLEMENTARY INFORMATION	
Budgetary Comparison Statements.....	50
Schedules of Percentage Return to the State of New Mexico	51
OTHER INFORMATION	
Exit Conference	52

REPORT OF INDEPENDENT AUDITORS

Board of Directors
New Mexico Lottery Authority

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities, and the aggregate remaining fund information of the State of New Mexico Lottery Authority (Lottery), a component unit of the State of New Mexico, as of and for the years ended June 30, 2014 and 2013, and the related notes to the financial statements, which collectively comprise the Lottery's basic financial statements as listed in the table of contents. We have also audited the budgetary comparison statements and the schedules of percentage return to the State of New Mexico presented as supplementary information in the accompanying financial statements as of and for the years ended June 30, 2014 and 2013, as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Lottery's internal control.

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

Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities, and the aggregate remaining fund information of the Lottery as of June 30, 2014 and 2013, and the respective changes in financial position and, where applicable, cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statements referred to previously present fairly, in all material respects, the budgetary comparison statements and schedules of percentage return to the State of New Mexico for the years ended June 30, 2014 and 2013 in conformity with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that management's discussion and analysis, on pages 4 through 23, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

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

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Lottery's basic financial statements. The budgetary comparison statements and schedules of percentage return to the State of New Mexico are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The budgetary comparison statements and schedules of percentage return to the State of New Mexico are the responsibility of management and were derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the budgetary comparison statements and schedules of percentage return to the State of New Mexico are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

A handwritten signature in black ink that reads "Mess Adams LLP". The signature is written in a cursive, flowing style.

Albuquerque, New Mexico
October 6, 2014

New Mexico Lottery Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

This Management's Discussion and Analysis of the New Mexico Lottery Authority (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, 2014 and 2013 with comparative numbers for the fiscal year ended June 30, 2012. Please read it in conjunction with the financial statements, which begin on page 24.

FINANCIAL HIGHLIGHTS

- At the end of fiscal years 2014 and 2013, the Lottery's total current assets increased by \$971,072, 6.8%, and \$2,677,330, 23.0%, respectively, in comparison to June 30th of each previous fiscal year.
- Compared to the end of the two preceding fiscal years, the Lottery's total liabilities increased by \$902,613, 6.0% at the end of fiscal year 2014 and by \$3,001,125, 25.2%, at the end of fiscal year 2013.
- In fiscal year 2014, total net ticket sales were \$136,002,604, a decrease of \$5,755,918, (4.1)%, from the prior fiscal year. In fiscal year 2013, total net sales were \$141,758,522, an increase of \$7,971,170, 6.0%, compared to total net ticket sales of \$133,787,352 in fiscal year 2012.
- From the prior fiscal years, total game expenses decreased by \$3,441,051, or (3.7)% in fiscal year 2014, while total game expenses increased by \$5,668,837, 6.5%, in fiscal year 2013.
- Total operating expenses increased by 3.2% or \$160,483 in fiscal year 2014, whereas operating expenses decreased by 1.3% or \$66,197 in fiscal year 2013, each in comparison to the previous fiscal year.
- Non-operating income decreased by \$14,659, (31.2)%, and \$16,917, (26.5) %, in fiscal year 2014 and fiscal year 2013, respectively, compared to each preceding fiscal year.
- Net income in fiscal year 2014 was \$41,208,550, a decrease of \$2,476,131, a (5.7)% decrease, compared to the previous fiscal year. Net income in fiscal year 2013 was \$43,684,681, a \$2,355,938 or 5.7% increase over the previous fiscal year's net income of \$41,328,743. Beginning July 1, 2007, the Lottery was required by the New Mexico Lottery Act to transmit at least twenty-seven percent of its gross revenues to the State of New Mexico and then at least 30% beginning in January 2009. In fiscal year 2014, the Lottery transmitted 30.09% in net return to the State, while in fiscal year 2013, the Lottery transmitted 30.80% in net revenues to the State. In each of the last two fiscal years, the Lottery met the 30% required gross revenue return each month.
- Including the final transfer on July 31, 2014 of June 2014's net revenues (net income); the Lottery has transferred \$613,435,077 to the State of New Mexico since the commencement of sales in April 1996.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

OVERVIEW OF THE FINANCIAL STATEMENTS

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

This report consists of four parts—the Management's Discussion and Analysis (this section), the basic financial statements, including the notes to the financial statements; required supplementary information, the Budgetary Comparison Statements, and supplementary information, the Schedules of Percentage Return to the State of New Mexico.

Financial Statements. The Statements of Net Position on Page 24 and the Statements of Revenues, Expenses, and Changes in Net Position on page 25 report the Lottery's assets, liabilities, revenues and expenses in comparative format for fiscal year 2014 and fiscal year 2013. The Statements of Cash Flows on pages 26 and 27 report the sources and uses of cash for fiscal years 2014 and 2013. The Statements of Fiduciary Net Position on page 28 and Statements of Changes in Fiduciary Net Position on page 29 report the balances and activity of the Lottery's Retirement Plan for fiscal years 2014 and 2013.

Notes to Financial Statements. The Notes to Financial Statements on pages 30 to 49 provide additional information that is essential for a full understanding of the financial statements and provide more detailed data.

Budgetary Comparison Statements. The Budgetary Comparison Statements on page 50 show the variances between the budgets and actual Lottery performance.

Schedules of Percentage Return to the State of New Mexico. The Schedules of Percentage Return to the State of New Mexico on page 51 reports the percentages of gross revenues that were returned to the State of New Mexico for fiscal years 2014 and 2013 in compliance with the New Mexico Lottery Act.

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 Position; 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 Position; and in the sources and uses of cash as set forth in the Statements of Cash Flows.

New Mexico Lottery Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) – CONTINUED

FINANCIAL ANALYSIS

Total Net Position

At the end of fiscal year 2014 the Lottery's net position was \$267,000, while at the end of fiscal year 2013 the Lottery's total assets and total liabilities were equal with total net position reduced to zero.

Total Assets

Table 1
Total Assets

	2014	2013	2012	Increase (Decrease) \$ Change 2013 to 2014	Increase (Decrease) % Change 2013 to 2014	Increase \$ Change 2012 to 2013	Increase % Change 2012 to 2013
Cash and cash							
Equivalents	\$ 10,280,672	\$ 9,340,237	\$ 6,885,806	\$ 940,435	10.1%	\$ 2,454,431	35.6%
Accounts receivable, (net of allowance for doubtful accounts)	1,326,831	1,371,427	1,225,638	(44,596)	(3.3)	145,789	11.9
Reserves on							
Deposit	3,431,968	3,405,568	3,396,831	26,400	0.8	8,737	0.3
Inventory	122,891	36,964	33,077	85,927	232.5	3,887	11.8
Prepaid expenses	108,078	145,172	80,686	(37,094)	(25.6)	64,486	79.9
Total current Assets	15,270,440	14,299,368	11,622,038	971,072	6.8	2,677,330	23.0
Capital assets, net	827,886	629,345	305,550	198,541	31.5	323,795	106.0
Total assets	\$ 16,098,326	\$ 14,928,713	\$ 11,927,588	\$ 1,169,613	7.8%	\$ 3,001,125	25.2%

Compared to each prior fiscal year, the Lottery's cash and cash equivalents increased at the end of fiscal year 2014 by \$940,435 or 10.1% and in fiscal year 2013 by \$2,454,431 or 35.6%, respectively. The changes in cash and cash equivalents relate mainly to changes in accounts receivable, accounts payable and prizes payable at the end of each fiscal year compared to the prior fiscal year.

Accounts receivable from the Lottery's retailers are collected weekly each Thursday through electronic bank transfers. Receivables are equal to sales by retailers net of any prizes paid by the retailers and any commissions earned, less the allowance for bad debts and plus any miscellaneous receivables from any other source. Accounts receivable decreased by \$44,596, (3.3)%, in fiscal year 2014, while accounts receivable increased by \$145,789 or 11.9% at the end of fiscal year 2013. The decrease in accounts receivable at the end of fiscal year 2014 is

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) – CONTINUED

FINANCIAL ANALYSIS – CONTINUED

Total Assets - Continued

partially due to having higher multi-draw sales at the end of the fiscal year that were for drawings in fiscal year 2015 compared to the multi-draw sales at the end of fiscal year 2013 that were for drawings in fiscal year 2014 sales. These multi-draw sales were adjusted into the fiscal year in which the drawings were held. In fiscal year 2013, this increase can be attributed to having eight days of transactions in accounts receivable at year end compared to only seven at the end of the previous fiscal year.

The Lottery has amounts on deposit with the Multi-State Lottery Association (MUSL) called reserves on deposit, as required by the Powerball® (Powerball), Hot Lotto® (Hot Lotto), and Mega Millions® (Mega Millions) game rules and an unreserved account for payment of expenses and to record receipts of interest and other income on the deposits. The changes in these accounts in both fiscal years 2014 and 2013 of \$26,400 and \$8,737, respectively, were caused by the receipts of interest earned and other income on the deposits with MUSL; payments of game expenses; changes to the Mega Millions and Hot Lotto reserve accounts, as required by the Mega Millions and Hot Lotto game rules; and the re-balancing of the Powerball reserve accounts. In addition, in fiscal year 2013 the payment of the Lottery's portion of intellectual property purchased for MUSL games was deducted from the unreserved account.

The inventory balance at the end of both fiscal year 2014 and 2013 increased by \$85,927, a 232.5% increase, and \$3,887, an 11.8% increase, respectively. The Lottery has agreements signed in March 2010, with its primary instant ticket printer, whereby the tickets printed are owned by the vendor with the Lottery having an obligation to pay for the tickets when the tickets are sold. Therefore, these tickets are not included in the Lottery's inventory. But, under an agreement signed with a secondary instant ticket printer in March 2010, the Lottery began purchasing the instant tickets printed by this vendor. The Lottery has accounted for games printed under this agreement as ticket inventory using the specific identification method at the lower of cost or market. At the end of each of the two fiscal years 2014 and 2013, the Lottery had remaining inventory of \$65,460 and \$9,633 for seven games and two games, respectively in each year, purchased under this agreement. In addition, at the end of fiscal years 2014 and 2013, the Lottery had inventory of \$2,309 and \$3,192, respectively, for a promotional instant game purchased. Included in inventory, the Lottery also had merchandise prizes at the end of each fiscal year of \$55,122 and \$24,139, respectively, for summer second chance drawing promotions.

As part of the agreement with INTRALOT, Inc. to provide an updated on-line gaming system, the Lottery installed and implemented a new internal control system (ICS) in fiscal year 2009. The cost of the ICS is included in the fixed fee paid to the vendor as a percentage of net sales.

New Mexico Lottery Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) – CONTINUED

FINANCIAL ANALYSIS – CONTINUED

Total Assets – Continued

The Lottery has accounted for this transaction as a capital lease and, therefore, the ICS cost of \$43,600 is reflected in capital assets. The related liability for the ICS is included in the current portion of capital lease obligation (\$6,229 at June 30, 2014 and 2013, respectively) and in the noncurrent portion of capital lease obligation (\$2,595 and \$8,823 at June 30, 2014 and 2013, respectively).

As part of the facility lease agreements signed in 2002 and 2012, the landlord paid for \$29,975 and \$51,858 in tenant improvements for the Lottery's corporate facility in fiscal years 2013 and 2012, respectively. The Lottery has capitalized \$72,543 as tenant improvements with a related deferred liability, while the remaining purchases of tenant improvements totaling \$9,290 were expensed because the items purchased did not meet the \$5,000 threshold for capitalization. \$7,835 in both fiscal years 2014 and 2013, respectively, are included in the current portion of capital lease obligation and \$60,724 and \$68,559 for fiscal years 2014 and 2013, respectively, are included in the noncurrent portion of capital lease obligation.

The changes in capital assets in fiscal years 2014 and 2013 are attributable to \$387,046 and \$463,188 in capital asset purchases and \$188,505 and \$139,393 in depreciation, for the two fiscal years, respectively.

Total Liabilities

Table 2
Total Liabilities

	2014	2013	2012	Increase (Decrease) \$ Change 2013 to 2014	Increase (Decrease) % Change 2013 to 2014	Increase \$ Change 2012 to 2013	Increase % Change 2012 to 2013
Accounts pay- able and other current liabilities	\$ 2,145,418	\$ 1,977,904	\$ 1,955,328	\$ 167,514	8.5%	\$ 22,576	1.2%
Current portion of capital lease Obligation	14,064	14,064	11,015	-	-	3,049	27.7
Prizes payable	10,552,075	9,355,989	6,860,315	1,196,086	12.8	2,495,674	36.4
Due to Lottery Tuition Fund	3,056,450	3,503,374	3,039,205	(446,924)	(12.8)	464,169	15.3
Total current liabilities	15,768,007	14,851,331	11,865,863	916,676	6.2	2,985,468	25.2
Noncurrent por- tion of capital lease obligation	63,319	77,382	61,725	(14,063)	(18.2)	15,657	25.4
Total liabilities	\$ 15,831,326	\$ 14,928,713	\$ 11,927,588	\$ 902,613	6.0%	\$ 3,001,125	25.2%

New Mexico Lottery Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Total Liabilities - Continued

Accounts payable and other current liabilities increased by \$167,514 or 8.5% and \$22,576 or 1.2% at the end of fiscal years 2014 and 2013, respectively. In both fiscal years, the changes compared to the prior fiscal year were mainly due to amounts owed to five vendors for advertising, the on-line gaming system, instant ticket printing fees, and the lottery's share of prizes payable to MUSL for Powerball, Hot Lotto, and Mega Millions. Sales amounts and advertising placed during the last few weeks of each fiscal year will generally determine the amounts owed at the end of each fiscal year to these vendors and whether that amount is higher or lower than in the prior fiscal year.

Prizes payable is essentially comprised of amounts accrued based on the Lottery's game designs and prize structures for draw game 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 years 2014 and 2013, prizes increased by \$1,196,086 or 12.8% and \$2,495,674 or 36.4%, respectively. These differences relate to the changes of prizes payable on individual Lottery games between the fiscal years as a result of sales in each fiscal year and prizes not yet claimed.

At the end of fiscal years 2014 and 2013, \$3,056,450 and \$3,503,274, 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 by the end of July of each year.

New Mexico Lottery Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Net Ticket Sales and Prize Expense

Table 3
Net Ticket Sales and
Prize Expense

2014	Net Ticket Sales	Prize Expense	Gross Margin
Instant tickets	\$ 69,804,813	\$ 39,624,564	\$ 30,180,249
Powerball	34,027,555	16,983,374	17,044,181
Mega Millions	13,410,732	6,704,090	6,706,642
Roadrunner Cash	8,592,684	5,266,316	3,326,368
Hot Lotto	5,700,311	2,907,024	2,793,287
Pick 3	3,828,187	2,208,335	1,619,852
Quicksters	638,322	366,543	271,779
Total	\$ 136,002,604	\$ 74,060,246	\$ 61,942,358
2013	Net Ticket Sales	Prize Expense	Gross Margin
Instant tickets	\$ 69,886,435	\$ 40,283,399	\$ 29,603,036
Powerball	46,734,439	23,332,651	23,401,788
Mega Millions	8,078,050	4,027,633	4,050,417
Roadrunner Cash	6,767,906	4,016,276	2,751,630
Hot Lotto	5,933,935	2,959,006	2,974,929
Pick 3	3,492,915	1,973,715	1,519,200
Quicksters	864,842	475,878	388,964
Total	\$ 141,758,522	\$ 77,068,558	\$ 64,689,964
2012	Net Ticket Sales	Prize Expense	Gross Margin
Instant tickets	\$ 68,736,331	\$ 38,273,594	\$ 30,462,737
Powerball	33,767,315	16,897,832	16,869,483
Mega Millions	14,255,730	7,230,117	7,025,613
Roadrunner Cash	7,509,592	4,586,920	2,922,672
Hot Lotto	5,430,132	2,723,879	2,706,253
Pick 3	3,634,804	2,068,225	1,566,579
Quicksters	453,448	246,741	206,707
Total	\$ 133,787,352	\$ 72,027,308	\$ 61,760,044
\$ (decrease) from FY 2013 to FY 2014	\$ (5,755,918)	\$ (3,008,312)	\$ (2,747,606)
% (decrease) from FY 2013 to FY 2014	(4.1)%	(3.9)%	(4.2)%
\$ Increase from FY 2012 to FY 2013	\$ 7,971,170	\$ 5,041,250	\$ 2,929,920
% Increase from FY 2012 to FY 2013	6.0%	7.0%	4.7%

Note: Instant ticket sales are net of tickets provided as prizes, stolen, and promotion tickets; Powerball, Mega Millions, Roadrunner Cash, Hot Lotto, Pick 3 and Quickster sales are net of spoiled and promotional tickets.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS – CONTINUED

Net Ticket Sales and Prize Expense – Continued

Table 3 compares net ticket sales, prize expense and gross margin (net ticket sales minus prize expense) for each lottery game for fiscal years 2014, 2013, and 2012. In fiscal year 2014 net sales, prize expense and gross margin increased for Mega Millions, Roadrunner Cash and Pick 3, while net sales, prize expense and gross margin decreased for Powerball, Hot Lotto, and Quicksters. In fiscal year 2014, net instant ticket sales and the related prize expense decreased, but gross margin increased due to the application of unclaimed prizes to supplement higher prize payouts, in an increased effort to bring back lapsed players. The last quarter of the year reflects a 4.66% growth in net instant sales due to a comprehensively planned instant ticket sales strategy, including using unclaimed prizes to supplement the prizes in instant ticket games, launching instant games on the first Tuesday of the month, using plans for retailers to place instant tickets into the dispensers and self-service lottery terminals and increasing the visibility of instant tickets by using on-counter dispensers.

In fiscal year 2013 net sales, prize expense and gross margin increased for Powerball, Hot Lotto, and Quicksters, while net sales, prize expense and gross margin decreased for Mega Millions, Roadrunner Cash, and Pick 3. In fiscal year 2013, net sales and prize expense increased for instant sales, but the gross margin for the year decreased in comparison to the prior fiscal year. This decrease in gross margin for instant sales was due to an increase in the overall payout percentage for instant tickets from 57.97% in fiscal year 2012 to 58.94% in fiscal year 2013, primarily to bring players back to purchasing instant games and stop the decline of instant sales over the prior six years.

Net Ticket Sales

In both fiscal years 2014 and 2013, the Lottery has continued to use the customer relationship management (CRM) system for placing instant game tickets at retailer locations. The Lottery's customer service representatives continue to place calls each week to each retailer location, review the inventory at each location with the retailer, and place orders continually as needed based on the inventory turnover at each location. In fiscal year 2014, forty-nine new instant ticket games were launched - 13 - \$1, 10 - \$2, 10 - \$3, 10 - \$5, 5 - \$10 and 1 - \$20—3 less \$1 games, 4 more \$3, 1 more \$5 and 2 more \$10 game than in fiscal year 2013. In fiscal year 2013, forty-five new instant ticket games were launched - 16 - \$1, 10 - \$2, 6 - \$3, 9 - \$5, 3 - \$10 and 1 - \$20—1 more \$1, 2 less \$3, 1 more \$5 and 3 more \$10 game than in fiscal year 2012. In fiscal year 2014, the Lottery launched 17 games with free (prize) tickets and 32 games without prize tickets, while in fiscal year 2013, the Lottery launched 22 games with free (prize) tickets and 23 games without free tickets. Net instant ticket sales for 5 months, including the last three months of the year, were higher than for the comparable month in fiscal year 2013. Net instant ticket sales for 7 months (including the last five months of the fiscal year) were higher than the comparable month in fiscal year 2012. Since fiscal year 2007, when net instant ticket sales were a record \$91.37 million, net instant ticket sales have

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Net Ticket Sales and Prize Expense - Continued

Net Ticket Sales – Continued

decreased by \$21.57 million or an approximate 23.6% drop to \$69.80 million in fiscal year 2014.

In January 2012, the Powerball game was changed from a \$1 price point to a \$2 price point. Along with this price change, the jackpot now starts at \$40 million, up from the previous starting jackpot of \$20 million. The matrix was changed from a 5 of 59 and 1 of 39 game to a 5 of 59 and 1 of 35 game. Two prize levels were changed; the Match 5 + 0 prize level going from a \$200,000 cash prize to a \$1 million cash prize and the Match 0 + 1 going from a \$3 prize to a \$4 prize. The overall odds and the jackpot odds were improved. The Powerplay option remained in the game, but the multiplier option was discontinued and instead increased set prize levels are included in the Power Play option. The roll down option was eliminated.

Although, Powerball sales are generally driven by the advertised jackpot, in fiscal years 2014 and 2013, the change in the price point and the matrix also affected the sales in each year. In fiscal year 2014, the highest jackpot was \$448.4 million in August 2013 with another jackpot of \$425.3 million in February 2014. Other jackpots reached to \$399.4, \$259.8, \$213.4, \$148.8, \$130.3, and \$122.9 with three other jackpots that were less than \$100 million when won. While three jackpots surpassed or were nearly \$400 million when won, not having the “super jackpots” of nearly six hundred million dollars caused sales in fiscal year 2014 to be over \$12.7 million less than in fiscal year 2013.

In fiscal year 2013, the highest jackpot for the year was \$590.5 million with another jackpot of \$587.5 million closely following. There were also other jackpots that each reached \$338.3, \$337.0, \$217.2, \$202.1, and \$131.5 million and ten jackpots that were \$70.0 million or less when they were won. Having a \$2 price point for a full year and the four jackpots that surpassed the \$300 million mark helped Powerball achieve net sales that were nearly \$13 million higher than in fiscal year 2012.

In fiscal year 2012, the highest jackpot for the year was \$336.4 million with three other jackpots reaching \$254.2, \$241.0, and \$228.9 million, three smaller jackpots reaching \$172.7, \$128.8, and \$108.8 million, and six jackpots being \$70 million or less when they were won. The change in the price point and the level of the jackpots helped to increase Powerball net sales by nearly \$4.7 million over the previous fiscal year.

Since fiscal year 2006 when net sales were a record \$54.1 million, Powerball net sales have decreased. Players wanting larger and larger jackpots before they buy tickets have affected Powerball sales each year.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Net Ticket Sales and Prize Expense – Continued

Net Ticket Sales – Continued

Mega Millions' sales are also driven by the jackpot amount. In fiscal year 2014, the highest jackpot for Mega Millions was \$648 million at the time it was won in December 2013 followed by a \$414 million jackpot in March 2014. There were also two jackpots of \$190 million and \$150 million and 8 jackpots of less than \$80 million. The December 2013 jackpot brought in approximately four million dollars of incremental sales during the last few drawings while the jackpot was growing. Due to the large jackpots, Mega Millions closed the year with \$5.3 million in net sales over the prior fiscal year; a 66% increase in net sales.

In fiscal year 2013, the highest jackpot won was \$198.0 million followed by another jackpot of \$120.0 million. Twelve other jackpots were won in fiscal year 2013 that were \$89 million or less. With Powerball having such large jackpots in fiscal year 2013 and Mega Millions staying relatively low, Mega Millions net sales dropped by over \$6 million dollars or 43.3%.

In fiscal year 2012, the highest jackpot reached a record \$656 million with another jackpot climbing to \$206 million and three smaller jackpots hitting \$118, \$113, and \$105 million when they were won. Six jackpots were won at amounts less than \$100 million. The \$656 million jackpot helped to increase sales in March 2012 by over five million dollars. Although, Mega Millions had a higher jackpot in fiscal year 2012 than Powerball, Mega Millions average monthly sales, without the \$656 million run-up spike, averaged less than \$800,000 per month, while Powerball's average sales, without run-up spikes, were over \$2.5 million per month.

Similar to the Powerball and Mega Millions games, Roadrunner Cash sales are driven by the jackpot (top) prize amount. In fiscal year 2014, Roadrunner Cash had a record setting jackpot of \$890,000. During that month, Roadrunner Cash sales grew by approximately \$1.5 million. There was also one jackpot that rose to \$385,000 and another jackpot that rose to \$307,000 with two other jackpots growing to \$265,000 and \$220,000 before being won; twelve other jackpots were \$160,000 or less. Fiscal year 2014 ended with Roadrunner Cash net sales being \$1.8 million dollars more than the prior fiscal year.

In fiscal year 2013, the Roadrunner Cash jackpot rose to \$320,000 in August 2012 and to \$430,000 in December 2012, plus two other times during the year to jackpots greater than \$150,000. Sixteen other jackpots were less than \$150,000 before being won during the fiscal year. In fiscal year 2012, the jackpot climbed seven times to more than \$150,000 climbing to \$420,000 and \$550,000 in August 2011 and in March 2012, respectively. These differences in the top prizes reflected on the net sales in these two fiscal years with fiscal year 2013's sale being lower than in the previous fiscal year—a 9.9% decline in net sales.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Net Ticket Sales and Prize Expense – Continued

Net Ticket Sales – Continued

The MUSL game, Hot Lotto, is another smaller national jackpot game offered by the Lottery. Sales for this game also track with the jackpot. Fiscal year 2014 started with the Hot Lotto jackpot at approximately \$6.9 million. The jackpot grew until it was won by a New Mexico Lottery player on August 3, 2013 when it was \$7.3 million. Following this win, the jackpot climbed to nearly \$2 million when it was won in October and then begin climbing again at that time, ending the year at just over \$8.1 million. In fiscal year 2013, Hot Lotto started fiscal year with a jackpot of just over \$1 million and grew to \$1.4 million before being won in July 2012. It then climbed to \$9.4 million in January before it was won. The jackpot then continued to rise from \$1 million until year end, where it ended the year at nearly \$6.9 million. These changing jackpots reflect on net sales during each fiscal year.

Pick 3 net sales increased in fiscal year 2013 by \$335,271. In early June 2014, the Lottery added a mid-day drawing. This mid-day drawing provided sales of approximately \$4,700 for each mid-day draw and provided nearly \$90,000 in additional sales in June 2014. Pick 3 net sales in fiscal year 2013 decreased by \$141,889 or 3.9%. Pick 3 remains a core game for the Lottery bringing in steady monthly average net sales of over \$300,000 each month.

A new game, Quicksters, was started on March 25, 2012. Quicksters are instant-win games, similar to instant ticket games, but produced by the same lottery sales terminals as draw game tickets and with no scratching needed to reveal the prizes. The first game offered was Super 7s. This game provided \$453,448 in net sales for fiscal year 2012. In fiscal year 2013, five new Quickster games were added producing \$864,842 in net sales for the fiscal year. In fiscal year 2014, Quickster net sales were \$638,000.

Prize Expense

Prize expense for the draw games of Powerball, Mega Millions and Hot Lotto is based on the overall prize payout per the game design, while prize expense for Roadrunner Cash, Pick 3 and Quicksters is determined by the prizes won each month for each drawing or game. The prizes included in the prize structure for 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 structures of the games.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS – CONTINUED

Net Ticket Sales and Prize Expense – Continued

Prize Expense - Continued

In fiscal years 2014 and 2013, the prize payout increased by approximately 1.09% and .12%, respectively, prior to the application of unclaimed prizes.

At the end of the claim period for each game, unclaimed prizes for the Lottery's instant games and draw games are paid into the "Prize Fund," in accordance with the New Mexico Lottery Act. These unclaimed prizes from the Lottery's prize fund have been used to supplement the prizes in instant and draw games and for second chance drawings and, therefore, reduce the prize expense for Lottery products and help the Lottery to maximize its sales and its return to education.

Prize Tickets

In fiscal years 2014 and 2013, tickets provided as prizes (prize or free tickets) claimed for instant games decreased by \$383,110 or 15.45% and \$411,456 or 14.23%, respectively, in comparison to the previous fiscal years. 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 that had the winning prize ticket. Each fiscal year, the Lottery has continued to study the market to determine the optimum quantity of prize tickets to place in its instant ticket games in order to optimize its instant ticket sales.

New Mexico Lottery Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS – CONTINUED

Game Expenses

Table 4
Game Expenses

	2014	2013	2012	Increase (Decrease) \$ Change 2013 to 2014	Increase (Decrease) % Change 2013 to 2014	Increase (Decrease) \$ Change 2012 to 2013	Increase (Decrease) % Change 2012 to 2013
Prize expense	\$ 74,060,246	\$ 77,068,558	\$ 72,027,308	\$ (3,008,312)	(3.9)%	\$ 5,041,250	7.0%
Retailer							
commissions	8,782,855	9,153,204	8,696,851	(370,349)	(4.0)	456,353	5.2
Advertising	2,267,772	2,263,221	2,277,892	4,551	0.2	(14,671)	(0.6)
On-line vendor							
fees	2,177,205	2,269,623	2,139,754	(92,418)	(4.1)	129,869	6.1
Ticket vendor							
fees	1,188,107	1,158,028	1,177,708	30,079	2.6	(19,680)	(1.7)
Other game							
expenses	<u>1,132,149</u>	<u>1,136,751</u>	<u>1,061,035</u>	<u>(4,602)</u>	<u>(0.4)</u>	<u>75,716</u>	<u>7.1</u>
Total game							
expenses	<u>\$ 89,608,334</u>	<u>\$ 93,049,385</u>	<u>\$ 87,380,548</u>	<u>\$ (3,441,051)</u>	<u>(3.7)%</u>	<u>\$ 5,668,837</u>	<u>6.5%</u>

The changes in retailer commissions for fiscal years 2014 and 2013 are consistent with the changes in gross ticket sales for the two years and are equivalent to 6.46% and 6.45% of gross revenues for the two years, respectively. Retailer commissions are paid to the Lottery's retailers for selling Lottery tickets, cashing Lottery prizes and for selling a jackpot/grand prize for Powerball, Mega Millions or Hot Lotto, for selling a match 5 prize for Powerball or Mega Millions, and for selling a jackpot prize of more than \$100,000 for Roadrunner Cash.

Since November 21, 2008, the on-line vendor fee has been a fixed percentage of net sales, plus applicable gross receipts taxes, with no additional terminal fees. The on-line fee increases or decreases as draw game and instant ticket net sales increase or decrease. The changes in the on-line vendor fees for the two fiscal years are consistent with the changes in draw game and instant ticket net sales in fiscal years 2014 and 2013 and are equivalent to 1.60% of gross revenues for the two years.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Game Expenses - Continued

Advertising money is expended to market the Lottery and its products to the public and to inform the public about the games that are available, the jackpot and top prize amounts for the draw games, to provide security tips and gambling awareness for our players and benefit messages to New Mexico students and their families, and to keep the lottery products fresh in the public's minds, all in order to maximize sales. Advertising expense was approximately 1.67% and 1.60% of gross revenues, respectively, for fiscal years 2014 and 2013 and stayed within the Lottery Board approved budgets of \$2,300,000 for each fiscal year.

In fiscal years 2010 the Lottery signed a new contract with its primary ticket printer effective in March of that year. Under this contract, the instant tickets are owned by the vendor with the Lottery expensing the cost to ticket vendor fees and paying for the tickets as a percentage of net instant sales when the tickets are sold. In addition, in March 2010, the Lottery signed a contract with a secondary printer, whereby the Lottery would be purchasing the tickets printed. These tickets are included in inventory with the cost of the tickets being recorded as ticket vendor fees as the tickets are consigned to retailers. In fiscal year 2014 and 2013, the cost for any licensing fees or special printing costs are also included in ticket vendor fees. The ticket vendor fees for both fiscal year 2014 and 2013 are .87% and .82% of gross revenues and are consistent with net instant ticket sales for each fiscal year.

Included in other game expenses are retailer equipment, shipping and postage, promotions, drawing game, responsible gaming, and game membership expenses. Fiscal year 2014 reflects a decrease of \$4,602 or (0.4) %, while fiscal year 2013 reflects an increase of \$75,716 or 7.1 %. In fiscal year 2014, this change is primarily due to achieving savings in the cost of shipping of instant games to retailers; savings in the cost of responsible gaming, game membership and drawing game expenses offset by the cost to purchase more cost effective electronic jackpot signs to replace eight year old signs at retailer locations. The new signs will have no communication costs and will replace signs that have cost over \$25,000 in annual communication expense. In fiscal year 2013, the increase was partially due to the purchase of lottery information centers to enable the Lottery to replace the aging equipment at some of the lottery's retailers and an increase in shipping and postage due to shipping additional instant tickets to lottery retailers, offset by a decrease in the amounts spent for marketing and sales promotions, for premium items and for other retailer equipment.

New Mexico Lottery Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) – CONTINUED

FINANCIAL ANALYSIS – CONTINUED

Operating Expenses

Table 5
Operating Expenses

	2014	2013	2012	Increase (Decrease) \$ Change 2013 to 2014	Increase (Decrease) % Change 2013 to 2014	Increase (Decrease) \$ Change 2012 to 2013	Increase (Decrease) % Change 2012 to 2013
Salaries, wages, and benefits	\$ 3,726,941	\$ 3,614,032	\$ 3,583,778	\$ 112,909	3.1%	\$ 30,254	0.8%
Utilities and maintenance	448,166	439,041	431,189	9,125	2.1	7,852	1.8
Leases and Insurance	423,932	514,990	585,629	(91,058)	(17.7)	(70,639)	(12.1)
Other operating Expenses	641,491	511,984	545,648	129,507	25.3	(33,664)	(6.2)
Total operating expenses	<u>\$ 5,240,530</u>	<u>\$ 5,080,047</u>	<u>\$ 5,146,244</u>	<u>\$ 160,483</u>	3.2%	<u>\$ (66,197)</u>	(1.3)%

Operating expenses are made up of salaries, wages and benefits, utilities and maintenance, leases and insurance, and other operating expenses, which include depreciation and amortization, professional fees, materials and supplies, travel, and other expenses. In fiscal year 2014, the Lottery's operating expenses increased by \$160,483 or 3.2%, while in fiscal year 2013, the Lottery decreased its operating expenses by \$66,197 or (1.3) %.

In fiscal year 2014, salaries, wages and benefits increased due to the \$165,000 contractual severance payments for the former CEO, whose contract was terminated and increases in professional fees and depreciation for replacement equipment. These costs were offset by cost savings on the new lease of over \$90,000.

The change in fiscal year 2013 is mainly due to over \$70,000, or 12%, in savings on leases and insurance following an extensive two-year review of the facility and other alternate sites and the final negotiation and acceptance of a new lease in June 2012; there were also smaller savings realized in professional fees, materials and supplies and travel. These decreases were offset with an increase in salaries, wages, and benefits mainly due to not having anyone leave the employ of the Lottery in the second half of the fiscal year and having all but two positions on the Lottery's organization chart filled plus an increase in depreciation and amortization for replacement equipment that has been recently purchased.

New Mexico Lottery Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Operating Expenses - continued

Non-Operating Income

Non-operating income decreased in both fiscal years 2014 and 2013. Interest rates continue to be low during both fiscal years. No significant other income was received in fiscal year 2014. For fiscal year 2013, other income decreased compared to fiscal year 2012, where liquidated damages had been received on a Lottery contract.

Net Income

	<u>Total Operating Revenues</u>	<u>Net Income</u>
Fiscal Year 2014	<u>\$ 136,025,057</u>	<u>\$ 41,208,550</u>
Fiscal Year 2013	<u>\$ 141,767,097</u>	<u>\$ 43,684,681</u>
Fiscal Year 2012	<u>\$ 133,791,602</u>	<u>\$ 41,328,743</u>
(Decrease) from FY 2013 to FY 2014	<u><u>\$ (5,742,040)</u></u>	<u><u>\$ (2,476,131)</u></u>
% (Decrease) from FY 2013 to FY 2014	<u><u>(4.1)%</u></u>	<u><u>(5.7)%</u></u>
Increase from FY 2012 to FY 2013	<u>\$ 7,975,495</u>	<u>\$ 2,355,938</u>
% Increase from FY 2012 to FY 2013	<u>6.0%</u>	<u>5.7%</u>

Effective July 1, 2007, the New Mexico Lottery Act, Chapter 6, Article 24 NMSA 1978, was changed to require the Lottery to transmit at least twenty-seven percent of its gross revenues to the State Treasurer until December 31, 2008 and at least thirty percent of its gross revenues thereafter. In fiscal years 2014 and 2013, the Lottery transmitted its net income each month, totaling \$40,941,550 and \$43,684,681, respectively. The gross revenue percentage return for fiscal year 2014 was 30.09%, while for fiscal year 2013, it was 30.80%. The Lottery was able to meet the 30% gross revenue percentage returns each month in both fiscal years.

The changes in net income for fiscal years 2014 and 2013 were related to the changes in sales for the Lottery's games during the two years netted against savings in the cost of the product and operating expenses during the two fiscal years.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Net Income - Continued

In addition to the changes that had been made in fiscal year 2008 of reducing staffing, retailer and sales staff incentives, advertising costs, and prize expense to meet the statutory requirement of 27% through December 2008 and 30% thereafter for gross revenue percentage return; the Lottery also commenced a new on-line system agreement in November 2008, whereby the fee to the on-line vendor was reduced, and separate terminal communication fees and vending machine fees that had previously been paid were eliminated. This change has continued to provide a percentage reduction of the on-line vendor fees to gross revenues of over 3.1% in both fiscal year 2014 and 2013 compared to fiscal year 2008. In addition, the Lottery has continued to realize a savings on instant ticket printing fees year over year since 2010 based on contracts that were signed with two vendors in that year. In addition, in 2012 a new lease was negotiated and signed where over half-a-million dollars will be saved over the term of the lease.

New Mexico Lottery Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) – CONTINUED

FINANCIAL ANALYSIS – CONTINUED

Budgetary Comparison

	2014				
	Original Budget	Final Budget	Actual	Variance with Final Budget	% Variance with Final Budget
Total operating revenues	\$ 131,400,000	\$ 135,303,000	\$ 136,025,057	\$ 722,057	0.5%
Total game expenses	86,280,000	89,031,000	89,608,334	577,334	0.6
Total operating expenses	5,716,000	5,698,000	5,240,530	(457,470)	(8.0)
Operating income	39,404,000	40,574,000	41,176,193	602,193	1.5
Total non-operating income	24,000	25,000	32,357	7,357	29.4
Net income before transfers to Lottery Tuition Fund	\$ 39,428,000	\$ 40,599,000	\$ 41,208,550	\$ 609,550	1.5%
	2013				
	Original Budget	Final Budget	Actual	Variance with Final Budget	% Variance with Final Budget
Total operating revenues	\$ 135,000,000	\$ 132,600,000	\$ 141,767,097	\$ 9,167,097	6.9%
Total game expenses	88,742,000	87,350,000	93,049,385	5,699,385	6.5
Total operating expenses	5,763,000	5,339,000	5,080,047	(258,953)	(4.9)
Operating income	40,495,000	39,911,000	43,637,665	3,726,665	9.3
Total non-operating income	18,000	24,000	47,016	23,016	95.9
Net income before transfers to Lottery Tuition Fund	\$ 40,513,000	\$ 39,935,000	\$ 43,684,681	\$ 3,749,681	9.4%

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Budgetary Comparison - Continued

In fiscal year 2014, the original budget was revised because Mega Millions, Roadrunner Cash and Pick 3 sales were performing better than forecast and thus sales for these games were increased. Instant, Hot Lotto, and Quickster sales were reduced because of poor performance during the first half of the fiscal year. Powerball was left at the same budget amount in anticipation of a jackpot run-up in the few months of the fiscal year. The sales budget was increased by \$3,903,000, which was made up of a \$4.0 million increase for Mega Millions, a \$1.6 million increase for Roadrunner Cash, and a \$300,000 increase for Pick 3 offset by a decrease of \$1.5 million for instants, a decrease of \$500,000 for Hot Lotto, and a \$400,000 decrease for Quicksters, along with a decrease of \$400,000 for tickets provided for prizes, a \$1,000 increase to spoiled, stolen, and promotional tickets, and a \$4,000 increase for retailer fees. Game expenses remained at approximately 65% of the budget and operating expenses were reduced by \$18,000. With these changes, net income was increased by \$1,171,000; still remaining at 30%.

In fiscal year 2014, actual net sales exceeded the revised budget by more than \$691,000. Net instant sales were \$2.0 million more than the revised budget and Mega Millions sales were \$1.4 million more than the revised budget. Roadrunner Cash, Hot Lotto, Pick 3 and Quicksters superseded the revised budget by \$202,000, \$707,000, \$134,000 and \$40,000, respectively. But, Powerball sales were less than the revised budget by over \$3.8 million. Total operating revenues ended the year at 100.53% of the revised budget; game expenses ended the fiscal year at 100.65% of the revised budget, tracking right in line with operating revenues. Operating expenses ended the year at 91.97% of the revised budget, with all budget line items finishing the year at less than the revised budget; in total less than the revised budget by \$457,470. Net return to the Legislative Lottery Scholarship fund was \$342,550 more than the revised budget amount at 100.84% of budget; generating return of 30% of gross revenues.

In fiscal year 2013, the original budget was revised because Powerball and Hot Lotto sales were performing better than expected, but Instant ticket, Mega Millions, Roadrunner Cash, Pick 3 and Quicksters were under performing. The sales budget was reduced by \$3.0 million, which was made up of an increase to Powerball of \$5.0 million and to Hot Lotto of \$600,000 offset by a sales reduction to Instant tickets of \$1.1 million, to Mega Millions of \$4.3 million, to Roadrunner Cash of \$1.2 million, to Pick 3 of \$300,000, and to Quicksters of \$1.7 million. Prize tickets were also reduced by \$500,000 and spoiled, stolen and promotional tickets by \$90,000, while retailer fees were increased by \$10,000. With all these changes, total revenues were reduced by \$2.4 million. Non-operating income was increased by \$6,000. In total, gross revenues were reduced by \$2,394,000. Related game expenses were reduced by \$1,392,000, operating expenses by \$424,000 and net income by \$578,000, but still returning over 30% of gross revenues.

New Mexico Lottery Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Budgetary Comparison - Continued

In fiscal year 2013, actual net sales for Instant tickets, Powerball, Mega Millions, Hot Lotto, Pick 3, and Quicksters all surpassed the projected net sales in the final budget with only Roadrunner Cash not meeting the budget by less than \$25,000. Actual net sales exceeded the budget by nearly \$9.2 million and due to higher sales, related game expenses were also more than the budget by nearly \$5.7 million. There was an additional cost savings in the operating expenses of over \$250,000 and an additional amount earned in non-operating income of \$23,000 in comparison to the final budget. The Lottery ended the year with net income surpassing the final budget by \$3,749,681; ending the year at 109.39% of the final budget.

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 of the Lottery as of June 30, 2014 and 2013, and results of its operations, cash flows, variances from budgets, and percentage return to the state for the years then ended and to demonstrate the Lottery's accountability for the revenues it receives. If you have any questions about this report or need additional information, contact the Director of Administration at the New Mexico Lottery Authority, P.O. Box 93130, Albuquerque, New Mexico 87199.

New Mexico Lottery Authority

STATEMENTS OF NET POSITION

June 30, 2014 and 2013

	<u>2014</u>	<u>2013</u>
CURRENT ASSETS		
Cash and cash equivalents	\$ 10,280,672	\$ 9,340,237
Accounts receivable (net of allowance for doubtful accounts)	1,326,831	1,371,427
Reserves on deposit	3,431,968	3,405,568
Inventory	122,891	36,964
Prepaid expenses	<u>108,078</u>	<u>145,172</u>
Total current assets	15,270,440	14,299,368
CAPITAL ASSETS, NET	<u>827,886</u>	<u>629,345</u>
Total assets	<u><u>\$ 16,098,326</u></u>	<u><u>\$ 14,928,713</u></u>
CURRENT LIABILITIES		
Accounts payable and other current liabilities	\$ 2,145,418	\$ 1,977,904
Current portion of capital lease obligation	14,064	14,064
Prizes payable	10,552,075	9,355,989
Due to Lottery Tuition Fund	<u>3,056,450</u>	<u>3,503,374</u>
Total current liabilities	15,768,007	14,851,331
LONG-TERM LIABILITIES		
Noncurrent portion of capital lease obligation	<u>63,319</u>	<u>77,382</u>
Total liabilities	<u><u>\$ 15,831,326</u></u>	<u><u>\$ 14,928,713</u></u>
NET POSITION		
Net investment in capital assets	\$ 827,886	\$ 629,345
Unrestricted (deficit)	<u>(560,886)</u>	<u>(629,345)</u>
Total net position	<u><u>\$ 267,000</u></u>	<u><u>\$ -</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 POSITION

Years ended June 30, 2014 and 2013

	<u>2014</u>	<u>2013</u>
OPERATING REVENUES		
Instant ticket sales	\$ 69,804,813	\$ 69,886,435
Powerball sales	34,027,555	46,734,439
Mega Millions sales	13,410,732	8,078,050
Roadrunner Cash sales	8,592,684	6,767,906
Hot Lotto sales	5,700,311	5,933,935
Pick 3 sales	3,828,187	3,492,915
Quickster sales	638,322	864,842
Net ticket sales	<u>136,002,604</u>	<u>141,758,522</u>
Retailer fees	22,453	20,575
Bad debts	-	(12,000)
Total operating revenues	<u>136,025,057</u>	<u>141,767,097</u>
GAME EXPENSES		
Prize expense	74,060,246	77,068,558
Retailer commissions	8,782,855	9,153,204
Advertising	2,267,772	2,263,221
On-line vendor fees	2,177,205	2,269,623
Ticket vendor fees	1,188,107	1,158,028
Retailer equipment	345,786	201,436
Shipping and postage	335,679	428,532
Promotions	221,036	236,268
Drawing game	102,880	116,081
Responsible gaming	83,050	87,400
Game membership	43,718	67,034
Total game expenses	<u>89,608,334</u>	<u>93,049,385</u>
OPERATING EXPENSES		
Salaries, wages, and benefits	3,726,941	3,614,032
Utilities and maintenance	448,166	439,041
Leases and insurance	423,932	514,990
Depreciation	188,505	139,393
Professional fees	186,035	112,893
Materials and supplies	135,260	125,050
Other	69,711	71,640
Travel	61,980	63,008
Total operating expenses	<u>5,240,530</u>	<u>5,080,047</u>
OPERATING INCOME	<u>41,176,193</u>	<u>43,637,665</u>
NON-OPERATING INCOME		
Interest income	18,753	21,324
Other income	13,604	25,692
Total non-operating income	<u>32,357</u>	<u>47,016</u>
Net income before transfers	41,208,550	43,684,681
Transfers to Lottery Tuition Fund	<u>40,941,550</u>	<u>43,684,681</u>
Change in net position	267,000	-
Net position at beginning of year	<u>-</u>	<u>-</u>
Net position at end of year	<u>\$ 267,000</u>	<u>\$ -</u>

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

New Mexico Lottery Authority

STATEMENTS OF CASH FLOWS

Years ended June 30, 2014 and 2013

Increase (Decrease) in Cash and Cash Equivalents

	<u>2014</u>	<u>2013</u>
Cash flows from operating activities		
Cash received:		
From retailers-sales net of commissions, incentives, and prize, spoiled, and stolen ticket credits	\$ 127,279,025	\$ 132,472,895
From MUSL - Hot Lotto jackpot	10,992,481	-
Cash payments:		
To prize winners and related taxes	(68,225,640)	(58,375,753)
To MUSL	(15,631,001)	(16,197,131)
To suppliers of goods or services	(8,748,786)	(9,058,917)
To employees for services and related taxes	<u>(3,027,629)</u>	<u>(2,880,565)</u>
Net cash provided by operating activities	<u>42,638,450</u>	<u>45,960,529</u>
Cash flows from investing activities		
Receipts of interest	12,319	10,254
Other	<u>682</u>	<u>367</u>
Net cash provided by investing activities	<u>13,001</u>	<u>10,621</u>
Cash flows from noncapital financing activities		
Transfers to Lottery Tuition Fund	<u>(41,388,474)</u>	<u>(43,220,512)</u>
Cash flows from capital and related financing activities		
Purchases of capital assets	(308,479)	(284,938)
Principal payments under capital lease	<u>(14,063)</u>	<u>(11,269)</u>
Net cash used by capital and related financing activities	<u>(322,542)</u>	<u>(296,207)</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	940,435	2,454,431
Cash and cash equivalents at beginning of year	<u>9,340,237</u>	<u>6,885,806</u>
Cash and cash equivalents at end of year	<u>\$ 10,280,672</u>	<u>\$ 9,340,237</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, 2014 and 2013

Increase (Decrease) in Cash and Cash Equivalents

	<u>2014</u>	<u>2013</u>
Reconciliation of operating income to net cash provided by operating activities		
Operating income	\$ 41,176,193	\$ 43,637,665
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	188,505	139,393
Vendor's non-cash transactions	(54,357)	(119,759)
Interest on MUSL unreserved account	2,919	3,088
Net changes in assets and liabilities:		
Accounts receivable	36,823	(140,998)
Reserves on deposit	(26,400)	(8,737)
Inventory	(85,927)	(3,887)
Prepaid expenses	37,094	(64,486)
Accounts payable and other liabilities	167,514	22,576
Prizes payable	1,196,086	2,495,674
	<u>1,196,086</u>	<u>2,495,674</u>
Net cash provided by operating activities	<u>\$ 42,638,450</u>	<u>\$ 45,960,529</u>

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

New Mexico Lottery Authority

STATEMENTS OF FIDUCIARY NET POSITION

June 30, 2014 and 2013

	<u>2014</u>	<u>2013</u>
ASSETS		
Cash and cash equivalents	\$ 669,043	\$ 500,847
Marketable securities and other investments	4,683,748	4,259,724
Contribution receivable	8,423	8,121
Total assets	<u>\$ 5,361,214</u>	<u>\$ 4,768,692</u>
NET POSITION		
Pension plan participants' benefits	<u>\$ 5,361,214</u>	<u>\$ 4,768,692</u>

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

New Mexico Lottery Authority

STATEMENTS OF CHANGES IN FIDUCIARY NET POSITION

Years ended June 30, 2014 and 2013

	<u>2014</u>	<u>2013</u>
ADDITIONS		
Investment earnings	\$ 885,971	\$ 559,478
Employer contributions	344,457	344,578
Total additions	<u>1,230,428</u>	<u>904,056</u>
DEDUCTIONS		
Distributions to participants	<u>637,906</u>	<u>203,727</u>
Total deductions	<u>637,906</u>	<u>203,727</u>
Change in net position	592,522	700,329
Net position - beginning	<u>4,768,692</u>	<u>4,068,363</u>
Net position - ending	<u><u>\$ 5,361,214</u></u>	<u><u>\$ 4,768,692</u></u>

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

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS

June 30, 2014 and 2013

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Reporting Entity

The financial reporting entity as defined by Governmental Accounting Standards Board (GASB) Statement 14 (as amended by GASB *Statement 61*) 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. 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 draw game 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 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, the Lottery has elected to follow all GASB pronouncements, and as other accounting literature, post-November 30, 1989 FASB pronouncements that do not conflict with or contradict GASB pronouncements. 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, 2014 and 2013

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 per Statements of Fiduciary Net Position and Statements of Changes in Fiduciary Net Position and Note D reflects the activities of the New Mexico Lottery Authority Retirement Plan (Plan) pursuant to a trust agreement with Wells Fargo 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 non-operating 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 draw game tickets. The Lottery also recognizes retailer fees for connecting new retailers to the system 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 non-operating 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. At the end of fiscal years 2014 and 2013 there were no restricted resources.

3. Budgets and Budgetary Accounting

Each year Lottery management prepares a budget in conformity with 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 Statements 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.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2014 and 2013

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

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 receivables. At June 30, 2014 and 2013, an allowance for doubtful accounts of \$34,315 and \$36,165, respectively, has been provided to recognize future uncollectible billings. In fiscal years 2014 and 2013, ten retail customers (503 and 477 retailer locations) represented 60% and 58% of sales for each year, respectively, and 62% and 59% of 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), Hot Lotto® (Hot Lotto) and Mega Millions® (Mega Millions) games for the Lottery. The Lottery sells Powerball, Hot Lotto and Mega Millions 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 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. The prize pool for Mega Millions is up to 55% of each drawing period's sales after the prize reserve accounts are funded to the amounts set by the MUSL product group, but may be higher or lower based upon the number of winners at each prize level.

MUSL has established prize reserve accounts for the games it operates. These prize reserve accounts are funded out of the prize pools for the games until the accounts reach amounts set by the MUSL product groups for each game. Once the prize reserve funds exceed these designated maximums, the excess becomes part of the grand prize pool. The prize reserve funds serve as contingency reserves to protect MUSL and the party lotteries from unforeseen prize liabilities. The money in these reserve funds is 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 prize reserve accounts may also be carried forward to a replacement game's prize reserve account.

As of October 1, 2014, the Powerball prize reserve deduction is set to begin at two percent (2%) when the annuity jackpot, as determined after sales are known, exceeds \$120 million, and four percent (4%) when the annuity jackpot, as determined after sales are known, exceeds \$250 million. Prior to this time, MUSL included 2% of the Lottery's Powerball

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2014 and 2013

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

6. Reserves on Deposit - Continued

drawing period's sales in two prize reserve accounts, the Powerball Prize Reserve Account (PRA) and the Set Prize Reserve Account (SPRA), until the Lottery's share in both the PRA and SPRA were fully funded. The maximum amounts designated by the MUSL Powerball product group for the PRA is \$80 million and for the SPRA is \$40 million for all member lotteries. At June 30, 2014 and 2013, the Lottery's share in the Powerball PRA was \$1,150,023 and \$1,150,604, respectively, and in the SPRA was \$500,010 and \$554,595, respectively. Both Powerball reserve funds were fully funded at the end of June 2014 and 2013, respectively.

MUSL includes up 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 (PRA). The MUSL product group has set the maximum Hot Lotto PRA balance at nine million dollars for all party lotteries. At June 30, 2014 and 2013, the Lottery's share in the Hot Lotto PRA was \$655,418 and \$735,241, respectively. The Hot Lotto PRA was fully funded at the end of June 2014 and 2013, respectively.

The Lottery commenced sales of Mega Millions tickets on January 31, 2010. MUSL includes an additional amount up to 5% of the Lottery's Mega Millions drawing period's sales into the Mega Millions Prize Reserve Account (PRA). As of March 22, 2013, the MUSL product group set the maximum PRA balance at \$45 million for all party lotteries. At June 30, 2014 and 20123 the Lottery's share in the Mega Millions PRA was \$514,756 and \$409,688, respectively. The Lottery's remaining Mega Millions prize reserve was fully funded at the end of June 2014; the buy-in amount for June 30, 2013 was \$114,165.

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, 2014 and 2013, the Lottery's share of the unreserved fund was \$611,761 and \$555,440, respectively.

A winner of a Powerball grand prize or Mega Millions grand prize may select that the prize be paid at the cash value of the prize or as an annuity. For both, Powerball and Mega Millions, the grand prize annuity is paid out in 30 graduated annual installments over 29 years. Government securities at the discounted value of the grand prize annuity are purchased 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.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2014 and 2013

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

6. Reserves on Deposit – Continued

As of May 12, 2013, the Hot Lotto advertised grand prize is paid as a withholdings taxes paid single, cash payment prize where the estimated advertised grand prize is grossed up to include federal and state tax withholdings and the prize winner receives the net prize after tax withholdings. Prior to May 12, 2013, a Hot Lotto grand prize was paid out at the cash value of the prize or as an annuity paid out in 25 annual installments.

7. Inventory

In March 2010, the Lottery entered into an agreement with its primary instant ticket printer, whereby the printer retains title to the instant ticket inventory until the instant tickets are sold. Under this agreement, the Lottery pays the vendor a fee based on a fixed percentage of the net instant tickets sold; net instant tickets sold represents instant ticket sales less prize, spoiled, stolen, and promotional tickets. In addition, in March 2010, the Lottery signed an agreement with a secondary instant ticket printer, whereby the Lottery purchases and owns the tickets printed. These tickets are carried at the lower of cost or market using the specific identification method. At the end of fiscal years 2014 and 2013, the Lottery was distributing games printed under the two March 2010 agreements.

As of June 30, 2014 and 2013, \$67,769 and \$12,825, respectively, of instant tickets are included in inventory. For each year respectively, \$55,122 and \$24,139 of merchandise prizes for second chance drawings are also included in inventory.

8. Capital Assets

Capital assets, which include data processing software and hardware, tenant improvements, vehicles, furniture and fixtures, intellectual property, and equipment, are stated at cost net of accumulated depreciation. The Lottery capitalizes all assets that have a cost greater than \$5,000 and an expected useful life of more than one year. Tenant improvements are amortized over five years or the remaining lease term, whichever is shorter, and intellectual property is amortized over the remaining life at the time of acquisition or at the time of development. For all other capital assets placed into service on or after July 1, 2013, depreciation and amortization are computed using the straight-line method over the estimated useful lives of 4 to 10 years. Prior to July 1, 2013, depreciation and amortization were computed using the straight-line method over the estimated useful lives of 2 to 5 years. When assets are retired or otherwise disposed, 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.

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2014 and 2013

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. Revenues and accounts receivable for instant tickets are recognized when packs are settled and retailers are billed for the tickets. Revenues and accounts receivable for all draw games are recognized when drawings are held, except for Quicksters, where the revenues and accounts receivable are recognized at the time the tickets are sold. Accounts receivable are stated at their net realizable value and their past due status is based upon contractual terms.

The following is a summary of total operating revenues that are comprised of instant and draw game ticket sales and the related prize, spoiled, stolen, and promotional tickets, which are netted into the applicable game sales on the financial statements; plus any retailer fees and related bad debts that are shown as a contra revenue account in total operating revenues.

	<u>2014</u>	<u>2013</u>
OPERATING REVENUES		
Instant ticket sales	\$ 71,961,184	\$ 72,397,663
Powerball sales	34,065,150	46,767,095
Mega Millions sales	13,418,660	8,088,972
Roadrunner Cash sales	8,599,410	6,784,566
Hot Lotto sales	5,709,957	5,996,195
Pick 3 sales	3,831,547	3,496,279
Quickster sales	639,311	867,111
Less tickets provided as prizes	(2,096,244)	(2,479,354)
Less spoiled, stolen, and promotional tickets	<u>(126,371)</u>	<u>(160,005)</u>
Net ticket sales	136,002,604	141,758,522
Retailer fees	22,453	20,575
Bad debts	-	(12,000)
Total operating revenues	<u>\$ 136,025,057</u>	<u>\$ 141,767,097</u>

10. Prizes

Prize expense for instant, Powerball, Mega Millions, 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 Quickster games is recorded based on the actual prizes won for each game.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2014 and 2013

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

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, 2014 and 2013, respectively, the Lottery maintained its cash balances in one financial institution. The balances for demand deposits were insured by the Federal Deposit Insurance Corporation up to \$250,000 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.

The Lottery's custodial risk for investments is in accordance with Article 10, NMSA, 1978 Compilation. The Lottery's investments are made in overnight repurchase agreements. Investments are made through a local financial institution and are held in safekeeping at the Federal Reserve Bank. Repurchase agreements are collateralized by the Government.

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2014 and 2013

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

14. Custodial Credit Risk and Interest Rate Risk - Continued

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, 2014 and 2013, the Lottery's bank balances of \$10,372,837 and \$9,523,952, respectively, were exposed to custodial credit risk as follows:

	<u>2014</u>	<u>2013</u>
Uninsured and uncollateralized	\$ -	\$ -
Collateral held by the pledging bank's trust department in the Bank's name	-	-
Collateral held by the pledging bank's trust department in the Lottery's name	<u>10,372,837</u>	<u>9,523,952</u>
	<u>\$ 10,372,837</u>	<u>\$ 9,523,952</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, 2014 and 2013, the Lottery had overnight yield repurchase agreements with one-day maturities.

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2014 and 2013

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

15. Bank Accounts

At June 30, 2014:

<u>Description</u>	<u>Bank</u>	<u>Balance per Bank</u>
Operating account - overnight repurchase Agreement	Wells Fargo Bank, NA	\$ 10,372,772
Operating account - checking	Wells Fargo Bank, NA	<u>65</u>
Total amount deposited in bank		10,372,837
Less: FDIC coverage		<u>(65)</u>
*Total uninsured funds - deposits and overnight repurchase agreement		<u>\$ 10,372,772</u>
102% pledged collateral requirement per statute for repurchase agreement		10,580,227
* Total pledged security		<u>(10,580,228)</u>
Amount under (over) requirement at June 30, 2014		<u>\$ (1)</u>
*Wells Fargo Bank, NA securities are held in safekeeping at the Federal Reserve Bank in San Francisco, CA. Presented at fair value, CUSIP Number 36179NTE8 (fair market value \$9,839,187), matures November 01, 2043. The repurchase agreement is collateralized with securities held in the name of the New Mexico Lottery Authority.		
Cash and cash equivalents per bank at June 30, 2014		10,372,837
Less reconciling items--outstanding checks		<u>(103,865)</u>
Reconciled cash in bank at June 30, 2014		10,268,972
Cash in vault		<u>11,700</u>
Total cash and cash equivalents per Statements of Net Position		<u>\$ 10,280,672</u>

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2014 and 2013

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

15. Bank Accounts - Continued

At June 30, 2013:

<u>Description</u>	<u>Bank</u>	<u>Balance per Bank</u>
Operating account - overnight repurchase Agreement	Wells Fargo Bank, NA	\$ 9,523,952
Operating account - checking	Wells Fargo Bank, NA	<u>-</u>
Total amount deposited in bank		9,523,952
Less: FDIC coverage		<u>-</u>
*Total uninsured funds - deposits and overnight repurchase agreement		<u><u>\$ 9,523,952</u></u>
102% pledged collateral requirement per statute for repurchase agreement		\$9,714,431
* Total pledged security		<u>(9,714,432)</u>
Amount under (over) requirement at June 30, 2013		<u>\$ (1)</u>
*Wells Fargo Bank, NA securities are held in safekeeping at the Federal Reserve Bank in San Francisco, CA. Presented at fair value, CUSIP Number 3128MJSN1 (fair market value \$9,691,268), matures March 01, 2043. The repurchase agreement is collateralized with securities held in the name of the New Mexico Lottery Authority.		
Cash and cash equivalents per bank at June 30, 2013		\$ 9,523,952
Less reconciling items--outstanding checks		<u>(191,420)</u>
Reconciled cash in bank at June 30, 2013		9,332,532
Cash in vault		<u>7,705</u>
Total cash and cash equivalents per Statements of Net Position		<u><u>\$ 9,340,237</u></u>

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2014 and 2013

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

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.

17. Shipping and Handling Costs

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

18. Net Position

Net position represents the difference between all other elements in a statement of financial position and should be displayed in the applicable components of net investment in capital assets, restricted and unrestricted.

Net Investment in Capital Assets – consists of capital assets, net of accumulated depreciation, reduced by outstanding balances of bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, constructions, or improvement of those assets.

Restricted – consists of restricted assets reduced by liabilities and deferred inflows of resources related to those assets. The Lottery does not have a restricted component of net position.

Unrestricted – consists of the net amount of assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of net investment in capital assets or the restricted component of net position. In May 2014, the New Mexico Lottery Authority Board executed a resolution to establish contingency reserves from operating expenses for the sole purpose of allowing the New Mexico Lottery Authority to successfully carry out the provision of the New Mexico Lottery Act.

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.

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2014 and 2013

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

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.

21. Compensated Absences Payable

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 lottery 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 hours that 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 at least one year of service 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 to an employee upon separation from service. During the years ended June 30, 2014 and 2013, the following changes occurred in the compensated absences liabilities:

<u>Balance</u> <u>July 1, 2013</u>	<u>Increase</u>	<u>Decrease</u>	<u>Balance</u> <u>June 30, 2014</u>
\$ 227,709	\$ 22,471	\$ (42,940)	\$ 207,240
<u>Balance</u> <u>July 1, 2012</u>	<u>Increase</u>	<u>Decrease</u>	<u>Balance</u> <u>June 30, 2013</u>
\$ 212,919	\$ 23,898	\$ (9,108)	\$ 227,709

The balances of compensated absences payable are reported on the Statements of Net Position in accounts payable and other current liabilities. The Lottery estimates all compensated absences are due within one year.

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2014 and 2013

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES -CONTINUED

22. Long-term Liabilities - Capital Lease Obligations

During the years ended June 30, 2013 and 2014, the following changes occurred in the capital lease obligations:

<u>Balance July 1, 2013</u>	<u>Increase</u>	<u>Decrease</u>	<u>Balance June 30, 2014</u>	<u>Amounts Due Within One Year</u>
\$ 91,446	\$ -	\$ (14,063)	\$ 77,383	\$ 14,064

<u>Balance July 1, 2012</u>	<u>Increase</u>	<u>Decrease</u>	<u>Balance June 30, 2013</u>	<u>Amounts Due Within One Year</u>
\$ 72,740	\$ 29,975	\$ (11,269)	\$ 91,446	\$ 14,064

23. Accounts Payable and Other Current Liabilities

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

	<u>2014</u>	<u>2013</u>
Accounts payable	\$ 798,344	\$1,478,280
Accrued liabilities, vendors*	985,907	115,042
Accrued liabilities, retailers*	24,000	28,000
Accrued payroll, and payroll taxes and benefits	129,927	128,873
Compensated absences	<u>207,240</u>	<u>227,709</u>
	<u>\$ 2,145,418</u>	<u>\$1,977,904</u>

* The Lottery has accrued an estimated amount of services delivered by its vendors and deposits for its retailers as of June 30, 2014 and 2013, respectively.

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2014 and 2013

NOTE B - CAPITAL ASSETS

Capital assets at June 30, 2014 consisted of:

	Beginning Balance	Reclass- ification	Increases	Decreases	Ending Balance
Data processing software	\$ 2,411,528	\$ -	\$ 19,337	\$ -	\$ 2,430,865
Data processing equipment	830,528	-	31,454	-	861,982
Equipment - Security and disaster recovery	635,807	(18,170)	21,200	-	638,837
Vehicles	493,280	-	67,284	(108,280)	452,284
Tenant improvements	425,850	-	-	-	425,850
Furniture and fixtures	230,767	-	-	-	230,767
Intellectual property	179,073	-	-	-	179,073
Equipment - communications	118,635	-	147,539	-	266,174
Equipment - drawing	116,478	-	100,232	(109,910)	106,800
Equipment - warehouse	71,174	-	-	-	71,174
Equipment - office	49,508	-	-	-	49,508
Obsolete capital assets	214,784	18,170	-	(67,842)	165,112
Capital assets	<u>5,777,412</u>	<u>-</u>	<u>387,046</u>	<u>(286,032)</u>	<u>5,878,426</u>
Data processing software	(2,411,528)	-	(1,174)	-	(2,412,702)
Data processing equipment	(753,529)	-	(36,230)	-	(789,759)
Equipment - Security and disaster recovery	(519,227)	18,170	(28,765)	-	(529,822)
Vehicles	(317,390)	-	(67,074)	108,280	(276,184)
Tenant improvements	(337,190)	-	(20,624)	-	(357,814)
Furniture and fixtures	(230,767)	-	-	-	(230,767)
Intellectual property	(12,350)	-	(24,700)	-	(37,050)
Equipment - communications	(118,635)	-	-	-	(118,635)
Equipment - drawing	(116,478)	-	(8,353)	109,910	(14,921)
Equipment - warehouse	(66,681)	-	(1,585)	-	(68,266)
Equipment - office	(49,508)	-	-	-	(49,508)
Obsolete capital assets	<u>(214,784)</u>	<u>(18,170)</u>	<u>-</u>	<u>67,842</u>	<u>(165,112)</u>
Accumulated depreciation	<u>(5,148,067)</u>	<u>-</u>	<u>(188,505)</u>	<u>286,032</u>	<u>(5,050,540)</u>
Capital assets, net	<u>\$ 629,345</u>	<u>\$ -</u>	<u>\$ 198,541</u>	<u>\$ -</u>	<u>\$ 827,886</u>

Included in data processing software, data processing equipment, and tenant improvements are \$116,143 in assets reported as capital leases at June 30, 2014 and 2013, respectively. For each fiscal year, there were \$14,063 and \$11,269, respectively, in related amortization on these assets.

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2014 and 2013

NOTE B - CAPITAL ASSETS - CONTINUED

Capital assets at June 30, 2013 consisted of:

	Beginning Balance	Reclass- ification	Increases	Decreases	Ending Balance
Data processing software	\$ 2,418,935	\$ (7,407)	\$ -	\$ -	\$ 2,411,528
Data processing equipment	852,857	(23,179)	850	-	830,528
Equipment - Security and disaster recovery	639,604	(42,374)	38,577	-	635,807
Vehicles	432,500	-	193,006	(132,226)	493,280
Tenant improvements	374,168	-	51,682	-	425,850
Furniture and fixtures	233,172	(2,405)	-	-	230,767
Intellectual property	-	-	179,073	-	179,073
Equipment - communications	118,635	-	-	-	118,635
Equipment - drawing	116,478	-	-	-	116,478
Equipment - warehouse	71,174	-	-	-	71,174
Equipment - office	49,508	-	-	-	49,508
Obsolete capital assets	901,871	75,365	-	(762,452)	214,784
Capital assets	<u>6,208,902</u>	<u>-</u>	<u>463,188</u>	<u>(894,678)</u>	<u>5,777,412</u>
Data processing software	(2,418,935)	7,407	-	-	(2,411,528)
Data processing equipment	(738,476)	23,179	(38,232)	-	(753,529)
Equipment - Security and disaster recovery	(541,966)	42,374	(19,635)	-	(519,227)
Vehicles	(395,031)	-	(54,585)	132,226	(317,390)
Tenant improvements	(325,141)	-	(12,049)	-	(337,190)
Furniture and fixtures	(233,172)	2,405	-	-	(230,767)
Intellectual property	-	-	(12,350)	-	(12,350)
Equipment - communications	(118,635)	-	-	-	(118,635)
Equipment - drawing	(115,522)	-	(956)	-	(116,478)
Equipment - warehouse	(65,095)	-	(1,586)	-	(66,681)
Equipment - office	(49,508)	-	-	-	(49,508)
Obsolete capital assets	(901,871)	(75,365)	-	762,452	(214,784)
Accumulated depreciation	<u>(5,903,352)</u>	<u>-</u>	<u>(139,393)</u>	<u>894,678</u>	<u>(5,148,067)</u>
Capital assets, net	<u>\$ 305,550</u>	<u>\$ -</u>	<u>\$ 323,795</u>	<u>\$ -</u>	<u>\$ 629,345</u>

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2014 and 2013

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

	Net Income	Due to Lottery Tuition Fund	Net Position
	<u> </u>	<u> </u>	<u> </u>
Balance at June 30, 2013	\$ 3,503,374	\$ 3,503,374	\$ -
Current year net return	40,941,550	40,941,550	-
Current year transfers	<u>(41,388,474)</u>	<u>(41,388,474)</u>	<u>-</u>
Balance at June 30, 2014	<u>\$ 3,056,450</u>	<u>\$ 3,056,450</u>	<u>\$ -</u>

In accordance with the Lottery Act, no later than the last business day of each month, the Lottery shall transmit at least thirty percent of the gross revenue of the previous month, to the New Mexico State Treasurer, who shall deposit it into state agency number 950, New Mexico Higher Education Department, the Lottery Tuition Fund, SHARE fund number 63700. As of July 31, 2014 and 2013, the Lottery has transferred \$40,941,550 and \$43,684,681, respectively, for the years ended June 30, 2014 and 2013 to the New Mexico State Treasurer.

NOTE D - RETIREMENT PLAN

Plan Description

All of the Lottery's eligible employees participate in a plan provided by the Lottery pursuant to the New Mexico Lottery Act (Chapter 6, Article 24 NMSA 1978). The Lottery is the administrator of the Plan, which is a defined contribution money purchase pension plan, and Wells Fargo Bank is the trustee for the plan. Employees become eligible to participate for the purposes of money purchase pension plan contributions when they have completed six months of service. Contributions start on the first day of the quarter coinciding with or next following the date in which the employee satisfied the eligibility requirement. The plan provides twenty-eight investment funds for employees to self-direct their contributions. The New Mexico Lottery Authority Retirement Plan provides for retirement benefits to plan members and their beneficiaries. Sixty-two and sixty-four current and former employees of the Lottery were participants in the plan at the end of fiscal years 2014 and 2013, respectively.

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2014 and 2013

NOTE D - RETIREMENT PLAN - CONTINUED

Plan Description – Continued

The balances and activity of the Plan as of and for the years ended June 30, 2014 and 2013 are presented in the Statements of Fiduciary Net Position and Statements of Changes in Fiduciary Net Position. There are no separately issued financial statements available for the New Mexico Lottery Authority Retirement Plan.

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 years ended June 30, 2014 and 2013, the Lottery recognized \$344,457 and \$344,578 of pension expense for the Plan on eligible compensation of \$2,599,675 and \$2,600,589, respectively. There were no forfeitures of employee balances for the years ended June 30, 2014 and 2013, respectively. The entire pension amounts applicable to all compensation paid during the respective fiscal years have been paid to the Plan by June 30, 2014 and 2013, respectively. For the years ended June 30, 2014 and 2013, the Lottery recognized a contribution liability of \$8,423 and \$8,121, respectively, for contributions owed on compensation earned, but not paid, for the last few days of each fiscal year.

Retirement Plan Subsequent Event

At a Lottery Board of Directors' meeting on May 6, 2014, the Board by an adopted resolution removed Wells Fargo Bank and appointed Verisight Trust Company (c/o Verisight, Inc.) as the new trustee for the retirement plan (the "New Mexico Lottery Authority Retirement Plan") to be effective as of the date the money purchase pension plan retirement assets were transferred to or deposited at Verisight Trust Company. The retirement assets were liquidated by Wells Fargo Bank as of August 15, 2014 and transferred to Verisight Trust Company. With the appointment of Verisight Trust Company, the Lottery Board elected to allow new employees to enter the retirement plan on their date of hire.

In addition at the May 6, 2014 meeting, the Board adopted a Section 457(b) Plan, (the "New Mexico Lottery Authority 457(b) Plan") that allows both pre-tax and Roth (after tax) contributions by employees for their retirement to be effective July 1, 2014 or shortly thereafter. Employee contribution commenced with the payroll ended on August 2, 2014. This new plan, like the money purchase pension plan, now allows employees to self-direct their investments into any of the 41 investment funds. Verisight Trust Company is also the trustee for the 457(b) plan.

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2014 and 2013

NOTE E - CREDIT AGREEMENT

In July 2012, the Lottery entered into an agreement with Wells Fargo Bank effective May 15, 2012 for an automatic unsecured overdraft line of credit sweep in the amount of \$4,000,000 with a variable interest rate, which was 3.25% as of June 30, 2014 and 2013, respectively. This line matured on May 14, 2014 and May 14, 2013 and was renewed for another year under the same terms and conditions each year.

For the years ended June 30, 2014 and 2013, the Lottery had no outstanding borrowings against the line of credit.

NOTE F - LEASES

In 1996, the Lottery entered into operating leases for the rental of office and warehouse space for a term of ten years. In September 2002, the Lottery renegotiated these leases. The leases were extended until March 31, 2013 at the same lease amounts that were to be paid in the final year of the original lease with no further yearly escalations of the monthly lease amounts.

In June 2012, the Lottery executed a new lease for its corporate office and warehouse space. The new lease commenced on July 1, 2012 and cancelled the remaining nine months of the 2002 lease extension. The new lease is for ten years and nine months, ending on March 31, 2023. The Lottery has the option to extend the new lease for five additional years until March 31, 2028.

Rent expense was \$293,530 and \$391,495 for the years ended June 30, 2014 and 2013, respectively.

Future minimum rental payments on these leases with original terms of one year or more are scheduled as follows:

<u>Year</u>	<u>Amount</u>
2015	\$ 280,165
2016	280,165
2017	280,165
2018	281,664
2019	286,164
2020-2023	1,073,118
	<u>\$ 2,481,441</u>

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2014 and 2013

NOTE F - LEASES - CONTINUED

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

	<u>2014</u>	<u>2013</u>
Minimum rentals	\$ 280,165	\$ 368,813
Less: Subleases	<u>-</u>	<u>-</u>
	<u>\$ 280,165</u>	<u>\$ 368,813</u>

As part of the agreement with INTRALOT, Inc., to provide an updated on-line gaming system, the Lottery installed and implemented a new internal control system (ICS) in fiscal year 2009. The cost for the ICS is included in the fixed fee paid to the vendor as a percentage of net sales. The Lottery has accounted for this transaction as a capital lease. The ICS cost was projected over the initial term of the contract of seven years and has been capitalized on the books of the Lottery at the present value of this cost, as determined with a discount rate of 4%.

Years ending June 30:

2015	\$ 8,237
2016	<u>3,432</u>
Total minimum payments	11,669
Less the amount representing interest	<u>(2,846)</u>
Present value of net minimum payments	<u>\$ 8,823</u>

As part of the 2002 lease extension with NMLB, LLC, the Lottery received \$50,000 in 2012 to be used for tenant improvements to the facility. In addition, as part of the 2012 lease, the Lottery received \$1,858 in 2012 and \$29,975 in fiscal year 2013 for tenant improvements to the facility.

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2014 and 2013

NOTE F - LEASES - CONTINUED

The Lottery has recorded the \$81,833 as tenant improvements with a related deferred liability to be amortized over the life of the lease using the straight-line method.

Years ending June 30:	
2015	\$ 7,836
2016	7,835
2017	7,835
2018	7,835
2019	7,836
2020-2023	<u>29,382</u>
Total minimum payments	<u>\$ 68,559</u>

NOTE G - COMMITMENT

Effective on November 15, 2007, the Lottery entered into an agreement with INTRALOT, Inc., a Georgia-based company, to provide an updated on-line gaming system for a total of seven years with the option of three additional one year periods or any combination thereof. The option to extend the agreement until November 2018 was exercised during fiscal year 2014. The system includes the supply, installation, maintenance, service, and operation of a communication network, lottery terminals and peripheral equipment for the Lottery's existing and future retailers, ticket scanners to enable players to check their tickets for prizes, self-service ticket vending machines that sell both instant and draw game tickets, a disaster recovery and business continuity facility, and various employees to operate the system and provide sales and marketing support to the Lottery. The transition to this new on-line gaming system took place on November 16, 2008. Since November 21, 2008, the on-line vendor fee has been fixed at 1.5% of net sales, plus the applicable gross receipts tax.

NOTE H - OTHER EXPENSES

Other expenses at June 30 consisted of:

	<u>2014</u>	<u>2013</u>
Other	\$ 29,336	\$ 17,404
Registrations and memberships	23,912	30,044
Training	12,015	20,250
Publications and subscriptions	<u>4,448</u>	<u>3,942</u>
	<u>\$ 69,711</u>	<u>\$ 71,640</u>

New Mexico Lottery Authority

**SUPPLEMENTARY INFORMATION
BUDGETARY COMPARISON STATEMENTS**

Years ended June 30, 2014 and 2013

	2014				2013			
	Original Budget	Final Budget	Actual	Variance with Final Budget	Original Budget	Final Budget	Actual	Variance with Final Budget
Operating revenues								
Instant ticket sales	\$ 68,893,000	\$ 67,797,000	\$ 69,804,813	\$ 2,007,813	\$ 67,984,000	\$ 67,434,000	\$ 69,886,435	\$ 2,452,435
Powerball sales	37,851,500	37,850,000	34,027,555	(3,822,445)	35,859,200	40,901,000	46,734,439	5,833,439
Mega Millions sales	7,989,800	11,989,000	13,410,732	1,421,732	11,988,400	7,688,000	8,078,050	390,050
Roadrunner Cash sales	6,791,300	8,391,000	8,592,684	201,684	7,992,200	6,792,000	6,767,906	(24,094)
Hot Lotto sales	5,493,000	4,993,000	5,700,311	707,311	4,995,200	5,595,000	5,933,935	338,935
Pick 3 sales	3,395,700	3,694,000	3,828,187	134,187	3,696,400	3,396,000	3,492,915	96,915
Quickster sales	998,700	598,000	638,322	40,322	2,497,600	797,000	864,842	67,842
Net ticket sales	131,413,000	135,312,000	136,002,604	690,604	135,013,000	132,603,000	141,758,522	9,155,522
Retailer fees	11,000	15,000	22,453	7,453	11,000	21,000	20,575	(425)
Bad debts	(24,000)	(24,000)	-	24,000	(24,000)	(24,000)	(12,000)	12,000
Total operating revenues	131,400,000	135,303,000	136,025,057	722,057	135,000,000	132,600,000	141,767,097	9,167,097
Total game expenses	86,280,000	89,031,000	89,608,334	577,334	88,742,000	87,350,000	93,049,385	5,699,385
Total operating expenses	5,716,000	5,698,000	5,240,530	(457,470)	5,763,000	5,339,000	5,080,047	(258,953)
Operating income	39,404,000	40,574,000	41,176,193	602,193	40,495,000	39,911,000	43,637,665	3,726,665
Total non-operating income	24,000	25,000	32,357	7,357	18,000	24,000	47,016	23,016
Net income before transfers to Lottery Tuition Fund	\$ 39,428,000	\$ 40,599,000	\$ 41,208,550	\$ 609,550	\$ 40,513,000	\$ 39,935,000	\$ 43,684,681	\$ 3,749,681

New Mexico Lottery Authority

SUPPLEMENTARY INFORMATION
SCHEDULES OF PERCENTAGE RETURN TO THE STATE OF NEW MEXICO

Years ended June 30, 2014 and 2013

	<u>2014</u>	<u>2013</u>
OPERATING REVENUES		
Instant ticket sales	\$ 69,804,813	\$ 69,886,435
Powerball sales	34,027,555	46,734,439
Mega Millions sales	13,410,732	8,078,050
Roadrunner Cash sales	8,592,684	6,767,906
Hot Lotto sales	5,700,311	5,933,935
Pick 3 sales	3,828,187	3,492,915
Quickster sales	638,322	864,842
Net ticket sales	<u>136,002,604</u>	<u>141,758,522</u>
Retailer fees	22,453	20,575
Bad debts	-	(12,000)
Total operating revenues	<u>136,025,057</u>	<u>141,767,097</u>
NON-OPERATING INCOME		
Interest income	18,753	21,324
Other income	13,604	25,692
Total non-operating income	<u>32,357</u>	<u>47,016</u>
GROSS REVENUES	<u>136,057,414</u>	<u>141,814,113</u>
GAME EXPENSES		
Prize expense	74,060,246	77,068,558
Retailer commissions	8,782,855	9,153,204
Advertising	2,267,772	2,263,221
On-line vendor fees	2,177,205	2,269,623
Ticket vendor fees	1,188,107	1,158,028
Retailer equipment	345,786	201,436
Shipping and postage	335,679	428,532
Promotions	221,036	236,268
Drawing game	102,880	116,081
Responsible gaming	83,050	87,400
Game membership	43,718	67,034
Total game expenses	<u>89,608,334</u>	<u>93,049,385</u>
OPERATING EXPENSES		
Salaries, wages, and benefits	3,726,941	3,614,032
Utilities and maintenance	448,166	439,041
Leases and insurance	423,932	514,990
Operational Reserve Fund expense	267,000	-
Depreciation and amortization	188,505	139,393
Professional fees	186,035	112,893
Materials and supplies	135,260	125,050
Other	69,711	71,640
Travel	61,980	63,008
Total operating expenses	<u>5,507,530</u>	<u>5,080,047</u>
OPERATING INCOME	<u>40,909,193</u>	<u>43,637,665</u>
NET INCOME	<u>\$ 40,941,550</u>	<u>\$ 43,684,681</u>
GROSS REVENUE PERCENTAGE RETURN	<u>30.09%</u>	<u>30.80%</u>

New Mexico Lottery Authority

EXIT CONFERENCE

For the Year Ended June 30, 2014

An exit conference was held at the New Mexico Lottery Authority on October 6, 2014. The following individuals participated:

<u>Name</u>	<u>Title</u>
<i>New Mexico Lottery Authority Finance/Audit Committee</i>	
Dr. Dan Salzwedel	Board Chair
Mark Koson	Board Vice-Chair and Finance/Audit Committee Chairman
John Kubiak, CPA	Board Secretary/Treasurer
<i>New Mexico Lottery Authority Employees</i>	
David M. Barden	Chief Executive Officer
Sylvia Ann Jaramillo, CPA	Chief of Staff/Director of Administration
David Ramirez	Director of MIS
Michael Boland, CPA	Internal Auditor
<i>Moss Adams LLP</i>	
Jeff Bridgens, CPA	Audit Manager
Corrine Zajac-Clarkson	Auditor in-charge
Jaime Rumbaoa	IT Senior Manager

Financial Statement Preparation

The New Mexico Lottery Authority's financial statements, notes, and management's discussion and analysis have been prepared by the New Mexico Lottery Authority's accountants.